
EU Taxonomy

Frequently Asked Questions

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Executive Summary

The EU taxonomy is a classification system of environmentally sustainable activities. Large EU corporations will disclose information that indicates how aligned the company's revenue, operating expenditure, and capital expenditure are to the EU goal of being net-zero by 2050. The EU taxonomy will eventually cover six environmental green "objectives" and will be extended to cover social objectives and to identify "brown" activities.

EU-domiciled funds (or funds sold into the EU) must also calculate and disclose their portfolio's alignment with the EU taxonomy by providing an aggregation of the alignment of the underlying holdings. This FAQ describes the calculation of those fund-level metrics. Morningstar calculates, at the fund level, the revenue alignment of the climate mitigation objective only, using underlying data from Sustainalytics. This data may be estimated or collected data.

Not all holdings and economic activities can be assessed under the EU taxonomy. We refer to those that can be assessed as "eligible." The regulation specifically states that the alignment of derivatives and sovereign holdings (aside from green bonds issued by sovereign entities) cannot be assessed; this is an example of "not eligible." Likewise, not all activities of corporate holdings (equities and corporate bonds) can be assessed; as the regulation concentrates on economic activities with the largest carbon emissions, activities in sectors that do not have high emissions do not have rules and cannot be assessed.

Where a holding or economic activity cannot be assessed, the regulation effectively states that its alignment is treated as 0%. Technically, the regulation requires the alignment percentage to be expressed as a proportion of the entire portfolio, even when alignment cannot be assessed. In addition, a requirement to calculate the alignment percentage based on all holdings excluding any sovereign bond holdings was added to the technical standards published in October 2021.

Frequently Asked Questions

What data will Morningstar use for the calculations?

Morningstar will use both company reported and estimated data from Sustainalytics on the underlying company holdings taxonomy alignment where available.

What alignment information will Morningstar calculate?

Currently, the revenue alignment based upon the climate change mitigation objective will be calculated for portfolios. This is based on the aligned percentage of the entire portfolio (including sovereign holdings).

In the future, we will look to expand to overall alignment and other objectives, and by capital expenditure and operating expenditure. Additionally, we will look to expand to include the alignment percentage, excluding sovereign holdings.

What data will be calculated?

Alongside the total alignment percentage, the percentage of the portfolio that is aligned based on reported data and the proportion based upon estimated data will be disclosed.

The portion of the portfolio that is not aligned will be disclosed, and its following subdivisions will be calculated:

1. Eligible but not aligned (further broken down into "based on report" and "estimated data." This is the portion of the portfolio for which the EU taxonomy provides rules for the assessment but that are not aligned.
2. Not eligible (further broken down into cash, commodities, derivatives, sovereign bonds, and economic activities not eligible).
3. No research available. These are holdings in a portfolio that have not been identified or where no research on the alignment is available.

What happens when a fund holds another fund?

Morningstar will first attempt to "look through" any funds that are held by the portfolio to find the underlying holdings that are indirectly held. The exception to this rule is for funds that are synthetically replicated; for the purpose of the principal adverse impact calculations, they will be treated as being equivalent to the portfolio holding derivatives (where no "look through" is attempted).

How is the portfolio weight of a holding calculated?

Morningstar calculates portfolio weights based upon the proportion of a portfolio a holding represents (using the market value) once any fund holdings have been "looked through." For the EU PAI calculations, some additional steps will be taken to calculate the final portfolio weight:

1. Any securities that have both long and short positions will be "netted out"—that is, the short position weight will be subtracted from the long position weight;
2. Any remaining short positions will be removed;
3. Any currency offsets will be removed;
4. The portfolio weight will then be recalculated on the netted-out long positions only.

Are there any differences between the regulatory calculations and the Morningstar calculations?

These calculations are based upon the regulatory rules, but there are some differences:

Green bonds: The regulation allows the alignment for green bonds to be calculated based on the use of proceeds of those bonds. This data is not widely available; where a portfolio holds green bonds, the calculation will use the alignment of the issuer. This alignment is the cautious approach as it will always be lower than the green bond itself.

Real estate and infrastructure: The alignment of these types of holdings is not assessed by Sustainalytics. These will be added to the "no research available" breakdown of the portion that is not aligned.



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