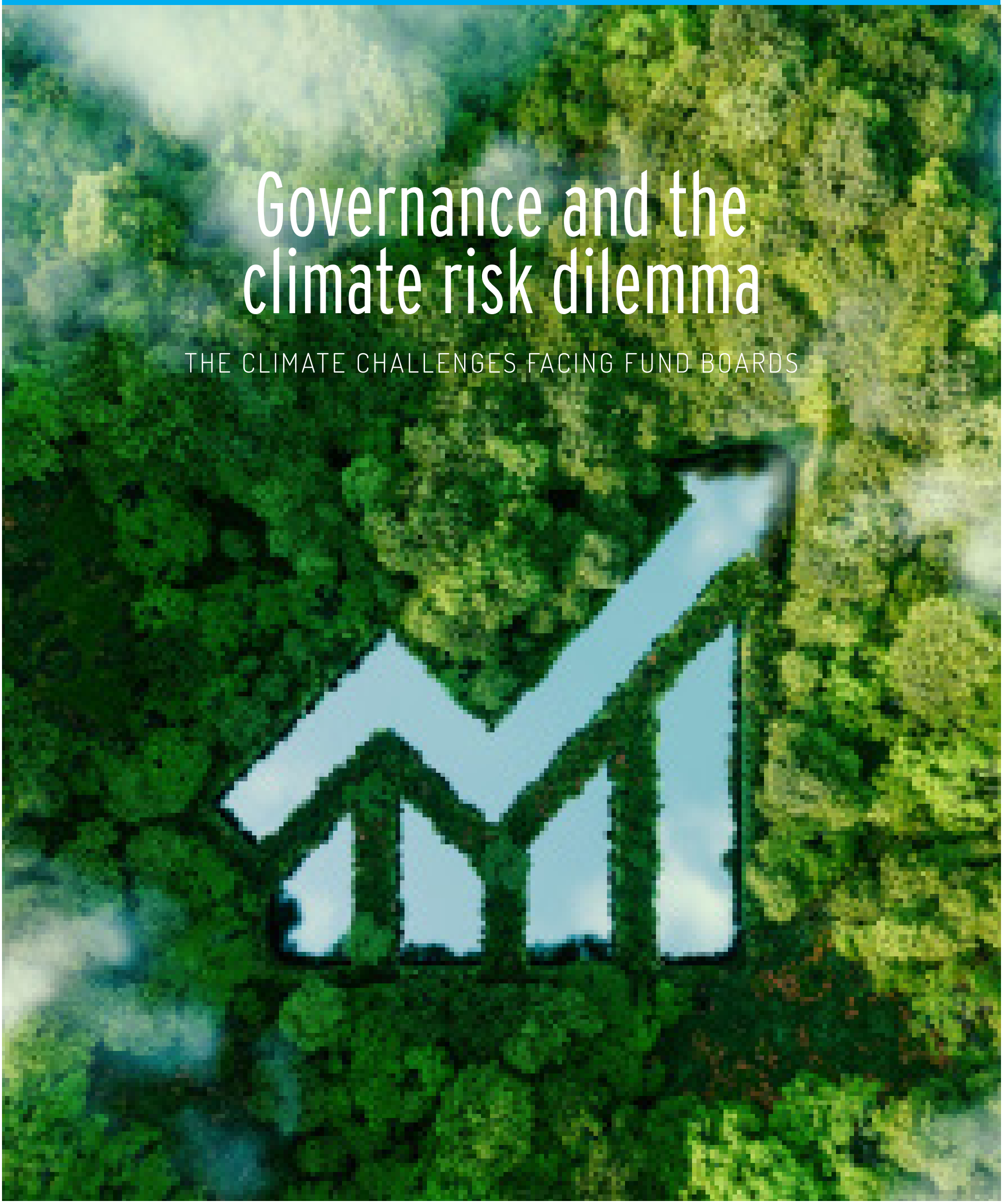
funds europe

A Funds Europe survey in partnership with CACEIS

Governance and the climate risk dilemma

THE CLIMATE CHALLENGES FACING FUND BOARDS



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Rising awareness

WHAT THIS SURVEY REVEALS

Highlights

Awareness of climate risk and its impact on the investment world is rising rapidly, but there are a number of challenges confronting asset managers and fund boards – from the implementation of a climate risk and governance framework to the availability of the tools and skills needed to monitor and manage climate risk.

The increased awareness of climate risk has been partly driven by reporting requirements such as the EU's Sustainable Finance Disclosure Regime (SFDR) as well as voluntary initiatives like the Taskforce on Climate-Related Financial Disclosures (TCFD). Other regulations are in motion, such as the UK's Greening Finance Roadmap and Sustainability Disclosure Requirements,

Although we are at the formative stages of this, we are also seeing more climate-focused investment products, from green bonds to climate change ETFs.

But, as asset managers look to implement their climate change commitments and comply with their reporting requirements, a perceived challenge of data availability has arisen. In many instances this data does exist and is readily available. So how and why is this perception gap emerging?

Is data and management information flowing into fund boards in a consistent format? Are boards sufficiently informed to make sense of it? Furthermore, to what extent are other functional business areas, such as audit and risk, viewing climate change as a key operational risk? And do fund boards require their own set of data as part of their monitoring and oversight responsibilities?

Another major governance challenge is the misalignment between the respective reporting requirements for asset owners and asset managers. To make effective governance decisions on climate risk, asset owners and fund boards need data at a consolidated level and at a security level. The latter is still a significant challenge within the asset management industry, especially for the firms that are rightly treating climate as a traditional investment risk but feel that they lack the necessary information to do so.

In this survey, *Funds Europe*, in partnership with CACEIS, sought to answer these questions and examine the extent to which fund boards and asset managers are incorporating climate risk factors into their internal governance, investment risk management and their product design and development.

We also explore the various drivers for climate-based investment products, the reporting requirements from regulation, and the critical role that climate-related data will play in this rapidly developing market.

Among the survey's key findings:

The risks of not getting it right are well understood

• 83% of respondents said that there is reputational risk if climate commitments are not adhered to.
• 45% said that climate change risk standards will become mandatory. Just 10% do not think so.

Recognition on asset management boards is still growing

• Only 36% of respondents highlighted that their asset management boards are overseeing the integration of climate risk considerations into business and risk management processes.
• 34% of fund managers do not provide any investor reporting on climate risks and only 19% of respondents mentioned that they have the reporting in place to provide full disclosure on climate risks.

Reporting climate risk is a challenge

• 37% of fund boards do not have sufficient information on climate risk and how it impacts the funds or mandates that they oversee.
• 79% of respondents cited lack of consistent methodology as their biggest challenge in building a climate risk reporting framework. A lack of data (35%) and data inconsistency (33%) were also cited.

Product development underway

• 51% said that a stronger climate-focused approach would be a key focus for product design and 57% said new products would be aligned to investors' sustainability preferences.

Creating a climate risk framework

CLIMATE RISK AWARENESS MAY BE RISING BUT LARGE GAPS REMAIN IN HOW THESE RISKS SHOULD BE MEASURED, MONITORED AND MANAGED.

THE FUNDS INDUSTRY has emerged as a critical player in the transition to net zero. The International Monetary Fund (IMF), citing its own 'Global Financial Stability Report', forecast that the transition to net zero over the next two to three decades will require $20 trillion in additional investment.

And the funds industry is a likely source of this capital. "The world's $50 trillion investment fund industry, especially funds with a sustainability focus, can play an important role financing the transition to a greener economy and helping to avoid some of the most perilous effects of climate change," concluded the IMF.

Europe has taken the lead when it comes to climate funds. According to Morningstar, Europe accounts for more than three-quarters of global assets within a climate-related mandate with a total asset value of $325 billion. And while China and the US, with $47 billion and $31 billion of assets respectively, have far fewer climate fund assets, both saw their assets double within the last year.

The growth of the sustainable funds market has caught the attention of regulators, keen to ensure that investors are not short-changed by the rapid rise in sustainable funds. In particular, regulators are concerned about the threat of greenwashing and the wide variation in methodology and the use of data that makes it difficult for investors to compare different ESG funds.

2021 saw the introduction of the EU's Sustainable Finance Disclosure Regulation (SFDR). But firms also face requirements for MiFID II, the Insurance Distribution Directive and whatever rules the UK brings out. Added to this are other sustainability-related initiatives such as the Taskforce on Climate-Related Financial Disclosure (TCFD).

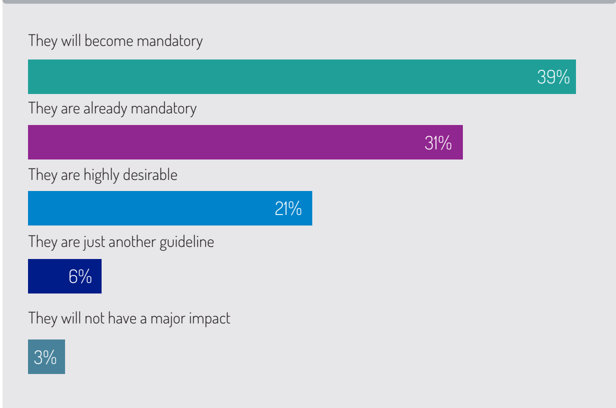
> *"The world's $50 trillion investment fund industry can play an important role financing the transition to a greener economy and helping to avoid some of the more perilous effects of climate change."*
>
> *International Monetary Fund*

There is also a growing recognition that ESG factors, and climate change especially, represent a significant investment risk. In the 2021 *Funds Europe*/CACEIS survey, the 'green transition' was cited by 30% of respondents as the greatest risk facing the funds industry over the next three years.

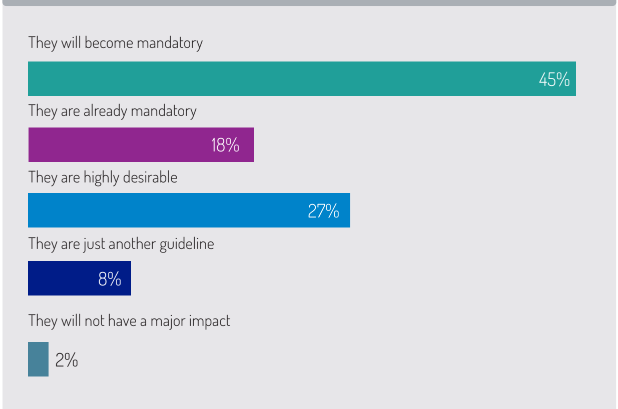
But how are firms treating this risk? Are fund boards meeting their fiduciary duty by tracking the investment risk posed by climate and other ESG factors? Do they have access to the required data? Are they able

ILLUMINATING – It's clear that ESG factors, particularly climate change, represent a significant investment risk.

Q1. How important will ESG standards become in fund governance?



Q2. How important will climate change risk standards become in fund governance?



to interpret that data and have they implemented a workable reporting framework that tracks ESG and climate exposure at a granular level?

Against this backdrop, the survey asked how important ESG standards will become in fund governance (Q1). It found that 70% believe they will become or are already mandatory. This is slightly down on the 73% that answered the same question in the same way in the 2021 *Funds Europe*/CACEIS survey. However, the difference is that more people now feel that ESG standards are already mandatory (31% as opposed to 22%).

This signifies the scale of the challenge facing the industry and the inevitability of mandatory reporting.

The survey also asked how important climate change risk standards will become in fund governance (Q2) and found that a similar number believe they will become or are already mandatory, 45% and 18% respectively. Just 10% do not believe they will have a major impact or else see them as a "just another guideline". This finding supports both the idea that ESG standards are going to be mandatory measures and that climate change is likely to become a standalone issue in its own right.

In terms of the progress of asset managers' net zero commitments (Q3), almost half (48%) are focused on implementing their commitments while over a third (35%) are planning to do so.

There have been lots of public statements from asset managers in reference to their net zero commitments. The Net Zero Asset Managers (NZAM) initiative launched in December

2020 with the mission statement to "galvanise the asset management industry to commit to a goal of net zero emissions". As of the end of 2021, it had 236 signatories with a combined £57.5 trillion in assets under management (AuM).

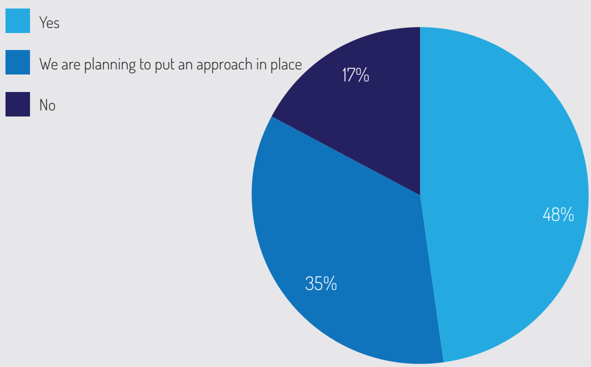
However, signing up to a commitment is one thing and implementing those initiatives is another. And the survey shows that we are still behind where we need to be as an industry, with less than half (48%) saying they have implemented their commitments.

Importance of investment risk overlooked:
When asked for the main drivers of future development of climate-related strategies (Q4), it is not surprising that 'regulatory requirements' was the most cited factor (30%), followed by changing investor preferences (24%). Managing investment risks and better expected performance only accounted for 22% and 6% respectively.

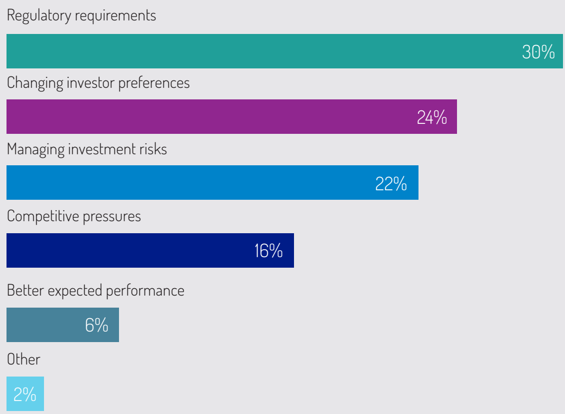
This suggests that too few fund managers are treating climate as a climate-related financial risk, much like an operational or traditional investment risk. This is a cause for concern given the risks that will be faced by companies and bond issuers to the physical and transition risks of climate change.

It is also concerning that more than a third (36%) of respondents believe climate change will only have a medium impact on companies and bond issuers (Q5). In fact, climate

Q3. Is your company focused on implementing its own net zero commitments?



Q4. What do you think are the biggest drivers in the future development of climate-related strategies?



factors will have a high impact when you take into account both physical and transition risks.

In contrast, there is much greater interest in reputational risk (Q6) where an overwhelming 83% stated that asset managers face greater reputational risk if their climate commitments are not clearly defined or adhered to.

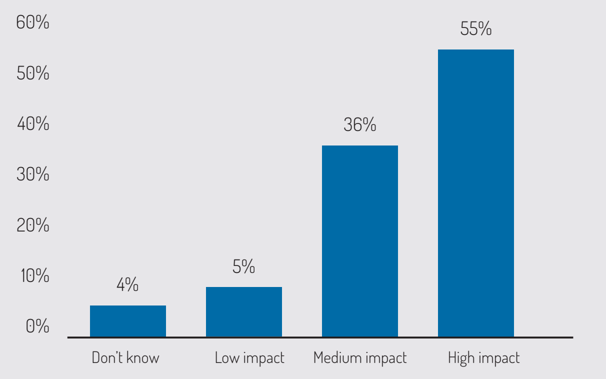
The reputational risk associated with climate change commitments is likely to be seen during this year's AGM season. The UK's Investment Association (IA) has warned that climate change, along with diversity, will be a shareholder priority. Consequently, the IA states that asset managers will be looking for companies to take "immediate action" on climate risks.

Andrew Ninian, director of stewardship and corporate governance at the Investment Association, said: "Climate change and the transition to net zero is not an issue which can be left for future management teams or boards. Investors wish to see the actions the current leadership will be taking, and investment managers will be watching closely this AGM season to ensure they are doing just that."

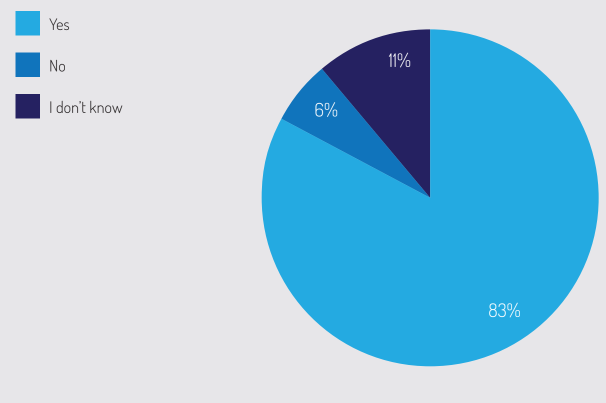
This has been recognised by asset managers, given that the management of climate change risk is high or somewhat high on the agenda for funds and mandates of 83.5% of respondents (Q7).

Yet, despite their importance, only 19% of respondents mentioned that they have the reporting in place to provide full disclosure on climate risks (Q8). More than a third (34%) of respondents stated that they are in the process of putting

Q5. What impact do you think climate change will have on companies and bond issuers?

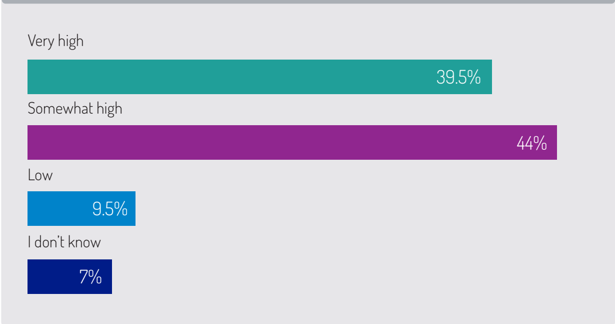


Q6. Do asset managers face greater reputational risk if climate commitments are not clearly defined or adhered to?



such a framework in place.

Q7. How high is the management of climate change risk on your agenda for your funds/mandates?



Q8. Are you in a position where you can provide full disclosure on forward-looking climate risks?

Internal governance still developing:
It is also useful to compare the priorities for integrating climate risk into firms' strategic thinking (Q9) with the drivers for climate change (Q4). The two clearest answers for Q9 are investment decision-making (38%), and integrating operational risk management (36%), which suggests that awareness of risks still has some way to go.

The survey results suggest that governance around climate risks is still developing. For example, when asked to what degree climate considerations have been embedded into the culture of the organisation (Q10), almost half (48%) could say that it is already embedded. Of the remaining 52%, about half (25%) say that they have been implemented to a limited degree while the rest (27%) have not yet started this process.

The importance of embedding climate considerations throughout the organisation cannot be overstated. Not only will it sharpen product design, it will also enhance risk management and improved internal governance.

Ultimately, cultural and organisational changes come from the top. Consequently, our survey also asked about the involvement of senior management in ensuring that climate risk considerations are integrated into business and risk management processes (Q11). While just over a third (36.5%) could say that the board is overseeing this process, a much larger number (48%) is still in the preparatory stages for integrating

> *"Climate change and the transition to net zero is not an issue which can be left for future management teams or boards. Investors wish to see the actions the current leadership will take."*
>
> *Andrew Ninian,*
> *The Investment Association*

climate risk considerations.

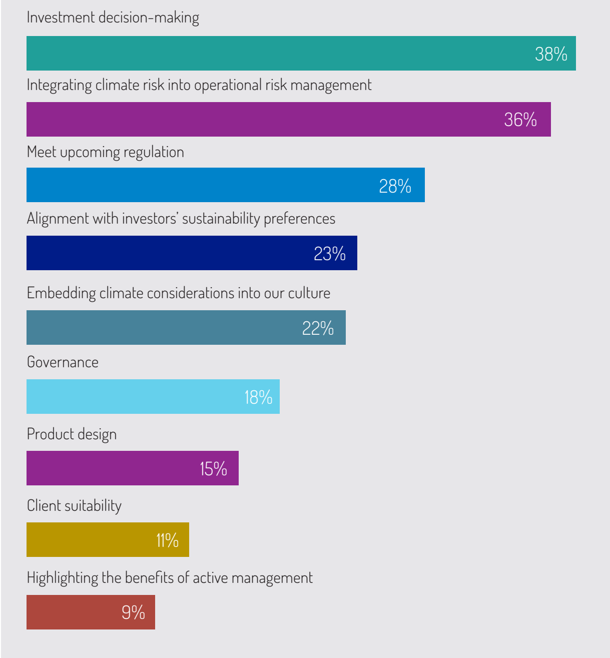
When it comes to the priorities on internal governance for climate risk (Q12), the most important is the integration of ESG data into portfolio selection (50%), followed by establishing management information of climate risk (28%). Once more this underlines the importance of data in firms' climate risk strategies and operations.

Education and skills are key: People will also play a critical role, especially those with expertise and/or experience in climate-related work. As Q13 suggests, the industry could be facing a potential skills shortage, as cited by 72% of respondents.

More than a fifth of respondents (21%) have prioritised the development of an educational framework to upskill key employees across all functional areas. Similar numbers cited the hiring of portfolio managers and analysts with specific expertise on climate risk (17%) and building expertise at board and senior management level (16%).

So given that climate specialists will likely come with a premium, it is surprising that firms are not doing more to improve the climate capabilities internally.

Q9. What are your top two priorities for integrating climate risk into your strategic thinking? (Select two)

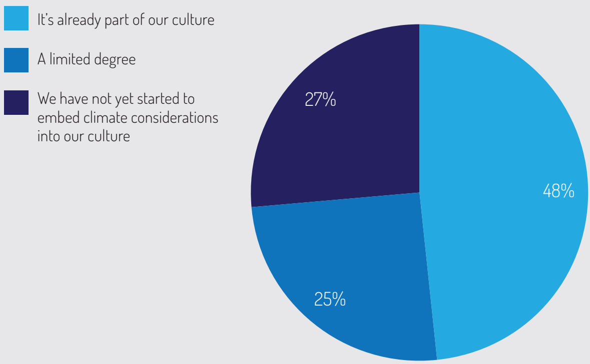


Our survey (Q14) shows that more than a quarter (26%) do not currently offer any formal training around climate. And while more than a third (37.5%) offer general training on climate change and its impacts, only 13.5% provide training on the operational risks resulting from climate change.

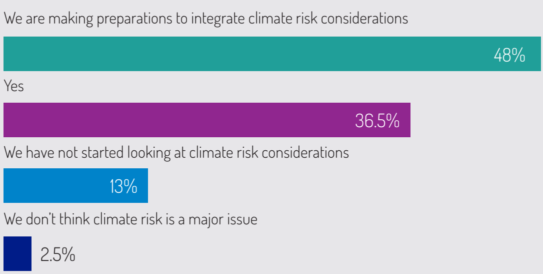
Our survey also suggests that asset managers are looking to apply climate credentials to their service providers (Q15). For example, 82% of respondents said there will be a greater focus on the ESG policies of their asset servicing providers and that they will look to align themselves with counterparties that share their views on climate.

Data availability challenge misplaced: As mentioned, data is critically important in the ESG world, not just for reporting but also for due diligence, risk management

Q10. To what degree have climate considerations been embedded into the culture of your organisation?



Q11. Is your board overseeing the integration of climate risk considerations into business and risk management processes?



> *"The intention is for the ISSB to deliver a baseline of disclosure standards that provide market participants with information about companies' sustainability-related risks."*
>
> *International Financial Reporting Standards Foundation*

and performance tracking and benchmarking. Data is also the area where asset managers highlighted that they face the biggest challenges, firstly with investment risk.

When asked if they have sufficient data to examine climate risk exposures across their funds (Q16), only a third (31%) have relevant data at a granular level across all of their funds. A similar number (32%), have sufficient information flow but only for climate-specific funds. The largest number though (37%) simply do not have sufficient information for all their funds.

This suggests a data availability problem. For example, when it comes to understanding how climate change risks impact funds and mandates (Q17), the same number (37%) do not have sufficient information.

However the reality is that there is an abundance of relevant data out there. There are challenges in the consistency of data – for example, different data providers have their own methodologies for reporting on climate risk. However, this should not be a barrier to making a start in collecting data – and the sooner the data is collected, the quicker asset managers can report on the direction of travel in their funds with respect to exposure to climate risks.

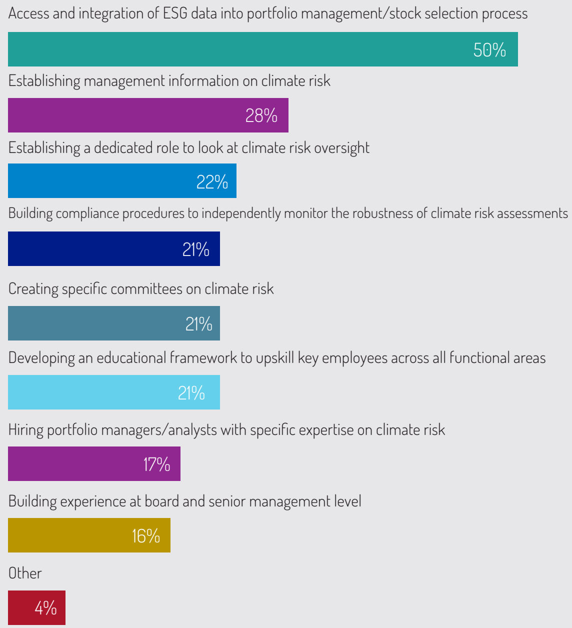
Is it falling or rising? This type of transparency will be key for investors of all sizes and will be crucial to building trust.

And this data is needed at both portfolio level and a security level. For fund boards, this is critical, so they can properly assess a fund's material weightings to climate risk.

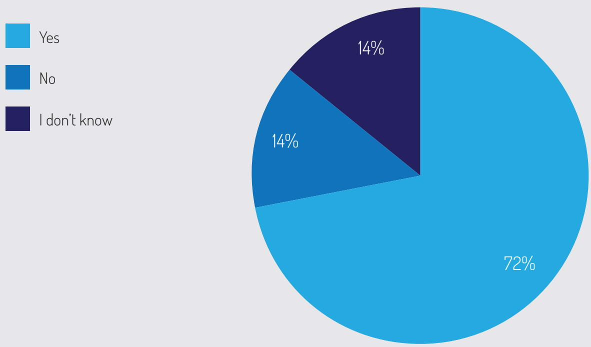
The availability of data is also highlighted as the biggest barrier in building a climate reporting framework (Q18), as cited by 35% of respondents. The other most common barrier is data consistency (33%). Again, neither of these issues should be reasons for asset managers to delay their plans for developing a reporting framework. While there are challenges around consistency and standards, they are not significant enough to prevent action.

Fortunately, the market has sought to address the data consistency issue through a number of standards initiatives. In 2021, following the COP26 climate conference, the International Financial Reporting Standards (IFRS) Foundation introduced the International Sustainability Standards Board (ISSB) to meet the demand from investors for more transparent and comparable ESG reporting by companies.

Q12. What top two priorities are you focusing on in developing your internal governance framework around climate change? (Select two)



Q13. Do you think there is a potential skills shortage in terms of climate specialists in the asset management sector?

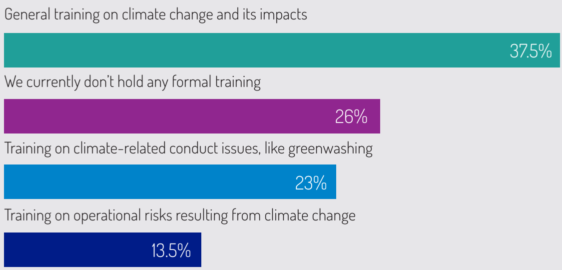


"The intention is for the ISSB to deliver a comprehensive global baseline of sustainability-related disclosure standards that provide investors and other capital market participants with information about companies' sustainability-related risks and opportunities to help them make informed decisions," stated the IFRS.

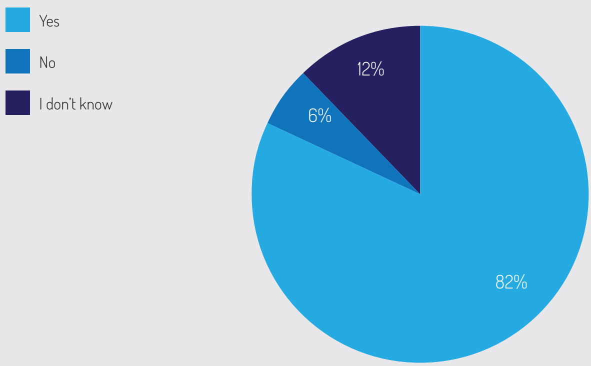
Reporting issues:
The survey asks if firms are planning to provide reporting based on TCFD recommendations (Q19). Only one in five (19%) are already providing this reporting, while just under a quarter (24.5%) definitely plan to. In total this accounts to less than half (43%), which is a disappointing total, even if 26.5% of respondents are still yet to make up their mind.

The TCFD is a useful framework that will help companies develop a robust and reliable foundation for their climate risk strategy. It is becoming more widely accepted by companies, although it will take time to increase adoption and this adoption rate will be dependent on the regulatory reporting burden, through directives likes the SFDR, and the ability to integrate with other disclosure initiatives.

Q14. On training, what's the current priority of your company?



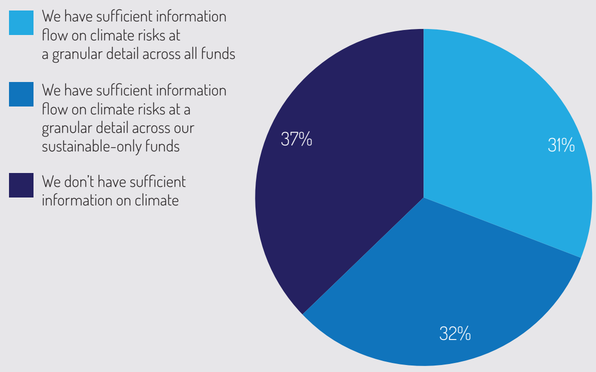
Q15. Over the next 12 months, will there be a greater focus on the ESG policies and climate commitments of asset servicing suppliers?



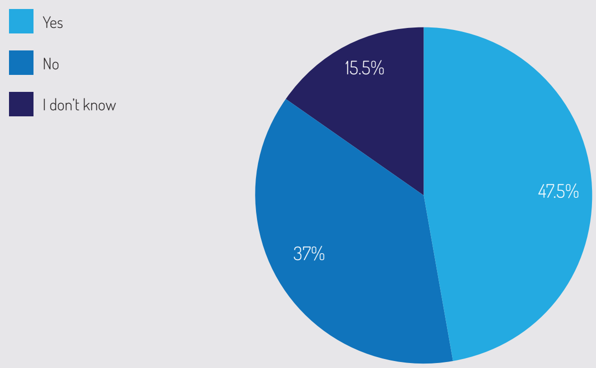
It is also worrying that more than a third (34%) do not provide any investor reporting on climate risk (Q20) while only 20.5% are able to provide this reporting at an individual security level rather than on a portfolio basis.

In the last two years, asset managers have been hit with a raft of sustainability reporting requirements – some of them mandatory, others voluntary. In general, there is wide support for the principle behind reporting, such as the need to give investors some metrics to

Q16. Does your fund board have sufficient information to examine climate risk exposures across the funds they oversee?



Q17. Do you have sufficient information to understand how climate change risks have an impact across your funds and/or mandates?



compare funds, and to limit the perception of greenwashing. There are also growing demands for Article 8 and Article 9 funds to walk the talk, which will require good standards of data.

The survey highlights not just the fact that there is a data challenge but also where this challenge is most acute. When asked what data and information firms most require (Q21), the most popular answer was 'data to analyse the impact of climate change on companies or bond issuers' in order to conduct scenario analysis (58%).

A similar number of respondents cited data to capture carbon emissions (57%) and data to help with climate risk disclosure reporting. Other data required by firms relate to the impact of transition risks and physical risks on funds.

What is notable is that even the least popular answer – information to assess transition risks – was still highlighted by 42% of respondents. This reveals the scale of the data challenge facing firms, especially when you refer back to the data-based barriers highlighted in Q18.

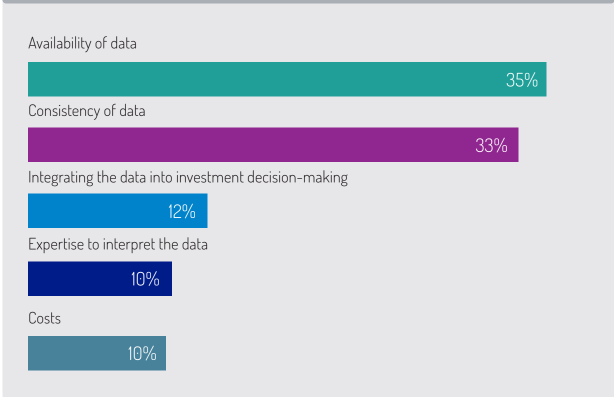
The data challenge has been exacerbated by the absence of global standards or consistent methodology for sustainability data. So it is not surprising that when asked to name their main data-related challenges for managing climate risks (Q22), 79% of respondents cited the lack of consistent methodology and global standards across data providers.

There are other challenges – the limited choice of companies providing ESG and climate data and the prohibitive costs were cited by 45% and 40% respectively, while 36% cited a lack of internal expertise to properly interpret the data, supporting the concerns about a potential skills shortage, highlighted in Q13.

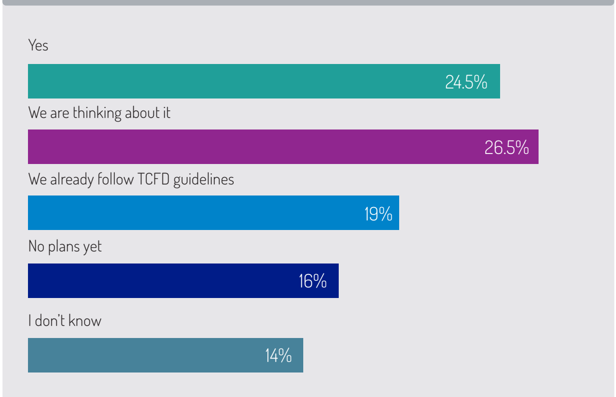
However, there is a broad acceptance among many fund managers that the data challenge is an extremely complex one, given the sheer breadth of factors involved in sustainability plus the fact that so many of these factors are qualitative, not quantitative, in nature.

So while there is recognition of the need to improve the provision and quality of data around climate change, there is also an acceptance that this will take some time. In the meantime, asset managers should still get involved and take action in getting their hands on what data is available to drive expanded reporting and governance requirements.

Q18. What have been the biggest barriers in building a climate reporting framework?



Q19. Are you planning to provide reporting on climate risks based on the recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD)?



Product development:

The survey asked where the strongest demand for climate-related products lies with investors (Q23). The clear answer was for sustainable equity funds (30%) which was cited by twice as many respondents as the next most popular option – existing strategies that have a greater climate focus via exclusion (14%).

While this shows that investor appetite is still for mainstream products, there is also a demand for funds with a direct impact mandate (12%) as well as more innovative asset classes such as clean energy funds (11%), low carbon funds (11%) and green bonds (10%).

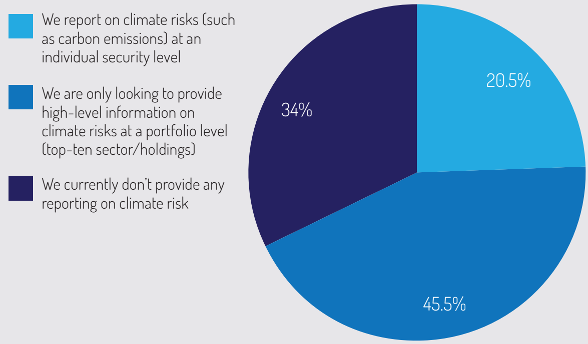
The green bonds market is clearly growing. Dutch asset manager NN Investment Partners has forecast that the green social and sustainability bond market will reach €1.1 trillion worth of issuances this year. The asset manager cited investor urgency to finance the energy transition as sovereigns and corporates look for fossil fuel alternatives and other low-carbon transport opportunities.

There is still a relatively small number of firms (28%) offering or investing in pure climate change funds (Q24), although 22% said they plan to do so, which accounts for a combined 50% of respondents. This means that exactly half of respondents offer no dedicated climate funds, including the 14% that offer exposure to climate factors through existing ESG products rather than on a standalone basis.

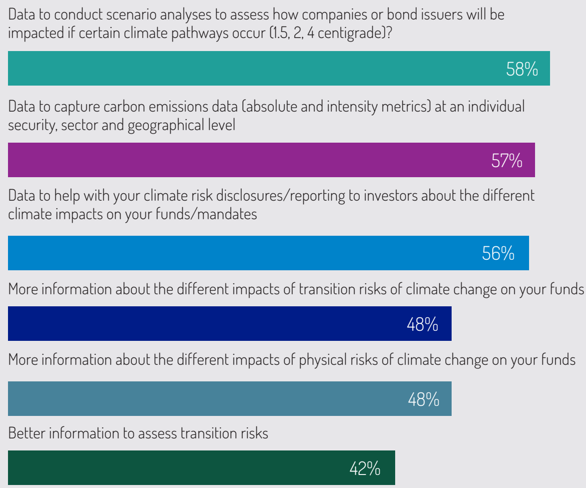
Repositioning existing products to align with a stronger climate-focused approach was mentioned by 51% of respondents as a key focus on product design (Q25). And for new products, the direction is very clear – 57% said new products would be aligned to investors' sustainability preferences.

Specific funds that target climate impacts through low-carbon companies or bond issuers was a priority for 36% of respondents. Clean energy opportunities was a focus for 26% of respondents. These all came ahead of launching green bond funds.

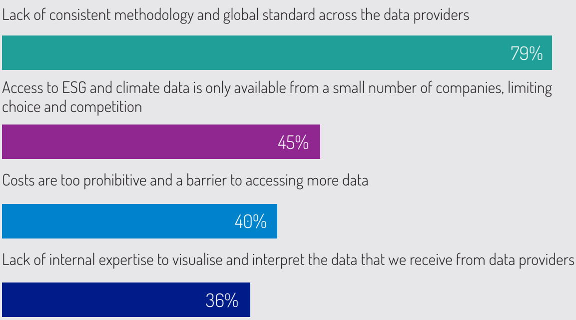
Q20. On investor reporting, which of the following statements is applicable to your company?



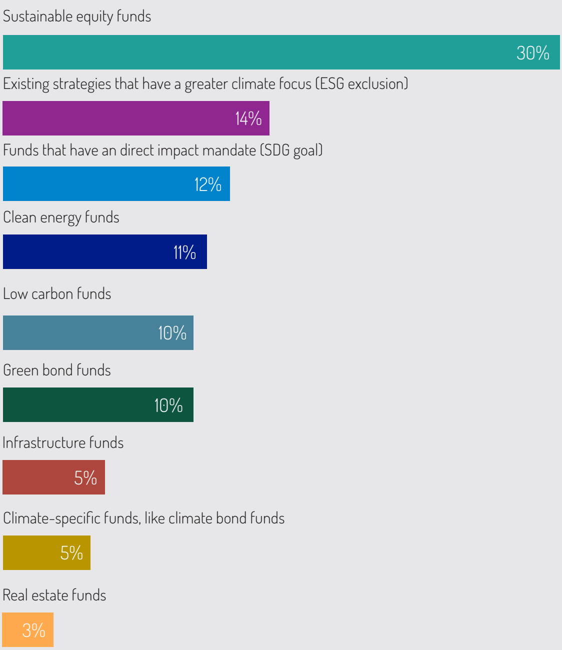
Q21. Which of the following reflects the additional data and information you require? Tick all that are relevant



Q22. What are the main data-related challenges for managing climate change risk? (Select two)



Q23. What are the strongest areas of demand that you are seeing from investors?



Engagement vs divestment: The final issue explored in the survey is the role of the asset manager in encouraging better behaviour from the companies in which they invest. The importance of this role is well understood by senior management. As Valérie Baudson, chief executive of Amundi, told *Funds Europe* recently: "As asset managers, we know that the pool of money that we manage is incredibly important and that it can have an impact on society.

"Given the size of this pool of money [roughly $100 trillion across the industry], we believe that if we channel it to the right projects and to the right companies, and try to encourage the companies that are moving in the right direction

> *"The pool of money that we manage is incredibly important... If we channel it to the right projects, and try to encourage the companies that are moving in the right direction, we can have an impact."*
>
> *Valérie Baudson, Amundi*

in terms of energy transition and social issues, we can have an impact. That's why I feel a personal commitment to this," said Baudson.

Part of this commitment involves holding companies or bond issuers accountable to their climate targets, although the survey shows that there is still some way to go in terms of how asset managers go about this task (Q26).

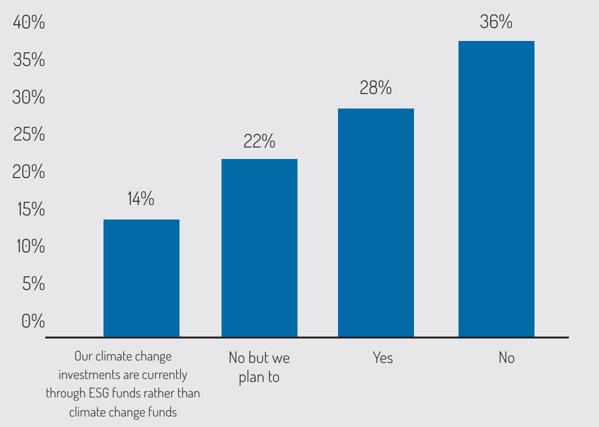
Almost a third (31.5%) set regular due diligence reviews throughout the year with company's senior management while 28% rely on third-party data sources to validate a company or bond issuer's progress.

More worrying is the fact that 17% of respondents rely on a single annual due diligence review, while almost a quarter (23.5%) don't currently have any policies in place.

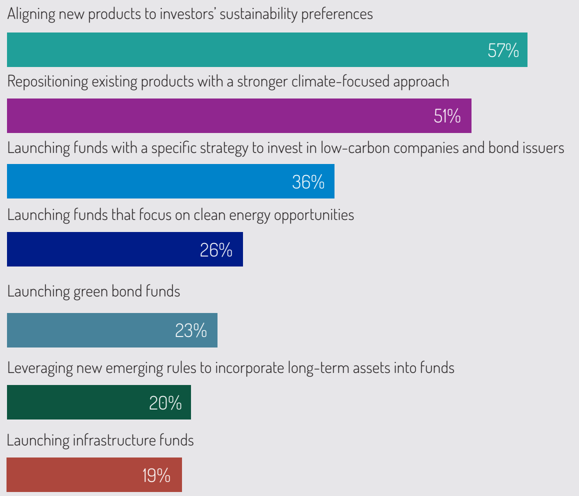
This is surely an approach that will not be tolerated by investors that are taking an increased interest in the stewardship and voting record of their asset managers.

When asked about their policies on voting and stewardship (Q27), almost half (46.5%) said that they look to align their voting policies with their own climate and sustainability strategy. Almost a

Q24. Do you currently offer or invest in 'pure' climate change funds?



Q25. What best describes your focus on future product design? (Tick all that are relevant)



third (32%) reflect their clients' views on sustainability in their voting, while 21.5% engage with other industry stakeholders to help inform their voting policy.

Voting policies are coming under increased scrutiny from investors. For years the lack of transparency around the proxy voting process has been an intense frustration for institutional investors and asset owners, who have not been able to tell if their vote was even cast, let alone how it was cast.

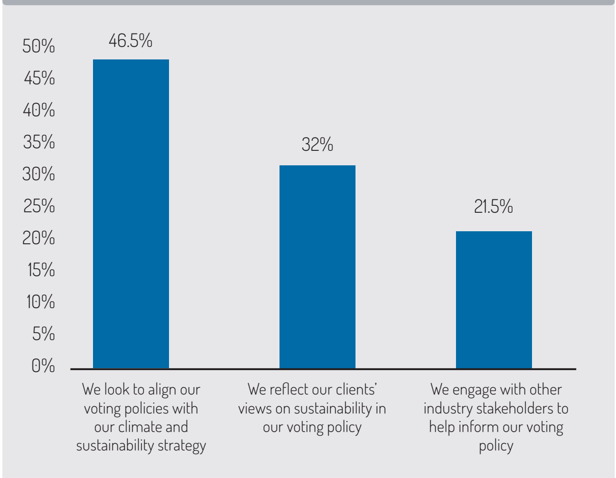
But a number of digital proxy voting solutions are now in the market, bringing much-needed transparency and greater demand for more information from investors into stewardship.

This is especially true for any companies with exposure to fossil fuel, where the argument of divestment versus engagement is very much to the fore. In general, the majority of asset managers currently favour engagement. When asked, the most popular approach to investing in fossil fuel industries (Q28) involves an active engagement process around how these companies are moving to net zero (42%).

This is twice as many as those with an active policy of divestment (22%), while 16% base their engagement more

Q26. What information do you use to hold companies or bond issuers accountable to their climate targets?

Q27. What best describes your policy on voting and stewardship?



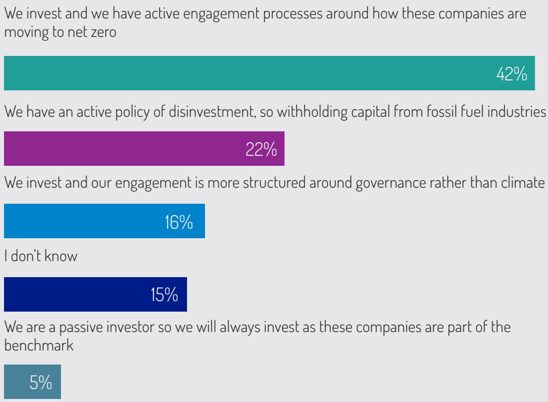
on governance than anything climate-specific.

Many of the biggest asset managers seem reticent to take a divestment-first approach to fossil fuel companies. BlackRock chief executive Larry Fink in his annual letter to shareholders in January 2022 made this point. "Divesting from entire sectors or shifting carbon-intensive assets from public to private markets will not get the world to net zero," he said.

However, engagement without the threat of divestment may not be the most effective strategy, as Laurent Ramsey, chief executive of Pictet Asset Management, told *Funds Europe*.

"Engagement is also part of our duty as active managers and a source of alpha creation if done well," said Ramsey. "But for effective engagement, you need to formalise it, you need a timeline and if you see no progress, you need to divest from these companies. Otherwise, it can be a never-ending friendly discussion that ultimately goes nowhere."

Q28. What best describes your firm's approach to investing in fossil fuel industries?



THE TCFD

The Taskforce on Climate Related Financial Disclosures (TCFD) was created in December 2015 by the Financial Stability Board to improve and increase reporting of climate-related financial information.

As the FSB states:
"Financial markets need clear, comprehensive, high-quality information on the impacts of climate change. This includes the risks and opportunities presented by rising temperatures, climate-related policy, and emerging technologies in our changing world."

Initially chaired by Michael Bloomberg, the TCFD has 32 members, all aiming to develop guidelines for voluntary climate-centred financial disclosures across industries. The first recommendations were published in 2017.

Unlike the SFDR, the TCFD is voluntary and serves as a guideline for businesses to share and identify climate-related financial risks, which will then allow investment firms and asset owners to better assess the value of the companies in their portfolios. The organisation's goal is to have climate-related disclosures in companies' mainstream financial filings.

In October 2021, the TCFD issued its most recent guidance on implementing its recommendations. There are four parts to the framework:

- **Governance** – the organisation's governance around climate-related risks and opportunities
- **Strategy** – the actual and potential impacts of climate-related risks and opportunities on the organisation's businesses, strategy, and financial planning
- **Risk Management** – the processes used by the organisation to identify, assess, and manage climate-related risks
- **Metrics and Targets** – the metrics and targets used to assess and manage relevant climate-related risks and opportunities

The guidance also includes seven principles for effective disclosure:

- **Principle 1** – Disclosures should present relevant information.
- **Principle 2** – Disclosures should be specific and complete.
- **Principle 3** – Disclosures should be clear, balanced and understandable.
- **Principle 4** – Disclosures should be consistent over time.
- **Principle 5** – Disclosures should be comparable among organisations within a sector, industry, or portfolio.
- **Principle 6** – Disclosures should be reliable, verifiable, and objective.
- **Principle 7** – Disclosures should be provided on a timely basis.

There are other climate-related disclosure regimes, which raises the issue of climate disclosure convergence. For example, the SEC in the US and the ISSB have recently released their own proposals for climate-related disclosure. This has inevitably led to calls from market participants – issuers, investors, brokers and asset managers – for consistency and alignment with international standards.

The SFDR

The Sustainable Finance Disclosure Regulation (SFDR) came into effect on March 10, 2021. Part of the EU's Action Plan on Sustainable Finance, it imposes mandatory disclosure requirements on asset managers in terms of how ESG factors are integrated at both an entity and product level.

The aim is to eliminate greenwashing and to give investors more transparency into asset managers' ESG credentials.

More specifically, managers must decide if their funds fit into one of three categories:

- **Article 6:** Funds without a sustainability scope
- **Article 8:** Funds that promote environmental or social characteristics (light green)
- **Article 9:** Funds that have sustainable investment as their objective (dark green)

The regulation has not been without controversy. This is partly because it was only been partially implemented back in March 2021, having gone live without the level 2 regulatory technical standards (RTS).

The 13 RTS will require more detailed disclosures from managers but have been repeatedly delayed due to the length and technical detail involved. As of May 2022, they are due to take effect from January 2023.

One of the most challenging requirements facing firms is the completion of the 18 principal adverse impact statements. But while the delay will give firms more time to prepare their submissions, there is still uncertainty as to what the final rules will look like.

Meanwhile some of the article 8 and 9 requirements have since been amended due to concerns of greenwashing and the absence of the RTS. Article 9 funds must disclose their environmental objective to highlight how they have impacted the environment while article 8 funds will face pre-contractual and periodic product disclosures.

And then there is the possibility that the SFDR will diverge from similar standards in other countries, such as the UK's Sustainability Disclosure Regime and whatever rules will emerge from the US following the recent proposal from the Securities and Exchanges Commission to add ESG factors to firms' reporting requirements.

And then there is the cost. Channel Islands-based thinktank ISICI believes the SFDR will increase operating costs for the asset management sector by more than €20 billion.

Yet despite the delays and the greenwashing concerns, investor demand for ESG funds continues to rise. By the end of 2021, assets in article 8 and 9 funds exceeded €4 trillion, according to Morningstar data.

Survey methodology

A total of 248 fund professionals participated in the survey, conducted online during March 2022.

Looking at the occupational breakdown of respondents, 44% indicated that they work for an asset manager. A further 14% indicated that they work for an institutional investor, while 11% work for an asset servicer and 11% work for an investment consultant.

The balance of respondents ('Other') includes respondents working in legal services, auditors, brokers, fund distributors and private banks.

The majority of respondents are based in either Europe (49%) or the UK (46%) with just 2% and 3% representing the Americas and Asia-Pacific respectively.

Any commentary in this report relating to survey results, or wider analysis of the industry, is that of *Funds Europe* and does not necessarily reflect the views of CACEIS.