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European Responsible Investing Fund Survey

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ALFI FOREWORD

Marc Saluzzi,
Chairman of ALFI

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The Association of the Luxembourg Fund Industry (ALFI) is the official representative body for the Luxembourg investment fund industry and was set up in November 1988 to promote its development.

Its mission is to lead industry efforts to make Luxembourg the most attractive international centre for investment funds. ALFI sets out its ambition for the Luxembourg Fund Centre, to be a global centre of excellence for the asset management industry, thereby creating opportunities for investors, fund professionals and the global community as a whole.

The Association of the Luxembourg Fund Industry (ALFI) recognises the significant potential of Responsible Investing, both in terms of client demand, the desire to "make a difference" and of the opportunity this presents to the asset management sector.

ALFI believes that Responsible Investing is not a sector that will come and go in fashion, but the start of a tectonic shift that will ultimately create a new landscape and set new norms for the industry.

There are many different strands to the Responsible Investing movement and the overall picture is unclear. If we are to foster the movement a first important step is to clarify definitions and understand the size of the market.

To this end ALFI commissioned the following study, which we hope will become an annual fixture.

The study was designed by members of the ALFI Responsible Investing Technical Committee. This committee brings together fund directors, investment managers, consultants and service providers, experts in microfinance, impact investing, islamic finance, carbon finance and other related fields, all of whom share the ambition of fostering the Responsible Investing industry.

We would like to thank KPMG, the ALFI Secretariat and the ALFI Responsible Investing Technical Committee for designing and carrying out this study.

KPMG FOREWORD

Nathalie Dogniez,

Head of Investment Management,
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KPMG is committed to the Responsible Investing sector recognising the significant potential and opportunities that this investment product will bring to the financial sector in the future and the positive impact that such investment strategies can bring to the world-wide community as a whole.

Social investing, impact investing, microfinance, impact finance, sustainable and responsible investing, are terminologies that are often used in a multitude of overlapping and sometimes confusing ways. Although responsible investors tend to see the global picture in a much clearer way than before, challenges remain present when it comes to defining and categorising responsible investing products. Methods and approaches to value and integrate Environmental, Social and Governance "ESG" considerations into investment processes are multiplying and appear to be in constant evolution.

Whereas it is clear that responsible investing will continue to evolve in various ways and under various names, it is also important to be able to measure the size of the market in a comprehensive manner to allow comparisons and measure evolution over time. The principal aim of this study is to establish an accurate point from which to measure both the current Responsible Investment fund market and future evolution.

Whilst this study confirms that the Responsible Investment Funds remained a niche product in 2010, we believe that the sector, driven by customers demand and authority initiatives, will encounter significant evolution in the future. For instance, this study confirms that social entrepreneurship funds were marginal in 2010 but with the EU initiative on Social Entrepreneurship funds, this picture could radically change in the upcoming years. It was therefore very useful to analyse the nature of the funds, their policy and their domicile as a snapshot and as a starting point to monitor the sector evolution.

We hope that this will form the basis for future quantitative measures and trends faced by the responsible investment fund sector.

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KPMG Luxembourg is a leading provider of professional services in Luxembourg and abroad. As part of KPMG Europe LLP we are part of the largest integrated accounting firm in Europe.

EXECUTIVE SUMMARY

This first edition of the European Responsible Investing Fund Survey gives a snap shot of the European Responsible Investing Fund universe as at 31 December 2010. ALFI has recognised that the responsible investment fund industry has reached a point where having a reliable and accurate picture of the size, number and domicile of funds as well as the nature of assets within these funds is critical in order to be able to track the progress of this growing sector in the coming years.

This study pulls together the definitions of responsible investing used by the various different fund market research agencies, as well as the fund data available, which has been analysed to provide key statistics within each responsible investing category, as further explained later in this study. The study focuses only on investment fund vehicles and excludes pension fund and segregated managed accounts, as obtaining reliable, publicly available data for such institutional assets, is currently too challenging.

Despite the existence of a number of reliable databases which include relevant investment fund information, the definitions used across the industry vary between different players. Whilst capturing the various and numerous responsible investing approaches into one single definition seems critical to facilitate increased awareness of the broad investment community, gathering such a wide spectrum of approaches into one unique definition will continue to remain a challenge.

In addition to the "definition challenge" there is also a lack of transparency within certain sectors where data is simply not reported and therefore does not enter into the databases used for this study – ensuring a more harmonised, centralised market data source would increase the clarity and positioning of the responsible investing sector. Increased transparency of investment approaches and selection methods would appear to be an instrumental leverage point to accelerate growth of responsible investments within the mainstream markets.

We consider that there are three key action points for the industry associations and their members:

- **Harmonised definitions across the industry** would assist investors at all levels to better understand responsible investing products and more comfortably direct their assets to such investment products. Industry associations and their members should seek to harmonise existing definitions.
- **Industry associations across Europe must encourage increased transparency and clarity among their members** such that the data captured by industry organisations and data researchers is as complete and accurate as is reasonably possible.
- **More clarity and transparency of responsible investing strategies, related investment products and reported statistics is required** from asset managers.

Key action points

- Harmonised definitions across the industry is essential;
- Industry associations across Europe must encourage increased transparency and clarity among their members to better capture data;
- Asset managers should improve disclosure of their responsible investing strategies, related investment products and environmental and social impacts.

Key statistical results

- The European responsible investing fund universe totals EUR 129.49 billion, across a total of 1,236 investment fund vehicles;
- The activities of the larger institutional investors are paving the way for more retail investor-destined responsible investment fund products;
- ESG (cross-sectoral) category represents by far the largest proportion of the total assets under management, amounting to 70% represented by 704 funds;
- When it comes to selecting a particular theme of investment, asset managers tend to favour the environmental sectors;
- France and Luxembourg as domiciles dominate overall, principally due to the large number of ESG (cross-sectoral) funds.

What are the key statistical results from the study?

- **The total assets under management in the European responsible investing fund universe totals EUR 129.49 billion, across a total of 1,236 investment fund vehicles.** This represents only 1.6% of the total assets of the European investment fund market and 2.3% of the total number of funds (according to EFAMA figures, there were 52,636 investment funds totalling EUR 8,025 billion at the end of 2010); it is therefore clear that this is still only a niche market when it comes to investment funds. When looking at other studies or even simply reading the specialised investment press, **the activities of the larger institutional investors,** including certain pension funds, with responsible investing policies, **are paving the way for more retail investor-destined responsible investment fund products.** This should have a positive impact on the growth of the number of funds and total assets.
- Once the EUR 129.49 billion is broken down between different investment categories, **it is the ESG (cross-sectoral) category which represents by far the largest proportion of the total assets under management,** amounting to 70% represented by 704 funds. When it comes to selecting a particular theme of investment, **asset managers tend to favour the environmental sectors.** Climate change/ renewable energies, environmental/ecological, carbon and water are the four largest thematic sub-categories in terms of assets under management totalling EUR 30.49 billion.
- **If you consider the domiciles across all funds, it is France and Luxembourg which dominate overall,** principally due to the large number of ESG (cross-sectoral) funds domiciled within these two jurisdictions. Both countries combined represent 45% of the total number of funds identified for this study and 56% of combined assets under management. Other countries such as Belgium, the United Kingdom and Switzerland distinguish themselves as key players within the industry albeit with lower figures in terms of assets under management.

Key trends

- The majority of responsible investment professionals will confirm that there is a steady stream of new responsible investing funds;
- In the case of carbon and sustainable forestry funds, the industry waits for upcoming regulations to be clarified;
- Impact investments are emerging as a new asset class;
- The European Commission has also formally "invited" European asset managers and asset owners to sign up to the UN Principles of Responsible Investment;
- European Commission focus as well as increased market and media focus on the responsible investing market will bring positive developments within the sector.

What key trends are emerging within the responsible investing market?

- **The majority of responsible investment professionals will confirm that there is a steady stream of new responsible investing funds** being created. Certain thematic sectors, still nascent in 2010, are progressively emerging.
- Carbon and sustainable forestry funds benefited from the implementation of the Kyoto protocol and the possibility to invest into carbon credits or projects aiming to reduce greenhouse gas emissions, although more recently **there is certain stagnation within the carbon funds category whilst the industry waits for upcoming regulations to be clarified.**
- **On the "social" side, impact investments are emerging as a new asset class,** which should be accelerated by the creation of new investment vehicle options such as the **"société d'impact"** currently discussed within the Luxembourg framework, as well as the proposed European Commission regulation on European Social Entrepreneurship Funds. Developments are supplemented by the emergence of new social investment products such as social impact bonds and charity bonds, providing increased product opportunities for investors.
- **The European Commission has also formally "invited" European asset managers and asset owners to sign up to the UN Principles of Responsible Investment**, in their October 2011 communication "A renewed EU strategy 2011-2014 for Corporate Social Responsibility". **Such support can only boost developments in the responsible investing market.** It is also worth noting that the UN PRI signatories list has recently exceeded 1,000 signatories despite the introduction of fees and more extensive disclosure requirements to be introduced with the new reporting framework.
- **European Commission focus as well as increased market and media focus** on the responsible investing market and on the topic of sustainable development more broadly **can only bring positive developments within the sector.** The role of asset managers and industry associations is to seize the emerging opportunities and contribute to this growth.

I INTRODUCTION

The European Responsible Investing Fund Survey covers the European responsible investment fund market as at 31 December 2010, including the size of the market, category of investments and the domicile of such funds.

This report focuses essentially on mutual funds domiciled in Europe, Cayman Islands and Bermuda. It does not address pension fund assets, segregated managed accounts or insurance company assets due to the relative difficulty of accurately measuring the size, nature and domicile of such assets.

Whilst this approach excludes a potentially significant part of responsible investing, we believe that the findings of this study give an accurate view of the European responsible investment funds market, which probably is representative of the more extended responsible investment market. This report is divided into three main sections.

The first part outlines the scope and definitions used for this study and aims to assist the reader to understand the methodology behind the results. In order to position this study within the context of the responsible investing universe, the statistics obtained are put into perspective as compared to other European studies on Responsible Investments.

The second part of the study highlights the key results of this report. Results are presented by categories as well as by domicile. Each category is broken down by sub-categories and analysed in terms of number of funds and assets under management.

The conclusion summarises the results obtained in this study.

II DEFINITIONS & METHODOLOGY

2.1 Definitions

2.1.1 What is Responsible Investing?

Answering this question in a clear and concise manner has been a challenge for every professional working in this field. The lack of standardisation, both at international and European level, and also the fact that RI can be implemented through several strategies possibly combined, does not facilitate the process.

Definitions vary greatly between the two sides of the Atlantic. Even within Europe itself, the concept is highly influenced by culture making a common definition of "responsible investing" hard to pin down.

The United Nations-backed Principles for Responsible Investment ("UNPRI"), launched in April 2006, were the first set of internationally recognised principles that provided a key to understand this concept.

Indeed, when signing the PRI, signatories have to commit to the following statement[1]:

"We have a duty to act in the best long-term interests of our beneficiaries. In this fiduciary role, we believe that environmental, social, and corporate governance (ESG) issues can affect the performance of investment portfolios (to varying degrees across companies, sectors, regions, asset classes and through time). We also recognise that applying these Principles may better align investors with broader objectives of society, therefore, where consistent with our fiduciary responsibilities".

They also have to commit to the 6 principles listed below:

1. We will incorporate ESG issues into investment analysis and decision-making processes;
2. We will be active owners and incorporate ESG issues into our ownership policies and practices;
3. We will seek appropriate disclosure on ESG issues by the entities in which we invest;
4. We will promote acceptance and implementation of the Principles within the investment industry;
5. We will work together to enhance our effectiveness in implementing the Principles;
6. We will each report on our activities and progress towards implementing the Principles.

Along with the PRI, a certain number of European organisations, such as EFAMA[2] and Eurosif[3] have voiced the importance of transparency in RI to the European Union.

At a national level, logos and labelling initiatives, such as the Eurosif Transparency logo, the Novethic Label[4] and the LuxFLAG Label[5], have flourished and help investors make informed investment decisions.

1 www.unpri.org

2 "EFAMA report on Responsible Investment, 8 April 2011", European Fund and Asset Management Association "EFAMA"

3 European Sustainable Investment Forum

4 www.novethic.com

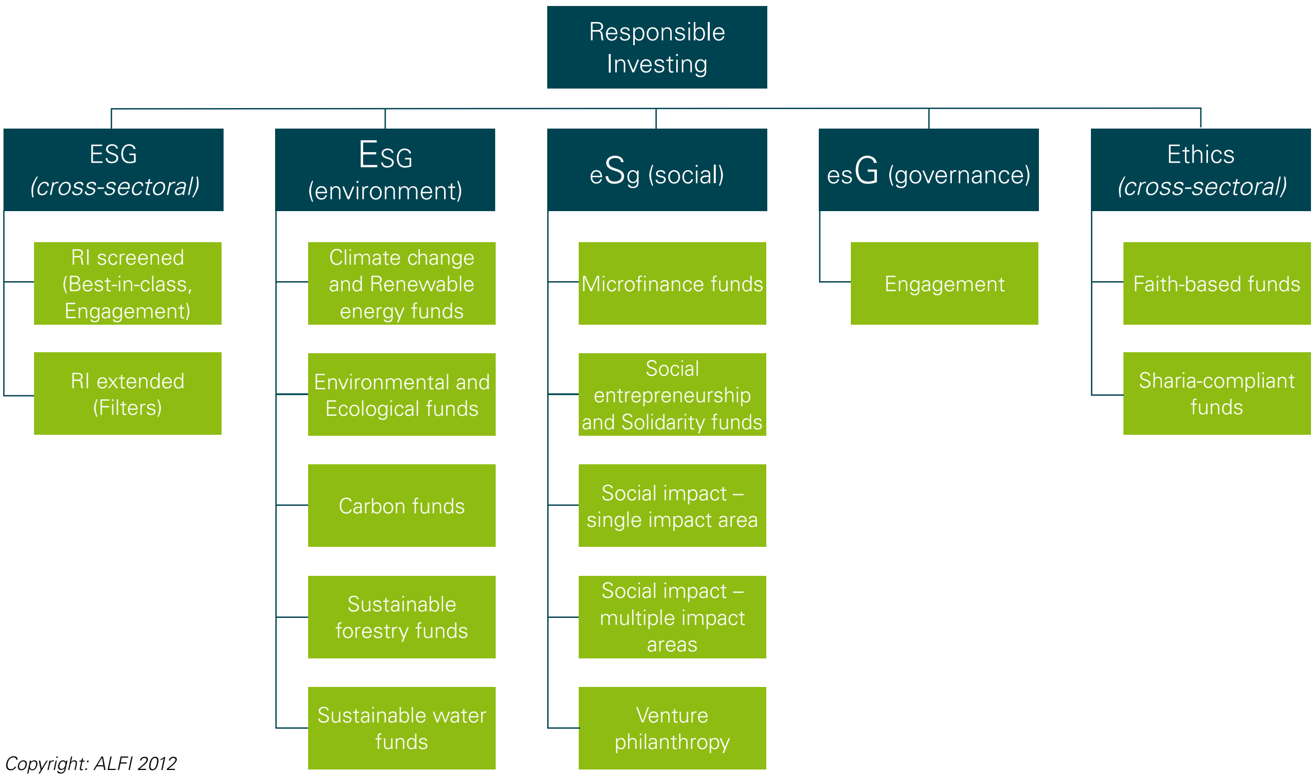
5 www.luxflag.lu

Although a great deal of effort has been made to clarify the situation, responsible investors must still read the small print of the fund manager's literature before investing, in order to understand the real nature of the "responsible investment fund" that they are targeting.

2.1.2 Definitions used in this market study

As a result of a consultation with members of the ALFI RI Technical Committee, the following categories and sub-categories were established for the responsible investing fund market. The Committee has deliberately split the fund categories between cross-sectoral fund and thematic funds, using the widely accepted concept of Environmental, Social and Governance "ESG" as sub-classification. The categories used, and outlined in the chart, are defined below.

ALFI Responsible Investments categorisation



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With the classification, the Committee strove to cover all sectors in the responsible investing space, pulling together data that has traditionally been treated separately (such as microfinance investment vehicles, impact funds, faith-based funds, etc.), and using publicly available information.

ESG (cross-sectoral): funds classified under this category are not linked to a particular theme of investment. They may therefore invest in multiple sectors (e.g. consumer goods, energy, banks, pharmaceuticals…) and apply filters to select investments. These filters may include any or all of the environmental, social and governance criteria. Some funds will favour negative screening while others will prefer to use positive screening techniques or they may be combined.

This category has been divided into two sub-categories, namely "RI screened" and "RI extended". The definitions used for these two sub-categories are the following:

ESG (cross-sectoral)	**RI screened funds[6]**	Funds which use a positive screen to select their investments. This includes either a best-in-class approach (investment in a portfolio of companies screened on their Environmental, Social and Governance (ESG) policies and performance) or an engagement approach (funds which 'engage' with companies in their portfolio to encourage them to improve their ESG performance);
	RI extended funds[7]	Funds which use a multiple-exclusion approach when selecting investments (e.g. avoiding tobacco or gambling- related securities) or a normative approach (adherence to internationally-recognised standards and principles).

6 Source: Lipper FundFile
7 Ibid

Esg (environment): funds which primarily invest in "environmental sectors" and which also apply a level of ESG screening to their investments.
This category has been divided into five sub-categories, namely Renewable energy/Climate change funds, Environmental/Ecological funds, Water funds, Carbon Investment Vehicles and Sustainable Forestry Funds.

The definitions used for the five sub-categories are the following:

Esg (environment)	**Renewable energy/ Climate change funds[8]**	Funds investing at least 80% of the assets in equities of companies engaged in new/renewable energy (biomass, wind/solar power, etc), recycling, sustainable construction, and sustainable transport. Funds that invest in similar sectors but are not equity funds (e.g. bonds, money market or guaranteed funds) have also been classified under this sub-category;
	Environmental/ Ecological funds[9]	Funds investing at least 80% of their assets in equities of companies in the area of environmental technology, renewable and alternative energy & resources; the sector includes a mix of environmental/green sectors. Funds that invest in similar sectors but are not equity funds (e.g. bonds, money market or guaranteed funds) have also been classified under this sub-category;
	Carbon Investment Vehicles (CIVs)[10]	CIVs include all types of investment vehicle that raise public and/or private capital to purchase carbon emission reductions: - Structures that directly purchase carbon credits on the primary market from projects reducing greenhouse gas emissions; - Structures that directly finance such projects, via project finance or equity interests; - Structures active on the voluntary market; - Structures implementing trading strategies on secondary carbon-emissions markets.
	Sustainable forestry funds[11]	Funds investing a majority of their assets directly or indirectly in projects related to sustainable forest management. In practice, most forestry funds use adherence to one of the two leading certification systems to demonstrate sustainability, the Forest Stewardship Council "FSC" and the Programme for the Endorsement of Forest Certification "PECF" schemes;
	Water funds[12]	Funds investing worldwide in shares of companies focused on the water related sector, such as water supply and treatment, water technology, environmental services and mineral water. Funds that invest in similar sectors but are not equity funds (e.g. bonds, money market or guaranteed funds) have also been classified under this sub-category.

8 Source: Lipper FundFile

9 Ibid

10 Source : ALFI Carbon Commitee

11 Source : Environmental Finance Publications

12 Source: Lipper FundFile

eSg (social): funds which primarily invest in "social sectors" and which also apply a level of ESG screening to their investments. This category has been broken down into five sub-categories namely Microfinance Investment funds, Social entrepreneurship/Solidarity funds, Social Impact funds – single impact area, Social impact funds – multiple impact areas and Venture Philanthropy funds.

Below are the definitions used for the eSg (social) sub-categories:

eSg (social)	**Microfinance Investment Vehicles (MIVs)[13]**	MIVs raise funds from public, institutional and private investors to support Microfinance Institutions worldwide. MIVs can take the form of Collective Investment Schemes (e.g. mutual funds) or other dedicated investment vehicles. MIVs loan money to MFIs or alternatively purchase their debt or equity instruments. Although this definition includes all types of vehicles, this study solely includes investment funds;
	Social entrepreneur-ship/ Solidarity funds[14]	Funds investing a share of their assets in solidarity projects, or funds devolving part of their commissions raised to charitable organisations. This category also includes funds that invest in companies under the French status "entreprises sociales et solidaires". Funds that invest in similar sectors but are not equity funds (e.g. bonds, money market or guaranteed funds) have also been classified under this sub-category;
	Social impact funds – single impact area[15]	Impact investments are investments made into companies, organisations, and funds with the intention to generate social impact alongside a financial return. This sub-category includes funds investing in one specific social impact area;
	Social impact funds - multiple impact areas[16]	Funds investing in a mix of diversified social impact areas such as education, sustainable health, food and nutrition, community development, fair-trade, sustainable agriculture, sustainable infrastructure;
	Venture Philanthropy funds[17]	Venture philanthropy works to build stronger social purpose organisations by providing them with both financial and non-financial support in order to increase their societal impact. The European Venture Philanthropy Association ("EVPA") purposely uses the word societal because the impact may be social, environmental, medical or cultural. The Venture Philanthropy approach includes both the use of social investment and grants.

13 Source: LuxFLAG/ALFI

14 Source: Lipper FundFile

15 Source: Global Impact Investing Network «GIIN»

16 Ibid

17 Source: www.evpa.eu.com

esG (governance): Funds which adopt a specific engagement strategy in order to influence the way the companies in which they invest do business. Engaging practices usually include dialogue and the use of voting rights to raise awareness and influence decisions on Environmental, Social or Governance issues. Funds using engagement strategies are already included in the RI screened funds (cf above) therefore, to avoid double counting, this category was not considered in the study.

Ethics (cross-sectoral): Funds classified in this category are not linked to a particular theme of investment. They may therefore invest in multiple sectors (e.g. consumer goods, energy, banks, pharmaceuticals, etc.) and apply faith-based filters to select their investments. In most cases, these funds will favour negative screening as is for example the case of Sharia-compliant funds (see definition below) but various other screening techniques may be applied.

This category has been broken down into two sub-categories namely Faith-based funds and Sharia-compliant funds. The definitions used for these sub-categories:

Ethics (cross-sectoral)	**Faith-based funds**	Funds investing according to faith-based principles, such as Christian or Catholic funds for instance.
	Sharia-compliant funds	Funds investing according to the Sharia principles and with a certain number of exclusions such as: - Prohibition of Haram investments; - Prohibition of Riba (usury); - Prohition of Gharar (deception, speculation); - Prohibition of Gambling; - Prohibition of Short Sales.

2.2 Scope

This study includes regulated mutual funds available to the general public and open-ended in nature. A mutual fund is a professionally-managed collective investment scheme that pools money from many investors (e.g. Undertakings for Collective Investment in Transferable Securities "UCITS" or Undertakings for Collective Investment "UCI" funds). The study also includes other types of fund vehicles e.g. Specialised Investment Funds (SIF), as far as such data is available.

In the case of umbrella funds, the study addresses data at sub-fund level. Assets under management for each share class are therefore aggregated at sub-fund level.

Funds of funds have been excluded from the list to avoid double-counting.

In terms of geographic universe, the study includes funds domiciled in Europe, Cayman Islands and Bermuda. A clear distinction has been made between where a fund is domiciled and where it may be registered for distribution. This survey addresses fund domiciles only.

The assets under management are presented in Euro billions as at 31 December 2010. Funds created after December 2010 are not included in this study.

2.3 Methodology

This market study was developed following three key phases detailed below:

Phase 1	Development of clear definitions of the different responsible Investing sectors and classifications based upon validated data sources
Phase 2	Collection of data and classification of assets under management statistics per sector and per country of domicile
Phase 3	Analysis of data sets and drawing of conclusions based on such analysis

The principal and basic data source used for the study is the Lipper FundFile database[18]. Lipper FundFile is a database specially designed for the European and Asian fund industry. It is a data mine that tracks over 45,000 funds sold throughout Europe and Asia each month and provides comprehensive information on the funds and companies that sell them. Lipper FundFile database uses various flags (such as: RI screened, RI extended, Sharia-compliant or Microfinance) that are applied to funds on the basis of the information provided in each prospectus.

This database was cross checked and supplemented with a number of other databases as further explained below. All data sources used are publicly available databases, either free or on the basis of specific fees payable. An extensive list of databases used and details of these databases is included in section VI of this report.

The majority of definitions used were those of Lipper FundFile, being the principal data source. For each classification and sub-category, Lipper FundFile definitions were reviewed for consistency with other data sources and modified where considered relevant. Where Lipper FundFile did not include a specific definition and classification, other sources were used.

This same process with regard to the content of the databases has been carried out whilst validating the definitions and classifications. Secondary sources have been used to assist more accurate categorisation, to supplement missing data e.g. assets under management statistics, and in certain cases, to provide full data for categories not provided by Lipper FundFile.

18 Source: www.lipperfmi.com

Following collection of data, cross checking and reclassification of data, a final data collection step was carried out to check certain information back to fund prospectuses and to also request certain assets under management data directly from asset managers as such data is not publicly available.

The following sections aim to further detail the methodology used to collect data for each of the categories identified by ALFI.

2.3.1 ESG (cross-sectoral)

The two sub-categories, RI screened and RI extended correspond to "flags" that are available in Lipper FundFile database. Additional cross checks were performed with various other sources:

- The Eurosif list of funds which obtained the Transparency logo;
- The Novethic list of funds which obtained the Novethic Label;
- The Finesti list of funds flagged "ethical";
- The SRI Fund advice database;
- The Sustainable Investment database.

2.3.2 ESG (environment)

This category has been divided into five sub-categories, namely Renewable energy/Climate change funds, Environmental/Ecological funds, Water funds, Carbon Investment Vehicles and Sustainable Forestry Funds. The first three sub-categories correspond to sector classification in Lipper FundFile while funds in the last two sub-categories have been sourced from Environmental Finance Publications. Additional cross checks have been performed with the Finesti list of ecology flagged funds.

The classification of funds belonging to the first three sub-categories, renewable energies/climate change, environmental/ecological and water is based on the Lipper FundFile sector classification.

Funds listed in these three categories are also flagged as RI screened or RI extended by Lipper FundFile which means that these funds also apply certain ESG screening thus ensuring that funds which invest in the above categories with the sole objective of a financial return are excluded.
In order to avoid double-counting (e.g. a fund may be allocated to the sector "renewable energies/climate change" and flagged RI extended in Lipper FundFile), KPMG has removed these funds from the sub-categories RI screened and RI extended and classified such funds on a thematic basis only.

With regard to the Carbon Funds database maintained by Environmental Finance, the directory list of carbon funds[19] includes those carbon funds, buyer's pools, government purchase programmes and other investment funds that invest in carbon credits. Most of the information was collected from publicly available sources and by journalists at Carbon Finance and Environmental Finance. Environmental Finance stresses that in some cases funds are closed to new investors or to new investments but have been included nonetheless.

19 "Carbon Funds 2011", Environmental Finance Publications

Nota Bene: carbon and sustainable forestry funds may not be structured as mutual funds with open-ended structures. In most cases, these investment vehicles take the form of closed-ended structures and it may be quite difficult to allocate a domicile to the fund. Indeed, some structures are initiated by multiple countries and/or European and /or international organisations. It may also be challenging to find the total net assets as of December 31, 2010 as figures provided are generally "target amounts" fixed by the fund or "secured capital".

With regard to the Sustainable Forestry Funds database maintained by Environmental Finance, the directory list of Sustainable forestry funds[20] includes vehicles that are open to institutional investors and that also manage their assets according to explicit sustainability criteria. Environmental Finance stresses that their list of "sustainable forestry funds" may not be comprehensive as some funds restrict the information they are prepared to disclose publicly.

In addition, funds for which a significant percentage of investments are in wood product companies such as pulp and paper producers rather than pure timber operations have also been excluded from the list of Environmental Finance.

2.3.3 ESG (social)

This category has been broken down into five sub-categories namely Microfinance Investment Funds, Social Entrepreneurship/Solidarity funds, Social impact funds – single impact area, Social impact funds – multiple impact areas and Venture Philanthropy funds. In order to allocate funds to these sub-categories, KPMG used multiple sources of information to perform cross-reference checks:

- The CSSF list of Microfinance Investment Vehicles;
- The Finesti list of funds flagged "Microfinance";
- The Lipper FundFile list of funds flagged "Microfinance";
- The funds classified under the "equities social/solidarity" category from Lipper FundFile;
- The LuxFLAG list of MIVs;
- The MicroRate Study on MIVs 2010;
- The Symbiotics MIVs survey 2011.

2.3.4 Ethics (cross-sectoral)

This category has been broken down into two sub-categories namely Faith-based funds and Sharia-compliant funds. In order to allocate funds to these sub-categories, KPMG used both the Lipper FundFile list of funds flagged "Islamic" and the Finesti list of funds flagged "Islamic" to perform cross-reference checks.

While the validity of including Islamic Finance as a responsible investing segment is debated, it was decided to cover all possible themes that could be considered as responsible investing and leave the reader to decide whether these funds meet their own definition of responsible investing.

20 "Sustainable Foresty Funds, 2011-12", Environmental Finance Publications

2.4 Limitations of the study

Whilst numerous cross checks of the reference database have been made to ensure the integrity and reliability of data, the completeness of the reference database may still be questioned due to the fundamental reliance of Lipper FundFile on the accuracy and completeness of data provided by asset managers and administrators. The Lipper FundFile database is updated on a monthly basis and can be considered as a reliable and consistent source of data whereas the other sources used to perform cross checks may not have been updated in a regular manner. In some cases funds may have been renamed, merged into other funds or even closed, leaving space for slight discrepancies in terms of number of funds and assets under management.

It should also be noted that, in terms of completeness, KPMG identified 1,236 funds and obtained assets under management data for 1,129 of them, representing a 91% coverage. The 107 funds, for which, KPMG could not obtain accurate data are still included in the list however display assets under management of 0. The total assets under management figure for the study, is therefore slightly understated by the total of assets of the 107 funds for which such information was not publicly available.

KPMG used a set of definitions (see section 2.1 above) to classify funds in their relevant categories and in some cases challenged the initial category of the fund. However, KPMG relied on the appreciation of Lipper FundFile and other relevant sources and did not perform a check against the prospectuses for each of the funds in the reference database.

A majority of the funds' assets are denominated in Euros, however, some funds are denominated in other currencies. Although the exchange rate used was at 31 December 2010, the impact of foreign exchange translations may slightly distort the final figures.

2.5 Comparisons with other European studies

The section hereafter puts this study in perspective compared to the results of other studies on Responsible Investing and identifies the possible alignments as well as the possible discrepancies in terms of scope and methodology.

2.5.1 Comparison with Eurosif figures

The European Sustainable Investment Forum ("Eurosif") produces a European SRI study every two years, the latest dating from 2010[21]. This study includes nineteen distinct European Markets.

In terms of main factual findings, Eurosif estimated the size of the RI market in Europe to be EUR 5 trillion, as of December 31, 2009 broken down as follows: EUR 1.2 trillion for Core SRI and EUR 3.8 trillion for Broad SRI. Investment funds represent 14% of the Core SRI category accounting for approximately EUR 168 billion.

Core SRI is composed of the following strategies (with possible combinations):	Broad SRI is composed of the following strategies:
• Norms and values/ethical based exclusions (three or more criteria) • Positive screening, including Best-in-Class and SRI thematic funds	• Simple screening (one or two exclusion criteria, norms-based or values(ethical based)) • Engagement • Integration

While the figures published by Eurosif and the results obtained from this study (see section: key results below) are relatively close and are an encouraging sign for comparison purposes, Eurosif figures still appear to be significantly higher than those presented in this study. It is therefore worthwhile highlighting differences in scope and methodologies that justify the variances:

- **Scope –** wider asset universe - the Eurosif report includes pension funds, discretionary mandates and investment funds in its study. According to Eurosif, discretionary mandates, including pension funds, represent 84% of the Core SRI category and investment funds account for 14% (approximately EUR 168 billion of assets under management);

21 "European SRI Study 2010", Eurosif, 2011

- **Methodology –** different base reference data - while the Eurosif study relied on the self-reporting of asset managers and self-managed asset owners, the present study is based on figures obtained via published investment fund database sources;
- **Analyses –** Comparisons at country level may also differ as Eurosif analyses figures at national market level i.e. the country where the SRI assets are being managed, as opposed to this study which uses the country of domicile for the analysis (country where the fund has actually been registered);

Although great efforts have been made to reconcile the results obtained in this study with figures obtained by other RI information providers, the lack of standardisation in terms of methodology and definition clearly restricts the analysis.

2.5.2 Comparison with Novethic figures

Novethic, the French research centre on Corporate Social Responsibility and Socially Responsible Investment, in its study of the French SRI Market, dated 2011, estimated the SRI assets held by French customers at EUR 68.3 billion at the end of 2010.

Out of this amount, pooled funds/mutual funds represent EUR 40.1 billion (58.7%) of the total and segregated mandates/separate account management accounted for EUR 28.2 billion (42.3%). When excluding employee savings, the amount of pooled/mutual funds amount to EUR 32.4 billion broken down between 66% of institutional investors and 34% of retail investors.

This study has identified a total of 208 RI funds domiciled in France with assets under management totalling EUR 43.26 billion as of end of December 2010.

The figures published by Novethic and the results from this study disclosed above are relatively close which is an encouraging sign for comparison purposes.

However here again, there are still differences in scope which probably contribute to the difference - the Novethic study considers funds that are sold on the French market, whereas the analyses in this study focus on countries of domiciliation of funds. Moreover, Sharia-compliant and Microfinance Investment Funds are not included in Novethic's study.

III KEY RESULTS

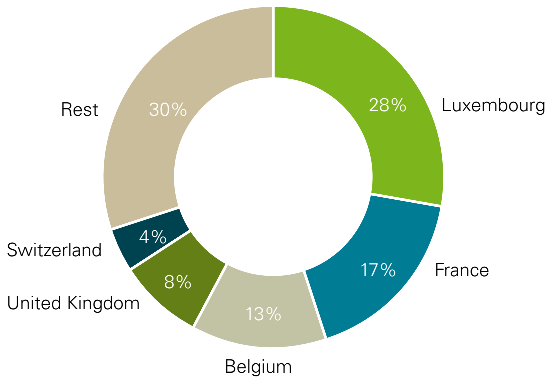
3.1 General industry overview

EFAMA has estimated the number of investment funds to 52,636 totaling assets under management of EUR 8,025 billion at the end of 2010. KPMG has identified 1,236 RI investment funds with assets under management totalling EUR 129.49 billion.

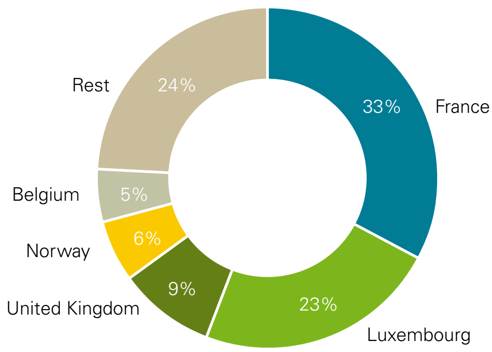
Based upon the results of this study, the total RI assets in Europe represent almost 1.6% of the European investment fund market in terms of assets and 2.3% in terms of number.

By domicile

RI in % of nb of funds
Total = 1,236 funds



RI in % of AuMs
Total = EUR 129.5 billion



KPMG has identified 1,236 RI investment funds with assets under management totalling EUR 129.49 billion

In terms of favoured domiciles for RI funds, Luxembourg and France stand out as clear frontrunners. Both countries combined represent 45% of the total number of funds identified for this study and 56% of combined AuM. Other countries such as Belgium, United Kingdom and Switzerland distinguish themselves as key players within the industry albeit with lower figures in terms of AuM.

Unsurprisingly the ESG (cross-sectoral), combining *RI screened* and *RI extended* funds, are by far the largest sub-categories of funds with a combined total of 704 funds, more than half of the total number of RI funds identified in this study. In terms of AuM this figure is even higher - *RI screened* and *RI extended* combined, account for almost 70% of the total AuM of RI funds with EUR 89.73 billion as of 31 December 2010.

The fact that these funds are more retail oriented and probably widely distributed products is one of the key reasons for this high number. The success of the United Nations Principles for Responsible Investment "UNPRI" has also probably significantly influenced these results and the new framework for the disclosure of responsible investment activities recently published by the UNPRI will certainly continue to encourage RI practices.

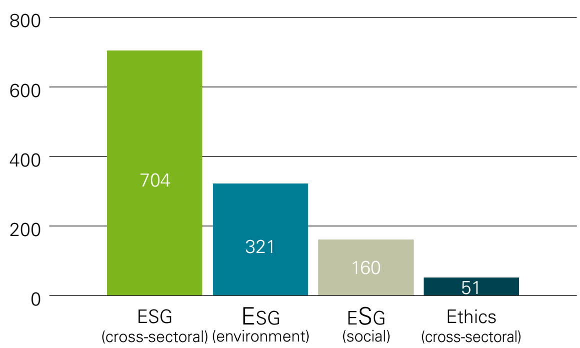
When it comes to selecting a particular theme of investment, asset managers tend to favour the environmental sectors. *Climate change/ renewable energies, environmental/ecological, carbon and water* are the four largest thematic sub-categories in terms of AuM totaling EUR 30.49 billion.

When it comes to selecting a particular theme of investment, asset managers tend to favour the environmental sectors

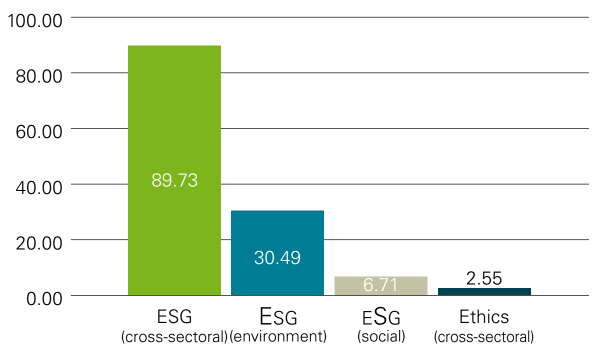
Here again this is not a surprise as the environmental sector, and in particular the renewable energy market, has progressed at a fast pace over the last decade in Europe. An increasing number of asset managers now consider that companies developing alternative energy and working to mitigate the impacts of climate change will offer sustainable growth, while the environmental laggards will be facing increasing pollution taxes and penalties on top of reputation risks.

By categories

RI in nb of funds
Total = 1,236 funds



RI in AuMs
Total = EUR 129.5 billion



As per the eSg (social) category, *microfinance* is at the top of the ranking with 69 funds identified and AuM of EUR 3.55 billion. Although the financial crises have had some effect on these funds, *microfinance* remains a sector of interest for institutional investors. This figure, yet only covering microfinance funds domiciled in Europe, seems to be in line with the findings of two leading MIVs information providers, Symbiotics and MicroRate. Indeed, Symbiotics, in its "2011 MIV survey report", identified 102 MIVs and gathered information on 70 of them. These 70 MIVs totalled AuM of EUR 4.4 billion as of 31 December 2010. Whilst MicroRate, in their study "The State of Microfinance Investment 2011", obtained information on 80 MIVs which amounted to a total of AuM of EUR 4.79 billion.

Social Impact funds, being focused on one particular or various impact areas, are emerging from the bottom of the list. The concept of social impact is still blurred and overlaps other themes. The frontier between microfinance funds and Social Impact funds is grey and open to debate. Lack of reliable and accurate data still constitutes a barrier to evaluate the real size and potential of this new market. However, the creation of the Global Impact Investing Network "GIIN" in 2009 and the development of initiatives around Europe, for example the emerging case for the "société d'impact" in Luxembourg, is a sign that these sub-categories are likely to trigger more investment in the future.

Taking a closer look at *faith-based funds*, the 42 funds identified as Sharia-compliant account for approximately EUR 0.94 billion. Although a relatively small number, islamic finance is receiving considerable attention in the financial press in Europe and is also likely to develop in the coming years.

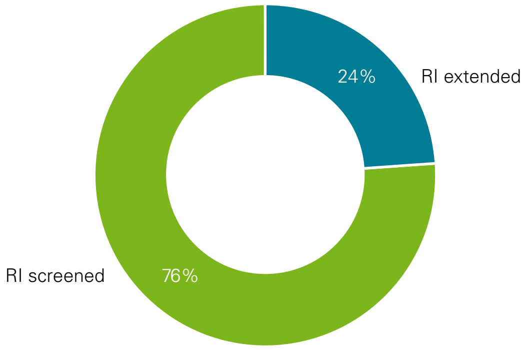
3.2 Responsible Investing breakdown by sub-category and domicile

3.2.1 ESG (cross-sectoral)

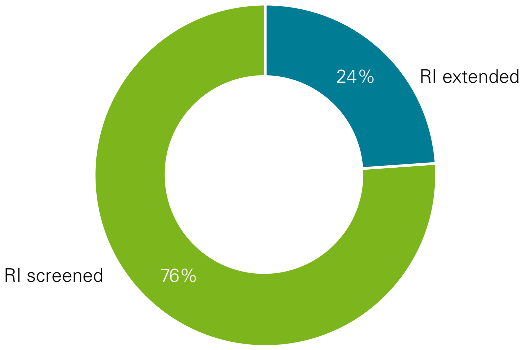
The ESG (cross-sectoral) category is by far the largest of all categories both in number with 704 funds identified and in total AuMs with EUR 89.7 billion. This category represents almost 70% of the total assets of the RI funds.

By categories

ESG (cross-sectoral) in % of nb of funds
Total = 704 funds



ESG (cross-sectoral) in % of AuMs
Total = EUR 89.7 billion



The ESG (cross-sectoral) category is by far the largest of all categories both in number with 704 funds identified and in total AuMs with EUR 89.7 billion. This category represents almost 70% of the total assets of the RI funds

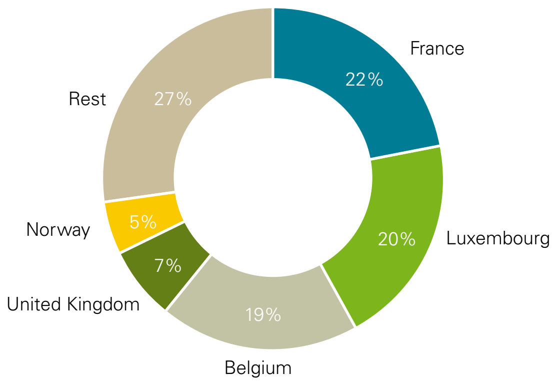
In terms of *RI screened*, France is well ahead of the field with 131 funds totaling AuM of approximately EUR 35.25 billion. As with the RI extended category, this figure is clearly boosted by one particular money-market fund which accounts for approximately 30% of the total AuM of France. Here again, another possible explanation could be the French appetite for "Best-in-Class" strategies[22].

22 as stated in Eurosif's study 2010, p14 22

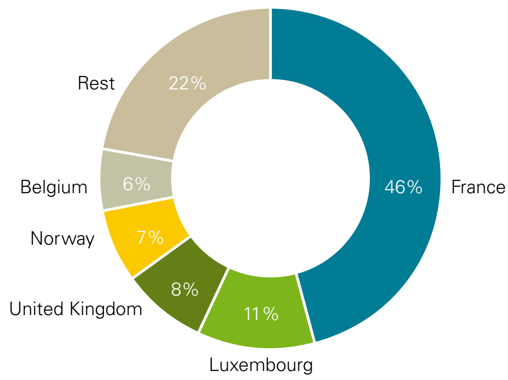
In terms of *RI extended*, Norway tops the list in terms of AuM with 32 funds totaling EUR 6.46 billion. This figure is mainly boosted by one money market fund which represents almost one sixth of the total AuM of this sub-category. Another explanation for the leading position of Norway may be that norm-based or value-based approaches are very popular forms of RI in Norway[23].

By domicile

ESG (cross-sectoral) in % of nb of funds
Total = 704 funds



ESG (cross-sectoral) in % of AuMs
Total = EUR 89.7 billion



It is worth noting that whilst the Netherlands is identified as one of the largest RI markets in Eurosif's study 2010[24], this is not reflected in the results of this report. This is due to the fact that the Dutch RI market is essentially driven by pension funds and insurance companies and this study focuses on investment fund vehicles only.

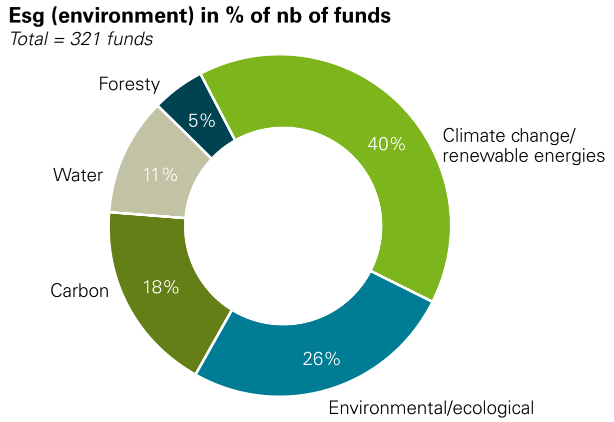
23 Source: Eurosif SRI Study 2010, p13
24 Source: as stated in Eurosif's study 2010, p 41

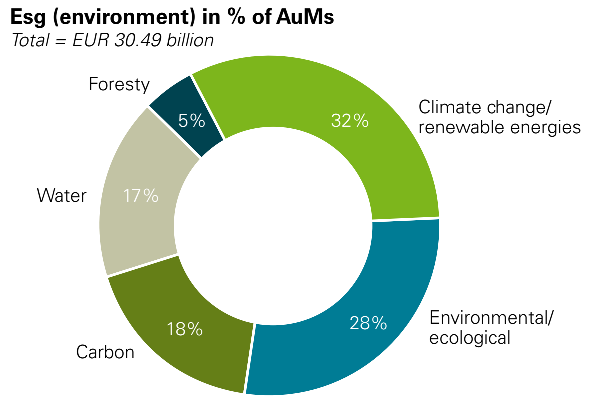
3.2.2 Esg (environment)

The Esg (environment) is the second largest of all categories both in number and AuMs with 321 funds in total and AuMs of EUR 30.49 billion. This category represents in fact 23.5% of the total assets of the RI funds.

When looking at the Esg (environment) category in more details, the *Climate Change and Renewable Energy* sub-category attracts almost 40% of the funds of the category with 128 funds and accounts for 32% of the total AuM (with EUR 9.7 billion).

By categories





The Esg (environment) is the second largest of all categories both in number and AuMs with 321 funds in total and AuMs of EUR 30.49 billion. This category represents 23.5% of the total assets of the RI funds

The *Environmental/Ecological* sub-category, which includes funds investing in a variety of environmental sectors, also demonstrates dynamism with 84 funds identified and totals AuMs of EUR 8.6 billion, which represents 28% of the total Esg (environment) category.

While niche sectors such as *Carbon, Forestry and Water* represent a smaller share in terms of number of funds, they still represent 40% of AuMs.

As this is the first edition of this study, analyses of evolution over time is not possible. However, CDC Climat[25] states in its Carbon Fund Report in 2010 that the number of carbon funds has increased rapidly since 2005. In 2009, the sector numbered 96 funds worldwide and declared a total capitalisation of EUR 10.8 billion in 2009. However, since 2009, the carbon market has faced a number of challenges and the demand picture after 2012 remains unclear.

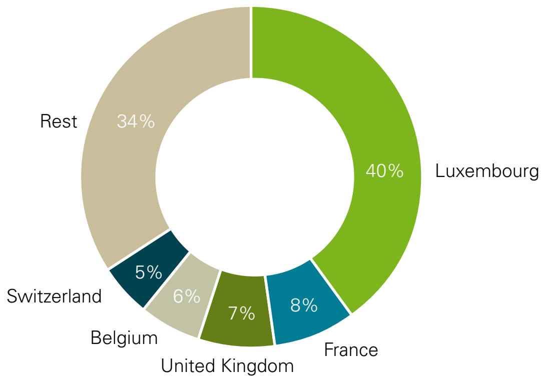
25 CDC Climat is Caisse des Dépôts' subsidiary launched in 2010 to tackle climate change as a long term investor. (source: www.cdcclimat.com)

Regarding *Sustainable Forestry Funds,* this area is expected to develop in the coming years - according to Environmental Finance, whether investors are looking at traditional sustainable timberland or at emerging opportunities arising from the Reducing Emissions from Deforestation and Forest Degradation ("REDD") projects (being developed as a new way of generating carbon credits), there is an emerging opportunity for investors. Environmental Finance has however warned "that it remains a niche investment with significant regulatory risks"[26].

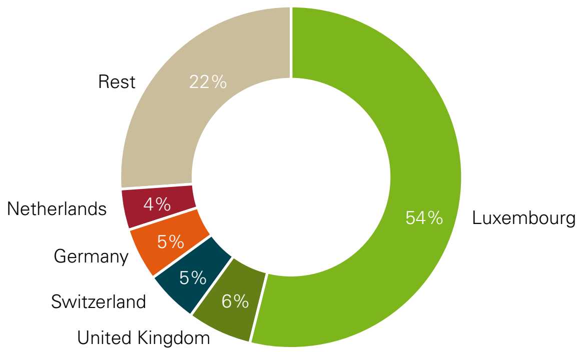
With regard to *Sustainable Water Funds*, the market is mainly driven by two major funds, representing 73% of the total AuM of this sub-category. These two funds invest in products and services that address global challenges related to the scarcity, quality, and allocation of water.

By domicile

Esg (environment) in % of nb of funds
Total = 321 funds



Esg (environment) in % of AuMs
Total = EUR 30.49 billion



In terms of number of fund vehicles, Luxembourg is the favoured domicile for every sub-category. This is largely due to the fact that major Swiss sustainable asset managers, have chosen to register their funds in Luxembourg.

The analysis of AuM shows the same story, except for Carbon funds where the United Kingdom reaches the first place with EUR 0.72 billion and for sustainable forestry funds where Guernsey is the favoured domicile with EUR 0.62 billion. Interestingly, Carbon and Forestry funds are often registered in off-shore locations such as Jersey, Guernsey, Isle of Man, Cayman Islands or Virgin Islands.

26 Source: "Sustainable Forestry Funds, 2011-12" Environmental Finance Publications

3.2.3 eSg (social)

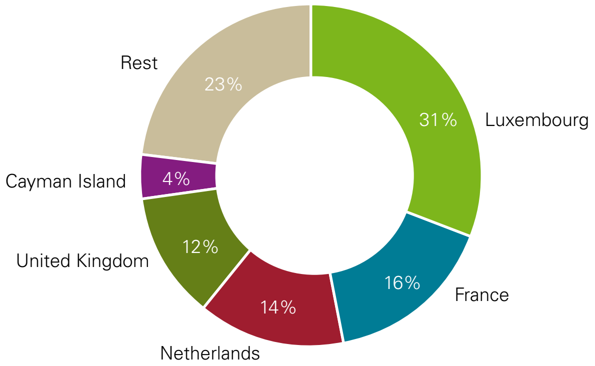
The eSg (social) category represents 5.2% of the total Responsible Investing assets and reaches the third place in terms of AuMs by categories with 160 funds identified and AuMs of EUR 6.71 billion.

Microfinance funds constitute the largest sub-category of the eSg (social) category, with 69 funds gathering EUR 3.5 billion of AuMs.

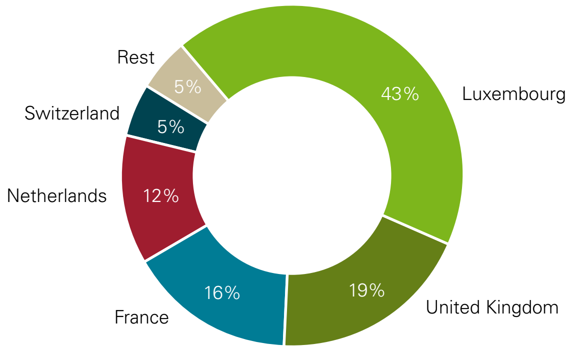
Luxembourg is the domicile of choice for Microfinance funds in Europe with 32 funds gathering 66% of the total AuM of the Microfinance sub-category.

By domicile

eSg (social) in % of nb of funds
Total = 160 funds



eSg (social) in % of AuMs
Total = EUR 6.71 billion



The eSg (social) category represents 5.2% of the total RI assets and reaches the third place in terms of AuMs by categories with 160 funds identified and AuMs of EUR 6.71 billion.

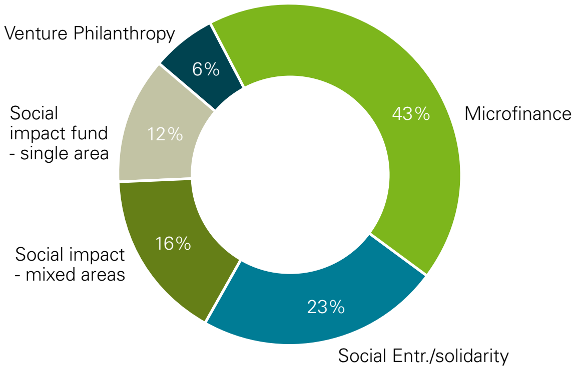
Similarly to our observation for the Esg (environment) category, the major Swiss Microfinance Asset managers have selected Luxembourg to register their funds.

The Social Entrepreneurship/Solidarity funds sub-category reveals France as a leader in terms of number of funds. This is probably partly explained by the fact that France has defined a clear status for "social and solidarity companies" facilitating investments in this particular sector. The United Kingdom appears at the top of the list with 54% of total AuM of this sub-category, mainly with funds donating part of commissions raised to charitable organisations.

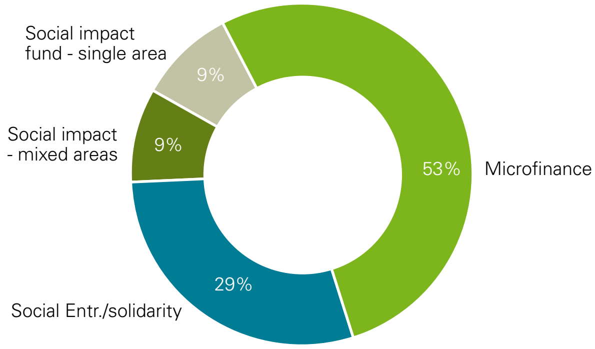
With regard to the other sub-categories within the eSg (social), assets under management are not significant. However it is important to note that obtaining data within these categories is relatively difficult, principally due to the fact that certain funds restrict the availability of such information and also that the concept of *Social Impact funds* is still at a nascent stage so there is little reliable data available. Going forward, with the increased interest of investors in this sector, we expect to see both increased publicity of data for existing funds as well as absolute growth in this sector.

By categories

eSg (social) in % of nb of funds
Total = 160 funds



eSg (social) in % of AuMs
Total = EUR 6.71 billion



It is however worth mentioning that the two *Social Impact* sub-categories captured approximately EUR 1.19 billion in AuM with 44 funds identified as of 31 December 2010. Recent market activity in this area would indicate that the market is slowly increasing within this category.

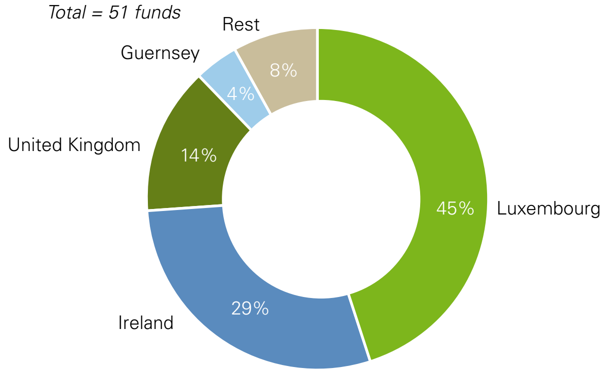
3.2.4 Ethics (cross-sectoral)

Ethics (cross-sectoral) category is the smallest of all categories both in number of funds and AuMs with 51 funds in total and AuMs of EUR 2.5 billion. This category represents in fact 1.9% of the total assets of the RI funds.

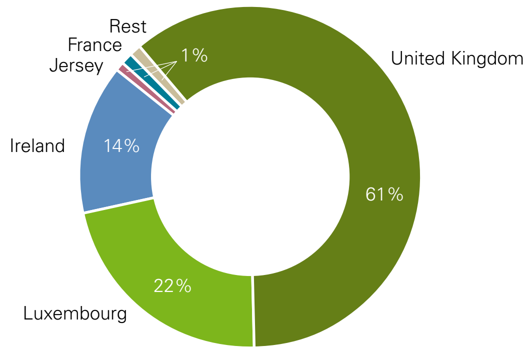
The majority of these funds are *Sharia-compliant funds*, 42 funds against 9 for the *Faith-based funds*. In terms of domicile, more than half of the Sharia-compliant funds are domiciled in Luxembourg and one third in Ireland.

By domicile

Ethics (cross-sectoral) in % of nb of funds
Total = 51 funds



Ethics (cross-sectoral) in % of AuMs
Total = EUR 2.5 billion



The Ethics (cross-sectoral) category is the smallest of all categories both in number and AuMs with 51 funds in total and AuMs of EUR 2.5 billion. This category represents in fact 1.9% of the total assets of the RI funds.

However in terms of assets tendencies are reversed as the 9 Faith-based funds gather AuMs of EUR 1.6 billion (63% of the total AuMs of the category). This is largely due to one fund which accounts for almost 62% of the faith-based funds.

Due to this particular fund, the United Kingdom accounts for 61% of the assets of the Ethics (cross-sectoral) category.

By categories

Ethics (cross-sectoral) in % of nb of funds
Total = 51 funds

Ethics (cross-sectoral) in % of AuMs
Total = EUR 2.5 billion

IV CONCLUSION

This study, based on reliable data sources, gives a fair picture of the way European responsible investment fund assets are being invested as of December 2010. The following observations can be drawn from the study:

- The responsible investment fund market is relatively small in comparison to the European investment fund market as a whole;
- The European responsible investing market is essentially driven by segregated investment mandates, pension funds and insurance companies;
- Whilst the sector remained dominated by cross-sectoral funds in 2010, new thematic sectors are emerging as new responsible investing asset classes, such as carbon funds, forestry funds and social impact investing;
- France and Luxembourg are the major domiciles for RI investment funds;
- It remains difficult to obtain comprehensive and comparable data on the responsible investing market as a whole, partly due to the lack of standardised definitions used by the sector and the complexity to clearly allocate funds to one unique category where frontiers between categories are sometimes blurred.

This study constitutes a starting point to expand in the future, providing a snap shot of the European responsible investment fund market which can be extended and enhanced going forward. This will allow responsible investing professionals to continue to follow the evolution and trends in the market.

V LIST OF TERMS AND ACRONYMS

ALFI: Association of the Luxembourg Fund Industry

AuM: Assets under Management

CIV: Carbon Investment Vehicles

EFAMA: European Fund and Asset Management Association

EIV: Environment related Investment Vehicles

EUROSIF: European Sustainable Investment Forum

EVPA: European Venture Philanthropy Association

MFI: Microfinance Financial Institution

MIV: Microfinance Investment Vehicles

RI: Responsible Investing

SRI: Socially Responsible Investments

UNPRI: United Nations Principles for Responsible Investments

VI INFORMATION SOURCES

One challenge of this piece of research is to deal with numerous publications and data sources available on the market. It was therefore decided that KPMG would use a reference database that would be challenged by other independent sources during a desk review.

The reference database used for this market study is Lipper FundFile, a Lipper FMI database. Lipper FundFile has been challenged with the following sources in order to ensure completeness of data:

- **Environmental Finance Publications:** Environmental Finance Publications is a UK based global magazine analysing the impact of environmental issues on the investment, borrowing, insurance and trading decisions affecting industry; (source: www.environmental-finance.com)
- **Ethibel label:** Ethibel is an independent consultancy agency for SRI funds that advises banks and brokers offering ethical savings accounts and investment funds. Ethibel has developed its own European quality labels (the Pioneer and Excellence Labels). These labels offer the investor a guarantee that these investment funds only invest in companies selected on the basis of Ethibel's evaluation model; (source: www.forumethibel.org)
- **Etika:** Etika is an non for profit association founded in 1995 which aims to promote alternative financing means and to raise awareness on the concept of ethics in finance, thus promoting access to credit initiatives that favour: Social and cultural use of money; International solidarity; Ecology support; in Luxembourg and in developing countries; (source: www.etika.lu)
- **European Sustainable Investment Forum (Eurosif):** Eurosif is a pan-European group whose mission is to address sustainability through financial markets. Eurosif acts as a partnership of the national Sustainable Investment Forums (SIFs) within the EU and with the support and involvement of Member Affiliates. The European SRI Transparency logo aims to create more clarity on the principles and processes of SRI mutual funds; (source: www.eurosif.org)
- **Finesti:** Finesti is a Luxembourg-based company and a subsidiary of the Luxembourg Stock Exchange. Finesti focuses solely on offering products and services related to investment fund information. Finesti has developed flags in its database enabling searches by categories. For this study, KPMG has used the following flags to cross-check the reference database: Ethical, Ecology, Healthcare, Islamic, Microfinance, Energy; (source: www.finesti.com)

- **Luxembourg Fund Labelling Agency (LuxFLAG):** LuxFLAG is an independent, nonprofit making, association that aims to promote the raising of capital for Microfinance and Environment related sectors by awarding a recognisable label to eligible Microfinance Investment Vehicles (MIVs) and Environment related Investment Vehicles (EIVs); (source: www.luxflag.lu)
- **MicroRate:** MicroRate is a microfinance rating agency dedicated to evaluating performance and risk in microfinance institutions "MFIs" and MIVs. Every year, MicroRate surveys MIVs to highlight the trends and outlook for the industry. For this study KPMG has used the information presented in the study "The State of Microfinance Investment 2010" and has also used LUMINIS, MicroRate's web-based analytic service on microfinance funds, to access further information on MIVs; (source: www.microrate.com)
- **Novethic:** Novethic, part of Caisse des Dépôts et Consignations, is a French research centre on Corporate Social Responsibility "CSR" and Socially Responsible Investment (SRI) and a sustainable development media expert. The Novethic Label, launched in 2009, aims to provide individual investors with a framework for SRI products offered by investment managers; (source: www.novethic.com)
- **Syminvest:** Syminvest "funds gateway" is a Symbiotics tool that includes a global list of Microfinance Funds, an up-to-date catalogue of all the specialised funds active in microfinance, and a Luxembourg list, which provides a focus on the funds incorporated in Luxembourg, with a monthly assessment of the asset size and microfinance portfolio. (source: www.syminvest.com)

NOTES

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