SFDR ARTICLE 9 FUNDS:
A MARKET OFF TO A ROUGH START

European Disclosure regulation opens up new frontiers in sustainable finance

Deliberate vagueness

in the choice of sustainable objectives and indicators for their attainment

P. 11

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Executive **summary**

The asset management industry has been grappling with significant challenges in implementing the Regulation on sustainability-related disclosures in the financial services sector (SFDR) since the March 2021 application date. This is due to unanswered questions on how the guiding principles (Level 1) should be interpreted and pitfalls in the regulatory technical standards (Level 2) specifying the disclosure obligations. As a result, the second half of 2022 has seen a wave of fund downgrades from Article 9 to the less stringent Article 8 classification.

Despite the lack of clarity in the official texts, the European Supervisory Authorities (ESAs) have released a series of Frequently Asked Questions to help navigate the difficulties and help facilitate implementation. National authorities are also active, with audits of compliance being conducted in both Sweden and the Netherlands.

Just a few short weeks from entry into force of the Level 2 obligations under the Regulation, confusion abounds. Implementation is hampered by limited guidance and competing interpretations of core concepts. There is some way to go for Article 9 funds to demonstrate their contribution to often unclear environmental and social objectives.

The market has been slow to formulate a robust objective, which, in large part, stems directly from the difficulty in interpreting the Regulation's definition of sustainable investment (Article 2(17)). The passage of time only brings more questions. And how to apply the definitions at granular holding level divides market participants.

As this research paper goes to print, only 19 out of a total of 195 funds in the panel had disclosed a minimum share of sustainable investments as per the definition in Article 2(17) – around 80% in general. Turning to the state of play under the Taxonomy Regulation, thus far, funds have only indicated the minimum proportion of Taxonomy-aligned investments (asset allocations according to stricter environmental criteria) when this allocation was expected to represent a minority share.

At this stage, the majority of indicators reported by funds to measure the attainment of their sustainable investment objectives are derived from the list of principal adverse impact (PAI) indicators. As the name suggests, these focus on reducing the main negative impacts of investments, rather than on demonstrating a positive contribution. Proprietary indicators, which aggregate contributions based on firms' convictions and ESG screening criteria come second. Many funds still only prepare disclosures based on generic ESG indicators. Adopting the templates in Annex III and V of the Regulation across the industry would constitute a significant qualitative step forward.

The principle of double materiality – a core concept in the Regulation – is dogged by semantic problems: what does "consideration" of principal adverse impacts mean in practice? Furthermore, as can be illustrated by some questionable fund holdings, the text currently does not impose specific tolerance thresholds.

The French market for funds claiming to have a sustainable investment approach is dominated by positive screening strategies, such as best-in-class. And so is the Article 9 fund market. Indicators derived from this approach are sometimes used to measure attainment of the objective, which raises questions about how relevant they are to the double materiality principle.

While fund managers are beginning to adopt the European Taxonomy, it has yet to fully replace existing analysis frameworks. 31 out of the 195 funds already disclose an estimated percentage of their portfolios' eligibility or alignment with the Taxonomy, topping out at 77% and 61%, respectively.

Apart from funds that measure performance against a European climate benchmark – the Paris-Aligned Benchmark (PAB) or Climate Transition Benchmark (CTB) –, Article 9 funds are still reluctant to specify a reference benchmark deemed aligned with their sustainable investment objective. PAB/CTB funds, whose portfolios can comprise of several hundred holdings, risk having to review their compliance approach when the European Commission comes out with its eagerly-awaited clarification on how to ensure compliance with Article 2(17).

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« A real challenge in terms of interpretation and **implementation** »

This is how Verena Ross, Chair of the European Securities and Markets Authority (ESMA) summarised the outlook for the sustainable funds market in her address to the European Parliament's Committee on Economic and Monetary Affairs. Despite significant achievements with regulation, there remains complexity on the sustainable finance market. "*Navigating through the many different products and offerings and understanding the differences in terms of sustainability remains extremely difficult*". To prevent trust in sustainable finance products being eroded by mis-sold ESG-labelled products, ESMA strives to provide recommendations and guidance to address some of the outstanding challenges. Certain critical challenges have yet to be resolved, as was clear from the issues raised in the FAQs on interpretation and application between the European supervisory authorities and the European Commission. The German financial regulator BaFin went as far as releasing FAQs with its own interpretation of the Commission's responses.

The first implementation stage (Level 1), mainly involved firms aligning with a number of the regulatory framework's guiding principles. For asset management firms, this meant publishing policies describing how sustainability risks and principal adverse impacts are informing investment decisions; for financial products, it entailed the introduction of the now well-known «Article 6, 8, or 9" fund nomenclature, based on a self-classification process by managers. However, this self-classification process means that asset managers are not necessarily applying the nomenclature like the legislator imagined it. Indeed, the trend in part of the market to use fund classification as a marketing pitch prompted the European Commission to remind market participants that SFDR "*is not a labelling regime*". At the same time, MiFID II has introduced new mechanisms for considering individual investors' sustainability preferences. These mechanisms pose a big commercial challenge for asset management firms fearful that their funds might not tick all the boxes on the new form, which could cause inflows to slow.

To bring SFDR further, a delegated Regulation with the final technical standards (RTS) regarding the transparency and disclosure obligations under SFDR comes into force on 1 January 2023. These RTS provide additional guidelines on the content, methodologies and presentation of disclosures through a set of principles known as Level 2 obligations. All of which provides the context for this study which delves into a panel of Article 9 funds managed in France using quantitative and qualitative analysis. By scrutinising funds which all have an extra-financial sustainable investment objective, which is, in theory, measurable, the study aims to capture the current breadth of diverse strategies and objectives and to highlight how far we still have to go to achieve compliance with the spirit and the letter of SFDR.

Study panel

Asset class	Number of funds	AuM (€bn)
Equity	143	60.8
Bonds	41	10.3
Diversified	11	1.1
Total	**195**	72.2

The study examines in granular detail a panel of 195 self-classified Article 9 funds under the Sustainable Finance Disclosure Regulation, all managed in France. 42 of these funds had already published some form of standard SFDR disclosure document. The panel was put together[1] using Morningstar Direct on 10 March 2022, i.e. one year after the main SFDR Level I obligations took effect. It initially comprised 217 funds; however between March and October[2] 2022, Novethic identified 22 funds that had been downgraded to the less restrictive Article 8 category. The majority of downgrades followed publication by the Commission of the practical details of SFDR Level 2 obligations. This study, conducted jointly with ADEME, the French environment agency, takes a deep dive into these Level 2 obligations. At the time of writing, it was common to find on the same web page documents classifying funds under two different SFDR articles.

1 See Methodology in the Annex.

2 Moreover, this panel does not reflect the wave of fund downgrades from Article 9 to Article 8 announced in November by some of the biggest European asset management firms.

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EDITORIALS

Anne-Catherine Husson-Traore, CEO, Novethic

Novethic has been working together with ADEME for a number of years to assess the promises made by the strictest sustainable funds. The hope is that these funds could help finance the transition to a greener economy. Zeroing in on funds classified as Article 9 under SFDR allows us to approach the research from a new angle and examine how asset managers are using the Regulation as it is taking shape. This study highlights the initial misunderstandings between industry professionals and regulators – confusion that does nothing to help the end client navigate the regulatory maze.

For asset management firms, the new Regulation and the technical standards due to take effect in January 2023 will standardise transparency by clearly setting out the regulator's requirements for sustainability objectives, the indicators to use and the share of assets allocated to sustainable investments. However, Novethic's comparison between these requirements and actual fund disclosures shows up certain discrepancies.

This explains why many asset managers have decided to prudently withdraw. As the 31 December 2022 deadline nears, the wave of reclassifications from Article 9 to Article 8 has swelled to a flood, no doubt also prompted by regulators rapping on knuckles in several countries. This sends the wrong message just a few weeks before another provision enters into force – the introduction of ESG questionnaires to assess client sustainability preferences, provided for in MiFID II. However, since self-classification of funds to either Article 8 or Article 9 came into effect, inflows to those opting for Article 9 classification have been much higher.

Mathieu Garnero, Project leader, ADEME

Ever since Novethic started working on green funds, it has addressed the thorny issue of whether financial products are a fit means to reach environmental objectives: their market share is small and there are no guarantees as to what they contribute. This, our sixth report, takes stock of what European regulations have contributed amid expectations that they would standardise practices for green and ESG fund disclosures, notably by creating a category of products whose objective is sustainable investment: the now well-known «Article 9 SFDR».
But, by sowing confusion for asset managers, supervisors and – ultimately – investors, this classification is failing in the role (which was not really its intended purpose) of establishing a new labelling framework for green and ESG funds and even for impact products.

We cannot ignore the need for an in-depth review of existing labels (SRI, Greenfin), while also hoping that the Ecolabel for financial products, which incorporates science-based criteria on the energy transition and investor impact, will be finalised.
Even more importantly, asset management firms will have to put their words into action. Doing nothing is no longer an option! Today, there is neither a divestment strategy nor a real shareholder engagement with investee companies, as consistently pointed out by both:

- the latest ACPR-AMF report: "*Shareholder engagement is frequently highlighted, [...] but, in contrast, the information disclosed by asset management firms reveals a low level of engagement*".
- the latest Carbon Disclosure Project (CDP) report on its science-based targets (SBTi) campaign, which was supported by only 27% of Glasgow Financial Alliance for Net Zero (GFANZ) asset managers and asset owners.

Without a concerted and energetic effort, it will be up to the regulator to quickly take over to transform the sector.

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A work in progress

Implementation of SFDR has stumbled upon a number of challenges since March 2021. There is still confusion around how to interpret the scope of certain key concepts of the regulatory framework (Level 1), while there are also pitfalls in the technical standards (Level 2) that specify the expected content of disclosures. These challenges largely stem directly from the definition of sustainable investment in the Regulation.

So what exactly does Article 2(17) mean?

Article 2(17) defines a sustainable investment under SFDR. The definition has generated intense debate. In the view of many market participants, it is too open to interpretation as currently phrased. But, this self-same definition is where Article 9 fund managers turn to specify the underlying environmental or social objectives of their funds and therefore to determine how they will evidence their contribution to achieving these targets.

Under Article 2(17) a sustainable investment means "*an investment in an economic activity that contributes to an environmental objective, as measured, for example, by key resource efficiency indicators [...] 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, [...] provided that such investments do not significantly harm any of those objectives and 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 reference to an economic activity suggests that a sustainable investment is defined at this level, by reference to the revenue generated by each particular activity, rather than in terms of a company as a whole.

Yet, the Do No Significant Harm (DNSH) principle refers to characteristics that cannot be differentiated by economic activity; instead it is related to companies' good governance practices (sound management structures, employee relations, remuneration of staff and tax compliance).

Eurosif, the European sustainable finance forum, has called for the definition to be either clarified or scrapped altogether. In a June 2022 report[3], Eurosif makes recommendations for the legislator. The report's authors are concerned that if the current Article 2(17) is not amended, "*we are left with a situation where each financial market participant, possibly with the help of data vendors, will have to decide which companies or bonds are considered to meet the definition*", with no guarantee of improving comparability between products. In Eurosif's words, management firms that have "*taken the most creative interpretation*" could be exposed to significant reputational risk and accusations of greenwashing, especially as the definition in Article 2(17), as it currently stands, is only moderately discriminating[4]. One such example is the methodology applied by an asset manager in the study panel with nine Article 9 funds: according to this methodology, 55% of CAC 40 securities pass the sustainable investment screening test. On a larger scale, Eurosif found that close to 5,000 different companies (10% of all listed companies worldwide) are held in 272 European Article 9 portfolios.

[3] «Making the framework fit for purpose. Eurosif Policy Recommendations for Article 8 & 9»

[4] Within the major stock market indices, data and software solutions provider Clarity AI estimates the share of companies that meet the Article 2(17) definition at 25% for the FTSE 100 , 31% for the MSCI ACWI, 37% for the S&P 500 and 40% of Euro Stoxx 50 companies. It obtained these metrics by screening company databases for three factors: contribution to the solution, no significant harm and good governance.

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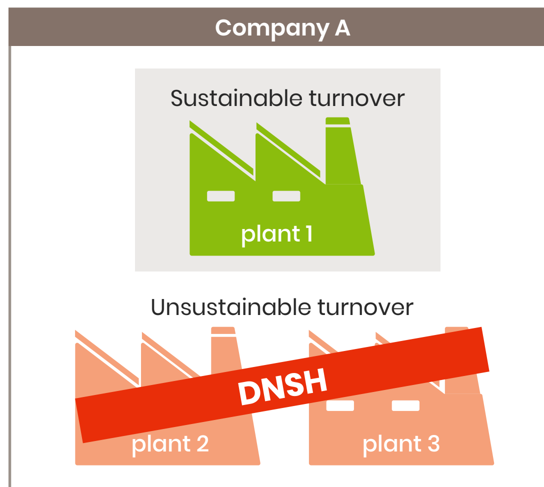
It is crucial to clarify this definition for two reasons. First, aside from certain specific exceptions, an Article 9 fund must only invest in assets that meet this definition[5]. Second, managers are expected[6] to interpret the definition in Article 2(17) uniformly across all their funds, including ETFs and funds of funds.

Take for example an Article 9 fund applying a definition under which compliance with the DNSH principle involves excluding fossil fuels. Then consider another of the same firm's funds that does not apply the same exclusions: the second fund would be hard pushed to claim that an oil major contributes to a portfolio's sustainable investment asset allocation by virtue of its investments in renewable energy production capacity.

Sustainable investment?



Where do we stand with supervision of SFDR roll-out?

Several official documents dealing with practical implementation of SFDR and how it aligns with the Taxonomy Regulation have been published since July 2021: two FAQs drafted by the European Commission and a Supervisory Statement prepared by the three European Supervisory Authorities (ESAs), the European Securities and Markets Authority (ESMA), the European Banking Authority (EBA) and the European Insurance and Occupational Pensions Authority (EIOPA). The ESAs also released clarification on the technical standards due to take effect in 2023, as well as a list of eight pending queries submitted to the Commission by the ESAs in September 2022 requesting a legal interpretation according to EU law. These are thorny questions on the definition of a sustainable investment under Article 2(17), Article 9 funds with reduction of carbon emissions as an objective, consideration of principal adverse impacts (PAIs) and periodic disclosure frequency.

Interpretation FAQs	**Application FAQs**
Queries related to interpretation of SFDR sent to the European Commission by the ESAs (Level I interpretation)	ESA responses to clarify Level 2 application (SFDR technical standards)
8 questions submitted in September 2022. Replies hoped for in Q1 2023	Most recent FAQs published on 17 November 2022

[5] Clarifications on the ESAs' draft RTS under SFDR (June 2022)
[6] Questions and answers (Q&A) on the SFDR Delegated Regulation (November 2022)

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In March 2020, the French financial markets authority (AMF) published its policy paper on the disclosures required from collective investment undertakings incorporating extra-financial approaches. The AMF requires that, "*considering the definitions and provisions in the Sustainable Finance Disclosure Regulation, the products described in Article 9 must adopt a significantly binding approach as defined in the policy*". The AMF policy specifies that fulfilling the criteria for this approach cannot be considered sufficient in itself to comply with Article 9 of SFDR. It also reserves the right to reassess the policy depending on the outcome of then-ongoing work on the regulatory technical standards applicable to SFDR, as adopted by the European Commission on 25 July 2022.

Europe-wide, several national supervisors also began issuing recommendations or clarifications regarding application of SFDR – in Belgium, Denmark and Ireland – acknowledged by ESMA in a Supervisory Briefing intended to encourage convergence (see below). The Dutch financial markets authority (AFM) conducted an exploratory study in 2021 covering 1,250 Article 8 & 9 funds and announced a further study in 2023 to check whether the funds it considered mis-classified had adjusted the classification. Sweden also carried out an audit of Article 9 funds in 2022.

The Swedish watchdog (FI) pointed to the lack of clarity in Article 9 fund disclosures

In 2022, Finansinspektionen, the Swedish supervisor, took a fine-tooth comb to the documentation of 30 funds self-classified as Article 9 by Swedish asset managers. It found[7] that SFDR sustainability disclosures were "*unclear and would need to be clearer and more precise so it is easier for an investor to understand and compare funds.*". While all the funds analysed stated they had sustainable investment as their objective, they did not all provide clear information regarding the social and environmental objectives which their investments contribute to or on how these objectives should be achieved. What's more, a portion of the sample buried the DNSH principle in its documentation, even though it is central to the definition in Article 2(17).

Based on published documents, Finansinspektionen also notes that the lack of clarity raises questions as to how managers assess whether an underlying asset is a sustainable investment. It further points out that some funds have securities in their portfolios "*where the assessment of being a sustainable investment could be questioned*". Only one-third of the sample stipulated a minimum percentage of sustainable investments, but it was not always possible to determine what definition these investments were required to satisfy. Given the differences in terminology and the many different concepts of sustainability used by asset managers, Finansinspektionen encourages them to work together to agree on how to fill in SFDR templates to make it easier for investors to understand the disclosures and compare funds.

ESMA provides tools to national supervisors

To ensure a degree of convergence in the supervision of so-called sustainable funds by national competent authorities (NCAs), in May 2022 ESMA issued a Supervisory Briefing[8] with a number of recommendations on common criteria. The Briefing covers supervision of fund documentation, marketing material, fund naming and incorporation of sustainability risks. National supervisors are asked to create a check-list based on the information to be provided in pre-contractual reports that will help to assess the compliance of fund disclosures under SFDR, Article 8 or 9. In ESMA's view, supervisors should see the repeated use of the same or similar standard text across different funds as a red flag. Supervisors should also check that sustainability objectives and disclosures are clearly identified. Boilerplate language such as "*the fund pursues general ESG objectives*" without further detail should be avoided and, in the case of environmental objectives, ESMA recommends referring to the Taxonomy Regulation as a way to clearly identify those objectives.

The Briefing is part of ESMA's 2022–2024 roadmap to guide its work with the Commission on formulating minimum criteria for Article 8 funds. It also includes a section entitled "*Regulatory interventions in case of breaches*", for instance when the portfolio of a fund self-classified as Article 9 does not align with the principles set out in the prospectus or when a material proportion of its investments do not comply with the definition in SFDR, Article 2(17).

[7] See Finansinspektionen's report on "Funds with sustainable investment as their objective"
[8] Sustainability risks and disclosures in the area of investment management (May 2022)

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Risk of confusion between Article 9 funds and Impact funds

The English version of the Regulation uses the term "positive impact" when referring to Article 9 funds as "*financial products which have as an objective a positive impact on the environment and society*". As a result, some market participants consider that there is a tacit equivalence between "impact" funds and "Article 9" funds. One example is the asset management firm that states in its fund documentation that "sub-funds using the word "impact" in their name are considered compliant with Article 9 of SFDR".

But several studies[9] have highlighted the confusion created by these marketing claims and point out that SFDR does not make the distinction between investee company impact and investor impact, the latter being defined as the positive change brought about in a company or in the real economy (for example by supporting growth in "impact" companies in inefficient financial markets), beyond what would have happened in any case (additionality). The other potential impact of investing in listed securities is through active shareholder engagement, including voting at AGMs to pass environmental or social-focused resolutions in laggard companies. However this type of action comes up against the definition of sustainable investment in Article 2(17), which, in theory, should guide the composition of portfolios of Article 9 funds.

The panel for this study comprised 23 funds with "impact" in the name, most of which also featured among the 38 funds that publish an impact report[10] separately from monthly reports, or Factsheets with extra-financial indicators. Besides one green bond fund explaining that the manager assesses the environmental additionality of each bond, a handful of reports are organised around the three core concepts:

- Intentionality (what is the intended positive impact of the investments);
- Measurability (what are their measurable benefits); and
- Additionality (what are the added benefits that would not have occurred without the investment).

But the case of German asset manager Deka was a wake-up call. Accused of greenwashing, it was forced to remove the impact calculator for sustainability funds from its website to avoid a lawsuit brought by the Baden-Württemberg consumer protection agency. This prompted other asset managers to insert a warning in their prospectuses or impact reports pointing out the limited scope of certain indicators. Wording found includes: "*investing in listed impact companies does not augment or strengthen this impact*" or "*investing in the fund does not generate a direct environmental or social impact*".

A July 2022 white paper by Eurosif and Hamburg University puts forward a new classification methodology for sustainable investments. The authors propose seeing "*impact-aligned investments*" and "*impact-generating investments*" as separate categories, based on four general characteristics not fully covered by the SFDR framework. Think tank 2° Investing Initiative has a similar message. It argues that Article 9 funds are basically funds that offer investors value-aligned products rather than investments that generate real impact.

[9] See "Fighting greenwashing … what do we really need?»" (2° Investing Initiative, July 2022) and the "Classification Scheme for Sustainable Investments" White Paper (Eurosif & University of Hamburg, July 2022)

[10] Sometimes also called a "positive contribution" report or "ESG performance" report

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More light cast on Article 9 funds by SFDR technical standards

Since a draft version of the planned templates to use for Article 8 and Article 9 funds was first published in February 2021, delays in the timeline for adoption and entry into force have piled up. The new mandatory templates were finally published in the Official Journal of the European Union on 25 July 2022. They form part of the SFDR regulatory technical standards (RTS), also known as Level 2 obligations. They specify the content and presentation of the disclosures on all points required by SFDR. All told, asset management firms will have had until 1 January 2023 to comply.

To get the measure of how prepared Article 9 funds are to meet their disclosure obligations in 2023, Novethic sifted through the documentation of all 195 funds in the panel. Findings are summarised in the tables that follow, according to the structure and headings in Annex III of the technical standards (pre-contractual disclosures).

Methodology

Novethic delved into the documentation published by the panel of 195 funds in the study. We identified 42 funds with a dedicated SFDR document or section, based on the SFDR templates. Some funds opted to use all or part of Annex III (pre-contractual disclosure) or Annex V (periodic disclosure) of the RTS. The majority based the disclosures on Article 10 of SFDR, which specifies what information asset managers should publish on their websites. Several of the headings in Article 10 are the same as in the Annex III template.
Two asset management firms were early adopters and included all or part of the Annex V template in their funds' 2021 annual reports. The majority opted for hybrid reporting during the interim period. Novethic identified headings referring to fund "legitimacy" under Article 9 in impact reports, "SFDR" or "Article 10" summaries, or SFDR chapters in "Article 29 Energy and Climate Act (LEC)" reports for funds with more than €500 million in assets under management.

ANNEX III

Template pre-contractual disclosure for the financial products referred to in Article 9 of Regulation (EU) 2019/2088 and Article 5 of Regulation (EU) 2020/852

Sustainable investment objective

Does this financial product have a sustainable investment objective?	
☐ **It will make a minimum of sustainable investments with an environmental objective (%)** ☐ in economic activities that qualify as environmentally sustainable under the EU Taxonomy ☐ in economic activities that do not qualify as environmentally sustainable under the EU Taxonomy ☐ **It will make a minimum of sustainable investments with a social objective (%)**	The first heading in the RTS refers directly to the definitions of a sustainable investment under Article 2(17) of SFDR and, for funds that choose this path, the definition of economic activities that qualify as environmentally sustainable in Article 3 of the Taxonomy Regulation. As the ESAs confirmed in June 2022, checking one of these boxes implies that assets can only be allocated to sustainable investments that comply with the definition(s) selected, apart from investments used for hedging and cash held as ancillary liquidity. Of the 19 funds that are already using this part of the template for reporting, five state that they allocate assets based on both social and environmental contributions.

In the bulk of fund prospectuses to date, a summary of the SFDR definition suffices as brief comment on self-classification as an Article 9 fund with a sustainable investment objective.

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SUSTAINABLE INVESTMENT OBJECTIVE AND INDICATORS USED TO MEASURE HOW IT IS ATTAINED

Disclosures of intentions to contribute to objectives that are still not clearly defined

What is the context

As pointed out in the Eurosif – Hamburg University white paper on a classification scheme for sustainable investments, the purpose of an investment (or "*operationalisation of an investment's intention*") can generally be broken down into three types of main objectives:

1 - adherence to specific values or norms,

2 - reducing financial risk or improving financial performance, and

3 - contributing to solving environmental or social challenges in the real economy.

The definition in Article 2(17) is intended to be holistic and encompasses all three dimensions. It should provide the framework for demonstrating that the investment process reflects the intention, using concrete and measurable indicators.

Throughout this learning phase as market participants get to know the Regulation, the main sticking point is how to understand "objective". The word appears twice and refers to two distinct concepts:
- the fund's investment objective, according to Article 9; and
- the environmental or social objective to which the underlying economic activities contribute, according to Article 2(17).

In turn, the second concept refers to different goals, such as the use of energy, renewable energies, raw materials, water and land, waste production, GHG emissions, impacts on biodiversity and the circular economy, tackling inequality, social cohesion, social integration and labour relations, investment in human capital or economically or socially disadvantaged communities.

What we observed

The documentation for funds that have yet to adopt a template (see below) is peppered with references to "extra-financial objective", "sustainable development objective" or simply "sustainable objective". Their aim is to clarify that the fund's intention is to build in sustainability issues and to comply with criteria that speak to the definition in Article 2(17), using analysis and screening. Many simply state that the fund has an objective that complies with Article 9 of SFDR, which is tantamount to saying that its sustainable investment objective is sustainable investment.

Disclosures by the 42 funds that publish information based on one of the SFDR templates provide greater insight into their intention. The majority refer to contributing to (and more rarely "financing") the energy transition, access to water, achieving the Sustainable Development Goals (SDGs), improving employment conditions or access to education. They do this by tilting investments towards companies whose products, services or social policies help meet these challenges – this is their "expected contribution".

Funds' objectives may also be to allocate investments to companies whose combined emissions trajectory is compatible with the Paris Agreement milestones. Alternatively they may fine-tune the screening process to include a company's practices, business activities or social impact. Again, the objective could be purely quantitative when it involves allocation thresholds by type of contributing company or a percentage difference in the carbon intensity of the portfolio against a market index.

The panel includes four funds that include shareholder dialogue or engagement as part of their sustainable investment objective. They specify that the asset manager intends to be actively engaged in prodding companies "*to boost their contribution to sustainable development and ESG goals*", or that dialogue will help formulate "precise and monitored opportunities for improvement". Although the SFDR technical standards require asset managers to provide information on engagement on their websites, the Annex III template does not include a specific heading on engagement.

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Attainment of the objective navigates between control of adverse impacts and contribution indicators that are yet to build

What is the context

In this section, Article 9 funds are asked to disclose “a minimum set of standardised and comparable quantitative and qualitative indicators that demonstrate how each financial product meets the sustainable investment objective that it aims to attain”. They must be relevant to the design and investment strategy of the financial product as described in the pre-contractual information.

SFDR texts do not provide a specific list of possible indicators, although asset managers could draw on the various environmental and social challenges referred to in Article 2(17) to create indicators that align with those used in their analysis and selection processes. In their June 2022 statement, the ESAs clarified that firms could tap into the 64 PAI indicators (differentiated by asset class) for DNSH disclosures. The document does however state that there is no direct link between sustainability indicators and PAI indicators, but that it could make sense to show improvements of the investments against those indicators over time.

What we observed

What sustainability indicators are used to measure the attainment of the sustainable investment objective?

List of indicators found in dedicated SFDR documents

Category	Indicators and number of occurrences found
PAI and similar (49)	Board gender diversity (11), Human rights policies (11), Carbon footprint (10), Exposure to companies active in the fossil fuel sector (10), Share of companies with(out) carbon emission reduction initiatives such as SBTi (2), Carbon intensity (1), (De)carbonised energy production (1), Energy consumption (buildings) (1), Biodiversity indicator (1), Carbon footprint (buildings) (1)
Proprietary indicators (19)	Societal contribution (11), Good jobs rating (5), Human capital (1), Social impact (1), SDG score (1)
Social and diversity indicators (14)	Workforce growth (10), Average number of training hours per employee (2), Percentage of women in the workforce (1), Employee turnover rate (1)
Financial management rules (14)	Indicators derived from criteria for a climate or green bonds index (9), Internal rules (4), Indicators derived from Greenfin label criteria (1)
Environmental rating metric (10)	Net Environmental Contribution (10)
Taxonomy and SFDR (6)	Percentages: minimum of sustainable investments (3), eligibility or alignment with the Taxonomy (2), assets allocated to Article 9 funds (1)

The bulk of the indicators announced to date to measure attainment of the objective are based on Annex 1 of the technical standards and its 64 PAI indicators. They can be grouped into three categories:

- exposure to companies in breach of international standards;
- exposure to companies with significant negative externalities (operating in a controversial sector or that have yet to adopt the right policies); and
- quantitative indicators at portfolio level (GHG emissions, hazardous waste ratio, board gender diversity, etc.).

We note that firms have not identified all PAIs as such.

Next on the list are the proprietary indicators, created based on firm-specific ESG convictions and screening. These are followed by social indicators and those derived from management rules or index construction and allocation thresholds. Also prominent is the NEC (Net Environmental Contribution), a rating metric co-developed by one of the leading asset managers in our panel. In contrast to PAI indicators, the NEC measures positive externalities – as do social indicators.

Funds that have yet to publish documents that unambiguously demonstrate the link between the indicators and the level of transparency sought in SFDR have chosen a middle way and taken steps towards this goal: “*measuring the fund’s sustainable objective*” or “*indicators used to track the portfolio’s environmental or social performance*”. That said, it is often difficult to distinguish between binding indicators and simple descriptions of how ESG criteria are considered in the investment strategy. Some funds merely prepare a long-winded “Focus on ESG indicators”. Consequently, the mainstreaming of transparency based on RTS reporting templates across the industry will allow fora big qualitative step forward.

The other challenge will be to find appropriate sustainability indicators for funds themed on customer satisfaction, sport or cloud computing.

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Absence of significant harm (DNSH) still far from convincing

What is the context

The DNSH principle in SFDR refers to any social or environmental objective and differs from the meaning of DNSH in the Taxonomy Regulation.

Firms must consider PAI indicators in order to comply with the spirit of the DNSH provisions in Article 2(17). They must also scrutinise whether investee companies have good governance practices, including sound management structures, employee relations, staff remuneration and tax compliance.

In their June 2022 clarification document, the ESAs make clear that the use of PAI indicators is mandatory to demonstrate that an investment qualifies as "sustainable".

But in practice, managers are free to set what they think are the appropriate tolerance thresholds or levels.

What we observed

How do sustainable investments not cause significant harm to any environmental or social sustainable investment objective (DNSH)

How have the indicators for adverse impacts on sustainability factors been taken into account?

The most common practice we found was to cross-reference existing exclusion policies more or less accurately with the list of PAI indicators. The funds in our panel refer to sector and normative exclusion policies that "*reduce exposure to social and environmental harm*" or to a combination of different exclusions that "*exclude areas of the market that cause harm*".

Documents may also mention systematic ESG analysis that allows to "*only invest in companies that manage their impacts*", internal efforts to "*avoid exposure to sectors where climate change indicators are not met*", or internal policies for monitoring controversies.

Funds that publish a specific document go into more detail about which PAI indicators are exactly matched in their proprietary ESG screening or exclusion policies. Alternatively they declare that DNSH is already incorporated in the construction methodology of the benchmark that the fund replicates.

Compliance with OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights

To date, very few funds address this aspect. Those who do mention how that they monitor controversies around abuse or breach of the OECD principles and UN Global Compact or apply exclusion policies scaffolded by these principles. One asset management firm states that it examines how a company engages with stakeholders but that full compliance with the guidelines referred to under this heading cannot be guaranteed.

Tolerance thresholds vary when it comes to interpreting the DNSH principle

We examined the portfolios of 113 funds invested in equities at 31 December 2021. Of these the study found eight French Article 9 funds with more than 5% of their assets concentrated in the fossil fuel sector (PAI No. 4). In a study[11] published in early November 2022 focusing on 750 Article 9 funds (Europe-wide), Clarity AI posits that nearly 10% of Article 9 funds have more than 10% exposure to fossil fuels. Clarity AI's study also estimates that almost 40% of funds have more than 10% of their assets in the worst performing companies on mandatory quantitative PAIs (for example, energy, water and waste).

It also found that some 20% of European Article 9 funds allocate at least 10% of their assets under management to companies known to violate the UN Global Compact principles or the OECD Guidelines for Multinational Enterprises – and 40% have more than 5% exposure. Turning to the Novethic panel, the pool of the top 100 investee companies includes six that have been placed on the Sustainalytics watchlist for possible infringements of the UN Global Compact.

Looking at ESG ratings, the European Fund and Asset Management Association (EFAMA) found[12] that average scores for Article 9 funds are only slightly higher than for Article 8 funds. It points out the importance of verifying that the fund's ESG approach is aligned with the investor's ESG preferences (for example regarding exclusions) and views on risks (such as risks related to specific environmental or social themes in some market conditions).

[11] SFDR: Just How Sustainable Are Article 9 Funds?
[12] Market Insight – ESG Ratings of Article 8 & 9 funds

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CONSIDERATION OF PRINCIPAL ADVERSE IMPACTS ON SUSTAINABILITY FACTORS

Differences in interpretation derail intended double materiality à la SFDR

What is the context

Principal adverse impacts (PAI) are the most material negative impacts of investment decisions on sustainability factors: environmental, social and employee, human rights, corruption and bribery matters.

In the SFDR framework, PAIs relate to integration of the double materiality concept. When looking at a fund's investment decisions, double materiality involves explaining how external sustainability risks are taken into account and, using the PAIs, whether these decisions consider an investee company's potential negative impact on society and on the environment.

The PAI indicators are meant to be the basis for measuring these unwanted impacts and financial products that apply them are asked to include "*a clear and reasoned explanation of whether, and, if so, how*" they are considered. In its May 2022 Supervisory Briefing, ESMA recommends that national supervisory authorities could "reasonably expect" that products self-disclosing under Article 9 SFDR would disclose the PAIs of investment decisions referred to in SFDR.

What we observed

What we found when PAI indicators are kept track of

Novethic identified only one fund in the sample that currently voluntarily discloses all 14 core PAI indicators listed in Annex I of the RTS, in its 2021 "Article 29" report (transposition of SFDR into French law).

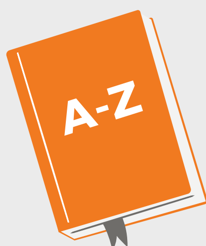
Around 40 funds have updated their prospectus to include consideration or "use" of these indicators, sometimes illustrating how this is done in practice. For instance, one fund with investments in sovereign bonds considers the carbon intensity of the investee countries.

Consideration of PAIs is poorly documented and still appears variable in the 42 funds that publish some form of SFDR disclosures. A number of funds state that PAIs will soon be "measured", while others refer to the asset manager's statement regarding what it does to consider, address and mitigate the indicators. One firm is in the process of ranking the indicators by order of priority. It indicates that only the relevant adverse impact indicators are taken into account "*through the fund's exclusion, voting and engagement policies*". Finally, the most compelling evidence is provided in a periodic SFDR reporting template that details the PAI indicators and how they map to data points within each pillar of the internal sustainability analysis tool. It also details how this consideration can influence the firm's assumptions about a company's financial prospects and valuation models.

This smorgasbord of approaches arises directly from SFDR Level I interpretation difficulties. Yet, one Article 9 fund, which has climate in its name and claims to monitor the adverse impacts of its investments, will find it hard to justify why three European oil majors are in its portfolio when Level 2 of SFDR (which includes greenhouse gas emissions up to scope 3) is fully implemented.

PAI indicators not taken into account

At the study completion date, 30 or so funds reported that they did not consider PAIs, not to mention those that make no reference to the indicators in either their prospectus or KIID as yet. Other funds have put off the decision until later when SFDR Level 2 requirements come into effect. One small asset management firm considers itself exempt because it has fewer than 500 employees, and is therefore below the threshold for mandatory publication of PAI indicators at entity level.



One major issue remains unresolved. Included in the ESA list of queries to the European Commission that require interpretation of EU law is a question on what "consideration" of PAIs by a financial product actually means. Could "consideration" of principal adverse impacts by a fund mean that a financial product only discloses the relevant principal adverse impacts of the investments or is the asset manager required to take action taken to limit the adverse impacts of the investments, such as engagement with investee companies? The industry eagerly awaits the Commission's response.

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INVESTMENT STRATEGY FOLLOWED TO ACHIEVE A PRODUCT'S SUSTAINABILITY OBJECTIVE

French Article 9 fund market dominated by positive screening strategies

What is the context

This heading in the technical standards asks for a description of how the investment strategy guides investment decisions based on factors such as investment objectives and risk tolerance. Managers are asked to describe how strategy is implemented in the investment process on a continuous basis.

What we observed

Best-in-class, best-in-universe or best-effort strategies predominate in our panel of 195 French Article 9 funds. They concern two-thirds of the total panel under review, which includes some 70 funds that only use this type of strategy. The next most common strategies are thematic environment and social approaches – for around 45% of the sample. These are sometimes combined with ESG screening to select the securities with the best environmental, social or governance credentials within the thematic investment universe.

After that, some 40 funds use a low-carbon strategy to shrink the portfolio's carbon footprint or lessen its carbon intensity by 20–50% relative to the benchmark universe, sometimes with an additional annual reduction target of 2–8%. Ten or so index-linked funds are managed against a European Climate Transition or Paris-Aligned benchmark (CTB or PAB).

The strategy for "SDG Focus" funds is based on their contribution to one or more of the UN SDGs. The most popular are SDG 3 (good health and well-being), 5 (gender equality), 8 (decent work and economic growth) and 13 (action to combat climate change and its impacts). The panel includes 15 "impact" funds, that also adopt this approach based on intentionality to invest in activities that have a measurable environmental or social impact. Here again, the majority draw on the SDGs. 20 solidarity and/or shared-return funds complete the picture for Article 9 funds managed in France.

Investment approaches*	Number of funds
Sélection ESG (Best...)	127
Thematic strategies	91
Multi-thematic	*22*
Social	*22*
Environmental (incl. green bonds)	*47*
Low-carbon	42
SDG focus	32
Shared return or solidarity funds	17
Impact (declared)	13

*A fund's investment policy can include several sustainable strategies.

What are the binding elements of the strategy used to select the investments to attain the sustainable investment objective?

Generally speaking these elements are clearly identified, mostly thanks to AMF policies (see page 8). Comprehension difficulties arise, however, when the strategy includes both the intention to seek companies "*that provide solutions*" to climate and environmental issues through their products or services, and those "*that contribute to achieving the objectives of the Paris Agreement*" with low emissions or a stated compatible GHG reduction pathway.

In some cases the investment strategy itself, with its ESG screening rules for example, provides the indicators intended to measure achievement of the sustainable investment objective (see page 12), which is not always the appropriate approach, since ESG ratings were not originally designed to reflect sustainability issues using the same double materiality approach as SFDR.

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DESCRIPTION OF THE ASSET ALLOCATION AND THE MINIMUM REQUIRED SHARE OF SUSTAINABLE INVESTMENTS

Cautious breakdown of investments lacking in specifics

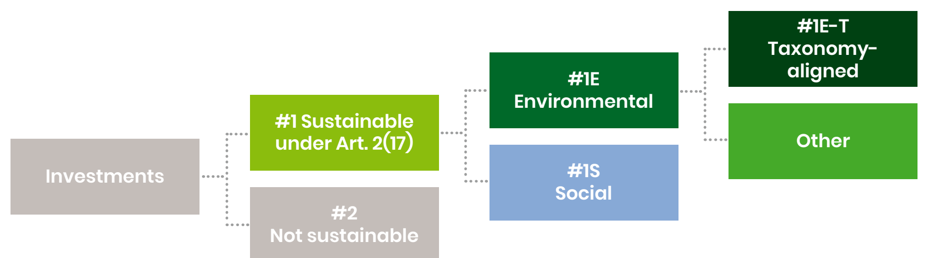
What is the context

The SFDR template for Article 9 funds gives a framework for allocating and distributing sustainable investments between assets that contribute to one or more sustainable environmental or social objectives. Environmental investments are in turn broken down between those that are aligned with the EU Taxonomy and those that are not.

At this stage, there are two ways to allocate investments in box 1: count each line only in proportion to the business segments of interest with regard to a theme, or count each line in its entirety as soon as the company is considered relevant to the theme or when the filter is a "binary" sustainable/non-sustainable ESG filter. The method chosen determines the minimum percentage declared (comparatively lower in the first case and higher in the second), although, for now, it can be impossible to determine the approach adopted from the disclosures provided.

What we observed

Thus far, only a rare sprinkling of asset management firms explain how they screen which investments are sustainable and which are not, according to their interpretation of Article 2(17). They typically explain how they assess a positive contribution while ensuring there are no adverse impacts. The information that these funds provide is more qualitative than that from funds that are content with the assumption that 80% of their investment universe is necessarily "sustainable", since the SRI label requires restricting it by 20%.



Pre-contractual disclosures

Box 1: Novethic identified a total of 19 funds declaring a minimum proportion of sustainable investments, under the interpretation of Article 2(17). It ranges from 50% to 90%, but is typically 80%.

Boxes 1E and 1S: to date, excluding Greenfin-labelled funds, only ten or so thematic funds make minimum allocation commitments in line with their theme, which, in the case of the SDGs, includes both social and environmental objectives.

Box 1E-T: considering the timetable for the provision of alignment disclosures by firms (in 2023 for the 2022 financial statements), the percentage of alignment with the Taxonomy stated in pre-contractual disclosures is currently only provided when the aligned share is expected to only represent a small sub-set of the minimum exposure to sustainable investments. The lower limit declared varies between 1 and 10%. Some funds only state an upper limit (30 or 100%). Managers of thematic funds – that could be expected to focus on the Taxonomy – are in the process of assessing the preliminary data available to them.

Periodic disclosures

A screening of the annual reports published by funds in the panel allowed to identify12 funds that, based on the periodic disclosure template provided in Annex V of the RTS, declared they held 75 to 99.5% sustainable investments in their portfolios as at 31/12/2021. Of these, five funds broke down this percentage between environmental and social objectives (boxes 1E and 1S), and four disclosed only investments with social objectives. Another fund included a similar breakdown in its monthly reports, putting the proportion of sustainable investments at around 40%.

So far, only one asset management firm has completed box 2 (% of investments that are not sustainable), which, for Article 9 funds refers solely to assets held for liquidity and hedging.

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DISCLOSURE OF A MINIMUM THRESHOLD FOR ALIGNMENT WITH THE TAXONOMY

Observation round for the green share aligned with the Taxonomy objectives

What is the context

By virtue of the link between the SFDR and Taxonomy Regulations, Article 9 funds invested in economic activities that contribute to an environmental objective must provide "*a description of how and to what extent the investments underlying the financial product are in economic activities that qualify as environmentally sustainable*" under the Taxonomy Regulation and its six environmental objectives.
If not, the prospectus must mention the fact that the investments underlying the financial product do not consider the Taxonomy's criteria.

What we observed

To what minimum extent are sustainable investments with an environmental objective aligned with the EU Taxonomy?

All funds with an environmental objective must make ex-ante disclosures on the minimum share of sustainable investments in the portfolio that will be aligned with the EU Taxonomy. This obligation also applies to funds with a social or combined objective, when even a small proportion of the portfolio's allocation is to activities that contribute to an environmental objective.

During this interim period, fund managers are encouraged[13] not to use estimates for disclosures regarding taxonomy-aligned economic activities, but only data available directly from investee companies or "*equivalent information*". Unsurprisingly, given that neither investee company disclosures nor explanation[14] of what should be considered "*equivalent information*" was available, only one green bond fund in the study panel has so far explicitly set a minimum level of alignment with the Taxonomy. Its threshold was set at 75%, owing to the features of green bonds as asset class[15].

The minimum Taxonomy-aligned threshold is a continuous commitment. Therefore it would have been risky for managers to commit to a minimum percentage this year, since they would have had to continue to adhere to it throughout 2023, even as preliminary disclosures are replaced by companies' reported data.

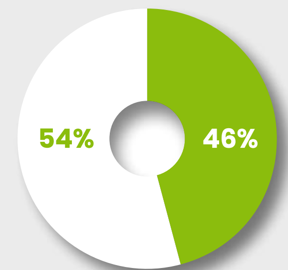
Preliminary data found in periodic reports

Moving outside the framework of future SFDR templates, Novethic identified 31 funds that already disclose the consolidated portfolio's estimated percentage of eligibility or alignment with the Taxonomy in their reports. Four of these funds provide both estimates. The information is included in disclosures to comply with Article 29 of the French Energy and Climate Act (LEC) for funds with assets in excess of €500 million, as well as in various monthly, annual and impact reports.

Estimates range from 15 to 77% for eligibility for the first two Taxonomy objectives (mitigation and adaptation), and from 0.1 to 61% for alignment. The asset management firm disclosing the highest percentage of alignment sees "*no particular difficulty in implementing the indicator*", while another states that it has used the services of two different data providers and obtained similar results.

Analysis of the information published by the 12 asset management firms that provide one of these estimates for at least one fund shows that the majority used an external data provider. Two market participants outline a methodology developed in-house. One uses data from a provider to isolate green revenue from investee companies, while the other uses a proprietary tool to analyse their business segments. Both supplement the analysis with data from external providers regarding environmental and social controversies to run controls on DNSH and minimum social safeguards under the Taxonomy. ESMA has since clarified that controversy-based approaches should be discouraged and are considered insufficient to assess the DNSH principle at company level.

Average eligibility
(17 funds)



Average alignment
(18 funds)

[13] Especially in the "Updated Joint ESA Supervisory Statement on the application of SFDR" issued in March 2022
[14] Since then, ESMA provided additional clarification in the Q&A on the SFDR Delegated Regulation published in November 2022
[15] Preliminary taxonomy disclosures from green bond issuers remain scarce nonetheless. According to a study published by the Luxembourg Stock Exchange in October 2022 analysing the documentation of 5,400 green, sustainability and sustainability-linked bonds worldwide, only 14% of issuers provide qualitative disclosures on alignment with the Taxonomy. This percentage rises to 27% for issuers based in the European Union.

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ENVIRONMENTAL OBJECTIVES THAT ARE NOT ALIGNED WITH THE EU TAXONOMY

General sustainability-themed funds still favour SDGs

What is the context

The definition of sustainable investment in Article 2(17) leaves open the possibility of contributing to an environmental objective through investments based on criteria other than those applicable to economic activities under the Taxonomy.

In their prospectuses, many funds already refer to the Taxonomy objective(s) they intend to contribute to. Some also point out that economic activities not listed in the Taxonomy "*are not necessarily harmful to the environment or unsustainable*" or that "*other activities with the potential to contribute substantially to environmental objectives are not yet necessarily included in the Taxonomy*".

In any event, when the fund's environmental approach is broader, the manager must explain why the financial product includes sustainable investments with an environmental objective that is not Taxonomy-aligned.

What we observed

During this uncertain interim period, most funds with an environmental theme that seems to fit into the Taxonomy's list of six environmental objectives have opted to play safe. Prospectuses commonly state that although the fund may already be investing in activities aligned with the Taxonomy Regulation, "*it does not currently have a specific environmental objective and is not committed to a minimum share of aligned investments.*"

Some funds do however have broader themes. Chief among these is the macro-concept of "transition". Without a commonly-accepted definition, managers have a lot of latitude: energy and ecological transition, mobility and infrastructure transition, or transition within energy-intensive industries or that have a significant impact on biodiversity At the time of writing, the European Commission had yet to issue a statement on possible extensions to the green Taxonomy based on a traffic light system. Extending it to "amber" activities could lead to recognising economic activities in the "*middle space of environmental performance*".

The eight categories of the Greenfin label criteria, or, for green bond funds, the taxonomy developed by the Climate Bonds Initiative (on which the Greenfin reference framework is based) can also provide the themes on which achievement of the environmental objective is based. They include sectors currently absent from the European Taxonomy, such as agriculture.

Amongst the 42 funds that use some form of SFDR template, five also use the SDG framework to define their contribution to environmental objectives. For example, they identify investee companies whose activities involve "*goods and services that make a contribution deemed positive*" to the SDGs, in particular SDGs 7, 9, 11, 13, 14 and 15.

One other method, which is arithmetical and has no standard framework, aims for "*a neutral overall CO2 emissions profile*". Under this approach, funds measure and balance both emissions induced and avoided by investee companies. What is more, a handful of funds claim to "offset" their scope 1 and 2 emissions, i.e. without taking into account the portfolio's induced emissions.

[16] Clean water and sanitation (6), Affordable and clean energy (7), Industry, innovation and infrastructure (9), Sustainable cities and communities (11), Climate action (13), Life below water (14), Life on land (15)

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SUSTAINABLE INVESTMENTS WITH A SOCIAL OBJECTIVE

Social objectives are rarely articulated

What is the context	What we observed
According to Article 2(17), a social objective can be achieved through "*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*".	Only four of the funds that commit to a minimum share of sustainable investments under SFDR have a purely social objective. The remainder do not as yet give the breakdown of minimum environmental and social allocations. Three funds also reference SDGs[17] 1 to 4 in their minimum sustainable investment objective, while one fund states their objective as that of at least 75% investment in social or sustainability bonds.

[17] No poverty (1); Zero hunger (2); Good health and well-being (3); Quality education (4)

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ARTICULATION OF THE SUSTAINABLE INVESTMENT OBJECTIVE WITH THE DESIGNATED REFERENCE BENCHMARK

Funds reticent to designate a benchmark aligned with their sustainable investment objective

What is the context

When a fund designates an index as a reference benchmark, Article 9 of SFDR requires managers to explain why the index is relevant and how it is aligned with the sustainable investment objective. The benchmark can be a thematic ESG index based on environmental and social indicators. "Low-carbon" funds can use tailored indices that conform to a "*reduction in carbon emissions to meet the Paris Agreement targets*".

Funds that have CO_2 reduction as their objective are sometimes referred to as Article 9.3 funds. To promote a consistent framework to guarantee reliable low-carbon benchmarks, the Commission amended the Benchmark Regulation to add two new benchmarks. Regulation-compliant indices guarantee that underlying assets (equities or bonds) are selected, weighted or excluded so that, on aggregate, the portfolio is allocated to an ambitious decarbonisation trajectory, without causing significant harm to other environmental objectives. There are PAB (aligned with the objectives of the Paris Agreement) and CTB (aligned with the objectives of a climate transition) benchmarks.

What we observed

Novethic identified 33 funds out of the 195 in the panel whose prospectus or KIIDs specify a reference benchmark against which to measure their investment objectives. They comprise nine ETFs that track a PAB or CTB index (Article 9.3 funds, in other words), six green bond funds and 18 with a broad market index not specific to the ESG constraints relevant to the sustainable investment objective. As the ESA's confirmed in the Q&A released in November 2022, this approach is not compliant.

In a nutshell, no thematic fund declares a reference benchmark aligned with the fund's objectives at this stage. Why? Because many asset management firms have their own screening methodologies matching the fund theme(s). They are also reticent to measure performance against a benchmark based on a different methodology that does not reflect their investment convictions. Generally speaking, the rationale provided for funds with a carbon-reduction objective and not measured against either a PAB or CTB relates to a specific feature of the fund (for example, "*an algorithmic portfolio with maximum variation*" for which there is no pertinent index).

In the sub-set of 42 funds that provide disclosures in the form of an SFDR template, several state "*that there is no benchmark specific to the fund's objectives*", or that the manager intends to demonstrate that a green bond fund can outperform a broad market index. And one fund makes its selection based on PAB specifications, but measures performance against a conventional benchmark.

To recap, in 2023, funds with a reference benchmark aligned with their objective will need to answer these questions:

- How does the reference benchmark take into account sustainability factors in a way that is continuously aligned with the sustainable investment objective?
- How is the alignment of the investment strategy with the methodology of the index ensured on a continuous basis? How does the designated index differ from a relevant broad market index?
- Where can the methodology used for the calculation of the designated index be found?

Uncertainty regarding PAB/CTB benchmarks

Although they arise from the same Action Plan on Sustainable Finance, there is lingering uncertainty as to whether the specifications of the Paris Agreement Benchmark (PAB) and the Climate Transition Benchmark (CTB) mean that Article 9 index-linked products replicating these benchmarks "automatically" fulfil all SFDR obligations. The queries submitted to the Commission in September 2022 by the ESAs include this question. The stakes are higher still when we consider that the portfolios of the six funds measured against a PAB and the three against a CTB in this study contain between 200 and 300 lines. One fund has 800 companies in its portfolio.

It is also important to note that the deadline was 31 December 2022 for CTB benchmark administrators to exclude any company that caused significant harm to at least one of the environmental objectives of the Taxonomy (according to the DNSH principle) or associated with breaches of the principles of the Global Compact or the OECD Guidelines for Multinational Companies. The ESAs opine[18] that the CTB rules are not strict enough to satisfy the sustainable investment requirements according to Article 2(17) SFDR. The documentation of the three CTB-indexed funds examined in the study explains that companies not subscribed to the Global Compact had already been screened out. The materials also specify that the manager relies on the benchmark administrator to ensure compliance with the DNSH principle.

[18] https://www.esma.europa.eu/sites/default/files/library/jc_2022_62_jc_sfdr_qas.pdf

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The need to align Regulations

In their report on Taxonomy data and usability (commissioned by the European Commission), the members of the Platform on Sustainable Financing have formulated[19] a set of recommendations to improve consistency between the three pieces of legislation: SFDR, the Taxonomy Regulation and the Benchmark Regulation. These recommendations echo this study's findings, in part.

The authors stress that while the Taxonomy covers investments in economic activities that make a significant contribution to an environmental objective, sustainable investment under SFDR only requires a social or environmental contribution, without any material technical criteria. Environmental economic activities aligned with the Taxonomy – typically clearly-defined products or services – are therefore a sub-set of sustainable economic activities according to the meaning of Article 2(17), based on more generic criteria.

	Contribution to the objective	Do no significant harm (DNSH) principle	Additional safeguards
Taxonomy-aligned Investments	Investment in an economic activity that substantially contributes to environmental objective	DNSH for environmental objectives (activity level)	Minimum Safeguards (Social and Governance)
Sustainable Investments - Art. 2(17	Investment in an economic activity that contributes to environmental and/or social objective	DNSH for social and environmental objectives (entity level)	Good governance

Source: Platform on Sustainable Finance

DNSH principle: As per the Taxonomy, DNSH relies on precise criteria for each environmental objective, customised to the specificities of economic activities and which provide a performance threshold, whereas, in the context of SFDR, DNSH is verified by considering a list of indicators which is non-risk based and provides no guidance on expected performance for different sectors, company sizes or geographic areas. For Article 8 & 9 funds, an investment aligned with the Taxonomy, because it is part of a sub-set, must then undergo two layers of DNSH verification. The Platform encourages the EU Commission to rely on Taxonomy metrics and their underlying methodologies to define environmental PAIs, as well as include a short list of "*always principally adverse*" activities.

Additional safeguards: The Platform regrets that the concepts of additional safeguards are not aligned either, and invites the Commission to replace the *good governance* principle as per SFDR with the Taxonomy Regulation's definition of minimum safeguards, while also harmonising the list of affected PAI indicators (Global Compact and social indicators).

The Platform also flags a number of incompatibilities between criteria that complicate our understanding of the summary table below:

The Platform recommends harmonising PAI indicators (SFDR) and the exclusion rules applicable to PABs and CTBs (Benchmark Regulation) in terms of both granularity and the number of industries covered by both Regulations. This would be well-advised considering the large number of securities held in PAB and CTB index-linked funds

[19] Platform Recommendations on Data and Usability as part of Taxonomy reporting (October 2022)

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Identikit picture of a **French Article 9 fund**

Top 20 companies in Article 9 fund portfolios invested in equities

Portfolio data for 113 equity funds analysed at 31/12/2021 using Morningstar Direct showed 2,550 different companies, including 40 that showed up in at least 30 funds. The table below lists the 20 most frequently held companies, across all investment strategies, as well as in the portfolios of funds with a dominant environmental, social or carbon theme.

<table>
<tr><th>Position (number)</th><th>AuM (€M)</th><th>Company</th><th>E theme (28 portfolios)</th><th>S theme (20 portfolios)</th><th>Carbon theme (24 portfolios)</th></tr>
<tr><td>1</td><td>656</td><td>Schneider Electric SE (68)</td><td>Schneider Electric SE (18)</td><td>Air Liquide SA (11)</td><td>STMicroelectronics NV (17)</td></tr>
<tr><td>2</td><td>1340</td><td>ASML Holding NV (65)</td><td rowspan="2">Vestas A/S, Saint-Gobain SA (15)</td><td rowspan="2">Schneider Electric SE, AXA SA (10)</td><td>Schneider Electric SE (16)</td></tr>
<tr><td>3</td><td>531</td><td>L'Oréal SA (53)</td><td rowspan="3">Siemens AG, Sanofi SA, Intesa Sanpaolo (15)</td></tr>
<tr><td>4</td><td>288</td><td>STMicroelectronics NV (53)</td><td rowspan="3">Orsted A/S, EDP Renovaveis SA, ASML Holding NV (13)</td><td rowspan="3">ASML Holding NV, L'Oréal SA, SEB SA (9)</td></tr>
<tr><td>5</td><td>490</td><td>Air Liquide SA (52)</td></tr>
<tr><td>6</td><td>459</td><td>Saint-Gobain SA (51)</td><td rowspan="4">L'Oréal SA, Kering SA, Deutsche Telekom AG, Saint-Gobain SA (14)</td></tr>
<tr><td>7</td><td>478</td><td>Dassault Systèmes SE (49)</td><td rowspan="2">Tomra Systems ASA, STMicroelectronics NV (12)</td><td rowspan="2">BioMerieux SA, Hermes International SA (8)</td></tr>
<tr><td>8</td><td>486</td><td>Koninklijke DSM NV (43)</td></tr>
<tr><td>9</td><td>291</td><td>Capgemini SE (42)</td><td rowspan="4">Veolia Environnement SA, Air Liquide SA, Alfen NV, Dassault Systèmes SE (11)</td><td rowspan="7">Dassault Systèmes SE, LVMH SE, Soitec SA, AstraZeneca PLC, Microsoft Corp, Michelin SA, Edenred SA (7)</td></tr>
<tr><td>10</td><td>439</td><td>AXA SA (41)</td><td rowspan="3">AXA SA, Capgemini SE, ASML Holding NV (13)</td></tr>
<tr><td>11</td><td>292</td><td>Alstom SA (41)</td></tr>
<tr><td>12</td><td>411</td><td>Infineon Technologies AG (40)</td></tr>
<tr><td>13</td><td>444</td><td>Allianz SE (39)</td><td rowspan="4">Linde PLC, Kingspan Group PLC, Infineon Technologies AG, Koninklijke DSM NV (10)</td><td rowspan="8">Teleperformance SE, SAP SE, Vivendi SE, Publicis Groupe SA, Legrand SA, Enel SpA, adidas AG, BNP Paribas (12)</td></tr>
<tr><td>14</td><td>233</td><td>Michelin SA (39)</td></tr>
<tr><td>15</td><td>497</td><td>Novo Nordisk A/S (37)</td></tr>
<tr><td>16</td><td>423</td><td>Sanofi SA (37)</td><td rowspan="5">Alstom SA, Sanofi SA, Legrand SA, Sopra Steria Group SA, Essilorluxottica, Kering (6)</td></tr>
<tr><td>17</td><td>323</td><td>Siemens AG (37)</td><td rowspan="4">Microsoft Corp, Alstom SA, Ecolab Inc (9)</td></tr>
<tr><td>18</td><td>260</td><td>Intesa Sanpaolo (37)</td></tr>
<tr><td>19</td><td>221</td><td>Legrand SA (37)</td></tr>
<tr><td>20</td><td>430</td><td>Veolia Environnement SA (36)</td></tr>
</table>

Source : Novethic

The number of funds that invest in each company is given in parentheses.

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The companies that stand out in this Top 20 are the Dutch ASML Holding, which manufactures lithography equipment for the semiconductor industry, and French companies Schneider Electric and L'Oréal. These three stocks each make up more than 1% of the assets of the Article 9 funds whose portfolios were available to the study (2.5%, 1.2% and 1%, respectively). An apparent bias towards French companies in funds' interpretations of Article 2(17) can also be pointed out: there are 12 French companies in the Top 20, but only eight funds out of the total panel invest exclusively in France. By comparison, Eurosif's July 2022 data on 272 European Article 9 funds showed only three French companies in the Top 20.

For single-themed funds, the following observations can be drawn from the Top 20 in each category:

- although not all funds with an environmental theme apply the same sectoral exclusions as Greenfin funds, their Top 20 is very similar to the Top 20 for Greenfin-labelled funds.

- the equity selection for social funds, which is often guided by overweighting the S in the ESG rating, shows a bias towards the pharmaceutical and luxury industries.

- none of the big tech companies (GAFAM) stand out in the broad range of approaches taken by funds to build carbon trajectories, even though they are usually prominent[20] in European low-carbon funds.

Where French Article 9 funds are invested

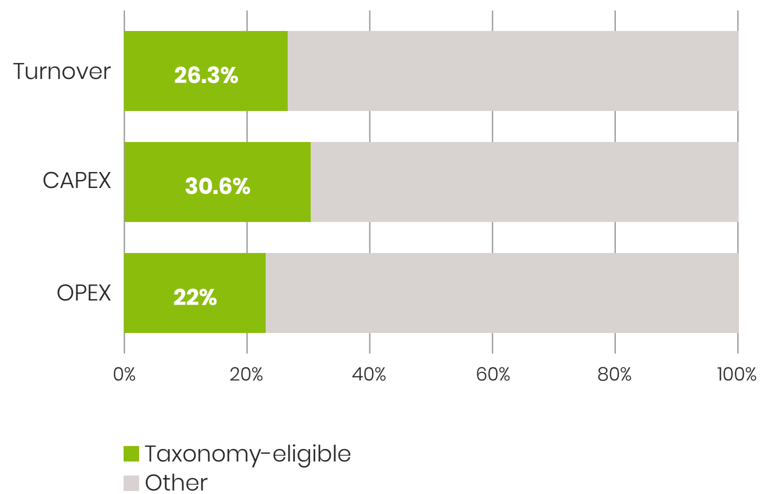
EU Taxonomy eligibility (year 1)

Out of the 100 most popular investee companies in equity funds, Novethic identified 85 European companies directly subject to the Non-Financial Reporting Directive (NFRD)[21], or who published taxonomy-related information on a voluntary basis. The KPIs reported in their annual reports were used for the purpose of this study (see full details in the Annex).

Let's take the theoretical case of a fund whose portfolio consists of these 100 companies, all equally weighted. The distribution would be as follows: 26.3% of eligible turnover, 30.6% of eligible CapEx and 22% for OpEx.

In our case, the Taxonomy-eligible turnover for the 15 companies outside the NFRD scope was counted as zero, since they do not disclose equivalent Taxonomy information to date. Eligibility ratios for financial companies were equated to eligible turnover.

Taxonomy-eligible investments
(notional portfolio made up of the Top 100)



[20] See Novethic-ADEME 2021 study

[21] Directive 2013/34/EU on non-financial disclosures for companies employing more than 500 staff. As of this year, companies in the scope of the Directive are required to publish three Taxonomy-related key performance indicators (KPIs): share of turnover, capital expenditure (CapEx) and operating expenditure (OpEx) eligible for the Taxonomy. In 2023, disclosures for these KPIs must consider all the Taxonomy's cumulative criteria.

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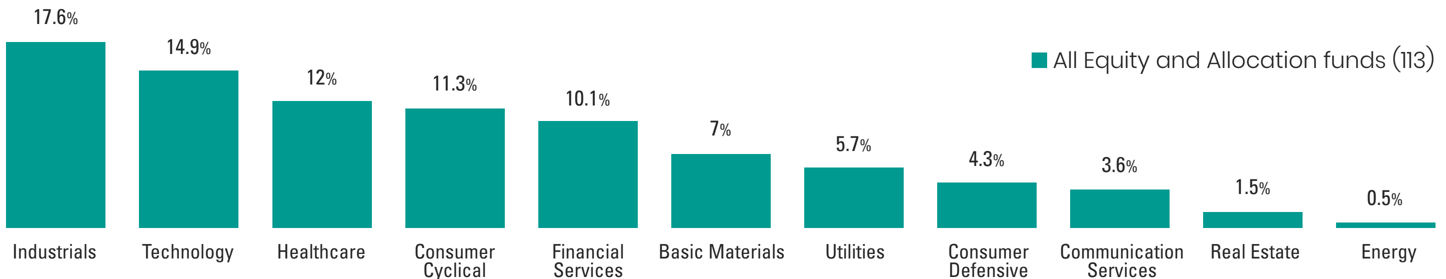
Analysis of the documentation produced by the funds in the panel shows that although asset managers are already keenly aware of the Taxonomy, they have not as yet fully switched over from their existing screening filters to those imposed under the Taxonomy. Preliminary uses include some monthly reports or factsheets that might stress an investee company's close alignment with the Taxonomy as one reason underlying confidence in that stock's financial potential.

For those funds where the Taxonomy is more embedded, documents include wording like "*the criteria defined by the Taxonomy take precedence*" for all climate themes already included in the delegated acts published to date. One fund in the panel has anticipated the delegated acts relating to the Taxonomy's non-climate objectives (whose publication has been repeatedly postponed). It analyses the water value chain (measurement and control of water pollution, water treatment, equipment and infrastructure) based on the scant information available to date.

Unsurprisingly, of the funds that do publish their own eligibility and alignment figures, Greenfin-labelled funds rank highest (up to 77% eligible green investments and 61% aligned green investments). Transferring the Greenfin taxonomy to the European Taxonomy is expected to take effect after the delegated acts on the four remaining objectives are adopted (these are still in the drafting process).

Industry sector breakdown of equity funds

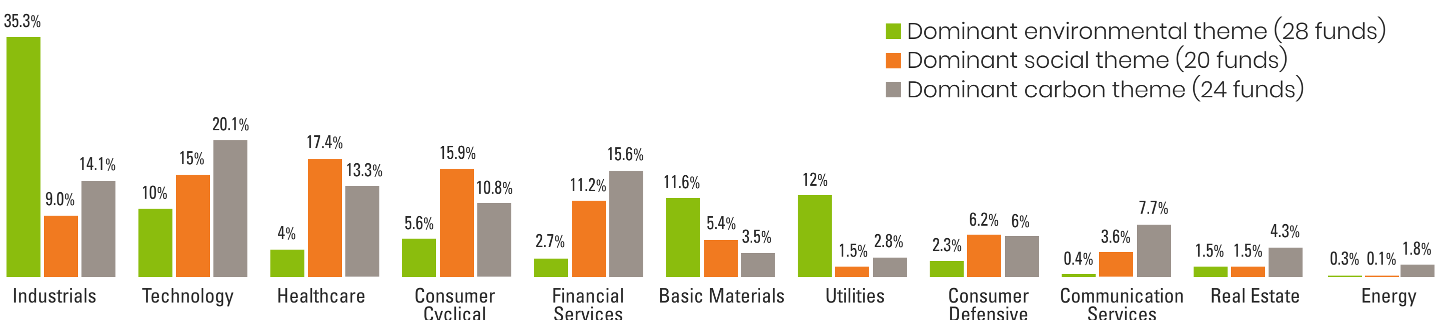
The asset allocation by industry in the graph opposite was prepared from Morningstar Direct data extracts covering the portfolios of 113 funds that are partially or exclusively invested in equities (Equity and Allocation funds). The percentages reflect the total amounts invested. As a result the sector orientations of the largest funds are more prominent in this overview. The graph does not include feeder funds or funds of funds.



Source: Novethic

Compared to the "classic" asset allocation of ESG funds (e.g. that of European Article 8 funds as described by EFAMA in its latest Factbook)[22], French Article 9 funds overweight the "Industry", "Basic Materials" and "Utilities" sectors. Fund managers select these sectors because they include companies they see as being able to contribute to environmental objectives. Conversely, the Finance and Communication sectors are underweighted.

When looking at funds with a distinctive theme, the expected asset allocation picture can be observed. Environment-themed funds overweight Industry (transport, renewable energy generation equipment, power connections and interconnections), Basic Materials (industrial gases, chemicals and products from renewable materials) and Utilities (energy and water). Funds with a social theme – for which there is no taxonomy – overweight the Healthcare and Consumer Cyclical sectors, while funds that have carbon emissions criteria naturally opt for low-carbon industries (Technology, Finance and Communication).



[22] https://www.efama.org/data-research/research/fact-book

Source: Novethic

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Significant overlap between Article 9 and labelled funds

When the study panel of Article 9 funds is cross-referenced with the Novethic database of labelled funds (as at 30 June, 2022), we find that more than two-thirds of the Article 9 funds managed in France are labelled, compared to one-third for Article 8 funds.

Unsurprisingly, the SRI label is the most common: 80% of Article 9 funds have been awarded with it, (compared with 12% for the Greenfin label), as well as 92% of Article 8 funds. But, this label differs fairly markedly from the SFDR framework for Article 9 funds, especially when it comes to the DNSH principle, even though some funds refer to binding SRI label KPIs as among the indicators they use to measure attainment of their sustainable investment objective.

There are also 15 Article 9 and 33 Article 8 labelled funds domiciled in France that own neither the SRI or Greenfin labels.

	Article 9 funds 137 of the 195 funds are labelled (70%)		Article 8 funds [23] 441 of the 1281 funds are labelled (34%)	
Label	**Number of funds**	**AuM* (€bn)**	**Number of funds**	**AuM* (€bn)**
ISR	84	21.2	396	402.7
Multi-label	33	30.2	12	22.9
Towards Sustainability	29	28.2	10	22.8
ISR	26	26.4	10	22.7
FNG-Siegel	11	5.3	3	0.3
Greenfin**	9	7.6	-	-
Umweltzeichen	3	1.4	-	-
LuxFlag ESG	1	0.5	2	0.2
Towards Sustainability	8	3.7	5	1.2
LuxFlag ESG	2	0.7	25	15.9
FNG-Siegel	-	-	1	0.6
Umweltzeichen	2	0.2	-	-
Greenfin**	8	2	2	0.5
Total	**137**	**60.5**	**441**	**444**

Source : Novethic

* Excluding feeder funds
** Some Greenfin funds are not managed in France or were not listed as Article 9 funds at 10 March 2022.

A greater proportion of Article 9 funds are multi-label. The 137 labelled funds have 1.33 labels per fund on average, compared with 1.03 labels for Article 8 funds.

[23] Data extracted from Morningstar Direct, dated 10 March 2022

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How do label criteria link with for SFDR and the Taxonomy Regulation?

Pending the awaited reform of the SRI label, the updated Towards Sustainability Quality Standard incorporates the approach under SFDR by requiring fund managers to evaluate both the likely impacts of sustainability risks on the product's profitability ("outside in") and the risks of principal adverse impacts on sustainability factors (E, S and G) for each investment ("inside out"). Double materiality is a key priority for the review of the SRI label.

Similarly, to make sure that the fund's portfolio is consistent with the advertised theme, the Towards Sustainability standard has introduced the concept of "contributing activities". This concept encompasses the activities already included in the Taxonomy, those that will be added, and activities that make a clear and concrete contribution to the SDGs. In contrast, the standard also gives adverse impacts on sustainability as a reason for sector exclusions.

Conclusion

As 2022 draws to a close, major questions about the ability of sustainable finance to make a difference in the energy and green transition are being levelled at Article 9 funds. In the last quarter, the pace of downgrades from Article 9 to Article 8 classification picked up further still, as fund managers reviewed their Article 9 status in light of the more stringent technical requirements adopted over the summer months. This wave of downgrades by leading firms with substantial ESG assets under management (Amundi, Blackrock, AXA IM, etc.) has been interpreted as a retreat from the most advanced aspect of sustainable finance: classification as Article 9 indicates a fund with sustainable investment objectives, using measurement indicators and selecting the companies with the best social and environmental performance. At least, this is what the regulator requires at this stage.

Asset managers blame misunderstanding and competing interpretations of Article 9 of the Regulation. In their view, this article should standardise transparency and help make it easier for clients to compare financial products. As shown by the findings of our deep dive into the available reports for the funds in the Novethic study, conducted with the support of ADEME, there is still a long way to go – even on transparency. What is more, the confusion that reigns around names (green, sustainable, climate, etc.) and the definitions they cover compromise the credibility of these funds in the eyes of the general non-expert public.

The Great Green Investment Investigation by a consortium of journalists published at the end of November in Le Monde and several major European dailies, goes as far as accusing the industry of deception, by lumping European Article 9 funds together with the broader category of green funds. It found that, despite the green promises, many had carbon-intensive assets in their portfolios.

Publication of this investigation's findings has rippled through the sustainable finance market. It should also increase pressure on the regulators and push asset management firms to be more cautious when classifying their sustainable funds as Article 9 funds. What we can infer from the recent wave of downgrades from Article 9 to Article 8 is that managers are more reticent than hitherto expected to commit to green funds that meet all the regulator's criteria. And yet, in focusing on reporting, the new European framework aimed to encourage funds to walk the walk and move beyond hollow sustainability claims to align their asset allocations with sustainable objectives.

This is what the European Union's Sustainable Finance strategy promises retail investors: to make it easier to navigate through the jungle of sustainable, green, ESG, SDG, climate and energy transition products. This study, and the questions around Article 9 funds – which many had begun to interpret as a label –, especially in countries that still lack their own green label, show that this promise is far from being fulfilled.

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Annex 1:

Taxonomy data for the most popular investee companies (NFRD scope)

Non-financial companies

Name	Country	AuM (€m)	Number of funds	Sector	Eligible turnover	Eligible CapEx	Eligible OpEx
Schneider Electric SE	FRA	656.1	68	Industrials	28.0%	27.0%	23.0%
ASML Holding NV	NLD	1 339.9	65	Technology	0.0%	0.1%	1.0%
L'Oreal SA	FRA	530.5	53	Consumer Defensive	0.0%	20.4%	-
STMicroelectronics NV*	SGP	287.5	53	Technology	37.0%	46.0%	36.0%
Air Liquide SA	FRA	489.5	52	Basic Materials	10.4%	11.9%	11.6%
Saint-Gobain SA	FRA	459.0	51	Industrials	16.2%	66.5%	10.0%
Dassault Systemes SE	FRA	473.9	49	Technology	50.0%	33.0%	55.0%
Koninklijke DSM NV	NLD	485.9	43	Basic Materials	17.0%	N/A	N/A
Capgemini SE	FRA	290.8	42	Technology	1.5%	50.0%	<2%
Alstom SA	FRA	291.7	41	Industrials	99.0%	99.0%	99.0%
Infineon Technologies AG	DEU	410.5	40	Technology	57.7%	72.4%	51.1%
Michelin SA	FRA	233.4	39	Consumer Cyclical	57.0%	66.0%	57.0%
Novo Nordisk A/S	DNK	496.6	37	Healthcare	0.0%	0.0%	-
Sanofi SA	FRA	423.2	37	Healthcare	0.0%	6.0%	-
Siemens AG	DEU	323.0	37	Industrials	N/A	N/A	N/A
Legrand SA	FRA	220.9	37	Industrials	8.0%	16.4%	N/A
Veolia Environnement SA	FRA	430.3	36	Industrials	48.1%	58.3%	44.9%
Worldline SA	FRA	195.1	35	Technology	77.0%	95.0%	93.0%
LVMH SE	FRA	576.2	34	Consumer Cyclical	0.0%	34.0%	-
Essilorluxottica	FRA	482.6	34	Healthcare	0.0%	0.0%	<10%
Vestas Wind Systems A/S	DNK	325.0	33	Industrials	100.0%	91.0%	97.0%
SAP SE	DEU	257.5	33	Technology	33.0%	14.0%	15.0%
adidas AG	DEU	169.9	33	Consumer Cyclical	0.0%	51.0%	-
Kering SA	FRA	164.8	33	Consumer Cyclical	0.0%	61.0%	-
Bureau Veritas SA	FRA	144.8	33	Industrials	3.7%	39.9%	30.6%
Linde PLC*	GBR	441.2	32	Basic Materials	8.0%	24.0%	8.0%
Iberdrola SA	ESP	381.1	32	Utilities	50.2%	86.0%	64.2%
Danone SA	FRA	170.4	31	Consumer Defensive	0.0%	0.0%	<3%
EDP Renovaveis SA	ESP	118.1	31	Utilities	99.0%	99.0%	98.0%
Smurfit Kappa Group PLC	IRL	334.8	30	Consumer Cyclical	2.0%	3.0%	2.0%
Kerry Group PLC	IRL	210.6	30	Consumer Defensive	0.0%	24.0%	-
Deutsche Telekom AG	DEU	210.3	30	Communication Services	1.8%	0.2%	2.1%
Symrise AG	DEU	438.1	29	Basic Materials	0.0%	N/A	N/A
Orsted A/S	DNK	289.6	29	Utilities	66.0%	99.0%	80.0%
Energias de Portugal SA	PRT	213.0	28	Utilities	78.0%	97.0%	75.0%
Hermes International SA	FRA	417.0	26	Consumer Cyclical	0.0%	0.0%	-
Enel SpA	ITA	102.9	25	Utilities	33.5%	85.0%	66.0%
Soitec SA	FRA	204.0	24	Technology	68.0%	49.0%	40.0%
Deutsche Post AG	DEU	166.6	24	Industrials	56.0%	64.0%	62.0%
SEB SA	FRA	130.6	24	Consumer Cyclical	0.0%	43.0%	-
BioMerieux SA	FRA	74.9	24	Healthcare	0.0%	0.8%	-
Stellantis NV	NLD	159.6	23	Consumer Cyclical	99.0%	100.0%	99.0%
Umicore SA	BEL	66.7	23	Industrials	5.0%	48.0%	17.5%
Cellnex Telecom SA	ESP	143.1	23	Communication Services	2.4%	1.5%	-
Stora Enso Oyj	FIN	113.0	23	Basic Materials	5.0%	4.0%	6.0%
Amadeus IT Group SA	ESP	106.1	23	Technology	9.7%	5.8%	46.6%
Teleperformance SE	FRA	97.3	23	Industrials	0.0%	51.3%	-

continued ▶

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Name	Country	AuM (€m)	Number of funds	Sector	Eligible turnover	Eligible CapEx	Eligible OpEx
Prysmian SpA	ITA	165.7	22	Industrials	46.6%	63.7%	51.0%
Siemens Gamesa SA	ESP	154.8	22	Industrials	N/A	N/A	N/A
Kingspan Group PLC	IRL	150.2	22	Industrials	63.0%	77.0%	77.0%
Tomra Systems ASA*	NOR	148.8	22	Industrials	60.0%	0.0%	-
Vinci SA	FRA	106.9	22	Industrials	36.0%	32.0%	-
Merck Kgaa	DEU	104.3	22	Healthcare	1.0%	1.0%	1.0%
SPIE SA	FRA	123.3	21	Industrials	57.7%	73.0%	-
Faurecia SE	FRA	100.2	21	Consumer Cyclical	13.1%	16.6%	10.5%
TotalEnergies SE	FRA	87.8	21	Energy	9.9%	13.4%	14.7%
Unibail-Rodamco-Westfield	FRA	79.5	21	Real Estate	90.3%	97.0%	98.2%
Unilever PLC*	GBR	183.6	20	Consumer Defensive	0.0%	1.0%	-
Alfen NV	NLD	108.2	20	Industrials	98.8%	90.3%	100.0%
BMW AG	DEU	91.5	20	Consumer Cyclical	82.9%	99.7%	100.0%
Nexans	FRA	189.7	19	Industrials	16.0%	19.0%	47.0%
Publicis Groupe SA	FRA	78.1	19	Communication Services	13.4%	41.2%	0.0%
Arkema SA	FRA	61.5	19	Basic Materials	30.0%	38.0%	27.0%
Daimler Truck Holding AG	DEU	31.7	19	Industrials	100.0%	100.0%	100.0%
Getlink SE	FRA	111.0	18	Industrials	99.0%	100.0%	35.0%
Edenred SA	FRA	86.0	18	Financial Services	<1%	0.0%	-
Orange SA	FRA	53.3	18	Communication Services	1.4%	0.6%	11.1%
Eurofins Scientific SE	FRA	160.2	17	Healthcare	N/A	N/A	N/A
Neste Corp	FIN	90.9	17	Energy	39.0%	67.0%	43.0%
Pernod Ricard SA	FRA	75.4	17	Consumer Defensive	0.0%	29.1%	-
Vonovia SE	DEU	45.1	17	Real Estate	97.0%	98.0%	94.0%
HelloFresh SE	DEU	33.1	17	Consumer Cyclical	0.0%	10.0%	76.0%
Vivendi SE	FRA	20.0	17	Communication Services	60.1%	90.4%	<5%
Orpea SA	FRA	165.0	16	Healthcare	2.0%	54%	-

* Companies outside the strict NFRD scope but that disclose Taxonomy indicators

Financial companies

Name	Country	AuM (€m)	Number of funds	Sector	Eligibility ratio*
AXA SA	FRA	439.4	41	Financial Services	38.6%
Allianz SE	DEU	443.6	39	Financial Services	79.0%
Intesa Sanpaolo	ITA	259.7	37	Financial Services	22.0%
BNP Paribas	FRA	269.5	33	Financial Services	25.8%
Credit Agricole SA	FRA	332.7	32	Financial Services	46.0%
Banco Bilbao Vizcaya Argentaria SA	ESP	77.6	21	Financial Services	45.6%
KBC Group SA/NV	BEL	171.6	20	Financial Services	20.3%
ING Groep NV	NLD	149.4	20	Financial Services	37.4%
MunichRe AG	DEU	165.3	18	Financial Services	54.5%
FinecoBank SpA	ITA	69.9	17	Financial Services	16.3%
Adyen NV	NLD	255.6	24	Technology	0.0%

* The eligibility ratio selected here for insurers is the underwriting ratio: the share of non-life insurance or reinsurance revenue corresponding to underwriting activities covering climate-related perils. For banks, the ratio corresponds to the proportion of exposure to eligible economic activities (loans to households and loans to counterparties subject to NFRD). The green asset ratio (GAR) will be calculated from this ratio in 2024. In 2022, banks could opt to disclose a mandatory ratio and a voluntary ratio, including the NFRD scope. The ratio shown in this table is the voluntary ratio where it was possible to identify it.

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Annex 2:

Taxonomy-eligible economic activities in the Top 100

Based on the details published by the companies in their Annual Reports, the opposite tables shows the codes specific to their economic activities, as listed in the Delegated Act for the Climate Mitigation objective of the Taxonomy Regulation. The first digit corresponds to the sector (e.g. "4" for energy or "6" for transport), and the second is the number attributed to each activity in its sector list.

Ocurrences	Activity detail
7	(3.6) Manufacture of other low carbon technologies
6	(8.1) Data processing, hosting and related activities
5	(3.5) Manufacture of energy efficiency equipment for buildings; (4.9) Transmission and distribution of electricity; (7.2) Renovation of existing buildings; (7.5) Installation, maintenance and repair of instruments and devices for measuring, regulation and controlling energy performance of buildings
4	(3.1) Manufacture of renewable energy technologies; (4.1) Electricity generation using solar photovoltaic technology; (4.3) Electricity generation from wind power; (4.15) District heating/cooling distribution; (4.20) Cogeneration of heat/cool and power from bioenergy ; (6.5) Transport by motorbikes, passenger cars and light commercial vehicles; (7.3) Installation, maintenance and repair of energy efficiency equipment; (7.4) Installation, maintenance and repair of charging stations for electric vehicles in buildings; (7.7) Acquisition and ownership of buildings; (8.2) Data-driven solutions for GHG emissions reductions
3	(3.2) Manufacture of equipment for the production and use of hydrogen; (3.3) Manufacture of low carbon technologies for transport; (3.17) Manufacture of plastics in primary form; (5.3) Construction, extension and operation of waste water collection and treatment; (6.6) Freight transport services by road; (6.15) Infrastructure enabling low-carbon road transport and public transport; (7.1) Construction of new buildings; (7.6) Installation, maintenance and repair of renewable energy technologies; (9.3) Professional services related to energy performance of buildings
2	(1.3) Forest management; (3.4) Manufacture of batteries; (3.10) Manufacture of hydrogen; (3.13) Manufacture of chlorine; (3.14) Manufacture of organic basic chemicals; (4.5) Electricity generation from hydropower; (4.7) Electricity generation from renewable non-fossil gaseous and liquid fuels; (4.13) Manufacture of biogas and biofuels for use in transport and of bioliquids; (5.2) Renewal of water collection, treatment and supply systems; (5.5) Collection and transport of non-hazardous waste in source segregated fractions; (5.6) Anaerobic digestion of sewage sludge; (5.7) Anaerobic digestion of bio-waste; (5.10) Landfill gas capture and utilization; (6.2) Freight rail transport; (6.14) Infrastructure for rail transport
1	(1.4) Conservation forestry; (3.12) Manufacture of soda ash; (3.16) Manufacture of nitric acid; (4.2) Electricity generation using concentrated solar power (CSP) technology; (4.6) Electricity generation from geothermal energy; (4.8) Electricity generation from bioenergy; (4.10) Storage of electricity; (4.24) Production of heat/cool from bioenergy; (5.1) Construction, extension and operation of water collection, treatment and supply systems; (5.4) Renewal of waste water collection and treatment; (5.8) Composting of bio-waste; (5.9) Material recovery from non-hazardous waste; (6.4) Operation of personal mobility devices, cycle logistics; (6.10) Sea and coastal freight water transport, vessels for port operations and auxiliary activities; (6.16) Infrastructure enabling low carbon water transport

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Annex 3:
Methodology for selecting the study panel

Novethic compiled the panel of funds for this study in mid-March 2022, one year after the SFDR Level 1 obligations came into force. An initial list of 217 funds was put together by applying the following filters in the Morningstar Direct tool:

- Firm country: France
- Distribution country: all of Europe
- SFDR classification: Article 9
- Type of fund restrictions: funds of listed assets, excluding company mutual funds
- Fund creation date: before 10 March 2022

During the documentary review stage (from April to end-October 2022), 22 funds that mentioned classification as Article 8 under SFDR were eliminated. It was possible to identify both the date and reason for the change of classification for around half of these. For the other half, the documentation did not include reference to previous classification as Article 9 funds; therefore the date on which Morningstar had listed them as such is not known.

Some funds are marketed by French asset managers but managed by subsidiaries based in Luxembourg or elsewhere in Europe. For these, the country in which the subsidiary is based takes precedence in Morningstar searches. In practical terms, this means that the panel may not include the full Article 9 fund ranges for the same asset management firm.

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12.22

SFDR Article 9 funds: a market off to a rough start

Study conducted by Nicolas Redon, Lorène Moretti, Estelle Cazard and Myriam Menif
Supervised by Anne-Catherine Husson-Traore.

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