SFDR Article 8 and Article 9 Funds: 2021 in Review
A rapidly evolving landscape as assets hit EUR 4 trillion.

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Contents

Hortense Bioy, CFA
Global Director of Sustainability Research
Manager Research
hortense.bioy@morningstar.com

Samiya Jmili
ESG Analyst, Manager Research, EMEA
samiya.jmili@morningstar.com

Andy Pettit
Director, Policy Research
andy.pettit@morningstar.com

Executive Summary

It's been almost a year since the European Union introduced its Sustainable Finance Disclosure Regulation, requiring for the first time that asset-management companies provide information about their investments' environmental, social, and governance risks as well as their impact on society and the planet. Since 10 March 2021, funds available for sale in the EU have been classified by their managers as Article 6, 8, or 9, depending on their sustainability objectives.

A lack of clear policy guidance has resulted in different approaches to product classification, which in turn have led to confusion and greenwashing concerns. This report provides a view of the rapidly evolving landscape of Article 8 and Article 9 funds at the end of 2021, examining the continued growth in assets, flows, and products, with a focus on the last three months of the year. We also analyse the ESG credentials of these so-called "light green" and "dark green" funds, looking at their current level of ESG risk and controversial activities exposures.

Key Takeaways

- Assets in Article 8 and Article 9 funds[1] reached EUR 4.05 trillion at the end of December 2021, representing 42.4% of all funds sold in the EU.
- In the fourth quarter, Article 8 and Article 9 funds captured 64% of EU fund inflows, at EUR 81.4 billion.
- SFDR spurred product development and innovation in 2021. In the fourth quarter alone, close to 200 new Article 8 and Article 9 funds hit the shelves, accounting for 54% of new fund launches in the EU. While broad ESG and sustainable strategies represented the bulk of new offerings, funds with an environmental theme accounted for about one fifth of new launches.
- Asset managers continued to reclassify strategies from Article 6 into Article 8 or Article 9 by enhancing ESG integration processes, adding ESG exclusions, or switching to brand-new strategies. Changes to justify a reclassification vary in depth and breadth.
- Active funds still largely dominate the landscape, but Article 8 and Article 9 passive products are gaining ground, ending 2021 with market shares of 9% and 17.4%, respectively, partly helped by the EU Climate benchmark regulation.
- In aggregate, Article 8 and Article 9 funds continue to perform better on ESG metrics than Article 6 funds, while Article 9 offerings exhibit the highest sustainability credentials, as expected.
- Amundi, Nordea, and Swedbank remain the three largest providers of Article 8 and Article 9 funds.

1 Excluding money market funds, funds of funds, and feeder funds. As of this writing, Morningstar had collected SFDR Level 1 data on close to 91% of funds available for sale in the EU.

Introduction

The Sustainable Finance Disclosure Regulation, which came into effect on 10 March 2021, is a cornerstone of the European Commission's Action Plan on Sustainable Finance. It aims to trigger changes in behavioural patterns in the financials sector, discouraging greenwashing and promoting responsible and sustainable investments.

Since March, asset managers have been required to classify their investment products into one of three categories, Article 6, Article 8, or Article 9, based on the products' sustainability objective. Article 8 refers to financial products that promote "environmental and/or social characteristics," provided that companies in which the investments are made follow good governance practices. Article 9 refers to products that have a sustainable investment objective and all holdings must be sustainable investments that meet the standard of "do no significant harm." All funds are required to provide some ESG disclosure, as per Article 6, while Article 8 and Article 9 funds will be asked to provide more detailed ESG information to investors (see regulatory update in the last section of this report).

Exhibit 1 SFDR Classification

Source: Morningstar Research.

As discussed in previous reports[2], asset managers have taken different interpretations of the definitions, some opting for a softer approach than others. This has resulted in an unexpectedly high number and broad range of products labelled Article 8 (light green) and Article 9 (dark green) that aim to address a variety of sustainability preferences and investment objectives. Their approach to ESG ranges from using ESG exclusions to focusing on impact. Many employ a best-in-class approach and/or focus on specific sustainability themes such as climate transition, water, or the UN Sustainable Development Goals. Many also use stewardship to nudge companies towards better ESG practices. ESG approaches are often used in combination and are by no means mutually exclusive at the fund level.

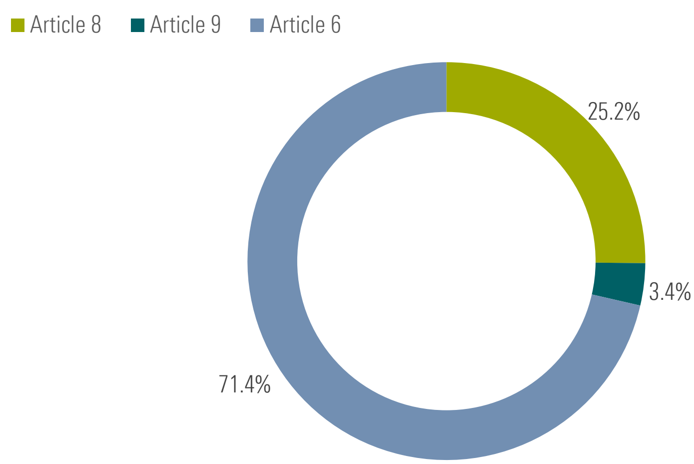
Article 8 and Article 9 Fund Assets Smash Through the EUR 4 Trillion Milestone

As of 31 Dec 2021, based on SFDR data collected from prospectuses on 91% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds, we found that 5,862 (25.2%) were classified as Article 8, while 797 (3.4%) were classified as Article 9. The overall number of Article 8

2 SFDR: The First 20 Days and SFDR: Four Months After Its Introduction.

and Article 9 funds increased by 16% over the fourth quarter. Combined, the two categories represented 28.6% of the overall EU fund universe at the end of December, up from 24.5% at the end of September 2021.

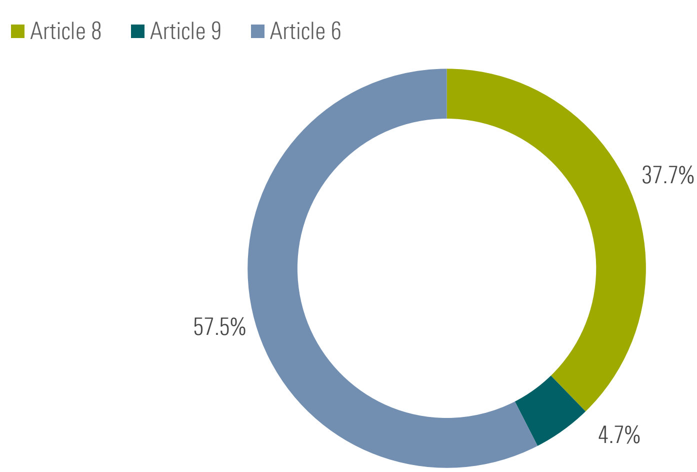
Exhibit 2 SFDR Fund Type Breakdown (by Number of Funds)



Source: Morningstar Direct. Data as of 31 Dec 2021. Based on SFDR data collected from prospectuses on 91% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds.

In terms of assets, the two fund groups accounted for a bigger share of the EU universe: 42.4%, split into 37.7% for Article 8 products and 4.7% for Article 9 products, at the end of December. Combined assets amounted to EUR 4.05 trillion, from EUR 3.32 trillion at the end of September.

Exhibit 3 SFDR Fund Type Breakdown (by Assets)



Source: Morningstar Direct. Data as of 31 Dec 2021. Based on SFDR data collected from prospectuses on 91% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds.

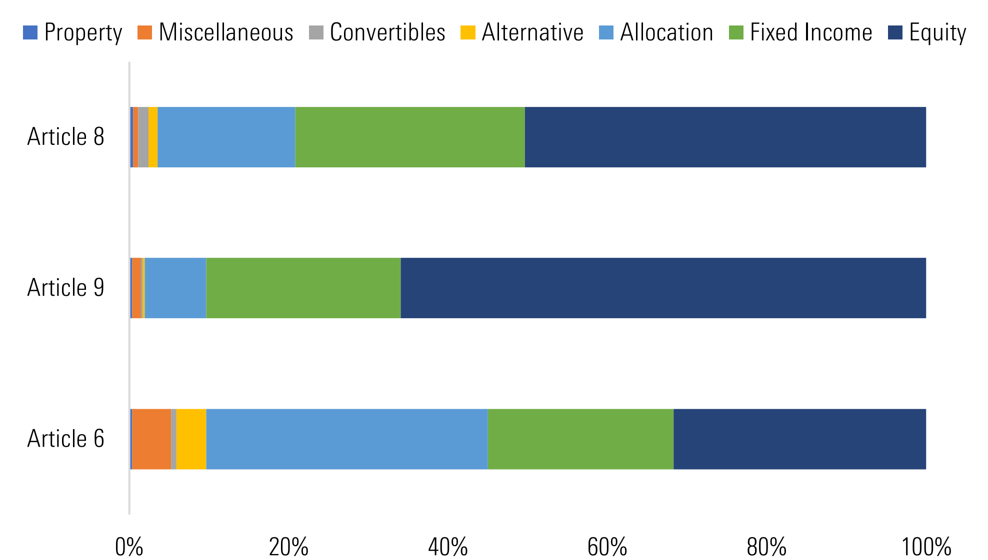
From 36.9% at the end of September to close to 42.4% at the end of December, Article 8 and Article 9 funds are on track to reach 50% of overall EU fund assets by mid-2022 or sooner as managers continue to upgrade strategies and launch new products that will meet the articles' requirements. Many managers, including Amundi, BNP Paribas, AXA, and Robeco, have already reported much higher asset ratios, while others that are currently exhibiting lower numbers plan to catch up. For example, DWS aims to categorise the quasi-totality of its EU fund assets under Article 8 or Article 9. BlackRock targets a 50% ratio for its active fund business.

Article 8 and Article 9 Funds per Broad Asset Class

Article 8 and Article 9 funds vary in asset class exposure compared with Article 6 funds. Both categories lean more towards equity, with equity funds accounting for half of Article 8 offerings and two thirds of Article 9 products, at the expense of allocation funds, which represent 17% and 8% of Article 8 and Article 9 funds, respectively, versus 35% in the Article 6 fund group.

Close to 29% and 24% of Article 8 and Article 9 funds, respectively, offer exposure to fixed income. The representation of other asset classes in the two groupings remains very low.

Exhibit 4 Article 8 and Article 9 Funds per Broad Asset Class



Source: Morningstar Direct. Data as of 10 July 2021. Excluding money markets, feeder funds, and funds of funds

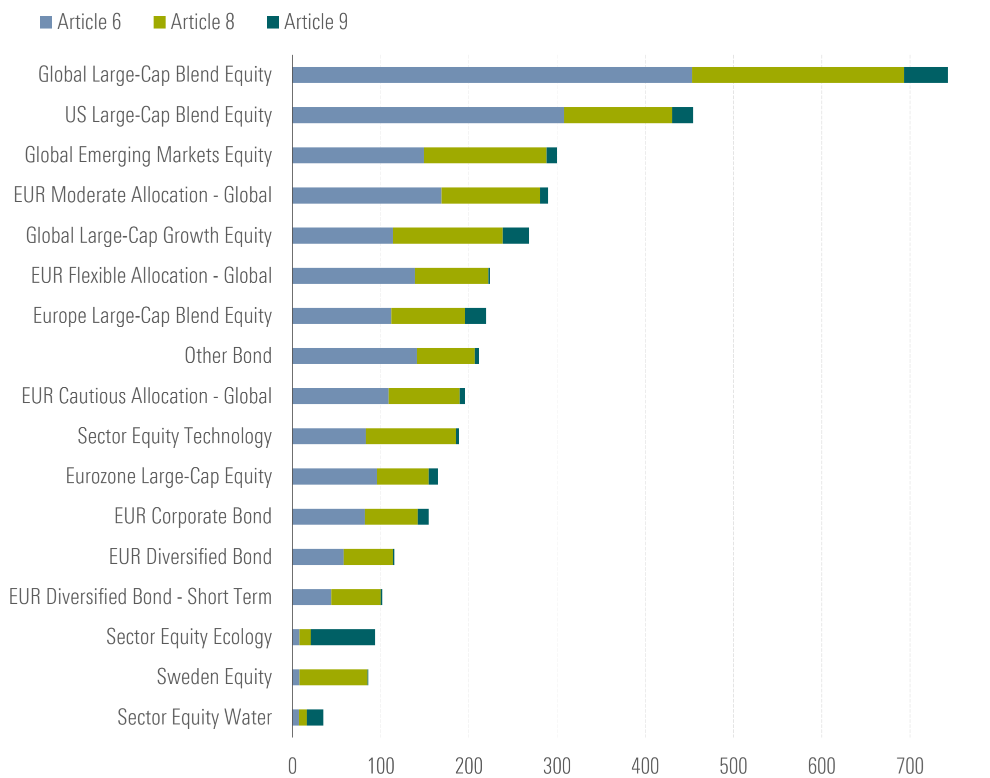
Article 8 and Article 9 Funds per Morningstar Category

Diving into some of the most popular Morningstar Categories, we can see that Article 8 and Article 9 fund assets are distributed unevenly, some categories having a much higher proportion of Article 8 and Article 9 fund assets than others. While the largest one, global large-cap blend equity, has 39% of its assets in Article 8 funds (32%) and Article 9 funds (7%), two of the smallest categories selected in our sample, Sweden equity and sector equity ecology, both have 91% of their assets in Article 8 and Article

9 funds. Interestingly, 90% of Sweden equity funds are classified as Article 8 and 78% of ecology funds as Article 9.

The lowest proportion of Article 8 and Article 9 offerings in aggregate is in US large-cap blend equity, where only 27% of the assets are held in Article 8 funds and 5% in Article 9 funds, so 32% in total. By comparison, US large-cap growth equity (not shown in the exhibit) has only a slightly higher percentage of its assets (35%) in Article 8 and Article 9 funds.

Exhibit 5 Article 8 and Article 9 Funds per Morningstar Category (EUR Billion)



Source: Morningstar Direct. Data as of 31 Dec 2021. Based on SFDR data collected from prospectuses on 91% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds.

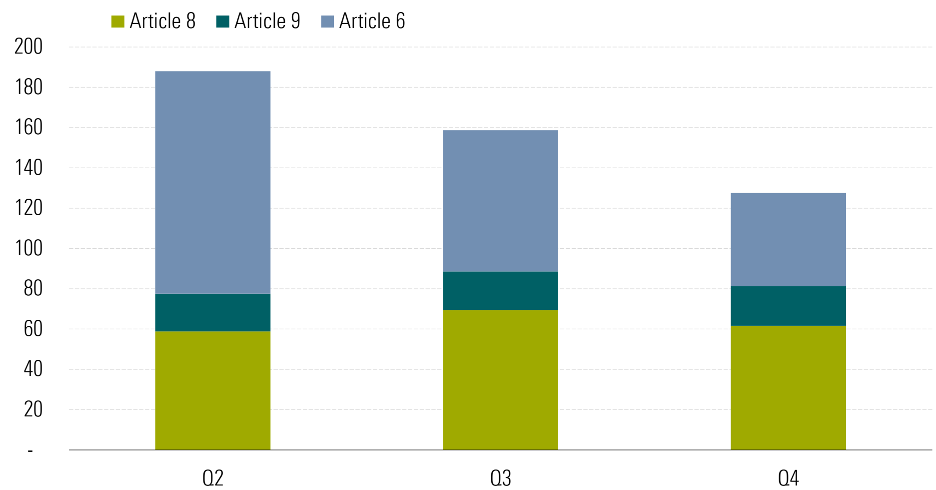
These differences mean that investors have varying numbers of Article 8 and Article 9 options depending on the asset class and sub-asset class they're looking to gain exposure to. While this may remain the case going forward because there are asset classes where ESG is easier to implement than others, we expect choice to continue to increase across the board.

Flows Into Article 8 and Article 9 Funds

In the fourth quarter of 2021, investors poured EUR 81.4 billion into Article 8 and Article 9 funds. This was 8% less than the EUR 88.5 billion in the third quarter. But by comparison, Article 6 fund flows declined by over 30%. Article 8 and Article 9 captured 64% of our reviewed fund universe's total flows in the fourth quarter. This compared with 56% in the third quarter and 41% in the second quarter.

Looking at a more-granular level, in the fourth quarter, Article 8 funds attracted 76% of the total Article 8 and Article 9 fund flows, while Article 9 funds attracted 24%.

Exhibit 6 Flows into Article 8 and Article 9 Funds versus Article 6 Funds (EUR Billion)



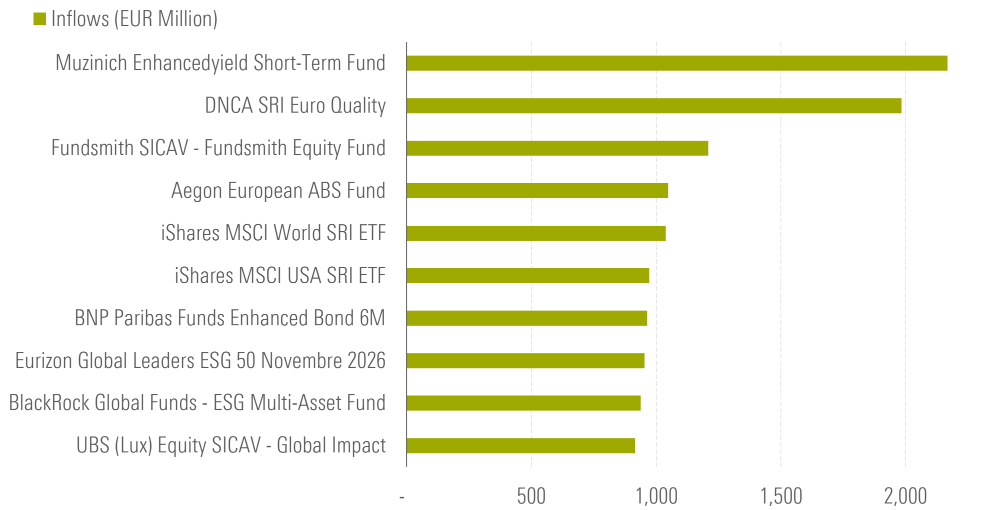
Source: Morningstar Direct. Data as of 31 Dec 2021. Based on SFDR data collected from prospectuses on 91% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds.

The increasing share of Article 8 and Article 9 funds in overall fund flows can be explained by the growing investor interest in ESG and sustainability issues, especially climate change, and the expanding range of options available. We expect this trend to continue this year as ESG becomes the norm and more funds are classified as Article 8 or Article 9. The MiFID II amendment coming into effect in August will encourage more retail flows into sustainable funds as financial advisors will be required to ask clients about their sustainability preferences, in addition to their financial objectives. This is expected to spur more interest and education around sustainable investing.

Flows—Leaders and Laggards

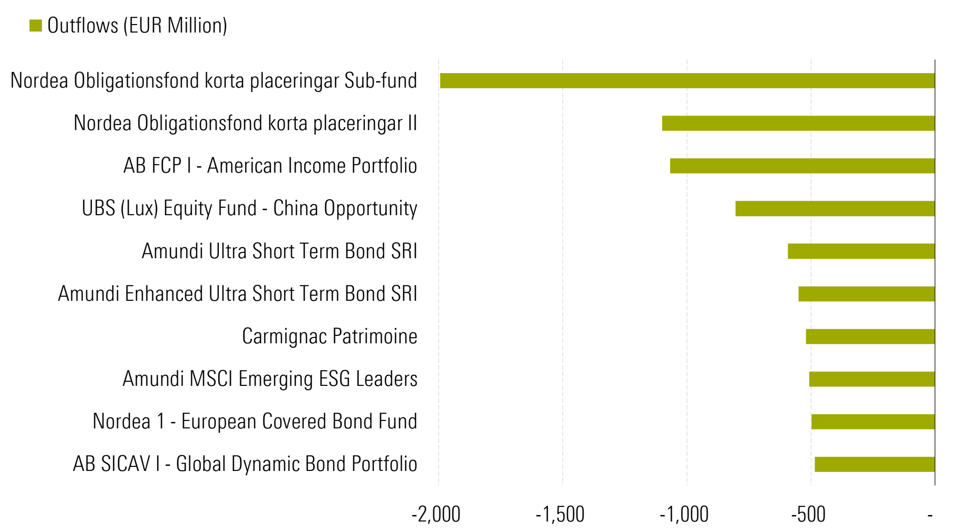
Below are the Article 8 and Article 9 funds that experienced the largest inflows and outflows in the fourth quarter.

Exhibit 7 Article 8 Funds with the Largest Inflows in the Fourth Quarter of 2021



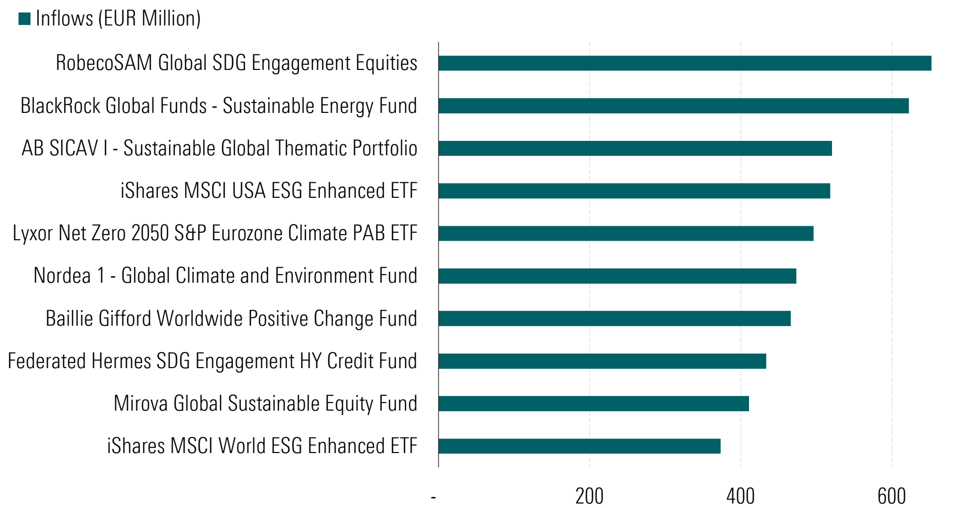
Source: Morningstar Direct. Data as of 31 Dec 2021. Based on SFDR data collected from prospectuses on 91% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds.

Exhibit 8 Article 8 Funds with the Largest Outflows in the Fourth Quarter of 2021



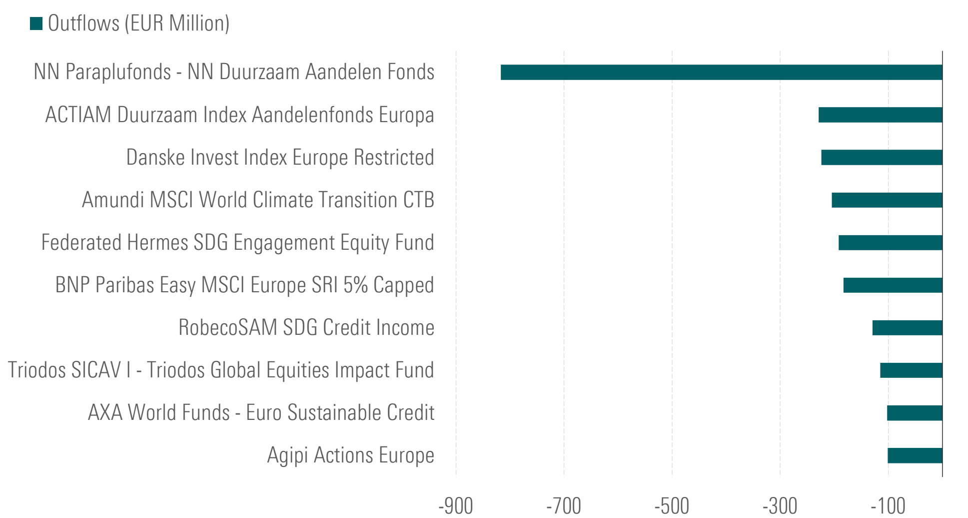
Source: Morningstar Direct. Data as of 31 Dec 2021. Based on SFDR data collected from prospectuses on 91% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds.

Exhibit 9 Article 9 Funds with the Largest Inflows in the Fourth Quarter of 2021



Source: Morningstar Direct. Data as of 31 Dec 2021. Based on SFDR data collected from prospectuses on 91% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds.

Exhibit 10 Article 9 Funds with the Largest Outflows in the Fourth Quarter of 2021



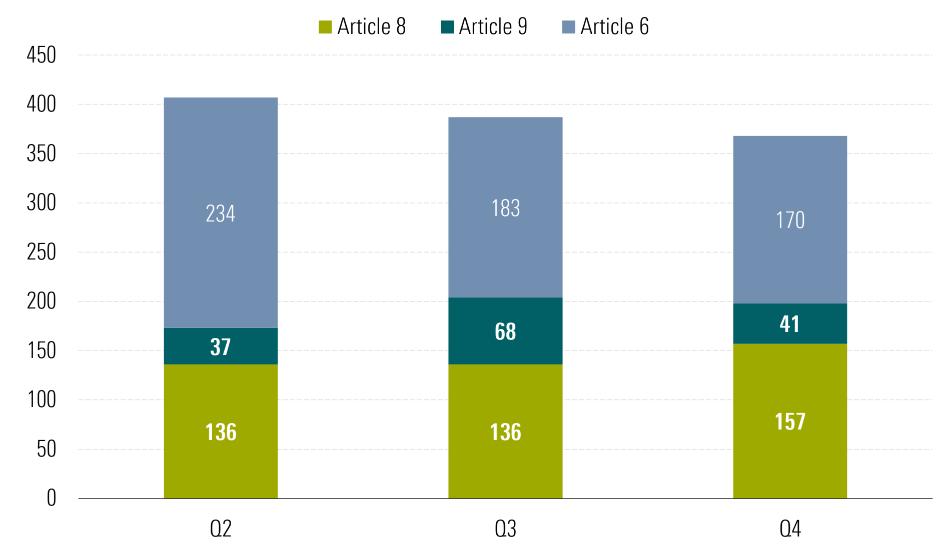
Source: Morningstar Direct. Data as of 31 Dec 2021. Based on SFDR data collected from prospectuses on 91% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds.

Article 8 and Article 9 Fund Launches

SFDR has acted as a catalyst for product development and innovation in Europe, with close to 600 new funds launched as Article 8 or Article 9 since its introduction in March, representing almost half of all EU new fund launches over the period.

While the overall number of launches in our reviewed EU fund universe decreased from March to December, the number of new funds classified as Article 8 increased to reach a record high of 157 in the fourth quarter. The number of Article 9 fund launches was the highest in the third quarter, at 68.

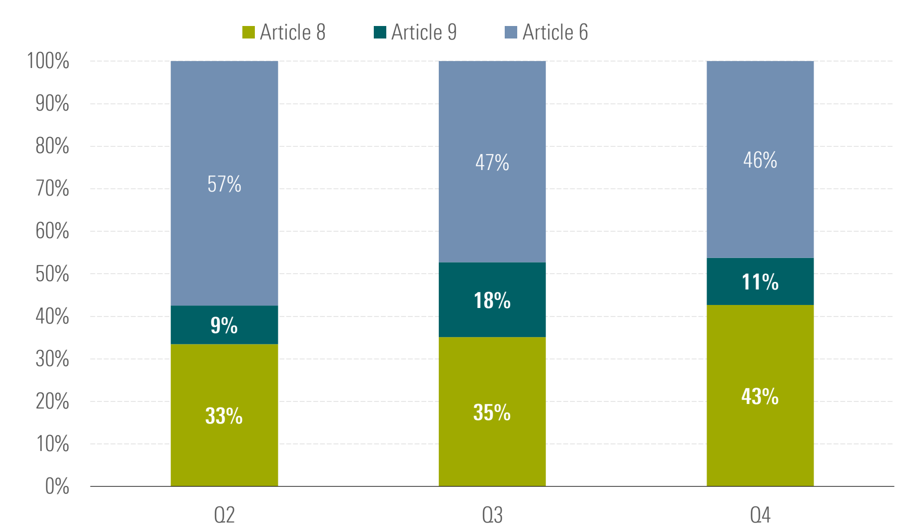
Exhibit 11 Quarterly Number of Fund Launches



Source: Morningstar Direct. Data as of 31 Dec 2021. Based on SFDR data collected from prospectuses on 91% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds.

As a result, the share of Article 8 and Article 9 funds in the total new funds launched in the EU incrementally increased to reach 54% in the fourth quarter, from 43% in the second quarter.

Exhibit 12 Quarterly Breakdown of Fund Launches

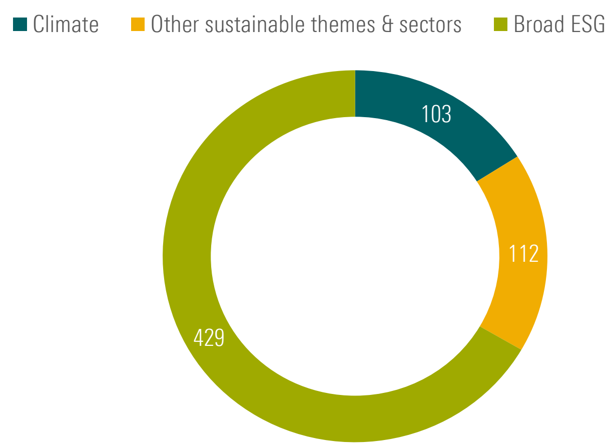


Source: Morningstar Direct. Data as of 31 Dec 2021. Based on SFDR data collected from prospectuses on 91% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds.

Throughout the year, asset managers expanded the range of Article 8 and Article 9 options available to investors in terms of asset class, market exposure, investment style, and theme. Equity remained the source of the greatest product proliferation with 329 new offerings, followed by fixed income and allocation with 141 and 121, respectively. Passive offerings accounted for 14% of new launches.

While broad ESG and sustainable funds represented the bulk of new Article 8 and Article 9 offerings, funds with an environmental flavour accounted for more than one fourth of new launches. Of these, 87% (103) were funds marketed as climate-focused funds.[3] Climate-themed funds allow investors to reduce climate risk in portfolios and/or gain exposure to companies that will benefit from, or contribute to, the transition to a low-carbon economy. We expect the range of options for climate-conscious investors to continue to expand in 2022.

Exhibit 13 Types of New Article 8 and Article 9 Fund Launches Since 10 March 2021



Source: Morningstar Direct. Data as of 31 Dec 2021. Based on SFDR data collected from prospectuses on 91% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds.

Recently launched Article 8 climate funds include **Allianz Green Transition Bond fund**, which focuses on debt issuers who work towards the transition to a low-carbon society, natural capital preservation, and adaptation to climate change. **Alliance Bernstein Sustainable Climate Solutions Portfolio** is another example. This Article 9 strategy invests in companies providing products or services that address environmental challenges relating to climate change, such as clean energy, transportation, recycling, resource efficiency, and water.

Other sustainability-related themes addressed last year included gender, smart cities, the ocean, and the UN's Sustainable Development Goals. Examples include **RobecoSAM QI Global SDG & Climate Beta Equities**, an Article 9 quant-driven fund targeting companies that advance the UN Sustainable Development Goals and contribute to maintaining the global temperature rise below 2 degrees Celsius.

3 Investing in Times of Climate Change—A Global View of the Expanding Choice Available to Climate-Aware Investors.

Another recently launched fund is **M&G Diversity and Inclusion** (Article 9), which invests in companies that have demonstrable gender and/or ethnic diversity as well as firms that provide solutions empowering social equality.

Reclassified Funds

Launching new Article 8 and Article 9 funds is not the only way asset managers have responded to increased investor demand for ESG and sustainable investment options. They have also retooled Article 6 funds by enhancing their ESG integration processes and/or adding binding ESG criteria to their investment objectives and/or investment policies. The changes applied to these funds vary greatly, ranging from adding exclusionary screens to a complete overhaul of the investment objective, investment policy, and holdings.

Post March 10, around 1,800 funds were upgraded either from Article 6 to Article 8 or Article 9, or from Article 8 to Article 9, according to Morningstar's database. Only a minority of these upgraded products experienced a name change. We didn't identify any Article 8 or Article 9 funds that were downgraded.

Examples of funds recently upgraded from Article 6 to Article 9 include BGF China Impact, previously called BGF China A-Shares Fund. The fund was fully revamped into an impact-oriented strategy, which:

> "*invests in "impact" investments which are those made with the intention to generate positive, measurable social and/or environmental impact alongside a financial return. […] the Investment Adviser (IA) will seek to limit and/or exclude […] issuers which, in the opinion of the IA, have exposure to, or ties with, certain sectors. […]*"

On the passive side, BNP Paribas AM recently converted several products to broad ESG or Paris-Aligned Benchmarks, some from Article 6 to Article 8, while others, already categorised as Article 8, were reclassified as Article 9.

While some funds have used SFDR to overhaul their strategies entirely to align with sustainable objectives, others have simply formalized ESG exclusions that were already employed to define the investable universe, or merely clarified the role that ESG factors play in the strategy without making significant, or any, changes to the investment process.

For example, UK-based manager Artemis recently notified fundholders that it will add exclusions-related language to some funds' prospectuses to make them Article 8, but that no impact on the portfolios should be expected as a result. The firm stated:

> "*The investment policy [...] will be updated to* ***include detail on exclusions****. [...] The exclusions represent certain sectors and business activities which are not already considered part of the sub-fund's investable universe: tobacco, gambling, weapons and fossil fuels. […]* ***The changes are intended to clarify*** *the way in which the sub-fund is currently managed. [...]* ***It is not expected that any of the sub-fund's portfolio holdings will need to be sold as a result, nor***

> ***will there be any change in the sub-fund's investment strategy and the operation and/or manner in which the sub-fund is being managed following these changes.***"

It's worth noting that such language isn't unique to reclassified funds. Similar language was used by funds classified as Article 8 from March 10. For example, the Fundsmith Equity Fund's shareholders were notified then that:

> "*The Investment Manager's responsible investment approaches can be summarised as "considering ESG issues when building a portfolio." […]* ***The changes are intended to clarify*** *the way in which the Sub-fund is currently managed. All other key features of the Sub-fund will remain the same.* ***There is no change in the Sub-fund's investment style, investment philosophy, investment strategy, and the operation and/or manner in which the Sub-fund is being managed following these clarifications.***"

Such light-touch and business-as-usual approaches have legitimately raised concerns that asset managers are greenwashing their product ranges, and that investors could be misled in thinking that funds now marketed as promoting ESG characteristics or pursuing sustainable goals are noticeably different from what they were prior to SFDR or different from similar offerings that haven't been classified as Article 8 or Article 9.

That said, it is also important to keep in mind that SFDR classification is about disclosing relevant ESG information, but it doesn't constitute an ESG label and additional analysis and metrics are required to assess funds' ESG credentials.

The Largest Article 8 and Article 9 Funds

In the past three months, the league tables of the largest Article 8 and Article 9 funds haven't changed much. Two AllianceBernstein fixed-income funds remain at the top. In their prospectuses, **AB American Income** and **AB Global High Yield** state that they promote environmental and/or social characteristics through the consideration of material ESG factors and through engagement, with seemingly no binding constraints.

Exhibit 14 The 20 Largest Article 8 Funds

Name	SFDR Fund Type	Morningstar Global Category	AUM (EUR Billion)	Active / Passive	Morningstar Sustainability Rating
AB American Income	Article 8	US Fixed Income	19.8	Active	—
AB Global High Yield	Article 8	Global Fixed Income	17.1	Active	—
hausInvest	Article 8	Property-Direct	17.1	Active	—
Fidelity Global Technology Fund	Article 8	Technology Sector Equity	14.5	Active	🌐🌐🌐🌐
Findlay Park American Fund	Article 8	US Equity Large Cap Growth	14.4	Active	🌐🌐🌐🌐
Pictet-Global Megatrend Selection	Article 8	Global Equity Large Cap	13.9	Active	🌐🌐🌐
M&G (Lux) Optimal Income Fund	Article 8	Cautious Allocation	13.6	Active	🌐🌐🌐
Muzinich Enhancedyield Short-Term Fund	Article 8	Global Fixed Income	12.7	Active	—
DWS Concept Kaldemorgen	Article 8	Flexible Allocation	12.7	Active	🌐🌐🌐🌐
Mercer Multi Asset Growth Fund	Article 8	Aggressive Allocation	11.0	Active	🌐🌐🌐
Allianz China A Shares	Article 8	Greater China Equity	10.8	Active	🌐🌐🌐
Schroder ISF EURO Corporate Bond	Article 8	Europe Fixed Income	10.6	Active	🌐🌐🌐
Swedbank Robur Technology	Article 8	Technology Sector Equity	10.2	Active	🌐🌐🌐🌐
Carmignac Patrimoine	Article 8	Moderate Allocation	10.1	Active	🌐🌐🌐
JPMorgan Emerging Markets Equity Fund	Article 8	Global EM Equity	10.1	Active	🌐🌐🌐🌐
Fidelity Global Dividend Fund	Article 8	Global Equity Large Cap	10.0	Active	🌐🌐🌐🌐🌐
Wellington Global Quality Growth Fund	Article 8	Global Equity Large Cap	10.0	Active	🌐🌐🌐🌐
Jupiter Dynamic Bond	Article 8	Global Fixed Income	10.0	Active	—
grundbesitz europa	Article 8	Property-Direct	9.8	Active	—
iShares MSCI USA SRI ETF	Article 8	US Equity Large Cap Blend	9.3	Passive	🌐🌐🌐🌐🌐

Source: Morningstar Direct. Data as of 31 Dec 2021. Based on SFDR data collected from prospectuses on 91% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds.

DWS Concept Kaldemorgen made an entry into the Article 8 league table after DWS reclassified it from Article 6 at the end of December. In addition to considering ESG criteria alongside financial performance when selecting stocks or bonds, the fund applies exclusions based on DWS' proprietary ESG scoring framework and on controversial activities (such as tobacco, controversial weapons, and coal mining).

For the first time, a passive fund, **iShares MSCI USA SRI ETF**, appears in the Article 8 league table, helped by strong inflows of EUR 971 million in the last three months of the year. **IShares MSCI USA SRI ETF** happens to be the only fund in the list reflecting its ESG mandate in its name. One may be surprised to see that no other funds have ESG-related terms in their names that would indicate they are actively marketed as ESG or sustainable.

This is unlike the Article 9 league table below, which includes 17 funds with terms in their names reflecting their sustainable strategy. The three exceptions are two Handelsbanken index funds, which kept their traditional names after switching in May 2021 to newly created Paris-Aligned Benchmarks, and **Carmignac Investissement**, which was recently reclassified from Article 8. According to its latest KIID, **Carmignac Investissement** now primarily invests "in companies that generate more than 50% of their revenue from goods and services linked to commercial activities that are positively aligned with one of 9 of the 17 United Nations Sustainable Development Goals. [...] Furthermore, the fund targets carbon emissions 30% lower than those of the reference indicator." We wouldn't be surprised if this fund is rebranded at some point in the near future.

Exhibit 15 The 20 Largest Article 9 Funds

Name	SFDR Fund Type	Morningstar Global Category	AUM (EUR Billion)	Active / Passive	Morningstar Sustainability Rating
Nordea 1 - Global Climate and Environment	Article 9	Global Equity Mid/Small Cap	11.4	Active	🌐🌐🌐🌐🌐
Pictet - Global Environmental Opportunities	Article 9	Global Equity Large Cap	10.4	Active	🌐🌐🌐🌐🌐
Pictet-Water	Article 9	Equity Miscellaneous	9.7	Active	🌐🌐🌐🌐
BlackRock Sustainable Energy	Article 9	Energy Sector Equity	7.3	Active	🌐🌐🌐🌐🌐
Handelsbanken Global Index Criteria	Article 9	Global Equity Large Cap	6.2	Passive	🌐🌐🌐
ALM Souverains Euro ISR	Article 9	Europe Fixed Income	5.6	Active	🌐🌐🌐
Pictet-Clean Energy	Article 9	Energy Sector Equity	5.3	Active	🌐🌐🌐🌐🌐
Mirova Global Sustainable Equity	Article 9	Global Equity Large Cap	5.1	Active	🌐🌐🌐🌐🌐
iShares Global Clean Energy ETF	Article 9	Energy Sector Equity	4.9	Passive	🌐🌐🌐🌐
iShares MSCI USA ESG Enhanced ETF	Article 9	US Equity Large Cap Blend	4.7	Passive	🌐🌐🌐🌐
Handelsbanken USA Index	Article 9	US Equity Large Cap Blend	4.3	Passive	🌐🌐🌐🌐
BNP Paribas Funds Aqua	Article 9	Equity Miscellaneous	4.3	Active	🌐🌐🌐
AB Sustainable Global Thematic Portfolio	Article 9	Global Equity Large Cap	4.2	Active	🌐🌐🌐🌐
BNP Paribas Funds Global Environment	Article 9	Global Equity Large Cap	4.1	Active	🌐🌐🌐🌐🌐
Carmignac Investissement	Article 9	Global Equity Large Cap	3.9	Active	🌐🌐🌐
BNP Paribas Funds Climate Impact	Article 9	Global Equity Mid/Small Cap	3.8	Active	🌐🌐🌐🌐
RobecoSAM Smart Energy Equities	Article 9	Energy Sector Equity	3.7	Active	🌐🌐🌐🌐🌐
NN Duurzaam Aandelen Fonds	Article 9	Global Equity Large Cap	3.7	Active	🌐🌐🌐🌐🌐
RobecoSAM Sustainable Water Equities	Article 9	Equity Miscellaneous	3.7	Active	🌐🌐🌐
Handelsbanken Hållbar Energi	Article 9	Energy Sector Equity	3.5	Active	🌐🌐🌐🌐

Source: Morningstar Direct. Data as of 31 Dec 2021. Based on SFDR data collected from prospectuses on 91% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds.

Another fund that reclassified from Article 8 and is now part of the Article 9 league table is the **iShares MSCI USA ESG Enhanced ETF**. The fund is part of a range of six iShares ESG Enhanced ETFs that now track Climate Transition Benchmarks. The new indexes implement a 30% carbon intensity reduction versus the parent index and a 7% year-on-year decarbonisation target.

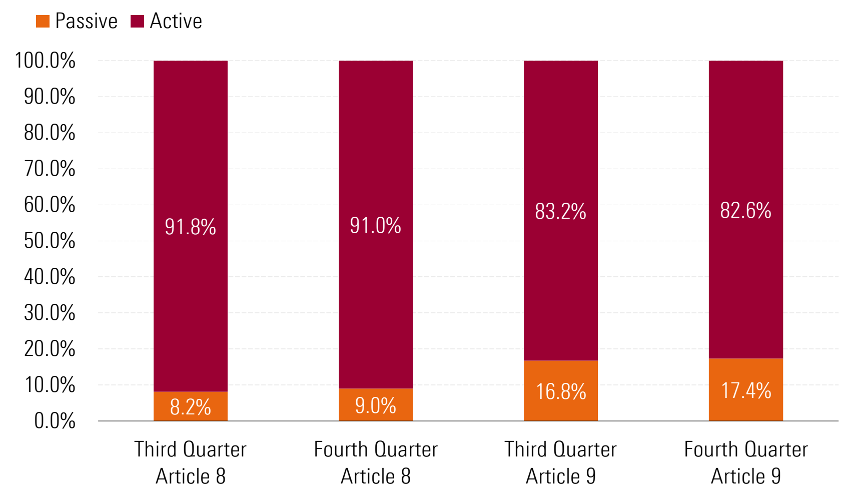
The leader board of Article 9 funds is well staffed with products focused on the environment and themes like renewable energy, climate transition, and water. Three funds, namely **ALM Souverains Euro ISR**, **Mirova Global Sustainable Equity**, and **NN Duurzaam Aandelen Fonds**, offer broader exposure to the equity and bond markets

Spotlight on Passive Article 8 and Article 9 Funds

Active funds continue to largely dominate the SFDR Article 8 and Article 9 landscape, However, the market share of passive funds increased slightly throughout the year, ending at 9% and 17.4%, respectively.

Combined, passive funds account for 9.7% of overall Article 8 and Article 9 fund assets, less than half of the 20.3% market share for passive funds in the overall European fund universe.

Exhibit 16 Market Share of Active and Passive Funds Classified as Article 8 and Article 9



Source: Morningstar Direct. Data as of 31 Dec 2021. Based on SFDR data collected from prospectuses on 91% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds

The larger market share of passive funds classified as Article 9 may appear counterintuitive but it can be partly explained by the growing number of sizable index funds and ETFs that track EU Climate benchmarks (more on this below).

There were 331 passive ETFs and 240 index-tracking open-end funds classified as Article 8 and Article 9, as of the end of December 2021. Open-end funds have historically been the passive vehicle of choice for socially conscious investors in Europe, but growth in the size and breadth of the offering in the ETF space has tipped the balance to the other side. Assets in Article 8 and Article 9 ETFs closed the year at just shy of EUR 200 billion. ESG remains a top priority for most ESG providers in terms of product development for 2021. Below are the top 10 ETFs in Article 8 and Article 9.

Exhibit 17 The 10 Largest Article 8 ETFs

Name	SFDR Fund Type	Morningstar Global Category	AUM (EUR Billion)	Morningstar Sustainability Rating
iShares MSCI USA SRI ETF	Article 8	US Equity Large Cap Blend	9.3	🌐🌐🌐🌐🌐
iShares MSCI World SRI ETF	Article 8	Global Equity Large Cap	6.1	🌐🌐🌐🌐🌐
iShares MSCI Europe SRI ETF	Article 8	Europe Equity Large Cap	5.3	🌐🌐🌐🌐🌐
Amundi MSCI USA SRI ETF	Article 8	US Equity Large Cap Blend	5.2	🌐🌐🌐🌐🌐
SPDR® Bloomberg SASB U.S. Corporate ESG ETF	Article 8	US Fixed Income	5.1	🌐🌐🌐🌐🌐
iShares Global Clean Energy ETF	Article 8	Energy Sector Equity	4.9	🌐🌐🌐🌐
iShares MSCI USA ESG Enhanced ETF	Article 8	US Equity Large Cap Blend	4.7	🌐🌐🌐🌐
UBS MSCI World Socially Responsible ETF	Article 8	Global Equity Large Cap	4.6	🌐🌐🌐🌐🌐
iShares MSCI USA ESG Screened ETF	Article 8	US Equity Large Cap Blend	4.6	🌐🌐🌐
Xtrackers MSCI USA ESG UCITS ETF	Article 8	US Equity Large Cap Blend	4.2	🌐🌐🌐🌐🌐

Source: Morningstar Direct. Data as of 31 Dec 2021. Based on SFDR data collected from prospectuses on 91% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds

The top 10 ETFs categorised as Article 8 are very much dominated by US large-cap equity strategies, which occupy five spots in the league table.

Exhibit 18 The 10 Largest Article 9 ETFs

Name	SFDR Fund Type	Morningstar Global Category	AUM (EUR Billion)	Morningstar Sustainability Rating
iShares Global Clean Energy ETF	Article 9	Energy Sector Equity	4.9	🌐🌐🌐🌐
iShares MSCI USA ESG Enhanced ETF	Article 9	US Equity Large Cap Blend	4.7	🌐🌐🌐🌐
BNP Paribas Easy MSCI USA SRI PAB 5% Capped	Article 9	US Equity Large Cap Blend	2.9	🌐🌐🌐🌐🌐
iShares MSCI World ESG Enhanced ETF	Article 9	Global Equity Large Cap	2.0	🌐🌐🌐🌐
BNP Paribas Easy MSCI Europe SRI PAB 5% Capped	Article 9	Europe Equity Large Cap	1.7	🌐🌐🌐🌐🌐
iShares MSCI EM ESG Enhanced ETF	Article 9	Global Emerging Markets Equity	1.6	🌐🌐🌐🌐
Lyxor Net Zero 2050 S&P Eurozone Climate PAB ETF	Article 9	Europe Equity Large Cap	1.4	🌐🌐🌐🌐
BNP Paribas Easy MSCI Japan SRI PAB 5% Capped	Article 9	Japan Equity	1.2	🌐🌐🌐🌐🌐
Deka MSCI USA Climate Change ESG ETF	Article 9	US Equity Large Cap Blend	1.1	🌐🌐🌐🌐
iShares MSCI Europe ESG Enhanced ETF	Article 9	Europe Equity Large Cap	1.1	🌐🌐🌐

Source: Morningstar Direct. Data as of 31 Dec 2021. Based on SFDR data collected from prospectuses on 91% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds

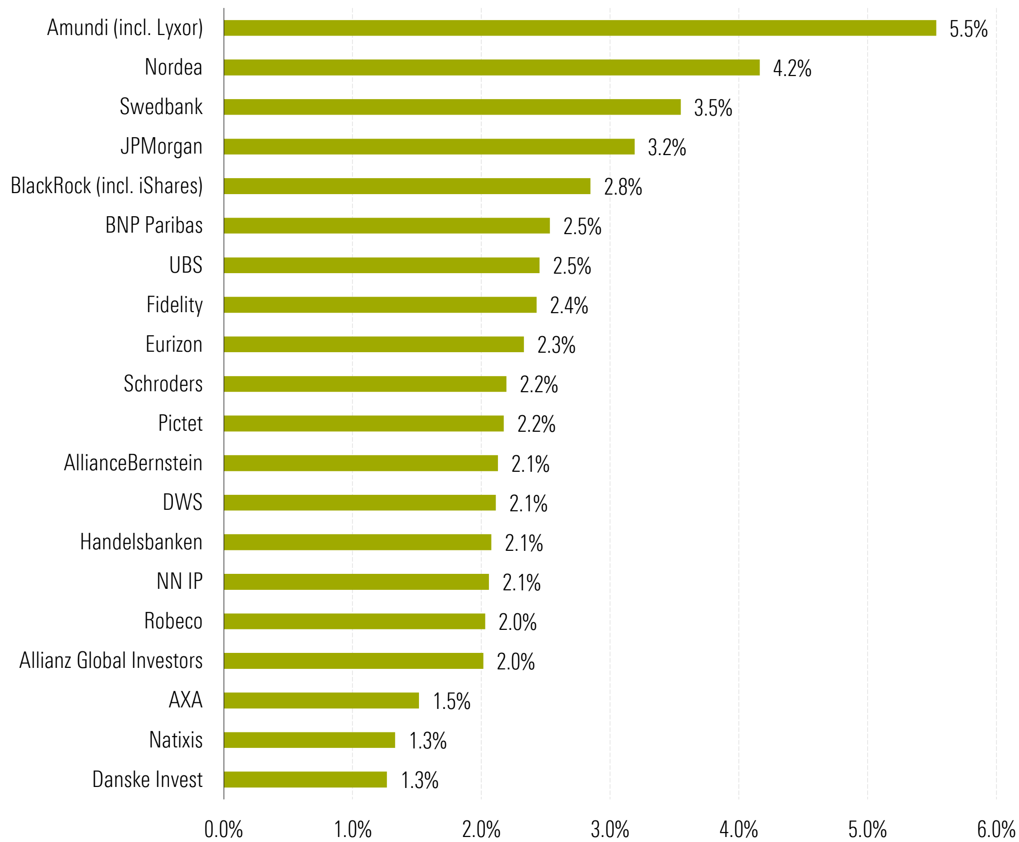
The Article 9 ETF league table is more diversified in terms of geographic exposure and provider. Interestingly though, all 10 funds track indexes that integrate the climate theme. As previously mentioned, in December, the iShares MSCI ESG Enhanced ETF range switched to Climate Transition Benchmarks, while BNP Paribas MSCI SRI ETFs switched to Paris-Aligned Benchmarks.

To achieve Paris-Alignment classification, a fund must invest in companies that reduce their carbon intensity by an average of 7% annually—the pace of phasing-out of fossil fuels set out in the Paris Agreement—and the fund overall must have a carbon footprint (including scope 3 emissions) 50% below that of the investable universe. For EU Climate Transition Benchmarks, the carbon footprint must be only at least 30% lower. There is currently a debate as to whether funds that track either benchmark should be classified as Article 9.

Provider League Table

Exhibit 19 ranks the 20 asset managers with the largest Article 8 and Article 9 fund assets, based on SFDR data representing 91% of the EU fund universe excluding money markets, feeder funds, and funds of funds.

Exhibit 19 Top 20 Asset Manager Ranking by Article 8 and Article 9 Fund Assets



Source: Morningstar Direct. Data as of 31 Dec 2021. Based on SFDR data collected from prospectuses on 91% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds. Using Branding Name.

The trio topping the league table—Amundi, Nordea, and Swedbank—remains unchanged compared with the third quarter, albeit with slightly lower market shares of 5.5%, 4.2%, and 3.5%, down from 6.2%, 4.7%, and 3.9%, respectively, as competition heats up.

All asset managers in the table bar four (BNP Paribas, UBS, DWS, and AXA) saw their market shares erode slightly in the last three months. BNP Paribas registered the highest market share increase (0.6 percentage points), propelling it to sixth place from the 16th. The French manager has partly benefitted from the retooling of several passive offerings from Article 6 to Article 8 or Article 9. The firm announced in December that it will integrate ESG criteria across its entire passive fund range by the end of 2022. Meanwhile, DWS has recently reclassified close to 40 strategies across all asset classes from Article 6 to Article 8.

Finally, Danske Invest made its entry in 20th position, replacing Credit Suisse.

How Do Article 8 and Article 9 Funds Stack Up?

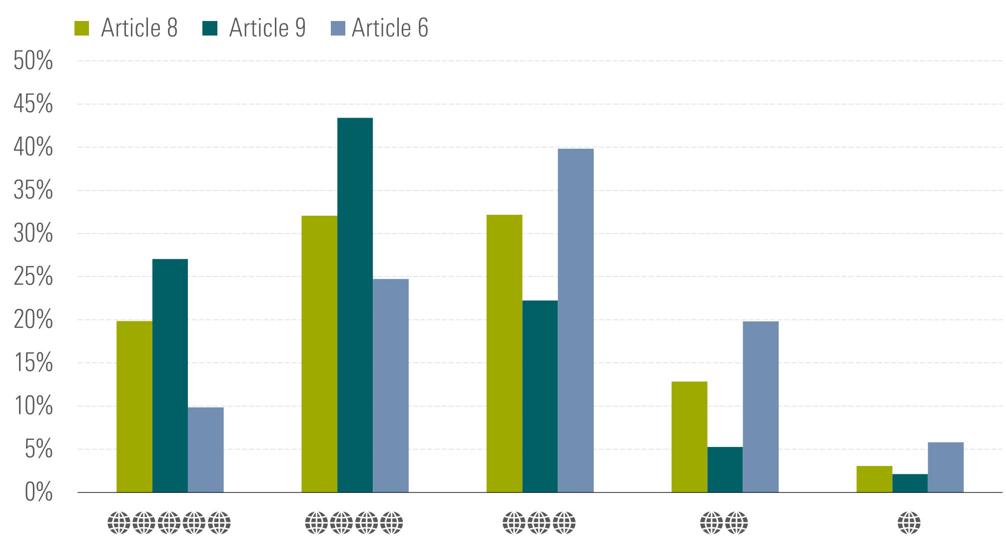
Independent of their classifications, we can use metrics to assess whether Article 8 and Article 9 funds exhibit desirable ESG characteristics. For example, do they have a high exposure to companies with less ESG risk? Do they have low exposure to severe controversies? Do they invest in companies whose activities and products will help the transition to a low-carbon economy? In this section, we address these questions and compare the ESG characteristics of Article 8 and Article 9 funds and the extent to which they differ from Article 6 funds. We also analyse how the ESG profile of these funds has evolved over the past six months.

Do Article 8 and Article 9 Funds Manage Their ESG Risks Better Than Article 6 Funds?

First, we examine the extent to which Article 8 and Article 9 funds are limiting their portfolios' exposure to ESG risk compared with peers. The Morningstar Sustainability Rating can help answer these questions.

The Morningstar Sustainability Rating is an asset-weighted roll-up of Sustainalytics' company and sovereign ESG Risk Ratings based on the trailing 12 months of a fund's portfolios. Intuitively, we would expect Article 8 and Article 9 funds to be managing their ESG risks better than Article 6 funds.

Exhibit 20 Globe Distribution for Article 6, 8, and 9 funds



Source: Morningstar Direct. Based on SFDR universes as of December 2021, while the ratings are as of November 2021.

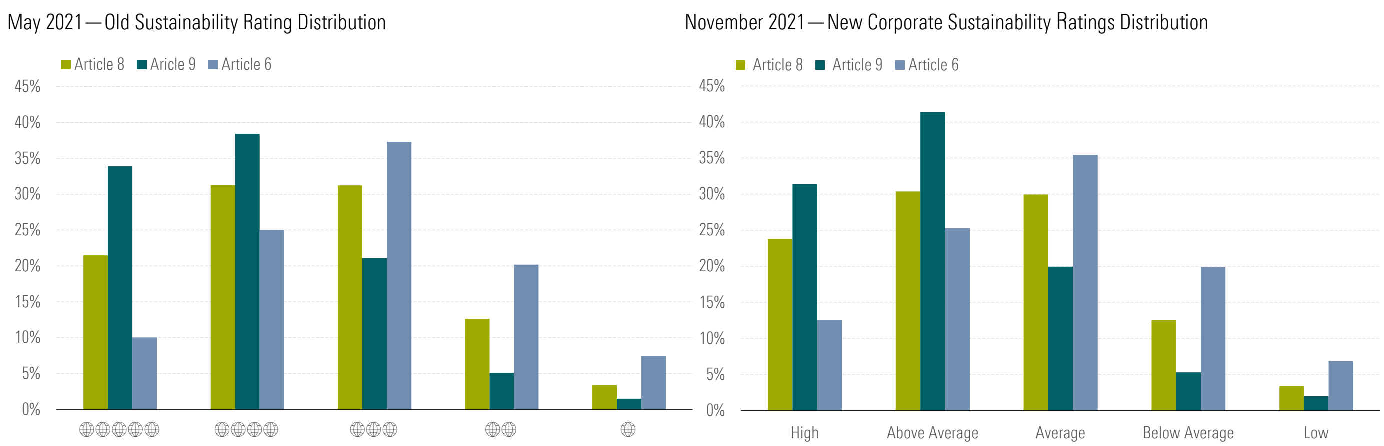
As seen in Exhibit 20, that is indeed the case. The rating distribution skews towards the higher Sustainability Ratings for Article 8 and Article 9 funds. In November, 52% of Article 8 funds and 70.4% of Article 9 funds received the highest ratings, 4 or 5 globes, compared with 34.6% of Article 6 funds. It's worth noting that the latter also skews positively, albeit to a lesser degree. This may be evidence that

ESG risk management has become more common practice in Europe relative to the rest of the world, especially following the introduction of SFDR.

In November 2021, Morningstar enhanced its Sustainability Rating[4] to incorporate sovereign ESG risk into the calculation of a fund's ESG risk, as the previous methodology only captured a fund's corporate ESG risk. While this enhancement increased the number of funds receiving globe ratings and allowed for a more-nuanced evaluation of the overall ESG risk and performance of a fund, it makes it difficult to make historical comparisons. The globe distribution at the end of 2021 in Exhibit 20 couldn't be compared with the one we reported on six months prior.

Instead, we use the corporate ESG risk component of the new rating called the "Portfolio Corporate Sustainability Rating," which captures the same information as the old "globes" methodology. Below, we compare the distribution of the Portfolio Corporate Sustainability Rating at end-November with the distribution of the globe rating at end-May.

Exhibit 21 Globe and Corporate Sustainability Rating Distribution for Article 6, 8, and 9 Funds



Source: Morningstar Research, Morningstar Direct. Based on SFDR universes as of June and December 2021, respectively.

Both rating distributions skew towards the higher end of the spectrum for Article 8 and Article 9 funds. The percentage of funds with top globe and Corporate Sustainability ratings is highest among Article 9 funds, indicating the latter invest in companies with lower ESG risks than Article 8 and Article 6 funds. The 72.8 % of Article 9 funds that earned High or Above Average Corporate Sustainable ratings in November was roughly in line with the proportion (72.3%) of Article 9 funds that earned 4 or 5 globes at the end of May 2021.

Meanwhile, Article 8 funds experienced a slight improvement of their ESG risk exposure profile in aggregate compared with May's levels. Of Article 8 funds, 54.2% had a High or Above Average

4 ESG Ratings Are Now Available for Bond Funds, Allocation Funds, Karen Wallace, Nov. 17, 2021.
https://www.morningstar.com/articles/1067453/esg-ratings-are-now-available-for-bond-funds-allocation-funds

Corporate Sustainable rating in November, up from 52.7% six months earlier. This improvement was partly helped by the new Article 8 funds added to our universe in the second part of the year, 55% of which earned High or Above Average Corporate Sustainability ratings. Some of these additions stem from portfolio managers reclassifying conventional strategies from Article 6 to Article 8 following the enhancement of their ESG integration process.

Do Article 8 and Article 9 Funds Have Low Exposure to Controversial Activities?

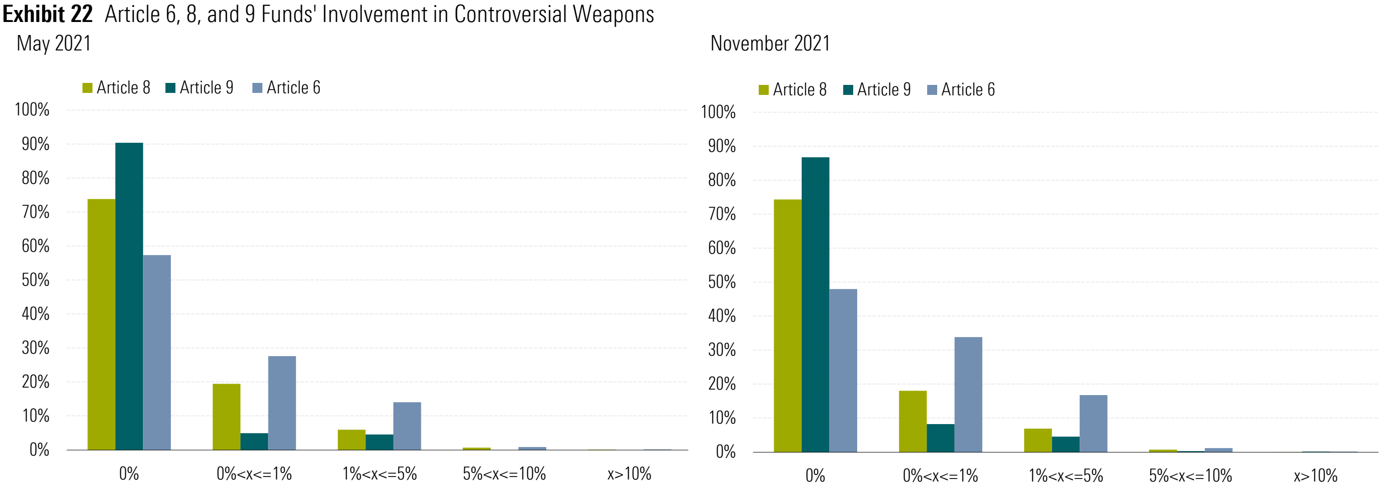
A growing number of funds in Europe are adding exclusions to their investment policies in order to limit, or completely avoid, exposure to companies involved in controversial activities such as controversial weapons and tobacco, as well as companies facing severe controversies. Yet, investors should not assume that all the funds classified as Article 8 and Article 9 do so, even the latter, which are supposed to invest in what SFDR defines as sustainable companies, provided that these companies do not also cause significant harm. Many asset managers have incorporated the "do no significant harm," or DNSH, principle in their Article 8 and Article 9 strategies by excluding issuers that violate international norms as defined by the UN Global Compact Principles.

Here, using Sustainalytics' underlying data rolled up to the portfolio level, we examine the exposure of Article 8 and Article 9 funds to several controversial activities and sectors, including controversial weapons, tobacco, thermal coal, and fossil fuel. We also analyse exposure to severe controversies and carbon solutions.

Controversial Weapons

First, we test the exposure of Article 8 and Article 9 funds to controversial weapons. For this, we use Morningstar's "Product Involvement %—Controversial Weapons" data point.[5]

Exhibit 22 Article 6, 8, and 9 Funds' Involvement in Controversial Weapons



Source: Morningstar Research, Morningstar Direct. Based on SFDR universes as June and December 2021, respectively.

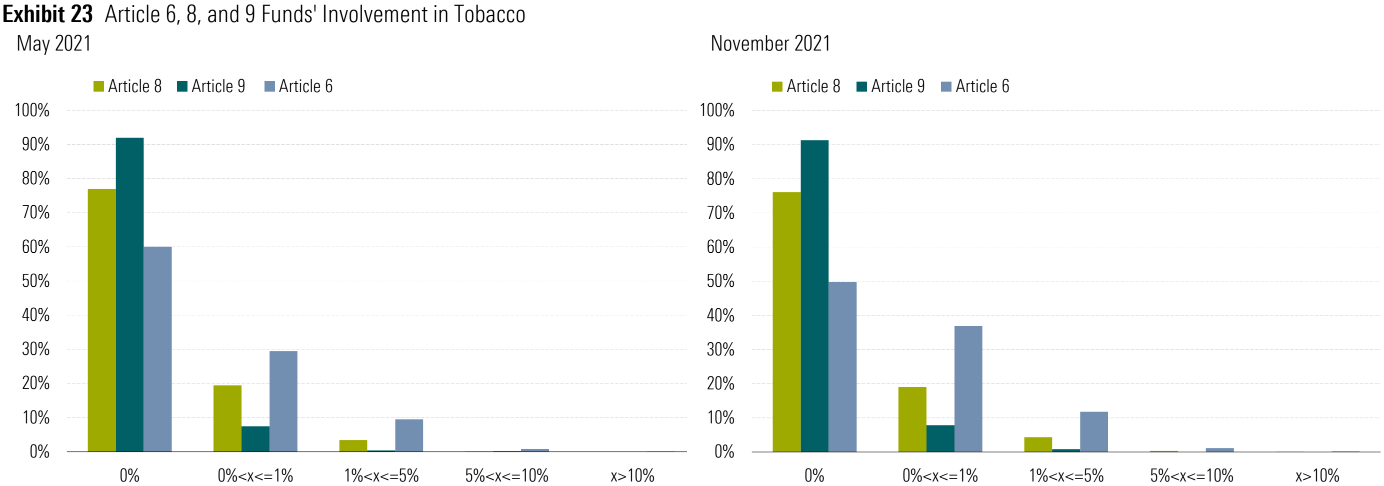
5 "Product Involvement %—Controversial Weapons" refers to the percentage of a fund's assets under management that is invested in companies that are classified as directly involved in the core weapon system that are considered tailor-made and essential for the lethal use of the weapon; indirectly by providing services for the core weapon system, which are either tailor-made or essential to the lethal use of the weapon. "Product Involvement %—Controversial Weapons" is binary, either yes or no.

As expected, Article 8 and Article 9 funds are less exposed to controversial weapons than Article 6 funds. About 74% and 87% of Article 8 and Article 9 portfolios, respectively, had zero involvement in controversial weapons at the end of November 2021, in line with May's involvement levels. This compares with just 48% of Article 6 funds, which is even lower than the 57% six months earlier.

Tobacco

Next, we test the exposure of Article 8 and Article 9 funds to tobacco. For this, we use Morningstar's "Product Involvement %—Tobacco" data point.[6]

Exhibit 23 Article 6, 8, and 9 Funds' Involvement in Tobacco



Source: Morningstar Research. Morningstar Direct. Based on SFDR universes as of June and December 2021, respectively.

As expected here again, Article 8 and Article 9 funds are less exposed to tobacco than Article 6 funds. About 76% and 91% of Article 8 and Article 9 portfolios, respectively, had no involvement in companies that derive more than 5% of their revenues from tobacco manufacturing at the end of November, which is in line with May's numbers. This compares with 50% of Article 6 offerings.

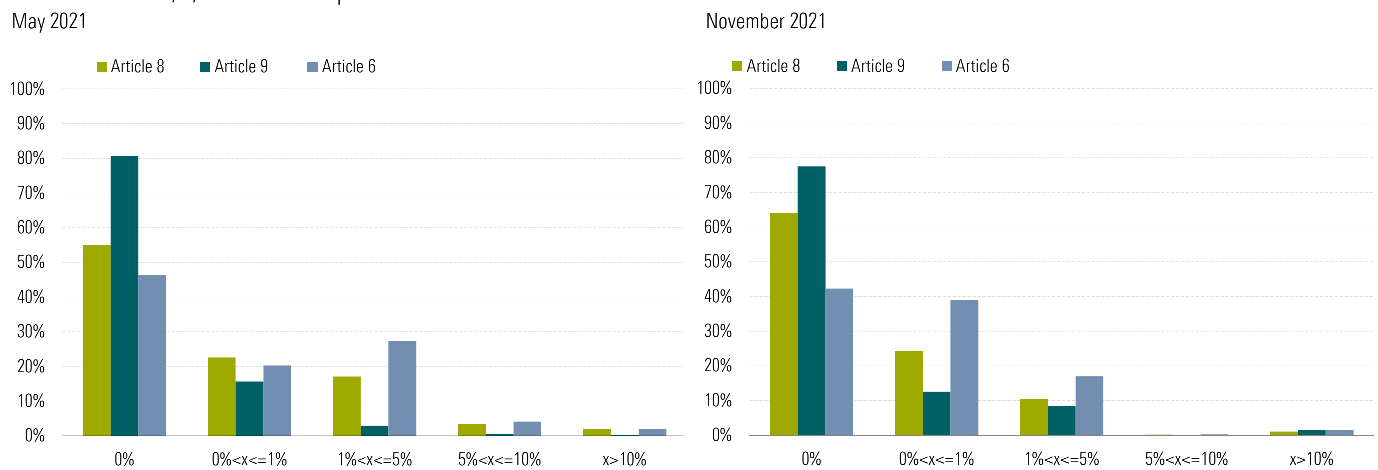
Severe Controversies

Now, we test the exposure of Article 8 and Article 9 funds to severe controversies. For this, we use Morningstar's "Percent of AUM with Severe Controversies" data point.[7]

6 "Product Involvement %—Tobacco" refers to the percentage of a fund's assets under management that is invested in companies that are classified as directly involved in the manufacturing of tobacco products; indirectly involved by supplying tobacco-related products; or deriving 10% or more of revenue from the distribution/retail sales of tobacco products. The minimum revenue threshold to mark a company as involved are the following ranges: Manufacturing: 0.1%-4.9%; Related & Revenues: 10%-24.9%.

7 Overall controversy assessments are assigned to companies using a five-point scale: Low, Moderate, Significant, High, Severe.

Exhibit 24 Article 6, 8, and 9 Funds' Exposure to Severe Controversies



Source: Morningstar Research, Morningstar Direct. Based on SFDR universes as of June and December 2021, respectively.

Article 8 and Article 9 funds remain less exposed to severe controversies than Article 6 funds, but surprisingly, over the past six months, Article 9 funds' exposure to severe controversies has deteriorated while that of Article 8 funds has improved. The percentage of Article 9 strategies exhibiting zero exposure to severe controversies declined from 81% to 77%, and as many as 10% now have over 1% exposure to severe controversies, up from 4% six months ago.

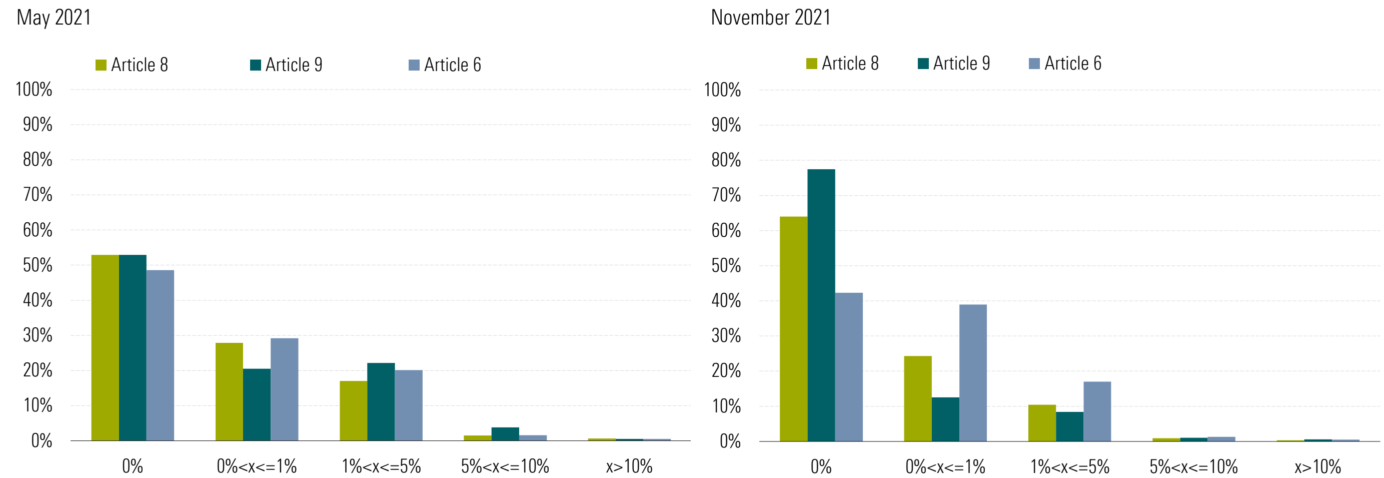
Meanwhile, 64% of Article 8 strategies have no exposure to severe controversies, an improvement over 55% in May, and only 12% have over 1% exposure to severe controversies, compared with 22% six months prior.

Thermal Coal Involvement

Now we test the exposure of Article 8 and Article 9 funds to one of the most carbon-intensive energy sources, thermal coal. We use the "Product Involvement %—Thermal Coal" data point.[8]

8 "Product Involvement %—Thermal Coal" refers to the percent of a fund's assets under management that is invested in companies that are classified as directly involved in the extraction of thermal coal; indirectly by generating electricity from thermal coal. The minimum revenue threshold to mark a company as involved is the following range: 5%-9.9%. On a lifecycle basis, thermal coal is the most carbon-intensive fossil fuel source, while from an energy-generation perspective, it is easily substitutable.

Exhibit 25 Article 6, 8, and 9 Funds' Involvement in Thermal Coal



Source: Morningstar Research, Morningstar Direct. Based on SFDR universes as of June and December 2021, respectively.

Most notable is the improvement in thermal coal involvement of Article 8 and Article 9 offerings. Close to 64% and 78% of funds classified as Article 8 and Article 9, respectively, exhibited no exposure to companies deriving more than 5% revenue from thermal coal at the end of November, compared with 53% in May.

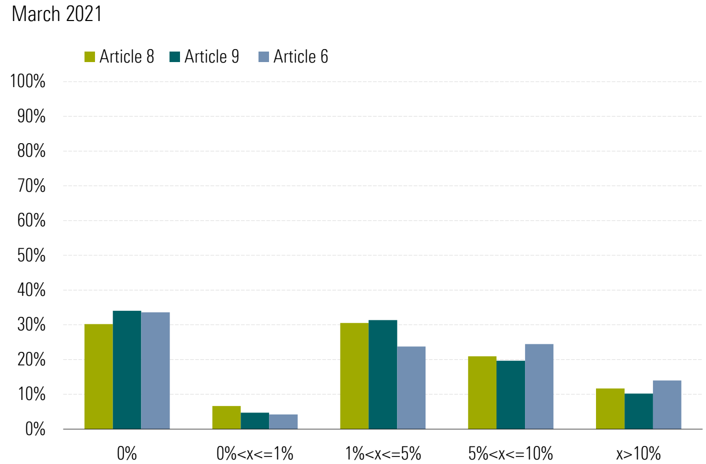
These better numbers could be explained by the more systematic exclusions of the worst carbon-intensive companies by asset managers. The strategies added to our reviewed universe in the second part of the year also exhibited a better profile on average than the existing ones.

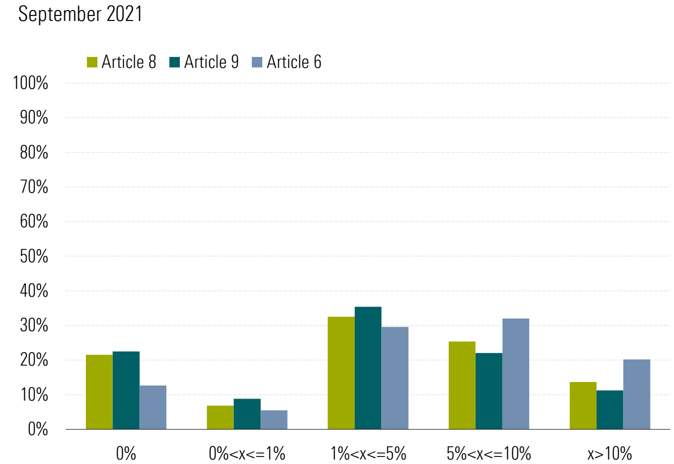
Fossil Fuel Involvement

We test the exposure of Article 8 and Article 9 funds to fossil fuel companies. For this, we use Morningstar's "Portfolio Fossil Fuel Involvement" metric, the percentage of the fund's assets that are involved in fossil fuels.[9] Unlike the previous metrics, the fossil fuel product involvement data is available only on a quarterly basis.

9 Companies are considered involved in fossil fuels if they derive at least an aggregate 5% share of total revenue from the following activities: thermal coal extraction, thermal coal power generation, oil and gas production, and oil and gas power generation. Companies deriving at least 50% of their revenue from oil and gas products & services are also included. Companies involved in Arctic oil & gas exploration and oil sands extraction will be included only if there is no involvement in oil & gas production.

Exhibit 26 Article 6, 8, and 9 Funds' Involvement in Fossil Fuel





Source: Morningstar Research, Morningstar Direct. Based on SFDR universes as of June and December 2021, respectively.

Perhaps not surprisingly given the rally in oil and gas prices last year, fund involvement in fossil fuel has increased across the board over the past six months, with only 22% of Article 8 and Article 9 funds exhibiting zero exposure to fossil fuels at the end of September, compared with 30% and 34%, respectively, six months prior.

As much as 39% and 33% of Article 8 and Article 9 portfolios, respectively, had over 5% exposure to fossil fuel companies in September, up from 33% and 30%, respectively, in March. The higher fossil fuel involvement of Article 9 funds, in particular, may still come as a surprise to some. But it is largely because many of these funds invest in so-called transitioning companies. These typically are oil and gas or utilities companies that have made a commitment to transition away from their highly carbon-intensive activities and have set net-zero emissions targets. These include oil and gas companies and utilities companies that are increasing their exposure to renewable energy but still operating their legacy fossil fuel businesses.

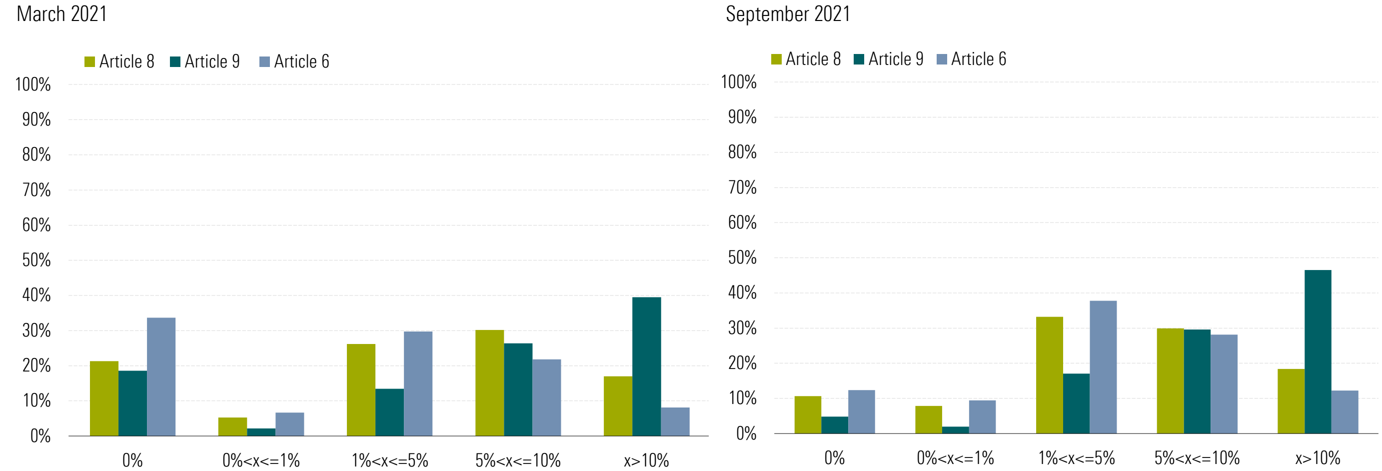
Here, we wondered if these deteriorating figures could be also partly explained by the newly launched and reclassified Article 9 funds added to our universe in the second part of the year. But it is not the case. In fact, the new additions had a better-than-average fossil fuel involvement profile at the end of September.

Carbon Solutions Involvement

Finally, we analyse how much exposure to climate solutions investors can expect from Article 8 and Article 9 funds.[10] Like fossil fuel product involvement, the carbon solutions product involvement data is available only on a quarterly basis.

10 Morningstar's Carbon Solutions Involvement is defined as a fund's asset-weighted percentage exposure to carbon solutions, including renewable energy production, renewal energy supporting products and services, and green transportation. Holdings are considered involved with carbon solutions if they have at least 0.1% exposure.

Exhibit 27 Article 6, 8, and 9 Funds' Involvement in Carbon Solutions



Source: Morningstar Research. Morningstar Direct. Based on SFDR universes as of June and December 2021, respectively.

As expected, investors are more likely to get exposure to carbon solutions by opting for Article 9 funds. About 76% of them had at least 5% exposure to companies with carbon solutions in September, up from 66% in March. This compares with just 48% for Article 8. The proportion of Article 8 funds with an above 5% exposure to carbon solutions remained stable.

In line with this more favorable trend, more Article 6 funds also experienced an increase in exposure to carbon solutions. Forty percent had at least 5% involvement in carbon solutions in September, versus only 28% in March.

Regulatory Update

The last quarter of 2021 began with the publication of the final draft rules for financial product disclosures under the SFDR. The rules aim to create a single rulebook for products' pre-contractual and periodic product sustainability disclosures, including taxonomy-related product disclosures. However, the European Commission stated in November that it will delay their application by six months, until 1 Jan 2023.

Consequently, product providers face two sets of taxonomy disclosure rules—these SFDR-defined product disclosures plus those in respect of their firm-level, or entity disclosures, as defined by Article 8 of the taxonomy regulation. While products will be required to disclose their taxonomy alignment from this year, the companies within their portfolios will not have to start disclosing their degree of alignment until 2024, disclosing only the proportions of their businesses that are taxonomy-eligible until that time.

Based on our research, it appears that many asset managers who have started publishing taxonomy-alignment disclosures are simply stating that there is insufficient data to report taxonomy alignment.

Meanwhile, on 2 Feb 2022, The European Commission adopted its long-awaited legal text confirming that nuclear and some natural gas activities will be labelled environmentally sustainable in the EU Taxonomy. The controversial sectors will be included in the Taxonomy “under clear and tight conditions” and as so-called "transitional" activities.

Beyond SFDR and the taxonomy, further details of a proposed ecolabel for financial products are expected this year. And in August, changes to MiFID II will take effect and require financial advisers to consider their clients' sustainability preferences as part of the advice process. This new piece of regulation has the potential to accelerate adoption of sustainable investments among retail investors.

This version of the report has been updated to remove incorrect information regarding ESG exclusions, iShares MSCI Europe ESG Enhanced ETF, and T. Rowe Price Responsible Income bond.

Appendix: Different Interpretations, Different Approaches

In this appendix, we re-share some of the work we published in our mid-year SFDR report, which showcased the spectrum of green approaches adopted by Article 8 and Article 9 funds. Asset managers have taken different approaches to fund classification based on their interpretation of the regulation. These different approaches have in turn resulted in a wide range of investment products classified as Article 8 or Article 9, with similar strategies featuring in both categories.

Article 8 Funds

Article 8 refers to financial products that promote "among other characteristics, environmental or social characteristics," provided that companies in which the investments are made follow good governance practices. Many asset managers have interpreted the term "promotion" to mean there must be a "binding element" in the investment selection process.

As expected, the Article 8 category is a catch-all category, with a wide range of products applying a variety of ESG approaches, ranging from exclusions-only to a dark-green thematic approach.

Exclusions

Exclusions—also referred to as *negative screening*—focus mostly on avoiding securities, issuers, or industries based on certain activities and business practices. Exclusions are typically based on values, norms, or opinions. Commonly, screening targets companies in breach of the UN Global Compact Principles—a set of globally accepted standards on human rights, labour, environment, and corruption—and those associated with controversial products such as weapons and tobacco. More recently, amid a heightened public awareness of environmental issues and rising concerns about climate risks, the list of common exclusions has expanded to include thermal coal, tar sands, Arctic oil, oil sands, as well as traditional oil and gas producers and distributors.

Looking at the data collected so far, we find that the majority of funds classified as Article 8 apply exclusions. Some employ more expansive exclusions than others. Some, mostly passive funds, apply only exclusions. Examples include:

> ***IShares MSCI Europe ESG-Screened ETF*** *tracks an index that "* ***excludes*** companies [...] associated with controversial and nuclear weapons; producing tobacco; or deriving their revenues from the following activities: (i) thermal coal; (ii) tobacco; (iii) civilian firearms; or (iv)

> oil sand. Companies that are classified as violating United Nations Global Compact principles are also excluded from the Index."
>
> ***L&G Asia Pacific ex Japan Equity ETF***, which doesn't have ESG or any related terms in the name, tracks an index that "***excludes*** companies: (a) engaged in pure coal mining; (b) involved in the production of controversial weapons [...]; or (c) that, for a continuous period of three years, have been classified as being in breach of at least one of the UN Global Compact principles."
>
> Some passive funds apply more expansive exclusion lists. For example:
>
> ***Vanguard ESG Global Corporate Bond ETF*** promotes environmental and social characteristics by "***excluding*** fixed income securities [...] that engage in activities in, and/or derive revenue [...] from adult entertainment, alcohol, gambling, tobacco, nuclear weapons, controversial weapons, conventional weapons, civilian firearms, nuclear power, GMO, or thermal coal, oil, or gas. The index methodology also excludes the bonds of issuers that [...] have no controversy score or a controversy score of less than one as defined by MSCI's ESG controversies assessment framework."

Since the introduction of SFDR, more active funds state in their legal documents that they apply an exclusions policy. It is worth noting that a fund can invest within an investment universe that generally exhibits a high level of ESG performance across constituents. Consequently, the screenings that apply to the strategy have limited impact on the investment universe and the actual investments of the fund, and only serve as an insurance that underlying investments consistently represent the expected ESG characteristics of the asset class.

Exclusions + ESG Integration

For many Article 8 active funds, exclusions are only the first step in the investment process. In addition to screening out controversial activities, and sometimes also the worst-rated issuers, an investment manager integrates ESG factors in financial analysis. ESG considerations contribute to investment decisions but are not the main drivers. Examples include:

> ***Bright Stars SICAV SIF—VITALIX***—"*The **exclusions** applied to the investment universe rely on a two-levels approach: a) Controversial activities and Jurisdictions; and b) All entities displaying weak ESG ratings. On top of those exclusions, the investment manager **applies ESG scores to analyze issuers and to monitor investments, from a risk-management perspective**.*"

Exclusions + ESG Integration + Engagement

Many Article 8 strategies state that they promote ESG characteristics via a combination of approaches, including exclusions, ESG integration, and engagement. Examples include:

> ***Neuberger Berman Global Bond*** *— "ESG factors are integrated at three different levels:*
> *1)* ***Exclusion lists****. The Investment Manager and Sub-Investment Managers exclude companies, which are involved in controversial weapons, child labour, and the tobacco industry and thermal coal mining companies.*
> *2)* ***Integration of ESG factors in fundamental analysis****. ESG scores are assigned to each issuer using the proprietary ESG scoring system.*
> *3)* ***Analysis of Controversies and Direct Engagement****. The Investment Manager […] engages with corporate issuers which have high impact controversies or which have low internal ESG scores to assess if the issues are being addressed."*

> ***CS (Lux) European Dividend Plus Equity*** *"promotes ESG characteristics […] through a combination of* ***exclusions, ESG integration and active ownership****. The most material ESG factors are combined with traditional financial analysis to make an ESG adjusted risk-return assessment, which serves as the basis for the portfolio construction. […]"*

Some strategies apply a formal and targeted engagement program. Examples include:

> ***Allianz Floating Rate Notes Plus*** *"promotes responsible investment by including environmental factors and* ***climate engagement with outcome and proxy voting*** *in the analysis of investments. A Sub-Fund managed in accordance with the Climate Engagement Strategy promotes an environmental characteristic through the engagement with the top 10 carbon emitting issuers of the fund to encourage their transition pathway to a low carbon economy by setting objectives targets which are sector specific. […] In addition, the fund* ***excludes*** *issuers associated with severe violations of United Nations Global Compact Violators, involved in the production of controversial weapons, thermal coal extraction, tobacco."*

ESG Integration + Engagement

While the vast majority of funds classified as Article 8 apply some level of exclusions, not all Article 8 strategies do, or at least do not state it explicitly in their legal documents. Some funds promote environmental and/or social characteristics by focusing on the consideration of financially material ESG factors and engagement. Examples include:

> ***Federated Hermes Global Small Cap Equity Fund*** *"through its* ***ESG and stewardship integration approach****, promotes environmental and/or social characteristics […]. The Investment Manager assesses the material ESG characteristics of a company by considering a variety of sources. […] The Investment Manager may invest in companies with material ESG issues where the company has shown a desire to improve their ESG behaviours and can demonstrate good corporate governance practices and/or a willingness to* ***engage*** *in issues if they arise. […] The dedicated stewardship team […] encourages companies to improve their ESG practices."*

> ***Alliance Bernstein Emerging Markets Corporate Debt*** *— "For AB, promotion of environmental and/or social is accomplished through a combination of the following:*
> *1.* ***integration of ESG Factors*** *[…] into all aspects of the investment making process whereby the impacts of a target investment with respect to ESG Factors will be assessed through all steps of the investment process; and 2.* ***extensive engagement*** *with corporate issuers and governments to encourage action and progress towards environmental, social and governance goals."*

In some cases, the fund focuses solely on ESG integration, with seemingly no binding ESG criteria. Examples include:

> ***Artemis Funds (Lux) Global Select*** *— "The fund promotes environmental and/or social characteristics within the meaning of Article 8 of SFDR. In that respect, the Investment* ***Manager assesses the sustainability of each investment****, including ESG factors […] alongside traditional financial metrics. However, investments are chosen on the basis of many attributes and need not rate highly on any or all of these sustainability factors to be included in the portfolio.*

Portfolio-Level ESG Metrics

In addition to exclusions, ESG integration, and engagement, some Article 8 funds have set explicit binding constraints at the portfolio level. They must, for example, achieve a higher aggregate ESG score or lower carbon intensity than their benchmark or investment universe. Some use an optimiser to maximise exposure to issuers with higher ESG ratings. Examples include:

> ***Amundi European Equity Conservative*** *"integrates Sustainability Factors in its investment process […]. Further, the Sub-Fund seeks to* ***achieve an ESG score*** *of its portfolio* ***greater than that of the Benchmark****. […] ESG performance is assessed by comparing the average performance of a security against the security issuer's industry, in respect of each of the three ESG characteristics of environmental, social and governance. […]"*

> ***Carmignac Euro-Entrepreneurs*** *"is managed according to a low-carbon-emission approach with the goal of* ***keeping its carbon intensity 30% lower than that of the reference indicator*** *[…]. Extra-financial analysis is applied to the investment strategy through the following processes, which actively* ***reduce the fund's investment universe by at least 20%****: (1)* ***Negative screening*** *to exclude certain equity issuers on the basis of energy-related or ethical criteria. (2)* ***Positive screening*** *to define the equity investment universe in order to identify companies demonstrating solid governance and corporate conduct […] and companies that demonstrate an environmental policy targeting either low carbon emissions or climate risk management. Particular attention is paid to the way in which companies can contribute positively to achieving these sustainable development objectives. The fund also applies* ***standards-based exclusions*** *to exclude certain companies having exposure to controversial sectors and/or activities and breaching international standards."*

Security-Level ESG Metrics

Some strategies set minimum ESG criteria for a portion of the portfolio. Examples include:

> ***JPM Europe Equity invests*** *"**at least 51% of assets are invested in companies with positive environmental and/or social characteristics** that follow good governance practices […]. The Investment Manager evaluates and applies **values and norms-based screening** to implement exclusions." In addition, securities must be within the top 80% threshold based on their ESG score.*

> ***Fidelity Emerging Markets Fund*** *invests "**at least 50% of its net assets in shares of companies that maintain sustainable characteristics**. […] The fund adheres to the firm-wide **exclusion** list […]."Equally, issuers which the Investment Manager considers have failed to conduct their business in accordance with accepted **international norms**, […] will not form part of the fund's investment universe."*

Best-in-Class

A large number of Article 8 funds are broad ESG funds that employ a best-in-class or positive screening strategy. They seek to invest in securities of issuers that exhibit strong or improving ESG credentials. Examples include:

> ***JPMorgan Emerging Markets Sustainable Equity Fund*** *invests "primarily in emerging market **sustainable companies** or companies that **demonstrate improving sustainable characteristics**. Sustainable companies are those that the Investment Manager believes to have effective governance and superior management of environmental and social issues. […]"*

> ***Invesco Sustainable Pan European Structured Equity Fund*** *"invests in […] companies, which meet the Fund's ESG criteria with a particular focus on environmental issues. The Fund's ESG criteria will be based on a set of screening thresholds […]. **Positive screening** will be used based on an **integrated-best-in-class approach** to identify issuers, which in the view of the Investment Manager meet sufficient practice and standards in terms of transition to a lower carbon economy […]. Screening will also be employed to **exclude** companies […] which derive or generate a pre-determined level of revenue or turnover from activities such as (but not limited to) fossil fuel industries, coal or nuclear power, extraction of tar sands and oil shale, fracking or Arctic drilling activities."*

Thematic

And finally, also included in the Article 8 category are funds with a sustainable theme such as climate change, gender diversity, or sustainable water. In addition to ESG criteria considered during company selection, other sustainability criteria are taken into account in the thematic analysis at sector and company level. Examples include:

> ***Fidelity Sustainable Water & Waste*** *"adopts a **Sustainable Thematic strategy** which actively seeks to select companies involved in the design, manufacture or sale of products and services used for or in a connection with water and waste management sectors. **At least 70% will be invested in securities that maintain sustainable characteristics**. […] The fund complies with a **principle-based exclusion** framework which includes norm-based and negative screening of sectors, companies, practices based on specific ESG criteria […]. The fund may also invest in issuers which demonstrate improving sustainable characteristics."*

> ***IShares Global Clean Energy ETF*** *tracks an index that "comprises companies involved **in clean energy production** or the provision of **clean energy equipment & technology** from both developed and emerging markets. […] Companies exceeding a pre-determined carbon-to-revenue footprint standard score […] are **excluded** from the Index. The Index is weighted by market capitalisation. […] The Index caps individual constituent weights […]."*

> ***Lyxor Net Zero 2050 S&P Eurozone Climate PAB (DR) ETF*** "tracks the S&P Eurozone Large Mid Cap ***Paris-Aligned Climate Index***. […] The Index aims to meet and maintain the criteria set out by the European Union's Technical Expert Group on Climate Benchmark's ESG Disclosures, to qualify as an ***EU Paris-Aligned Benchmark***."

Impact

> ***AZ Fund 1—AZ Bond—Green & Social*** *"invests between 50% and 100% of its net assets in **green bonds and/or social bonds** issued […] by governments, supranational institutions, governmental authorities and/or companies from anywhere in the world […] The Sub-fund seeks to **maintain an overall ESG rating of at least BBB at portfolio level**, calculated based on [MSCI] ESG ratings."*

> ***UniInstitutional Green Bonds****—"invests **at least 51% in Green Bonds of international issuers.**"*

> ***Goldman Sachs Global Environmental Impact Equity Portfolio*** *"invests at least two thirds of its net assets in […] **companies that […] are aligned to the key themes associated with solving environmental problems** including, but not limited to, clean energy, resource efficiency, sustainable consumption and production, waste management & recycling and water sustainability. […] The Investment Adviser will generally seek to **avoid investing** in companies that are […] directly engaged in, and/or deriving significant revenues from the following activities […] but are not limited to: controversial weapons […]; tobacco; extraction and/or production of certain fossil fuels; adult entertainment; for-profit prisons; and civilian firearms."*

Article 9 Funds

The Article 9 category is the category that asset managers consider “dark green.” They invest in companies offering products and services that are deemed to contribute positively to society, while making sure the companies don't do significant harm and follow good governance practices. As a result, a majority of Article 9 funds have a thematic and/or impact focus aligned with one or more of the UN Sustainable Development Goals.

That said, we’re seeing strategies categorised under Article 9 that look similar to those classed as Article 8, including thematic and core ranges of sustainable funds that employ a best-in-class or positive screening approach. This suggests that some managers may have taken a too-prudent classification approach or others a too-generous approach. It could be the case that managers who parked more funds into Article 9 are more confident in their ability to demonstrate the “sustainable” nature of their investments in their future disclosures. Examples of Article 9 strategies include:

Best-in-Class

> ***Candriam Fund Sustainable Euro Corporate Bonds Fossil Free*** *"aims to have long-term* ***positive impact*** *on environment and social objectives. More specifically the fund aims to* ***achieve overall greenhouse gas emissions at least 30% lower than those of the benchmark*** *(for corporate issuers), and to* ***invest*** *at least 10% (and 20% by the end of 2025) of its assets* ***in green bonds*** *[…]. To achieve these objectives the fund implements a combination of positive* ***selection of the best issuers*** *based ESG criteria,* ***exclusion*** *of issuers detrimental to these objectives or deemed to prone to controversies. In particular, the fund* ***excludes issuers from the fossil fuel industry*** *such as oil & gas companies or power utilities producing electricity from natural gas. […]."*

> ***AXA World Funds—Framlington Sustainable Eurozone*** *invests "in sustainable securities that have implemented good practices in terms of […] ESG practices. Firstly, the Sub-Fund bindingly applies* ***AXA IM's Sectorial Exclusion and ESG Standards Policies*** *[…] and a* ***"Best-in-class" selectivity approach*** *which consists in selecting the best issuers in the investable universe based on their extra-financial ratings with a focus on the Climate Change scores […]. Secondly, […] the securities selection process relies on a rigorous analysis of the companies' business model, underlying assets and balance sheet, whether the company meets* ***Responsible Investment criteria*** *and risk/return profile. […]"*

Thematic

> ***RobecoSAM Sustainable Water*** *"is a* ***thematic*** *equity product offering investors pure access to a high-impact, sustainable investment theme […]. The Fund employs systematic, bottom-up stock selection that combines proprietary ESG data and research throughout the investment process.* ***ESG criteria for exclusions and theme-specific suitability*** *are applied during universe construction. […]. Direct and active engagement with the management of portfolio companies*

*on sustainability topics offers additional channels for sustainable impact. […] The Fund **directly contributes to** UN Sustainable Development Goals via its focus on protecting and improving water quality and supply.*"

***Pictet—Clean Energy** invests in "**companies that contribute to lowering carbon emissions** by, for instance, favouring **clean energy** in their production process. The investment manager uses a combination of market and fundamental company analysis with a bias towards companies with superior ESG characteristics […]. It also applies an **exclusion** policy […]. It methodically **exercises voting rights and may engage** with issuers in order to positively influence ESG practices.*"

***Handelsbanken Europa Index Criteria tracks "the** Solactive ISS ESG Screened **Paris Aligned Europe Index**. The companies in the index are selected and weighted in such a manner that the index portfolio's greenhouse gas emissions are aligned with the long-term global warming targets in the Paris Agreement. […] The index follows, and in several cases exceeds, the minimum requirements set in the **Benchmark Regulation for Paris Aligned Benchmarks**.*"

Impact

***DWS Invest Green Bonds** "predominantly invests in interest-bearing debt securities issued by public, private and semi-private issuers worldwide that finance special ESG related/themed projects. Mainly that covers **Green Bonds**, which are debt instruments where **the use of proceeds is limited to projects with environmental and/or climate benefits** […].*"

***Credit Suisse (Lux) Environmental Impact Equity Fund** "invests at least two-thirds of its assets worldwide in […] companies whose products, services and business models are built on offering and developing solutions which have **a real and direct impact** on solving the most pressing environmental and climate issues. The Fund has sustainable investments as a primary investment objective […]. The objective is attained through a dedicated investment process focusing on **investments in themes and sectors whose economic activities address specific ESG challenges.** […]*"

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For More Information

Morningstar Manager Research Services
ManagerResearchServices@morningstar.com

MORNINGSTAR®

22 West Washington Street
Chicago, IL 60602 USA