

# Can mandatory disclosure enhance sustainable investment?

Lara Spaans' research focuses on the factors affecting portfolio allocation decisions in mutual funds, with particular attention to the sustainability performance of their holdings. One of her papers examines how mandatory disclosure of funds' sustainability characteristics affects mutual funds' carbon intensity, ESG scores, and investment flows.

Responsible investing has gained significant traction among investors since the adoption of the Paris Agreement in 2015. Despite this development, there have been concerns that ESG investment vehicles are not alike, difficult to compare, and potentially even susceptible to greenwashing. These concerns may significantly hinder the flow of capital to sustainable investments. To address these issues and promote the mainstreaming of sustainable investments, the EU introduced the Sustainable Finance Disclosure Regulation (SFDR) in 2019, which became effective in 2021. It specifically mandates that EU-regulated financial market participants such as providers of

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mutual funds report on the sustainability characteristics of their products or services.

Our research (Spaans et al. 2024) investigates if, and how, the 2021 EU Sustainable Finance Disclosure Regulation (SFDR) affected the flows to mutual funds and portfolio allocations of fund managers. For a sample of European funds (affected by the SFDR) and US-domiciled (unaffected) equity mutual funds, we gathered data on their flows and various portfolio-level ESG measures, such as portfolio carbon intensity and ESG score.

One way through which SFDR could affect flows is through a labelling regime that it has effectively encouraged, potentially enabling funds to provide a new signal to investors about the use of ESG information. EU funds were required to choose whether they align with SFDR's regulatory Article 6 (fund does not align with ESG), Article 8 (the fund, next to a financial objective, chooses to align its investments with ESG characteristics) or Article 9 label (the fund has both a financial and sustainability objective). In our study, we document that many European funds effectively chose Article 8 around the introduction of SFDR. However, this labelling as such had a modest impact on capital flows: relative to Article 6 funds, Article 8 and 9 funds experienced a marginally higher flow of nearly 1 bp per year after the SFDR announcement, and this flow effect mainly concerned retail funds.

Although the effects on capital allocations to mutual funds appear to have been limited, we also provide evidence that SFDR encouraged EU fund managers to change their portfolio composition. Compared to U.S.-domiciled funds unaffected by SFDR, European retail Article 8/9 funds improved

the ESG score and reduced the carbon intensity of their portfolios after the announcement of SFDR. This evidence suggests that by requiring funds to be transparent about their ESG integration, the SFDR incentivized mutual funds to align portfolios with their stated integration. Moreover, we found that European funds that primarily serve institutional investors improved their portfolio carbon intensity and ESG scores *regardless* of having selected Article 6, 8, or 9. Possibly, this implies that despite the limited flow-based incentives to choose a certain SFDR label, the EU mutual fund sector expected, going forward, a structural increase in mandated ESG disclosure regardless of their chosen Article classification. This may have encouraged affected European funds to improve the ESG profile of their holdings.

Our findings have implications for disclosure regulation policy and its effect on investment practice. At first glance, the modest effects of SFDR on fund flows could suggest that SFDR – following its implementation in 2021 – only weakly promoted greater capital allocations into sustainable investment products. At the same time, our research also supports the idea that mandated sustainability disclosure for capital market actors by itself, has the *potential* to causally affect fund flows and the portfolio allocations of institutional investors. Perhaps not unexpectedly, SFDR is currently undergoing review and consultation to make rules clearer and more effective.

## Reference

- Spaans, L., J. Derwall, J. Huij and K. Koedijk (2024), 'DPI8881 The Sustainable Finance Disclosure Regulation: Voluntary Signaling or Mandatory Disclosure?', CEPR Discussion Paper No. 18881.