## 4. The Fallacy of ESG ratings

Setting aside for a moment the 'zero rates' world, the mainstreaming of the ESG framework is the single most relevant change in the asset management industry. ESG scores are mistakenly believed by many professional and non professional investors to be somehow indicators of 'greenness'.
The truth is that the scores are heavily skewed towards the assessment of risks for the corporation and say very little on the impact the corporation has on nature and people.
The car sector possibly represents the most spectacular failure of ESG score to actually mean anything. S&P is a good example of the problem with ESG scores. The S&P Global ESG score is split into pillars that each carry a certain weight of the total score. For the Automotive sector the composition of the weights are:

- E - 31 %
- S - 31%
- G - 38%

These weights are then split in KPIs determined by information that is self-reported by the companies. The Environmental's 31% is composed by the following:

- Operational Eco-Efficiency - 8%
- Climate Strategy - 6%
- Low Carbon Strategy - 6%
- Environmental Reporting - 4%
- Product Stewardship - 4%
- Environmental Policy & Management Systems - 3%

Scope 3 emissions only account for 10% of the 6% within the 'Climate strategy' KPIs. Meaning that scope 3 in and emission heavy industry will only account for 0.6% of the total ESG-Score. This means that even if the score was 0 (and it never is) it would only detract 0.6 from 100.
So, despite $CO_2$ emissions, together with air pollution, being the most material of environmental KPIs for the sector, this specific parameter (emissions) is virtually ignored in the context of ESG ratings.
**Let's repeat this and ponder the fact for a moment: emissions represent less than 1% of an ESG score in the car sector.** Unsurprisingly, despite being responsible for nearly 25% of the world's $CO_2$ emissions, car manufacturers score very high on environmental grounds.

| ESG- Ratings | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Name | MSCI | MSCI E-Score (0 - 10), weight pillar 30% | S&P | S&P E-Score (0 - 100) weight of the pillar 31% | Sustainalytics | Bloomberg | Bloomberg E-Score (0-100) - weight 33% | CDP |
| Volkswagen AG | B | 5.6 | 61 | 77 | 29.6 | 59.5 | 53.5 | 7 |
| BMW AG | A | 7.1 | 74 | 83 | 23.4 | 62 | 64.34 | 8 |
| Daimler | A | 6.8 | 38 | 51 | 22.1 | 62.4 | 61.24 | 7 |
| Renault SA | BBB | 6.4 | 48 | 78 | 22.5 | 59.9 | 55.81 | 7 |
| Stellantis | BB | 4.7 | 59 | 53 | 23.4 | 64.46 | 66.67 | 7 |
| Toyota | A | | 40 | 47.0 | 23.8 | 58.86 | 66.67 | 8 |
| Ford | B | | 34 | 34.0 | 29.9 | 62 | 64.34 | 8 |
| GM | BB | | 78 | 82.0 | 30.9 | 67.8 | 62.02 | 8 |
| Hyundai | B | | 78 | 80.0 | 30.7 | 57.4 | 58.91 | 7 |
| Honda | A | | 74 | 79.0 | 29.3 | 42.56 | 34.11 | 7 |
| AVERAGE | | 6.12 | | 66.4 | | | 58.8 | |

The E score of car manufacturers is really hard to explain. In particular it is hard to fathom how VW, for example, a company with the carbon intensity of an oil major, scores 77/100 for S&P or how Honda is rated 79/100 on environmental grounds.

## 5. The new kid on the block: the EU taxonomy

The Taxonomy Regulation establishes the list of environmentally sustainable activities, and it mandates financial and non financial entities (funds and corporations) in the EU to disclose to what extent funds marketed as 'sustainable' are aligned with such definition. Such alignment, in the case of an investment fund for example, is represented by a Green Asset Ratio (GAR), literally a % of 'EU greenness determined by the weighted sum of all assets' greenness. The greenness of each individual asset is determined as a % of the corporation's revenue that are taxonomy aligned.
For example: if Volkswagen is 7% taxonomy aligned and it represents 1% of the overall portfolio the portfolio will add 0,07% to its overall greenness.

The criteria for sustainability in the car sector were approved with the Climate Delegated Act on January 2022 . The criteria are rather strict as they consider as 'sustainable' cars that emit 50gr $CO_2e$/km (basically EVs and PHEVs) until December 2025 and then, as of January 2026 only EVs or 'zero tailpipe emissions' vehicles (BEV and FCEV).

Corporations will have to disclose their alignment as of 2024 and at the moment the situation is the following:

| Manufacturer | Total vehicles sold | EV PHEV BEV sold | Taxonomy rate |
|---|---|---|---|
| Volkswagen Group | 9,305,400 | 231,600 | 2.49% |
| BMW AG | 2,325,179 | 192,990 | 8,3% |
| Daimler | 2,840,402 | 160,000 | 5.63% |
| Renault–Nissan–Mitsubishi Alliance | 7,830,000 | 116,196 | 1.48% |
| FCA PSA (STELLANTIS) | 6,210,000 | 146,652 | 2.36% |
| Toyota | 9,528,438 | 53,629 | 0.56% |
| Ford | 4,187,000 | 23,000 | 0.55% |
| General Motors | 6,829,000 | 202,488 | 2.97% |
| Hyundai Motor Group | 3,744,737 | 209,724 | 5.60% |
| Honda Motor Group | 4,790,000 | 0 | 0.00% |

Taxonomy scores are far from flattering for most manufacturers, exception made for Tesla that would score 100/100 if it got itself to clear the other five Do No Significant Harm provisions. The score has been structured as a pure impact score on climate mitigation. If compared with the ESG scores it's as if the entire E pillar was computed simply by calculating the % of EVs over the total sold. Unsurprisingly the E score of most raters pale in comparison with the severity of the taxonomy scoring methodology.