EFAMA

European Fund and Asset Management Association

INDEFI

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SUSTAINABLE INVESTMENT IN THE EUROPEAN ASSET MANAGEMENT INDUSTRY: DEFINING AND SIZING ESG STRATEGIES

Sustainable investment has taken centre stage. Asset managers in Europe manage almost EUR 11 trillion of assets that take some form of environmental, social or governance (ESG) considerations into account. Measuring the breadth of this development requires a shared view on what constitutes the sustainable investment market. In collaboration with its member associations and strategy consultants INDEFI, EFAMA has undertaken a survey to measure the size of the European ESG market at the end of 2019[1], focusing on the state of the various sustainable investment strategies applied by asset managers.

DATA COLLECTION ON ESG STRATEGIES - THE FACTS

The ESG practices employed by European asset managers can be broadly split into firm-level frameworks and product-level strategies. Firm-level frameworks are applied on all or a large part of the portfolios managed by an asset management firm. Exclusion criteria, ESG integration methodologies or voting and engagement policies fall within these frameworks. Product-level strategies are more specific and apply only to individual funds or discretionary mandates[2], notably through strategies such as exclusions, sustainability-themed or impact investments[3].

The definitions used in the survey are broadly aligned with those of the UN Principles for Responsible Investment and the Global Sustainable Investment Alliance. Data was collected on the basis of where the day-to-day management of the fund and mandate portfolios is carried out.

Finally, it is important to note that the wide variety of approaches followed, and sometimes loose criteria used, demonstrate the need to exercise caution when quantifying the true size of the European ESG market. The EU Taxonomy and several other EU initiatives will allow a more granular analysis while preventing ESG-washing.

Considering the asset managers' fast pace of innovation in the development of new products and strategies for ESG investments, it is equally important that the definitions and ESG metrics ensure enough flexibility to support the industry's contribution to the financing of the green transition.

A. Firm-level ESG selection strategies

Definition: all assets covered by an ESG selection strategy applied at overall firm-level or across part of the assets of a firm (A). This includes two broad types of ESG selection strategies: exclusions (A.1) and ESG integration (A.2). Assets are counted under the specific strategy (A.1 or A.2) that is applied. If the two types of strategies cover these assets, they are included under each strategy, but they are counted only once in the total (A).

Firm-level ESG selection strategies essentially mean that asset managers make use of some form of ESG selection strategy in selecting all or a large part of their assets. This encapsulates a diverse array of selection strategies ranging from sector-based exclusions to fundamental ESG analysis that are part of the firm's valuation models. In Europe, a total of EUR 10.7 trillion of assets applied an ESG selection strategy; this represented 45% of the total assets under management (AuM) at the end of 2019 in the countries covered in the survey.

A.1. Firm-level: Exclusions

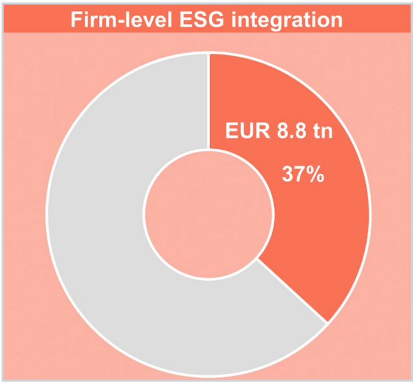
Definition: exclusions prohibit certain types of investments from a firm, fund, or portfolio. This implies that investments are systematically avoided in businesses, sectors, countries, or behaviours on the basis of criteria laid down in the policy on sustainable investment, which go beyond legal and regulatory requirements (e.g. exclusion of anti-personnel mines and cluster munitions). A norms-based screening approach is a specific type of exclusionary strategy where certain criteria (e.g. international norms, human rights, labour standards, …) must be met for the investor to invest in the company.

Exclusions are one of the most basic and most common forms of ESG selection strategy. EUR 8 trillion of assets are subject to firm-level exclusionary criteria, nearly a third of assets managed in Europe. Instead of excluding assets, some asset managers prefer to engage with issuers in order to achieve positive change in corporate practices (see B. Engagement and voting). Norms-based exclusions remain more common than sector-based exclusion strategies, particularly among the largest firms.

A.2. Firm-level: ESG integration

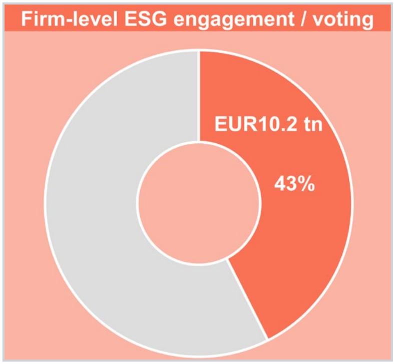
Definition: integration is the systematic and explicit integration of ESG risks and opportunities in the investment decision-making process. This means that the portfolio managers and research analysts of an asset manager take ESG criteria under consideration in investment decisions.

EUR 8.8 trillion of assets are subject to an ESG integration framework, making it the most popular ESG selection strategy. A little over 37% of total AuM are selected following an ESG integration framework. This investment strategy has the most diverse forms of implementation and has seen the most innovation in recent years. Methodologies range from systematic best-in-class screening (i.e. selection of investments based on their positive performance relative to industry peers) to integration of ESG factors into quantitative strategies.



B. Firm-level: ESG engagement and voting

Definition: strategy through which the asset manager enters into dialogue with investee companies and/or makes active use of any voting rights to drive long-term changes in corporate governance, influence ESG practices and/or improve ESG disclosure.



EUR 10.2 trillion of assets are subject to ESG-related engagement or voting policies, over 43% of total AuM. The intensity of investment stewardship has been on an upward trend over the last years, encouraged by the development of stewardship codes, various actions taken by EFAMA member associations to promote good corporate governance and regulatory measures intended at enhancing the tools for engagement and voting, such as the Shareholders Rights Directives I and II and the upcoming initiatives on Sustainable Corporate Governance.
While equity managers are the primary users of such strategies, making use of their voting rights, also managers of other asset classes (fixed income, private assets, etc.) are increasingly voicing their ESG expectations.

C. Product-level ESG selection strategies

Common Definition: asset managers can apply a clearly defined ESG selection strategy at the level of individual fund or mandate. For funds, this means that they should include a specific reference to ESG in their KI(I)D or prospectus A fund/mandate is counted under the specific ESG selection strategy (C.1 to C.4 below) it applies. If a fund/mandate applies several types of strategies, it is included under each selection strategy (C.1 to C.4) it applies. Fund assets considered in this section include but are not limited to ESG-labelled funds[4].

C.1. Product-level: Exclusions

Definition: see A.1.

Assets of investment funds and mandates applying product-specific exclusions totalled EUR 2.9 trillion at the end of 2019. 10% of mandates are subject to specific exclusions in their documentation, indicative of the interest in mandates to be tailored to clients' exclusionary criteria, and 15% of the fund assets have product-level exclusion criteria specified in their KI(I)D.

C.2. Product-level: ESG integration

Definition: see A.2.

ESG integration is the most common sustainable investment practice used at the product-level in Europe. In total, EUR 3.8 trillion of assets are managed in this way, accounting for around 16% of total fund and mandate assets. Product-level ESG integration methodologies include both quantitative top-down screening techniques and fundamental analysis of issuers and are used across all asset classes, whether passively or actively managed.
The ability to tailor the ESG integration methodology to match the asset manager's investment philosophy has been a core driver of this strategy's success.

C.3. Product-level: Sustainability-themed products

Definition: this strategy includes a variety of themes, which allows investors to choose specific areas of sustainability-themed investment, such as sustainable energy technology, water management, labour rights or green real estate.

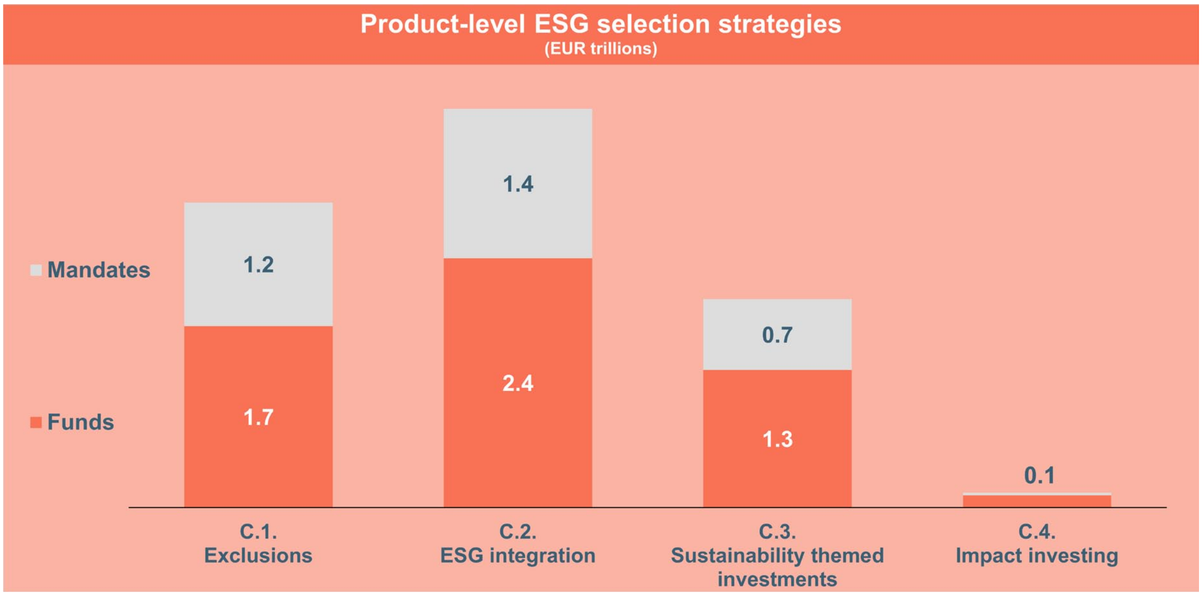
At the end of 2019, EUR 2 trillion of assets were managed in sustainability-themed products, which explicitly target specific themes of sustainable development in their investment strategy. Sustainability themed funds accounted for 11% of fund assets, whereas mandates with a specific sustainability theme represented 6% of the mandate assets.
The growing interest in such strategies resides in their ability to communicate a clear message towards both retail and institutional clients who wish to have exposure to specific sustainable development thematics.

C.4. Product-level: Impact investing

Definition: impact investments are investments made into companies and organisations with the intention of generating a measurable social and/or environmental impact alongside a financial return.

Impact investment products are the least common in the European fund management industry, but still represent nearly EUR 150 billion of assets, primarily in the form of investment funds. Impact investing accounted for just under 1% of the investment fund AuM covered by the survey.

Despite impact investing remaining a nascent field, it is attracting growing interest among both institutional and private clients. Further growth can be expected in this market, particularly as new regulatory measures (EU Taxonomy and Disclosures Regulations) and other industry initiatives contribute to harmonising its definition.



DATA COLLECTION ON ESG STRATEGIES – CONCLUSIONS

This research exercise is a first step towards assessing the state of sustainable investment strategies applied by European asset managers. It will be followed by complementary surveys and reports to further analyse the evolution of the participation of asset managers in the European ESG market.

LOOKING AHEAD

The ESG market in Europe will undoubtedly continue to grow. Retail demand for funds that take ESG considerations into account is booming and asset managers are responding accordingly by launching new ESG funds. Asset managers also get more and more requests for specific ESG mandates from their institutional clients.

At the same time, the EU has set an ambitious sustainable finance agenda, aimed at mainstreaming sustainability in all aspects of financial institutions' business. As a result, European regulators have taken a leading role in the global efforts to address environmental and social challenges. Players from all jurisdictions who wish to market ESG financial products in the EU will face strict rules, hopefully encouraging a global "race-to-the-top" in mainstreaming sustainability and fighting ESG-washing.

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The following factors will play a crucial role in the further development of the European ESG market:

• **ESG data:** Meaningful, reliable and comparable ESG data reporting by European companies is essential in supporting investment decisions and enhancing the offering of ESG products. Initiatives such as the review of the Non-Financial Reporting Directive, or the disclosures requirements under the EU Taxonomy Regulation, will help narrow down the ESG data gap that currently limits the development of sustainable finance. The establishment of an EU-wide ESG database could serve as a single access point to the public and provide unprocessed data for the industry to use. To ensure proper international diversification of ESG portfolios and avoid a systematic geographical bias, it is important to ensure good coordination with third countries around the EU agenda so that non-European companies be subject to similar disclosure requirements as their EU counterparts.

• **Increased transparency:** In March 2021 asset managers will start disclosing information on how they integrate sustainability risks in their investment decision-making, and how these decisions affect sustainability factors. These disclosure rules are a corner piece of the EU Sustainable Finance framework. They are intended to enhance comparability and trust for end-investors, hold market participants accountable and avoid greenwashing. They will be complemented by rules for financial advisers to effectively inquire about retail investors' sustainability preferences and distribute ESG products.

• **Standards and labels:** At the moment, there is a proliferation of national ESG labels for retail financial products throughout Europe, with significant differences in their specifications. The creation of an EU label dedicated to green retail financial products would adequately address this fragmentation – provided the national labels fall in line with the newly created EU one – and encourage the cross-border distribution of such products. The EU is developing a proposal for such an Ecolabel, aiming to strike the right balance between the strictness of the label criteria, giving it credibility, and ensuring a sufficiently large pool of eligible investment opportunities. This initiative would help channel individual investors' savings into sustainable projects and represent an important step in the fight against greenwashing.

[1] *This information is based on data covering the following countries: Belgium, Bulgaria, Denmark, France, Germany, Greece, Italy, Liechtenstein, the Netherlands, Norway, Poland, Portugal, Slovenia, Sweden, Switzerland, and the United Kingdom. The data has been provided by EFAMA member associations and asset management companies.*

[2] *Discretionary mandates are explicit investment 'mandates' delegated to an asset manager by a specific investor. The asset manager receives the sole authority to buy and sell assets and execute transactions on behalf of the investor. Mandates are tailor-made to the precise investment goals of each individual investor. Discretionary mandates are usually only geared towards institutional investors.*

[3] *Assets covered under a product-level strategy are per definition also counted under the corresponding firm-level framework.*

[4] *The total AuM in the sixteen countries covered in the survey can be split down in two parts: EUR 12.5 trillion of investment fund assets and EUR 11.4 trillion of mandate assets*

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THE VOICE OF THE EUROPEAN INVESTMENT MANAGEMENT INDUSTRY

EFAMA represents 28 Member Associations, 60 Corporate Members and 24 Associate Members. At end Q2 2020, total net assets of European investment funds reached EUR 17.1 trillion. These assets were managed by almost 34,200 UCITS (Undertakings for Collective Investments in Transferable Securities) and more than 29,100 AIFs (Alternative Investment Funds).

More information is available at www.efama.org. Follow us on Twitter @EFAMANews or LinkedIn @EFAMA.

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