SFDR Article 8 and Article 9 Funds: Q2 2022 in Review

Assets surpass 50% market share ahead of a challenging MiFID II amendment.

Morningstar Manager Research

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Executive Summary

It's been more than 16 months 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.

This report provides an update on the rapidly evolving landscape of Article 8 and Article 9 funds at the end of the second quarter 2022, examining flows, assets, and products. We also analyse the ESG credentials of these so-called "light green" and "dark green" funds, looking at their levels of ESG risk and controversial activities exposures, including fossil fuels and nuclear.

Additionally, with the amended Markets in Financial Instruments Directive II (MiFID II) coming into force on 2 August, we discuss the challenges we believe advisers will face to fulfill their new obligations. They will be required to consider clients' sustainability preferences when conducting suitability assessments. If clients express interest in making sustainable investments, advisers will have to source products that have a minimum proportion of sustainable investments as defined by the SFDR or EU Taxonomy. Clients may also choose only investments that consider principal adverse impacts, or PAIs.

To facilitate this process, asset managers have started to disclose this key information via a new European ESG template, or EET, developed by industry representatives (FinDatEx) to ease the exchange of data between asset managers and distributors. As of 18 July, Morningstar collected EET data on 70,580 share classes, accounting for 43% of all share classes in scope of MiFID II. In this report, we share insights on the coverage and values of PAI consideration, sustainable investment exposure, and taxonomy alignment.

Key Takeaways

- In the second quarter of 2022, Article 8 funds bled EUR 30.3 billion, while Article 9 funds attracted inflows of EUR 5.9 billion, amid investor concerns over a global recession, inflationary pressures, and the conflict in Ukraine.
- Article 8 and Article 9 fund assets declined by 6.4% to EUR 4.18 trillion at the end of June. In comparison, Article 6 fund assets dropped by 8.9% over the period.
- Assets in Article 8 and Article 9 funds surpassed 50% market share.

- Product development remained stable, with an estimated 183 Article 8 and Article 9 fund launches in the second quarter of 2022. This represents 60% of total new funds incepted in the EU over the period.
- Over 700 products changed SFDR status in the last quarter. While the vast majority were upgraded from Article 6 to 8, we identified 16 downgrades from Article 9 to 8. No fund was downgraded from Article 8 or 9 to Article 6.
- For the first phase of EET reporting, asset managers have prioritised Article 8 and Article 9 products. But the data is patchy. Less than half of surveyed Article 8 and Article 9 funds reported PAI consideration and sustainable investment exposure as defined by SFDR. Just over one fourth disclosed taxonomy alignment.
- As expected, Article 9 funds plan to hold more sustainable investments than Article 8 funds. Over half of Article 9 funds target allocations greater than 70%, but just 2.3% target allocations higher than 90% and close to 40% target less than 50%.
- Of the Article 8 and Article 9 products that reported taxonomy alignment, 90% provided 0% values. Only 2% target exposure higher than 10%.
- Different interpretations of SFDR and the EU Taxonomy have led asset managers to adopt different approaches to the calculation of sustainable investment exposure and taxonomy alignment, rendering it impossible to compare products directly.
- Because of data patchiness and a lack of direct comparability between products, financial advisers will struggle to fulfil their new obligations.

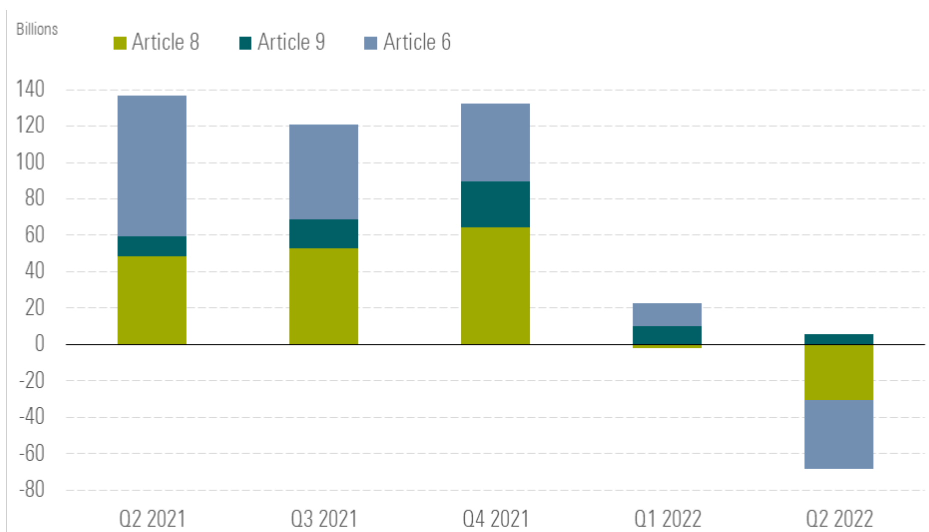
The Article 8 and Article 9 Fund Universe

Our Article 8 and Article 9 fund universe in this study encompasses open-end and exchange-traded funds in scope of the Sustainable Finance Disclosure Regulation that state in their prospectuses that they either promote environmental and/or social characteristics (Article 8, "light green" funds) or have a sustainable investment objective (Article 9, "dark green" funds). We identified these funds using the EU SFDR Fund Type (Article 8 or Article 9) data point in the Morningstar Direct database. Funds in scope of SFDR that are neither Article 8 nor Article 9 are Article 6 funds (Not Stated in Morningstar Direct). This report uses SFDR disclosure collected from prospectuses on 97% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds.

Article 8 Funds Register Net Outflows for Another Quarter; Article 9 Funds Continue to Hold Up
Against a challenging backdrop of inflationary pressures, geopolitical risks, and market volatility, Article 8 funds bled EUR 30.3 billion in the second quarter after shedding a revised EUR 2.1 billion over the previous quarter.

Investors continued to pour money into Article 9 products, however, as these registered EUR 5.9 billion in net inflows over the past three months. These net inflows were nonetheless lower than the EUR 10.0 billion net inflows recorded in the first quarter.

Exhibit 1 Quarterly Flows Into Article 8 and Article 9 Funds Versus Article 6 Funds (EUR Billion)

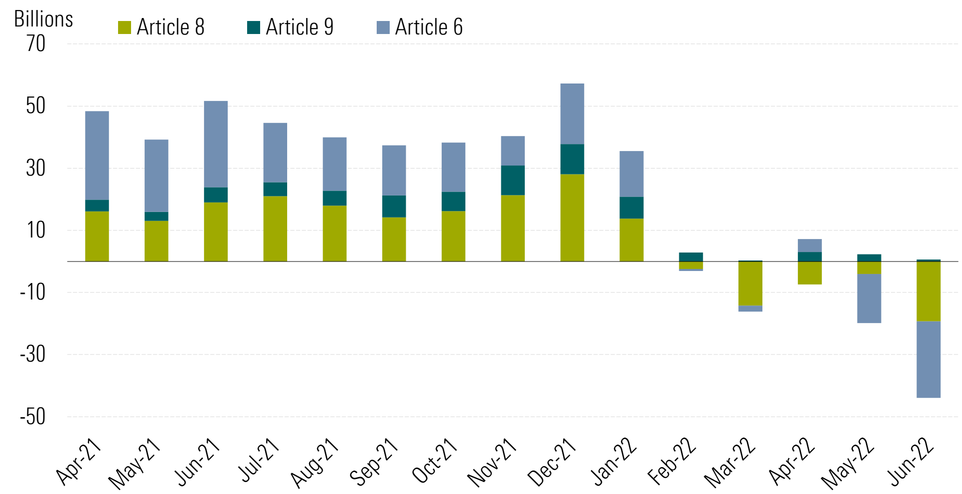


Source: Morningstar Direct. Data as of 30 June 2022. Based on SFDR data collected from prospectuses on 97% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds.

The monthly flows breakdown shows that Article 8 funds started experiencing outflows in February (EUR 2.4 billion), which deepened in June at EUR 19.3 billion. In comparison, Article 6 funds recorded larger outflows in May (EUR 15.7 billion) and June (EUR 24.7 billion).

In contrast, investors poured money into the Article 9 funds every single month from February through June.

Exhibit 2 Monthly Flows Into Article 8 and Article 9 Funds Versus Article 6 Funds (EUR Billion)

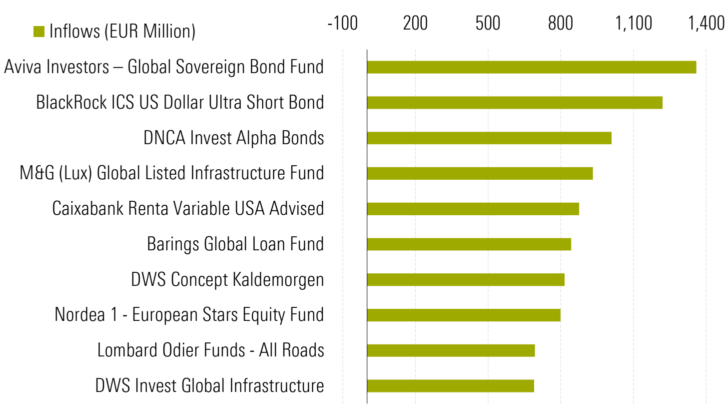


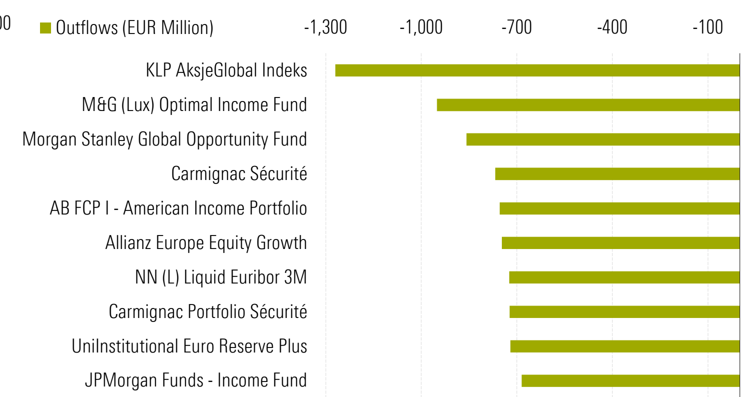
Source: Morningstar Direct. Data as of 30 June 2022. Based on SFDR data collected from prospectuses on 97% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds.

Flows—Leaders and Laggards

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

Exhibit 3 Article 8 Funds With the Largest Inflows and Outflows in the Second Quarter of 2022



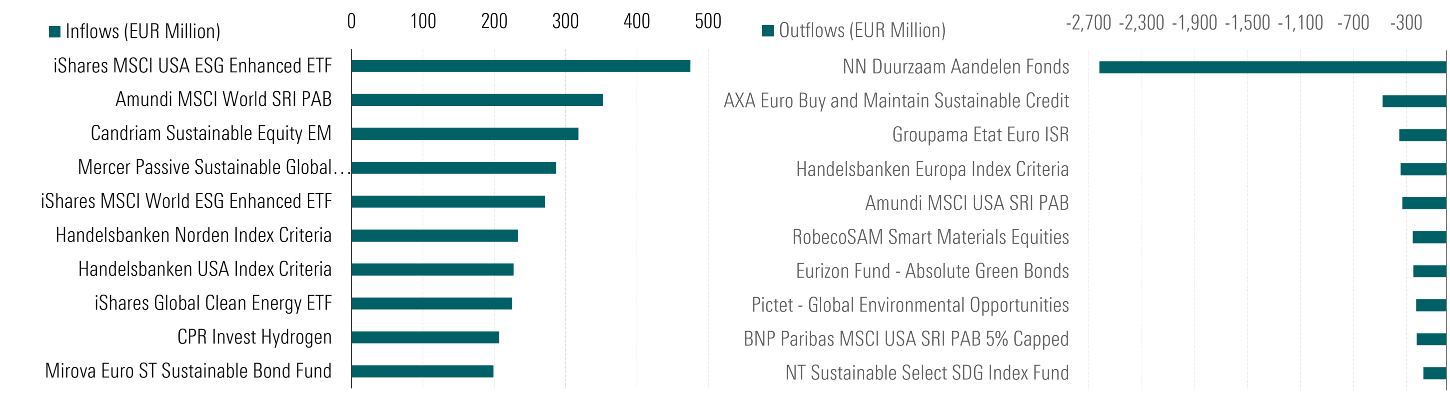


Source: Morningstar Direct. Data as of 30 June 2022. Based on SFDR data collected from prospectuses on 97% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds.

The Article 9 flow leader board is well staffed with passive climate-flavoured funds, with eight of the top 10 funds tracking either EU Paris-aligned benchmarks or climate-transition benchmarks or alternative energy-themed indexes.

Meanwhile, the biggest outflows were registered by **NN Duurzaam Aandelen Fonds** after institutional investors withdrew money from the fund to transfer it to similar internal mandates.

Exhibit 4 Article 9 Funds With the Largest Inflows and Outflows in the Second Quarter of 2022



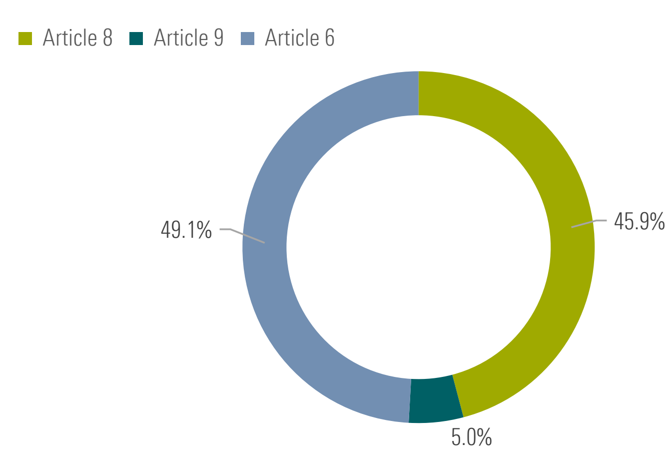
Source: Morningstar Direct. Data as of 30 June 2022. Based on SFDR data collected from prospectuses on 97% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds.

Article 8 and Article 9 Fund Assets Surpass 50% Market Share

Against the challenging macroeconomic backdrop of inflationary pressures, geopolitical risks, and market volatility, Article 8 and Article 9 fund assets declined by 6.4% over the second quarter of 2022 to EUR 4.18 trillion at the end of June, from a restated amount of EUR 4.46 trillion at the end of March. In comparison, Article 6 fund assets dropped by 8.9% over the period.

As a result, the two fund groups accounted for a bigger share of the EU universe: 50.9%, thus crossing the 50% mark, which we predicted last year would happen by the middle of 2022 as managers upgraded strategies and launched new products that meet the articles' requirements. The 50.9% market share at the end of June was split into 45.9% for Article 8 products and 501% for Article 9 products. This compares with a combined and restated market share of 49.4% at the end of March.

Exhibit 5 SFDR Fund Type Breakdown (by Assets)

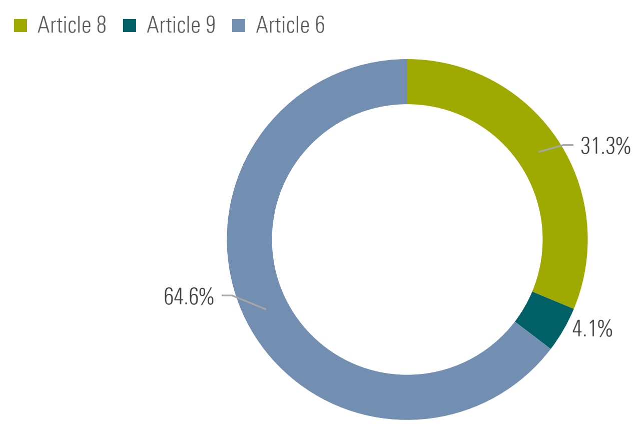


Source: Morningstar Direct. Data as of 30 June 2022. Based on SFDR data collected from prospectuses on 97% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds.

In terms of number of funds,[1] the market share of Article 8 and Article 9 funds also grew in the second quarter, with 7,273 (31.3%) funds classified as Article 8 and 948 (4.1%) classified as Article 9.

Combined, the two categories represented 35.4% of the overall EU fund universe at the end of June.

Exhibit 6 SFDR Fund Type Breakdown (by Number of Funds)



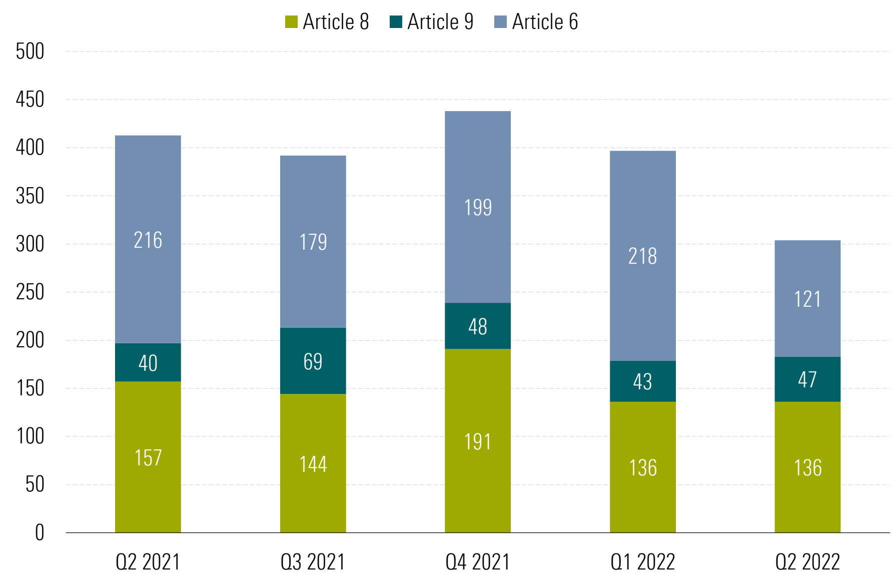
Source: Morningstar Direct. Data as of 30 June 2022. Based on SFDR data collected from prospectuses on 97% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds.

Fund Launches

Product development slowed down in the Article 6 category but remained stable for green funds, with an estimated 183 Article 8 and Article 9 fund launches in the second quarter of 2022. And it is likely that this number will be restated in future reports as we identify more launches and additional ones are reported to Morningstar.

1 Based on SFDR data collected from prospectuses on 97% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds.

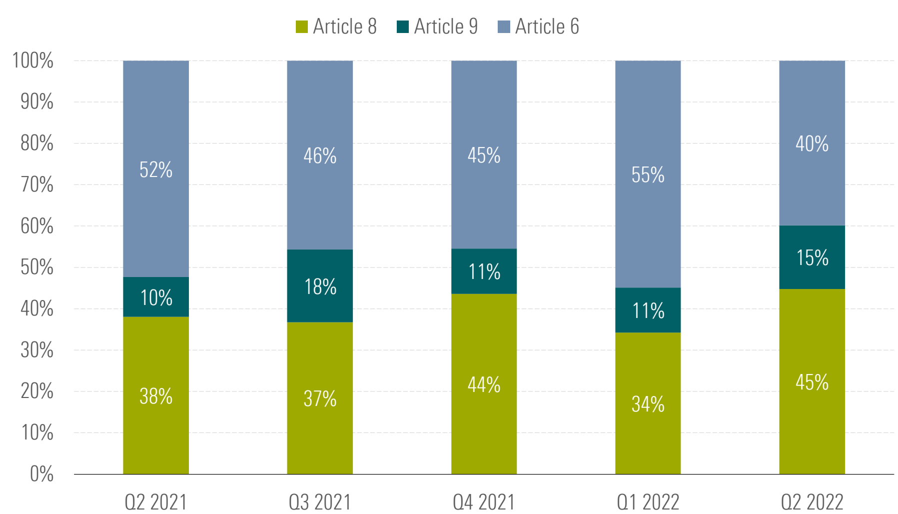
Exhibit 7 Quarterly Number of Fund Launches



Source: Morningstar Direct. Data as of 30 June 2022. Based on SFDR data collected from pospectuses on 97% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds.

Reverting to the trend we reported in the second half of last year, Article 8 and Article 9 funds registered a higher proportion (60%) of new fund launches in the second quarter of 2022.

Exhibit 8 Quarterly Breakdown of Fund Launches



Source: Morningstar Direct. Data as of 30 June 2022. Based on SFDR data collected from prospectuses on 97% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds.

Asset managers continued to expand 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 90 new equity offerings, followed by allocation and fixed income, with 46 and 41, respectively.

While broad environmental, social, and governance and sustainable funds represented the bulk of new Article 8 and Article 9 offerings, climate funds remained a popular theme among new launches: We counted six and 10 of such fund launches in the Article 9 and Article 8 categories, respectively. 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.

Recently launched Article 8 climate funds include **Nordea Global Climate Engagement**, which invests in companies whose business models are aligned with the goals of the Paris Agreement. Active ownership and engagement are key components of the fund's strategy to push companies to transition faster. **DWS Invest ESG Mobility** is another example. The fund mainly invests in companies operating within the multilayered mobility value chain/industries, including companies involved in transportation, logistics, clean energy, autonomous driving, hydrogen application, battery technology, cloud computing, real estate, consumer discretionary, online platforms, food delivery, as well as sport and lifestyle vehicles.

The largest new Article 8 entrant was **Swedbank Robur-Sverige**, which amassed a whopping EUR 3.6 billion less than a month after its launch. The fund has a strong focus on minimising climate-related risks and actively seeks investments that promote the transition to a more sustainable society and achievement of the Paris Agreement goals.

Launches in the Article 9 category clustered around similar sustainable themes and included several impact strategies. An example is **Pictet Climate Government Bond**. Actively managed, this Paris-aligned sustainable strategy invests in bonds issued by countries that are reducing their greenhouse gas emissions and carbon intensity (net of land and forestry management) or ones that are taking steps to implement policies and regulations that are meant to reduce their carbon emissions.

Another example of a climate-themed Article 9 strategy is **BNP Paribas Emerging Climate Solutions**. The fund targets companies in emerging markets that provide solutions to preserve aquatic, terrestrial, and urban ecosystems, as well as renewable energy production, energy efficiency, energy infrastructure, and transportation.

Reclassified Funds

In the second quarter, asset managers continued to upgrade funds by enhancing the ESG integration processes and/or adding binding ESG criteria to the investment objectives and/or investment policies, or in some cases completely changing the mandate of the strategy.

During the second quarter, 713 funds altered their SFDR status, including 696 that upgraded and 16 that downgraded. The vast majority (652) that upgraded their status moved from Article 6 to Article 8, while

17 upgraded from Article 6 to Article 9. All of the downgraded funds (16) reclassified from Article 9 to Article 8. We didn't identify any funds that reclassified from Article 8 or Article 9 to Article 6.

Exhibit 9 The 10 Largest Funds Upgraded From Article 6 to Article 8

Name	Old SFDR Fund Type	New SFDR Fund Type	AUM (EUR Billion)	Morningstar Category	Active / Passive
Flossbach von Storch - Multiple Opportunities	Article 6	Article 8	24	EUR Flexible Allocation - Global	Active
Morgan Stanley Global Brands Fund	Article 6	Article 8	19	Global Large-Cap Blend Equity	Active
Flossbach von Storch - Multiple Opportunities II	Article 6	Article 8	13	EUR Flexible Allocation - Global	Active
Santander Gestión Global Equilibrado FI	Article 6	Article 8	9	EUR Moderate Allocation - Global	Active
Morgan Stanley Global Opportunity Fund	Article 6	Article 8	8	Global Large-Cap Growth Equity	Active
Fidelity Funds - Global Multi Asset Income Fund	Article 6	Article 8	8	USD Moderate Allocation	Active
Franklin Technology Fund	Article 6	Article 8	6	Sector Equity Technology	Active
Aviva Investors – Global Sovereign Bond Fund	Article 6	Article 8	6	Global Bond - EUR Hedged	Active
Barings Global InvestBarings Global Loan Fund	Article 6	Article 8	6	Other Bond	Active

Source: Morningstar Research, Morningstar Direct. Data as of 30 June 2022. Based on SFDR data collected from prospectuses on 97% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds.

Flossbach von Storch Multiple Opportunities, the largest fund to have changed SFDR status from Article 6 to Article 8 last quarter, does now apply some very light exclusions related to weapons, tobacco, and coal. It additionally screens out companies in serious violation of the principles of the United Nations Global Compact and sovereign issuers of inadequate scores in the Freedom House Index.

Another example is **Aviva Investors–Global Sovereign Bond.** The fund has baseline exclusions focused mainly on controversial weapons and civilian armaments, but it also assesses sovereign issuers based on 11 national-level compositive ESG indicators derived from over 400 data points pertaining to environmental performance, natural hazards, inequality, human development, gender inequality, infrastructure, business environment, governance, state fragility, and press freedom. The results aim to capture an issuer's momentum and provide forward-looking judgements on how ESG credentials are likely to evolve, which in turn facilitate investment decisions and engagements.

Exhibit 10 The 10 Largest Funds Upgraded From Article 6 to Article 9

Name	Old SFDR Fund Type	New SFDR Fund Type	AUM (EUR Million)	Morningstar Category	Active / Passive
Amundi MSCI Europe ESG Broad CTB	Article 6	Article 9	1,837	Europe Large-Cap Blend Equity	Passive
Sycomore Sélection Responsable	Article 6	Article 9	541	Eurozone Flex-Cap Equity	Active
Vindobona Metternich	Article 6	Article 9	355	EUR Diversified Bond	Active
BL- Global Bond Opportunities	Article 6	Article 9	311	Global Bond - EUR Hedged	Active
BL-Bond Emerging Markets Euro	Article 6	Article 9	292	Global Emerging Markets Bond	Active
Lonvia Avenir Mid-Cap Europe	Article 6	Article 9	220	Europe Mid-Cap Equity	Active
Symphonia Electric Vehicles Revolution	Article 6	Article 9	113	Sector Equity Technology	Active
HC Boston Common Global Equity Impact Fund	Article 6	Article 9	44	Global Large-Cap Blend Equity	Active
BNP Paribas Sustainable Asian Cities Bond	Article 6	Article 9	31	Asia Bond	Active
Lonvia Avenir Small Cap Europe	Article 6	Article 9	30	Europe Small-Cap Equity	Active

Source: Morningstar Research. Morningstar Direct. Data as of 30 June 2022. Based on SFDR data collected from prospectuses on 97% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds.

Amundi MSCI Europe ESG Broad CTB is the largest fund that reclassified from Article 6 to Article 9 last quarter, joining the growing list of passive funds that have switched from a plain-vanilla or broad ESG index to a climate transition or Paris-aligned benchmark in the past 18 months. Both types of benchmarks were designed to be in line with the transition to a climate-resilient economy, while ensuring a yearly decarbonisation target of at least 7%, in line with the decarbonisation trajectory of the Intergovernmental Panel on Climate Change's 1.5°C scenario[2].

Among other funds that upgraded their status from Article 6 to 9, **BL–Global Bond Opportunities** invests at least two thirds of its net assets in green bonds, corporate bonds, as well as bonds issued by governments and quasi-sovereign entities. Proprietary ESG ratings and evaluations of different issuers are conducted covering a wide range of topics ranging from carbon emission and water scarcity to renumeration policy and business ethics.

Meanwhile, **BNP Paribas Sustainable Asian Cities Bond**, which rebranded from Asia ex-Japan Bond, was subject to a complete overhaul. The strategy now follows a thematic approach, investing in companies with at least 20% of the revenue derived from products and services addressing specific environmental and/or social challenges, including low-carbon public transport, basic infrastructure against extreme weather events, and health and education facilities with easy access.

Finally, the 16 products that were downgraded from Article 9 to Article 8 include 10 NN and four PIMCO strategies. The exhibit below shows a sample.

Exhibit 11 The 10 Largest Downgraded Funds

Name	Old SFDR Fund Type	New SFDR Fund Type	AUM (EUR Million)	Morningstar Category	Active/ Passive
NN Enhanced Index Sustainable Equity Fund A	Article 9	Article 8	2,852	Global Large-Cap Blend Equity	Passive
PIMCO GIS Emerging Markets Bond ESG Fund	Article 9	Article 8	2,113	Global Emerging Markets Bond	Active
PIMCO GIS Global Bond ESG Fund	Article 9	Article 8	2,083	Global Bond - USD Hedged	Active
PIMCO GIS Global Investment Grade Credit ESG Fund	Article 9	Article 8	1,364	Global Corporate Bond - USD Hedged	Active
NN Enhanced Index Sustainable Equity Fund	Article 9	Article 8	944	Global Large-Cap Blend Equity	Passive
NN Enhanced Index Sustainable Emerging Markets Equity Fund	Article 9	Article 8	869	Global Emerging Markets Equity	Passive
Lyxor MSCI USA ESG Broad CTB (DR) ETF	Article 9	Article 8	787	US Large-Cap Blend Equity	Passive
NN Enhanced Index Equity Sustainable Equity Fund DPF	Article 9	Article 8	688	Global Large-Cap Blend Equity	Passive
NN Duurzaam Aandelen Fonds	Article 9	Article 8	584	Global Large-Cap Growth Equity	Active
NN Enhanced Index Sustainable North America Equity Fund	Article 9	Article 8	431	US Large-Cap Blend Equity	Passive

Source: Morningstar Research. Morningstar Direct. Data as of 30 June 2022. Based on SFDR data collected from prospectuses on 97% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds.

These reclassifications emerged as a result of a more precautious approach taken by the asset managers in light of recent regulatory clarification. For example, NN noted that "new clarification offered by the European Commission and AFM made clear that funds making Article 9 disclosures may only invest in

2 EU Paris-aligned benchmarks must have a carbon footprint (including scope 3 emissions) 50% below that of the investable universe. For EU climate-transition benchmarks, the carbon footprint only must be at least 30% lower. EU Paris-aligned benchmarks also employ additional activity exclusions on high-emitting fossil fuels and electricity producers, which EU climate-transition benchmarks do not have.

sustainable investments based on the definition provided within SFDR. This additional clarification was not in place when NN IP initially implemented SFDR, which is why we are now intended to update the disclosures in line with evolving regulatory guidelines." NN added that the reclassification doesn't reflect any change in the funds' investment process.

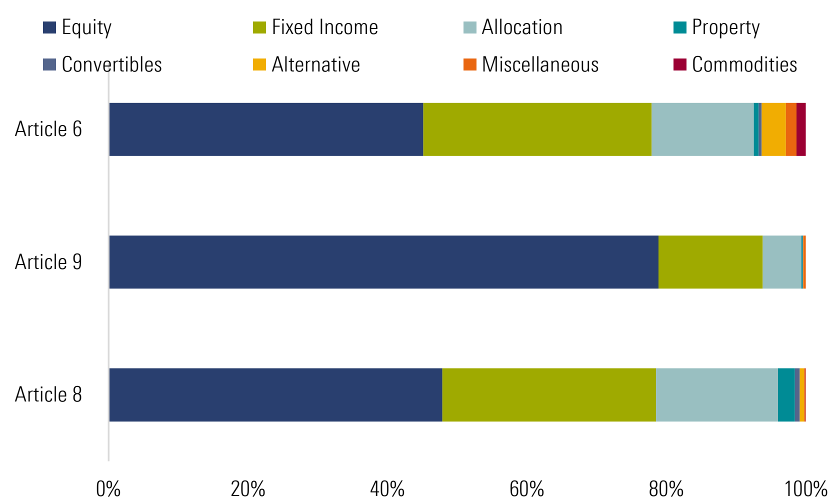
As regulators continue to provide further guidance on the implementation of SFDR, we can expect more funds to be reclassified to Article 8 in the future. Nevertheless, it remains to be seen if any managers will decide to downgrade strategies from Article 8 to 6.

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 toward equity, with equity funds accounting for almost half (48%) of Article 8 offerings and 79% of Article 9 products as of June 2022, versus 45% in the Article 6 fund group.

At the end of June, fixed-income and allocation funds remained under-represented. Fixed-income funds accounted for 30.6% and 15.0% of Article 8 and Article 9 funds, respectively, compared with 32.7% in the Article 6 fund group. Meanwhile, allocation funds constituted 17.5% and 5.5% of Article 8 and Article 9 funds, respectively, versus 14.7% of Article 6 products. The representation of other asset classes in the two groupings remains low.

Exhibit 12 Article 8 and Article 9 Funds Per Broad Asset Class

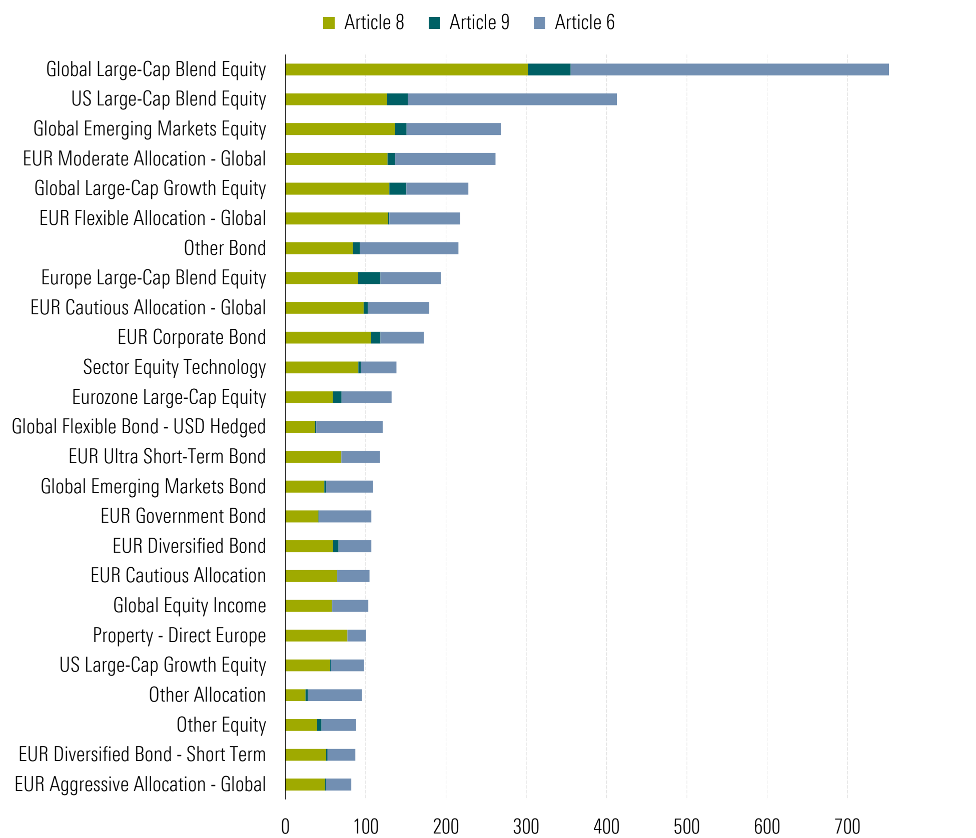


Source: Morningstar Direct. Data as of 30 June 2022. Based on SFDR data collected from prospectuses on 97% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds.

Article 8 and Article 9 Funds Per Morningstar Category

Diving into the 25 Morningstar Categories with the highest asset ratios among Article 8 and Article 9 funds, we can see that Article 8 and Article 9 fund assets are distributed unevenly across these categories.

Exhibit 13 Article 8 and Article 9 Funds Per Morningstar Category (EUR Billion)



Source: Morningstar Direct. Data as of 30 June 2022. Based on SFDR data collected from prospectuses on 97% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds.

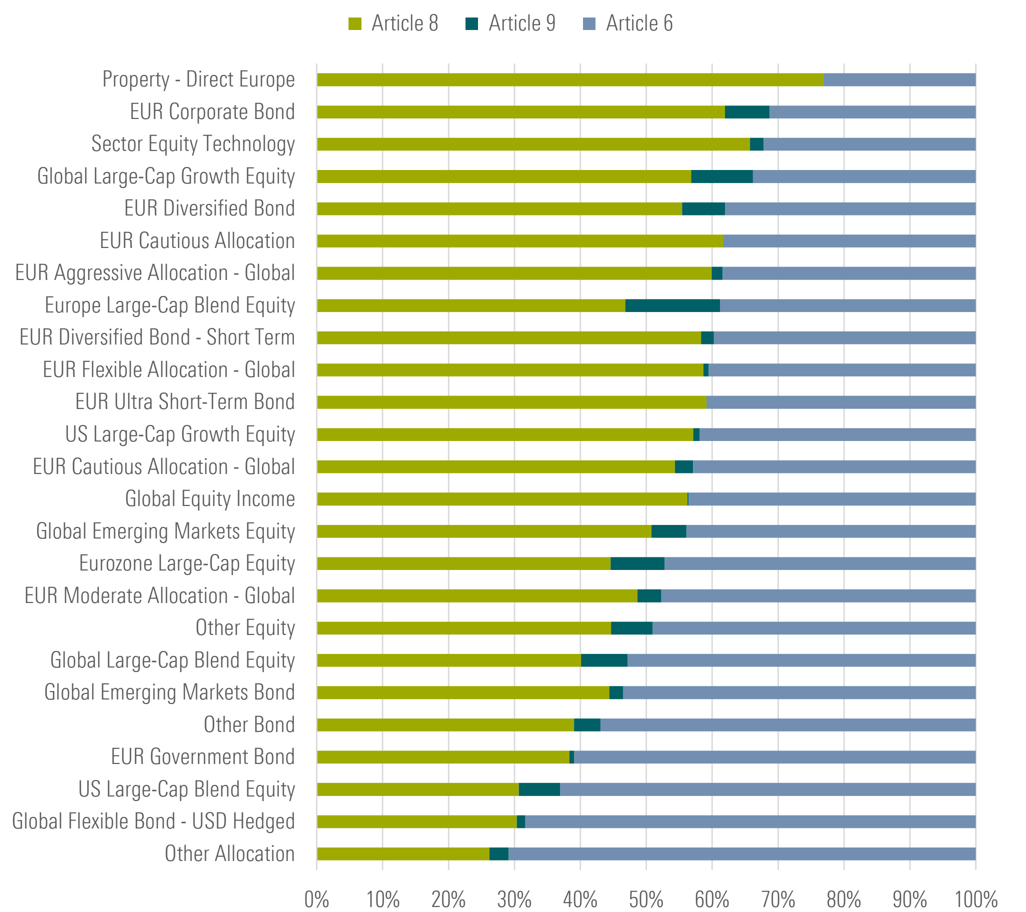
While the largest one, global large-cap blend equity, has over 47% of its assets in Article 8 funds and Article 9 funds, two of the smallest categories selected in our sample, EUR aggressive allocation–global and EUR diversified bond–short term, have 62% and 60% of their assets in Article 8 and Article 9 funds, respectively.

Outside of the equity categories, property-direct Europe and EUR corporate bond are the categories with the highest proportion of Article 8 or Article 9 fund assets (77% and 69%, respectively).

Among the biggest categories, the lowest proportion of Article 8 and Article 9 offerings in aggregate is in US large-cap blend equity, where only 31% of the assets are held in Article 8 funds and 6% in Article 9 funds, so 37% in total. The under-representation of Article 8 assets here could be attributed to the fact that the US large-cap blend equity categories house many sizable passive plain-vanilla funds.

By comparison, US large-cap growth equity has a much higher percentage of its assets (58%) in Article 8 and Article 9 funds combined.

Exhibit 14 Proportion of Article 8 and Article 9 Fund Assets Per Morningstar Category



Source: Morningstar Direct. Data as of 30 June 2022. Based on SFDR data collected from prospectuses on 97% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds.

These differences in proportions of Article 8 and Article 9 fund assets across categories may reflect the fact that ESG integration is easier or in higher demand in certain asset classes and subasset classes than others. As demand for ESG and sustainability strategies continue to grow, we expect these percentages to keep increasing across the board.

The Largest Article 8 and Article 9 Funds

Against a backdrop of market turbulences, the league tables of the largest Article 8 and Article 9 funds have changed a little.

Two Flossbach von Storch allocation funds made their entrance in the top 20 Article 8 funds after being upgraded (see section on reclassified funds). **Flossbach von Storch SICAV–Multiple Opportunities** has become the largest Article 8 fund with assets of EUR 24.4 billion at the end of June. **DWS Vermögensbildungsfonds** is also a new joiner and one that also recently changed its SFDR status to Article 8.

Only one passive fund, **Northern Trust World Custom ESG Equity Index**, appears in the Article 8 league table. It also happens to be the only fund in the list reflecting its ESG mandate in its name. Most, if not all the funds in this table, including the NT fund, are what we would consider "light green." These funds promote environmental or social characteristics through the consideration of material ESG factors and through engagement, while some also apply sector and activity-related exclusions.

Exhibit 15 The 20 Largest Article 8 Funds

Name	SFDR Fund Type	Morningstar Global Category	AUM (EUR Billion)	Active / Passive	Morningstar Sustainability Rating
Flossbach von Storch SICAV - Multiple Opportunities	Article 8	EUR Flexible Allocation - Global	24.4	Active	🌐🌐🌐
DWS Top Dividende	Article 8	Global Equity Income	19.5	Active	🌐🌐
Morgan Stanley Investment Funds - Global Brands Fund	Article 8	Global Large-Cap Blend Equity	19.3	Active	🌐🌐🌐🌐🌐
Deka-ImmobilienEuropa	Article 8	Property - Direct Europe	17.7	Active	–
hausInvest	Article 8	Property - Direct Europe	17.2	Active	–
AB FCP I - American Income Portfolio	Article 8	USD Flexible Bond	15.2	Active	–
AB FCP I - Global High Yield Portfolio	Article 8	Global High Yield Bond	13.7	Active	–
DWS Concept Kaldemorgen	Article 8	EUR Flexible Allocation - Global	13.5	Active	🌐🌐🌐🌐
Flossbach von Storch - Multiple Opportunities II	Article 8	EUR Flexible Allocation - Global	12.5	Active	🌐🌐🌐
Fidelity Funds - Global Technology Fund	Article 8	Sector Equity Technology	12.1	Active	🌐🌐🌐🌐
Findlay Park American Fund	Article 8	US Large-Cap Growth Equity	11.1	Active	🌐🌐🌐🌐
Muzinich Enhancedyield Short-Term Fund	Article 8	Global Flexible Bond - USD Hedged	11.0	Active	🌐🌐
DWS Vermögensbildungsfonds I	Article 8	Global Large-Cap Blend Equity	10.7	Active	🌐🌐🌐
M&G (Lux) Optimal Income Fund	Article 8	EUR Cautious Allocation - Global	10.1	Active	🌐🌐🌐
Fidelity Global Dividend Fund	Article 8	Global Equity Income	10.1	Active	🌐🌐🌐🌐🌐
Mercer Multi Asset Growth Fund	Article 8	GBP Allocation 60-80% Equity	9.8	Active	🌐🌐🌐🌐
grundbesitz europa	Article 8	Property - Direct Europe	9.8	Active	–
JPMorgan Income Fund	Article 8	USD Flexible Bond	9.5	Active	–
WestInvest InterSelect	Article 8	Property - Direct Europe	9.4	Active	–
Northern Trust World Custom ESG Equity Index Fund	Article 8	Global Large-Cap Blend Equity	8.9	Passive	🌐🌐🌐

Source: Morningstar Direct. Data as of 30 June 2022. Based on SFDR data collected from prospectuses on 97% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds.

The leaderboard of Article 9 funds is well staffed with products focused on the environment and themes like renewable energy, climate transition, and water.

Exhibit 16 The 20 Largest Article 9 Funds

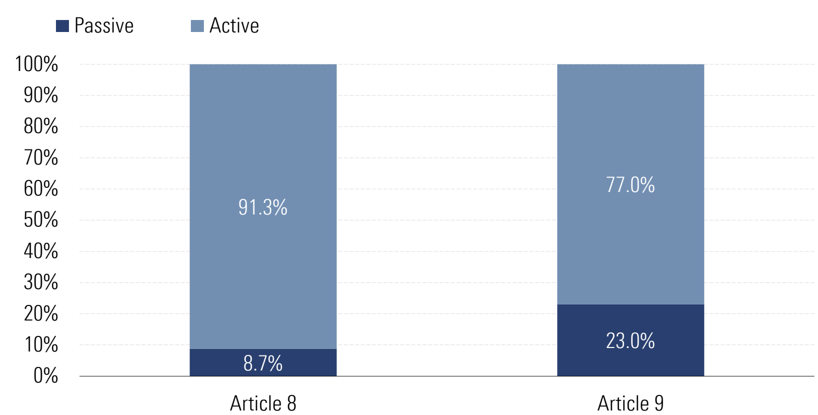
Name	SFDR Fund Type	Morningstar Global Category	AUM (EUR Billion)	Active / Passive	Morningstar Sustainability Rating
Pictet-Global Megatrend Selection	Article 9	Global Flex-Cap Equity	10.6	Active	🌐🌐🌐
Nordea 1 - Global Climate and Environment Fund	Article 9	Sector Equity Ecology	9.4	Active	🌐🌐🌐🌐🌐
Pictet-Water	Article 9	Sector Equity Water	7.8	Active	🌐🌐🌐🌐
Pictet - Global Environmental Opportunities	Article 9	Sector Equity Ecology	7.4	Active	🌐🌐🌐🌐🌐
BlackRock Global Funds - Sustainable Energy Fund	Article 9	Sector Equity Alternative Energy	5.9	Active	🌐🌐🌐🌐🌐
Handelsbanken Global Index Criteria	Article 9	Global Large-Cap Blend Equity	5.4	Passive	🌐🌐🌐
iShares Global Clean Energy ETF	Article 9	Sector Equity Alternative Energy	5.4	Passive	🌐🌐🌐🌐
iShares MSCI USA ESG Enhanced ETF	Article 9	US Large-Cap Blend Equity	4.7	Passive	🌐🌐🌐🌐
Mirova Global Sustainable Equity Fund	Article 9	Global Large-Cap Growth Equity	4.3	Active	🌐🌐🌐🌐🌐
Pictet-Clean Energy	Article 9	Sector Equity Alternative Energy	4.2	Active	🌐🌐🌐🌐🌐
Amundi MSCI USA SRI PAB	Article 9	US Large-Cap Blend Equity	4.1	Passive	🌐🌐🌐🌐🌐
Handelsbanken USA Index Criteria	Article 9	US Large-Cap Blend Equity	3.6	Passive	🌐🌐🌐🌐
BNP Paribas Funds Aqua	Article 9	Sector Equity Water	3.3	Active	🌐🌐🌐
RobecoSAM Sustainable Water Equities	Article 9	Sector Equity Water	3.2	Active	🌐🌐🌐🌐
BNP Paribas Aqua	Article 9	Sector Equity Water	3.1	Active	🌐🌐🌐
Handelsbanken Hållbar Energi	Article 9	Sector Equity Alternative Energy	3.0	Active	🌐🌐🌐🌐
Carmignac Investissement	Article 9	Global Large-Cap Growth Equity	3.0	Active	🌐🌐🌐
Amundi Funds - Global Ecology ESG	Article 9	Sector Equity Ecology	3.0	Active	🌐🌐🌐🌐🌐
AB SICAV I - Sustainable Global Thematic Portfolio	Article 9	Global Large-Cap Growth Equity	3.0	Active	🌐🌐🌐🌐
Amundi MSCI World SRI PAB	Article 9	Global Large-Cap Blend Equity	2.9	Passive	🌐🌐🌐🌐🌐

Source: Morningstar Direct. Data as of 30 June 2022. Based on SFDR data collected from prospectuses on 97% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds.

Passive Article 8 and Article 9 Funds

Active funds continue to largely dominate the SFDR Article 8 and Article 9 product landscape. However, passive funds are gaining ground in the Article 9 category, reaching 23.0% at the end of June 2022 from 17.4% six months ago. Meanwhile, passive Article 8 funds ended the second quarter with a slightly smaller market share of 8.7% compared with that of 9.0% at the end of last year.

Exhibit 17 Market Share of Active and Passive Funds Classified as Article 8 and Article 9



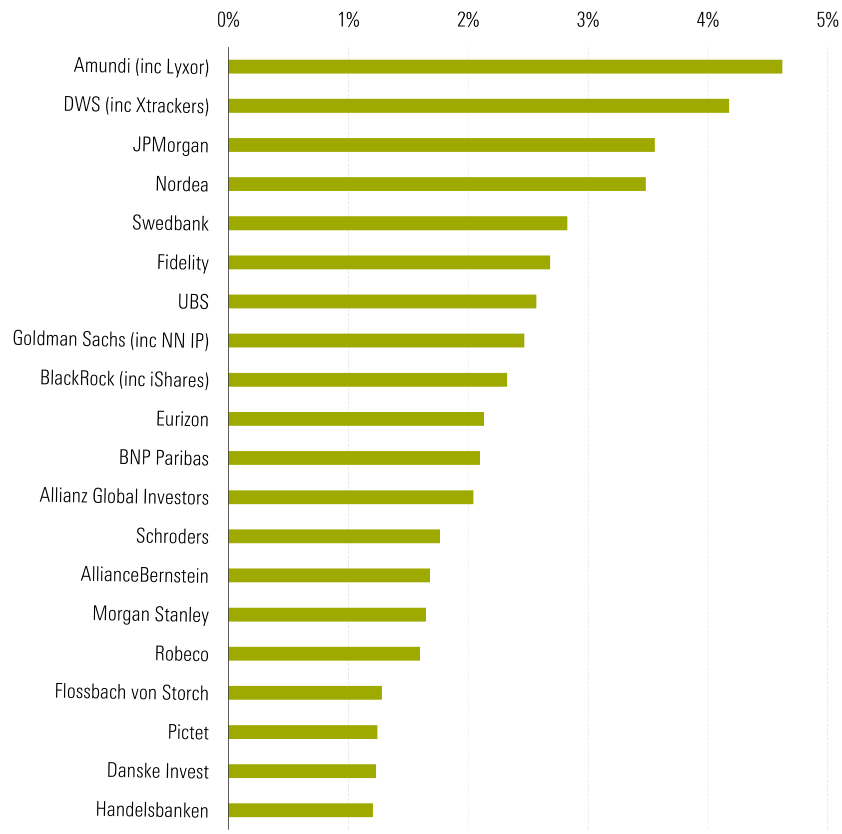
Source: Morningstar Direct. Data as of 30 June 2022. Based on SFDR data collected from prospectuses on 97% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds.

The larger market share for passive Article 9 funds may appear counterintuitive, but it is partly due to the growing number of sizable index funds and ETFs tracking EU climate benchmarks (Paris-aligned and climate transition benchmarks). The 23% market share for passive Article 9 funds is slightly higher than the market share for passive funds in the overall European fund universe.

Provider League Tables

Exhibits 18 and 19 show the 20 asset managers with the highest market share in Article 8 and Article 9 funds, ranked by assets in Article 8 and Article 9 funds, respectively, based on SFDR data representing 97% of the EU fund universe excluding money markets, feeder funds, and funds of funds.

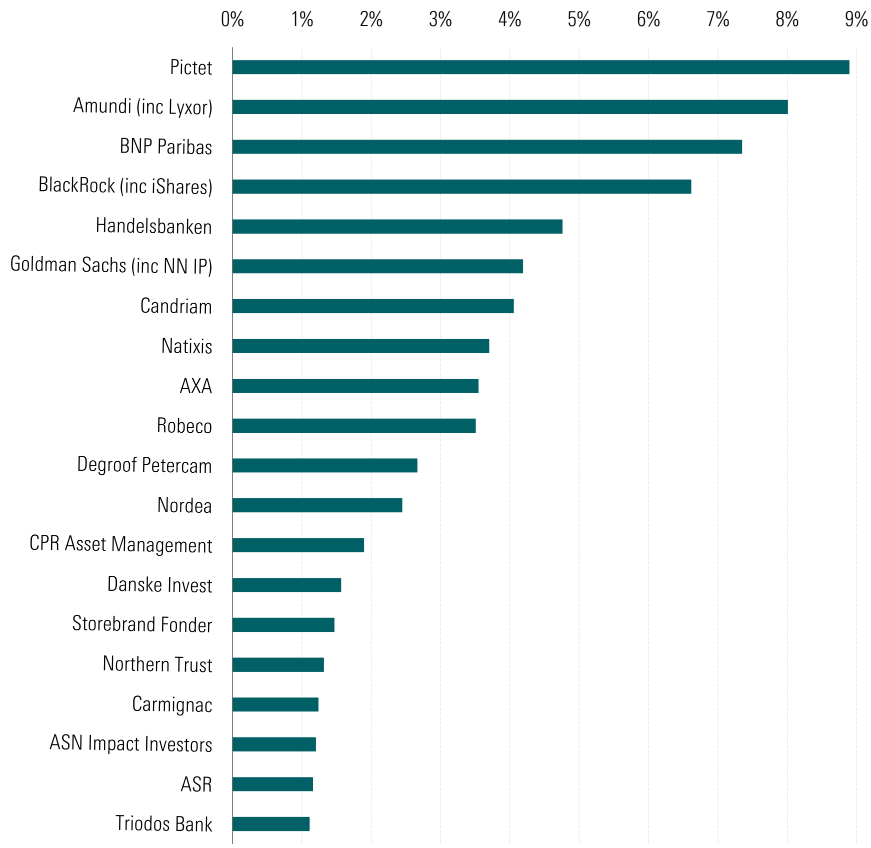
Exhibit 18 Top 20 Asset Managers by Article 8 Fund Assets



Source: Morningstar Direct. Data as of 30 June 2022. Based on SFDR data collected from prospectuses on 97% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds. Using Branding Name in Morningstar Direct, a manager's market share is calculated as following: manager's Article 8 fund assets divided by total market Article 8 fund assets.

At the end of the second quarter of 2022, Amundi topped the Article 8 league table, but with a lower market share of 4.6% (from 5.4% three months ago). DWS moved up the rank to take the second position (from the fourth at the end of March), while JP Morgan came third, closely followed by Nordea.

Exhibit 19 Top 20 Asset Managers by Article 9 Fund Assets

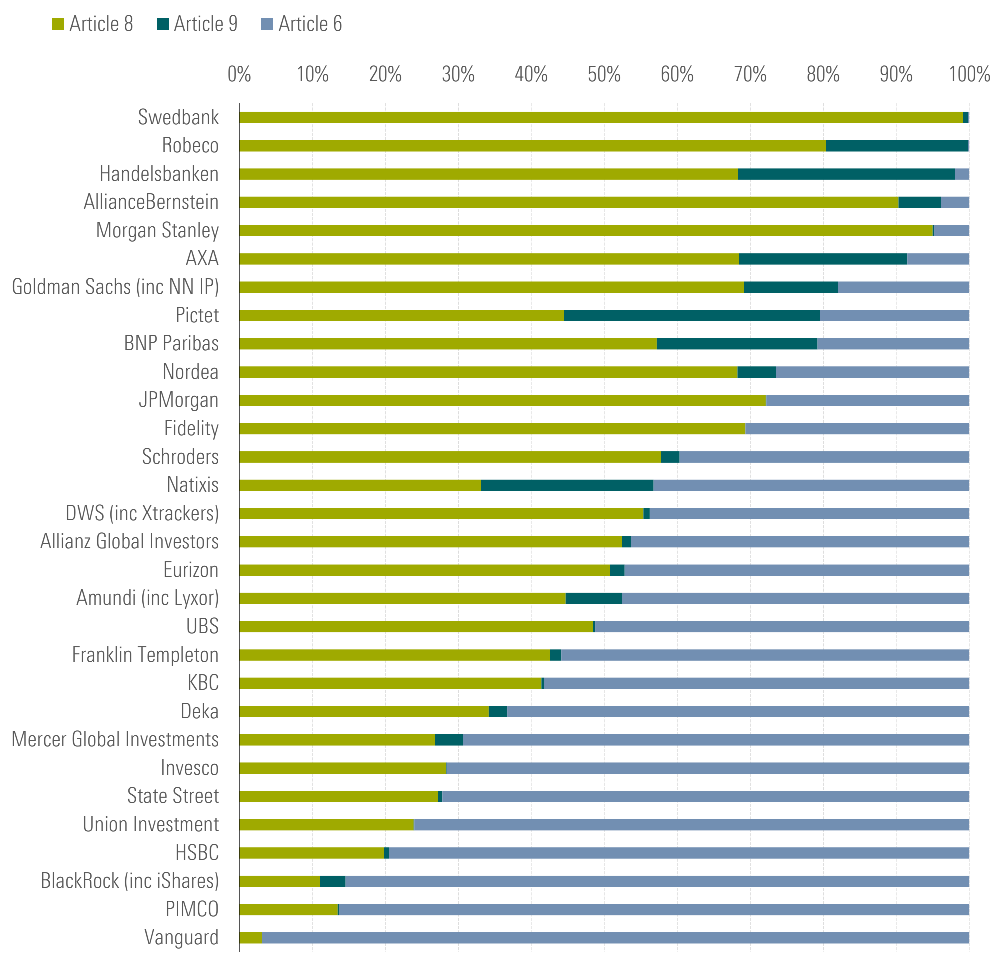


Source: Morningstar Direct. Data as of 30 June 2022. Based on SFDR data collected from prospectuses on 97% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds. Using Branding Name in Morningstar Direct, a manager's market share is calculated as following: manager's Article 9 fund assets divided by total market Article 9 fund assets.

Boosted by its long-standing ESG thematic product range, Pictet remained the firm with by far the highest share of total assets in Article 9 funds at the end of June, albeit lower than at the end of March (8.9% versus 9.7%). Amundi overtook BNP Paribas as the second-largest provider of Article 9 funds.

Looking below at the 30 asset managers with the highest market share in Article 8 and Article 9 funds, we found that the managers with the biggest proportion of Article 8 and Article 9 funds within their fund range at the end of June remained Swedbank and Robeco. Both firms almost exclusively offer Article 8 and Article 9 funds (99.8% of their assets in scope each). They are closely followed by Handelsbanken and AllianceBernstein, which display 98.1% and 96.1%, respectively.

Exhibit 20 Top 30 Asset Managers by Percentage of Articles 8 and 9 Fund Assets



Source: Morningstar Direct. Data as of 30 June 2022. Based on SFDR data collected from prospectuses on 97% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds. Using Branding Name in Morningstar Direct. Managers are ranked firstly by assets, and then by their percentage of combined assets in Article 8 and Article 9 funds. Each percentage is calculated as following: manager's Article 8 and 9 fund assets divided by manager's aggregated assets in Article 6, Article 8, and Article 9 funds.

How Do Article 8 and Article 9 Funds Stack Up?

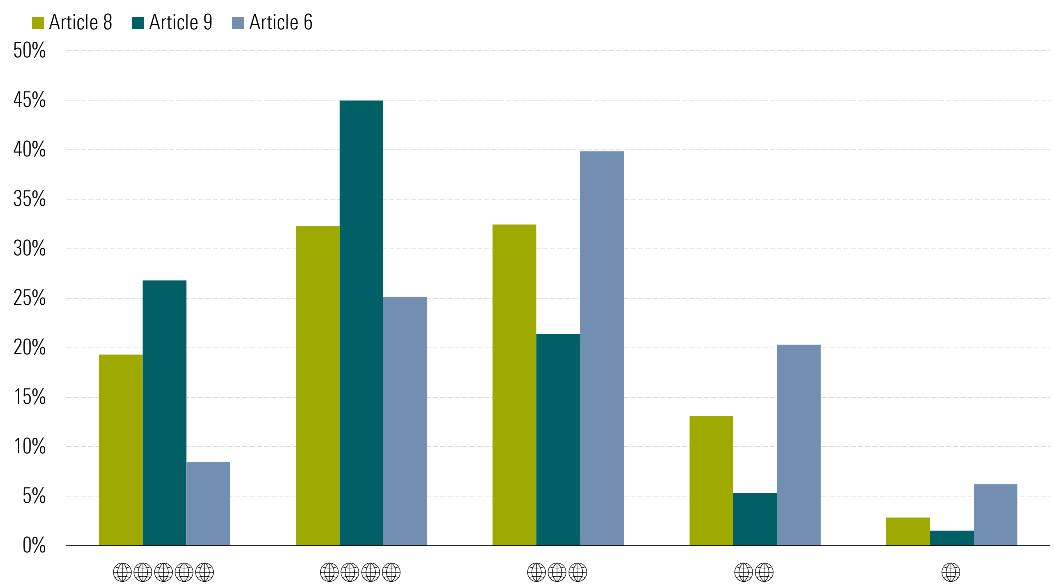
As done in previous reports[3], we analyse here the portfolio characteristics of Article 8 and Article 9 portfolios using a number of metrics. We're looking to assess whether Article 8 and Article 9 funds exhibit desirable ESG characteristics. For example, do they have a high exposure to companies with 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.

3 SFDR: Four Months After Its Introduction (July 2021) and SFDR Article 8 and Article 9 Funds: 2021 in Review (February 2022)

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' exposures to ESG risk compared with peers. The Morningstar Sustainability Rating can help answer these questions. The Sustainability Rating is an asset-weighted roll-up of Morningstar 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 21 Globe Distribution for Article 8 and 9 Funds Compared With the Overall Fund Universe



Source: Morningstar Direct. Data as of 30 June 2022. Based on SFDR data collected from prospectuses on 97% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds.

As seen in the exhibit above, that is indeed the case. The rating distribution skews toward higher Sustainability Ratings for Article 8 and Article 9 funds. In June, 51.6% (52.0% six months ago) of Article 8 funds and 71.8% (70.4% six months ago) of Article 9 funds received the highest ratings, 4 or 5 globes, compared with 33.6% (34.6% six months ago) of Article 6 funds. It's worth noting that the proportion of 4- or 5-globe funds in the Article 9 grouping has slightly increased in the past six months, at the expense of Article 6 funds.

Do Article 8 and Article 9 Funds Have Low Exposures 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 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

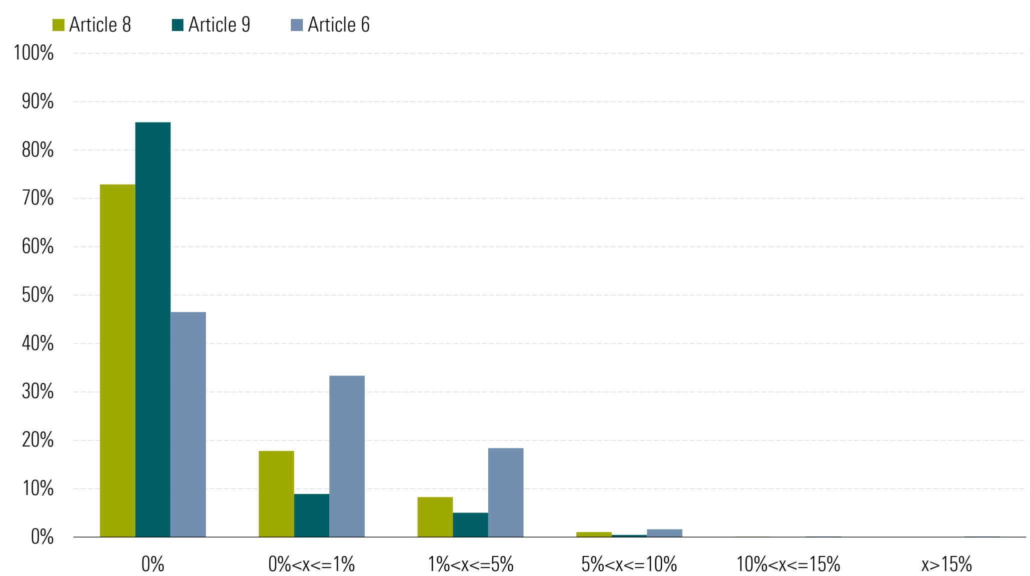
Article 8 and Article 9 strategies by excluding issuers that violate international norms as defined by the UN Global Compact Principles.

Here, using Morningstar 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.[4]

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



Source: Morningstar Direct. Data as of 30 June 2022. Based on SFDR data collected from prospectuses on 97% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds.

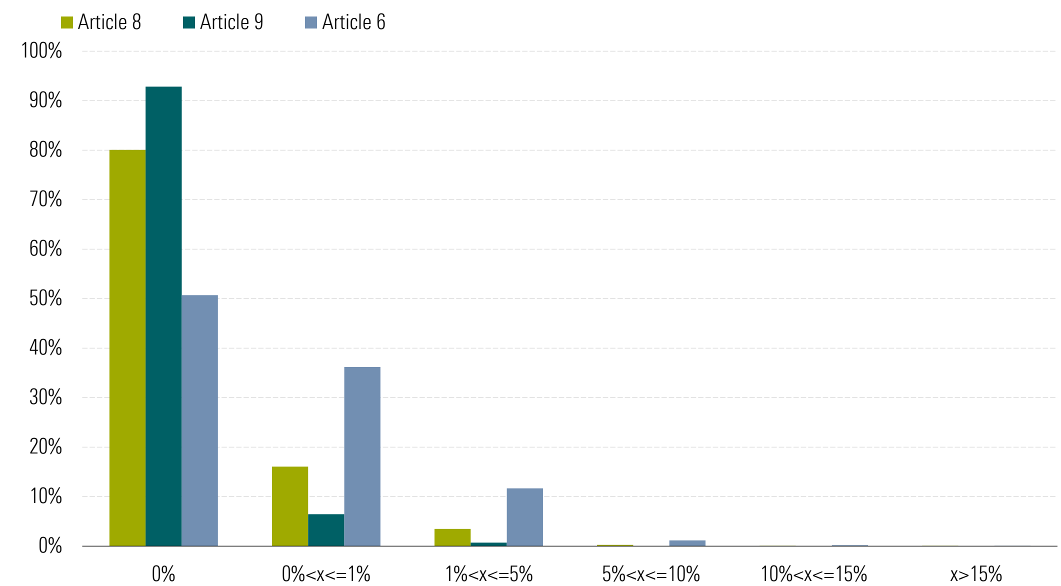
Article 8 and Article 9 funds continue to be less exposed to controversial weapons than Article 6 funds. About 73% (74% six months ago) of Article 8 products and 86% (87% six months ago) of Article 9 portfolios, had zero involvement in controversial weapons at the end of June 2022. This compares with 46% (48% six months ago) of Article 6 funds. The slight percentage drops observed here over the past six months aren't large enough to draw any conclusion about the potential increase in investments in defense companies following the conflict in Ukraine.

4 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 involved 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.

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.[5]

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



Source: Morningstar Direct. Data as of 30 June 2022. Based on SFDR data collected from prospectuses on 97% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds.

Article 8 and Article 9 funds remain much less exposed to tobacco than Article 6 funds. About 80% (76% six months ago) and 93% (91% six months ago) of Article 8 and Article 9 portfolios, respectively, had no involvement in companies that derive some revenues from tobacco manufacturing at the end of June 2022. These numbers are higher than those reported six months ago. They compare with 51% (50% six months ago) of Article 6 offerings.

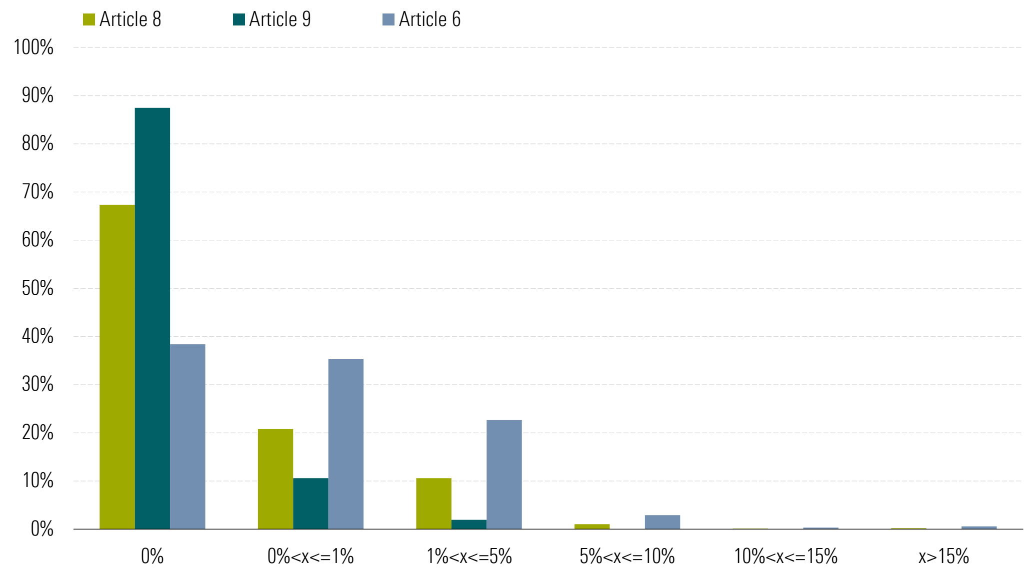
Severe Controversies

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.[6]

5 Product Involvement %—Tobacco refers to the percentage of a fund's assets under management 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%.

6 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' Involvement in Severe Controversies



Source: Morningstar Direct. Data as of 30 June 2022. Based on SFDR data collected from prospectuses on 97% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds.

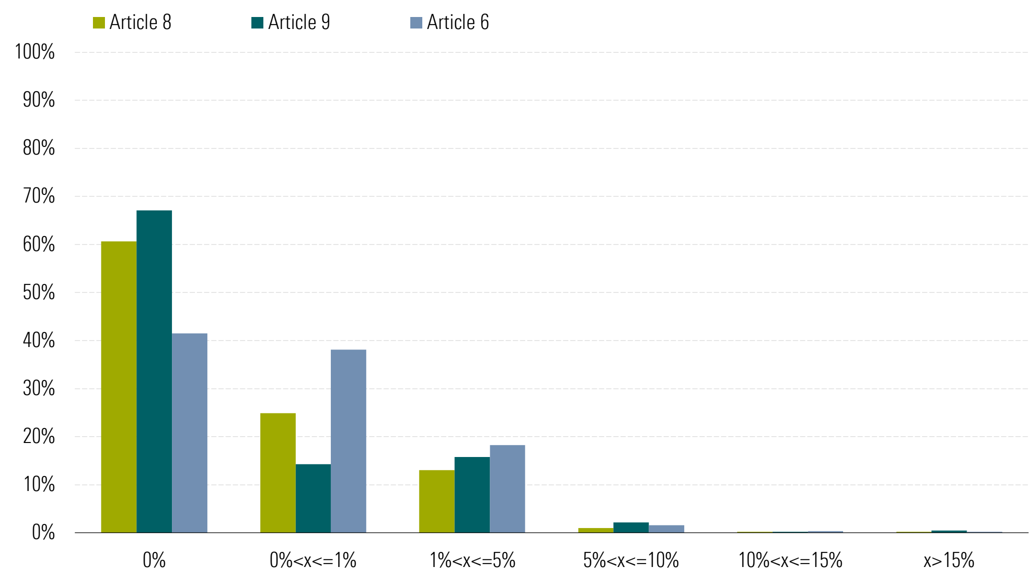
Article 8 and Article 9 funds reduced their exposure to severe controversies. The proportion of Article 9 strategies exhibiting zero exposure to severe controversies increased significantly to 87% (from 77% six months ago and 81% a year ago). Meanwhile, 67% (64% six months ago) of Article 8 strategies have no exposure to severe controversies, compared with 38% of Article 6 funds.

Thermal Coal Involvement

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.[7]

7 Product Involvement %—Thermal Coal refers to the percentage of a fund's assets under management invested in companies that are classified as directly involved in the extraction of thermal coal; indirectly involved by generating electricity from thermal coal. The minimum revenue threshold to mark a company as involved is the following range: 5.0%-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 Direct. Data as of 30 June 2022. Based on SFDR data collected from prospectuses on 97% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds.

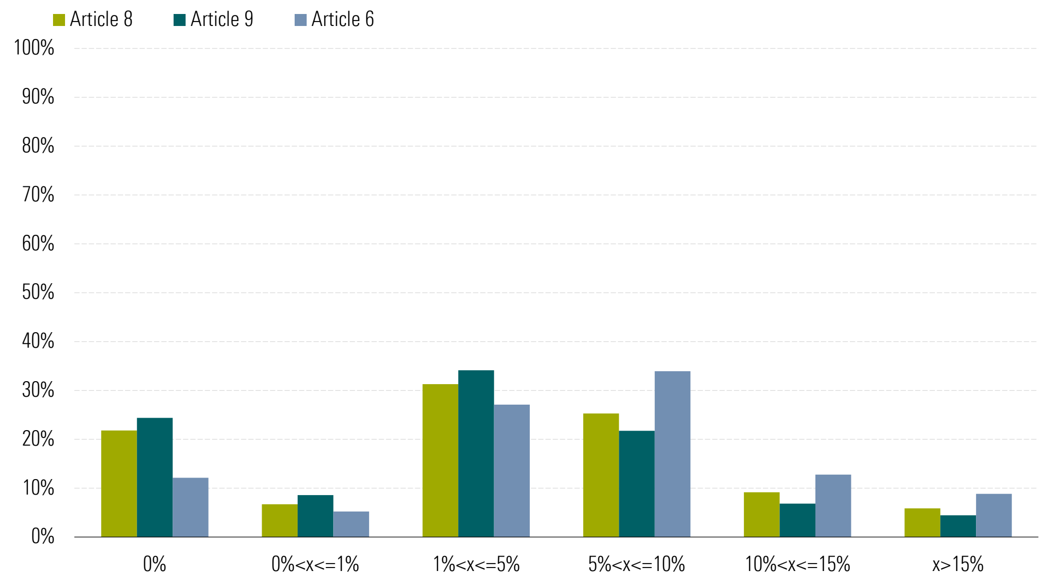
We can see a slight deterioration in the thermal coal involvement of Article 8 and Article 9 offerings, especially for Article 9 products. Close to 61% (64% six months ago) and 67% (78% six months ago) of funds classified as Article 8 and Article 9, respectively, exhibited no exposure to companies deriving some revenue from thermal coal at the end of June. These numbers may look surprising, particularly for Article 9 funds, where the SFDR's "do no significant harm" requirement is meant to apply. These numbers remain better than the 41% of Article 6 with no thermal coal involvement.

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.[8] Unlike the previous metrics, the fossil fuel product involvement data is available only on a quarterly basis.

8 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 and services are also included. Companies involved in Arctic oil and gas exploration and oil sands extraction will be included only if there is no involvement in oil and gas production.

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



Source: Morningstar Direct. Data as of 30 June 2022. Based on SFDR data collected from prospectuses on 97% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds.

While the majority of Article 8 and Article 9 funds have zero exposure to all the controversial activities previously mentioned, this is not the case for fossil fuel. Only a minority of Article 8 funds (22%) and Article 9 funds (24%) have no fossil fuel involvement. These numbers have remained stable over the past six months, despite the energy crisis and continued rally in oil and gas prices this year. Additionally, as much as 40% (39% six months ago) of Article 8 products and 33% (33% six months ago) of Article 9 portfolios, had over 5% exposure to fossil fuel companies at of the end of June.

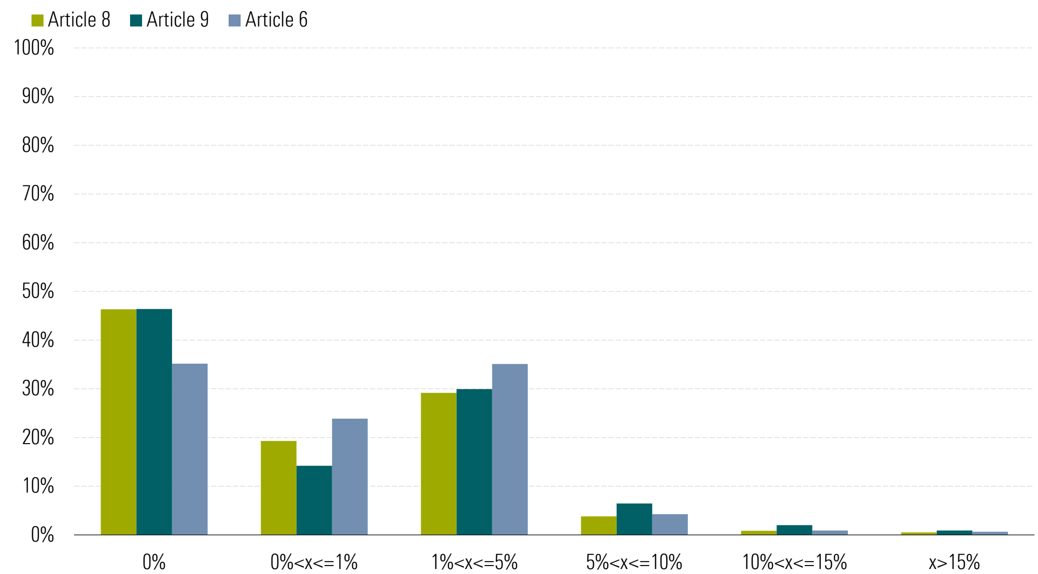
The relatively higher fossil fuel involvement of Article 9 funds, in particular, may still come as a surprise to some investors. But it is largely because many of these funds invest in so-called transitioning companies. These typically are oil and gas or utilities companies that have made a commitment 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.

Nuclear Involvement

Finally, we test the exposure of Article 8 and Article 9 funds to nuclear energy. We use the Product Involvement %—Nuclear data point.[9]

9 Product Involvement %—Nuclear refers to the percentage of a fund's assets under management invested in companies that produces nuclear power, including utilities that own or operate nuclear power generators, companies that provide products/services that support the nuclear power industry, such as designing and constructing nuclear power plants, manufacturing specialised parts for use in nuclear power plants, or companies involved in uranium mining exploration, as well as companies that distribute electricity generated from nuclear power

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



Source: Morningstar Direct. Data as of 30 June 2022. Based on SFDR data collected from prospectuses on 97% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds.

Similar to fossil fuel, it's a minority of Article 8 funds (46%) and Article 9 funds (46%) that have no nuclear involvement. As much as 34% of Article 8 portfolios and 39% of Article 9 products have more than 1% exposure to companies associated with nuclear energy. Noteworthy here is the higher percentage for Article 9. In light of the inclusion of nuclear in the EU Taxonomy, we could see both types of funds increase their exposure to nuclear.

What Are the Most Popular Article 8 and 9 Fund Holdings?

In this section, we look inside Article 8 and Article 9 funds and examine the most commonly held companies in each grouping as well as their sector, equity style, and Morningstar ESG Risk Rating Assessment[10].

Following are the 20 most commonly held companies in Article 8 and Article 9 funds, separately displayed in Exhibits 28 and 29.

10 Morningstar® ESG Risk Rating Assessment for Companies

Exhibit 28 Most Commonly Held Companies in Article 8 Funds

Stock	Sector	Number of Funds Owning the Stock	Average Portfolio Weight	Equity Style Box	ESG Risk Rating Assessment
Alphabet Inc	Communication Services	1002	3.0%	Large Growth	🌐🌐🌐
Microsoft Corp	Technology	860	4.8%	Large Growth	🌐🌐🌐🌐
ASML Holding NV	Technology	810	2.9%	Large Growth	🌐🌐🌐🌐
Roche Holding AG	Healthcare	715	2.5%	Large Blend	🌐🌐🌐
Novo Nordisk A/S	Healthcare	691	3.2%	Large Growth	🌐🌐🌐
Taiwan Semiconductor Manufacturing Cc	Technology	650	4.6%	Large Blend	🌐🌐🌐🌐
Sanofi SA	Healthcare	631	2.4%	Large Blend	🌐🌐🌐
AstraZeneca PLC	Healthcare	612	2.9%	Large Growth	🌐🌐🌐
Schneider Electric SE	Industrials	611	2.0%	Large Blend	🌐🌐🌐🌐
LVMH Moet Hennessy Louis Vuitton SE	Consumer Cyclical	587	3.0%	Large Growth	🌐🌐🌐🌐
SAP SE	Technology	571	4.2%	Large Blend	🌐🌐🌐🌐
Apple Inc	Technology	571	2.1%	Large Growth	🌐🌐🌐🌐
Amazon.com Inc	Consumer Cyclical	558	2.9%	Large Growth	🌐🌐
Visa Inc	Financial Services	557	2.2%	Large Growth	🌐🌐🌐🌐
Nestle SA	Consumer Defensive	548	3.1%	Large Blend	🌐🌐🌐
NVIDIA Corp	Technology	539	1.8%	Large Growth	🌐🌐🌐🌐
Samsung Electronics Co Ltd	Technology	527	3.0%	Large Value	🌐🌐🌐🌐
Tencent Holdings Ltd	Communication Services	512	3.9%	Large Blend	🌐🌐🌐
L'Oreal SA	Consumer Defensive	500	2.1%	Large Growth	🌐🌐🌐🌐
Alibaba Group Holding Ltd	Consumer Cyclical	495	2.9%	Large Blend	🌐🌐🌐

Source: Morningstar Direct. Data as of 30 June 2022. Based on SFDR data collected from prospectuses on 97% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds.

The 20 most popular stocks in Article 8 portfolios haven't changed much in the last 12 months. Since July 2021, three companies have left the leader table: **Atlas Copco AB**, **Unilever**, and **Allianz SE**, to be replaced by **Apple**, **Visa**, and **Nvidia**.

The top 20 include a majority of companies (11) with a Low ESG Risk profile (4 globes), while eight carry a Medium ESG Risk Rating Assessment (3 globes) and one—**Amazon.com**—scores High ESG Risk (2 globes). This compares with 14 companies with a Low ESG Risk Rating (4 globes) and six with a Medium rating (3 globes) in the top 20 stocks in Article 9 funds. None, however, carries a Negligible rating (5 globes), which represents the lowest level of the five-point scale ESG Risk Rating Assessment.

The differences in ESG risk profiles between the top 20 in the two categories of portfolios are in line with our analysis earlier of their Morningstar Sustainability Ratings. Article 9 funds tend to invest in companies with lower ESG risk, and more Article 9 funds receive 4 and 5 globes.

Meanwhile, one can see that eight companies—four with Medium ESG risk (3 globes) and four with Low ESG Risk (4 globes)—feature in both tables (highlighted in green in Exhibits 28 and 29). In both tables, growth-oriented stocks dominate.

Exhibit 29 Most Commonly Held Companies in Article 9 Funds

Stock	Sector	Number of Funds Owning the Stock	Average Portfolio Weight	Equity Style Box	ESG Risk Rating Assessment
Schneider Electric SE	Industrials	278	2.2%	Large Blend	🌐🌐🌐🌐
ASML Holding NV	Technology	223	2.7%	Large Growth	🌐🌐🌐🌐
Vestas Wind Systems A/S	Industrials	215	1.2%	Large Growth	🌐🌐🌐🌐
Novo Nordisk A/S	Healthcare	196	2.5%	Large Growth	🌐🌐🌐
Koninklijke DSM NV	Basic Materials	191	1.6%	Large Blend	🌐🌐🌐🌐
Roche Holding AG	Healthcare	188	2.0%	Large Blend	🌐🌐🌐
Microsoft Corp	Technology	179	4.1%	Large Growth	🌐🌐🌐🌐
L'Oreal SA	Consumer Defensive	176	1.8%	Large Growth	🌐🌐🌐🌐
Alphabet Inc	Communication Services	169	2.1%	Large Growth	🌐🌐🌐
Infineon Technologies AG	Technology	165	1.3%	Large Growth	🌐🌐🌐🌐
EDP Renovaveis SA	Utilities	157	1.3%	Large Blend	🌐🌐🌐🌐
SAP SE	Technology	157	1.6%	Large Blend	🌐🌐🌐🌐
Thermo Fisher Scientific Inc	Healthcare	155	2.1%	Large Growth	🌐🌐🌐🌐
SolarEdge Technologies Inc	Technology	147	1.5%	Mid Growth	🌐🌐🌐
Orsted A/S	Utilities	145	1.5%	Large Blend	🌐🌐🌐🌐
American Water Works Co Inc	Utilities	143	1.4%	Mid Blend	🌐🌐🌐
AstraZeneca PLC	Healthcare	143	2.3%	Large Growth	🌐🌐🌐
Xylem Inc	Industrials	142	1.0%	Mid Blend	🌐🌐🌐🌐
Allianz SE	Financial Services	141	1.5%	Large Value	🌐🌐🌐🌐
Atlas Copco AB	Industrials	141	0.7%	Large Blend	🌐🌐🌐🌐

Source: Morningstar Direct. Data as of 30 June 2022. Based on SFDR data collected from prospectuses on 97% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds.

Six companies have left the top-20 Article 9 table since last July: **Siemens Gamesa Renewable Energy SA**, **Koninklijke Philips NV**, **Air Liquide SA**, **Umicore SA**, **Siemens AG**, and Unilever. These companies were replaced by **EDP Renovaveis SA**, **SolarEdge Technologies**, **Orsted A/S**, **American Water Works**, **AstraZeneca PLC**, and Atlas Copco AB.

In total, out of the 9,827 stocks[11] held in Article 8 and Article 9 portfolios, 2,853 are included in both types. This represents a 27% overlap. Common holdings are among the companies deemed the most attractive in terms of ESG risk and/or impact. These tend to be large and innovative companies for which sustainability plays a central role in the strategy. The large number of individual names in the Article 8 group can be explained by the broad spectrum of ESG approaches represented, from light green exclusions-only strategies to dark green thematic approaches. The Article 8 fund group holds almost every company in the world's total market indexes.

While the Article 8 category is very large and heterogeneous, the Article 9 category is smaller and homogenous. Article 9 funds typically focus on companies that provide positive solutions to the world's

11 We included here only stocks that have an average weight across portfolios of at least 0.2%.

biggest challenges like climate change. Solutions to environmental issues tend to be found in the industrial sectors. Article 9 portfolios tend to be more concentrated at both stock and sector levels, and this is somewhat reflected in Exhibit 29. Industrial, technology, and healthcare are the most represented sectors in the top-20 league table.

The European ESG Template (EET Data) Ahead of MiFID II

From 2 Aug 2022, the amended Markets in Financial Instruments Directive II (MiFID II) will require financial advisors to consider clients' sustainability preferences when conducting suitability assessments. If clients express interest in making sustainable investments, advisers will have to accommodate. Depending on the specific client's preferences, advisers will have to source products that have a minimum proportion of sustainable investments as defined by the Sustainable Finance Disclosure Regulation or the EU Taxonomy. Clients may also choose only investments that consider principal adverse impacts, or PAIs.

To facilitate this process, a new European environmental, social, and governance template, or EET, has been developed by industry representatives (FinDatEx) to ease the exchange of data between asset managers and distributors. Asset managers marketing their funds in the European Union started to submit EET data on a voluntary basis from 1 June.

As of 18 July, Morningstar collected EET data on 70,580 share classes, accounting for 43% of all share classes in scope of MiFID II. These represent 10,316 funds[12], including 4,297 Article 8 funds and 556 Article 9 funds[13].

In this section, we share insights on the coverage and values of the three key EET fields required for the August deadline, as featured in the Morningstar Direct database, namely:
1) **Principal Adverse Impact Consideration**, indicating if a product considers Principle Adverse Impact in its investments. Answers are "Yes" or "No".[14]
2) **EU Sustainable Finance Disclosure Regulation Minimum or Planned Investments Sustainable Investments**, representing the minimum percentage of portfolio investments that are deemed sustainable but are not taxonomy aligned. Answers are numerical values.[15]
3) **EU Sustainable Finance Disclosure Regulation Minimum or Planned Investments Sustainable Investments Taxonomy Aligned**, representing the minimum percentage of the portfolio that are aligned with the EU Taxonomy. Answers are numerical values.[16]

We also discuss the challenges that asset managers will face when selecting suitable products for clients given the patchiness of the data available to them and the lack of comparability between

12 The number of funds and share classes estimated to be in scope of the EET is 38,330 and 143,179, respectively.

13 As of 18 July, Morningstar had collected SFDR data types for 30,060 funds based on fund prospectuses, including 10,462 Article 8 and Article 9 funds.

14 EET Name: 20100_Financial_Instrument_Does_This_Product_Consider_Principle_Adverse_Impact_In_Their_Investment

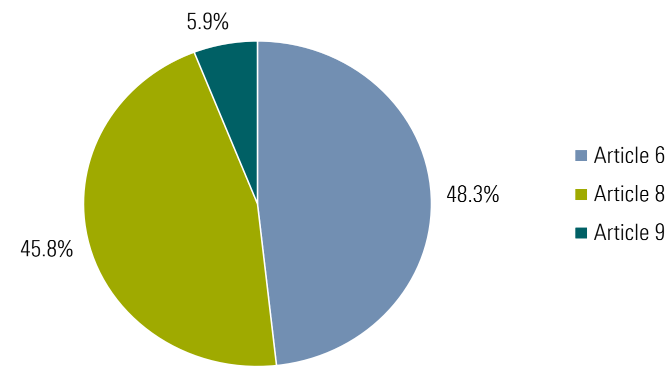
15 EET Name: 20420_Financial_Instrument_EU_SFDR_Minimum_Or_Planned_Investments_Sustainable_Investments

16 EET Name: 20450_Financial_Instrument_EU_SFDR_Minimum_Or_Planned_Investments_Sustainable_Investments_Taxonomy_Aligned

products due to the different approaches taken by asset managers to calculate sustainable investment and taxonomy-alignment exposure.

Exhibit 30 provides the breakdown of the surveyed funds by their reported SFDR product type.

Exhibit 30 Breakdown of Surveyed Funds by SDFR Product Type

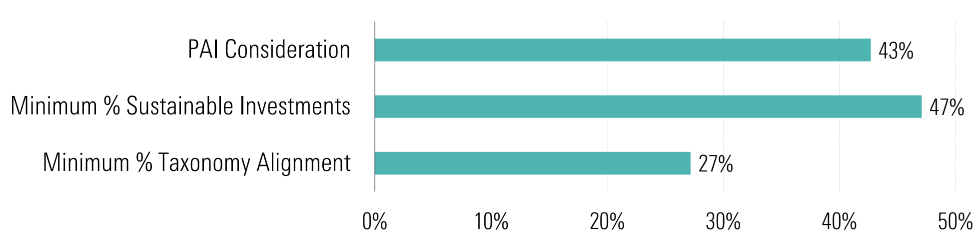


Source: Morningstar Direct. Data as of 18 July 2022. Based on 9,379 funds that reported SFDR product type, excluding 749 funds that reported "Product is not in SFDR scope."

Article 8 and Article 9 funds constitute the majority (51.7%) of the 9,379 funds that populated the SFDR Product Type field. This proportion is much higher than the actual representation of Article 8 and Article 9 funds in the EU universe (35.4% at the end of June). This indicates that product manufacturers have prioritised Article 8 and Article 9 funds for the first phase of reporting. Eventually, manufacturers will complete the EET for all SFDR scope products.

Exhibit 31 shows the coverage of these three fields for the 4,853 Article 8 and Article 9 funds included in this report.

Exhibit 31 Coverage of Key EET Datapoints for the Surveyed Article 8 and Article 9 Funds



Source: Morningstar Direct. Data as of 18 July 2022. Based on 4,853 reported as Article 8 and Article 9 products.

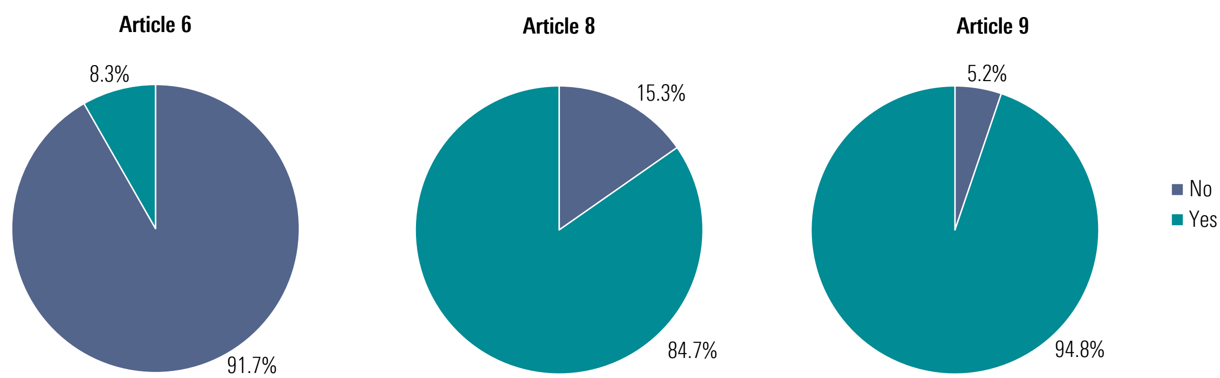
All Article 8 and Article 9 products are required to disclose whether or not they consider principal adverse impact indicators. Yet, as Exhibit 4 shows, only 43% of surveyed Article 8 and Article 9 funds populated the **PAI consideration** field.

Meanwhile, 47% reported a minimum percentage of sustainable investments. A much smaller number of funds, 27%, disclosed a minimum percentage of taxonomy-aligned investments.

PAI Consideration

Looking at a more granular level, only 41% of the Article 8 funds and 48% of the Article 9 funds in our sample populated the Principal Adverse Impact Consideration field. And among those, the vast majority stated they do consider PAIs, as shown in Exhibit 5, although it may come as a surprise that not all of these funds do. About 15% of Article 8 and 5% of Article 9 do not consider PAIs.

Exhibit 32 SFDR Product Type and PAI Consideration



Source: Morningstar Direct. Data as of 18 July 2022. Based on 2,476 Article 6 funds, 1,764 Article 8 funds, and 268 Article 9 funds that reported filled in the PAI Consideration field.

Article 6 products are also required to publish a PAI statement or explain the choice not to. More than half (55%) of surveyed Article 6 funds have responded to the field, and of these, 8.3% reported considering PAIs.

Overall, of the 10,316 surveyed funds, including Article 6, 8, and 9 funds, about one fifth (19.6%) reported taking PAIs into account in investment decisions.

PAI indicators are intended to show investors what adverse impacts a financial product may have on sustainability factors relating to environmental, social, and employee matters, respect for human rights, anticorruption and antibribery matters.

Below is a sample of the PAIs that product manufacturers should disclose using the EET. The EET data fields cover the 64 PAI indicators designed under SFDR. The sample below includes 14 PAI indicators for corporates, two for sovereigns, and two for real estate assets.

Exhibit 33 18 of the 64 PAI Indicators Under the EET

Corporate		
Greenhouse gas emissions	1	GHG emissions
	2	Carbon footprint
	3	GHG intensity of investee companies
	4	Exposure to companies active in the fossil fuel sector
	5	Share of non-renewable energy consumption and production
	6	Energy consumption intensity per high impact climate sector
Biodiversity	7	Activities negatively affecting biodiversity-sensitive areas
Water	8	Emissions to water
Waste	9	Hazardous waste ratio
Social and employee matters	10	Violations of the UNGC principles and OECD Guidelines for Multinational Enterprises
	11	Lack of processes and compliance mechanisms to monitor compliance
	12	Unadjusted gender pay gap
	13	Board gender diversity
	14	Exposure to controversial weapons
Sovereign and supranational		
Environmental	15	GHG intensity of investee countries
Social	16	Number of investee countries subject to social violations
Real estate		
Fossil fuels	17	Exposure real-estate assets involved in the extraction, storage, transport of fossil fuels
Energy efficiency	18	Exposure to energy-inefficient real estate assets

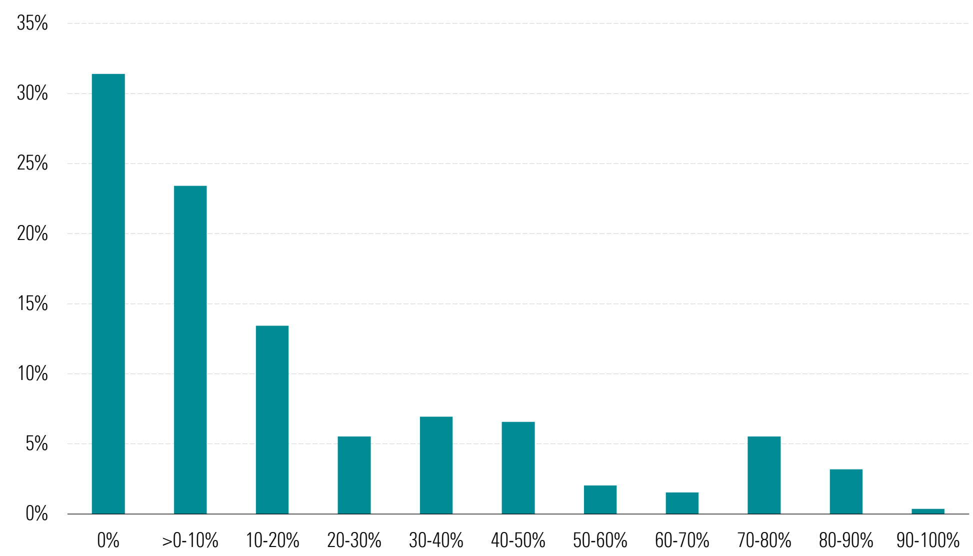
Source: SFDR delegated regulation-annex I.

Minimum Proportion of Sustainable Investments

As previously mentioned, only 47% of surveyed Article 8 and Article 9 funds populated the **SFDR Minimum or Planned Investments Sustainable Investments** field. This field represents a portfolio's targeted exposure to sustainable investments, regardless of taxonomy alignment.

Exhibit 6 shows the distribution of the 2,203 Article 8 and Article 9 funds that reported the field. Funds with reported values of 0% account for a third of that universe. Another 36% disclosed minimum exposure to sustainable investments between 0 and 20%, while almost one fifth target over 40%.

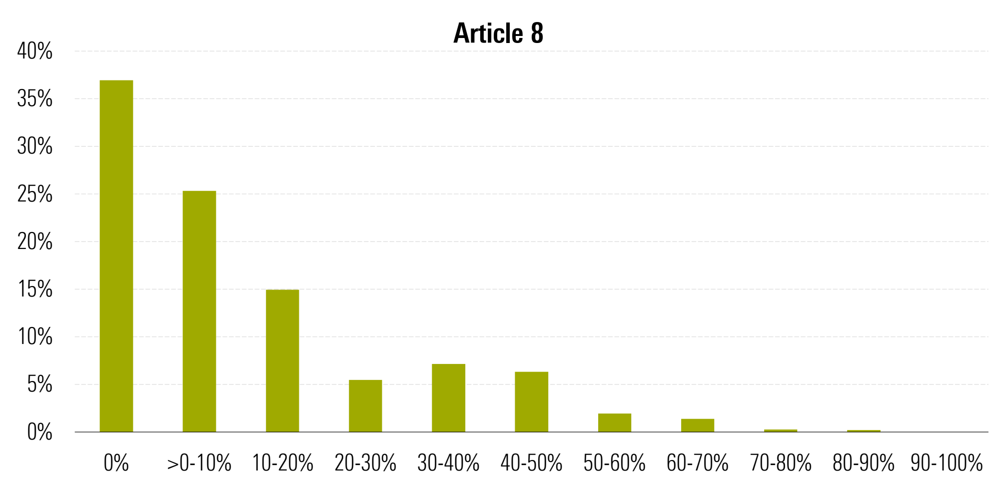
Exhibit 34 Distribution of Article 8 and Article 9 Funds (Combined) Based on Minimum % of Sustainable Investments



Source: Morningstar Direct. Data as of 18 July 2022. Based on 2,203 Article 8 and Article 9 funds that report the field.

Exhibits 8 and 9 provides a breakdown of the minimum proportion of sustainable investments by reported **SFDR Product Type.**

Exhibit 35 Minimum % of Sustainable Investments for Article 8 Funds



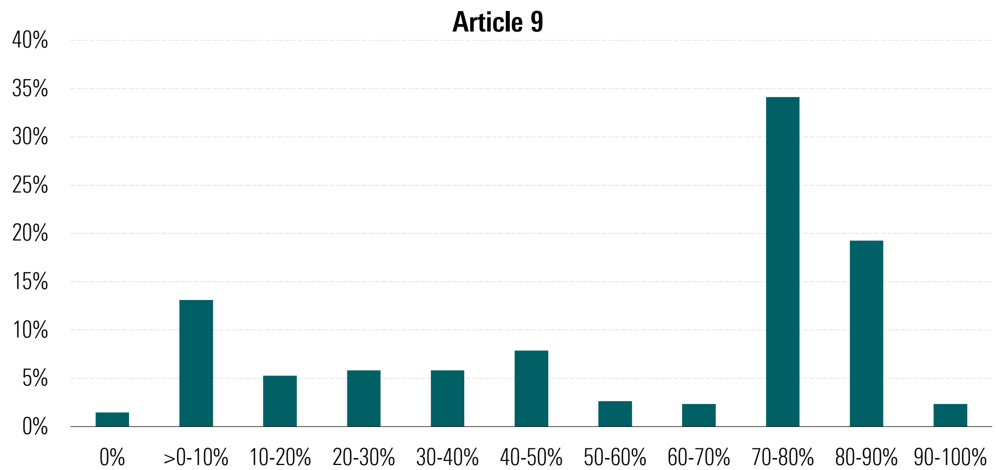
Source: Morningstar Direct. Data as of 18 July 2022. Based on 1,860 Article 8 funds that report the field.

As expected, Article 9 funds target higher exposure to sustainable investments than Article 8 funds, the distribution of former skewing on the right while that of latter skews on the left. The majority of Article 9 products (55.7%) plan to have more than 70% exposure to sustainable investments, while just 10% of

Article 8 funds target more than 40% of sustainable investments and 62% target allocations between 0% and 10%.

It's worth noting, however, that close to 40% of the respondent Article 9 funds reported **Minimum or Planned Sustainable Investments** of less than 50%, and only 2.3% target allocations between 90% and 100%. This could be due to several factors, one of which relates to the multitude of methodologies used to calculate the percentage of **Minimum or Planned Sustainable Investments**. We will discuss this issue in more detail in the last section of the report.

Exhibit 36 Minimum % of Sustainable Investments for Article 9 Funds



Source: Morningstar Direct. Data as of 18 July 2022. Based on 343 Article 9 funds that report the field.

The exhibit below shows the 20 Article 8 products with the highest minimum exposures to sustainable investments ranked by fund size. Topping the list are six German WI funds—three indirect property and three equity strategies—with sustainable investment allocations ranging from 77% to 89%. Two other sector funds feature in the table: **DWS Biotech** and **BNP Paribas Energie & Industrie Europe ISR**, while the remaining products are broadly diversified strategies targeting at least 70% sustainable investment exposure.

Exhibit 37 Top 20 Article 8 Funds by Minimum or Planned Investments Sustainable Investments

Fund Name	SFDR Type	Min % of Sustainable Investments	Fund Size (EURO Mil)	Morningstar Category	Broad Category
WI Immobilienaktien EMEA ESG TX	Article 8	89	45	Property - Indirect Europe	Equity
WI Immobilienaktien Asia Pacific ESG TX	Article 8	88	29	Property - Indirect Asia	Equity
WI Immobilienaktien America ESG TX	Article 8	86	40	Property - Indirect North America	Equity
WI Aktien Europe ESG Leaders T	Article 8	81	33	Europe Large-Cap Blend Equity	Equity
WI Aktien Pacific ESG Leaders T	Article 8	78	92	Asia-Pacific Equity	Equity
WI Global Challenges Index-Fonds	Article 8	77	402	Global Large-Cap Blend Equity	Equity
DWS Biotech	Article 8	75	399	Sector Equity Biotechnology	Equity
Santander Latin American Investment Grade ESG Bond	Article 8	75	27	Other Bond	Fixed Income
BNP Paribas Energie & Industrie Europe ISR	Article 8	75	19	Sector Equity Energy	Equity
Robeco Financial Institutions Bonds	Article 8	70	1,784	EUR Subordinated Bond	Fixed Income
Metzler Global Growth Sustainability	Article 8	70	667	Global Large-Cap Growth Equity	Equity
Santander GO Global Equity ESG	Article 8	70	524	Global Large-Cap Blend Equity	Equity
Metzler European Smaller Companies Sustainability	Article 8	70	451	Europe Small-Cap Equity	Equity
BNP Paribas Funds Sustainable Europe Multi-Factor Equity	Article 8	70	360	Europe Flex-Cap Equity	Equity
Metzler Euro Corporates Sustainability	Article 8	70	304	EUR Corporate Bond	Fixed Income
Metzler Global Equities Sustainability	Article 8	70	241	Global Large-Cap Growth Equity	Equity
Metzler European Growth Sustainability	Article 8	70	175	Europe Large-Cap Growth Equity	Equity
Metzler Multi Asset Income Sustainability	Article 8	70	163	EUR Moderate Allocation - Global	Allocation
Metzler European Dividend Sustainability	Article 8	70	113	Europe Equity Income	Equity
Metzler European Equities Sustainability	Article 8	70	109	Europe Large-Cap Blend Equity	Equity

Source: Morningstar Direct. Data as of 18 July 2022. Based on 1,860 Article 8 funds that report the field. Funds are ranked first by sustainable investment exposure and second by fund size

Exhibit 11 shows the 20 Article 9 funds with the highest minimum exposures to sustainable investments ranked by fund size. Unsurprisingly, the vast majority of these funds (18 out of 20) focus on a theme or sector, including water, healthcare, alternative energy, or technology. We're also seeing a few broad ESG funds, which select securities based on environmental, social, or combined ESG scores.

It is worth noting that only eight Article 9 funds in our sample reported 100% exposure to sustainable investments. In the absence of a standardised approach to calculating sustainable investment exposure, we expect to continue to see asset managers implement a variety of methodologies including ones that enable them to report higher sustainable investment allocations.

Exhibit 38 Top 20 Article 9 Funds by Minimum or Planned Investments Sustainable Investments

Fund Name	SFDR Type	Min % of Sustainable Investments	Fund Size (EURO Mil)	Morningstar Category	Broad Category
ÖkoWorld ÖkoVision Classic	Article 9	100	2,116	Sector Equity Ecology	Equity
ÖkoWorld Klima	Article 9	100	710	Sector Equity Ecology	Equity
ÖkoWorld Growing Markets 2.0	Article 9	100	304	Global EM Small/Mid-Cap Equity	Equity
ÖkoWorld Rock 'n' Roll Fonds	Article 9	100	303	EUR Flexible Allocation - Global	Allocation
JPMorgan Funds - Climate Change Solutions Fund	Article 9	100	195	Sector Equity Ecology	Equity
ÖkoWorld Water Life	Article 9	100	62	Sector Equity Water	Equity
BNY Mellon Smart Cures Innovation Fund	Article 9	100	3	Sector Equity Healthcare	Equity
BNY Mellon Future Earth Fund	Article 9	100	2	Sector Equity Ecology	Equity
Mirova Global Sustainable Equity Fund	Article 9	90	4,403	Global Large-Cap Growth Equity	Equity
RobecoSAM Sustainable Water Equities	Article 9	90	3,295	Sector Equity Water	Equity
RobecoSAM Smart Energy Equities	Article 9	90	2,920	Sector Equity Alternative Energy	Equity
Mirova Europe Environmental Equity Fund	Article 9	90	2,463	Sector Equity Ecology	Equity
Federated Hermes SDG Engagement Equity Fund	Article 9	90	1,549	Global Small/Mid-Cap Equity	Equity
RobecoSAM Smart Materials Equities	Article 9	90	1,384	Sector Equity Industrial Materials	Equity
Federated Hermes SDG Engagement High Yield Credit Fund	Article 9	90	1,335	Global High Yield Bond	Fixed Income
Stewart Investors Asia Pacific Leaders Sustainability Fund	Article 9	90	1,001	Asia-Pacific ex-Japan Equity	Equity
Franklin Templeton Global Climate Change Fund	Article 9	90	975	Sector Equity Ecology	Equity
Mirova Europe Environnement	Article 9	90	872	Sector Equity Ecology	Equity
Mirova Euro Sustainable Equity Fund	Article 9	90	867	Eurozone Large-Cap Equity	Equity
Insertion Emplois Dynamique	Article 9	90	863	Europe Large-Cap Growth Equity	Equity

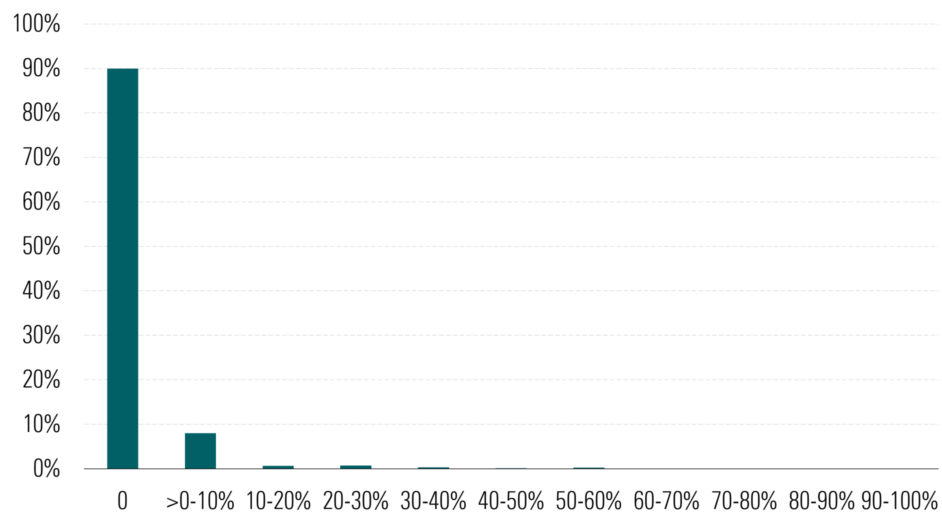
Source: Morningstar Direct. Data as of 18 July 2022. Based on 343 Article 9 funds that report the field.

Minimum Proportion of Taxonomy-Aligned Investments

The number of Article 8 and Article 9 funds in our sample that reported their minimum sustainable investment exposure as defined under the EU Taxonomy-aligned is small. About 27% populated the **Minimum or Planned Investments Sustainable Taxonomy Aligned** field. Exhibit 13 shows the distribution of these funds.

Unsurprisingly, 0%-values account for the overwhelming majority of the responses received (90%), while 8% reported minimum taxonomy-aligned sustainable investments of between 0% and 10%. Very few funds, only 2%, target exposure higher than 10% and none are higher than 60%. This can be explained by the fact that issuers will only disclose their level of taxonomy-alignment in 2023 and that, in the meantime, European Supervisory Authorities have pushed asset managers to be conservative in their taxonomy disclosure (for example, by not allowing the use of estimates).

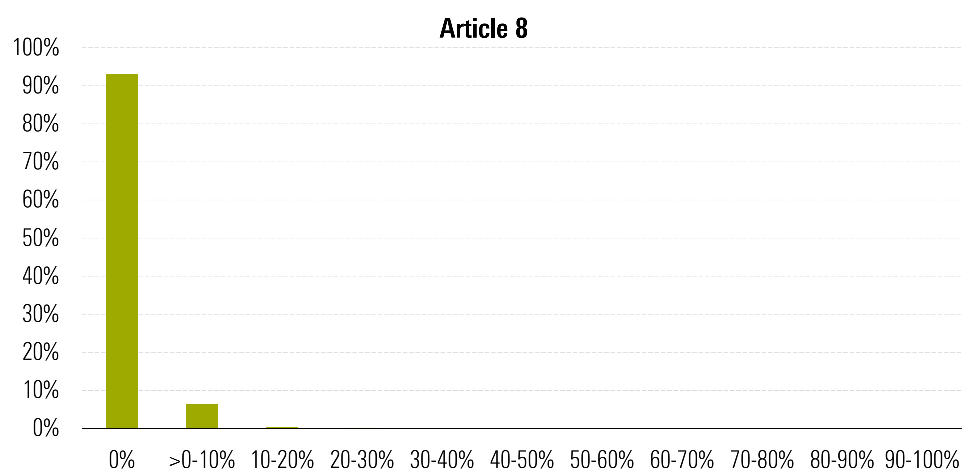
Exhibit 39 Distribution of Article 8 and Article 9 Funds (Combined) Based on Minimum or Planned Investments Sustainable Taxonomy Aligned



Source: Morningstar Direct. Data as of 18 July 2022. Based on 1,239 Article 8 and Article 9 funds that report the field.

A further breakdown of the same field by reported SFDR Product Type draws a similar picture, as shown in the following exhibits.

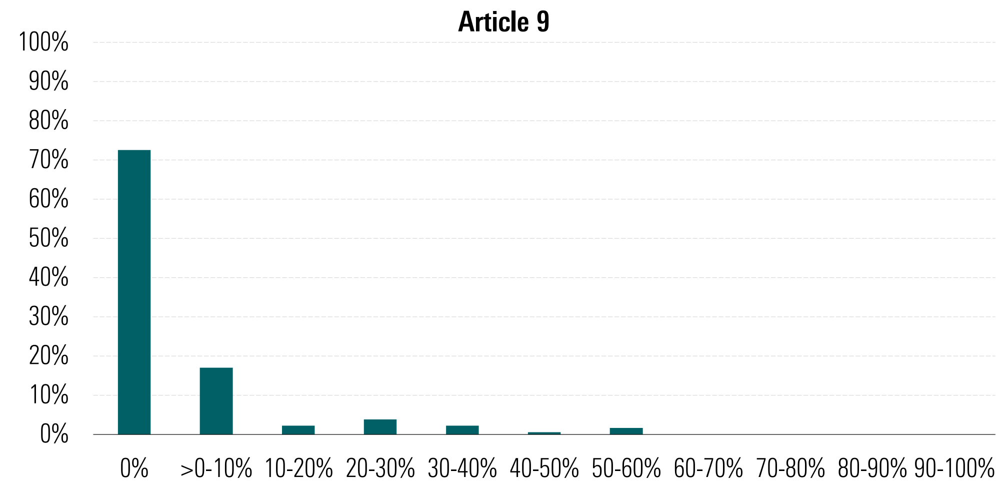
Exhibit 40 Minimum % of Taxonomy Aligned Sustainable Investments for Article 8 Funds



Source: Morningstar Direct. Data as of 18 July 2022. Based on 1,057 Article 8 funds that report the field.

First, it's worth noting that, out of the 556 Article 9 funds surveyed in this study, only 182 populated the **Minimum or Planned Investments Sustainable Taxonomy Aligned** field, which represents a very small sample. And close to three quarters (73%) of these reported to have no sustainable investment aligned with the EU Taxonomy at all, while 17% target up to 10% exposure. About 10% plan to have between 10% and 60% of Taxonomy-aligned sustainable investments.

Exhibit 41 Minimum % of Taxonomy Aligned Sustainable Investments for Article 9 Funds



Source: Morningstar Direct. Data as of 18 July 2022. Based on 182 Article 9 funds that report the field.

Below feature the 20 Article 8 funds with the highest level of taxonomy-alignment ranked by fund size. We're seeing there again a few WI strategies with taxonomy-aligned sustainable investments as high as 30%. But very quickly the proportions fall to below 10%. Only seven Article 8 products reported exposure of 10% or greater.

Exhibit 42 Top 20 Article 8 Funds by Minimum % of Taxonomy-Aligned Investments

Fund Name	SFDR Type	Min % of Taxonomy Aligned Sustainable Investments	Fund Size (EURO Mil)	Morningstar Category	Broad Category
WI Immobilienaktien Asia Pacific ESG TX	Article 8	30	29	Property - Indirect Asia	Equity
WI Immobilienaktien EMEA ESG TX	Article 8	23	45	Property - Indirect Europe	Equity
Assenagon Credit Selection ESG	Article 8	20	255	EUR Flexible Bond	Fixed Income
Nordea Invest Danske Oblig Bolig 0-3 KL	Article 8	20	51	DKK Domestic Bond - Short Term	Fixed Income
WI Immobilienaktien America ESG TX	Article 8	12	40	Property - Indirect North America	Equity
WI Global Challenges Index-Fonds	Article 8	11	402	Global Large-Cap Blend Equity	Equity
Assenagon Funds - Assenagon Funds Value Size Global	Article 8	10	381	Global Flex-Cap Equity	Equity
Assenagon Funds - Assenagon Funds Asymmetric Beta US	Article 8	8	38	US Large-Cap Blend Equity	Equity
Assenagon Funds Substanz Europa	Article 8	6	89	Europe Equity Income	Equity
Pictet Global Selection Fund - Global Utilities Equity	Article 8	5	8,427	Sector Equity Utilities	Equity
PGSF Global Utilities Equity Currency Hedged	Article 8	5	245	Other Equity	Equity
WI Global Challenges Corporate Bonds	Article 8	5	32	EUR Corporate Bond	Fixed Income
Pictet Global High Yield Utilities Equity Fund	Article 8	5	25	Sector Equity Utilities	Equity
WI Aktien North America ESG Leaders T	Article 8	4	53	US Large-Cap Blend Equity	Equity
Assenagon Balanced EquiVol	Article 8	3	169	EUR Moderate Allocation - Global	Allocation
Assenagon Credit Opportunity Plus (P)	Article 8	3	38	Convertible Bond - Europe	Convertibles
BNP Paribas Funds Sustainable Multi-Asset Balanced	Article 8	2	1,415	EUR Moderate Allocation - Global	Allocation
Pictet-Quest Europe Sustainable Equities	Article 8	2	1,174	Europe Large-Cap Blend Equity	Equity
Pictet-Quest Global Sustainable Equities	Article 8	2	821	Global Large-Cap Blend Equity	Equity
BNP Paribas Funds Sustainable Multi-Asset Growth	Article 8	2	654	EUR Aggressive Allocation - Global	Allocation

Source: Morningstar Direct. Data as of 18 July 2022. Based on 1,057 Article 8 funds that report the field.

Below feature the 20 Article 9 funds with the highest proportions of taxonomy-aligned sustainable investments. Unsurprisingly, most focus on an environmental theme such as climate, alternative energy, and water. The strategies with the highest taxonomy-alignment are fixed-income strategies investing in green bonds and other types of "impact" bonds.

Exhibit 43 Top 20 Article 9 Funds by Minimum % of Taxonomy-Aligned Investments

Fund Name	SFDR Type	Min % of Taxonomy Aligned Sustainable Investments	Fund Size (EURO Mil)	Morningstar Category	Broad Category
GAM Sustainable Climate Bond	Article 9	80	17	EUR Subordinated Bond	Fixed Income
KlimaVest ELTIF	Article 9	75	886	Other Allocation	Allocation
Federal Global Green Bonds	Article 9	75	48	Global Bond	Fixed Income
Assenagon Funds Green Economy	Article 9	65	26	Sector Equity Ecology	Equity
Xtrackers USD Corporate Green Bond ETF	Article 9	50	235	USD Corporate Bond	Fixed Income
Xtrackers EUR Corporate Green Bond ETF	Article 9	50	151	EUR Corporate Bond	Fixed Income
Xtrackers World Net Zero Pathway Paris Aligned ETF	Article 9	50	18	Global Large-Cap Blend Equity	Equity
Xtrackers EMU Net Zero Pathway Paris Aligned ETF	Article 9	50	13	Eurozone Large-Cap Equity	Equity
Pictet-Clean Energy	Article 9	25	4,382	Sector Equity Alternative Energy	Equity
Raiffeisen-SmartEnergy-ESG-Aktien	Article 9	25	284	Sector Equity Alternative Energy	Equity
ÖkoWorld ÖkoVision Classic	Article 9	21	2,116	Sector Equity Ecology	Equity
ÖkoWorld Klima	Article 9	21	710	Sector Equity Ecology	Equity
ÖkoWorld Growing Markets 2.0	Article 9	21	304	EEA Fund Global EM Small/Mid-Cap Equity	Equity
ÖkoWorld Rock 'n' Roll Fonds	Article 9	21	303	EUR Flexible Allocation - Global	Allocation
ÖkoWorld Water Life	Article 9	21	62	Sector Equity Water	Equity
Pictet - Global Environmental Opportunities	Article 9	15	7,648	Sector Equity Ecology	Equity
Pictet-Timber	Article 9	15	1,560	Sector Equity Natural Resources	Equity
PriorNilsson Sverige Aktiv	Article 8	15	155	Sweden Equity	Equity
BNP Paribas Easy ECPI Global ESG Hydrogen Economy	Article 9	15	38	Other Equity	Equity
BNP Paribas Funds Climate Impact	Article 9	10	2,771	Sector Equity Ecology	Equity

Source: Morningstar Direct. Data as of 18 July 2022. Based on 182 Article 9 funds that report the field.

Different Approaches to Calculating Sustainable Investment Exposure

In this section, we discuss the challenges faced by asset managers in implementing MiFID II requirements, especially the reporting of sustainable investment exposure.

Calculating a fund's minimum percentage of sustainable investments as defined under SFDR or the EU taxonomy isn't easy. In addition to the well-known conundrum of issuer data availability, there is a definitional problem.

Article 2(17) of SFDR defines the term *sustainable investment* as:

- An investment in **an economic activity that contributes to an environmental objective**, as measured, for example, by key resource efficiency indicators on the use of energy, renewable energy, raw materials, water and land, on the production of waste, and greenhouse gas emissions, or on its impact on biodiversity and the circular economy,
- Or an investment in **an economic activity that contributes to a social objective**, in particular an investment that contributes to tackling inequality or that fosters social cohesion, social integration and labour relations, or an investment in human capital or economically or socially disadvantaged communities,
- Provided that **such investments do not significantly harm any of those objectives**,

► And [provided] that the investee **companies follow good governance practices**, in particular with respect to sound management structures, employee relations, remuneration of staff, and tax compliance.

The issue with this definition of "sustainable investment" is that it leaves too much room for interpretation, especially when it comes to the "do no significant harm," or DNSH, condition.

For the purpose of the DNHS test, a list of PAI indicators as outlined in Exhibit 6 must be considered. But regulators haven't specified any thresholds, so the determination of what these should be has been left to the discretion of asset managers.

Another aspect left to the discretion of managers relates to the way sustainable companies are counted in portfolios. While one firm might count the entirety of a sustainable company (beyond a certain level of revenue derived from sustainable activities), another might only count the proportion of revenue attributed to those activities. These two approaches, broadly referred to as revenue-weighted and pass-fail approaches (and highlighted in the exhibit below), would produce opposite results: high percentages of sustainable investments in the first case, and much lower levels in the latter case[17].

Exhibit 44 The Two Main Approaches to Calculating "Sustainable Investment Proportion"

	Revenue-weighted approach	Pass-Fail approach
Description	Only the proportion of revenue generated from sustainable activities is taken into account, and after the DNSH test is applied at company or activity level	A company for which eligible revenue exceeds a certain threshold counts fully towards portfolio alignment with Sustainable Investments, after the DNSH test is applied.
Example	If 25% of a company's revenue contribute to the UN SDGs and the company is not involved in any business activities deemed significantly harmful, then the 25% of the investment in the company is considered sustainable.	If 25% of a company's revenue contribute to the UN SDGs and the company's remaining business activities are not deemed significantly harmful, then an investment in the whole company is considered a sustainable one.
Proportion of Sustainable Investment typically reported	20-40%	60-80% (and in some cases 100%)

Source: Morningstar Research.

Other factors that could drive divergent numbers reported by different asset managers for similar portfolios include different criteria and thresholds to set sustainable activity eligibility, among others.

Different interpretations of the regulation have led asset managers to adopt different approaches to the calculation of sustainable investment exposure, rendering it impossible to compare competing products directly. Products with similar mandates and portfolios will report divergent exposures to sustainable investments depending on the methodology chosen by their providers.

17 For more detail on the benefits and limitations of these approaches, read this blog.

To illustrate the wide range of numbers that investors should expect to see, we have selected five global large-cap ETFs that track a Paris-aligned benchmark and have similar portfolios.

Exhibit 45 Minimum % of Sustainable Investments for 5 Funds Tracking Large-Cap Paris-Aligned Benchmarks

Fund Name	Min. % Sustainable Investments
Xtrackers World Net Zero Pathway Paris Aligned ETF	50%
BNP PARIBAS EASY - Low Carbon 300 World PAB	45%
BNP Paribas Easy MSCI World SRI S-Series PAB 5% Capped	45%
Amundi MSCI World SRI PAB	1%
Amundi MSCI World Climate PAB Umweltzeichen ETF	1%

Source: Morningstar Direct. Data as of 18 July 2022.

Despite the holding similarities, the minimum percentages of sustainable Investments reported by the five ETFs diverge significantly, from 1% for the two Amundi funds to 45% and 50% for the two BNP Paribas ETFs and the Xtrackers fund, respectively. Hence the need to go beyond headline numbers and dive into the methodologies.

It's also worth mentioning that diverging approaches may be found even within an asset-management firm. For example, a firm offering both active and passive investments would apply the index provider's methodology for each of its passive products, while it would use another approach to calculate the proportion of sustainable investment in its actively managed products. This situation will certainly be even more confusing for financial advisors and investors.

In the absence of a standardised approach to calculating sustainable investment exposure, we expect to continue to see asset managers implement a variety of methodologies, including ones that enable them to report higher sustainable investment allocations and meet the sustainability preferences of clients expressed under the new MiFID suitability assessment.

To conclude, we can say that investors should brace themselves for a confusing investment product landscape when the amended MiFID II goes live next month. There is no doubt that financial advisers themselves will struggle to fulfil their new obligations. Many will have to teach themselves while they educate their clients about the new, complex, and growing landscape of sustainable investments.

As we've seen, in addition to the methodological challenge, an adviser's work will be hamstrung by the mere fact that many funds haven’t reported the required information yet or have reported zero exposure to sustainable investments.

Although the recent EU Taxonomy and SFDR were designed to clarify the definition of sustainable investment and reduce opportunities for greenwashing, we are in the early days, and there is much work to do. Additional clarifications are expected soon, but in the meantime, caution and thorough due diligence will remain key.

Regulatory Update

The European Financial Reporting Advisory Group, mandated by the European Commission, is consulting on its draft sustainability standards, which, once finalised and endorsed by the European Commission, will underpin the Corporate Sustainability Reporting Directive that will govern the disclosures required by EU listed companies.

Other aspects of the EU's Sustainable Finance Action Plan continue to see goal posts moving in areas of regulations both already in effect and soon to be so. The European Commission's controversial Taxonomy Delegated Act to include specific nuclear and gas energy activities, under certain conditions, on the list of environmentally sustainable economic activities covered by EU Taxonomy passed through the Parliament and Council and will take effect on 1 Jan 2023. Consequently, certain fossil gas and nuclear energy activities will be classified as transitional activities contributing to climate change mitigation.

The European Securities and Markets Authority, or ESMA, together with the European Banking Authority and European Insurance and Occupational Pensions Authority, issued clarifications on the draft regulatory technical standards issued under the Sustainable Finance Disclosure Regulation. The statement covered areas including the calculation of principal adverse indicators, or PAIs; the use of sustainability indicators; and taxonomy-related and "do no significant harm" disclosures. At the same time, the supervisory authorities have been tasked by the European Commission to review and potentially extend the entire PAI framework as well as assess financial product disclosure requirements, particularly around decarbonisation targets.

Separately, ESMA also published a supervisory briefing to ensure convergence across the EU in the supervision of investment funds with sustainability features, and in combating greenwashing by investment funds. The briefing provides guidance for the supervision of fund documentation and marketing material, as well as guiding principles on the use of sustainability-related terms in funds' names and guidance for convergent supervision of the integration of sustainability risks by alternative investment fund managers and UCITS managers.

All these developments will be relevant to firms planning for the August MiFID II changes. On a related note, ESMA has kicked off a review of its guidelines on MiFID II product governance requirements, and in particular a proposed addition to specify any sustainability-related objectives a product is compatible. M

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