
EU Taxonomy

Frequently Asked Questions

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Methodology History
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Executive Summary

The EU taxonomy classification system of environmentally sustainable activities and 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 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 methodology paper describes the calculation of those fund-level metrics. Morningstar calculates the alignment at the fund level for the revenue, capital expenditure, and operational expenditure alignment of the climate mitigation objective only. These will be calculated as a percentage of the fund's total portfolio and the portfolio excluding sovereign investments. These calculations will use underlying data from Sustainalytics, and this data may be estimated or collected.

Not all holdings and economic activities can be assessed under the EU taxonomy; we refer to those that can be assessed as *eligible*. As an example of those that are not eligible: The regulation specifically states that the alignment of derivatives and sovereign holdings (aside from green bonds issued by sovereign entities) cannot be assessed. Likewise, not all activities of corporate holdings (equities and corporate bonds) can be assessed, as the regulation concentrates on those economic activities that have the largest carbon emissions; activities in sectors that are not highly emitted 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 for those where alignment cannot be assessed. 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 alignment based on revenue, capital expenditure, and operational expenditure for the climate change mitigation objective will be calculated for portfolios. These are based both on the aligned percentage of the entire portfolio (including sovereign holdings) and the percentage of the portfolio excluding sovereigns.

In the future, we will look to expand to overall alignment and other objectives.

What data will be calculated?

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

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

1. Eligible but not aligned (further broken down to indicate data based on data reported by the company and data estimated from Sustainalytics). This is the proportion 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.

How is the total portfolio weight of a holding calculated?

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

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.

How is the portfolio weights excluding sovereign calculated?


Morningstar calculates portfolio weights based on the proportion of a portfolio that a holding represents excluding sovereign investments, once any fund holdings have been "looked through." For the EU taxonomy calculations, some additional steps will be taken to calculate the final portfolio weights used to calculate the excluding sovereign statistics:

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. Any sovereign or supranational investments will be removed;
5. 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 on 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 the proceeds of those bonds. This data is not widely available, and where a portfolio holds green bonds, the calculation will use the alignment of the issuer. This alignment will always be lower than the green bond itself and so is the cautious approach.

Real estate and infrastructure: The alignment of these types of holdings are not assessed by Sustainalytics, and these will be added to the "no research available" breakdown of "not aligned" classification. 

Methodology History

Version: 1.0 31 Dec 2021 Original publication
Version: 1.1 30 April 2022 Addition of information for calculations of capital expenditure
and operational expenditure and excluding sovereigns statistics.