SFDR: Four Months After Its Introduction
Article 8 and 9 Funds in Review

Morningstar Manager Research
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Contents

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Executive Summary

On 10 March, the EU Sustainable Finance Disclosures Regulation took effect, requiring for the first time that asset managers provide information about their investments' environmental, social, and governance risks as well as impact on society and the planet. Funds have been classified into one of three categories, Article 6, 8, or 9, based on the sustainability objective.

In the report SFDR: The First 20 Days, we analysed the first classification exercise. In this report, we provide an update on the implementation of the regulation four months after its introduction. We analyse the landscape of Article 8 (light green) and Article 9 (dark green) products in terms of assets, market exposures, investment style (active vs. passive), ESG risk and controversial activities exposures, and holdings. We also take a deep dive into the variety of ESG approaches employed by these 'green' funds. Our analysis in based on Morningstar Direct data. As of 10 July, Morningstar had collected SFDR Level 1 data on close to 82% of funds available for sale in the European Union. (See Appendix for details on the covered universe.)

Key Takeaways

- Since the introduction of SFDR in March, asset managers have upgraded strategies and launched new ones that meet Article 8 or 9 requirements.
- Article 8 and 9 funds account for 30.3% and 3.7%, respectively, of reviewed fund assets and amount to EUR 3 trillion in total[1]. We estimate that Article 8 and 9 products could reach half of total assets in scope of SFDR within the next 12 months.
- Active management largely dominates the post-SFDR ESG fund landscape. Passive funds account for only 11% and 10% of assets in Article 8 and 9 funds, respectively.
- Fund companies have taken different approaches to product classification based on their own interpretation of the regulation, resulting in a wide range of ESG approaches represented in Articles 8 and 9 funds, with similar strategies featuring in both categories.
- In aggregate, Article 8 and 9 funds perform better on ESG metrics than the rest of the universe, Article 9 funds exhibiting higher sustainability credentials, as expected. Three fourths of Article 9 funds carry Morningstar Sustainability Ratings of either 4 or 5 globes, compared with 56% of Article 8. Article 9 funds also typically have lower involvement in controversial weapons, tobacco, fossil fuel, and severe controversies. They have higher exposure to carbon solutions, but at the same time they also exhibit higher exposure to thermal coal.

1 Ex-money market funds, funds of funds, and feeder funds.

What Are SFDR's Article 8 and 9 Funds?

The Sustainable Finance Disclosure Regulation, which came into effect on 10 March 2021, is a cornerstone of the European Commission's Action Plan on Sustainable Finance. The regulation aims to trigger changes in behavioural patterns in the financials sector, discouraging greenwashing and promoting responsible and sustainable investments. The SFDR will set common EU rules on:
i) how financial product manufacturers and financial advisors should inform end-investors about sustainability risks,
ii) how the impact of investments on the environment and society should be disclosed, and
iii) how financial products that are marketed as sustainability-related actually meet that ambition.

This enhanced transparency will increase awareness of financial products' sustainability credentials.

Under SFDR, the entire universe of European funds is being classified by their managers into one of three categories, Article 6, 8, or 9, based on the products' sustainability objective (see below). The nomenclature derives from the regulatory text, and all funds will be required to provide some ESG disclosure, as per Article 6, while Article 8 and Article 9 funds will be asked to provide more detailed ESG information to investors. (See regulatory update in the last section of this report.)

Exhibit 1 SFDR Classification

Source: Morningstar Research.

As previously reported and detailed further in this report, asset managers have taken different interpretations of the definitions[2], some opting for a softer approach than others. This has resulted in an unexpectedly high number and broad range of products labelled Article 8 (light green) and Article 9 (dark green).

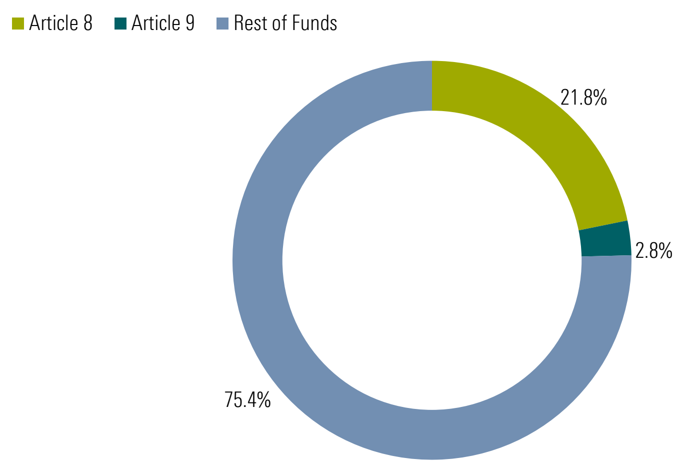
Assets in Article 8 and 9 Funds

As of 10 July, based on SFDR data collected from prospectuses on 81.6% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds, we find that 5,008 (21.8%) have been classified as Article 8, while 643 (2.8%) have been classified as Article 9. Combined, the two

2 To read more about the EU sustainability disclosures: EU Sustainability Disclosures and EU Taxonomy of Sustainable Activities.

categories represent close to a fourth (24.6%) of the overall EU fund universe. (See Appendix for details on the covered universe).

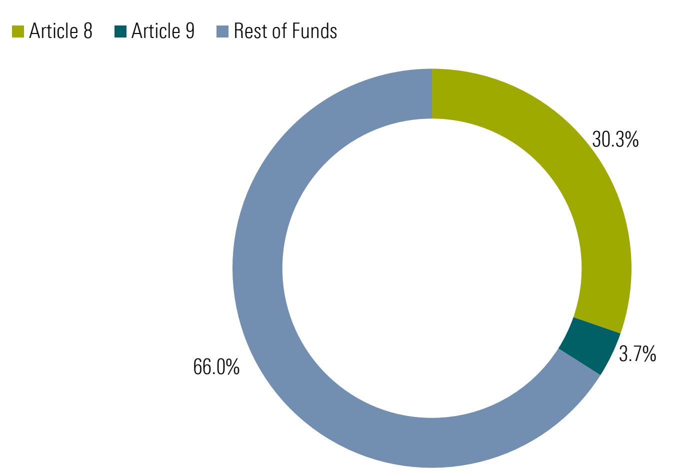
Exhibit 2 SFDR Fund Type Breakdown (by Number of Funds)



Source: Morningstar Direct. Data as of 10 July 2021. Based on SFDR data collected from prospectuses on 81.6% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds

In terms of assets, the two fund groups account for a bigger share of the EU universe: 34%, split into 30.3% for Article 8 funds and 3.7% for Article 9 products. Combined assets amount to shy of EUR 3 trillion (2.98 trillion).

Exhibit 3 SFDR Fund Type Breakdown (by Assets)



Source: Morningstar Direct. Data as of 10 July 2021. Based on SFDR data collected from prospectuses on 81.6% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds

From 34% of overall EU fund assets today, we predict that Articles 8 and 9 could reach 50% within the next 12 months as managers continue to upgrade strategies and launch new products that will meet Article 8 or 9 requirements. The proportion of Article 8 and 9 products has already increased since March (SFDR: The First 20 Days), and many managers are already reporting higher asset ratios, including Amundi (75%), BNP Paribas (80%), AXA (90%), and Robeco, (93%), while others who are currently exhibiting lower numbers plan to catch up. For example, DWS aims to categorise the quasi-totality of its EU fund assets under Article 8 or 9. Schroders targets a 70% ratio by the end of the year.

The Largest Article 8 and 9 Funds

In the table below, we show the 20 largest Article 8 funds based on the data collected so far. Two of Alliance Bernstein's fixed-income funds top the chart. In their prospectuses, **AB American Income** and **AB Global High Yield** state that they promote environmental and/or social characteristics through the consideration of material ESG factors and through engagement, with seemingly no binding constraints.

Exhibit 4 The 20 Largest Article 8 Funds

Name	SFDR Fund Type	Asset Class	AUM (EUR Billion)	Morningstar Sustainability Rating	Low Carbon Designation
AB American Income	Article 8	Fixed Income	21.1	—	—
AB Global High Yield	Article 8	Fixed Income	17.5	—	—
hausInvest	Article 8	Property	16.6	—	—
Fidelity Global Technology	Article 8	Equity	12.9	🌐🌐🌐🌐	Yes
Pictet-Global Megatrend Selection	Article 8	Equity	12.6	🌐🌐🌐	Yes
Carmignac Patrimoine	Article 8	Allocation	11.5	—	—
Allianz China A Shares	Article 8	Equity	11.4	🌐🌐	—
JPM Emerging Markets Equity	Article 8	Equity	11.0	🌐🌐🌐🌐🌐	Yes
Schroder ISF EURO Corporate Bond	Article 8	Fixed Income	10.6	🌐🌐🌐	No
Fidelity Global Dividend	Article 8	Equity	9.2	🌐🌐🌐🌐🌐	No
Robeco High Yield Bonds	Article 8	Fixed Income	9.2	—	
Swedbank Robur Technology	Article 8	Equity	8.6	🌐🌐🌐🌐	Yes
Algebris Financial Credit	Article 8	Fixed Income	8.6	🌐	No
Wellington Glbl Quality Growth	Article 8	Equity	8.6	🌐🌐🌐🌐	Yes
Opcimmo LCL Opcimmo	Article 8	Property	8.3	—	—
Pictet - Robotics	Article 8	Equity	8.2	🌐🌐🌐	Yes
Robeco Global Consumer Trends	Article 8	Equity	8.1	🌐🌐🌐🌐	Yes
Allianz Europe Equity Growth	Article 8	Equity	8.1	🌐🌐🌐🌐🌐	Yes
Swedbank Robur Allemansfond Komplett	Article 8	Equity	8.0	🌐🌐🌐🌐	Yes
Vontobel mtx Sustainable EM Leaders	Article 8	Equity	8.0	🌐🌐🌐🌐	Yes

Source: Morningstar Direct. Data as of 10 July 2021. Excluding money markets, feeder funds, and funds of funds.

Looking at the list, one may be surprised to see that the quasi-totality of the top 20 funds do not have any ESG or related terms in their names that would indicate that they are actively marketed by their asset managers as ESG or sustainable. There is only one: **Vontobel mtx Sustainable Emerging Markets Leaders**. Many investors would have expected more Article 8 funds to reflect the 'greenness' of their mandate in their name, as is the case for Article 9 funds, as shown below. Out of the 20 largest funds categorised under Article 9, 18 have terms in their names reflecting their sustainable strategy.

Exhibit 5 The 20 Largest Article 9 Funds

Name	SFDR Fund Type	Asset Class	AUM (EUR Billion)	Morningstar Sustainability Rating	Low Carbon Designation
Nordea 1 - Global Climate and Environment	Article 9	Equity	8.8	🌐🌐🌐🌐🌐	Yes
Pictet - Global Environmental Opportunities	Article 9	Equity	8.4	🌐🌐🌐🌐🌐	Yes
Pictet-Water	Article 9	Equity	7.7	🌐🌐🌐	Yes
Handelsbanken Global Index Criteria	Article 9	Equity	5.7	🌐🌐🌐	Yes
BlackRock GF - Sustainable Energy Fund	Article 9	Equity	5.7	🌐🌐🌐🌐🌐	No
ALM Souverains Euro ISR	Article 9	Fixed Income	5.6	—	—
Pictet-Clean Energy	Article 9	Equity	4.7	🌐🌐🌐🌐🌐	No
NN Duurzaam Aandelen Fonds	Article 9	Equity	4.0	🌐🌐🌐🌐🌐	Yes
Handelsbanken USA Index Criteria	Article 9	Equity	3.7	🌐🌐🌐🌐	Yes
Mirova Global Sustainable Equity	Article 9	Equity	3.7	🌐🌐🌐🌐🌐	Yes
RobecoSAM Smart Energy Equities	Article 9	Equity	3.6	🌐🌐🌐🌐🌐	Yes
BNP Paribas Funds Energy Transition	Article 9	Equity	3.5	🌐🌐🌐🌐	—
Handelsbanken Hållbar Energi	Article 9	Equity	3.5	🌐🌐🌐🌐	—
BNP Paribas Funds Global Environment	Article 9	Equity	3.3	🌐🌐🌐🌐🌐	Yes
BNP Paribas Funds Climate Impact	Article 9	Equity	3.2	🌐🌐🌐🌐	No
BNP Paribas Funds Aqua	Article 9	Equity	3.2	🌐🌐🌐	No
iShares Green Bond Index Fund (IE)	Article 9	Fixed Income	2.9	🌐🌐🌐🌐🌐	—
Amundi Funds - Global Ecology ESG	Article 9	Equity	2.8	🌐🌐🌐🌐🌐	Yes
AB Sustainable Global Thematic Portfolio	Article 9	Equity	2.8	🌐🌐🌐🌐	Yes
RobecoSAM Sustainable Water Equities	Article 9	Equity	2.7	🌐🌐🌐	Yes

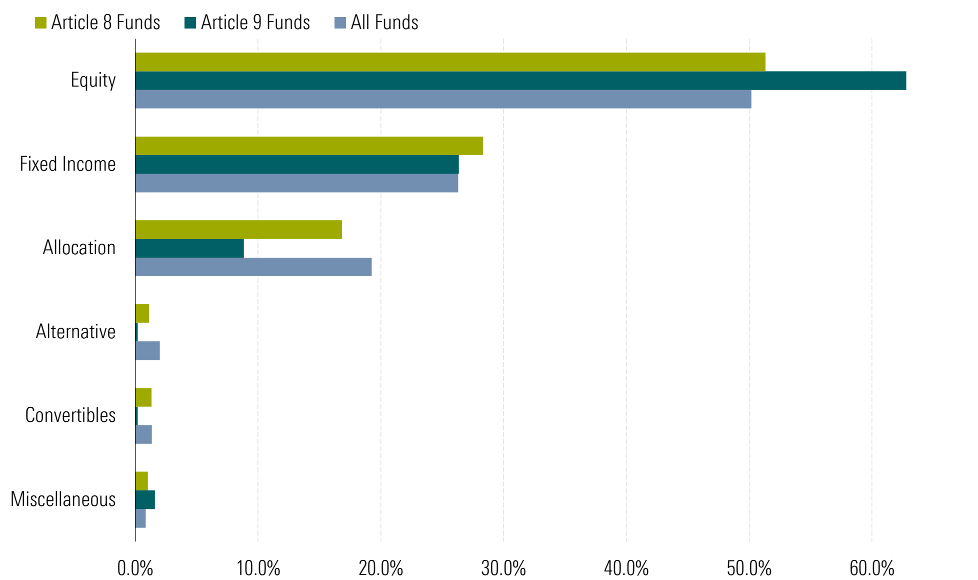
Source: Morningstar Direct. Data as of 10/07/2021. Excluding money markets, feeder funds, and funds of funds.

The leader board of Article 9 funds is well-staffed with products focused on the environment and themes like renewable energy, climate transition, and water. Three funds, namely **ALM Souverains Euro ISR**, **NN Duurzaam Aandelen Fonds**, and **Mirova Global Sustainable Equity**, offer broader exposure to the equity and bond markets.

Article 8 and 9 Funds per Broad Asset Class

In line with what we see in the overall fund universe, just over 50% of Article 8 funds offer exposure to equity, followed by fixed income (28%) and allocation (17%). The Article 9 universe, however, leans much more towards equity, with equity funds accounting for close to 63% of that group, at the expense of allocation funds, which represent less than 9% of Article 9 funds, half of what investors can find in the overall fund market.

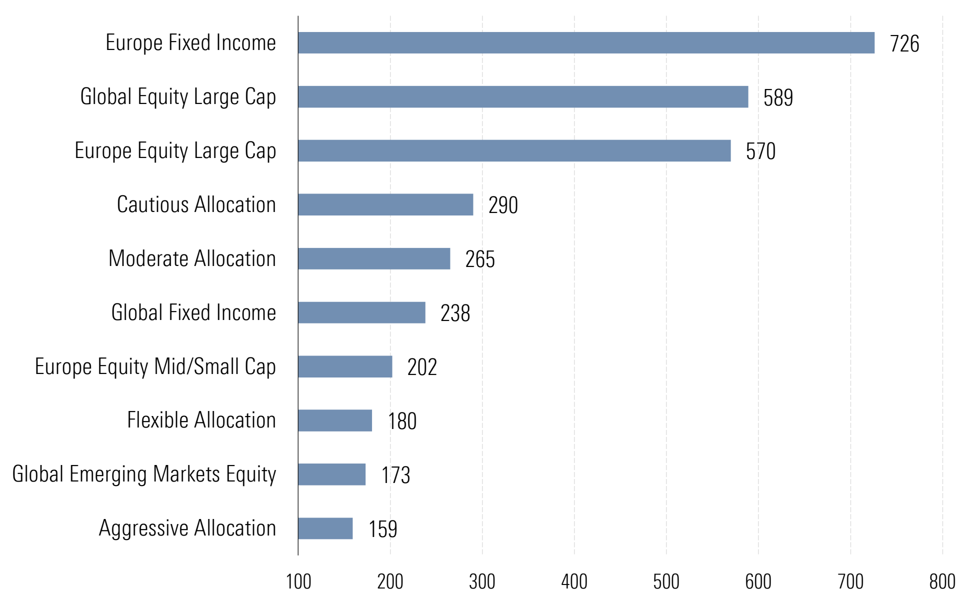
Exhibit 6 Article 8 and 9 Funds per Broad Asset Class



Source: Morningstar Direct. Data as of 10 July 2021. Excluding money markets, feeder funds, and funds of funds

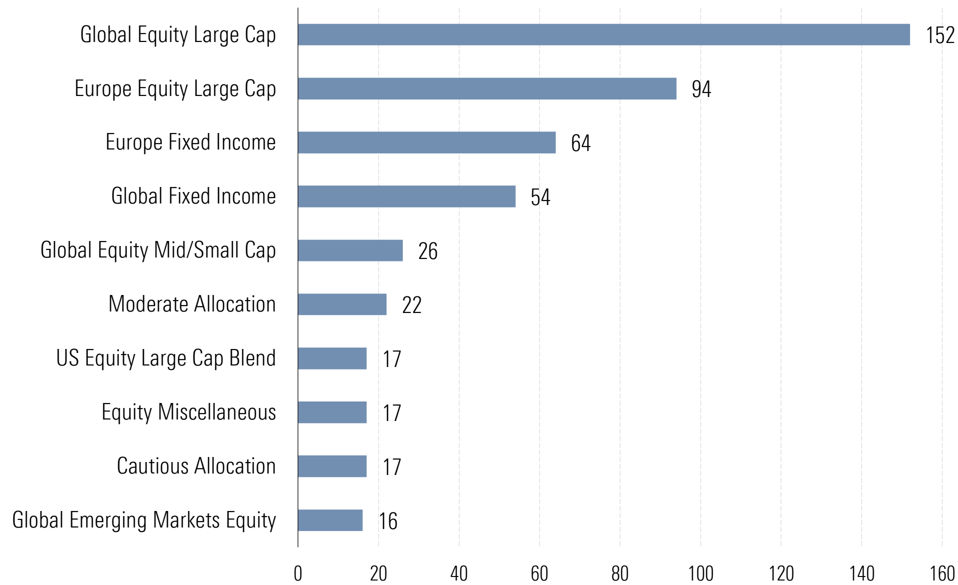
Europe fixed income is the most represented Morningstar Global Category in the Article 8 funds category. These include about 250 Euro corporate and diversified bond funds. Article 8 and 9 are also found in great numbers in the global equity large cap Morningstar Category.

Exhibit 7 The 10 Most Represented Morningstar Global Categories in Article 8 Funds



Source: Morningstar Direct. Data as of 10 July 2021. Excluding money markets, feeder funds, and funds of funds.

Exhibit 8 The 10 Most Represented Morningstar Global Categories in Article 9 Funds

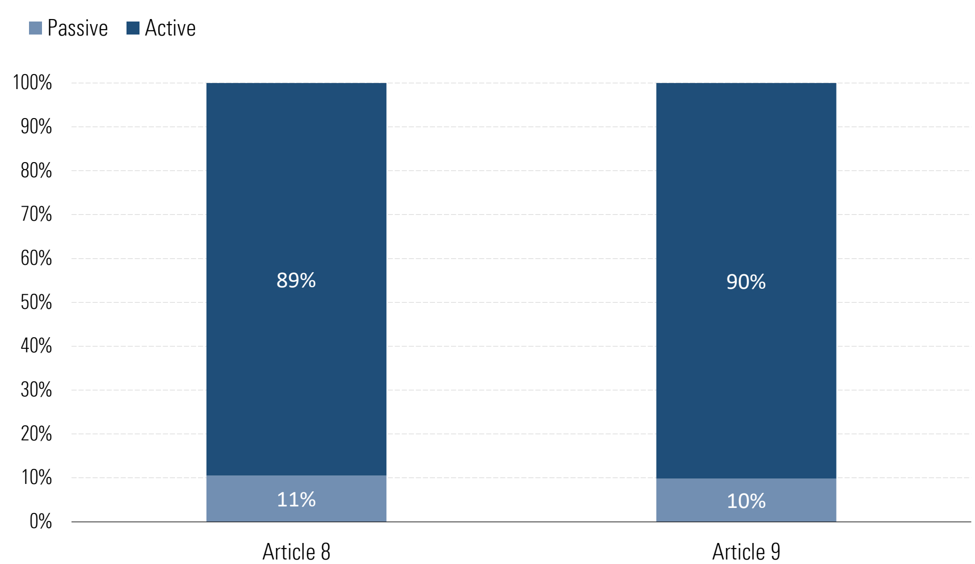


Source: Morningstar Direct. Data as of 10 July 2021. Excluding money markets, feeder funds, and funds of funds.

Passive Article 8 and 9 Funds

Based on the data collected so far, we find that active management largely dominate the post-SFDR ESG fund landscape. Passive funds account for only 11% and 10% of assets in Article 8 and 9 funds, respectively. This is half the 21% market share for passive funds in the overall European fund universe.

Exhibit 9 Article 8 and 9 Funds - Active vs. Passive



Source: Morningstar Direct. Data as of 10 July 2021. AUM as of 30 June 2021. Excluding money markets, feeder funds, and funds of funds.

Exhibit 10 The 10 Largest Passive Article 8 Funds

Name	SFDR Fund Type	Asset Class	AUM (EUR Billion)	Investment Type	Morningstar Sustainability Rating
KLP AksjeGlobal indeks	Article 8	Equity	7.7	Index Fund	🌐🌐🌐
iShares MSCI USA SRI ETF	Article 8	Equity	6.7	ETF	🌐🌐🌐🌐🌐
State Street World ESG Screened Index Equity	Article 8	Equity	5.4	Index Fund	🌐🌐🌐
iShares Global Clean Energy ETF	Article 8	Equity	4.8	ETF	🌐🌐🌐🌐
SPDR® Bloomberg SASB U.S. Corporate ESG ETF	Article 8	Fixed Income	4.7	ETF	🌐🌐🌐🌐🌐
Handelsbanken Sverige Index Criteria	Article 8	Equity	4.3	Index Fund	🌐🌐🌐
Länsförsäkringar Global Index	Article 8	Equity	4.1	Index Fund	🌐🌐🌐
Northern Trust EMC ESG Equity Index Fund	Article 8	Equity	3.9	Index Fund	🌐🌐🌐
iShares MSCI World SRI ETF	Article 8	Equity	3.9	ETF	🌐🌐🌐🌐🌐
iShares MSCI Europe SRI ETF	Article 8	Equity	3.9	ETF	🌐🌐🌐🌐🌐

Source: Morningstar Direct. Data as of 10 July 2021. AUM as of 30 June 2021. Excluding money markets, feeder funds, and funds of funds.

The top 10 passive funds classified as Article 8 represent a mix of ESG strategies, including five index funds that employ only sector and norms-based exclusions, four exchange-traded funds that adopt a best-in-class approach, and one thematic ETF focused on clean energy.

Exhibit 11 The 10 Largest Passive Article 9 Funds

Name	SFDR Fund Type	Asset Class	AUM (EUR Billion)	Investment Type	Morningstar Sustainability Rating
Handelsbanken Global Index Criteria	Article 9	Equity	5.7	Index Fund	🌐🌐🌐
Handelsbanken USA Index Criteria	Article 9	Equity	3.7	Index Fund	🌐🌐🌐🌐
iShares Green Bond Index Fund (IE)	Article 9	Fixed Income	2.9	Index Fund	🌐🌐🌐🌐🌐
Handelsbanken Europa Index Criteria	Article 9	Equity	2.1	Index Fund	🌐🌐🌐
Amundi MSCI World Climate Transition CTB	Article 9	Equity	1.5	Index Fund	🌐🌐🌐
ACTIAM Duurzaam Index Aandelenf. Noord-Amerika	Article 9	Equity	1.4	Index Fund	🌐🌐🌐🌐
Danske Invest Index USA Restricted	Article 9	Equity	1.4	Index Fund	🌐🌐🌐
Handelsbanken Global Småbolag Index Criteria	Article 9	Equity	1.3	Index Fund	🌐🌐🌐
Danske Invest Index Global AC Restricted	Article 9	Equity	1.3	Index Fund	🌐🌐🌐
ACTIAM Duurzaam Index Aandelenfonds Europa	Article 9	Equity	1.1	Index Fund	🌐🌐🌐

Source: Morningstar Direct. Data as of 10 July 2021. AUM as of 30 June 2021. Excluding money markets, feeder funds, and funds of funds.

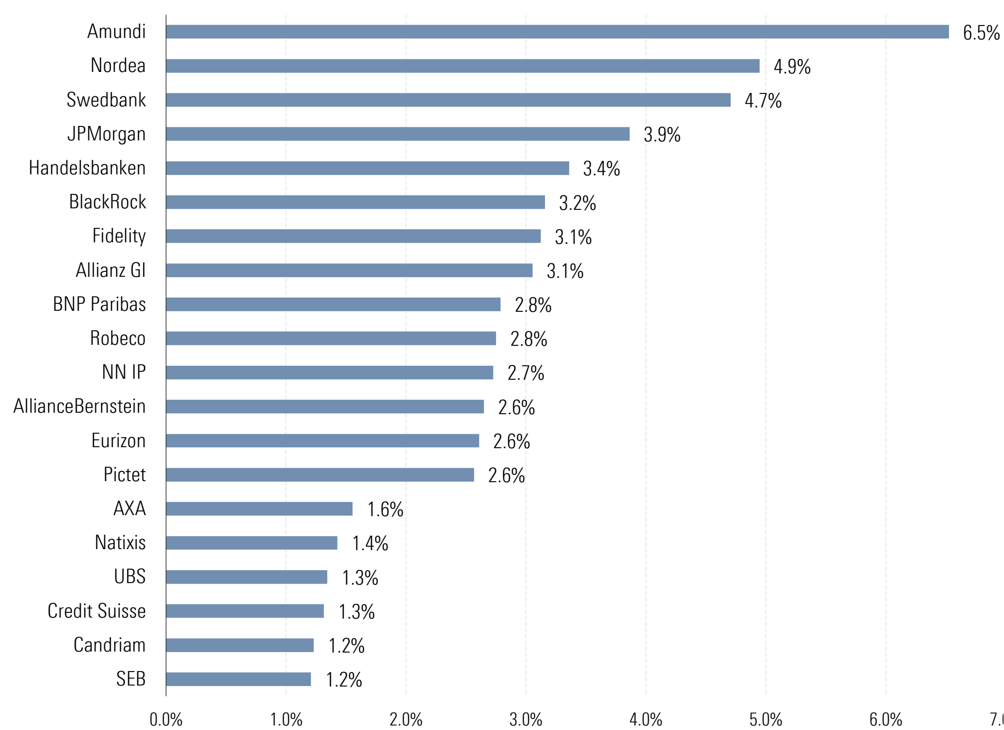
Nordic-domiciled index funds dominate the passive Article 9 league table. These include four Handelsbanken products which, in May, switched to new Paris-Aligned Benchmarks. To achieve Paris-alignment classification, a fund must invest in companies that reduce their emissions by an average of 7% annually—the pace of phasing-out of fossil fuels set out in the Paris Agreement—and the fund overall must have a carbon-emissions footprint 50% below that of the broader market. On 1 July, Danske Invest from Denmark followed in the footsteps of the Swedish manager and converted six of its responsible index funds to EU Climate Transition Benchmarks. Their underlying assets are now selected, weighted or excluded in such a way that the overall portfolios are on a decarbonisation trajectory.

The two ACTIAM index funds in the table take a different approach to achieve their sustainable investment objectives. They track conventional indexes but exclude companies that do not meet ACTIAM's ESG policies. In May last year, the Dutch manager refined its exclusion policy by increasing the percentage of excluded companies to 20% from 5%, including a large number of companies in the oil and gas industry.

Asset Manager Ranking

Exhibit 12 ranks the 20 asset managers with the largest Article 8 and 9 fund assets, based on SFDR data representing 82% of the EU fund universe excluding money markets, feeder funds, and funds of funds. Amundi tops the league table, with a 6.5% market share, followed by Nordea and Swedbank.

Exhibit 12 Asset Manager Ranking by Article 8 and 9 Fund Assets



Source: Morningstar Direct using 'Branding Name' as a filter and based on AUM data as of 30 June 2021. SFDR data as of 10 July 2021. Excluding money markets, feeder funds, and funds of funds.

Since the introduction of SFDR in March, managers have upgraded funds and launched new ones classified as either Article 8 or 9. For example, in May, JPMorgan uplifted 55 funds from Article 6 to Article 8. Out of 210 funds launched in the second quarter for which we have reviewed SFDR disclosures, 48% were classified as Article 8 or 9.

Fund companies feel commercial pressure to have as many funds as possible meeting at a minimum Article 8 requirements. Many distributors and fund buyers across Europe have said they would only consider funds in Article 8 and 9 categories going forward.

Different Interpretations, Different Approaches

As previously mentioned, asset managers have taken different approaches to fund classification based on their interpretation of the regulation. And these different approaches have resulted in a wide range of investment products classified as Articles 8 and 9, with similar strategies featuring in both categories, suggesting that some asset managers may have taken a too prudent approach while others took a too generous approach.

Below is a representation of the spectrum of green approaches adopted by Article 8 and 9 funds and where they overlap.

Article 8 Funds

Article 8 refers to financial products that promote "among other characteristics, environmental or social characteristics", provided that companies in which the investments are made follow good governance practices. Many asset managers have interpreted the term "promotion" as to mean there must be a "binding element" in the investment selection process.

As expected, the Article 8 category is a catch-all category, with a wide range of products applying a variety of ESG approaches, ranging from exclusions-only to a dark-green thematic approach.

Exclusions

Exclusions—also referred to as *negative screening*—focuses mostly on avoiding securities, issuers, or industries based on certain activities and business practices. Exclusions are typically based on values, norms, or opinions. Commonly, screening targets companies in breach of the UN Global Compact Principles—a set of globally accepted standards on human rights, labour, environment, and corruption—and those associated with controversial products such as weapons and tobacco. More recently, amid a heightened public awareness of environmental issues and rising concerns about climate risks, the list of common exclusions has expanded to include thermal coal, tar sands, Arctic oil, oil sands, as well as traditional oil and gas producers and distributors.

Looking at the data collected so far, we find that the majority of funds classified as Article 8 apply exclusions. Some employ more expansive exclusions than others. Some, mostly passive funds, apply only exclusions. Examples include:

> ***iShares MSCI Europe ESG-Screened ETF*** *tracks an index that "**excludes** companies […] associated with controversial and nuclear weapons; producing tobacco; or deriving their revenues from the following activities: (i) thermal coal; (ii) tobacco; (iii) civilian firearms; or (iv) oil sand. Companies that are classified as violating United Nations Global Compact principles are also excluded from the Index."*

> ***L&G Asia Pacific ex Japan Equity ETF**, which doesn't have ESG or any related terms in the name, tracks an index that "**excludes** companies: (a) engaged in pure coal mining; (b) involved in the production of controversial weapons […]; or (c) that, for a continuous period of three years, have been classified as being in breach of at least one of the UN Global Compact principles."*

Some passive funds apply more expansive exclusion lists. For example:

> ***Vanguard ESG Global Corporate Bond ETF** promotes environmental and social characteristics by **excluding** fixed income securities […] that engage in activities in, and/or derive revenue […] from adult entertainment, alcohol, gambling, tobacco, nuclear weapons, controversial weapons, conventional weapons, civilian firearms, nuclear power, GMO, or thermal coal, oil, or gas. The index methodology also excludes the bonds of issuers that […] have no controversy score or a controversy score of less than one as defined by MSCI's ESG controversies assessment framework.*"

Since the introduction of SFDR, more active funds state in their legal documents that they apply an exclusions policy. It is worth noting that a fund can invest within an investment universe that generally exhibits a high level of ESG performance across constituents. Consequently, the screenings that apply to the strategy have limited impact on the investment universe and the actual investments of the fund, and only serve as an insurance that underlying investments consistently represent the expected ESG characteristics of the asset class.

Exclusions + ESG Integration

For many Article 8 active funds, exclusions are only the first step in the investment process. In addition to screening out controversial activities, and sometimes also the worst rated issuers, an investment manager integrates ESG factors in financial analysis. ESG considerations contribute to investment decisions but are not the main drivers. Examples include:

> ***Bright Stars SICAV SIF - VITALIX**--"The **exclusions** applied to the investment universe rely on a two-levels approach: a) Controversial activities and Jurisdictions; and b) All entities displaying weak ESG ratings. On top of those exclusions, the investment manager **applies ESG scores to analyze issuers** and to monitor investments, **from a risk-management perspective.***"

Exclusions + ESG Integration + Engagement

Many Article 8 strategies state that they promote ESG characteristics via a combination of approaches, including exclusions, ESG integration, and engagement. Examples include:

> ***Neuberger Berman Global Bond**--"ESG factors are integrated at three different levels:*

*1) **Exclusion lists**. The Investment Manager and Sub-Investment Managers exclude companies, which are involved in controversial weapons, child labour, and the tobacco industry and thermal coal mining companies.*
*2) **Integration of ESG factors in fundamental analysis**. ESG scores are assigned to each issuer using the proprietary ESG scoring system.*
*3) **Analysis of Controversies and Direct Engagement**. The Investment Manager […] engages with corporate issuers which have high impact controversies or which have low internal ESG scores to assess if the issues are being addressed."*

***CS (Lux) European Dividend Plus Equity** "promotes ESG characteristics […] through a combination of **exclusions, ESG integration and active ownership**. The most material ESG factors are combined with traditional financial analysis to make an ESG adjusted risk-return assessment, which serves as the basis for the portfolio construction. […]"*

Some strategies apply a formal and targeted engagement program. Examples include:

Allianz Floating Rate Notes Plus "promotes responsible investment by including environmental factors and ***climate engagement with outcome and proxy voting*** in the analysis of investments. A Sub-Fund managed in accordance with the Climate Engagement Strategy promotes an environmental characteristic through the engagement with the top 10 carbon emitting issuers of the fund to encourage their transition pathway to a low carbon economy by setting objectives targets which are sector specific. […] In addition, the fund ***excludes*** issuers associated with severe violations of United Nations Global Compact Violators, involved in the production of controversial weapons, thermal coal extraction, tobacco."

ESG Integration + Engagement

While the vast majority of funds classified as Article 8 apply some level of exclusions, not all Article 8 strategies do, or at least do not state it explicitly in their legal documents. Some funds promote environmental and/or social characteristics by focusing on the consideration of financially material ESG factors and engagement. Examples include:

***Federated Hermes Global Small Cap Equity Fund** "through its **ESG and stewardship integration approach**, promotes environmental and/or social characteristics […]. The Investment Manager assesses the material ESG characteristics of a company by considering a variety of sources. […] The Investment Manager may invest in companies with material ESG issues where the company has shown a desire to improve their ESG behaviours and can demonstrate good corporate governance practices and/or a willingness to **engage** in issues if they arise. […] The dedicated stewardship team […] encourages companies to improve their ESG practices."*

***Alliance Bernstein Emerging Markets Corporate Debt**--"For AB, promotion of environmental and/or social is accomplished through a combination of the following:*

> *1. **integration of ESG Factors** […] into all aspects of the investment making process whereby the impacts of a target investment with respect to ESG Factors will be assessed through all steps of the investment process; and*
> *2. **extensive engagement** with corporate issuers and governments to encourage action and progress towards environmental, social and governance goals.*"

In some cases, the fund focuses solely on ESG integration, with seemingly no binding ESG criteria. Examples include:

> ***Artemis Funds (Lux) Global Select***--"*The fund promotes environmental and/or social characteristics within the meaning of Article 8 of SFDR. In that respect, the Investment **Manager assesses the sustainability of each investment**, including ESG factors […] alongside traditional financial metrics. However, investments are chosen on the basis of many attributes and need not rate highly on any or all of these sustainability factors to be included in the portfolio.*

Portfolio-Level ESG Metrics

In addition to exclusions, ESG integration, and engagement, some Article 8 funds have set explicit binding constraints at the portfolio level. They must, for example, achieve a higher aggregate ESG score or lower carbon intensity than their benchmark or investment universe. Some use an optimiser to maximise exposure to issuers with higher ESG ratings. Examples include:

> ***Amundi European Equity Conservative*** "*integrates Sustainability Factors in its investment process […). Further, the Sub-Fund seeks to **achieve an ESG score** of its portfolio **greater than that of the Benchmark**. […] ESG performance is assessed by comparing the average performance of a security against the security issuer's industry, in respect of each of the three ESG characteristics of environmental, social and governance. […]*"

> ***Carmignac Euro-Entrepreneurs*** "*is managed according to a low-carbon-emission approach with the goal of **keeping its carbon intensity 30% lower than that of the reference indicator** […]. Extra-financial analysis is applied to the investment strategy through the following processes, which actively **reduce the fund's investment universe by at least 20%**: (1) **Negative screening** to exclude certain equity issuers on the basis of energy-related or ethical criteria. (2) **Positive screening** to define the equity investment universe in order to identify companies demonstrating solid governance and corporate conduct […] and companies that demonstrate an environmental policy targeting either low carbon emissions or climate risk management. Particular attention is paid to the way in which companies can contribute positively to achieving these sustainable development objectives. The fund also applies **standards-based exclusions** to exclude certain companies having exposure to controversial sectors and/or activities and breaching international standards.*"

> ***iShares MSCI Europe ESG Enhanced ETF*** "*aims to reflect the return of the MSCI Europe ESG Enhanced Focus Index. […] The index excludes companies from the Parent Index based on the*

> *index provider's **ESG exclusionary criteria**. The remaining companies are then weighted by the index provider using an optimisation process to **maximise exposure to companies with higher ESG ratings and reduce exposure to carbon emissions** relative to the parent Index. […]"*

Security-Level ESG Metrics

Some strategies set minimum ESG criteria for a portion of the portfolio. Examples include:

> ***JPM Europe Equity** invests "**at least 51% of assets are invested in companies with positive environmental and/or social characteristics** that follow good governance practices […]. The Investment Manager evaluates and applies **values and norms-based screening** to implement exclusions." In addition, securities must be within the top 80% threshold based on their ESG score.*

> ***Fidelity Emerging Markets Fund** "invest **at least 50% of its net assets in shares of companies that maintain sustainable characteristics**. […] The fund adheres to the firm-wide **exclusion** list […]."Equally, issuers which the Investment Manager considers have failed to conduct their business in accordance with accepted **international norms**, […] will not form part of the fund's investment universe."*

Best-in-Class

A large number of Article 8 funds are broad ESG funds that employ a best-in-class or positive screening strategy. They seek to invest in securities of issuers that exhibit strong or improving ESG credentials. Examples include:

> ***JPMorgan Emerging Markets Sustainable Equity Fund** invests "primarily in emerging market **sustainable companies** or companies that **demonstrate improving sustainable characteristics**. Sustainable companies are those that the Investment Manager believes to have effective governance and superior management of environmental and social issues. […]"*

> ***Invesco Sustainable Pan European Structured Equity Fund** invests in […] companies, which meet the Fund's ESG criteria with a particular focus on environmental issues. The Fund's ESG criteria will be based on a set of screening thresholds […]. **Positive screening** will be used based on an **integrated-best-in-class approach** to identify issuers, which in the view of the Investment Manager meet sufficient practice and standards in terms of transition to a lower carbon economy […]. Screening will also be employed to **exclude** companies […] which derive or generate a pre-determined level of revenue or turnover from activities such as (but not limited to) fossil fuel industries, coal or nuclear power, extraction of tar sands and oil shale, fracking or arctic drilling activities."*

Thematic

And finally, also included in the Article 8 category are funds with a sustainable theme such as climate change, gender diversity, and sustainable water. In addition to ESG criteria considered during company selection, other sustainability criteria are taken into account in the thematic analysis at sector and company level. Examples include:

> ***Fidelity Sustainable Water & Waste*** *adopts a* ***Sustainable Thematic strategy*** *which actively seeks to select companies involved in the design, manufacture or sale of products and services used for or in a connection with water and waste management sectors.* ***At least 70% will be invested in securities that maintain sustainable characteristics****. […] The fund complies with a* ***principle-based exclusion*** *framework which includes norm-based and negative screening of sectors, companies, practices based on specific ESG criteria […]. The fund may also invest in issuers which demonstrate improving sustainable characteristics."*

> ***iShares Global Clean Energy ETF*** *tracks an index that "comprises companies involved* ***in clean energy production*** *or the provision of* ***clean energy equipment & technology*** *from both developed and emerging markets. […] Companies exceeding a pre-determined carbon-to-revenue footprint standard score […] are* ***excluded*** *from the Index. The Index is weighted by market capitalisation. […] The Index caps individual constituent weights […]."*

> ***Lyxor Net Zero 2050 S&P Eurozone Climate PAB (DR) ETF*** *"tracks the S&P Eurozone Large Mid Cap* ***Paris-Aligned Climate Index****. […] The Index aims to meet and maintain the criteria set out by the European Union's Technical Expert Group on Climate Benchmark's ESG Disclosures, to qualify as an* ***EU Paris-Aligned Benchmark****."*

Impact

> ***AZ Fund 1 - AZ Bond - Green & Social*** *"invests between 50% and 100% of its net assets in* ***green bonds and/or social bonds*** *issued […] by governments, supranational institutions, governmental authorities and/or companies from anywhere in the world […] The Sub-fund seeks to* ***maintain an overall ESG rating of at least BBB at portfolio level****, calculated based on [MSCI] ESG ratings."*

> ***UniInstitutional Green Bonds*** *- "invests at least 51% in Green Bonds of international issuers."*

> ***Goldman Sachs Global Environmental Impact Equity Portfolio*** *invest at least two thirds of its net assets in […]* ***companies that […] are aligned to the key themes associated with solving environmental problems*** *including, but not limited to, clean energy, resource efficiency, sustainable consumption and production, waste management & recycling and water sustainability. […] The Investment Adviser will generally seek to* ***avoid investing*** *in companies that are […] directly engaged in, and/or deriving significant revenues from the following activities […] but are not limited to: controversial weapons […]; tobacco; extraction and/or production of certain fossil fuels; adult entertainment; for-profit prisons; and civilian firearms."*

Article 9 Funds

The Article 9 category is the category that asset managers consider “dark green”. They invest in companies offering products and services that are deemed to contribute positively to society, while making sure the companies don't do significant harm and follow good governance practices. As a result, a majority of Article 9 funds have a thematic and/or impact focus aligned with one or more of the UN Sustainable Development Goals.

That said, we’re seeing categorised under Article 9 strategies that look similar to those classed as Article 8, including thematic and core ranges of sustainable funds that employ a best-in-class or positive screening approach. This suggests that some managers may have taken a too prudent classification approach or others a too generous approach. It could be the case that managers who parked more funds into Article 9 are more confident in their ability to demonstrate the “sustainable” nature of their investments in their future disclosures. Examples of Article 9 strategies include:

Best-in-Class

> ***Candriam Fund Sustainable Euro Corporate Bonds Fossil Free*** *"aims to have long-term* ***positive impact*** *on environment and social objectives. More specifically the fund aims to* ***achieve overall greenhouse gas emissions at least 30% lower than those of the benchmark*** *(for corporate issuers), and to* ***invest*** *at least 10% (and 20% by the end of 2025) of its assets* ***in green bonds*** *[…]. To achieve these objectives the fund implements a combination of positive* ***selection of the best issuers*** *based ESG criteria,* ***exclusion*** *of issuers detrimental to these objectives or deemed to prone to controversies. In particular, the fund* ***excludes issuers from the fossil fuel industry*** *such as oil & gas companies or power utilities producing electricity from natural gas. […]."*

> ***AXA World Funds - Framlington Sustainable Eurozone*** *invests "in sustainable securities that have implemented good practices in terms of […] ESG practices. Firstly, the Sub-Fund bindingly applies* ***AXA IM's Sectorial Exclusion and ESG Standards Policies*** *[…] and a* ***"Best-in-class" selectivity approach*** *which consists in selecting the best issuers in the investable universe based on their extra-financial ratings with a focus on the Climate Change scores […]. Secondly, […] the securities selection process relies on a rigorous analysis of the companies' business model, underlying assets and balance sheet, whether the company meets* ***Responsible Investment criteria*** *and risk/return profile. […]"*

Thematic

> ***RobecoSAM Sustainable Water*** *"is a thematic equity product offering investors pure access to a high-impact,* ***sustainable investment theme*** *[…]. The Fund employs systematic, bottom-up stock selection that combines proprietary ESG data and research throughout the investment process.* ***ESG criteria for exclusions and theme-specific suitability*** *are applied during universe construction. […]. Direct and active* ***engagement*** *with the management of portfolio companies*

on sustainability topics offers additional channels for ***sustainable impact****. […] The Fund directly contributes to* ***UN Sustainable Development Goals*** *via its focus on protecting and improving water quality and supply.*"

Pictet - Clean Energy *invests in "****companies that contribute to lowering carbon emissions*** *by, for instance, favouring* ***clean energy*** *in their production process. The investment manager uses a combination of market and fundamental company analysis with a bias towards companies with superior ESG characteristics […]. It also applies an* ***exclusion*** *policy […]. It methodically* ***exercises voting rights and may engage*** *with issuers in order to positively influence ESG practices.*"

Handelsbanken Europa Index Criteria *tracks "the Solactive ISS ESG Screened* ***Paris Aligned Europe Index****. The companies in the index are selected and weighted in such a manner that the index portfolio's greenhouse gas emissions are aligned with the long-term global warming targets in the Paris Agreement. […] The index follows, and in several cases exceeds, the minimum requirements set in the* ***Benchmark Regulation for Paris Aligned Benchmarks****.*"

Impact

DWS Invest Green Bonds *"predominantly invests in interest-bearing debt securities issued by public, private and semi-private issuers worldwide that finance special ESG related/themed projects. Mainly that covers* ***Green Bonds****, which are debt instruments where the use of proceeds is limited to projects with environmental and/or climate benefits […].*"

Credit Suisse (Lux) Environmental Impact Equity Fund *invests at least two-thirds of its assets worldwide in […] companies whose products, services and business models are built on offering and developing solutions which have* ***a real and direct impact*** *on solving the most pressing environmental and climate issues. The Fund has sustainable investments as a primary investment objective […]. The objective is attained through a dedicated investment process focusing on* ***investments in themes and sectors whose economic activities address specific ESG challenges.*** *[…]*"

How Do Article 8 and 9 Funds Stack Up?

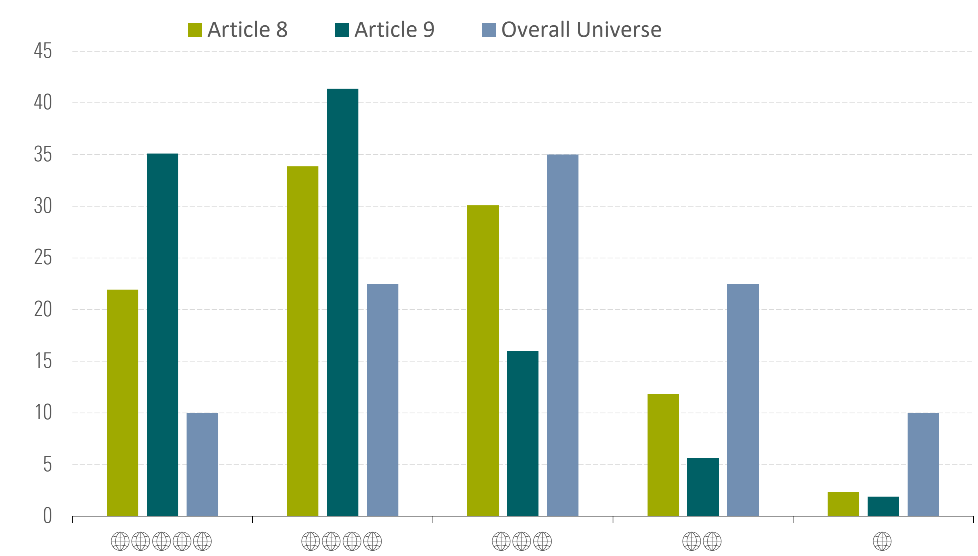
Independent of their classifications, we can use other metrics to assess whether Article 8 and 9 funds exhibit desirable ESG characteristics. For example, do they have a high exposure to companies with less ESG risk? Do they have low exposure to severe controversies? Do they invest in companies whose activities and products are well aligned with a low-carbon economy? In this section, we address these questions and compare the ESG characteristics of Article 8 and 9 funds and the extent to which they differ from the overall fund universe.

Do Article 8 and 9 Funds Manage Their ESG Risks Better Than Conventional Funds?

Here, we look at the extent to which Article 8 and 9 funds are investing in companies with lower ESG risk using the Morningstar Sustainability Rating. Also known as the "globe rating", the Morningstar Sustainability Rating is a measure of how well a fund's holdings are managing their ESG risks relative to the fund's peer group. Globes are awarded based on a normal distribution within each Morningstar Global Category.

Certainly, we should expect Article 8 and 9 funds to be managing their ESG risks better than the rest of the fund universe. As seen in Exhibit 14, that is indeed the case. The rating distribution skews towards the higher Sustainability Ratings for Article 8 and 9 funds. The percentage of funds with 4 and 5 globes is highest among Article 9 funds. Nearly 75% of rated Article 9 funds have a Sustainability Rating of 4 or 5 globes, indicating they invest in companies with lower ESG risks than their broader peer groups. About 56% of Article 8 funds have a 4 or 5-globe rating, which is higher than the percentage suggested by the ratings distribution of the overall universe (32.5%) but lower than the percentage of Article 9 funds. It is also lower than the 72% figure exhibited by the sustainable fund universe, as reported by Morningstar at the end of 2020. This can be explained by the broad spectrum of ESG strategies represented in the Article 8 category, including strategies that consider financially material ESG factors but are not required to divest from ESG laggards.

Exhibit 13 Globe Distribution for Article 8 and 9 Funds Compared With the Overall Fund Universe



Source: Morningstar Direct. Data as of 10 July 2021. Excluding money markets, feeder funds, funds of funds, and funds with no Morningstar Sustainability Rating (due to insufficient coverage of portfolio holdings, for example).

Do Article 8 and 9 Funds Have Low Exposure to Controversial Activities?

As we will see in the next section, more funds than ever before aim to avoid companies associated with controversial products such as controversial weapons, tobacco, and fossil fuel, as well as companies facing severe controversies. Yet, investors should not assume that all ESG funds do so, including Article

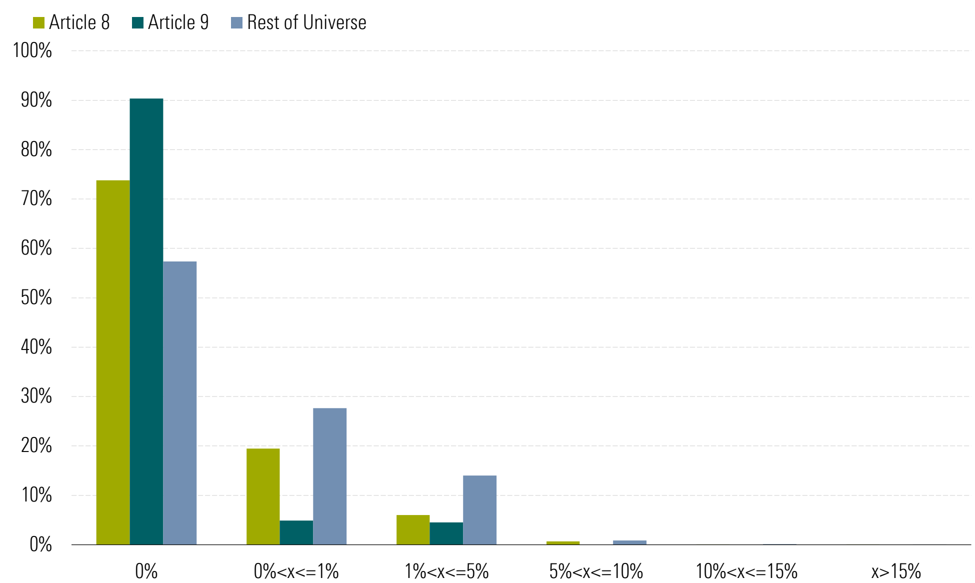
9 funds, which are supposed to invest in what SFDR defines as sustainable companies provided that these companies do not also cause significant harm. Many asset managers have incorporated the DNSH (do no significant harm) principle in their Article 8 and 9 strategies by excluding issuers that violate international norms as defined by the UN Global Compact Principles.

Here, we will examine the level of exposure of Article 8 and 9 funds to some of these activities.

Controversial Weapons

First, we test the exposure of Article 8 and 9 funds to controversial weapons. For this, we use Morningstar's "Product Involvement % - Controversial Weapons" data point[3].

Exhibit 14 Article 8 and 9 Funds' Involvement in Controversial Weapons



Source: Morningstar Direct. Data as of 10 July 2021. Excluding money markets, feeder funds, and funds of funds.

As expected, Article 8 and 9 funds are less exposed to controversial weapons than the rest of the EU fund universe. About 74% and 90% of Article 8 and 9 portfolios, respectively, have zero involvement in controversial weapons. This compares with just 57% of nonclassified funds.

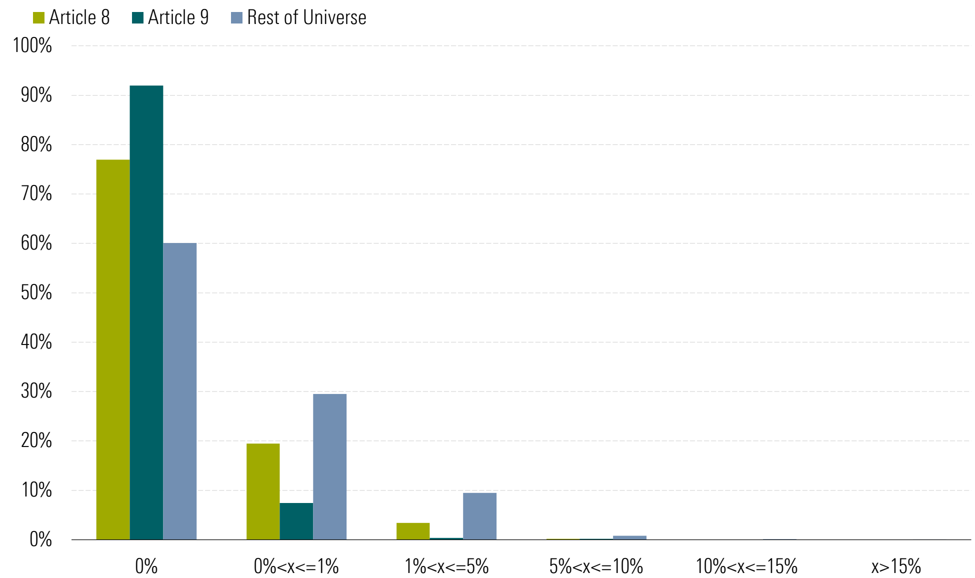
Tobacco

Next, we test the exposure of Article 8 and 9 funds to tobacco. For this, we use Morningstar's "Product Involvement % - Tobacco" data point[4].

3 "Product Involvement % - Controversial Weapons" refers to the percentage of a fund's assets under management that is invested in companies that are classified as directly involved in the core weapon system that are considered tailor-made and essential for the lethal use of the weapon; indirectly by providing services for the core weapon system, which are either tailor-made or essential to the lethal use of the weapon. "Product Involvement % - Controversial Weapons" is binary, either yes or no.

4 "Product Involvement % - Tobacco" refers to the percentage of a fund's assets under management that is invested in companies that are classified as directly involved in the manufacturing of tobacco products; indirectly involved by supplying tobacco-related products; or deriving 10% or more

Exhibit 15 Article 8 and 9 Funds' Involvement in Tobacco



Source: Morningstar Direct. Data as of 10 July 2021. Excluding money markets, feeder funds, and funds of funds.

As expected, Article 8 and 9 funds are less exposed to tobacco than the rest of the EU fund universe. About 77% and 92% of Article 8 and 9 portfolios, respectively, have no involvement in companies that derive more than 5% of their revenues from tobacco manufacturing. This compares with 60% of nonclassified funds.

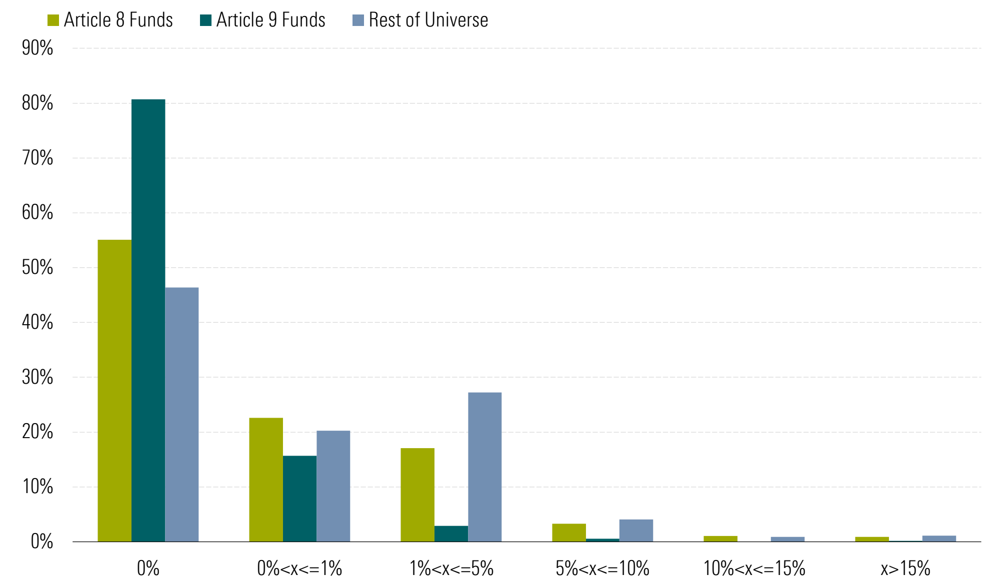
Severe Controversies

Now, we test the exposure of Article 8 and 9 funds to severe controversies. For this, we use Morningstar's "Percent of AUM with Severe Controversies" data point[5].

of revenue from the distribution/retail sales of tobacco products. The minimum revenue threshold to mark a company as involved are the following ranges: Manufacturing: 0.1%-4.9%; Related & Revenues: 10%-24.9%.

5 Overall controversy assessments are assigned to companies using a 5-point scale: Low, Moderate, Significant, High, Severe.

Exhibit 16 Article 8 and 9 Funds' Exposure to Severe Controversies



Source: Morningstar Direct. Data as of 10 July 2021. Excluding money markets, feeder funds, and funds of funds

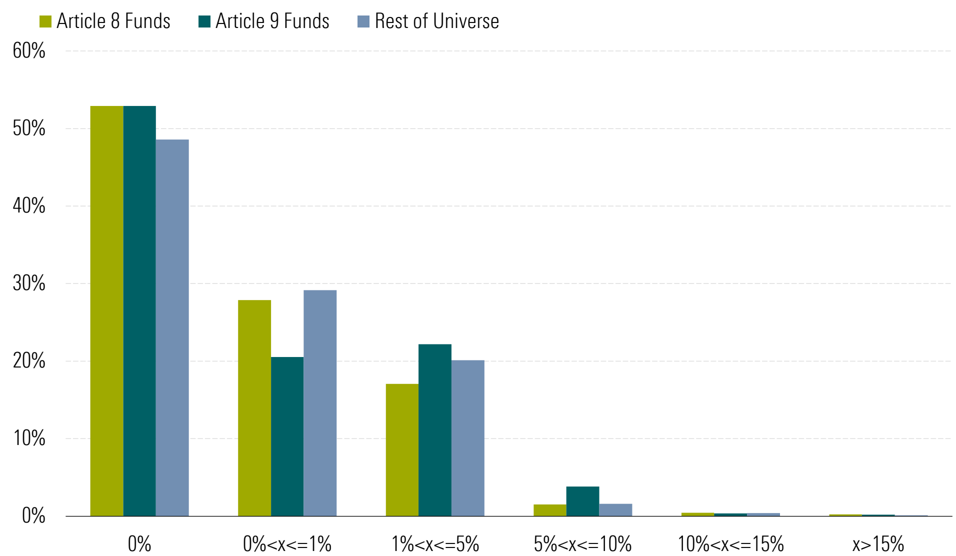
Article 8 and 9 funds are less exposed to severe controversies than the rest of the EU fund universe, with many more Article 9 strategies exhibiting zero exposure to severe controversies (81% versus 55% of Article 8 funds). By comparison, less than half (46%) of strategies in the rest of the universe have no exposure to severe controversies. That said, close to 4% of Article 9 funds still have over 1% exposure to severe controversies, although none exceeds 10%, unlike 2% of Article 8 funds.

Thermal Coal Involvement

Now we test the exposure of Article 8 and 9 funds to one of the most carbon-intensive energy sources, thermal coal. We use the "Product Involvement % - Thermal Coal" data point[6].

6 "Product Involvement % - Thermal Coal" refers to the percent of a fund's assets under management that is invested in companies that are classified as directly involved in the extraction of thermal coal; indirectly by generating electricity from thermal coal. The minimum revenue threshold to mark a company as involved is the following range: 5 -9.9%. On a lifecycle basis, thermal coal is the most carbon-intensive fossil fuel source, while from an energy-generation perspective, it is easily substitutable.

Exhibit 17 Article 8 and 9 Funds' Involvement in Thermal Coal



Source: Morningstar Direct. Data as of 10 July 2021. Excluding money markets, feeder funds, and funds of funds.

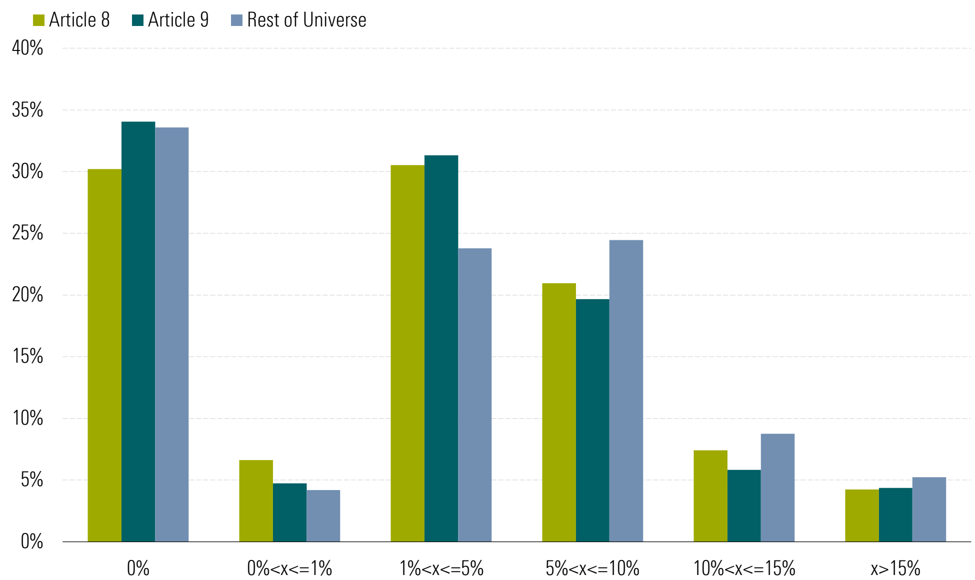
Most notable is the high level of Thermal Coal Involvement with Article 9 funds. Close to 27% of Article 9 funds exhibit more than 1% exposure to companies deriving more than 5% revenues from thermal coal, compared with 19% of Article 8 funds and 22% of nonclassified funds. This can be explained by the relatively high number of climate-themed funds in the Article 9 category that invest in traditional utilities companies that have built large renewable energy operations but still operate their highly intensive coal-fired electricity generation activities.

Fossil Fuel Involvement

We test the exposure of Article 8 and 9 funds to fossil fuel companies. For this, we use Morningstar's "Portfolio Fossil Fuel Involvement" metric, the percentage of the fund's assets that are involved in fossil fuels[7].

7 Companies are considered involved in fossil fuels if they derive at least an aggregate 5% share of total revenue from the following activities: thermal coal extraction, thermal coal power generation, oil and gas production, and oil and gas power generation. Companies deriving at least 50% of their revenue from oil and gas products & services are also included. Companies involved in arctic oil & gas exploration and oil sands extraction will be included only if there is no involvement in oil & gas production.

Exhibit 18 Article 8 and 9 Funds' Involvement in Fossil Fuels



Source: Morningstar Direct. Data as of 10 July 2021. Excluding money markets, feeder funds, and funds of funds.

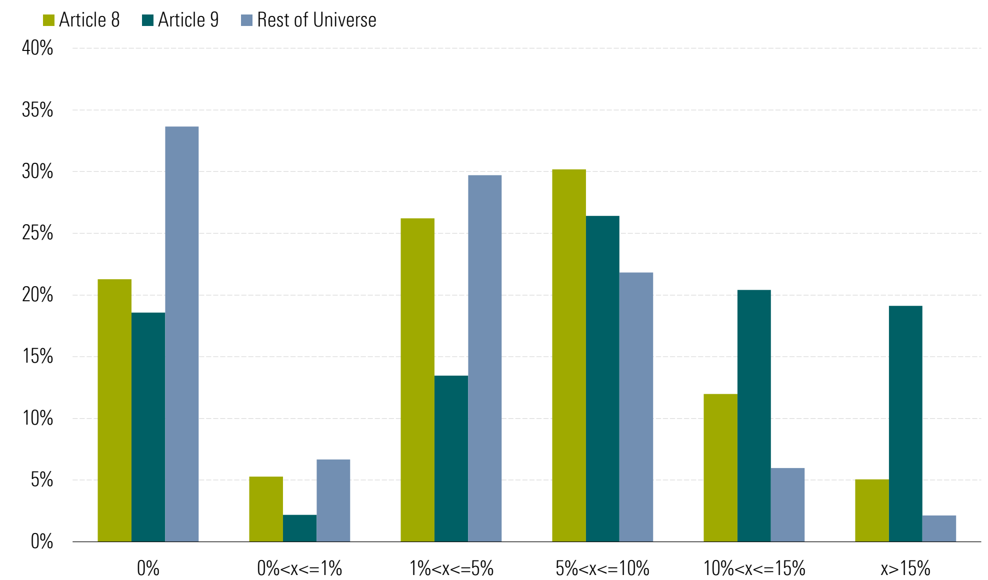
The relatively high fossil fuel involvement of both Article 8 and 9 funds may come as a surprise to many. Only 37% and 39%, respectively, have less than 1% exposure to fossil fuel companies, which is no different from what one can see in the rest of the fund universe (38%). As much as 33% and 30% of Article 8 and 9 portfolios, respectively, have more than 5% exposure to fossil fuel companies vs. 38% for nonclassified funds. It is largely because many of them invest in so-called *transition companies*. These typically are oil & gas or utilities companies that have made a commitment to transition away from their highly carbon-intensive activities and set net-zero-emissions targets. These include oil & gas companies and utilities companies that are increasing their exposure to renewable energy but still operating their legacy fossil fuel businesses.

Carbon Solutions Involvement

Finally, we analyse how much exposure to climate solutions investors can expect from Article 8 and 9 funds[8].

8 Morningstar's Carbon Solutions Involvement is defined as a fund's asset-weighted percentage exposure to carbon solutions, including renewal energy production, renewal energy supporting products & services, and green transportation. Holdings are considered involved with carbon solutions if they have at least 0.1% exposure.

Exhibit 19 Article 8 and 9 Funds' Involvement in Carbon Solutions



Source: Morningstar Direct. Data as of 10 July 2021. Excluding money markets, feeder funds, and funds of funds.

As expected, investors are more likely to get exposure to carbon solutions by opting for Article 9 funds. About 40% of them have at least 10% exposure to companies with carbon solutions, compared with just 17% of Article 8 funds and a mere 8% of the rest of funds. Over 19% of Article 9 portfolios have more than 15% exposure to carbon solutions, versus only 5% of Article 8 funds and just 2% of the rest of the universe.

On the other hand, more than a fifth (21%) of those so-called dark green funds have less than 1% carbon solutions involvement.

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

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

Following are the 20 most commonly held companies in Article 8 and 9 funds, separately displayed in Exhibits 21 and 22.

9 Morningstar® ESG Risk Rating Assessment for Companies

Exhibit 20 Most Commonly Held Companies in Article 8 Funds

Stock	Sector	Number of Funds Owning the Stock	Average Portfolio Weight	% of Article 8 Funds Owning the Stock	Equity Style Box	ESG Risk Rating Assessment
Alphabet Inc	Communication Services	485	2.8%	29%	Large Growth	🌐🌐🌐
Microsoft Corp	Technology	439	4.2%	26%	Large Growth	🌐🌐🌐🌐
Novo Nordisk A/S	Healthcare	384	2.5%	23%	Large Growth	🌐🌐🌐
Roche Holding AG	Healthcare	384	1.9%	23%	Large Blend	🌐🌐🌐
ASML Holding NV	Technology	377	3.0%	22%	Large Growth	🌐🌐🌐🌐
Schneider Electric SE	Industrials	358	1.7%	21%	Large Blend	🌐🌐🌐🌐
Taiwan Semiconductor Manufacturing Co Ltd	Technology	345	4.4%	20%	Large Blend	🌐🌐🌐🌐
Alibaba Group Holding Ltd	Consumer Cyclical	327	3.3%	19%	Large Blend	🌐🌐🌐
SAP SE	Technology	324	1.9%	19%	Large Blend	🌐🌐🌐🌐
Sanofi SA	Healthcare	313	1.9%	19%	Large Blend	🌐🌐🌐
AstraZeneca PLC	Healthcare	312	2.1%	18%	Large Growth	🌐🌐🌐
Samsung Electronics Co Ltd	Technology	310	3.2%	18%	Large Value	🌐🌐🌐
Atlas Copco AB	Industrials	301	1.8%	18%	Large Blend	🌐🌐🌐🌐
Unilever PLC	Consumer Defensive	300	1.7%	18%	Large Blend	🌐🌐🌐
Tencent Holdings Ltd	Communication Services	292	4.3%	17%	Large Growth	🌐🌐🌐
Amazon.com Inc	Consumer Cyclical	292	3.2%	17%	Large Growth	🌐🌐
Allianz SE	Financial Services	283	1.7%	17%	Large Value	🌐🌐🌐🌐
L'Oreal SA	Consumer Defensive	278	1.8%	16%	Large Blend	🌐🌐🌐
Nestle SA	Consumer Defensive	275	2.4%	16%	Large Blend	🌐🌐🌐
LVMH Moet Hennessy Louis Vuitton SE	Consumer Cyclical	271	2.7%	16%	Large Growth	🌐🌐🌐🌐

Source: Morningstar Direct. Data as of 30/06/2021.

The 20 most popular stocks in Article 8 portfolios include a majority of companies (11) with a Medium ESG Risk profile (3 globes), while eight carry a Low ESG Risk Rating Assessment (4 globes) and one -- Amazon.com-- scores High ESG Risk (2 globes). This compares with 12 companies with a Low ESG Risk Rating (4 globes) and eight with a Medium rating (3 globes) in the top 20 stocks in Article 9 funds. None, however, carries a Negligible rating (5 globes), which represents the lowest level of the five-point scale ESG Risk Rating Assessment.

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

Meanwhile, one can see that nine companies—five with Medium ESG risk (3 globes) and four with Low ESG Risk (4 globes)—feature in both tables (highlighted in green in Exhibits 21 and 22).

Exhibit 21 Most Commonly Held Companies in Article 9 Funds

Stock	Sector	Number of Funds Owning the Stock	Average Portfolio Weight	% of Article 9 Funds Owning the Stock	Equity Style Box	ESG Risk Rating Assessment
Schneider Electric SE	Industrials	123	2.3%	45%	Large Blend	🌐🌐🌐🌐
ASML Holding NV	Technology	100	2.9%	37%	Large Growth	🌐🌐🌐🌐
Vestas Wind Systems A/S	Industrials	99	1.8%	37%	Large Growth	🌐🌐🌐🌐
Microsoft Corp	Technology	80	3.6%	30%	Large Growth	🌐🌐🌐🌐
Novo Nordisk A/S	Healthcare	79	1.9%	29%	Large Growth	🌐🌐🌐
Roche Holding AG	Healthcare	74	1.8%	27%	Large Blend	🌐🌐🌐
Unilever PLC	Consumer Defensive	71	1.8%	26%	Large Blend	🌐🌐🌐
Koninklijke DSM NV	Basic Materials	71	1.6%	26%	Large Blend	🌐🌐🌐🌐
SAP SE	Technology	70	1.8%	26%	Large Blend	🌐🌐🌐🌐
Thermo Fisher Scientific Inc	Healthcare	67	2.1%	25%	Large Growth	🌐🌐🌐🌐
Siemens Gamesa Renewable Energy SA	Industrials	65	1.3%	24%	Large Growth	🌐🌐🌐🌐
Koninklijke Philips NV	Healthcare	65	1.7%	24%	Large Blend	🌐🌐🌐
L'Oreal SA	Consumer Defensive	64	1.9%	24%	Large Blend	🌐🌐🌐
Xylem Inc	Industrials	63	1.4%	23%	Mid Blend	🌐🌐🌐🌐
Allianz SE	Financial Services	63	1.8%	23%	Large Value	🌐🌐🌐🌐
Alphabet Inc	Communication Services	63	2.5%	23%	Large Growth	🌐🌐🌐
Air Liquide SA	Basic Materials	63	1.6%	23%	Large Blend	🌐🌐🌐🌐
Umicore SA	Industrials	62	1.1%	23%	Large Blend	🌐🌐🌐
Siemens AG	Industrials	62	1.7%	23%	Large Blend	🌐🌐🌐
Infineon Technologies AG	Technology	60	1.7%	22%	Large Growth	🌐🌐🌐🌐

Source: Morningstar Direct. Data as of 30/06/2021.

In total, out of the 17,230 companies held in Article 8 and 9 portfolios, 4,986 are included in both. This represents a 29% overlap. Common holdings are among the companies deemed the most attractive in terms of ESG risk and/or impact. These tend to be large and innovative companies for which sustainability plays a central role in the strategy.

The large number of individual names in the Article 8 group can be explained by the broad spectrum of ESG approaches represented, from light green exclusions-only strategies to dark green thematic approaches. The Article 8 fund group holds almost every company in the world's total market indices, including ESG-unfriendly ones such as tobacco companies like British American Tobacco and Philip Morris and thermal coal businesses such as India Coal and China Shenhua Energy. As of this writing, we found no such names in Article 9 portfolios, although 75 hold oil & gas majors, including Exxon Mobil and Shell.

While the Article 8 category is very large and heterogenous, the Article 9 category is smaller and homogenous. Article 9 funds typically focus on companies that provide positive solutions to the world’s biggest challenges like climate change. Solutions to environmental issues tend to be found in the industrial sectors. Article 9 portfolios tend to be more concentrated at both stock and sector levels, and this is somewhat reflected in Exhibit 22. Industrial, technology, and healthcare are the most represented sectors in the top 20 league table.

SFDR and Other European Regulatory Updates

In early July, the commission announced that the next stages of SFDR disclosures will be delayed from 1 January to 1 July 2022, citing the length and technical detail of the regulatory technical standards, late submissions to the commission, and envisaged amendments. The extra time should help firms prepare the detailed metrics in relation to Article 8 and 9 product goals, as well as the entity level adverse impact indicators that will be required.

The commission also published the Delegated Act for Taxonomy Regulation Article 8, governing how and when companies must do their taxonomy-related reporting. This, too, incorporated delays, with nonfinancial companies now not required to report their degree of alignment until 2023 and financial companies not until 2024. It is unclear at the time of writing whether associated changes will be made to the product taxonomy reporting obligations that are incorporated into SFDR.

Lastly, the European Commission published its Strategy for Financing the Transition to a Sustainable Economy to build on the 2018 Action Plan. The new strategy identifies forthcoming steps in four main areas:

1. Financing the transition: tools and policies to finance transition plans and reach climate and other environmental goals
2. Inclusiveness: access to sustainable finance for individuals and small and medium-size companies
3. Financials-sector resilience and contribution: support the financials sector to contribute to meeting the EU's Green Deal targets, becoming resilient, and combating greenwashing
4. Global ambition: collaborating globally and promoting an ambitious global sustainable finance agenda

Meanwhile, in the UK, where, post-Brexit, SFDR is not implemented, the Financial Conduct Authority set out its own proposed climate-related disclosure rules in a consultation paper. Applicable to asset managers, life insurers, and FCA-regulated pension providers, the rules would cover firms and products accounting for 98% of assets under management in the UK. Recognizing that many firms will be subject to parallel disclosure requirements in other jurisdictions, the proposals, together with parallel proposals on issuer disclosures, leverage the increasingly widely adopted Task Force on Climate-Related Financial Disclosures reporting framework.

To read more about European Sustainable Finance Regulation:

EU Sustainability Disclosures

EU Taxonomy of Sustainable Activities

Regulating ESG Investing the EU Way

Appendix

This report is based on Morningstar Direct data as of 10 July 2021. At that time, Morningstar had collected SFDR Level 1 data from fund prospectuses on 81.6% of funds available for sale in the European Union (that is, 22,972 of 28,145 funds). Below is the breakdown of the covered universe by market.

Exhibit 23 SFDR Coverage by Domicile

Market	Number of Funds Reviewed	Number of Funds in Scope	Coverage as of 10 July
Luxembourg	9,146	10,806	84.6%
France	2,888	3,800	76.0%
Ireland	2,645	3,971	66.6%
Germany	1,561	1,809	86.3%
Spain	1,525	1,670	91.3%
Italy	1,024	1,165	87.9%
Sweden	735	753	97.6%
Austria	724	935	77.4%
Denmark	671	760	88.3%
Belgium	652	720	90.6%
Finland	482	506	95.3%
Netherlands	390	439	88.8%
Norway	249	396	62.9%
Portugal	232	263	88.2%
Liechtenstein	45	67	67.2%
United Kingdom	2	71	2.8%
Switzerland	1	4	25.0%
Greece	-	2	0.0%
Hong Kong	-	2	0.0%
Malta	-	3	0.0%
Grand Total	**22,972**	**28,145**	**81.6%**

Source: Morningstar Direct. Data as of 10 July 2021.

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