

## **BNP PARIBAS RESPONSE TO EC CONSULTATION ON DRAFT DELEGATED ACT OF THE ARTICLE 8 OF THE TAXONOMY REGULATION**

BNP Paribas welcomes the opportunity to respond to the Commission's consultation on the Taxonomy Regulation Article 8 Draft Delegated Act. As a leading European financial services group recognized as a global leader in sustainable finance, we strongly support the EU Taxonomy and consider that the transparency it aims to build based on science is a cornerstone in the journey of Europe's transition to a net zero economy. As such, the reporting requirements in the Article 8 Delegated Act will be a critical factor in the successful implementation of the Taxonomy, not only in Europe but also in influencing similar initiatives at international level.

The Taxonomy is a very ambitious and far-reaching policy initiative. Great progress has already been made but the framework is still a work in progress, with the delegated acts for four of the six objectives still in the drafting phase, and the development of complementary social, harmful, and neutral taxonomies being considered. There are also several closely related legislative initiatives that are about to begin application (SFDR) or are still in a review stage such as the proposal for the Corporate Sustainability Reporting Directive.

For these reasons we advocate for a carefully considered phased-in approach for introducing reporting requirements, focusing firstly on the most material and relevant indicators for informing companies, the markets and society on progress being made towards greening the economy while relying on reliable underlying data that reflects economic reality. This will allow for building a robust reporting framework that is credible, reliable, and accepted in Europe and beyond.

We believe that what is needed at this early stage is not all-encompassing and exhaustive reporting, but rather smart, pragmatic reporting sequenced on the availability of the underlying information -- in particular for financial institutions which themselves will rely on the reporting of their clients-- and focused on those KPIs that are directly related to the objectives of the Taxonomy and for which methodologies have been developed. For banks, that is clearly their lending and investment activities, and for asset managers and insurers, it is the investments they make, manage and market. Thus from the perspective of a financial institution, we call on the Commission to adopt a building blocks approach, in line with the CSRD timeline, and focused on these main KPIs.

### **Application timeline**

We very much welcome the phase-in approach proposed by the Commission to the application of the reporting requirements, whereby from 1 January 2022 companies will only disclose a limited scope of "taxonomy-eligible" information and from 1 January 2023 the broader scope of the "taxonomy-aligned" disclosure requirements will become applicable. This is the right approach that will allow companies additional time to obtain the very granular and detailed information necessary to report fully on their operations' taxonomy alignment.

However, for financial undertakings, the full reporting required from 1 January 2023 presents an insurmountable obstacle, as that they will not be able to obtain their clients' Taxonomy alignment

prior to having to produce their own reporting. On its face, it is simply unfeasible. Reporting of non-financial and financial companies cannot take place at the same time. Moreover, as financial institutions' own disclosures would also take place at the same time, the inclusion of a bank's exposures to other financial institutions needs to be phased-in as well. Not doing so, risks undermining the entire purpose of these disclosures for financial companies as the markets and investors understand well that high quality reporting relies on the ability to collect data that is reliable, comparable, auditable, and on timely basis. Here we would underline that an initial ratio wholly based on estimates made with methodologies not validated officially would have little or no significance for banks' stakeholders. This is true for banks' exposures to non-financial counterparties, but it is even truer for banks' exposures to financial counterparties. It would indeed be impossible and make no sense to estimate our financial counterparties' alignment of their activities with the taxonomy, such estimates being even more difficult than for corporates. More importantly, we would like to highlight the fact that relying on estimates could generate potential legal risks for banks and this is why we are very concerned by their use.

Furthermore, we cannot stress enough the importance of appropriate sequencing and alignment of the reporting obligations under the EU Taxonomy and other legislative and regulatory measures. In particular, the EBA update of the ITS on Pillar 3 disclosures on ESG risks that may also incorporate elements of the Taxonomy disclosures, such as the Green Asset Ratio (GAR). Under the updated ITS, banks in scope will be required to produce the first set of Pillar 3 disclosures in 2023 covering the annual period of 2022. If banks are not able to obtain information from their counterparties sufficiently in advance of the reporting deadline, they will not be able to fulfil their obligations not only under the EU Taxonomy Regulation but also under the ITS.

Finally, financial market participants in the scope of the SFDR will need to comply with a set of disclosure obligations starting January 1, 2022<sup>1</sup>. Specifically, asset managers will be required to assess Taxonomy alignment of investee companies in the investment funds for the purpose of periodic reporting taking place in 2022 onwards (including quarterly reporting by MIFID investment firms). It is not clear how the Taxonomy alignment can be measured in the absence of this information from the investee companies until 2023. There is therefore a need for consistency between the different pieces of legislation, notably requirements under Art 5 / 6 of the Taxonomy Regulation and those under Art 8. If non-financial undertakings and financial ones have to disclose only qualitative information from 1 Jan 2022, it will not be possible for financial undertakings to comply with their disclosure obligations on taxonomy-alignment under the SFDR and Art 5 & 6 of the Taxonomy Regulation on the same date.

Recommendations: We call on the Commission to provide for a logical sequence of disclosure requirements for the financial sector vis-a-vis those for the non-financial sector whereby financial institutions would be required to report in 12 months following the reporting completed by their non-financial counterparties. The interim period would allow financial institutions to obtain access to, process and perform due diligence on, the data disclosed (directly or via ESG data providers) by borrowers/investee companies, thus enabling their own disclosures. We also think that an additional 12-month period is needed for financial institutions to report on their exposures to other financial companies. Also, appropriate sequencing is needed vis-à-vis other legislation (SFDR, which applies from Jan 2022) and the EBA ITS on Pillar 3.

We would also welcome the sequencing of reporting between flows to start with and then with the stocks after the end of the transition period. This additional time is indeed necessary for banks in order

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<sup>1</sup> According to the Regulatory Technical Standard issues with regard to the content, methodologies and presentation of disclosures pursuant to Article 2a(3), Article 4(6) and (7), Article 8(3), Article 9(5), Article 10(2) and Article 11(4) of Regulation (EU) 2019/2088 - [https://www.esma.europa.eu/sites/default/files/library/jc\\_2021\\_03\\_joint\\_esas\\_final\\_report\\_on\\_rts\\_under\\_sfdr.pdf](https://www.esma.europa.eu/sites/default/files/library/jc_2021_03_joint_esas_final_report_on_rts_under_sfdr.pdf)

to gather all the requested data on the full stock, process it and industrialize the data processing at the stock scale.

## **Disclosures**

### **Consistency of numerator and denominator**

The EBA advice to the Commission on Art 8 proposed the GAR as a ratio of taxonomy-aligned exposures to taxonomy-eligible exposures as the primary indicator for banks' disclosures. Moreover, the EBA expressed the need to ensure that the KPI ratios proposed would be measured consistently, specifying that if certain activities/investments are excluded from the numerator they should also be excluded from the denominator as this would ensure a methodological accuracy of the calculation. However, we note that the Commission has taken a very different approach whereby the numerator would contain the proportion of taxonomy aligned exposures and the denominator would include the amount of total assets, only excluding exposures to central banks and central governments (i.e. Total GAR = Total taxonomy aligned exposures / (Total assets – Exposures to central banks and governments)).

We believe that the Commission's proposed approach is not consistent and will result in metrics that would lack comparability and thus usability. Comparing to the proportion of taxonomy aligned assets to total assets would not adequately show the progress made by banks towards financing more environmentally sustainable activities. Nor would it reflect the fact that much of the Economy is not yet included in the existing Taxonomy, meaning that the ratio as proposed by the Commission would be minimal but could also never be 100%. The Taxonomy disclosures need to be conceptually robust just as the Taxonomy is science-based.

Recommendation: The EBA proposal for the GAR as a ratio of taxonomy-aligned exposures to taxonomy-eligible exposures should be retained in the Delegated Act. Moreover, this sound principle of consistency between numerator and denominator of KPIs should be applied to all financial undertakings: credit institutions, investment firms, asset managers and insurers.

### **Stock vs. Flow**

The draft DA provides that the KPIs should cover the previous five reporting periods (art. 9(3)). Through exchanges with the associations and Commission representatives, we understand that this requirement will be applied on a go-forward basis, i.e. firms will append annual numbers in disclosures as a forward looking measure. We are very supportive of this approach as a retroactive application would not have been feasible. We would recommend that the final Delegated Act clarifies this important point and explicitly states that the first full 5\_year retroactive reporting period will begin in 2028.

In addition, much more clarity is needed in the Delegated Act on the application of the non-retroactivity of the 5 years history:

- Does it mean that banks will have to disclose only the Taxonomy alignment of the annual flows, starting with 2022 annual flows, till the full constitution of the stock in 5 years time?
- Or does it mean that banks will have to start calculating the GAR from 2022 end of year stock (without simulating the GARs based on stocks at 2021, 2020, 2019 and 2018 position dates) ?

The management of a credit portfolio where the stock is totally conditioned by the long-term nature of the relationship of the banks with their clients is completely different from that of investment portfolios. We understand that the objective of the point-in-time information on the stock of lending is to have a clear view of the level of alignment with the Taxonomy. Banks' contribution to sustainability, however, **mainly relies on the new origination and in its progress. Given this and the challenges to provide information on the existing stock, we believe the first option would be much more appropriate** than to start collecting information on the whole stock as of December 2022 position, which is the second option.

### **Types of counterparties**

We strongly support the Commission proposal that at this stage KPIs should only include exposures to entities that report under the NFRD (in the future – CSRD). In its Opinion, the EBA rightly acknowledges that *“where counterparties and clients are not obliged to disclose relevant information and their economic activities cannot be mapped or assessed according to the taxonomy screening criteria in a systematic and comprehensive way that ensures the reliability of the information disclosed, the EBA’s advice is not to include these activities in the information to be disclosed”*, which we fully support. From banks' perspective, the information needs to be not only available, comparable but also regulated and with a level of assurance to ensure reliability. Only the information disclosed as per the NFRD / CSRD would meet all these criteria.

As stated earlier, regarding exposures to financial counterparties that are subject to the NFRD, it is not clear how the data collection and reporting would work in practice if financial institutions would need to report at the same time as their financial clients (other banks asset managers, insurers...) We therefore recommend that the inclusion of exposures to financial institutions in the calculation of the GAR be phased-in until there are agreed consistent methodologies and practices to assess taxonomy alignment of such counterparties, whose activities incidentally are not part of the Taxonomy for the time being

In summary, we propose a GAR with a fully consistent numerator and denominator, as follows:

- Scope focused on the exposures to non financial CSRD counterparts, within the Banking Book
- Be able to include non-EU large corporates if data is available and verifiable
- Exposures to financial CSRD counterparties to be phased-in until there are agreed consistent methodologies and practices to assess taxonomy alignment of such counterparties.
- Scope focused on activities covered by the EU Taxonomy, the ‘eligible’ activities
- Exclusion of Exposures to central banks and governments, exclusion of derivatives until further assessment for the next review of the Delegated Act

### **Exposures to non-EU corporates and SME clients**

We agree that in a first stage of implementation disclosure requirements should mandate only those KPIs that are based on exposures to NFRD clients. However, as an international financial institution, we are keen to be able to disclose on our sustainable finance activities in other jurisdictions and therefore support an additional voluntary GAR that would be more comprehensive and integrate exposures to non-EU corporates as well as SME clients when the information is available. Allowing for reporting on these entities will encourage Financial Market Participants to invest in these companies as some may indeed have a better taxonomy performance compared to some companies in the scope of the NFRD. This approach would be coherent with the objectives of the Taxonomy.

This voluntary additional KPI would consist of the GAR established for NFRD counterparties and add in the numerator Taxonomy-aligned exposures to non-EU corporates and SMEs and the corresponding Taxonomy-eligible exposures to those counterparties to the denominator.

We also encourage the Commission to work on consistent methodologies and guidelines for providing estimated information for non-EU exposures. Concerning SMEs, we understand that the Commission will be issuing further analyses and we support that a simplified reporting should be developed for these clients to be able to voluntarily disclose their non-financial information after the transition period. In this regard, we reiterate that exposures to non-EU and SME clients should be disclosed in a separate KPI and not be included in neither the numerator nor the denominator of the main Green Asset Ratio until these methodologies are available. This said, we support a voluntary and separate disclosure as outlined above.

### **Trading book KPI**

As we emphasized at the beginning of our response, we believe that focus in an initial stage should be on those indicators directly related to the main Taxonomy objectives that will allow stakeholders to evaluate the progress of financial institutions towards financing taxonomy-aligned economic activities. In that vein, we do not see the materiality of the value added by the proposed KPI on the Trading Book. Presumably, this additional indicator would aim to measure the level of market liquidity of green financial instruments but we do not see how it would measure *financing* of taxonomy-aligned activities.

We would also note that, even if the DA proposes to limit the scope to issuers and counterparts submitted to the CSRD, operationalizing this KPI would be very burdensome, implying for a bank that all issuers of the traded securities would need to report on their level of taxonomy alignment. If complete information is needed on all issuers, this also underlines the fact that the reporting of this KPI by banks cannot happen at the same time as the reporting of issuers.

### **Fees & Commissions KPI**

While we understand that the intention of this KPI is to provide information about the proportion of fee and commission income linked to services provided to corporates aligned with the Taxonomy, we do not think this metric is relevant nor necessary at this stage. Similar to the Trading Book KPI, this information would not portray in a meaningful way the progress towards financing the greening of the economy. And, as for the trading book KPI, the costs of preparing these disclosures would significantly outweigh any expected benefits.

This notwithstanding, we do recognize the relevance of reporting on fees and commission income related to the structuration and placement of Taxonomy aligned financial products such as green bonds, loans and certain equity issuances, which will enable the re-allocation of financing to Taxonomy-aligned activities. If a KPI on fees and commissions were to be required at this stage, this would be the relevant metric as opposed to reporting, for example, on income foreign exchange services, loan servicing activities, clearing and custody, etc.

### **KPIs based on the stock of off- balance sheet commitments (FinGar, AuM KPIs)**

We agree with the original EBA Advice that credit institutions may influence the orientation of capital flows through their off-balance-sheet exposures, for example by backing loans that are financing taxonomy-aligned activities, or in the case of their asset management services, by investing the assets under management in companies that are aligned with the Taxonomy. We therefore support the proposed KPI for Financial Guarantees and for Assets under Management.

### **Other issues**

#### Granularity of the information required:

BNP Paribas and the industry at large are of the view that the granularity required is too exhaustive and probably not feasible in a first stage. Indeed this level of granularity calls into question the feasibility of the reporting, which for banks will imply millions of data points (of uncertain quality at first) for the first two taxonomy objectives. The number of data points will be multiplied by two by the EC requirement to duplicate the calculation of the GAR in two parallel reports: one based on revenues KPIs disclosed by non-financial counterparts and the other based on Capex KPIs. In addition, the number of data points will be also multiplied by three when the other four objectives come into force, and this does not take into account the reporting that may be required under an eventual social, neutral, or harmful taxonomy.

Our recommendation is that this type of breakdowns (ow transitional, ow specialized lending, ow enabling...) should be postponed at least until 2024, when the Delegated Acts for all taxonomy objectives will have been adopted and the underlying data start to become available.

#### Group-level reporting disclosures:

As a universal and diversified financial institution, we favor the approach proposed by EBA for banks to disclose on a mandatory basis both the Main GAR on their lending and investment and the Off balance sheet KPIs. Thus, the AuM KPI will reflect our Asset Management and Insurance activities.

We believe banks should not be required on a mandatory basis to calculate and disclose an aggregated weighted average ratio to include these different activities (based on different nature KPIs), which will add complexity to the complexity. Investors should be able to choose the main KPI of the main business for a consolidated group.

#### Grandfathering:

Grandfathering is very important for existing green/ sustainable bonds and loans. We are of the view that grandfathering of taxonomy-aligned products should be permitted as the Taxonomy criteria and thresholds evolve over time. By the same logic, we do not think that activities that are not taxonomy-aligned at loan origination should be allowed to be classified as aligned in future even if their performance improves through the counterparty's own initiatives (unless, of course, it is due to new dedicated financing in which case the loan would be classified as taxonomy-aligned).

#### Transition Pathways:

Should the Taxonomy Technical Screening Criteria change, science based transition pathways should have at least a one-year time lag for application in order to allow practitioners sufficient time to align

to new projections. This will allow CSRD entities to align their reporting appropriately. This should not affect existing financial products to ensure market consistency. However should terms of the financial transaction change, e.g. re-financing, then the new TSC or pathways should be reflected.

### Transition

We would like to finish our remarks by highlighting an issue that we consider critical: The imperative of measuring and disclosing information on financing the transition path of our clients. In this regard, we welcome the recommendations of the Platform for Sustainable Finance to the Commission on how transition finance can be further integrated in the EU Taxonomy framework. In particular, we support that the Platform proposes to study further “transition-related reporting and how the taxonomy fits within the latter”. This work needs to be prioritized in our view.

We also strongly encourage the European Commission to consider opening the door to transition finance in both the forthcoming-delegated acts on the technical screening criteria for the environmental objectives and Article 8, as well as the Renewed Sustainable Finance Strategy. A regulatory recognition of transition finance is fundamental to meeting the EU carbon neutrality by 2050 objective.

In terms of concrete suggestions, we are fully supportive of the EBF proposal to recognize the full transition pathways of corporates at the 2050 horizon, duly validated by eligible third parties such as an assessment using the ACT (Assessing low Carbon Transition) methodology. This would allow credit institutions to calculate a “transition-aligned ratio” on their banking book exposures in order to take into account the transition of their counterparties without misleading investors.

As a closing comment, we would note that French banks are already working closely with ADEME (the French Environment and Energy Management Agency) on the opportunity to review their ACT methodology to better integrate sectoral de-carbonization pathways and credible corporate transition plans that could be used to assess the transition.