Global Sustainable Fund Flows: Q3 2023 in Review

Inflows decrease further amid gloomy markets, but Europe continues to show resilience.

Morningstar Manager Research
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Contents

Key Takeaways

- Global sustainable funds attracted inflows of USD 13.7 billion in the third quarter of 2023, half of the revised USD 23.6 billion in the previous quarter. In comparison, the global mutual fund and ETF universe suffered outflows. Sticky inflation, rising interest rates, and recession fears continued to weigh on investor sentiment.
- Despite the challenging macro backdrop, European sustainable funds remained resilient and garnered USD 15.3 billion of net new money in the third quarter. Although down from the revised USD 25.4 billion in the second quarter, sustainable fund inflows in the last quarter contributed more than two thirds of the overall European fund flows.
- This picture contrasts with the spiraling out of outflows from sustainable funds in the United States, which reached USD 2.7 billion in the third quarter. The rest of the world registered muted subscription, in aggregate.
- Because of falling stock valuations, global sustainable fund assets declined to USD 2.74 trillion at the end of September.
- Slowdown in product development continued. Also, amid greenwashing accusations and regulatory tightening, fewer funds are adding ESG-related terms to their names. Meanwhile, a growing number are removing ESG-related terms from their names in the U.S., but not in Europe.

The Global Sustainable Fund Universe

The global sustainable fund universe encompasses open-end funds and exchange-traded funds that, by prospectus or other regulatory filings, claim to focus on sustainability; impact; or environmental, social, and governance factors[1]. (See the Appendix for more details on how we define the global sustainable fund universe.)

The global universe is divided here into three segments by domicile: Europe, United States, and Rest of World. There is more-granular data available in this report for Canada, Australia and New Zealand, and Japan. China, Hong Kong, India, Indonesia, Malaysia, Singapore, Taiwan, Thailand, and South Korea are grouped under the Asia ex-Japan label because of their relatively low assets.

This report examines recent activity in the global sustainable fund universe and details regional flows, assets, and launches for the third quarter of 2023. A summary is provided in Exhibit 1.

1 Note: This is not the same as the definition under the European Union's Sustainable Finance Disclosure Regulation, which defines "sustainable investments" at a holding level.

Exhibit 1 Global Sustainable Fund Statistics

Q3 2023	**Flows**	**Assets**		**Funds**	
Region	USD Billion	USD Billion	% Total	#	% Total
Europe	15.3	2,293	84	5,608	73
United States	-2.7	299	11	661	9
Asia ex-Japan	2.0	67	2	539	7
Australia/New Zealand	0.0	31	1	268	4
Japan	-0.9	23	1	236	3
Canada	-0.1	31	1	336	4
Total	**13.7**	**2,744**		**7,648**	

Source: Morningstar Direct, Manager Research. Data as of September 2023.

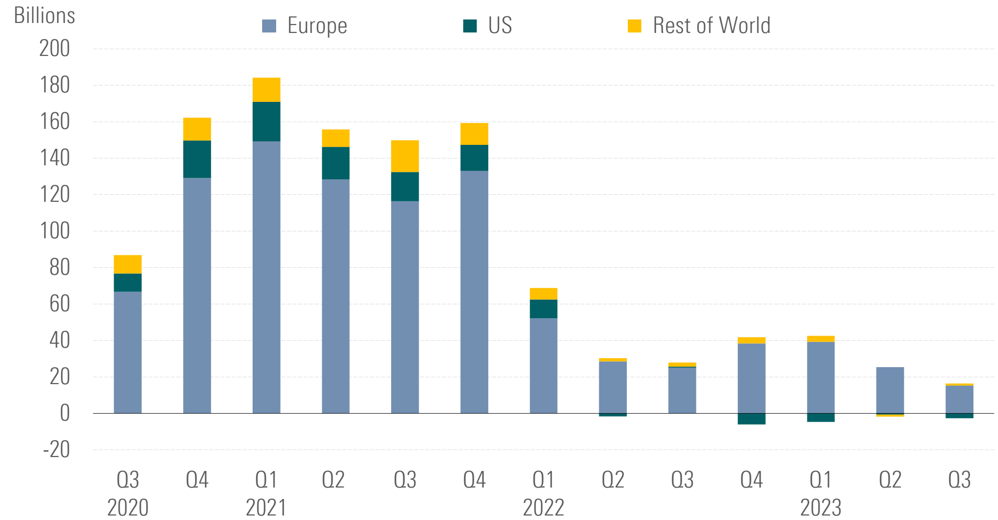
Global Sustainable Fund Inflows Continue to Fall, but Remain Positive

The global universe of sustainable funds attracted close to USD 13.7 billion of net new money in the third quarter of 2023, almost half of the revised USD 23.6 billion in the second quarter, as slowing growth in some of the world's largest economies weighed on most stock and bond markets, against a continuously challenging backdrop of high inflation, rising interest rates, and fears of recession.

The decrease was mirrored by a lower quarterly organic growth rate, or OGR. Calculated as net flows relative to total assets at the start of a period, global sustainable funds saw their organic growth rate decline to 0.5%, from the restated 0.9% in the previous quarter.

Yet, the positive OGR for sustainable funds contrasted with the continued contraction for the overall fund universe from July to September. The global mutual fund and ETF universe suffered almost USD 3 billion of redemptions in the third quarter, down from the restated USD 19 billion in the second quarter. These redemptions contrast with the uptick in inflows of USD 77 billion in the first quarter.

Exhibit 2 Quarterly Global Sustainable Fund Flows (USD Billion)



Source: Morningstar Direct, Manager Research. Data as of September 2023.

Europe, the biggest market for sustainable funds, attracted USD 15.3 billion of net new money in the third quarter, down from the revised USD 25.4 billion in the previous quarter. Other markets registering inflows were Asia ex-Japan, with USD 2 billion of net subscriptions, from the restated USD 1.3 billion three months prior. Flows in Australia and New Zealand experienced a minor pickup as the local sustainable funds attracted USD 30 million after bleeding almost USD 1.7 billion in the second quarter.

Meanwhile, outflows from U.S. sustainable funds spiraled to USD 2.7 billion from the restated USD 576 million in the previous quarter. In Japan, net withdrawals were almost USD 900 million, slightly down from the USD 1.1 billion in outflows registered in the second quarter. In Canada, sustainable funds registered their first quarter of net outflows, with net redemptions amounting to USD 52 million.

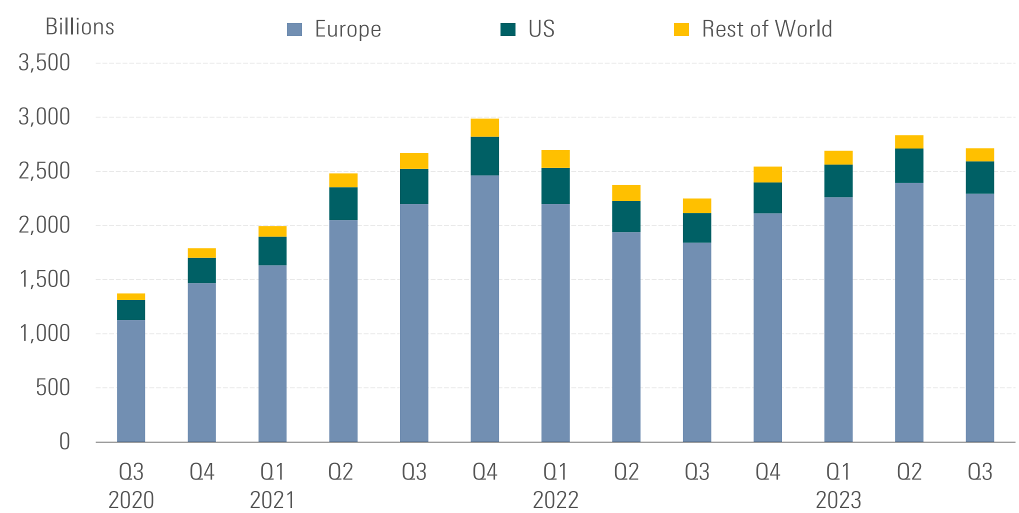
Global Assets Slip Amid Market Turbulence

Global sustainable fund assets declined by 4.2% to USD 2.74 trillion at the end of the third quarter, from USD 2.86 trillion three months earlier. By comparison, the global mutual fund and ETF market slid by 5%. Market volatility and global macroeconomic pressures, including persistent inflation, climbing interest rates, and fears of recession, have contributed to this retreat. For context, although the Morningstar US Market Index is up 12.8% so far in 2023, it fell by 3.2 percentage points in the third quarter. Fixed-income markets, as illustrated by the Morningstar US Core Bond Index, also fell by 3.2 percentage points in the third quarter, extending year-to-date losses to negative 1.2%.

Europe continued to make up the lion's share of the sustainable fund landscape, with 85% of global sustainable fund assets. It also remains by far the most developed and diverse ESG market, followed by the United States, which housed 11% of global sustainable fund assets at the end of September 2023.

Asia ex-Japan, of which China is the biggest sustainable market with more than 67% of the region's asset base, ranks third in terms of sustainable fund market size.

Exhibit 3 Quarterly Global Sustainable Fund Assets (USD Billion)

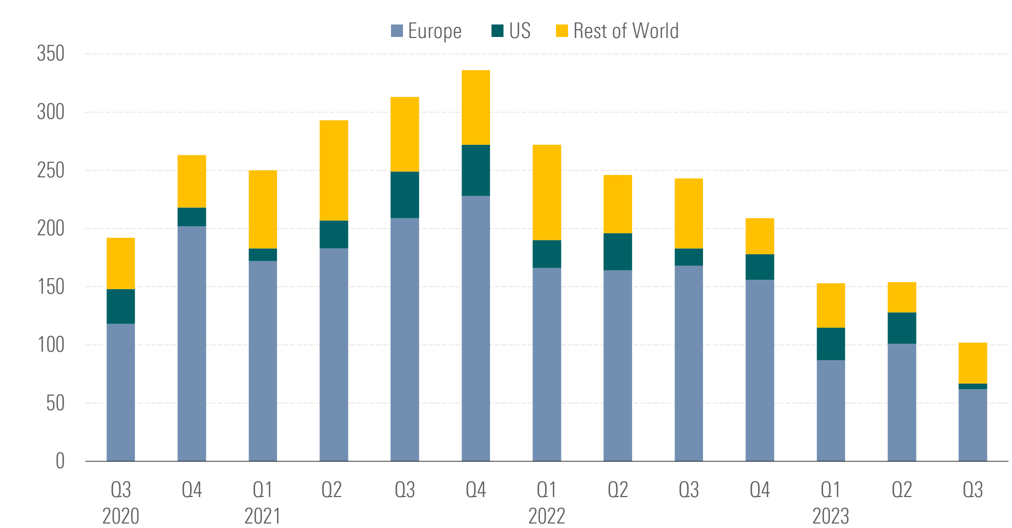


Source: Morningstar Direct, Manager Research. Data as of September 2023.

Global Fund Launches

An estimated 102 new sustainable funds hit the shelves globally in the third quarter, down from the restated number of 154 launched in the second quarter of 2023. However, the number of 102 will likely also be restated upward in our next report as we identify more launches and additional ones are reported to Morningstar.

Exhibit 4 Global Sustainable Fund Launches per Quarter



Source: Morningstar Direct, Manager Research. Data as of September 2023.

The cooldown in new sustainable product development was entirely driven by a significant reduction of new sustainable fund launches in Europe, which almost halved. Product development in the U.S. also reached its historical low with only five new launches, and the rest of the world was mixed.

Global Regulatory Update

In September 2023, the Taskforce on Nature-related Financial Disclosures, or TNFD, launched the final set of disclosure recommendations and guidance, a comprehensive framework for organizations to report and address their ever-evolving dependencies, impacts, risks, and opportunities related to nature. It was built on the Financial Stability Board's Task Force on Climate-related Financial Disclosures', or TCFD's, recommendations to provide a similar approach and enable integrated climate and nature reporting.

More regulatory updates can be found in each regional section in this report.

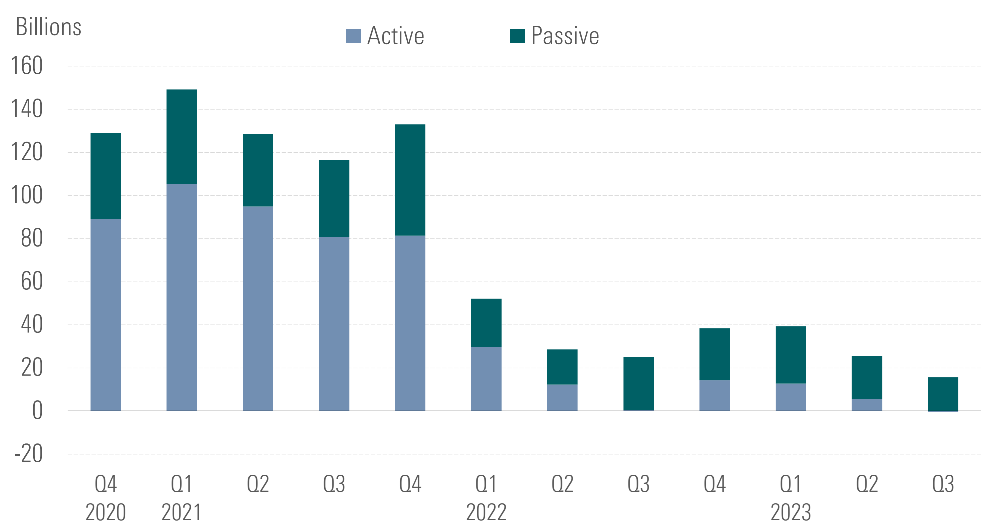
Quarterly Statistics per Domicile

Europe

Weak Inflows Extend Into the Third Quarter; Active Funds Register Outflows for the First Time

Weak inflows extended into the third quarter of 2023, as net new money into European sustainable funds reached an estimated new low of USD 15.3 billion from the restated USD 25 billion in the previous quarter. The lower subscriptions were dragged mostly by the slight estimated outflows of USD 402 million from the actively managed sustainable strategies.

Exhibit 5 European Sustainable Fund Flows (USD Billion)

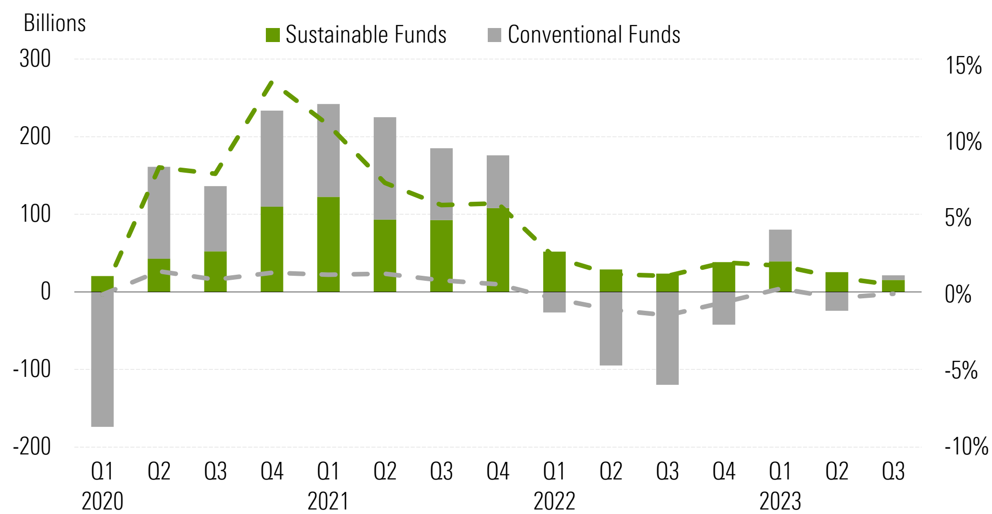


Source: Morningstar Direct, Manager Research. Data as of September 2023.

The decline in net inflows was echoed by a declining organic growth rate. Calculated as net flows relative to total assets at the start of a period, the organic growth rate for the European sustainable fund universe in the third quarter fell to 0.6%, compared with 1.1% in the previous quarter.

However, sustainable funds contributed more than two thirds of the overall European fund flows. Flows into European conventional funds showed a minor pickup of just over USD 6 billion in the past three months, after bleeding almost USD 25 billion in the second quarter of 2023. Although global inflationary pressures subsided, indications that central banks may keep interest rates high for longer weighed on stock and bond markets.

Exhibit 6a European Sustainable Fund Flows Compared With Conventional Fund Flows (USD Billion)



Source: Morningstar Direct, Manager Research. Data as of September 2023.

Exhibit 6b European Sustainable Fund Flows Compared With Conventional Fund Flows by Asset Class (USD Billion)

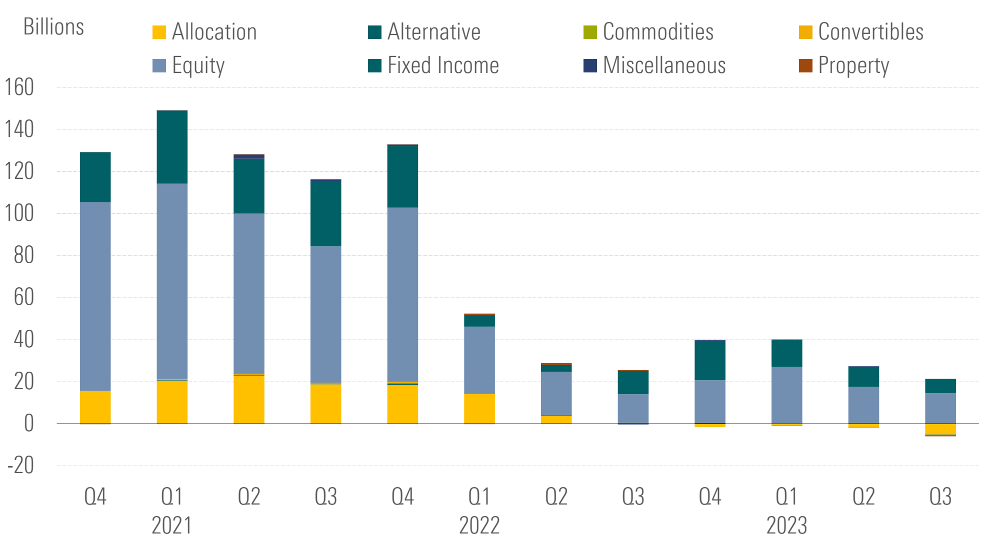
USD Billion	Sustainable Funds		Conventional Funds		Overall Fund Universe	
	Q2 2023	Q3 2023	Q2 2023	Q3 2023	Q2 2023	Q3 2023
Allocation	-1.4	-5.2	-10.5	-11.8	-11.8	-17.0
Alternative	0.2	0.0	-6.2	-6.1	-6.0	-6.1
Commodities	0.1	0.0	-2.9	-4.0	-2.8	-4.0
Convertibles	-0.4	-0.3	-1.6	-1.4	-2.0	-1.7
Equity	17.2	14.5	-32.7	17.3	-15.5	31.8
Fixed Income	9.6	6.8	30.2	15.5	39.8	22.3
Miscellaneous	0.2	0.0	0.8	-0.9	1.0	-1.0
Property	-0.1	-0.4	-2.1	-1.5	-2.1	-2.0
Total	**25.4**	**15.3**	**-24.9**	**7.0**	**0.5**	**22.3**

Source: Morningstar Direct, Manager Research. Data as of September 2023.

In the sustainable fund universe, equity remained the most favored asset class, pocketing almost USD 15 billion over the last three months. Meanwhile, sustainable bond funds gathered only USD 6.8 billion, reduced by almost one third compared with the USD 9.6 billion restated for the second quarter. Conventional bond fund flows softened as well. The prospect of high financing costs for longer coupled with slowing growth in some of the world's largest economies weighed on stock and bond markets.

Sustainable allocation funds continued bleeding assets for the fourth-consecutive quarter. Withdrawals rose to over USD 5 billion in the third quarter from the previous quarter's USD 1.4 billion.

Exhibit 7 European Sustainable Fund Flows by Asset Class



Source: Morningstar Direct, Manager Research. Data as of September 2023.

Leaders and Laggards

Among the bestselling sustainable products in the third quarter of 2023, we continue to see a strong presence of passive products netting altogether almost USD 4.5 billion of net new money.

BlackRock ACS US ESG Insights Equity Fund and **BlackRock ACS US Equity Tracker Fund** rose to the top two places of the bestselling leaderboard, with combined inflows of USD 2.2 billion. In a close third place is a new entry, **JPMorgan US Research Enhanced Index Equity (ESG) ETF**. The fund is actively managed and invests at least 51% of its assets in companies with positive ESG characteristics.

Exhibit 8a Top 10 European Sustainable Fund Flows in Third-Quarter 2023

Fund Name	Net Flows (USD, Million)
BlackRock ACS US ESG Insights Equity Fund	1,155
BlackRock ACS US Equity Tracker Fund	1,059
JPMorgan US Research Enhanced Index Equity (ESG) ETF	890
BlackRock CCF Developed World Paris-Aligned Climate Index Fund	814
Storebrand Global Plus	806
DNCA Invest Alpha Bonds	755
JPMorgan Global Research Enhanced Index Equity (ESG) ETF	718
Länsförsäkringar Global Index	690
Amundi MSCI USA SRI PAB	613
iShares MSCI World SRI ETF	610

Source: Morningstar Direct, Manager Research. Data as of September 2023.

At the other end of the spectrum, **Northern Trust World Custom ESG Equity Index Fund** tracks an index that aims to exclude companies not considered to meet socially responsible principles identified by applying criteria that refer to the United Nations Global Compact 10 principles, as well as other ESG criteria selected by the asset manager.

The second fund registering the largest outflows in the third quarter, **iShares Environment & Low Carbon Tilt Real Estate Index Fund (UK),** tracks an index, which, after screening out nonrenewable energy, tobacco, weapons, and controversies, reweighs the remaining constituents based on three sustainable-investment considerations, including green building certification, energy usage, and carbon emissions. At the third place of the worst-sellers, **Allianz Nest Style US Equity** bled over USD 600 million. The Article 8 product follows a socially responsible investing strategy, excluding the worst issuers based on their SRI ratings. The screening achieves a 20% reduction of the initial investment universe.

Exhibit 8b Bottom 10 European Sustainable Fund Flows in Third-Quarter 2023

Fund Name	Net Flows (USD, Million)
Northern Trust World Custom ESG Equity Index Fund	-861
iShares Environment & Low Carbon Tilt Real Estate Index Fund (UK)	-734
Allianz Best Styles US Equity	-616
Multi Manager Access US Multi Credit Sustainable	-509
HSBC Asia Pacific Ex Japan Sustainable Equity ETF	-483
Vontobel Sustainable Emerging Markets Leaders	-471
Carmignac Patrimoine	-435
Fidelity Sustainable Research Enhanced US Equity ETF	-435
Swisscanto (CH) IPF II EF Resp World ex CH	-417
BNP Paribas Easy MSCI Europe SRI S-Series PAB 5% Capped	-403

Source: Morningstar Direct, Manager Research. Data as of September 2023.

Differing from the previous quarter, Exhibit 8b features a strong presence of equity strategies including two dedicated to the U.S. market. Fear that the Federal Reserve will keep interest rates higher for longer than previously expected weighed on stocks.

The aggregate inflows among the top 10 bestselling firms netted almost USD 18 billion in the third quarter, an almost 15% contraction from the previous quarter. By and large, such a decrease was due to the decelerated inflows into BlackRock's, Swisscanto's, and Natixis' sustainable funds, leading a significant reshuffle of the ranking below compared with the previous quarter. Seven out of the 10 firms were new entries, including Amundi, Storebrand, Länsförsäkringar, KBC, Pimco, and ABN AMRO.

Exhibit 9a Top 10 European Sustainable Fund Providers by Flows in Third-Quarter 2023

Firm	Net Flows (USD Million)
BlackRock (incl. iShares)	5,968
JPMorgan	2,133
Amundi (incl. Lyxor)	1,936
Swisscanto	1,743
Storebrand Fonder	1,533
Länsförsäkringar	1,451
KBC	1,307
Natixis	914
Pimco	628
ABN AMRO	619

Source: Morningstar Direct, Manager Research. Data as of September 2023.

At the other end of the spectrum, Eurizon topped the ranking of the outflows of sustainable fund managers because of outflows across several of its sustainable products over the third quarter, including **Eurizon Next Strategia Azionaria ESG**, **Eurizon, Equity Europe ESG LTE**, and **Eurizon Equity USD ESG LTE**. Fidelity International followed closely, with over USD 900 million in outflows, attributed mostly to **Fidelity Sustainable Research Enhanced US Equity ETF.**

Exhibit 9b Bottom 10 European Sustainable Fund Providers by Flows in Third-Quarter 2023

Firm	Net Flows (USD Million)
Eurizon	-1,003
Fidelity International	-906
CPR Asset Management	-872
Pictet	-870
Northern Trust	-828
Allianz Global Investors	-736
Carmignac	-703
abrdn	-627
Liontrust	-605
UBS	-503

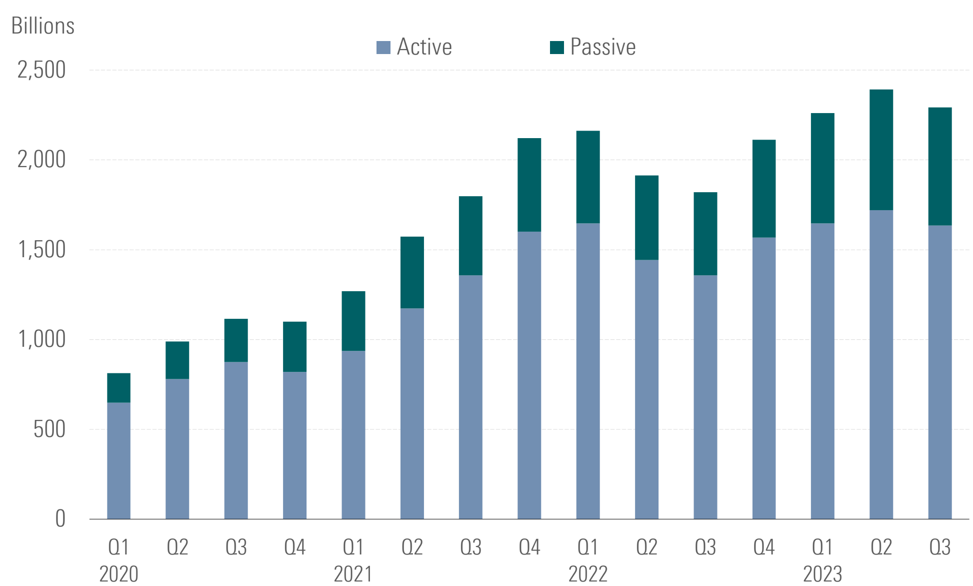
Source: Morningstar Direct, Manager Research. Data as of September 2023.

European Sustainable Funds Assets Retreat From Historical High

Price depreciation across most equity and bond markets caused assets in European sustainable funds to retreat from the historical high of USD 2.39 trillion to USD 2.29 trillion, representing a 4.2% fall. For context, although the Morningstar US Market Index is up 12.8% so far in 2023, it fell by 3.2% in the third quarter. Fixed-income markets, as illustrated by the Morningstar US Core Bond Index, also fell by 3.2% in the third quarter, extending year-to-date losses to negative 1.2%.

The market share of sustainable funds in Europe stood at 21% at the end of September.

Exhibit 10 European Sustainable Fund Assets (USD Billion)



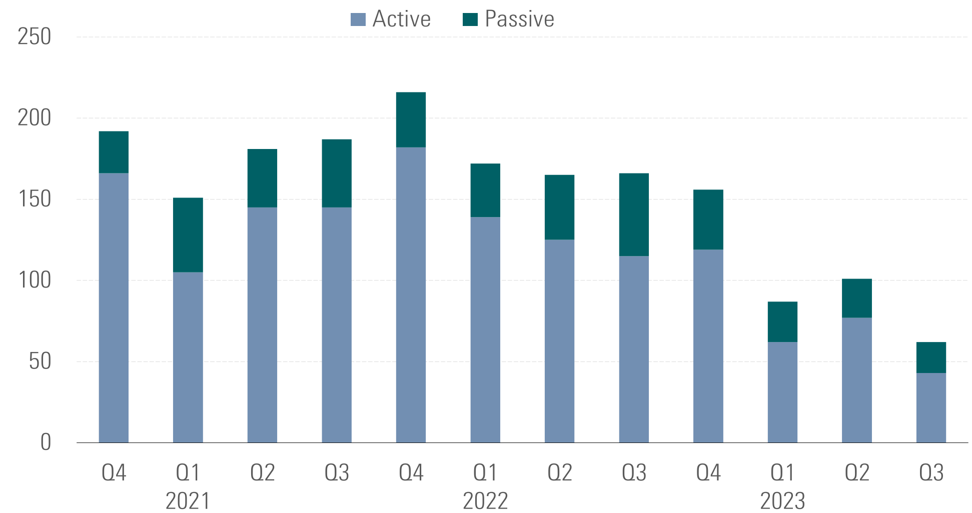
Source: Morningstar Direct, Manager Research. Data as of September 2023.

Sustainable funds should continue to gain ground as investor demand for strategies that align with their sustainability preferences continues to grow, prompting asset managers to launch additional sustainable products and repurpose existing conventional ones. The MiFID II amendment, which came into effect in August 2022 and which requires financial advisers to consider their clients' sustainability preferences, has the potential to accelerate adoption of sustainable investments among retail investors.

Launches Slow Down

Product development slowed in the third quarter of 2023, with the number of newly launched sustainable funds reaching a historical low of 62, from the restated 101 in the second quarter. However, it is likely that the third-quarter 2023 number will be restated in future reports as we identify more launches and additional ones are reported to Morningstar.

Exhibit 11a European Sustainable Fund Launches



Source: Morningstar Direct, Manager Research. Data as of September 2023.

The slowdown in new products can be attributed partly to the overall market sentiment damped by the challenging macro backdrop. This is also reflected in the number of new conventional strategy launches, which remains low. But asset managers have also been more cautious in their development of new ESG and sustainable strategies because of greenwashing accusations and the uncertainties of the regulatory environment.

For more details on SFDR: Read SFDR Article 8 and Article 9 Funds: Q3 2023 in Review

The table below shows the 10 largest new fund launches in the third quarter, with equity and bond strategies equally splitting the list. While the Fed hit the pause button on its rate-hiking plans, the European Central Bank continued to tighten in September, bringing rates to the highest level since the creation of the eurozone, making fixed income a more attractive asset class for investors. The overwhelming majority of newly incepted funds distributed in Europe were classified as Article 8 under the Sustainable Finance Disclosure Regulation, or SFDR.

Exhibit 11b Top 10 European Sustainable Fund Launches

Fund Name	SFDR Fund Type	Size (USD Million)
Amundi MSCI USA ESG Leaders ETF	Article 8	2,260
BlackRock CCF Developed World Paris-Aligned Climate Index Fund	Article 8	764
Amundi MSCI World ESG Leaders ETF	Article 8	715
CT (Lux) Sustainable Global Equity Enhanced Income Fund	Article 8	452
Robeco Climate Global High Yield Bonds	Article 9	127
Swiss Life Bond ESG US Corporates	Article 8	99
Caixa Obrigações Fundo De Investimento Mobiliário Aberto De Obrigações	Article 8	82
Swedbank Robur Climate Bond	Article 9	56
JPMorgan Global Short Duration Corporate Bond Sustainable Fund	Article 8	54
HANetf European Green Deal ETF	Article 8	52

Source: Morningstar Direct, Manager Research. Data as of September 2023.

While broad sustainable and ESG offerings continued to account for most of the product development in the last three months, climate remained by far the most popular theme, taking up over one third (24 products) of new product launches.

These new climate fund launches were mostly climate transition and climate solution strategies, as per Morningstar's own classification[2]. Examples include **BlackRock CCF Developed World Paris-Aligned Climate Index Fund** and **HANetf European Green Deal ETF**. The latter invests in companies that could potentially benefit from the "European Green Deal"[3], a policy initiative enacted by the European Commission in 2020 aimed at making Europe the first climate-neutral continent. Stocks are selected based on their exposure to four key policy areas, including clean energy, sustainable mobility, building and renovation, and circular economy.

While not listed above, **Robeco** launched **Climate Global High Yield Bonds,** which offers access to the high-yield market with a significantly lower carbon impact than traditional high-yield products. The latter traditionally tend to have a higher carbon footprint compared with investment-grade bonds because of the sector composition and industry focus. Starting with a 50% lower carbon intensity than the current investment universe and excluding fossil-fuel-related activities, the Article 9 strategy also contributes to a 7% reduction in overall emission intensity in the portfolio on a yearly basis. Despite its recent inception, the fund netted over USD 128 million in assets as of September 2023.

Furthermore, among the new launches, we see several strategies that target other sustainable themes, including biodiversity, health and wellbeing, social fairness, and inclusion, as well as anticorruption. For example, Franklin Templeton launched **Franklin Future of Health and Wellness ETF**, which targets companies from developed markets that use technology and demonstrate innovation within the healthcare industry as well as companies enabling access to care, health, or wellness provision. With ongoing geopolitical tensions increasingly affecting financial markets, **TOBAM Civil Liberty and**

2 https://www.morningstar.com/en-uk/lp/investing-in-times-of-climate-change

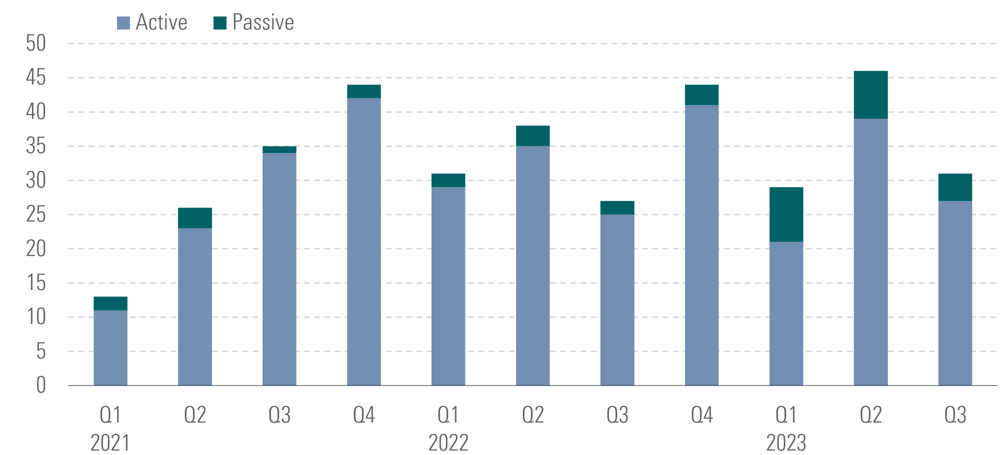
3 https://commission.europa.eu/strategy-and-policy/priorities-2019-2024/european-green-deal_en

Democracy All Countries World Equity Fund seeks to lower the risk exposures to nondemocratic countries based on factors such as civil liberty, inclusiveness, rule of law, and corruption.

Closures

So far this year, the European sustainable fund universe saw the closure of 106 funds, including 31 in the third quarter of 2023. This compares with 96 and 74 in the first nine months of 2022 and 2021, respectively. While the number of closures has increased, the rise should be put in perspective of the expansion of the overall sustainable fund universe, which has grown to 5,608 at the end of third-quarter 2023 from 3,444 at the end of first-quarter 2021.

Exhibit 11c European Sustainable Fund Closures



Source: Morningstar Direct, Manager Research. Data as of September 2023.

Renaming

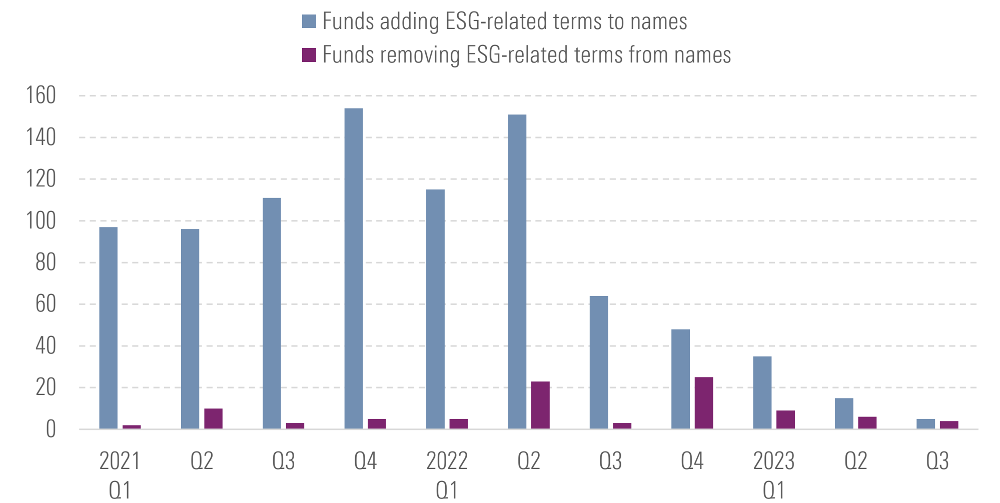
We regularly report on funds that add ESG-related terms to their name and adjust their mandates accordingly.[4] As seen in the exhibit below, the number of such funds increased significantly in 2021 but has since declined, reaching only five in the third quarter of this year. We have also started to track funds that do the opposite, that is funds that remove ESG-related terms from their names, either by fear of being accused of greenwashing or because of tighter regulation[5]. But as the same exhibit shows, we're not seeing a notable increase this year compared with last year.

Examples of funds that rebranded in the last three months include **LLB Strategie TR Ausgewogen ESG Amundi MSCI Digital Economy** and **Metaverse ESG Screened ETF, MetWest Sustainable Securitized Fund, Lumyna-MW TOPS Environmental Focus (Market Neutral) Fund and Vontobel Global Environmental Change.**

4 Rebranded_ESG_funds.pdf (contentstack.io)

5 In November 2022, the European Securities and Markets Authority, or ESMA, launched a consultation on fund names. Under the proposed guidelines, a fund would only be able to use ESG-related words in its name if 80% of its investments meet environmental or social characteristics or sustainable-investment objectives. A fund with *sustainable* in its name, or words derived from it, would need to meet an additional 50% threshold related to sustainable investments.

Exhibit 11d European Rebranded Funds



Source: Morningstar Direct, Manager Research. Data as of September 2023.

Examples of funds that dropped ESG-related terms from their names in the last three months include **Morgan Stanley US High Yield Bond Fund** (previously named **Morgan Stanley Sustainable US High Yield Bond Fund**) and **SBI Global Equity Bond Balance Fund Hedged** (previously branded as **SBI Global ESG Balance Fund UnHedged**).

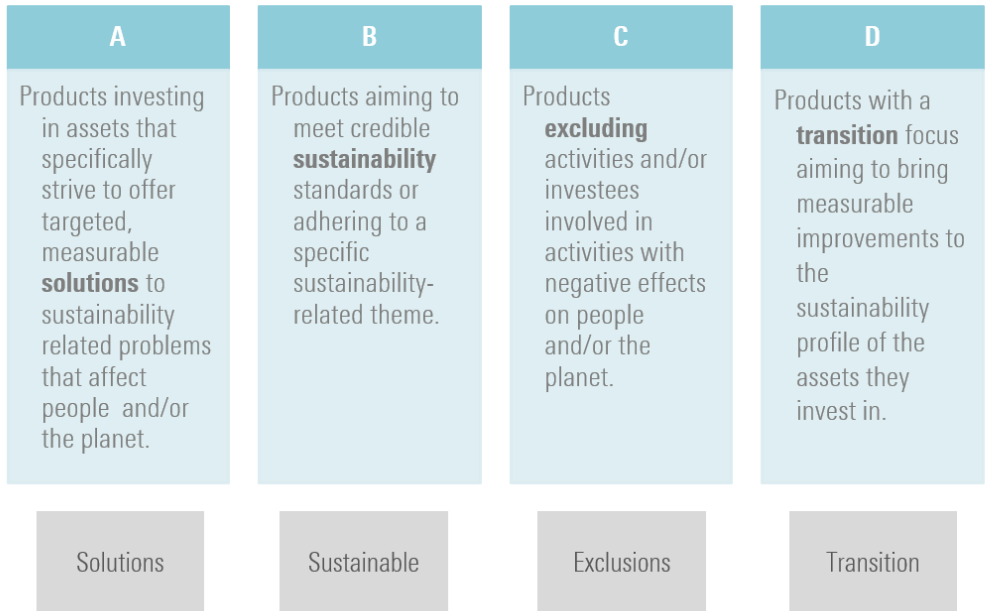
Regulatory Update

On Sept. 14, 2023, the European Commission published a consultation on the functioning and future of the SFDR. This represents the first step in a process that may lead to significant amendments to the current SFDR regime. The scope and detail of the questions asked in the consultation papers speak to Brussels' serious concerns about the implementation of the SFDR since its introduction in March 2021, as well as its increasing contemplation of an overhaul of the existing framework. While any proposed changes would not come into force for several years, asset managers and other financial market participants should expect continuing legal uncertainty as it relates to future obligations under the SFDR.

The consultation focuses on legal certainty, the usability of the regulation, and its ability to play its part in tackling greenwashing. Under this document, the EC asks a wide range of questions, including the opportunity to replace Article 8 and Article 9 with new labels resembling the U.K. draft sustainable labels (see exhibit below), the relevance of principal adverse impact, or PAI, disclosures at entity level, and the opportunity to require sustainability disclosure for all products offered in the EU regardless of their sustainability claims. The European Commission has set a deadline of Dec. 15, 2023, for feedback and aims to publish a finalized report on the SFDR in second-quarter 2024.

For more details on SFDR: Read SFDR Article 8 and Article 9 Funds: Q3 2023 in Review

Exhibit 12 Proposed Categories of Sustainability Products in the EC's SFDR Consultation Paper



Source: Morningstar Research based on our interpretation of the TARGETED CONSULTATION DOCUMENT - IMPLEMENTATION OF THE SUSTAINABLE FINANCE DISCLOSURES REGULATION (SFDR) - Question 4.1.4., Page 32. The label's names are indicative and based on Morningstar's interpretation of the description of the categories.

The SFDR consultation comes right after the one put forward by the European Supervisory Authorities on the delegated regulation of SFDR, which closed on July 4, 2023. The current EC is expected to leave it up to the next legislature to decide how to act on the findings of both consultations.

In the meantime, the Dutch Authority for the Financial Markets, or AFM, published Guidelines on Sustainability Claims for financial institutions and pension providers, describing the use of the SFDR classification as a means of promoting products "undesirable."

In the context of the broad SFDR consultation, it's unclear if ESMA will finalize the guidelines on the use of ESG-related terms[6]. A recent study by ESMA seems, however, to indicate that it could well be a possibility: '*Our findings support recent regulatory efforts – both in the EU and abroad – regarding disclosure requirements for investment funds. For example, the evolution of ESG language in fund names demonstrates the usefulness of ESMA's recent public consultation on guidelines to ensure fund names accurately reflect their portfolio from an ESG perspective*.'

6 For a reminder, ESMA had proposed to raise the bar for Article 8 funds:

- if the fund uses ESG-related words in its name, at least 80% of its investments should meet E/G characteristics;
- if the fund uses sustainability-related terms in its name, it should also have at least 50% of investments meeting the definition of sustainable investment;
- Funds using *ESG* or sustainable-related terms should comply with the exclusions set for EU Paris-aligned benchmarks (for example, controversial weapons, tobacco, UNGC and OECD Multinational Enterprises violators, coal, fossil fuels, and so on).

The UK Financial Conduct Authority has further delayed the publication of its own version of SFDR—namely, Sustainability Disclosure Requirements, or SDR—to fourth-quarter 2023. For a reminder, in October 2022, the FCA had published CP 22/20 on the SDR. This set out the FCA's proposals for a regime that would increase transparency on the sustainability profile of products and firms and reduce the risk of harm arising from greenwashing, notably by mandating funds using ESG-related terms to pick between three labels: sustainable focus, sustainable improvers, and sustainable impact.

On the issuer disclosure side, on July 31, the European Commission published the European Sustainability Reporting Standards, or ESRS, to implement the recently adopted Corporate Sustainability Reporting Directive, or CSRD. This proposal replacing the Non-Financial Reporting Directive is meant to further help investors and other stakeholders to evaluate the sustainability performance of companies, as part of the European Green Deal. It covers a broad of range of quantitative and qualitative information across a wide range of E, S, and G topics that needs to be disclosed against by issuers operating in the EU, subject to double materiality assessment. The CSRD requires "limited assurance" of compliance with reporting obligations under the CSRD (and ESRS) as well as EU Taxonomy Regulation disclosures. The EC originally estimated that, from 2024 onward, the new directive and standards should affect 50,000 companies. But the EC just announced as part of its 2024 working program that it will adjust the thresholds under the accounting directive, carving out a large part of small and medium-size enterprises that were intended to be captured by CSRD.

The U.K. FCA confirmed in August 2023 that the U.K. Sustainability Disclosure Standards, or U.K. SDS, will be based on the International Financial Reporting Standards' Sustainability Disclosure Standards issued by the International Sustainability Standards Board, or ISSB[7], and will only depart from those global standards "if absolutely necessary for UK specific matters." The FCA intends to consult in the first half of 2024 on its proposal for listed companies and aims to finalize its policy position by the end of 2024, with first report due in 2026 (fiscal-year 2025). The FCA would mandate ISSB disclosures for listed issuers.

Building off the success of the Taskforce on Climate-related Finance Disclosures, the International Sustainability Standards Board disclosure requirements follow the same four key areas, while surpassing TCFD in terms of specificity and sophistication. The ISSB standards also come with industry-based guidance to enable more companies in more areas of the global economy to disclose their approaches to physical climate risk and climate transition risk. For more info: What the New ISSB Climate Standard Means for Investors (from Sustainalytics, a division of Morningstar).

7 ISSB published its first two new standards on June 26, 2023. They are IFRS S1: General Requirements for Disclosure of Sustainability-related Financial Information and IFRS S2: Climate-related Disclosures.

United States

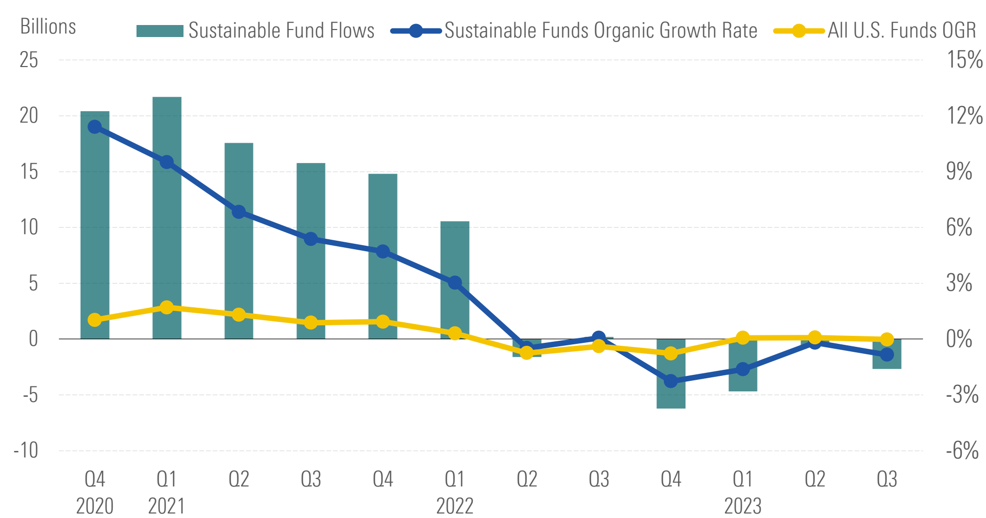
Weaker Demand for Sustainable Funds Persists

Investors pulled USD 2.7 billion from sustainable funds in 2023's third quarter, for a total of USD 14.2 billion from these funds over the past year.[8] These withdrawals mark the segment's fourth-consecutive quarter of net outflows and the fifth period of losses since 2022's first quarter.

Market volatility and global macroeconomic pressures, including persistent inflation, climbing interest rates, and fears of recession, have contributed to this retreat. For context, although the Morningstar US Market Index is up 12.8% so far in 2023, it fell 3.2% in the third quarter. Fixed-income markets, as illustrated by the Morningstar US Core Bond Index, also fell 3.2% in the third quarter, extending year-to-date losses to negative 1.2%. Another factor continuing to weigh on investor demand for ESG products is the political backlash against sustainable investing in the United States.

Although the broader universe of U.S. long-term funds lost nearly USD 3.9 billion over the period, the relative decline in demand was more significant for sustainable funds, compared with conventional peers.

Exhibit 13 U.S. Fund Flows: Sustainable vs. All U.S. Funds (USD Billion)



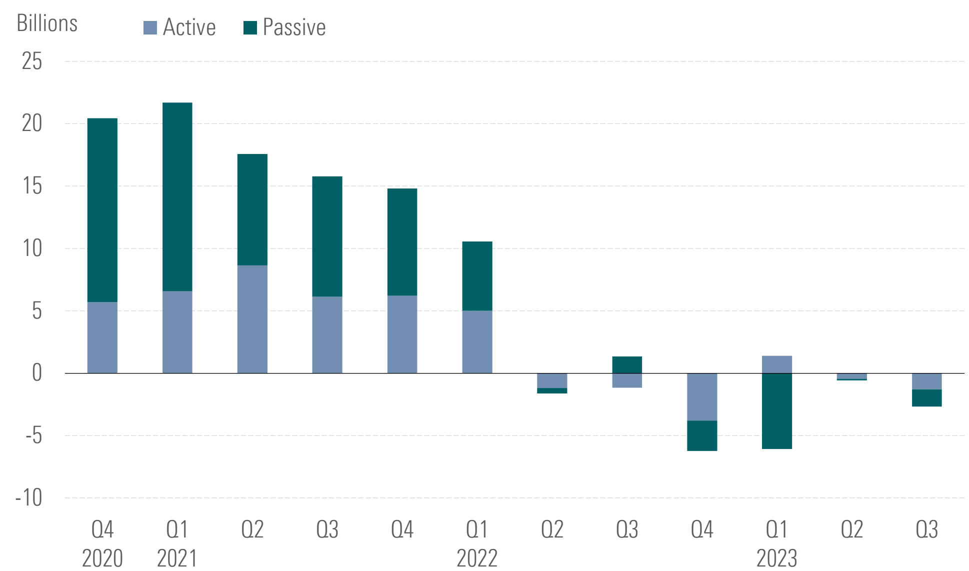
Source: Morningstar Direct, Manager Research. Data as of September 2023.

Consequently, for the fourth quarter in more than five years, the U.S. sustainable funds segment saw a lower organic growth rate than the total U.S. fund universe. Calculated as net flows as a percentage of total assets at the start of a period, the organic growth rate puts the magnitude of fund flows into perspective. During the third quarter, sustainable funds contracted by 0.85% compared with a tiny 0.02% decline in the overall U.S. funds landscape.

8 In the U.S., funds of funds are included in the count of funds but excluded from flows and assets calculations.

Outflows were split almost evenly between actively managed funds and index-tracking counterparts. Both groups shed more than USD 1.2 billion apiece during the period. Sustainable actively managed funds and their passive peers have suffered outflows in five of the past six quarters. As shown in the exhibit below, passive funds saw inflows during 2022's third quarter, and actively managed funds collected flows in 2023's first quarter.

Exhibit 14 U.S. Sustainable Fund Flows (USD Billion)



Source: Morningstar Direct, Manager Research. Data as of September 2023.

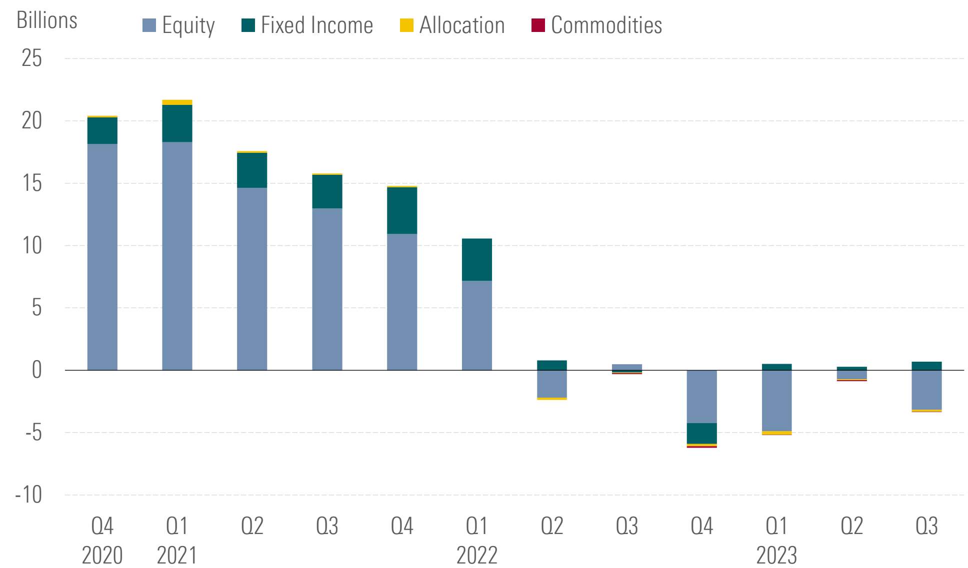
One passive fund – iShares ESG Aware MSCI USA ETF ESGU – lost nearly USD 2.1 billion during the quarter. Without this fund, sustainable passive funds would have seen minor gains.

Similarly, one fund accounted for nearly half of the quarter's withdrawals from actively managed offerings. Parnassus Core Equity PRBLX lost more than USD 600.7 million during the quarter, marking its eighth-consecutive quarter of outflows.

Bond Funds Continue to Attract Net New Money Amid Rising Rates

Sustainable bond funds were the lone recipients of net new money for the third-consecutive quarter in the U.S. Sustainable fixed-income offerings collected nearly USD 689.3 million as investors sought to lock in attractive yields.

Exhibit 15 U.S. Sustainable Fund Flows by Asset Class



Source: Morningstar Direct, Manager Research. Data as of September 2023.

On the other hand, sustainable equity funds endured a fourth-consecutive quarter of outflows in the U.S. Affected funds range from diversified offerings that seek to minimize environmental and social risks to more-concentrated strategies in renewable energy or electric vehicles[9]. IShares Global Clean Energy ETF ICLN is the largest U.S. climate fund but shed more than USD 794.2 million so far this year.

Barely visible in the exhibit above, sustainable commodity funds debuted in 2022's third quarter and have suffered outflows in every quarter since. There are just 13 sustainable commodity funds in the U.S. sustainable funds landscape, most of which trade carbon credits. The largest is KraneShares Global Carbon ETF KRBN, with nearly USD 486.5 million in assets at the end of 2023's third quarter.

Leaders and Laggards

The third quarter's biggest winner extended its streak at the front of the pack. IShares ESG U.S. Aggregate Bond ETF EAGG has landed among the top 10 flow recipients for the past five quarters, collecting nearly USD 1.5 billion over that time.

9 For more insights on climate funds: https://www.morningstar.com/en-uk/lp/investing-in-times-of-climate-change

Exhibit 16a Top 10 U.S. Sustainable Fund Flows

Fund Name	Net Flows (USD Million)
iShares ESG U.S. Aggregate Bond ETF	470
iShares MSCI USA ESG Select ETF	436
Goldman Sachs International Equity ESG	248
First Trust NASDAQ Clean Edge Smart Grid Infrastructure	230
Fidelity US Sustainability Index	205
Brown Advisory Sustainable Growth	195
Vanguard FTSE Social Index	134
Calvert Core Bond	124
iShares ESG USD Corporate Bond ETF	99
IQ Candriam U.S. Mid Cap Equity ETF	94

Source: Morningstar Direct, Manager Research. Data as of September 2023.

Two additional bond funds have benefited from inflows as investors seek to lock in attractive yields. Calvert Core Bond CLDAX collected USD 124.4 million during the quarter, driving a substantial 20% organic growth rate. This marked the fund's seventh-consecutive quarter of net inflows. IShares ESG USD Corporate Bond ETF SUSC saw USD 99.2 million in net new money during the quarter.

The newest fund to reach the top 10 flow recipients is IQ Candriam U.S. Mid Cap Equity ETF IQSM, which launched in October 2022 and raised nearly USD 172.1 million in its first year. Well known in Europe, this is only Candriam's third U.S.-domiciled fund. The firm also earns a Morningstar ESG Commitment Level of Advanced.

The Largest Sustainable Funds Extend Their Outflows

With USD 25.5 billion and USD 12.1 billion in assets, respectively, Parnassus Core Equity and iShares ESG Aware MSCI USA ETF are two of the largest funds in the U.S. sustainable funds landscape. These two funds have also landed among the 10 biggest losers for each of the past four quarters.

Exhibit 16b Bottom 10 U.S. Sustainable Fund Flows

Fund Name	Net Flows (USD Million)
iShares ESG Aware MSCI USA ETF	-2,078
Parnassus Core Equity	-601
iShares Global Clean Energy ETF	-278
Parnassus Mid-Cap	-229
TIAA-CREF Social Choice Equity	-185
Pioneer	-175
iShares ESG Aware MSCI EM ETF	-160
Calvert Equity	-155
Impax Large Cap	-118
Global X Conscious Companies ETF	-115

Source: Morningstar Direct, Manager Research. Data as of September 2023.

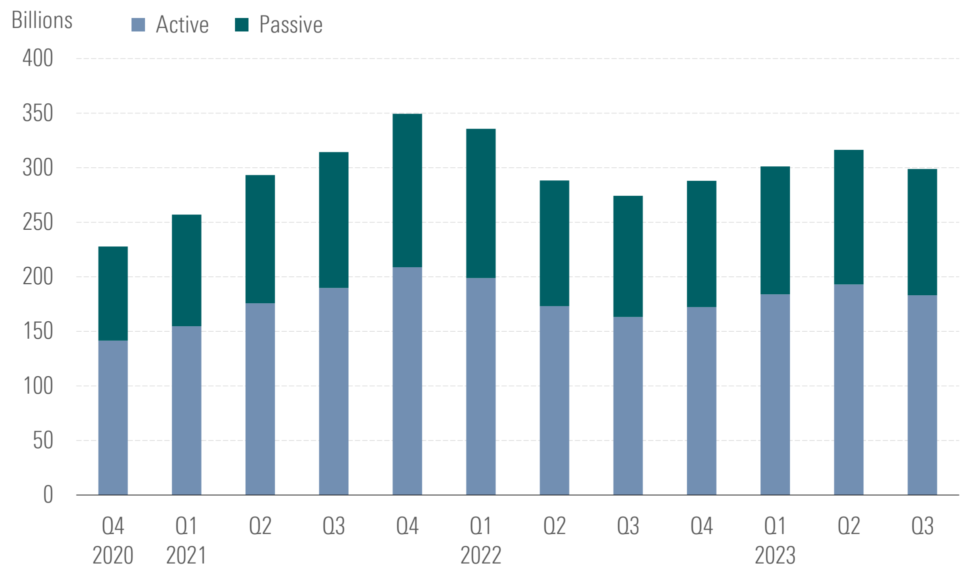
Parnassus Core Equity has been one of the 10 biggest losers for two years straight, shedding more than USD 3.9 billion over that period. Parnassus attributes a portion of the fund's outflows to the launch of a less-expensive collective investment trust and the subsequent conversion of investors from one vehicle to the other. Our data includes only open-end and exchange-traded funds.

IShares ESG Aware MSCI USA ETF once featured in BlackRock's flagship Target Allocation ETF model portfolio series, which boosted demand for this fund since 2020. Following a change to the model portfolios, this fund has shed more than USD 9.2 billion so far in 2023, driving a 47% contraction to the fund's asset base.

Assets in U.S. Sustainable Funds Waver

Driven by withdrawals and broad market volatility, assets in sustainable funds shrank back below USD 298.8 billion mark at the end of 2023's third quarter. This represents a 17% decline from the all-time record of USD 358.2 billion at the end of 2021 but a 10% increase from the recent low of USD 272.2 billion in 2022's third quarter.

Exhibit 17 U.S. Sustainable Fund Assets

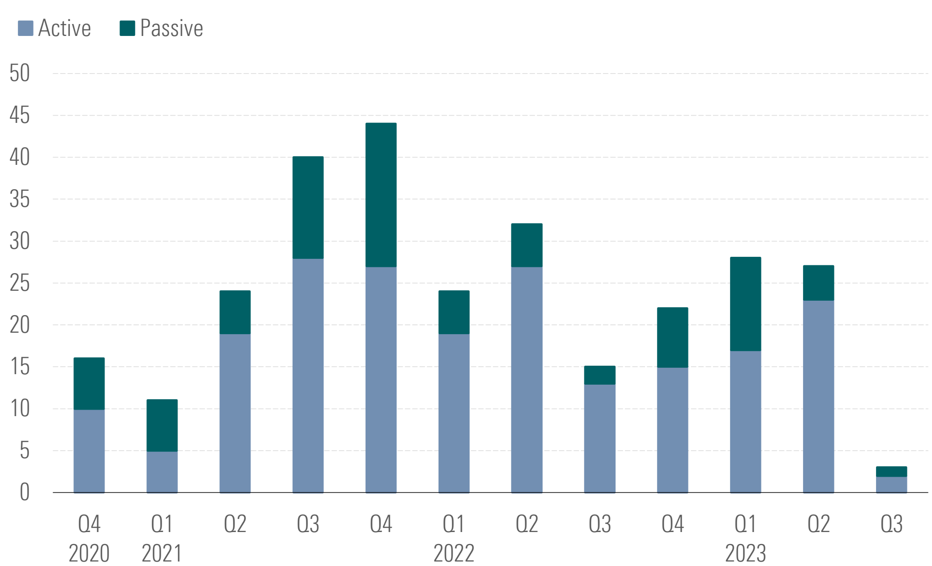


Source: Morningstar Direct, Manager Research. Data as of September 2023.

New Sustainable Fund Launches Slow Amid Weakening Demand

In the U.S., sustainability-focused product development slowed significantly in 2023's third quarter. Fewer new funds launched than at any point in the past three years. Just three new sustainable funds launched during the period, compared with 27 in the previous quarter.

Exhibit 18a U.S. Sustainable Fund Launches



Source: Morningstar Direct, Manager Research. Data as of September 2023.

Xtrackers launched one new sustainable funds during the period. Xtrackers US Green Infrastructure Select Equity ETF UPGR tracks an index comprised of companies involved in the production, generation, or distribution of green energy. The index also leverages various sustainability data to minimize ESG risk exposure and avoid involvement in controversial weapons or oil & gas. Including this fund, Xtrackers' ESG-focused U.S. offerings now number 16. This new launch was muted compared with Xtrackers MSCI USA Climate Action Equity ETF USCA, which launched in April and shot to the top of the second-quarter flows chart.

Exhibit 18b U.S. Largest New Sustainable Funds

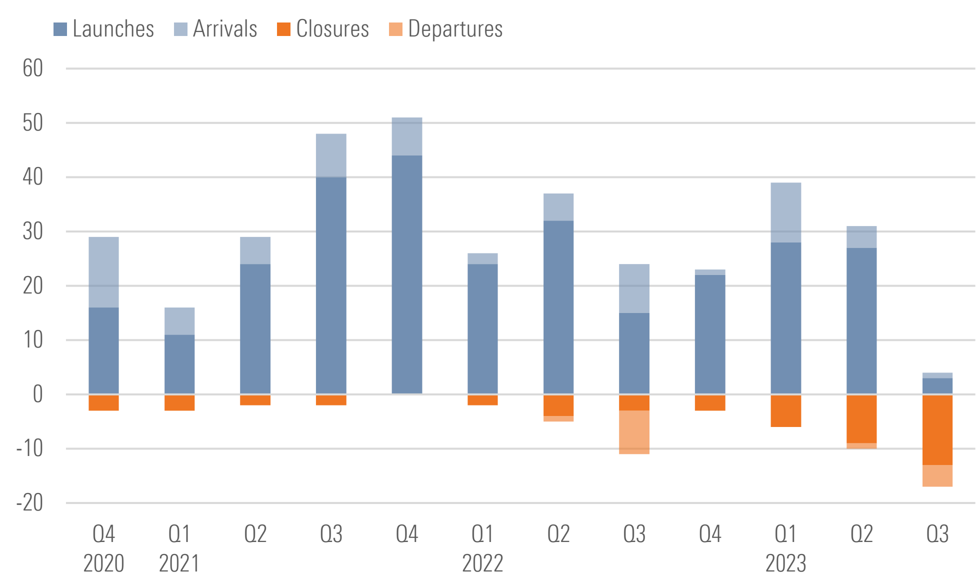
Fund Name	Fund AUM (USD Million)
Xtrackers US Green Infrastructure Select Equity ETF	5
Uscf Sustainable Commodity Strategy	3
Matthews Emerging Markets Sustainable Future Active ETF	1

Source: Morningstar Direct, Manager Research. Data as of September 2023.

Sustainable Fund Closures Pick Up

For the first quarter in recent history, sustainable fund departures outpaced arrivals. In 2023's third quarter, three new sustainable funds launched and one existing fund was added to the sustainable funds landscape (labeled "Arrivals" in the exhibit below). During the same period, 13 sustainable funds closed and four funds moved away from ESG mandates (labeled "Departures").

Exhibit 18c U.S. Sustainable Funds: New Arrivals & Departures



Source: Morningstar Direct, Manager Research. Data as of September 2023.

Out of the 13 sustainable funds liquidated during the third quarter, the largest (in terms of assets) came from Columbia Threadneedle, Hartford, and BlackRock. Columbia Threadneedle shuttered Columbia U.S.

Social Bond Fund in August, which had amassed USD 35.8 million in its eight years on the market. Hartford closed the USD 9.8 million Hartford Schroders ESG US Equity ETF in July after roughly two years on the market. After three years on the market, BlackRock closed two smaller funds—BlackRock U.S. Impact Fund and BlackRock International Impact Fund—with USD 5.4 million and USD 4.2 million in assets, respectively. The remaining funds that closed in the past three months had average assets under management of USD 2.0 million.

The new offerings and repurposed funds brought the total number of sustainable open-end and exchange-traded funds in the U.S. to 661 at the end of the quarter.

Regulatory Update

On Sept. 20, 2023, the SEC amended the Investment Company Act Names Rule to expand the types of names that could be considered materially deceptive or misleading if a fund does not adopt a policy to invest, under normal circumstances, at least 80% of the value of its assets in the investment focus that the name suggests. The amendments apply to financial and extra-financial terms such as "growth" and "value" or certain terms that reference a thematic investment focus, such as the incorporation of one or more environmental, social, or governance factors. This comes ahead of the upcoming disclosure rules for funds that incorporate ESG factors, which we expect to be finalized by the end of the year.

U.S. Securities and Exchange Commission Chair Gary Gensler testified before the House Financial Services Committee on Sept. 27, 2023, casting doubt over the timeline of the upcoming Climate-Related Disclosures rulemaking and potential inclusion of scope 3 emissions.

One state isn't waiting on federal guidance. On Oct. 7, 2023, California signed into law a bill requiring large businesses with more than USD 1 billion in annual revenue that operate in California to disclose their scope 1, 2 and 3 greenhouse gas emissions to an emissions reporting entity. This bill is largely viewed as a test case for the SEC, as market reactions will shed light on which parts of the SEC's proposal may be disputed.

Meanwhile, also in September, the U.S. Department of the Treasury announced the launch of its nine Principles for Net-Zero Financing and Investment, highlighting best practices for financial institutions that have made net-zero pledges. Finally, members of Congress wrote an open letter to the U.S. Federal Reserve to urge measures to be adopted to adequately address climate-related financial risk.

Finally, in September 2023, a federal judge sided with the U.S. Department of Labor in a lawsuit concerning "Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights," the rule finalized by the DOL in November 2022. The rule states that the duty of prudence (a retirement plan fiduciary's responsibility to make investment decisions based on financially material factors) could include the consideration of climate change and other ESG issues, and it allows for collateral benefits (such as positive impact on people and planet) to act as tiebreakers in plan selection. The rule also lifted prior guidance that made it difficult and risky for employers that wanted to use ESG-focused investment options as default investments for workers automatically enrolling in a qualified plan.

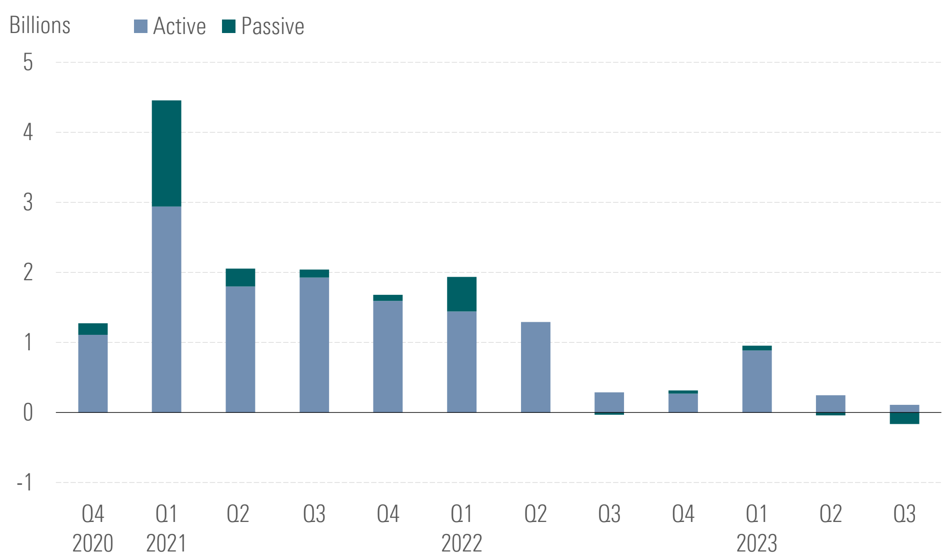
Canada

Flows Turn Negative for the First Time

In the third quarter of 2023, the Canadian sustainable fund market saw its first quarter of net outflows, with net withdrawals amounting to USD 52 million. This is in contrast with the second quarter, which saw muted but positive net inflows of USD 200 million. Passive equity strategies represented the majority of the outflows.

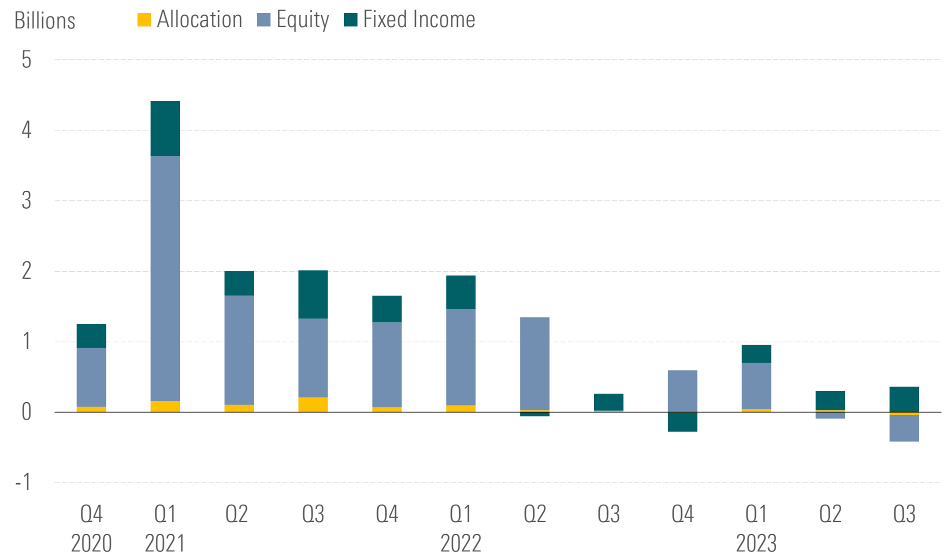
However, Canadian sustainable funds held up better than their conventional peers. Calculated as net flows as a percentage of total assets at the start of a period, the organic growth rate puts the magnitude of flows into perspective. During the third quarter, the Canadian sustainable funds landscape contracted by a modest 0.3%, compared with a 0.6% shrinkage in the total Canadian funds landscape.

Exhibit 19 Canada Sustainable Fund Flows



Source: Morningstar Direct, Manager Research. Data as of September 2023.

Exhibit 20 Canada Sustainable Flows by Asset Class



Source: Morningstar Direct, Manager Research. Data as of September 2023.

When looking at the breakdown of asset classes, while equity and allocation funds experienced outflows, fixed-income strategies registered inflows of USD 362 million as investors sought to lock in attractive yields.

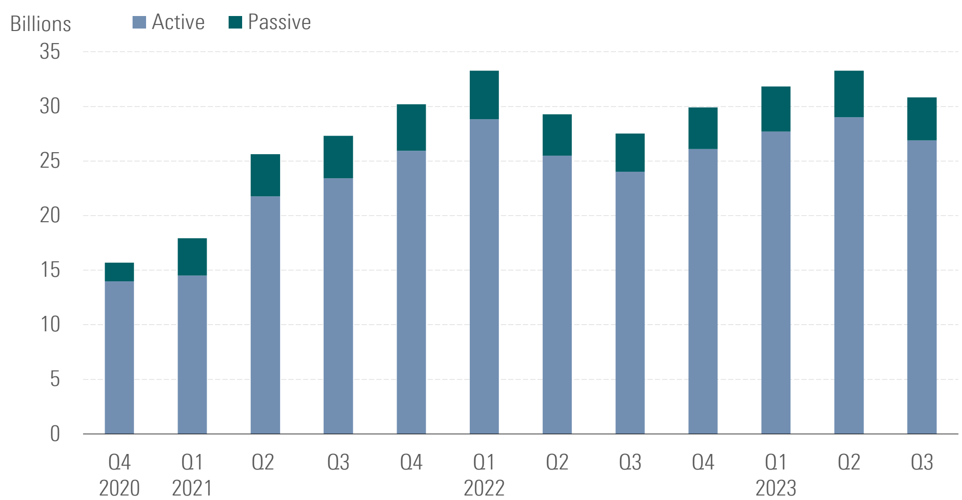
RBC Vision Global Equity Fund and some of the **Desjardins SocieTerra funds** experienced the largest outflows for a second-consecutive quarter. The former lost USD 50 million in the third quarter compared with USD 31 million in the second quarter.

On the other hand, National Bank Investments, Northwest Ethical Investments, and Invesco are the firms that attracted the largest portion of net new money. Collecting USD 448 million during the period, **NBI Sustainable Canadian Bond ETF** was the top flow-getter for a second-consecutive quarter.

Assets Decline

Assets invested in Canadian sustainable funds declined in the third quarter of 2023 mainly because of falling market prices. Canadian sustainable funds stood at USD 30 billion at the end of September, representing a decline of 7.2% relative to the previous quarter. The Canadian funds market overall witnessed a similar drop in assets of 6.9%, to USD 1.32 trillion in the third quarter from USD 1.23 trillion in the second quarter.

Exhibit 21 Canada Sustainable Fund Assets



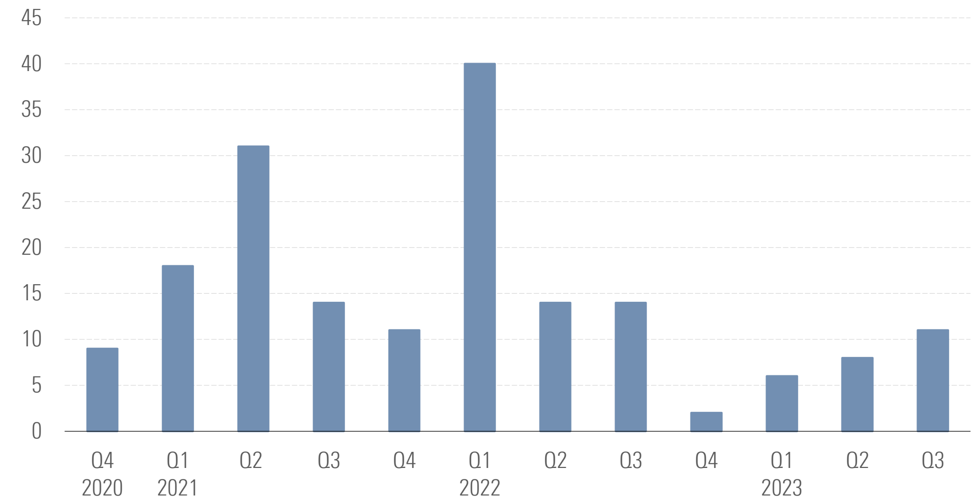
Source: Morningstar Direct, Manager Research. Data as of September 2023.

The distribution of funds across asset classes remained unchanged, with a greater percentage of assets allocated to equities (71%), followed by fixed income (23%), and the remainder to allocation funds. No asset class showed any significant changes in market share compared with the previous quarter.

New Launches Pick Up a Bit

Product development in the sustainable funds and ETF market in Canada increased in the last three months compared with the previous quarter, although it decreased slightly compared with a year ago. As of this writing, the third quarter of 2023 saw the launch of 11 new products. While Desjardins SocieTerra dominated the second quarter with three new product launches, it was NEI that stood at the top in the third quarter. NEI launched four new impact-focused funds, the largest of which is **NEI Canadian Impact Bond Fund**, a core investment-grade Canadian fixed-income fund with a responsible-investing approach. This strategy is subadvised by Addenda Capital, a specialist in the field of impact investing. NEI also announced three new impact-focused fund-of-fund solutions that invest in a mix of NEI impact funds and third-party ESG ETFs.

Exhibit 22 Canada Sustainable Fund Launches



Source: Morningstar Direct, Manager Research. Data as of September 2023.

Regulatory Update

Regulatory developments were relatively muted in Canada during the third quarter. The Canadian Securities Administrators extended to Sept. 29 the public comment period on a proposed amendment to corporate governance disclosure rules and policies surrounding the nomination process, board renewal, and diversity. The proposal seeks to consider diversity, equity, and inclusion criteria beyond strictly gender, as it is defined currently. The extension was granted because of stakeholder feedback suggesting it would be beneficial to have additional time to prepare their responses.

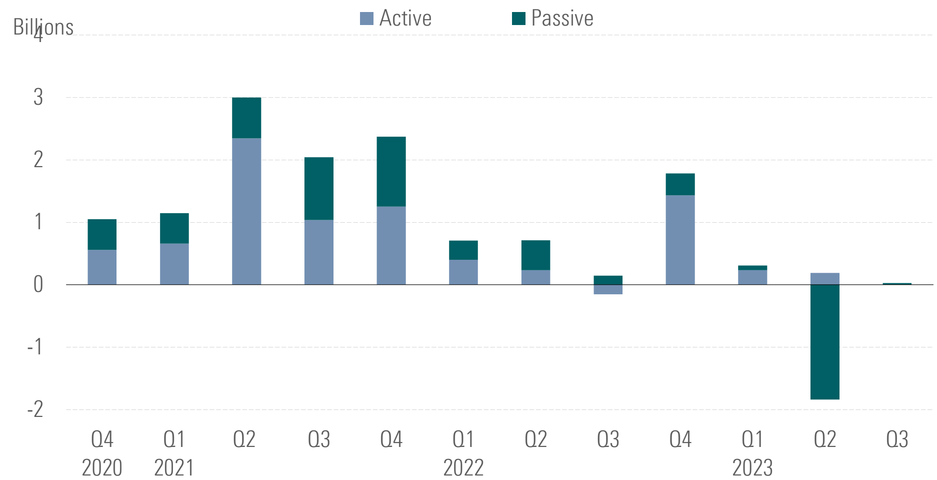
Australia and New Zealand

Flows

Flows into the Australasian (Australia and New Zealand) sustainable funds universe were relatively muted, though positive, with USD 30.1 million in net inflows in the third quarter of 2023. This was predominantly driven by passive strategies, which saw net inflows of USD 26.2 million.

Betashares and iShares were the two key beneficiaries of the passive net inflows, with more than USD 40 million each, while Vanguard experienced just over USD 70 million in net outflows.

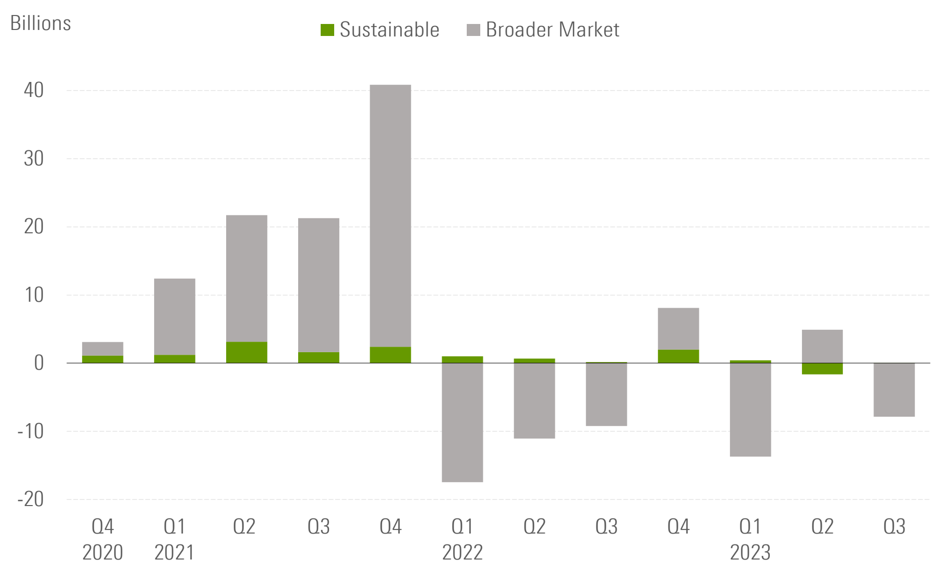
Exhibit 23 Australia and New Zealand Sustainable Fund Flows (USD Billions)



Source: Morningstar Direct, Manager Research. Data as of September 2023.

To provide context, the broader market saw outflows of USD 7.85 billion over the period. Market conditions have been challenging with persistent inflation, rising interest rates, and recession fears. Furthermore, elevated energy prices have affected sustainable fund returns relative to their conventional peers as the former tend to either not hold energy companies or underweight them.

Exhibit 24 Australian and New Zealand Sustainable Fund Flows Compared With the Broader Market (USD Billions)

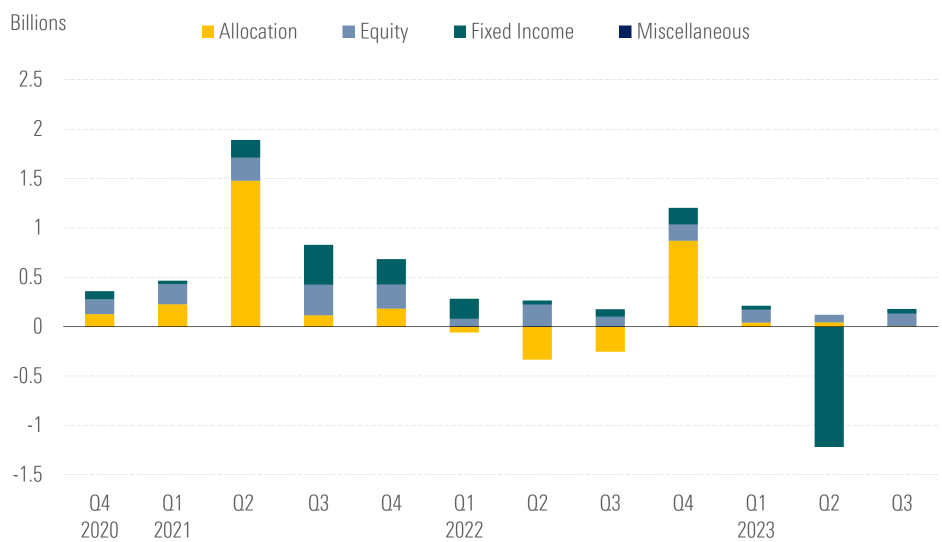


Source: Morningstar Direct, Manager Research. Data as of September 2023.

Flows by Category

In the Australasia region, fixed-income strategies saw USD 125 million in net inflows, which contrasted with the net outflows of USD 133 million from equity strategies. Miscellaneous and allocation funds registered net inflows of USD 48 million and USD 4.3 million, respectively.

Exhibit 25 Australia and New Zealand Sustainable Flows by Asset Class

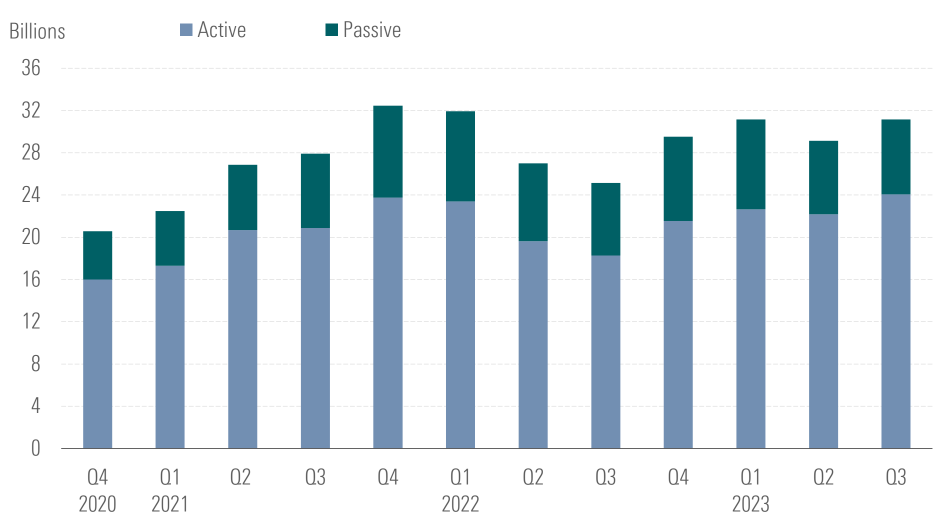


Source: Morningstar Direct, Manager Research. Data as of September 2023.

Assets

The total size of Australasian sustainable investments is estimated to be USD 31.1 billion, which is up around USD 2 billion, or 7%, compared with the previous quarter.

Exhibit 26 Australia and New Zealand Sustainable Fund Assets (USD Billion)



Source: Morningstar Direct, Manager Research. Data as of September 2023.

The Australian sustainable funds market remains quite concentrated, with the top 10 funds accounting for 68% of total assets in sustainable funds.

The top five fund houses by sustainable fund assets are listed below. Australian Ethical has increased its market share following its merger with Christian Super. DFA continues to steadily grow its market share and now sits in second place, replacing index giant Vanguard, which, after its huge quarter-two outflows, fell by two ranks and landed behind Betashares[10].

Exhibit 27 Top Five Australian and New Zealand Fund Houses

Sustainable FUM Market Share	**% Market Share**
Australian Ethical Investment Ltd	18.7%
DFA Australia Limited	10.2%
BetaShares Capital Ltd	10.0%
Vanguard Investments Australia Ltd	5.8%
Mercer Investments (Australia) Limited	4.9%

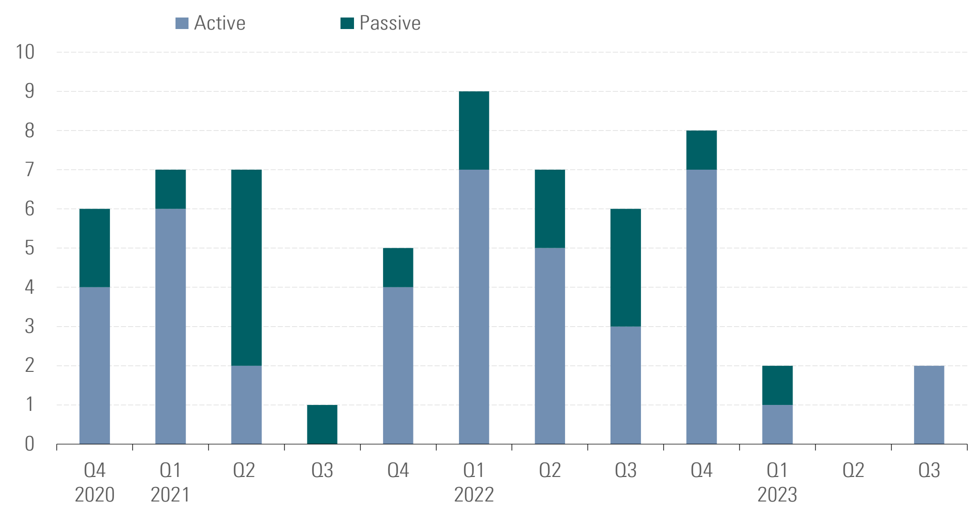
Source: Morningstar Direct, Manager Research. Data as of September 2023.

Launches

There were two new sustainable funds launched in the region in the third quarter of 2023. Launches so far this year are significantly lower than the previous year. This can be only partly attributable to the challenging market conditions. As of the end of September 2023, we counted 269 strategies in our Australasian sustainable fund universe.

10 Vanguard's Ethically Conscious funds were down by more than USD 3.7 billion in the second quarter following large outflows from one institutional client who moved its investment from the Ethically Conscious funds into mandates managed by another firm. Institutional redemptions at Vanguard are the direct result of the firm's strategy to withdraw from offering segregated mandates and to scale back from the institutional investor segment to focus on serving individual investors, either directly or through the financial intermediaries that support them.

Exhibit 28 Australia and New Zealand Sustainable Fund Launches



Source: Morningstar Direct, Manager Research. Data as of September 2023.

Regulatory Update

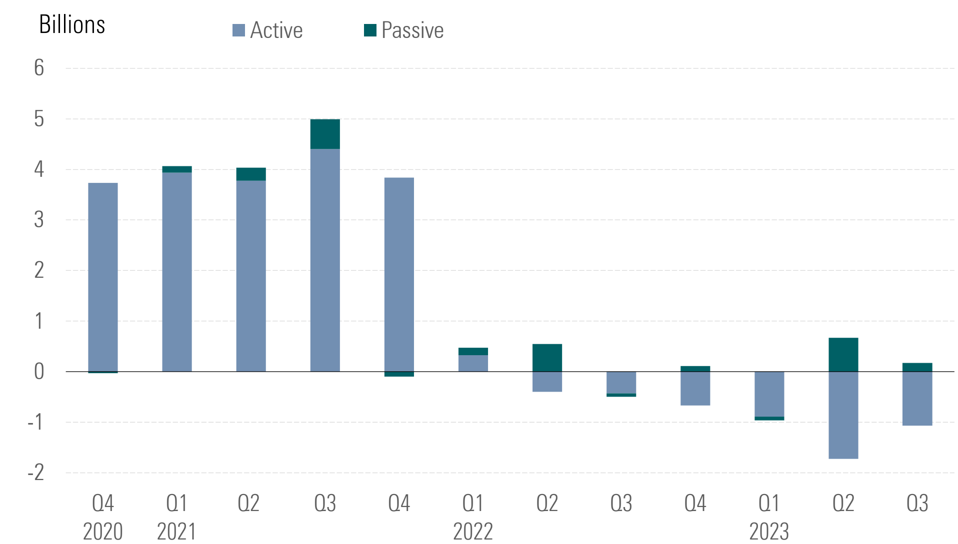
The Treasury of Australia has released a consultation paper indicating the implementation of mandatory climate-related financial disclosure requirements for companies and financial institutions. The reporting requirements are expected to commence in 2024 for large businesses, with smaller companies to be phased in over the following three years. This was a sign of momentum from the initial discovery paper launched in December 2022. The paper also acknowledged the importance of alignment to the IFRS Foundation's International Sustainability Standards Board, or ISSB, which released its inaugural standards IFRS S1 and IFRS S2 on June 26, 2023.

Japan

Flows

In the third quarter of 2023, the Japanese sustainable funds landscape saw its sixth-consecutive quarter of outflows, with net withdrawals amounting to USD 1.7 billion. Actively managed funds accounted for more than 90% of the quarter's outflows and marked their fifth-consecutive quarter of withdrawals. Notably, 30% of the outflows could be attributed to just two funds—**AMOne Global ESG High Quality Growth Equity Fund Unhedged** and **SMDS Innovative Decarbonization Strategy Fund**—which shed USD 367 million and USD 124 million, respectively.

Exhibit 29 Japan Sustainable Fund Flows (USD Billion)

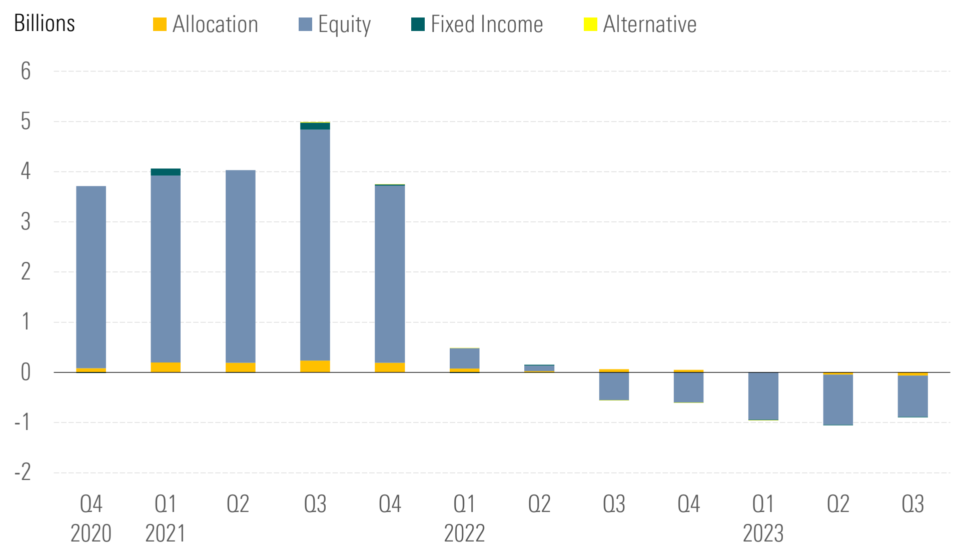


Source: Morningstar Direct, Manager Research. Data as of September 2023.

It should be noted that there is a possibility of double counting at the global level. We include Japan-domiciled funds of funds and feeder funds in this review to better reflect the actual flow situation in the Japanese fund market, as many Japanese funds of funds are invested in European funds.

Japanese sustainable equity funds lost USD 817 million during the third quarter of 2023, representing more than 97% of the quarter's outflows. Of the 20 funds worst hit by withdrawals, 19 were equity funds. This contrasts with the broader Japanese funds landscape, which registered inflows of USD 29 billion in the third quarter, for a total of USD 49 billion so far in 2023.

Exhibit 30 Japan Sustainable Fund Flows by Asset Class (USD Billion)

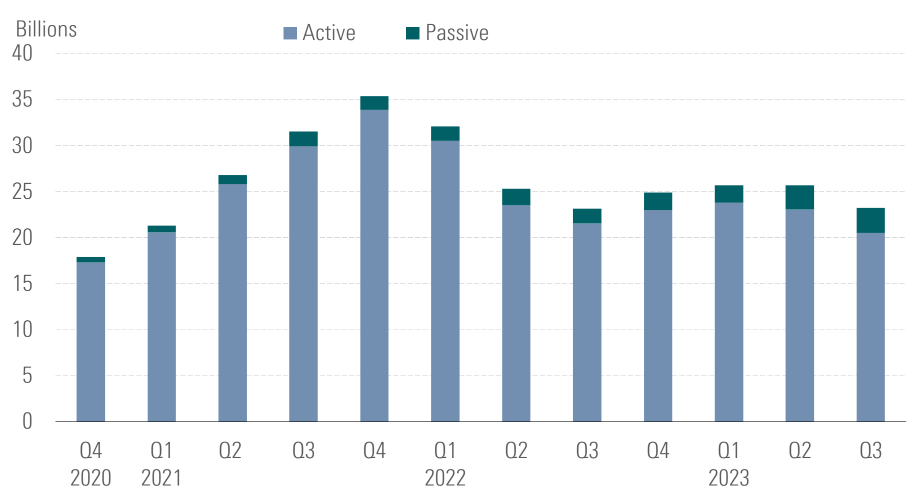


Source: Morningstar Direct, Manager Research. Data as of September 2023.

Assets

Total assets in Japan-domiciled sustainable funds slid to USD 23.2 billion in the third quarter, a 9.4% decline from the end of June. Despite persistent outflows from actively managed funds, these strategies retain the majority (88%) of sustainable fund assets. With equity funds constituting an overwhelming majority (95%) of Japan-domiciled sustainable funds, a slowdown in global equity markets during the third quarter contributed to a decline in assets.

Exhibit 31 Japan Sustainable Fund Assets (USD Billion)

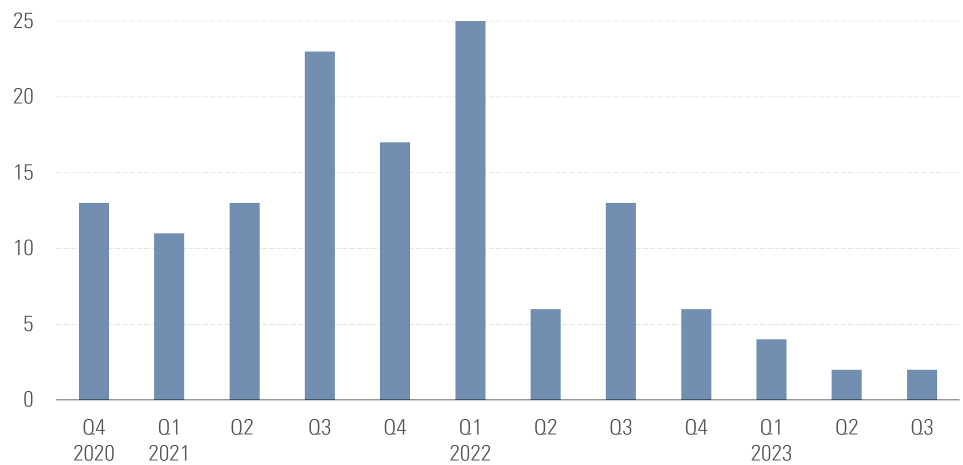


Source: Morningstar Direct, Manager Research. Data as of September 2023.

Launches

Japanese investors gained just two new sustainable funds in the third quarter of 2023, like in the previous quarter. The two funds are **Nomura Wellington Corporate Value Co-Creation World Equity Fund** and the **Daiwa Global Life Equity Fund**. Between the new launches, the Nomura fund recorded the larger net inflows (USD 346 million).

Exhibit 32 Japan Sustainable Fund Launches



Source: Morningstar Direct, Manager Research. Data as of September 2023.

Asia ex-Japan

We used the most-recent data available within the past quarter for funds whose full quarterly data was unavailable at the time of publication. Because China's data was not available at the time of publication, we used second-quarter 2023 data as a proxy for third-quarter 2023 data in every exhibit of this section.

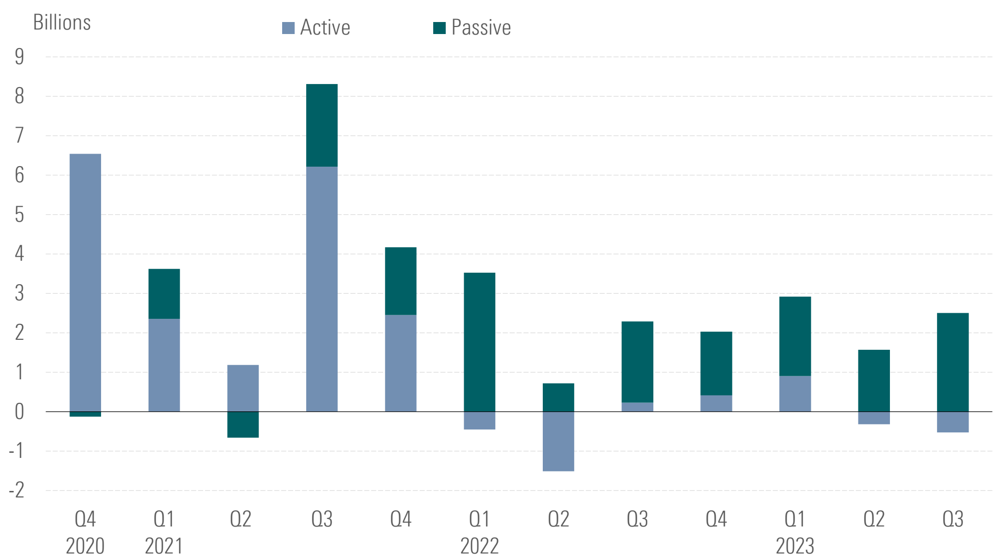
Flows

In second-quarter 2023, China-domiciled sustainable funds experienced USD 1.66 billion in inflows. Roughly two-thirds of the flows were into ETFs, with USD 664 million of inflows into China Southern CSI New Energy ETF and GF New Energy Vehicles Battery ETF alone, which track the CSI New Energy Index and CNI New Energy Vehicle Battery Index, respectively.

Excluding China, the Asia ex-Japan region recorded net inflows of roughly USD 322 million over the third quarter. The largest inflows came from Singapore- and South Korea-domiciled sustainable funds. The September 2023 launch of the **iShares MSCI Asia ex Japan Climate Action ETF** in Singapore drove most of the region's flows. The ETF tracks an index that selects the top 50% of companies in each sector on the basis of their relative climate transition risk and steps taken to mitigate these risks. South Korea-domiciled sustainable funds experienced net inflows of USD 372 million over the period, with secondary battery-related ETFs and bond funds leading the inflows.

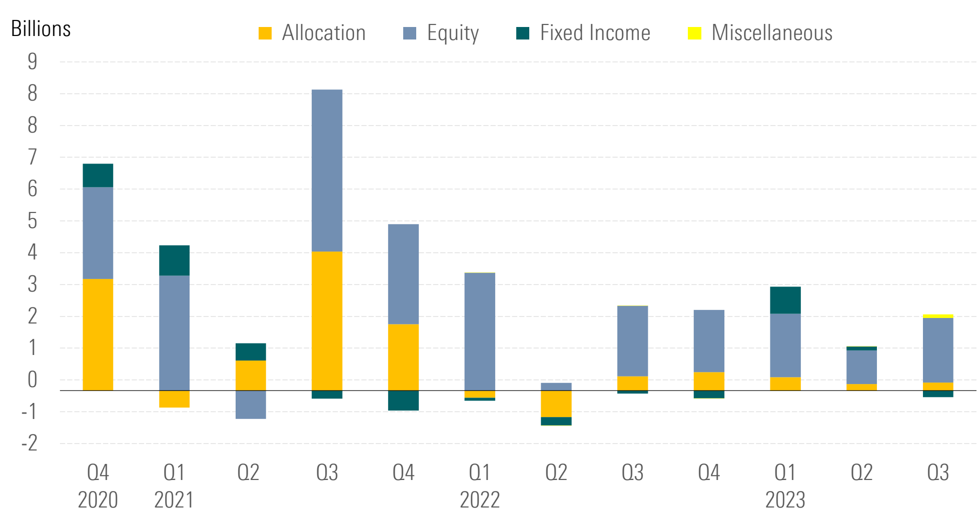
Taiwan- and Hong Kong-domiciled sustainable funds saw USD 292 million and USD 67 million in outflows over the quarter, respectively, with the latter experiencing its fifth-consecutive quarter of outflows. The Hang Seng ESG Index's 6.8% loss over the last three months was worse than its parent index's 5.9% loss, and its 2.8% gain over the past year ended September 2023 also underperformed the Hang Seng Index's 3.4%.

Exhibit 33 Asia ex-Japan Sustainable Fund Flows (USD Billion)



Source: Morningstar Direct, Manager Research. Data as of September 2023.

Exhibit 34 Asia ex-Japan Sustainable Fund Flows by Asset Class (USD Billion)

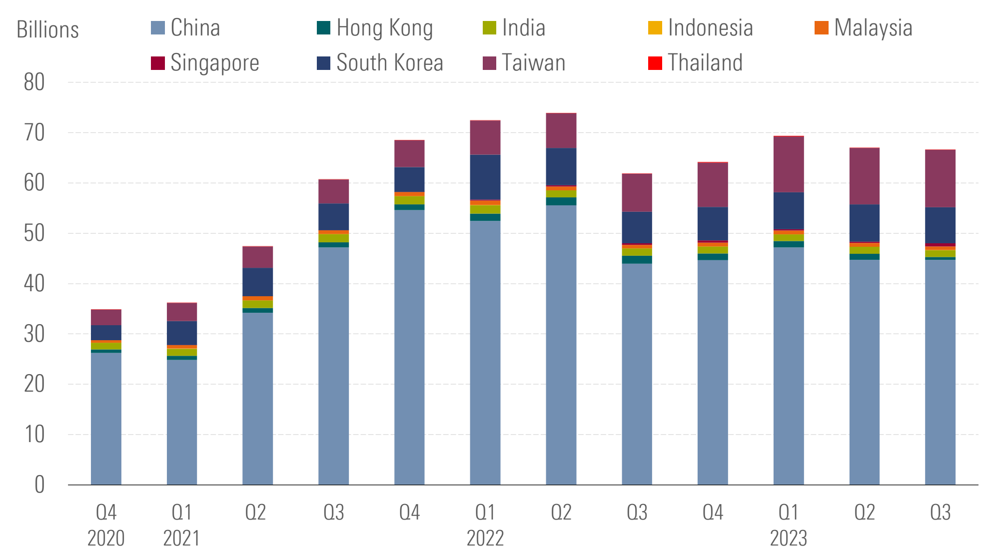


Source: Morningstar Direct, Manager Research. Data as of September 2023.

Assets

Total assets in sustainable funds across Asia ex-Japan were roughly stagnant quarter-over-quarter, dropping by 0.6% since the end of June. Outside of China (for which data was not available at the time of publication), Taiwan and South Korea remained the two largest sustainable fund markets in the region, comprising 17% and almost 11% of the region's sustainable fund assets, respectively. Assets in Malaysia-domiciled funds dropped by 4.1% over the quarter to USD 720 million at the end of September. Despite experiencing net inflows, South Korea sustainable assets decreased by 3.4% in part because of equity market losses, with the Korea Composite Stock Price falling 3.9%, while the KRX ESG Leaders 150 Index increased slightly by 1% in the third quarter.

Exhibit 35 Asia ex-Japan Sustainable Fund Assets (USD Billion)



Source: Morningstar Direct, Manager Research. Data as of September 2023.

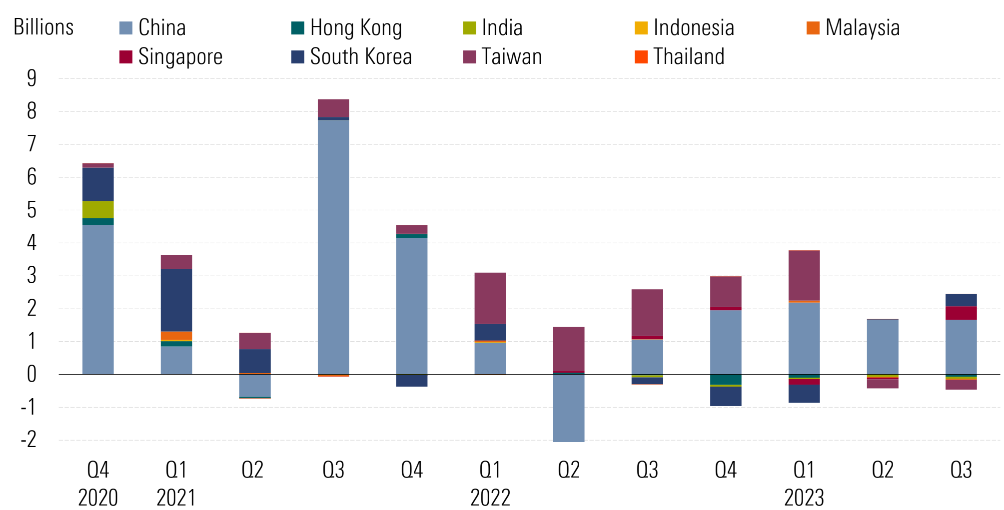
Equity funds remained the dominant asset class in the region at 70% of Asia ex-Japan sustainable fund assets at the end of September, while allocation and fixed-income funds comprised 26% and 4.5%, respectively. Sustainable passive funds continued to gain prominence, with inflows of USD 2.5 billion over the quarter versus outflows of USD 522 million for active funds, and assets in passive strategies rose slightly to 47.7% of sustainable assets from 46.4% in second-quarter 2023.

Launches

From July through September 2023, 20 new sustainable funds were launched across the region. Nine of the launches were in South Korea, seven in China, two in Taiwan, and one each in Singapore and Thailand.

Nine of the launches were passive funds, including the Singapore-listed iShares MSCI Asia ex Japan Climate Action ETF mentioned earlier. South Korea-domiciled sustainable funds experienced net inflows of USD 372 million over the period, with secondary battery-related ETFs and bond funds leading the inflows. Another new passive fund is **Mega ESG High Dividend Equal Weight ETF**, which tracks the TIP Customized Taiwan ESG High Dividend Equal Weight Index. The index invests in mid- and large-cap stocks that demonstrate strong ESG performance and a superior dividend yield. In South Korea, five of the funds were secondary battery ETFs and four were equity funds.

Exhibit 36 Asia ex-Japan Sustainable Fund Launches



Source: Morningstar Direct, Manager Research. Data as of September 2023.

Similar to last quarter, just one ESG-focused fixed-income fund was launched during the quarter—**Neuberger Berman China Green Bond**, which invests in China green bonds while incorporating green investment principles. After gaining approval from the China Securities Regulatory Commission, or CSRC, for independent fund business operation, Neuberger Berman launched this fund, which is the first Chinese onshore ESG fund launched and managed solely by a foreign investment manager. Differing from their European peers, Chinese green bond issuers consist mostly of central state-owned enterprises from the financial sector and, to a much lesser extent, the utilities and transport sectors. By and large, convergence between domestic and international green bond market standards, in particular those regarding issuers' eligibility and disclosure of proceeds use, facilitates scrutiny and monitoring of the issuers' green credentials. As the Chinese yields remain insulated from the inflationary pressure clouding the U.S. and European bond markets, the target clients of Neuberger Berman's green bond strategy so far reside largely with domestic institutional investors.

Regulatory Update

Further developments in regulation affecting Asia ex-Japan sustainable funds occurred during third-quarter 2023. In July, the Securities and Exchange Board of India, or SEBI, separated ESG investments into a separate subcategory under their thematic categorization of equity schemes, allowing funds in the country to launch multiple ESG schemes—exclusion, integration, best-in-class and positive screening, impact investing, sustainable objectives, and transition or transition-related investments— versus only one scheme under the previous classification framework. The decision was made in response to industry demands and increasing needs for green financing, according to SEBI's circular on the topic.

In July, the Taiwan Stock Exchange launched ESG InfoHub, a platform for international investors with ESG data on listed domestic companies and a dedicated page for products such as sustainable ETFs.

In Singapore, the Sustainability Reporting Advisory Committee, or SRAC, published a consultation paper seeking market feedback on proposals to make climate-related disclosures mandatory for listed (fiscal-year 2025) and certain nonlisted companies (fiscal-year 2027).

The Korean Financial Supervisory Service recently established disclosure standards for ESG funds based on the results of task force discussions. Funds that claim to be ESG, such as including *ESG* in the fund name or indicating and stating in the investment prospectus that ESG is considered in the investment process and strategy, shall state the investment purpose, strategy, and management capabilities in the securities report. The relationship between important information such as investment risk and ESG must be disclosed in advance, and management progress must be reported regularly through asset-management reports. It is scheduled to go into full effect from February 2024.

Appendix—Defining the Global Sustainable Fund Universe

The global sustainable fund universe encompasses open-end funds and ETFs that, by prospectus or other regulatory filings, claim to focus on sustainability; impact; or environmental, social, and governance factors.

Our universe of sustainable funds is based on intentionality rather than holdings. For example, a portfolio can score well on ESG metrics such as the Morningstar Sustainability Rating, but if ESG issues are not the focus of the fund's investment strategy, it will not be included in our universe. To identify intentionality, we relied on a combination of fund names (a strong indicator of intentionality) and information found in fund documents. The fund's documents should contain enough details to leave no doubt that ESG concerns figure prominently in the security-selection and portfolio construction process.

The global sustainable fund universe does not contain the growing number of funds often referred to as "ESG integrated funds," which formally consider ESG criteria in the investment process and engage with portfolio holdings but do not make ESG considerations the focus of the investment process.

Furthermore, the global sustainable fund universe doesn't include funds that employ limited exclusionary screens such as controversial weapons, tobacco, and thermal coal (combined with an ESG integration approach or not). We however include ESG-screened passive funds in our universe as, typically for these, the exclusions are the sole purpose of the strategy.

Finally, the global sustainable fund universe excludes money market funds, feeder funds, and funds of funds to avoid double counting and inflating flows and assets. We make an exception for Japan and South Korea to better reflect the actual flow situation there as many Japanese funds of funds are invested in European funds.

To identify sustainable funds in their respective regions, manager research analysts use the "Sustainable Investment–Overall" data point in Morningstar Direct. We also use the "Sustainable Investment Overall Start Date" data point to account for repurposed funds, where relevant.

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