

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

Patchy data and a lack of direct comparability between products mean that financial advisers will struggle to fulfil their new obligations.

Morningstar Manager Research

28 July 2022

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

Boya Wang, PhD
ESG Analyst, Manager Research, EMEA
boya.wang@morningstar.com

Arthur Carabia
ESG Policy Research Director, EMEA
arthur.carabia@morningstar.com

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Executive Summary

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

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

As of 18 July, Morningstar collected EET data on 70,580 share classes, accounting for 43% of all share classes in scope of MiFID II. These represent 10,316 funds¹, including 4,297 Article 8 funds and 556 Article 9 funds. In this report, we share insights on the coverage and values of PAI consideration, sustainable investment exposure, and taxonomy alignment. We also discuss the challenges that we believe advisers will face to find suitable products for clients due to patchy data and a lack of direct comparability between products driven by the different approaches that asset managers are taking to calculate sustainable investment and taxonomy-alignment exposure.

Key Takeaways

- ▶ Asset managers have prioritised Article 8 and Article 9 products for the first phase of EET reporting. But the data is patchy. Less than half of surveyed Article 8 and Article 9 funds reported PAI consideration and sustainable investment exposure as defined by SFDR. Just over one fourth disclosed taxonomy alignment.
- ▶ As expected, Article 9 funds plan to hold more sustainable investments than Article 8 funds. Over half of Article 9 funds target allocations greater than 70%, but just 2.3% target allocations higher than 90% and close to 40% target less than 50%. About two thirds of Article 8 funds target a 0%-10% minimum exposure to sustainable investments, while 10% plan to have over 40%.
- ▶ Of the Article 8 and Article 9 products that reported taxonomy alignment, 90% provided 0% values. Only 2% target exposure higher than 10%.

¹ The number of funds and share classes estimated to be in scope of the EET is 38,330 and 143,179, respectively.


- ▶ Different interpretations of SFDR and the EU Taxonomy have led asset managers to adopt different approaches to the calculation of sustainable investment exposure and taxonomy alignment, rendering it impossible to compare products directly.
- ▶ Because of patchy data and a lack of direct comparability between products, financial advisers will struggle to fulfil their new obligations.

What Is the EET?

The European ESG Template is the FinDatEx data exchange template for ESG data, which was designed by industry representatives to "facilitate the necessary exchange of data between product manufacturer and distributor for the purpose of fulfilling ESG-related regulatory requirements contained in the SFDR, relevant provisions of the Taxonomy Regulation, and the relevant delegated acts complementing MiFID II and Insurance Distribution Directive."

From 1 June, asset managers distributing funds in the EU started to release the first version of the EET (EET "light") ahead of the introduction of MiFID II in August. The full template includes close to 580 data points, which Morningstar will be collecting over time from all asset managers filling in an EET.

Exhibit 1 EU ESG Template issued by FinDatEx

EUROPEAN ESG TEMPLATE - EET V1.0 - 2022 03 14								
								
NUM	DATA NAME	DEFINITION	CODIFICATION	COMMENT	Mandatory / Conditional from 1. Jan 2022 (Reg date 1. August 2021)	Mandatory / Optional / Conditional (Combines all regulations)	SFDR products periodic	
EET Data Set Information								
1	0000_EET_Version	This field specifies the output version of the template used in used by the recipient to understand the number of fields respecting their labeling and order.	Y1		M	M	M	
2	0000_EET_Producer_Name	If the Manufacturer/distributor have chosen to outsource the production of an EET pointing to another party responsible for the production and publication of the EET data set, each party name should be entered in this field.	Alphabetic	This field enables firms to report EET on behalf of an issuer/Manufacturer	O	O	O	
3	0000_EET_Producer_LEI	If the Manufacturer/distributor have chosen to outsource the production of an EET pointing to another party responsible for the production and publication of the EET data set, each party LEI should be entered in this field.	Alphabetic	This field enables firms to report EET on behalf of an issuer/Manufacturer	O	O	O	
4	0004_EET_Producer_Email	Contact entry point for distributors regarding EET	Alphabetic		O	O	O	
5	0000_EET_File_Generation_Date_and_Time	Date and Time of the creation of the EET file	YYYY-MM-DD Numeric ISO 8601 (UTC+0)	Universal Time zone	M	M	M	
6	0000_EET_Data_Reporting_SFDR_Prt_Contractual	Data points refer to column J	Y / N	These data points are spread across sections	M	M	M	
7	0000_EET_Data_Reporting_SFDR_Periodic	Data points refer to column I	Y / N	These data points are spread across sections	M	M	M	
8	0000_EET_Data_Reporting_SFDR_Entry_Level	Data points refer to column K	Y / N	These data points are spread across sections	M	M	M	
9	0000_EET_Data_Reporting_MFID	Data points refer to column L & N	Y / N	These data points are spread across sections	M	M	M	
10	0000_EET_Data_Reporting_IDO	Data points refer to column M & O	Y / N	These data points are spread across sections	M	M	M	
Manufacturer Information								
11	0000_Manufacturer_Name	Name of the Manufacturer	Alphabetic		M	M	M	
12	0010_Manufacturer_Code_Type	Codification used to determine the identification code, either LEI or None.	L / N	LEI codification should be provided if available.	M	M	M	
13	0020_Manufacturer_Code	Identification code of the Manufacturer	Alphabetic	Conditional to field 0010 is set to LEI	C	C	C	
14	0030_Manufacturer_Email	Contact entry point for distributors or contact	Alphabetic		O	O	O	
15	0040_General_References_Data	Date to which the general data refer	YYYY-MM-DD ISO 8601	All actions without specified date will be considered as fulfilled under the general reference date	M	M	M	
Manufacturer commitment to responsible investment								
16	1000_Manufacturer_PRL_OI_PRR_Signatory	Has the Manufacturer signed the Principle for Responsible Investment ?	Y / N	Consider PRR or equivalent organization for the banking strategy. Do we need to consider to consider the group or the asset manager itself ? This data point has been modified to	O	O	O	

Source: FinDatEx.

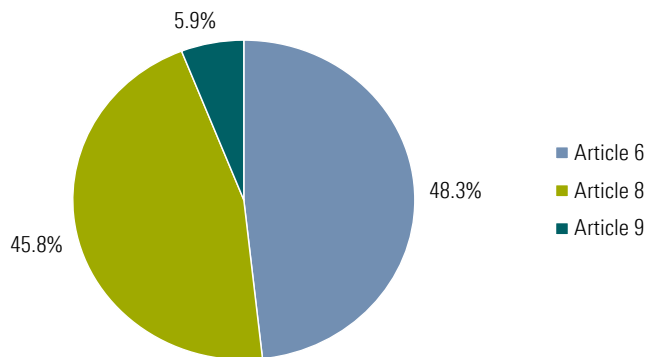
What's the Scope of This Report?

As of 18 July, Morningstar collected initial EET data on 70,580 share classes, accounting for 43% of all share classes in scope of MiFID II. These represent 10,316 funds offered by 207 asset managers and

include 4,297 funds classified as Article 8 and 556 as Article 9, representing about 46% of the total number of Article 8 and Article 9 funds in the Morningstar database³.

Exhibit 2 provides the breakdown of the surveyed funds by their reported SFDR product type.

Exhibit 2 Breakdown of Surveyed Funds by SFDR Product Type



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

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

Exhibit 3 lists the top 20 asset managers ranked by number of funds with EET data represented in our initial sample and their average coverage ratios for the mandatory fields.

³ As of 18 July, Morningstar had collected SFDR data types for 30,060 funds based on fund prospectuses, including 10,462 Article 8 and Article 9 funds.

Exhibit 3 Top 20 Managers Ranked by Number of Surveyed Funds

Manager Name	Number of Surveyed Funds	Average Coverage for Mandatory EET Fields
Amundi (incl. Lyxor)	1,219	67%
DWS (incl. Xtrackers)	512	71%
UBS	433	74%
Nordea	343	67%
Allianz Global Investors	325	62%
Hansainvest	288	72%
Goldman Sachs (incl. NN IP)	284	68%
Fidelity	265	63%
abrdn	260	62%
WisdomTree	257	71%
Credit Suisse	242	67%
Invesco	235	71%
AXA	194	76%
Franklin Templeton	192	71%
BNP Paribas	189	81%
JPMorgan	171	63%
Natixis	165	62%
Schroders	165	62%
State Street	165	67%
BlackRock (incl. iShares)	164	57%

Source: Morningstar Direct. Data as of 18 July 2022. The number of funds per manager (identified by branding name) is calculated using the 21 mandatory EET fields. We have included here only the funds with at least one mandatory field populated.

Data Analysis

In this section, we analyse the data collected from the 10,316 surveyed funds for three key EET fields required for the August deadline, as featured in the Morningstar Direct database:

- 1) **Principal Adverse Impact Consideration**, indicating if a product considers Principle Adverse Impact in its investments. Answers are "Yes" or "No".⁴
- 2) **EU Sustainable Finance Disclosure Regulation Minimum or Planned Investments Sustainable Investments**, representing the minimum percentage of portfolio investments that are deemed sustainable but are not taxonomy aligned. Answers are numerical values.⁵
- 3) **EU Sustainable Finance Disclosure Regulation Minimum or Planned Investments Sustainable Investments Taxonomy Aligned**, representing the minimum percentage of the portfolio that are aligned with the EU Taxonomy. Answers are numerical values.⁶

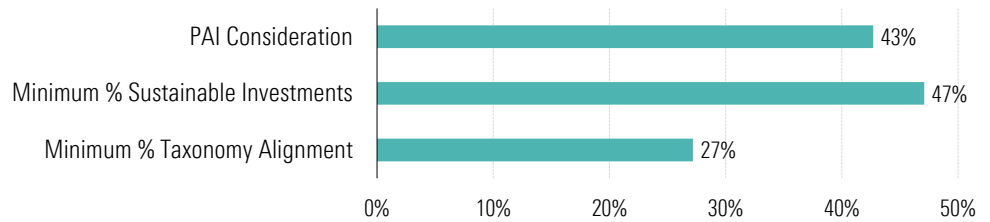
Exhibit 4 shows the coverage of these three fields for the 4,853 Article 8 and Article 9 funds included in this report.

⁴ EET Name: 20100_Financial_Instrument_Does_This_Product_Consider_Principle_Adverse_Impact_In_Their_Investment

⁵ EET Name: 20420_Financial_Instrument_EU_SFDR_Minimum_Or_Planned_Investments_Sustainable_Investments

⁶ EET Name: 20450_Financial_Instrument_EU_SFDR_Minimum_Or_Planned_Investments_Sustainable_Investments_Taxonomy_Aligned

Exhibit 4 Coverage of Key EET Datapoints for the Surveyed Article 8 and Article 9 Funds



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

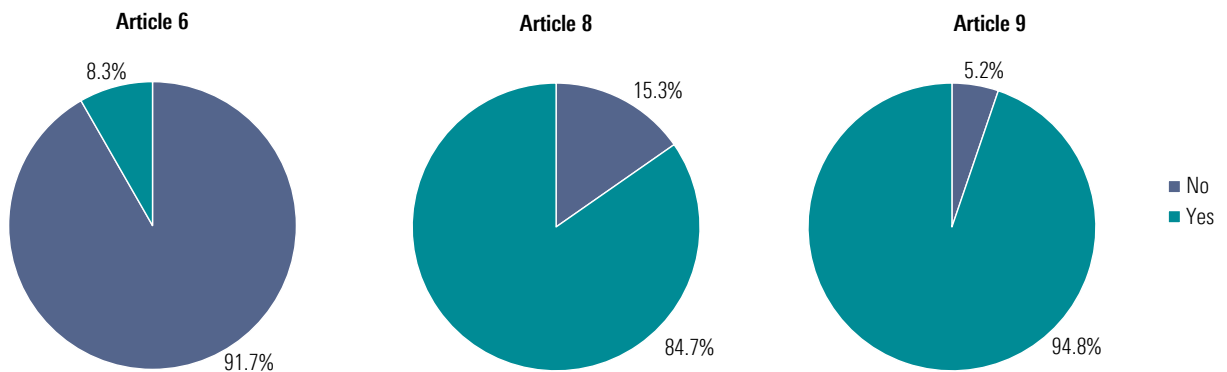
All Article 8 and Article 9 products are required to disclose whether or not they consider principal adverse impact indicators. Yet, as Exhibit 4 shows, only 43% of surveyed Article 8 and Article 9 funds populated the PAI consideration field.

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

PAI Consideration

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

Exhibit 5 SFDR Product Type and PAI Consideration



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

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

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

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

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

Exhibit 6 18 of the 64 PAI Indicators Under the EET

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

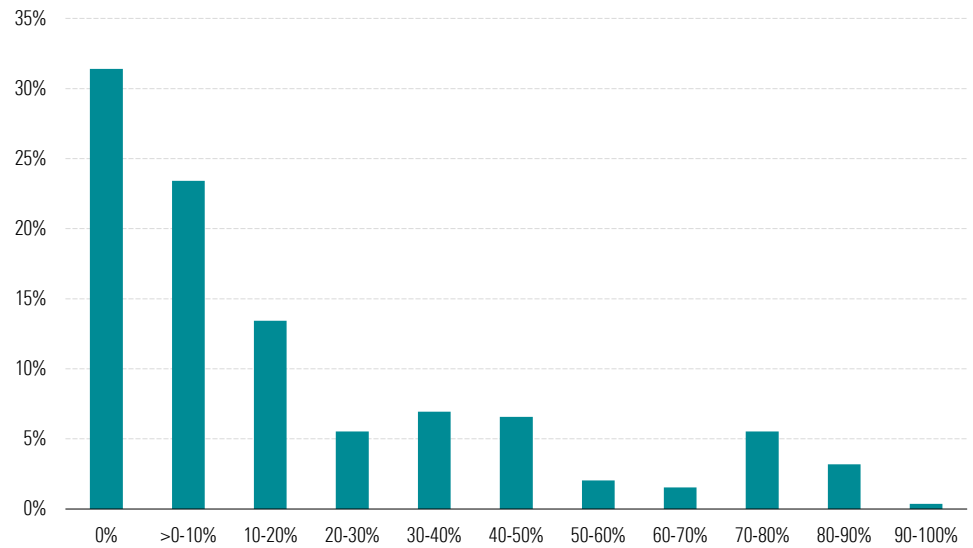
Source: SFDR delegated regulation-annex I.

Minimum Proportion of Sustainable Investments

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

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

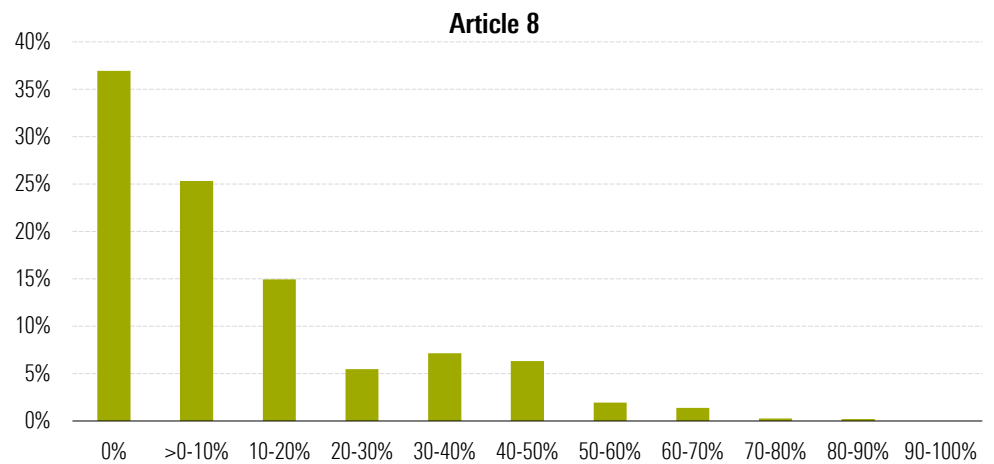
Exhibit 7 Distribution of Article 8 and Article 9 Funds (Combined) Based on Minimum % of Sustainable Investments



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

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

Exhibit 8 Minimum % of Sustainable Investments for Article 8 Funds



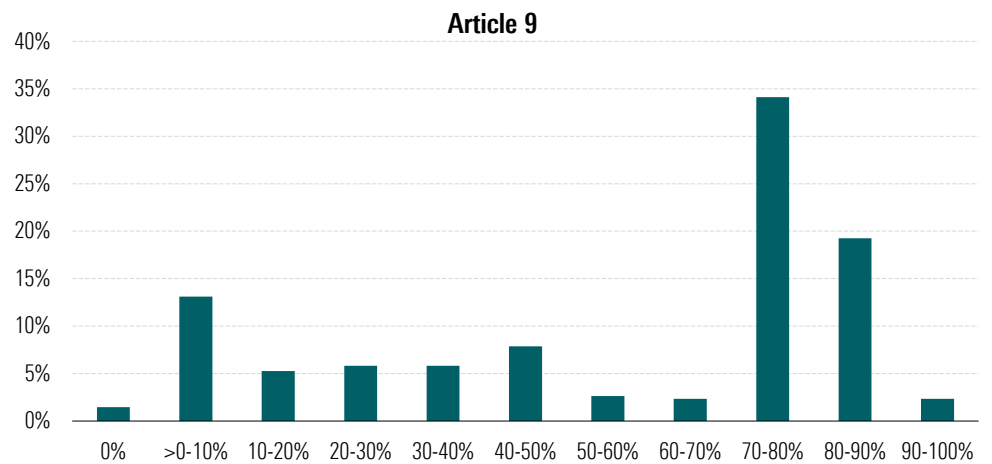
Source: Morningstar Direct. Data as of 18 July 2022. Based on 1,860 Article 8 funds that report the field.

As expected, Article 9 funds target higher exposure to sustainable investments than Article 8 funds, the distribution of former skewing on the right while that of latter skews on the left. The majority of Article 9

products (55.7%) plan to have more than 70% exposure to sustainable investments, while just 10% of Article 8 funds target more than 40% of sustainable investments and 62% target allocations between 0% and 10%.

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

Exhibit 9 Minimum % of Sustainable Investments for Article 9 Funds



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

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

Exhibit 10 Top 20 Article 8 Funds by Minimum or Planned Investments Sustainable Investments

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

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

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

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

Exhibit 11 Top 20 Article 9 Funds by Minimum or Planned Investments Sustainable Investments

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

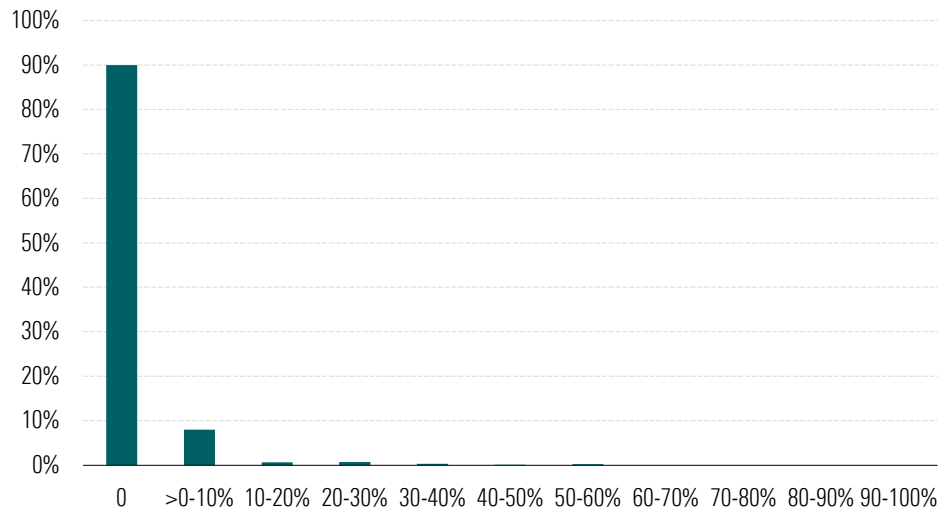
Source: Morningstar Direct. Data as of 18 July 2022. Based on 343 Article 9 funds that report the field.

Minimum Proportion of Taxonomy-Aligned Investments

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

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

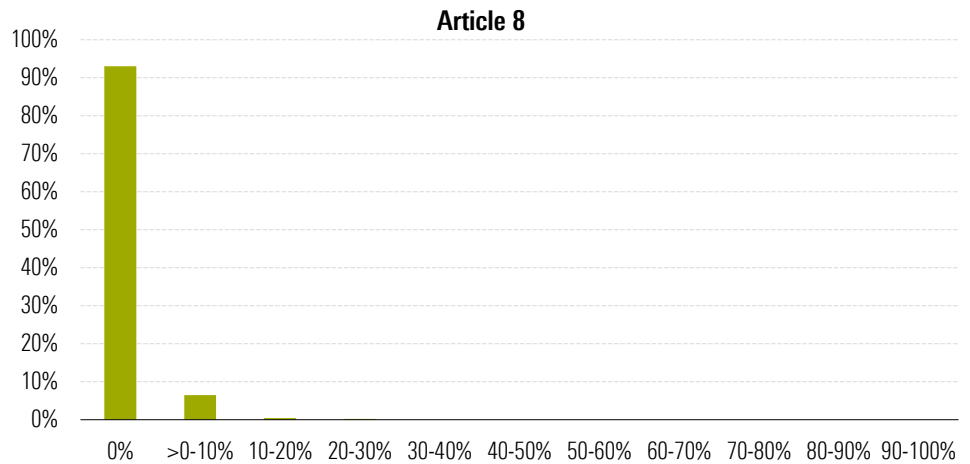
Exhibit 12 Distribution of Article 8 and Article 9 Funds (Combined) Based on Minimum or Planned Investments Sustainable Taxonomy Aligned



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

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

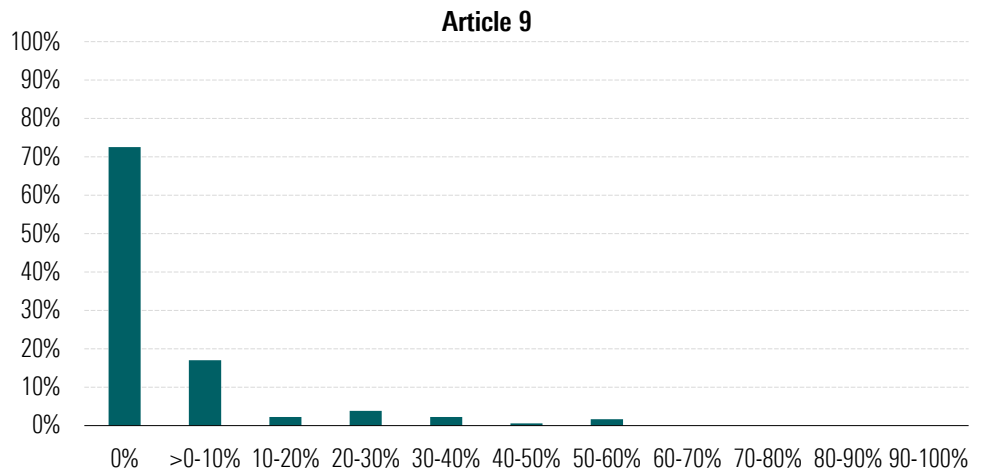
Exhibit 13 Minimum % of Taxonomy Aligned Sustainable Investments for Article 8 Funds



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

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

Exhibit 14 Minimum % of Taxonomy Aligned Sustainable Investments for Article 9 Funds



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

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

Exhibit 15 Top 20 Article 8 Funds by Minimum % of Taxonomy-Aligned Investments

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

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

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

Exhibit 16 Top 20 Article 9 Funds by Minimum % of Taxonomy-Aligned Investments

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

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

Different Approaches to Calculating Sustainable Investment Exposure

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

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

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

- ▶ An investment in **an economic activity that contributes to an environmental objective**, as measured, for example, by key resource efficiency indicators on the use of energy, renewable energy, raw materials, water and land, on the production of waste, and greenhouse gas emissions, or on its impact on biodiversity and the circular economy,
- ▶ Or an investment in **an economic activity that contributes to a social objective**, in particular an investment that contributes to tackling inequality or that fosters social cohesion, social integration

and labour relations, or an investment in human capital or economically or socially disadvantaged communities,

- ▶ Provided that **such investments do not significantly harm any of those objectives**,
- ▶ And [provided] that the investee **companies follow good governance practices**, in particular with respect to sound management structures, employee relations, remuneration of staff, and tax compliance.

The issue with this definition of "sustainable investment" is that it leaves too much room for interpretation, especially when it comes to the "do not significantly harm," or DNSH, condition.

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

Another aspect left to the discretion of managers relates to the way sustainable companies are counted in portfolios. While one firm might count the entirety of a sustainable company (beyond a certain level of revenue derived from sustainable activities), another might only count the proportion of revenue attributed to those activities. These two approaches, broadly referred to as revenue-weighted and pass-fail approaches (and highlighted in the exhibit below), would produce opposite results: high percentages of sustainable investments in the first case, and much lower levels in the latter case⁷.

Exhibit 17 The Two Main Approaches to Calculating "Sustainable Investment Proportion"

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

Source: Morningstar Research.

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

Different interpretations of the regulation have led asset managers to adopt different approaches to the calculation of sustainable investment exposure, rendering it impossible to compare competing products

⁷ For more detail on the benefits and limitations of these approaches, read this [blog](#).

directly. Products with similar mandates and portfolios will report divergent exposures to sustainable investments depending on the methodology chosen by their providers.

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

Exhibit 18 Minimum % of Sustainable Investments for 5 Funds Tracking Large-Cap Paris-Aligned Benchmarks

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

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

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

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

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

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

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

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

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