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The rise of the sustainable fund market

and its role in financing sustainable development

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Executive summary

Sustainable funds – mutual funds and exchange-traded funds (ETFs) that integrate sustainable development-related considerations in their asset allocation process – have been growing rapidly in recently years. This market has the potential to contribute to sustainable development through investments in sectors relevant to the attainment of the Sustainable Development Goals (SDGs), including in developing countries. This paper aims to analyse the latest developments in the global sustainable fund market, asses its sustainability performance and its alignment with the SDGs, and discuss the challenges and opportunities for the further expansion of this market.

Key findings of the report include:

- The number of sustainable investment funds has almost doubled in the last five years, reaching 3,987 by June 2020, with assets under management (AUM) of over $1.7 trillion, just over 3% of the assets of the world's open-ended funds. Net investment flows to these funds reached $159 billion in 2019 and are estimated to surpass $300 billion in 2020.
- The sustainable fund universe includes 3,435 sustainable mutual funds and 552 sustainable ETFs, with AUM of $1.56 trillion and $174 billion respectively. Equity funds account for about two-thirds of sustainable funds in both number and assets, with the remainder split between fixed income and mixed allocation funds.
- Geographically, the majority of funds are domiciled in developed countries, particularly in Europe, and target developed regions in their portfolio selection. Developing and transition economies host about 5% of the world's sustainable funds by number and less than 3% by assets.
- Based on an analysis of over 800 sustainable equity funds, for which sustainability data are available, sustainable funds on average outperform the overall market in terms of sustainability, and have significantly lower exposure to fossil fuels and controversial sectors.
- On average, these funds deployed 27% of their assets across eight key SDG sectors, such as health, renewable energy and infrastructure. However, the wide variance in sustainability ratings among funds indicates that a large share of underperforming funds may not meet their sustainable credentials.
- Analysis suggests that the funds' returns did not systematically suffer a financial disadvantage for having a sustainable tilt in their portfolios. Over a period of three years, there was almost no difference between sustainable funds and their respective benchmarks in terms of financial performance.
- Going forward, sustainability integration should not be limited to sustainable funds. Instead, the whole fund industry needs to enhance its sustainability disclosure and performance and take actions to channel more investments into SDG-related sectors.
- Actions need to be taken by regulators and the fund industry in both developed and developing countries to support the growth of sustainable funds both domiciled in, and with a portfolio exposure to developing countries.
- In order to address "sustainability washing" concerns, fully transparent self-reporting on the sustainability performance of funds, supported by external auditing and regulation, will be needed. Stock exchanges can also put in place relevant guidelines or demand greater disclosure in their listing requirements, with support from securities regulators.

About the UNCTAD Investment and Enterprise Division and the SDG Investors Partnership

The UNCTAD Investment and Enterprise Division is the focal point in the United Nations System for investment and enterprise development. As a global centre of excellence, the Division conducts leading-edge research and policy analysis, provides technical assistance to 160 member States and regional groupings, and builds international consensus among the 196 member States of the organization. Its mission is to promote investment and enterprise for sustainable development and prosperity for all.

The SDG Investors Partnership, initiated by the Division, aims to foster partnerships among institutional investors, governments, and international organizations to facilitate institutional investment in key SDG sectors, in particular in developing countries. The Initiative, in partnership with all stakeholders, seeks to create an enabling environment for SDG-oriented investment by institutional investors through evidence-based research, dissemination of best practices and international standards, consensus building and policy advocacy on strategic issues that are critical for facilitating institutional investment in sustainable development.

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Table of contents

1. Introduction

Capital markets that are aligned with sustainable development can be instrumental in filling the financing gap for the Sustainable Development Goals (SDGs). The pursuit of sustainability in business operations and investment has led to a proliferation of sustainability-themed financial products in recent years. The global efforts to fight the COVID-19 pandemic and climate change are accelerating this momentum, with a surge in climate and social funds and bonds. UNCTAD estimates that sustainability-dedicated investments – investment products targeting sustainable development-related themes or sectors – reached over $3.2 trillion in 2020, with each component – sustainable funds, green bonds and social bonds – almost doubling from their respective 2019 levels (UNCTAD, 2020a; UNCTAD 2021a).

Sustainable funds, including sustainable mutual funds and exchange-traded funds (ETFs), are the largest component of this pool of capital for sustainable investment, with over $1.7 trillion of assets under management (AUM). Nevertheless, given the size of the global open-ended fund market, estimated to be over $50 trillion,[1] the market penetration of sustainable funds remains limited. Moreover, a lack of market transparency and international standards has given rise to "green or sustainability-washing" concerns, and makes an accurate assessment of the market, including its size and impact, challenging.

This study analyses the latest trends in the global sustainable fund market and assesses its sustainability, financial performance and alignment with the SDGs. In doing so, the paper contributes to efforts to better quantify and evaluate the impact of the sustainable fund market and to support its contribution to sustainable outcomes and the achievement of the SDGs.

The report is structured in three sections: first, an overview of the global market for sustainable funds; second, an assessment of their sustainability and financial performance, and their alignment with the SDGs; and third, the challenges for further growth of the market and recommendations for regulators and market players on how to harness the opportunities for sustainable investment presented by the fund industry and minimize the influence of "sustainability washing".

[1] According to the quarterly statistics of the European Fund and Asset Management Association (EFAMA), assets of regulated, open-ended funds worldwide (fund of funds excluded) were about $54 trillion at the end of the second quarter of 2020.

2. The rise of the sustainable fund market

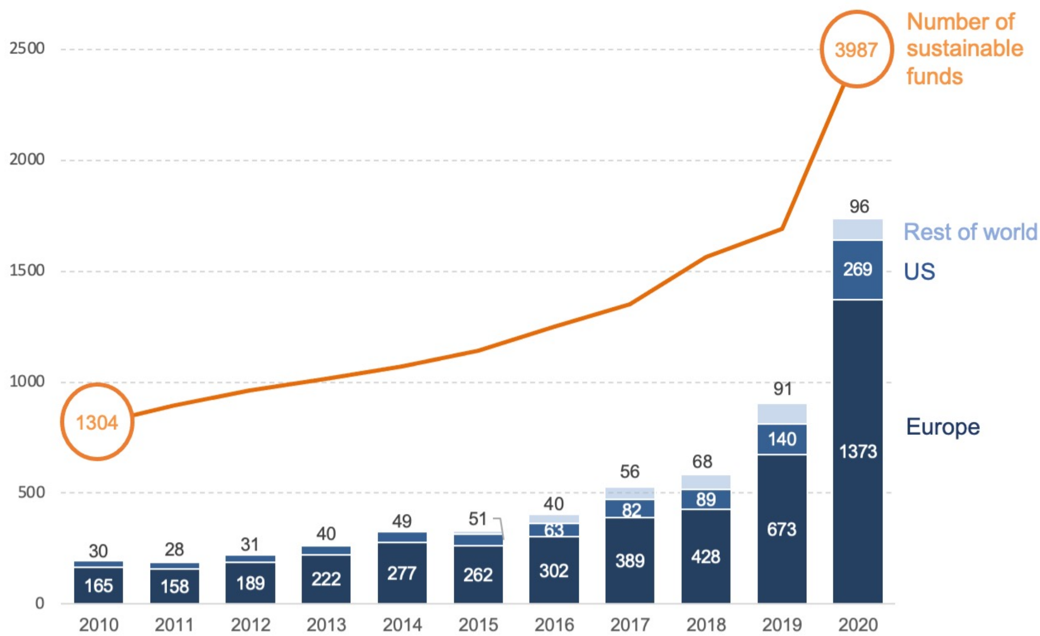
2.1 Global trends

As the fund industry and companies increasingly pivot towards sustainability, recent years have witnessed a surge in sustainable funds, i.e., mutual funds and ETFs that describe themselves as targeting sustainable development-related themes or sectors, or integrating sustainability, impact or environmental, social and governance (ESG) factors in their asset selections in their prospectus or other filings.

According to data from Morningstar and TrackInsight, the total number of sustainable funds reached 3,987 by June 2020, up 30% from 2019 (UNCTAD, 2020a). The AUM of sustainable funds nearly doubled from about $900 billion in 2019 to over $1.7 trillion, representing about 3.2% of the assets of all open-ended funds worldwide. The sustainable fund universe comprises 3,435 sustainable mutual funds and 552 sustainable ETFs, with AUM of $1.56 trillion and $174 billion respectively. Equity funds account for 62% of sustainable funds by number, with the remainder split equally between fixed income (19%) and mixed allocation funds (19%). In terms of assets under management, equity funds account for a slightly greater share of total fund allocations at 66%, or about two-thirds of the sustainable fund universe.

About half of the sustainable funds were launched in the last five years. From 2016 to 2020, the aggregate number of sustainable funds nearly doubled, while AUM more than quadrupled from $405 billion to over $1.7 trillion. This momentum has accelerated significantly in the last two years, in particular in terms of AUM, which grew by over 50% in 2019 and then nearly doubled in 2020 (figure 1). This exceptional growth was witnessed in both sustainable mutual funds and ESG ETFs (Box 1).

Figure 1. Number and AUM of sustainable funds, 2010-2020

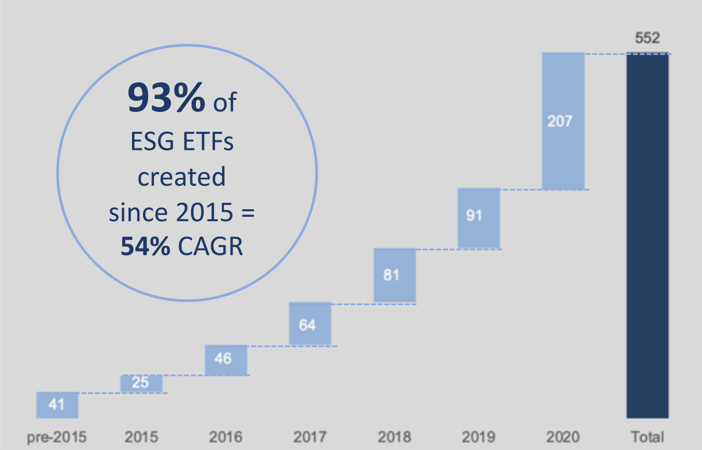


Source: UNCTAD based on Morningstar and TrackInsight data.
Notes: Numbers of funds do not include funds that were liquidated; the numbers for 2020 are as of 30 June.

Box 1. The rise of sustainable exchange traded funds (ETFs)

ETFs with an environmental, social and governance (ESG) tilt are a subset of the sustainable investment funds in this study. Providers of ETFs are increasingly responding to the demand for sustainability-oriented products, with a particular focus on ESG performance. Since UNCTAD's first study on ESG ETFs (UNCTAD, 2020b) the number of such funds increased from 345 in 2019 to 552 in 2020 – a huge jump in annual growth compared to previous years (box figure 1.1).

Box figure 1.1. Number of ESG ETFs, pre-2015 - 2020



Source: UNCTAD, based on Trackinsight data

ETFs integrate ESG performance in a number of ways and by using one of several strategies, including: (i) exclusionary screening; (ii) a general integration of ESG performance; (iii) pursuing a best-in-class ESG strategy; and (iv) thematic strategies, specifically targeting a sustainable development-related sector or theme, market, or theme, such as the SDGs. Of the 552 ESG ETFs, 77 followed a themed strategy, up from 49 in 2019. This illustrates the growing attraction of themed strategies that often correspond with, or explicitly target, a specific SDG. Overall, 208 ESG ETFs targeted the SDGs in their investments in 2020, of which almost 90% covered just three goals: SDG 13 (Climate action), SDG 7 (Affordable and clean energy) and SDG 5 (Gender equality).

In terms of the regional distribution of ESG ETFs by domicile, Europe accounted for a greater share in 2020 than in 2019, up from 59% of funds to 67%, reflecting the overall geographic distribution of the whole sustainable fund market (see below). Only seven ESG ETFs, or just over 1% of the total were domiciled in developing countries – the same number as in 2019.

Source: UNCTAD, based on TrackInsight data