# Sustainable Investment Funds
## From Niche Market to Megatrend

Scope | Scope Analysis

**The concept of sustainability as a synthesis of economic, ecological and social objectives has become much more important in recent years. An increasing number of institutional investors are implementing aspects of sustainability in their investment guidelines and taking them into account in their investment decisions.**

The number of investment funds focusing on sustainability is growing steadily. German investors can currently choose from 433 UCITS investment funds with an explicit focus on sustainability. Taken as a group these funds currently manage about EUR 85bn. Around 90 new funds have entered the market since 2015.

## Some approaches to sustainability are very heterogeneous

There has never been a standard definition of sustainable investments. As a general role, they share the goal of investing in a responsible, conscientious way. They aim to minimise the negative effects of consumption on the environment and society. In practice, investment funds pursue different approaches – some of which are difficult to compare – to implement sustainability in their portfolio.

One of the oldest and most commonly used strategies in sustainable investing is to employ criteria for exclusion. The most common of these criteria for exclusion is weapons: 89% of the funds that Scope classifies as sustainable explicitly rule out investments in the arms industry. Addictive drugs (87%) and nuclear energy (72%) follow.

## 433 sustainable funds are distributed across 57 peer groups

Scope groups all UCITS investment funds into 181 peer groups. Just under a third (57) of these include funds with a sustainable focus. Some peer groups are comprised exclusively of sustainable funds. Examples include Equity Sustainability/ Ethics World (75 funds) and Equity Sustainability/Ethics Europe (33 funds). Both peer groups are the 'sustainable' equivalents to Equity World and Equity Europe. The majority of peer groups, however, contain funds that do not have a sustainable focus and some that have one.

**Chart 1: Sustainable funds with the highest Scope Fund Rating (A)**

| Fund | ISIN | Vol. (EUR m) | Perf. 5Y (p. a.) |
|---|---|---|---|
| LO Funds - Generation Global* | LU0428704042 | 1,239.2 | 18.0% |
| RobecoSAM Sustainable Water Fund | LU0133061175 | 821.9 | 14.9% |
| Lyxor World Water UCITS ETF | FR0010527275 | 589.3 | 16.3% |
| LGT Sustainable Equity Fund Global | LI0106892966 | 453.0 | 15.5% |
| Stewart Investors Global Emerging Markets Sustainability Fund | GB00B64TS881 | 432.4 | 8.5% |
| KCD-Union Nachhaltig MIX | DE0009750000 | 414.5 | 5.6% |
| Pioneer Funds Austria - Ethik Fonds | AT0000731575 | 303.2 | 6.1% |
| Deka-Nachhaltigkeit Renten | LU0703711035 | 284.7 | 7.7% |
| Apollo Euro Corporate Bond Fund | AT0000746938 | 284.4 | 5.3% |
| UBS ETF (LU) MSCI EMU Socially Responsible UCITS ETF | LU0629460675 | 274.0 | 15.0% |
| Muzinich Bondyield ESG | IE00B2R9B880 | 173.8 | 5.2% |

* Soft close.

Source: Scope Analysis, Thomson Reuters, 31.05.2017.

**Analysts**

Sina Hartelt
+49 69 6677389 31
s.hartelt@scopeanalysis.com

André Härtel
+49 69 6677389 33
a.haertel@scopeanalysis.com

**Business Development**

Christian Michel
+49 69 6677389 35
c.michel@scopeanalysis.com

**Editor / Press**

André Fischer
+49 30 27891 147
an.fischer@scopeanalysis.com

**Other publications**

Green Bond Funds
July 2017

Biotechnology Stocks
May 2017

Emerging Markets Stocks
April 2017

Inflation is Back
February 2017

Liquid Alternatives
January 2017

**Scope Analysis GmbH**

Lennéstraße 5
10785 Berlin

Tel. +49 30 27891 0
Fax +49 30 27891 100
Service +49 30 27891 300

info@scopeanalysis.com
www.scopeanalysis.com

in Bloomberg: SCOP

## Active funds dominate sustainable domain

Of the 433 funds with a sustainable focus, 397 (more than 90 percent) are actively managed funds. Passive approaches are divided between ETFs (27 products, AuM: EUR 2.8bn) and index funds (eight products). Only two ETFs are swap-based. The other products track their respective index physically. The largest provider of passive strategies is BlackRock with 12 ETFs, followed by UBS with eight ETFs.

## Candriam has the largest number of sustainable funds in Germany

Although the majority of providers only have a couple of funds with a sustainable focus in their product range, 10 investment firms each have more than 10 such funds. Three firms – Candriam, Bank J. Safra Sarasin and Union Investment – offer more than 20.

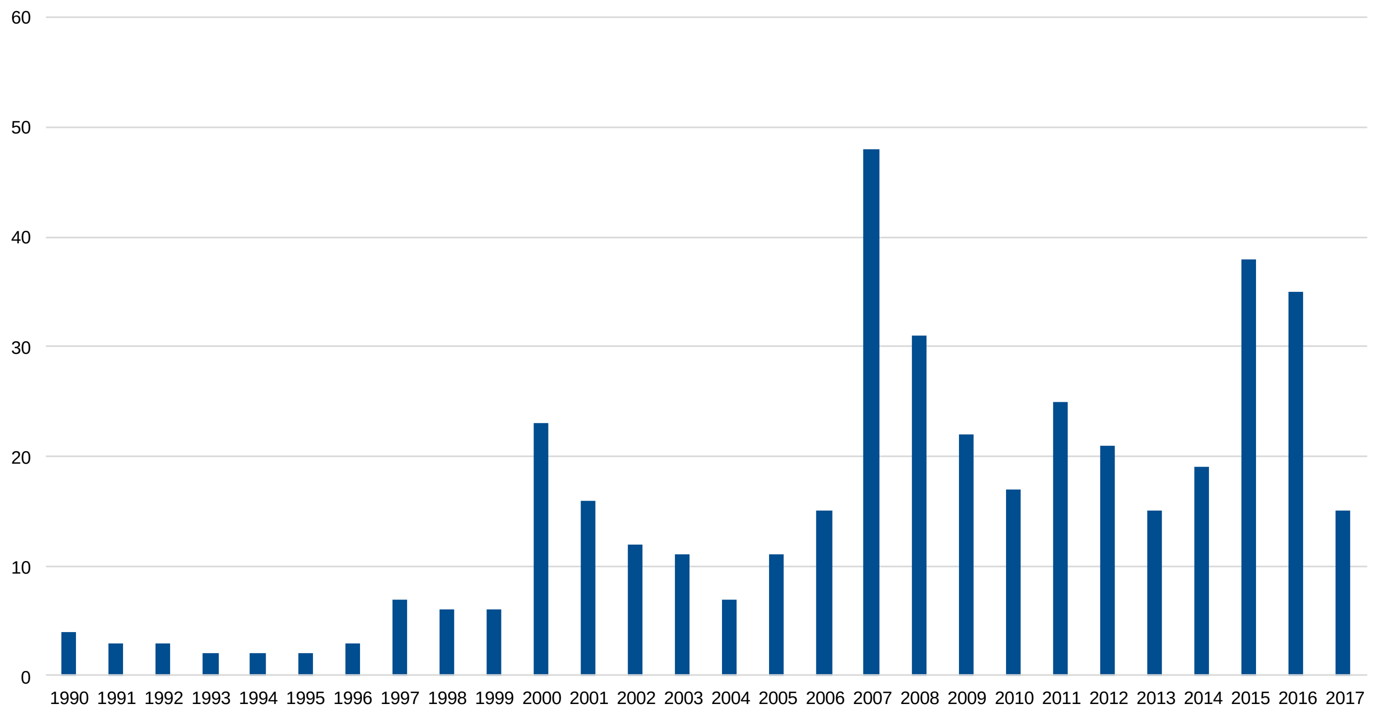
## BNP Paribas has the highest sustainable AuM

BNP Paribas Asset Management has the most assets under management (AuM). It currently manages over EUR 6.3bn in its sustainable funds. Pictet occupies second place. Union Investment follows in third place, making it the largest German provider of investment funds geared towards sustainable criteria.

## No trade-off between a good conscience and good yields

Scope compared the peer groups Equity Sustainability/ Ethics Europe to Equity Europe and Equity Sustainability/ Ethics World to Equity World. We found hardly any differences over three years on average. The average performance of sustainable funds was just slightly higher – as was their volatility.

**Figure 2: Issues of funds with a sustainable focus by year**




Source: Scope Analysis, Thomson Reuters, 31.05.2017. Numbers reflect investment funds approved for sale in Germany (UCITS).

## What makes a fund sustainable?

**No standard definition of sustainable investments**

There has never been a standard definition of sustainable investments. As a general role, they share the goal of investing in a responsible, conscientious way. They aim to minimise the negative effects of consumption on the environment and society.

It is common to distinguish between three dimensions of sustainability: environmental (E), social (S), and corporate governance (G). These ESG criteria thus comprise more than just financing environmentally friendly technologies.

**Some approaches to sustainability are very heterogeneous**

In practice, investment funds pursue different approaches to implement sustainability in their investmentdeciscions – and some of these approaches are difficult to compare. Every asset manager, and in some cases every individual investment fund, has its own selection criteria and approaches.

Scope classifies a fund as sustainable when it implements at least one of the following eight approaches:

- **Criteria for exclusion:** Systematic exclusion of certain investments or investment classes, such as companies, industries or countries, when they violate specific criteria.
- **ESG integration:** Explicit incorporation of ESG criteria and risks in traditional financial analysis.
- **Commitment:** Long-term dialogue with firms to improve their conduct with regard to ESG criteria.
- **Best-in-class:** The best firms are selected within an industry, category or class based on ESG criteria.
- **Investment impact:** Investments in companies, organisations or funds that aim to have an impact on social and environmental concerns in addition to financial gains. For example, funds that invest in green bonds.
- **Sustainable thematic funds:** Investments in themes or assets that are connected with promoting sustainability and have an ESG focus. Examples include water funds and funds that invest in renewable energy.
- **Norm-based screening:** Verifying conformity of investments with specific international standards and norms, such as the Global Compact, OECD Guidelines for Multinational Enterprises and ILO Core Labour Standards.
- **Exercising voting rights:** Exercising shareholder rights at general meetings to influence corporate policy regarding ESG criteria.

## Criteria for exclusion are most common strategy

One of the oldest and most common strategies for sustainable investing is to employ criteria for exclusion. However, such criteria can vary greatly from fund to fund. Scope has maintained a database for selecting and assessing the sustainability of investments since 2008. This database has provided the following results:

**Most common criterion for exclusion is weapons and arms**

The most common criterion for exclusion is weapons and munitions. This applies both to shares and bonds from companies in the weapons industry as well as to securities from national governments and public issuers. For many sustainable investment funds, bonds from countries that have not signed international conventions on cluster munitions and anti-personnel mines are off-limits.

The criteria for exclusion most commonly used by sustainable investment funds can be divided into five main categories (numbers in brackets indicate percent of funds using them):

- Weapons and munitions (89%)
- Addictive drugs (87%)
- Nuclear energy (72%)
- Labour laws (69%)
- Human rights (68%)

These main categories can be further divided into subcategories. The criteria for exclusion most commonly used by sustainable investment funds are as follows:

**Figure 2: The most commonly used criteria for exclusion**

| Criteria for exclusion | Percentage of sustainable funds that use each criterion for exclusion |
|---|---|
| Tobacco | 83.1% |
| Atomic energy/nuclear energy | 68.3% |
| Pornography | 68.3% |
| Child labour | 64.8% |
| Cluster munitions | 62.7% |
| Gambling | 61.6% |
| Land mines | 59.9% |
| Weapons of mass destruction | 59.2% |
| Genetic engineering | 54.9% |
| Ammunition components | 52.8% |
| Alcohol | 48.6% |
| Green genetic engineering | 46.8% |
| Nuclear power station operators | 29.2% |
| Nuclear services | 25.0% |
| Uranium extraction | 20.4% |
| Genetic engineering (medical) | 19.7% |

Source: Scope Analysis Sustainability Database.

**Differences also exist in how criteria for exclusion are applied**

In addition to which criteria for exclusion they choose, sustainable funds differ in terms of how rigorously they apply these criteria. Some funds accept enterprises that generate a small portion of their revenue (up to 10%) in areas that are actually excluded. One reason for this is that an enterprise that is sustainably orientated by itself could supply products that could be used for military purposes.

## 433 sustainable funds distributed across 57 peer groups

**Four peer groups only comprise sustainable funds**

Scope groups all UCITS investment funds into 181 peer groups. Just under a third (57) of these include funds with a sustainable focus. Some peer groups are comprised exclusively of sustainable funds. Examples include Equity Sustainability/ Ethics World and Equity Sustainability/ Ethics Europe. These two peer groups are the respective 'sustainable' equivalents to the Equity World and Equity Europe peer groups.

The majority of the 55 peer groups contain funds that have a sustainable focus and funds that do not. We have not yet divided these peer groups into funds that are and are not sustainably orientated – as is the case for Equity World and Equity Europe. The reason for this is that the number of sustainable funds is still too small to warrant its own peer group.

**Figure 3: Peer groups with the highest number of sustainable funds**

| Peer group | Number of funds with a sustainable focus | Percentage of peer group |
|---|---|---|
| Equity Sustainability World | 75 | 100% |
| Equity Environmental Technology | 39 | 100% |
| Equity Sustainability Europe | 33 | 100% |
| Bonds EURO | 25 | 9.9% |
| Bonds EURO Corp. Inv. Grade | 22 | 13.0% |
| Mixed Global Flexible | 19 | 2.5% |
| Mixed Global Conservative | 19 | 7.5% |
| Equity Water | 19 | 100% |
| Mixed Global Balanced | 18 | 6.3% |
| Equity Emerging Markets | 18 | 6.5% |

Source: Scope Analysis, Thomson Reuters, 31.05.2017. Numbers reflect investment funds approved for sale in Germany (UCITS).

**Sustainable funds have a volume of around EUR 85bn**

The 433 funds with a sustainable focus have a combined volume of around EUR 85bn. Two thirds of them, or around EUR 55bn, fall into the following 10 peer groups:

**Figure 4: Peer groups with the highest volume of sustainable funds**

| Peer group | Volume in EUR m | Percentage of peer group |
|---|---|---|
| Equity Sustainability World | 13,256.8 | 100% |
| Equity Water | 8,531.2 | 100% |
| Bonds EURO Corp. Inv. Grade | 5,794.6 | 5.7% |
| Mixed Global Conservative | 5,514.8 | 7.9% |
| Equity Sustainability Europe | 5,353.7 | 100% |
| Equity Environmental Technology | 5,096.9 | 100% |
| Mixed Europe Conservative | 3,807.0 | 13.6% |
| Mixed Global Balanced | 3,435.1 | 2.8% |
| Equity industries and themes | 3,168.8 | 7.1% |
| Equity Emerging Markets | 2,904.2 | 1.7% |

Source: Scope Analysis, Thomson Reuters, 31.05.2017.
Numbers reflect investment funds approved for sale in Germany (UCITS).

## Only 10 firms have more than 10 sustainable funds

**Candriam has the largest number of sustainable funds in Germany**

The weight that investment firms place on sustainability varies. Although the majority of providers only have a couple of funds with a sustainable focus in their product range, 10 investment firms each have more than 10 such funds. Three firms offer more than 20.

**Figure 5: Investment firms with the highest number of sustainable funds**

| Firm | Number of funds with a sustainable focus | Volume in EUR m |
|---|---|---|
| Candriam | 23 | 2,893.5 |
| Bank J. Safra Sarasin | 22 | 1,680.3 |
| Union Investment | 20 | 3,778.0 |
| BNP Paribas Asset Management | 16 | 6,307.4 |
| BlackRock | 16 | 2,967.2 |
| UBS Asset Management | 13 | 1,787.0 |
| Robeco | 12 | 3,351.6 |
| Swisscanto | 11 | 1,114.9 |
| Vontobel Asset Management | 11 | 1,392.6 |
| LGT Capital Partners | 10 | 3,402.5 |

Source: Scope Analysis, Thomson Reuters, 31.05.2017.
Numbers reflect investment funds approved for sale in Germany (UCITS).

**BNP Paribas Asset Management has the highest sustainable assets under management**

BNP Paribas Asset Management currently has the most assets under management (AuM). It now manages over EUR 6.3bn in its sustainable funds. It is followed by Pictet with just under EUR 6bn. Union Investment comes in third place, making it the largest German provider of investment funds geared towards sustainable criteria.

**Figure 6: Investment firms with the highest volume in sustainable funds**

| Firm | Number of funds with a sustainable focus | Volume in EUR m |
|---|---|---|
| BNP Paribas Asset Management | 16 | 6,307.4 |
| Pictet | 6 | 5,978.4 |
| Union Investment | 20 | 3,778.0 |
| LGT Capital Partners | 10 | 3,402.5 |
| Robeco | 12 | 3,351.6 |
| BlackRock | 16 | 2,967.2 |
| Candriam | 23 | 2,893.5 |
| Deka Investment | 7 | 2,428.0 |
| Shareholder Value | 1 | 2,141.9 |
| Natixis | 9 | 2,105.5 |

Source: Scope Analysis, Thomson Reuters, 31.05.2017.
Numbers reflect investment funds approved for sale in Germany (UCITS).

## Does sustainability kill performance or give it a boost?

One of the most urgent questions from investors is whether a focus on sustainability hurts performance or has a positive effect on yields.

We can begin to answer this question by comparing Scope's two sustainable peer groups, Equity Sustainability/ Ethics Europe and Equity Sustainability/ Ethics World, to their nonsustainable equivalents, Equity Europe and Equity World.

**Minimal differences in performance and volatility**

We found hardly any differences over three years on average. The average performance of sustainable funds was just slightly higher – as was their volatility. There were virtually no differences to be found in the percentage of top ratings either. They comprised around one third of funds in all four peer groups.

**Figure 7: Peer group comparison – Equity Europe**

| | Equity Sustainability Europe | Equity Europe |
|---|---|---|
| Number of funds | 34 | 490 |
| Number of funds rated | 23 | 353 |
| Number of top-rated funds | 7 | 106 |
| in % | 30.4% | 30.0% |
| 3Y average performance (p. a.) | 7.7% | 7.2% |
| Average volatility | 13.6% | 13.3% |
| Max. loss 6M average | -13.2% | -13.9% |

Source: Scope Analysis, Thomson Reuters, 31.05.2017.
Numbers reflect investment funds approved for sale in Germany (UCITS).

**Figure 8: Peer group comparison – Equity World**

| | Equity Sustainability World | Equity World |
|---|---|---|
| Number of funds | 74 | 756 |
| Funds rated | 50 | 510 |
| Number of top-rated funds | 15 | 170 |
| in % | 30.0% | 33.3% |
| 3Y average performance (p. a.) | 11.6% | 11.1% |
| Average volatility | 12.9% | 12.6% |
| Max. loss 6M average | -13.9% | -14.0% |

Source: Scope Analysis, Thomson Reuters, 31.05.2017.
Numbers reflect investment funds approved for sale in Germany (UCITS).

Our performance comparison for these two peer groups is only an initial indicator for answering the question of the advantages of sustainable funds. It shows that the risk-yield profile of sustainably orientated funds differs very little from that of traditional funds.

**No trade-off between a good conscience and good yields**

As a result, there is no trade-off between a good conscience and good yields. On the contrary, more and more studies and evaluations are demonstrating a positive correlation between the sustainability of investment strategies and their performance. (For more on this, see the interview with Andreas Feiner of Arabesque Asset Management at the end of this report.)

## Active funds dominate sustainable domain

Of the 433 funds with a sustainable focus, 397 (more than 90 percent) are actively managed funds. Passive approaches are divided between ETFs (27 products, AuM: EUR 2.8bn) and index funds (eight products). Only two ETFs are swap-based. The other products track their respective index physically. The largest provider of passive strategies is BlackRock with 12 ETFs, followed by UBS with eight ETFs.

**Andreas Feiner**
Head of ESG Research at Arabesque Asset Management

## "It's the performance, stupid!" – Interview with Andreas Feiner

*There are many sides to sustainability. Some people think there are too many. But sustainability won't be disappearing from the investment industry anytime soon. In this interview, Andreas Feiner of Arabesque Asset Management explains why.*

**Sustainability was a niche market until very recently. Now it is one of the biggest themes in investing. What are the reasons behind this change?**

**Andreas Feiner:** Sustainability's status has changed because more and more investors are convinced that investing in sustainable businesses is good for people's conscience as well as for performance. In other words, sustainable companies have higher earnings potential and better risk-yield profiles then companies with a lower sustainability profile. Numerous studies have demonstrated this correlation.

**Does that mean the driving force behind this development is performance rather than ethics?**

**Andreas Feiner:** Naturally, moral and ecological aspects continue to play important role. Having said that, sustainability is no longer just about investing in environmental protection projects or avoiding the tobacco and weapons industry. It's much more about the core aspects of investing – risk and yields. Or to rephrase Bill Clinton's famous campaign slogan, "It's the performance, stupid!"

**What role have the numerous corporate scandals of recent memory played?**

**Andreas Feiner:** The scandals and the massive price drops that followed as a result for Volkswagen, Toshiba and Wells Fargo gave sustainability an extra boost. They were a painful illustration that investors should not base investment decisions solely on conventional financial performance indicators and that it's risky to ignore sustainability factors. What value are good quarterly results when scandals of this magnitude destroy years' worth of performance?

**Many investors think sustainability is still too vague a concept. There are simply too many soft factors that are difficult to integrate in investment processes. What has changed in this respect?**

**Andreas Feiner:** A lot. For one, companies are publishing more and more qualitative information beyond the conventional financial performance indicators. At the same time, the digital revolution we are all experiencing is transforming our ability to quantify and measure sustainability.

**Have you got an example?**

**Andreas Feiner:** Leadership culture is a good example in this context. Until recently, you could describe it but you could hardly quantify it. Big data and intelligent algorithms have changed that. Those technologies enable us to calculate a score for the sustainability of a corporate culture based on massive quantities of data and all of the information available on that company – and they enable ongoing, automated updates to that score.

**Can you apply that process to every sustainability factor?**

**Andreas Feiner:** In principle, yes. For example, at Arabesque we have developed a **tool** that condenses all relevant ESG information – environmental protection, social concerns and corporate culture – about a company in a single score. The benefit for investors is that they no longer have to deal with the various aspects of ESG separately; they get all available information aggregated in a single indicator.

**Does that mean investors should stay away from companies that have good financial performance but a low ESG score?**

**Andreas Feiner:** I wouldn't make such a blanket statement. But investors should be sure to have a closer look in such cases. A low ESG score always entails risk. Investors should analyse that risk in detail.

**To conclude, would you give us your forecast for how sustainability will develop in future?**

**Andreas Feiner:** Investors will use sustainability criteria as a standard performance indicator for investment decisions, like a price-earnings ratio or dividend yield. Sustainability will become an essential component in any risk analysis. The quantifiability of sustainability aspects will increase as well, because data quality is improving rapidly.

**Will this evolution lead to a more sustainable economy too?**

**Andreas Feiner:** Investors bear a great deal of responsibility. They decide how capital is allocated in our economic system. The more investors integrate ESG criteria in their decision-making processes, the more capital will be allocated to companies that meet high sustainability standards. That would obviously be an encouraging development.

**Thanks for speaking with us, Andreas.**

***Background note:*** *Arabesque Asset Management implemented its technology and sustainability know-how in conjunction with a quantitative investment model in its Arabesque Systematic fund.*

**Scope Analysis GmbH**

**Headquarters Berlin**
Lennéstraße 5
D-10785 Berlin

Tel. +49 30 27891 0

**Frankfurt am Main**
Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Tel. +49 69 66 77 389 0

info@scopeanalysis.com
**www.scopeanalysis.com**

## Disclaimer