

# **Concept paper on improving the green asset ratio under the EU taxonomy by the Sustainable Finance Advisory Committee’s working group on “regulatory consistency”**

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*Working group: regulatory consistency*

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# Proposals for improving the green asset ratio under the EU taxonomy

## A. How to boost the EU taxonomy's steering effects

### Recommendations of the Sustainable Finance Advisory Committee (SFB):

- The Green Asset Ratio (GAR) should be amended in such a way as to exclude SMEs and non-EU companies from both the numerator and the denominator. The scope of the numerator and denominator should be limited to companies that are subject to reporting under the Corporate Sustainability Reporting Directive (CSRD). The amended GAR should also include an indication of the share of the total financing volume to which the stated GAR relates.
- The ratio of taxonomy-eligible to taxonomy-aligned financing must be given greater weight, in line with its informational value. This ratio is the central piece of information for financial services providers in relation to the taxonomy and should therefore be communicated more effectively.

## B. The taxonomy metrics

The EU Green Deal includes various instruments designed to boost private financing for the green transition of the European economy. The cornerstone of these efforts is the EU taxonomy, a classification system for sustainable economic activities. Its aim is to allow investors to see how sustainable a company's activities already are and how much it is investing in the sustainability of its business. Activities are classed as sustainable if they contribute substantially to one of the taxonomy's six environmental objectives while simultaneously doing no significant harm (DNSH) to any of the other five objectives.

Under Article 8 of the Taxonomy Regulation, all companies that are required to issue non-financial statements must disclose the following:

- They must state what proportion of their turnover and what proportion of their capital expenditure and operating expenditure<sup>1</sup> is associated with activities that are included in the taxonomy (taxonomy-eligible). Because the taxonomy only includes activities from sectors with a potential negative impact on one of the six environmental objectives, it covers only part of the economy. Thus, the taxonomy-eligibility figure shows how relevant a company's activities are for the taxonomy – in other words, how active it is in sectors that are potentially environmentally harmful. This is because the taxonomy concentrates on these potentially problematic economic sectors.

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<sup>1</sup> These expenditures must be disclosed in conjunction with a plan for the company's transition towards taxonomy-eligibility.

- In addition, companies must disclose what proportion of their turnover and their capital expenditure and operating expenditure on taxonomy-eligible activities meets the criteria set out in the Taxonomy Regulation, meaning that the company is reducing the negative impact (taxonomy-aligned or environmentally sustainable).

These two metrics give an indication of the following:

- How relevant are the economic activities covered by the taxonomy for the company in question (taxonomy-eligible)?
- To what extent is the company already fulfilling the taxonomy criteria in the relevant sectors or investing in fulfilling them in the future (taxonomy-aligned)?

This means that the ratio between taxonomy-eligible and taxonomy-aligned activities is crucial. A company with hardly any activities in taxonomy-eligible sectors can be more sustainable than a company that is very active in taxonomy-eligible sectors but only has a small proportion of taxonomy-aligned activities. After all, if a company has a small share of turnover from taxonomy-aligned activities despite a high share of turnover from taxonomy-eligible activities, this indicates that the company is active in carbon-intensive sectors (for example), but does not put a focus on sustainability as defined under the taxonomy. In contrast, a high share of taxonomy-aligned activities in conjunction with a high share of taxonomy-eligible activities shows that the company has already transitioned to more environmentally sustainable production. Alongside their turnover associated with taxonomy-eligible and taxonomy-aligned activities, companies also disclose their capital expenditures (CapEx) on taxonomy alignment. These provide an indication of whether and to what extent the company is investing in the shift towards greater sustainability and is thus in a state of transition.

In its paper entitled “The EU Taxonomy: implementation challenges and proposed solutions”, the SFB already examined fundamental problems with the taxonomy and offered potential solutions.<sup>2</sup>

### C. Green Asset Ratio (GAR)

The GAR is an indicator designed to provide comparable information for banks.

It is calculated in three steps. First, all lending to and investments in taxonomy-eligible activities are recorded. In the second step, the taxonomy-alignment of these activities is determined. Finally, the ratio of taxonomy-aligned assets to all lending and investments is calculated (excluding government bonds, supranational bonds and central bank bonds). This third step produces the GAR. The GAR is considered to be a key metric in the taxonomy reporting of banks and, in slightly modified form, of asset managers. Accordingly, it receives a great deal of public attention.

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<sup>2</sup> [https://sustainable-finance-beirat.de/wp-content/uploads/2023/03/SFB\\_The-EU-Taxonomy\\_implementation-challenges-and-proposed-solutions.pdf](https://sustainable-finance-beirat.de/wp-content/uploads/2023/03/SFB_The-EU-Taxonomy_implementation-challenges-and-proposed-solutions.pdf)

There are further rules setting out which loans and investments should or should not be included in the calculation. The following rules apply to banks:

- The numerator includes all lending and investments (loans and equity investments) that are directed towards taxonomy-aligned activities, with separate ratios calculated based on companies' turnover and capital expenditure KPIs.
- The denominator includes all the bank's loans and investments with the exception of government bonds, supranational bonds and central bank bonds. These are excluded from both the numerator and the denominator.

These exclusions are due to the fact that there is no taxonomy for government activities, so their inclusion in the GAR would increase the denominator even though there is no way of reflecting them in the numerator. This would have the effect of lowering the GAR for no reason and risk distorting the GAR as an indicator.

Exposures to small and medium-sized enterprises (SMEs) as well as lending to companies outside the EU are excluded from the numerator only. This is because these companies are not required to publish EU taxonomy data.

SMEs and companies from third countries are potentially active in EU taxonomy sectors, but are not required to supply data. As a result, data from SMEs and non-EU companies is either not available or, if available, has not been verified or cannot be assessed in terms of quality. For this reason, this data is included in the denominator but not the numerator.

In the case of SMEs, there are no plans to introduce a reporting obligation under the EU taxonomy because this would place a disproportionate additional burden on SMEs in terms of collecting the data.

A disclosure requirement similar to the GAR applies to asset managers and insurance companies – they are required to disclose their Green Investment Ratio (GIR). The GIR's numerator includes investments in taxonomy-aligned activities, on the basis of the taxonomy metrics of the companies or the GARs of the banks in which the asset managers or insurance companies invest. The denominator consists of the assets under management (AUM). In the case of asset managers, too, government bonds, supranational bonds and central bank bonds are excluded from both the numerator and the denominator. Data relating to SMEs and investments outside the EU that are included in the numerator are each reported separately.

Given (a) that the EU taxonomy only ever covers a limited part of the economy, (b) the different business models of banks and asset managers, (c) their (in some cases substantial) exposures outside the EU and (d) the fact that SMEs can be pioneers in the area of sustainability, it is questionable whether the GAR and GIR have the intended informational value and steering effect in their current form.

In summary, the GAR's informational value is limited for the following reasons:

- Banks, asset managers and insurance companies have investments in government bonds and supranational organisations for which the EU taxonomy was not developed.

- Banks, asset managers and insurance companies have investments in non-EU companies that are not subject to EU taxonomy reporting requirements.
- Banks, asset managers and insurance companies have investments in SMEs that are also not subject to EU taxonomy reporting requirements.
- The EU taxonomy covers only certain sectors of the economy. Socially sustainable activities are not included, for example. Thus, there is an inherent conflict between, on the one hand, the aim of increasing the GAR and GIR and, on the other hand, the aim of maintaining and strengthening activities that are not taxonomy-eligible but are nevertheless valuable to society.
- The GARs and GIRs of different banks, asset managers and insurance companies are not comparable. Diverging business models result in very different shares of taxonomy-eligible financing and investments, which affects the GAR significantly.

## D. The GAR's (lack of) informational value

These problems affect the informational value of a bank's GAR in the following ways when viewed over time, in comparison with other banks and as an incentive for more green investment:

- ***As an indicator of transition risks***  
At present, the GAR can offer a first indication of the share of a bank's loans and investments with potentially lower transition risks. It could reveal whether this share is increasing or decreasing over time. As set out above, SMEs are not covered even if they operate in the area of renewable energy, for example. Investments in green bonds are also not taken into account, since government bonds are excluded. As a result, the GAR's value as an indicator of non-existent or lower transition risks is limited, since the share of assets that are free from transition risks can be significantly higher.
- ***Over time***  
The informational value of GAR trends over a period of several years is also limited. After all, a decline in a bank's GAR does not necessarily mean that the bank is investing less in environmentally sustainable activities. Such fluctuations could also be the result of a shift in the bank's exposures to non-EU countries or to activities that are not taxonomy-eligible. For this reason, the GAR should be accompanied by qualitative information that contextualises the situation and allows for a comprehensive assessment of banks' environmental risks.
- ***When comparing banks***  
The same situation arises when comparing different banks with each other. The first annual reports of banks are currently available (as of early May 2024). They show that Degussa Bank, for example, has a GAR of 1.8%, while the sustainable Dutch bank Triodos Bank N.V. has a GAR of 19.7%. However, these figures are of limited use when it comes to comparing banks. It is perfectly possible for one bank with a high level of exposure to (taxonomy-eligible) power generation but only a relatively small share of

taxonomy-aligned lending in the area of energy to have a relatively high GAR. Another bank might have a low GAR because its lending activities focus on the social sector rather than on taxonomy-eligible sectors. In this scenario, the first bank has more problematic loans on its books despite its higher GAR.

- ***From an economic point of view***

As set out above, a rising GAR is of limited informational value on the level of an individual bank. On the level of the economy as a whole, a progressive rise in GARs could even become harmful at a certain point. If all banks in the euro area worked towards achieving the highest possible GAR, there would be a danger that they might neglect important parts of the economy, such as the entire social sector or the publishing industry. Therefore, the question is what target should be set for the GAR. If it is not about achieving a certain target, but rather a ratio (specifically, the ratio of taxonomy-eligible to taxonomy-aligned lending), then it is important to place the focus on this ratio.

Given the GAR's limited informational value, it can only be viewed as one of several indicators when it comes to measuring a bank's environmental sustainability. This is taken into account by banking supervisors, who also look at other contextualised qualitative information when assessing a bank's environmental sustainability. However, this does not resolve the GAR's failure to take account of activities that have little impact on the environment but contribute to the economy and society in important ways.

The low informational value of a solitary GAR also remains a problem for banks, given the potentially high level of public awareness of this metric. There is a danger that a bank's sustainability might be judged solely on the basis of its GAR. Precisely because GARs are currently low, there is great scope for public misinterpretation.

Against this background, the question for the financial industry is whether the benefits are proportionate to the costs.

## E. Proposed solutions

There are already some ideas on how to improve the GAR's low informational value. One is the Banking Book Alignment Rate (BTAR), an indicator that banks can disclose on a voluntary basis alongside the GAR.<sup>3</sup> The BTAR expands the numerator to include EU non-CSR D exposures (that is, SMEs) and non-EU CSR D exposures (larger companies outside the EU), thus giving a better overview. As the Bundesbank puts it in its April 2023 monthly report: "In comparison with the GAR, the additional reporting of the BTAR thus provides a better picture of a bank's taxonomy-eligible credit exposures, as such exposures for which no data are otherwise disclosed can also feed into the calculation." However, it is important to note that

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<sup>3</sup> The EBA's original draft (EBA/ITS/2022/01, paragraphs 23c and 63) stated that the BTAR was to be calculated and published by banks on a "best effort basis". To avoid uncertainties resulting from this wording, the European Commission clarified that the disclosure of the BTAR from June 2024 onwards is voluntary ("may disclose").

the data is collected on a best effort basis and thus does not have the quality that is to be expected from companies subject to reporting obligations.

In this way, the BTAR follows the approach already chosen for the GIR, but shows more clearly than the GAR how much of a bank's assets are free from transition risks, because it takes into account all taxonomy-eligible activities that are implemented by private stakeholders.

However, the BTAR does not solve the GAR's lack of a clear focus, because the BTAR too merely creates a ratio of taxonomy-eligible activities to total lending and investments, albeit one that has been expanded to include non-EU companies and SMEs.

In the same way, the problem of insufficient comparability between banks and over time is only addressed to a certain extent, because the BTAR alone does not show how high a bank's share of taxonomy-aligned lending is.

Another possible solution is for all investments that are excluded from the GAR's numerator due to a lack of data (specifically, SMEs and non-EU companies) to also be excluded from the denominator as long as there is no sufficiently valid data, as is already the case for government bonds, for example. The result would be an indicator for banks that exclusively pertains to the EU taxonomy and the available data in relation to it. In other words, a significant part of a bank's lending volume would not be included. As a result, the informational value regarding the proportion of a bank's lending that is free of transition risks would be lower than in the case of the BTAR. However, comparability would be improved, because the GAR would no longer be distorted by lending to SMEs and non-EU companies.

Banks' varying levels of exposure to taxonomy-aligned activities would still limit comparability significantly, however. There would still be no target GAR, meaning that the GAR would not be very suitable as a steering instrument if calculated in this way.

These two flaws of the GAR can be resolved only if the ratio of taxonomy-eligible to taxonomy-aligned lending and investments is presented alongside the absolute figure.

This can be implemented both for the BTAR and for the GAR without SMEs and non-EU lending in the denominator. This ratio is crucial when it comes to generating an indicator with steering potential based on the figures reported by companies.

The ratio of taxonomy-eligible to taxonomy-aligned investments produces an indicator that can be used to map out a trajectory and a target. It is appropriate and desirable for 100% of taxonomy-eligible activities to develop into taxonomy-aligned activities and for banks to support this process by financing the transition. It is appropriate and desirable for banks that invest in sectors covered by the EU taxonomy (taxonomy-eligible sectors) to invest increasingly in taxonomy-aligned spending and activities. An indicator that depicts this transition over time is therefore useful, especially from a steering perspective.

Such an indicator would serve two purposes: First, it would enable meaningful comparisons by showing what share of lending to potentially environmentally very harmful sectors (taxonomy-eligible sectors) is taxonomy-aligned.



Second, it would also show how a bank's activities change over time, revealing whether or not the share of lending for (environmentally sustainable) taxonomy-aligned activities is increasing.

Because this ratio is already calculated in the second step when determining the GAR and BTAR and therefore already exists, we propose that it should be viewed as the central metric for banks' taxonomy-related disclosure requirements.

The SFB currently favours a GAR that excludes SMEs and non-EU companies from both the denominator and the numerator. This is because it is currently unclear whether and when the data situation for SMEs and non-EU companies might improve, and a requirement to report this data would place significant additional burdens on SMEs in particular, which could be indirectly triggered by the BTAR. In addition, the SFB would like to underline the importance of the ratio of taxonomy-eligible to taxonomy-aligned lending as a key indicator.

This ratio is what provides guidance and allows for comparability, albeit only at the EU level, and produces a desirable target for the financing of taxonomy-aligned activities.

## **F. CONCLUSION**

### **SFB recommendations:**

The GAR should be amended in such a way as to exclude both SMEs and non-EU companies from both the numerator and the denominator. The scope of the numerator and denominator should be limited to companies that are subject to reporting under the Corporate Sustainability Reporting Directive (CSRD). The amended GAR should also include an indication of the share of the total financing volume to which the stated GAR relates.

The ratio of taxonomy-eligible to taxonomy-aligned financing must be given greater weight, reflecting its informational value. This ratio is the central piece of information for financial services providers in relation to the taxonomy and should therefore be communicated more effectively.