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Taxonomy Disclosure in the EU – A Useful Framework, Despite Current Challenges

https://doi.org/10.1515/ev-2025-0016
Received April 10, 2025; accepted April 11, 2025; published online May 2, 2025

Abstract: The EU Taxonomy is a classification system for sustainable economic activities and a framework for various regulatory initiatives. Its primary objectives are to enhance transparency, to reduce greenwashing and ultimately to redirect capital toward more sustainable activities. However, since its introduction, market participants have raised concerns about whether the benefits justify the costs. This article examines current challenges, such as the initial implementation costs, data gaps, sector and counterparty coverage, while also highlighting opportunities like enhanced international competitiveness and improved ESG risk management. The focus of this article is on banks as both preparers and users of Taxonomy data, addressing issues related to Taxonomy eligibility, alignment, and the Green Asset Ratio (GAR). The article concludes with recommendations for policy makers and authorities to improve the effectiveness of the Taxonomy disclosure.

Keywords: EU taxonomy; ESG disclosure; regulatory uncertainty; banking regulation; ESG risk management; omnibus

JEL Classification: G28; G32; Q58

1 Introduction

Within the context of the EU Green Deal objectives, the EU requires a systematic reorientation of capital flows towards a sustainable economy. To achieve this transition, the market called for a standardised definition of sustainability. The EU Taxonomy is a classification system defining sustainable economic activities and provides a framework for other regulatory initiatives. Article 8 of the

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Taxonomy Regulation[1] (in the following: Taxonomy disclosure) specifies the required annual reporting of quantitative and qualitative information on the sustainability of the undertaking's economic activities (European Commission 2020, Article 8, 2021a, p. 2020). According to the European Commission, the objective of the Taxonomy disclosure is to create transparency, diminish greenwashing and reduce associated reputational risks for financial institutions (Recital 5 and 6, European Commission 2020, Question 1 and 2, 2021b, 2025a). The implementation of disclosure requirements are supposed to spark environmental and social benefits following the shift of capital flows toward more sustainable activities (Recital 5 and 6, European Commission 2020, Question 2, 2021b). The Taxonomy disclosure applies to large EU corporations and financial institutions, requiring them to assess to what extent their economic activities meet Technical Screening Criteria (TSC). In this context, institutions assess whether their assets substantially contribute to one of the six environmental objectives, do not significantly harm others (DNSH criteria), and comply with Minimum Social Safeguards.

In the context of current political discussions on deregulation and bureaucracy, the European Commission has adopted a set of proposals to simplify sustainability disclosures and boost competitiveness, called the Omnibus-initiative. It covers simplifications in the disclosure according to the EU Taxonomy, Corporate Sustainability Reporting Directive (CSRD) and Corporate Sustainability Due Diligence Directive (CSDDD).[2] In particular, the modifications in the proposals on the Taxonomy Disclosure and the CSRD reduce the scope of applicants by around 80 % and the number of data points to be reported, along with a delayed directive application. Next steps for the Omnibus-initiative are the review and approval of the European Parliament and the Council. The Commission requested to fast-track the review, yet, an agreement for all proposals are not expected before the end of 2025 or even 2026 for some (European Commission 2025b, 2025a). In a first vote on April 4th, the Parliament approved the delayed application of sustainability reporting, confirming the current efforts to soften mandatory regulation (European Parliament 2025).

This article focuses on banks' perspective regarding Taxonomy disclosure. As banks are both preparers and users of Taxonomy data, they are highly dependent on the flow of information from their counterparties. Banks disclose to what extent their assets are covered by the EU Taxonomy (Taxonomy eligibility) and the share of assets meeting TSC (Taxonomy alignment) in their Green Asset Ratio (GAR). Given that most banks assess and disclose their contribution toward climate objectives

1 Taxonomy Regulation (EU) 2020/852.

2 Financial institutions are not directly applicable to the CSDDD.

(climate change mitigation and adaptation), our article focuses on these, leaving other environmental and social objectives to future research.

Despite authorities' efforts to provide a structured framework, financial market participants question whether Taxonomy disclosure meets its objectives. The initial years of implementation resulted in numerous studies, that highlight the significant challenges facing banks, such as the cost of implementation, sector coverage, and data gaps, leading to low values of GAR. However, Taxonomy disclosure also presents opportunities for banks, such as international competitiveness and improved ESG risk management. This article discusses both challenges and opportunities of Taxonomy disclosure, concluding with recommendations for policy makers and authorities to improve its effectiveness for banks.

2 Challenges of the Taxonomy Disclosure

2.1 Initial Costs of Implementation

In the first years of reporting, banks must ensure regulatory compliance. The implementation requires employee training, collection of (historical) sustainability data of the counterparty and the financed economic activity for new and the stock of relevant financing and investments, as well as adjustments to reporting processes and IT systems. Moreover, it requires constant screening of regulatory updates from authorities. The initial cost of implementation entails a large investment for the first years of reporting. However, just like with other regulatory initiatives, the costly initial implementation will be followed by declining costs, mostly consisting of monitoring and recurring adjustments of processes (Hoskins and Labonte 2015, p. 2; Sathye 2008, pp. 348–354).

If proposed simplifications on Taxonomy disclosure in the context of the Omnibus-initiative are approved by the Parliament and the Council, many banks and companies currently disclosing under the EU Taxonomy will no longer be required to do so. Thus, unless they choose to report voluntarily, their costs for Taxonomy disclosure drop.

2.2 Regulatory Uncertainty

Despite the efforts of authorities, the implementation of Taxonomy disclosure is associated with challenges. Several Delegated Acts were complemented by FAQ documents which specify regulatory requirements for the sustainability assessment. Since the requirements are not consolidated in a Delegated Act, credit institutions

are required to scan hundreds of FAQs – assessing their relevance – thus driving up costs. Moreover, their publication has triggered uncertainty among applying banks due to inaccuracies in the regulatory requirements. For example, the Commission published FAQs outlining approaches to include subsidiaries in the taxonomy assessment, based on whether they fall under CSRD requirements or are covered by group reporting. However, interpretations vary in practice, with some corporations excluding subsidiaries entirely and others using group Key Performance Indicators (KPIs) for evaluation. Consequently, results are not easily comparable between institutions and transparency is limited.

The Omnibus-initiative further adds uncertainty for banks.[3] The proposal's legislative process will take months, creating further uncertainty about its scope and requirements. If adopted, it would in parts ease GAR disclosure for most banks. However, banks still face the strict criteria under Pillar 3 reporting according to Art. 449a CRR III.[4] Unless the EBA aligns its final Implementing Technical Standards (ITS) with the proposal or removes Taxonomy disclosure from Pillar 3, credit institutions will still face strict requirements and demand sustainability data from companies.

Regulatory uncertainty often prompts banks to adopt a conservative approach to avoid (accusations of) greenwashing as it is associated with reputational risks (EBA 2023, p. 33). However, this approach might underestimate the overall Taxonomy alignment of assets (Alessi and Battiston 2022, p. 9).

2.3 Lack of Data Availability and Quality

Financial institutions face challenges in meeting EU Taxonomy requirements due to limited data availability and quality. Assessing taxonomy eligibility and alignment requires access to historical and high-quality data on counterparties and activities, which is often missing from portfolios. Limited availability of data restricts the validity of current assessments and distorts results, which consequently influences the value of the GAR. This, in turn, hinders transparency and comparability between credit institutions.[5]

3 According to the proposal, financial institutions who do not exceed an average of 1,000 employees during the financial year and a net turnover of 450 million euros, are not mandatorily obliged to provide a Taxonomy disclosure.

4 Regulation (EU) 2024/1623.

5 A study on published KPIs by PWC provides an example of the influence of available data. It found significantly higher GARs for banks in the Netherlands. As property financings make up a significant part of the bank portfolio, the authors assume that this is because EPC ratings are publicly available in the Netherlands (PWC 2024).

The EU Commission stipulates that data must be obtained directly from counterparties, while the use of proxies and estimates is prohibited. While the use of proxies could lead to increased greenwashing risks and reduced comparability, allowing them could enhance coverage and transparency (if underlying assumptions are made transparent). The European Commission plans to introduce the European Single Access Point as a central register for corporate, financial, and sustainability information. However, its implementation has been delayed until 2027, when data is urgently required today (European Commission 2023).

With the extension of corporations applicable to Disclosure according to the EU Taxonomy and the CSRD in the next years, more corporations are expected to disclose sustainability information. However, the suggestions in the Omnibus-initiative slow down this progress by reducing the scope of applicants and extending the adoption period, thereby aggravating the availability of sustainability data (European Commission 2025a).

2.4 Sector and Counterparty Coverage

Another key challenge of the Taxonomy is its limited sector coverage which influences the value of the GAR, as illustrated in Figure 1. The Delegated Acts cover those economic activities in sectors most harming the environmental objectives

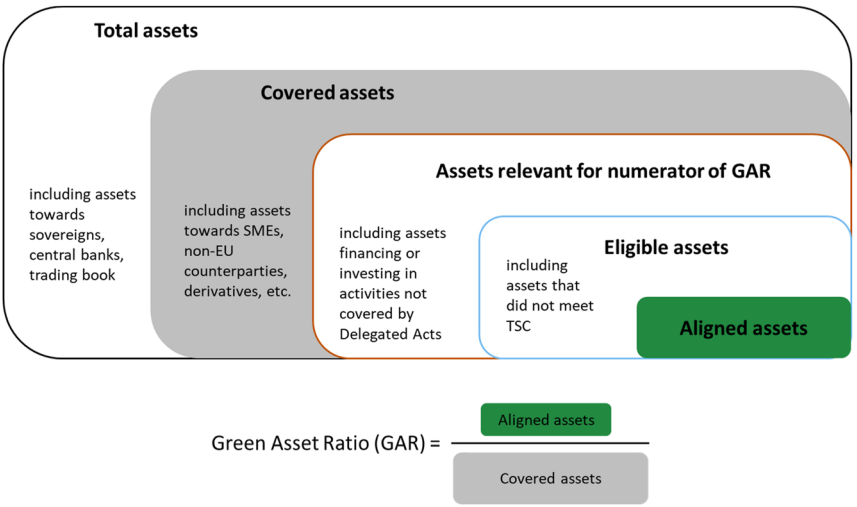

Figure 1: Composition of the Green Asset Ratio (GAR).

which can be transformed, e.g. they cover economic activities responsible for about 80 % of GHG emissions in the EU.

According to banks' disclosures, the share of taxonomy aligned assets compared to covered assets is low, leading to GAR's of about 2 % for large banks (CRIF 2024; EY 2024; PWC 2024). Currently, this share has little informative value with regards to the potential climate change effect of non-eligible activities or assets, as there is no further distinction. They could either be brown, low-emission (e.g. education, research and other services), transition, or green activities with insufficient data for the classification. Companies in a low-emission sector can still influence their indirect emissions in the value chain or they can offer products that reduce emissions further down the value chain (Möllers 2022). Furthermore, disregarding transition-related activities in the EU Taxonomy can result in a disadvantage for banks financing transition activities. Thereby, the Taxonomy may overlook key sectors of the economy that are required for the transformation. However, setting thresholds too low could lead to carbon lock-in, where fossil fuel-based infrastructure and high-emission technologies persist for decades (Schütze and Stede 2021; Zetzsche and Bodellini 2023).

The term "transition finance" has been used and discussed by academia (Boissinot et al. 2016; Caldecott 2022) and practitioners in sustainable finance but there is no commonly accepted definition in the literature. Some examples of international taxonomies show possible solutions (Marchewitz et al. 2025) provides an in-depth discussion on transition elements in international taxonomies. Like the suggestion by the EU Platform on Sustainable Finance (Platform on Sustainable Finance 2022) some international taxonomies, especially the ASEAN taxonomies, already define a transition (or "amber") taxonomy next to the green taxonomy.[6] This category usually has less stringent thresholds but is only valid for a certain timeframe. For example, the Singapore taxonomy requires companies to meet the criteria for the green category by 2040 at the latest and to have a transition plan that is compatible with the Paris Agreement.[7]

In addition to sectors, the counterparty coverage of the EU Taxonomy is also limited. Counterparties that do not have to disclose sustainability information according to the CSRD are excluded from the taxonomy assessment. Therefore, exposures towards both small and medium sized companies (SMEs) and companies that are not located in the EU cannot be taxonomy aligned. This does significantly influence the value of the GAR, as SMEs make up a large portion of corporations in

6 See ASEAN Taxonomy at: https://asean.org/book/asean-taxonomy-for-sustainable-finance-version-3/.
7 See Singapore Taxonomy at: https://www.mas.gov.sg/-/media/mas-media-library/development/sustainable-finance/singaporeasia-taxonomy-dec-2023.pdf.

the EU. Moreover, sustainable projects for example, renewable energy producers are often SMEs, yet banks cannot include these potentially taxonomy aligned activities in their GAR.[8] This problem would be exacerbated by the proposed amendments of the Omnibus-initiative, excluding corporations with fewer than 1,000 employees (compared to 250 employees in the current version of the CSRD).

3 Opportunities of the Taxonomy Disclosure

Despite the challenges in the design of the Taxonomy disclosure and the GAR, the implementation of the regulation comes with opportunities.

3.1 Obtaining a Competitive Advantage

A clear opportunity is the early development of the EU Taxonomy, which has led the EU to become a standard setter internationally. By the end of 2023, a total of 25 taxonomies in different countries or regions have been published or adopted (Marchewitz et al. 2024).[9] Several use the EU Taxonomy as a main reference. For example, the Taxonomies of the ASEAN countries align their Technical Screening Criteria and emission thresholds with the EU Taxonomy. Because of companies trading globally and the development of several international taxonomies, it is necessary to harmonize the different frameworks, allowing for applicants of the EU Taxonomy to include non-EU green assets. This could be a competitive advantage for EU companies with a high share of exports or non-EU investments, improving their share of green assets.

Despite its challenges and design limitations, the GAR remains the most advanced sustainability metric disclosed by banks, covering multiple environmental objectives. Allowing banks to define their own sustainability metrics or having different voluntary industry standards instead, would reduce comparability and transparency. Moreover, if the KPI and related goals are integrated in banks' strategy, disclosing the GAR could offer a strategic advantage by enhancing growth, profitability, and value amid evolving customer expectations.

8 For example, special purpose vehicles (SPVs), often used for renewable energy or infrastructure projects, are not directly considered in the GAR. This problem is addressed in the FAQs. However, open questions in practical implementation remain.

9 However, some important financial markets, such as the United States, are currently not planning to develop or implement a Sustainable Finance Taxonomy.

3.2 Contribution to ESG Risk Management

Taxonomy disclosure requires banks to assess their portfolio and classify assets accordingly. The Taxonomy assessment requires banks to analyse ESG risks associated with their financed activities and counterparties. Hence, it has become an important element of more standardised ESG risk disclosure and provides a useful foundation for the management of ESG risks.

ESG risks can impact institutions' assets through transitional and physical risk drivers, which are addressed by the EU Taxonomy either through the substantial contribution or through do no significant harm (DNSH) criteria. Climate change and related physical risks are seen as important risk factors with implications on economic output and prices.[10] These costly events, in turn, might require a sudden and faster transition leading to transition risks, which leave the market with less time to adapt.

Transition and physical risks in the portfolio translate to traditional risk categories, which should be mitigated and managed. This is necessary to ensure resilience of the institution's business model in the short, medium and long-term (EBA 2025, p. 4) as well as to promote the transition to a more sustainable economy. According to the ECB supervisory board vice-chair Frank Elderson, current political developments on deregulation might even risk long-term financial stability (Arnold 2025).

3.3 Lower Bureaucratic Burden

As previously discussed, a key limitation of the Taxonomy is its exclusion of low-emission sectors and those with minimal transformation potential. However, it is also an opportunity. The EU Taxonomy was designed to define economic activities that can contribute to the transition of the economy, rather than to encompass a catalogue of all sectors, including low-emission ones. Despite the challenges that come with limited coverage, this approach reduces reporting requirements for banks (and counterparties), as they are not obliged to assess and disclose the taxonomy-eligibility and alignment of all assets.

10 For example (Pankratz and Schiller 2024), find that weather shocks, like extreme heat and floods, harm suppliers' financial performance, which is passed on to customers through supply chains and (De Winne and Peersman 2021) report that extreme weather events, like droughts and heatwaves, affect global agricultural commodity prices and economic activity.

4 Recommendations for Policy Makers and Authorities

Regulatory requirements should be clear and existing gaps must be addressed. To minimize contradictory statements and reduce the effort required for applicants to implement regulations accurately, numerous FAQs should be consolidated with Delegated Acts.

Large amounts of exposures of banks are toward non-CSRD corporations (especially SMEs) that cannot count toward taxonomy-alignment, thereby limiting the value of the GAR that a bank can achieve. The suggestion by the Omnibus-initiative to exclude around 80 % of companies from the scope of the CSRD aggravates this data challenge. A solution should be found to assess the sustainability of those exposures, e.g. based on proxies and estimates or simplified standards for SMEs.

Furthermore, to address currently uncovered activities and to avoid misperceptions of these, a crucial step in further development is distinguishing between harmful and non-harmful activities, as well as those with significant supply chain emissions. To address the limited coverage of sectors in the GAR, one proposal is to additionaly disclose taxonomy-aligned as a share of taxonomy-eligible assets instead of covered assets.

Furthermore, a clear definition of transition activities is needed and the reporting of an additional KPI covering transition activities should be established. The definition needs to strike a balance between including more transition-relevant activities without leading to long-term carbon lock-in.

Limited data availability and quality is currently hindering progress in assessing assets' contributions to environmental objectives based on complex TSC. Access to corporate sustainability data is urgently needed and public databases could help address this gap. Given that real estate financing constitutes a significant share of credit institutions' portfolios, market participants could greatly benefit from EU wide public databases for EPC labels. It is necessary to reduce the complexity of disclosure requirements, however, a narrower scope of applicants disclosing sustainability information, as suggested in the Omnibus-initiative, is going to aggravate the data challenge.

The EU should continue to play an active role in the development and harmonization of Taxonomies internationally. There is large interest from emerging and developing economies to develop Taxonomies to attract foreign investment and to diversify the investor base. Many Asian, African and South America jurisdictions have developed or are developing taxonomies. It will help to create a level-playing field for companies and financial institutions with international portfolios.

To conclude, there are several challenges in the development and implementation of the EU Taxonomy, impacting the informative value of the GAR. Yet, improving climate and sustainability related transparency for all stakeholders is an important complement to climate policy instruments (e.g. CO_2 price, subsidies, environmental standards or other climate regulation). Therefore, the EU Taxonomy plays an important role in an effective policy mix. Banks can tailor their financial instruments and products based on a common definition, while also improve their risk management. The Omnibus-initiative presents an opportunity for authorities to address regulatory shortcomings. However, current proposals focus on reducing the regulatory burden, mainly by weakening the coverage of the Taxonomy and, hence, the informative value of resulting KPIs.

While ESG regulation being softened globally, the current anti-ESG developments in the US are likely to influence companies and authorities in the EU. However, ESG risks in banks' portfolios will persist, requiring long-term portfolio transformation to mitigate these risks. The recommendations provided in this article aim to improve the implementation for banks, enhancing transparency and comparability while mitigating greenwashing, thereby contributing to the initial targets of the EU Taxonomy.

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