KURTOSYS

2020

ESG Distribution Study

Executive Summary

As we write, the world at large is picking its way carefully through the aftermath of COVID-19, a crisis borne of many mothers, but one which can unquestionably be traced back to environmental and social factors. Businesses are beginning to come to terms with the long-term financial impact of the pandemic, making proper corporate governance key to emerging from this period unscathed. Against this backdrop, the European Union in March quietly released the final draft of the sustainable finance taxonomy, a document which, in spite of the little fanfare that met it, will change how almost every market participant invests, possibly forever.

While the detail may be lacking - the finer points of compliance being delegated to the ESAs and due for delivery by December 2020 - the direction is clear. From 2022, the responsibilities of financial advisers operating in the European union will expand to encompass the evaluation of sustainability factors within the investments they recommend. At the same time, financial market participants (UCITS, AIFs, et al) will be under obligation to report on their own sustainable investment practices in much greater detail. This incorporation of sustainability as a core responsibility of fiduciaries will have far reaching implications – many of them unquestionably good.

In this context, we feel that the results of our 2020 ESG Distribution study depict an industry on the verge of metamorphosis. We hope that this snapshot serves as a point of comparison for our future selves to see how far our business has come in ensuring the growth of all our wealth, while creating a better world for our descendants. In addition, this report should provide a useful tool for heads of distribution and marketing to benchmark their own internal efforts, to help drive change within their organization, and ultimately to advance the art and science of sustainable investing in our industry.

When approaching the task, we wanted to answer three key questions:

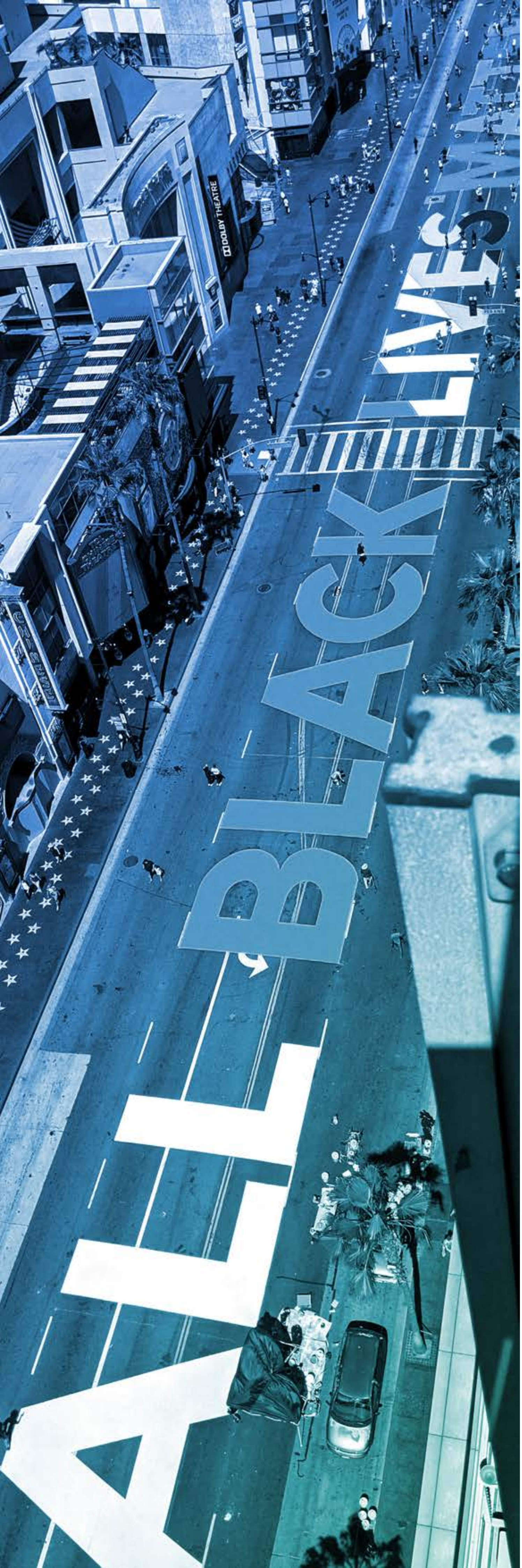
1. How deeply has the phenomenon of sustainable investing taken hold in the asset management industry?
2. How are managers adapting their service and reporting practices to accommodate the new regulatory requirements and investor demands?
3. What are the emerging best practices in this new discipline and who is leading the way?

To complete our study, we reviewed the public websites of each of the top 100 asset managers by AUM, identifying 11 common categories across the group, each of which rolled up into one of three key areas.

- Availability of ESG Products
- Integration of ESG into brand and messaging
- Provision of sustainability metrics in investor reporting

In summary, European managers lead the way in terms of product availability, thought leadership, and brand positioning, followed quickly by UK managers and global managers primarily domiciled in the United States. On the other hand, US centric managers were conspicuous laggards in all metrics we observed, as were managers from Asia and the rest of the world.

Well established firms offer a wide variety of products and a much deeper level of content to their clients and partners, focusing on education and demonstrating



impartiality in their evaluation of investment suitability. From a brand perspective these appear to be key tenets, as does the integration of the ethos into the core of the business. While environmental concerns dominate in most strategies, we were left feeling that the social and governance angles were not yet well occupied by the managers in our study.

The current state of reporting lags product availability and clear best practices are yet to appear, impacted by imperfect data and lack of clear direction from regulators. However, the digital channel appears to be a natural venue for the exchange of this data going forward, and some of the class leaders are already providing tools to their clients and distribution partners to allow them to gain insight into both stewardship and sustainability metrics.

Looking into 2021 and 2022, as regulation in the EU becomes more mature, the level of reporting will no doubt increase in sophistication, and anecdotally we already observe this shift within our own clients. Our recommendation for the moment is to prepare the data foundation and to put tooling in place to allow the distribution business to react quickly as demands shift. Again, we predict a particular emphasis will be placed on the digital channel, in particular the use of portals to share ESG content. This data is costly, voluminous, and sensitive in nature, making it unsuitable for the public web or print. Adding capabilities to furnish sales partners or clients with these data in a secure portal would also be advised.

Availability of ESG Products

The spectrum of products available to investors seeking to align their investment style with their personal or corporate worldview – economic or social – is widening at a breath-taking pace. From funds that invest exclusively in companies that provide sustainability solutions, to those that merely exclude the worst offenders, and on to those with specific active ownership mandates for effecting change through engagement and voting.

Given this deceptively broad spectrum within what is seemingly such a narrow style, we thought it important to understand how widely the label was being used by the biggest asset managers in the world. Our research revealed that these dedicated ESG labelled funds, or funds focusing on sustainable investing, were made available by precisely 50 of the top 100 asset managers.

Furthermore, 31 had more than five distinct sustainable investing products.

Geographically, the incidence of ESG products was slightly less in American managers, at 44% (22 of 50). This lies in stark contrast to European managers where the rate was closer to 73% (19 of 26). UK based managers pipped their European siblings slightly, at 80% (8 of 10).

Across the rest of the world (Japan, China, Australia, Canada, Brazil), the picture was decidedly less developed, with only two of the remaining 14 managers in the top 100 offering ESG products. While it is premature to draw any conclusions without a broader study, this does initially tell the story of ESG investing being a more well established in the eurozone.

This is also backed up when you control for the truly global and largest American managers, such as Blackrock and State Street. Considering the largest 20 American managers, 65% (13 of 20) offer dedicated products, as opposed to 30% (9) of the smaller 30 US managers. We posit that the importance of the European market to these firms makes their presence at the forefront of ESG investing easily explained.

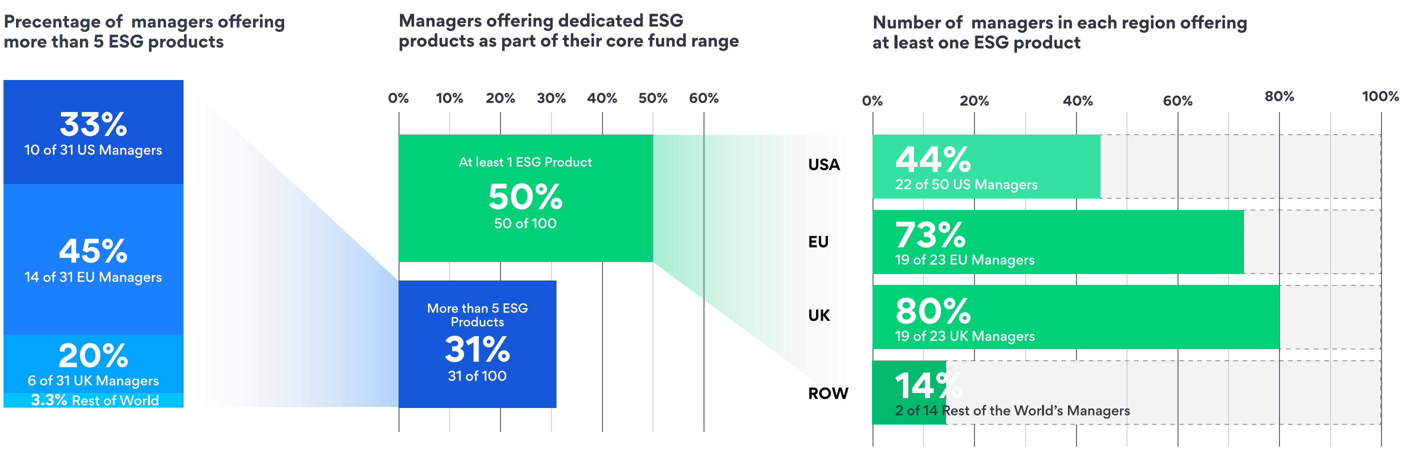
For those managers with multiple ESG labelled offerings, the findings confirmed the above observations. Of the 31, 33% (10) were American, 20% were British (6) and 45% (14) were European, with the latter being a global manager originating in Canada.

To us, these numbers confirm that sustainable investing is a largely Eurocentric phenomenon at present, a fact that can be explained by both the Union's legislative stance towards climate change as well as the more liberal attitudes of many of the bloc's citizens. Simply put – there is more demand both from the consumer and the regulator. However, we wonder whether the "S" in ESG might start to create more demand in the USA and other jurisdictions, particularly given the growing swell of support for social justice movements such as Black Lives Matter. To put it another way, while many of the current products emphasize the E in ESG, might we see more that emphasize the S or the G?

Of course, just because we could not locate sustainably labelled products for certain managers, it does not mean that they were not there, although the lack of discoverability may tell another story. In both our research and conversations with customers we sense a level of conservatism in the product labelling process around ESG products at present. Invariably the notion of greenwashing inevitably sits at the root of much of this, particularly those who are on the more established end of the spectrum.

Indeed, in certain instances we found managers that were providing specific sustainable investing content on products that were not specifically labelled as sustainable investments. It is easy to conclude that the confluence of both enhanced regulation and conservatism on the part of managers may result in ESG labelling disappearing completely from the lexicon of the product marketer. As Bloomberg coined in their January 2020 Trillions podcast "Everything is ESG now" – and we tend to agree. Once regulation mandates specific reporting across all products it will be almost impossible to discern a fund that is simply managed in a responsible way versus one that is also marketed as such.

While this may be tomorrow's problem, it presents an opportunity for marketers today, as inevitably there is brand recognition to be had in the use of the sustainable vernacular. For example, while there may be other



"Climate Funds" in the future, Nordea have clearly taken that ground for themselves. We feel that there are still similar opportunities for marketers to steal a march on the competition, the underlying fund notwithstanding.

Integration of ESG into Brand and Messaging

We move now from product availability and labelling to the integration of sustainability into the core brand and messaging of the manager. In years past, the playbook for distribution teams was relatively slim when it came to the positioning of financial products. Returns, downside insulation, growth, value. One might posit that this is the language that purveyors of financial products have used – in one form or another – for millennia.

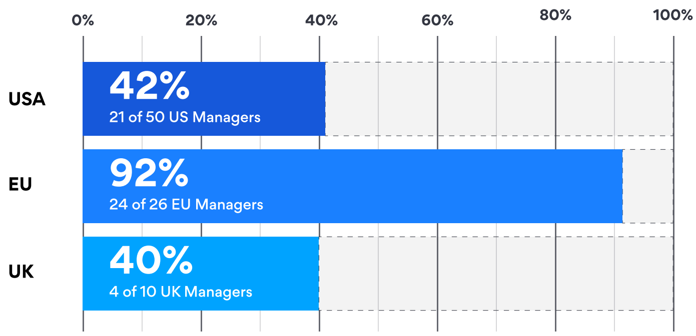
Sustainable investing changes this. Now we not only invest for ourselves and our future but for that of generations to come. We take what some consider to be a self-serving act and transform it to one of extreme altruism. The job of the marketeer and salesperson is, of course, to maximize the potential of this trend to their business. In fact, if you subscribe to the view we outline above, namely that in just a few short years all products will in some way be viewed as ESG – either very or not a lot – then the challenge of distribution organizations now is to position themselves at the apogee of this orbit, far and away from the competition.

Continuing the Eurocentric trend, 24 of the 26 European asset managers in the study incorporated ESG as a core anchor within their brand messaging and content. We note that this is in fact a larger percentage than those managers offering dedicated ESG products. Whether that is because those managers in the delta are taking the 'everything is ESG' approach, or whether their line-up is merely catching up remains to be examined. Similarly, the number of managers featuring a sustainable investing policy on their site in addition to dedicated ESG insights were 24 of 26.

Switching to North America only 21 of 50 managers studied (42%) featured sustainability in any way on their sites. Interestingly, 41 of 50 (82%) included sustainability policies, while 44 of 50 (88%) included sustainability content within their thought leadership. In the UK only 4/10 managers anchored their core messaging to ESG. In contrast, all featured a sustainable investing policy as well as ESG focused thought leadership.

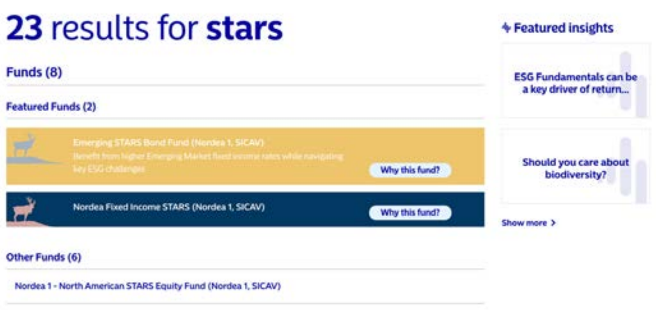
How this messaging was incorporated ranged widely, but for those leading the way there were clear best practices. While beautiful imagery of the natural world may be the go-to shtick of marketers looking to amp up the E in ESG for their brand, we feel that those managers leading the way are those providing real evidence of how sustainability has been incorporated into their investing process through direct engagement.

Asset managers that have incorporated ESG as a core anchor within their brand messaging and content

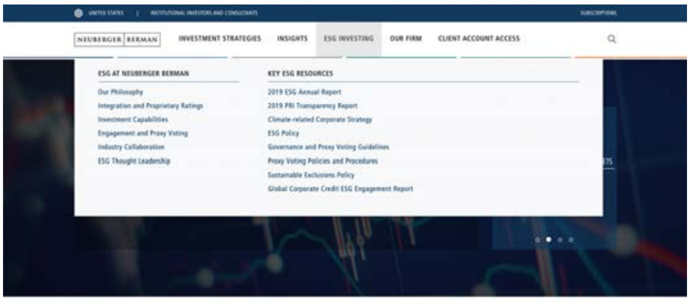


Nordea (www.nordea.lu), as one might expect, provides a great example of how to do this well. Firstly, responsible investment is given pride of place within site navigation. Within a drop-down mega menu, key links to their various policies and investment principles are also prominent, show alongside their flagship sustainable investing products as well as regularly updated ESG insights.

This theme continues throughout the rest of the site, even to less trafficked areas such as search results, clearly indicating how deeply grounded their entire business is in responsible and sustainable investing.



Moving to the US, Neuberger also do a good job of not just talking the talk, but firmly walking the walk. They showcase both quality thought leadership in addition to evidence of how sustainable investing has been entrenched into their investment process and corporate structure. Their climate related corporate strategy shows that the practice of sustainability is something that permeates well beyond the front office. We would proffer that firms that show this deep commitment to ESG across the length and breadth of their business will gain greater brand equity.



Staying within North America, BMO are also a notable leader. A great example of this is their ESG Profile and Impact Report, released in June 2020. The report serves as a wonderful piece of educational content for the investor – taking them through the foothills of sustainable investing, including the UN sustainable development goals, before outlining the alignment of their investments to the aforementioned UNSDGs. They also make a particular point of highlighting the negative as well as the positive aspects of each portfolio issuer and their underlying businesses. To some this may seem counterintuitive, but in fact therein lies the opportunity of sustainable investing to the marketeer – that we are not just funding the virtuous, but helping to reform the offenders too. We believe that taking this balanced worldview will be a key facet in a strong brand strategy aligned to sustainable investing.

As we mentioned earlier in this report, much emphasis appears to be placed on the "E" in ESG. On the other hand, social investing appears to be a less accentuated element of the style in many investor's minds. Movements such as Black lives matter have presented a mirror to the world and highlighted some of the hidden biases that lie within the depths of the human psyche. Just as climate change has prompted the beginnings of change within the broad-based investment behaviours of our industry, what impact will these social movements have on our industry, beyond merely divesting from fossil fuels? Will we see North American managers, sitting so close to the seat of such movements start to 'own the S' in the same way as their European competitors have taken the high ground on environmental matters. There are already smaller managers, such as Ariel Investments, who have developed businesses – and brands – that hold this idea of social justice and equality as core to everything they do.

Clearly, firms such as Nordea, BMO, Neuberger Berman, and Federated Hermes who have held responsible investing at their core for some time have an advantage over those in the industry who are perhaps at the beginning of this journey. The challenge for the chasing pack involves not only building sustainable investing teams but developing thought leadership and investing capabilities that compete with and exceed the early front runners. Thankfully, for those who are already on the path, these firms are forging the way forward. How this race plays out will be fascinating, and we consider a future where one of these ESG leaders grows to assume a position in the trillion-dollar club more than just a slight possibility.

ESG Reporting

In this section we explore how well the firms studied are furnishing their clients and distribution partners with the information underpinning their investment decisions, specifically as these data relate to sustainability. These reports will become a critical part of the decision making and selling process for these key stakeholders in the years ahead, so we were interested to see whether trends were emerging in these communications.

We should caution that these findings should be considered with an understanding of the various challenges faced by market participants in sourcing, normalizing, and evaluating the vast ocean of issuer focused metrics that are collectively known as "ESG data".

To begin with there are multiple ESG data vendors: MSCI, Sustainalytics/Morningstar, and Refinitiv being the most commonly leveraged. Between them there is a lack of a common baseline for many of the metrics, and even where there are commonalities, they often disagree with each-other. Into this murky breach step the big four, with PWC and Deloitte beginning to offer services to harmonise these data sets on behalf of managers, a baseline service badly needed for those who are just building their sustainability teams.

Next, once data has been sourced, sanitized and leveraged within the investing process, it must be made available for the reporting teams to include. This is all before compliance have opined on its suitability for inclusion in outputs. Set against this backdrop, it is unsurprising to see that in comparison to the relative abundance of ESG style products, the reporting that accompanies them is much less mature. Nevertheless, we identified six emergent behaviours and trends within the cohort:

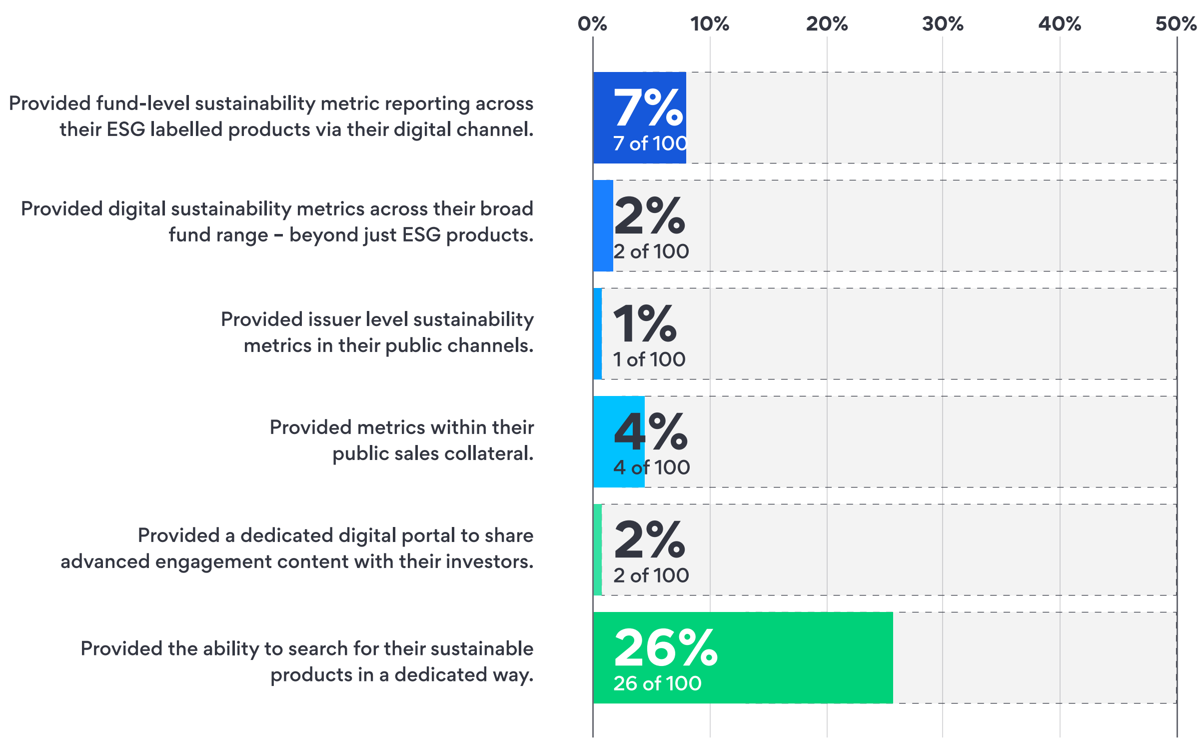
- 7/100 managers provided fund-level sustainability metric reporting across their ESG labelled products via their digital channel. These ranged from the inclusion of carbon consumption metrics to overall sustainability scores.
- Only 2/100 managers provided digital sustainability metrics across their broad fund range – beyond just ESG products. With greenwashing in mind, we wanted to see whether there were managers who were providing sustainability metrics across non ESG labelled products. We must caveat that in these two examples, metrics were provided liberally but not universally.
- 1/100 managers provided issuer level sustainability metrics in their public channels.
- 4/100 managers provided metrics within their public sales collateral.
- 2/100 managers provided a dedicated digital portal to share advanced engagement content with their investors.
- 26/100 managers provided the ability to search for their sustainable products in a dedicated way – either way their fund center or main site search.

Given the paucity of available data it was not useful to draw any more conclusions as to whether any particular subdivision of the cohort was leading the way – it is easy to see here that we are very early on in this process and best practices are not yet well established. However, what we did see provides an interesting look into the future of client reporting.

Before we expose our broader observations, we start with a deeper dive into what was actually being reported, starting with metrics. In our study, we saw four distinct groups:

- Ratings: Amalgamations of issuer level metrics at the fund level. We observed both home grown ratings provided by internal teams or third party ratings such as those provided by MSCI and Morninstar Sustainalytics

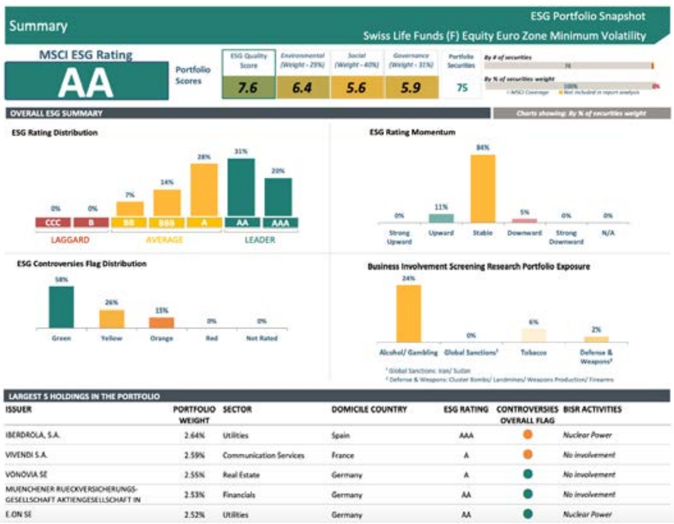
ESG reporting trends across the top 100 asset managers



- Aggregated ESG metrics: Rolled up metrics representing things such as aggregate carbon intensity across the portfolio.
- Issuer Level Metrics: ESG metrics at the issuer level.
- Engagement Metrics: An objective measurement of how issuers have been engaged with and what progress has been made.

Within these categories there is a wide dispersion of different metrics represented, a good first example being within the iShares Corporate Bond ESG UCITS ETF. For this product, Blackrock chose to show both the aggregate MSCI ESG Fund Rating (a rollup of the underlying issuers according to specified MSCI methodology), along with peer group rankings and weighted average carbon intensity metric. Interestingly, this information was not available for comparison purposes versus other products on the site, but this is potentially because of data licensing implications.

In other words, while we at Kurtosys may consider it highly useful for an adviser to be able to filter by the overall ESG rating and carbon intensity (we absolutely do), we appreciate that we are still in the foothills of this climb. Overall, we fell Blackrock should be commended for starting to include these data in their digital investor reports.

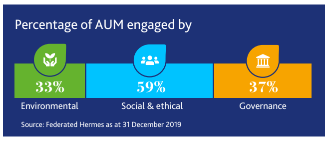


ISSUER	PORTFOLIO WEIGHT	SECTOR	DOMICILE COUNTRY	ESG RATING	CONTROVERSIES OVERALL FLAG	BISR ACTIVITIES
IBERDROLA, S.A.	2.64%	Utilities	Spain	AAA		Nuclear Power
VIVENDI S.A.	2.59%	Communication Services	France	A		No involvement
VONOVIA SE	2.55%	Real Estate	Germany	A		No involvement
MUENCHENER RUECKVERSICHERUNGS-GESELLSCHAFT AKTIENGESELLSCHAFT IN	2.53%	Financials	Germany	AA		No involvement
E.ON SE	2.52%	Utilities	Germany	AA		Nuclear Power

An interesting point of comparison is provided by Swiss life, who provide an in-depth ESG report, again curated by MSCI, across many of their products – and not only those that are labelled as ESG. In addition to providing the same high-level rating classifications as Blackrock, this report delves deeper into portfolio issuers, exposing the overall ratings of each as well as highlighting controversies and

business exposure. We feel this sort of reporting will become a mainstay for most managers going forward, making its way into both client reports but also dedicated portals for sales partners and institutional clients. The inclusion of these data across non-ESG products is particularly noteworthy.

Thirdly, we come to Federated Hermes, who include stewardship and engagement content within all of their factsheets. From a marketing perspective, the exposition of engagement – if it exists within the investment process – is going to become a key differentiator going forward as more firms add products and look to set themselves apart. This is an early example of an industry leader showing how it might be done in the future.



While we cannot show the finer details of our final example, we know from our clients that exploiting the digital channel – via a secure portal – is proving to be an effective way of communicating all of these types of data and content to investors. In the instances we've seen, all four main reporting categories are included in a portal where investors and sales partners can login to explore the ESG profile of the products in detail - but most importantly the engagement that the asset manager is undertaking with the underlying issuers, and how this engagement will have an impact on long term returns.

We feel that, in the future, these advanced investor portals will become as common as a public fund's website, for several key reasons.

Firstly, there will be an ever-increasing demand from investors and fund selectors to understand the underlying suitability of the investment product. In fact the recently released white-papers on the sustainable finance taxonomy indicate that "Financial advisers should integrate in their processes, including in their due diligence processes and should assess on a continuous basis not only all relevant financial risks but also including all relevant sustainability risks" (Page 3, section I.12). This will create a natural demand from the adviser for more information and in particular more enablement content to support their decision making process – which will require data and tools.

A portal is a natural medium for this, as exposing vendor data in the public domain inevitably carries much higher fees from data providers than when shared with a smaller private audience. Given the push to reduce cost across entire industry, we feel that this will be the preferred option as firms look to achieve this reporting as efficiently as possible.

Furthermore, the volume and required context of the data requires a medium much more expansive than traditional reporting. While it can be shoe-horned into a twelve page client report, it is much more useful in digital form. When provided in this medium, clients and distributors will be better enabled and happier as a result.

In addition, because of the subjective and sophisticated nature of some of the data involved, CCOs will be more comfortable sharing these reports in a restricted forum to lower the risk of misinterpretation and to restrict it to a sophisticated audience. The portal will provide certainty around who has seen what, while assuring compliance teams that the messaging is more tightly controlled.

Finally, because of the importance to investors and prospects, the quality of a manager's ESG portal will provide a natural sales aid and point of differentiation. If implemented correctly, it can also provide a natural source of leads to the sales team. One of the key challenges for all asset managers is understanding who the individual advisers and investors are that may hold an interest in their products. Persuading these individuals to reveal their identities and engage in sales dialogue is not something they acquiesce to easily, as even without surrendering their information to lead forms they are already inundated by calls from wholesalers.

As one head of fund selection told us "If I wanted to fill my diary, every day, with meetings with sales team from asset managers, I could block out the whole year". With proper analytics, providing gated access to this content to qualified prospects can inform sales leaders and allow them to direct their efforts more effectively. In this sense, ESG content provides a new opportunity to build deeper engagement with prospects and improve sales effectiveness.

Of all the areas covered in this study we feel that reporting is perhaps the one where it is easiest to peer into the future. We posit that whatever the forthcoming regulation brings, there remain a few clear certainties:

- Transparency into underlying issuers will be demanded by investors, particularly those in an advisory capacity, given the onus placed on them by the regulation. It will not be enough for a manager to report an aggregate rating – selectors and consultants will need to do their own due diligence to trust and verify.
- Ratings will remain useful but will need to be consistent and comparable, something regulation will assist with. Until that point, managers will interpolate and do the best based on their own judgement. Firms such as PWC and Deloitte are already stepping into the gap to help build concordance here.
- Understanding engagement will be the critical differentiator of an asset manager's proposition. Applying metrics to engagement tied to positive outcomes will show a clear link between the investment, the returns, and the overall impact to society and the world. Showing evidence of this will drive AUM growth for those who can do it.
- Investor demands will be as important as regulation in driving change, so a clear dialogue will be important with the client base and distribution partners.
- Things will move most quickly once regulators signal their intent in terms of required reporting output, December 2020 being a key milestone.
- The volume and complexity of data will mean that managers will need to invest in technologies to support its communication and understanding.

If you subscribe to this world view, the next question should be, aside from building the core capabilities around responsible investing, what can be done to prepare? In our view there are some clear takeaways:

- Data: building the infrastructure around ESG data, access to data providers, association with portfolio data, and defining a process for how it can be used will be required in any scenario. Putting these building blocks in place now will give firms a head start in the near future.
- Reporting Technology: ESG reporting will stress reporting teams like never before. Requirements will change rapidly and the business will need to react without adding costly headcount. Putting in place systems that can adapt quickly in both the digital and document reporting spheres will be key.

Conclusion

If the results of our study are to be believed, we anticipate that in spite of the best efforts of COVID-19, the work to integrate sustainability into the core of our industry will continue apace in 2020 and 2021. Our study confirms that, while a euro-centric phenomenon, sustainability is creeping gradually into the US funds market, and in reality, the early leaders in this new world are creating a strong defensive moat around them, not just in terms of expertise but in terms of brand perception and client service.

For the chasing pack to compete, investments need to be made in people, data, process, and technology to evolve their existing businesses for the new world of responsible investing. Lessons can be learned from the vanguard, both in terms of how they have positioned their brand, but also in terms of how they are terraforming their businesses to meet the new requirements of investors and partners. For UCITS, regulation will force change both for the asset manufacturer as well as the frontline adviser, so these adaptations appear non-negotiable.

We at Kurtosys are positioning ourselves to assist in this effort by:

- Launching a series of ESG focused web and print components to help managers accelerate their client reporting through these new challenges.
- Launching an addition to our existing client portal offering that will allow managers to demonstrate engagement reporting alongside ESG metrics.
- Adding ESG data to our core data model to allow for seamless integration with product book of record systems.
- Orienting our product management process to stay aligned to upcoming regulatory change, with the goal of keeping our customers ahead.

While we are merely one piece of the puzzle, we feel this is an important component in the strategy of every asset manager in preparing for this new world. To further assist, we are happy to provide an analysis of how your current distribution organization compares to some of these class leaders.

The Kurtosys cloud helps asset managers to drive AUM growth through automation across their entire distribution organisation, from fund buyer portals to ESG reporting and everything in between. Whether you are a marketer, sales leader, or client service professional, Kurtosys can provide solutions to some of your most challenging distribution problems.

Our technology is underpinned by robust and scalable infrastructure, using the latest cloud technologies and supported by teams that understand the security, data, and regulatory needs of global financial institutions. As an ISO 27001 certified company, we have implemented a comprehensive information security management system to safeguard customer services including data centre protection, business continuity, risk assessment, and incident management.

Founded in 2002, Kurtosys operates across three global offices, employing over 200 people. The company works with some of the world's largest financial brands, including asset managers, wealth managers, banks, and alternative investment firms.

Visit www.kurtosys.com to learn more about our platform or visit www.kurtosys.com/contact to request a free demo.

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