



EUROPEAN SUSTAINABLE INVESTMENT  
FUNDS STUDY 2022

# Hitting the road to a greener future

Sustainable funds: from niche to mainstream

*Commissioned by the Association of the  
Luxembourg Fund Industry (ALFI)*



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# Key findings

- 1** Net assets in sustainable funds domiciled in Europe have reached almost EUR 2 trillion in 2021 – this figure is three times as high as in 2019 and up 71% from 2020. The share in total net assets went up to 16%, and half of the net flows were attracted by the sustainable sector.
- 2** Equity remains by far the most important asset class of sustainable funds. The integration of ESG factors into money market funds has significantly accelerated, resulting in a share of 25% in total net assets of money market funds.
- 3** Sustainable passive funds continue their disproportionate increase, now reaching a 27% share in sustainable assets, as opposed to a share of passive funds of only 21% in the conventional fund sector.
- 4** At European level, about 44% of net assets were invested in funds classified by their managers as Article 8 and Article 9 funds according to the Sustainable Finance Disclosure Regulation (SFDR).
- 5** Europe remains the forerunner in terms of sustainable investment funds with a market share of 83% of the total EUR 2.4 trillion in net assets considered sustainable in the major global fund domiciles – far ahead of the US and Asia.

# What's in it for you?

This study provides a snapshot of the recent investment and regulatory trends in the sustainable fund market in Luxembourg and other European fund domiciles. The following statements summarize the key observations and principal learnings derived from the analysis of the European fund market.

- Sustainable funds have represented a growing segment of investment solutions in Europe, especially in recent years. Based on Morningstar's strict definition of sustainability, net assets in sustainable fund products have reached almost EUR 2 trillion, a figure that is about three times as high as in 2019 and up 71% from 2020. They now make up 16% of the total net assets of funds domiciled in Europe at the end of 2021. Sustainable funds attracted half of the net new money that went into the investment fund market in 2021.
- The steady increase in the share of sustainable assets is observable in both the UCITS and the regulated open-end AIF spheres although the proportion of sustainable net assets in the AIF market is still comparatively lower.
- Equity remains by far the most important asset class, making up 64% of the sustainable fund assets compared to 48% in conventional funds, allowing asset managers to exert a greater influence on the ESG efforts of companies. Nevertheless, the interest in fixed income has also risen steadily over the past three years.

Money market funds in particular have increasingly integrated ESG factors into their investment strategies, resulting in an above-average share of 25% of sustainable net assets in total money market funds' assets at the end of 2021 as opposed to only 13% in the previous year and 8% in 2019.

- Sustainable passive funds continue their disproportionate increase, their net assets reaching 27% of the total sustainable fund sector, which represents an increase of 280% in sustainable net assets over the past three years<sup>1</sup>. This compares with a passive share of 21% in the conventional sphere where passive net assets grew by only 24% over the same period. Roughly 23% of new products were launched in the passive sector, up from 16% in 2019.
- Impact funds are still very much outweighed by funds with less ambitious ESG objectives. Only about 1.5% of total European funds' net assets follow an impact investing approach. Nevertheless, assets in impact funds increased by 50% in 2021 compared to 2020, reflecting a growing demand for more ambitious sustainable strategies.
- The classification of funds according to SFDR is ongoing. Of the funds domiciled in Luxembourg, where 97% of net assets have been reviewed by Morningstar so far, 44% and 6% of the corre-

1) Note that the sustainability criteria applied for passive funds are less restrictive than those for active funds. While ESG-screened passive funds are part of the respective ESG universe, active funds that apply only limited exclusion criteria in their investment strategy are not considered as sustainable, see section 2.1.

sponding net assets were classified as Article 8 and Article 9. The respective shares for the whole European investment universe are lower due to the inclusion of non-EU domiciles and funds that are not marketed in the EU and do not need to be categorized – 39% of corresponding net assets are classified as Article 8 and 5% as Article 9.<sup>2</sup> These figures differ significantly from what is considered sustainable in our study, reflecting the strict, conservative nature of Morningstar's definition of sustainability that was applied.

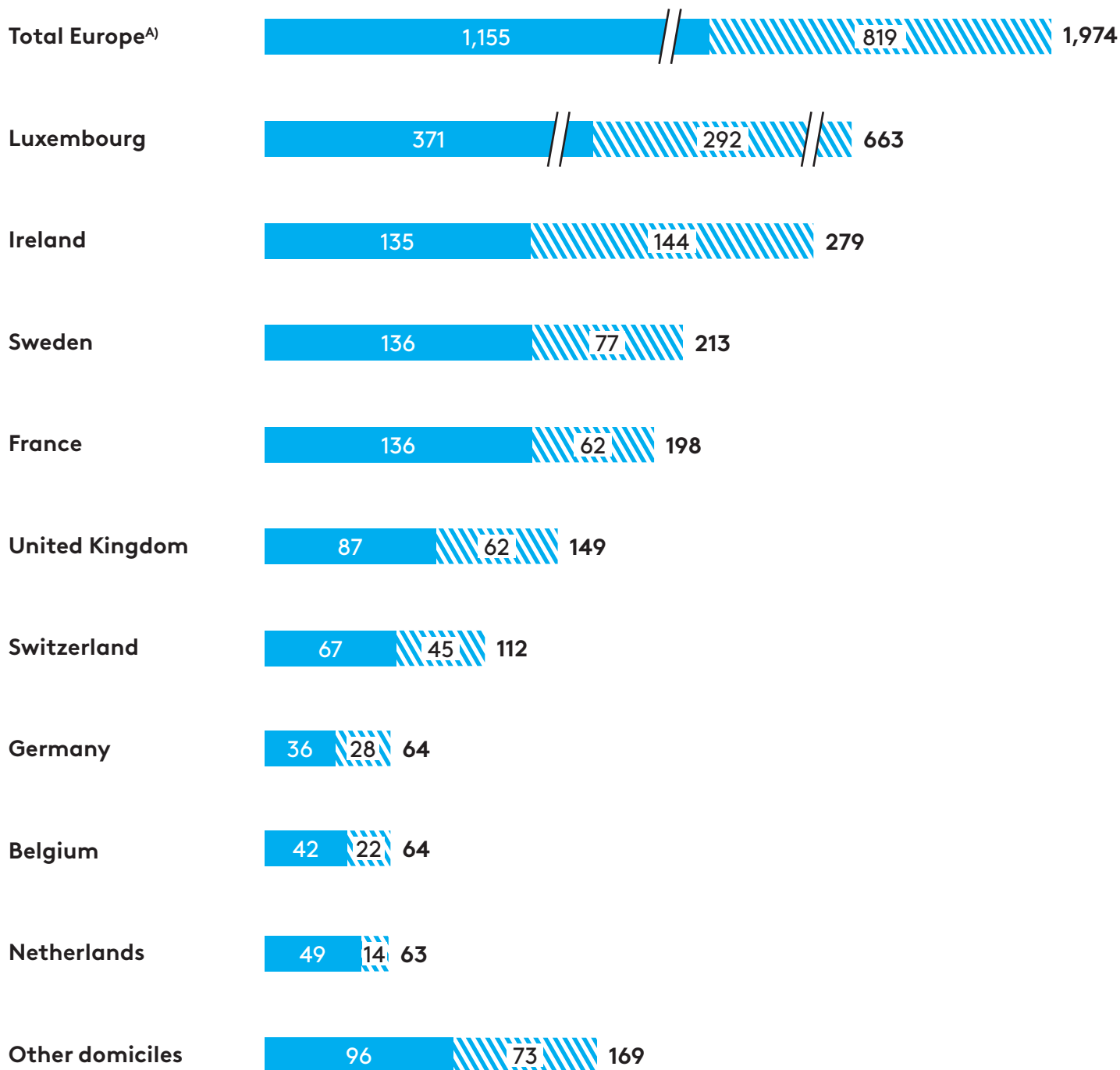
- In line with its positioning as the largest European fund hub, Luxembourg maintains its market leader position also in terms of sustainable fund products. As in previous years, about a third of the assets managed by sustainable funds are domiciled in Luxembourg. Ireland benefits from its leading position as a hub for both sustainable and conventional passive funds where it reached a market share of 44% in 2021.
- The increased demand for sustainable funds can be observed across Europe – the share of sustainable funds' net assets in total net assets domiciled in the respective countries grew significantly across all countries, reaching almost 40% in Belgium, the Netherlands and Sweden. Some domiciles like the UK, Switzerland and France recorded 100% of their net inflows directed towards sustainable funds at the expense of conventional funds which experienced net outflows.

2) Note that these figures differ from other reports from Morningstar or other institutions due to a different coverage at different times of data extractions and the exclusion of money market funds, funds of funds and feeder funds in this report.

- Launches of new funds and the repurposing of traditional funds reached record levels and resulted in 1,193 new funds being offered to investors looking for sustainable strategies. 652 new funds were launched with net assets of EUR 86 billion. While in 2019 the combined net assets of new sustainable and repurposed funds were less than half of those of new conventional funds, they were twice as high in 2021.
- The high concentration of the asset management industry has not changed and is especially prevalent in the sustainable fund sector of the major European fund domiciles. Of the net assets of sustainable funds domiciled in Ireland, 58% were managed by the top 5 fund providers alone, making Ireland particularly dependent on individual asset managers. In this respect, Luxembourg benefits from a broader range of fund initiators both in terms of individual companies and provenience.
- All figures confirm the ongoing transition that sustainable finance is experiencing in Europe. With a share of 83% of global sustainable funds' net assets, Europe remains the sustainability driver of the fund industry, far ahead of the US and Asia where the share of sustainable funds' net assets in total net assets domiciled in these regions reaches only 1% and 5% respectively, as opposed to 16% in Europe. Nevertheless, climate change, new regulatory requirements and changing investors' preferences will see these regions increasingly catch up in the future.

# Net assets of sustainable funds domiciled in Europe reach almost EUR 2 trillion

Net sustainable assets per domicile  
EOY 2021 in EUR bn



■ Net sustainable assets 2020    ▨ Change of net sustainable assets in 2021

A) EU27 and Switzerland, Norway, UK, Liechtenstein

Source: Morningstar Direct. Excluding money market funds, closed end funds, fund of funds and feeder funds.



# Introduction and objective of the study

The year 2021 saw many ecological calamities such as floods in Germany, the US and China or wildfires in Canada and southern Europe to name but a few, contributing to the growing perception of climate change impact. The consideration of environmental, social and governance (ESG) factors has become an important topic across nearly every sector of the economy including finance. During the 26th UN Climate Change Conference of the Parties to the UNFCCC (UN Framework Convention on Climate Change) in Glasgow, known as COP 26, in November 2021, financial institutions and investors pledged trillions in green funding in a commitment to accelerating and mainstreaming the decarbonization of the world economy and reaching net zero emissions by 2050. The commitment was made by more than 450 financial institutions across 45 countries managing assets valued at USD 130 trillion.

Asset managers function as intermediaries between investors and companies or institutions in need of financing the necessary adjustments of their operations and the restructuring of the entire economy. By integrating ESG factors into their investment processes and assessing and managing sustainability risks, asset managers serve as an important stakeholder to direct capital towards sustainable projects and business models, thus contributing towards achieving the ambitious goals set by the EU Commission's Action Plan for Financing Sustainable Growth. At the same time, regulators require asset managers to make their ambition levels and activities regarding sustainability transparent to investors, following the requirements of the Sustainable Finance Disclosure Regulation (SFDR).

Among established fund hubs in Europe, which function as domiciles for UCITS as well as AIFs and as platforms for the domestic and cross-border distribution of funds, Luxembourg has been playing a key role as the largest fund domicile in Europe and the worldwide leader in cross-border distribution of funds for a long time. However, other fund hubs, often forming a significant part of the local financial marketplace, also benefit from the increased activity of asset managers launching new ESG funds and try to attract as much business as possible, resulting in fierce competition between European domiciles.

This study aims at providing a snapshot on how sustainability objectives and the respective legislative interventions are shaping the fund industry in Europe, and analyzing the role, competitiveness and positioning of the different domiciles within this dynamically changing environment. It is the second of a series of regularly conducted studies based on an analogous approach to monitor the dynamic development and trends of the European sustainable fund sector.

Looking back to 2021, all trends observed in our last report have continued and strengthened as expected, confirmed by the figures that we have analyzed. These figures indicate an increased acceptance and demand for sustainable investment products, satisfied by an intensified offering of sustainable funds at the expense of conventional products. 2021 will be remembered as the transition year for ESG as managers continued to work their way through the required adjustments in their investment processes and the respective disclosures to comply with the ever-evolving Sustainable Finance Disclosure Regulation (SFDR), even though the final draft rules for the financial product disclosure were published only towards the end of 2021.

In the absence of Level 2 measures, the fund industry started to implement SFDR on a best-effort basis. Combined with diverging understandings between Member States this resulted in different interpretations of the qualifying criteria and disclosure requirements defined in the respective Articles 6, 8 and 9 of the SFDR. Nevertheless, SFDR has split the EU fund universe into three categories: funds that integrate sustainability risks (Article 6), those that promote environmental or social characteristics (Article 8) and funds that have sustainability objectives (Article 9).

The categorization of funds as Article 8 or Article 9 has led to confusion as not all funds, in particular those qualifying as Article 8 funds, may be considered as sustainable in a stricter sense. This is best reflected by the significant difference between the share of sustainable funds' net assets in total net assets measured by Articles 8 and 9 funds on the one hand and the more rigid Morningstar classification methodology applied in this study on the other hand – contributing to the discussion about greenwashing.

After a brief introduction into the data base and methodological approach, the following section looks at the key trends observed in the European market for sustainable funds and investigates the development path of sustainable funds domiciled in Luxembourg and other traditional European fund hubs. The next chapter gives an update of the latest developments in the regulatory landscape for sustainable finance in Europe. In the final section we put the observed developments in Europe in a global context.

**“Our new study confirms the forecasts we made in our previous study: the industry’s shift towards sustainability is progressing at high speed despite an unprecedented dynamic geopolitical and regulatory environment.”**

**Dr. Carsten Wittrock,**  
Partner, zeb, Frankfurt



# Recent trends in the European sustainable funds industry

## Analyzed fund universe and definitions used for sustainable funds

For the purpose of this study, the Morningstar fund database was used. Relevant extractions from it were performed in February 2022. The study considers open-end funds (both UCITS and regulated AIFs) including ETFs domiciled in the EU-27 countries, Switzerland, Liechtenstein, Norway and the United Kingdom (excluding British Overseas Territories, crown colonies, etc.). Feeder funds and funds of funds were excluded from the analyzed fund universe to avoid double counting of fund assets. Money market funds are cash-equivalent investments and have also been excluded from the core study as they tend to be rather volatile in terms of flows due to the short-term investment horizon of their investors (which arguably is not consistent with the overall sustainability principles aiming for a long-term impact on sustainability goals). Nevertheless, they are analyzed separately as ESG factors are increasingly considered in the management of money market funds as well. The analyses cover the period from 1/2019–12/2021. Funds with incomplete information on either flows or net assets were excluded from the analysis.

Based on the data basis used, not all funds domiciled in the EU and the selected European countries are considered. Especially the AIF sector is only partially covered as only regulated open-end AIFs such as UCIs<sup>3</sup> in Luxembourg are taken into account. Therefore, on a total level, most of the figures do not match other statistics produced by ALFI, EFAMA, CSSF or national fund associations, which needs to be considered if different domiciles are compared.<sup>4</sup>

As a result, the analyzed fund universe consists of approximately 33,200 funds for 2021, of which about 4,400 (2020: 3,200) are sustainable funds. When counting fund numbers, only the oldest non-liquidated share class with the longest history of a fund is considered rather than each share class reflected by ISINs, as share classes merely differ in terms of fees, currency, etc., but not in the actual investment strategy.

3) Investment funds set up under Part II of the Law of 17 December 2010 relating to undertakings for collective investment. Other investment funds which may qualify as AIFs are funds which are set up under the Law of 13 February 2007 relating to special investment funds and funds set up under the Law of 15 June 2004 relating to the investment company in risk capital. The open-end AIF sector covered by the study represents only about 13% of the total AIF market in Europe at the end of 2021.

4) See annex for further information regarding the respective differences and the data coverage in general.



# As more ESG data becomes available, ratings will improve



**Interview with**  
**Hortense Bioy, CFA, Global**  
**Director of Sustainability**  
**Research, Morningstar**



[morningstar.com](https://www.morningstar.com)

**The EU, US and other jurisdictions are taking steps to improve company reporting of sustainability-related information. How will this change the products and services offered by ESG data and rating providers?**

Morningstar and Sustainalytics will continue to review the regulatory rules coming from various jurisdictions to ensure that any services we provide allow our clients to fulfill their regulatory requirements. As company-level sustainability improves, this will enable data providers, such as ourselves, to collect and supply more comprehensive information and use this information

to further improve and develop new analytics to help both the industry and end investors evaluate financial products and companies through various ESG lenses. At present, given the regulatory uncertainty in some areas and the fact that many companies are not reporting the information required by asset managers, the situation is challenging for data providers.

**The criteria used by Morningstar and applied in this study to delineate the universe of ESG and sustainable funds are more stringent than those applied by other classification regimes, including the criteria used by Article 8 funds to meet regulatory requirements. Why have you taken this approach?**

We have adopted this approach to help investors identify funds that are truly intentional in their use of ESG data. Since the introduction of the Sustainable Finance Disclosure Regulation (SFDR) in March 2021, we have seen a proliferation of funds that claim to use ESG factors in the investment process. In many cases, ESG contributes to the manager's investment process, but is not a decisive factor. Our universe of sustainable funds includes only funds that use ESG factors in a determined and intentional way.

To identify intentionality, we rely on a combination of fund names (a strong indicator of intentionality) and information found in fund prospectuses or other regulatory filings. The fund's documents should contain enough details to leave no doubt that ESG concerns are seriously considered in the security selection process. We believe these are the funds that sustainability-focused investors are looking for when screening the fund universe.

**Will investors soon face another flood of benchmarks to reflect different sustainable (active or passive) investment strategies?**

We can expect more innovation in the indexing space as more ESG data becomes available. One area of great product development we have seen in the passive space in the last year and a half is EU climate benchmarks. There has been a proliferation of index funds and ETFs tracking newly created Paris-aligned benchmarks ("PAB") and climate transition benchmarks ("CTB"). We have identified 70 such products in Europe, representing EUR 47 billion in assets, or almost 9% of the total passive ESG fund market, as of April 2022.

This is testament to the growing appetite among passive investors to align portfolios with net zero ambitions. As more environmental and social data becomes available in areas like climate, natural capital, supply chains and diversity, index providers will develop new indices. This will allow investors to not only access new themes, but also compare their investments against more robust benchmarks.

**"Fund documents should leave no doubt that ESG concerns are seriously considered in the security selection process."**

For the identification of sustainable funds in this study, the Morningstar classification has been applied<sup>5</sup>. Morningstar defines a strategy as “sustainable” if it is described as primarily focusing on sustainability, impact or ESG factors in the prospectus or other regulatory filings and/or the fund uses binding ESG criteria for its investment selections. At the next level of granularity, “Sustainable Investment” funds are categorized into three distinct groupings.

**“ESG Funds”** prominently focus on incorporating binding ESG factors into the investment process (e.g. by applying a best-in-class screening process, frequently in conjunction with the exclusion of certain sectors or individual companies which are considered critical with regard to ethical values or norms or their involvement in the production or sale of tobacco, weapons, etc.).

**“Impact Funds”** seek to deliver a measurable impact on specific issues (often with reference to the well-known 17 UN Sustainable Development Goals) or consider themes like gender diversity, low carbon, or community development alongside financial return. **“Environmental Sector Funds”** are strategies that invest in environmentally oriented industries like renewable energy or water. In practice, all these sustainable strategies are not mutually exclusive as various combinations of the strategies are applied in order to construct a sustainable portfolio. For a considerable proportion of funds, two or even more categories are therefore relevant at the same time. For the purpose of this study, only a distinction between impact funds and all other sustainable funds is made. Funds are only considered as impact funds if their investment strategy is solely directed towards impact investments without combining it with other strategies.

Funds that merely employ exclusions of certain sectors, companies or practices but do not integrate sustainability as a central and binding feature into their investment strategy are not considered sustainable and are assigned to the conventional fund universe. In contrast to active funds, this definition does not fully apply to passive funds as ESG-screened passive funds are part of the respective ESG universe whereas active funds that apply only limited exclusion criteria in their investment strategy are not considered to be sustainable.

All funds that are not (yet) characterized/flagged as sustainable in the Morningstar database are considered conventional funds. This conservative approach is taken on purpose, although it may underestimate the actual importance of sustainability in the European fund industry in some areas.

Under the SFDR rules, European funds are classified by their managers into one of the following three categories:

- Sustainable or Article 9 funds: so called after the regulation that defines them as funds that have a sustainable investment objective.
- Other ESG or Article 8 funds: a category of financial products that promote, among other characteristics, environmental or social characteristics or a combination of those characteristics, provided that the companies in which the investments are made follow good governance practices.
- All other funds that have no stated sustainability / ESG ambitions.

Morningstar was, during the time this study was conducted, in the progress of reviewing the fund universe regarding their regulatory classification. By the end of 2021, 91% of the funds in scope of the SFDR, i.e. funds available for sale in the EU, were reviewed and classified.

5) Morningstar Sustainable Attributes<sup>SM</sup>, Framework and Definitions for “Sustainable Investment” and “Employs Exclusions” Attributes, July 2020.



## European sustainable funds market: trends and characteristics

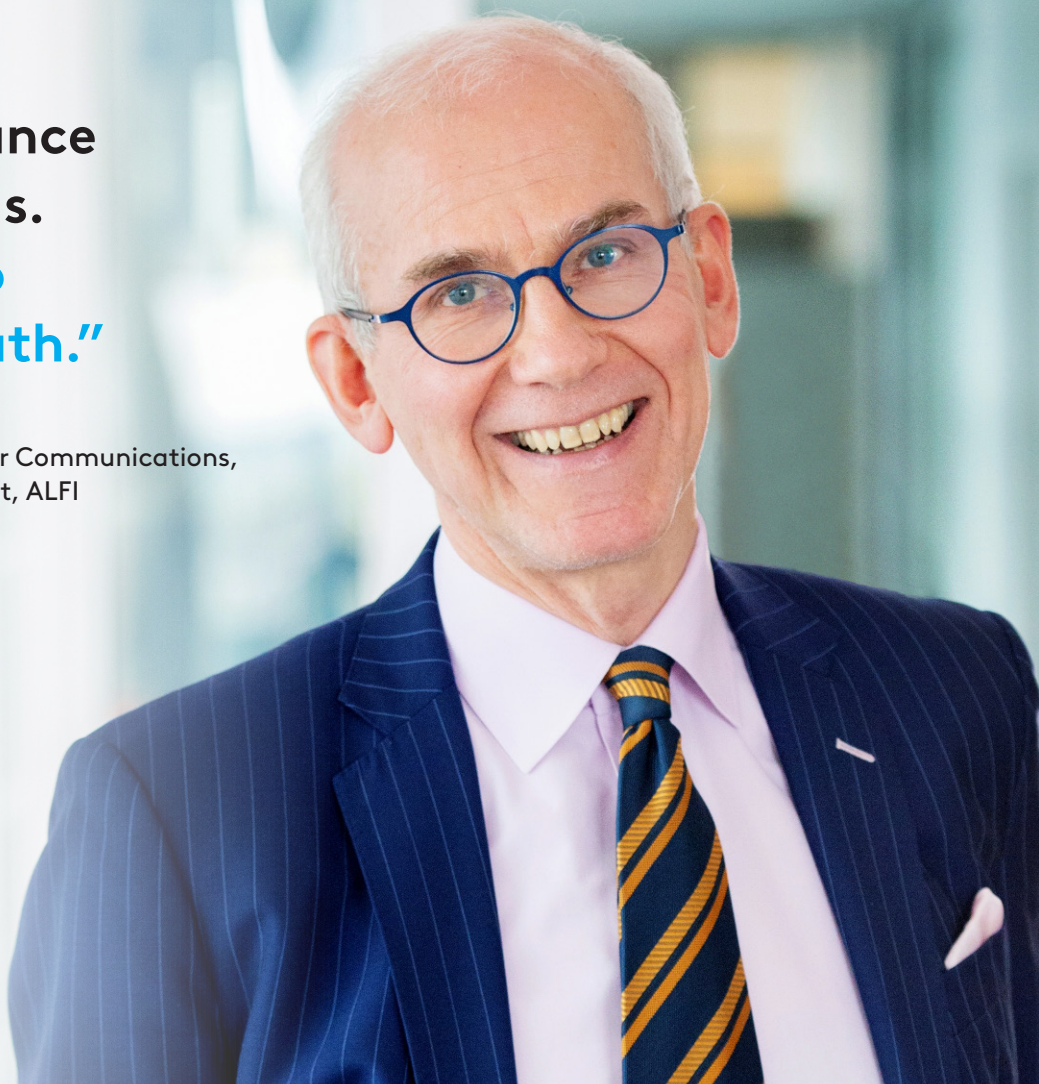
### Luxembourg remains market leader for sustainable funds in Europe

Net assets in sustainable funds domiciled in Europe reached almost EUR 2 trillion at the end of 2021.<sup>6</sup> This was a 70% increase over the EUR 1,155 billion record set one year ago and represents about 16% of the total European fund market. Nearly equally driven by net flows and market performance, the significant increase in net assets can be observed across all domiciles.

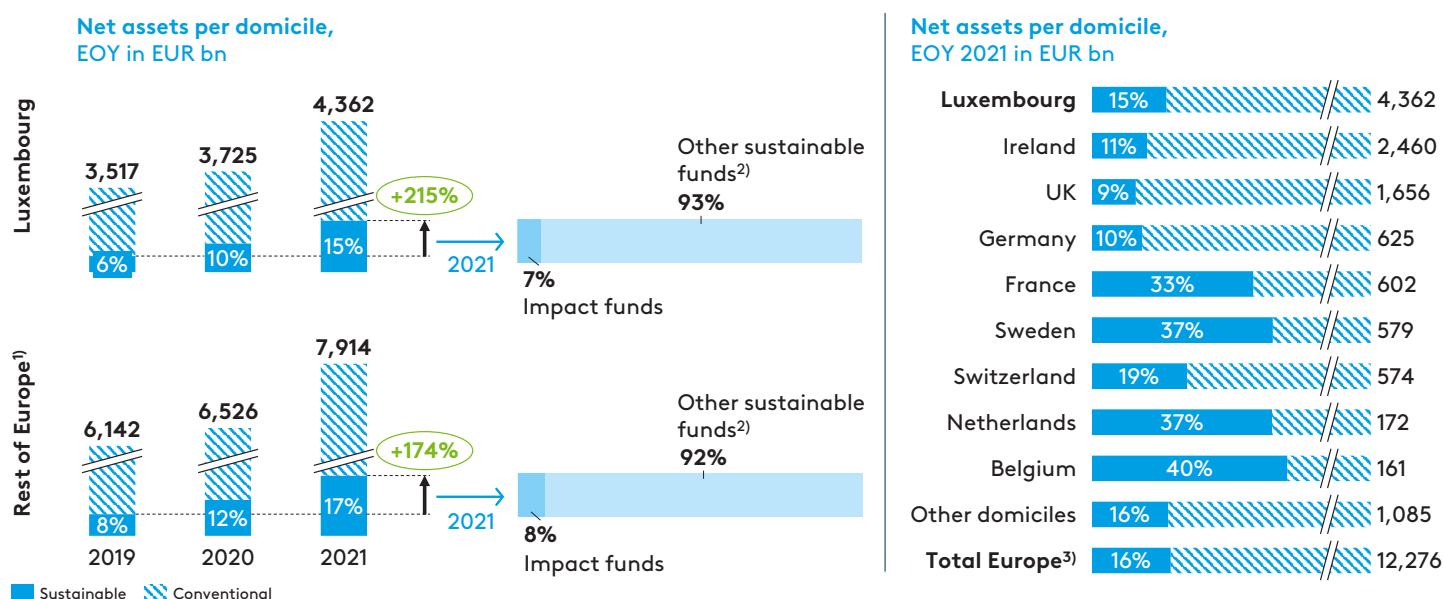
As Figure 1 shows, Luxembourg remains by far the leading domicile for both conventional as well as sustainable funds with regard to net assets. Sustainable funds accounted for EUR 663 billion by the end of 2021, followed by Ireland, Sweden and France. Compared to 2020, where the net assets of these followers exhibited almost identical levels of about EUR 135 billion, net assets in Ireland increased disproportionately by over 100%, making it the second largest domicile for sustainable funds.

**"Sustainable finance  
is at a crossroads.  
2022 will lead to  
a moment of truth."**

**Marc-André Bechet,**  
Deputy Director General, Director Communications,  
Events and Business Development, ALFI



<sup>6</sup>) If sustainable net assets of money market funds were included, the respective net assets amounted to EUR 2,351 billion vs. EUR 1,297 billion at the end of 2020.

**Figure 1: Net assets, overall and split by domicile**


The share of sustainable funds' net assets in total net assets increased across all domiciles, resulting in 16% for total Europe at the end of 2021 as opposed to 11% the year before. As noted in the previous study in 2020, the share of sustainable funds' net assets differs significantly between the different domiciles, with France, Sweden, the Netherlands and Belgium exhibiting well above-average figures in a range from 33% to 40% of the respective total assets as opposed to 16% in the total European market. The higher-than-average proportion of ESG funds in these markets is consistent with their longer history in undertaking efforts to integrate sustainability aspects into the investment process, committing to sustainability through legislation and building capabilities for the market of sustainable investments. Most of them also have a strong pension market due to the nature of their retirement systems with a corresponding legislation that often requires the consideration and disclosure of ESG factors in the pension funds' investment strategies.

In contrast, the share of sustainable funds as a percentage of total net fund assets is close to average for Luxembourg and below average for the second biggest fund domicile in Europe, Ireland. Compared to Ireland, Luxembourg is chosen by a considerably higher proportion of European asset managers as a domicile for their funds.

Funds managed in countries like France or Germany, which have a significant share of the domiciled funds in Luxembourg, exhibit much higher shares of sustainable products in their own countries compared to the US and the UK, which may contribute to the higher average share of sustainable net assets in comparison to Ireland. Larger fund domiciles in Europe with below-average shares in sustainable net assets include the UK (9%), Spain (7%) and Italy (15%).

Overall, European net assets for both conventional and sustainable funds increased by 27% over the period from 2019 to 2021. Net assets of sustainable funds increased disproportionately compared to those of conventional funds by as much as 180% in total Europe – 215% and 174% in Luxembourg and the rest of Europe, respectively. Over the same period, conventional funds' net assets grew by 15% only.

Sustainable funds are mainly categorized as ESG funds both in Luxembourg and the rest of Europe. The share of net assets of the more ambitious impact funds in total sustainable net assets reaches almost equal levels of about 7% in Luxembourg and 8% for the rest of Europe at the end of 2021 – a slight decrease compared to last year where we observed a share of 9% on a total European level.

## Sustainable funds attract half of all flows

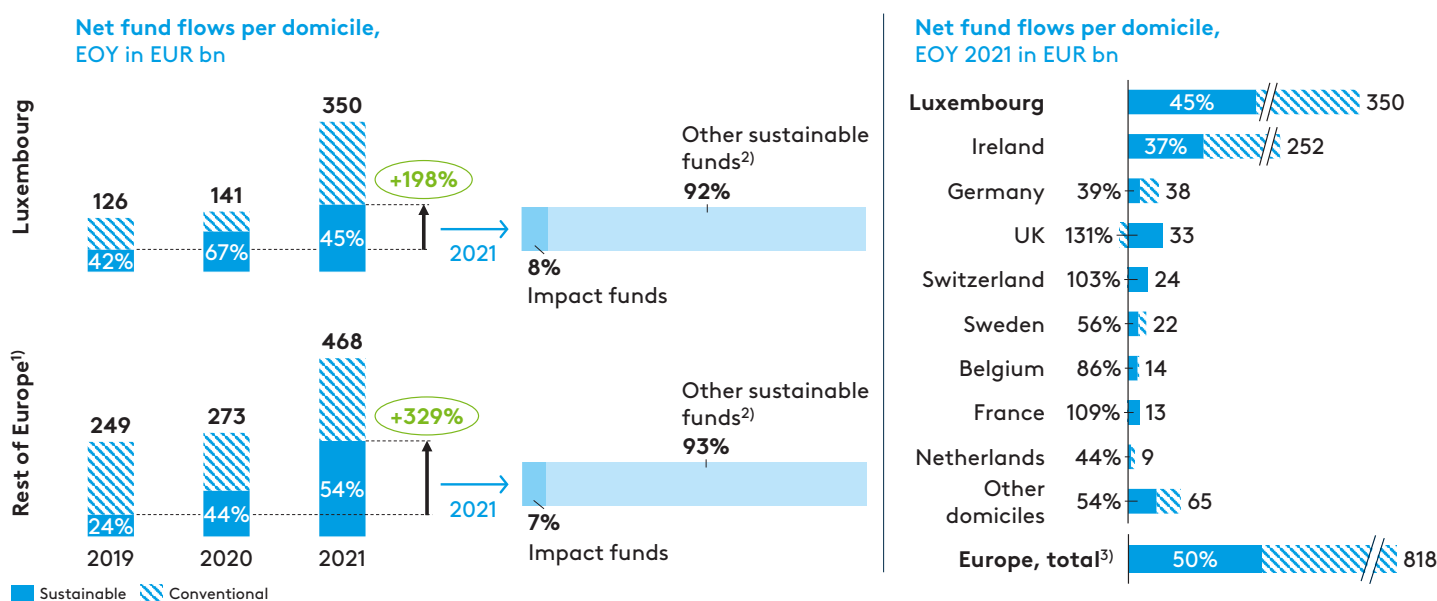
As Figure 2 reveals, net flows were positive across Europe over the period from 2019 to 2021. For the whole of 2021, European funds considered in this study attracted EUR 818 billion in net new money, which was double the amount of 2020, with a stable 50% share of flows directed towards sustainable funds. That means a 239% increase in absolute net new money in sustainable funds compared to 2019 over the 3-year period.

Luxembourg alone attracted 43% of the total net flows into European funds and 38% of those directed towards sustainable funds in 2021, underlining its position as market leader in the European sustainability market. Interestingly, the share of net flows into sustainable funds has significantly and steadily increased across all domiciles but Luxembourg, which exhibited a share of 45% as opposed to an average share of 54% for the other European domiciles in 2021.<sup>7</sup> This is also reflected in the 329% increase in net flows into sustainable funds domiciled in the rest of Europe over the 3-year period as opposed to 198% in Luxembourg. These dynamics show the increasingly broad acceptance of sustainable funds across Europe and the fierce competition between the different domiciles.

Strikingly, some domiciles like the UK, Switzerland and France saw 100% of their net flows directed towards sustainable funds at the expense of conventional funds which exhibited net outflows.

The share of net flows directed to impact funds out of total flows directed to sustainable funds decreased slightly from 10% in 2020 to about 8% and 7% in Luxembourg and the rest of Europe, respectively. Nevertheless, the absolute flows to these more ambitious sustainable strategies increased significantly by 44% from EUR 21.9 billion to EUR 31.6 billion in 2021 on a total European level, which reflects the growing demand for more ambitious investment funds with strategies other than simply incorporating ESG factors into their investment processes.

**Figure 2: Net fund flows, overall and split by domicile**



7) It has to be noted, however, that the share of net flows into sustainable funds domiciled in Luxembourg was extraordinarily high (67%) in the previous year.



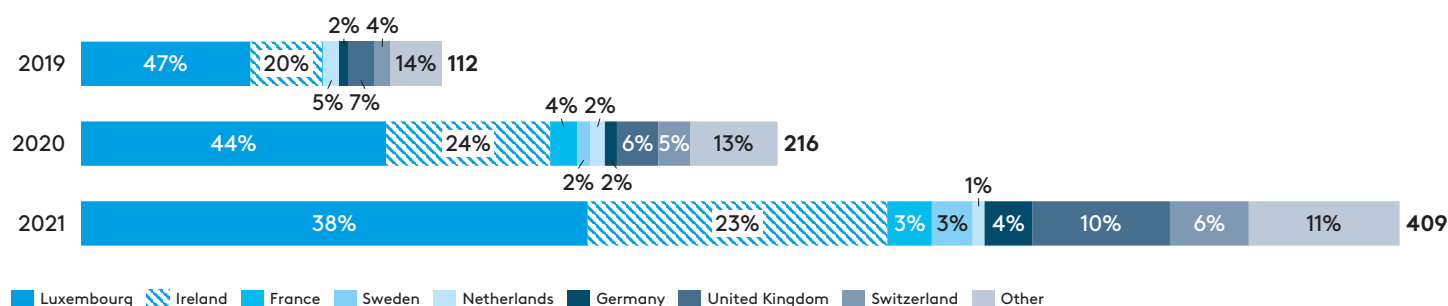
Analyzing the net flows into sustainable funds domiciled in Europe over time, Figure 3 reveals that Luxembourg kept attracting by far the largest proportion of flows in the last three years. However, other domiciles are increasingly catching up, namely the UK, Switzerland and Germany, at the expense of Luxembourg. Ireland, the second biggest fund hub in Europe with a high proportion of passive funds and funds managed by asset managers from the US, kept a relatively stable share of about 22% on average over the last 3 years.

### Fund providers domiciled in Luxembourg are increasingly active in launching sustainable products or repurposing conventional funds

Figure 4 shows that both Luxembourg and Ireland continued to strengthen their market position in terms of sustainable net assets over the last three years. The steady increase in market share of these two major domiciles in Europe was mainly at the expense of domiciles like France, Sweden and the Netherlands whose market shares continuously decreased over the last years.

**Figure 3: Net fund flows into sustainable funds, split by domicile**

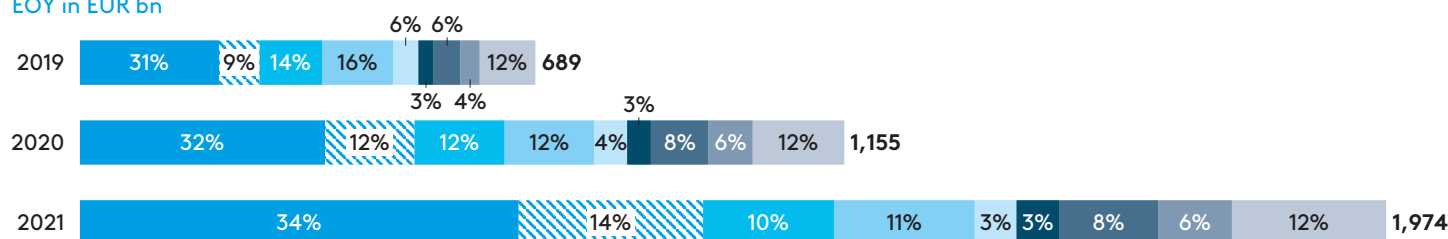
Net fund flows into sustainable funds per domicile  
EOY in EUR bn



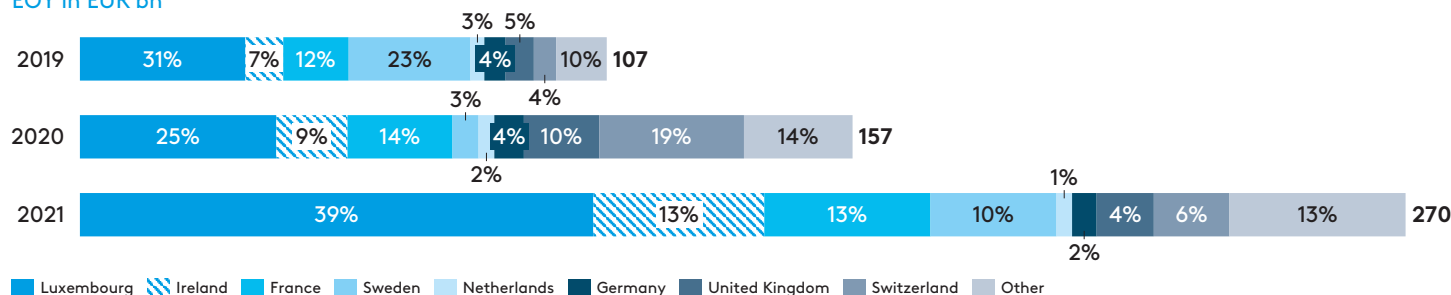
Source: Morningstar Direct. Excluding money market funds, closed end funds, funds of funds and feeder funds.

**Figure 4: Net assets and new launches/repurposing of sustainable funds, split by domicile**

Net assets of sustainable funds per domicile  
EOY in EUR bn



Net assets of newly launched & repurposed sustainable funds per domicile  
EOY in EUR bn



Source: Morningstar Direct. Excluding money market funds, closed end funds, funds of funds and feeder funds.

In 2021, about 14% of the net assets in sustainable funds domiciled in Europe originated from new fund launches and conventional funds that were repurposed to sustainable funds by asset managers. This is consistent with previous years.

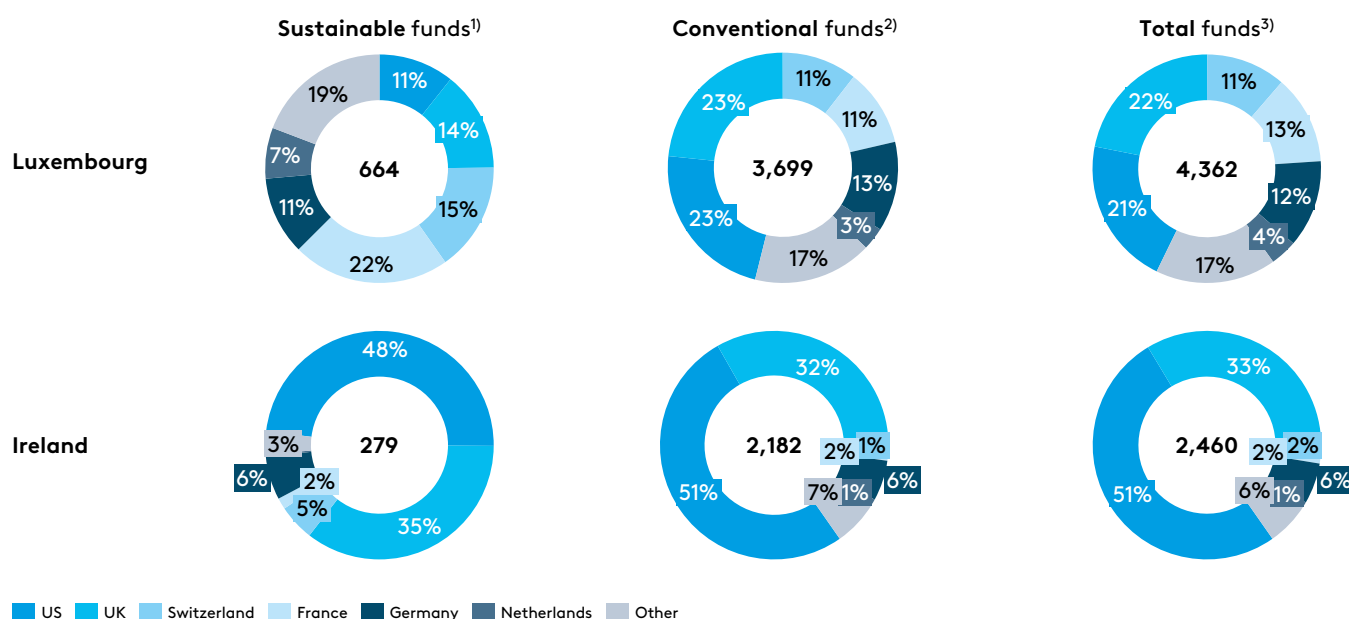
In contrast to previous years though, the share of the different domiciles in net assets due to new launches and repurposing of conventional to sustainable funds is more in line with the overall market share in sustainable net assets – apart from Luxembourg which was able to increasingly attract new fund launches with significant volumes at the expense of other domiciles in 2021, contributing to its strong market position.

### Structural differences of the two major European fund hubs remain

Figure 5 confirms the ever high relevance of funds of US and UK provenience domiciled in Ireland: 51% of the total fund assets domiciled in Ireland originate from US asset managers and 33% from UK asset managers as opposed to only 21% and 22% respectively for Luxembourg.<sup>8</sup> In absolute terms, however, Luxembourg retains its leadership as the preferred domicile for UK asset managers in Europe. The continuing high relevance of Anglo-American asset managers for the Irish marketplace is also supported by the flows depicted in Figure 6: almost 80% of the total net new money in 2021 originates from Anglo-American firms, with a focus on US firms. These figures are all in line with the previous years and are highly constant over time.

**Figure 5: Provenience of asset management companies for funds domiciled in Luxembourg and Ireland<sup>9)</sup>**

Provenience of asset management companies by net assets  
EOY 2021 in EUR bn



1) In the pie chart, total sustainable net assets in EUR bn 2) In the pie chart, total conventional net assets in EUR bn 3) In the pie chart, total net assets in EUR bn  
Source: Morningstar Direct. Excluding money market funds, closed end funds, funds of funds and feeder funds

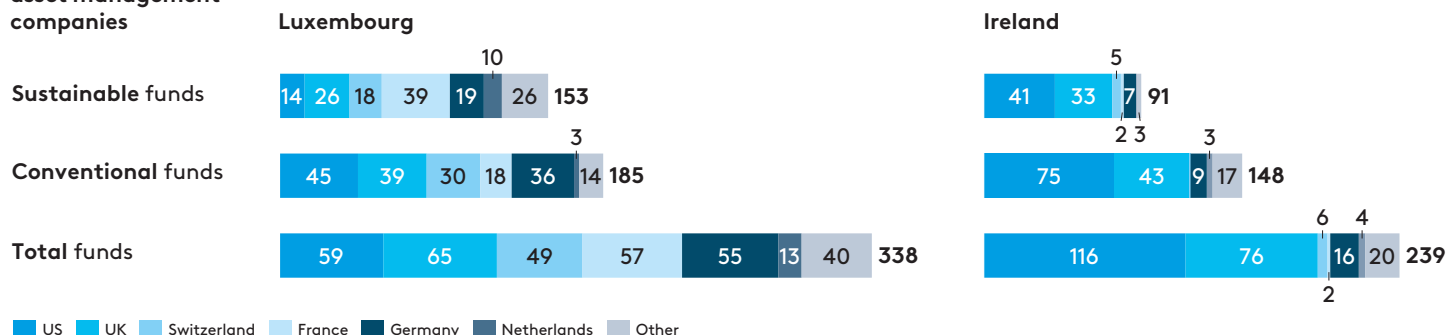
8) The allocation of net assets between US and UK asset managers is somewhat ambiguous as the large Anglo-American asset management firms manage their funds on different management platforms not necessarily located where their headquarters are. Nevertheless, the analysis shows the structural difference between the two domiciles in terms of their main fund initiators.

9) So far analyses were based on the domicile of funds regardless of where they are managed. A large amount of funds domiciled especially in Luxembourg and Ireland are managed by subsidiaries of asset management firms that are located elsewhere. To get a rough estimate about the shares and flows of funds domiciled in Luxembourg or Ireland by provenience as shown in Figure 5 and Figure 6, the funds were allocated to the country of the global headquarters of the respective subsidiary (or, in case of companies with sites in two different countries, volumes were allocated between the involved countries). Note that the figures do not necessarily comply with other statistics as only a part of the market is considered. Notwithstanding, the results confirm that Ireland functions as the main hub for US asset managers and to a lesser extent British, Swiss and German firms whereas Luxembourg is the main hub for European asset managers, especially those from Switzerland, France and Germany – countries which also function as significant domiciles in their own right.

**Figure 6: Net fund flows attracted by Luxembourg and Ireland by provenience of asset management companies<sup>10)</sup>**

Net fund flows into sustainable and conventional funds per domicile  
EOY 2021 in EUR bn

Provenience of  
asset management  
companies



Source: Morningstar Direct. Excluding money market funds, closed end funds, funds of funds and feeder funds.

European asset managers who are, for example, located in Switzerland, France or Germany tend to choose Luxembourg as their favorite domicile. This, together with funds originating from US and UK firms, leads to a much broader and diversified base of fund initiators in Luxembourg as opposed to the highly concentrated fund hub in Ireland relying mainly on US and UK managers. This is also supported by the statistics regarding the net flows in 2021 in Figure 6. The net flows attracted by funds domiciled in Luxembourg show almost evenly distributed shares between the main proveniences of asset management companies.

It also reveals another structural difference of the two most significant fund domiciles in Europe: while the funds domiciled in Luxembourg attract 40% more net flows in 2021 as opposed to 2020 where both markets attracted more or less equal levels, at 44% the share of flows in sustainable funds is significantly higher in Luxembourg compared to Ireland with only 36%.

### Sustainability is more prevalent in UCITS than in regulated AIFs

The European fund market is largely driven by UCITS, accounting for more than 60% of the total net assets of EUR 21.9 trillion of the total fund market at the end of 2021. This study considers open-end funds and ETFs only, regardless of whether they are UCITS or regulated AIFs. While UCITS are largely covered by the data base, the regulated open-end AIFs covered only amount to net assets of EUR 1.1 trillion, therefore representing only a fraction of the total market segment with net assets of EUR 8 trillion at the end of 2021.<sup>10)</sup>

The main reason for the low coverage is that large parts of the AIF market are driven by fund wrappers preferred by institutional investors in some markets like Germany and the Netherlands, whereas in other markets like the UK, institutional investors tend to invest via segregated accounts (discretionary mandates). For these individual funds, however, no detailed information is available.

<sup>10)</sup> This means that only 14% of the entire AIF market is covered by our data base in terms of net assets in 2021 (2020: 15%, 2019: 17%). See appendix and our former report.



Therefore, no specific reference can be made regarding the share of sustainable assets and the corresponding market shares of the European domiciles across the whole AIF market, as the respective information is restricted to the sub-segment of regulated open-end AIFs covered in the study. Nevertheless, a closer look at this segment may provide at least some high-level hints on sustainability trends in the whole AIF sector.

Figure 7 compares the share of sustainable net assets in both UCITS and the regulated open-end AIF segment included in the study across all European domiciles. Compared to UCITS, the share of sustainable open-end AIFs in total net assets is lower at the end of 2021 but also increased from 7% in 2019 to 11% in 2021. At the end of 2021, the domiciles that mainly drive the overall sustainability share in this segment are France with a sustainability share in regulated open-end AIF net assets of 42%, followed by Sweden (39%) and the Netherlands (27%). These are all domiciles where the share of sustainability is also far above average in the UCITS sector. In contrast, the share of sustainable net assets in AIFs in the UK – with AIF net assets of EUR 310 billion the largest domicile in Europe for the regulated open-end AIFs considered in this study – reaches only 8%. Luxembourg (6%) and Ireland (less than 1%) exhibit rather small levels in the regulated AIF segment.

All in all, the demand for sustainable funds is also increasing in the AIF sector, albeit not to the same extent as in the UCITS segment. In absolute terms, the net assets in open-end regulated AIFs increased by 86% within the period from 2019 to 2021 while UCITS increased by 193%. As pointed out above, all conclusions regarding the AIF segment can only be drawn for the relatively small, regulated sub-segment of the AIF market considered here.

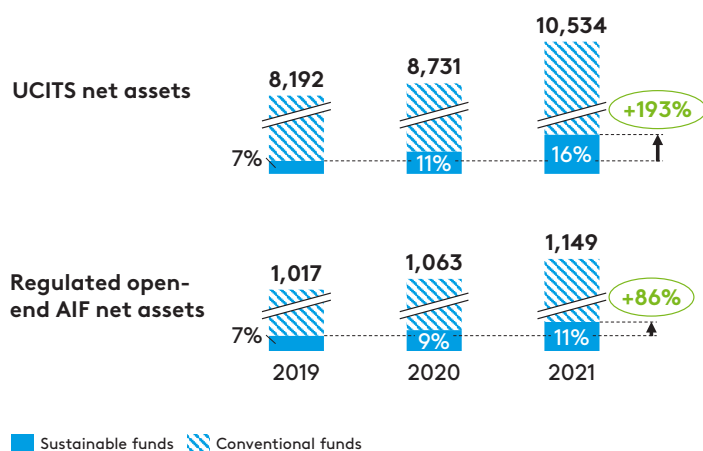
### Equity is the dominating asset class of sustainable funds

As can be seen in Figure 8, equity is the dominating asset class of sustainable funds across all European domiciles, accounting for more than 60% of the sustainable assets managed by funds. They are followed by fixed-income (20%) and allocation funds (15%) at the end of 2021. So far, all other asset classes are insignificant in terms of net assets. This differs significantly from the conventional funds sphere where the share in equity funds accounts for only 48% of the net assets and fixed income plays a much more important role, amounting to over 31%.

The share of equity in total net assets has increased both in the sustainable as well as in the conventional sphere, mirroring the soaring equity markets and the typical pro-cyclical investment behavior of investors. The increase in equity was at the expense of allocation funds in the sustainable segment and alternatives and fixed income in the conventional segment.

**Figure 7: Development of UCITS/AIF funds**

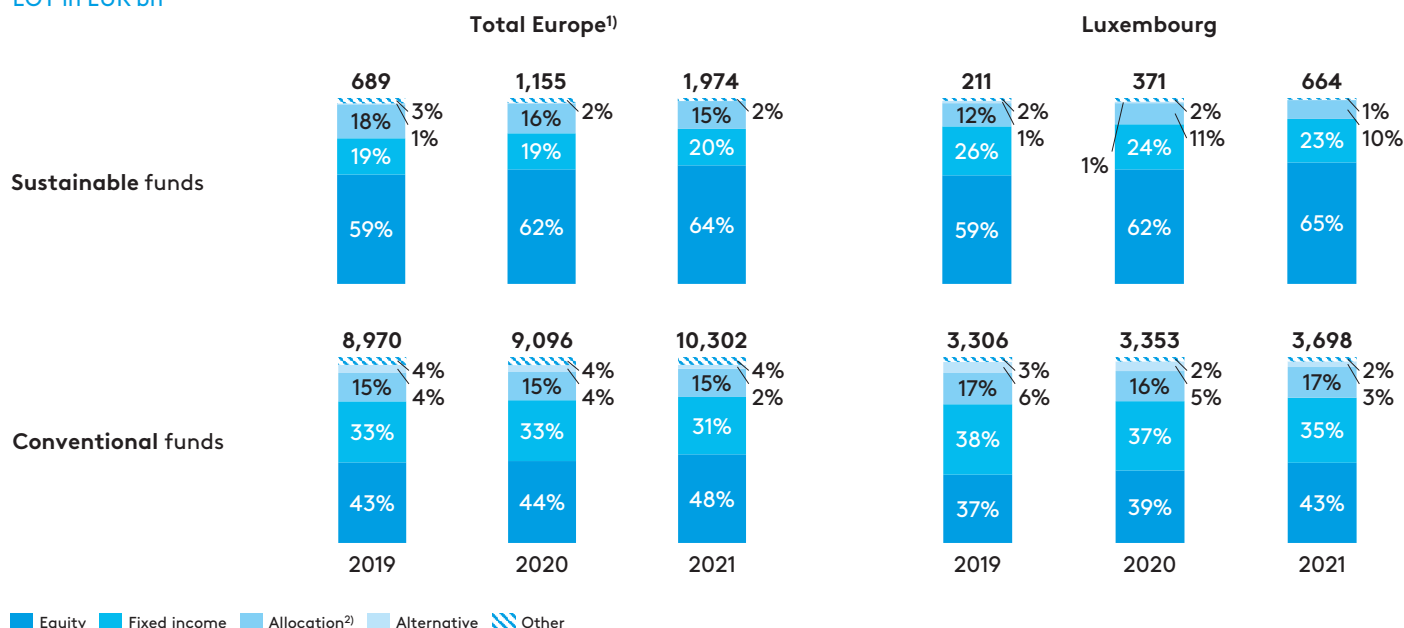
Breakdown of net assets in UCITS/AIFs in Europe<sup>1)</sup>  
EOY in EUR bn



<sup>1)</sup> EU27 and Switzerland, Norway, UK, Liechtenstein  
Source: Morningstar Direct. Excluding money market funds, closed end funds, funds of funds and feeder funds.  
Excluding funds with no data available on UCITS/AIF categorization.

**Figure 8: Asset class distribution by net assets**

Asset class distribution by net assets  
EOY in EUR bn



1) EU27 and Switzerland, Norway, UK, Liechtenstein 2) Multi-asset class strategy  
Source: Morningstar Direct. Excluding money market funds, closed end funds, funds of funds and feeder funds.

One explanation for the focus on equity in the sustainable sphere is the more favorable possibility of engaging in stewardship and influencing the companies' behavior towards sustainability targets. Figure 9 shows the even higher proportion of equity funds within the impact funds category – 73% as opposed to only 63% in the less ambitious sustainable fund strategies – which supports the expectation that the higher the ambition level regarding sustainability, the higher the percentage of equity investments.

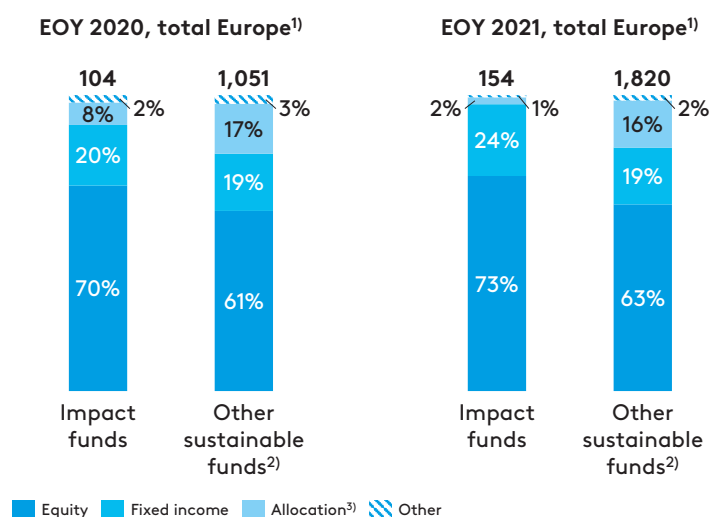
### Sustainable fixed-income funds are increasingly popular

Figure 8 also shows that the share in sustainable fixed-income funds' net assets increased slightly in contrast to the conventional ones which decreased in 2021 compared to 2020. Luxembourg maintains its leading position of sustainable fixed-income funds supported by a higher share of 24% in sustainable fixed-income funds compared to the rest of Europe with only 18% in 2021 (20% on a total European level).

This indicates that the integration of sustainability in fixed income has become more widespread recently, in line with the increased availability of sustainable fixed-income instruments such as green bonds, despite the complexity and diversity of bond markets as well as the corresponding data availability. Remarkably, this holds true also

**Figure 9: Asset class distribution by net assets, split by ESG categorization**

Asset class distribution by net assets per ESG categorization  
EOY 2020–2021 in EUR bn



1) EU27 and Switzerland, Norway, UK, Liechtenstein 2) Including funds with ESG or environmental focus or funds that combine impact objectives with other ESG or environmental factors 3) Multi-asset class strategy  
Source: Morningstar Direct. Excluding money market funds, closed end funds, funds of funds and feeder funds.

within the more ambitious impact funds segment as revealed in Figure 9. While the 19% share of fixed-income funds within the ESG and other funds sectors remained constant compared to the previous year, it increased from 20% in 2020 to 24% in 2021 within the impact funds sector.

In contrast, allocation and other fund strategies lost further ground and reached only negligible levels in the impact funds sector in 2021.

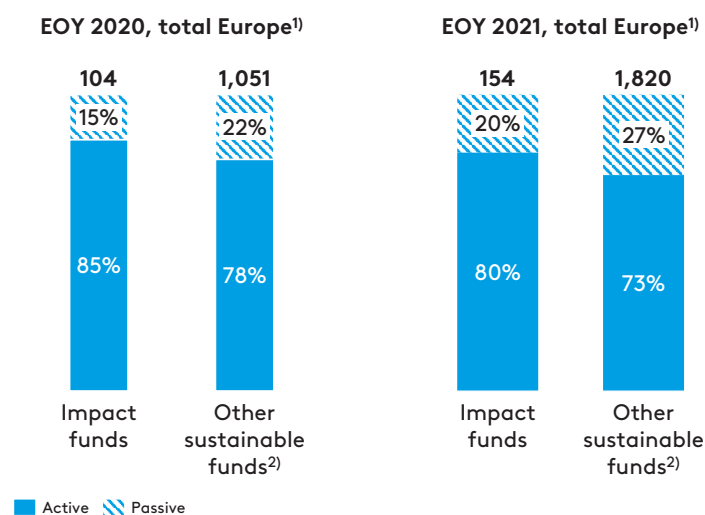
### Passive investment strategies do not stop at impact funds

The debate about active and passive investing does not stop when it comes to sustainable investments. Some argue that a thorough integration of ESG factors into the investment process can only be achieved by active managers, especially when more ambitious targets like those defined for impact funds are set. In general, this is supported by the higher percentage of active funds in the impact funds category (80%) compared to the other sustainability fund categories (73%) in 2021, as can be seen in Figure 10. However, passive funds also reach surprisingly high shares in total sustainable assets, even within the impact funds sphere. Remarkably, the share of passive investments increased significantly in both the impact and other sustainable funds sectors compared to 2020, showing the high competitiveness of passive fund providers not only in the conventional funds sector.

Notwithstanding the discussion about pros and cons of passive investing, Figure 11 shows the pickup of passive investments for the overall sustainability sector. At the end of 2021, they made up about 27% of the net assets of the European sustainable fund universe, totaling about EUR 523 billion in net assets in index-tracking open-end funds and passive ETFs. Remarkably, this share is now higher than the 21% observed in the conventional sphere. This compares with passive net assets of about EUR 139 billion in 2019 – an increase of almost 280% compared to only about 25% in the conventional funds sector over the period of 2019 to 2021. It seems that passive management is switching from traditional, plain vanilla approaches to sustainability.

## Figure 10: Active/passive distribution by net assets, split by sustainability categorization

Active/passive funds distribution by net assets per ESG categorization  
EOY 2020–2021 in EUR bn



<sup>1)</sup> EU27 and Switzerland, Norway, UK, Liechtenstein <sup>2)</sup> Including funds with ESG or environmental focus or funds that combine impact objectives with other ESG or environmental factors  
Source: Morningstar Direct. Excluding money market funds, closed end funds, funds of funds and feeder funds.

As shown in Figure 11, the increasing importance of sustainable passive products is observable across all European domiciles, but the growth rates are particularly high in Luxembourg and Ireland, both exhibiting almost equal growth rates of about 330% over the last three years. As expected, the share of sustainable passive investments in total sustainable assets is highest in Ireland (68%) with net assets of EUR 190 billion. Ireland is also the leading hub for conventional passive funds. The respective net assets in this segment amount to EUR 990 billion, representing a share of total conventional net assets of 45%.

With net assets in passive funds of EUR 411 billion of which 30% are sustainable, Luxembourg is ranked third after Ireland (EUR 1,178 billion/16%) and the UK (EUR 443 billion/6%) with Switzerland being another player with significant net assets in this segment (EUR 326 billion/9%). Luxembourg, however, exhibits the highest share of sustainable passive funds within the passive sector. The passive investment business is highly concentrated with only a few large providers. Therefore, the market position of a domicile is significantly affected by the choice of hub made by a single asset management company. For example, ETFs from iShares, the biggest passive ETF provider, are mainly domiciled in Ireland and to a lesser extent in Germany.

# Active owners create value by building sustainable businesses



**Interview with**  
**Andre Frei, Chairman**  
**of Sustainability,**  
**Partners Group**



[partnersgroup.com](https://partnersgroup.com)

## **What are the advantages and the challenges of ESG integration in private markets?**

The private markets industry has a significant advantage when integrating ESG considerations: an active ownership philosophy. We have the unique opportunity and responsibility to go beyond exclusion criteria or shareholder engagement and actively drive change within our investments. With our governance rights and expertise, we adopt a strategic ESG approach that enables us to enhance and transform our controlled portfolio companies. As active owners, we not only mitigate risks to protect value, but also seek to create value by building more sustainable businesses.

A strategic approach to ESG also comes with challenges. Strong processes and control frameworks are required to drive ESG initiatives, and reliable data is required to measure the progress we achieve. Whereas in public markets, one can purchase data from external providers, data collection in private markets is a much more involved exercise. We collect every data point from each portfolio company individually.



**Is there a dimension of E, S and G you focus on more in terms of targets or initiatives?**

At Partners Group, ESG starts with the “G”. For the assets and companies that we own and control as majority shareholders on behalf of our clients, we establish a clear ESG governance structure. We appoint three leaders at asset level, who are responsible for ESG at every level – board, executive and operational. We ask these leaders to develop a meaningful ESG journey for their business and to identify several strategic ESG initiatives with meaningful impact in relation to environmental, social or governance aspects.

The focus of the initiatives depends on what ESG topics are material for the respective portfolio company. As part of our sustainability strategy for controlled private equity and infrastructure assets in our portfolio, we have defined four focus areas/targets for each of the three ESG dimensions.

**Do you think that the positive risk/return properties often declared for liquid investments are also applicable to private equity?**

By building better and more sustainable portfolio businesses, we aim to create long-term value and generate superior financial returns for our clients. However, while in public markets the performance attribution of ESG is typically measured by comparing the performance of stocks with high ESG ratings to the benchmark, this approach is not applicable to private markets.

Many of our ESG initiatives lead to measurable positive financial impact. For example, in companies where we significantly increase the energy savings, it contributes to reducing the GHG footprint, while also increasing the EBITDA. How-

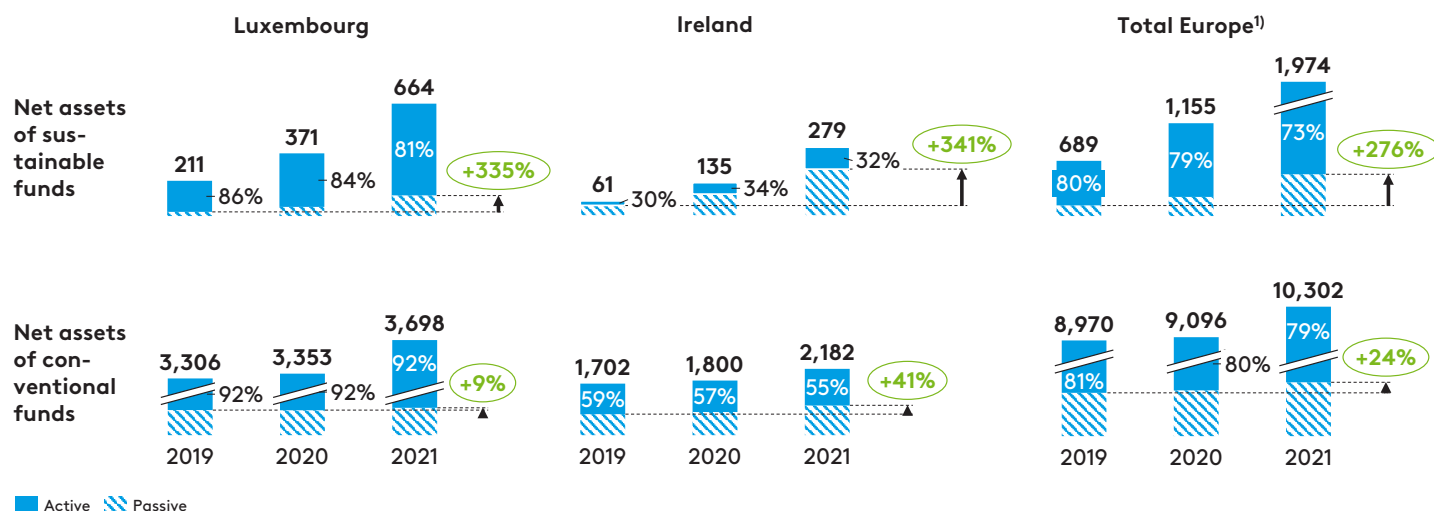
ever, not all ESG progress can be translated into financial return characteristics. For example, we cannot measure what the valuation of a company would have been if we had not improved the health & safety standards or established a diversity & inclusion policy.

It is important for investors to note that transformative ESG strategies can require significant resources and capital expenditure. ESG is not a “free lunch” but a long-term journey that requires conviction, competence and capacity.

**“We have the **unique opportunity and responsibility** to go beyond exclusion criteria or shareholder engagement and **actively drive change within our investments.**”**

**Figure 11: Overview of net assets, split by active vs. passive investment strategies**

Breakdown of net assets by active/passive strategy  
EOY in EUR bn



<sup>1)</sup> EU27 and Switzerland, Norway, UK, Liechtenstein  
Source: Morningstar Direct. Excluding money market funds, closed end funds, funds of funds and feeder funds.

The products of Northern Trust, one of the biggest open-end index fund providers, are also to a substantial proportion domiciled in Ireland. This explains the dominant market position of Ireland as a domicile for passive funds with a market share of 44% at the end of 2021, followed by Luxembourg and the UK (both around 16%) as well as Switzerland (12%). Interestingly, market shares based on the total volumes in sustainable passive funds only paint another picture: even though Ireland is still the leading domicile with a market share of 36%, Luxembourg can build on its strengths in sustainable passive with a market share of 24%. Third-ranked Sweden has a market share of 16% and is thus well ahead of the UK and Switzerland, both with a market share of only 5% in this segment.

The ongoing trend towards passive funds within the sustainable sphere is also supported by the net new money development. Figure 12 reveals that in 2021, similar to 2020, flows were again equally directed towards sustainable and conventional funds. More importantly, it confirms the increasing demand for passive sustainable investments in 2021: 31% of the net flows were directed towards sustainable passive funds while the flows to the conventional sector went mainly

into active funds – at the expense of their passive counterparts which could only attract 22% of the flows in 2021 as opposed to 54% in 2020.

The trend towards sustainable passive is also recognizable in Luxembourg – obviously on another level compared to Ireland where 68% of the flows into sustainable funds and 49% of those into conventional funds were directed towards passive strategies. Ireland's strong position in the passive market is also reflected by the fact that 67% of the total net flows in passive funds in 2021 were attracted by funds domiciled in Ireland. When considering only the total flows into sustainable passive funds, Ireland attracted 50% in 2021.

All in all, the trend towards passive seems to be unbroken and has switched from the conventional to the sustainable universe.

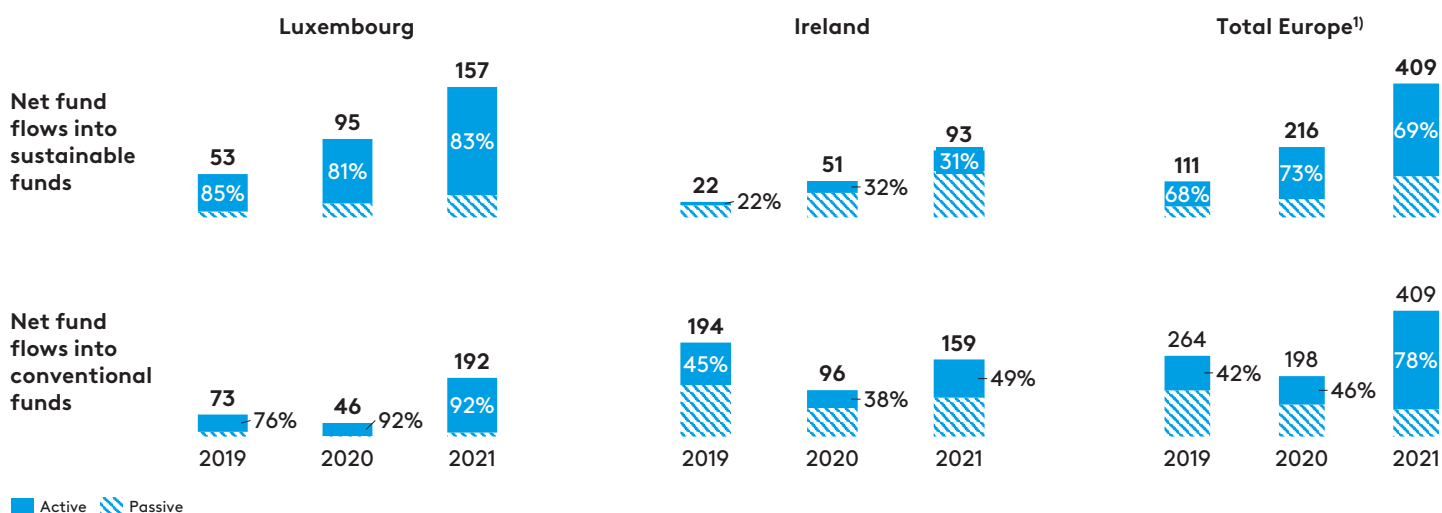
“The high proportion of **passive strategies in the sustainability environment** is remarkable – after all, it is often claimed that **an orientation towards more sustainability can only succeed via active strategies.**”

Tommaso Cavalli,  
Manager, zeb, Warsaw



Figure 12: Overview of net fund flows, split by active vs. passive investment strategies

Breakdown of net fund flows by active/passive strategy  
EOY in EUR bn

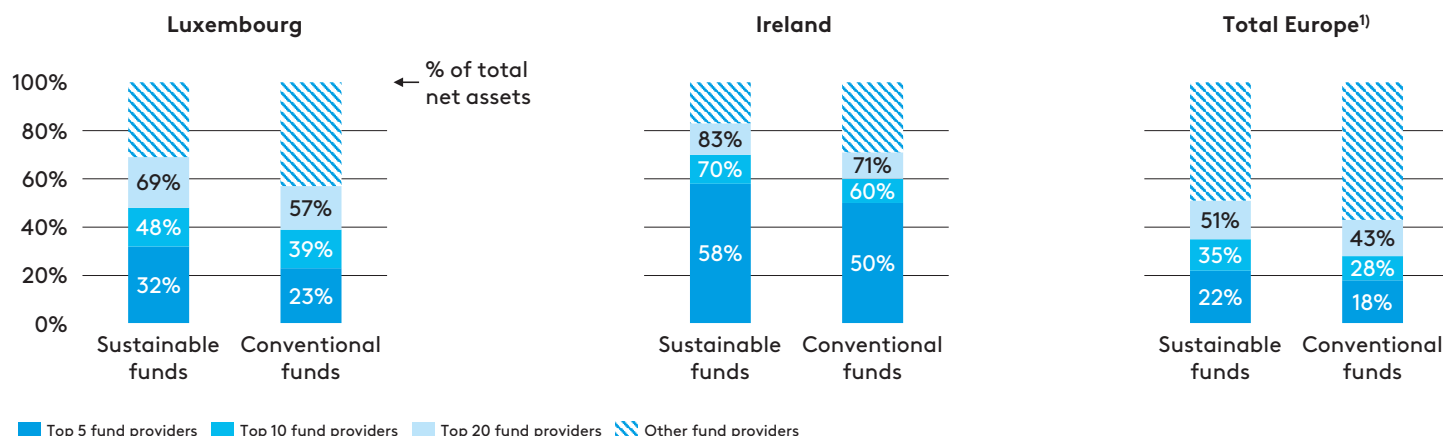


<sup>1)</sup> EU27 and Switzerland, Norway, UK, Liechtenstein

Source: Morningstar Direct. Excluding money market funds, closed end funds, funds of funds and feeder funds.

**Figure 13: Market share of main fund providers in Luxembourg**

Percentage of sustainable and conventional funds' net assets of largest fund providers  
EOY 2021



<sup>1)</sup> EU27 and Switzerland, Norway, UK, Liechtenstein  
Source: Morningstar Direct, zeb analyses. Excluding money market funds, closed end funds, funds of funds and feeder funds.

### A marketplace dominated by large players

In our last report we confirmed the well-known fact that the asset management industry is a highly concentrated industry with only a few large players dominating the markets. Nothing has changed in this respect as the aggregated market shares of the largest fund providers in 2021 depicted in Figure 13 basically remained unchanged compared to 2020. Figure 13 reveals that the high concentration in the industry is even higher in the sustainable funds segment. On average, 51% of the net assets in sustainable active funds in Europe were invested in funds launched by the top 20 providers as opposed to only about 43% for conventional funds.

Looking at individual fund hubs, Luxembourg and, even more significantly, Ireland show a strong positioning of the top fund providers in either market. The top 5 asset managers cover approximately 32% of net assets in Luxembourg-domiciled sustainable funds and a staggering 58% of net assets in Ireland-domiciled funds. The high concentration in Ireland is certainly due to its position as the largest hub for passive investments where Ireland has a market share of 44% as opposed to Luxembourg with only 16% at the end of 2021. The high concentration in these domiciles shows that the large global asset management companies are the key success drivers for both Luxembourg and Ireland as they tend to direct their cross-border distribution into Europe and

other countries via these hubs – for both active and passive funds. However, high concentration also means high dependency on individual asset managers leading to higher risks in terms of the level and volatility of net flows and net assets. In this respect, Luxembourg has significant advantages over Ireland as the concentration regarding both individual asset managers as well as their provenience is much lower.

### Special focus: sustainability has reached the money market funds sector

Given their short-term nature and the specific underlying investment objectives (mainly as cash equivalent), money market funds were analyzed separately, in line with our previous report. As Figure 14 shows, money market funds in Europe are to a very large extent domiciled in three major hubs: Ireland, Luxembourg and France. They have traditionally been important in France where their share in the total fund market in terms of net assets reached over 35% in the past three years. In Ireland, their share in total assets amounted to 20% in 2021. A much lower relevance of these funds can be observed in Luxembourg where they have been representing a – remarkably constant – 9% of the total net assets over the past three years.



The integration of ESG factors is challenging in any asset class given the data limitations and lack of market infrastructure. This is especially true for money market funds as they operate under tight regulatory and investor-driven requirements to maintain high levels of liquidity and security. As a result, they seek conservative, liquid short-term assets and primarily hold sovereign debt and high-quality securities issued by global banks. As there is only a limited number of AA- and A-rated global banks that access the market daily, excluding or limiting exposure to even a small number of them for sustainability reasons could create issuer diversification challenges. Non-financial issuers also pose challenges for several reasons: their often lower ratings, the lower frequency of corporate issuances and the inconsistency as well as smaller size of non-financial issuances relative to the overall market.

Other short-term investments that are normally used by money market funds include asset-backed commercial papers, repurchase agreements secured by non-government collateral (alternative repo) and municipal securities. Evaluating and monitoring the ESG characteristics of the underlying collateral for these types of securities creates a broad set of operational challenges. These challenges are exacerbated by infrequent data reporting as well as inconsistent information provided by the various parties involved.

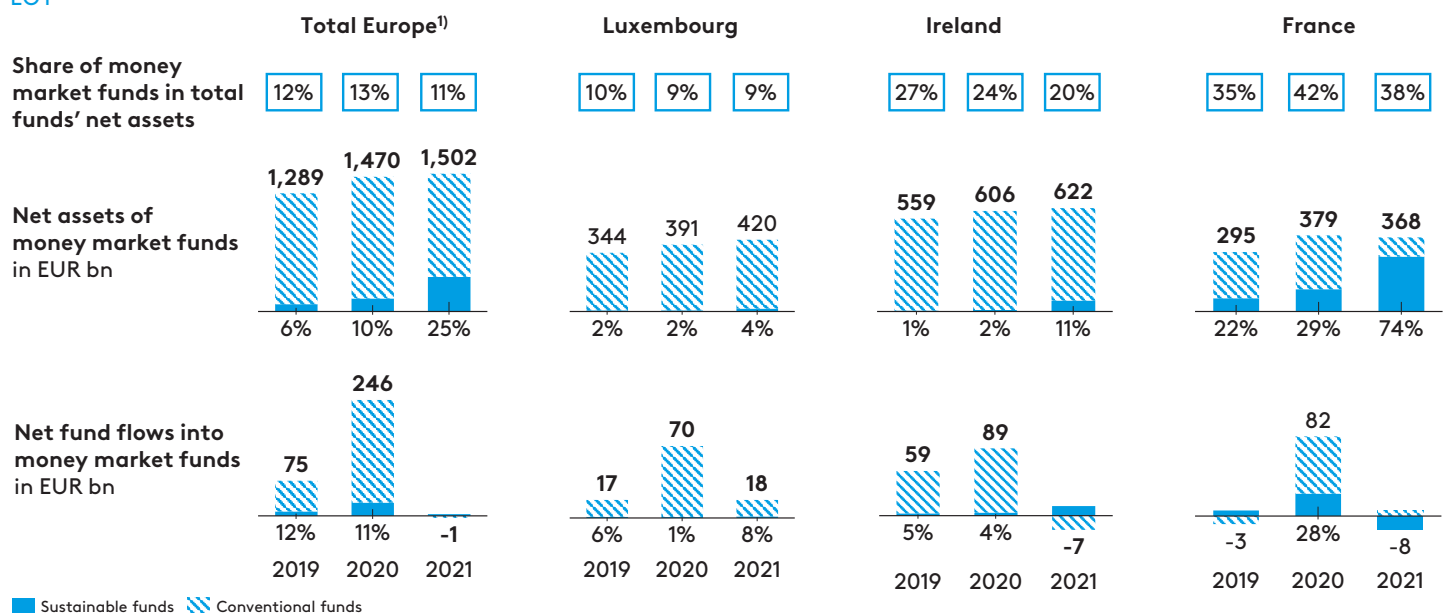
Against this background, the developments in this sector are striking: while the share of sustainable money market funds' net assets in total money market net assets in Europe was only 6% in 2019, it reached a striking 25% in 2021. This means that the penetration of sustainability in this asset class is now significantly higher than in the overall markets where we observed a share of 16% in 2021. Obviously, compared to previous years, sustainability has now also entered the money market fund segment – within a short period of time it has become “greener” than the rest of the fund market.

This development was mainly driven by France where the already high share in sustainable money market funds in 2020 more than doubled to 74%, and Ireland where only 2% of net assets in money market funds were considered sustainable in 2020 but 11% by the end of 2021.

Net new money data in 2021 showed negative net flows of EUR 812 billion for European money market funds. While EUR 4,520 billion were withdrawn from conventional money market funds, EUR 3,710 billion were invested in sustainable money market funds. This confirms the increasing demand for sustainability in this asset class at the expense of conventional funds.

**Figure 14: Development of sustainable money market funds**

**Development of sustainable money market funds**  
EOY



<sup>1)</sup> EU27 and Switzerland, Norway, UK, Liechtenstein  
Source: Morningstar Direct, zeb analyses. Excluding closed end funds, funds of funds and feeder funds.

## Sustainable product development is accelerating

The European sustainable funds space saw an unprecedented level of product development activity in 2021, with 652 new funds coming to market with corresponding net assets of EUR 86 billion, an increase by 35% p.a. compared to the figures in 2019. Roughly 23% of the new products were launched in the passive sector, up from 16% in 2019 as shown in Figure 15.<sup>11</sup> This compared to a decrease of new conventional funds of 11% p.a. in terms of numbers and 25% p.a. in terms of corresponding assets, with the share of new passive products dropping from 8% in 2019 to 6% in 2021 in terms of numbers.

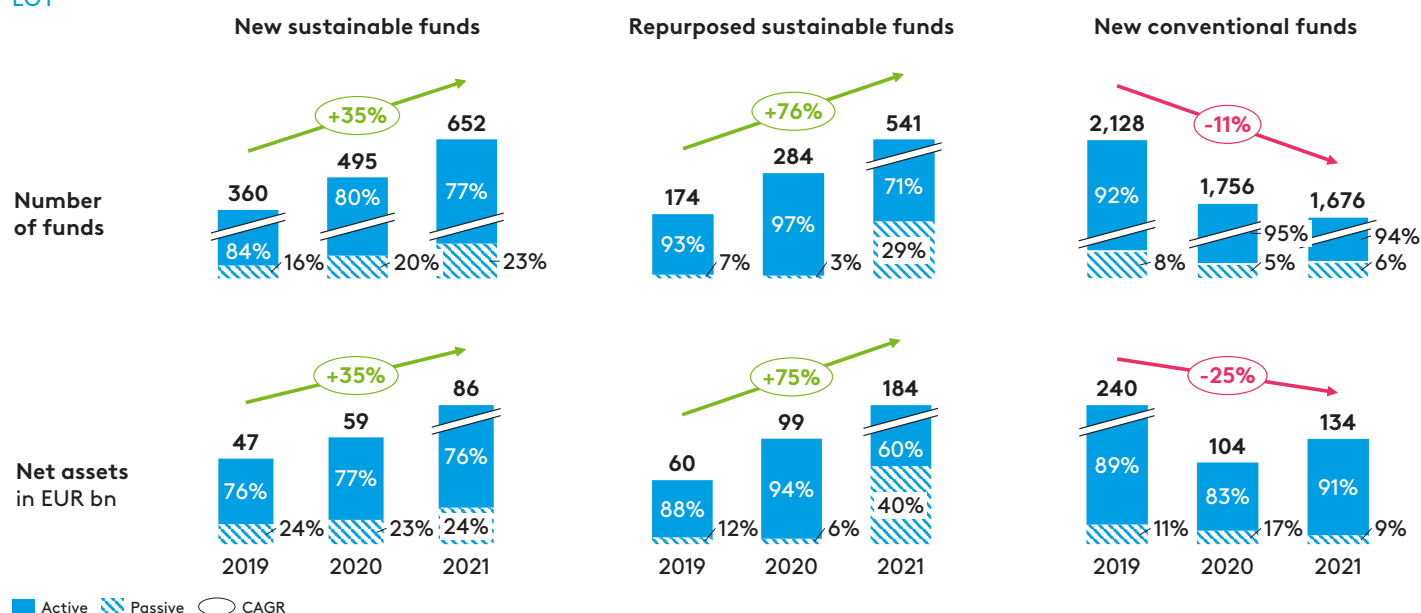
Transforming existing funds into sustainable strategies is also a way for asset managers to leverage existing assets to build their sustainable funds business, thereby avoiding having to create funds from scratch. Repurposed funds are typically also rebranded by adding terms such as sustainable, ESG, green or SRI to their names to increase their visibility among investors who are looking to invest more sustainably.

Consistent with record numbers of fund launches, repurposed funds also increased to a record level. Asset managers seized the opportunity of having to publish new SFDR-compliant prospectuses to review their offerings, add binding ESG criteria and exclusions and typically rebrand their funds. 541 such funds were identified in 2021 with corresponding net assets of EUR 184 billion, reflecting growth rates compared to 2019 that were almost identical with the ones observed for new fund launches, both in terms of numbers and net assets.<sup>12</sup>

Newly launched funds and repurposed funds together amounted to 1,193 new funds offered to investors looking for sustainable investment strategies. Of these, almost 40% were domiciled in Luxembourg, 19% in Ireland and 10% in France.

**Figure 15: New sustainable product launches and product repurposing**

Breakdown of sustainable funds split by active/passive for total Europe<sup>1)</sup>  
EOY



<sup>1)</sup> EU27 and Switzerland, Norway, UK, Liechtenstein

Source: Morningstar Direct. Excluding money market funds, closed end funds, funds of funds and feeder funds. Count of number of funds including only oldest share class per fund.

<sup>11)</sup> Figures on the number of new fund launches or repurposed funds may differ from other reports. This is due to different data definitions (e.g. exclusions) as well as different points of times of data extractions for analyses.

<sup>12)</sup> Since the repurposing of funds is an ongoing process and updated documents need to be both identified and analyzed by Morningstar, these figures are most likely of a conservative nature and reflect the review status as of February 2022.

While in 2020 the number of new conventional fund launches was still more than 2.2 times as high as the combined number of new and repurposed funds in the sustainable sphere, this ratio was much smaller in 2021 where it was only 1.4 times as high. Even more strikingly, the combined net assets of new sustainable and repurposed funds were less than half of those from new conventional funds in 2019 but twice as high in 2021. As expected, all figures show a clear trend towards sustainable funds.

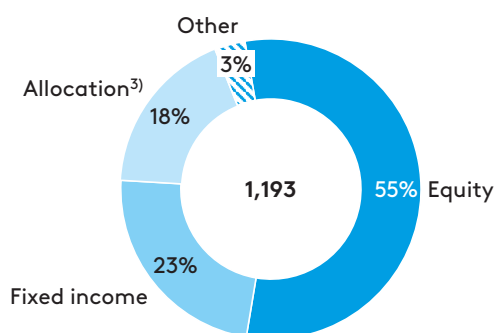
As Figure 16 reveals, equity remained the source of the greatest product development in 2021 with a share of 55% in the new offerings in terms of numbers, which is the same share as in 2020. This was followed by fixed-income and allocation strategies with 23% (2020: 20%) and 18% (2020: 19%), respectively.

While broad ESG funds continued to represent the bulk of new offerings in 2021, impact funds accounted for about 5% of new fund launches and repurposed funds. Surprisingly, this is lower than compared to 2020 (9%) given the increased interest in impact investing.

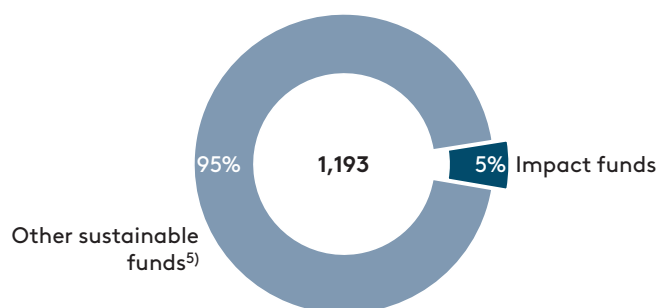
Additional analyses show that climate funds remained by far the most popular theme represented among new fund launches, spanning all climate-related themes like low carbon, climate transition and solutions, clean energy/tech and green bonds. On the passive side, funds came to market tracking the EU Paris-Aligned and EU Climate Transition benchmarks. Fewer funds focus on social issues, e.g. by investing in companies that demonstrate gender and/or ethnic diversity or that provide solutions empowering social equality. Others offer exposure to emerging markets through a broad ESG lens.<sup>13</sup>

**Figure 16: Product development per asset class**

**Asset class distribution by number of new sustainable fund launches and repurposed funds for total Europe<sup>1)</sup> EOY 2021<sup>2)</sup>**



**New sustainable fund launches and repurposed funds by sustainable fund categorization EOY 2020<sup>4)</sup>**



1) EU27 and Switzerland, Norway, UK, Liechtenstein 2) In the pie chart, total number of new sustainable fund launches and repurposed funds 3) Multi-asset class strategy 4) In the pie chart, total number of new sustainable fund launches and repurposed funds 5) Including funds with ESG or environmental focus or funds that combine impact objectives with other ESG or environmental factors  
Source: Morningstar Direct. Excluding money market funds, closed end funds, funds of funds and feeder funds. Count of number of funds including only oldest share class per fund.

13) See Morningstar, Global Sustainable Fund Flows: Q4 2021 in Review, January 2022.

# Greenwashing jeopardizes the key role of financial institutions



**Interview with**  
**Hadewych Kuiper, Managing**  
**Director, Member of the**  
**Management Board, Triodos**  
**Investment Management**



[triodos-im.com](https://triodos-im.com)

**Investors' trust is one of the most important factors for financial services providers. How much is this affected negatively by reports of greenwashing potential in the industry?**

Greenwashing is a serious problem for the financial sector at large as it jeopardizes the crucial role the sector plays in the transition towards a sustainable economy. To direct capital to places where it is most needed to generate positive impact, financial services providers need to deliver on their promises and should be held accountable for it. While it might seem lucrative in the short term to capitalize on the market appetite for sustainable products with offerings that are only sustainable in name, this behavior will seriously damage trust in the sector as a whole.

We see a risk of misleading and potentially mis-selling of "green" / ESG funds. Retail investors expect specific companies to be included

in their sustainable portfolios which are part of the solution rather than companies just having an ESG policy. They can be shocked to discover that, rather than wind and solar companies, their "sustainable" portfolios' biggest holdings are actually oil companies and bank stocks. The Financial Times addressed this risk in an article on a potential new mis-selling scandal for green investments last February.

All in all, this may lead to investors becoming suspicious of any sustainability claims made by financial institutions and reluctant to invest in those products. The resulting lack of capital inflow could seriously hinder the much-needed transition in the energy, agriculture, food and other crucial sectors.



**Retail investors are considered to be not very knowledgeable about investment topics, especially in countries with a limited capital market culture. Do you believe that an interest in sustainability may trigger some more interest in financial matters?**

It is very well possible that interest in sustainability leads to more interest in financial matters as the two subjects are very much interlinked. A huge amount of capital is needed to address the enormous sustainability challenges that are awaiting us, and retail investors have an important role to play in freeing up this capital. Not only with their personal investment decisions but also because they can influence the way banks, pension funds, insurance companies and other big financial players invest their capital. We are currently seeing increasing pressure, for instance from NGOs, being put on the financial industry to direct capital towards sustainable

investments. The more it becomes clear that the financial sector is key in the sustainability transition, the more people will likely become interested in it.

Moreover, we think it is key to involve citizens in the sustainability transition. Not making them part of this would increase the risk of social unrest and exacerbate inequalities in society. Sustainable finance can help engage retail investors (and savers) in this transition, for example by letting them participate in local green energy cooperatives.

**Do you think that the different criteria applied by rating/data providers to assess the sustainability level of a fund, together with the Article 8/9 classification according to SFDR, are beneficial or rather counterproductive for the market with regard to the acceptance and understanding of sustainable investments?**

Neither the acceptance nor the understanding of sustainable investments are being served by the inconsistency of criteria applied to assess the sustainability level of a fund. The introduction of the SFDR classification into Article 8/9 is an important step forward because it creates more clarity for investors as to how sustainable a fund really is.

However, at this point classifications into Article 8 or 9 are still based on fund managers' own assessments of their products, leading to a situation where not all funds really live up to their classification yet. This will hopefully level out over time but until then it does not help retail investors in comparing sustainable fund offerings.

**“Investors may become suspicious of any sustainability claims made by financial institutions and reluctant to invest in those products.”**

# European regulatory landscape – latest developments

While the demand for sustainable investment products has skyrocketed, regulators have strengthened their efforts to implement a more regulated and standardized playing field in the sustainable finance area.

By launching the European Union Action Plan on Sustainable Finance in 2018, the EU laid the foundation for a broad package of rules which intends to reorient capital towards sustainable investments. The Action Plan brings together under one roof the Taxonomy Regulation, a disclosure regime including the Sustainable Finance Disclosure Regulation (SFDR) as well as the Corporate Sustainability Reporting Directive (CSRD) and further regulatory initiatives or tools aiming to connect financial investments and sustainability.

However, industry experts complain that currently existing regulations could lead to an increase in greenwashing practices and confusion regarding sustainable investments. This is due to vague definitions of what can be described as sustainable and differing interpretations of ESG criteria, sustainability risks and targets as well as insufficient data on sustainability factors from investee companies.

Hence, the last year was marked by launches of new rules and regulatory updates aimed at combating greenwashing and establishing a comprehensive consideration of regulatory aspects in the sustainable investment fund universe.

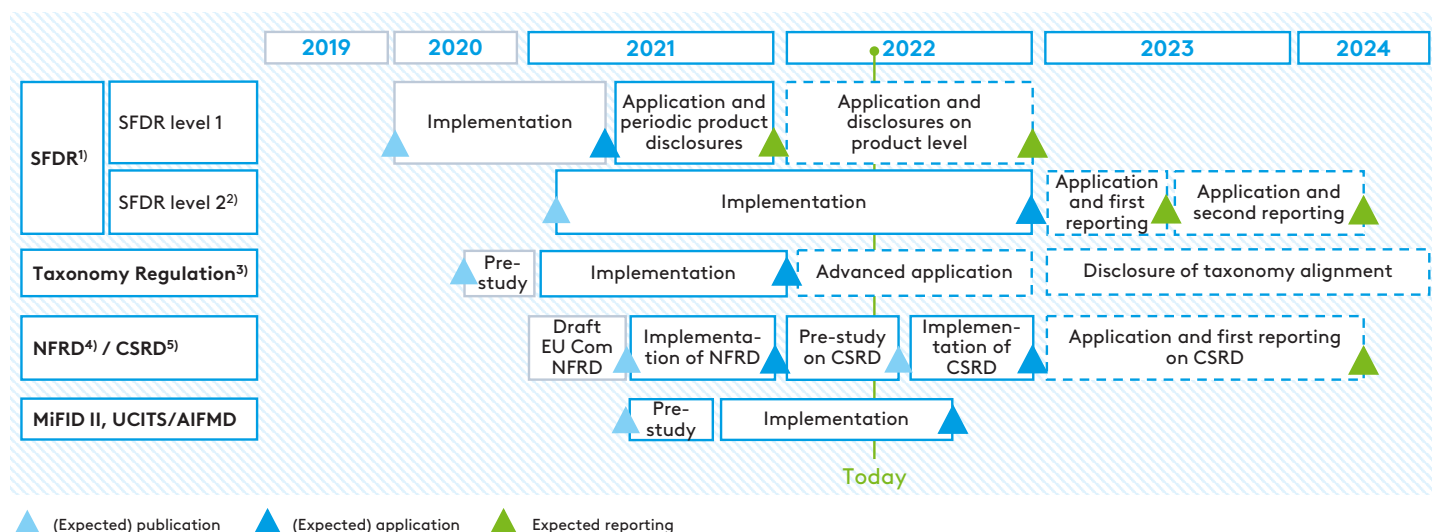
The European Commission published its new “EU Sustainable Finance Strategy for Financing the Transition to a Sustainable Economy” on July 6, 2021, which builds on the EU Action Plan on Sustainable Finance. To name but a few, actions derived from the strategy encompass the development of international sustainable finance initiatives and standards, ensuring the integrity of the EU financial system and monitoring its orderly transition to sustainability, increasing the contribution of the financial sector to sustainability and extending the existing sustainable finance toolbox to facilitate access to transition finance. The European Green Bonds Standard (EUGBS) and the Delegated Act on Article 8 of the EU Taxonomy Regulation constitute two further initiatives provided by the renewed strategy. The Commission will report on the Strategy’s implementation by the end of 2023.

Moreover, ESMA presented its “Sustainable Finance Roadmap 2022–2024”. On top of this, two of the cornerstones of sustainable finance regulation in Europe, the Sustainable Finance Disclosure Regulation (SFDR) and the Taxonomy Regulation, have been updated and evolved. Other regulations like CSRD, MiFID II, UCITS and AIFMD have been modified, updated or finalized in 2021.

The considerable number of legislative efforts resulted in a high complexity of the current European regulatory landscape for sustainable funds. The most important initiatives within the EU are summarized in Figure 17.

**Figure 17: Selection of relevant ESG regulatory initiatives for European funds industry**

**European initiatives – illustrative roadmap**



1) Sustainable Finance Disclosure Regulation 2) SFDR Regulatory Technical Standards 3) Climate change mitigation and adaptation as of January 1, 2022. Extended application of water, circular economy, pollution prevention and biodiversity and ecosystems-related objectives as of January 1, 2023 4) Non-Financial Reporting Directive 5) Corporate Sustainability Reporting Directive

The following paragraphs will provide more insights into the latest developments and their expected evolution within the European sustainable fund universe.

### **Sustainable Finance Disclosure Regulation (SFDR)**

SFDR “Level 1”, whose main provisions have entered into application in March 2021, is the first part of the implementation of Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector. It requires asset managers, financial advisers and financial market participants (FMPs) to provide prescriptive and standardized disclosures on how sustainability factors are considered at both the entity and product level.

On April 6, 2022, the EC announced that it had adopted all the various regulatory technical standards (RTS) under the SFDR in a single draft delegated act, also known as “SFDR Level 2”, based on previously published draft RTS. The respective obligations aim at enhancing further guidance on sustainability-related disclosures. In general, the SFDR RTS specify a mandatory website as well as pre-contractual and periodic reporting templates for FMPs. In fact, final draft versions do not normally differ from previous versions significantly, so asset managers should focus on the required disclosures by considering

the mandatory reporting templates for pre-contractual, periodic disclosures and principal adverse impacts (PAI) on sustainability.

Further clarification on the ESAs’ draft RTS under SFDR was provided in a statement by EBA, ESMA and EIOPA at the beginning of June 2022. This concerns key areas of the SFDR disclosures such as the use of sustainability indicators, and the taxonomy-related financial product as well as the “do not significantly harm” disclosures.

The application of SFDR “Level 2” requires asset managers to disclose their funds’ level of alignment with the Taxonomy. As a result, these products must pursue six environmental objectives as defined by the Taxonomy. This level of alignment has to be measured with two graphs showing the taxonomy alignment based on a specified calculation methodology.

SFDR “Level 2” had been planned to take effect in January 2022. However, the date of application of the RTS has been delayed twice by the Commission, the reason being the length and technical detail of these standards and the aim to bundle them all. The current application date will not be definitive until confirmed by the European Parliament and the Council, but it is expected that January 1, 2023 will be the effective date. From June 30, 2023, FMPs will be required to disclose PAIs and sustainability features of their financial products for the first time.

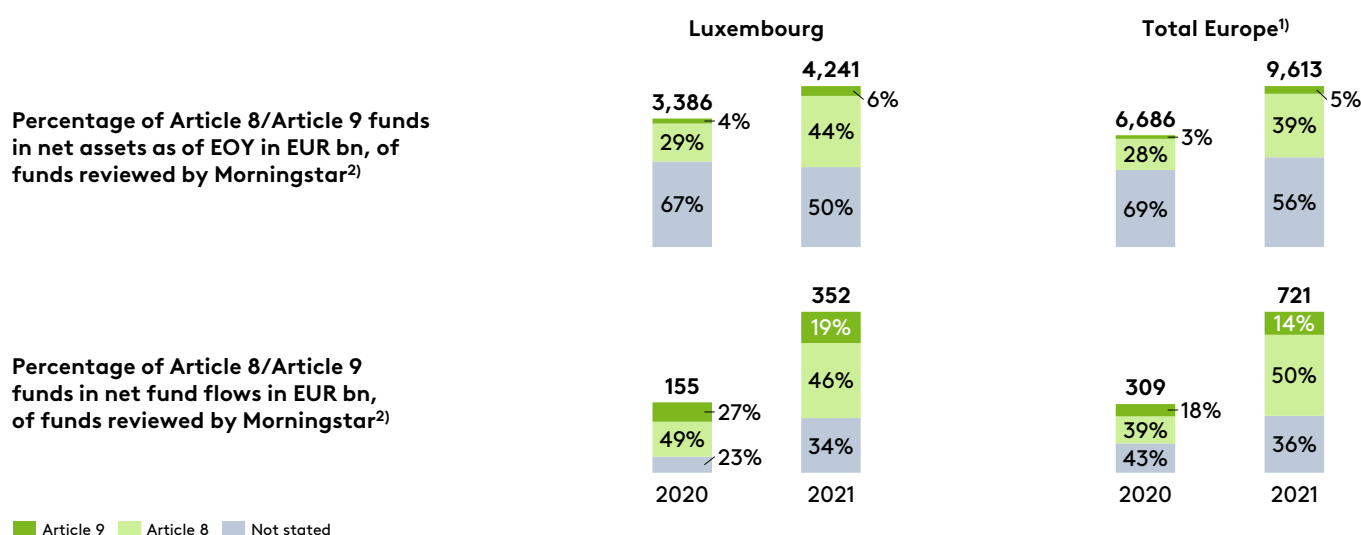
More precisely, SFDR requires asset managers to explain in pre-contractual disclosures how sustainability risks are considered in their investment process and how sustainability risks may impact the returns of their financial products (Article 6). In addition, they will need to assess if and to what extent their funds qualify as funds that promote social or environmental characteristics ("Article 8 funds") or that have sustainable investment as their main objective ("Article 9 funds"), and comply with the respective reporting requirements.

At the time of this analysis, Morningstar had about 88% of the funds domiciled in Luxembourg reviewed with respect to their classification as either Article 8 or Article 9 funds. This corresponded to 97% of the net assets. The coverage for the other European domiciles was 67% (numbers) and 68% (assets) at that stage. This results in an overall coverage of more than 74% of the total European fund universe as defined in this study, which corresponded to 78% of the net assets.<sup>14</sup>

Figure 18 shows that of the reviewed funds domiciled in Luxembourg half the funds' net assets are classified as sustainable whereas the other half are to be considered Article 6 funds. This compares with only a third of the net assets classified as sustainable in 2020.<sup>15</sup> About 6% of the net assets are managed according to the principles set out by Article 9 and 44% based on less ambitious sustainable strategies as defined in Article 8, representing combined assets of EUR 2.1 trillion, twice as much as in 2020. The respective shares for the whole European investment universe that has been reviewed so far are lower due to the inclusion of non-EU domiciles. Nevertheless, the respective figures do not change significantly even though the share of Article 8 in particular decreases by 5 percentage points. 39% of the corresponding net assets are classified as Article 8 and 5% as Article 9, reflecting an increase in the underlying assets by 100% up to EUR 4.2 trillion compared to 2020.

**Figure 18: Distribution of net assets for Article 8 and Article 9 funds for Luxembourg-domiciled funds**

#### Breakdown of funds' net assets and fund flows per SFDR classification



<sup>1)</sup> EU27 and Switzerland, Norway, UK, Liechtenstein <sup>2)</sup> Morningstar's assessment of fund managers' declarations as of end of December 2021

Source: Morningstar Direct, zeb analyses. Excluding money market funds, closed end funds, funds of funds and feeder funds. Coverage of approx. 88% of funds domiciled in Luxembourg and 67% of European funds overall, as of Feb 28, 2022

<sup>14)</sup> Note that only funds in scope of SFDR, i.e. those available for sale in the EU, are reviewed rather than all funds domiciled in Europe. At the end of 2021, Morningstar's coverage of funds in scope of SFDR was 91%.

<sup>15)</sup> The net asset figures for the end of 2020 are of a hypothetical nature as SFDR was not in place at the end of 2020. The respective figures reflect the net assets of those funds that were classified as Article 8 and 9 funds in May 2021, at the time we collected the data for our previous study.



**“Although the marketing of funds as sustainable by the industry is criticized in detail, the general discussion of the topic alone is of value for both providers and investors.”**

**Arnd Heßeler,**  
Executive Manager, zeb, Luxembourg



Given that more than two-thirds of the European funds have already been reviewed, and 91% of those available for sale in the EU, these figures should provide a solid insight into the status of the European market structure in terms of the classification of funds according to SFDR, assuming that the structures within the remaining net assets will not deviate significantly from the ones reviewed.

The trend towards sustainable funds is supported by the net flows shown at the bottom of Figure 18. More than two thirds of the net flows are directed towards sustainable funds both in Luxembourg and Europe, with Luxembourg exhibiting a higher percentage of flows attracted by Article 9 funds. Interestingly, the share of net flows in sustainable funds domiciled in Luxembourg has decreased in 2021 from a high level in 2020 (76%) in contrast to Europe as a whole where it increased from 57% to 64%. Irrespective of these differences, the structure of the flows clearly shows the trend towards sustainable strategies and confirms what has been already observed by applying the sustainability definition of Morningstar.

When comparing the shares of sustainable funds' net assets in the total funds' net assets based on the regulatory classification and the definition applied by Morningstar, a significant difference is noticeable. While the share of sustainable funds based on the regulatory classification is 44% across European domiciles at the end of 2021<sup>16</sup>, it is only 16% based on Morningstar's approach. Also, the share of Article 9 funds in net assets of all Article 8 and 9 funds is about 11% (or 5% in net assets of all funds that were reviewed) – higher than the 8% share of impact funds' assets in all sustainable funds' assets (or 1% in total net assets of all funds) following Morningstar's assessment. If the underlying criteria for the qualification as Article 8 or 9 funds were similar to those set by Morningstar, the shares should be more or less equal. One would particularly expect impact funds to qualify as Article 9 funds, which would result in similar respective shares in total net assets.

<sup>16</sup> This is based on the assumption that the share of 44% observed in the universe reviewed so far does not materially change if the total net assets of EUR 12.3 trillion domiciled in Europe are considered.

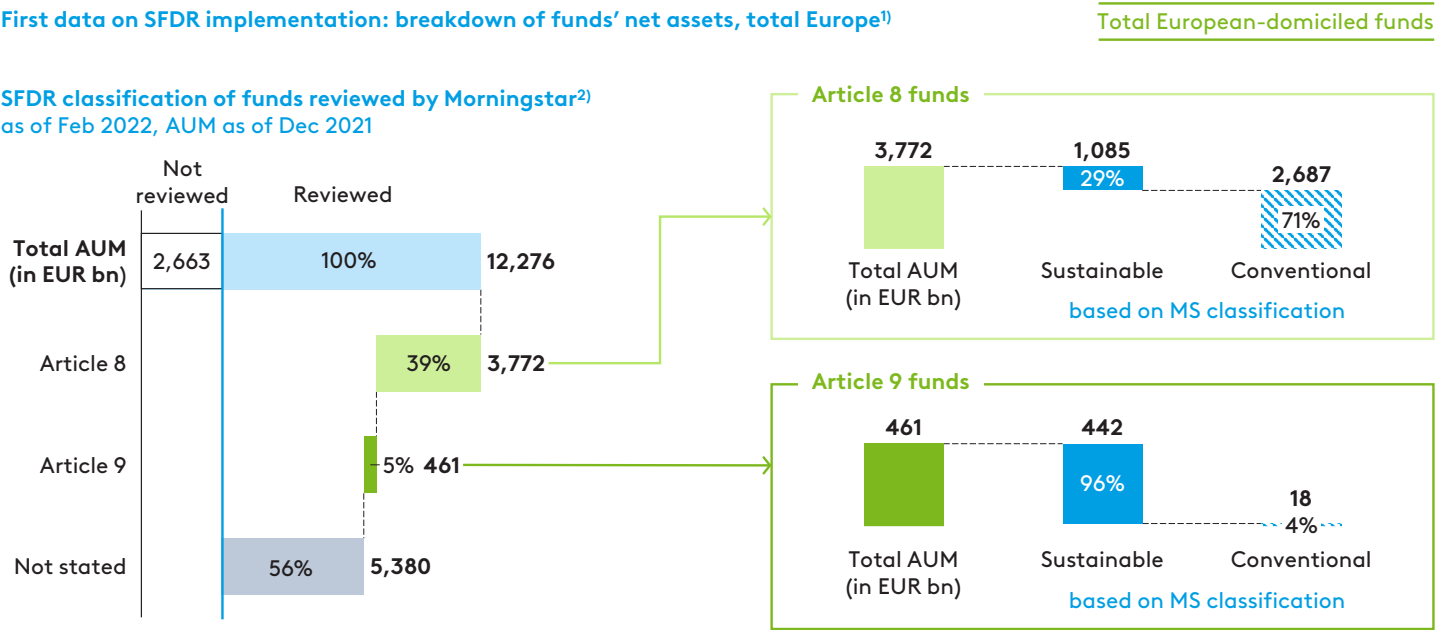
As pointed out earlier, however, the definition of sustainability used in this study is of a much more conservative nature. To qualify as sustainable, an investment strategy is required to include sustainability as a central and binding feature – rather than just employing exclusions of certain sectors or practices, which can be found in most investment guidelines nowadays anyway.

Figure 19 shows the shares of Article 8 and 9 funds' net assets in the total net assets that have been reviewed by Morningstar by February 2022 and the match of the respective net assets with the classification used by Morningstar. As expected, almost all of the Article 9 funds are also considered sustainable by Morningstar. However, looking at the net assets of funds whose providers categorized as Article 8 funds, only 29% are also classified as sustainable by Morningstar. This huge gap shows the stringent approach used by Morningstar and points to the confusion and different interpretation of the criteria defined by the regulators for qualifying a fund as an Article 8 fund.

It is also important to understand that the objective of the regulator was not to establish a differentiated classification scheme for sustainable funds, but to define disclosure requirements for fund providers dependent on the character of the funds' strategy.

Figure 20 looks at these differences from another angle: it shows the net assets of funds that are classified as sustainable based on Morningstar's methodology, differentiated into impact funds and other sustainable funds, and analyzes the corresponding SFDR classification. Only funds domiciled in Luxembourg are considered here as the coverage of funds reviewed with regard to SFDR is particularly high compared to other domiciles. Obviously, one would expect the net assets of impact funds to be highly correlated with net assets classified as Article 9 funds as opposed to the rest of the sustainability strategy spectrum, namely ESG funds, which should rather have a high proportion of Article 8 funds.

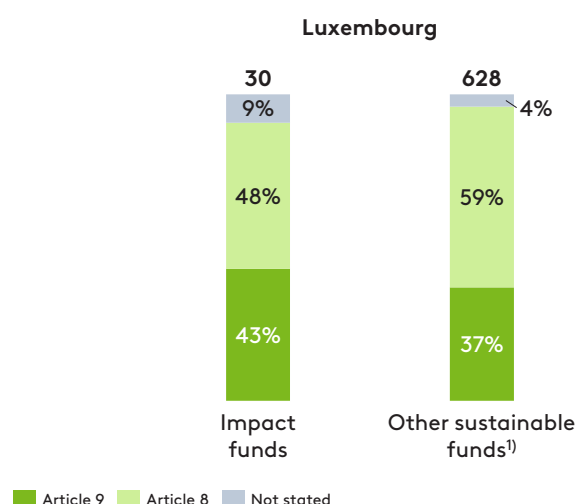
Figure 19: Breakdown of SFDR classification according to Morningstar



<sup>1)</sup> EU27 and Switzerland, Norway, UK, Liechtenstein <sup>2)</sup> Morningstar's assessment of fund managers' declarations on Article 8/Article 9 funds as of December 2021  
Source: Morningstar Direct, zeb analyses. Excluding money market funds, closed end funds, funds of funds and feeder funds.

**Figure 20: Article 8/Article 9 funds distribution by net assets, split by ESG categorization**

Article 8/9 funds by net assets per ESG categorization  
EOY 2021 in EUR bn



<sup>1)</sup> Including funds with ESG or environmental focus or funds that combine impact objectives with other ESG or environmental factors  
Source: Morningstar Direct, zeb analyses. Excluding money market funds, closed end funds, funds of funds and feeder funds.  
Coverage of approx. 88% of funds domiciled in Luxembourg, as of Feb 28, 2022

However, only 43% of the net assets in the impact funds sector are classified as Article 9 funds whereas 48% are classified as Article 8 funds by their asset managers. A fraction of 9% are not even assigned as Article 8 or 9 funds at all. Even more striking is the significant 37% share of Article 9 funds' net assets among the other sustainable funds.<sup>17</sup>

These observations can be caused by several factors:

- Different definitions of what constitutes an ESG fund (light exclusions and ESG integration may not meet Morningstar's criteria for setting a sustainable attribute, but could be enough for the fund manager to state the fund as being Article 8)
- Vague language in fund documentation
- Timing – many groups have updated their funds prospectus language to either clarify, remove or add references to ESG which takes time to be reviewed

- Diverse policies of asset managers, ranging from setting ambitious targets to aligning their entire product spectrum to a restrictive placement of only dedicated sustainable sector funds
- Different interpretations of the criteria defined in SFDR of what qualifies as sustainable in a regulatory sense especially regarding Article 8 funds

For these reasons it is possible that some self-declared Article 8 funds are not classified as sustainable investments by Morningstar or that a fund may be considered as an impact fund by Morningstar, but the asset manager did not declare it as an Article 9 fund. The various interpretations of the regulation have resulted in a diverse group of funds represented by Article 8 with completely different ambition levels and heterogeneous investment strategies.

<sup>17)</sup> This can partly be attributed to the fact that for the purpose of this study impact funds are only classified as such if the attributes "sustainable" and "impact" are flagged but not if their strategy is mixed with other approaches. Those funds that combine different strategies may therefore also qualify as impact funds and Article 9 funds, respectively.

# We should align the processes of taxonomies across the world



## Interview with Julie Becker, CEO, Luxembourg Stock Exchange



[bourse.lu/green](https://bourse.lu/green)

**There is currently a multitude of green taxonomies across the world – what can be done to bring them together and why is this important?**

The lack of standardization of the underlying methodology of different taxonomies is likely to lead to fragmentation in the market. Different taxonomies create confusion among investors and complicate the investment decision process, and the lack of harmonization also requires more efforts from issuers. We have seen examples of issuers that declare alignment with four different taxonomies or standards when issuing a sustainable bond, each requiring an in-depth analysis, which again multiplies costs and resources.

In my view, we should focus on reaching alignment on the process across taxonomies, including screening criteria, minimum social safeguards and the Do No Significant Harm principle, and not necessarily try to reach full agreement on specific KPIs or thresholds.

In terms of harmonization, the work done by the International Platform on Sustainable Finance on its Common Ground Taxonomy is essential and can help improve the comparability and interoperability of taxonomies across different jurisdictions.

## How can funds investing in fixed-income instruments calculate their alignment with the EU taxonomy and report on their sustainable investments?

Calculating and reporting on the alignment with the EU taxonomy is a real challenge for many market participants. Funds investing in equity or in plain vanilla bonds will focus on the taxonomy alignment of the corporates and may be able to partially obtain these figures in 2023 only. However, when it comes to Green, Social or Sustainability (GSS) bonds, it is ideally the alignment of the Use of Proceeds that should be screened and assessed against the EU Taxonomy.

Measuring concrete reductions in carbon emissions and properly reporting on the environmental impact of the projects financed by the GSS bonds require granular data, which may be available in the post-issuance reporting of the bonds, but not in a structured and comparable form.

This is what led us to build the LGX DataHub, a unique centralized database providing structured sustainability data on more than 6,000 listed sustainable bonds. It provides investors and asset managers with the data they need to make informed investment decisions and report on the social and environmental impact of these investments.

## What tools are available for retail investors to verify that their investments are truly sustainable?

Just as consumers are becoming more conscious of their choices, investors are also increasingly considering the sustainability angle before investing in a product.

There are certain tools available to guide investors in this respect, such as internationally recognized sustainability labels, standards and ESG ratings, although further transparency is needed on the methodologies behind those tools. However, there is no single tool that retail investors can use to verify the green or social credentials of their investment, and this is why financial literacy and sustainable finance knowledge are key.

To fully understand what the concrete impact of their investment is, investors need to analyze different documents, gather data from different sources and gain a deep understanding of what different standards and labels represent.

Investors have a responsibility to inform themselves not just about the product they are investing in, but also about the ESG profile of the issuer or the entity itself. The financial industry should focus on making that process easier and give investors the means, notably via financial and sustainability education, to better master these tools.

**“Investors have to inform themselves about the ESG profile of the company they are investing in. The financial industry should make this process easier.”**



## Taxonomy Regulation

In 2021, the EU released the first set of technical screening criteria to define activities that contribute to two of the environmental objectives of the EU Taxonomy: climate change mitigation and climate change adaptation. However, in February 2022, the European Commission approved a draft Complementary Climate Delegated Act stating that specific nuclear and gas energy activities could be considered as sustainable and are in line with the EU Taxonomy, as they help accelerate the shift from fossil fuels towards carbon neutrality. Many concerns were expressed about this decision.

The second delegated act for the remaining four environmental goals – protection and restoration of biodiversity and ecosystems, sustainable use and protection of marine water resources, transition to a circular economy and pollution prevention and control – is expected to be released in the second quarter of 2022. In July 2022, the European Commission will report on the status of the Taxonomy Regulation application, and from January 2023, the disclosure of the remaining four environmental objectives will be mandatory for companies.

Beyond that, further work on a social taxonomy is expected. In February 2022, the Platform on Sustainable Finance published its final report on a social taxonomy. Within their report, three social objectives addressing different groups of stakeholders such as workers, consumers and communities are suggested, as economic activities affect different stakeholders:

1. Decent work (for own workforce) including for value-chain workers
2. Adequate living standards and well-being for end-users
3. Inclusive and sustainable communities and societies

Further sub-objectives include health and safety, healthcare, housing, wages, non-discrimination, consumer health and communities' livelihoods. The "Do no significant harm" principle is also included in this taxonomy.

Furthermore, the report specifies the relation between the social and the environmental taxonomy. Most economic activities inherently cause greenhouse gases, but at the same time these activities can be described as social by creating jobs or by producing social goods. Therefore, the Platform suggests that social and governance-related minimum safeguards are part of the environmental taxonomy and minimum environmental safeguards should be part of the social one.

The proposed structure of the Social Taxonomy corresponds to the Environmental Taxonomy. Screening criteria will be used to identify socially sustainable economic activities that contribute to at least one social objective of the EU Social Taxonomy, do not significantly harm any other social objective and are carried out – as already stated – in compliance with (social or environmental) minimum safeguards. Depending on the respective social objective, either the turnover or the capital expenditure and operating expenditure per socially sustainable economic activity are to be reported. Thus, the taxonomy will affect numerous legislative efforts such as the CSRD or the SFDR when it comes to disclosure obligations on the alignment of funded activities with social objectives.

It is expected that the Social Taxonomy will serve to direct investments towards funds focusing on the protection of human rights and on the social impact on the main stakeholder groups of employees, customers and communities.

## Further initiatives

Having entered into force on January 3, 2018, MiFID is a legislative framework that intends to strengthen investor protection and improve the functioning of financial markets. In 2021, some key ESG-related changes to MiFID II were finalized, which will come into force on August 2, 2022.

These include the incorporation of ESG considerations in organizational requirements and risk management processes, the integration of sustainability preferences of clients into the suitability assessment of products, and the identification of conflicts of interests, considering potential damages to investors' sustainability preferences.

From August 2022 onwards, investment advisors and portfolio managers are required to include sustainability preferences in reports on the suitability of products provided to clients, to show that sustainability factors are understood. This requires respective policies and the consideration of sustainability risks and factors in risk management, internal reporting, organizational structures and decision-making processes.

Beyond that, from November 22, 2022 onwards, MiFID II firms will have to integrate sustainability factors in product governance. As a result, product governance arrangements must include sustainability-related objectives, and sustainability factors need to be presented transparently. Consequently, asset managers need to ensure that their product offering conforms to MiFID requirements so that they can be sold to retail clients by their sales partners.

As the Non-Financial Reporting Directive (NFRD) is not suitable to serve as a basis for all information required by the SFDR and the EU Taxonomy, the Corporate Sustainability Reporting Directive (CSRD) was proposed by the EC on April 21, 2021.

This Directive requires companies to provide the information necessary to underpin the reporting and disclosure obligations under the SFDR and EU Taxonomy. They must report on how sustainability issues affect their performance, position and development and on their impact on people and environment. The scope of companies affected by the CSRD has been extended to all listed companies on the EU-regulated market and large companies that exceed two of the following three criteria:

1. Total assets of EUR 20 million
2. Net turnover of EUR 40 million
3. 250 employees

Approximately 50,000 companies in the EU are therefore in scope. SMEs and listed companies are given three years to comply. The new reporting standard will be defined by the end of 2022. Companies should be able to apply the new standard for the financial year 2023 and publish financial reports integrating non-financial information in 2024.

As part of the renewed sustainable finance strategy, the EC unveiled its proposal for a EU Green Bonds Standard (EUGBS). Once the proposal for the EUGBS has been adopted, it will set a voluntary "gold" standard benchmark for issuers of green bonds at EU level. This proposed standard can be useful for both issuers and investors, as the regulation intends to create a universal and credible approach for the process of issuing green bonds. On the one hand, investors benefit from a high degree of transparency. For instance, the proposal asks for third parties to ensure compliance with the regulation and taxonomy alignment of the funded projects. On the other hand, issuers face reputational benefits as their financing of activities goes hand in hand with public and social opinions.

## ESMA Sustainable Finance Roadmap 2022–2024

Published by the European Securities and Markets Authority (ESMA) on February 10, 2022, the “Sustainable Finance Roadmap 2022–2024”<sup>18</sup> is a tool in which ESMA’s priority work areas and its respective deliverables on sustainable finance are set out. The Roadmap intends to provide more transparency on supervisory work regarding sustainable finance and how this work will be implemented until 2024. On its own, the EU markets watchdog describes the Roadmap as a “tool to ensure the coordinated implementation of ESMA’s broad sustainable finance mandate for the period 2022–2024”.

Within this Roadmap, three priority areas are defined for ESMA’s sustainable finance work:

1. Tackling greenwashing and promoting transparency
2. Building NCAs’ (National Competent Authorities) and ESMA’s capacities
3. Monitoring, assessing and analyzing ESG markets and risks

As shown in this study, money flowing into funds advertised as sustainable has grown rapidly. This evolution risks mis-selling in financial products by greenwashing practices. Greenwashing is the process of putting up a façade of sustainability for investment funds while continuing to engage in activities which, for instance, generate greenhouse gases. This is quite a complex process and takes various forms. As a result, such practices can reduce credibility and trust in sustainable investments.

As sustainable finance has reached the mainstream in recent years and in order to understand and address the supervisory implications of new legislation and market practices such as greenwashing, the second anchor point of the Roadmap aims to further acquire new skills beyond traditional areas of focus. Based on this, ESMA intends to build an advanced and efficient supervision on a national and international basis.

By monitoring, assessing and analyzing ESG markets and risks, the watchdog will focus on building its data analytics capabilities in order to foster the supervision provided by itself and by NCAs.

ESMA’s Sustainable Finance Roadmap for 2022–2024 is a response to current problems in the European regulatory landscape. As mentioned, legislative efforts such as SFDR are associated with timing issues and differing interpretations. ESMA itself admits that the current status of sustainability reporting will still be “sub-optimal” for some years to come. The rapidly evolving sustainable investment funds market and the respective complexity of greenwashing practices require the watchdog to enhance its supervisory work regarding ESG-related topics. The Roadmap seems to be a step in the right direction.

<sup>18</sup>) Sustainable Finance Roadmap 2022–2024 (europa.eu)

# Global context – Europe as a forerunner in sustainability

The previous chapters focused exclusively on the development of sustainable funds within Europe, which is mainly driven by regulatory initiatives. Indeed, the EU Commission and its supervisory bodies are leading the race of regulation, having laid the foundations for a sustainable future with a large tool kit of disclosures, reporting and classification frameworks, to name but a few.

Other regions around the world, namely the United States and Asia, have set none to only few, less stringent requirements on sustainable investing. What concerns market players most is the confusion of different requirements around the world that do not set the same standards. A US asset management firm needs to comply with European standards in order to market its funds in the EU, while the same standards may not be used or understood in the US. In this respect, EU disclosure requirements do not only apply to the EU, but to every market participant wanting access to the EU markets.

The fact is, just as regulation, global warming is an issue that concerns the entire globe, from small to large countries, from heavy to low polluters, from western to eastern regions. Taking this into consideration, a look beyond the borders of the European Union is necessary to understand the global dynamics around sustainable assets and to assess the current progress of Europe compared to other regions. Moreover, considering the weight and power of the United States and Asia in financial markets and the world economy in general, their developments in sustainable assets cannot be neglected.

Figure 21 illustrates the global development of sustainable fund markets. The total volume of sustainable assets has grown significantly at 62% p.a. during the last three years to a level of roughly EUR 2.4 trillion. A closer look confirms that Europe is leading the way when it comes to sustainable assets with an impressive market share of 83%. Both the US and Asia lag far behind with a market share of only 13% and 4% respectively. Strikingly, the market shares of each region have stayed relatively constant during this growth phase. This means that even if Europe has seen huge developments in sustainable assets in the last three years, the US and Asia were able to keep up and secured their market share. However, the market share of sustainable assets gives no indication of the progress that has been made so far in transferring funds from conventional to sustainable assets in order to make progress towards a greener future.

# The EU is more open towards regulation



## Interview with Eric Pan, CEO, ICI

 [ici.org](https://ici.org)

**What are the key differences between the US and EU approaches to sustainability in general? Will the US eventually look beyond climate change to broader sustainability goals?**

Differences in the US and EU approaches can be attributed to differences in regulatory systems, legal frameworks and historic approaches to capital markets regulation. The legal mandate of the US Securities and Exchange Commission (SEC) is to protect investors and facilitate capital formation, and any move to incorporate climate risk and human capital considerations must be connected to this mandate. ICI believes that promoting climate risk disclosure is consistent with the SEC mandate, noting that investors need consistent, comparable and reliable information on climate-related risks that could impact their

investments. But that focus on disclosure requirements is also consistent with the SEC's historic approach that the market ultimately decides how best to allocate capital. In contrast, the EU is much more overt in using regulation to drive the capital markets to fund the net zero transition. Thus, EU initiatives such as a sustainable finance taxonomy, stress testing and capital requirements are quite novel in the United States.



**The US SEC recently proposed a comprehensive disclosure framework for climate-related information. How does the US proposal compare to the EU reporting regime, including the Taxonomy Regulation and the Corporate Sustainability Reporting Directive?**

The SEC's regulatory proposals avoid a mistake that we feel has been a flaw in the EU reporting regime, which is that asset managers have been required to disclose climate information about their investments before the companies they invest in have had to report such information. US policymakers also have not attempted and likely will not attempt to create a taxonomy to define what it means to be "sustainable". Instead, the SEC's focus is on standardized disclosure of climate risks to allow investors to make informed investment and capital allocation decisions.

The EU is focused on the impacts of companies' activities on external environmental factors. Despite these differences, we do believe there is potential common ground for both jurisdictions to support the global baseline for corporate disclosure reporting, which is being developed by the ISSB, and we call on the US and EU to find this common ground.

**Are there differences in how regulators are approaching concerns of greenwashing? Given that regulators are working at differing speeds to address these concerns, what can funds do to ensure that fund investors understand the sustainability characteristics of investment products?**

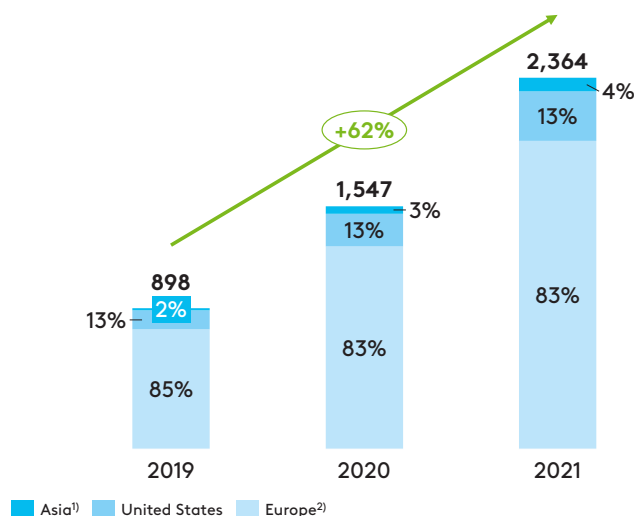
The pursuit of sustainability requires an economy-wide approach to achieve net zero goals: that means that the simplistic solutions you may hear touted by some – like divestment from certain industries – are not a tenable or desirable approach. Investing in companies across all sectors that are effectively transitioning to net zero emissions is part of the solution and is not greenwashing. A "golden rule" for fund managers is to do what you say and say what you do. The SEC has made sustainability claims a key component of its annual exam process to enforce this golden rule. This is the right approach. EU policymakers are considering minimum standards for funds that hold themselves out as sustainable.

ICI cautions against imposing minimum standards that attempt to create an arbitrary hierarchy of sustainable products rather than providing transparency for investors to make an informed investment choice. Only by empowering investors to make informed choices will the market evolve to meet investor demand for sustainable investing. We welcome the fact that US and EU regulators require all funds, including sustainability-themed funds, to describe their investment goals and how they plan to achieve those goals. Funds should ensure that this information is clearly articulated and presented to investors using such funds.

**"A 'golden rule' for fund managers is to do what you say and say what you do."**

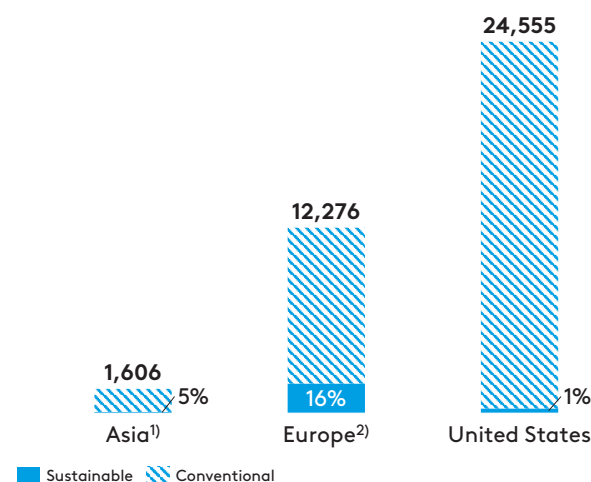
**Figure 21: International breakdown of net assets, split by region**

Net assets of sustainable funds by region  
EOY in EUR bn



Source: Morningstar, zeb analyses. Excluding money market funds, closed end funds, funds of funds and feeder funds.

Net assets by region  
EOY 2021 in EUR bn



Looking at the low shares of sustainable assets in total assets in the US (1%) and Asia (5%), it becomes clear that sustainable investing is still a niche in these markets, indicating low interest among investors and arguably low knowledge and transparency among the entire population about the specifics of sustainable investments. This contrasts with the corresponding share of 16% in Europe, confirming its leading position in sustainable investing with a comfortable lead on the US and Asia. Although remarkable progress has been made in Europe in transferring funds to sustainable funds, a share of less than 20% indicates that even here there is still a long way to go in order to become the new standard for investing.

Beside cultural and other differences between the regions, one reason for the significant gap between Europe on the one hand and the US and Asia on the other could be the lack of or later application of regulatory frameworks and standardized classification systems as seen in Europe, making it more difficult for investors to identify a fund as sustainable or not. However, while a lack of regulatory requirements is certainly a huge roadblock for investors and market participants when it comes to investing in sustainable assets, it is certainly not the only one.

### Closing the gap: What are the roadblocks in the US and Asia?

According to a survey conducted by Schroders<sup>19</sup> in 2020, the interest in sustainability does not seem to be the issue in the US. Indeed, 60% of Americans stated that they wanted financial market participants to consider sustainability factors, while only 15% said that they were actually investing in sustainable products. A factor that is certainly playing a big role in the US is politics. Under the Trump administration, the notion of sustainability and climate change was buried from the beginning of his mandate with the promise of booming economics thanks to coal and oil production. The exit of the US from the Paris Climate Accord, pursued by President Trump in 2017 (but only effective since the end of 2020), made investors, shareholders and the regulator put sustainability at the bottom of their agenda and focus on conventional topics. Pulling out of this agreement while being one of the world's largest polluters with roughly 15% of global greenhouse gases has certainly taken skepticism regarding the need for sustainability to an unprecedented high. The signature of President Biden in 2021 to re-enter the Climate Agreement is an important step towards a common global goal, even though the previous deviation may have led the US to losing significant ground in the race towards net zero.

19) Schroders Global Investor Study 2020 – Financial Professionals – Schroders

When it comes to Asia, the story is similar. First of all, just as the US, Asia has no ESG framework based on classifications or disclosures that allows for standardization and benchmarking in the markets. The most prominent strategies are simple, for example excluding certain sectors, but frequently no other consideration of ESG factors is made transparent to investors. Hong Kong and Singapore are leading the local race due to their international and foreign investor base, with mainland China following at a moderate pace. Asian institutional investors and mostly sovereign wealth funds have adopted the ESG trend early, but with low volumes, whereas retail investors can be considered as being in a discovery phase of this new type of investing. According to a survey conducted by Fidelity<sup>20</sup>, 70% of retail investors would consider investing in sustainable assets, but there is still a lack of awareness, a similar observation as the one made in the US. Interestingly, about 60% say that they face a lack of knowledge to understand the concept of sustainable investing and knowing which investments to select, something that can be tackled by standardized frameworks and transparency requirements.

The increasing volume of sustainable assets around the globe as seen in Figure 21, growing at a fast pace of more than 60% p.a. during the last three years, shows that important progress in the adoption of sustainable funds has been made. The difference in or absence of regulatory requirements is certainly one of the main blockers for an even faster adoption of sustainable investing. Therefore, regulators on a global level need to provide both standardized frameworks and comprehensive disclosure requirements so that market participants as well as retail investors can better understand sustainable products. Moreover, in the light of recent discoveries on greenwashed funds, a level playing field will drive transparency and fairness among market participants. This will enable investors to better manage their expectations regarding the performance and understand the real added value of their sustainable investment.

**“Europe is leading the way when it comes to sustainable investing – it remains to be seen whether the USA in particular will catch up as a result of the changed political circumstances.”**

**Fränk Hamélius,**  
Consultant, zeb, Munich



# Outlook

The negative effects of climate change were again visible in 2021 in the form of various natural disasters. The accompanying discussions, public engagement and political initiatives further raised the awareness of the compelling need for a more sustainable economy. The finance sector plays a significant role in the required transformation process of the economies. The progress of this transformation is, among other indicators, increasingly reflected in the growing demand for sustainable investments, especially in the European fund market. The implementation of the

complex patchwork of regulatory rules defined in the EU is in full swing, and new regulations have already been drafted. These provide more guidance for the interpretation of the rules but also encompass areas beyond environmental aspects that have not yet been addressed in detail, such as the integration and disclosure of social factors in investment strategies. It is therefore easy to conclude that we will see the trends identified in our study continue: Europe's fund industry stays on its way towards more sustainability.

**“The consequences of climate change were again clearly noticeable in 2021 – despite all the criticism about its role in detail, the financial sector will continue to play a key part in ensuring the transformation of the European industry towards greater sustainability.”**

Norman Karrer,  
Partner, zeb, Zurich





“Sustainable finance is at a crossroads. 2022 will lead to a moment of truth. While there is a genuine willingness of the asset management industry to meet the challenges of sustainable finance – and at the same time, retail and institutional investors alike are keen to direct fresh money towards sustainable activities – the reality is that, so far, funds which pursue one or several environmental objectives have not really been able to show their true credentials.

On a positive, forward-looking note, the puzzle is slowly but surely beginning to take shape. Companies are starting to report on the alignment of their activities with the Taxonomy Regulation, and for those that do not yet do so, reporting will be required from 2023 and 2024 onwards. Data vendors and asset managers are keen to obtain data from investee companies in a structured and efficient way. With the publication of the final draft regulatory technical standards by the European Commission in early April, there is now clear guidance on how the information contained in the funds’ offering documents and in annual reports should be presented to investors.”



**Marc-André Bechet,**  
Deputy Director General, Director  
Communications, Events and Business  
Development, ALFI

Other important fund markets, namely the US, are still lagging far behind, and their regulators follow different approaches in terms of setting up legal frameworks in line with a substantially different culture, making it complex for globally active fund providers to ensure regulatory compliance.

Meanwhile, after dealing with the impact of the pandemic, the markets are now also affected by the Ukraine conflict with all its disastrous consequences for the country and its people. Its long-term impact on the global economy and the financial markets is not yet fully foreseeable. In any case, the energy price hikes triggered by the war and the corresponding sanctions, combined with the discussion about securing energy supplies, have both negative and positive short- and medium-term effects on the objective to make the global economy a more sustainable marketplace in terms of environmental change and better social and corporate governance practices.

In the short term, the immediate impact of the war may push questions of sustainability into the background. For instance, citing the instability of the geo- and political situation, BaFin, the German financial regulator, most recently announced on May 3, 2022, that it would indefinitely postpone a planned guideline for sustainable investment funds, which, in addition to the SFDR and Taxonomy, contains regulations on the design of domestic sustainable retail funds.

To secure energy supplies in the short term, for example, more intensive recourse to non-sustainable energy is being discussed. In their search for returns, asset managers are ever more confronted with the trade-off between meeting sustainability requirements and the loss of opportunity when refraining from investing in often non-sustainable segments that promise high returns, e.g. due to the rise in energy prices, the shortage of raw materials or the demand for weapons. On the other hand, an acceleration of the shift away from traditional, unsustainable energy sources is to be expected in the long term as many countries try to reduce their dependence on fossil energy carriers and the supplying countries.

The market shares of the different domiciles in Europe have been remarkably stable in recent years with Luxembourg continuously functioning as the largest fund domicile in Europe both overall and for sustainable funds. With its outstanding fund expertise and ecosystem supporting the cross-border distribution of funds, its multilingual environment and central position in the heart of Europe, Luxembourg remains well positioned to further participate in the industry development and, more specifically, to contribute to making the world’s economy more sustainable.



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# Annex

## Definitions and methodology

In this report, the same definition of sustainable funds as in our previous report is used. Morningstar is continuously reviewing the fund universe by analyzing and reviewing legal filings and documents, identifying new ESG disclosures following the entry into application of SFDR in March 2021 as well as assigning attributes based on its own strict definition of sustainability. This may result in a fund as not being considered sustainable regardless of whether it lists ESG criteria to self-classify as promoting environmental and/or social characteristics under Article 8. Since this is an ongoing process, not all funds have been analyzed yet, and adjustments are likely over time as asset managers are revising their strategies and adding ESG-related disclosures in legal documents.

At the beginning of 2020, Morningstar introduced a stricter definition of what is considered a sustainable strategy. To qualify as a sustainable fund, ESG must be the core of its strategy. The application of this more stringent definition resulted in a significant number of reclassifications within the existing fund universe. About 600 funds with net assets of EUR 345 billion (~35% of all sustainable assets by the end of 2019) were reclassified from being sustainable to being conventional at the beginning of 2020 without having changed their strategy. In order to avoid drawing incorrect conclusions about developments from the results of the analysis solely due to methodological changes in the period under review, all funds that were recategorized from sustainable to conventional at the beginning of 2020 were also classified as conventional for the preceding years retrospectively.<sup>21</sup>

For the purpose of the study, the following methodological approaches have been applied:

Morningstar data point	Methodological remark
Domiciles in scope	All EU-27 countries, United Kingdom (excluding Channel Islands and Gibraltar), Switzerland, Liechtenstein and Norway
Investment funds in scope	Only open-end and exchange-traded funds, excluding feeder funds and funds of funds to avoid double counting of assets
Asset classes in scope	All, excluding money market (if not stated otherwise) which are analyzed separately
Assets under management/net new money	All values as of the respective year-end
Number of funds	Counts and sum of assets based on oldest share class only, to avoid double counting of assets
Obsolete funds	Merged funds excluded from analysis to avoid double counting of assets
Country of management	Approximation made by allocating the funds to the country of the global head office of the respective asset management company. In case of asset managers with multiple head offices, assets distributed across countries.
UCITS data point (Y/N)	In case of funds with no information on UCITS classification, funds considered as UCITS if fund flagged with “no” under Morningstar AIF data point
Sustainable investment overall (Y/N)	Funds with no information available for data point “sustainable investment overall” counted as conventional funds

21) Funds which were classified as sustainable in the past based on the less stringent definition but did not survive until 2021 were not subject of the recategorization exercise performed by Morningstar. Therefore, such funds were not detected and could not be reclassified accordingly. The effects are, however, insignificant since only a few sustainable funds were liquidated in 2020 and 2019.



## Analyzed data and data coverage

Feeder funds and funds of funds were excluded from the analyzed fund universe to avoid double counting of fund assets. The study includes regulated open-end funds only, and money market funds are treated separately. Therefore, on a total level, most of the figures do not match other statistics produced by ALFI, EFAMA, CSSF or national fund associations, which is particularly important if different domiciles are compared.

The main differences in figures, apart from the exclusion of the above-mentioned fund categories, result from the non-inclusion of certain categories of AIFs, which are captured in official statistics but not by the Morningstar database and for which no fund-specific sustainability-related information is available. One important category of these AIFs includes funds which are used by institutional investors to manage their assets rather than relying on discretionary mandates, often for accounting and tax-related reasons. This is, for example, the case for institutional investors in Germany, the Netherlands and Austria who mainly use AIFs to manage such assets. In contrast, institutional investors in France and the UK tend to rely on discretionary mandates. Since these kind of AIFs (in Germany and other markets referred to as Special Funds) as well as discretionary mandates are not subject of this study, no explicit conclusions are drawn regarding the institutional business and the sustainability investment levels (institutional share classes of UCITS and AIFs only cover a fraction of institutional investments).

The following Morningstar data points have been used for the purpose of the study. All counts are based solely on non-liquidated share classes of funds with the longest history. Extractions from the Morningstar database were performed in February 2022.

Morningstar data point	Data coverage information <sup>22</sup>
Fund domicile	Coverage of 100% of funds
Assets under management	Coverage of approx. 90% of funds
Net fund flows	Coverage of approx. 92% of funds
Active/passive strategy	Coverage of 100% of funds
Asset class	Coverage of approx. 99% of funds
Fund provider	Coverage of approx. 97% of net assets
UCITS flag (Y/N)	Coverage of approx. 95% of funds
Morningstar Sustainable Investment – Impact Fund (Y/N)	Coverage of approx. 83% of funds
SFDR Article 8/Article 9 flag	Coverage of 91% of funds in scope of SFDR, i.e. funds available for sale, at the end of 2021. This reflects approx. 88% of Luxembourg-domiciled funds and 67% for all European domiciles within the scope of this study.

<sup>22</sup>) Data coverage as per end of 2021. Percentages based on total fund universe in scope, i.e. excluding fund of funds, feeder funds and counting only the oldest share class.

## About zeb

**zeb** zeb is a leading European strategy and management consultancy specializing in the financial services sector with more than 1,000 employees in 11 countries and 15 offices throughout Europe. zeb has been offering strategy support and transformation expertise along the entire value chain in the financial services sector in Europe since 1992. With dedicated practice groups, zeb has a strong focus on asset management and capital markets, supporting clients in aligning and optimizing

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## About Morningstar, Inc.

**MORNINGSTAR**® Morningstar is a leading provider of independent investment research in North America, Europe, Australia and Asia. The company offers an extensive line of products and services for individual investors, financial advisors, asset managers, retirement plan providers and sponsors, and institutional investors in the debt and private capital markets.

Morningstar provides data and research insights on a wide range of investment offerings, including managed investment products, publicly listed companies, private capital markets, debt securities and real-time global market data. The company has operations in 29 countries.

Morningstar and its subsidiary Sustainalytics deliver a combined suite of ESG solutions to meet regulatory demands with a coherent and consistent approach at

the fund and company level. Sustainalytics is a global leader in ESG with over 25 years' experience in developing innovative ESG research solutions (in 2020, Sustainalytics was acquired by Morningstar). Several of its established, high-quality ESG products are already well aligned to the EU Taxonomy's criteria. The combined power of Sustainalytics and Morningstar accelerates their ability to provide meaningful ESG insights. Together, with Morningstar's scale and Sustainalytics' specialty expertise, they are able to develop ESG content, build ESG products and deliver ESG data specifically with the goal of empowering investor success at all levels.

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## About ALFI



The Association of the Luxembourg Fund Industry (ALFI) represents the face and voice of the Luxembourg asset management and investment fund community, championing sustainable investing, mainstream and private assets. ALFI's mission is to promote Luxembourg as the world's leading cross-border investment fund center, facilitate the transition towards more sustainable economies globally and empower investors to meet their goals. Created in 1988, the Association today represents over 1,500 Luxembourg-domiciled investment funds, asset management companies and a wide range of businesses that serve the sector. These include depositary banks,

fund administrators, transfer agents, distributors, legal firms, consultants, tax advisory firms, auditors and accountants as well as specialized IT and communication companies. Luxembourg is the largest fund domicile in Europe and a worldwide leader in cross-border distribution of funds. Luxembourg-domiciled investment funds are distributed in more than 70 countries around the world.

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