

Over Two Years with the EU Taxonomy:

An ERM Expert Briefing
on its Impact on the Global
Reporting Landscape





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Executive Summary

This report addresses the challenges companies face in complying with the requirements of the new EU Taxonomy Regulation. It seeks to answer three questions:

- What lessons can be learned from the experience of companies in the first year reporting on Taxonomy-eligibility?
- What challenges are becoming apparent for companies in striving for Taxonomy-alignment, and how can they be overcome?
- How does Taxonomy-style reporting fit into the evolving global landscape of ESG and sustainability reporting?

To answer these questions, this two-part paper provides an analysis of the EU Taxonomy along with ERM's research into the initial years' use of the Taxonomy by a range of companies, including our lessons learned so far and predictions for the Taxonomy's near-term evolution. This current deep dive into the use of the Taxonomy follows ERM's prior work this year into the evolution of sustainability disclosure in the United States and Europe, analysing the impacts of new regulatory frameworks affecting corporate sustainability disclosure worldwide.¹

In Part One, we conducted research based on publicly reported information from listed companies in France, Germany, Italy, Spain, and the Netherlands. The companies included in this research were selected on the basis of being part of the leading stock index in each country: CAC 40 (France), DAX 40 (Germany), IT 40 (Italy), IBEX 35 (Spain), and AEX/AMX (Netherlands). As financial and non-financial undertakings have different Taxonomy performance indicators to report and face different challenges in gathering underlying data, ERM decided to present financial and non-financial undertakings separately.

In Part Two, we present our recommendations based on ERM's experience of working directly with companies, investors, and portfolio companies on Taxonomy-related concerns. This work includes assessments of performance against the criteria for Substantial Contribution, Do No Significant Harm (DNSH), and Minimum Social Safeguards (MSS).² ERM has also worked with investors on assessing whether their investments classify as Sustainable Investments³ for activities that do not fall under scope of the EU Taxonomy. Due to the principal similarity in approach between the EU Taxonomy and the Sustainable Finance Disclosure Regulation (SFDR) in this regard, insights from ERM's SFDR project work were also incorporated into our recommendations.

In the Conclusion, we discuss the implications of the EU Taxonomy for the evolving global ESG and sustainability disclosure landscape.

Key Insights from Part 1: Baseline Assessment

- Based on our research, the majority of listed companies in the major European markets reported on EU Taxonomy. Among 204 listed companies across France, Germany, Italy, Spain, and the Netherlands selected for analysis, 165 companies (80.8 percent) have at least partially reported on Taxonomy-eligibility.
- The other 19 percent are partially explained by companies with diverging fiscal years. Yet it also speaks to the fact that the market still needs to adapt to the Taxonomy being a new conceptual framework that comes with its own set of technical challenges.
- The average EU Taxonomy-eligibility figure is 34 percent for non-financial undertakings, across turnover, CapEx and OpEx, and 28 percent for financial undertakings, based on data for asset managers, asset management activities of insurers, and credit institutions. Eligible CapEx for non-financial undertakings was the highest by comparison, suggesting that overall eligibility figures are likely to increase over the next five years due to planned investments in Taxonomy-aligned activities.
- It is likely that financial undertakings will seek to increase their exposure to Taxonomy-eligible assets in the short-term, which may lead to a run on potentially green assets. This will in turn create pressures for non-financial undertakings to increase their eligibility and alignment figures to remain competitive and attractive to investors. Non-financial undertakings whose activities inherently classify as doing significant harm may on the other hand be faced with decreasing valuations.

Key Insights from Part 2: EU Taxonomy-alignment Requirements

- The main challenges of financial and non-financial undertakings in dealing with EU Taxonomy-alignment are twofold: first, the regulatory complexity and on-going updates to screening criteria; and second, the internal multi-stakeholder set-up required to tackle strategic and operational implications.
- The EU Taxonomy requires for people across any organization to not think and operate in silos. Successful companies are setting up their Taxonomy implementation projects with a change management mentality.
- Two anticipated best practices emerge in ERM's roadmap for companies operationalising these requirements. The first is to develop internal ownership and capacity building to ensure the company understands the relevant data and knows how to disclose it effectively. The second is to engage both top-down and bottom-up approaches in assessing Taxonomy-alignment in order to ensure efficient process and effective decision-making within the company.
- While the initial focus of the EU Taxonomy-alignment work was on the environmental objectives, the first draft recently released on the minimum social safeguard compliance increased the attention on social performance of activities. Many stakeholders have reported that compliance on minimum social safeguards will be difficult, with some anticipating it would even become an obstacle to a larger market uptake of the EU Taxonomy.

The global ESG disclosure landscape is much more than the EU Taxonomy. Different disclosure schemes driven by various stakeholder globally have but one common direction to guide the ESG and Sustainability professionals: **This is a journey, and the disclosure requirements will only get more detailed and comprehensive. Increased ESG transparency will have an impact on company evaluations. The 'change' is happening at an ever-increasing pace – Better act now than later.**

Introduction: What is the EU Taxonomy?

The EU Taxonomy provides a classification system to create a common language for sustainable finance and corporate sustainability. It was developed to provide investors with enough information to compare companies' sustainability disclosure and performance.⁴ In this expert briefing, we provide a deep dive into the technical aspects of the Taxonomy to examine early indicators of potential challenges and impacts as the framework gains ground with companies and investors.

The EU Taxonomy⁵ is a sustainability framework at the level of individual economic activities, and therefore linked to financial performance indicators. For non-financial undertakings—that is, the “real economy”—the Taxonomy asks for data about turnover, capital expenditure (CapEx) and operating expenditure (OpEx). For financial undertakings, the data requirements vary by type of undertaking. It requires weighted average portfolio-level information for asset managers. In addition to that portfolio-level information, it requires underwriting-based indicators for insurance undertakings and an on-balance sheet green asset ratio for credit institutions.

The EU Taxonomy is applicable on three levels:



1

EU or member state level requirements for financial market participants, financial products or bonds



2

Financial market participants making available financial products



3

Undertakings that are subject to the Non-Financial Reporting Directive (NFRD) or its successor, the Corporate Sustainability Reporting Directive (CSRD)⁶

This does not mean that readers from non-EU geographies and companies are exempt. Any of these levels can potentially lead to extraterritorial reporting obligations, either directly or indirectly. For example, the CSRD reporting obligations are foreseen to also apply to non-European companies generating a net turnover of €150 million in the EU and having at least one subsidiary or branch in the EU.⁷

The EU Taxonomy is built around two key concepts:

- Eligibility refers to financial performance indicators being linked to economic activities covered by the Taxonomy Regulation.
- Alignment describes economic activities for which all corresponding sustainability performance and compliance criteria are simultaneously met.

The performance and compliance criteria for alignment encompass three components:

- Substantial Contribution: a substantial contribution to one of the six environmental objectives outlined below.
- Do No Significant Harm (DNSH): doing no significant harm to any of those applicable environmental objectives.
- Minimum Social Safeguards (MSS): complying with minimum social safeguards.

The six environmental objectives in use in determining alignment for Substantial Contribution and DNSH criteria are:

- Climate change mitigation
- Climate change adaptation
- Sustainable use and protection of water and marine resources
- Transition to a circular economy
- Pollution prevention and control
- Protection and restoration of biodiversity and ecosystems.

Part One:

Looking back: Fiscal Year 2021 Eligibility Disclosures

Certain patterns in disclosure emerge in Fiscal Year 2021, the first year of disclosures since the EU Taxonomy was introduced. The focus for the analysis in the current expert briefing was the markets where ERM's core Green Deal team is based. This research did not set out to assess the entire landscape for listed companies subject to EU Taxonomy compliance. It is estimated that around 6,000 companies are in scope for the Taxonomy, and our research provides a useful snapshot into the initial reporting experiences of companies as well as the patterns of disclosure that are emerging.

Findings for non-financial undertakings

To analyse the impacts of the first year of compliance with the EU Taxonomy, ERM conducted desktop research on publicly available information for listed companies in major European countries.

Insights

- **Approximately 82 percent** of non-financial undertakings have reported on eligibility for at least one of the three financial indicators. Missing data for the remaining companies is partially explained by companies having a fiscal year diverging from the calendar year, meaning that the respective reports have not yet been published at the time of ERM's research.
- Average reported eligible figures range from **29 percent for turnover to 40 percent for CapEx**, with deviations above and below these values depending on country.
- This phenomenon is partially explained by the **nature of CapEx reporting for the EU Taxonomy**, where CapEx may include a so-called CapEx plan aiming at expanding Taxonomy-aligned activities or at ensuring alignment for previously eligible-only activities.⁸ CapEx figures may also comprise forward-looking information for up to five years into the future, whereas turnover and OpEx, with the exception of OpEx forming a part of the CapEx plan, relate to the previous fiscal year only.
- **For turnover and OpEx reporting**, a large share of companies have disclosed eligibility **towards the extremes** (either zero percent or between 50.01 to 100 percent). Disclosures for CapEx are more balanced and spread across the spectrum, with the exception of the high CapEx extreme.

Table 1 summarises the findings across Germany, France, Italy, Spain, and the Netherlands on a country-by-country basis for non-financial undertakings.

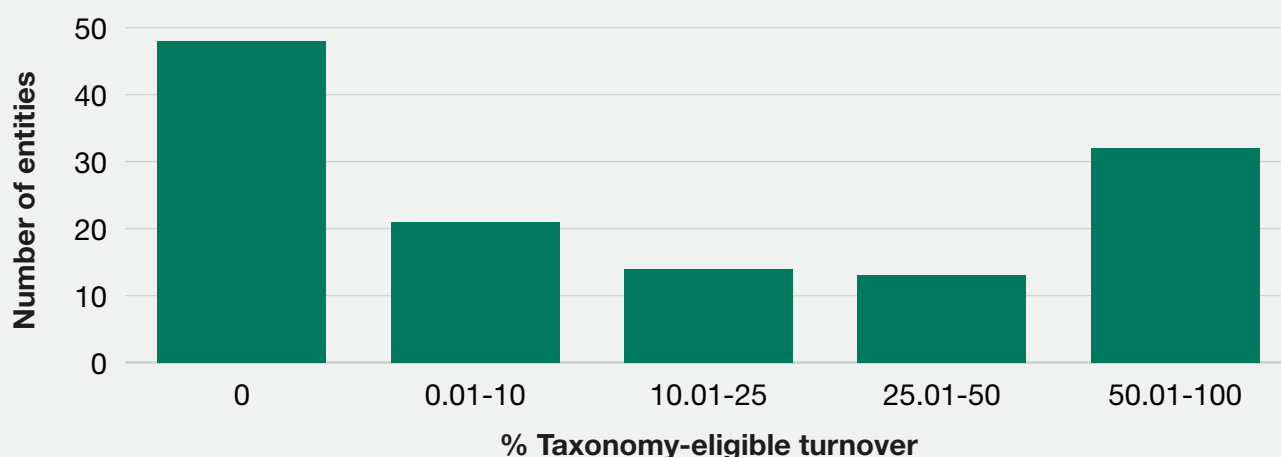
Table 1
Findings for non-financial undertakings

Country	Number of non-financial undertakings	Number of non-financial undertakings reporting on eligibility for at least one financial indicator	Average % Eligible turnover	Average % Eligible CapEx	Average % Eligible OpEx
Germany	37	30	24%	38%	29%
France	36	33	28%	47%	27%
Italy	33	26	37%	42%	42%
Spain	29	23	37%	50%	41%
Netherlands	44	34	21%	24%	23%
Total	179	146 (81.6%)	29%	40%	32%

Source: Publicly available data disclosed by listed non-financial undertakings for fiscal year 2021 in selected European markets

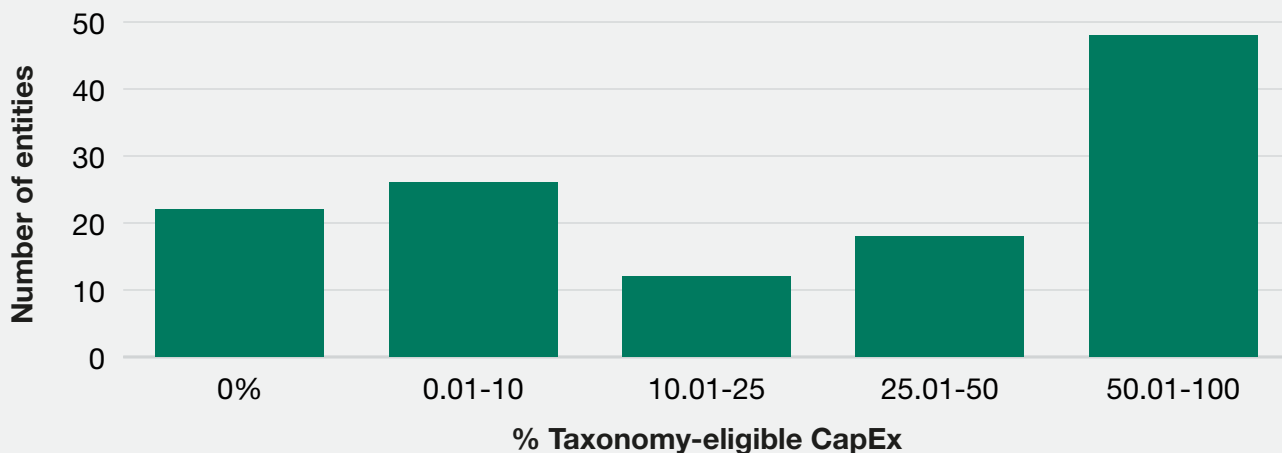
Figures 1-3 show the breakdown of eligibility indicators for turnover, CapEx and OpEx across the sub-sample.

Figure 1
Percentage of eligible turnover reported by non-financial undertakings



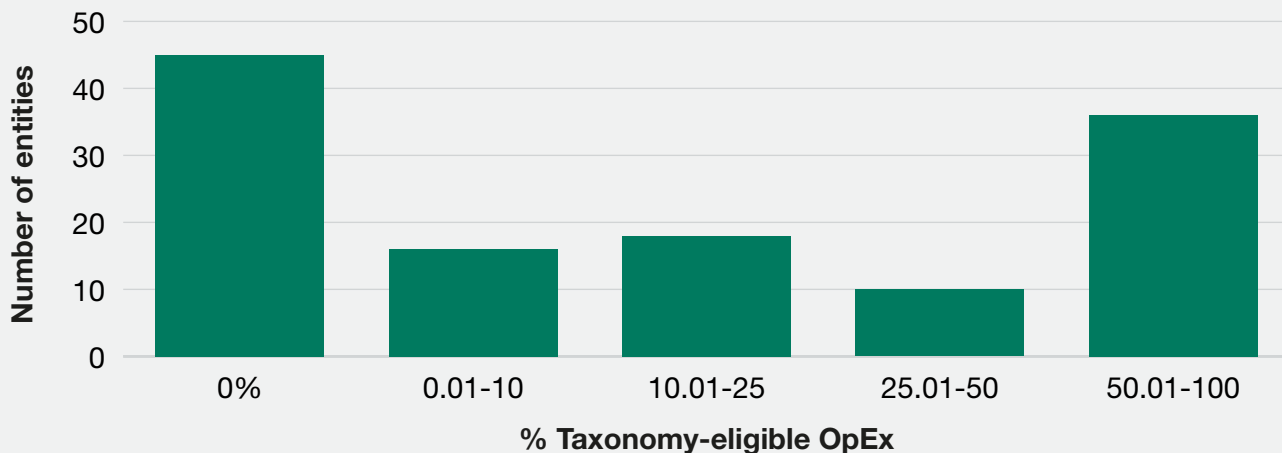
Source: Publicly available data disclosed by listed non-financial undertakings for fiscal year 2021 in selected European markets, n = 128

Figure 2
Percentage of eligible CapEx reported by Non-Financial undertakings



Source: Publicly available data disclosed by listed non-financial undertakings for fiscal year 2021 in selected European markets, n = 126

Figure 3
Percentage of eligible OpEx reported by non-financial undertakings



Source: Publicly available data disclosed by listed non-financial undertakings for fiscal year 2021 in selected European markets, n = 125

Findings for financial undertakings

The financial undertakings include asset managers, asset management activities of insurers, and credit institutions. It excludes the underwriting activities of insurers as they are considered liabilities in comparison to the previous group, which constitute assets.

Insights

- **76 percent** of financial undertakings have **reported on their Taxonomy-eligibility**, compared to 82 percent of non-financials (see previous section). A partial explanation for financials reporting at a lower rate than non-financials is the fact that financial undertakings have to rely on their investees and borrowers for the provision of data.
- At an average of **28 percent**, eligibility figures for the financial undertakings are in a **similar ballpark to** the reported eligible turnover and OpEx of **non-financial undertakings**.
- On average, **credit institutions and asset managers have similar exposures** to Taxonomy-eligible assets, although larger differences exist in countries such as Germany and the Netherlands.

Table 2 summarises the findings for financial undertakings on a country-by-country basis.

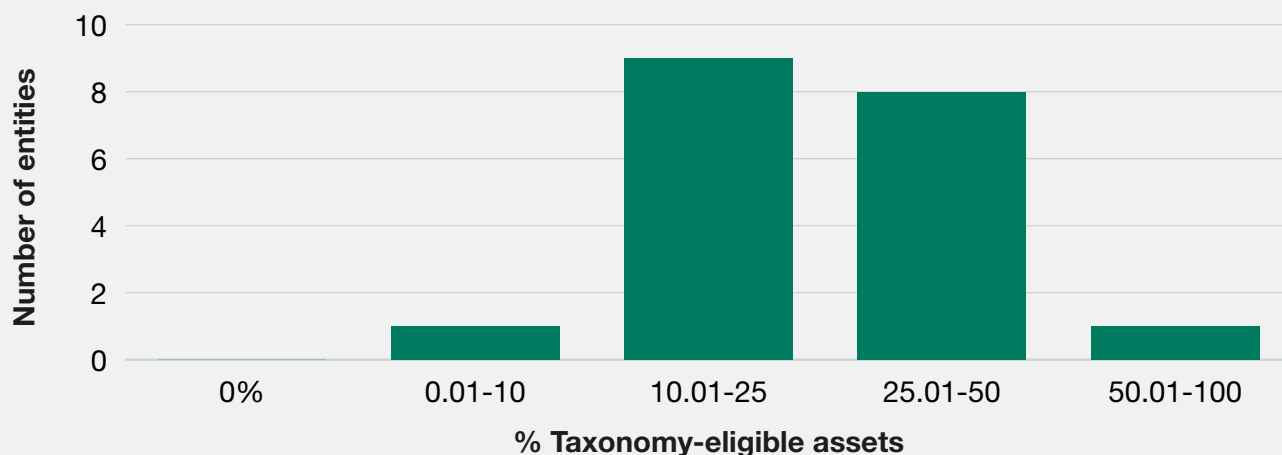
Table 2
Findings for financial undertakings

Country	Number of financial undertakings	Number of financial undertakings reporting on eligibility	% of Taxonomy-eligible assets
Germany	3	3	31%
France	4	4	18%
Italy	7	5	20%
Spain	6	4	42%
Netherlands	5	3	30%
Total	25	19 (76%)	28%

Source: Publicly available data disclosed by listed financial undertakings for fiscal year 2021 in selected European markets

Figure 4 shows the breakdown of eligibility percent of asset-level eligibility across the sub-sample.

Figure 4
Percentage of Taxonomy-eligible assets reported by financial undertakings



Source: Publicly available data disclosed by listed financial undertakings for fiscal year 2021 in selected European markets, n = 19

Looking ahead – what does this mean moving towards alignment disclosures?

Insights

- Non-financial undertakings subject to the NFRD are exempt from alignment reporting from 1 January 2022 until 31 December 2022. Financial undertakings subject to the NFRD are exempt until 31 December 2023. Regardless, a large share of the non-financial and financial undertakings in the sample have already discussed the challenges of alignment in their disclosures.
- Five percent of the non-financial undertakings have already disclosed alignment figures for turnover, CapEx and OpEx on a voluntary basis. Those early adopters were non-financial undertakings predominantly active in the energy and utilities sectors, as well as engineering and technology industries. The turnover alignment percentages for these undertakings ranged from 1.5 to 100 percent, the CapEx alignment percentages ranged from 1.1 to 100 percent, and the OpEx alignment percentages ranged from 14 to 100 percent.
- None of the financial undertakings voluntarily disclosed alignment figures yet.
- As a basis for alignment disclosure, companies tended to rely on high-level assessments based on the existing management system elements and procedures and information about the compliance status with local environmental regulations. At the same time, the need for further assessment covering operations outside of Europe was stated as an essential next step to improve the robustness of the assessment results.

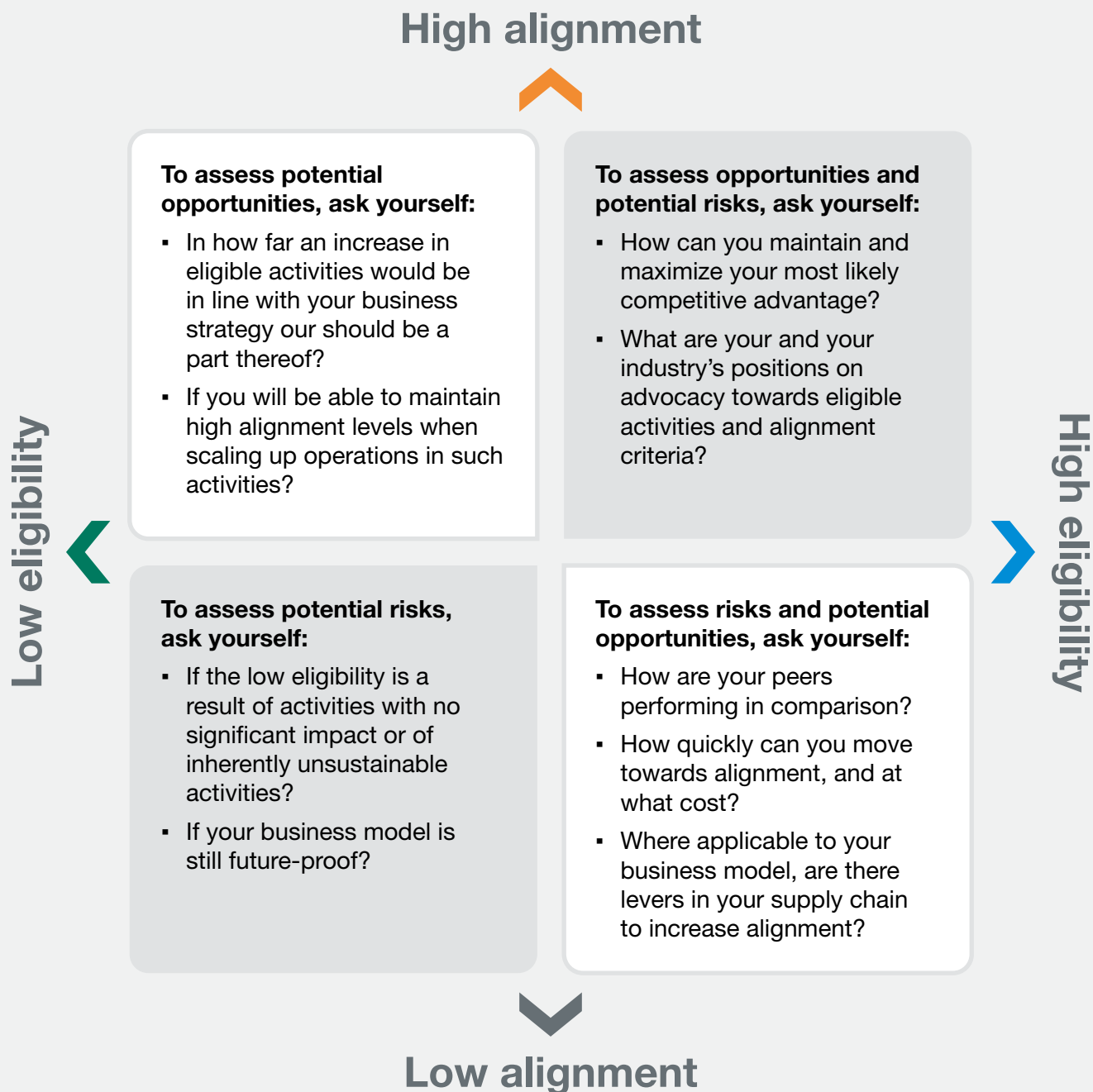
These insights raise a pertinent question: how will the financial markets interpret these figures? Taxonomy reporting certainly will not exempt companies from best-in-class and worst-in-class considerations, and underlying comparisons within a given sector are inevitable. Going forward, what will ‘good’ and ‘not good’ look like?

Three things are clear going into this line of questioning:

- Eligibility and alignment figures cannot be interpreted in isolation: the former always provides the baseline and context against which the latter is measured.
- While reporting on alignment is ultimately binary, interested stakeholders will seek to understand how big the gap towards alignment is. Moreover, stakeholders will need to determine whether a gap is due to the criteria for Substantial Contribution, DNSH, MSS, or a combination thereof. The reporting templates for non-financial undertakings are designed to provide these nuances.
- Low eligibility does not always imply the same thing. Due to a number of EU Commission statements and the Platform on Sustainable Finance’s report on the Extended Taxonomy,⁹ it is clear that for regulators, low eligibility activities may fit into any one of four categories, namely economic activities already in scope of the Taxonomy, activities not yet in scope of the Taxonomy, activities with low environmental impact that therefore will not be part of the Taxonomy, and activities that inherently cause significant harm to environmental objectives and therefore are not part of the Taxonomy. An example for the latter would be power generation from solid fossil fuels.¹⁰

Figure 5 provides a conceptual framework on how to think about the risks and opportunities of the conceivable pairings of low and high eligibility and alignment, respectively.

Figure 5
Risks and opportunities of the conceivable pairings of low and high eligibility and alignment



Our research has found that all the extremes shown in the matrix are covered by companies that voluntarily report on alignment, and the picture will not look much different once mandatory reporting on Taxonomy-alignment kicks in. Companies and investors are well-advised to interpret Taxonomy disclosures on a case-by-case basis. This will be easier said than done. The scope and complexity of the EU Taxonomy continue to grow, due to changes in eligible activities through the addition of activities for the remaining four environmental objectives not yet in scope; potential agreements on the Extended and Social Taxonomies; and the introduction of Taxonomy-like regimes in other jurisdictions.

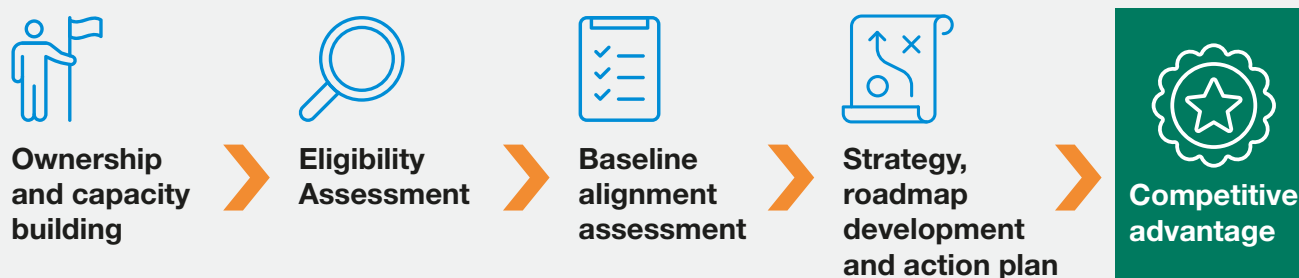
Part Two:

Looking into the near future: First lessons learned for EU Taxonomy-alignment

Roadmap to EU Taxonomy-alignment

Non-financial undertakings are facing distinct challenges in assessing and proving Taxonomy-alignment. These challenges are relevant to financial undertakings at the portfolio level, as they will need to understand the challenges their borrowers and investees are facing to be able to inform decision-making. In this section we further highlight our findings for best practices for operationalising the EU Taxonomy for alignment.

Figure 6
Roadmap to EU Taxonomy-alignment



Main Challenges

We have identified five main challenges pertaining to Taxonomy-alignment based on our work with financial undertakings and non-financial undertakings.

Complexity

Taxonomy-alignment is complex. The published documentation on the EU Taxonomy with its delegated acts and additional expert group reports is very extensive and thousands of pages in length. The technical screening criteria for alignment and DNSH can be complex in nature and are often cross-referencing to several other EU Directives and Regulations at a time. This leads to a variety of sources to be reviewed and stakeholders to be consulted to fully understand the requirements.

Fluid Developments

Some elements of the Taxonomy are still fluid. Whilst the timeline for the overall implementation is defined, many details are still to be developed or agreed on. This leads to uncertainty as most find it difficult to follow all the changes and to identify the right timing for starting the internal discussions and preparations. As such, many are taking the position to “wait and see” instead of integrating Taxonomy-alignment thinking into strategic and operational planning, thereby potentially losing out on the first mover advantage.

Multi-Stakeholder Set-Up

The EU Taxonomy requires multi-stakeholder engagement and ownership. Different perspectives, awareness and knowledge levels often lead to many internal discussions and potential misunderstandings. Many undertakings, especially non-financial undertakings, find it difficult to nominate a single process owner to take accountability for EU Taxonomy assessment and alignment, which needs to involve different functions such as finance/accounting, legal, management system representatives, environmental managers, human resource, operational leaders as well as sustainability reporting and public relations. In addition, focusing on group-level corporate functions only is insufficient, as assessing alignment for individual economic activities and turnover streams requires understanding and support from regional, country and operational site levels also.

Operational Challenges

Many companies will face operational challenges in finding and gathering relevant information. Non-financial undertakings face the challenge that their corporate and site-level EHS/ESG management systems are not providing the necessary information. The new EU Taxonomy criteria, which go beyond legal environmental and permit requirements are not covered by existing data collection processes. In addition, EHS/ESG IT systems and digital solutions are not well suited to satisfy the new data collection and data processing requirements such as the split of revenue per aligned and not aligned economic activity. It is evident that financial and sustainability systems are not aligned and do not 'talk' to each other.

Strategic Challenges

Taxonomy-alignment will create strategic challenges. As a small number of non-financial undertakings begin to align their sustainable business strategy to the EU Taxonomy, the EU's regulatory timeline largely governs the pace, notably the absence of criteria for the remaining four environmental objectives. Companies that have positioned themselves as sustainability leaders in the past might need to disclose a mix of low eligibility and/or alignment figures for the time being and thus will find themselves having to justify that narrative. On the other hand, companies who positioned themselves as sustainability leaders before and whose activities are well-covered under the climate mitigation and adaptation objectives will have to re-evaluate that narrative in the context of their alignment figures. Figure 5 provides impulses to kick-start these conversations.

Best practices for operationalising the requirements

Based on ERM's insights from implementation projects and discussions with companies of different sizes and sectors, we have identified two process steps as leading practice for structuring engagement with the EU Taxonomy: **Ownership & Capacity Building**, and **Alignment Assessment**.

Ownership & Capacity Building

To ensure ownership, an executive sponsor needs to nominate a **core team** that drives the process and regularly engages with the organisation's sustainability leadership committee. **The core team** should be supported by a dedicated project management office to coordinate all stakeholders and activities.

Awareness raising and capacity building around a complex new topic such as the EU Taxonomy requires target-group specific interventions. The main target-groups are top management, corporate level accountable management on specific areas, and subject matter experts to actually implement the change. Depending on type of company and country level specifics, individual site

or country management will typically also need to get involved. The following paragraphs describe the roles different employees across any organisation typically take on during an EU Taxonomy implementation project and on a regular basis thereafter.

- The **top management** needs to be enabled to disseminate the ‘big picture’ and strategic positioning regarding sustainability in the context of the EU Taxonomy. It requires condensed information and guidance on embedding EU Taxonomy in the company’s strategy. Board level accountability is likely to drive the best outcomes in implementation and improvements going forward.
- The **corporate-level functional management** (e.g., finance, investor relations, sustainability / EHS, legal, procurement, IT, communications, etc.) typically being part of the core team needs to better understand the context and the implementation steps. Training can be provided via a comprehensive kick-off workshop and regular update discussions covering technical and practical implementation questions. The team members will serve as change agents and will need to feel confident to explain the context, planned process and answer questions from the organisation.
- **Corporate-level subject matter experts** should be provided with information tailored to their role in the company. Subject matter experts are the ones who can assess complex technical aspects of the EU Taxonomy and have access to the required data, both on the financial and non-financial side.
- Where applicable, **site management** should typically get involved by an engagement session at a country-level before interactions at a site level start. In addition to understanding the big picture, the implications for the site should be communicated and discussed together with resources required.

Feedback received in the different workshops and discussions should be discussed in the core team and should be considered for the development of the implementation approach.

Alignment Assessment

Experience on running alignment assessments shows that it requires a suite of input and data varying in granularity, source, and ownership. To enable robust understanding and decision-making, companies should engage in a blended assessment approach with two components: both top-down and bottom-up assessments.

The Top-Down Component: Corporate Management System Review

Companies should use this approach to identify links to and overlaps with the EU Taxonomy within existing corporate-level programs and systems. A comprehensive review at this level enables companies to leverage synergies and efficiencies by avoiding and/or reducing the need for one-topic-one-system implementation.

The process should comprise structured interviews to understand the use of management systems as well as a review of tech-enabled solutions used in the process from emails to Excel to ERP systems. Management Systems optimised for Taxonomy-alignment help companies in laying the foundation for the more compliance-focused sustainability criteria of the regulation, for example with regards to the Minimum Social Safeguards or certain elements of the DNSH criteria.

The main output is a list of findings and recommendations that can be used both centrally and across the organisation to build EU Taxonomy-alignment criteria into existing workflows.

The Bottom-Up Component: Assessment at the Asset and Site Level

Companies should use this approach to assess performance with applicable EU Taxonomy-alignment criteria at the level of relevant assets and sites to enable confidence in internal and external reporting. It is this depth of assessment that will yield the most accurate data, thus making it imperative from an assurance perspective too.

The process takes the form of a typical gap assessment based on reviews of documentary evidence and interviews with those in charge of managing the respective asset and/or site. When interacting with internal stakeholders at this level, it is beneficial to communicate the broader implications of the EU Taxonomy and to frame the alignment criteria in the context of local legal requirements. This gap assessment is also fundamental to the understanding of whether the sustainability performance metrics, such as emissions intensity thresholds, are being met.

The output will help in improving internal and external reporting as well as provide an entry point into asset/site level action plans for improving Taxonomy-alignment over time.

Deep Dive into the Minimum Social Safeguards

While the EU Taxonomy is set out to drive substantial contribution to its six environmental objectives, it also aims at doing no significant harm to the other aspects while complying with minimum social safeguards. This is to ensure addressing climate change without creating rebound effects on broader aspects of sustainability. The application of mandatory Minimum Social Safeguards (MSS) helps companies and investors to identify, prevent, manage, and remediate negative impacts of their activities on human rights including labour rights and rights of local communities. The MSS in the EU Taxonomy will help ensure that green investments can be labelled as ‘sustainable’ in the wider sense of the term, that is including social considerations.

The application of the concept leaves room for interpretation: What is the meaning of ‘minimum’ in the context of the safeguards referring to voluntary frameworks and standards? Another concern is lack of clarity on the expected level and depth of application across the organization and its supply chain. These are yet to be answered via further guidance.

While the Platform on Sustainable Finance has published guidance and a call for feedback on the MSS early in the second half of 2022, uncertainties remain as to whether official guidance will be available by the time companies are expected to comply with the safeguards. Importantly, companies may be reluctant to disclose immediately due to the potential risk of having to revise alignment figures downward later. Thus, these uncertainties may result initially in more conservative alignment figures being reported.

Current Interpretation of Minimum Social Safeguards

The Taxonomy regulation stipulates that undertakings whose economic activities are to be considered as Taxonomy-aligned must align with the standards for responsible business conduct as prescribed in:

- The Organisation for Economic Cooperation and Development Guidelines for Multinational Enterprises (OECD MNE),¹¹ a set of guidelines for responsible business conduct.
- The United Nations Guiding Principles on Business and Human Rights (UNGPs),¹² including the principles and rights set out in the eight fundamental conventions identified in the Declaration of the International Labour Organisation on Fundamental Principles and Rights at Work.
- The International Bill of Human Rights, which consists of the Universal Declaration of Human Rights¹³ and related international treaties.

The Platform for Sustainable Finance's Draft Report on Minimum Safeguards, from July 2022, proposes disclosure and implementation of two sets of criteria for the establishment of compliance with minimum safeguards:

- 1 Adequate due diligence processes implementation; and
- 2 The actual outcome of these processes or the company's performance relying on external checks on companies.

The required due diligence processes are based on the six steps of the UNGPs and the OECD MNE Guidelines,¹⁴ which take a risk-based approach to human rights due diligence. Companies should carry out human rights' due diligence as appropriate to their size, the nature and context of operations and the severity of the adverse human rights impacts. Companies operating in a highly regulated context might need to perform levels of due diligence distinct from those operating in countries with less stringent legislation. However, certain sectors such as solar panel components, or certain supply chain risks, such as construction with migrant labour require companies to conduct human rights diligence even in highly regulated contexts.

Right now, it is crucial to monitor developments regarding MSS. The EU Commission itself is yet to provide guidance on the usability of the MSS based on the Platform for Sustainable Finance's Draft Report and feedback from stakeholders. Crucially, the MSS are intricately linked to other EU regulations such as the upcoming EU Corporate Sustainability Due Diligence Directive (CSDDD) and CSRD, which are both expected to provide further guidance on the interpretation and application of the MSS.

Conclusion:

Looking further ahead: Taxonomies and the evolving Global disclosure landscape

In early 2020 when the first draft of the EU Taxonomy was published by the Technical Expert Group (TEG), it seemed unlikely for anyone to have been able to imagine just how prominent the EU Taxonomy would become by late 2022. The TEG recommendations were quickly adopted in law and became the novel tool for the EU in addressing its broader sustainability challenges. Consequently, the EU's approach to regulating corporate sustainability shifted away from environmentally regulating high-impact sectors in favour of a more holistic approach focusing on all pillars of sustainability. The EU's requirements for the financial sector to use the EU Taxonomy for its own disclosures were a key component in shifting capital flows towards a newly found focus on broader sustainability.

Today, there are over twenty Taxonomies in place, announced or under development globally. While some of these differ from the EU Taxonomy to prioritise friendliness to local economies, other jurisdictions are embracing the EU Taxonomy as a blueprint; thereby cementing the EU's first-mover advantage. Most notably, the South African, Canadian, and ASEAN Taxonomies are predominantly built on the EU Taxonomy. Further, the EU and China have released the 'Common Ground Taxonomy' and are working on a global Taxonomy with leading countries under the International Platform on Sustainable Finance.

CSRD reporting will be based on the European Sustainability Reporting Standards under development that are very ambitious and require companies to disclose very comprehensive sustainability data. Due to the fact that a majority of multinational corporations also operate in the EU and European investors actively invest in different parts of the globe, these developments are creating extraterritorial impacts in other parts of the world. Likewise, there are likely to be global impacts from two developments anticipated in late 2022 or early 2023: first, the finalisation of the International Sustainability Standards Board (ISSB) General Requirements for Disclosure of Sustainability-related Financial Information, and second, the anticipated finalisation of climate-related disclosure requirements by the U.S. Securities and Exchange Commission (SEC).

However, the motivation is not only about compliance. The need for sustainable business conduct is also driven by political developments which will increase the adoption of EU Taxonomy as a ready tool for implementation to address broader sustainability issues.

When the EU Taxonomy was drafted in early 2020, it was not easy to foresee the current global reality. The earliest Covid lockdowns occurred shortly after TEG's report was finalised, as the world began to confront a new era of supply chain disruptions and increased awareness of sustainability risks for businesses. Since early 2022, the markets are impacted by further supply chain disruptions due to the Ukraine conflict, and prolonged lockdowns in China and lately the Taiwan conflict. Over the last two years we have witnessed the first examples of companies being ruled by courts for inadequate climate goals, and governments reassessing climate policies due to activists and NGO pressure. Real world impacts of climate change are manifesting as for example Europe had the worst flood damages in 2021 followed by the worst droughts in 2022.

Today, we are seeing trends towards localisation driven by sustainability concerns, inequality of environmental and social standards globally, and a reversal of the 1990s offshoring to “low-cost countries” where lower operating costs were accompanied by lower social and environmental standards. Impacts of climate change are increasingly acknowledged by the public, and governments are more protective in keeping local economies self-dependent and less vulnerable. It is conceptually recognised that business valuations should not be solely measured by financial KPIs but also via ESG factors. Various third parties now rate companies’ sustainability performance based on disclosed data.

Looking forward, increasing availability of ESG disclosures including the Taxonomy will have an impact on consumer and investor decisions and valuation of businesses. The future success of businesses depends on how they act now to improve their ESG performance. The EU Taxonomy and its replications across other jurisdictions are likely to converge in approaches and play a key role in future valuation of businesses. In a nutshell, be it due to sustainability concerns or compliance reasons, the EU Taxonomy is here to stay and is likely to have an increasing market uptake in the coming years.

Endnotes

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¹¹ The Organisation for Economic Cooperation and Development. *Guidelines for Multinational Enterprises*.
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¹⁴ Due Diligence | OECD Guidelines | National Contact Point OECD Guidelines



About The SustainAbility Institute by ERM

The SustainAbility Institute is ERM's primary platform for thought leadership on sustainability. The purpose of the Institute is to define, accelerate, and scale sustainability performance by developing actionable insight for business. We provide an independent and authoritative voice to decode complexities. The institute identifies innovative solutions to global sustainability challenges built on ERM's experience, expertise, and commitment to transformational change.

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