Picture credits: Philip Steury

SME-friendly design of the Sustainable Finance Regulation / Taxonomy Ordinance

Impulse paper

Status Quo

Green Deal and Sustainable Finance are designed to channel capital flows into sustainable investments. The central building block here is the EU Taxonomy, which classifies all economic activities in terms of their sustainability. The Taxonomy is accompanied by numerous new requirements for businesses and the financial sector (e.g. CSRD, ESRS, GAR/BTAR, MiFID).

Initial experience shows that small and medium-sized enterprises (SMEs) are already indirectly affected and overwhelmed by the challenging standards, reporting and labeling obligations. So what could further development of the regulatory framework look like in line with practical requirements? And how can financing of the transformation be promoted?

Practical requirements from the SME side are:
- Focus on essentials (e.g. CO_2 pricing)
- Proportionality of the effort compared to the improvement in sustainability
- Innovation and financial support to advance sustainability

Reporting obligations (in)direct affect Companies across the board
Up to now, around 500 German companies have been obliged to submit sustainability reports; in the future around 15,000 companies will have to do so. This does not take into account an extremely high number of indirectly affected companies, primarily SMEs, which have to collect sustainability information due to their integration in value and supply chains or financing by third parties. Large clients, for example, are required to fill out 75-page checklists. Companies must also show their principal banks the extent to which they operate sustainably. There is no common standard for this in the form of digital checklists.

The reporting system is designed for large capital market-oriented companies and cannot be implemented by SMEs
Large companies already clearly demonstrate the enormous effort and complexity involved in implementation of this practice. For example, EFRAG requires the collection of approximately 400 data points in the company. In practice, personnel-intensive, interdisciplinary team structures are set up for this purpose and external consultants are brought in, both of which are associated with high costs. For SMEs with 10 or more employees, this is not feasible; such costs disproportionately change the overall cost structure.

EU-Taxonomy

"If a company's borrowing costs increase, it reduces its chance of changing its business model. At the same time, companies that are already operating sustainably today, are not being properly captured by the taxonomy.

Take BayWa, for example: our auditors confirmed that only 5.5 % of BayWa's sales were taxonomy-compliant in 2021. And this applies to a company that is a pioneer of the energy transition, which has a green profit share of at least 50 to 60 % every year! You can't help but shake your head at that."

BIHK President
Prof. Klaus-Josef Lutz

Claims

- *CO_2 pricing is preferable to bureaucratic reporting.*
- *Taxonomy ordinance can only represent a transitional solution and show "best practice approaches".*
- *Focus on essentials: After evaluating all criteria, companies should be able to define individual material influencing factors and associated measurable KPIs. This makes it possible to measure the improvement, the "differences". Companies should be allowed to refrain from having ongoing reporting on criteria that are of little relevance.*

IHK München und Oberbayern

WKO Wirtschaftskammer Österreich EU Representation

CO2 pricing and SME-oriented furthers development of reporting requirements based on best practice examples

A consistent cross-sectoral CO2 pricing system is much more effective and more purposeful, as it can make small-scale interventions unnecessary.[1] The Taxonomy Regulation should be seen as a transitional solution.[2] Proportionality should apply to SMEs; here, the Taxonomy Regulation could be understood as "best practice examples" that evolves based on practical examples. For voluntary reporting, a "slimmed-down" implementation specification could be developed, e.g. a digital checklist with few criteria to cover reporting requirements.[3]

Banking regulator calls for: Classifying loan portfolios according to ESG criteria

80 percent of SMEs are credit-financed and therefore also have additional reporting obligations to their banks. At present, however, it is still largely unclear in what form the banks request information - harmonization would be desirable. Important: Expanding and not restricting financing options for SMEs.

Implementation of sustainability goals via targeted innovation and equity promotion

The energy crisis has already provided a strong impact for climate protection measures, but this alone is not enough. Companies need targeted support for sustainable innovation projects, suitable equity offerings and project financing that brings about positive (measurable) impacts/changes, regardless of whether companies are currently categorized as "green" or "brown." Understanding the US Inflation Reduction Act to be a wake-up call.

Evaluation of the effectiveness of the sustainability reporting

Initial results reveal that even in the case of strategically sustainably oriented companies (e.g. suppliers of e-mobility, agricultural and energy sectors, real estate, etc.), only a minimal percentage of Taxonomy-compliant sustainable sales/investments can be calculated. This means that the goals set are not being achieved, and a fundamental evaluation of the measures appears necessary.

Claims

- *Specifications should be provided in the form of a standardized digital checklist.*
- *For voluntary reporting by non-capital-market-oriented SMEs: digital checklist that is "slimmed down" to few measurable criteria need to be collected.*
- *Expand financing options, do not restrict them (e.g., through high "green asset ratio" or bank regulation, etc.).*
- *Promote support for projects to improve sustainability, especially innovation and equity offerings. "Understanding the Inflation Reduction Act to be a wake-up call.*
- *Implementation experience is frustrating (effort vs. benefit/achievement of goals), evaluation urgently needed..*

[1] Results of the IHK/ifo study "Sustainable Finance" (https://www.ihk-muenchen.de/de/Service/Branchen/Finanzwirtschaft/#st_text_picture_14).

[2] KfW Research position paper "An investment boost for the transformation - what is needed in concrete terms? p. 5 (An investment boost for the transformation - what is needed in concrete terms? | KfW).

See also DIHK statement on the draft CSRD (230109_DIHK-Stellungnahme ESRS BMJ barrierefrei).

[3] According to a recent study by IfM Bonn on behalf of VDMA, the SMEs that are concerned already have to comply with 375 different regulations at federal level alone. The fact is, however, the burden is about twice as high because legal requirements at state and municipal level are added. With the regulation projects now being considered, such as the CSRD Directive or the reporting obligation with regard to the EU Taxonomy, the indirect bureaucratic burdens for SMEs will increase seriously.