Morningstar Observations and Recommendations

Australian Taxonomy Second Public Consultation

Summary

Morningstar welcomes the opportunity to comment on ASFI proposal for an Australian Taxonomy. Our response primarily focuses on the viability and usability of the proposed voluntary framework and does not opine on the relevancy of the specific criteria. In summary, we believe that for the Australian Taxonomy to succeed as an optional market standard, it must be both investment-relevant and scalable across asset classes and jurisdictions. This is essential to encourage adoption by investors and support from data providers. Consistency and interoperability with the EU Taxonomy are critical to achieving economies of scale and meeting the needs of investors who seek a unified sustainability framework. As concerns grow over the fragmentation of ESG markets, a common sustainability language will be vital to ensuring the Taxonomy's relevance and effectiveness.

About Morningstar and Morningstar Sustainalytics

Morningstar's mission is to empower investor success, and this includes helping individual investors, professional financial advisors, and institutional clients identify sustainability risks, impacts, and opportunities. Our products, offered through separate business lines and subsidiaries, include a broad range of data, tools, ratings, indexes, second-party opinions, and governance services. More recently, Morningstar Sustainalytics has taken a leadership position in helping clients respond to the various requirements of the EU Sustainable Finance Action Plan, including EU Taxonomy data.

Comments

Voluntary nature and market dynamics

The Australian Taxonomy is expected to be voluntary, at least initially. In jurisdictions where taxonomies are voluntary, there has been limited demand for related data provision services. The only example of a taxonomy with significant adoption is the EU Taxonomy, where reporting is mandated at both company and financial product levels. Its uptake can be attributed to the "first mover advantage" and the size of the European market.

While mandating a taxonomy does not guarantee success, it can help structure the market around it. Alternative methods, such as introducing optional labels for financial products and securities endorsed by regulators or market participants, can also enhance a taxonomy's relevance. For Australia, it remains uncertain whether a voluntary taxonomy framework could establish itself as a new standard among market participants, thereby generating positive ripple effects across the market, including data providers.

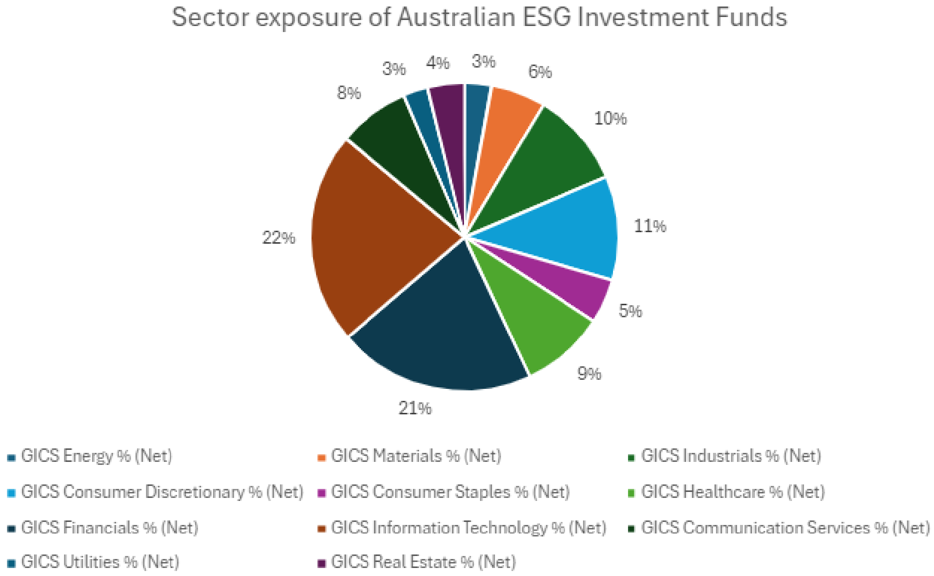
To encourage adoption, the framework must prioritize usability and support investment decision-making. Without these qualities, it may struggle to gain traction and influence market behaviour.

Use case and sector coverage

ASFI has understandably prioritized the most critical sectors of the Australian economy. Notably, many of these sectors and activities are not covered by the EU Taxonomy, which is advantageous for interoperability. However, while local banks are heavily exposed to these sectors, Australian ESG investors typically allocate to a broader range of sectors not currently included in the framework.

Morningstar data shows that only 23% ESG funds are focused on local equities or fixed income, meaning the majority are exposed to global markets and uncovered sectors (see graph below). If one of the applications of the Australian Taxonomy is intended to assess the sustainability credentials of investment funds, its current framework appears incomplete. Should it become mandatory in the future, there is a risk of presenting misleading figures to investors. Furthermore, if the Taxonomy were used as a basis for fund labelling (e.g., requiring a specific percentage of alignment with the Australian Taxonomy), it might disproportionately benefit only a subset of local ESG funds.

We therefore suggest utilizing the EU Taxonomy criteria (or a selected subset) to incorporate sectors that are currently excluded, ensuring more extensive and inclusive coverage.



Global convergence and interoperability

We commend the Australian Taxonomy's alignment with the structure and processes of the EU Taxonomy and its emphasis on interoperability. However, there are still concerns as in some instance we note significant differences in ultimate sustainability criteria for a similar activity covered by two frameworks (as highlighted in box below). Broadly speaking, the Australian taxonomy tends to offer more specific but narrowly scoped criteria, while the EU taxonomy provides more generalized guidelines applicable to a wider range of activities.

While the pace of transition may vary across jurisdictions, reflecting local circumstances, the endpoint—what is deemed "sustainable" or "green," along with corresponding criteria—should be convergent. ESG investors require a common and consistent sustainability framework across markets to support global investment strategies effectively.

If a taxonomy is voluntary, prescriptive in data requirements, and diverges significantly from existing frameworks, its utility for global investors—and, consequently, its ability to drive demand for data provision—will be limited. To maximize its relevance, we recommend ensuring as much convergence with the EU Taxonomy as possible for overlapping sectors. If full alignment cannot be achieved or is not be desirable due to usability challenges, the Australian Taxonomy should focus on ensuring interoperability by using a subset of EU criteria.

Examples where differences between the Australian and EU Taxonomy is unlikely to impair interoperability.

C16. Manufacture and Recycling of Batteries

The definition of the activity and the technical screening criteria are identical. The only distinction is that the Australian taxonomy applies the technical screening criteria starting in 2030, whereas the EU taxonomy does not impose any time restrictions.

C14. Manufacture of Low-carbon Technologies for Transport

The Australian taxonomy outlines four criteria, all of which are also addressed in the EU taxonomy. The key difference is that the EU taxonomy includes nine additional criteria.

Examples where differences between the Australian and EU Taxonomy may impair interoperability.

C10. Manufacture of Biogas

The Australian taxonomy specifies four feedstock types for defining biogas, whereas the EU taxonomy references Article 29, paragraphs 2 to 5, of Directive (EU) 2018/2001, offering a broader definition without explicitly listing the feedstock types mentioned in the Australian taxonomy. Additionally, the Australian taxonomy includes criteria for utilizing electricity produced from renewable sources after 2030, which is absent in the EU taxonomy. It also establishes criteria for greenhouse gas savings, a feature not included in the EU taxonomy.

C15. Manufacture of Energy Efficiency Equipment for Buildings

While the conceptual approach is similar, the products included within the scope of manufacturing under the technical screening criteria differ. The Australian taxonomy specifies exact product types (e.g., induction cooktops), whereas the EU taxonomy outlines criteria based on specific functions (e.g., household appliances within the top two energy efficiency classes as defined by Regulation (EU) 2017/1369 of the European Parliament and Council). Consequently, the Australian taxonomy has a more limited scope compared to the EU taxonomy.

D1. Energy Generation from Solar Photovoltaic (PV) and Concentrated Solar Power (CSP)

This aligns with two activities in the EU taxonomy: Electricity Generation using Concentrated Solar Power (CSP) technology and Electricity Generation using Solar Photovoltaic technology. For CSP, the EU taxonomy provides a more general rule, whereas the Australian taxonomy specifies that remote or off-grid CSP facilities must generate no more than 15% of their electricity from non-renewable sources.

D3. Energy Generation from Ocean Energy

Both taxonomies are quite similar in this regard, as neither provides detailed technical screening criteria. The key difference is that the Australian taxonomy includes an exclusion criterion not specified in the EU taxonomy: power plants supporting fossil fuel infrastructure (e.g., operations related to fossil fuel activities) are deemed ineligible.