The EU Taxonomy and Swedish Funds

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MASTER THESIS

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The EU Taxonomy and Swedish Funds

A qualitative study of how the EU Taxonomy Regulation will impact Swedish funds and their sustainable investments

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LUND UNIVERSITY

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How the EU Taxonomy Regulation will impact Swedish funds and their sustainable investments

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Abstract

A new regulation regarding sustainability is currently being implemented by the EU. The EU Taxonomy Regulation, TR, is a classification system that defines sustainable economic activities and standardizes the reporting of sustainability factors for both non-financial companies and financial market participants. The purpose of the regulation is to facilitate sustainable investments and limit the risk of greenwashing. However, since the TR is new there is a lack of research on its potential effects. This thesis investigates how the TR compares to other established systems used to evaluate the sustainability and aims to determine the impact the TR will have on Swedish funds and their sustainable investments. A qualitative study was conducted using a literature review and semi-structured interviews with Swedish funds. The results of the study were analyzed inductively through a grounded theory approach.

The comparison of the TR and established systems showed that they have a lot of differences. The most significant differences are that (1) the TR is more comprehensive than the established systems, both in terms of sustainability factors included and stakeholders affected, (2) the TR is more transparent, and (3) the TR is regulatory. Furthermore, the interviews revealed that (1) Swedish funds generally believes the TR will have a positive effect on sustainable investments, (2) the TR will make sustainability more clear and easier to understand, (3) the compliance work required by the TR will demand a lot of resources, both in terms of money and time, and (4) there is a risk that the TR will benefit some sectors more than others. The author concludes that Swedish funds' sustainable investments will increase as a result of the TR, however, so will their costs as compliance with the TR will require resources. The TR will also help standardize sustainability factors. Moreover, the TR presents some risks as it is vulnerable to lobbying and not nuanced in its judgment of sustainability.

Keywords: EU-Taxonomy, Swedish Funds, Sustainable investments, ESG.

Sammanfattning

EU håller just nu på att implementera en ny hållbarhetsreglering kallad EU Taxonomin. EU Taxonomin är ett klassificeringssystem som definierar hållbara ekonomiska aktiviteter och standardiserar rapportering av hållbarhetsfaktorer för både finansiella och icke finansiella aktörer. Syftet med regleringen är att främja hållbara investeringar och minska risken för greenwashing. Då taxonomin är ny saknas dock forskning på dess potentiella effekter. Denna uppsats undersöker hur taxonomin jämför sig mot etablerade hållbarhetssystem och hur den kan komma att påverka svenska fonder och deras hållbara investeringar. Arbetet är en kvalitativ studie byggd på litteraturstudier och semistrukturerade intervjuer.

Jämförelser mellan taxonomin och etablerade system visade att det finns många skillnader. De största skillnaderna är att (1) taxonomin är mer omfattande och detaljrik än tidigare system, (2) taxonomin är mer transparent och (3) taxonomin är en reglering och inte ett frivilligt åtagande. De genomförda intervjuerna visade att (1) svenska fonder generellt är positiva till taxonomin och tror att den kommer gynna hållbara investeringar, (2) taxonomin kommer att göra hållbarhet tydligare och mer lättförstått, (3) det kommer att vara resurskrävande för företag att uppfylla kraven taxonomin ställer och (4) det finns en risk att taxonomin kan komma att gynna vissa aktörer och missgynna andra. Sammanfattningsvis tror författaren att svenska fonders hållbara investeringar kommer att öka till följd av taxonomin men att det kommer att vara resurskrävande att uppfylla taxonomins krav. Taxonomin kommer att bidra till att förtydliga och standardisera begreppet hållbarhet men kommer även att innebära vissa risker. Taxonomin är känslig mot lobbying och onyanserad i sin definition av vad som är hållbart.

Nyckelord: EU Taxonomi, Hållbara investeringar, ESG, Svenska fonder.

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Lund, June 2021

Ebba Edholm

Table of contents

List of acronyms and abbreviations

TEG	Technical Expert Group on Sustainable Finance
TR	The EU Taxonomy Regulation
DNSH	do no significant harm
SC	substantial contribution
NFRD	Non-Financial Reporting Directive
ESG	environmental, social, and governance

1 Introduction

This chapter presents the background and purpose of the thesis. It also describes the project objective and states the specific research questions. In addition, a summary of the structure of the thesis and its delimitations can be found.

1.1 Background

Sustainability is a topic that is becoming increasingly relevant. Factors such as climate change, natural disasters, and the corona pandemic, among others, have made politicians, companies, and individuals realize that change towards a more sustainable society is necessary.

In line with this trend, several political commitments have been made in Europe. In 2015 the EU and its member states signed the Paris Agreement, which is the first global climate change agreement (European Commission, 2015) and in 2018 the EU set a goal of being climate neutral by 2050 as part of the European Green Deal. The European Green Deal is a plan to make the EU economy sustainable and the EU the first continent to be climate neutral (European Commission, u.d.). To reach these high set targets it is clear that investments in sustainability are necessary. A report by OECD states that a reallocation of investments from carbon-intensive assets towards low emission and climate-friendly assets is necessary to reach the targets. For example, the OECD argues that to reach the Paris agreement goal of keeping the average surface temperature increase below 2%, USD 103 trillion will be needed in investments between 2016 and 2030. Furthermore, the report stresses the need for both public and private capital for investments to be sufficient (OECD, 2017).

During the last decade investments in sustainable and socially responsible products have increased dramatically (Vörösmarty, et al., 2018). It is estimated that circa a quarter of global assets under management are invested with consideration of sustainability factors (Hill, Chapter 1 - Introduction, 2020a). In addition, a historic reallocation of capital towards more sustainable investment products is expected as generation Y and generation Z, people born circa between 1980-1995 and 1995-2012 respectively, emerge into the adult world (Kelly J. , 2019; Kull, 2020). When investing, this generation generally considers ESG factors more than previous generations have done (Humphrey, Kogan, Sagi, & Starks, 2020; Kull, 2020; Lannebo Fonder, 2020). Furthermore, generation Y's

wealth is expected to increase significantly by 2030 as they stand to inherit from earlier generations (Kelly J. , 2019).

There are numerous established systems for evaluating the sustainability performance of a company. These systems come in the form of ratings, certificates, lists, and commitments. Most of these systems divide sustainability into three categories: environment, social, and governance. However, terms relating to ESG can sometimes be misleading as they lack clarity and standardized definitions (Eccles & Viviers, 2011). A metric or term does not necessarily have the same meaning for different stakeholders (Hill, Chapter 16 - What's next for ESG investing?, 2020). The increase of sustainable investments in combination with the lack of clarity regarding sustainability metrics has caused an environment where greenwashing is possible. The definition of greenwashing may vary but it generally refers to when companies market or communicate their business as more sustainable than it is (Delmas & Burbano, 2011).

To reach the high set targets of The European Green Deal and the Paris Agreement the EU has taken on several actions, including, but not limited to, financial ones. One of these commitments is the EU Taxonomy Regulation, TR (European Commission, 2021). The TR is a classification system defining sustainable activities (TEG, 2020). Key purposes of the regulation are to facilitate sustainable investments in Europe and limit the risk of greenwashing (European Commission, 2020). As the TR is new and yet to be implemented the literature and research on its potential effects on investors and sustainable investments as well as how relevant stakeholders perceive it is scarce.

The Nordic countries are ahead regarding sustainability. When countries are ranked based on ESG factors, Sweden is ranked as number one, closely followed by the other Nordics countries (ROBECO, 2020). Sweden is also ranked highest based on the UN sustainable development goals, SDG, achievement (Sachs, et al., 2020). Based on this it can be assumed Sweden is a country prepared to implement the TR. Swedish companies and investors are familiar with sustainability and most already have an expressed focus on sustainability. This suggests that Swedish stakeholders should be positive towards the taxonomy.

1.2 Project objective

The thesis aims to investigate how the new TR will affect Swedish funds and their sustainable investments. The intended effect of the regulation is to make it easier for investors to find potential sustainable investments and to increase the number of sustainable investments. However, the TR's definition of sustainability have been criticized for not being nuanced. This thesis hopes to analyze if the TR will have the intended effect of facilitating sustainable investment among Swedish funds.

Potential difficulties the project might face are primarily because the suggested taxonomy regulation will not come into full effect until the first of January 2022, meaning that the project deadline might be too early for the legislature to have had a real impact, or to deduce which impact can be attributed to this change and what is attributable to other factors. During the months this thesis was researched and written new information regarding the taxonomy was released multiple times.

1.3 Research questions

This thesis investigates three research questions.

1. *What systems and methods do Swedish funds use to evaluate sustainability in a company today?*
2. *How does the EU Taxonomy compare to existing systems for evaluating sustainability?*
3. *How will the EU Taxonomy Regulation impact funds in Sweden and their sustainable investments?*

1.4 Delimitations

This thesis is limited to Swedish funds and the Swedish market. The European countries' sustainability work are at different levels and they have different local regulations and initiatives. Furthermore, the systems used by funds to evaluate sustainability differ depending on country and market. As mapping the established systems and investigating the potential effects of the TR in several countries would be too big of a scope for this thesis, the author has chosen to focus on one country. Sweden was the natural choice as the author have experience from the Swedish finance industry and a Swedish education. Furthermore, Sweden is far ahead in terms of sustainability, which makes it a country where the TR should have good conditions for reaching its full potential.

1.5 Structure of the thesis

To make this thesis easier to read the different chapters of the thesis are presented below.

Chapter 1 Introduction

This chapter presents the background and purpose of the thesis. It also describes the project objective and states the specific research questions. In addition, a summary of the structure of the thesis and its delimitations can be found.

Chapter 2 Methodology

This section describes the methodology used for this thesis. It discusses the chosen research strategy and explains and motivates the methods used for data collection and analysis. Furthermore, it explains how research creditability has been considered throughout the work of the thesis.

Chapter 3 Theoretical Framework:

This section presents the results from the literature study. It describes and analyses frequently used established systems and methods for evaluating sustainability in a company. This includes exclusion, ratings, frameworks, and certificates. This section also describes the new EU Taxonomy Regulation.

Chapter 4 Interview results

In this chapter, the results of the semi-structured interviews are presented clearly and systematically. As all interviews were conducted in Swedish quotes have been translated.

Chapter 5 Discussion and Analysis

In this chapter, the findings of the data collection will be discussed and analyzed. The EU Taxonomy and established systems for determining and communicating sustainability are compared and interview results are analyzed.

Chapter 6 Conclusion

This section of the thesis presents the findings and conclusions of the studies that have been made. It answers the research questions as well as explains the academic contribution of the thesis and a critical review of the thesis. It also suggests future studies relating to the subjects of the taxonomy and sustainable investments.

2 Methodology

This section describes the methodology used for this thesis. It discusses the chosen research strategy and explains and motivates the methods used for data collection and analysis. Furthermore, it explains how research creditability has been considered throughout the work of the thesis.

2.1 Research strategy

When conducting research, it is important to have a clear strategy for the results of the research to have authenticity and credibility. Denscombe describes a strategy as a plan to achieve a certain goal. Furthermore, he argues that a research strategy has three important components.

1. An overview of the topic as a basis for the research and chosen methodology.
2. A well-structured and detailed plan of action.
3. A precise and clear goal.

The goal and overview of this thesis can be found in chapter 1. The following part of chapter 2 describes and motivates how the research was conducted.

2.1.1 Purpose of research

According to Höst et al. research can be divided into four groups in terms of purpose.

1. Descriptive research
2. Exploratory research
3. Explanatory research
4. Problem-solving research

The four categories are best suited to different types of research. As the previous research on the topic of this thesis is scarce and the TR is a new regulation that is yet to be fully implemented this thesis could be described as an emerging field study. The research of this thesis is, therefore, best described as exploratory. The purpose of exploratory research is to find in-depth knowledge on a certain topic (Höst, Regnell, & Runeson, 2006). The goal of this thesis is to investigate the TR and

present deeper knowledge of its potential effects on Swedish funds and how it will affect their sustainable investments. .

2.1.2 Research approach

When conducting research, several different methods can be used to collect, interpret and analyze data. However, research tends to be divided into two overarching themes:

1. Qualitative analysis
2. Quantitative analysis

(Höst, Regnell, & Runeson, 2006; Denscombe, 2010)

Quantitative research is based on quantitative data, meaning data that is represented by numbers and can be analyzed through statistical and mathematical methods (Vukojević, 2016). Qualitative research is based on non-numerical data such as words and descriptions (Höst, Regnell, & Runeson, 2006). An advantage of qualitative research is that it allows the researcher to get deep insight into a topic (Colbin & Strauss, 2008). For this thesis qualitative research was used. The EU Taxonomy is a new regulation and therefore an emerging field in terms of research. The exploratory nature of this research and the depth of information it requires makes qualitative research and a flexible research design suitable. Furthermore, qualitative research is better suited for managing contradicting data and alternative explanations (Denscombe, 2010). As little research had been done on the TR prior to when this thesis was written, the author expected that some of the data would be contradictory. Moreover, the TR is yet to be implemented and can therefore result in different scenarios, which might require different explanations. Robson and McCartan (2016) argue the need for a flexible research design for qualitative research. A flexible research design allows the researcher to go back and change the initial research questions during the work for them to align with the purpose of the study. In qualitative research the researcher may encounter unexpected, interesting information, a flexible research design enables an iterative process where new findings can be considered (Robson & McCartan, 2016). Since new information regarding the TR was released during the work of this thesis the author had to be flexible and able to adapt to new knowledge. While working on this thesis the author altered the research questions slightly as a result of new information and insights from interviews.

In addition, Denscombe (2010) states that the grounded theory approach is often used when conducting qualitative research. The grounded theory approach emphasizes the need for empirical fieldwork and the need for data to be linked to what happens in the real world. It is also dedicated to generating new theories rather than investigating testing existing ones (Denscombe, 2010). A grounded theory approach was used for this thesis as the goal of the thesis is to deliver a theory of

the effects of the EU Taxonomy while the research is highly connected to practical real-world situations. Finally, the existing quantitative data on the topic is scarce and not comprehensive which limits the possibilities for qualitative research. In addition, much of the existing data is not standardized which means it is not possible to compare it in a reliable way.

2.1.3 Deductive, Inductive and Abductive Research

Research can be divided into three different categories in terms of reasoning. These are deductive, inductive and abductive reasoning. Inductive reasoning is when general conclusions are drawn based on observations or a dataset. As a consequence, the conclusions are not certain put probable based on the quality and quantity of the observations or data. The contrast of inductive reasoning is deductive reasoning. Deductive reasoning is sometimes referred to as top-down reasoning. Through a hypothesis a conclusion is drawn based on known theory. The conclusions drawn from deductive reasoning are certain. Abductive reasoning is a combination of deductive and inductive reasoning. Abductive reasoning allows the researcher to take surprising data into account an form an explanatory hypothesis. Furthermore, abductive reasoning is a iterative process where the researcher can go back and forth between data and theory. The conclusions drawn from abductive reasoning are less secure than those drawn from inductive reasoning, however, they have the potential to introduce something new and be innovative. Examples of inductive, deductive, and abductive reasoning and the differences between them can be found in table 2.1.

Table 2.1 Inductive and deductive reasoning (Timmermans & Tavory, 2012)

Reasoning	***Example***	***Results***	***Strategy***
Deductive reasoning	All A are B and C are A. → C are B.	Certain	"Top-down"
Inductive reasoning	Observed A are B. → All A are B.	Probable	"Bottom-up"
Abductive reasoning	B is observed. If A is true, B is a matter of course. → A is true.	Possible	Combination

(Timmermans & Tavory, 2012)

For this thesis abductive reasoning was used. The goal of the thesis is to present a possible theory of the implications of the EU Taxonomy. The conclusions emerged from interviews, published literature and existing theoretical frameworks.

2.1.4 Work Process

The work process used by the author is shown in figure 2.1. As new information was released during the work of this thesis the data collection and problem definition

stages were dynamic. The author wanted to be able to adapt to new findings and knowledge.

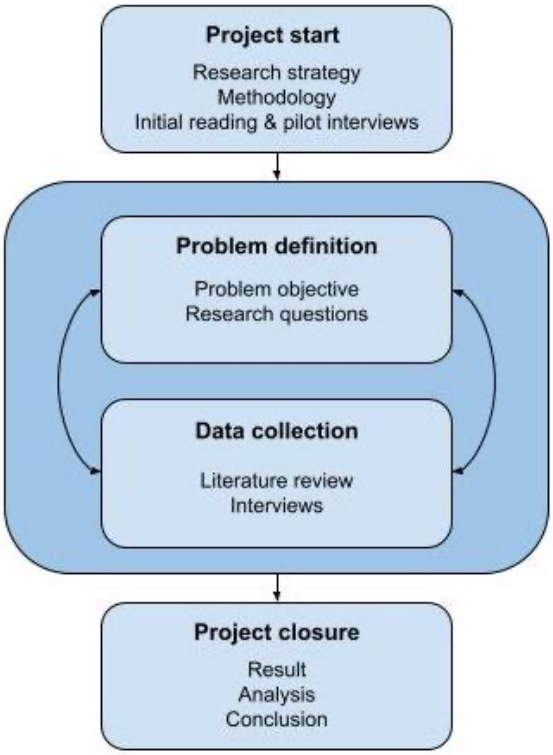


Figure 2.1 The work process of this thesis

2.2 Data collection

For this thesis a combination of methods was used in order to collect relevant data and increase the validity and authenticity of the research.

2.2.1 Primary or secondary data

In research two types of data can be used, primary or secondary data. For this thesis a combination of the two has been used. Primary data was gathered through interviews and secondary data through literature review of academic research and

official reports. As mentioned, the Taxonomy is a new subject which limited the availability of secondary data.

2.2.2 Literature review

Literature reviews are used in almost all research. It gives the author knowledge of the published literature and research regarding the research topic. The first step of the literature review for this thesis was an umbrella review. Umbrella reviews are used to get an overview of a topic (Robson & McCartan, 2016). A broad search was made in order to navigate the territory of the research topic. Material related to the research questions was gathered and analyzed. Through the umbrella review insights of established systems and methods was gathered as well as an understanding of gaps in the published research. The topics that was researched was sustainable investments, methods used to evaluate sustainability and the EU Taxonomy. Based on the findings from the umbrella review a more detailed literature review was made. Furthermore, the gathered information helped form the interview questions. As a flexible research design was used for this thesis the literature review was an iterative process. Based on the answers received in the interviews the author went back and gathered more information.

When conducting the literature review material was sourced from established databases. Table 2.2 shows descriptions of the main databases used to search for published literature.

Table 2.2 List of databases used for the literature review.

Database	*Description*
LUBSearch	LubSearch is the search engine of Lund University. It gives access to journals, academic books, academic articles, theses etc.
Google Scholar	Google Scholar provides access to journals, academic books, academic articles, theses, dissertations and more. Google Scholar is owned by Google.

Furthermore, non-academic literature in the form of reports, articles and websites provided by relevant stakeholders was used. Information regarding the EU Taxonomy was mainly collected through official documents and reports published by the European Commission as limited academic literature could be found on the subject. In addition, documents published by the European Commission is the most reliable source regarding the EU Taxonomy as they are the source of origin and the determining body. During the work of this thesis new versions of the EU Taxonomy and information regarding it was released multiple times. As a consequence, some of the research done in the early stages of the work period became obsolete and was removed. Worth noting is that when this thesis is published the EU Taxonomy is yet

to be formally adopted in its current form, meaning changes are still theoretically possible and part of this thesis could be outdated. In addition, more comprehensive versions of the Taxonomy will be released in 2022.

Moreover, reports and analyzes that strengthened the authors assumptions and theses were received from AltoCumulus and interviewees. However, these were proprietary reports and not public, which is why they have been excluded from this thesis.

2.2.3 Interviews

In general, there are three different types of interviews in terms of structure: Structured, Semi-structured and Unstructured. They all have advantages and disadvantages. In a structured interview all the interviewees are asked the same predetermined questions. There is no room for reaction or improvised follow up questions. The structured interview facilitates comparison of answers and the standardization of results. (Höst, Regnell, & Runeson, 2006) The opposite of the structured interview is the unstructured interview. This form of interview demands the least number of predetermined questions, instead the interviewer has the overall purpose of the study in mind. The unstructured interview is similar to a normal conversation and allows the interviewer to get deep answers and insight. However, unstructured interviews can be time consuming, and the answers of interviews can have different patterns and topics, which in turn can make comparison difficult. (Wildemuth, 2016) The final form of interview is the semi-structured interview, which is a combination of the structured and unstructured interview. This type of interview has predetermined questions, but the interviewer is allowed to ask for clarification and can be more flexible (Griffee, 2005).

For this thesis semi-structured interviews were used. The semi-structured interview allows both closed and open questions, which means both in-depth answers and comparable standardized answers could be obtained. The author wanted to receive comparable answers but also wanted to keep some freedom to ask follow up questions and adapt the interview to the interviewee. The semi-structured interview form also suits well with the chosen qualitative research method. Furthermore, pilot interviews were used to ensure that the predetermined questions were relevant and comprehensive. A pilot interview is way of practicing interviewing, testing the topics and getting feedback before conducting the real interviews (Griffee, 2005). The pilot interviews also brought the author an understanding of the different levels of knowledge regarding Sustainability and the Taxonomy among funds, which was helpful when deciding who to interview. As the TR is new and not implemented yet, the author discovered that the knowledge regarding it and its potential effects was generally low. The pilot interviews helped identify the most suitable category of interviewees for the purpose of this thesis. The category was employees of Swedish funds with high positions and responsibility for sustainability. The reason for this

was that this was the group with most knowledge on the TR that also had influence on the investment decisions. Furthermore, the pilot interviews helped identify the most important and interesting questions for the semi-structured interviews. The pilot interviews were conducted with three of the interviewees later interviewed in the semi-structured interviews.

The EU Taxonomy will affect a number of different stakeholders. However, this thesis focuses on asset managers in Sweden, especially funds. After conducting the pilotinterviews, five persons from different funds were interviewed with semi-structured interviews. All interviewees possess deep knowledge of sustainability factors in finance as well as the financial world as a whole. All of them have years of experience working with sustainable investments and now have high-ranking roles with responsibility for sustainability. To increase the credibility of the research and protect the interviewees all interviews have been anonymized. The author noticed that interviewees tended to be more open and relaxed when guaranteed anonymity. The roles of the interviewees of the semi-structured interviews are listed in table 2.2. Moreover, unformal conversations with other stakeholders relevant to the TR were also used. The stakeholders included asset owners, stockbrokers and analysts. The conversations were used to validate the interview results and get a feeling of what the overall opinion of the TR were. The conversations occurred during and after the semi-structured interviews.

Table 2.2 List of interviewees

Interviewee	***Role***
Interviewee 1	Senior Sustainability Investment Specialist
Interviewee 2	Head of Sustainability and Business Support
Interviewee 3	Head of Sustainable Investments
Interviewee 4	Analyst and Head of Sustainability
Interviewee 5	Asset Manager and Head of Sustainability

Due to prevailing circumstances, with the corona virus spreading and demands on social distancing, all interviews were conducted through zoom. To imitate a regular in person interview, both audio and video were used. The interviewees were also informed that the interviews were recorded. After a finished interview, the material was transcribed and sent back to the interviewee for validation.

The interviews were divided into two parts covering two topics. To understand how investors and banks currently evaluate sustainability the first part covered established systems and how sustainability affects investment decisions. The second part covered the EU Taxonomy regulation and its potential effects. When interviewing the interview guide in appendix A was used. However, because of interviewees' different expertise and roles certain questions were altered or removed for each interview.

2.3 Data analysis

Once the data had been collected it was analyzed by the author. According to Höst et al. (2006) qualitative analysis consists of four steps: Data collection, Coding, Grouping and Conclusions. The data collection phase is described in section 2.2 and is finalized when the data is gathered in documents. In the next phase, which is the coding phase, the data is analyzed based on key words or through protocol analysis. Protocol analysis is when common descriptions or phenomena are identified in the data. For this thesis, a combination of key words and protocol analysis was used. The author identified key themes and words from the interview data. Based on these themes, paraphrases summarizing similar answers from several interviewees were produced. The third phase is when the data is grouped based on the key words or phenomena. Interview answers relating to the keywords are grouped together in a clear and scientific way. Based on the paraphrases and common themes the author identified a pattern and context from the interviews. The fourth and final phase is when conclusions are drawn based on the grouped data. Based on the findings of the interviews the author drew conclusions regarding the most likely effects of the TR. Moreover, risks were identified.

2.4 Research credibility

For research to have creditability it must meet certain criteria. According to Höst et al. these criteria can be summarized into three categories, Reliability, Validity and Representativeness. These three categories are confirmed by Denscombe who also adds another category, confirmability. In this thesis measures were taken with regard to each category.

2.4.1 Validity

Validity means that the data used in the research is related to and accurately describes the topic of the research. There are a number of methods that can be used in order to increase the validity of the research. One method is triangulation. Triangulation is when the same topic is studied through contrasting data sources. (Denscombe, 2010) (Höst, Regnell, & Runeson, 2006) In this thesis both literature review and interviews has been used. Another method is respondent validation, which is when the researcher returns data to participants in order for them to confirm it (Denscombe, 2010). This was achieved by transcribing all interviews and returning them to the interviewee for validation. Finally, validity can be increased by using grounded data. Denscombe argues that this is naturally achieved by using qualitative data as it is grounded in fieldwork.

2.4.2 Reliability

Reliability refers to the reliability of the chosen methods for data collection and the analysis. To increase the reliability the author can carefully describe the methodology used for the research and analysis. This way a reader can judge whether the results are reasonable, and the research can be repeated. (Höst, Regnell, & Runeson, 2006) The reliability of this thesis is increased through this section, section 2, which motivates and explains the different methods used.

2.4.3 Representativeness

Representativeness refers to the fact that the results of research should be generalizable, meaning the results should be applicable to other similar situations (Denscombe, 2010). As qualitative research is used for this thesis representativeness is hard to achieve. Qualitative research is generally based on small samples from a few cases. However, in order to increase the representativeness of qualitative research a detailed explanation of the context of the research can be included (Denscombe, 2010). Like reliability, the representativeness was increased by thoroughly describing and motivating the methodology used for this thesis.

2.4.4 Confirmability

Confirmability refers to the researcher's ability to be objective. Research will never be completely objective; it will always be biased by the author's preconceptions and interpretations. However, according to Denscombe the objectivity can be increased in two ways. The author can state awareness of the fact that values and beliefs can influence the research and either explain how they have distanced them self for the research to be objective or describe how those beliefs have shaped the research. Both alternatives make the reader aware of the author's influence on the research. To increase the confirmability of this thesis representatives from different types of asset managers were interviewed. Furthermore, the author tried to have an open mind when interpreting and analyzing the data and the thesis was peer reviewed multiple times to limit the influence by the author.

2.5 Research ethics

When choosing a research strategy and conducting research it is important to consider research ethics. Research ethics regards the professionality and integrity of the research as well as the notion that no participant in the research should be

harmed. Denscombe states that over time 4 codes of ethics for research has been developed. They state that research should be conducted in a way that:

- *Protects the interest of the participants.*
- *Ensures that participation is voluntary and based on informed consent.*
- *Avoids deception and operates with scientific integrity.*
- *Compiles with the laws of the land.*

(Denscombe, 2010)

These four codes were considered for the research of this thesis and potential risks were identified. The author's personal beliefs and experiences could impact the analysis and interpretation of data. In addition, some of the information received in the interviews could be sensitive and if put in the wrong context harmful to the interviewee. In an attempt to limit these risks results from the interviews were returned to the interviewees for validation and anonymized in this thesis. The interviewees were also sent the interview questions in advance in order for them to be able to give their consent. The author was aware that personal beliefs could influence the results of research and undermine the conclusions. Finally, the author received confidential reports regarding the EU Taxonomy and its impact from different stakeholders. To increase the authenticity and integrity of the research and guarantee that no regulations or laws were broken these were not included in this thesis. However, information gathered from them was used as a foundation when writing the interview questions.

3 Theoretical framework

This section presents the results from the literature study. It describes and analyses frequently used established systems and methods for evaluating sustainability in a company. This includes exclusion, ratings, frameworks and certificates. This section also describes the new EU Taxonomy Regulation.

3.1 Definition of ESG

When researching sustainable investments and systems used to evaluate and determine sustainability the term ESG must be understood. ESG stands for Environment, Social and Governance and is an overview term used to describe organizations performance and commitments regarding these topics. Lately, ESG factors has become an increasingly discussed and relevant topic. Most established systems to evaluate the sustainability performance of a fund or company as based on these three categories. However, according to research definitions of ESG factors can be considered unclear and misleading (Hill, Chapter 16 - What's next for ESG investing?, 2020). Terms in regard to ESG-factors are used interchangeably and some are synonyms or polysemes (Eccles & Viviers, 2011). The lack of clarity regarding ESG factors creates confusion for investors and help facilitate greenwashing.

3.2 Established systems for evaluating sustainability

The established systems for evaluating, determining, and communicating sustainability are many. The shape and design of these systems vary. Some are statutory regulations that investors and companies must comply with, others are certificates, ratings, list or principles developed by independent organizations or self-developed by companies. However, some systems are more common than others on the Swedish market. The Swedish Investment Fund Association argues that “Hållbarhetsprofilen”, section 3.2.6, and the Morningstar Sustainability rating, section 3.2.5, are the most common systems used to compare different funds by investors in Sweden (Swedish Investment Fund Association, 2020). Furthermore, MSCI and Sustainalytics ESG-ratings, section 3.2.4, are the world’s leading

providers of ESG-ratings for companies (Kelly L. , 2020; Motta, 2020). In addition, investors that represent 2/3s of the worlds investments have chosen to sing on to the UN PRI, section 3.2.3, (PRI Association , 2020). Lastly a common way for companies to declare their sustainability performance is to align against one of the UN's SDGs, section 3.2.2.

3.2.1 List of exclusion

In Europe, a list of exclusion is the most common system used by funds to include sustainability factors in investment decisions (Global Sustainable Investment Alliance, 2018). The list declares all sectors and products that the organization have chosen to exclude from their investment universe based on sustainability factors. Reasons for excluding a sector varies but common motivations are that they are believed to violate human rights, have a negative environmental or social effect or are believed to produce unsustainable products or services. Nuclear weapons, coal, uranium and commercial games are examples of sectors that can be found on these lists. Furthermore, sectors can be excluded in their entirety or companies can be excluded based on other key financial metrics such as percentage of total sales that goes to a specific sector (SEB, 2021). An example is SEB (2021) who restrains from investing in companies where more than 5% of sales comes from weapons or alcohol. The exclusion list plays an important role in integrating sustainability factors in organizations' investment strategies as well as their sustainability policies and is usually updated at least once a year. Lists of exclusion can usually be found on fund's websites or through their published reports. Furthermore, lists of recommended exclusion are also published by banks and independent organizations. These list serves as guidance to asset managers and investors and can have big impact on outflows and inflows in products or companies.

3.2.2 The UN's sustainable development goals

In 2015 the 2030 Agenda for Sustainable Development was adopted by all Member States of the United Nations. A key part of the agenda is the 17 Sustainable Development Goals, SDGs. The overall goal of the SDGs is to promote prosperity now and, in the future, while protecting people, the planet's natural resources and the climate (UN, 2021). The goals cover both environmental and social factors and each of the 17 overarching objectives comes with specific underlying targets and actions. The targets are global and measurable (UN Department of Economic and Social Affairs, 2021). Since the SDGs were established companies and organizations have committed to align with them, meaning their activities and products are contributing to reaching the targets. It is also increasingly common that companies chose to report their SDG engagement (Mhlanga, Gneiting, & Agarwal,

2018). The SDGs do not state how the targets should be reached which means companies can be creative. Furthermore, the SDGs to not define sustainability, leaving room for nuanced interpretation. However, according to Mhlanga, Gneiting and Agarwal (2018) the lack of standardization has made reporting on the SDGs inconsistent and limited. They address the need for improved and more ambitious SDG-alignment in order to reach the targets and the risk of the SDGs mainly becoming a communication and marketing tool for some companies.

3.2.3 UN PRI – United Nations Principles for Responsible Investments

PRI stands for Principles for Responsible Investments and they were developed by a group of institutional investors from different countries. The PRI (2020) is a global initiative supported by the United Nations and one of the world's leading advocates for sustainable investments. The initiative consists of six investment principals that guides investors towards a more sustainable financial system. By signing on to the PRI investors agree to commit and implement them. The PRI:s are:

> *" 1. We will incorporate ESG issues into investment analysis and decision-making processes."*
>
> *2. We will be active owners and incorporate ESG issues into our ownership policies and practices.*
>
> *3. We will seek appropriate disclosure on ESG issues by the entities in which we invest.*
>
> *4. We will promote acceptance and implementation of the Principles within the investment industry.*
>
> *5. We will work together to enhance our effectiveness in implementing the Principles.*
>
> *6. We will each report on our activities and progress towards implementing the Principles."*

The number of signatories of the PRI has increased continually since they were established in 2006. In 2020 the number of signatories was over 3000 and represented a majority of the world's investments (PRI Association , 2020). The PRI (2021) require signatories to write a report with comprehensive information about their responsible investments every year. The report is a list of standardized questions regarding the principles answered by the signatory (UN PRI, 2021). All reports are public and published on the PRI's website.

3.2.4 ESG-rating

In recent years ESG-ratings has become increasingly relevant. Research by Humphrey et al. (2020) argues that ESG-factors affect how investors perceive the outcome of an investment. For example, an investment with a 5% return and high ESG-rating might be as highly valued as an investment with 10% return an low ESG-rating by an investor. Furthermore, the research also shows that the effect of ESG-factors on the perceived outcome of an investment is asymmetrical. A poor ESG score has a greater negative effect on perceived outcome than a high ESG score has positive effect. Investors respond strongly to negative ESG factors but not to positive ESG factors. As a result, the more traditional theory claiming that investors only consider return and risk when evaluating an investment has become obsolete (Humphrey, Kogan, Sagi, & Starks, 2020).

Funds that invest based on ESG-ratings has experienced sizeable inflows during the last years (Hartzmark & Sussman, 2019) and as a result more investors relies on third-party ESG-ratings when evaluating a potential investment (Berg, Koelbel, & Rigobon, 2020). Likewise, funds that has been labeled as low sustainable or unsustainable has experiences significant outflows (Hartzmark & Sussman, 2019).

A number of different actors, including banks and independent organizations, offer ratings of companies based on ESG performance. Two of the world's leading providers of these ratings are MSCI and Sustainalytics (Sustainable Insight Capital Management, 2016; Kelly L. , 2020; Motta, 2020).

However, research done by Berg, Koelbel and Rigobon (2020) for MIT shows a divergence of ESG-ratings. According to them different ESG-rating providers tend to rate the same companies substantially different. They state that the divergence is caused by three factors: different scope of categories, different measurements, and different weights of categories (Berg, Koelbel, & Rigobon, 2020). The divergence in ESG ratings cause confusion and makes the definition of what can be considered sustainable unclear. Each of the providers of ESG ratings create their own definition of sustainability trough their choice of measurements and scope of categories.

3.2.4.1 Sustainalytics ESG-rating

Sustainalytics is a global independent organization and one of the leading providers of ESG data and research. They score over 12 000 companies based on their ESG performance. The rating is called the Sustainalytics ESG-rating and consist of a quantitative score and a risk category. There are 5 risk categories, and they are based on the quantitative score. The risk category is an absolute measurement which makes it comparable between sectors. (Sustainalytics, 2021a) The qualitative scores and how they relate to the risk categories can be seen in figure 3.1.

Negligible	Low	Medium	High	Severe
0 - 10	10 - 20	20 - 30	30 - 40	40+

Figure 3.1 The scale for the Sustainalytics ESG-rating (Sustainalytics, 2021b).

The ESG-ranking reflects the company's unmanaged ESG risk and is based on three categories: Corporate Governance, Material ESG Issues (MEIs) and idiosyncratic ESG issues. The rating is calculated by Sustainalytics´ experts and both sector factors and company specific data is used. However, the company does not disclose how they value the different ESG-risks. (Sustainalytics, 2021a)

3.2.4.2 MSCI ESG-rating

MSCI is another of the world's leading providers of financial data. The MSCI ESG-rating scores companies based on their exposure to ESG-risks and how they manage those risks in relation to sector peers (MSCI, 2021). It is similar to the Sustainalytics ESG-rating, however according to research by Berg, Koelbel and Rigobon they tend to rate companies differently. To calculate the ESG rating the MSCI (2020) uses over 1000 datapoints relating to 35 ESG-risk factors covering both company specific risks and sector issues. Moreover, they use comparison of industry peers to normalize the rating. Companies can be rated between AAA, which is the best rating, and CCC, which is the worst rating (MSCI ESG Research, 2020). The ratings and how they correspond to the categories leader, average and laggard can be found in figure 3.2.

Figure 3.2 The MSCI ESG-Rating scale (MSCI, 2018).

3.2.5 Morningstar Sustainability Rating

Morningstar is one of the world's leading providers of fund data. One of the metrics they provide is the Morningstar Sustainability Rating. As stated by Morningstar (2020), the rating scores funds based on their portfolios' exposure to ESG-risk compared to competing portfolios. Funds can be rated between one and five globes, where five globes is the highest grade. The different grades and their distribution can be found in figure 3.3.

Figure 3.3 The Morningstar Sustainability Rating Scale (Silano, 2020).

Morningstar (2020b) calculates the sustainability rating in a three-step process. In the first step the Morningstar Portfolio Sustainability Score, which is a weighted average of Sustainalytics ESG Ratings of the positions in the portfolio, is calculated. In the second step the Historical Portfolio Sustainability Score, HPSS, is calculated. The HPSS is a weighted average of the sustainability risk of the previous 12 months where the most recent months are weighted heavier. In the third and final step the fund's Morningstar Sustainability Rating is determined based on its HPSS in relation to the average of its Global Category. The Global Categories are groups of similar portfolios. (Morningstar Nordic Info Team, 2020)

The Morningstar Sustainability Rating was the first of its kind. Before it was established sustainability was unclear and investors could not evaluate or compare fund's sustainability without great effort and expertise. By being an influential provider of fund data and releasing a sustainability rating, Morningstar made sustainability clearer (Morningstar, 2016). When the Morningstar Sustainability Ratings were first published in March 2016, they had significant impact on fund outflows and inflows for the 20 000 funds that were rated (Hartzmark & Sussman, 2019). According to Hartzmark and Susman's (2019) research funds that were rated five globes experienced inflows of ca 4% of fund size over the following 11 months while funds rated one globe experienced outflows of ca 6% of fund size. According to their estimations that translated to between 12 and 15 billion dollars in assets leaving funds with one globe ratings and between 24 and 32 billion dollars in assets entering funds with 5 globe ratings. The increase of fund flows can be seen in figure 3.4, the blue line represents five globe funds and the red line one globe funds. The dashed line represents the time when the Morningstar Sustainability Rating was first published.

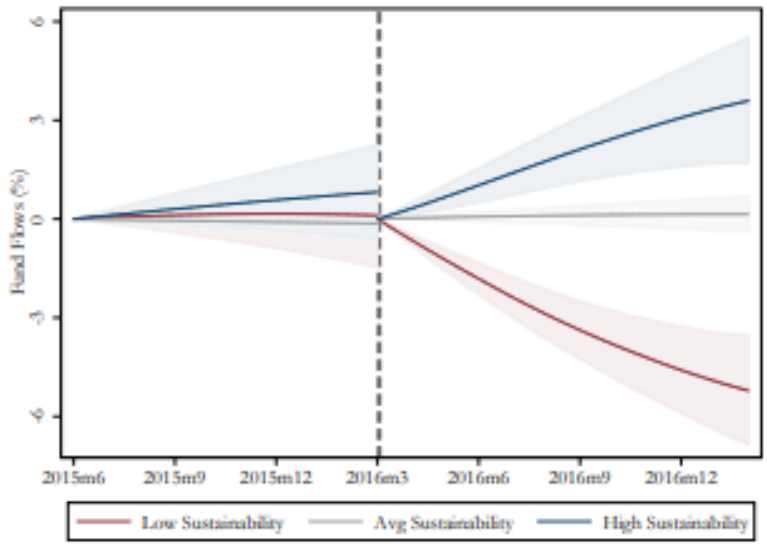


Figure 3.4 Fund flows based on Morningstar Sustainability Rating by Hartzmark and Sussman (2019).

3.2.6 Hållbarhetsprofilen

"Hållbarhetsprofilen" describes funds integration of sustainability factors in their management and investment strategies. It was established in 2013 by Swesif, which is Sweden's forum for sustainable investments. Swesif is an independent organization with the goal of increasing sustainability awareness among investors and facilitating sustainable investments. The profile is updated regularly and since 2018 it is managed by Swesif in collaboration with the Swedish Investment Fund Association (Swesif, 2021).

Fund´s that choose to join "Hållbarhetsprofilen" fills out a standardized form divided into five mandatory categories and two voluntary categories.

Mandatory categories:

1. Sustainability information
2. Sustainability factors that are considered in the management of the fund.
3. What the fund chooses to include
4. What the fund excludes
5. The fund's impact.

Voluntary categories:

1. Resources
2. Additional information

(Swesif, 2019). The declared information is not validated or confirmed by Swesif meaning Hållbarhetsprofilen is a self-declaration and not a certification or indication of quality. Instead, it should be considered a tool for comparing funds and retrieving sustainability information. The target group for Hållbarhetsprofilen is mainly private investors. (Swesif, 2021)

3.2.7 Comparison of the established systems

It is clear that the systems have differences and similarities. In table 3.1 some of the key characteristics of the established systems are summarized. The characteristics mentioned are the form of the final product of the system, the party responsible for the evaluation, verification and publishing of final product of the system and whether the system evaluate funds or companies.

Table 3.1 Key characteristics of the established systems

System	***Evaluation of company or fund***	***Form of final product of the system***	***Self-declaration or third-party***
UN PRI	Fund	Commitment to principles	Self-declaration
Sustainalytics ESG rating	Company	Rating	Third-party
MSCI ESG rating	Company	Rating	Third-party
Morningstar Sustainability Rating	Fund	Rating	Third-party
Hållbarhetsprofilen	Fund	Communication of sustainability	Self-declaration
List of exclusion	Fund	Commitment to principles	Self-declaration

Furthermore, the systems are have different strengths and weaknesses. These are summarized in table 3.2. The systems strengths and weaknesses mainly regards their transparency, how easy they are to understand and how comprehensive they are.

Table 3.2 Strengths and weaknesses of the established systems

System	*Strengths*	*Weaknesses*
UN PRI	Nuanced, industry standard, Comprehensive	Heavily administrative
Sustainalytics ESG rating	Objective, easy to understand and compare	Untransparent method, insufficient as a total assessment
MSCI ESG rating	Objective, easy to understand and compare	Untransparent method, insufficient as a total assessment
Morningstar Sustainability Rating	Objective, easy to understand and compare	Untransparent method, Not nuanced
Hållbarhetsprofilen	Compilation of information in one place	No requirements, only a communication tool
List of exclusion	Clear, easy to understand, industry standard	Not nuanced, does not always apply

3.3 The EU Taxonomy regulation

The EU taxonomy is a new regulation that will be fully implemented by January 2022. It's a classifications system that determines if an activity is sustainable or not. The overall goal of the regulation is to help the EU reach the goals of the European Green Deal and the Paris Agreement by defining sustainable activities and facilitating sustainable investments.

3.3.1 Purpose

The EU taxonomy regulation is one of several actions the EU commission has committed to to reach the goals of the EU Green Deal and the Paris Climate Agreement. The Taxonomy will also help reach the EU's targets to reduce greenhouse gas emissions by 55% by 2030 and being climate neutral by 2050 (European Commission, 2020). According to the European Commission, EC, (2021) the purpose of the new EU Taxonomy regulation is to facilitate sustainable investments and limit the risks of green washing. By declaring which activities most contribute to meeting the EU's environmental objectives the EC has made the term sustainability clearer (European Commission, 2021) Furthermore, the regulation presents a standardized way of reporting sustainability factors for both companies and investors.

3.3.2 Environmental objectives

The EU Taxonomy Regulation is based on six defined environmental objectives.

1. *Climate change mitigation*
2. *Climate change adaption*
3. *The sustainable use and protection of water and marine resources*
4. *The transition to a circular economy*
5. *Pollution prevention and control*
6. *The protection and restoration of biodiversity and ecosystems*

For an activity to be considered sustainable the TEG states it must make an substantive contribution to one of these objectives and do no significant harm, DNSH, to any of the others. Furthermore, the activity must meet minimum safeguards. The TEG has established technical screening criteria that each economic activity must comply with to substantially contribute and DNSH to the objectives. The first version of the taxonomy regulation, entering fully into force in January 2022, will cover economic activities contributing to the two first objectives. Future versions of the regulation will cover all 6 objectives (TEG, 2020).

3.3.2.1 Do No Significant Harm, DNSH

The DNSH criteria refers to the principle that for an activity to be considered taxonomy aligned it is not allowed to have a negative impact on any of the other environmental objectives. The TEG has established technical screening criteria defining limits for when a substantially contributing activity does not harm any of the other objectives.

3.3.2.2 Substantive contribution

The TEG (2020) defines that economic activities can "substantially contribute" to the environmental objectives either by substantially contributing through their own performance or by being an enabling activity, which means the activity enables another activity to substantially contribute to the environmental objectives. An example of an activity that contributes through its own performance is low carbon energy production. To be considered an enabling activity it must fulfill two objectives:

a) *Does not lead to a lock-in in assets that undermine long-term environmental goals, considering the economic lifetime of those assets.*
b) *Has a substantial positive environmental impact based on life-cycle considerations.*

(TEG, 2020). An example of an enabling activity is manufacturing of low carbon products.

3.3.2.3 Minimum Safeguards

The European Parliament and the Council has declared that in addition to substantive contribution and DNSH an economic activity must be performed "*in alignment with the OECD Guidelines for Multinational Enterprises and UN Guiding Principles on Business and Human Rights, including the International Labour Organisation's ('ILO') declaration on Fundamental Rights and Principles at Work, the eight ILO core conventions and the International Bill of Human Rights"* (TEG, 2020). These are considered the minimum safeguards of an activity. In addition, an activity most comply with EU laws (TEG, 2020).

3.3.3 Climate Change Mitigation

The TEG (2020) established screening criteria for the climate change mitigation objective with the EU's goal of net-zero emissions by 2050 and a reduction of 50-55% by 2030 in mind. They recognized that to reach those targets both an expansion of sectors with net-zero emissions and a decarbonization of heavily emitting sectors are necessary. To enable transition opportunities for heavily emitting sectors the TEG established two principles:

1. *Ensuring no lock-in of assets inconsistent with these goals*

2. *Environmental performance well above sector average.*

Furthermore, in line with these principles the TEG established three criteria that transitional activities must meet in order to substantially contribute to climate change mitigation.

- *Has greenhouse gas emission levels that correspond to the best performance in the sector or industry.*
- *Does not hamper the development and deployment of low carbon alternatives*
- *Does not lead to a lock-in in carbon-intensive assets considering the economic lifetime of those assets.*

3.3.4 Climate Change Adaption

The TEG has established criteria for when an activity can be considered to substantially contribute to climate change adaption. The criteria are:

- *Do not lead to increased climate risk for others or hamper adaption elsewhere.*
- *Do not increase the risk of an adverse climate impact on other people, nature or assets.*
- *Consider the viability of 'green' or 'nature-based' solutions to address adaption.*

3.3.5 Technical Screening Criteria

The EU commission convened a technical expert group on sustainable finance, TEG, which was tasked with developing technical screening criteria for economic activities contributing to climate change mitigation and climate change adaption. The expert group has 35 members representing the financial sector, civil society, academia, and businesses (European Commission, 2020). The TEG established technical screening criteria for economic activities responsible for 93,5% of the direct greenhouse gas emissions in the EU and prioritized sectors with large emissions footprint. The technical screening criteria define limits for when an activity substantially contributes to one of the environmental objectives as well as limits for when the activity DNSH to any of the other environmental objectives.

The Technical screening criteria will be established through Delegated Acts. On 21 April 2021 the EU Taxonomy Climate Delegated Act, which was the first act, was released by the European Commission (2021). It covers climate change mitigation and climate change adaption and will be formally adopted in the end of May 2021. For this thesis, the author has assumed there will be no further changes in the released act. The acts for the remaining environmental objectives will be released

in 2022 (European Commission, 2021). The author is aware that the future acts might affect the Taxonomy's impact and shape. However, a choice has been made to limit the analysis of this thesis to the two first environmental objectives and not include the possible effects of the remaining 4 and their future delegated acts.

3.3.5.1 Definition of economic activity

The economic activities included in the Taxonomy were defined using NACE codes (TEG, 2020). The NACE codes are an established European standard defining and classifying economic activities. The codes organize activities according to business sector and has a hierarchal structure (Siccode, 2008). As stated by the TEG the NACE codes cover a majority of the economic sectors in Europe. However, not all economic activities have a NACE code. For the Taxonomy to be comprehensive in the future, further codes might need to be added (TEG, 2020).

3.3.5.2 Sectors included in the EU Taxonomy

The TEG (2020) has developed technical screening criteria for economic activities in 7 economic sectors contributing to climate change adaption and climate change mitigation:

1. *Information and Communication Technologies*
2. *Water, waste, and sewerage remediation*
3. *Buildings*
4. *Transport*
5. *Manufacturing*
6. *Agriculture and forestry*
7. *Electricity, gas, steam, and air conditioning supply*

3.3.6 Disclosure requirements

The TEG states that the EU Taxonomy regulation entails obligations for three groups: financial market participants offering products in the EU, large companies who are under the Non-Financial Reporting Directive and the EU and its member states when setting standards for green financial products. This thesis primarily focuses on Swedish funds, which belongs to the first category. However, as the thesis investigates how funds, and their investments will be affected by the Taxonomy focus will also be on companies. Funds invests in companies and could therefore be affected by regulatory requirements put on companies. In addition, funds disclosure against the taxonomy is partly based on disclosures of the

companies in their portfolios (TEG, 2020). The disclosure requirements of these two groups are described in section 3.3.6.1 and 3.3.6.2.

3.3.6.1 Financial market participants

Financial market participants will have to disclose against the taxonomy for the first time by the 31st of December 2021 (European Commission, 2021). As stated by the TEG the first disclosures will only cover activities relating to climate change mitigation and climate change adaption. However, technical screening criteria will be released for the remaining environmental objectives in 2022 meaning disclosure against all 6 will be required by the end of 2022.

The TEG has declared that financial market participants should disclose:

- *How and to what extent they have used the Taxonomy in determining the sustainability of the underlying investments.*
- *To what environmental objective(s) the investment contribute; and*
- *The proportion of underlying investments that are Taxonomy-aligned, expressed as a percentage of the investment, fund, or portfolio. This disclosure should include details on the respective proportions of enabling and transition activities, as defined under the Regulation.*

However, the disclosure requirements vary depending on the type of fund. The funds have been divided into three categories which are defined in the Regulation on Sustainability-Related Disclosures in the Financial Services Sector, SFDR (2019). The categories are based on which article in SFDR the funds have chosen to classify as. The classification is a declaration of a fund's level of commitment to sustainability in investments. The different articles, what they stand for and their disclosure requirements can be seen in table 3.1.

Table 3.1 Fund categories as defined in the SFDR.

	Description	***Disclosure requirements***
Article 6	Integration of sustainability risks. This category is referred to as "grey".	Must carry disclaimer that the product does not take the EU criteria for sustainable investments into account.
Article 8	Promotes environmental or social characteristics. This category is referred to as "light green".	Taxonomy disclosures where environmental characteristics are promoted.
Article 9	Sustainable investments are the objective. This category is referred to as "dark green".	Taxonomy disclosures where the investment concerns activities that contribute to an environmental objective.

(European Parliament, 2019) (TEG, 2020)

The TEG (2020) allows Taxonomy-alignment to be calculated based on both turnover and capex for activities contributing to climate change mitigation and capex for activities contributing to climate change adaption. Furthermore, the TEG recommends that funds taxonomy-alignment is calculated separately for each environmental objective. In order to help financial market participants, implement the Taxonomy the TEG has established a 5 step process to evaluate the portfolio positions.

1. Firstly, taxonomy aligned activities conducted by the company should be identified. In addition, the environmental objective to which they contribute should also be identified.
2. Secondly the alignment of each activity should be confirmed by verifying that relevant technical screening criteria are met.
3. The third step is to verify that the DNSH criteria are met by the activities.
4. The fourth step is when due diligence is conducted in order to avoid violations of minimum safeguards.
5. The final step is when the Taxonomy-alignment of the portfolio is calculated.

The Taxonomy alignment of a portfolio is calculated based on the proportion of each position's revenue or capex that is taxonomy aligned weighted by the position's proportion of Asset Under Management, AUM. Figure 3.1 shows an example of how to calculate the taxonomy alignment of a portfolio.

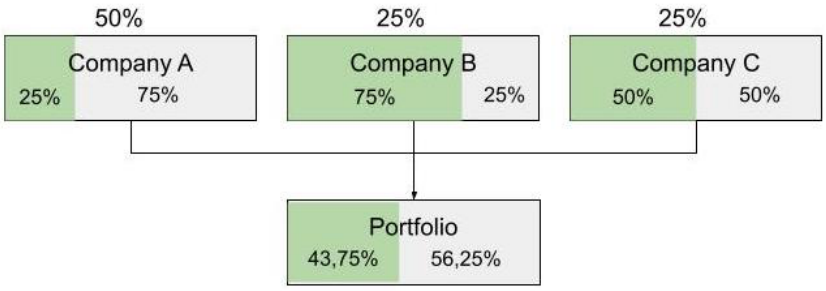


Figure 3.1 Example of how to calculate the Taxonomy alignment of a portfolio. The example portfolio is 43,75% taxonomy aligned.

Taxonomy alignment and the narrative descriptions should be published in the annual report, period report and on the financial market participant's website.

3.3.6.2 Large companies

Disclosure against the Taxonomy will start in 2022 for companies (European Commission, 2021). The TEG states that companies that are under the Non-Financial Reporting Directive must declare against the taxonomy. At a minimum this includes companies with more than 500 employees and all listed companies

(Finansinspektionen, 2021). Companies will have to report how and to what extent their activities relate to the taxonomy trough disclosure of:

- *Proportion of turnover aligned with the Taxonomy; and*
- *Capex and, if relevant, opex aligned with the Taxonomy (TEG, 2020).*

The TEG motivates the choice of financial metrics with turnover showing where a company is right now relative to the taxonomy and capex being an indicator of where the company is going. In addition to these measurements, the TEG recommends companies to report the proportions of their taxonomy aligned activities that are transitional or enabling activities as investors will need to disclose that information. No official verification of disclosures against the taxonomy is needed. However, the TEG considers it good practice to seek external assurance.

3.3.7 Future extensions of the EU Taxonomy

The TEG will publish delegated acts relating to the remaining four environmental objectives in the course of 2022. For the Taxonomy to be comprehensive they also state the need for social objectives to be added to the environmental objectives. However, no timeline for the development of the social objectives has been presented. Finally, the TEG recommends that technical screening criteria for significant levels of harm to environmental objectives are developed. These would be “polluting” Taxonomy criteria and define activities that are exceptionally harmful to the environment.

4 Interview results

In this chapter the results of the semi structured interviews are presented in a clear and systematic way. As all interviews were conducted in Swedish quotes have been translated.

4.1 Organization and interviewee

Out of the interviewed three interviewees represented small organizations, one a medium sized organization and one a large organization. The categories are an EU standard, which defines companies with more than 250 employees as large, companies with up to 50 employees as small and companies with between 50 to 250 employees as medium (European Commission, 2009). Companies representing each category were chosen because size was believed to have effect on views and understanding of the Taxonomy. Furthermore, 90% of companies in Europe are medium or small companies (European Commission, 2009), which is why the majority of the interviewees represented these two categories.

All the interviewees declared that their roles are head of sustainability or similar, meaning that they are the person with the ultimate responsibility for sustainability factors in their organizations. In addition, all of them had multiple years of experience working with sustainability performance and sustainable investments in the Finance industry. In terms of how the funds worked with sustainability, the author noticed that two categories could be used. The categories are Policy and Reporting and Sustainability of Investments. Policy and reporting refer to the development and management of fund policies regarding sustainability. The category also include work related to compliance and reporting of sustainability factors as well as guaranteeing requirements presented by commitments such as UN PRI are met. Sustainability of investments refers the evaluation and judgement of sustainability factors in future potential investments. All the interviewed organizations had an employee with expressed responsibility for the Policy and Reporting category. However, not all of them had employees with expressed responsibility for the Sustainability of Investments category, instead these responsibilities fell on the asset managers. All small companies had six employees working as asset managers out of which one also had responsibility for the first category. The exception was the large company that had 200 employees actively

working with investments out of which 150 had an expressed responsibility for one of both categories.

4.2 Established systems for sustainability.

All interviewees stated that their own systems for evaluating sustainability in a potential investment is the system that is most important to them. They also stated that their own system is the one they rely on most. They stressed that they need to be able to defend and motivate their investments and understand the sustainability risks connected to them. According to them no previous established system is comprehensive or reliable enough to provide all that is needed. As quoted by one interviewee:

> *'We rely mostly on our own system and knowledge. We need to do an assessment of a potential investment's ESG-risk and no established system gives us enough information.'*

However, all of them use some of the established systems mentioned in section 3.2 as a part of their own system to evaluate sustainability in a potential investment or as a way of communicating with their customers. Figure 4.1 shows the number of interviewed funds that use each system in section 3.2.

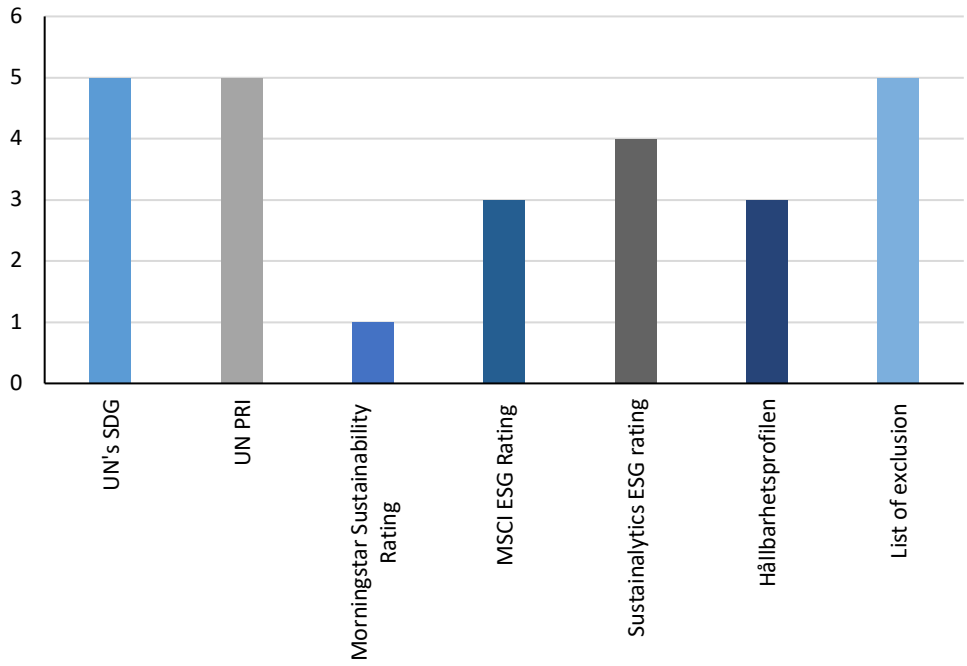


Figure 4.1 Number of interviewed funds that use the different systems described in section 3.2.

A list of exclusion was a part of all the funds' systems. One interviewee described it as:

> *'Exclusions might not be the best way to evaluate sustainability as it is so black and white. However, it is clear and easy to understand for our customers. It has become an industry standard, and the customers' demands it.'*

All but one of the interviewed organizations used either both the MSCI and Sustainalytics ESG ratings or one of them. They agreed that the ESG-ratings are a good start when evaluating the sustainability of a potential investment, but the ratings are not comprehensive enough to fully reflect sustainability factors. Instead, the interviewees use them as guidance. If a potential investment has a bad rating the investor can save time and resources and move on to other alternatives. The two interviewees who used both the MSCI and the Sustainalytics ESG rating said the ratings have different strengths. Furthermore, they said the use of multiple sources increases security. As stated by one of the interviewees:

> *'Systainalytics have more focus on the Nordics while MSCI have global focus. We use them both as they complement each other.'*

Three of the interviewees commented that different ESG-ratings tend to score companies differently which makes investing solely based on the sustainability information they provide difficult. In addition, interviewees said there are examples of companies having good ratings and then information is brought forward that contradicts the rating, which affects the stock price and valuation of the company negatively. A quote from one of the interviewees summarized it:

> *'There are examples of companies having a great rating from one provider, then another provider gives them a bad rating and the stock price fall. It makes it difficult for us to know what can be defined as sustainable and not.'*

Furthermore, all interviewees mentioned that most systems are based on historical data, which is not always representative of the future. When investigating an potential investment they need information on the company's future sustainability risks and how they plan on handling them. For this purpose, the UN SDGs are a better system. Three interviewees said companies tend to report which of the SDGs they contribute to and how. However, the information is usually an overall description and lacks details.

UN PRI is an industry standard and used by all the interviewed organizations. However, four of the interviewees regarded it more as a marketing or communication tool than a system used to evaluate sustainability. One interviewee said:

> *'Not being an UN PRI signatory is like saying to your customers that you do not care about sustainability.'*

Hållbarhetsprofilen received similar comments.

> *'It makes it easier for customers to find fund's sustainability information as it is all gathered in one place.'*

4.2.1 List of exclusion

As mentioned above and illustrated by figure 4.1 all interviewees stated that they have a list of sectors and products that they do not invest in, i.e. a list of exclusion. They all agreed the exclusion list is an industry standard. Table 4.1 shows which sectors the interviewed organizations exclude.

Table 4.1 List of excluded sectors

Sector	***Number or interviewees that exclude the sector***
Weapons (Chemical, biological, nuclear, cluster bombs, non-personnel mines)	5
Pornography	5
Tobacco	3
Coal	4
Uranium	5
Alcohol	3
Commercial gambling	5

The interviewed described that a majority of the sectors they exclude are excluded based on moral or social factors and not environmental factors. Examples are pornography, weapons, and commercial gambling. Furthermore, according to two interviewees the list can be disregarded in some cases. They said:

> *'Some investors exclude certain sectors but trade index products that are not ESG-adjusted.'*

> *'The exclusion list is a good guideline; however, it is not nuanced. There are cases when investments in the sectors on the list are justifiable.'*

The answers indicate that the list of exclusion is more of a communication tool than a system to evaluate the sustainability of a potential investment.

4.3 Sustainability vs return

When asked about sustainability and return all interviewees stated that their main goal is return. The said that generally the purpose of a fund is to maximize the return

for its investors. However, they all also agreed that most investors and funds have realized that to maximize the return, sustainability performance must be considered. Table 4.2 presents paraphrases of what the interviewed funds said of the relationship between sustainability and return.

Table 4.2 Paraphrases from answers received to 'How does your investors value sustainability in relation to return?'

Nbr of interviewees	*Paraphrases of answers to interview question 'How does your investors value sustainability in relation to return?'*
4 of 5	When investing in a fund the customer expects maximized return.
3 of 5	Investors have more patience with bad performance if the fund has good sustainability performance.
5 of 5	We have seen a significant increase in interest in sustainability performance during the last four years. More investors have realized that sustainability and return does not contradict each other.
5 of 5	Funds have realized that bad sustainability performance is a high risk. If they want to maximize their performance, they must consider sustainability factors.
2 of 5	An increased number of funds use their sustainability performance as marketing. It makes it hard to know if there is an increased interest in sustainability among investors that has caused the increased inflows in sustainable funds or if it is that these are the funds who get the most marketing.
5 of 5	Companies that are considered unsustainable are a risky investment.

All interviewees agreed that a company that is considered unsustainable is a risky investment. The reasons they stated for this are that investors generally are reluctant to invest in unsustainable companies and consequently the valuations and stock prices of these companies have fallen. This is a trend that is expected to continue and intensify. In addition, two interviewees stated that unsustainable companies are expected to have both high conversion costs as new regulations force them to change their business to become more sustainable and high cost of dept. Both factors could have negative effects on a company's performance. Furthermore, all interviewees also agreed that companies with good sustainability performance generally are a good investment as they are expected to benefit from authorities like the EU and the UN's future initiatives.

4.4 The EU Taxonomy regulation and its effects

4.4.1 Resources

All interviewees representing small companies stated that they do not have the resources to conduct the work the Taxonomy requires by themselves. They lack both monetary resources and personnel with enough time and knowledge to conduct the entire work required. Furthermore, they all thought the use of external resources would increase the credibility of their disclosures. This sentiment is well summarized in a quote by one of the interviewees:

> *'Initially external resources will be used to gather data, both because we want to be able to motivate our disclosures by referring to them and because we believe it will be more cost effective than retrieving the data ourselves.'*

The companies in the medium and small categories all had one or two employees with expressed responsibility for sustainability factors. This can be compared with the large company's 150 employees with expressed focus on sustainability. The small and medium companies all plan on using independent sources to retrieve the necessary data. However, they all stated that they will analyze and compile the data themselves. Two of the small companies declared that they would take inspiration from how the large company interviewed for this thesis adapts and disclose against the Taxonomy and use them as one of their sources. Moreover, the interviewee from the large company stated that they also plan on using external resources to some extent, primarily to increase the authenticity of and validate their disclosures.

All interviewees expressed a concern that the costs of complying with the Taxonomy will be high, especially for small companies and investors. As quoted by one interviewee:

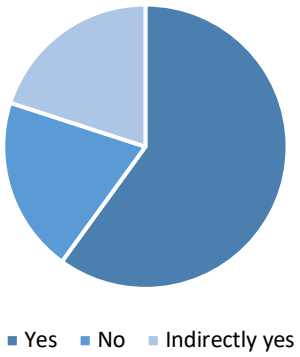
> *'The compliance work will be cost driving for small companies.'*

Another aspect all interviewees agreed on is that there is a lack of data. Four of them mentioned that companies do not need to disclose whether their taxonomy-aligned activities are transitional, enabling, or sustainable in their own right, which financial market participants needs to do. As this data is not easily accessible, funds will be required to either have good contact with all positions in the portfolio or use a third-party data provider. Moreover, the interviewees also agreed that initially most funds will have low taxonomy-alignment as only a few sectors are included in the TR. As a result, a lot of resources will be needed to communicate the new regulation and the fund's sustainability performance to existing and potential investors.

4.4.2 Investment strategy

Table 4.1 shows the distribution of the answers received to whether the TR will affect the fund's investment strategy or not. As can be seen in the figure most interviewees stated that the TR will affect their investment strategy either directly or indirectly. The interviewees that answered yes said that they expected the taxonomy-alignment of companies to affect their future valuations and therefore the TR will be included in their investment strategy. However, all of them stated the TR will not completely change their strategy but instead be a contributing factor. The interviewee who said it will indirectly affect their investment strategy said that as the TR puts requirements on most investors and companies the whole EU market will likely be affected. As they are active on the EU market their strategy will inevitably be affected. The interviewee whose fund's investment strategy will not be affected already had a strong focus on sustainability.

Table 4.1 Answers to the whether the Taxonomy will affect the fund's investment strategy or not.



4.4.3 Do you believe the EU Taxonomy Regulation will favor/disfavor certain sectors or companies?

Table 4.3 Paraphrases from answers received to 'Do you believe the EU Taxonomy Regulation will favor/disfavor certain sectors or companies?'

Nbr of interviewees	*Paraphrases of answers to interview question 'Do you believe the EU Taxonomy Regulation will favor/disfavor certain sectors or companies?'*
3 of 5	Tech companies, for example Google and Amazon, will benefit from the Taxonomy.
3 of 5	Companies active in the seven sectors covered by the first version of the TR will benefit from the taxonomy initially.
5 of 5	Big companies will benefit from the TR and small companies will be disfavored as they lack the resources needed.
5 of 5	All companies with low taxonomy-alignment will be disadvantaged as financial market participants will strive towards high taxonomy alignment.

The interviewees all agreed that investments will increase in companies that disclose high taxonomy-alignment as they all believed that most funds would strive towards high taxonomy-alignment. Furthermore, most of the interviewees believed big companies would benefit from the taxonomy as they have more resources. They will likely have the resources to do the work required by the taxonomy and adapt their business so that more activities are taxonomy aligned.

Furthermore, two interviewees expressed concern that the TR might cause European investors to avoid certain sectors that disclose low taxonomy-alignment but are important to society, leaving companies in these sectors to investors that do not care about sustainability or investors from countries that do not have as stringent sustainability requirements. Examples of sectors are some parts of the manufacturing industry and nuclear power. They said that this could leave these sectors vulnerable.

4.4.4 Do you believe the EU Taxonomy will replace other systems for evaluating and reporting sustainability or will it become a complement?

All interviewees agreed the that the TR will not replace other systems as it is the first of its kind. The established systems will make a good complement to the TR as they cover different factors. However, two interviewees stated that the established systems will most likely need to change and involve the TR. For example, one interviewee said that the ESG-ratings probably will have to take the TR's definition sustainable activities into account.

4.4.5 Do you believe the EU Taxonomy will facilitate sustainable investments?

All interviewees agreed that the TR will facilitate sustainable investments. They stated that they have noticed an increased interest for sustainability among their customers and as a result sustainability has become an increasingly relevant part of judging a potential investment. As the TR will ease that judgement more sustainable investments are expected. However, two interviewees mentioned that the TR will facilitate investments that are sustainable according to its own definitions. They argued that sustainability is not always as black and white as the regulation makes it out to be. Some investments could be sustainable even if they are not defined as it by the regulation. These investments are not expected to benefit from the TR.

4.4.6 Can you identify any risks or problems with the EU Taxonomy?

Table 4.4 Paraphrases from answers received to 'Can you identify any risks or problems with the EU Taxonomy?'

Nbr of interviewees	*Paraphrases of answers to interview question 'Can you identify any risks or problems with the EU Taxonomy?'*
4 of 5	There is a risk the TR will be affected by lobbying. Relevant stakeholder will likely try to influence the TR to their advantage.
4 of 5	The TR will benefit large companies.
3 of 5	The TR is not nuanced in its judgement of what is sustainable.
2 of 5	The TR could reduce the competitiveness of European companies and funds against Chinese and American companies and funds.
5 of 5	The work needed to disclosure against the TR will require a lot of resources and could be time consuming.

As seen in table 4.4 the risk mentioned by most investors are the risk of lobbying affecting the shape of the taxonomy. Interviewees stated that as the TR will steer investments towards companies with high taxonomy alignment it is in the companies' interest that their activities are defined as sustainable. It is therefore likely that relevant stakeholders will try to influence the TR to favor them. One interviewee said that lobbying has already been observed regarding whether nuclear power should be included in the taxonomy or not.

The risk of the TR benefiting big companies over small companies was also mentioned by most interviewees. The stated reason was that disclosure against the taxonomy will be resource intensive. Two interviewees went as far as to say the TR might lead to a monopolistic market.

Lastly two interviewees raised concern about how the TR will affect the competitiveness of European companies and funds against non-EU companies and funds, especially Chinese and American companies. They stated that as these countries does not have similar initiatives their funds will have bigger investment universes and their companies does not need to consider taxonomy alignment when choosing what activities to perform. In addition, neither will have to allocate resources towards disclosing against the TR.

4.4.7 What do you believe will be the long-term effects of the EU Taxonomy Regulation?

Table 4.5 shows paraphrases of answers received to the open-ended question regarding what long term effects the TR might have.

Table 4.5 Paraphrases from answers received to 'What do you believe will be the long-term effects of the EU Taxonomy?'

Nbr of interviewees	*Paraphrases of answers to interview question 'What do you believe will be the long-term effects of the EU Taxonomy?'*
5 of 5	The TR will make sustainability clearer and more understandable for both companies and investors.
5 of 5	It will be easier for investors to judge and compare the sustainability performance of different companies.
3 of 5	Private investors will be able to make more informed investments decisions in terms of sustainability.
4 of 5	The TR will help stir investments towards sustainable companies.
4 of 5	It will be harder for companies to green wash their business as standard definitions of sustainability are established.

As can be seen in table 4.5 all interviewees agreed that by defining measurable criteria and standardizing the metrics used to report sustainability performance the TR will make sustainability clearer. Three interviewees said the TR will be especially helpful for private investors. As there has been no standardized way for companies and funds to disclose sustainability performance knowledge has been needed to compare and judge companies and funds. This knowledge is mainly possessed by institutional investors as it is a part of their job. All interviewees agreed that the TR will improve institutional investor's systems to evaluate sustainability. However, the three interviewees who stated that it will be most helpful for private investors argued that the TR will limit the effort needed to make informed investment decision for this category. As the TR presents comparable metrics, they do not need possess deep knowledge of sustainability factors themselves. Ultimately, all interviewees agreed that the standardization and clear definition of sustainability the TR provides will limit the risk of green washing. It will be harder

for companies to market themselves as more sustainable than they are as the TR has defined sustainable activities. In the future, when the TR covers most sectors, a company marketing themselves as sustainable while reporting a low taxonomy alignment will be contradictory.

4.5 Key insights from the interviews

After analyzing the answers from the interviews, the key insights are:

1. The interviewees are generally positive towards the TR and believes it will increase sustainable investments.
2. The compliance work needed to meet the disclosure requirements of the TR will be time consuming and demands resources. Furthermore, there is a lack of data needed for good disclosures.
3. The TR is believed to increase the clarity of sustainability as it provides standardized definitions and metrics.
4. The TR comes with certain risks. Firstly, the interviewees stated that there is a high risk of the TR being affected by lobbying. Secondly, the TR might be disproportionately beneficial to big companies as they are more likely to have the resources to conduct and communicate their disclosures against the TR.
5. When evaluating the sustainability of a potential investment the most important system for funds are their self-developed policies and procedures. Many of the established systems are mainly used to communicate sustainability performance to customers.
6. The interviewees agreed that sustainable investments could increase returns, but they were less certain that investing to achieve high taxonomy-alignment would. Their largest concerns were that the TR initially would limit the number of investable companies too much.

5 Discussion and analysis

In this chapter the findings of the data collection will be discussed and analyzed. The EU Taxonomy and established systems for determining and communicating sustainability are compared and interview results are analyzed.

5.1 Market conditions

As mentioned, Sweden is ranked high in terms of sustainability. This suggests Swedes have a great interest in sustainability. Furthermore, both the literature study and interviews conducted for this thesis presented evidence that Swedish funds generally considers sustainability-factors when investing and often market themselves as sustainable. As the TR defines sustainability it can be assumed most Swedish funds will strive towards high taxonomy alignment. A fund marketing itself as sustainable while having low taxonomy-alignment will be contradictory and reduce the credibility of the fund. Furthermore, increased inflows have been noticed for funds after they have received good sustainability ratings and significant outflows have been noticed for funds that are considered unsustainable. As taxonomy-alignment is similar to a sustainability rating it can be assumed to have the same effect. Moreover, this is another indicator that Swedish funds will strive towards high taxonomy-alignment.

However, it is hard to estimate what level of taxonomy-alignment that will be considered high. As the TR only has environmental objectives and so far, only covers seven sectors it can be assumed that only a few companies will be able to report high taxonomy alignment. This suggest that initially low taxonomy-alignment percentages will be considered good for funds as their investment universes will be small. In addition, what is considered high taxonomy-alignment will probably differ between sectors and geographical regions as their conditions differ. It will be easier for some sectors to fulfill the technical screening criteria than others and will be easier for some geographical regions to adapt than others.

The assumption that funds will want to invest sustainably and have high taxonomy alignment is partly based on the fact that historically, sustainable investments and inflows to sustainable funds have steadily increased. According to the Global Sustainable Investment Alliance (2018) sustainable investments increased with 11% in Europe between 2016 and 2018. In 2018 sustainably managed assets in Europe

amounted to over USD 14 trillions which was 48,8% of total managed assets (Global Sustainable Investment Alliance, 2018). The increased focus on sustainability factors of investments started after the financial crisis in 2008, before that the interest of these factors was small (Fidelity Australia, 2018). However, since 2008 the conditions of the financial market have been beneficial meaning the increase of sustainable investments have occurred during good market conditions. The research on how bad market conditions would affect sustainable investments is limited. However, 2020 presented a number of different crises, including the corona pandemic and the Black Lives Matter movement, and sustainable investments reached record heights (Adamczyk, 2021; Umunna, 2020; Sims, 2020). Due to large support packages in response to the corona pandemic the financial market remained mainly beneficial during 2020. However, the trend of increased sustainable investments during 2020 and the younger generations' interest in sustainability are indicators sustainable investments and fund inflows based on sustainability factors will continue to grow.

5.2 Comparison of established systems and the EU Taxonomy

To investigate how Swedish funds and their sustainable investments will be affected by the TR the differences between the TR and the established systems described in section 3.2 has been investigated. The purpose of the comparison is to investigate if the TR will contribute with something new. Sweden is ahead in terms of sustainability so there is a possibility that the requirement of the TR is already covered by other systems. As the goal of the TR is to facilitate sustainable investments the systems have been compared regarding how they define sustainability and what type of investors they have as target groups. Moreover, most established systems are based on ESG factors which is why the systems have been compared regarding the three categories of ESG. Finally, as sustainability systems comes in many different forms the design of the systems have been compared.

5.2.1 Target groups

The systems that have been researched and investigated have both shared and different target groups. For this thesis, the author defines target group as the investor type for whom the final product of the system is targeted. The target groups can be summarized into two categories, investors in funds and investors in companies. A summary of the different system's target groups can be found in table 5.1.

Table 5.1 The sustainability rating

System	*Investors in companies*	*Investors in funds*
UN PRI		X
Sustainalytics ESG rating	X	
MSCI ESG rating	X	
Morningstar Sustainability Rating		X
Hållbarhetsprofilen		X
List of exclusion		X
EU Taxonomy Regulation	X	X

As can be seen in table 5.1 the EU Taxonomy regulation is the only system that has both investors in funds and investors in companies as target groups. The final assessments of the TR are of interest for both categories of investors. The difference is that the TR force both non-financial and financial companies to disclose taxonomy-alignment and descriptions of their sustainability performance. The other systems either evaluate the sustainability of a company or a fund. The final assessment presented by these systems are a rating or description of either a fund or a company.

In addition to having different target groups in terms of investors, the systems also apply to different markets. Some of the systems are global or European and some are limited to the Swedish market. The different systems and their markets can be found in table 5.2. As can be seen, most of them are global meaning they evaluate companies from all over the world. The EU Taxonomy only applies to the EU. However, according to one interviewee non-EU companies interested in being active on the European market will have to adapt to the Taxonomy in order to be able to receive investments as investors would have to include them in their disclosure against the TR.

Table 5.2 The sustainability and their markets

System	*Global*	*EU*	*Sweden*
UN PRI	X		
Sustainalytics ESG rating	X		
MSCI ESG rating	X		
Morningstar Sustainability Rating	X		
Hållbarhetsprofilen			X
List of exclusion	X		
EU Taxonomy Regulation		X	

5.2.2 Design

As mentioned in section 5.2.1 the final assessment of the systems comes in different forms. Sustainalytics ESG rating, MSCI's ESG-rating and the Morningstar Sustainability rating comes in the form of a score. UN PRI is an initiative of which funds can be signatories. Hållbarhetsprofilen and the exclusion lists are informatory lists. The final assessment of the TR is taxonomy-alignment for funds, and both proportion of turnover or capex and descriptions for non-financial companies. The metrics disclosed against the TR could be classified as ratings which is the most common way to disclose sustainability. Ratings are easy to understand and compare.

As seen by the final products of the systems they also apply to different stakeholders. Both non-financial companies and financial market participants must disclose against the TR. Sustainalytics and MSCI's ESG ratings applies to companies. The exclusion lists, Morningstar Sustainability Rating, Hållbarhetsprofilen and the UN PRI applies to funds. The UN SDGs applies to both financial and non-financial companies, however the SDGs are overarching objectives and does include disclosure requirements like the other systems.

Furthermore, the systems differ in terms of who is responsible for the development and analysis of the final assessment. Some of the systems are self-declarations and some of the systems are managed by a third party. The TR, Hållbarhetsprofilen and the exclusion lists are self-declarations. The compliance work and development of the disclosures are done by the fund. In addition, the disclosures do not need to be validated. The different EGS-ratings and the sustainability ratings are managed by a third-party.

The systems also have different purposes and can be used at different stages in an investment decision. The timeline in figure 5.1 shows how the different systems

complement each other. Some of the systems are used to communicate sustainability performance to customers and some are used during investment decisions. They all play important roles and highlight different aspects of sustainability. This suggest that the TR will not replace existing systems but instead be a complement to the other systems. Moreover, the existing systems have an established role in funds' organizations making them hard to replace. However, the established systems will likely need to adapt to the TR. As the TR is regulatory and defines sustainability, the other systems' definition of sustainability will need to resemble the TR's definition to be credible.

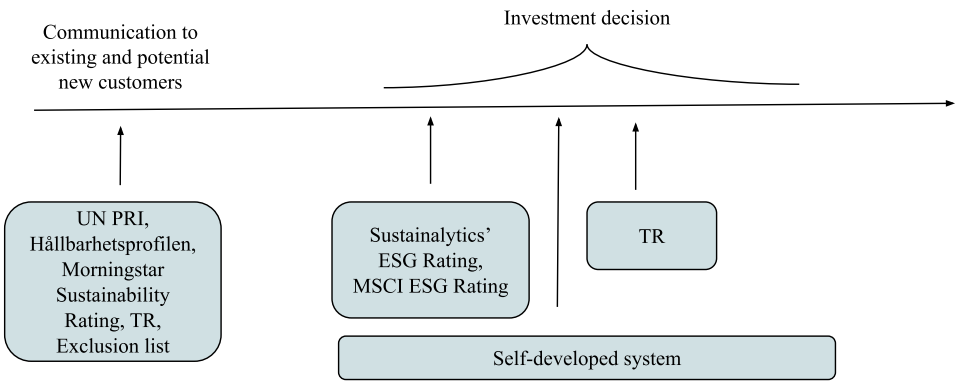


Figure 5.1 A timeline showing when in an investment decision the different systems can be used

5.2.2.1 Transparency

The methodology used for calculating taxonomy alignment is thoroughly described in reports published by the European Commission. The reports also give detailed descriptions of the activities that can be defined as sustainable and what thresholds they have to meet. The methodologies used to calculate MSCI and Sustainaltyics ESG-ratings are not as transparent. Descriptions of the overall methods used to calculate the ratings and the ESG-factors that contribute can be found. However, they do not disclose the weights of the different factors or exactly how they relate to each other. Furthermore, the ESG-ratings are partly based on sector comparison, which makes comparison of companies in different sectors difficult. The exclusion list is transparent in the sense that it states sectors that should be excluded. However, interviews revealed they can sometimes be disregarded. Some funds still trade index products that include the sectors or companies whose revenue partly comes from sectors on the list. As most lists only state the sectors that are excluded and not how the fund define exclusion the transparency of the lists is reduced.

The UN PRI and Hållbarhetsprofilen publish information lists of the companies that have chosen to be signatories. The initiatives are transparent about what is expected of the funds, however the information published is delivered by the funds.

5.2.3 Environmental, Social and Governance - ESG

5.2.3.1 S and G, Social and Governance

The TR does not include social or governance factors to the same extent as the other systems. The different ESG ratings are partly based on datapoints strictly relating to social and governance performance. The current version of the TR is limited to environmental objectives. Governance and social factors are only considered through the minimum safeguards criteria and does not have their own objectives. The minimum safeguards refer to compliance with EU regulations and established guidelines. Hållbarhetsprofilen have specific fields where funds can declare if they consider social and governance factors and describe in what capacity. Furthermore, as discovered by the interviews most funds choose to exclude sectors based on social or governance factors. The UN PRI and the UN SDGs consider all aspects of ESG and have principles and goals specifically for the social and governance factors.

As the requirements regarding social and governance factors presented by ESG ratings are more comprehensive than those presented by the TR and the minimum safeguards only cover established regulations and guidelines it can be assumed companies and funds already complies with the minimum safeguard criteria.

5.2.3.2 E, Environment

The technical screening criteria connected to the different environmental objectives makes the TR more comprehensive and detailed than previous systems in terms of environmental performance. Most of the established systems mentioned in this thesis focus on whether a company's activities are conducted in a sustainable way and if there are any risks connected to the performance of the activities. They generally do not consider the activity type. The exception is the exclusion list that only focus on the type of activity by excluding certain sectors and takes to consideration to how activities are conducted. The TR includes how activities are performed but also regards what type of activities the company conducts. Only some activities have been defined as sustainable in the TR and they have clear thresholds that must be met. Unlike established systems who assumes all sectors and activities can be sustainable if performed in a sustainable way, the TR considers all areas not defined as sustainable as unsustainable. The current version of the TR covers activities for seven sectors, meaning activities conducted by other sectors cannot be considered taxonomy-aligned or sustainable at this point. This limits the investment universe for investors who wants to have high taxonomy alignment. In this sense the established systems are more comprehensive as they cover more sectors, however the TR is more comprehensive regarding the sectors it does cover.

5.2.4 Definition of sustainability

A major difference between the systems is that they have different definitions of sustainability. The TR defines a sustainable activity as an activity that fulfills technical screening criteria for substantial contribution to at least one of the environmental objectives while simultaneously fulfilling criteria for DNSH to any of the other objectives and meeting minimum safeguards. The different ESG rating providers define sustainability as low ESG-risk in comparison to sector peers. However, the companies providing the ESG ratings do not disclose exactly what ESG-risks they include or how they are valued in comparison to each other. The fact that there is a divergence in ESG ratings indicates that providers value ESG-risks differently, which in turn indicates that providers have different definitions of sustainability. In addition, ESG-rating providers includes sector comparison in their evaluation of ESG performance, meaning sustainability is partly defined based on how far ahead companies' sustainability performance currently are and not on where they should be in order to reach the EU's sustainability targets. Morningstar Sustainability Rating is based on the Sustainalytics ESG Rating and therefore they define sustainability similarly.

The UN PRI and the UN's SDGs indirectly defines sustainability. If an investor does not live up to the principles of the UN PRI they are considered unsustainable as it is an industry standard to be signatories of the principles. The UN's SDGs only state overarching objectives that must be reached for the world to be sustainable. They do not state how these objectives are to be reached, instead companies can choose to declare how they contribute to one or several of the SDGs. Hållbarhetsprofilen does not define sustainability. It is simply a platform where funds can choose to report their sustainability performance in an organized way.

A result of the different ESG ratings and the TR having different definitions of sustainability is that getting a high ESG-rating does not necessarily mean a company will have high taxonomy-alignment. Funds who want to have high taxonomy alignment will have to choose to invest in companies whose activities meet technical screening criteria and contribute to one of the six environmental objectives. That might mean the fund's Morningstar Sustainability rating will fall.

5.3 Risks connected to the EU Taxonomy Regulation

By comparison of the TR and established systems and through interview insights the author has identified potential risks connected to the TR. These are listed below.

Like all regulations there is a risk that the TR will be affected by lobbying. As capital allocation towards companies with high taxonomy alignment is expected stakeholders will likely work hard to ensure that activities connected to their sectors or interests are classified as sustainable. The TR has already been criticized by some

NGOs and news reporters for having been influenced by lobbyists (Godinot & Azau, 2021; Sanchez Nicolas, 2021; Dunand, 2021; Greenpeace European Unit, 2021). To reduce this risk and make sure the TR stays objective the expert group tasked with developing technical screening criteria must make sure the thresholds are strictly science-based and are solidly motivated.

Another identified risk is that the TR will have negative effects on small companies as they do not have the resources to conduct the compliance work required by the Taxonomy. The requirements presented by the TR are extensive and are expected to be cost driving for both small and large companies. However, larger companies are more likely to have a structure able to manage the requirements. Furthermore, smaller non-financial companies do not have to disclose against the TR and therefore risk losing investments from investors who strive towards high taxonomy alignment.

A third identified risk is that the TR could lead to a large capital allocation towards sectors that already have high taxonomy alignment and leave sectors that might need investments to change without. Research has shown that high sustainability ratings increase investments in a company and a low sustainability rating reduce investments (section 3.2.4). It can be assumed the TR will have similar effects. This could leave companies that are important to society but are in much need of investments vulnerable.

Finally, the TR only affects the EU. For the TR to have its intended effect of improving the overall sustainability of the world it could be argued it should have a global focus. As European funds strive towards high taxonomy-alignment companies with bad taxonomy-alignment are left to be owned and controlled by funds and investors that do not value sustainability or are non-EU and therefore do not need to comply with regulations like the TR. A consequence of this could be that the sustainability of companies with low taxonomy-alignment are not improved. It could be argued that improvements of these companies are necessary if the overall sustainability of the world is to be increased. If this situation were to occur the effect of the TR would only be that most EU funds limits their investment universe to companies with high taxonomy-alignment and reduce their competitiveness against funds who are more positive towards companies with low taxonomy alignment. The EU could be argued to be sustainable, but the overall sustainability of the world is not increased. If the overall sustainability is to be increased and the UN's targets to be reached it could be argued global initiatives, regulations and definitions are necessary.

6 Conclusion

This section of the thesis presents the findings and conclusions of the studies that have been made. It answers the research questions as well as explains the academic contribution of the thesis and a critical review of the thesis. It also suggests future studies relating to the subjects of the taxonomy and sustainable investments.

6.1 Answers to research questions

Below summarized answers to the research questions can be found. For deeper motivations and analysis, the author refers to chapter 5.

6.1.1 What systems and methods does Swedish funds use to evaluate sustainability today?

Through research and interviews it is clear to the author that Swedish funds' most frequently used systems are their own self developed policies and procedures. Funds state that there is no system comprehensive enough to provide a sufficient estimation of sustainability risks in a company. A problem is that the sustainability or ESG metrics independent companies provide lack standardization, which makes them unclear. To evaluate the sustainability risks of a potential investment, funds state a deep understanding of sustainability risks and fundamental analysis is necessary.

The self-developed systems used by investors often include some of the established systems. Most funds use at least one provider of ESG-ratings on a regular basis. Usually, these ratings are used as a first step when evaluating a potential investment. Furthermore, the ratings are used to validate an investment. However, since there is a lack of transparency and divergence in ESG-ratings funds agree that they cannot be used on a stand-alone basis to motivate an investment.

Furthermore, most of the established systems adapted by companies are primarily used to communicate sustainability performance to customers and other interested parties, not to evaluate the sustainability of potential investment.

It is an industry standard for Swedish funds to be signatories of the UN PRI and to have a list of exclusion. Most Swedish funds also use Hållbarhetsprofilen as it is managed by the Swedish fund Association.

6.1.2 How do the EU Taxonomy Regulation compare to existing systems for evaluating sustainability?

One difference between the TR and established systems is that the TR is regulatory. European financial market participants as well as big and listed companies must disclose their taxonomy-alignment. The TR is also the only system that applies to both categories. The established systems evaluate the sustainability of either funds or companies, not both. Moreover, the disclosure requirements of the TR are more extensive than those of the established systems. A consequence of this is that more resources are needed to comply with the TR than with other systems. The TR is bureaucratic and require a lot of administrative work. In addition, the TR is the only system that has both investors in funds and investors in companies as target groups.

Furthermore, the TR is more transparent than the established systems. It defines which activities can be considered sustainable and what thresholds the activity must meet. In addition, the methodology used to calculate taxonomy alignment is thoroughly described and public. This is not the case with most sustainability ratings. The providers of these ratings often disclose the methods and overall sustainability factors used, but they do not disclose exactly how the data is gathered or the weights used for different factors. However, like many established systems the TR is a self-declaration that do not need validation.

The disclosures against the TR are standardized which makes them easier to understand and compare. However, there is risk of the seemingly objective metrics being misleading. Sustainability is not necessarily as black and white as the TR makes it out to be. Activities or companies can have degrees of sustainability which are not captured by the taxonomy.

Moreover, the TR has a clear focus on the environmental aspects of sustainability. Regarding environmental objectives the TR is more comprehensive than the established systems. For the sectors and activities included, the TR has clear and detailed technical screening criteria. However, the TR only consider social and governance factors through the minimum safeguard criteria. The established systems include all aspects of ESG in their assessment of sustainability performance.

Finally, the TR is not as nuanced as the UN PRI and the UN SDGs. As all ratings, the TR assess sustainability performance with quantitative methods. The UN PRI and the UN SDGs have a broader qualitative view of sustainability.

6.1.3 How will the EU Taxonomy Regulation impact Swedish funds and their sustainable investments?

Swedish funds are generally positive towards the TR. They believe it will limit the risk of greenwashing as sustainability is clearly defined and sustainability disclosures standardized. Furthermore, analysis of the interviews and the literature review suggests Swedish funds will strive towards high taxonomy alignment.

All Swedish funds will have to disclose against the TR. The compliance work needed to comply with the TR is extensive and will require resources. There is a risk that the TR will cost driving for companies and funds. As big companies and funds usually have more resources the TR is likely to benefit them.

Furthermore, funds' investments in companies defined as sustainable by the taxonomy will increase. In that sense sustainable investments will increase because of the TR. However, investing to achieve high taxonomy alignment is not necessarily the same as investing sustainable. The TR only covers some sectors and activities, and the rest is considered unsustainable. This limits the investment universe for funds that wants to disclose high taxonomy alignment. Until the TR covers more sectors and activities some companies with low-taxonomy alignment could be considered sustainable in a more general term. For example, a company could have positive social impact but receive low taxonomy-alignment. Funds' investments in companies defined as sustainable by this more inclusive definition will likely not be affected by the TR.

Finally, there are some risks connected to the TR. As the TR is a regulation with many powerful stakeholders there is a risk it will be affected by lobbying. Relevant parties will likely try to influence the TR so that their activities or sectors are defined as sustainable. Furthermore, the TR could limit Swedish and other European funds' competitiveness towards funds not covered by the Taxonomy as they have bigger investment universes. If these funds choose to invest in companies with low-taxonomy alignment the overall sustainability of the world will not increase, the ownership of unsustainable companies will just have been transferred to other stakeholders. In order for the TR to have its intended effect of increasing the overall sustainability it could be argued it should have a global focus.

6.2 Critical Review

In this thesis interviews are used as one method to gather information about the effects of the taxonomy regulation. The conclusions of this thesis are partly based on the answers received in these interviews. However, it could be argued that the results might have been different or other factors brought forward if more people had been interviewed. It was sometimes hard to find and reach suitable interviewees

and due to the corona virus, and the increased workload it has entailed, some interviewees declined to participate in an interview. More interviews in each category could have increased the credibility of the conclusions and validated the results.

Furthermore, the result of this thesis is limited to the Swedish market. The same conclusions might not be applicable to another market affected by the EU Taxonomy. To fully understand the EU Taxonomy's effects on sustainable investments in Europe suggestions for future research can be found in section 6.3 of this thesis.

6.3 Academic Contribution

This master thesis examines what effect the new EU Taxonomy might have on Swedish funds and sustainable investments. This is done by answering three research questions. The first question, which covers how sustainability is evaluated today, will contribute to existing literature on the subject. A lot of literature and research can be found on systems and methods used to evaluate and determine a company's sustainability. However, the established systems are many and not all of them are used in practice. This thesis will help clarify which systems are most frequently used by Swedish actors.

The second research question investigates Swedish market participants ability to comply with the Taxonomy Regulation. The new regulation demands that investors evaluate the taxonomy-alignment of their portfolio and that companies evaluate the sustainability of their activities. These tasks require resources, time and expertise. In academic terms, this question will contribute to research on the taxonomy's potential. For the TR to have the full intended effect, relevant stakeholders must be able to comply with it.

The third and final research question, which investigates what effect the TR will have on sustainable investments, will make an academic contribution in an emerging field. As mentioned earlier in this thesis, the TR has not been implemented yet and therefore limited literature can be found on what effect it will have on sustainable investments. Furthermore, it has been established that sustainable investments are needed to reach the targets of the Paris climate agreement and the EU green deal among other initiatives. The TR is a comprehensive regulation with high ambitions and many stakeholders. Research regarding how it can facilitate sustainable investments could therefore be seen as academically relevant.

6.4 Suggestion of future studies

This thesis is limited to Swedish banks and funds. To get a full understanding of the TR's effect on sustainable investments more countries could be studied. Sweden and the other Scandinavian countries are ahead in terms of sustainability and already have established systems. It would be interesting to investigate what effect the TR could have in European countries that have less focus on sustainability. Furthermore, it could also be of interest to evaluate how the EU Taxonomy compares to similar classification systems used in countries outside of the EU and how the potential differences/similarities affect sustainable investments.

Further studies could also be made on Swedish stakeholders. The TR affects non-financial companies, and these are not included in this thesis. How these companies adapt and relate to the TR will have a significant effect on the regulation's success. Furthermore, since the TR is relatively unexplored the future possible research topics are many. The data that will be available when the TR has been fully implemented will create new opportunities for research. Especially, more data could

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Appendix A Interview guide

The following interview guide was used when interviewing representatives from different Asset Managers. The questions were asked in Swedish but has been translated for this thesis.

A.1 Background of organization and interviewee

1. What is your role within the company?
2. How many employees does your organization have who works actively with investments?
3. Do you have employees with pronounced focus on sustainability/ESG
    a. If yes, how many?
    b. In what way do they work with sustainability/ ESG?

A.2 Established methods for assessment of sustainability

1. How do you assess the sustainability of a potential investment?
    a. Do you use any established systems? (Certificates, ratings, exclusions lists, own policies/systems etc)
        i. If you exclude certain sectors, which ones?
        ii. Are you working towards the UN's 17 Sustainable Development Goals?
        iii. Are you a member of the UN PRI?
        iv. Do you use Sustainalytic's ESG-rating?
        v. Do you use MSCI's ESG rating?
    b. Which system, if any, do you consider to be most important?
    c. Do you use the Morningstar Sustainability Rating?
    d. Do you use "Hållbarhetsprofilen"?
2. Which article in the EU Sustainable Finance Disclosure Regulation have you chosen to classify according to? (If applicable)
3. Does these systems affect whether you choose to invest in a company/product or not?

4. Have you experienced an increased interest in/ demand on sustainability from your investors?
    a. If yes, have you noticed an effect on outflows/inflows in your products?
5. How does your investors value sustainability in relation to return?

A.3 The EU Taxonomy

2. Will you be affected by the EU Taxonomy?
    a. If yes, in what way?
3. How are you planning on reporting your Taxonomy-alignment?
    a. Do you have the resources to conduct the work that the EU Taxonomy regulation requires?
    b. How are you planning on handling companies that does not need to report according to the EU Taxonomy? (Non-EU companies etc)
    c. Do you have a target-value in percent for your portfolio/portfolios in terms of Taxonomy-alignment?
4. How objective do you believe the assessment of whether an activity aligns with the technical screening criteria or not will be?
5. Do you believe the EU Taxonomy will affect your investment strategy?
6. Do you believe the EU Taxonomy will favor/disfavor certain sectors or companies?
    a. If yes, what sectors and companies?
7. Do you believe the EU Taxonomy will replace other systems for evaluating and reporting sustainability or will it become a complement?
8. Do you believe the EU Taxonomy will facilitate sustainable investments?
9. Are there any amendments or changes of the EU Taxonomy you believe would help facilitate sustainable investments?
10. Can you identify any risks or problems with the EU Taxonomy?
11. What do you believe will be the long-term effects of the EU Taxonomy?