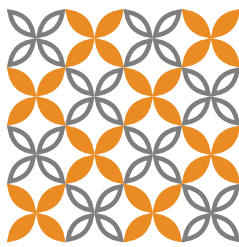
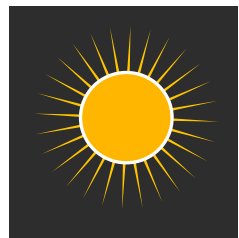


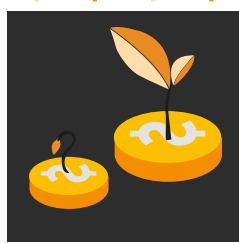
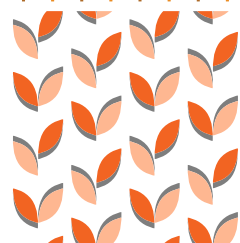
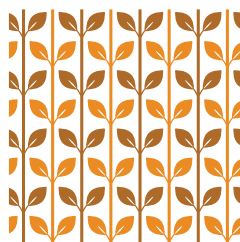
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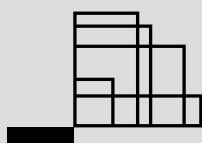


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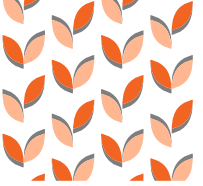
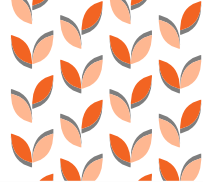
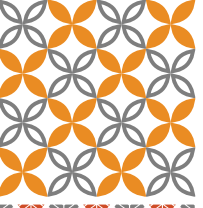
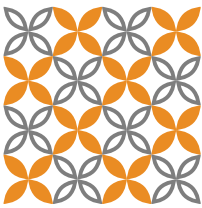


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Foreword

While the term was originally coined in 2005, ESG emerged as somewhat of a buzzword following the implementation of the UN Sustainable Development Goals (SDGs) in 2015. Back then, ESG investing was a niche investment strategy that was adopted by only the most sustainably conscious of asset and wealth managers. Nonetheless, this marked the onset of a paradigm shift in the investment landscape - establishing the first voluntary link between sustainability and financial services. This was a watershed moment in sustainable finance, preceding major milestones such as the signing of the UN Paris Agreement in 2016 and the release of the European Commission's Action Plan on Financing Sustainable Growth in 2018. These have tightened the reins on the sustainable finance agenda, implementing mandatory minimum standards and highlighting how the asset management industry could play a key role in driving positive change.

In the new decade, the wheel that began turning in 2015 has reached unparalleled speed; and ESG has gone from a trend to a revolution of proportions unseen in the European fund industry since the advent of UCITS and AIFMD. Virtually all stakeholders in the asset management landscape are attributing strategic focus to sustainability issues, and the Asset and Wealth Management (AWM) industry's role in addressing them. Institutional investors, in particular, are prioritising non-financial impacts alongside financial returns, demonstrating a strong proclivity for sustainable products and managers. Moving forward, we expect to see this trend mirrored by retail investors as millennials increasingly enter the investor base and upcoming changes to MiFID investment suitability rules encompass sustainability factors.



We are seeing a similar shift in sentiment among EU policymakers, with a recent surge in regulatory momentum embedding ESG as a central tenet of the investment landscape. The above resulted in a widescale blurring of the boundary between traditional and sustainable investment; a boundary which we expect to have all but disappeared by 2022, by which the Taxonomy and Sustainable Finance Disclosure Regulation will have been fully implemented in the EU. Widespread unrest surrounding racial and gender inequality, rising wealth disparity and the escalating climate crisis have added fuel to the ESG fire; further highlighting the room for improvement in managers' approaches to considering ESG investment criteria and embedding ESG standards within their own corporate processes. Successful change will require the alignment of both services, products and corporate sustainability.

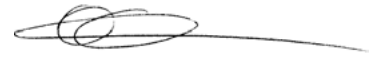
In PwC's "Sustainable Finance, A New Era for Asset Managers" report published earlier this year, we initiated a discussion about how changing regulation was expected to impact asset management operations and how managers could best prepare for imminent change. Evidently, recent events have heightened the urgency and prominence of ESG issues like never before. Change is undeniably upon us and asset managers must adapt fast in order to thrive. In this report, we quantify and assess Europe's dominance in the global ESG sphere, identify any shortcomings and emphasise the urgent need for asset managers to embark on full-scale ESG integration both within their business strategies and their operations. We then propose a roadmap that we believe will set asset managers on the path to achieving total strategic and operational ESG integration.

Reflecting on when the UN SDGs shone the spotlight on the connection between financial prosperity and environmental protection in the context of the present day, we believe that there has never been a time like the present to establish an inherent link between profitability and sustainability. Doing so would represent a century-defining opportunity not only for Europe's asset management industry, but in Europe as a whole. It is our view that by striving to be ESG aligned, asset and wealth managers will not only be able to sail the tides of change, but also to protect investors against downside risks and conquer new investment opportunities - realising financial and non-financial value that is meaningful not only to investors and regulators but to society as a whole. We hope that this report sparks the necessary conversations among industry stakeholders and provides the guidance that asset and wealth managers need to take advantage of this landmark change.



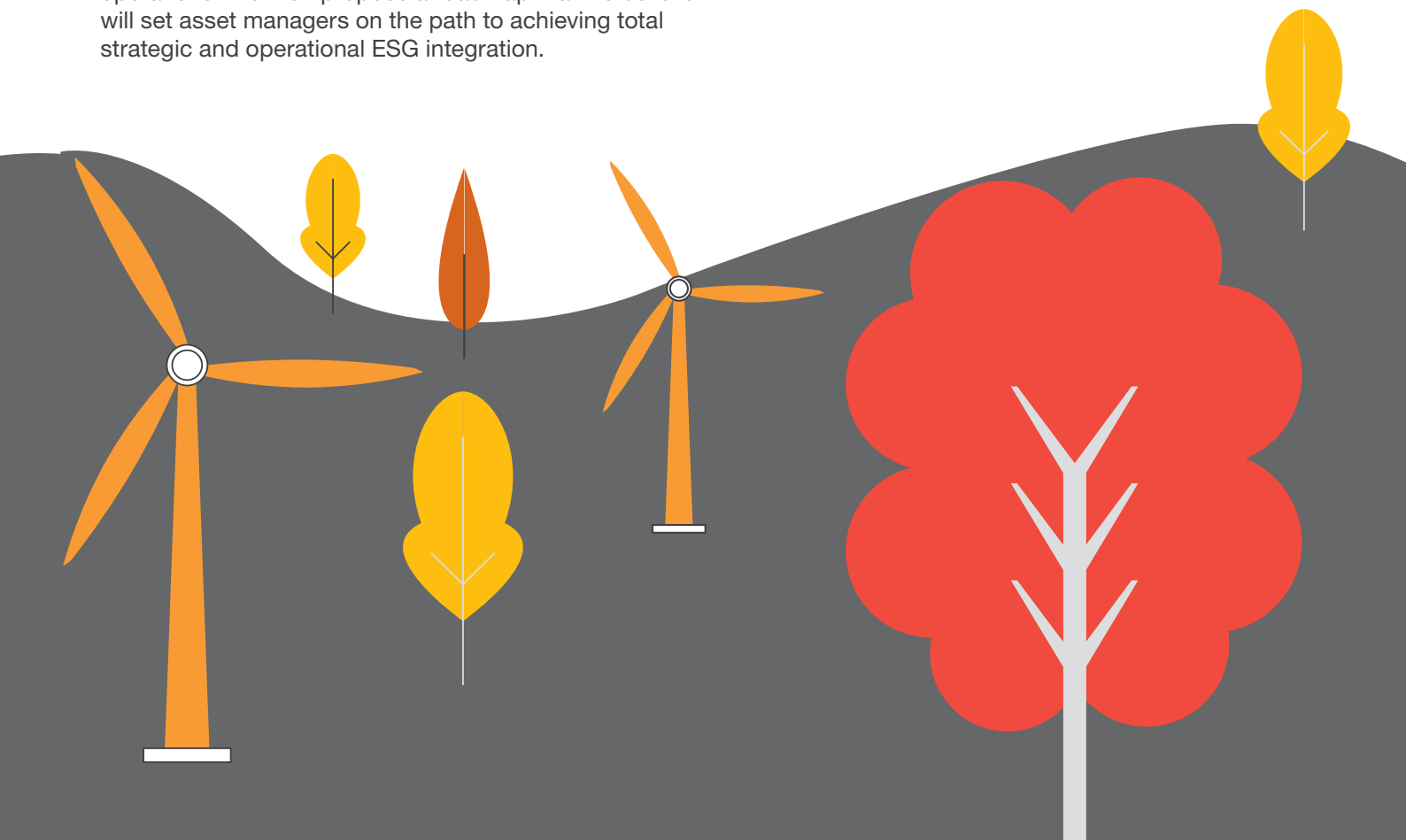
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Executive Summary

The ESG¹ wave has begun to break! Societal changes mark our generation and decade: Black Lives Matter protests have sparked some of the largest discussions related to persistent and pervasive racism (both covert and overt), mass climate protests have left young people concerned whether humanity will survive the next 100 years, and the global pandemic has highlighted the growing disconnect between the one percent and the other 99. The current focus on ESG policy within the EU (EU Action Plan for Financing Sustainable Growth) is certainly not addressing all of these problems completely, but for the first time, this new regulatory standard puts non-financial and financial KPIs on a level playing field and attempts to re-direct capital to more sustainable business activities. Thus, for the financial services industry and corporate businesses in the EU, it is no longer a matter of if this wave washes away old structures and business patterns, but when. This marks a landmark change in investment approach and as such to the competitive environment for asset and wealth managers – a change that represents an opportunity that will resonate long after the end of this decade.

The financial services industry has long ridden the coattails of societal change, waiting for certainty in the way that non-financial factors influence performance and return of their investments. The myth of underperforming “ESG aligned assets” has long been widely accepted wisdom in our industry. Yet, with the change in policy and the clear intention of the EU regulators to favour capital flows into sustainable economic and business activities, this wisdom could soon prove false. In fact, we are already seeing leaders in the AWM space distancing themselves from this widely held belief – spearheading the move towards ESG strategies and investments not only in response to investor demand and to create performance, but even more so to avoid underperforming assets in industries that are non-sustainable.

Sustainability might not be the golden ticket to outperformance, but it could very soon be widely accepted as a source of downside protection against ESG related risks.

The expectations and market trends investigated in our paper stress the immediate need for the Asset and Wealth Management industry to actively endorse the ESG trend and for the leaders to step-up their strategic measures in order to change along with the times.

A vast majority of institutional investors expect a convergence between ESG and non-ESG products by 2022, and 77% of them plan to stop purchasing non-ESG products in the same year. While asset managers agree that there will be a convergence, only 14% plan to stop launching non-ESG products by that time. Therein lies the fundamental disconnect. You cannot have your cake and eat it too, so the saying goes. For asset managers, this will ring true – you cannot be both ESG and non-ESG.

While ESG is commonly considered a rapid and significant development, many managers see it as just another product, similar to smart-beta or factor investing. Our data and market views will prove these sentiments wrong.

ESG is nothing less than an all-encompassing shift in the investment landscape; placing financial and non-financial performance criteria on a level playing field. It might have the same, if not a greater, impact than the introduction of UCITS or AIFMD standards. Indeed, the emergence of Sustainable Finance policy in Europe will see a significant impact not only on products (UCITS, AIFs, Discretionary Mandates), but on financial agents (MiFID firms, Insurance brokers) and fiduciary investors (Insurance companies, pension funds) at the same time.

The rapid uptick of ESG products is ushering in a paradigm shift across the greater European AWM industry. **In Europe alone, in our best-case scenario, we expect ESG fund assets under management (AuM) to account for over 50% of total European mutual fund assets by 2025. This will represent a staggering 28.8% compound annual growth rate (CAGR) from 2019 to 2025.**

ESG’s impact will transcend Europe’s borders, and will likely have immediate impacts outside the EU, given EU investor requirements imposed on non-EU corporates and financial market participants – just as was the case with the AIFMD and MiFID II.

¹ We define ESG funds as those classified as Article 8 or 9 in the SFDR for future assets. For current and past assets, we define ESG as funds that have been classified by Lipper/Morningstar as ESG.

In a European context, we've identified four key catalysts that are driving the sustained growth of ESG:

1. Complete regulatory overhaul

The regulatory and legislative momentum behind ESG has shifted and strengthened significantly in recent years. We have seen a major shift from voluntary regulations and initiatives to rigid and binding legislation. This rising legislative and regulatory pressure has bolstered the increased attention ESG is receiving and is likely to have the biggest impact on accelerating the shift to a sustainable model of investing. As the regulatory landscape develops, unsustainable corporates will lose out on capital and non-compliant sectors will be penalised as a result. Interestingly, the COVID-19 crisis has stimulated a strong response from policymakers on the important role that ESG can and should play in economic recovery measures (i.e. a "green recovery"). In the face of the rigid and ever-changing regulatory environment, AWMs, as well as corporate and institutional investors, will need to adapt to the new normal in order to remain relevant.

2. ESG's outperformance

A wealth of research has disproved the widely held belief that in order to invest sustainably, investors must sacrifice strong returns. To the contrary, there is increasing evidence that suggests a perfect synergy between performance and sustainability. Moreover, ESG-aligned assets also outperformed the market in the wake of the COVID-19 sell-off; with a Bloomberg analysis finding that the average ESG fund declined by 12.2% in 2020, less than half the decline of the S&P 500². We believe that, as we emerge into the new normal' the performance gap between ESG and non-ESG products will continue to widen, as ESG investment processes become more sophisticated and the increasing impact and social acknowledgment of sustainability risks further shifts investor sentiment in favour of ESG investments. We also expect to see a wider range of products in the future as more corporates turn green, providing opportunities for enhanced diversification.

3. Increasing investor demand

A shift in societal values has given rise to a new generation of investors who prioritise non-financial impacts alongside financial returns. The strongest push stems from institutional investors, who are reacting to increasing pressure from policymakers and stakeholders to incorporate sustainability into their mandates. Considering this, managers are experiencing increasing client pressure to incorporate ESG standards into their fund offerings. In order to meet this demand, asset managers have taken action; launching new funds with sustainable mandates and repurposing funds. However, the speed and scope of embracing the ESG revolution by asset managers need to accelerate.

4. Fundamental societal shifts, magnified by current environmental, social and health crises

The rise of ESG is bolstered by significant societal changes. Public awareness of ESG related risks has catapulted climate change and sustainability to the top of the global agenda. Society is attributing increased levels of importance to sustainable finance and ESG. COVID has accelerated this shift, bringing the real-life impacts of overlooking ESG factors into the spotlight.

These catalysts are set to usher in the greatest shift the European AWM industry has ever undergone; presenting managers with the opportunity to drive change by playing a key role in mitigating climate risk. As the European Commission has noted, the scale of investment needed to transition to a sustainable and green economy is beyond the capacity of the public

sector alone. Asset managers can change the world for the better by rechanneling capital towards sustainable businesses and innovations, contributing to the creation of a low-carbon, climate resilient and circular economy and strengthening efforts to eradicate social injustices across the globe.

² Bloomberg, *Older ESG Funds Outperform Their Newer Rivals in Market Turmoil*, 2020

We have identified seven key actions that managers should consider from both a strategic and operational perspective in order to stay ahead of the curve and make these changes.

1. Repositioning your organisation

As the ESG revolution fast approaches, managers must carefully consider what role they would like to play in it. A clear strategic decision needs to be made as to how deeply they would like to embed ESG considerations in their organisation. We have identified three strategic options that asset managers can pursue: they can restructure to become a “sustainable asset manager”, undergoing a strategic overhaul and integrating ESG at all levels of their organisational structure. Alternatively, they can pursue a selective strategy, maintaining both ESG and traditional products; or maintain business as usual – complying with regulation but overall sticking to the status quo.

2. Being credible and consistent in your ESG approach

Beyond the above mentioned necessary strategic changes, managers must also strive to be consistent in their chosen ESG approach in order to establish and maintain credibility. This calls for a demonstrable commitment to walking the talk by exemplifying the same level of sustainability and ESG consciousness in corporate strategy and philosophy that asset managers expect from their portfolio companies. They must also talk the walk by upping transparency and thoroughness in internal ESG reporting, as well as by embarking on firmwide circulation of ESG knowledge in order to harmonise their sustainability story.

3. Moving to the next level of ESG integration at a product level

Once managers have positioned themselves with regards to ESG, they must make a number of strategic product considerations. Firstly, they must decide which new “Sustainable Finance Disclosure Regulation” category they would like to launch their products under (i.e. Art. 9, Art. 8 or non-sustainable). They must then decide how to implement ESG indicators in their investment and risk processes, how they will structure and rationalise their fee structures; and how they will elucidate and market their ESG efforts to the investor base.

4. Tackling the ESG data challenge

The ESG data constraints that asset managers face border mainly on inaccuracy and non-alignment. This impacts ESG benchmarking, impact evaluation, risk management and the identification of sustainable investment opportunities. We identify two main options available to Asset and Wealth managers when it comes to overcoming this hurdle. Firstly, they can engage more closely with underlying corporates in order to receive accurate and timely data sets and reporting. Secondly, they can manage various data sources in order to foster an internal data environment sufficiently granular and exhaustive to serve their needs by implementing solid, regulatory-backed ESG reporting strategies and leveraging on third-party data providers. However, considering an immature data market, the management and intellectual assessment of ESG data will be one of the key success factors for Asset and Wealth managers leading the ESG competition over the coming three to five years.



5. Develop a strong ESG Risk Management framework

As investors and policymakers alike attribute increasing importance to the assessment and mitigation of ESG risks, asset managers will need to vitally restructure their risk management frameworks in order to comply and thrive. Overlooking ESG-related risks could have serious reputational and financial repercussions for asset managers in the new landscape. Developing a more resilient structure for risk management involves adopting and implementing expert risk identification and management practices internally and within underlying corporates. Managers will also have to monitor and evaluate portfolios at a high level and frequently disclose whatever ESG exposures there may be. Furthermore, they will have to reinforce efforts to ensure ESG compliance of investee companies either through greater engagement or through proxy voting.

6. Reporting to investors

As regulatory requirements relating to reporting and disclosure mount, and investors attribute increasing attention to the ESG metrics of the asset managers with which they invest, it is imperative that AWMs restructure their reporting processes. Those that go above and beyond minimum reporting requirements stand to be the biggest winners in this new landscape.

7. Educating the investment community and your staff

In order to accelerate the consideration for ESG indicators and risks as well as to successfully respond to an increased expectation of investors for ESG matters, asset and wealth managers need define their ESG strategy and corporate indent. Based on this they need to educate both their portfolio companies and their investors on ESG and the interaction with capital flows and financial performance. It will be critical to build stronger ESG expertise among their employees by upskilling existing staff on ESG principles and strategically scout for and integrate more diverse and ESG-trained talent.



About our European Sustainable Finance Series and this report

This paper marks the first in our European Sustainable Finance Series. Given the critical importance of sustainable finance globally, we have endeavoured to highlight the key issues that face all players within the Financial Services sector.

The aim of this report is to take a deep dive into these major trends that are already transforming the ESG wave sweeping across the European traditional asset management industry, and which looks set to continue in the years ahead. Within this report we only discuss ESG related to traditional asset class (i.e. Equities, Fixed Income, Mixed Asset and Money Market) funds. We use our findings to make informed recommendations as to the key actions that AWMs should consider in order to navigate the changing ESG landscape and unlock the opportunities it presents. We have further enhanced our report based on a wide range of primary data gathered through a Europe-focused survey of 200 asset managers, 300 institutional investors, and over 800 retail investors. We also carried out in-depth interviews with a number of asset managers and institutional investors in order to get first-hand accounts of where the players think the industry is going.

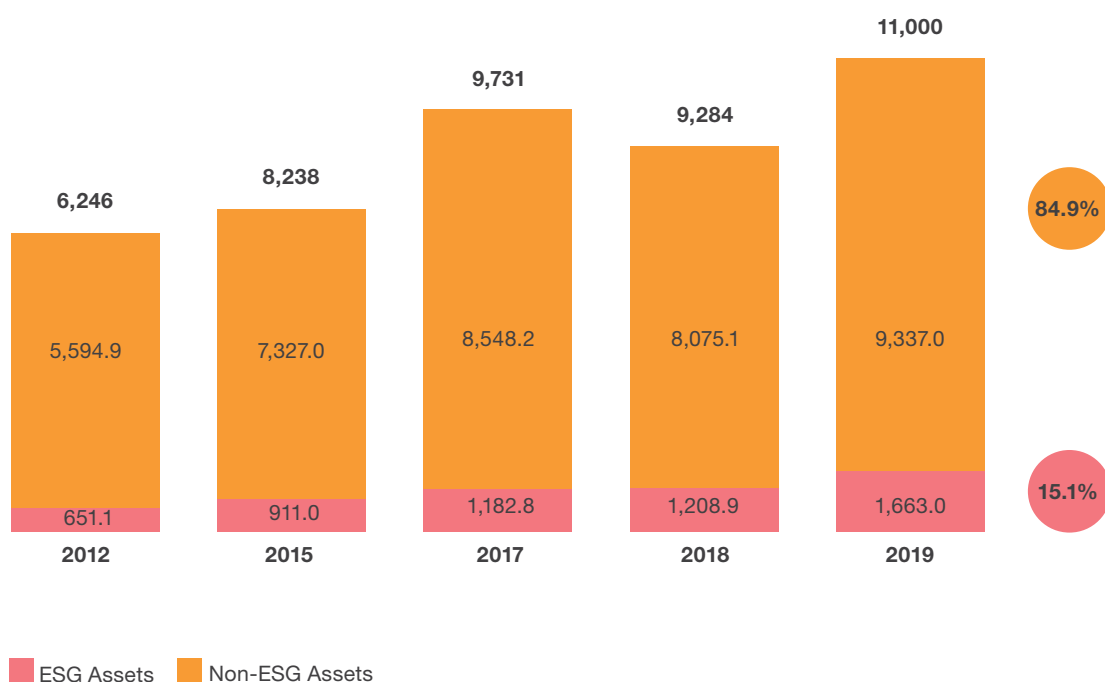


1

A paradigm shift

ESG represents the largest fundamental change in the investment landscape since the introduction of ETFs. We forecast European ESG assets to reach between EUR 5.5 trillion and EUR 7.6 trillion by 2025, making up between 41% and 57% of total mutual fund assets in Europe by 2025³; up from 15.1% in end-2019 (cf. Exhibit 1). Driven by four catalysts, we believe that this will be the fastest growing area within the industry this decade.

Exhibit 1: ESG and non-ESG Assets held in European mutual funds (EUR bn)



Source: PwC Global AWM Research Centre analysis, Morningstar, Refinitiv Lipper, EFAMA

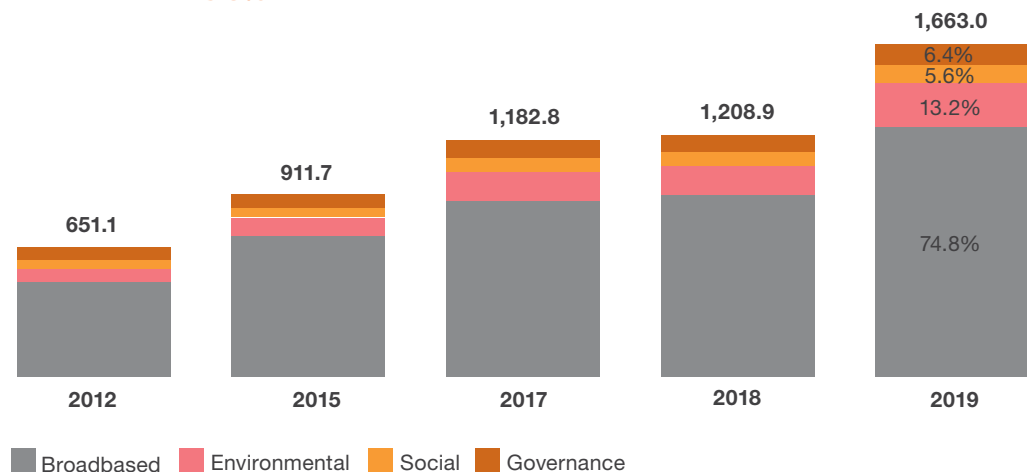
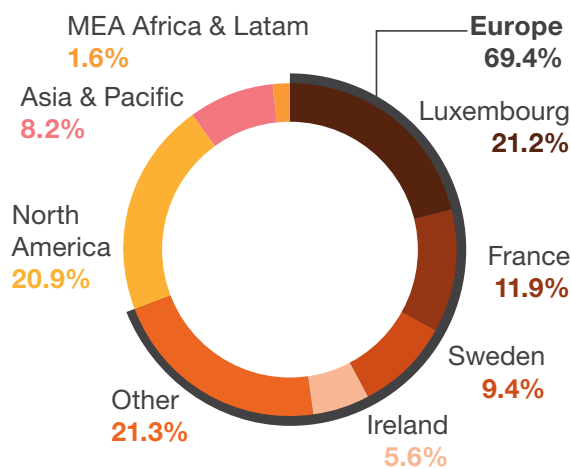
³ Note: Based on PwC Market Research Centre forecasts that overall European mutual fund assets in a U-shaped scenario will reach USD 15.8 trillion by 2025, which converts to EUR 13.4tn at the current exchange rate of 1 USD = 0.85 EUR (as of 30th September 2020).

It's December 2019; ESG mutual fund assets amount to 15.1% of the EUR 11 trillion held in European mutual funds. Europe dominates the global ESG landscape, with the region's 4,741 ESG mutual funds holding almost 70% of global ESG assets (cf. Exhibit 2). Within ESG, broadbased funds (those without a specific ESG focus) account for almost 75% of all

funds, which is unsurprising given that they are likely to be more attractive to a wider range of investors (cf. Exhibit 3). As European policy makers push decisive and all-encompassing regulations, ESG continues to outperform, investor demand grows, and societal shifts urge change, the AWM industry is set to be forever altered.

Exhibit 2 & 3: Global ESG AuM by domicile (%) & European ESG Mutual Fund AuM by theme (EUR bn)

2019 ESG AuM by domicile



Note: Analysis of 9,700 ESG-labelled funds between 2010 and 2019

Source: PwC Global AWM Research Centre analysis, Morningstar, Refinitiv Lipper.



ESG values are becoming increasingly entrenched in Europe's AWM ecosystem, with European ESG funds receiving significant backing from private and government-backed institutions. HSBC's 2019 Sustainable Financing and Investing Survey highlights the extent of Europe's ESG-oriented mindset, discovering that Europe is the only region where the majority of investors (52%) always factor in ESG considerations when making investments⁴. Regional discrepancies remain however, with the Nordics leading the push for ESG – a strong indicator of the link to sustainability that is ingrained within the region's financial systems.

Europe's dominance extends across all asset classes. However, equity, being the most popular asset class among investors when it comes to ESG, still attracts the lion's share of assets; currently accounting for 65% of global ESG equity assets. This is not to say that assets in sustainable fixed income vehicles have not seen a period of remarkable growth in recent years, however. Since the first Green Bond was issued on the Luxembourg Stock Exchange in 2007, the European sustainable bond market has seen consistent growth, with AuM tripling from 2010 to 2019 to reach EUR 327.9 billion, and currently represents 70.7% of the global ESG bond assets. The formidable growth that these asset classes have undergone are driven by a number of key factors, which we expect to accelerate moving forward. (see Core trends beside).

We strongly believe that Europe will maintain its pole position in the ESG space for years to come. However, should the asset growth slowdown resulting from the recent market slowdown persist, this will likely extend also to the ESG space. If this materialises, we foresee ESG asset growth slowing to roughly 13% CAGR from 2019 to 2025.

⁴ HSBC, *Responsible Investment Review*. 2019

⁵ Article 8 funds refer to financial products which promote environmental or social characteristics of the investment, either alone or in combination with other characteristics. Article 6 funds refer to other financial products which do not promote any form of sustainability.

Core trends bolstering ESG Equity & Bond Adoption

Equity



1. Structurally linked

Equities are intrinsically linked to ESG considerations. There is a structural overlap between the “Governance” factor of ESG and the stewardship and ownership agenda which is inherent to active management. Corporate governance is one of the key value drivers in equities, with many studies finding a strong link between strong ESG metrics and lower volatility risk.

2. Institutional investor demand

A number of major institutional investors in Europe have bolstered equity investments to incorporate ESG into their portfolios – specifically pension funds and SWFs. In recent years, some of the world’s largest institutional investors have expanded their sustainability efforts in equity.

3. Outperformance and underperformance

Financial attractiveness and performance are key drivers in equity’s dominance in the ESG asset universe. According to our analysis, the MSCI AC Asia ESG Leaders, Eurostoxx ESG Leaders 50, and S&P 500 ESG indices outperformed their corresponding benchmark indices by 5.5%, 4.9% and 4.2% respectively over a two-year period*. Moreover, the downside risk on non-sustainable equity investments is likely to increase.

Bonds



1. Growing corporate bond market

We see increased issuance from non-financial corporates - both private and public. Corporate green bonds are playing an increasingly large role in the green bond market. While corporates only entered the green bond market in 2013, they represented over 60% of issued bonds in 2018 according to ESMA.

2. Deepening entrenchment in EU regulation

A common taxonomy for the green bond market will aid in further harmonising standards across the region. This harmonisation would also ensure that the regulatory landscape helps AWMs embed sustainable funds in their investment processes, paving the way for more engagement with issuers.

3. Issuer diversification

The issuance of green bonds outside of the dominant markets (supranational entities) is growing. Private-sector issuers are increasingly turning to green bonds to achieve their sustainable development strategies. In 2018, banks accounted for 21% of total ESG bond issuance in Europe, while no other single players accounted for more than 15%.

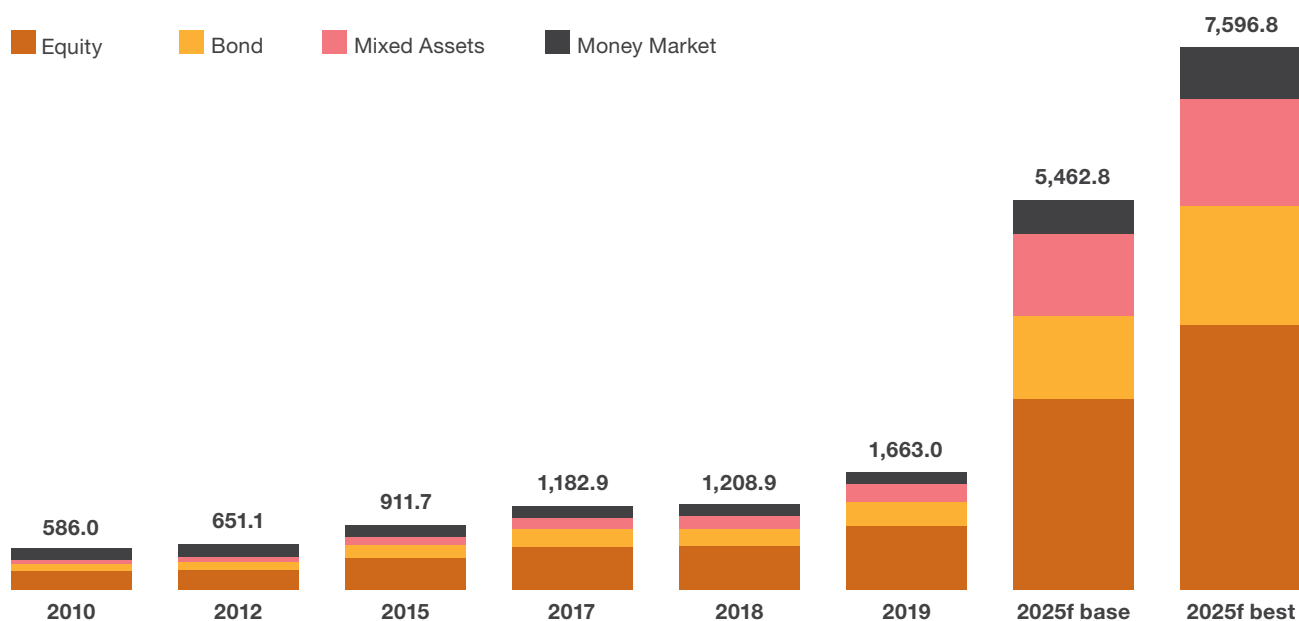
* We use a two-year period analysis because the Eurostoxx ESG Leaders 50 and the S&P 500 ESG were launched in 2019 hence historical performance is backtested.

Should current conditions persist, however, ESG stands to reshape the entire European fund landscape. The full pace and extent to which this occurs is largely dependent on a number of drivers. As a result, we have developed two potential forecast scenarios. In either case, Europe is set to capitalise on the opportunities presented by ESG and cement its position as the global leader in sustainable investment.

The sheer transformational potential of ESG is highlighted by the fact that, even in a conservative forecast scenario, it is still poised to become the default approach for European asset managers. Our base case scenario sees ESG AuM tripling by 2025 to reach just under EUR 5.5 trillion, a CAGR of 21.9% from 2019 (cf. Exhibit 4). This “conservative” scenario is likely to materialise should we see a continuation of current market trends and product launches, with European asset managers simply aligning with regulations. While these regulations do not apply to non-EU countries within Europe, we believe that the major non-EU markets, namely the UK, Switzerland and Norway, will still align with regulations, developing ESG-relevant regulations modelled on those implemented in the EU. That being said, in the base case, the majority of assets are unlikely to be reclassified as Article 8 or 9⁶ (less than 30%).

Our best-case forecast sees a complete overhaul of the European asset management industry with sustainable products redefining the current landscape. Should this occur, we see AuM growing at a 28.8% CAGR to reach EUR 7.6 trillion by 2025 (cf. Exhibit 4). This scenario sees a full endorsement and implementation of new ESG regulations by market participants, catalysing major structural shifts, as well as a significant reclassification of legacy products into Article 8 or 9⁶ products. Moreover, this scenario sees asset managers predominantly launching new products classified as Article 8 or 9, rather than as “non-ESG” in the coming years. This, combined with a strong asset performance, would see Europe represent 74% of global ESG assets by 2025. Equities, given the acceleration of current growth drivers, will see a 26.8% CAGR and AuM more than quadruple to exceed EUR 3.6 trillion by 2025. Similar to the base case, bonds are likely to see the strongest growth given companies looking at targeted issuances for specific sustainable projects. COVID-19 is further accelerating bond’s growth case with a number of companies looking for financing. The ECB, for example, announced it would use its EUR 2.8 trillion asset purchase scheme to buy green bonds for the first time. This will likely have a knock-on effect, spurring demand for green bonds throughout the financial sector. Given the above factors, in this scenario, we see ESG bond fund AuM growing at a 30.4% CAGR to reach just over EUR 1.6 trillion by the end of 2025.

Exhibit 4: European ESG Mutual Fund AuM (EUR billion)



Source: PwC Global AWM Research Centre analysis. Past data based on Morningstar and Refinitiv Lipper.

⁶ Article 9 funds refer to financial products which have sustainable investment (as per art. 2(17) of the SFDR) as their investment objective.

We further based our forecasts on the continuation of four key catalysts that are fuelling the ESG revolution, embedding sustainability concerns into the financial system and solidifying Europe's position as the global leader in sustainable finance.

These catalysts are:

1 Regulation



2 Outperformance of ESG funds



3 Growing investor demand



4 Societal shifts, highlighted by COVID-19



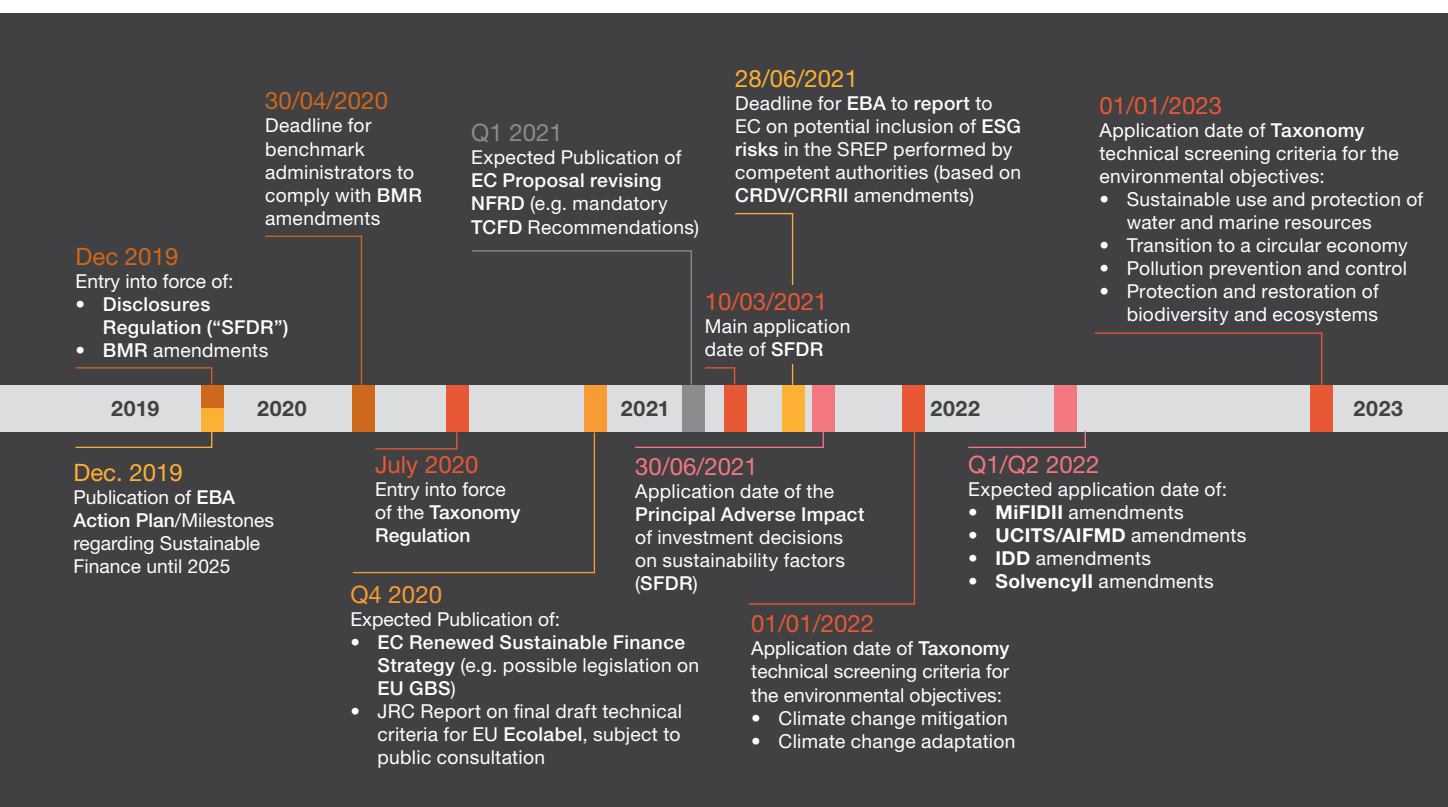
1.1 Regulation – policymakers accelerating industry shift

Arguably the primary differentiator which cements Europe as the global leader in the ESG space is its strong regulatory and legislative structure. This momentum behind ESG has been highly conducive to the market's growth, pushing the transition towards a sustainable standard for investing – with EU regulators leading the charge.

EU regulators have been increasingly aware of Financial Services' role in mitigating sustainability risks and have taken an increasingly hard-line approach to implementing relevant legislation. Both the EU Action Plan and the Sustainable Financial Disclosure Regulation (SFDR) represent a landmark change in the industry, that stand to transform sustainable finance from an optional consideration to a focal point of the European fund industry.

From 2021 onwards, a range of core new regulations will be introduced, and pre-existing regulations will be altered to align with sustainability requirements (cf. Exhibit 5). This will introduce a whole new set of non-financial standards for investors, financial advisors and financial market participants. Change is coming and the AWM industry must adapt accordingly to not only comply but thrive in this new landscape where sustainable investment is no longer optional, but mandatory.

Exhibit 5: Regulatory roadmap - 2020 to 2023



These upcoming regulations will have four major implications for the AWM industry by:

1

Obliging fiduciary investors to go ESG

Fiduciary investors will need to apply suitably sustainable investment classification practices, incorporating sustainability into their prudential requirements and ensuring that their governance policies are compliant with ESG values and benchmarks.

2

Spreading good governance along the investment chain

By fostering greater investment into sustainable projects and companies, all market players will need to modify their investment and operational processes. This will require the implementation of a sustainability classification for financial products and a complete review of risk management procedures.

3

Implementing new disclosure requirements at a product level

AWMs will need to be far more specific in their product disclosures, providing investors and regulators with a high degree of transparency. Key questions will need to be answered relating to how a product considers principally adverse impacts on sustainability factors. Further, do the products specifically promote ESG characteristics or do they have a specific ESG objective.

4

Implementing new disclosure requirements at an entity level

While managers will need to take new product disclosure levels to heart, they also need to understand and disclose how they are onboarding ESG into their internal operations. This will require enhancements across their governance, remuneration, and diversity policies. It will also require them to explain if, and why, they haven't taken sustainability factors into account.

These changes stand to restructure the entire European fund industry. The Action Plan and SFDR introduce a long-needed harmonisation of ESG taxonomy and disclosure that has long been a source of concern and confusion for investors. In doing so, EU regulators have brought a degree of certainty and objectivity to the realm of sustainable finance.

Moreover, in the face of the COVID-19-related disruption, we are seeing a strong push from European policymakers to stimulate a "green recovery" in the

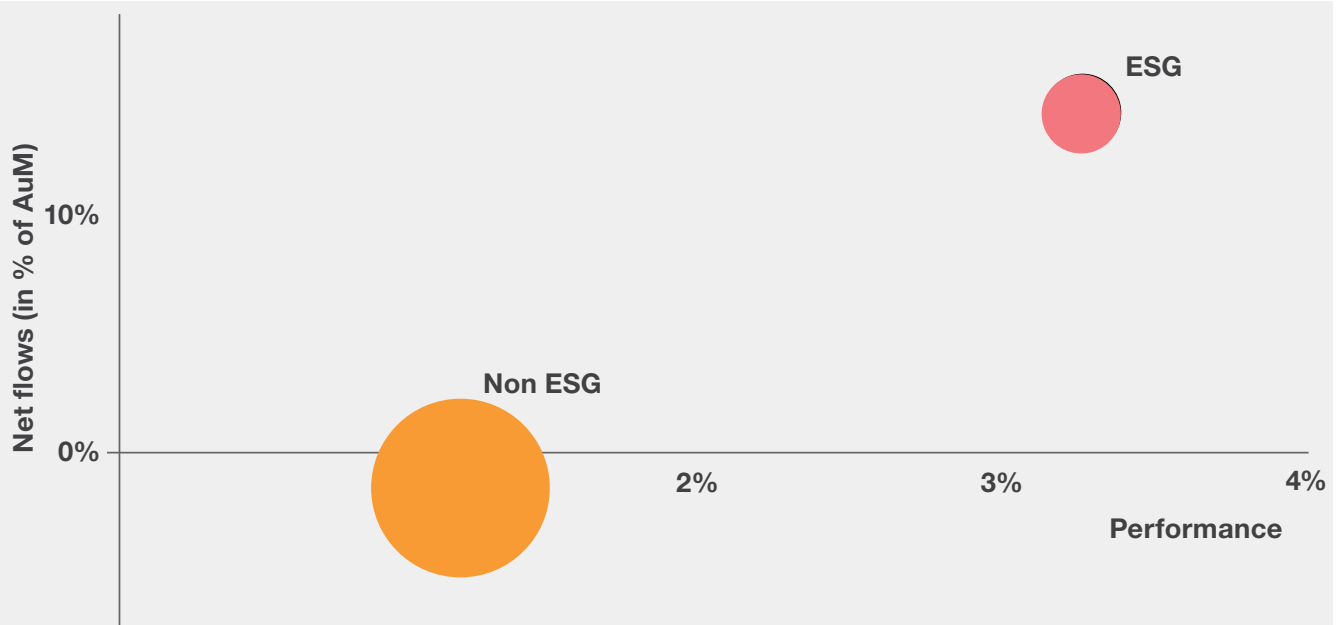
region. The European Commission has unveiled a EUR 750 billion recovery plan to stimulate EU economies out of the downturn, applying the "do no harm" principle to all investments. Moreover, EUR 150 billion of the funding will be allocated to funding green transport, clean industry, and green home renovations. This represents a significant shift in policymaker mentality that may see a greener approach to fiscal stimulus and sovereign investment overall as we emerge from the pandemic into the "new normal".

1.2 ESG outperformance – the gap widens in the future

In the past, ESG adoption was often hampered by the notion that this form of investing had a negative impact on financial returns when compared to traditional forms of investing. Today, the opposite is true, with the resilience and performance of sustainable funds compared to their traditional counterparts being a key driver behind the ESG wave that is sweeping across the fund landscape.

Our analysis shows that ESG-aligned funds cumulatively outperformed their traditional counterparts by 9% over a period from 2010 to 2019. A Morningstar analysis⁷ shows similar results, noting that close to 60% of sustainable funds delivered higher returns than their non-sustainable equivalents over the last decade. ESG funds have also seen a significant rise in inflows, exceeding their non-sustainable equivalents by over 15% from end-2018 to April 2020, when relative to their AuM (see Exhibit 6).

Exhibit 6: ESG vs non-ESG flows and performance end-2018 to April 2020



Note: Size of the bubble related to AuM relative to flows

Source: PwC Global AWM Research Centre based on Morningstar and Refinitiv Lipper

⁷ Morningstar, *How does European Sustainable Funds' performance measure up?*, 2020

Backtesting by asset managers has also shown that integrating ESG considerations into investment decisions tends to provide enhanced returns. A Schrodgers analysis revealed that companies with a commitment to improving their ESG profile produced risk-adjusted stock returns 20% higher than the MSCI Europe Index and approximately 70% higher than companies with deteriorating ESG scores. Our survey showed that backtesting has become a widely used method in order to demonstrate ESG outperformance, with the majority of respondents having backtested their funds.

COVID-19 has further highlighted the performance and resilience of ESG funds through stressful market periods. While traditional asset classes suffered near-unprecedented outflows in Q1 2020, the financial impact of the pandemic was not felt as strongly in the ESG space – with ESG funds outperforming the broader market and for the most part seeing inflows during the first quarter of 2020 (cf. Exhibit 7). This is in strong contrast to their traditional counterparts, that saw EUR 160 billion in outflows in the same period. Actively managed ESG funds in particular showed a higher degree of downside protection during this period, outperforming their passive counterparts and underscoring the benefits of having a human touch to portfolio management. For active managers, this could represent a unique opportunity to leverage on the financial resilience they provide to break away from passives and lead the pack. That being said, passive ESG indices still outperformed their traditional counterparts, despite their relative underperformance compared to active ESG. As we see a deepening

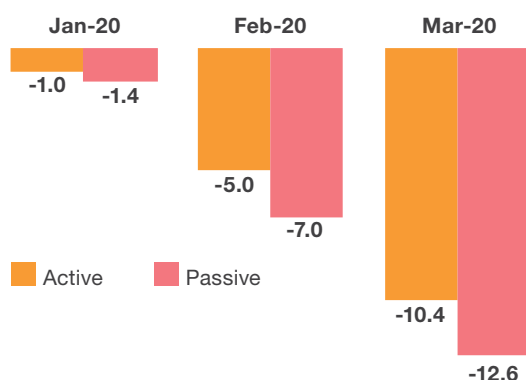
entrenchment of ESG values in the fund landscape, we expect to see increased interest in ESG among both active and passive managers.

The resilience and downside protection provided by ESG products throughout periods of downturn is somehow unsurprising, given that these qualities are inherent to their nature. By their very definition, ESG-oriented managers are specifically focused on navigating uncertainty and environmental, social, and governance risks. It is this strong degree of adaptability and constant monitoring that allows these managers to identify – and avoid – potential financial losses and scandals before they impact returns and product value.

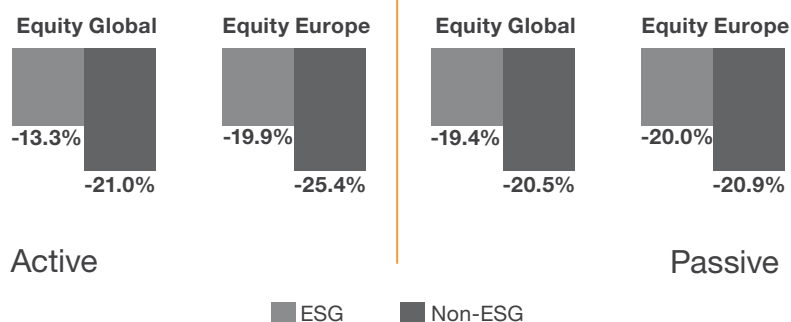
We believe that this performance gap between ESG and non-ESG products will widen significantly in the future, and that the long-held concern of ESG products' tendency to underperform will reverse entirely – with these products emerging as a stronger source of returns with respect to their mainstream equivalents. As regulation stimulates sustainable investment, and societal scrutiny of climate change and social injustice approaches boiling point, we expect to see unsustainable corporates and sectors lose out on capital or be penalised. As this trend progresses, we will likely see the performance gap between ESG and non-ESG products widen significantly. Already, the European Investment Bank (EIB) has transitioned towards a climate bank model citing performance concerns, suggesting that this shift may be well underway. In the short-term however, limitations to the ESG investment universe could hamper portfolio diversification and risk mitigation.

Exhibit 7: COVID-19 highlights ESG outperformance and attractiveness

Performance of active vs passive ESG funds during COVID-19 (in %)



AuM % change between Dec 2019 and Mar 2020



Source: PwC Global AWM Research Centre analysis based on Refinitiv Lipper and Morningstar

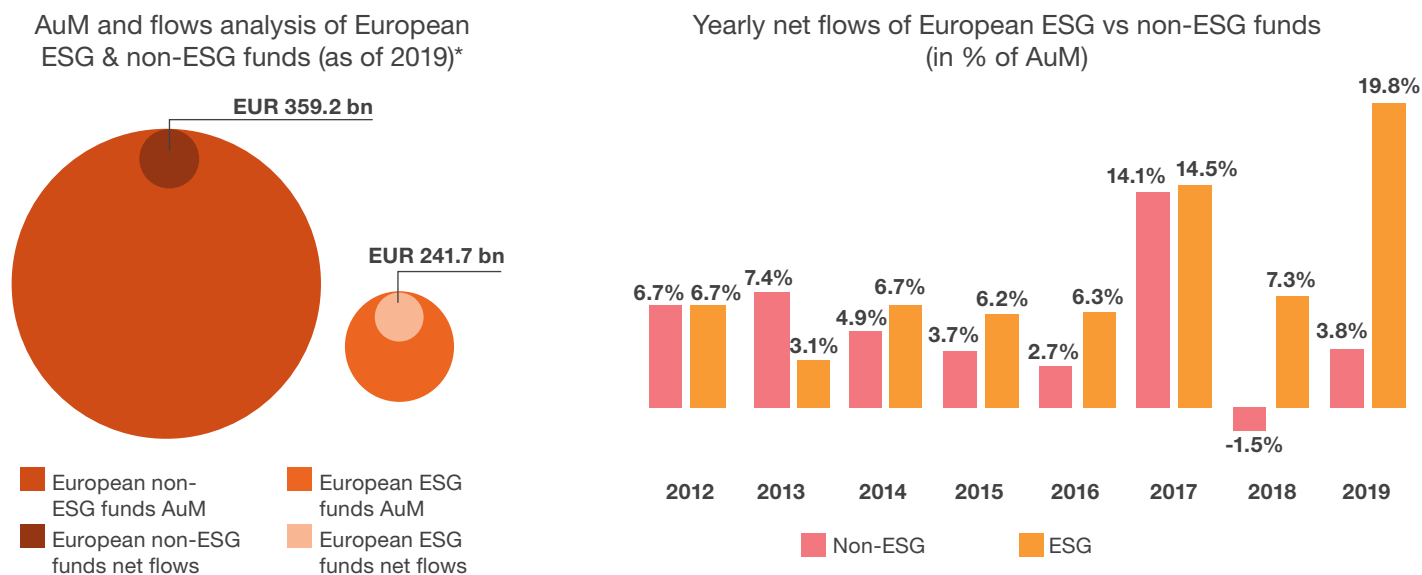
1.3 Surge in investor demand leaves the industry with no choice

Investors are leading the green revolution, demanding that asset managers allocate capital in a sustainable manner. Both retail and institutional segments are showing fast increasing interest in sustainable investment and are increasingly allocating capital in a sustainability conscious manner.

Inflows into Europe-domiciled sustainable products were particularly pronounced in 2019, more than tripling from the previous year. Moreover, our analysis shows that annual net flows into ESG funds as a percentage of AuM

have consistently exceeded those into non-ESG funds since 2014. The flows into European ESG products in 2019 represented 19.8% of their total AuM, while non-ESG fund flows (although larger in absolute terms) only accounted for 3.8% of their AuM (cf. Exhibit 8). These strong inflows persisted throughout the COVID-19 crisis, with investors allocating a record-breaking volume of assets to ESG funds during the pandemic. In fact, ESG fund flows accounted for almost a third of all European fund flows in Q2 2020 according to Morningstar.

Exhibit 8: ESG vs non-ESG net flows



* The size of the circles are scaled to European non-ESG AuM

Sources: PwC Global AWM Research Centre analysis based on Morningstar and Refinitiv Lipper

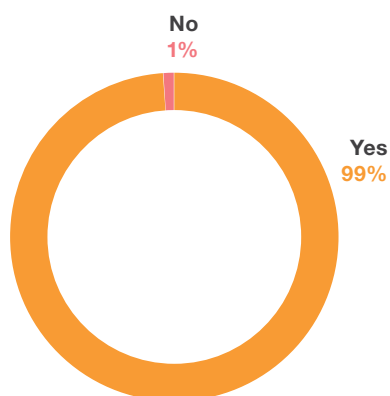
While both investor segments have been instrumental in the push towards ESG, institutional investors are leading the charge. ESG has begun to redefine institutional investors' perception of the industry and their role within it. Some of the largest have already begun to expand their sustainability efforts and embrace more ambitious strategies in this area. Our survey shows that 99% of institutional investor respondents expect a convergence between ESG and non-ESG fund products – with an overwhelming majority expecting this to occur by 2022 (cf. Exhibit 9).

Within the institutional segment, pension funds are strong proponents of ESG. The Institutional Investors

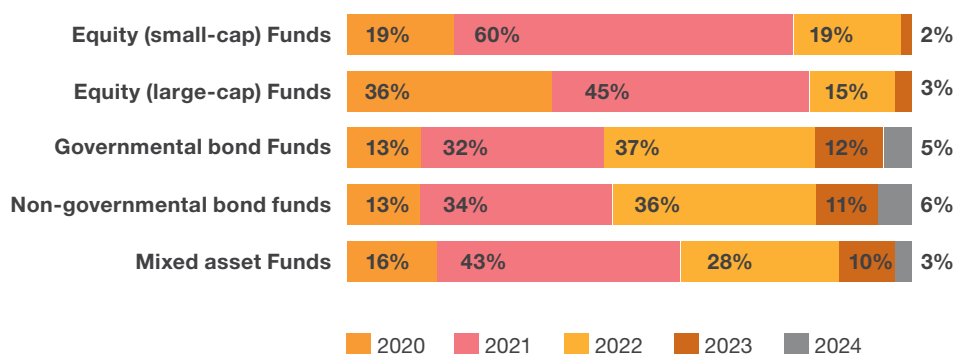
Group on Climate Change, a coalition of more than 60 pension funds and investment managers managing more than USD 16 trillion, recently announced a series of measures to design a net zero framework for portfolios. Furthermore, we expect to see the demand from this particular segment rise further under mounting regulation. While European pension funds have been permitted to take ESG consideration into account since the ratification of IORP, proposed amendments to IORP II from the European Insurance and Occupational Pensions Authority (EIORPA) could see these considerations become a regulatory requirement. If approved, these revisions would solidify the key role of European pension funds in the global ESG space.

Exhibit 9: Institutional investors expect ESG and non-ESG convergence by 2022

Do you believe there will be a convergence of traditional ESG and non-ESG products? (Institutional Investors)



If yes, by when do you believe this will occur? (Institutional Investors)



Base: Those who believe there will be a convergence of traditional ESG and non-ESG products (296)



While ESG-oriented investment philosophies are commonplace within the European institutional segment, it is the Nordic players in particular that are leading the race and solidifying Europe's leading position. Norway's USD 1.1 trillion SWF is set to emerge as one of the world's largest investors in unlisted renewable energy infrastructure in the next three years⁸, taking EUR 9 billion in positions. The SWF has also begun a divestment process relating to oil, gas and coal corporations – with Swedish and Danish pension funds following suit. As institutional demand continues to surge and AWMs pivot towards sustainability, we expect to see Europe's AWM industry become increasingly ESG-focused, both in terms of products and institutions.

The retail investor segment lags behind institutional but is fast catching up – especially as an increasing number of millennials enter the space. Currently, only 41% of retail investor respondents incorporate ESG considerations into their investment strategies. However, this is not to say that retail investors are not increasingly moving in this direction. Assets in this space are likely to see a far stronger growth in the coming years, however we believe that this largely stems from regulatory efforts rather than an overwhelming sense of societal responsibility on the investors' part.

However, as the millennial and subsequent generations become more active, retail investors are likely to take up the ESG mantle. Millennials are set to be on the receiving end of a record-breaking USD 41 trillion intergenerational wealth transfer, and 95% are interested in sustainable investing according to Morgan Stanley⁹. This new generation of investors stands to vitally reshape the future of investment. In response to this, asset managers are likely to further integrate ESG considerations into their investment processes – launching new funds with sustainable mandates and repurposing existing funds.

This expected growth in assets could, however, be hampered by limitations to investment opportunities outside of the EU for both managers and investors. Managers may find that regulatory constraints, given their fiduciary responsibility, could restrict investments in ESG products outside the EU despite investor appetite; as it will be difficult to find products that meet EU regulatory specifications in non-EU countries who are not bound by these regulations. This could potentially limit the investment universe accessible to managers, with negative impacts on diversification and performance.

⁸ IPE, *Norway's SWF braces for big fluctuations in next three years*, 2019

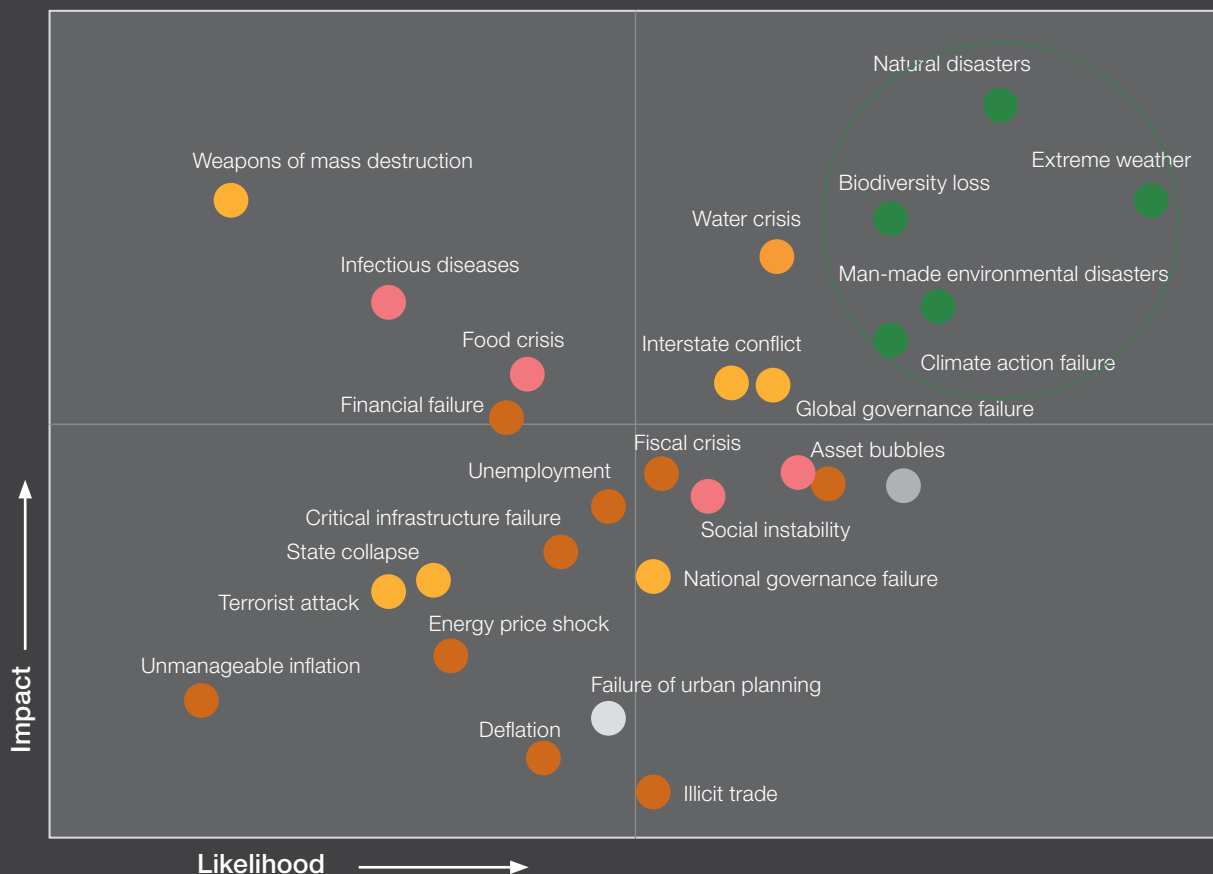
⁹ Morgan Stanley, *Sustainable Signals*, 2019

1.4 Rapidly shifting societal values highlighted during COVID-19 pandemic

Global discourse has shifted in recent years, marked by a growing recognition of the threats that could materialise if ESG and sustainability issues continue to be overlooked. ESG risks have topped the WEF's Global Risk Landscape¹⁰ both in terms of severity and likelihood, outranking threats that tend to place far higher

on the global political agenda, such as terrorism and financial failure (cf. Exhibit 10). Similarly, Deutsche Bank recently identified four catastrophic ESG-related tail risks which stand to majorly disrupt the global economy within the coming decade¹¹.

Exhibit 10: 2020 global risks landscape



Source: World Economic Forum Global Risks Landscape 2020

¹⁰ The World Economic Forum's Global Risks Landscape maps out all major risks that pose a legitimate threat to everyday life according to key decision makers globally.

¹¹ Deutsche Bank, *After Covid: The Next Massive Tail Risk*, 2020

The social and investor sentiment shifts have already had concrete implications on the global financial system, factoring ESG metrics into the economic value and pricing of certain goods and services. The widescale acceptance of these price restructurings in the real economy suggests that investors may be equally as accepting of paying a premium for ESG products; as far as they can see the value being provided by asset managers.

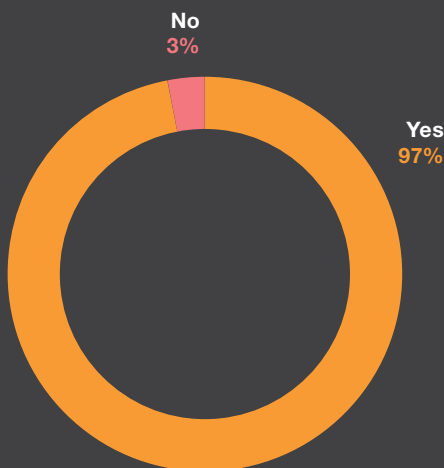
The COVID-19 pandemic and subsequent market downturn will catalyse the shift in society's awareness of ESG issues. This will likely further advance the strategic case for sustainable investment, shining light onto the materiality of ESG issues and demonstrating the impact ESG risks can have on the worldwide economic system. The results of our institutional investor survey mirror this, with 97% of respondents stating that the pandemic

will impact their ESG approach in the future (cf. Exhibit 11). Similarly, 71% of institutional investors surveyed by JP Morgan responded that it was “rather likely,” “likely,” or “very likely” that the occurrence of a low probability/high impact risk, such as COVID-19, would increase awareness and actions globally to tackle high probability/high impact risks such as those related to climate change and biodiversity losses.

The AWM industry has so far played a key role in mitigating sustainability risks and meeting societal expectations by going beyond their mandate. However, this role will need to continue to adapt quickly to increasing demands from both legislators and investors as new ESG investing rules are set and demand surges into the future.

Exhibit 11: Vast majority of AWMs believe COVID-19 will impact their ESG approach

Will the COVID-19 pandemic impact your ESG approach for the future in any manner? (Asset Managers)



Source: PwC Global AWM Research Centre

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The game-changer in 2020 has obviously been COVID-19. And in the aftermath of the pandemic we wouldn't be surprised if regulators choose to intensify their scrutiny on the ways in which ESG risks more broadly are integrated within the investment process.

Michael Baldinger,
Head of Sustainable & Impact Investing,
UBS Asset Management

1.5 Asset and wealth managers need to increase the speed and scope of their ESG efforts

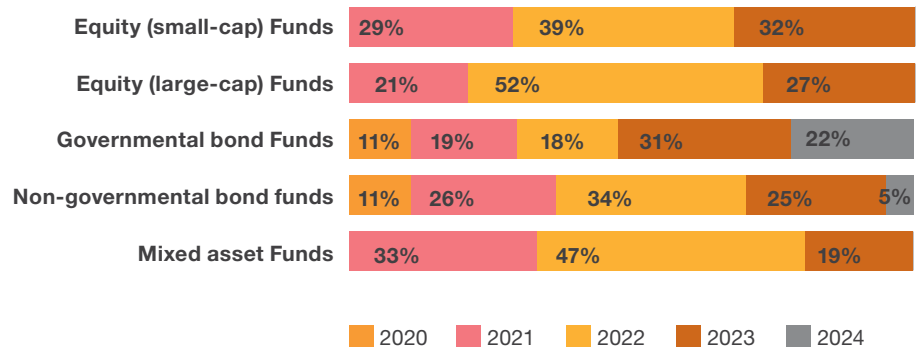
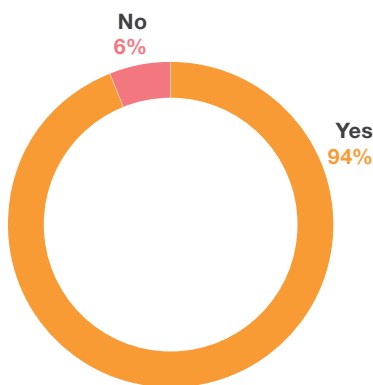
The industry is at a turning point – where non-ESG funds risk falling by the wayside, finding it increasingly difficult to gain traction with investors. We believe that investments into ESG and sustainability will bring about a fundamental restructuring of the investment landscape, changing the very nature of the industry from the ground up.

European managers are seemingly well aware that change is on the horizon, with 94% of the asset managers we surveyed anticipating a convergence of ESG and non-ESG products (cf. Exhibit 12). Many asset managers are adjusting to the ESG wave and have begun reinventing themselves accordingly.

Exhibit 12: Managers less convinced about ESG and non-ESG convergence than Institutional Investors

Do you believe there will be a convergence of traditional ESG and non-ESG products? (Asset managers)

If yes, by when do you believe this will occur? (Asset Managers)



Source: PwC Global AWM Research Centre

With as many as 360 new funds with sustainable mandates launched in Europe in 2019 alone¹², it is clear that ESG funds have emerged as one of the key areas for fund innovation. Moreover, current funds are becoming increasingly sustainable – with managers repurposing legacy funds into sustainable funds and actively engaging with their portfolio companies to ensure that they are operating in a sustainable manner.

What separates European asset managers from those in other regions is that they are being proactive in their approach to ESG, increasingly acknowledging their role in developing an ethical and sustainable model of finance. As a result, we are seeing an increasing number of managers adapting their businesses and products to operate in a sustainable manner. This is reflected in the volume of managers aligning their practices in accordance with a number of voluntary ESG codes and

regulations such as the UN's Principles for Responsible Investing (PRI), which now has over 2000 asset manager signatories backed by asset owners with a combined AuM of over USD 90 trillion.

That being said, there is room for improvement and managers should consider increasing the speed and scope of their ESG efforts. While the vast majority acknowledge that a major change is on the horizon, many seem to be somewhat hesitant to alter their operations accordingly. According to our survey, only 14% of European AWMs plan to stop launching non-ESG products within the coming 24 months.

In order to meet this surging demand, successfully navigate and thrive within the ever-changing landscape, there are a number of key actions that we recommend European asset managers take.

¹² Morningstar estimates

2

Unlocking the ESG opportunity

ESG is destined to structurally alter the competitive environment within the industry. In order to thrive and fully unlock the ESG opportunity, European Asset & Wealth Managers will need to reconsider their value proposition and competitive distinctiveness. This will require not only a shift in how these managers consider their investments, but how they bring ESG principles into their own organisations – strategically and on an operational level. As the idiom states, they need to talk the talk and walk the walk.

In this section, we outline the key actions we believe managers should take. These stem across multiple areas and start at the strategic level before focusing on key operational factors that should be considered. These actions go from integrating ESG at an organisational and product level, to tackling the ESG data challenge and educating staff and investors. Finally, we will offer recommendations as to how market players should re-visit their competitiveness and the differentiation of their products and services.



2.1 Repositioning your organisation

In order to best understand how to proceed, managers must evaluate the role they would like to play not only in the asset management industry, but society overall. They then need to make a board-level decision as to the definition of ESG within their organisation, the revaluation of their visions and missions and the extent to which they would like to incorporate ESG within their business functions. We have identified three main strategic options that asset and wealth managers can pursue: “business as usual”, a “selective approach” or “sustainable asset management”:

“Business as usual”: Firstly, managers can opt to stick to the status quo, making no changes within their organisational and governance structure, investment philosophy/policies, risk framework or reporting other than the minimum regulatory requirements. This could be the result of a “wait and see” philosophy, where the respective asset managers want to see if ESG evolves into the default approach for investors (or if it loses steam over time) before committing to reshaping their strategy. That being said, given current industry, societal and regulatory trends, we believe these managers stand to lose out in the long term. As society and the investor base become increasingly ESG-conscious, and the regulatory momentum behind ESG accelerates, the managers that do not adapt will likely see a lower share of AuM going forward as they face increased investor and regulatory scrutiny. Furthermore, attempts to pivot towards a “sustainable asset management” strategy at a later stage may prove unsuccessful, as leaders with strong brands will have emerged, making it impossible for new entrants to win significant market share in this space. As a result, managers that maintain a “business as usual” approach risk potentially becoming niche providers within the coming decade as ESG becomes the new standard for investing. Furthermore, as their products will be predominantly non-ESG, they will potentially face higher downside risk on their assets and pressure on margins and profitability.

“Selective approach”: This strategy entails asset managers integrating ESG principles within key processes of their organisations in order to align with the varying interests of their internal and external stakeholders. This would entail simultaneously maintaining both ESG and non-ESG investment approaches, attributing equal importance to providing and marketing both strategies in an attempt to satisfy the demands of all investors. This strategy could prove as a useful stepping stone in transitioning towards a “sustainable asset management” model of operating. However, it poses a number of challenges. Firstly,

the organisation’s focus will be divided in driving both ESG and non-ESG product lines, hence limiting top management’s resources to react quickly to any sudden changes in demand or investor perception. Secondly, a parallel strategy would also drive up costs as numerous processes would need to be replicated. Thirdly, the asset managers that opt for the selective approach also run the risk of appearing contradictory in their strategy, undermining their credibility in the eyes of an increasingly sustainability-conscious institutional investor base. Investors would likely question the credibility and sincerity of these managers’ commitments to ESG given that they also offer non-ESG products and may not have implemented ESG considerations across their organisation. Finally, there will be little room for managers taking the selective route to impose pricing premiums on any sustainable products that do not integrate ESG as a primary investment strategy and simply rely on screening strategies – as these are already common among low-cost passive funds.

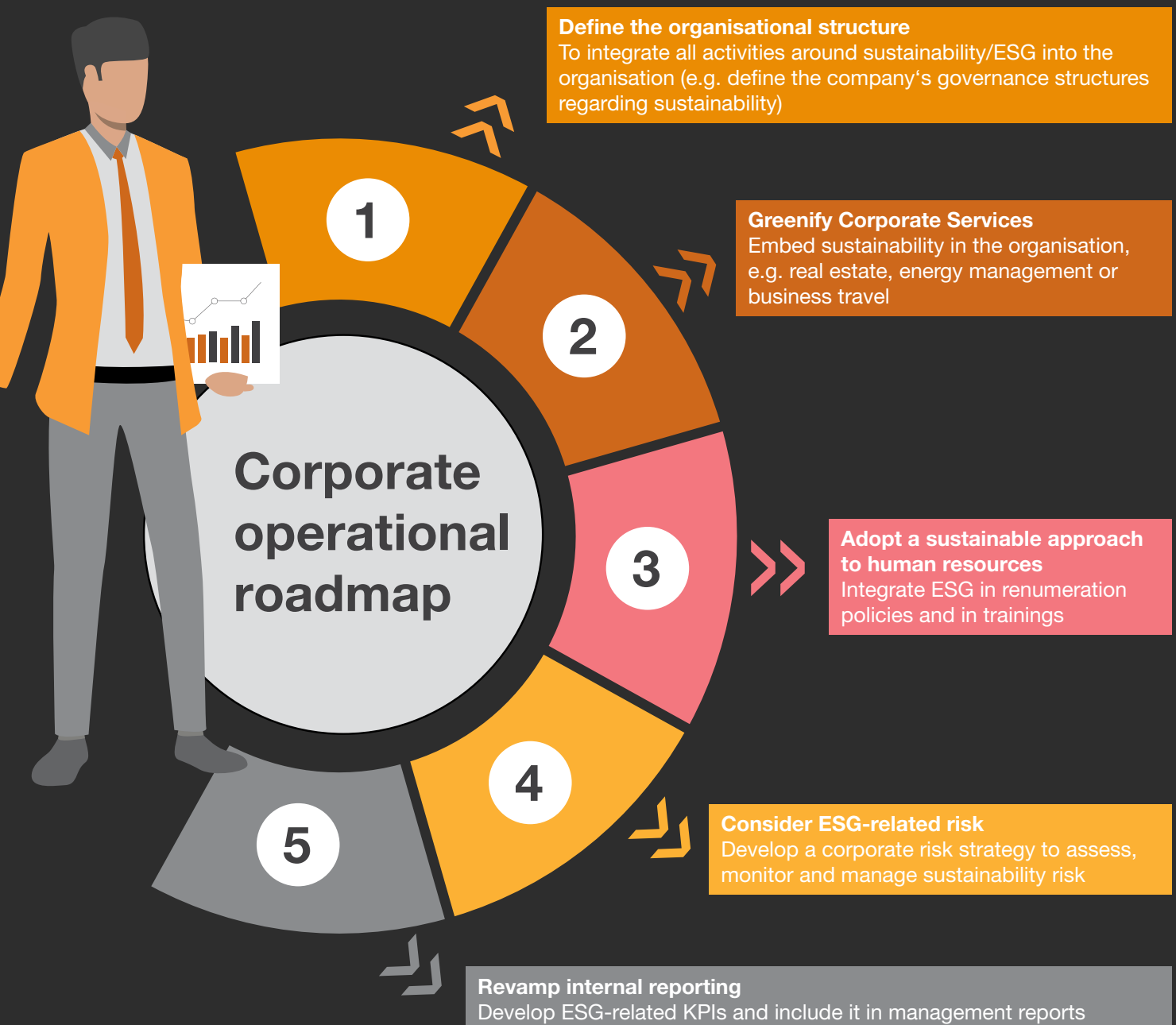
“Sustainable asset management”: Managers that pursue this strategy commit to having ESG become a core part of their vision and mission. This requires a revamping of not only their investment strategy, but their overall organisational strategy – anchoring ESG considerations from the bottom up and the inside out. These managers will have to view their activities and organisations through an ESG lens, taking an all-encompassing approach to sustainability; from adapting their legacy products, to assessing the sustainability metrics of their entire business structure. All of their investments must have ESG as an investment objective or characteristic. Managers that explore this option should consider going above and beyond, engaging with portfolio companies in order to demonstrate that they are living their core values. Asset managers focusing on purely sustainable portfolios would benefit from the advantage of focusing their efforts and capital on developing the capabilities and brands of their organisation and emerging as potential leaders within the new ESG competitive landscape. Furthermore, the managers that adopt such a proactive position in terms of sustainability and ESG strategy are likely to benefit from strong differentiation from competition and goodwill with institutional investors.

That being said, all asset managers are still bound by minimum ESG regulatory reporting standards, regardless of the organisational strategy that they choose to pursue, with upcoming regulations standing to have a number of implications across the organisation.

2.2 Being credible and consistent in your ESG approach

Asset managers looking to position themselves as sustainable would need to clearly demonstrate that, not only do they offer ESG-oriented products, but that they apply ESG requirements to themselves. In order to do so, their entire corporate strategy and organisational philosophy must be modified to reflect the very same level of sustainability and ethically conscious thinking that they demand from their underlying corporates (cf. Exhibit 13).

Exhibit 13: Developing an ESG-aligned corporate operational roadmap



>> Define the organisational structure

Asset managers will need to define ESG within their organisation and revisit their governance in the context of ESG, deciding how they plan to circulate and operationalise ESG expertise within their entire organisation. They need to decide whether to centralise their ESG knowledge within a single team or disseminate an ESG-conscious manner of thinking across their entire operations. The decision must also be made whether to task a Chief Sustainability Officer or board member with the oversight of sustainability issues. Addressing this dynamic is necessary to ensure firmwide convergence in ESG expertise and uniformity in their sustainability story.

>> Greenify corporate services

Especially as a sustainable asset manager, taking a holistic view of the impact of every facet of their operations on ESG metrics is of pivotal importance. This extends throughout the entire organisation, from travel policy and waste management and company car policies, to the offices in which they operate etc. In the case in which managers do not have a Chief Sustainability Officer, they can rely on external ESG experts to evaluate the sustainability metrics of the organisation and provides relevant ESG policies and how to implement them.

>> Greenify corporate services

Adopt a sustainable approach to human resources

There are numerous operational aspects of the corporate structure that managers can and should reshape in order to ensure that ESG considerations are deeply anchored in their organisational philosophies. Firstly, managers must take steps to reconfigure their HR policies to ensure that they are conducive to both diversity and inclusion. This has the capability to not only boost equality and close the wage and opportunity gap but is also commonly accepted to enhance engagement with stakeholders, enhance innovation and boost financial performance. This extends also to improving pay and promotion transparency, which is being increasingly regarded as instrumental to building trust between employers and employees, as well in addressing concerns of gender and racial wage gaps. Increasing transparency can help build a culture of trust and collaboration, which will in turn help managers to attract and retain talent.

>> Consider ESG related risk

Beyond the product and investment-related sustainability risk management, managers must look within their own operations to assess and rectify any potential ESG-related risk. The entire organisation must be viewed through an ESG-lens and adapted accordingly, embedding risk practices from the bottom up. Failure to do so could incur negative environmental, societal or governance impacts that could undermine any ESG efforts made by managers and could potentially lead to scandals and irreparable reputational damages.

In order to mitigate these risks, avoid any damages to brand reputation and maximise sustainability; managers should consider implementing an overarching Corporate Social Responsibility (CSR) policy, self-regulating and monitoring their internal operations to ensure ESG-compliance is attained throughout their entire operations.

>> Revamp internal reporting

That being said, words speak just as loudly as actions in this new environment. New and incoming disclosure requirements significantly heighten the degree of transparency in the EU asset management industry. The EU Reporting Directives (NFRD, SFRD, SRD2) require managers to report not only on their sustainable investment approach, but also on how sustainability informs the way they operate their business and engage with their stakeholders. This provides an opportunity for asset managers to demonstrate their engagement within their communities and their actions as corporates in addressing environmental and social issues towards their stakeholders.

“

If you want to succeed, all of your portfolio managers must be ESG aware. You must spread good practice from a centralised team to all departments: from compliance and marketing to sales forces.

Major European Asset Manager



2.3 Moving to the next level of ESG integration at a product level

Once they have defined their ESG ethos and decided on which type of organisation they wish to be, managers must undergo a strategic rethink of their investment approach and product strategy; clearly deciding whether to revamp their product shelf as purely ESG or to combine ESG and traditional products. However, those that opt for a pure ESG product line are faced by significant regulatory requirements.

Past efforts to embed ESG principles and criteria in AWM products have historically been limited to voluntary and non-binding initiatives such as the UNPRI or TCFD which relied on voluntary product and management standards. The EU taxonomy and SFDR, however, mark a major shift towards a mandatory and rigid regulatory structure. EU regulators have largely taken the decision out of managers' hands, transforming ESG from a voluntary commitment to a compulsory consideration. This marks a critical milestone, paving the road towards a globally recognised methodology for assessing environmental sustainability.

Upcoming regulations will require that managers undertake a far more sophisticated level of ESG criteria assessment testing in order to qualify their investments as sustainable. The EU taxonomy filter must be applied as soon as available and defined. Moreover, the "comply or explain" concept also applies, i.e. asset managers promoting ESG funds need to disclose to investors the binding ESG criteria used to select and assess investments.

In order to meet the taxonomy criteria and be deemed environmentally sustainable, a product must contribute substantially to one of the six environmental objectives¹³ identified by the European Commission, given that it does not harm any of the other aforementioned objectives. Furthermore, the Do No Significant Harm principle and the minimum safeguards criteria within the taxonomy call for a higher degree of granularity in terms of disclosure, both at the level of asset management entities and individual ESG products.

In order to comply with the SFDR, all EU financial market participants and all financial advisors will be required to assess and report to investors on their policies regarding the integration of sustainability risks in their investment decisions and investment advice. Moreover, large financial market participants will be required to assess and report to investors on any and all principal adverse impacts of investment decisions on sustainability factors. These will be measured using common "indicators" which will be established in upcoming legislation.

Moreover, following the different product classifications implemented by the SFDR, managers must make a clear and elucidated decision as to which category they operate within, as each category carries its own regulatory disclosure requirements (cf. Exhibit 14).

¹³ Climate change mitigation, climate change adaptation, sustainable use and protection of water and marine resources, transition to a circular economy, pollution prevention and control, protection and restoration of biodiversity and ecosystems.

Exhibit 14: SFDR category-specific disclosure requirements

	SFDR - Art. 9 fund	SFDR - Art. 8 fund	SFDR- Non-ESG fund
Disclosure Precontractual Documents	<ul style="list-style-type: none"> Information required for mainstream products Explanation on how the objective (e.g. environmental objective) is to be attained. If an index has been designated as a reference benchmark, information on how the designated index is aligned with that objective Taxonomy alignment or disclaimer 	<ul style="list-style-type: none"> Information required for mainstream products Information on how the characteristics (e.g. environmental characteristics) are met; If an index has been designated as a reference benchmark, information on whether and how this index is consistent with the characteristics Taxonomy alignment or disclaimer 	<ul style="list-style-type: none"> Manner in which sustainability risks are integrated into their investment decisions Results of the assessment of the likely impacts of sustainability risks on the returns of the financial products they make available Whether principal adverse impact on sustainability indicators are being considered
Disclosure Periodic Reports	<ul style="list-style-type: none"> Overall sustainability-related impact of the financial product by means of relevant sustainability indicators If an index has been designated as a reference benchmark, a comparison between the overall sustainability-related impact of the product with the impacts of the designated index and of a broad market index Taxonomy alignment or disclaimer 	<ul style="list-style-type: none"> Extent to which environmental or social characteristics are met Taxonomy alignment or disclaimer 	<ul style="list-style-type: none"> Disclaimer on taxonomy alignment
Disclosure Websites	<ul style="list-style-type: none"> Description of the sustainable investment objective Information on the methodologies used to assess, measure and monitor the impact of the sustainable investments selected for the financial product 	<ul style="list-style-type: none"> Description of the environmental or social characteristics Information on the methodologies used to assess, measure and monitor the environmental or social characteristics 	<ul style="list-style-type: none"> No requirements on product level



In order to thrive in this new regulatory environment and ensure that they make a positive impact on the society and environment in which they operate, European asset managers must make strategic decisions at a product level – deciding which type of products they want to promote; and the non-financial impacts they would like these products to have. In accordance with the product classifications set out by the SFDR, any manager can decide whether to continue providing products which do not promote any form of sustainability, integrate ESG characteristics among other aspects of the investment strategy (article 8), or completely revamp their products to be centred around sustainability objectives (article 9).

Organisations that have decided to go for the “business as usual” approach would likely see the majority of their products not qualify as sustainable, with no need to revamp legacy products. They will nevertheless need to ensure that ESG risks are adequately assessed and considered within the investment process, and reported on in their offering documents and product websites.

On the other hand, sustainable asset managers will consider launching products under article 8 or 9 and can decide to revamp their legacy products accordingly in order to align with their value proposition. Asset managers opting for a selective approach, boasting both ESG and traditional products, can adapt their products how they see fit.

In any case, under the new disclosure requirements, even the most ESG agnostic managers will be required to change their product marketing and as such their product positioning. Moreover, the managers that choose not to launch ESG products and do not consider sustainability risks when making investment decisions will be regulatorily required to explain clear reasons for why they do not do so; as well as providing information as to whether and when they intend to consider adverse impacts. This increased transparency will likely foster greater investment in Article 8 and 9 funds, as the growing share of ESG-conscious investors is likely to avoid allocating their assets to less sustainable products.

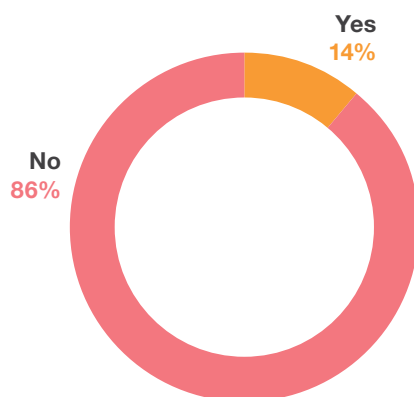
2.3.1 Deciding on the pace of implementation

Regardless of the extent to which managers have decided to revamp their product strategy; they must choose when and at which pace they plan to operationalise ESG going forward; progressively transitioning their product range to ESG or adopting a more radical approach and halting traditional product launches altogether. As the shift towards ESG gains momentum, and investor demand for sustainable products skyrockets, it is evident that managers who wait too long to adapt their businesses accordingly risk missing out on the benefits of a first-mover advantage, and may eventually be unable to meet their investors' demands for sustainable products.

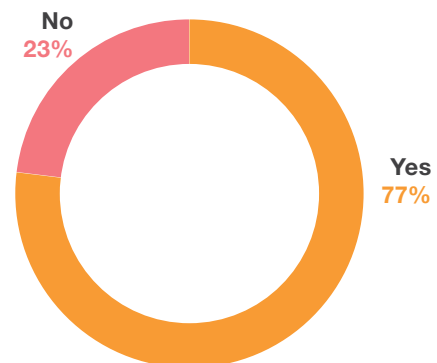
Our survey results demonstrate that 77% of institutional investors plan to stop investing in traditional non-ESG compliant products within the next two years; while only 14% (cf. exhibit 15) of asset managers indicated plans to stop launching these products in the same time period. This disconnect highlights the urgency with which asset managers should make decisive choices about their ESG versus non-ESG product offerings in order to align with shifting investor interest. Thus, managers need to stay ahead of the curve and show leadership in this area in order to maximise their impact, especially as regulatory requirements evolve from a voluntary to a more rigid nature. In order to do so in an efficient and timely manner and come up with an informed decision, managers should formulate an ESG roadmap with milestones and deliverables.

Exhibit 15: Vast majority of institutional investors plan to stop investing in non-ESG products by 2022

Do you intend to stop launching non-ESG European funds within the near future? (Asset managers)



Do you intend to stop investing in non-ESG products within the next 24 months? (Institutional investors)



Source: PwC Global AWM Research Centre

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From a wealth management perspective, the pace of change needed in sustainable investing will be rapid. Wealth managers will need to invest and innovate to develop credible sustainable solutions and meet rapidly growing client demand.

Andrew Lee, Head of Sustainable & Impact Investing, UBS Global Wealth Management Chief Investment Office

2.3.2 Pricing

In a high fee-pressure environment, bolstered by the flight to passives and rising investor and regulatory scrutiny, asset managers need to demonstrate the value for money that they are providing. This degree of competition is likely to also remain in the ESG space. Asset managers who opt to launch ESG products and/or revamp legacy products are likely to see their costs rise substantially as they are faced with increasingly stringent regulatory and data requirements in order to sufficiently assess and monitor the impacts of ESG risks. Thus, managers that choose to follow the ESG route, whether through a total revamp of their entire brand or in a selective approach, need to rethink their fee structures in order to maintain margins. Active managers in particular should evaluate fee increases for ESG aligned products, particularly as the underlying investment performance is structurally intended to provide strong returns and at the very least protect against downside risk. That being said, the direct competition from passive ESG funds will remain as a fee reference benchmark.

Our survey indicates that 37% of institutional investors are willing to pay a premium for ESG products, with the majority of them ready to pay between 21 and 40 bps (cf. exhibit 16). Given the cost sensitivity that has marked the AWM industry, the fact that investors are willing to accept higher costs attests to the high degree of investor demand and the attractiveness of sustainable products. That being said, asset managers will need to demonstrate the added value they provide if they would like to demand higher fees. A strong option would be for these managers to prove

their purpose by undertaking a high level of proactive engagement with portfolio companies, leveraging on their positions as shareholders to ensure that they are operating in a sustainable manner. They would also need to provide operational recommendations to these firms and clearly report quantifiable results of said engagement with portfolio companies.

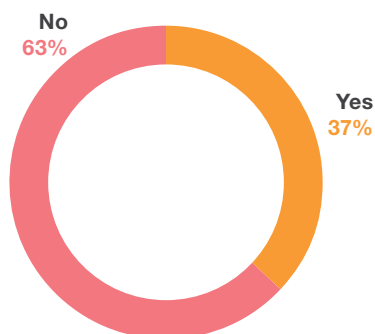
2.3.3 Focus on storytelling and brand building

In an ever-evolving competitive environment, and with EU regulations defining the minimum standards of the ESG product, asset managers will need to clearly differentiate themselves through investment intelligence, rigorous investment processes incorporating new extensive data inputs as well as marketing and brand-building in order to be successful.

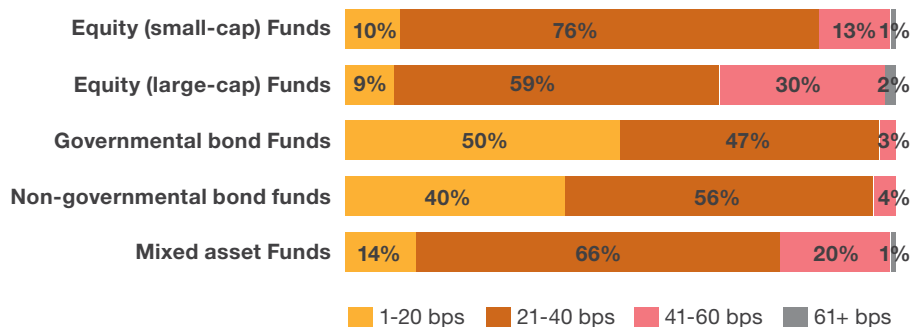
A coherent ESG story with clear and measurable KPIs beyond the minimum regulatory requirements will go a long way to win investors' support. This requires not only heightened engagement with portfolio companies, but also telling the story of the corporate values and how they are demonstrated on a day-to-day basis within the organisation and community. This applies also to managers who have always been ESG proponents, as regulations stand to erode the strong differentiation attained by those implementing ESG on a voluntary basis. As such, it is these asset managers' best interests to double down on their marketing and storytelling in order to differentiate themselves.

Exhibit 16: Institutional investors willing to pay a premium for ESG products

Are you willing to pay more for an ESG product ? (Institutional Investors)



If yes, what premium are you ready to pay? (Institutional Investors)



Source: PwC Global AWM Research Centre

2.4 Tackling the ever-present ESG data challenge

An effective and impactful model of ESG investing is heavily reliant on timely and accurate data – which is a central tenet of benchmarking ESG performance, impact assessment and risk management. While the use of ESG indicators and KPIs has risen considerably over the years, coverage is inconsistent and lacks breadth for comparison between sectors and stocks. This represents the most serious constraint to greater adoption of ESG among managers.

This barrier is likely to grow in terms of granularity and the scope of corporates that need to be covered as upcoming regulations will require new data sets and processes in order to monitor taxonomy alignment and principal adverse impacts on ESG issues. Traditional ESG data and ESG scoring will no longer suffice. The nature of ESG data and the methods with which it is analysed must evolve in order to be able to cope with these regulatory requirements.

Data management is already at present a core competency of the effective identification and management of investment opportunities. This core competency will significantly increase in relevance, as data requirements are more sophisticated, and the market of data providers is much less mature. As such, asset managers must take action to address the shortcomings in their data management processes, not only to be able to cope with the EU taxonomy requirements, but in order to fully capitalise on the opportunities presented by the surge in client demand for sustainable investing.

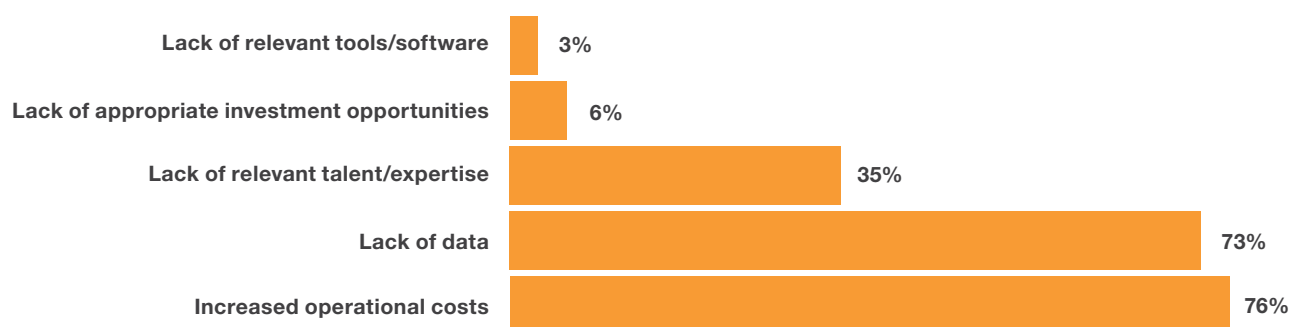
2.4.1 Asset managers must push underlying corporates for verifiable and quantitative data

The data AWMs receive from their underlying corporates is pivotal to their sustainable investment efforts. Insufficient data reported by investee companies and the absence of mandatory assurance on non-financial information is a key operational risk that asset managers will need to monitor. While there is no question that increasing demand has bolstered the prominence and availability of ESG and ESG data, major shortcomings persist. Most prominently, there is no meaningful consensus or standardisation of ESG metrics as of yet and most available data on companies' ESG efforts are self-reported – raising concerns about reliability or “greenwashing”.

As a result, asset managers are currently faced with a growing asymmetry between the information they need and the information with which they are provided. This is a major source of confusion and complication for asset managers when it comes to aligning their investment processes with EU regulations, with 73% of respondents in our asset manager survey citing lack of data as their largest challenge when implementing ESG products (cf. exhibit 17).

Exhibit 17: Lack of data a significant barrier to asset managers implementing ESG products

What were your largest internal and external challenges when implementing ESG products? (Asset managers)



Source: PwC Global AWM Research Centre

The lack of standardised ESG data also represents a major challenge to asset managers in the monitoring, assessing and disclosing of ESG-related risks; even as the materiality of these risks to investors translates to mounting pressure on asset managers. Self-reported data from underlying corporates tend to be skewed and inaccurate given the absence of a framework ensuring alignment.

Managers need ESG metrics to become more comparable, codified and aligned. This lack of alignment is commonly cited as a major barrier to greater ESG adoption, with 72% of asset managers in our survey identifying the lack of “objective and verifiable company level ESG metrics” as their main challenge. Many asset managers see increased regulation as a promising solution to this challenge, with approximately 77% of managers welcoming the implementation of regulatory requirements which would lead to improved data disclosure and transparency in their portfolios (cf. Exhibit 18). Envisaged NFRD amendments would already enhance the level of data, facilitating the benchmarking and integration of sustainability risk in the operations of all financial participants.

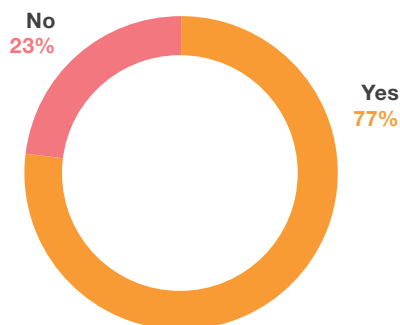
In the face of mounting regulation, asset managers should confront and align with what regulators qualify as “sustainable” as there may be key differences. In order to do so, managers must actively engage with the corporates in which they invest, providing oversight and guidance to ensure a truly sustainable order of operations.

European asset managers have been increasingly focusing on Engagement and Voting as an approach to ESG, which ranked as the most commonly applied strategy among the managers we surveyed. This is a strong indicator of the deepening entrenchment of ESG considerations in the industry. Nordic institutional investors are, for example, demanding concrete measures from their underlying corporates. It is no longer sufficient to say, “we engage”, managers must demonstrate the influence they have on underlying corporates and the results this has achieved.

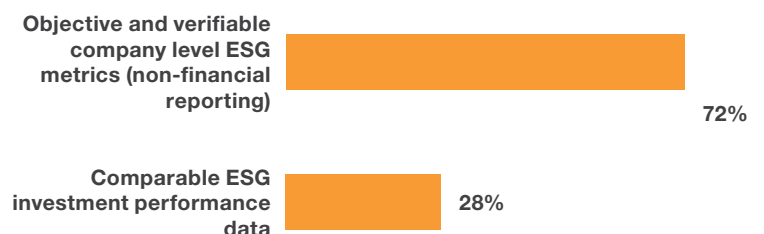
In short, the burden has fallen on asset managers to assure that their underlying corporates are being transparent and accurate in their ESG reporting. They must take an active role in engaging with these corporates to ensure that they are acting in a sustainable manner.

Exhibit 18: Asset managers welcome increased regulation

Given that lack of data is often cited as a challenge for setting up ESG products, do you want more regulatory requirements in terms of regulatory reporting in the companies in which you invest? (asset managers)



Which type of data posed the largest challenge? (asset managers)



Source: PwC Global AWM Market Research Centre

ESG information must be viewed with as much importance as financial information. The time has come for corporates to deliver up to date ESG data in an accessible, digital manner. This data must ideally be centralised and accessible to stakeholders- meaning asset investors and data providers.

Major European Asset Manager

2.4.2 To overcome the ESG data hurdle, managers must digitise

In order to overcome the aforementioned challenges related to ESG data and align their products and services with the requirements set out by the EU as well as meeting investor expectations, asset managers should leverage on technology and digitisation.

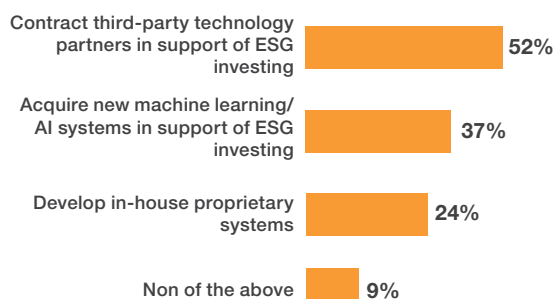
The use of a range of smart technologies has the capability to take ESG to the next level. Natural Language Processing (NLP), machine-learning and blockchain automatically extract ESG data on corporates, allowing managers to quantify the sustainability impacts of potential investments. Similarly, indirect data sourcing represents another significant option for asset managers, on which many managers have begun to leverage in order to gain a competitive edge. Indeed, of the 200 asset managers that we surveyed, 87% were collaborating with external data providers; with only 13% in-housing their data management operations (cf. Exhibit 19).

This reliance on smart technologies and external data providers is set to increase in the future, with over half of respondents in BNP Paribas' ESG survey planning to contract such providers and 37% planning to acquire new machine learning systems in support of ESG up until end-2021.

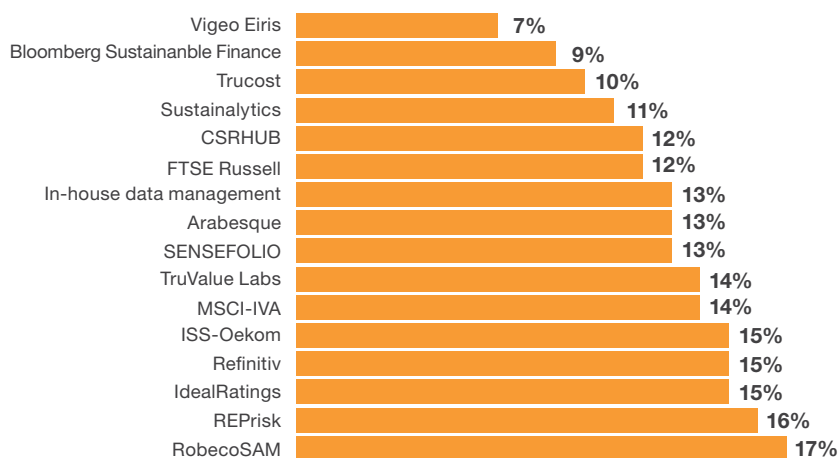
If properly integrated, these new technologies and data providers could soon redefine the industry, supporting asset managers in integrating ESG considerations into the investment process and allowing them to have a highly differentiated Sustainable Value Creation offering. Managers could also benefit from digitisation and indirect data sourcing as a way of monitoring and evaluating ESG-related risks on an ongoing basis, as well as assessing data obtained from their underlying companies to prop up their efforts to appropriately alter their risk management procedures.

Exhibit 19: Managers are already taking action to overcome the data challenge

Planned technological advances in coming 2 years



Which of the following ESG data providers do you use? (Asset managers)



Sources: PwC Global AWM Research Centre, BNP Paribas ESG Global Survey 2019

2.5 Develop a strong ESG risk management process

As the regulatory environment rigidifies, EU managers and managers of EU products will be required to modify their risk management frameworks to incorporate ESG and non-financial risk. This extends to all asset managers, regardless of the strategy they choose or category they launch their funds under. The SFDR mandates that all products will need to be assessed and monitored for any potential ESG risks – even if they do not explicitly promote ESG features.

ESG-related risks for asset managers can stem either indirectly, through non-compliance of underlying corporates; or directly, from their own operations. Either one of these put the asset manager at risk of reputational damage and related financial implications. It is therefore pertinent that, regardless of the sustainability approach, asset managers develop in-house expertise on ESG risk identification and management in order to regulate the dissemination of knowledge and monitor compliance in their own operations and as well as double down on underlying corporate engagement. Managing ESG-related risk would also mean that asset managers would have to consistently monitor their portfolios and regularly disclose whatever ESG exposures they may have.

Managers should consider boosting engagement with their investee companies in order to quantify the ESG metrics of their business strategies and operations and make necessary recommendations on how these companies can change business practices to mitigate possible ESG-related risks. They can also enforce ownership rights through proxy voting as a way of influencing underlying corporates. For those that decide to become fully sustainable asset managers, they would need to employ stricter risk management practices; going beyond widely used negative screening methods and incorporating other methods such as norms-based screening, which involves assessing each potential investment against their performance in specific ESG measures. They would also need to embark on more intensive corporate engagement with underlying companies.

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Risk management in relation to ESG issues should have been integrated some time ago. These risks are dually material, both in terms of corporate risk and externalities.

Major European Asset Manager

2.6 Going beyond the minimum reporting requirements

As ESG becomes increasingly entrenched in the investment landscape and society grows increasingly ESG-conscious, the investor base is attributing increased importance to sustainability and the quality of ESG data. Similarly, EU regulators are increasingly focusing on the ESG reporting provided by managers, with the Action Plan aiming to increase transparency and disclosure. As a result, asset managers that take a strong stance on implementing and reporting on their ESG metrics stand to be the biggest winners in this new landscape, complying with mounting regulations and attracting an increasingly ESG-oriented investor base.

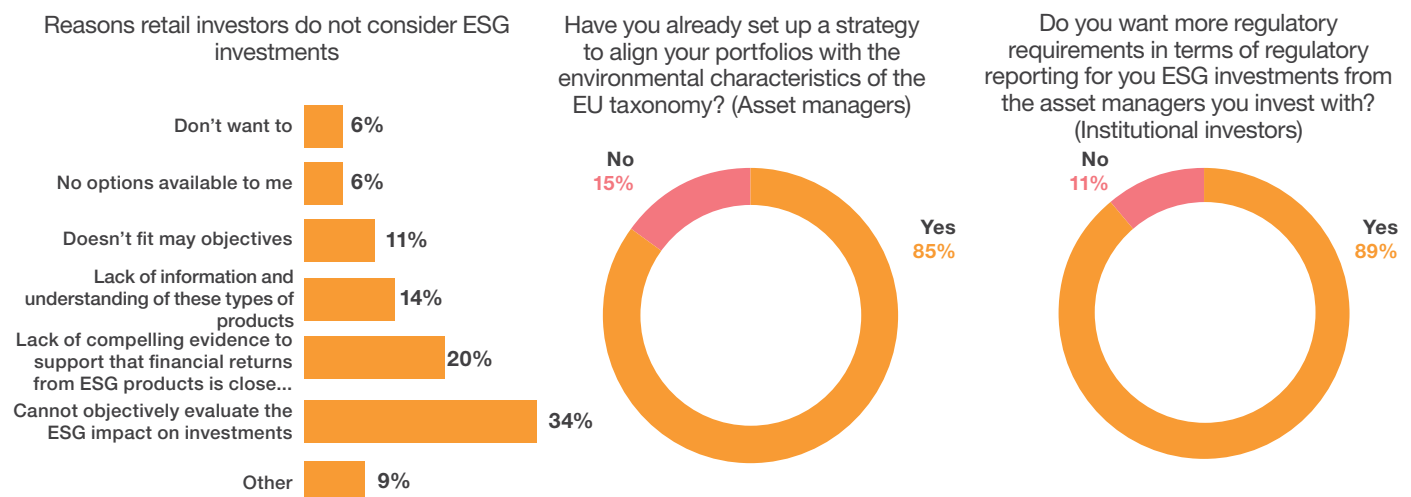
However, managers are struggling to provide their investors with accurate ESG data, often suffering from the same shortcomings mentioned above. Investors are having to synthesise and interpret a growing array of information: including a multitude of national requirements, private sector initiatives and voluntary ESG principles. For many investors, this lack of ESG comparability represents a significant barrier to adopting ESG into their portfolios. In fact, 89% of the institutional

investors we surveyed stated that they want more regulatory requirements in terms of regulatory reporting for their ESG investments from the asset managers with which they invest (cf. Exhibit 20).

Data inconsistencies and shortcomings represent a similar challenge within the retail segment, limiting the uptake of ESG investment. In our survey of over 800 retail investors, over one third of those who do not consider ESG factors in their investments cited ambiguities surrounding the objective evaluation of the ESG impact on investments as their reason for not doing so.

Those asset managers who are able to provide collect, evaluate and report on accurate ESG-related data and impact are set to win the confidence of ESG-oriented investors and will attract more inflows into their products as a result. Sustainable asset managers will need to ensure that they are reporting above the regulatory ESG reporting requirements in order to stand out and build long-term trust with investors.

Exhibit 20: Investors welcome heightened regulatory reporting



Source: PwC Global AWM Research Centre

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Pension funds are required to consider ESG risks in all of their investments and thus there is a natural demand to work with asset managers that provide this information for the investments that the pension funds make.

European Pension Fund

2.7 Educating the investment community and your staff

2.7.1 ESG education will be key in growing the asset pool

Fostering ESG education will accelerate the systemic considerations of ESG risks and raise demand for sustainable products. Investment managers can play a key role in the dissemination of knowledge on ESG issues. Not only can they educate their own workforce on how to incorporate ESG, but they can educate the investment community on the benefits and importance of sustainable finance.

Paramount to these efforts is the education of retail investors – streamlining the transition to a sustainability-centered manner of investing. Retail investors represent a growing portion of European ESG assets, and it is in the best interests of overall society if this segment is fully “clued up” on the importance and benefits of ESG investment.

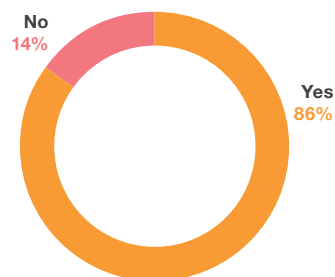
Once investors are “confronted” with sustainability requirements at the level of the MiFID suitability procedures or the fiduciary duties stemming from Solvency II and IORP II, they will become more aware of the importance of ESG and the opportunities presented by it, it is likely that we would see a strong acceleration of ESG asset growth. Our retail investors highlights this, with 86% of respondents stating that having more knowledge/information on ESG products would make them increase their allocation to these products (cf. Exhibit 21).

However, as a B2B2C industry, asset managers are not directly in contact with end investors. As a result, the responsibility falls to those who select and distribute funds to play a role in educating these investors on the benefits of ESG investing and how it can bring about a societal difference. Within the AM industry, trade associations can also play a key role in providing information and education to end-investors. Asset managers should inform and educate fund distributors and fund selectors, who would in turn pass on that education to retail investors.

Moreover, asset managers must consider using their expertise to educate underlying corporates on the important and urgent nature of ESG. In hosting webinars, lectures, or simply engaging with their underlying corporates as mentioned above, asset managers could benefit from improved corporate reporting while simultaneously building a better future.

Exhibit 21: Majority of retail investors believe improved ESG education would cause them to invest sustainably

Would having more knowledge/information on ESG products make you increase your allocation to them? (Retail investors)



Source: PwC Global AWM Research Centre



Without a doubt, there's a war for talent out there when it comes to ESG specialists. But at the same time, competition is fierce among candidates wanting ESG roles.

Michael Baldinger,
Head of Sustainable & Impact
Investing, UBS Asset Management



2.7.2 Upskilling staff will create ESG leaders

The need for, and opportunities presented by, ESG education do not pertain solely to investors. As ESG becomes increasingly entrenched in the industry, and becomes increasingly demanded by investors, a deeper knowledge and understanding of it needs to be ingrained within the asset management workforce. In order to make the transition towards a sustainable investment landscape and integrate ESG capabilities across organisations, asset managers need to build a diverse and ESG educated talent pool to offer fresh perspectives. To attain a future-proof workforce, asset managers must also reflect the diversity which they expect from the corporates in which they invest.

As such, an ESG & sustainability trained workforce will be increasingly required across the value chain, and different pedagogical goals must be considered as a result. It is pivotal for asset managers to build a talent pool to offer perspectives on ESG integration. This workforce will need to be skilled in ESG data and analytics, ESG risk analysis, ESG impact analysis and ESG policy monitoring.

Asset managers must seek to hire candidates with both financial experience and a passion for issues relating to ESG. However, competition for such skilled workers is limited. 35% of asset managers we surveyed cited a lack of ESG talent/expertise as the largest internal challenge preventing them from implementing ESG products. As such, upskilling current investment staff and management in relation to governance, risks, and general awareness on ESG principles is a compelling tactical answer for institutions and their business partners to overcome this challenge.

A broader range of knowledge within an organisation can help investment teams to make decisions on ESG-related matters, filling a gap that traditional investors, even armed with considerable amounts of data, cannot. Companies should pick up the pace in order to formulate the right structure and leadership, as well as attain the skills necessary to foster greater ESG expertise. Companies should also embed core values and follow up their commitment to ESG with action and pragmatism.



Conclusion

The ESG wave is fast approaching. Public awareness of ESG related risks, increased regulatory scrutiny and major demographic and societal changes are pushing ESG investing to the top of the asset management agenda. The combination of these trends has brought the European asset and wealth management industry to the brink of an imminent paradigm shift. Managers must anticipate and adapt to this new reality, taking a number of actions to integrate ESG into everything they do - from implementing sustainability into their product offering, to reengineering the very way they do business.

We expect that the AWM industry of tomorrow will be nearly unrecognisable from that of today, with ESG considerations becoming the new standard for investing. While barriers remain, regulators, investors and asset managers alike are uniting in overcoming these hurdles, as both regulators and investors continue the push for a sustainable investment strategy, and asset managers shift their operations to meet this demand.

This shift represents a once-in-a-century opportunity – not only for the AWM industry, but for the future development of the overall European continent. As global capital becomes increasingly channelled towards sustainable projects, Europe is well positioned to act as the global ESG hub – creating new jobs and opportunities and thus increasing the prosperity of its population.





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If you would like to discuss any of the issues raised in this Report in more detail, please speak with your usual PwC contacts or anyone listed below.

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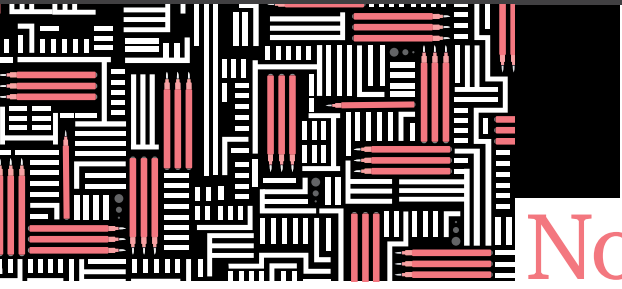
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