Morningstar culls $1.2tn worth of dubious sustainable funds

By **Caroline Rolle** 10 Feb, 2022

SINGAPORE: Only around half of the $4.6tn (£3.4tn) of assets held in funds marketed to investors as 'sustainable' in Europe meet the criteria set out by Morningstar after it carried out additional research, highlighting growing concerns about greenwashing and asset managers exploiting ESG as a marketing exercise.

The research house has slashed the list of funds it recognises as sustainable by 27%, cutting more than 1,600 strategies, with combined assets of $1.2tn, in a mass reclassification over the fourth quarter.

The move follows the analysis additional documentations provided by funds since the implementation of the EU's new Sustainable Finance Disclosure Regulation (SFDR) rules in March.

The new sustainable labelling is intended to deliver transparency for investors as money floods into products touting their environmental, social and governance (ESG) credentials, but the data provider's findings underline how confusing it remains to identify genuinely sustainable products.

Morningstar's mass cull means it only recognises 4,461 European funds, with combined assets of $2.3tn, as sustainable, compared with the 6,659 classified as such, with assets of $4.6tn, under SFDR rules.

'The sheer level of reclassification shows the scale of greenwashing that still exists,' said Ketan Patel, manager of the EdenTree Responsible and Sustainable UK Equity fund.
He said Morningstar's removal of these funds from its sustainable lists 'will allow investors access to those investment managers that are specialists in ESG and not those which are only adding a label to pad their bottom line'.

The reorganisation has been purely focused on Europe, with the number of sustainable funds outside of the continent rising from 1,312 to 1,471 globally over the quarter and assets increasing from $461.6bn to $513.3bn.

Morningstar now only recognises 4,461 sustainable funds in Europe...

Exhibit 1 Global Sustainable Funds' Q4 2021 Statistics

Region	Q4 2021 Flows		Assets		Funds	
	USD Billion	% Total	USD Billion	% Total	#	% Total
Europe	113.1	79%	2,231.0	81%	4,461	75%
United States	14.2	10%	357.1	13%	534	9%
Asia ex-Japan	7.9	6%	63.2	2%	342	6%
Australia/New Zealand	2.3	2%	30.6	1%	152	3%
Japan	3.4	2%	35.2	1%	212	4%
Canada	1.5	1%	27.3	1%	231	4%
Total	**142.5**		**2,744.3**		**5,932**	

Source: Morningstar Direct, Manager Research. Data as of December 2021.

...down from 6,147 at the end of September

Exhibit 1 Global Sustainable Funds Q3 2021 Statistics

Region	Q3 2021 Flows		Assets		Funds	
	USD Billion	% Total	USD Billion	% Total	#	% Total
Europe	108.7	81%	3,431.6	88%	6,147	83%
United States	15.7	12%	330.7	8%	484	6%
Asia ex-Japan	0.9	1%	50.0	1%	281	4%
Australia/New Zealand	1.9	1%	27.2	1%	144	2%
Japan	5.1	4%	31.6	1%	237	3%
Canada	1.7	1%	22.2	1%	166	2%
Total	134.0		3,893.2		7,459	

Source: Morningstar Direct, Manager Research. Data as of September 2021.

The EU's SFDR regime requires funds be categorised as either Article 8, meaning they promote 'environmental or social characteristics, or a combination of those characteristics', or Article 9, where the mandate requires they purely focus on sustainable objectives.

Assets in funds promoted as sustainable in Europe hit a record high at the end of December, accounting for 42.4% of total EU fund assets. At the end of 2021, 6,659 funds were classified under Article 8 and 9, with around 90% in the former category considered the source of the greenwashing problem.

SFDR has substantially increased disclosure, but there have been concerns that Article 8 requirements are fairly loose and can be exploited by asset managers looking to cash in on the rush for sustainable investments.

'Many funds that place themselves into Article 8, for example, are not funds we would independently classify as sustainable funds,' said Hortense Bioy, global director of sustainability research at Morningstar.

She expects more funds to be cut in the coming weeks as Morningstar analysts complete their review of the disclosures.

The research firm said it has found examples of asset managers now marketing their products as promoting ESG characteristics, when they have only added exclusions-related language to their literature to qualify for Article 8. The funds had made no material changes to the portfolios or investment strategy.

‘Such light-touch and business-as-usual approaches have legitimately raised concerns that asset managers are greenwashing their product ranges,’ Morningstar warned.

‘Investors could be misled in thinking that funds now marketed as promoting ESG characteristics or pursuing sustainable goals are noticeably different from what they were prior to SFDR or different from similar offerings that haven’t been classified as Article 8 or Article 9.’

These greenwashing concerns were echoed by impact investor and OnePlanetCapital co-founder Matthew Jellicoe, who noted that ‘often an ESG fund will have a marginal differentiation from a non-ESG fund with the same strategy’.

‘Refocusing ESG criteria and tightening up the thresholds on the part of Morningstar has to be a move in the right direction,’ he said.

‘If investors want to invest into sustainability they will need to cherry pick funds and companies who truly have sustainability at their core and they will need to put the due diligence work in. Fortunately there is an increasing number of these options available.’