Sustainable Funds U.S. Landscape Report

Flows stayed positive but sank to the lowest level in seven years.

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Contents

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Corrections and Clarifications
Corrections issued Feb. 21, 2023.

Key Takeaways

- The number of sustainable open-end and exchange-traded funds available to U.S. investors rose to nearly 600 in 2022, up 12% from 2021.
- Flows into U.S. sustainable funds sank to $3.1 billion in 2022, their lowest level in seven years, against a challenging macroeconomic backdrop. In 2022, the broader universe of U.S. funds suffered more than $370 billion in withdrawals, cementing their first calendar year of outflows since Morningstar began tracking data in 1993.
- Passive funds dominated sustainable fund flows again, while actively managed sustainable funds saw outflows.
- For the first time on record, fixed-income funds commanded the lion's share of sustainable fund flows.
- Total assets in sustainable funds landed at $286 billion, a 20% decline from the all-time high of $358 billion at the end of 2021.
- In 2022, the 87 new sustainable funds that launched topped the number from 2020 but lagged the record 121 set in 2021.
- Most sustainable funds underperformed in 2022, landing in the bottom half of their respective Morningstar Categories. For sustainable large-blend funds, the biggest drag on performance was a relative underweighting to the energy sector.
- However, one year of underperformance didn't erase long-term outperformance. Over the trailing three- and five-year periods, a sustainability-agnostic investor would have been better off with the typical sustainable fund over most conventional peers (based on the average annualized excess return and likelihood of success).
- Sustainable funds continue to deliver lower levels of ESG risk, compared with peers. At the end of 2022, nearly 70% of sustainable funds received the highest Morningstar Sustainability Ratings, 4 or 5 globes, compared with 27% of funds overall.
- The 10 largest sustainable voting funds supported more than 60% of the key ESG resolutions on which they voted in 2022. This ranged from 100% support (**Parnassus Core Equity** PRBLX and **Calvert Equity** CSIEX) to 20% (**Vanguard FTSE Social Index** VFTNX).

Introduction

Investors continued to pour new money into U.S.-domiciled sustainable funds in 2022—a notable departure from conventional peers—but this expansion came with growing pains. The U.S. sustainable funds universe includes a diverse range of investment approaches that may be suitable for different investors depending on their motivations or risk tolerances. The landscape continues to grow and evolve as it matures. In this respect, 2022 was much like the years that came before; in others, it was unprecedented.

Sustainable funds netted more than $3 billion in sales for the year, while their conventional peers endured their first calendar year of net outflows since Morningstar began tracking data in 1993. Still, demand for sustainable funds has fallen steadily since the all-time record $21.5 billion intake in 2021's first quarter, and these funds shed nearly $6.2 billion in the final stretch of 2022.

Macroeconomic headwinds abounded during the year. The war in Ukraine, a global energy shortage, inflationary pressures, rising interest rates, and recession fears weighed on investor sentiment. Although sustainable funds employ a range of approaches, many tend to limit exposure to traditional energy stocks based on concerns for that sector's long-term growth prospects. From a return's perspective, energy was the only place to be in 2022. Rising oil and natural gas prices contributed to the Morningstar US Energy Index's more than 60% gain during the year, which outperformed all other stock sectors by incredible margins.

Aside from global market pressures, political commentary around sustainable investing proliferated throughout the United States in 2022. On one hand, prominent politicians in Texas and other states have taken steps to ban asset managers and funds that are viewed as "boycotting" fossil fuel companies. The spotlight also turned to asset managers' public commitments to net-zero goals through the Net Zero Asset Managers initiative, where attorneys general expressed concern about Vanguard's ability to remain an impartial owner in public utility companies, and the NYC comptroller asked BlackRock to take a stronger stance on the climate crisis. The extent to which these events affected investor sentiment is nearly impossible to quantify. However, political opinions on this investing style have claimed their voice in the conversation, and if early 2023 is any indicator, there will be more debate to come.

Through the growing pains, investors gained greater clarity into sustainable investing. Not only has political interest ramped up, but regulators have turned their attention to this space, too. Recently proposed rules aim to standardize environmental, social, and governance fund disclosures and bring sustainable funds under the purview of the Investment Company Names Rule, among others.[1, 2] Additionally, enforcement actions emphasized the need for fund managers to triple-check claims related to ESG considerations in their investment processes.[3, 4]

As the spotlight on sustainable investing has grown brighter, advocates have become more deliberate about their choice of terminology. Throughout this report, we intentionally differentiate between ESG and sustainable investing, and we use terms like "impact" cautiously. We think ESG is better suited to describe the risks and related metrics that have become so widely used. Sustainable investing, on the other hand, is an umbrella term referring to a variety of investment approaches. These approaches range from applying exclusions to managing ESG risks and seeking impact.

Funds that apply exclusions are often labeled as "ethical" or "socially responsible" and trace their origins back more than 50 years in the United States. Funds marketed as "ESG" typically limit their exposure to material ESG risks and tilt toward companies with stronger ESG profiles than peers. Impact funds aim to drive positive, measurable change—usually working within a framework like the United Nations Sustainable Development Goals. Impact investment theses include increasing literacy rates in underprivileged communities, improving access to affordable housing, and strengthening infrastructure for low-carbon public transportation. In some ways, impact is easiest to quantify when investing in private equity and debt, but it is making its way into the sustainable funds universe, too.

1 Final Rule on Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights, U.S. Department of Labor, Nov. 22, 2022. https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/fact-sheets/final-rule-on-prudence-and-loyalty-in-selecting-plan-investments-and-exercising-shareholder-rights

2 SEC Proposes Rules to Enhance and Standardize Climate-Related Disclosures for Investors, March, 21, 2022. https://www.sec.gov/news/press-release/2022-46

3 SEC Charges BNY Mellon Investment Adviser for Misstatements and Omissions Concerning ESG Considerations, May 23, 2022. https://www.sec.gov/news/press-release/2022-86

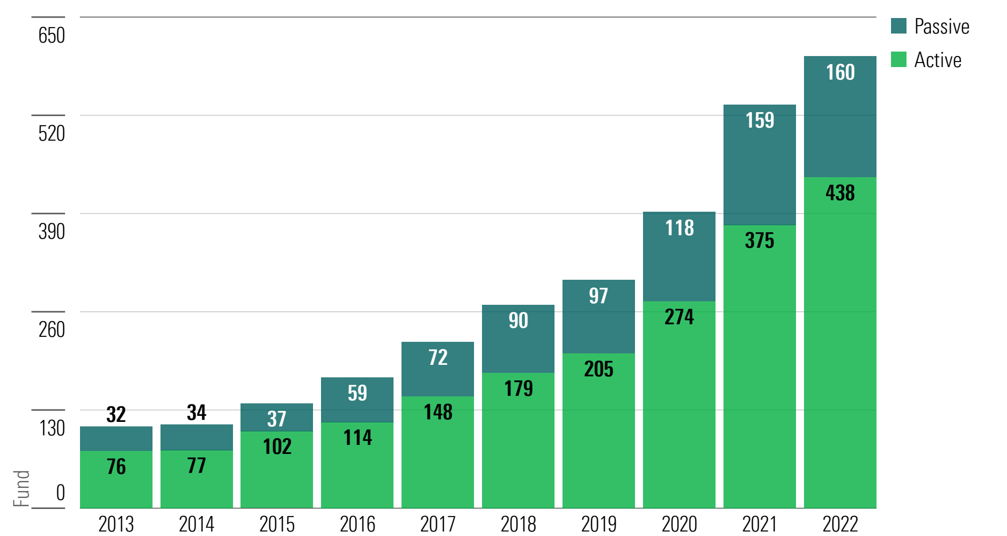
4 SEC Charges Goldman Sachs Asset Management for Failing to Follow its Policies and Procedures Involving ESG Investments, Nov. 22, 2022. https://www.sec.gov/news/press-release/2022-209

The Sustainable Funds Universe: Flows & Assets

At the end of 2022, the group of sustainable open-end funds and ETFs available to U.S. investors numbered 598, up 12% from 2021 and nearly double the number of investments available at the end of 2019.[5] The group has experienced a greater than fivefold increase over the past 10 years.

For a fund to be included in Morningstar's sustainable funds universe, it must hold itself out to be a sustainable investment, and the fund's intent should be apparent from a simple reading of its prospectus. The prospectus' Principal Investment Strategies section should contain enough detail to leave no doubt that ESG concerns figure prominently in the investment process. While many funds now consider ESG criteria as one factor in the security-selection process, those included in the sustainable funds universe make their commitment clear and prominent, usually through binding guidelines.[6]

Exhibit 1 The Sustainable Funds Universe



Source: Morningstar Direct, Manager Research. Data as of Dec. 31, 2022. Includes funds that have liquidated during this period. Excludes money market funds and feeder funds.

5 Last year's report included 534 funds. Twenty-three were removed as a result of updates made to Morningstar Sustainable Attributes framework or changing their strategies to become nonsustainable. Twenty have since been liquidated, and 107 funds have been added that launched or repurposed in 2022 or too late in 2021 to be included in last year's report.

6 For the occasional borderline cases, we further consulted fund reports, websites, and pitchbooks or spoke directly with portfolio managers to confirm the role that sustainability criteria play in a fund's process.

Not so long ago, identifying such a group was a much easier task—not all that many such funds existed, new launches were few, and one could be fairly certain that traditional funds did not include ESG considerations in their investment process. But as demand for ESG funds has grown, so too has the broad universe of funds saying they consider ESG risks, most of which do not qualify for Morningstar's sustainable funds universe. We expect that, driven by market demand and forthcoming regulatory guidance, virtually all funds will soon disclose the role of ESG data in their investment processes, regardless of how central it may be.

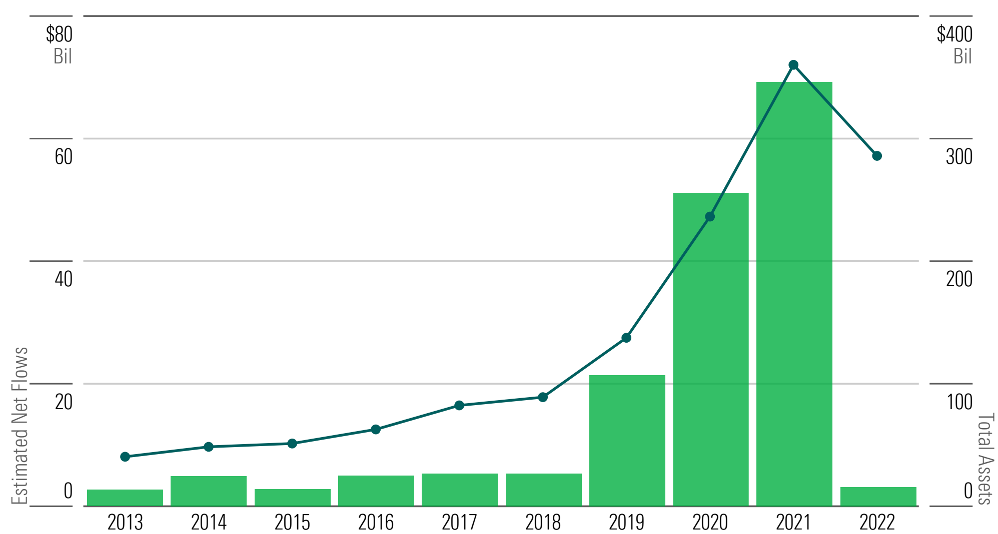
Morningstar Tightened Its Criteria

In August, Morningstar enhanced its Sustainable Attributes framework,[7] which is used to define Morningstar's U.S. sustainable fund universe. We have reflected the related changes in this report. As a result of this update, 19 funds that were included in the 2021 landscape no longer qualify for inclusion. For continuity and comparability purposes, we revised the universe and related data for 2022's first and second quarters.

Flows Sank to Their Lowest Level in Seven Years

Flows into U.S. sustainable funds have fallen steadily since their record $21.5 billion haul in the first quarter of 2021. Although U.S. sustainable funds ended 2022 in positive territory—a departure from the broader U.S. fund universe, which suffered the worst flows year on record—their $3.1 billion net annual inflow was well below the average $47 billion annual collection these funds had enjoyed over the previous three years.

Exhibit 2 Sustainable Fund Flows and Assets



Source: Morningstar Direct. Data as of Dec. 31, 2022. Includes sustainable funds as defined in Sustainable Funds U.S. Landscape Report, February 2023. Includes funds that have liquidated; excludes funds of funds, money market funds, and feeder funds.

7 Morningstar Sustainable Attributes, Morningstar Research, August 2022. https://assets.contentstack.io/v3/assets/blt4eb669caa7dc65b2/bltf30dfd231c4cb149/sustainable_attributes.pdf

Much of 2022's decline was driven by the broader market environment. In 2022, U.S. funds suffered more than $370 billion in withdrawals, cementing their first calendar year of outflows since Morningstar began tracking data in 1993.[8] Investors generally pulled out of actively managed funds and fixed-income funds amid persistent inflation and rising interest rates, risk of an impending recession, and poor market returns.

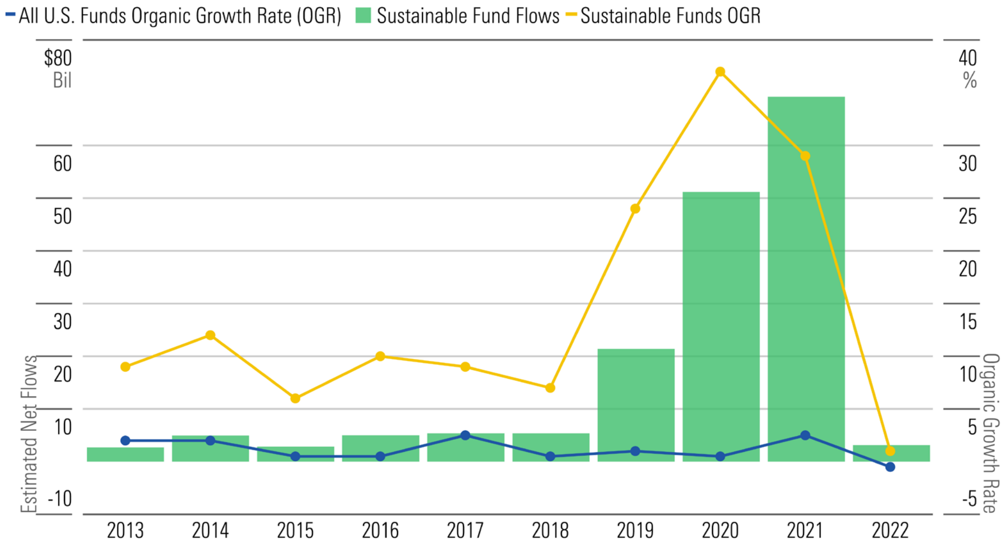
Sustainable funds showed resilience in the face of some of these headwinds—sustainable fixed-income funds fared better in terms of flows than conventional peers. But in terms of market returns, sustainable funds fared worse. In 2022, the energy sector was the best-performing unit of the S&P 500 index, gaining a remarkable 66%. On the other hand, communication services, consumer discretionary, and information technology suffered the most, losing 40%, 37%, and 28%, respectively. Funds with a structural underweighting to the energy sector, including many sustainable funds, suffered as a result. The opposite was true in 2020, when the tech sector gained 44% compared with energy's 34% loss. Investors may have favored traditional energy exposure over energy-light sustainable funds given relative return expectations.

Finally, the conversation around sustainable investing was increasingly marked by concerns about greenwashing and a political backlash against ESG investing. Prominent U.S. politicians have spoken out against ESG investing, and some have taken measures to limit state investment funds from doing business with asset managers based on perceptions of those managers' ESG approaches.[9]

8 U.S. Fund Flows: Investors Bail in 2022, Adam Sabban and Ryan Jackson, Jan. 17, 2023. https://www.morningstar.com/articles/1129741/us-fund-flows-investors-bail-in-2022

9 The Anti-ESG Rhetoric and Actions of Republican Politicians Are Bad for Investors and Business, Jon Hale, Aug. 26, 2022. https://www.morningstar.com/articles/1111509/the-anti-esg-rhetoric-and-actions-of-republican-politicians-are-bad-for-investors-and-business

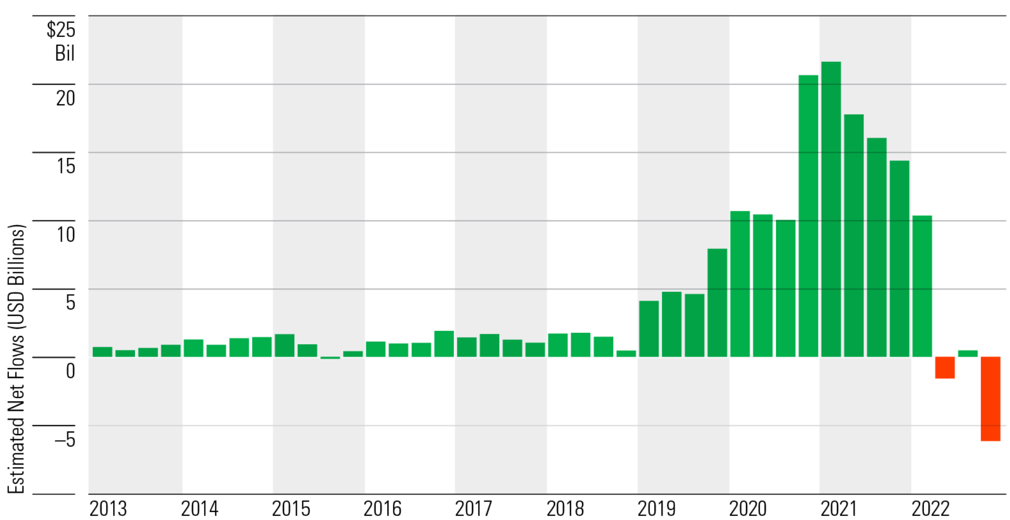
Exhibit 3 Sustainable Fund Flows Relative to Overall Fund Flows



Source: Morningstar Direct. Data as of Dec. 31, 2022. Includes sustainable funds as defined in Sustainable Funds U.S. Landscape Report, February 2023. Includes funds that have liquidated; excludes funds of funds.

In each of the past three calendar years, sustainable funds have grown at a faster pace than their conventional peers, but 2022's expansion was significantly more muted than previous years. Sustainable funds continue to constitute a small portion of the overall U.S. fund universe, so the organic growth rate (calculated as net flows as a percentage of total assets at the start of a period) puts the magnitude of fund flows into perspective. In 2022, sustainable funds grew by 0.9%, and the overall U.S. fund universe contracted by 1.3%. In 2021 and 2020, the sustainable funds universe swelled by 30% and 39%, respectively.

Exhibit 4 Sustainable Funds Quarterly Flows

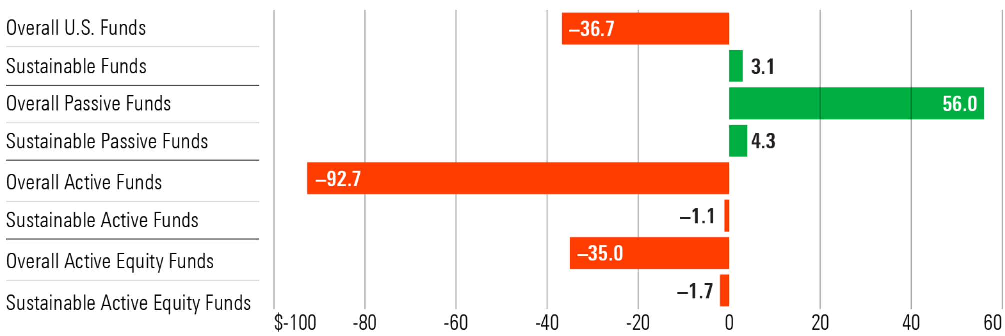


Source: Morningstar Direct. Data as of Dec. 31, 2022. Includes funds that have liquidated; excludes funds of funds.

Outflows in the final quarter of 2022 threatened to erase sustainable funds' first-quarter gains, capping off a roller-coaster year. Sustainable funds shed nearly $6.2 billion during the fourth quarter and sank to their lowest level in more than five years. Although conventional funds also saw outflows in the fourth quarter, the short-term withdrawals were more severe for sustainable funds. For the first quarter in more than three years, the U.S. sustainable funds landscape saw a lower organic growth rate than the total U.S. fund universe. During the fourth quarter, sustainable funds shrank by 2.2% compared with an 0.8% shrinkage in the overall U.S. landscape.

Investors pulled more than $920 billion out of nonsustainable actively managed funds in the U.S. in 2022, and active sustainable funds joined them in shedding assets for the first time in more than five years. Still, withdrawals from active sustainable funds accounted for a tiny 0.1% of overall outflows from active funds. On the other hand, passive sustainable funds collected 0.8% of total net flows into index-tracking funds.

Exhibit 5 Sustainable Fund Flows Relative to Overall Fund Flows*

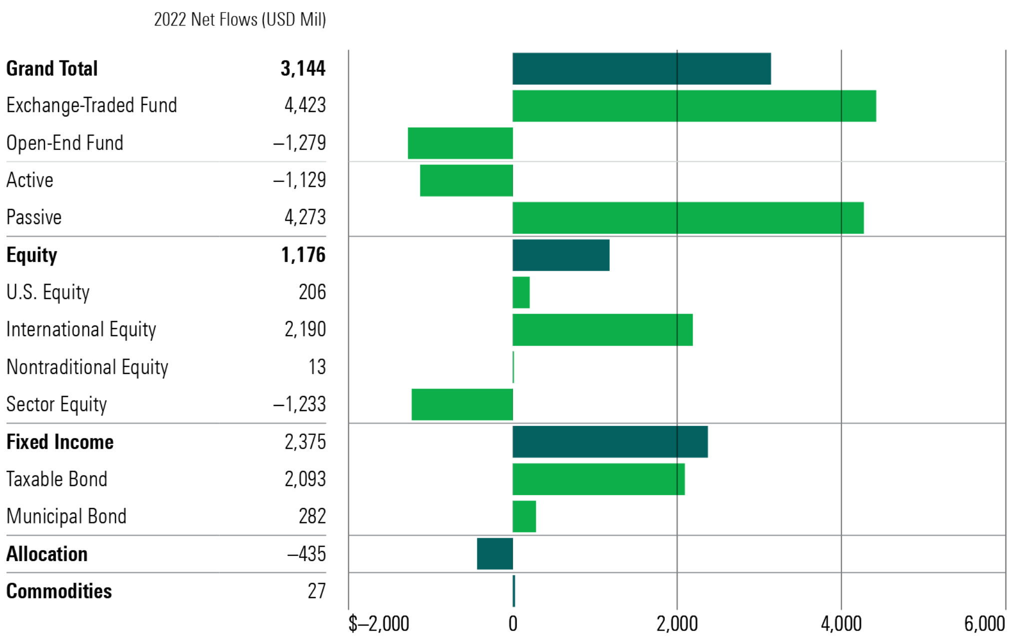


Source: Morningstar Direct. Data as of Dec. 31, 2022. *Note: Sustainable fund flows are shown in billions, while overall flows are shown in tens of billions to improve visibility. Includes funds that have liquidated; excludes funds of funds.

Demand for Exchange-Traded Funds Offset Outflows From Open-End Strategies

Exchange-traded funds, the majority of which are low-cost index-tracking strategies, carried the team in 2022. These funds collected $4.4 billion during the year to offset net outflows from open-end competitors. In the broader U.S. fund universe, open-end funds shed more than $950 billion during the year to mark their worst calendar year on record. Meanwhile, sustainable open-end funds lost nearly $1.3 billion in 2022, almost all of which came from actively managed strategies.

Exhibit 6 Sustainable Fund Flows by Fund Type, 2021

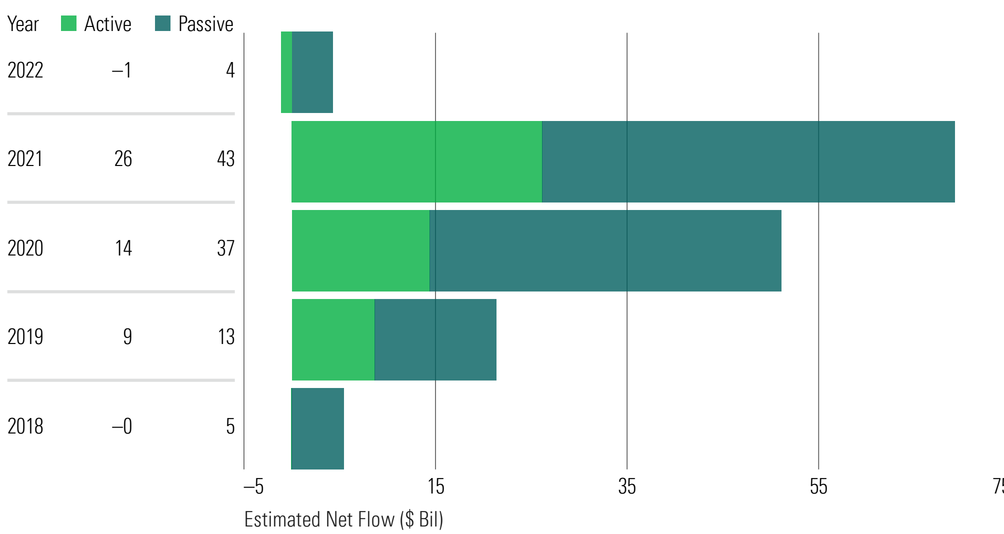


Source: Morningstar Direct. Data as of Dec. 31, 2022. Includes funds that have liquidated; excludes funds of funds.

Passive Flows Held Down the Fort

Continued investor preference for low-cost index-tracking strategies characterizes the sustainable funds landscape as well as the broader investment universe. In 2022, sustainable passive funds attracted $4.3 billion in flows, roughly one tenth of 2021's record haul but 1.5 times the $2.8 billion seen five years ago.

Exhibit 7 Sustainable Fund Flows: The Shift to Passive Funds Continued in 2022

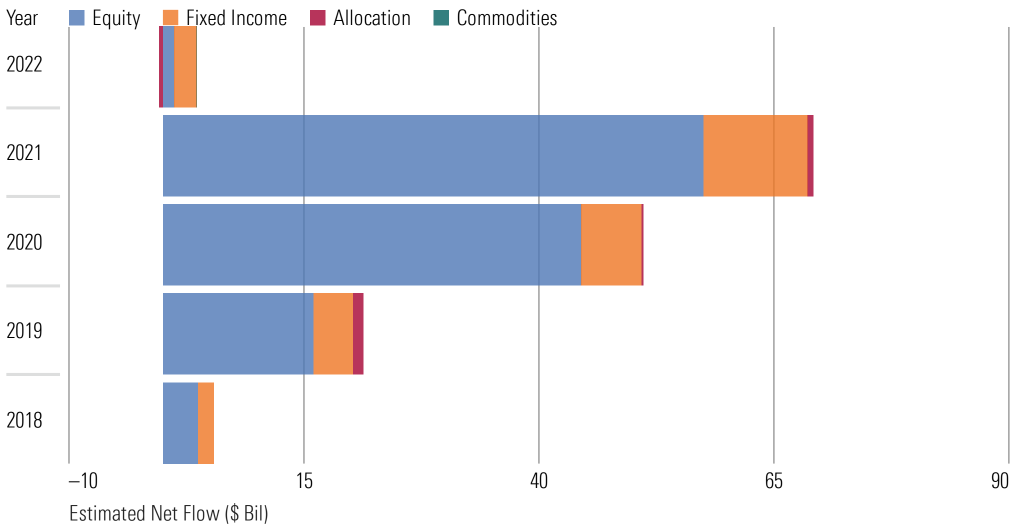


Source: Morningstar Direct. Data as of Dec. 31, 2022. Includes funds that have liquidated; excludes funds of funds.

Fixed-Income Surpassed Equity for the First Time

For the first time on record, fixed-income funds commanded the lion's share of 2022's sustainable fund flows. Flows into sustainable bond funds surged to three fourths of overall flows, up from 16% in 2021. Although down from their record $11.1 billion acquisition in 2021, these funds' net annual $2.4 billion intake set them apart from conventional peers in 2022. By comparison, nonsustainable taxable- and municipal-bond funds surrendered a record $335 billion during the year.

Exhibit 8 Sustainable Fund Flows by Asset Class



Source: Morningstar Direct. Data as of Dec. 31, 2022. Includes funds that have liquidated; excludes funds of funds.

The number of sustainable fixed-income funds has more than doubled over the past five years, to 129 from 47. More fixed-income choices help investors fill their bond allocations, making ESG-focused multi-asset portfolios more viable and ultimately helping drive more flows.

Largest Fund Flows

The roster of top flow-getters in 2022 is markedly different from the previous year. In 2021, 16 sustainable funds attracted net flows greater than $1 billion; no individual fund crossed this mark in 2022. Only seven funds netted more than $500 million during the year. The newest fund to make it to the top 10 was **iShares Paris-Aligned Climate MSCI USA ETF** PABU, which launched in February 2022 and secured third place. One component of the strategy is to reduce the fund's greenhouse gas intensity by an average 10% each year, compared with the previous year. This exceeds the minimum ask of Paris Aligned Benchmarks, which require a 7% year-on-year decarbonization rate (reduction in greenhouse gas emissions). Paris-aligned investment strategies have become more popular since the benchmarks themselves were debuted by the European Commission more than two years ago, and this fund marks the third available to U.S. investors.[10]

10 The European Parliament and the Council of the European Union. 2019. *Regulation 2019/2089 amending Regulation (EU) 2016/1011 as regards EU Climate Transition Benchmarks, EU Paris-aligned Benchmarks and sustainability-related disclosures for benchmarks.* Nov. 27, 2019. https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019R2089&from=EN

Exhibit 9 Sustainable Funds With Largest Flows in 2022

Name	Ticker	Estimated Net Flow ($ Mil)
American Century Sustainable Equity	AFDAX	927
Vanguard ESG U.S. Stock ETF	ESGV	899
iShares Paris-Aligned Climate MSCI USA ETF	PABU	872
iShares ESG U.S. Aggregate Bond ETF	EAGG	789
Brown Advisory Sustainable Growth	BAFWX	613
Invesco Floating Rate ESG	AFRAX	574
Vanguard ESG International Stock ETF	VSGX	542
TIAA-CREF Social Choice International Equity	TSONX	471
iShares ESG Aware MSCI EAFE ETF	ESGD	450
Calvert Equity	CSIEX	434

Source: Morningstar Direct. Data as of Dec. 31, 2022. Excludes funds of funds.

American Century Sustainable Equity AFDAX rose to the top with a $927 million intake following $459 million in net outflows in 2021. The fund saw outflows in the first and third quarters but secured a $1 billion deposit in the fourth quarter to bump it to first place. The fund's process provides diversified exposure to the S&P 500 universe but maintains a stronger ESG score than the index. During the final quarter of 2022, the fund outperformed its benchmark by more than 1 percentage point, gaining 8.9% versus the S&P 500's 7.6% total return.

Exhibit 10 Sustainable Equity Funds With Largest Flows in 2022

Name	Ticker	Estimated Net Flow ($ Mil)
American Century Sustainable Equity	AFDAX	927
Vanguard ESG U.S. Stock ETF	ESGV	899
iShares Paris-Aligned Climate MSCI USA ETF	PABU	872
Brown Advisory Sustainable Growth	BAFWX	613
Vanguard ESG International Stock ETF	VSGX	542
TIAA-CREF Social Choice International Equity	TSONX	471
iShares ESG Aware MSCI EAFE ETF	ESGD	450
Calvert Equity	CSIEX	434
Nuveen ESG Large-Cap Value ETF	NULV	434
iShares MSCI KLD 400 Social ETF	DSI	322

Source: Morningstar Direct. Data as of Dec. 31, 2022. Excludes funds of funds.

In 2022, equity investors spread their flows across a variety of asset managers. The top 10 equity funds came from six different shops. In 2021, by contrast, BlackRock and Vanguard claimed five and three of the top 10 spots, respectively, while Parnassus and Fidelity each secured one of the top spots.

Despite seeing outflows in the second half of 2022, **Invesco Floating Rate ESG** AFRAX managed to hold on to second place for the top 10 fixed-income flow-getters. This fund has followed a sustainable mandate for less than three years, but it has seen strong early adoption by the market. Rising interest rates were front-and-center for investment decision-makers this year, and investors looked to floating-rate bonds as a hedge.

Exhibit 11 Sustainable Fixed-Income Funds With Largest Flows in 2022

Name	Ticker	Estimated Net Flow ($ Mil)
iShares ESG U.S. Aggregate Bond ETF	EAGG	789
Invesco Floating Rate ESG	AFRAX	574
Calvert Bond	CSIBX	413
iShares ESG Advanced Total USD Bond Market ETF	EUSB	263
IQ MacKay ESG Core Plus Bond ETF	ESGB	238
Calvert Core Bond	CLDAX	177
PIMCO ESG Income	PEGIX	130
Impax Core Bond	PXBIX	122
Vanguard ESG U.S. Corporate Bond ETF	VCEB	111
Hartford Schroders Sustainable Core Bond	SCBRX	109

Source: Morningstar Direct. Data as of Dec. 31, 2022. Excludes funds of funds.

The newest fund to break into the top 10 was **Hartford Schroders Sustainable Core Bond** SCBRX, which adopted a sustainable mandate in November 2021. Schroders, the fund's subadvisor, evaluates the impact and risk related to sustainability and ESG issues for each prospective security before adding it to the portfolio. The fund's managers also generally avoid investing in industries such as thermal coal generation, tobacco production, and controversial weapons manufacturing.

What Goes Up May Come Down

Not all sustainable funds enjoyed inflows in 2022. **Parnassus Core Equity** PRBLX—the largest sustainable fund in the U.S. —lost more than $2.4 billion in 2022, more than two and a half times its neighbor at the bottom of the annual flows roster. The fund saw outflows in each quarter, but nearly half of its total annual withdrawals came during the fourth quarter. The outflows weren't insignificant in terms of magnitude, either. Parnassus Core Equity came into the year with $32.3 billion in assets, and it shed more than 7% of this total over the course of the year.

Exhibit 12 Sustainable Funds With Largest Outflows in 2022

Name	Ticker	Estimated Net Flow ($ Mil)
Parnassus Core Equity	PRBLX	(2,402)
iShares ESG Aware MSCI EM ETF	ESGE	(897)
Calvert Emerging Markets Equity	CVMIX	(728)
Parnassus Mid Cap	PARMX	(715)
iShares ESG MSCI USA Leaders ETF	SUSL	(567)
iShares MSCI USA ESG Select ETF	SUSA	(556)
TIAA-CREF Social Choice Equity	TISCX	(549)
First Trust NASDAQ Clean Edge Green Energy Index	QCLN	(439)
TIAA-CREF Core Impact Bond	TSBIX	(431)
Putnam Sustainable Leaders	PNOPX	(383)

Source: Morningstar Direct. Data as of Dec. 31, 2022. Excludes funds of funds.

A Behemoth Slid

BlackRock's $620 million intake in 2022 was less than 2.5% of its annual flows into sustainable funds in 2021. It remained among the top 10 sustainable asset managers in terms of annual flows but slid behind Vanguard, American Century, Brown Advisory, and Nuveen to land in fifth place for the year. Even five years ago, when BlackRock only offered 16 sustainable funds, it took in more than twice as much compared with demand in 2022. Environmental and social issues, and the investment strategies that prioritize those, have increasingly come under scrutiny from prominent U.S. politicians, and BlackRock has been the target of more criticism than other sustainable fund managers.

Vanguard's compact lineup of seven sustainable funds attracted more than $1.8 billion during the year, boosting the firm into first place for 2022. **Vanguard ESG US Stock ETF** ESGV accounted for nearly half of the firm's total sustainable fund flows. The fund features a straightforward approach to portfolio construction that harks to the early days of socially responsible investing. It tracks a diversified equity index that screens out firms involved in tobacco, cannabis, civilian firearms, and coal and oil. The fund’s popularity is largely driven by its low fee of just 9 basis points.

Exhibit 13 Asset Managers With Largest Flows Into Sustainable Funds

Annual Flows into Sustainable Funds	2018 Net Flow ($ Mil)	2019 Net Flow ($ Mil)	2020 Net Flow ($ Mil)	2021 Net Flow ($ Mil)	2022 Net Flow ($ Mil)
Vanguard	766	2,734	3,969	7,286	1,844
American Century	20	1,663	709	(225)	980
Brown Advisory	305	945	1,852	1,311	818
Nuveen/TIAA	1,914	2,697	2,851	3,665	805
BlackRock/iShares	1,471	5,047	23,247	24,989	620
Dimensional	1,115	689	2,106	1,997	419
Impax	(319)	147	669	1,511	381
State Street	(9)	(271)	189	646	359
Goldman Sachs Asset Mgmt.	(58)	(115)	190	593	354
GMO	94	5	87	268	315

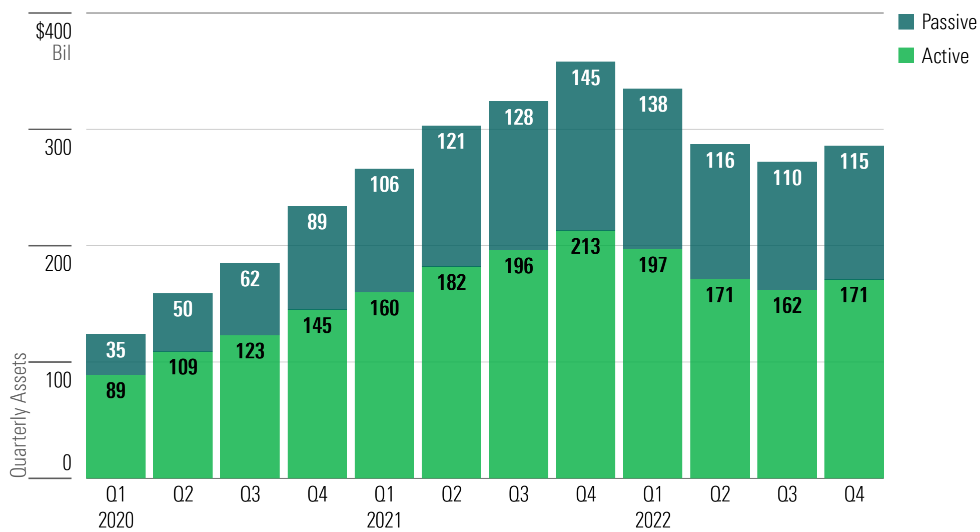
Source: Morningstar Direct. Data as of Dec. 31, 2022. Excludes funds of funds.

Sustainable Fund Assets Dipped to Pre-2021 Levels

Despite net inflows, assets in sustainable funds landed at $286 billion, a 20% decline from the all-time record of $358 billion at the end of 2021. By and large, market depreciation weighed on sustainable funds more than their conventional peers; the typical sustainable U.S. large-blend fund lost nearly 19% in terms of total returns during the year, lagging conventional peers by roughly 1 percentage point. By comparison, assets in the broader U.S. fund universe also peaked at the end of 2021 (at $28 trillion) and slid by 19% to $22.7 trillion at the end of 2022.

As they have since our records began, actively managed funds continue to dominate the sustainable funds landscape. At the end of 2022, 438 of the 598 sustainable funds available to U.S. investors were actively managed offerings, representing nearly three fourths of the landscape. However, passive funds have gained in popularity during recent years. Low fees and increased investor adoption of model portfolios have boosted passive fund flows. As a result, active funds' market share has been on the decline. Three years ago, active funds claimed more than 70% of sustainable assets; during all of 2021 and 2022, that portion hovered around 60%.

Exhibit 14 Sustainable Fund Assets



Source: Morningstar Direct. Data as of Dec. 31, 2022. Includes sustainable funds as defined in Sustainable Funds U.S. Landscape Report, February 2023. Includes funds that have liquidated; excludes funds of funds, money market funds, and feeder funds.

The Largest Sustainable Funds Stayed Consistent

It hasn't been easy for new active funds to break into the top 10 when it comes to total assets. With the exception of **Parnassus Value Equity** PARWX, the largest active offerings were all in the top 10 at the end of 2021. Parnassus' value equity offering—previously known as Parnassus Endeavor—was in 11th place last year and moved ahead of **Eventide Gilead** ETGLX to join 2022's top 10. Although Parnassus Value Equity lost 13.8% in terms of total returns during the year, its large-cap value investment style saved it from the worst of the market selloff. Eventide Gilead, on the other hand, follows a mid-cap growth approach and lost 34% during the year.

Despite suffering the worst annual withdrawal among all U.S. sustainable funds—more than $2.4 billion—**Parnassus Core Equity** PRBLX is nearly 4 times as large as the runner-up, making it unlikely to lose this crown.

Exhibit 15 10 Largest Actively Managed Sustainable Funds

Name	Ticker	Total Assets ($ Mil)
Parnassus Core Equity	PRBLX	23,911
Pioneer	PIODX	6,540
Parnassus Mid Cap	PARMX	6,083
Calvert Equity	CSIEX	5,989
TIAA-CREF Social Choice Equity	TISCX	5,809
TIAA-CREF Core Impact Bond	TSBIX	5,780
Brown Advisory Sustainable Growth	BAFWX	5,650
Putnam Sustainable Leaders	PNOPX	4,890
DFA U.S. Sustainability Core 1 Portfolio	DFSIX	4,785
Parnassus Value Equity	PARWX	4,604

Source: Morningstar Direct. Data as of Dec. 31, 2022. Excludes funds of funds.

The list of the 10 largest passive funds looks similar to last year, too. **Vanguard ESG International Stock ETF** VSGX slid into the 10th spot, displacing **iShares ESG MSCI USA Leaders ETF** SUSL from the table. The former netted the fourth highest annual flow, while the latter suffered the second harshest annual withdrawal (for sustainable passive funds). Overall, international equity funds fared better than their U.S. equity peers in 2022.

The top 4 haven't changed their order in the table. Surprisingly, **iShares ESG Aware MSCI USA ETF** ESGU managed to maintain first place despite bleeding nearly $900 million during the year. It remains more than one and a half times as large as **Vanguard FTSE Social Index** VFTNX, which itself has a strong lead over the fund in third place.

Exhibit 16 10 Largest Passive Sustainable Funds

Name	Ticker	Total Assets ($ Mil)
iShares ESG Aware MSCI USA ETF	ESGU	19,587
Vanguard FTSE Social Index	VFTNX	12,774
iShares ESG Aware MSCI EAFE ETF	ESGD	6,722
Vanguard ESG U.S. Stock ETF	ESGV	5,659
iShares Global Clean Energy ETF	ICLN	5,124
Calvert US Large-Cap Core Responsible Index	CISIX	3,838
iShares ESG Aware MSCI EM ETF	ESGE	3,746
iShares MSCI KLD 400 Social ETF	DSI	3,582
iShares MSCI USA ESG Select ETF	SUSA	3,248
Vanguard ESG International Stock ETF	VSGX	3,011

Source: Morningstar Direct. Data as of Dec. 31, 2022. Excludes funds of funds.

The Largest Sustainable Asset Managers Held Their Lead

Ranked by assets in sustainable funds, the top five asset managers have stayed consistent since 2019.

Exhibit 17 Top 10 Asset Managers by Sustainable Fund Assets

Total Assets in Sustainable Funds	2018 Assets ($ Bil)	2019 Assets ($ Bil)	2020 Assets ($ Bil)	2021 Assets ($ Bil)	2022 Assets ($ Bil)
BlackRock/iShares	4	10	41	72	60
Parnassus	22	29	35	48	36
Calvert	12	19	28	35	30
Vanguard	5	9	16	27	23
Nuveen/TIAA	7	11	17	23	20
Dimensional	3	5	8	12	10
Invesco	1	2	10	11	9
Impax	4	5	6	9	8
Amundi	-	-	-	9	7
Brown Advisory	1	2	5	8	6

Source: Morningstar Direct. Data as of Dec. 31, 2022. Excludes funds of funds.

For the third consecutive year, BlackRock/iShares commands more assets in sustainable funds than any other asset manager. Prior to 2020, Parnassus held that crown, and it has maintained second place since. BlackRock expanded its lead over Parnassus slightly in 2022, holding on to first place with a $24.3 billion margin.

Although sustainable funds comprise roughly 2% of BlackRock's assets in U.S. open-end and exchange-traded funds, its influence on the U.S. sustainable-investing landscape cannot be overstated. With nearly $60 billion invested in sustainable funds, BlackRock manages more money than Calvert and Vanguard, combined. Its mandate is also greater than the totality of the 145 smallest firms' sustainable assets.

Five of the top 10 asset managers have more than $10 billion in sustainable assets, and three of the top 10 are dedicated ESG shops: Parnassus, Calvert, and Impax (formerly known as Pax World).

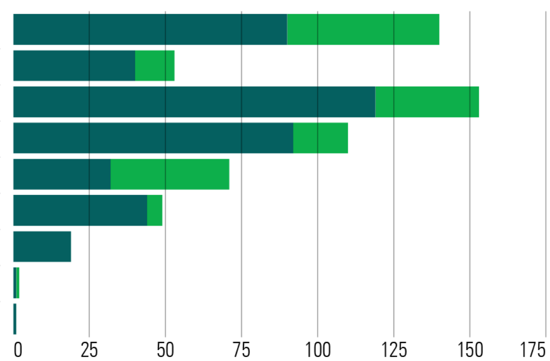
New Sustainable Launches & Repurposed Funds

Asset Class and Category Coverage

Of the 598 sustainable funds, 418 are equity funds, 129 are fixed-income funds, and 49 are allocation funds. Commodities entered the stage in 2022, with two funds focused on materials needed for the renewable energy transition—**Element EV & Solar Battery Materials (Lithium, Nickel, Copper, Cobalt) Futures ETF** CHRG and **Harbor Energy Transition Strategy ETF** RENW—joining the sustainable funds cohort in the latter half of the year. Overall, investors can find sustainable funds in 69 Morningstar Categories.

Exhibit 18 Sustainable Funds by Asset Class

	Total	Active	Passive
U.S. Large-Cap	140	90	50
U.S. S/Mid-Cap	53	40	13
International Equity	153	119	34
Taxable Bond	110	92	18
Sector Equity	71	32	39
Allocation	49	44	5
Municipal Bond	19	19	0
Commodities	2	1	1
Nontraditional Equity	1	1	0



Source: Morningstar Direct. Data as of Dec. 31, 2022. Does not include obsolete funds.

Investors have the most choices in U.S. equity, with 193 funds, and another 153 funds are international-equity offerings. Newly launched fixed-income funds have typically been in the taxable space, including high-yield and corporate bonds, largely because ESG data tends to be more readily available in the corporate space. However, the industry's understanding of sustainability has continued to mature, and seven sustainable municipal-bond funds came to market in 2022. The largest of these was **Franklin Municipal Green Bond ETF** FLMB—previously known as Franklin Liberty Federal Tax-Free Bond ETF—which repurposed to adopt its green bond mandate in May. The fund collected nearly $4.5 million in 2022 and ended the year with nearly $108 million in assets.

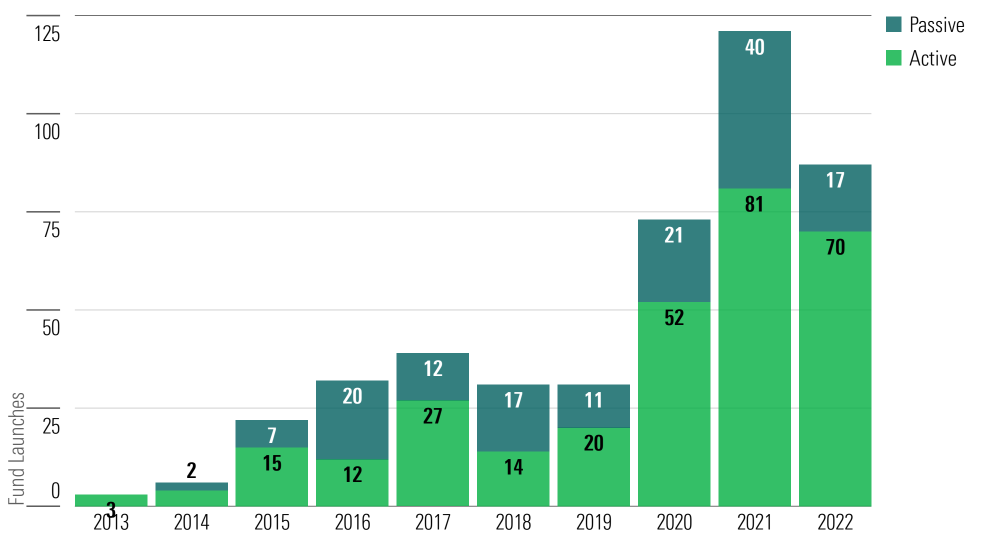
Sustainability-focused municipal-bond funds offer an opportunity to drive tangible impact in local communities, since the proceeds often contribute to tangible improvements in areas such as education programs and revitalizing infrastructure. Data availability remains a constraint because small communities may not have resources to provide consistent reporting on these projects, but the opportunity is significant.

As the sustainable fund universe has grown, particularly in fixed income, investors now have enough choices to construct well-diversified portfolios; however, many of these investments have short track records and small asset bases, which may prove a barrier to near-term adoption.

New Fund Launches: Active Funds Continued to Dominate

Sustainable fund launches continued to accelerate along a multiyear growth trend. In 2015, 22 new sustainable funds came to market, a record at the time, and at least 30 funds have been launched each year since. In 2022, the 87 new funds that launched topped the number from 2020 but lagged the incredible record 121 set in 2021.

Exhibit 19 Sustainable Fund Launches

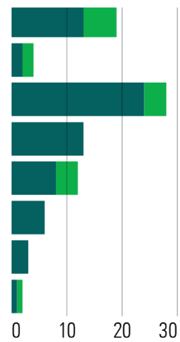


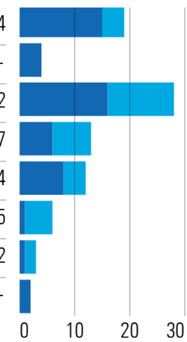
Source: Morningstar Direct, Manager Research. Data as of Dec. 31, 2022. Includes funds that have liquidated. Does not include original launches of funds that have subsequently repurposed.

Of the 87 newly launched funds, 70 are actively managed and 17 are passive. More than one third of 2022's new launches came to market during the second quarter, when Fidelity filled out its sustainable fund lineup with 15 new offerings. Nearly three fourths of new launches are equity funds. The ranks of sustainable sector and fixed-income funds increased by 12 and 19, respectively. The 87 new funds were placed in 26 Morningstar Categories—global large-stock blend and U.S. large blend claimed 11 and 10 new entrants, respectively.

Exhibit 20 Sustainable Fund Launches in 2022 by Category Group

Category Group	Total	Active	Passive	ETF	Open-End
U.S. Large-Cap	**19**	13	6	15	4
U.S. S/Mid-Cap	**4**	2	2	4	—
International Equity	**28**	24	4	16	12
Taxable Bond	**13**	13	—	6	7
Sector Equity	**12**	8	4	8	4
Municipal Bond	**6**	6	—	1	5
Allocation	**3**	3	—	1	2
Commodities	**2**	1	1	2	—
Grand Total	**87**	**70**	**17**	**53**	**34**





Source: Morningstar Direct, Manager Research. Data as of Dec. 31, 2022.

ETFs have grown as the most popular vehicle for sustainable fund launches since the first—**iShares MSCI USA ESG Select ETF** SUSA—launched in January 2005. For the second consecutive year, ETFs accounted for more than 60% of new sustainable fund launches in 2022. On average over the past decade, 40% of new sustainable funds have launched as ETFs. Increasingly, fund managers have looked to ETFs to house actively managed strategies, too. In 2020, one third of new ETF launches were actively managed; in 2022, that proportion rose to 68%.

For the fourth consecutive year, an offering from BlackRock/iShares topped the list of largest new funds. IShares Paris-Aligned Climate MSCI USA ETF launched in February and amassed more than $800 million by the end of the year. This was BlackRock's only climate-focused launch this year, but it joins a growing compendium of climate funds in the U.S. In 2022, 20 new climate offerings came to market, and three existing funds repurposed to adopt climate mandates.

Exhibit 21 New Sustainable Funds With Assets Greater Than $100 Million at End of 2022

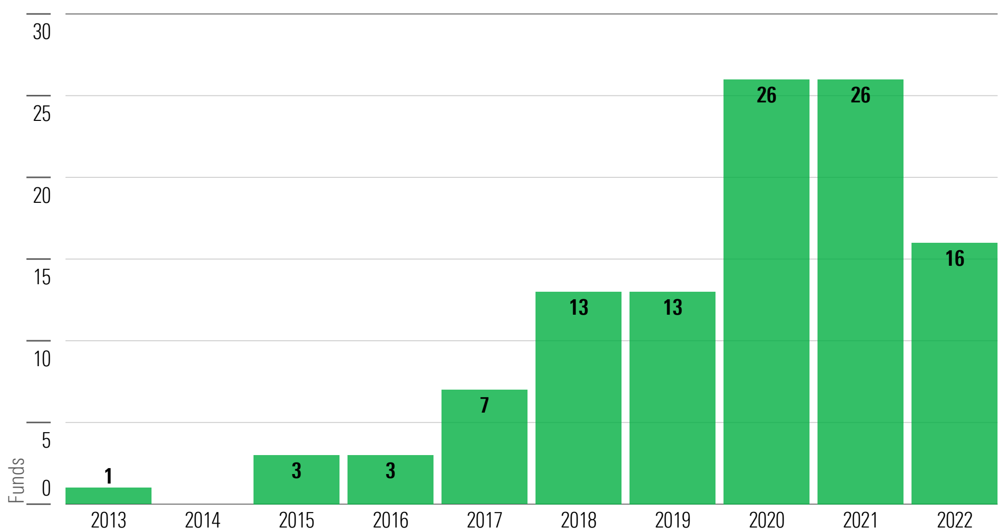
Name	Ticker	Inception Date	Fund Assets ($ Mil)
iShares Paris-Aligned Climate MSCI USA ETF	PABU	2/8/2022	848
Dimensional US Sustainability Core 1 ETF	DFSU	11/1/2022	136
Dimensional International Sustainability Core 1 ETF	DFSI	11/1/2022	111
Dimensional Emerging Markets Sustainability Core 1 ETF	DFSE	11/1/2022	104
OneAscent Core Plus Bond ETF	OACP	3/30/2022	103

Source: Morningstar Direct, Manager Research. Excludes funds of funds. Data as of Dec. 31, 2022.

More Than One Dozen Funds Repurposed to Become Sustainable

Last year, 16 existing funds changed their investment strategies to become sustainable funds, slightly more than half the previous record of 26 set in 2020 and 2021. In many cases, these funds also changed their names to reflect their repurposing. That brings the total count of repurposed funds in the current sustainable funds universe to 97, representing about 16% of all funds and 14% of total assets. The most common candidates for retooling tend to be actively managed funds experiencing chronic outflows. As investor demand for sustainable funds continues to grow, converting these active funds into sustainable offerings, rather than launching new funds, can be an attractive strategy for some asset managers.

Exhibit 22 Repurposed Funds



Source: Morningstar Direct, Manager Research. Data as of Dec. 31, 2022.

The largest repurposed fund was **BlackRock Sustainable Balanced** MACPX, with nearly $1.5 billion in assets at the end of 2022. As part of its new sustainability objectives, the fund targets a better aggregate ESG score and lower carbon emissions intensity versus the benchmarks as well as issuers that BlackRock believes will be better able to capture climate opportunities. The management team has long taken a global lens to its tactical allocation strategy, so this shift could prove additive.

Exhibit 23 Five Largest Funds Repurposed as Sustainable in 2022

Name	Ticker	Date of ESG Adoption	Original Name	Inception Date	Fund Assets ($ USD)
BlackRock Sustainable Balanced Fund	MACPX	4/8/2022	BlackRock Balanced Capital Fund	11/8/1973	1,476
Nationwide BNY Mellon Core Plus Bond ESG Fund	NWCIX	2/28/2022	Nationwide Core Plus Bond Fund	7/17/1992	570
BlackRock Impact Mortgage Bond Portfolio	PNIGX	9/1/2022	BlackRock U.S. Government Bond Portfolio	4/20/1992	436
ALPS/Kotak India ESG Fund	INDIX	5/1/2022	ALPS/Kotak India Growth Fund	2/14/2011	354
Pioneer Global Sustainable Equity Fund	GLOSX	2/15/2022	Pioneer Global Equity Fund	12/15/2005	317

Source: Morningstar Direct, Manager Research. Data as of Dec. 31, 2022.

One Firm No Longer Draws Inspiration From ESG Investing

During the third quarter, eight funds from Inspire renounced sustainable-investing mandates. As such, they were removed from our sustainable funds universe, although their flows and assets during the period that they followed ESG mandates are maintained for recordkeeping purposes. The announcement came in August, even though two of these funds—**Inspire 100 ETF** BIBL and **Inspire Global Hope ETF** BLES—adopted sustainable mandates in only March 2022.

In his statement, Inspire's CEO claims that ESG investing "has become weaponized by liberal activists," apparently the firm's key rationale for abandoning the investment strategy. Yet the most recent prospectus (dated Oct. 14, 2022) still indicates a focus on environmental issues such as air quality, greenhouse gas emissions, and ecological impacts (including biodiversity loss, habitat destruction, and deforestation).

Aside from the Inspire suite of funds, just one fund removed its sustainable-investing mandate during the year. **Viridi Bitcoin Miners ETF** RIGZ—formerly known as Viridi Cleaner Energy Crypto Mining & Semiconductor ETF—launched in July 2021 and changed its name in May 2022. It subsequently liquidated in January 2023.

Investment Performance

2022 From a Bird's Eye View

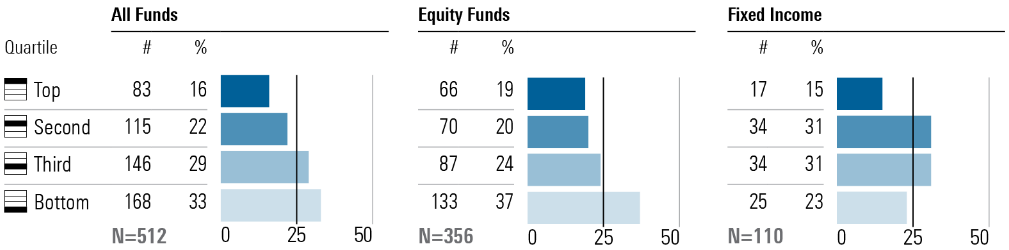
From a performance perspective, sustainable funds haven't encountered a year as challenging as 2022 in more than five years. With the exception of large-growth equity funds, most sustainable funds underperformed on nearly every metric in 2022: More often than not, they landed in the bottom half of their respective Morningstar Categories, lagged Morningstar Category benchmarks, and succeeded at a lower rate than peers. However, one year of underperformance didn't erase long-term outperformance on these metrics. Over the trailing three- and five-year periods, a sustainability-agnostic investor would have been better off with the typical sustainable fund over most conventional peers.

Furthermore, the typical sustainable large-blend equity fund's sector allocation was overwhelmingly additive over the trailing three- and five-year periods. The main detractor was, surprisingly, their modest overweighting in real estate, versus the Morningstar U.S. Large Cap Index. In 2022, on the other hand, the energy sector was the best-performing unit of the S&P 500 index, gaining a remarkable 66%. Communication services, consumer discretionary, and information technology suffered the most, losing 40%, 37%, and 28%, respectively. Funds with a structural underweighting to the energy sector, including many sustainable funds, suffered as a result.

Performance by Category Rank

To evaluate the investment performance of sustainable funds, we can compare how their returns rank relative to their respective Morningstar Category peers. On the whole, sustainable funds lagged their conventional peers in 2022, with 61% of sustainable funds landing in the bottom half of their respective Morningstar Categories. Equity funds suffered the worst of the underperformance, and 37% of sustainable equity funds dropped to the bottom quartile relative to peers. Although only 15% of sustainable fixed-income funds landed in the top quartile relative to peers, the performance was more balanced across the bottom three quartiles.

Exhibit 24 Sustainable Funds 2022 Return Rank by Morningstar Category Quartile



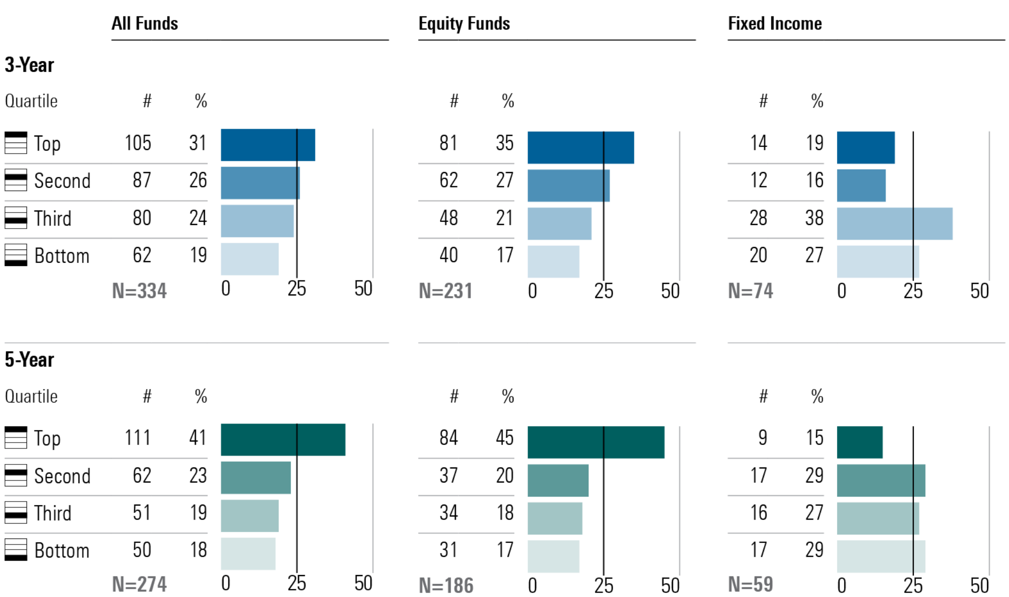
Quartile	All Funds #	All Funds %	Equity Funds #	Equity Funds %	Fixed Income #	Fixed Income %
Top	83	16	66	19	17	15
Second	115	22	70	20	34	31
Third	146	29	87	24	34	31
Bottom	168	33	133	37	25	23
	N=512		N=356		N=110	

Source: Morningstar Direct. Data as of Dec. 31, 2022.

Poor performance in 2022 wasn't enough to erase the edge of these funds over the longer term. During the trailing three-year period, 31% of sustainable funds placed in the top quartile relative to peers, including 35% of equity funds. On the other hand, sustainable bond funds found themselves in the bottom half of their respective categories more often than not.

Although 2020 provided a boost to long-term sustainable fund returns, they had been outperforming their peers, albeit to a more modest degree, prior to 2020. Sustainable funds' five-year track records beat peers more than 60% of the time, and nearly half of sustainable equity funds made it to the top quartile for five-year returns.

Exhibit 25 Sustainable Funds Three- and Five-Year Trailing Performance by Morningstar Category Quartile



3-Year

Quartile	All Funds #	All Funds %	Equity Funds #	Equity Funds %	Fixed Income #	Fixed Income %
Top	105	31	81	35	14	19
Second	87	26	62	27	12	16
Third	80	24	48	21	28	38
Bottom	62	19	40	17	20	27
	N=334		N=231		N=74	

5-Year

Quartile	All Funds #	All Funds %	Equity Funds #	Equity Funds %	Fixed Income #	Fixed Income %
Top	111	41	84	45	9	15
Second	62	23	37	20	17	29
Third	51	19	34	18	16	27
Bottom	50	18	31	17	17	29
	N=274		N=186		N=59	

Source: Morningstar Direct. Data as of Dec. 31, 2022.

U.S. large-blend funds make up more than 14% of the sustainable funds landscape, and they tend to be the core allocation in most investor portfolios. Therefore, this category is often one of the first candidates for integrating ESG-focused funds into a portfolio. In 2022, sustainable U.S. large-blend funds got pummeled. Roughly 46% of sustainable U.S. large-blend funds landed in the bottom quartile relative to peers. Longer-term returns bounced back, and more than 60% of these funds remained in the top half of the category for the trailing three- and five-year periods.

Exhibit 26 Sustainable U.S. Large-Blend Funds Fared Worse Than Peers

Quartile	One-Year #	One-Year %	Three-Year #	Three-Year %	Five-Year #	Five-Year %
Top	8	11	16	31	18	45
Second	13	18	17	33	10	25
Third	19	26	9	18	4	10
Bottom	34	46	9	18	8	20
	N=74		N=51		N=40	

Source: Morningstar Direct. Data as of Dec. 31, 2022.

Five other categories are worthy of examination: foreign large blend, U.S. large growth, diversified emerging-markets equity, intermediate core-plus bond, and intermediate core bond funds. The number of sustainable funds in these categories with three- and five-year track records is too small to evaluate with confidence. We can look at one-year performance versus category peers, but conclusions should be tempered given the small sample size. For instance, 31 sustainable foreign large-blend funds have a one-year track record, but only 18 sustainable intermediate core bond funds do.

Exhibit 27 Sustainable Funds in Five Major Categories Deliver Mixed Returns vs. Category Peers

Quartile	Foreign Large Blend #	%	U.S. Large Growth #	%	Diversified Emg Mrkts Equity #	%	Intermediate Core-Plus Bond #	%	Intermediate Core Bond #	%
Top	1	3	11	37	3	16	4	18	3	17
Second	6	19	9	30	6	32	7	32	8	44
Third	7	23	8	27	7	37	6	27	4	22
Bottom	17	55	2	7	3	16	5	23	3	17
	N=31		N=30		N=19		N=22		N=18	

Source: Morningstar Direct. Data as of Dec. 31, 2022.

Last year was a tough one for growth investors. In terms of total returns, the Morningstar US Growth Index lagged the Morningstar US Value Index by a jaw-dropping 36 percentage points. However, sustainability-focused growth funds fared better than conventional peers through the volatility. More than two thirds of sustainable U.S. large-growth funds landed in the top half of the Morningstar Category, and only 7% of these funds sank to the bottom quartile.

To varying degrees, sustainable funds in our four other notable asset classes suffered relative to peers. Sustainable intermediate core bond funds didn't shoot the lights out, but they held up well relative to peers, and 44% of these funds finished the year in the second quartile. Their core-plus bond counterparts were split evenly between the top and bottom half of the category, although they were underrepresented in the top quartile. This matches the dynamic in 2021, when sustainable core-plus bond funds saw an even 50/50 split between leaders and laggards.

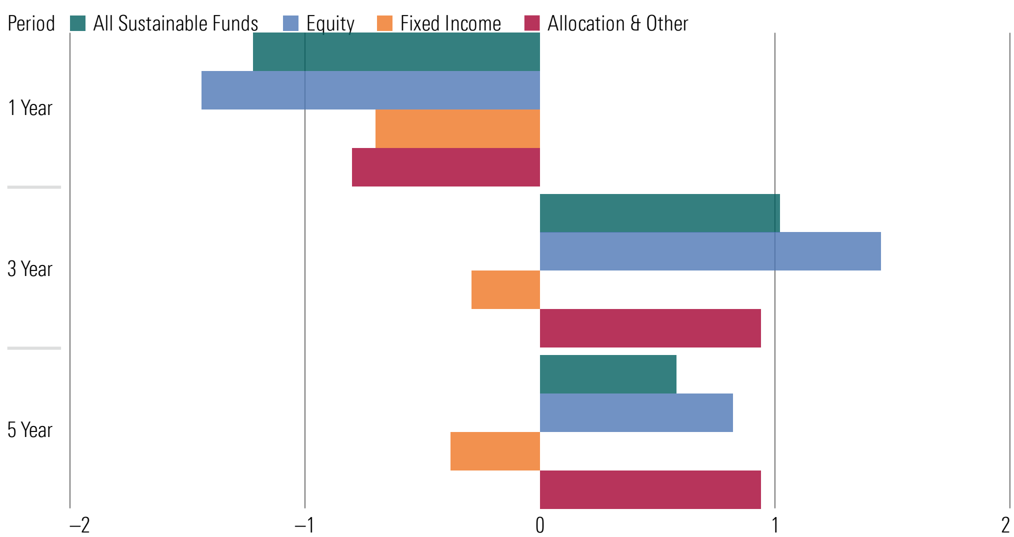
Sustainable funds struggled overseas, especially in developed markets, where nearly 80% of sustainable foreign large-blend funds finished in the bottom half of the category. Very few sustainable diversified emerging-markets equity funds have a full-year track record, but those that do came close to a 50/50 split between those that led and lagged in the category.

Excess Returns Vs. Morningstar Category Indexes

There are two main bogies against which we evaluate performance: category peers and the category index. Measuring a fund's performance relative to its category index helps to mitigate style biases and highlights the importance of fees. Compared against a costless benchmark, funds that charge high fees incur high hurdles to outperform.

On average in 2022, sustainable funds underperformed their respective category benchmarks by 1.2 percentage points, but this trend reversed for most sustainable funds over the trailing three- and five-year periods. Notably, over the past three years, sustainable equity funds outperformed their respective category benchmarks by nearly 1.5 percentage points.

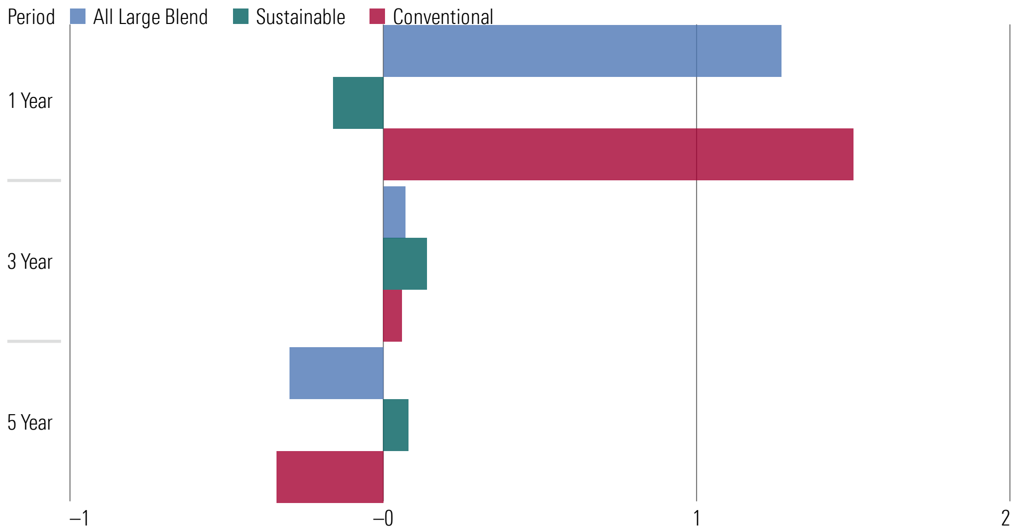
Exhibit 28 Sustainable Funds: Average Annualized Excess Return vs. Morningstar Category Indexes



Source: Morningstar Direct. Data as of Dec. 31, 2022. 1 Year sample includes 361 equity funds, 111 fixed-income funds, and 47 allocation funds. 3 Year sample includes 232 equity funds, 74 fixed-income funds, and 29 allocation funds. 5 Year sample includes 184 equity funds, 59 fixed-income funds, and 29 allocation funds. Does not include obsolete funds.

Within the large-blend equity category, sustainable funds' out- and underperformance over various time periods was more muted than that of conventional peers. In 2022, sustainable funds were the outliers in lagging the category benchmark—the Russell 1000 Index—by a modest 16 basis points on average. By contrast, conventional large-blend funds beat the benchmark by a full 1.5 percentage points.

Exhibit 29 Large-Blend Funds: Average Annualized Excess Return vs. the Russell 1000 Index



Source: Morningstar Direct. Data as of Dec. 31, 2022. 1 Year sample includes 79 sustainable funds and 515 conventional funds. 3 Year sample includes 48 sustainable funds and 455 conventional funds. 5 Year sample includes 38 sustainable funds and 413 conventional funds. Does not include obsolete funds.

However, these short-term trends weren't enough to erase longer-term returns. Over the past five years, the typical conventional large-blend fund lagged the benchmark by 34 basis points, and the average sustainable large-blend fund beat it by a humble 8 basis points.

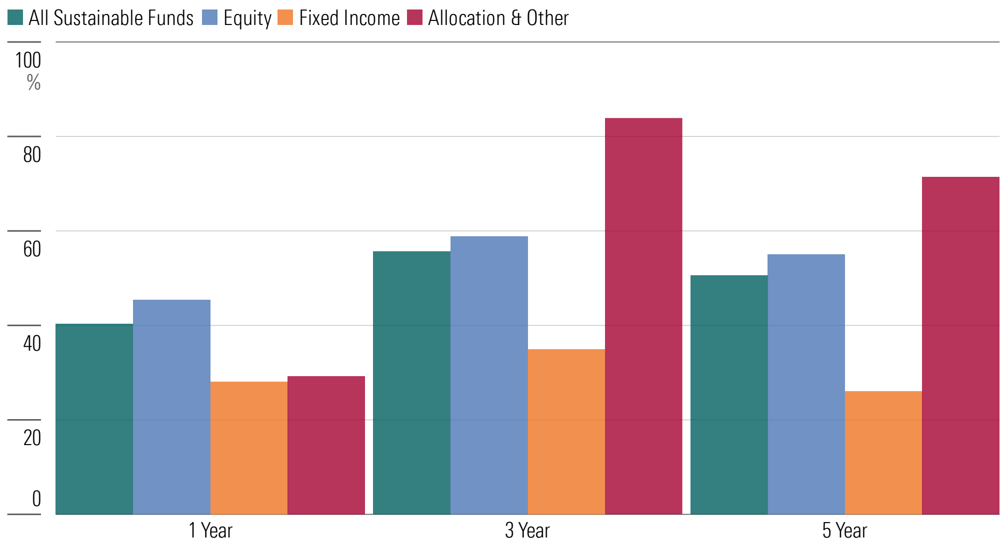
Sustainable Fund Success Rates

In this next section, we seek to understand a sustainable fund investor's likelihood of success. We define a successful fund, in this context, as one that survives to the end of a trailing period (without being liquidated or merged away) and delivers risk-adjusted returns that beat the benchmark.

To examine this dynamic, we calculated annualized alpha for each fund versus its respective Morningstar Category Index. At the beginning of our longest trial (January 2018), sustainable funds could be found in 72 individual Morningstar Categories, so we used each category's assigned index to control for stylistic differences. We used net-of-fee returns and controlled for multiple share classes (so that those funds didn’t have undue weight in the calculations). Finally, we included dead funds whenever possible.

Looking first at the overall sustainable fund universe, more than half of equity and allocation funds survived and beat the bogy over the trailing three- and five-year periods. A sustainable investor's likelihood of success was highest in allocation categories, but that sample size was also the smallest. Of the 29 sustainable allocation funds that entered 2018, 25 delivered bogy-beating five-year returns, while five were liquidated and four underperformed.

Exhibit 30 Sustainable Funds: CAPM Alpha Success Rates vs. Morningstar Category Indexes

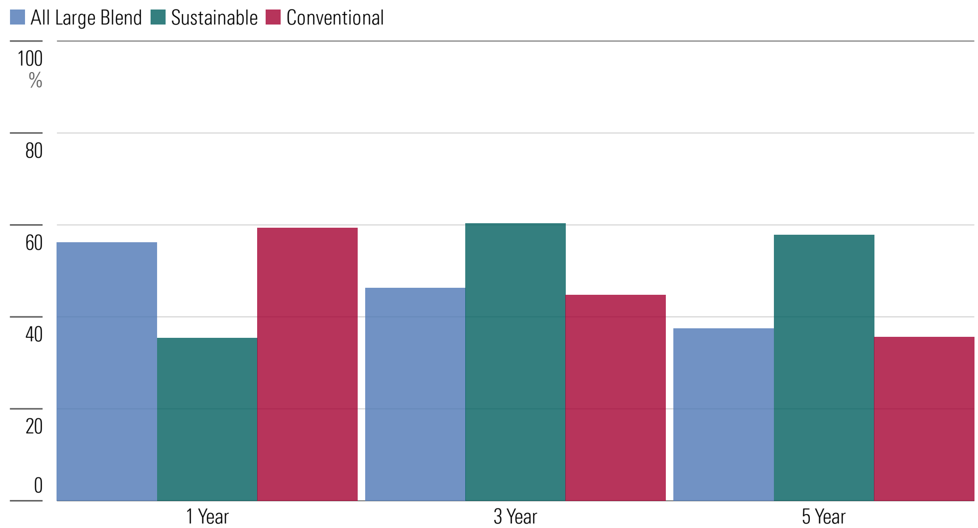


Source: Morningstar Direct. Data as of Dec. 31, 2022. Counts funds that liquidated during the respective time periods as "unsuccessful." 1 Year sample includes 361 equity funds, 111 fixed-income funds, and 47 allocation funds. 3 Year sample includes 232 equity funds, 74 fixed-income funds, and 29 allocation funds. 5 Year sample includes 184 equity funds, 59 fixed-income funds, and 29 allocation funds.

Two thirds of the equity funds that survived the full five years topped the index, while more than 30 sustainable equity funds closed during the period. By contrast, only 18 fixed-income funds triumphed. Ten sustainable bond funds were liquidated over the past five years, and 41 survived but underperformed.

As stated above, sustainable U.S. large-blend funds underperformed their conventional peers in 2022, which is reflected in their lower success rates for the year. Only 35% of sustainable funds outperformed the index during the year, while nearly 60% of their peers did so. It is even more impressive, then, that sustainable U.S. large-blend funds outperformed their conventional peers so heartily in the longer term.

Exhibit 31 Large-Blend Funds: CAPM Alpha Success Rate vs. the Russell 1000 Index



Source: Morningstar Direct. Data as of Dec. 31, 2022. Includes all large-blend funds as of beginning of each trailing period. Counts funds that liquidated during the respective time periods as "unsuccessful." 1 Year sample includes 79 sustainable funds and 515 conventional funds. 3 Year sample includes 48 sustainable funds and 455 conventional funds. 5 Year sample includes 38 sustainable funds and 413 conventional funds.

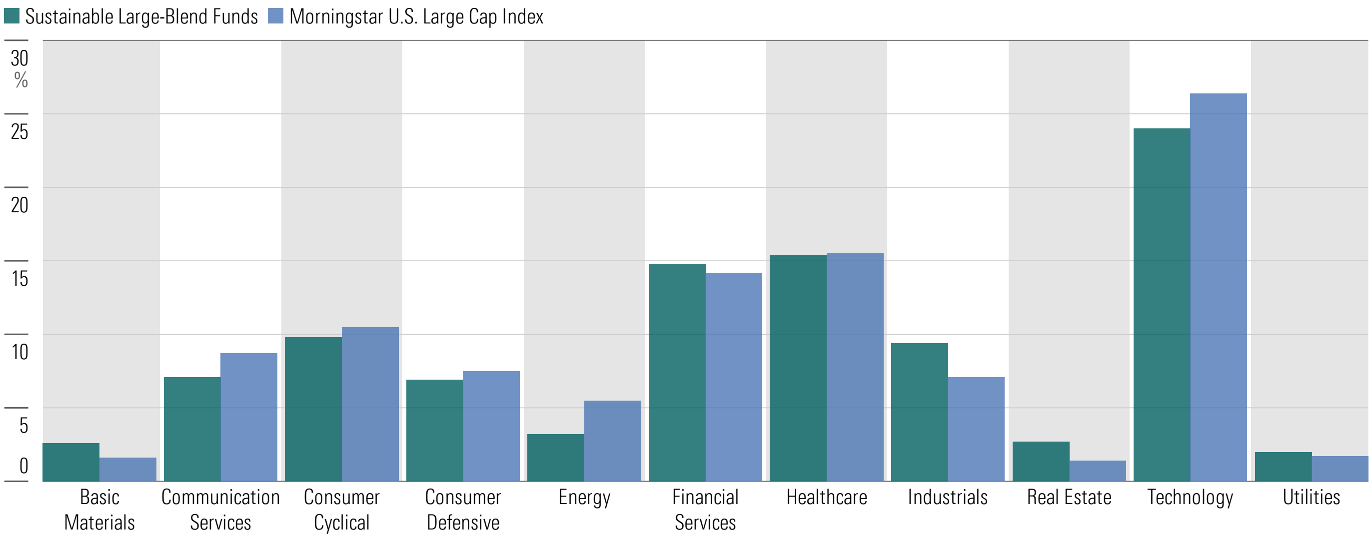
Over the trailing three- or five-year period, an investor seeking long-term returns would have been better off in a sustainable fund than in one of its conventional peers. Of the 451 U.S. large-blend funds an investor could have chosen in January 2018, 169 survived and beat the Russell 1000 Index, while 282 either closed or underperformed. Nearly 60% of the sustainable options succeeded, while only 35% of their conventional peers did.

Dissecting Performance: Portfolio Contribution by Equity Sector

Although sustainable funds come in all shapes and sizes, some commonalities exist. By and large, sustainable equity funds are thought to strategically limit their exposure to the traditional energy sector, compared with market-cap-weighted benchmarks, based on a lack of conviction in that sector's long-term investment merit. On the other hand, sustainable equity funds are expected to increase their exposure to the technology sector and the healthcare sector; however, these assumptions are not all reflected in the data.

To examine this dynamic, we compared a universe of nearly 100 sustainable U.S. large-blend equity funds with the Morningstar U.S. Large Cap Index. We find that the median of this group maintains an underweighting to the energy sector, compared with the broad-market index, but in absolute terms, this is only the third-largest sector bet held by sustainable funds, falling behind technology and industrials. Indeed, as of January 2023, the median sustainable U.S. large-blend equity fund allocated 24% to the technology sector, a 2.4-percentage-point underweight relative to the benchmark.

Exhibit 32 Sustainable Large-Blend Funds: Equity Sector Exposure vs. the Morningstar U.S. Large Cap Index



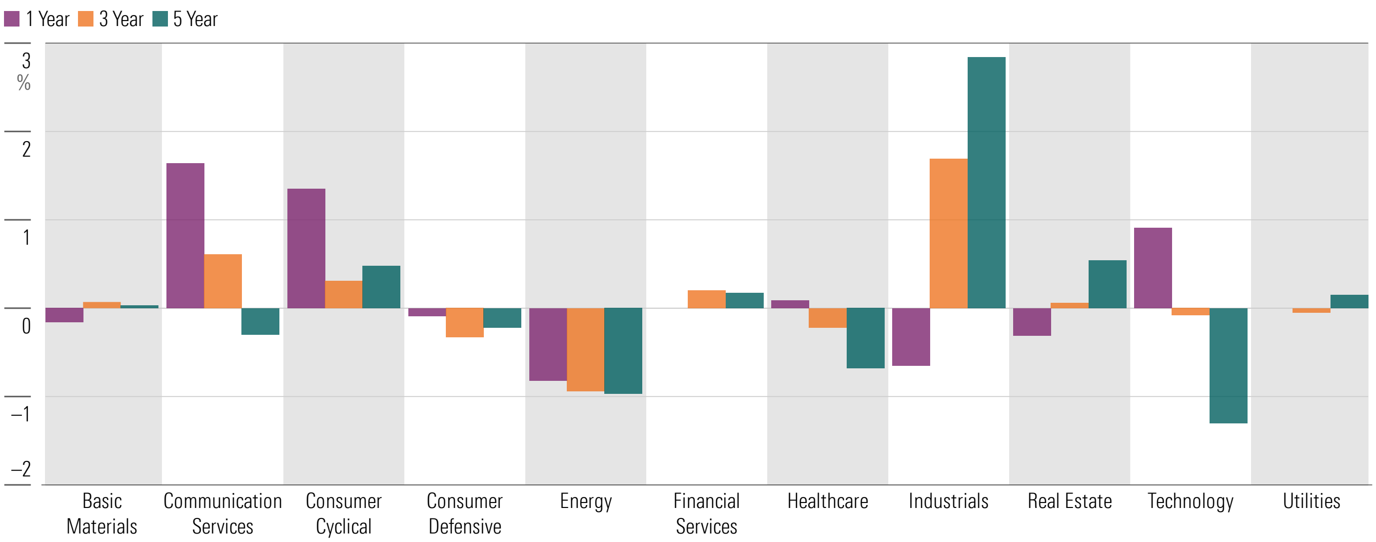
Source: Morningstar Direct. Data as of Dec. 31, 2022. Sustainable large-blend funds reflects the calculated median of a group of 86 funds. Excludes obsolete funds.

By contrast, the median sustainable fund held a 2.3-percentage-point overweighting in the industrials sector. The funds with the highest allocations to industrial stocks tend to be climate-focused strategies such as **Engine No. 1 Transform Climate ETF** NETZ and **Carbon Collective Climate Solutions U.S. Equity ETF** CCSO, with 61% and 39% in industrials, respectively.

Using this starting universe, we performed batch portfolio attribution analysis to understand how their portfolios and performance differed from the Morningstar U.S. Large Cap Index. We analyzed each fund's total return, its active return versus the Morningstar U.S. Large Cap benchmark, and the contribution of each equity sector to that active return.[11] After running this analysis for each fund in the sample, we calculated the median for each data point to arrive at single measures that were representative of the fund group.

11 Portfolio contribution by equity sector is the combined effect of sector allocation (return generated by dividing the portfolio among 11 equity sectors) and security selection (impact of a portfolio manager's choice of stocks) within each sector.

Exhibit 33 Sustainable Large-Blend Funds: Equity Sector Contribution to Active Returns vs. the Morningstar U.S. Large Cap Index



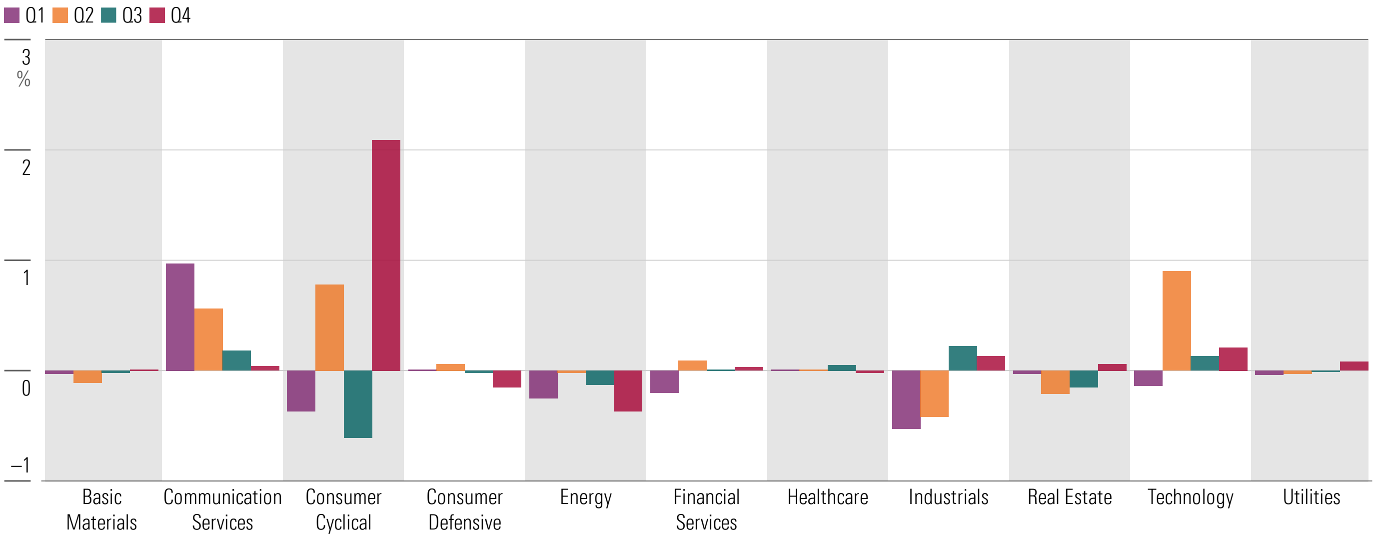
Source: Morningstar Direct. Data as of Dec. 31, 2022. Sustainable large-blend funds reflects the calculated median of a group of 86 funds. Excludes obsolete funds.

Over the trailing one-, three-, and five-year periods, the typical sustainable equity fund has outperformed the Morningstar U.S. Large Cap Index by 1.6, 2.7, and 2.5 percentage points, respectively. However, the picture wasn't uniformly pretty across all sectors.

During the same periods, the combination of an underweighting to and selection within the energy sector weighed on the typical fund's performance by 92, 120, and 164 basis points, respectively. On the other hand, although industrial stocks weighed on the typical fund's performance in 2022, their 2.8% contribution in the long-term blew all other sectors out of the water. Technology, often thought to be the driver of success for sustainable funds, dragged on their performance by more than 1 percentage point over the trailing five-year period, driven primarily by poor security selection within the sector.

Zooming in on 2022, the typical sustainable large-blend fund underperformed its benchmark in the first quarter, beat it in the second quarter, lagged in the third quarter, and rebounded in the home stretch. Even though the median fund lost nearly 16 percentage points in the second quarter, it held up better than the index, which lost more than 17 percentage points.

Exhibit 34 Sustainable Large-Blend Funds: Equity Sector Contribution to Active Returns vs. the Morningstar U.S. Large Cap Index



Source: Morningstar Direct. Data as of Dec. 31, 2022. Sustainable large-blend funds reflects the calculated median of a group of 86 funds. Excludes obsolete funds.

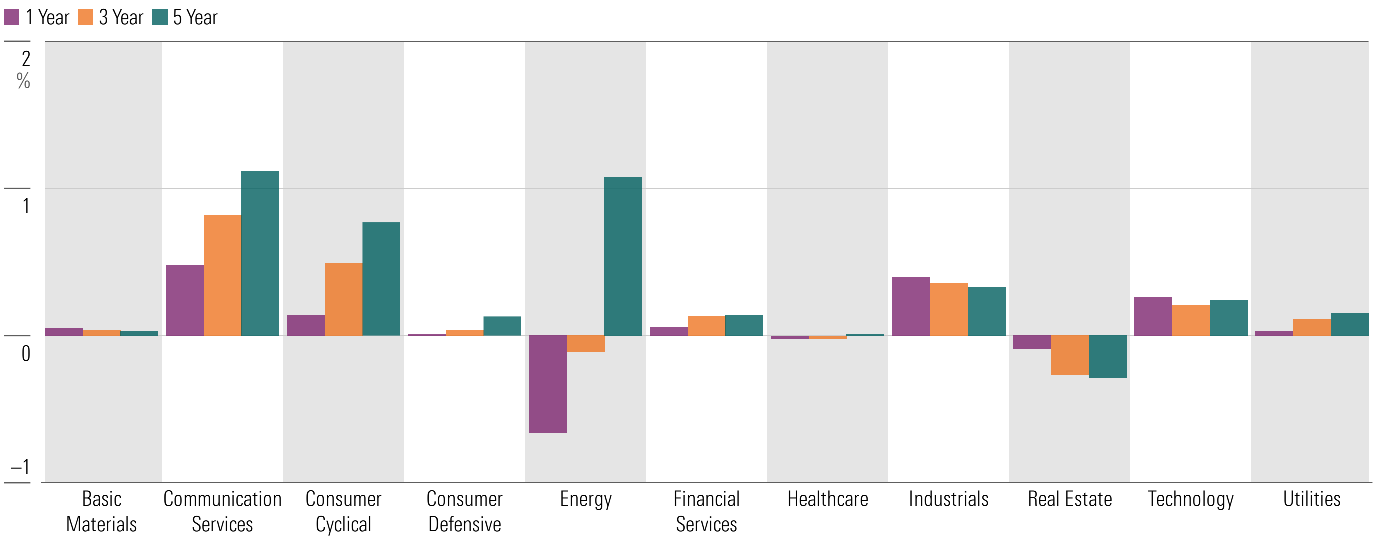
Most of the equity sectors had minimal impact to the typical fund's active return versus the benchmark, but not all. The combination of sector allocation and security selection within consumer cyclicals, which includes things like automobiles and entertainment, was all over the map. In the first and third quarters, that sector weighed on the typical fund's performance by 36 and 62 basis points, respectively. In the second and fourth quarters, it boosted returns by 87 and 200 basis points, respectively.

Also of note, the energy sector was a modest drag on performance in nearly all four quarters. Communication services stocks gave a strong boost in the first quarter but trickled off throughout the year. Although tech stocks weighed on performance to start out, their contribution in the subsequent quarters more than made up for the loss.

Digging Deeper: Equity Sector Allocation Effect

To get a clearer sense of common trends, we can dial in on the typical sustainable fund's allocation to each equity sector. This measure removes the effect of security selection, which is usually the result of an active manager's fundamental research into individual stocks. If sustainable funds follow similar sector-specific maps to analyze and adjust for material ESG risks, we will observe a trend in how sector allocation decisions affect active portfolio returns.

Exhibit 35 Sustainable Large-Blend Funds: Contribution of Sector Allocation to Active Returns vs. the Morningstar U.S. Large Cap Index

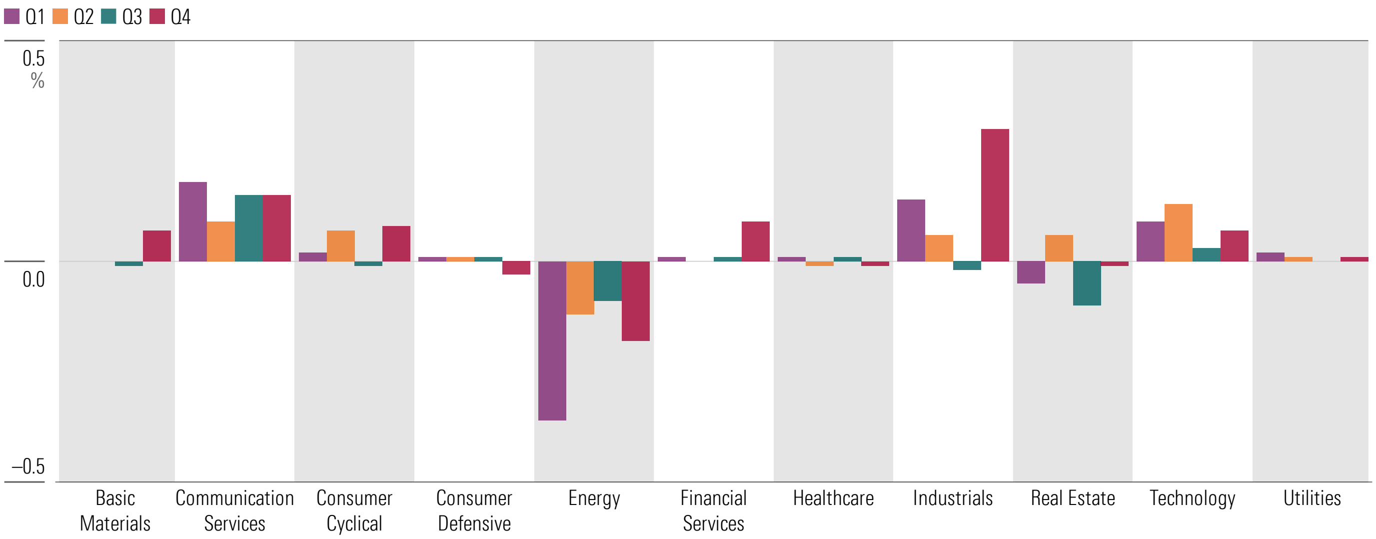


Source: Morningstar Direct. Data as of Dec. 31, 2022. Sustainable large-blend funds reflects the calculated median of a group of 86 funds. Excludes obsolete funds.

The exhibit above shows the impact of the median sustainable large-blend fund's sector allocation on its active return versus the Morningstar U.S. Large Cap Index over the trailing one-, three-, and five-year periods.

The reduced allocation to energy stocks was the strongest detractor in the short term, but it was also the second-strongest contributor over the long term. Overall, the energy sector saw massive swings in performance over the past five years. That it was such a heavy detractor in the short term but more than made up for this drag in the long term speaks to its volatility. The typical fund's allocation to communication services, on the other hand, added 47, 78, and 111 basis points over the trailing one-, three-, and five-year periods.

Exhibit 36 Sustainable Large-Blend Funds: Contribution of Sector Allocation to Active Returns vs. the Morningstar U.S. Large Cap Index



Source: Morningstar Direct. Data as of Dec. 31, 2022. Sustainable large-blend funds reflects the calculated median of a group of 86 funds. Excludes obsolete funds.

In 2022, energy stocks and industrial companies stand out as the strongest detractors and contributors, respectively. The typical sustainable fund's lower relative allocation to the energy sector weighed on returns by an average of 15 basis points in each quarter. In our overall portfolio analysis above, the energy sector's contribution was flat in the second quarter, meaning that portfolio managers may have picked winning stocks within the sector to offset their reduced exposure to it. On the other hand, the typical fund's exposure to industrials added one fourth of a percentage point in the final quarter of the year.

Dual Conviction in Investment Merit and ESG Quality

Looking to the future, we can consult our forward-looking ratings to identify those funds that Morningstar's manager research team believes will outperform. To do this, we searched within the U.S. sustainable funds universe for funds that earn medals under the Morningstar Analyst Rating.[12,13] Of those Morningstar Medalist funds, 10 are offered by asset managers that earn top marks on the Morningstar ESG Commitment Level.[14]

The ESG Commitment Level is a qualitative measure of the extent to which asset managers incorporate ESG considerations into their investment processes. The scale runs from best to worst as follows: Leader, Advanced, Basic, and Low. In many cases, firms that earn the Leader or Advanced designation

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12 Morningstar Analyst Rating for Funds Methodology, Morningstar Research, June 28, 2021.
https://assets.contentstack.io/v3/assets/blt4eb669caa7dc65b2/blt5c61046830e82ff2/MAR.pdf

13 Morningstar to Unite Two Forward-Looking Rating Systems into One: The Morningstar Medalist Rating, Morningstar Research, Aug. 31, 2022.
https://newsroom.morningstar.com/newsroom/news-archive/press-release-details/2022/Morningstar-to-Unite-Two-Forward-Looking-Rating-Systems-into-One-The-Morningstar-Medalist-Rating/default.aspx

14 The Morningstar ESG Commitment Level, Morningstar Research, December 2022.
https://assets.contentstack.io/v3/assets/blt4eb669caa7dc65b2/blt229e213cffff0332/Asset_Manager_ECL_2022_Landscape-FINAL.pdf

have focused on sustainable investing since day one, and this philosophy remains core to their identities today. They have stayed at the cutting edge of evolving investor expectations for sustainable strategies and ground their investment philosophies in outcomes-focused active ownership practices.

Exhibit 37 Top 10 Sustainable Medalist Funds

Name	Ticker	Fund Assets ($ Mil)	2022 Total Return	2022 % Rank Category	Morningstar Analyst Rating	Morningstar ESG Commitment Level	Morningstar Sustainability Rating™
Parnassus Core Equity	PRBLX	23,911	-18.6	60	Gold	Leader	5
Parnassus Mid-Cap	PARMX	6,083	-21.6	93	Silver	Leader	5
Boston Trust Walden Small Cap	BOSOX	1,003	-9.1	7	Silver	Leader	4
Parnassus Mid Cap Growth	PARNX	660	-33.5	80	Bronze	Leader	5
Impax Global Opportunities	PXGOX	105	-18.5	11	Bronze	Leader	5
Impax Global Environmental Markets	PGINX	2,208	-22.4	89	Bronze	Leader	5
TIAA-CREF Social Choice International Equity	TSONX	1,339	-14.8	38	Bronze	Advanced	3
TIAA-CREF Social Choice Equity	TISCX	5,809	-17.8	46	Bronze	Advanced	4
TIAA-CREF Green Bond	TGRNX	139	-13.0	33	Bronze	Advanced	2
TIAA-CREF Core Impact Bond	TSBIX	5,780	-14.0	75	Bronze	Advanced	3

Source: Morningstar Direct. Data as of Dec. 31, 2022.

All but two—**TIAA-CREF Green Bond** TGRNX and **TIAA-CREF Core Impact Bond** TSBIX—of the top 10 are equity funds. All 10 funds suffered negative returns in 2022, but five finished the year in the top half of their respective Morningstar Categories. **Parnassus Core Equity** PRBLX leads the pack in terms of assets, and it is the only fund to earn the highest merit under both ratings systems. In terms of sustainability performance, five of the top 10 earn 5 globes under the Morningstar Sustainability Rating, a sign that their portfolios are exposed to little ESG risk compared with peers.[15]

15 Morningstar Sustainability Rating Methodology, Morningstar Research, Nov. 8, 2021. https://www.morningstar.com/content/dam/marketing/shared/research/methodology/744156_Morningstar_Sustainability_Rating_for_Funds_Methodology.pdf

Sustainability Performance

Having evaluated the investment performance of sustainable funds, we now turn to sustainability performance. Sustainable funds employ various sustainable-investing approaches, which will result in different portfolio characteristics. For example, many funds focus on managing exposure to material ESG issues that may affect portfolio companies and their industries. These funds assess performance in areas like business ethics, treatment of workers, carbon emissions, and pollution, and we expect them to have little exposure to ESG and carbon risk.

Using Morningstar data, we can assess a fund's sustainability in three ways. We can evaluate sustainable funds' exposure to material ESG risk as well as carbon risk and fossil fuel activities. Our expectation is that sustainable funds will generally have low levels of ESG risk and little exposure to carbon risk and fossil fuels, compared with peers. Finally, we can evaluate active ownership via fund proxy voting on ESG issues. Our expectation is that sustainable funds will be strong supporters of ESG-related shareholder resolutions.

Limiting ESG Risk: The Morningstar Sustainability Rating

In this section, we examine the extent to which sustainable funds limit their portfolios' exposure to ESG risk compared with peers. The Morningstar Sustainability Rating can help answer these questions.

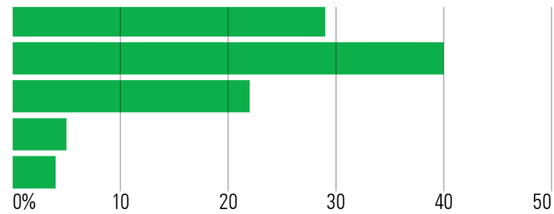
The Morningstar Sustainability Rating is an asset-weighted roll-up of Sustainalytics' company and sovereign ESG Risk Ratings[16] based on the trailing 12 months of a fund's portfolios. Each sleeve (corporate or sovereign) of the fund's portfolio is ranked within the global peer category group, and 1 to 5 globes are assigned. Each sleeve's rating is multiplied by its respective globe rating to arrive at the fund's overall globe rating.

Although the consideration of material ESG risks is becoming more common in traditional investment management, sustainable funds continue to deliver lower levels of ESG risk, compared with peers. Nearly 70% of sustainable funds receive the highest ratings, 4 or 5 globes, compared with 27% of funds overall. At the other end of the scale, less than one tenth of sustainable funds receive the lowest rating, 1 or 2 globes, compared with close to one third of funds overall.

16 ESG Ratings Are Now Available for Bond Funds, Allocation Funds, Karen Wallace, Nov. 17, 2021. https://www.morningstar.com/articles/1067453/esg-ratings-are-now-available-for-bond-funds-allocation-funds

Exhibit 38 ESG Risk in Sustainable Funds

		Sustainable Funds	
Sustainability Rating	Overall Universe %	#	%
🌐🌐🌐🌐🌐	7	154	29
🌐🌐🌐🌐	20	211	40
🌐🌐🌐	43	116	22
🌐🌐	23	29	5
🌐	7	19	4



Source: Morningstar Direct. Data as of Dec. 31, 2022. Does not include obsolete funds. Overall universe includes the oldest share class of all live U.S.-domiciled funds.

Limiting Carbon Risk: The Morningstar Low Carbon Designation

Many sustainable funds avoid fossil fuel companies, but investors should not assume that all sustainable funds do so. As the field of sustainable investing becomes more diverse, we see a broadening of portfolio characteristics. Over the past year, more than 20% of new sustainable funds launched with a climate focus. Some seek to reduce or even remove exposure to carbon risk, some target those companies developing innovative solutions to climate change, and many employ a mix of these strategies.[17] This may mean that portfolios look less “climate-friendly,” but it does not necessarily invalidate the sustainable-investing approaches in use.

We can quantify this development by measuring the carbon risk of sustainable funds' portfolios. The Morningstar Portfolio Carbon Risk Score is created by rolling up company-level Sustainalytics Carbon Risk Ratings, using portfolios from the trailing 12 months. Those that have low carbon risk and low fossil fuel exposure[18] receive the Morningstar Low Carbon Designation.[19] In 2022, 245 of the 439 sustainable funds with a Morningstar Portfolio Carbon Risk Score earned the Low Carbon Designation, or 56%. This is down from the highest level in 2020, when 73% received the designation, but up from less than 50% in 2019. Still, the proportion of sustainable funds that earn the Low Carbon Designation is consistently higher than in the overall universe of U.S.-domiciled equity funds, in which just 36% received the designation.

Portfolios with some involvement in fossil fuels may still earn the Low Carbon Designation. Of the 245 sustainable funds that earn the Low Carbon Designation, 75 (or 31%) had less than 1% average exposure to fossil fuels over the past 12 months. Below are the seven such funds that manage more than $500 million in assets and also earn a High Morningstar Sustainability Rating, indicating significantly little exposure to ESG or carbon risk.

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17 Climate Funds Dig Deeper Roots, Alyssa Stankiewicz, April 13, 2022. https://www.morningstar.com/articles/1088297/climate-funds-dig-deeper-roots

18 Companies are considered involved in fossil fuels if they derive at least an aggregate 5% share of total revenue from the following activities: thermal coal extraction, thermal coal power generation, oil and gas production, and oil and gas power generation. Companies deriving at least 50% of their revenue from oil and gas products & services are also included. Companies involved in arctic oil & gas exploration and oil sands extraction will be included only if there is no involvement in oil & gas production.

19 The Morningstar Low Carbon Designation is based on two metrics—Morningstar® Portfolio Carbon Risk Score™ and Morningstar® Portfolio Fossil Fuel Involvement.™ To receive the designation, a fund must have a 12-month average Portfolio Carbon Risk Score below 10 and a 12-month average Fossil Fuel Involvement of less than 7% of assets.

Exhibit 39 Sustainable Funds With Low Carbon Risk, Low ESG Risk, and $500 Million in Assets

Name	Ticker	Morningstar Category	Fund Assets ($ Mil)	Morningstar Sustainability Rating™	Low Carbon Designation™
Calvert Equity	CSIEX	Large Growth	5,989	🌐🌐🌐🌐🌐	Yes
Brown Advisory Sustainable Growth	BAFWX	Large Growth	5,650	🌐🌐🌐🌐🌐	Yes
Parnassus Value Equity	PARWX	Large Value	4,604	🌐🌐🌐🌐🌐	Yes
Impax Large Cap Fund	PXLIX	Large Blend	1,348	🌐🌐🌐🌐🌐	Yes
Parnassus Mid Cap Growth	PARNX	Mid-Cap Growth	660	🌐🌐🌐🌐🌐	Yes
iShares ESG Advanced MSCI USA ETF	USXF	Large Growth	599	🌐🌐🌐🌐🌐	Yes
Nuveen Winslow Large-Cap Growth ESG	NVLIX	Large Growth	591	🌐🌐🌐🌐🌐	Yes

Source: Morningstar Direct. Data as of Dec. 31, 2022.

Practicing Active Ownership: Proxy Voting

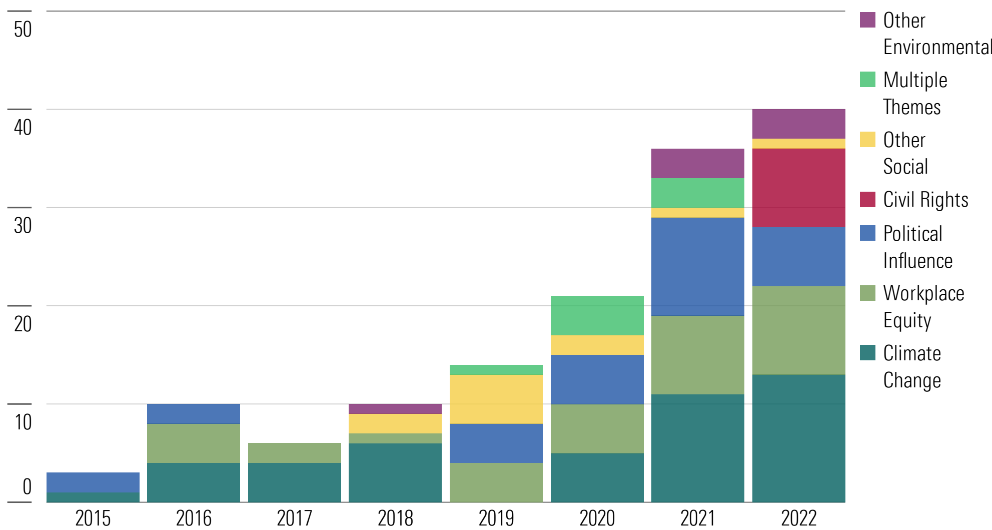
An increasingly important dimension of sustainable investing is stewardship: how a fund engages with the companies it owns, votes proxies, and seeks to provide measurable impact beyond financial return. Often called *active ownership*, this activity is not easy to evaluate overall, but we can assess the extent to which sustainable equity funds use their proxy votes to support progress on key sustainability initiatives in companies whose stocks they own.

Many of the issues that shareholders bring to company proxy ballots directly address sustainability concerns. Looking at the full universe, 102 key ESG-related shareholder resolutions appeared on proxy ballots in 2022.[20] Morningstar defines key resolutions as those that address environmental or social themes that were supported by 40% or more of a company's independent shareholders—that is, excluding company insiders such as directors, founders, and strategic investors. Including votes by company insiders, the average level of support for key resolutions was 44%, down from the record 53% in 2021.

Because they were unopposed by company boards and received an average of 92% support (which would have skewed the overall analysis), Morningstar moved to exclude seven shareholder proposals from the list of key resolutions in 2022. However, these seven proposals are included in Exhibit 45, which shows that 40 ESG-related shareholder resolutions were supported by a majority of independent shareholders, more than the previous record of 36 from 2021.

20 How Did the Top U.S. Asset Managers Vote on ESG Shareholder Resolutions?, Lindsey Stewart, Feb. 1, 2023. https://www.morningstar.com/articles/1134673/how-did-the-top-us-asset-managers-vote-on-esg-shareholder-resolutions

Exhibit 40 Majority-Supported Environmental and Social Shareholder Resolutions



Source: Morningstar Proxy-Voting Database. Data as of Jan. 5, 2023. Note: Years represent proxy-voting years ended June 30.

How meaningful are these resolutions to company management? Very meaningful, it turns out. While resolutions are advisory and management is under no obligation to adopt the proposed measures, a recent analysis by BlackRock found that, over a three-year period, ESG-related proposals were fully implemented in 94% of cases where they achieved majority support. In three fourths of cases where support was at least 30%, management acted on the proposal.[21]

We assessed sustainable funds' level of support for those 102 key ESG resolutions and found, not surprisingly, a higher rate of support than among funds overall. Sustainable funds, on average, supported 74% of the key ESG resolutions on which they voted.

Among sustainable funds, most funds exhibited strong support, but support ranged from 100% all the way down to zero.[22] The median level of support for key ESG resolutions was 93% among sustainable funds. Fund votes are cast in proportion to the value of their shares, meaning that a fund's size determines how influential its voting stance will be.

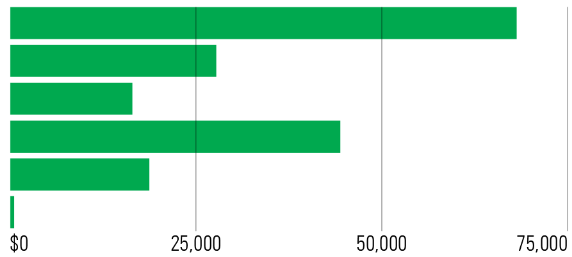
For the first time in at least three years, a majority of the sustainable funds that cast at least 10 key votes in 2022 voted for 100% of key ESG resolutions. This represented nearly 40% of assets in voting funds. Together, the sustainable funds that voted on at least 10 resolutions manage $176 billion in assets, and nearly 40% of those assets supported 100% of 2022's key ESG resolutions.

21 Our 2021 Stewardship Expectations, BlackRock, 2020. https://www.blackrock.com/corporate/literature/publication/our-2021-stewardship-expectations.pdf

22 Only funds that voted on at least 10 key ESG resolutions are included in the studied sample. There will likely be no votes for many if not most of the funds for the following reasons: Smaller/actively managed funds will have narrow holdings that don't intersect with the key ESG votes list; alternatively, the fund's vote record may not have been parsed for 2021; or, in a minority of cases, the equity data team has been unable to extract the vote record from the relevant filing because of the structure of the record.

Exhibit 41 Sustainable Fund Support for Key ESG Resolutions in 2022

% Support	Number of Funds	Total Assets (USD Mil)
100	88	68,145
76–99	53	27,747
51–75	26	16,452
26–50	30	44,440
1–25	6	18,744
0	8	581



Source: Morningstar Proxy-Voting Database. Data as of Jan. 5, 2023. Note: Includes funds voting on at least 10 key ESG resolutions. Total fund size in Mil USD.

However, sustainable funds also voted against key ESG resolutions more frequently than in previous years. In 2022, 44 funds supported less than half of the key ESG resolutions on which they voted, representing more than one third of assets. This is similar to the level seen in 2020 but less favorable than in 2021, where very few funds were unsupportive. Last year, only five funds supported less than half of their key ESG votes, accounting for less than 20% of assets.[23]

As investors put more money into sustainable funds, the collective influence of these strategies via their proxy voting also grows. Because of their size, larger funds have greater influence on any particular vote than do smaller funds, and the largest asset managers wield significant power. On average, sustainable funds managed by BlackRock, Vanguard, and State Street supported 48% of the key ESG resolutions on which they voted in 2022, representing $56 billion in assets.

Overall support for key ESG resolutions among the largest sustainable funds was largely positive in 2022. Across the 10 largest voting funds, average support for the key resolutions was 62%. At the high end, Parnassus Core Equity and **Calvert Equity** CSIEX each supported 100% of key ESG proposals. Both firms have been dedicated ESG shops since their founding, so the high level of support is unsurprising.

23 In the 2021 proxy season, 75 sustainable funds voted on at least 10 key ESG resolutions, representing $121.7 billion in assets. Of these, 70 funds backed at least half of the key resolutions on which they voted, representing $98.5 billion in assets. The remaining five funds supported less than half of their key votes and managed $23.2 billion in assets.

Exhibit 42 How the Largest Sustainable Funds Voted on Key ESG Resolutions

Name	Ticker	Fund Assets ($ Mil)	% Support
Parnassus Core Equity	PRBLX	23,911	100%
iShares ESG Aware MSCI USA ETF	ESGU	19,587	45%
Vanguard FTSE Social Index	VFTNX	12,774	20%
Pioneer	PIODX	6,540	77%
Calvert Equity	CSIEX	5,989	100%
TIAA-CREF Social Choice Equity	TISCX	5,809	65%
Vanguard ESG U.S. Stock ETF	ESGV	5,659	22%
Brown Advisory Sustainable Growth	BAFWX	5,650	95%
Putnam Sustainable Leaders	PNOPX	4,890	50%
DFA U.S. Sustainability Core 1 Portfolio	DFSIX	4,785	43%

Source: Morningstar Proxy-Voting Database. Data as of Jan. 5, 2023. Note: Includes funds voting on at least 10 key ESG resolutions. Total fund size in Mil USD.

On the other hand, Vanguard's largest ESG funds—Vanguard FTSE Social Index and Vanguard ESG U.S. Stock ETF—supported less than one fourth of the key ESG resolutions on which they voted in 2022. This is lower than Vanguard's overall level of support, which may surprise investors in those funds. On average, Vanguard funds have supported 36% of key ESG resolutions over the past three years.[24]

As one of the most powerful tools investors can use to effect sustainable change, we expect increasing focus on active ownership in the years to come.

24 How Did the Top U.S. Asset Managers Vote on ESG Shareholder Resolutions?, Lindsey Stewart, Feb. 1, 2023. https://www.morningstar.com/articles/1134673/how-did-the-top-us-asset-managers-vote-on-esg-shareholder-resolutions

Regulatory Developments

- **ESG Options for Retirement Savers**

  The U.S. Department of Labor finalized "Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights" in November.[25] This new rule explicitly states that the duty of prudence (a retirement plan fiduciary's responsibility to make investment decisions based on financially material factors) could include the consideration of climate change and other ESG issues.[26] The new rule also allows for the consideration of collateral benefits (such as positive impact on people and planet) as a tiebreaker in plan selection, and it reminds fiduciaries that their duty includes the management of shareholder rights, such as by voting proxies. The rule lifted prior guidance that made it difficult and risky for employers that wanted to use ESG-focused investment options as default investments for workers automatically enrolling in a qualified plan. In January 2023, 25 attorneys general sued the Labor Department to block this rule change. We will continue monitoring the situation.[27]

- **Climate Disclosures Should Be Comprehensive, Consistent, and Comparable**

  In March, the U.S. Securities and Exchange Commission proposed a rule to enhance and standardize climate-related disclosures for investors.[28] This rule would require public companies to enhance and standardize the disclosure of climate-related risks and opportunities.[29] Although the rule would only apply to company-level climate-risk disclosures, this data would enable funds to provide greater transparency into their climate-risk management strategies, a win for investors. The public comment period for this proposal closed in the second quarter, and we expect the guidance to be finalized in early 2023. More information about Morningstar's views of and suggested amendments to the proposal can be found in this article.[30]

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25 Final Rule on Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights, U.S. Department of Labor, Nov. 22, 2022. https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/fact-sheets/final-rule-on-prudence-and-loyalty-in-selecting-plan-investments-and-exercising-shareholder-rights

26 4 Takeaways on the New ESG Rule for Retirement Plans, Jon Hale, Nov. 30, 2022. https://www.morningstar.com/articles/1127944/4-takeaways-on-the-new-esg-rule-for-retirement-plans

27 GOP-led states sue Biden administration to block ESG investment rule, Matt Egan at CNN, Jan. 27, 2023. https://www.cnn.com/2023/01/27/investing/biden-esg-lawsuit/index.html

28 SEC Proposes Rules to Enhance and Standardize Climate-Related Disclosures for Investors, March 21, 2022. https://www.sec.gov/news/press-release/2022-46

29 The SEC's Proposed Climate-Risk Rule Helps All Investors, Jon Hale, March 24, 2022. https://www.morningstar.com/articles/1085746/the-secs-proposed-climate-risk-rule-helps-all-investors

30 What We Told the SEC About Climate-Related Risk Disclosures, Aron Szapiro, June 17, 2022. https://www.morningstar.com/articles/1098889/what-we-told-the-sec-about-climate-related-risk-disclosures

- **The SEC Joined the Battle Against Greenwashing**

In May, the SEC proposed two rules intended to help investors better understand and compare funds that feature ESG criteria in their investment processes. The first is an amendment to the Investment Company Names Rule, which has been around since 2001.[31] It requires a fund with a name suggesting a focus on a particular type of investment to invest at least 80% of its assets in that type of investment, under normal conditions. It currently applies to fund names with terms like "stock," "bond," and "tax-exempt," and the proposal would broaden the scope of the rule to include "ESG" and "sustainable" funds.[32]

- **It's Not Easy Being Green: Standardizing ESG Fund Disclosures**[33]

The SEC also proposed amendments to rules and disclosures with the goal of standardizing information concerning funds' and advisors' incorporation of ESG factors.[34] This proposal would require funds that use ESG criteria in their investment process to disclose more about how they do so in their prospectuses and annual reports. The proposal identifies and defines three broad types of ESG funds: ESG integration, ESG focused, and impact. The first, and most common cohort, would be required to describe how they incorporate ESG into their process. The disclosure requirements escalate for ESG focused funds to describe the approaches they use in an "ESG Strategy Overview" table, as well as how the fund votes proxies and/or engages with companies about ESG issues. Impact funds would have to disclose how they measure progress toward the stated impact, the relevant time horizon, and any expected trade-off between the targeted impact and investment returns. The comment period for these proposals concluded during the third quarter, and we expect the guidance to be finalized in early 2023.

31 Statement on Proposed Updates to Names Rule, Chair Gary Gensler, May 25, 2022. https://www.sec.gov/news/statement/gensler-statement-proposed-updates-names-rule-052522

32 SEC Proposes New Rules for Sustainable Funds Aimed at Standardizing ESG Disclosures, Jon Hale, May 27, 2022. https://www.morningstar.com/articles/1096343/sec-proposes-new-rules-for-sustainable-funds-aimed-at-standardizing-esg-disclosures

33 It's Not Easy Being Green: Bringing Transparency and Accountability to Sustainable Investing, Commissioner Allison Herren Lee, May 25, 2022. https://www.sec.gov/news/statement/lee-statement-esg-052522

34 Statement on ESG Disclosures Proposal, Chair Gary Gensler, May 25, 2022. https://www.sec.gov/news/statement/gensler-statement-esg-disclosures-proposal-052522

Corrections and Clarifications

Correction

Exhibit 3 on Page 7 has been updated to include a missing legend.
Exhibit 12 on Page 13 has been added. It had previously duplicated Exhibit 11.

About Morningstar Manager Research

Morningstar's global manager research team conducts objective, qualitative analysis of managed investment strategies such as mutual funds and exchange-traded funds. Manager research analysts express their views through the Morningstar Analyst Rating, which takes the form of Gold, Silver, Bronze, Neutral, or Negative. The analysts arrive at a strategy's Analyst Rating by assessing key areas including its management team and supporting resources (People Pillar), its investment approach and rationale (Process Pillar), and the investment organization backing the strategy concerned (Parent Pillar). The analysts juxtapose those assessments with the strategy's cost in arriving at a final Analyst Rating, which expresses their conviction in the strategy's ability to outperform a relevant benchmark index or category peers over a market cycle, adjusted for risk. The Morningstar Analyst Rating methodology is forward-looking in nature and applied consistently across geographies and markets. (The Analyst Rating is an opinion, not a statement of fact, and is not intended to be nor is a guarantee of future performance.)

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