Robeco Active Ownership

How regulation will enhance sustainable investing in 2021

- Sustainable Finance Action Plan is a sea change for investors in the EU
- New requirements to disclose the sustainability credentials of funds
- Regulations aim to boost transparency and combat greenwashing

Integrating sustainability into investments will become much higher profile under new EU regulations that take effect this year.

Coming into force on over the course of 2021, the EU's Sustainable Finance Action Plan represents one of the most impactful pieces of regulation to hit the investment management industry since MiFID II beefed up reporting and transparency in 2018. A core tenet of the plan is the Sustainable Finance Disclosure Requirement (SFDR), which will classify investment funds according to their sustainability credentials for the first time.

Article
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Masja Zandbergen and Kenneth Robertson

Aside from producing a level playing field that is better understood by end investors including the general public, the regulation aims to prevent greenwashing. This is where an asset owner or manager claims to be sustainable when it is only making token gestures, such as excluding an obviously contentious company from portfolios.

Preparing for over a year

Robeco has been preparing for the new classifications and what it will mean for documentation such as prospectuses for more than a year, with a team from across the company dedicated to making sure both Robeco and its clients can fully comply with all parts of the plan.

"The financial industry will need to become very specific on how environmental and social issues are promoted, and how risks are taken into account," says Masja Zandbergen, Head of ESG Integration at Robeco. "The level of transparency required should help in combating greenwashing."

"The most immediately impactful element of it is the SFDR, which sets out a number of actions aimed at 'greening' the finance industry. It aims to make the sustainability profile of funds more comparable and better understood by end-investors, using pre-defined metrics for the environmental, social and governance (ESG) characteristics used in the investment process."

Classifying funds

A key part of the regulation is a classification system which sets out the disclosures that must be made for any investment product. The three types of fund categorization as described by the EU under its articles are:

- **Article 6 funds**: those that do not promote their ESG characteristics.
- **Article 8 funds**: "Where a financial product promotes, among other characteristics, environmental or social characteristics, or a combination of those characteristics, provided that the companies in which the investments are made follow good governance practices."
- **Article 9 funds**: "Where a financial product has sustainable investment as its objective and an index has been designated as a reference benchmark."

Robeco already integrates ESG factors into the investment process for all the funds where it is possible to do so across its fundamental equity, fixed income, quantitative and bespoke sustainability strategies. Robeco also has a strict exclusion policy and a structured Active Ownership approach. This means the majority of strategies will fall under the Article 8 banner.

The range of impact investing strategies which are labeled as RobecoSAM and follow themes such as the Sustainable Development Goals or the new climate change fixed income funds will fall under the Article 9 heading. Only a handful of funds that do not intentionally follow ESG factors, such as those solely using derivatives, will be classified as Article 6.

A project team of more than 30 people has been working on making sure Robeco adheres to the regulations. Investment teams worked with the company's legal officers, Compliance department and external advisors and regulators to make sure all funds can meet the relevant criteria and disclosures.

Business as usual

But despite the extensive nature of the regulation, much of this is 'business as usual' for Robeco. As a pioneer of sustainable investing, Robeco has been taking sustainability seriously since the mid-1990s, fully using active ownership since 2005 and ESG integration since 2010.

"Our company-wide philosophy is that companies (and countries) that act in a sustainable way towards the environment, society and all their stakeholders are likely to be more able to deal with a variety of issues in their future endeavors," says Zandbergen.

"This does not mean there was no work involved, as risk measures, and environmental and social limits and disclosures needed to be aligned with the regulation."

Expanding disclosures

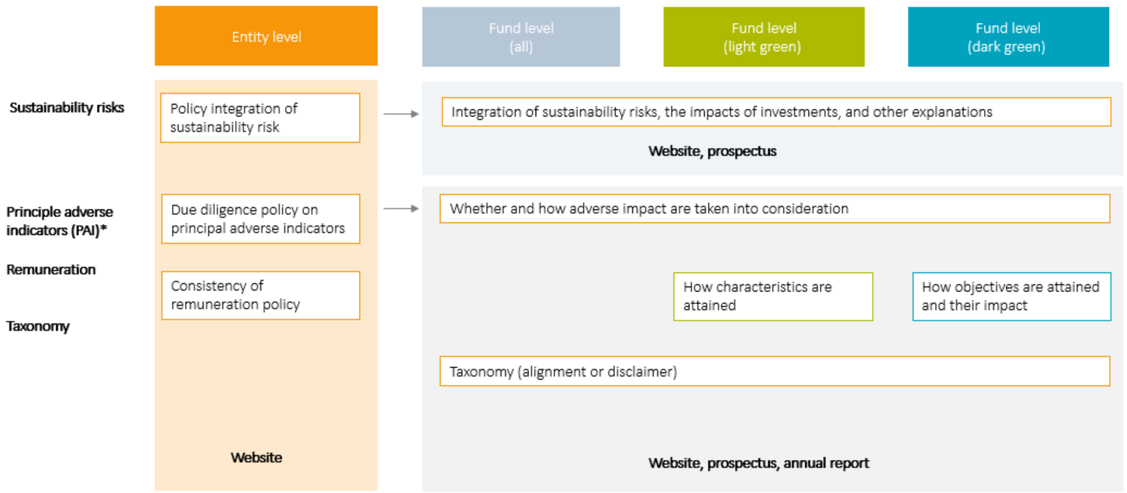
All client documents need to be upgraded, and will become available on the main Robeco website from early March. One regulatory change is that funds will have to disclose any adverse impacts that their portfolio companies have on a range of indicators, from carbon emissions to gender diversity.

"Fund prospectuses have been updated to reflected the necessary changes required under SFDR, including information on how each fund has been classified," says Kenneth Robertson, client portfolio manager for sustainable investing with Robeco's SI Center of Expertise.

"At the fund level, Robeco will start reporting fund performance on principle adverse impact indicators from 2023. The relevant indicators per strategy will be outlined in the prospectus and Key Investor Information Documents (KIIDs)."

An example of disclosure requirements

Entity and fund



* If <500 employees, comply or explain

"Funds aligning with Article 9 will address all adverse impact indicators. Funds classified under Article 8 and 9 will subsequently report on actions taken to mitigate adverse impact on a yearly basis, through regular fund reporting."

"Aside from our disclosures on an individual product level, we will also be publishing a range of additional policies and disclosures at an entity level, as also required under the regulation. This includes a new sustainability risk policy, renumeration policy, and a suite of disclosures giving more insight into the methodologies used to underpin our ESG integration and impact methodologies."

Next steps

One complicating factor has been a series of delays around the publication of the regulatory technical standards, known as 'level 2 RTS', stipulating the exact metrics, methodologies and further guidelines of the exact meaning and technical standards applied to each article. Asset managers subsequently had to use the Level 1 standards for planning, as level 2 was not made available until February.

"This is of course a bit upside down," says Robertson. "The financial industry first needed to classify its funds before the actual technical standards of what that classification would entail in terms of actual ESG restrictions were available."

"As most asset managers and asset owners will probably not want to go back on their earlier classifications, the level 2 requirements will most likely be implemented by everyone, pushing the bar on sustainable investing up, across the market!"

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