Assess companies against EU Taxonomy criteria to report on your portfolios’ contribution to mitigating climate change

One of the cornerstones of the EU Sustainable Finance Action Plan is to bring clarity to the market regarding which economic activities can be considered sustainable. The EU Taxonomy is an ambitious attempt to define these activities and the related technical standards for six environmental objectives (see diagram below). The economic activities and standards have been defined for the Climate Change Mitigation and Climate Change Adaptation objectives. The accompanying regulatory reporting requirements are currently being decided.

Sustainalytics’ EU Taxonomy Solution assesses companies’ eligibility and alignment to the Climate Change Mitigation objective, supplementing reported data with estimations that rely on proxies to give a more holistic picture of a company’s alignment. It will evolve to cover changes in the regulatory requirements as well as additional objectives as the relevant standards are defined or as sufficient data becomes available.

The EU Taxonomy encompasses a standard set of definitions for sustainable activities centered around six environmental objectives:

1. Substantial Contribution: Is the company involved in an activity that positively contributes to the objective? For example, a company that constructs green buildings.

2. Do No Significant Harm (DNSH): Do these activities detrimentally affect the other five environmental objectives? For example, when constructing green buildings, is it done in a sustainable way that does not cause excessive pollution (Objective 5)?

3. Minimum Safeguards: Is the company conducting its business in a way that respects global standards for responsible conduct? For example, does the company respect the rights of its employees and the local community?
How Does Sustainalytics Assess Companies’ Alignment to the Climate Change Mitigation Objective of the EU Taxonomy?

Our EU Taxonomy Solution is different from other types of ESG research in that the assessment focuses on a company’s economic activities rather than the company itself. This activity-based research relies on NACE, a statistical classification system of economic activities developed by the EU. The framework outlines four conditions that each economic activity must meet to qualify as environmentally sustainable to be aligned to the EU Taxonomy:

**STEP 1  Identify Eligible Activities**

What percentage of a company’s revenues, capital expenditure (CapEx), or operational expenditure (OpEx) associated with the economic activity could contribute to mitigating climate change according EU Taxonomy criteria?

**Example**
Production of energy by coal (not eligible) vs the production of energy by solar panels (eligible).

**Output**
Looking at company reporting and using sophisticated estimation approaches, we provide the percentage of eligible revenue, CapEx and OpEx (each broken down by reported data vs estimated data).

**STEP 2  Assess Whether Eligible Activities Meet EU Taxonomy Criteria**

Does the eligible activity meet the EU Taxonomy’s strict “substantial contribution” criteria for considering it environmentally sustainable?

**Example**
Building energy-efficient houses vs building energy-efficient houses that meet green building certification standards

**Output**
Types of activities that can be considered aligned to the EU Taxonomy’s Climate Change Mitigation objective:

**Own Contribution**
An activity that directly contributes to climate change mitigation, such as the production of green energy.

**Enabling**
An activity that enables another activity to mitigate climate change, such as the storage of green energy.

**Transition**
An activity for which no technologically and economically feasible low carbon alternative exists done in a way that is significantly more efficient than the industry average, such as interurban public transport that emit less than 50g of CO2 per km.
Granular Reporting

Based on the NACE classification system, our EU Taxonomy Solution includes granular activity-based research used to support substantial contribution assessments in terms of:

01 **REVENUES**

The percentage of revenue a company earns from products and services that mitigate climate change.

- Does it generate revenue from green products and services?

02 **CAPEX**

The percentage of a company’s capital investments that would enable it to become more sustainable.

- Is the company investing in equipment or machinery that would make it more sustainable?

03 **OPEX**

The percentage of a company’s operating expenses that is aligned to a low carbon economy.

- Is the company spending money to lower the CO2 footprint of its operations?
Key Benefits

High Quality Research and Reputable Research Partner: The EU Taxonomy Solution builds on our existing suite of well-established ESG and controversies research products

Holistic View of Alignment: Where reported data is lacking, sophisticated estimation and proxy approaches are used to give a more holistic view of a company’s alignment

Company Coverage: We now cover ~10,500 companies across 89 Taxonomy activities

Unparalleled Commitment: We strengthened our existing research capabilities by hiring over 70 additional analysts that are dedicated to EU Taxonomy research

Intuitive Online Company Profiles: The research is available in Global Access where users can see granular insights in each issuer’s EU Taxonomy alignment

Portfolio and Fund Expertise: Now part of Morningstar, we are co-developing the solution from the start to ensure alignment and to leverage Morningstar’s fund/portfolio capabilities

Delivery Options

Global Access: The company reports can be accessed via Global Access with user-friendly online tools

Data Services: Company-level data packages are available through both Morningstar and Sustainalytics’ data feeds

Portfolio calculation and reporting services are now added to these solutions, in line with the regulatory requirements

Use Cases

Regulatory Reporting – Leverage EU Taxonomy Solution to meet regulatory reporting requirements under the EU Action Plan or other regulations.

Sustainability & Impact Reporting – Enable investors to credibly quantify and report on the real-world contributions of their investments through this framework.

Ex Ante Research and Stock Selection – Use Taxonomy research as an input to stock selection, particularly for those funds looking to achieve impact on environmental objectives or attain environmental characteristics.

Product Creation – Leverage the EU Taxonomy framework and our alignment research to build credible green products and portfolios.

Ex Post Monitoring and Stewardship (Engagement) – Clients can use our solution to engage their holding companies to improve their alignment with the EU Taxonomy.