MARKET DATA

ARTICLE 9 FUNDS EUROPE

On June 30, 2022

novethic

SFDR: A HALF-HEARTED APPLICATION

Article 9 funds, which now constitute the Novethic Market Data analysis universe, are those which in principle, have the most ambitious approach in terms of sustainability. This must be formalized in a sustainable investment objective according to Article 2(17) of SFDR. These funds are also expected to apply the European Union's Sustainable Finance Action Plan regulations in the most exemplary way possible.

Does the reality of the "Article 9" market live up to expectations?

Golden rule: do not invest in the most controversial sectors. Management companies are showing that their sustainable investment strategies start with an ambitious exclusion policy that extends across entire portfolios.

Lack of clarity on sustainable investment objectives and the management methods used to achieve them. Only 80 funds state that they refer to a market index associated with their sustainable investment objective. The rest often provide unclear explanations of their objectives and the approach taken to achieve them.

ESG integration dominates management. More than half the scope of Article 9 funds adopt ESG integration in its many forms, particularly according to a best-in-class analysis. However, investing from this broad investment universe does not allow for real ambitious change. There is still a greater presence of thematic management than in the previous Novethic Market Data analysis scope, which also considered Article 8 and non-classified funds.

Reporting needs to be improved. Only 43% of Article 9 funds communicate indicators in impact reports, which are often separate from financial reports. Yet one of the fundamental requirements of Article 9 classification is the communication of results achieved on sustainable objectives through consistent year-after-year indicators. The reporting gaps are even more apparent with respect to the Principal Adverse Impacts of investments (PAI). Indeed, only 10% of Article 9 funds (82) announce that they consider the PAI out of the 145 funds that mention the "comply or explain" rule. The number of managers who publish the details and ad hoc indicators for each fund is even smaller.

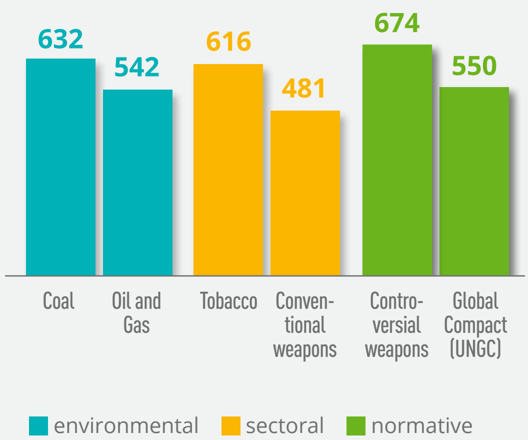
A Green Taxonomy not well represented. While 279 funds mention it in their pre-contractual documentation, only 132 claim to follow one or more of the six objectives of the Green Taxonomy. Communication on objectives concerning the green share of investments is confusing: management companies appear to remain vague on the percentage of eligibility for the green share and the minimum green share targeted.

877 Funds

€ 361 bn* **↓11%****

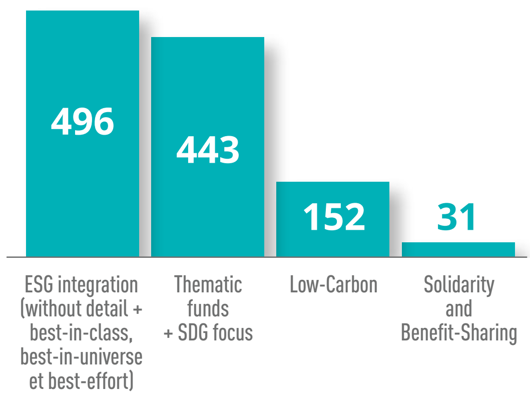
*assets under management **In the first semester of 2022

EXCLUSIONS APPLIED BY FUNDS



ART. 9 FUND MANAGEMENT APPROACHS

by number of funds[1]



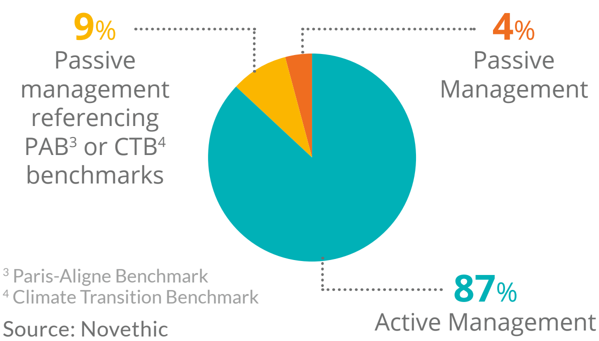
[1] Funds can combine the approaches

Novethic analyzes and quantifies the European market for "Article 9" funds open to retail investors. These are funds available for sale in the European Union, UCITS or accessible to individuals, outside FCPE.

WHICH MANAGEMENT APPROACHES FOR ARTICLE 9 FUNDS?

87% of Article 9 fund assets are managed according to an active strategy, which takes shape through a dozen methods. The most widespread ones are ESG selection in its various forms (Best-in-Class, Best-in-Universe and Best-Effort) as well as approaches using thematic selection and targeting the UN SDGs. In comparison, the sustainable investment universe defined by Morningstar adopts a passive strategy for more than 25% of assets under management, representing more than $500 billion[2].

Management of Article 9 Funds - Breakdown of AUM

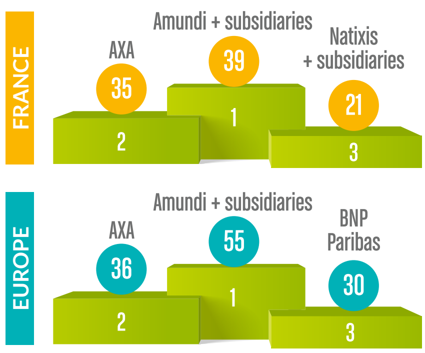


[3] Paris-Aligne Benchmark
[4] Climate Transition Benchmark

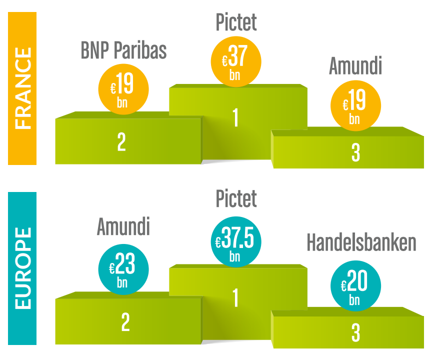
Source: Novethic

As far as management companies are concerned, the top three spots remain occupied by the same names year after year. Almost half of the funds are domiciled in Luxembourg, which is not surprising given its status as a European financial hub. Amundi is the French and European leader in terms of the number of funds listed in Article 9, with 55 funds available for sale in Europe, 71% of which are open to French investors. However, Pictet has the largest assets under management in the market, with over €37 billion. Of the 215 management companies offering Article 9 funds in Europe, 24 have opted for a wide range strategy with more than 10 Article 9 funds, which are driving the market, including: AXA WF, Candriam Sustainable, RobecoSAM, ACTIAM Duurzaam, Schroder ISF and ASN Duurzaam.

Top3 Management Companies by Number of Article 9 Funds



Top Three Article 9 Asset Management Companies

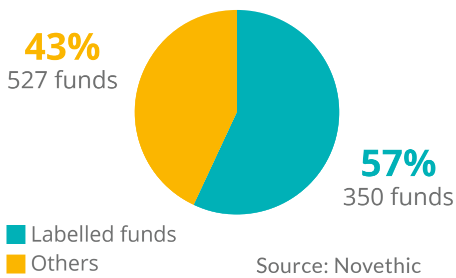


Source: Novethic

350 Article 9 funds hold one or more European sustainable finance labels, with the Label ISR leading the way, followed by Towards Sustainability. These funds account for 57% of assets under management. Luxembourg, France and the Netherlands are the three countries with the most Article 9 labelled funds.

Labels	Number of Funds
Label ISR	209
Towards Sustainability	155
FNG	43
Luxflag ESG	34
Greenfin	32
Nordic Swan	22
Umweltzeichen	21
Finansol	9
Luxflag Environment	3
LuxFlag Climate Finance	1

Article 9 Funds - % labelled assets

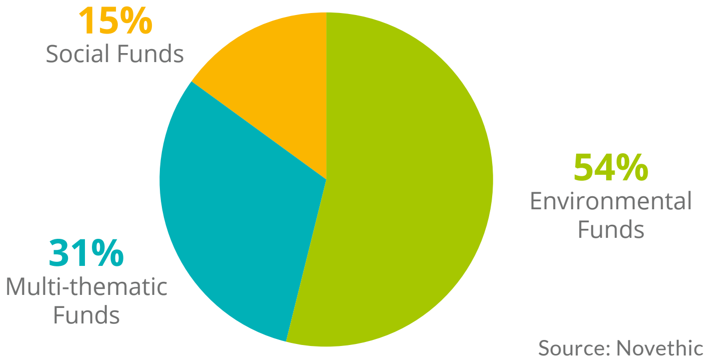


Source: Novethic

[2] This scope is defined as: « Sustainable investing [that] seeks to deliver competitive financial results, while also driving positive environmental, social, and corporate governance outcomes. ». Source: https://www.morningstar.com/articles/1058990/the-morningstar-sustainable-investing-framework

ALMOST HALF OF ARTICLE 9 FUNDS UNDER THEMATIC MANAGEMENT

The thematic approach is the most widely deployed strategy by fund managers after the more traditional ESG analysis. In June 2022, thematic management represented €209 billion in assets under management.



Source: Novethic

The environmental thematic remains the dominant approach, with funds focusing their sustainable investment objectives on three preferred sectors: Energy, Sustainable Consumption and Water. The predominance of environmental themes, which has long characterized sustainable funds in France and Europe, has of course been affirmed by the European regulations governing sustainable finance.

The trend towards low-carbon targets is growing, with 152 funds committing to a 7% annual reduction in their carbon footprint. These funds have already reduced their footprint by at least 30% compared to their investment universe, in order to move towards a portfolio with emissions that are in line with the objectives of the Paris Agreement. Low-carbon funds represent nearly 20% of the assets under management in the European scope of Article 9.

The funds promoting investment in social issues place the Health sector at the forefront, followed by Inclusion and the Fight against Inequalities, then Employment and Growth Issues. However, the structuring of a Social Taxonomy is still not on the European agenda. In the future, this type of regulation could encourage the development of pure social funds, which currently represent only 15% of the scope.

In addition to these funds with targeted thematic management methods, multi-thematic funds represent just over 30% of the sector. The Health theme is still in the majority here, combined with the thematics of the environmental top 3.

The thematics are often explicitly linked to certain Sustainable Development Goals in the funds' pre-contract documents. SDG 7 (Clean and Affordable Energy), 13 (Fighting Climate Change) and 12 (Responsible Consumption and Production) are the most popular among funds developing their management approach around their positive contributions, which confirms the bias towards environmental targeting.

DO ENERGY-FOCUSED GREEN FUNDS FINANCE THE ENERGY TRANSITION?

The energy crisis that Europe has been facing since the beginning of 2022 makes it more necessary than ever to invest rapidly in the energy transition. Article 9 "green" funds, with a sustainable investment objective focused on environmental issues, should be the preferred instruments for financing transition projects.

- 222 funds totaling €123 billion in Article 9 assets fall under the Energy thematic. In this category, the Renewable Energy thematic dominates, with 93% of the funds including it. Energy Efficiency is often a complement to the renewable energy objective and only 15 funds target efficiency alone.

- Funds that invest in Green Bonds are another source of financing for Energy transition projects that fall within the scope of bond benchmarks. This approach contributes up to €23 billion in green financing. Studies on the sector, such as that of the Climate Bonds Initiative[3], indicate that around 40% of Green Bond fund assets actually finance renewable energy and transition projects, i.e. €9 billion.

In total, this means that more than €131 billion can be used to work towards a climate resilient society based on an energy transition that is currently being implemented.

To be continued

The evolution of Article 9 funds will have to be followed closely in the second half of 2022. This will be a decisive period to prepare the reporting on PAIs just before "level 2" SFDR regulation becomes applicable, requiring the publishing of PAI information from June 2023. The same applies to data on the green share, which is still sorely lacking, even though European authorities have been encouraging fund managers to calculate the percentage of alignment with the EU Taxonomy since 2022.

The rise of a more stringent requirement is undoubtedly what led to the reclassification of roughly twenty Article 9 funds to Article 8 in the first half of 2022. This represents a small proportion of the market, but shows the gradual appropriation of the regulation after an initial phase of enthusiasm. Other funds with similar management styles (which apply a Best-in-Class ESG selection) could follow the same classification review, as this management method is not very well suited to the logic of demanding sustainable objectives and trajectory measurement with impact indicators.

[3] Source: Sustainable Debt, Global State of the Market 2021. Climate Bonds Initiative. https://www.climatebonds.net/files/reports/cbi_global_sotm_2021_02h_0.pdf

NOVETHIC MARKET DATA

Each quarter, Novethic captures trends in the European market for Article 9 funds under the SFDR regulation and continues to monitor the evolution of European funds with a sustainable finance label.

A Novethic publication conducted by Estelle Cazard, Nicolas Redon and Corinne Amori Brunet.

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Founded in 2001, Novethic, the sustainable transformation accelerator, is a subsidiary of the Caisse des Dépôts Group.

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