IMPACT WASHING GETS A FREE RIDE

AN ANALYSIS OF THE DRAFT EU ECOLABEL CRITERIA FOR FINANCIAL PRODUCTS

June 2019

FOREWORD

"Environmental performance means the result of a manufacturer's management of those characteristics of a product that cause environmental impact."

A *"Financial products or investments in themselves cannot be green. Greenness is derived from the uses to which they are being put in underlying assets or activities."*

B *"Just because an investee is doing great things doesn't mean that your investment will help the investee do more or better."*

THE ORIGINAL SIN: CONFUSING THE IMPACT OF INVESTMENTS WITH THE IMPACT OF INVESTEES

As you may have noticed, **statements A and B contradict each other**. Explained in the context of the documents from which they are extracted,

- statement A assumes that **investing in a financial product** (e.g. listed equity fund, bond fund) exposed to green economic activities (e.g. renewable power, railways) boosts these activities and/or enhances their environmental impact **even when this is not the goal of the investment strategy** and **there is no evidence** to suggest that the investment delivers any change. It also assumes that, for investors, **increasing their exposure to green activities is the *only* way to generate environmental impact;**
- statement B suggests that the environmental (or social) **impact of a financial product is not as simple as that;** it states that the environmental performance of an investment strategy is distinct from the "greenness" of a portfolio's "underlying assets or activities."
    - On the one hand, an investor can buy stocks or bonds from a company with green activities without changing its activities at all, simply because a shortage of investors is not necessarily an obstacle to changing activities in the first place. Take the example of bonds issued by a state-owned railway company. The company's ability to increase investment in high speed train lines—the green activity—is limited by several factors, including a cap on public debt. Clearly, the company is not prevented from increasing investment just because investors are unwilling to purchase their bonds. Thus, an approach that aims at **closing the climate finance gap by financing entities that already enjoy access to financial markets** is contradictory and likely ineffective.
    - On the other hand, investors exposed to brown activities can **use their voting rights** or other means of influence to push companies toward greener capital expenditure and practices. A financial product exclusively invested in brown activities can therefore deliver environmental impact. Take the example of a real estate fund that purchases old buildings with low energy efficiency, invests in their green refurbishment, and subsequently sells the assets. Increasing investment in this fund contributes to energy savings even though, at a any given time, most assets in the fund will have low environmental performance; **the financial product is "green" while the underlying assets are "brown."**

The second statement comes from the Stanford Social Innovation Review. The first sentence, unfortunately, comes from the European Commission, in its Technical Report on the Ecolabel for Financial Products. It summarizes the EC's current approach to designing the Ecolabel for financial products management (as a service). Based on 2°ii's research, the EC's approach is technically inconsistent and legally contradicts the Ecolabel Regulation, in which ***"environmental performance means the result of a manufacturer's management of those characteristics of a product that cause environmental impact."*** By trying to oversimplify a complex reality to deliver quick reforms, the EC may end up violating its own rules.

THE APPARENT STRATEGY: TURNING 1% OF THE MARKET INTO A GREEN ASSET BUBBLE

The Draft Ecolabel focuses exclusively on **environmental themed funds,** which **represent about 0.1% of today's market.** Based on the Draft Criteria, the Ecolabel eligible investment universe is composed of about 200 listed companies with environment-related activities, representing 1% of the global universe. Thus, the Ecolabel's strategy appears to be to **inflate this micro-niche artificially to a 10-20% market share** by promoting environmental themed funds to the 60-70% of retail clients interested in the environmental impact of their investment products.

As a result, these retail investors would be sold products that:
- are not associated with a guarantee of environmental impact, and
- expose them to a **potential asset bubble**.

Although the EC Ecolabel is unlikely to be enough of a success to generate a real bubble, it is reasonable to expect its implementation to support **mis-selling of unsuitable products** and to generate **unfair competition** for genuine impact investment products.

"SUSTAINABLE INVESTMENT" DEFINITION: THE ROTTEN APPLE HAS SPOILED THE BARREL

Furthermore, the confused definition of "sustainable investment" that lies at the core of Draft Ecolabel has spoiled the European Commission's *Sustainable Finance Regulatory Package* in its entirety. A **confusion of the environmental impact of investment in financial products and the impact of investment in underlying activities (i.e. capital expenditure of companies and other entities in the portfolio)** has spread across all key regulations of the Package: the taxonomy, the regulation on disclosures, and, more critically, the reform of financial advisors' obligations.

As a result, environmental themed funds will not only become the sole category of financial products officially associated with environmental benefits, but, given the reforms envisioned under MIFID and IDD, will also become **the only suitable choice for recommendation by financial advisors to clients with environmental preferences**. This disregards the fact that consumer surveys do not point to environmental themed funds, and contradicts the aim of MIFID and IDD to understand what clients want instead of selling a one-size-fits-all product.

Lastly, by pushing a dogmatic approach as opposed to an evidence-based one, the EC is creating a precedent that has the potential to undermine the integrity of the broader sustainable finance agenda in Europe.

BACK TO COMMON SENSE, IT'S TIME FOR ENVIRONMENTAL ASSET MANAGEMENT!

This paper recommends an alternate approach to the development of the Ecolabel that centers on implementing an **Environmental Management System to design and execute the investment strategy**. The approach can be adapted from the European Eco-Management and Audit Scheme (**EMAS**), and builds on the key principles of **impact investing** proposed by the Global Impact Investor Network (**GIIN**)—intention, additionality and measurement. It is technically and legally consistent with existing rules on the Ecolabel and consumer protection.

2° Investing Initiative believes that the next steps in the development of the Ecolabel will be a litmus test for understanding whether the EC's approach to sustainable finance will effectively contribute to the environmental policy goals of the European Union, or instead undermine them by legalizing impact washing by asset managers. While this conclusion may appear dramatic, it effectively summarizes the concerns that follow from this paper's findings.

Stan Dupre, CEO 2° Investing Initiative*

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*2° Investing Initiative is an independent, non-for-profit think tank that first introduced a plan to align EU financial regulation with climate and environmental policy goals in 2012. The organization has been the primary beneficiary of EC research grants on sustainable finance since then, and its CEO is a member of the EC HLEG.

EXECUTIVE SUMMARY

GOAL: REORIENTING CAPITAL FLOWS TOWARD SUSTAINABLE INVESTMENT

With its *Action Plan on Financing Sustainable Growth*, the European Commission has set itself the ambitious goal of **"reorienting capital flows towards sustainable investment."** The good news is that retail investors appear to be perfect allies to achieve this goal. **Interest in social and environmental impact-oriented financial products** has never been stronger than today. As demonstrated in surveys and academic research, a majority of retail investors are concerned about sustainability and want to leverage their power as shareholders and investors to generate positive change in the real economy.

In parallel, **major financial institutions are currently adopting impact-related objectives**, for example in the context of collective actions such as Climate Action 100+, the Katowice Pledge, and the UNEP Responsible Banking Principles. Projects like ISO 14097 and the Science Based Target Initiative for Financial Institutions are being developed to establish methodologies aimed at supporting science-based climate target-setting as well as the design of "decarbonization" plans by financial institutions. In this context, **impact-related claims and pledges are flourishing.**

The concurrent **evolution of regulatory requirements at EU level,** including the extension of the suitability assessment to ESG-related preferences, the integration of sustainability factors to the target market assessment of investment entities, and the introduction of sustainability-related disclosure requirements for financial institutions, appears to support this trend. The stated objective is to **enable retail investors to find financial products matching their impact-related expectations** and to support the emergence of such products on the mass market. In this context, the Ecolabel scheme is one of the first concrete tools that the EC plans to launch to help achieve this objective. However, the reality has become more complex.

CHALLENGE FOR THE ECOLABEL: IMPACT WASHING

The stated goal of the Ecolabel scheme is to help consumers identify products that **deliver a scientifically measurable environmental impact**, with the ultimate objective of reaching a market share of 10-20% for labeled products.

Over the past twenty years, many **sustainability-related investment techniques** (and related products) have been developed by asset managers: exclusion, positive screening, thematic investing, impact investing, shareholder action, etc. While one could argue that each of these techniques may indirectly contribute to reorienting investments in the real economy, most of them **are not explicitly designed to deliver this outcome, and do not provide a measurement of their effectiveness in delivering this type of benefit.**

Currently, the only category explicitly designed to generate an impact in the real economy is **impact investing,** which is characterized—according to Eurosif—by **intentionality** ("*intention of an investor to generate a positive and measurable social and environmental impact*"), **additionality** ("*fulfilling a positive impact beyond the provision of private capital*"), and **measurement** ("*ability to account for in a transparent way on the financial, social and environmental performance of investments*"). Funds in this category traditionally focus on closing a finance gap at the local level via microfinance and seed capital. However, as impact investing has become increasingly popular, it has started facing the **risk of mission drift:** Mainstream asset managers are entering the market to try replicating the impact investment approach on liquid assets (e.g. listed stocks and bonds), a universe where there is no finance gap to close since all investees inherently enjoy access to financial markets.

A good example of mission drift is the development of impact-related claims by **green themed funds.** These funds are invested in listed equity and bonds issued by companies exposed to environment-related activities, thus betting on the growth of these industries. While most of them do not explicitly aim to create positive environmental outcomes, this analysis found that **85% of them make unsubstantiated and misleading impact-related claims that violate existing marketing regulations. The most common such claim was to suggest that positive environmental impacts result from the investment strategy.**

THE PROPOSED APPROACH TO THE ECOLABEL: A DEAD END

The Ecolabel Regulation is focused entirely on assessing the environmental impact of the labeled product or service itself. Therefore, as stated by the EC, "*a credible labeling scheme for financial products should (i)* ***allow retail investors concerned with the environmental impact of their investment to make informed choices and contribute to the green transition*** *and (ii) provide incentives to industry to develop financial products with a reduced environmental impact or a positive environmental impact.*" From a legal standpoint, the proposed Ecolabel is therefore supposed to address mission drift by setting a high bar for making environmental impact claims based on strong evidence.

However, the draft scheme proposed by the EC Joint Research Centre does the exact opposite. The Draft Technical Report on the Ecolabel issued in April 2019 is based on **the assumption that *"financial products or investments in themselves cannot be green. Greenness is derived from the uses to which they are being put in underlying assets or activities,"* an assumption that is grossly inaccurate and directly contradicts the EC's previous study:**

- It **narrows the scope of the Ecolabel to financial products exposed to green activities** (i.e. green themed investment techniques), which represent a 0.1% market share and are not suitable to most retail investors due to their lack of sector diversification;
- It **discards the most popular investment technique used by institutional investors** managing diversified portfolios: **the use of shareholder rights** and other means of influence to push investee companies toward a trajectory consistent with environmental goals.
- It **relieves green fund managers of the obligation to back environmental impact-related claims with evidence** that the investment strategy is effective in delivering environmental benefits or even intended to do so.

2°ii's technical and legal analysis concludes that the JRC's proposed approach, which focuses exclusively on the environmental performance of the underlying companies/issuers, irrespective of how the investment strategy contributes to this performance, **does not comply with the Ecolabel's own regulation.** In addition, the proposed approach contradicts the EU's efforts to regulate unfair commercial practices by increasing the risk of mis-selling (in which labeled financial products with no demonstrated impact are sold to impact-sensitive consumers) and by promoting misleading impact-related claims and unfair competition (the label potentially being used as shield against criticism and legal action).

Lastly, given the size of the investment universe (1% of the market), the proposed Ecolabel will limit its adoption to a microscopic niche market and/or **expose consumers to a green asset bubble.**

AN ALTERNATIVE SOLUTION: ENVIRONMENTAL MANAGEMENT SYSTEM FOR ASSET MANAGEMENT

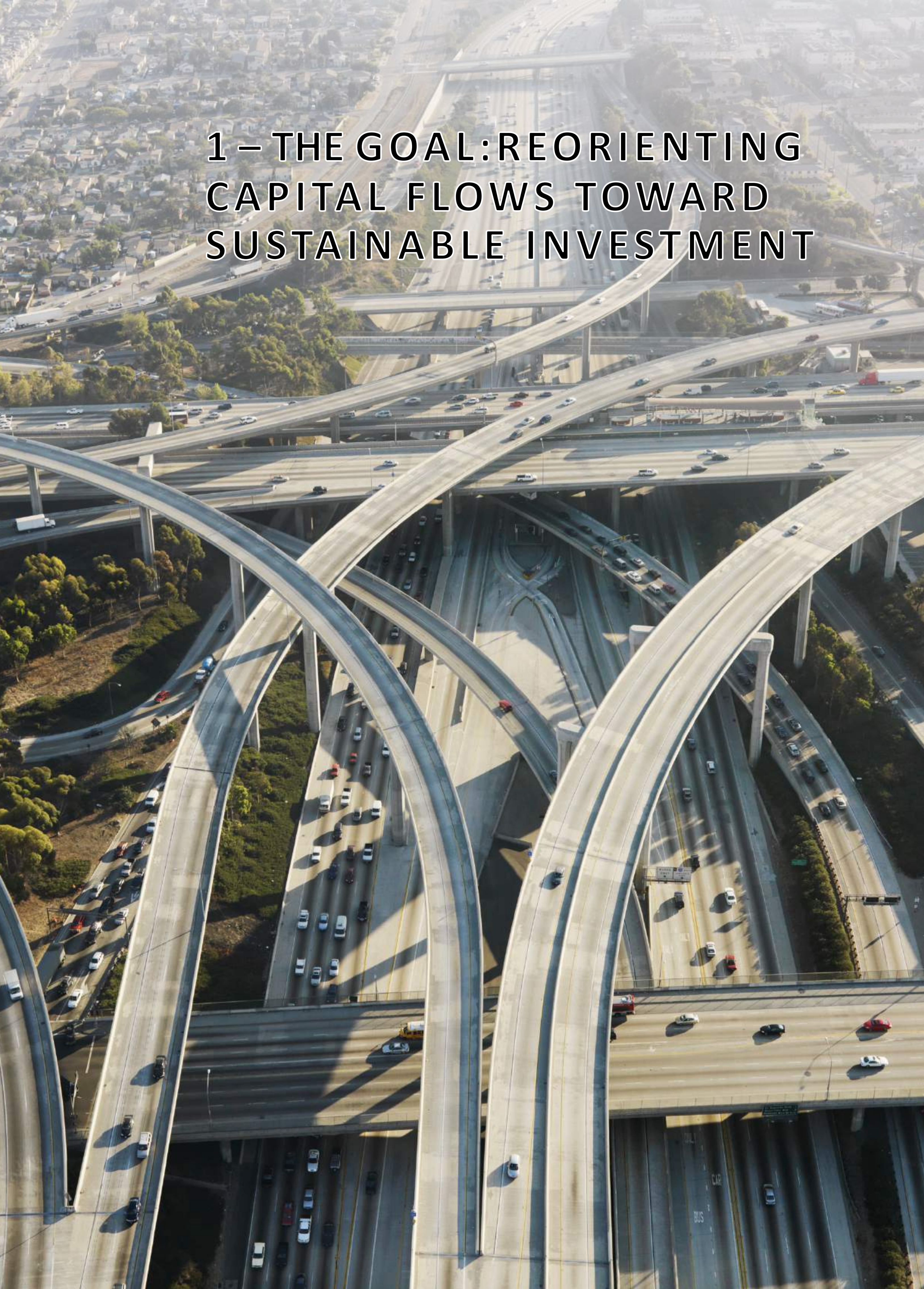
Rather than prescribing a specific investment approach (i.e. green themed funds) without any scientific evidence, the Ecolabel for Financial Products should be designed as a tool to identify investment strategies that *intend* and *succeed* in delivering environmental impact.

From this perspective, the definition of "environmental impact" should be the **reorientation of investments in the real economy** from unsustainable (e.g. coal-fired power production) to sustainable activities (e.g. renewable power production and, more generally, the activities included in the EU Taxonomy), in order to contribute to GHG emission reductions and other sustainability outcomes. **Financial products should be assessed based on the investment strategies' effectiveness in delivering these outcomes** in terms of the influence they have on decision-making in the real economy (which is complex to assess).

This process-based methodology would **build on the existing EU Eco-Management and Audit Scheme** and have the following core criteria: (i) an explicit intent/objective to generate environmental impact, (ii) an obligation to mobilize means consistent with this objective based on existing best practices and an ex-ante review of scientific evidence supporting the effectiveness of these practices, (iii) an obligation to assess and report the results of the approach in terms of its effectiveness in delivering change in the real economy, and (iv) a mechanism to ensure continuous improvement based on ongoing assessments of the state-of-the-art on the topic.

The paper concludes that this alternate approach would be **simpler** to implement than the proposed approach, more **applicable to mass market products**, and **aligned with policy goals and existing regulations**.

1 – THE GOAL: REORIENTING CAPITAL FLOWS TOWARD SUSTAINABLE INVESTMENT



1.1 POLICY OBJECTIVES

GENERAL POLICY OBJECTIVE: "ACHIEVE SUSTAINABLE AND INCLUSIVE GROWTH"

According to the EC Action Plan, the Ecolabel aims to contribute to the objective of "*reorienting capital flows towards sustainable investment in order to achieve sustainable and inclusive growth*" with a focus on the mobilization of retail investors: "*Labeling schemes can be particularly useful for **retail investors who would like to express their investment preferences on sustainable activities**. They could facilitate retail investors' choice by gradually being integrated in tools, like comparison websites or financial planning services, currently developed in the context of the Commission's Consumer Financial Services Action Plan*" (EC Action Plan).

OBJECTIVE OF THE EU ECOLABEL: "ALLOW RETAIL INVESTORS CONCERNED WITH THE ENVIRONMENTAL IMPACT OF THEIR INVESTMENT TO MAKE INFORMED CHOICES"

According to the EC "fitness check" on the EMAS and the EU Ecolabel (2017), the *"EU Ecolabel is achieved when the scheme is able to shift choice (professional or private) towards more environmentally friendly consumption. (...) Under the EU Ecolabel, the environmental benefit should be achieved when the product replaces another product with a worse environmental profile. In other words, **the final environmental effect depends on consumer choice."***[1.]

On the Ecolabel for Financial Products, the *EC Staff Working document on Sustainable Products in a Circular Economy states that* "*the aim is to allow **retail investors concerned with the environmental impact of their investment** to rely on a trusted and credible (third party verified) label when investing in Green financial products (those leading to a reduced environmental impact), thus **avoiding 'Greenwashing.'** A credible labeling scheme for financial products should (i) allow retail investors concerned with the environmental impact of their investment to **make informed choices and contribute to the Green transition** and (ii) provide incentives to industry to develop financial products with a reduced environmental impact or a positive environmental impact."*[2]

The EU Ecolabel will complement two other reforms that form part of the sustainable finance regulatory package: the obligation for financial advisors to ask their retail clients questions about environmental expectations and the obligation for financial products manufacturers to provide information on the topic.

OBLIGATION FOR FINANCIAL ADVISORS: "MANDATORY ASSESSMENT OF ESG PREFERENCES OF THEIR CLIENTS"

In its Action Plan on Sustainable Finance (Action 4), the EC plans to better integrate sustainability into financial advice: *"By providing advice, investment firms and insurance distributors can play a central role in reorienting the financial system towards sustainability. Prior to the advisory process, these intermediaries are required to assess clients' investment objectives and risk tolerance in order to recommend suitable financial instruments or insurance products. However, **investors' and beneficiaries' preferences as regards sustainability are often not sufficiently taken into account when advice is given**. The Markets in Financial Instruments Directive (MiFID II) and the Insurance Distribution Directive (IDD) require investment firms and insurance distributors to offer 'suitable' products to meet their clients' needs, when offering advice. **For this reason, those firms should ask about their clients' preferences** (such as environmental, social and governance factors) and take them into account when assessing the range of financial instruments and insurance products to be recommended, i.e. in the product selection process and suitability assessment*".[3]

In the implementation of the Action Plan, the EC introduced Draft Delegated Acts amending the abovementioned directives to **clarify** *"that investment firms providing financial advice and portfolio management **should carry out a mandatory assessment** of ESG preferences of their clients in a questionnaire addressed to them. These investment firms **should then take these ESG preferences into account** in the selection process of the financial products that are offered to these clients."* The amendment also "*requires investment firms to prepare a report to the client that explains how the recommendation to this client meets his investment objectives, risk profile, capacity for loss bearing and ESG preferences (ex-post information disclosure)*"[4]*.*

The Delegated Acts are supposed to be enforced by 2020, though it remains unclear, based on EC's communication, whether the obligation to consult clients on their ESG preferences is new or only a clarification of the existing requirements under MIFID II and IDD (see pg. 19).

[1] Fitness Check - Review of implementation of Regulation (EC) No 122/2009 and (EC) No 66/2010, pp. 7 & 10
[2] EC Staff Working document on Sustainable Products in a Circular Economy, p. 11
[3] Action Plan Sustainable Finance, p. 6
[4] Draft Delegated Regulation, p. 4

ARE FINANCIAL ADVISORS ALREADY OBLIGED TO ASK ABOUT SUSTAINABILITY OBJECTIVES?

The EC's decision to amend regulations on financial advisors follows the recommendation of the High-Level Expert Group (HLEG) report. As a member of the HLEG, 2° Investing Initiative drafted this recommendation based on the findings of its paper *Non-Financial Message in a Bottle*. This paper concludes that financial advisors are currently obliged to ask about sustainability preferences, as the regulation defines investment objectives broadly and not as exclusively financial. The paper only identifies the need to update the ESMA guidelines, not the Regulation itself. In the context of the HLEG debates, both the EC and the EU supervisors agreed with 2°ii's analysis of the Regulation and decided to clarify it.[1]

The Draft Delegated Acts seem to suggest, in a "politically correct" way, that there is an existing obligation that is not enforced: *"There is a divergence in how investment firms that provide investment advice and portfolio management integrate Environmental, Social and Governance (ESG) considerations and preferences in their suitability assessments, which leads to uncertainties and confusion for investors. To improve the functioning of the internal market and to stimulate the investor's demand for ESG products, the way those investment firms integrate ESG considerations and preferences into the suitability assessment should be harmonized.*"[2]

When asked about financial advisors' non-compliance with this existing obligation during ESMA's open hearing on sustainable finance (Feb 2019), ESMA provided an analysis that is broadly consistent with that of 2° Investing Initiative:

Question: *"The consumer surveys we reviewed and conducted ourselves suggest that about 70% of retail clients have 'non-financial' investment objectives, and our analysis of the existing text (regulation and guidelines) suggests that financial advisors are requested to ask about investment objectives, and as it is defined broadly, we did not see even a footnote suggesting that 'non-financial objectives' should be excluded. If you look the results of mystery shopping visits, there is no question asked by financial advisors on 'non-financial objectives', never: we did not see any retail bank that asks these questions. So our analysis suggests that there is currently non-compliance with the existing text, irrespective of the changes that will be introduced by the Commission. So I would be interested to hear your views on that, and the results of your own legal analysis on the topic."*

ESMA: *"We feel, as 2° Investing Initiative said but also the Commission acknowledged, that sustainability should have already been considered implicitly by intermediaries, of course, when acting in the best interest of the client. However, the Commission itself realized that this was probably not clear enough in the legal text. This is why they asked us to modify the legal text in level two, and I think what you have identified is one of the lead causes of why intermediaries are not asking those questions to clients."*[3]

However, in a previously published consultation document (2018), ESMA only considers it *"good practice for firms to consider non-financial elements when gathering information on the client's investment objectives, and (...) collect information on the client's preferences on environmental, social and governance factors."*[4]

2°ii commissioned several law firms to consider this issue from a legal risk perspective for financial advisors who fail to ask about ESG preferences. The law firms arrived at different conclusions regarding legal risks, but agreed on the confusing nature of the current regulatory situation (paper forthcoming).

[1] Non-Financial Message in a Bottle, p. 25
[2] Draft Delegated Regulation, p. 6
[3] ESMA Hearing on Sustainable Finance (referenced discussion begins at 18:40 minutes)
[4] ESMA Guidelines re MIFID II suitability requirements, p. 38

WHEN WORDS MATTER…

When dealing with the topic, the EC regulatory documents use various concepts inconsistently, thus fueling further regulatory uncertainty.

Financial vs. non-financial objectives

The members of the HLEG insist on the necessity to refer to specific objectives *"rather than referring to broader concepts such as 'integration of ESG factors' which, at that level of regulation, can create ambiguity about the objective and whether issues that are not financially material should be considered".* This distinction is critical when applied to retail investors. Consumer research shows that most retail investors want to have a positive impact through their investment even if it does not improve their returns, and that they are not particularly interested in mitigating financial risks related to ESG factors.[1]

ESG preferences

Counter to the HLEG members' insistence, the EC Action Plan and Draft Delegated Acts refer to "*ESG preferences", "considerations" and "factors",* without clarifying that non-financial objectives should be assessed and taken into account by financial advisors.[2]

Impact investing

On the other hand, the EC staff working document mentioned above and the Draft Disclosure Regulation (see pg. 10) identify *"financial products which have as an objective a positive impact for the environment and society"* as a specific category, which is consistent with consumer research.[3]

Thematic funds

Finally, as discussed in section 2.1 of this report, the draft regulations and the Ecolabel Technical Report define environmentally sustainable investment products exclusively on the basis of their exposure to economic activities with a positive environmental impact (i.e. environmental thematic funds), irrespective of whether the investment products aim at generating impact or deliver any result in this respect.[4]

Objectives or preferences?

Last but not least, while the MIFID (art. 24,25) and IDD (art. 30) refer repeatedly to "*investment objectives,*" when it comes to sustainability, the EC documents refer only to *"preferences."* This shift in vocabulary has two important implications:

- First, it suggests a weaker status for non-financial objectives and therefore might be interpreted by financial advisors as an invitation to discard the clients' non-financial objectives;
- Second, while an objective is actionable and can be achieved (or not), a preference is a static characteristic, suggesting that asset managers are not required to assess the effectiveness of their investment strategy in delivering environmental impacts.

[1] HLEG Final Report, p. 42
[2] Action Plan Sustainable Finance, pp. 2, 5, 6, 7, 8, 9, 11. & Draft Delegated Regulation, p. 1, 3, 4, 5, 7, 8.
[3] EC Staff Working document on Sustainable Products in a Circular Economy, p. 11
[4] JRC Report, p. 56

DISCLOSURE REGULATION: IDENTIFY "FINANCIAL PRODUCTS WHICH HAVE AS AN OBJECTIVE A POSITIVE IMPACT FOR THE ENVIRONMENT AND SOCIETY"

In the implementation of its plan, the EC has introduced another proposal (2016/2341 – EC) that aims at introducing new disclosure requirements for investment products.

The current version clearly identifies a sub-category of products that aims at generating an environmental impact: *"Sustainable products with various degrees of ambition have been developed so far. Therefore, it is necessary to distinguish, for the purposes of pre-contractual disclosures and disclosures by means of periodical reports, between the requirements for financial products which present environmental or social characteristics on the one hand, and* ***financial products which have as an objective a positive impact for the environment and society*** *on the other hand."*

Furthermore, it introduces specific disclosure requirements associated with impact-related claims: *"Financial market participants shall publish and maintain on their websites, for each financial product (…) the following:*

a) a description of the environmental or social characteristics or the sustainable investment objective;
b) information on the methodologies used to assess, measure and monitor the environmental or social characteristics or the impact of the sustainable investments selected for the financial product, including its data sources, screening criteria for the underlying assets and the ***relevant sustainability indicators used to measure*** *the environmental or social characteristics or* ***the overall sustainable impact of the financial product****."*[1]

KEY TAKEAWAYS: ENABLE RETAIL INVESTORS TO HAVE AN IMPACT

Despite inconsistent definitions, it is 2°ii's understanding that the policy objectives regarding environmental impact are threefold:

1. The primary policy objective is to leverage the power of retail investors as shareholders and investors to **support a reorientation of investments in the real economy** from unsustainable (e.g. coal-fired power generation) to sustainable activities (e.g. renewable power generation), in order to contribute to GHG emission reductions and other sustainability outcomes.
2. To achieve this primary objective, the reforms aim at enabling retail investors to **express their sustainability investment objectives** (Draft Delegated Acts) and identify suitable financial products (Ecolabel) that align with these objectives.
3. To aid retail investors' identification of suitable financial products, the third objective of the action plan is to **prevent greenwashing in order to avoid mis-selling of unsuitable products** to sustainability-minded retail investors.

[1] 2018/0179 (COD), art. 6

Acquiring a financial asset ≠ capex

The word "investment" can refer to:

- **Capital expenditure (capex)**, the investments made by firms or households in the real economy to build factories, buildings, and infrastructure;
- **The acquisition of an existing real asset**, such as an existing factory, mine, building); and
- **The acquisition of a financial asset**, such as an equity share, a bond, a securitized loan, a share in a mutual fund, etc.

These multiple definitions seem to be a key cause of a lot of confusion for retail investors and policymakers. For instance, the draft regulations of the EC sustainable finance package do not make any distinction between those three categories and only refer to "investments" broadly, including all three of these definitions.

Acquisition of financial assets and capex

This confusion sometimes leads to the **misconception** that the **acquisition of a financial asset** (equity, bond) issued by an entity exposed to certain economic activities (e.g. renewable power) is **more or less equivalent to a direct investment in those activities.** The reality is much more complex: most mature businesses primarily self-finance their capital expenditure with re-invested profits and to a lesser extent with bank loans and bonds. Equity issuance usually plays a minor role and is sometimes negative (through share buy-backs, shareholders can have a negative financing footprint). Analyzing this dynamic on a case by case basis is therefore critical to understanding whether the acquisition (or the selling) of a financial asset contributes to, enables or prevents a given activity.

Reorienting capital flows toward sustainable investment

In the context of a transition to a green economy, the objective of finance should be to **steer the allocation of capital expenditure** from brown to green projects, which is a different and much more complex process than **reallocating stock and bond portfolios** from brown to green securities. The policy documents from the EC suggest a confusion on this objective.

"The impact of green investments ***depends not only on the investment object*** *(the activity or the entity which receives money), but also on* ***the type of financial product*** *(bonds, shares, funds, etc.),* ***and the processes applied in generating these products****. Moreover, the environmental impact of an investment is* ***not always closely related to the amount*** *of the green investment (oekom research 2013)."* EC Report, Defining "green" in the context of green finance, 2017

1.2 INVESTMENT TECHNIQUES AND PRODUCTS

“Investors often use cleantech indexes as part of their satellite allocation to gain exposure to opportunities associated with environmental issues. Large institutional investors who have size and liquidity constraints adopt these types of approaches to potentially complement impact investing strategies which are narrower and characterized by additionality, intentionality and measurability. For their core allocation, they are looking for a broad and diversified investment universe and are increasingly integrating ESG signals (climate or ESG more broadly) through different approaches (i.e. exclusion, selection, reweighting)."
Veronique Menou, MSCI, TEG Member

"While not exclusive to impact investing, the direct and measurable effects achieved through impact investments often distinguish this approach from other categories of Responsible Investment (RI) (e.g., ESG Integration and ESG-screened funds), which tend to be more indirect and, therefore, more difficult to measure."
Eurosif 2018 Survey

SUSTAINABILITY-RELATED INVESTMENT TECHNIQUES

As discussed on pg. 9 of the report, a range of investment techniques have been developed by asset managers in relation to sustainability (exclusion, positive screening, thematic investing, impact investing, shareholder action, etc.), which has led to the development of various self-labeled investment strategies and products ("sustainable", "socially responsible", "impact investing", etc.).

RELATED INVESTMENT OBJECTIVES

Multiple publications[1] suggest that these techniques have been developed to achieve very different goals:

- Improving long-term financial returns by better integrating financial risk factors related to sustainability issues;
- Generating a “feel good” effect for clients by avoiding “guilt by association” when boycotting certain activities, and ensuring a “no harm” approach when investing in green activities;
- **Supporting positive and measurable changes in the real economy**.

Certain techniques can contribute to several goals, sometimes creating confusion between the means and the end.

While it can be argued that each of these techniques can indirectly contribute to reorienting investment in the real economy, most “socially responsible” approaches and products are not designed to deliver a direct contribution. Direct benefits are often not their stated objective (KID), and there is often no measurement of the effectiveness of delivering such benefits.

Based on definitions provided by Eurosif, **the only investment category explicitly designed to create an impact in the real economy is "impact investing."** According to Eurosif, *"Definitions around the key requirements for impact investing which differentiate it from other strategies are:*

- *Intentionality: the intention of an investor to generate a positive and measurable social and environmental impact;*
- *Additionality: fulfilling a positive impact beyond the provision of private capital;*
- *Measurement: being able to account for, in a transparent way, the financial, social and environmental performance of investments."*

Less than 1% of “socially responsible” assets under management are subject to this approach.

IMPACT INVESTING ≠ GREEN THEMATIC INVESTING

"Impact investing" differs from "thematic investing" (the approach the EC discusses in the draft Ecolabel), which does not explicitly aim to deliver an impact in the real economy, but rather seeks to seize the opportunity for financial return related to the expected growth of the green economy.

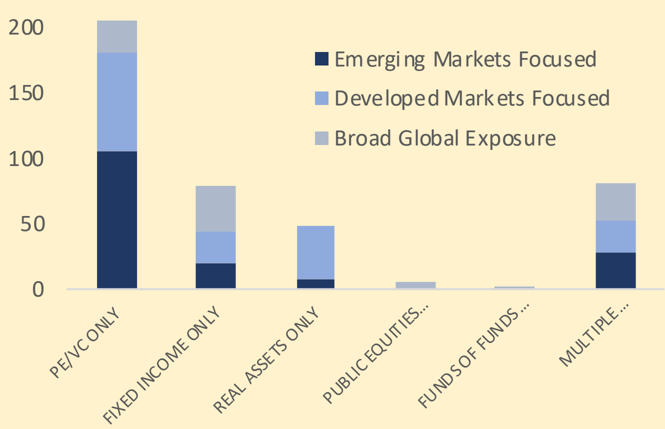
The associated products also differ: European green thematic funds are primarily invested in **listed equities** (86%), and impact investing funds are primarily invested in **venture capital and real assets** (see pg. 12). Our analysis suggests that the overlap between these two categories is about 1% (see pg. 14).

[1] See the Eurosif European Study 2018, used by the HLEG as a reference for definitions.

WHAT IS IMPACT INVESTING?

The Global Impact Investing Network (GIIN), which is Eurosif's primary source of definitions and data on impact investing, categorized $500Bn of assets under management (AuM) as impact investments in 2018. Some of these assets are invested in sectors facing environmental challenges, such as the energy sector (14%), housing (8%) and conservation projects (3%). Only a limited number of these are listed equity.

Impact investing funds by type of asset

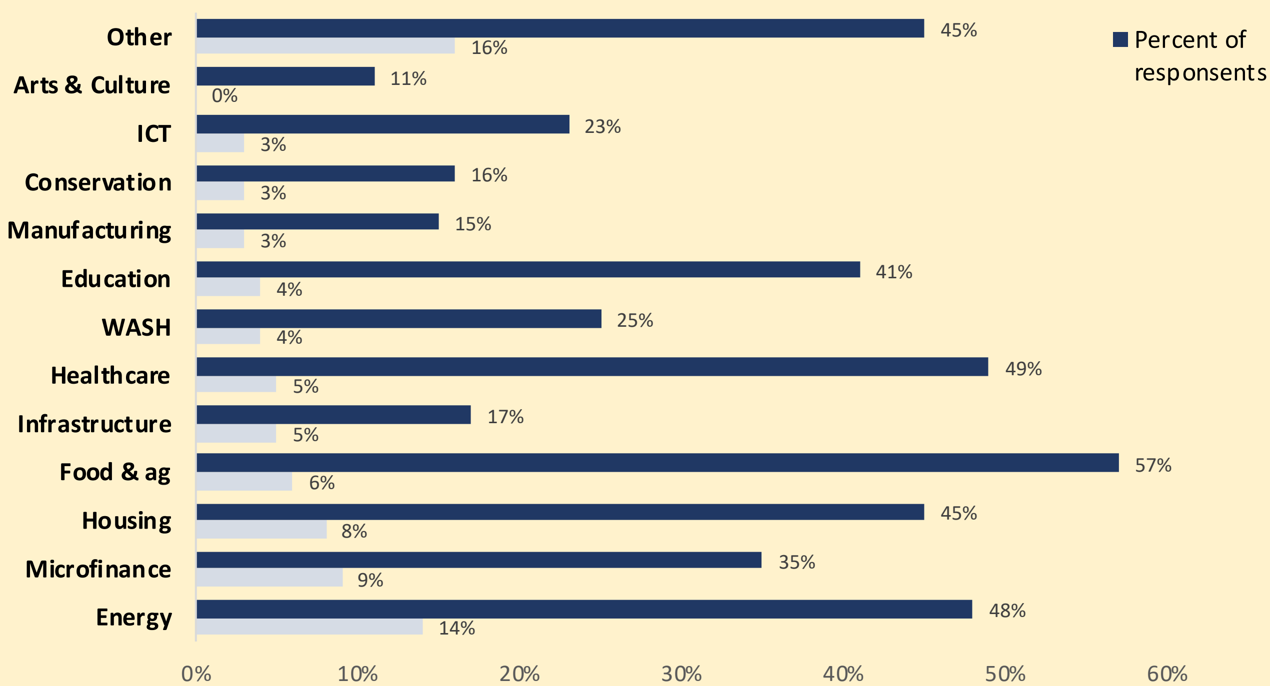


Source: GIIN 2018 Annual Impact Investor Survey.

In 2019, GIIN published a **set of principles** applicable to investment products self-labeled as "impact investments":

1. *"**Impact investments are investments made with the intention to generate positive, measurable social and environmental impact alongside a financial return.** We intentionally contribute to Positive Social and Environmental Impact through Investment alongside a Financial Return. We intentionally finance solutions and opportunities for social and environmental challenges. This includes: setting transparent financial and impact goals; articulating an investment thesis that is explicit about these goals and the strategies we will use to realize them.*
2. ***Use Evidence and Impact Data in Investment Design.** We use the best quantitative or qualitative impact data and evidence that we can to increase our contribution to positive impact.*
3. ***Manage Impact Performance.** We use impact performance data in decision-making to manage our investments towards achievement of our social and environmental objectives.*
4. ***Contribute to the Growth of Impact Investing.** We take action to enable more investors to make impact investments effectively."*

Sector allocation of impact investing funds



Source: GIIN 2018 Annual Impact Investor Survey. Respondents: 226 and 229 or about 50% of the impact investing market. Other sectors include SMEs, Child Welfare, Commercial goods, transport, retail, tourism, forestry and commercial real estate.

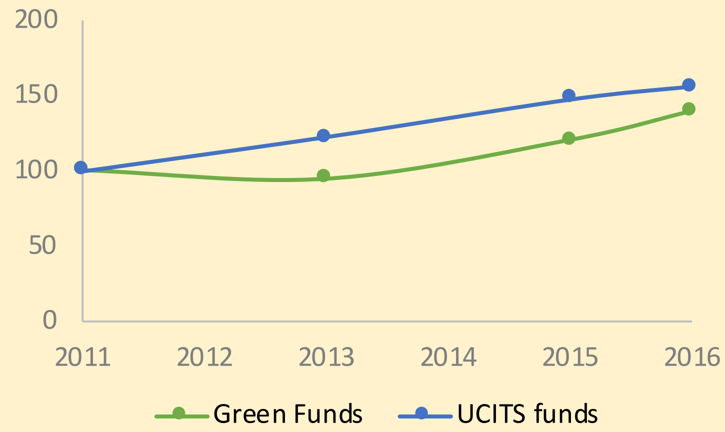
WHAT IS GREEN THEMED INVESTING?

Green themed funds. There is no generally agreed upon definition of green themed funds, but various surveys (e.g. Eurosif, Novethic/ADEME) define them broadly as investment products that claim a significant part of their investment is made in environment-related activities. In their 2018 market review of 2016 data, Novethic and ADEME identified 165 green themed funds, equivalent to €22Bn of assets under management, in the European market.

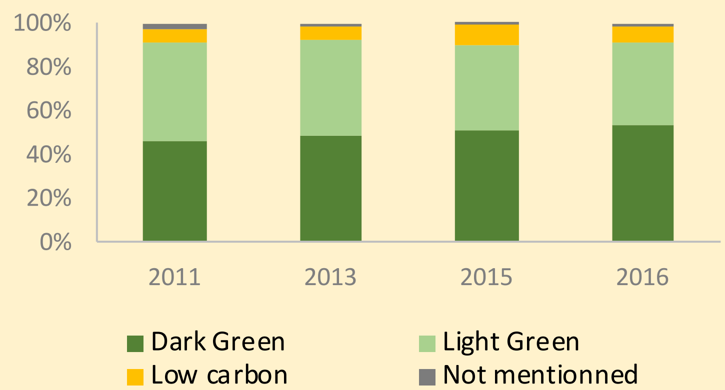
Funds compatible with the Ecolabel criteria. About 40% (in AuM) of these green themed funds (called "light green" in the chart) invest in a broader universe than "environment-related" activities (including banking, oil and gas, aviation, food and beverages) and would therefore not be eligible for the EC Ecolabel based on its current criteria. In addition, Novethic included in the scope of its survey "low-carbon" funds (8% of total funds in AuM) that are usually diversified equity funds for which the companies with the lowest carbon intensity in each sector are selected. This category is not eligible for the EU Ecolabel due to its exposure to brown activities. Novethic defines funds as "dark green" if they are invested in environment-related activities; they represent about **80 funds and €12Bn of AuM**.

Link with environmental funds. The companies selected for environmental funds are selected because **they *relate* to environmental issues**, not because their strategy or capital expenditure contributes to solving environmental challenges. For instance, the largest and fastest growing sub-theme in green funds is "water," largely because the investment universe has many large listed water utilities. A review of the business models of large water utilities suggests that their capital expenditure does not necessarily contribute to addressing key sustainability challenges such as water protection and access to water. In most cases, these companies only operate water distribution and treatment infrastructure. It is usually their clients, often municipalities and states, that invest in the infrastructure. In some cases, these water utility companies have even been criticized for under-investing in infrastructure maintenance. Thus, financing these companies' capex does not necessarily finance the development of water infrastructure.

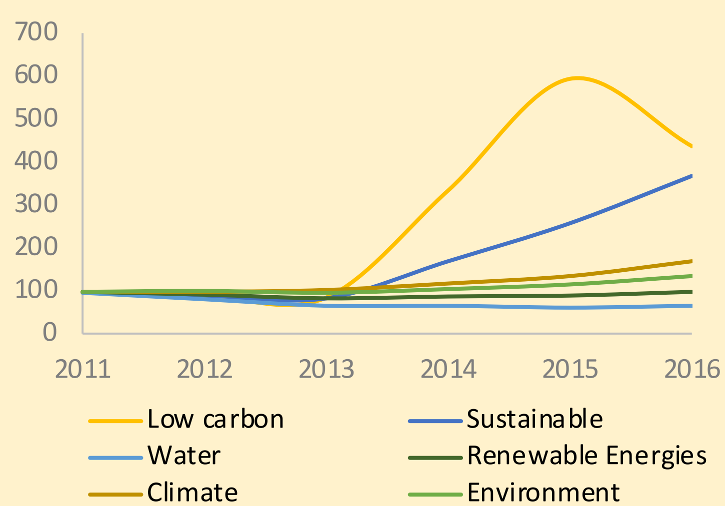
Evolution of total AuM of green funds
compared to the European fund market
(basis 100 = 2011)



Evolution by type of green fund
(in percentage of total AuM)



Evolution of green funds by theme
(basis 100 = 2011, in AuM)

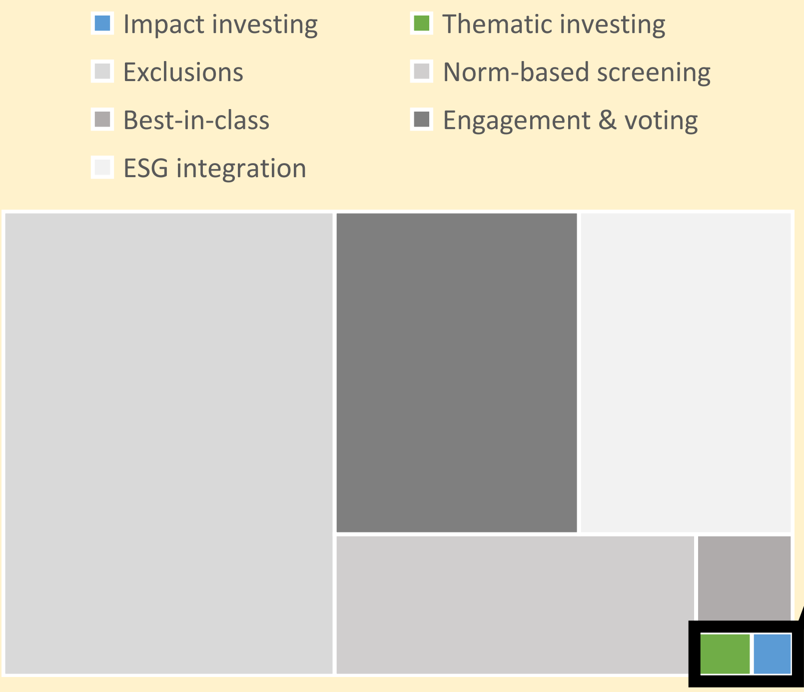


Source: Novethic/ADEME 2017, data Dec 2016.

WHAT IS THE OVERLAP BETWEEN THEMATIC INVESTING AND IMPACT INVESTING?

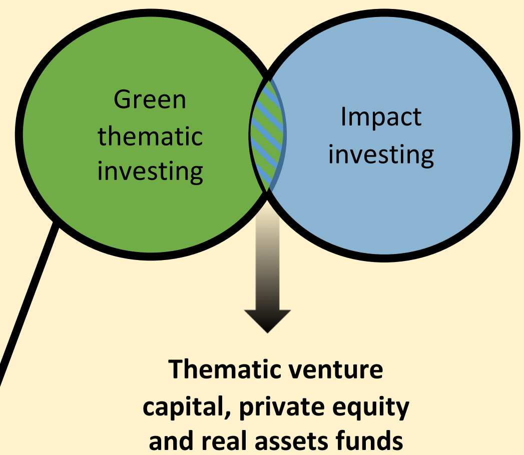
Because they have fundamentally different objectives, thematic investing and impact investing are accounted for in different categories by Eurosif and other surveys. The two categories have roughly the same size (<1% of AuM). A first analysis of the funds and asset classes covered in these categories suggest that the overlap is very limited: most likely below 1% and 15% at most. The small overlap that does exist primarily relates to thematic environmental venture capital, private equity and real assets funds. The rationale for this analysis is explained on pg. 11.

Overview of SRI strategies in Europe (Market share in AuM)

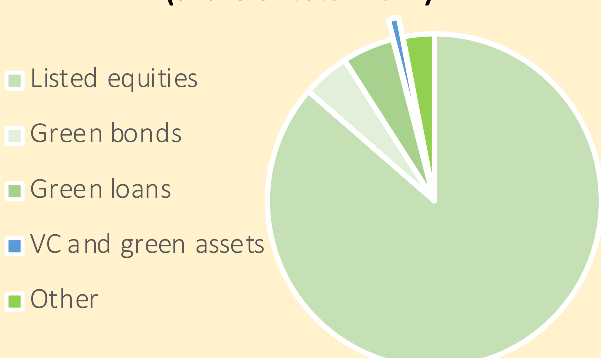


Source: Eurosif European Study 2018. Dec 2017 in total asset under management for each strategy.

Overlap between green thematic investing and impact investment

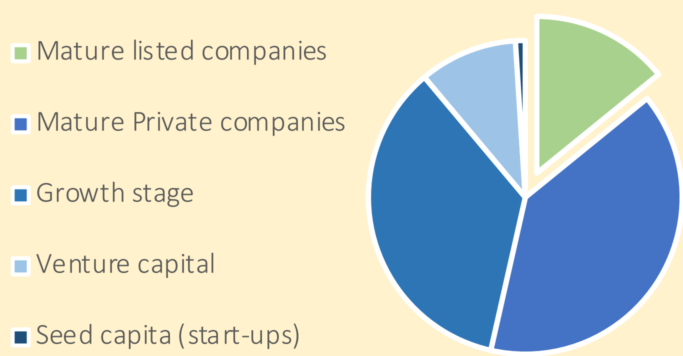


Composition of green thematic funds (share of total AuM)



Source: Le marché des fonds verts europeens. Novethic/ADEME 2017 – Data Dec 2016.

Impact investing strategies by stage of business (share of total AuM)



Source: GIIN annual survey 2017. 190 respondents.
NB: only 18% of respondents invest in listed equities.

ADOPTION OF IMPACT-RELATED OBJECTIVES BY MAINSTREAM FINANCIAL INSTITUTIONS

Impact-related pledges: a new trend

In parallel to the development of traditional impact investing (in illiquid assets) which remains a niche market, mainstream investors and commercial banks have recently started to communicate on impact-related objectives at organizational level. This evolution is notable: Traditionally, financial institutions tend to justify their environment-related actions with a risk management narrative in order to avoid being challenged internally and externally on their interpretation of their fiduciary duties.[1] An analysis of their actions suggests that the mainstreaming of an impact investing approach requires the mobilization of different techniques for investments in private and real assets, and introduces the challenge of "impact washing" (see pg. 23).

New finance sector coalitions

Since COP21, financial institutions have started to deploy climate actions as well as set climate targets and other sustainability-related targets at organizational level. Notable initiatives[2] include:

- The Climate Action 100+ Coalition, an initiative of 320 investors with $33Tn of assets under management, that aims at ensuring "that the world's largest corporate greenhouse gas emitters take necessary action on climate change." The target investee companies include 100 systemically important emitters, accounting for two-thirds of annual global industrial emissions, alongside more than 60 others with a significant opportunity of driving the clean energy transition;
- The "Katowice Banks", a group of five large commercial banks that announced in 2018 their objective to align their lending portfolio with the Paris Agreement;
- The UNEP Responsible Banking Principles, endorsed by 55 banks, which extend the commitment of the Katowice Banks to other sustainability topics, and include the development of tools to set targets and track results.

Focus on engagement with investees

In each of these initiatives, one of the key explicit objectives is to support a reorientation of investments in the real economy, similar to impact investing funds, and the main means mobilized is **engagement** with investees/clients operating in carbon-intensive sectors. This development is notable in the context of the EC Ecolabel design because:

- Engagement is currently not considered in the draft criteria.
- This approach is primarily relevant for carbon-intensive companies, which are excluded from the eligible universe of labeled funds.

Methodological frameworks to back impact-oriented claims

To support climate target-setting and the implementation of decarbonization plans by financial institutions, several projects have been developed over the past couple of years:

- The ISO 14097 standard is currently being developed by an international ISO working group led by the UNFCCC Secretariat and 2° Investing Initiative. It aims to define relevant climate actions for financial institutions, and to develop a framework for setting objectives, implementation, monitoring and reporting progress. The standard will be launched in 2020.

1. See the communication of the US Department of Labor that requests the pension funds not to take into account non-financial objectives if they do not contribute to optimize financial returns.
2. 2° Investing Initiative is a technical partner of the three initiatives.

Katowice Statement

We support the aim of "making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development (...) This is about more than de-risking. It's about making a positive impact. We will use a science-based, forward looking approach to financing sector-specific shifts in technology and production processes. Because it's not where our clients are today, but where they are heading tomorrow. (...) We believe in an engagement-focused approach, which means not simply excluding clients but working with them on their transition."

BBVA, BNP Paribas, Societe General, Standard Chartered, ING – Dec 2018

UNEP-FI Responsible Banking Principles

Identify the most significant positive and negative social, economic and environmental impacts resulting from your bank's activities, products and services

Set and publish targets within 12 months of becoming a signatory (24 months for banks self-assessing as "starters")

The targets have to meet or exceed the ambitions and timeframes expressed in the Sustainable Development Goals, the Paris Agreement and/or relevant national and regional frameworks

Considering your significant impacts and your operating context, prioritize focus areas for setting targets

- The Science-Based Target Initiative for the Financial Institutions aims to develop a methodological framework for setting climate targets. The project is led by WRI, WWF and CDP with technical inputs from 2° investing Initiative and Navigant. About 30 financial institutions have signed up as road-testers.

These frameworks are developed in close collaboration with financial institutions in order to deal with the challenges of combining environmental impact investing with large-scale deployment, especially on asset classes such as listed equities, bonds and bank loans. They are designed to provide a response to the mission drift risk identified by the impact investing community (see section 1.4).

A closer look at the Draft Technical Report suggests that the above-mentioned initiatives have been omitted by the Joint Research Centre (JRC), and that the distinction between impact investing and thematic investing has been overlooked.

A CLOSER LOOK
at EC review of labels

OBJECTIVE AND SCOPE OF THE JRC REVIEW: FOCUS ON GREEN FUNDS, IMPACT IGNORED

Section 2.3 of the Draft Technical Report aims to provide *"an overview of the existing Ecolabels and schemes available in the market for financial products."* Its approach is to consider a broad range of SRI labels and narrow down the selection to labels with an emphasis on green criteria: *"National and private financial Ecolabel schemes adopt the broader Social Responsible Investment (SRI) framework,* ***which considers both environmental and social sustainability while aiming at financial return*** *and encompassing transparency and reporting practices. Nevertheless, if a scheme focuses more on environmental sustainability by either including more environmental requirements or by weighting more heavily the importance of environmental aspects, then this scheme is rather characterized* ***as environmentally sustainable or green****."*

Note that the objective of the label in terms of the environmental benefits associated with labeled funds is not a criterion for identifying relevant labeling schemes. **As a direct result, the only scheme (GIIN; see pg. 12) that explicitly targets financial products that aim at generating impact is not included in the EC's overview.**

DO GREEN LABELS AIM AT IDENTIFYING GREEN IMPACT INVESTING PRODUCTS?

With the notable exception of the French Energy Transition Label, most of the labeling schemes identified in the EC Draft Technical Report **aim at labeling *environmental thematic funds***, and develop a set of criteria consistent with this approach. They do not aim at identifying the subset of products that aim at generating environmental impact:

- Most labels only guarantee that the funds are exposed to green activities, thus allowing investors to bet on the growth of these activities in order to optimize their financial returns.
- **They do not aim at generating changes in the real economy** and related environmental benefits, which should be the explicit purpose of the EU Ecolabel according to the relevant regulation.
- For retail investors who are conscious of the impact of their investments on the environment, the benefits associated with labeled funds could be summarized as "do no harm" and "feel good."

The only exception is the French label that aims at making a "*contribution to the energy and ecological transition and the fight against climate change.*"

EUROPEAN GREEN LABELS: PRIMARILY FOR GREEN THEMED INVESTMENT

FNG (Germany, Austria, Switzerland, Liechtenstein)

Proclaimed Objective*: To promote quality assurance for sustainable investments, competition between providers of sustainable funds, and more widespread use of sustainable investment approaches in the financial market.*

Main Eligibility Criteria:

- Selection/exclusion of underlying assets based on ESG-related critera (primarily best-in-class analysis).
- To a lesser extent: consideration of dialogue, voting, engagement and reporting on ESG-related indicators.

Austrian Ecolabel (Austria)

Proclaimed Objective: *(…) Green funds and sustainable financial products add value to you and to the environment.*

Main Eligibility Criteria:

- Selection/exclusion of underlying assets based on ESG-related criteria (primarily best-in-class analysis).
- To a lesser extent: consideration of voting, engagement and reporting on asset selection criteria and processes.

Luxflag (Luxembourg)

Proclaimed Objectives:

- *ESG Label: to reassure investors that the Investment Fund actually incorporates ESG (Environmental, Social, Governance) considerations throughout the entire investment process.*
- *Environment Label: to reassure investors that the Investment Fund primarily invests their assets in environment-related sectors in a responsible manner.*
- *Climate Label: to reassure investors that the Investment Fund invests at least 75% of total assets in investments related, or with a clear and direct link, to mitigation and/or adaptation of climate change or cross-cutting activities.*

Main Eligibility Criteria:

- ESG: portfolio screening according to an ESG strategy or standard (best-in-class/best efforts, multiple exclusion).
- Environment: selection of underlying assets based on the share of investees' turnover in environment-related activities; exclusion policy.
- Climate: selection of underlying assets based on the share of investees' turnover in activities *"related, or with a clear and direct link, to mitigation and/or adaptation of climate change or cross-cutting activities;"* exclusion policy.

Nordic Swan (Denmark, Iceland, Finland, Norway, Sweden)

Proclaimed Objective*: To reduce Nordic investors' investments in non-sustainable companies; increase investments in companies with good sustainability performance; influence and encourage companies to show greater accountability concerning the UN's Agenda 2030 through active ownership; increase visibility and engagement in sustainability issues from the financial industry through transparency and dialogue with investors; stimulate increased traceability between the investor's capital and concrete investments in sustainable projects, for example through green bonds.*

Main Eligibility Criteria:

- Selection/exclusion of underlying assets based on their ESG performance, calculated through internal or external ESG analysis.
- To a lesser extent: consideration of active ownership and reporting on the sustainability impact of funds in specific environment-related areas.

Climate, Energy and Ecological Transition Label (France)

Proclaimed Objective: *To promote "green" funds in order to further steer savings towards energy and ecological transition and the fight against climate change, either by drawing attention to existing investment funds or by giving rise to the creation of such funds. It is a guarantee, for investors and individual savers in particular, of the quality and transparency of the environmental characteristics of the funds distinguished in this way and of their contribution to the energy and ecological transition and the fight against climate change.*

Main Eligibility Criteria:

- Definition of environmental objectives; selection of underlying assets based on the share of the investee's turnover in activities supporting the energy and ecological transition; exclusion of assets running counter to the energy and ecological transition; consideration ofthe ESG-related performance of underlying assets.
- Specific consideration to the reporting on "*the organisation put in place to measure the environmental impact of its investments*" and "*the actual contribution of its investments in* (…) *i. Climate change; (ii) Water; (iii) Natural resources; (iv) Biodiversity."*

2 – CHALLENGE FOR THE ECOLABEL: IMPACT WASHING

2.1 RETAIL CLIENTS EXPECT IMPACT

60-70% OF RETAIL INVESTORS ARE INTERESTED IN SUSTAINABILITY

A review of surveys conducted on retail investors (see annex 1), of behavioral science research[1], and of 2°ii's internal research using quantitative surveys (see pg. 20) and focus groups (see annex 2) indicates that about 60% to 70% of retail investors are interested in sustainability.

Interestingly, a recent experiment with Dutch pension funds beneficiaries[2] suggests that **they "walk the talk"**: the gap between surveys and real-life tests was found to be negligible, contrary what is observed for most consumer products and service, including Ecolabeled product categories.

Another notable finding of this experiment and 2°ii's survey (see pg. 20) is that most retail investors are willing to **compromise on financial returns** (i.e. with higher risks, higher management fees) to see their sustainability objectives integrated.

FOCUS ON IMPACT, ENGAGEMENT AND FEAR OF IMPACT WASHING

When asked about their goals and motivations, a majority of people surveyed declared that they want to leverage their power as shareholders and debt investors to **generate positive changes in the real economy**, which is largely consistent with the policy goals of the EC (see section 1.1). Importantly, these investors don't trust marketing claims and want to see **evidence that the investment strategy is effective** in delivering desired outcomes. Furthermore, **fear of "impact washing"** was found to be the largest obstacle to the integration of sustainability criteria in investment decisions, well ahead of the fear to give up returns.

When asked about their preferred means of achieving these objectives, retail investors favor **engagement with the management of companies and the use of their voting rights** over exclusion and investment in thematic impact investing funds. These results are consistent with emerging practices among institutional investors.

These results suggest that most green thematic funds (eligible under the EC Ecolabel) **would not be suitable products for sustainability-minded retail investors**, given that they do not have the stated intention of generating environmental impacts and do not provide evidence that they do.

However, a significant minority of retail investors interested in sustainability are skeptical of the possibility to "make a difference" (i.e. generate impact) with their investments: They see the integration of environmental criteria as a **"feel good approach"** (i.e. avoiding guilt by association, doing no harm). For those investors, green thematic funds appear suitable, but they remain, from 2°ii's perspective, inconsistent with the objectives of the EC Ecolabel (see pg. 7).

[1] See Bauer et al. (2018)
[2] See Bassen et al. (2017) *Promoting climate friendly investing among retail investors*

MIFID II & IDD for DUMMIES

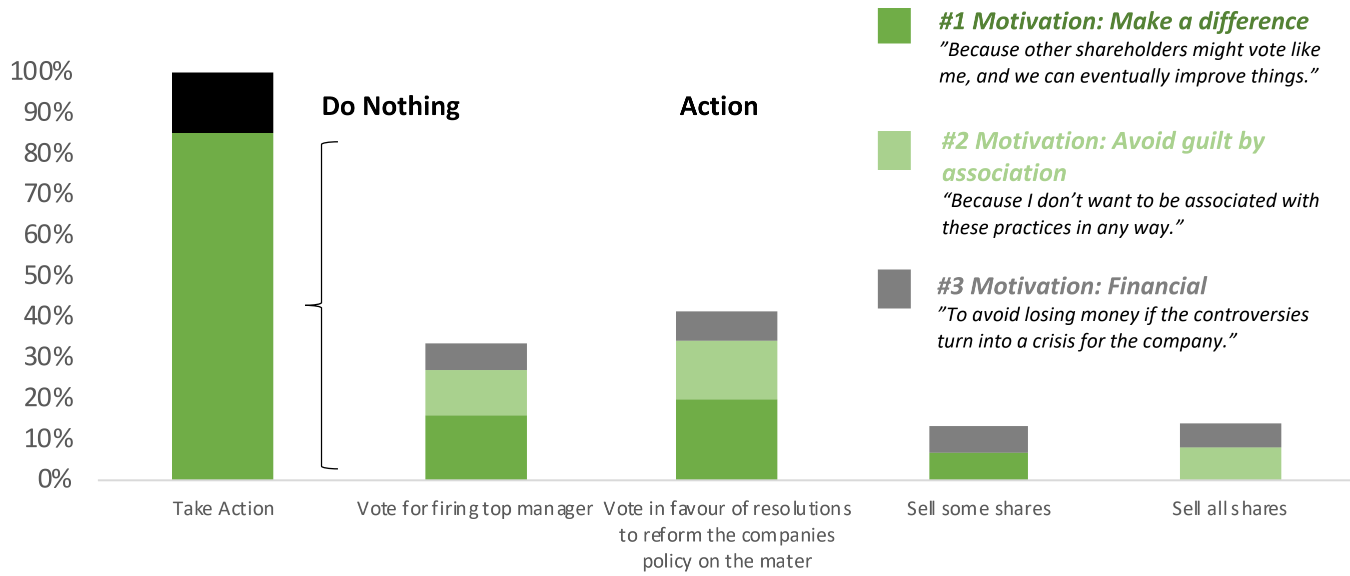
FINANCIAL PRODUCTS SUITABLE TO INVESTORS' OBJECTIVES

It is an essential duty of financial market participants to ensure that the products they offer to their clients are compatible with their investment objectives. In order to enhance investor protection against mis-selling, MIFID II states this obligation: "*When providing investment advice or portfolio management the investment firm shall obtain the necessary information regarding the client's or potential client's* (…) ***investment objectives***" (**MIFID II Art. 25**)

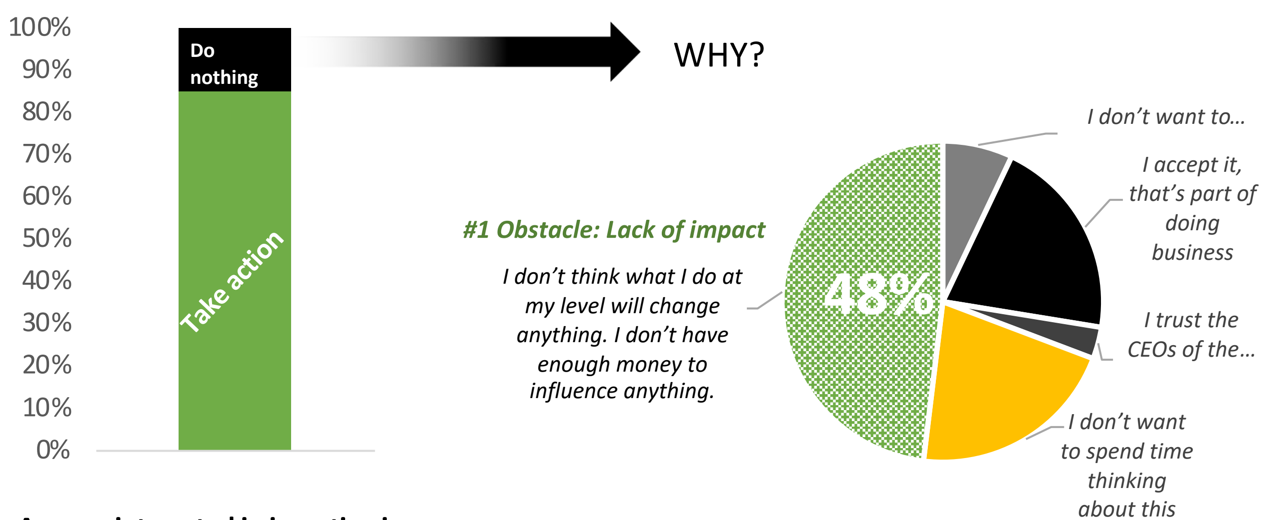
The EC's delegated regulation then specifies that *"The information regarding the investment objectives of the client or potential client shall include, where relevant, information on the length of time for which the client wishes to hold the investment, his preferences regarding risk taking, his risk profile,* ***and the purposes of the investment***" (**Delegated Regulation (EU) 2017/565 Art. 54**)

As demonstrated by surveys and academic research, most retail investors are motivated by the non-financial investment objective of producing a real environmental impact. This finding leads to the conclusion that the lack of inclusion of non-financial objectives in the suitability assessment performed by most market participants is inconsistent with the spirit of MIFID II and may potentially qualify as mis-selling. In response, the EC has recently issued a draft delegated proposition to confirm that ESG objectives must be included in the scope of the suitability assessment (see pg. 8).

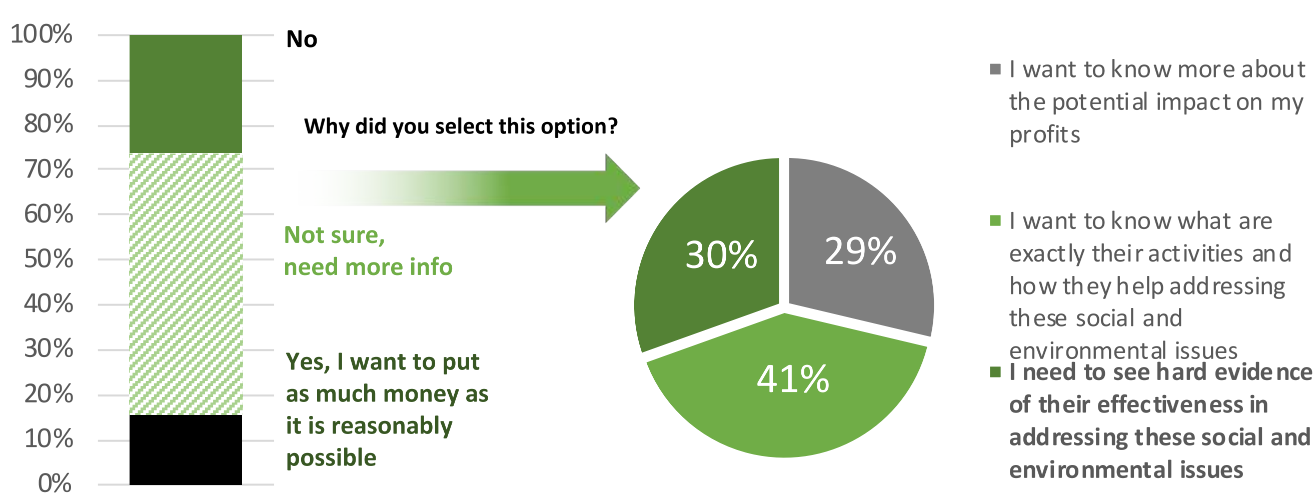
How would you respond to ethical, social or environmental concerns with your investments?



How would you respond to ethical, social or environmental concerns with your investments?



Are you interested in investing in "impact" funds?



This survey has been conducted on 1,000 active German retail investors in December 2018 by Splendid research. The survey is currently extended to other European Markets. The EU survey will be published in 2019. Preliminary results and other pre-existing surveys suggest similar results as for Germany.

DO PEOPLE ACTUALLY DO WHAT THEY CLAIM?

To assess the hypothetical gap between peoples' claims on their sensitivity to sustainability-related issues and their behavior in real life, the Maastricht University Department of Finance led a field experiment where a major Dutch pension fund granted its members a real vote on its sustainable investment policy:

"*We conducted a field experiment (n = 1,669) in cooperation with a Dutch pension fund which had 18.7 billion euros of assets under management in 2016. This defined -benefit pension fund invests on behalf of its members. As part of our experiment, the board of the pension fund gave its members a real vote on its future sustainable investment strategy. Participants faced the choice of more or less sustainable investments. The board guaranteed that it will implement the outcome of the voting. Pension savings of the members are at stake, so the choice is relevant*".

"*With half of the invited population, we ran a hypothetical treatment.*"

"*We told participants that sustainable investments not only focus on financial returns but also on societal returns. In addition, we measured participants' beliefs about the expected financial returns of sustainable investments.*"

"*We find that 67.9% of participants favor to invest their pension savings more sustainably. Only 10.8% are against it while 21.2% do not have an opinion.*"

"*We show that social preferences rather than financial beliefs drive the choice for more sustainability. The majority voted for the more sustainable option. This was the case even among those who expected lower financial returns with more sustainable investments and subjects who are uncertain about the returns.*"

"*The results further show that confusion or lack of information do not drive our results.*"

"*We show that social preferences play an important role in delegated investment decisions. Pension fund members are even willing to forego financial returns to invest in a sustainable manner.*"

Bauer (R.), Ruof (T.), Smits (P.), Get Real, Individuals Prefer More Sustainable Investments, Maastricht University, 2019

2.2. SETTING THE BAR FOR IMPACT-RELATED CLAIMS

The risk of mission drift in impact investing is identified as one of the three key trends in the annual survey of investors:
"The growing involvement of large-scale, mainstream firms also presents some risks – in particular, the risk of ***'impact washing'****, i.e. that some actors may be adopting the label without meaningful fidelity to impact. Encouragingly, impact investors are cognizant of this concern and emphasize the importance of greater transparency around impact to mitigate this risk. Other ideas include third-party certification or the development of shared principles. Indeed, the GIIN has committed to developing a set of principles [launched in 2019] to strengthen the identity of impact investing to drive growth and protect the* ***integrity of the market.****"*

GIIN Annual Survey 2018.

A LABEL FOR ENVIRONMENTAL IMPACT-RELATED INVESTMENT STRATEGIES

According to the EC action plan, *"labeling schemes can be particularly useful for retail investors who would like to express their investment preferences on sustainable activities. They could facilitate retail investors' choice by gradually being integrated in tools, like comparison websites or financial planning services, currently developed in the context of the Commission's Consumer Financial Services Action Plan."*

In practice, the analysis of impact investing products on one hand (see pg. 12) and clients' preferences on the other hand (see pgs. 19-20) suggest a strong need for a label on **environmental "impact investment" products.** GIIN has developed a set of principles (see pg. 12) applicable to investment strategies seeking environmental and/or social impact, but no label and certification scheme has been developed yet. In addition, the applicability of the approach to liquid assets, which are the main asset classes covered by the Ecolabel, remains a challenge.

PREVENTING IMPACT WASHING

Based on this analysis, the core focus of the Ecolabel should be to ensure that the investment techniques mobilized by asset managers who claim that their product contributes to climate and other sustainability goals are in fact consistent with this objective as well as effective at delivering expected outcomes (i.e. a **reorientation of investments in the real economy**). Our analysis shows that impact washing is both the main obstacle for retail investors (see pg. 19) and a well-justified fear (see pg. 23).

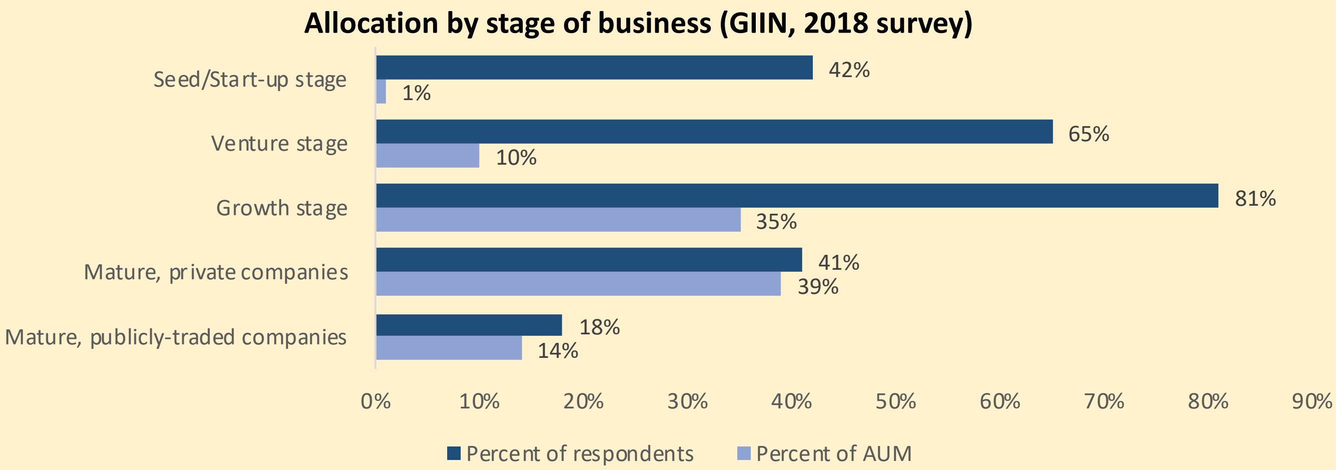
More specifically, the impact investing community currently faces the following challenges: in the context of its growth in general and the distribution to retail investors in particular.

- Most products have historically been developed based on **small-scale project finance**, **where the investments directly address a lack of access to finance.** Typical activities include micro-finance, affordable housing and access to energy in developing economies. This approach is, by design, limited to illiquid assets (most strategies focus on seed, venture and growth stages rather than mature businesses). These products therefore face obstacles to scaling up, which limit their potential of being distributed to retail investors.
- The entry of large asset managers to the market and their desire to develop scalable approaches to serve the mass market is currently leading to the development of self-labeled "impact investment" products invested primarily in mature businesses and more specifically **in liquid assets** (listed equities, bonds), which, **by design, are associated with issuers that already enjoy access to finance** and financial markets. These products therefore require the mobilization of different techniques, such as shareholder action, to generate additionality, and therefore new approaches to measure their effectiveness (noting that the acquisition of a financial asset differs from the financing of an investment in the real economy in terms of its impact).

According to the GIIN annual survey, mission drift is perceived as one of the main challenges faced by the impact investing community. In line with the objective of the Ecolabel regulation, the EU Ecolabel for Financial Products could be particularly helpful in addressing this challenge.

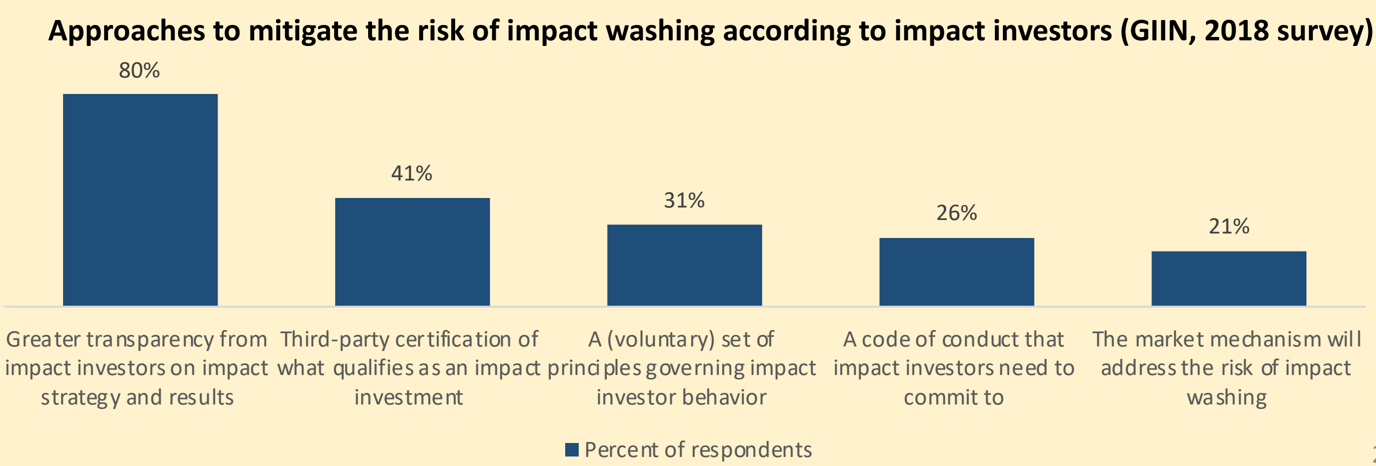
THE RISE OF IMPACT WASHING

Traditionally, impact investing is dominated by private and non-for-profit investors (family offices, foundations, etc.) that favor investment in real assets and non-listed companies: the **main technique** used is to provide **direct financing** to small entities and activities **facing a financing gap that acts as key barrier** to the development of practices associated with positive social or environmental impacts (e.g. access to renewable power for low income households in rural areas of developing economies). The growing involvement of large-scale, for-profit asset managers comes with the temptation to transfer the approach to mature, sometimes listed, companies and activities. Due to their size and this approach, the new entrants can quickly represent a significant part of total AuM, as illustrated in the chart below. The risk of impact washing arises when they mimic the technique by **providing financing to positive activities and entities that do not face any financing gap** (see pg. 24), rather than deploying impact-generating techniques specifically designed for mature businesses and liquid financial assets (see pg. 15).



As the GIIN puts it in its latest annual survey, *"the impact investing market has grown rapidly, with many well-known, **large-scale firms entering over the past few years**. Last year, respondents shared their opinions on the recent entry of these large investors, generally viewing the trend as positive but also **identifying a risk of mission drift or 'impact dilution.'** This year, they shared their views on how to mitigate risk of impact washing. Most respondents highlighted the importance of greater transparency around impact, with **80% agreeing that greater transparency from impact investors on their impact strategy and results' would help mitigate the risk of mission drift**"*

"To clarify what a shared set of principles or code of conduct might look like, respondents outlined their views on the importance of a variety of practices impact investors might demonstrate [see chart below]. Most important, respondents reported, were practices core to the definition of impact investing: impact investors should intentionally target investments that positively address one or more social or environmental challenges (92% rating this very important), determine their impact goals or objectives at the time of investment (76%), and regularly measure their progress towards those goals throughout the lifetime of the investment (76%).
Also important, according to respondents, are articulation and communication of organizations' impact strategies. Roughly two-thirds of respondents rated it very important for investors to articulate how impact is factored into investment decisions and management, to articulate a clear theory of change (i.e., linking their investment strategies to approaches to social or environmental challenges), and to regularly communicate progress towards impact goals to relevant stakeholders"



THE TRUTH STRETCH-O-METER

"I support art creation."

FINANCING AN ENTITY THAT ALREADY ENJOYS FULL ACCESS TO FINANCE DOES NOT CONTRIBUTE TO CLOSING THE CLIMATE FINANCE GAP

To contribute to a **shift of capital flows** from brown (e.g. coal-fired power plants) to green (e.g. windfarms), financial institutions have three levers:

1. Making **use of their influence** (e.g. as shareholder through voting rights; as lenders through terms and conditions) to convince the entities they own and/or finance to shift their capital expenditure;
2. Artificially creating a financing gap by **cutting access to finance** from entities who invest in brown activities;
3. Contributing to **closing the climate finance gap** by financing green entities willing to scale up their capital expenditure in green projects but having limited access to finance.

For financial institutions that focus on the third lever, the exclusive focus of the Ecolabel approach, it is critical to understand that **acquiring a financial asset** and **capital expenditure in the real economy** are two very different things (as described on pg. 10). The following examples illustrate the difference:

- The first example is a foundation with the mission to **support art creation**. Commissioning an **unknown talented artist** with no established business to design a sculpture certainly helps to achieve this mission. The amount invested can be used as a proxy to assess the contribution to **closing the financing gap** faced by this activity in a given region. On the contrary, **commissioning Jeff Koons** to produce a new piece certainly finances art creation, but does not directly contribute to the mission, as Jeff Koons faces no shortage of buyers for his work. Similarly, buying a Da Vinci will qualify as an **investment in art** that does not support art creation. When questioned by its board, the manager of the foundation can certainly explain that the acquisition of the Koons and the Da Vinci frees up capital from the seller, who may then invest in new art creation, but the argument is a long shot. As a result, **the amount invested cannot be used as a proxy** to assess the contribution to closing the financing gap related to art creation.

The same way overfilling a gas tank does not increase the car’s range, increasing the demand for bonds artificially does not increase the issuer’s investments.

- The same logic applies to a public fund that has the mission to **increase the supply of residential real estate** in Paris to help reduce tension on the rental market and introduce more affordable housing for low and middle income Parisians. **Financing the construction of social housing** in the city center certainly helps to achieve this mission. Financing the construction of luxury apartments is more questionable. Acquiring existing luxury buildings with foreign tenants would clearly not be in alignment with the mission, even if the fund manager argues that the entity that sold the building might reinvest the acquired money in the construction of social housing. In the preceding two examples, the **amount invested is not a relevant indicator.**

- The same logic applies to an impact investment fund that has the mission to boost the **development of zero carbon activities:**
    - In this context, setting up a **large seed capital investment fund** to finance startups that develop electric aircraft or the hyperloop will likely enable the creation of projects that would not exist otherwise. The fund will therefore contribute to close the climate finance gap and the amount invested will be relevant proxies to measure its contribution.
    - On the contrary, the **acquisition of stocks from an established electric car manufacturer** (e.g. Tesla) might contribute to an increase in the price of these stocks but the link with an increase of Tesla’s capital expenditure in new production capacity is very indirect and uncertain; other investors might for instance consider that the stock is overvalued and sell it. In fact, the shortage of investors might not be a significant barrier to an increase in production capacity at all. Assessing the **contribution to financing the potential financing gap faced by electric car manufacturing is therefore a more complex exercise**.
    - Finally, **certain investments in certain green companies have no effect on the closure of the climate finance gap** because the shortage of investors is not the obstacle in the first place. High speed trains in France are an example: the infrastructure investments are defined by the state and limited by caps on public spending to limit the budget deficit and level of debt. The State-Owned French Railways operator (SNCF) may be a green company according to a green taxonomy, but it does not own the infrastructure and is subject to the same cap on total debt that limits its bond issuance. **At no point is the company prevented from investing more because no investor is willing to buy its bonds.** Conversely, investing more in its bonds will not contribute to closing the finance gap on highspeed railway infrastructure in France. The amount invested in its bonds is therefore a misleading indicator in terms of assessing the contribution of the investor to this challenge.

CLARIFYING THE RULES FOR FINANCIAL PRODUCTS' GREEN MARKETING CLAIMS

The primary added value of an EU Ecolabel may be to clarify the rules and standards of evidence for impact investing products that are at risk of impact washing, such as products invested in liquid assets.

What is a misleading claim? (see pgs. 22-23)

In order to foster consumers' confidence across Europe, the EU adopted a renewed regulatory framework on **unfair commercial practices** aimed at prohibiting any practice "*that materially distorts or is likely to materially distort the economic behaviour with regard to the product of the average consumer whom it reaches or to whom it is addressed*" (*UCPD, art. 5.2.b*). A **misleading practice** is one that "*contains false information and is therefore untruthful or in any way, including overall presentation, deceives or is* ***likely to deceive the average consumer, even if the information is factually correct****, in relation to one or more of the following elements, and in either case causes or is likely to cause him to take a transactional decision that he would not have taken otherwise: (…) the main characteristics of the product" (UCPD, art. 6).*

The interpretation of the regulation for green marketing claims is developed in specific voluntary guidelines developed at European and international level (see pgs. 22-23). 2°ii's analysis suggests that a majority of impact claims fall in the category of misleading claims.

98% of reviewed funds that make impact claims do not comply with regulations (see pgs. 27-28)

Particularly exposed to impact washing are green thematic funds invested in liquid assets, which are the focus of the current version of the EU Ecolabel. For the purpose of this paper, 2° Investing Initiative has started to reviewed the Key Information Documents (KID) and other marketing materials associated with green thematic funds available to European retail investors (see pg. 28). The conclusions of this preliminary analysis are threefold:

- While most KIDs are rather factual and avoid making claims about the environmental impacts of the product, the marketing materials are significantly less cautious. Of the 100 funds reviewed, **85% made impact claims** in marketing documents. Only 2 claims were deemed not misleading.
- Many products are associated with explicit claims regarding the environmental impact of the product, as opposed to the investee companies, that are not substantiated. 2°ii did not find any specific "*robust, independent, verifiable and generally recognized evidence which takes into account the latest scientific findings and methods*" to back the claims.[1]
- In most cases, the misleading dimension is a confusion between the impact of the companies in the portfolio and the impact of the product (i.e. the investment strategy and the management of the fund). In the material reviewed to date, 2°ii did not find any attempt to explain the difference and clarify the "*scope and boundaries*" of the claims, as requested by the regulatory framework.

Conclusion: litigation risks for green asset managers

From a legal perspective, it appears that, under an impact-oriented retail investor's perspective, many marketing allegations referring to an environmental impact might be challenged under UCPD principles on misleading practices. The substance of numerous claims made in marketing documents related to green impact of financial products raises serious questions as to their compliance with UCPD standards, as interpreted by the MDEC reports.

In the wake of current developments in the field of climate change and environmental litigation, it can be reasonably expected that civil society stakeholders will not refrain from using the means offered to them by consumer protection rules to bring these types of misleading practices to justice.

MULTI-STAKEHOLDERS DIALOGUE ON ENVIRONMENTAL CLAIMS REPORT (2016) - EXCERPTS

In 2012, the European Consumer Agenda adopted by the EU acknowledged that "*consumers should be supported in easily identifying the truly sustainable choice*" and that *"effective tools are needed to protect them against misleading and unfounded environmental and health claims" (European Consumer Agenda, 2012).*

To that effect, the EU gathered a Multi-Stakeholder Dialogue on Environmental Claims (MDEC), which defined a set of principles aimed at tackling misleading green allegations and greenwashing.

These guidelines are established without prejudice of the "*national courts and authorities (...) case-by-case assessment of whether a claim is misleading either in its content or in the way it is presented to consumers, taking into account its impact on the average consumer's purchasing decisions."* (**MDEC 2016**)

- *"In order not to be misleading, environmental claims should reflect a **verifiable environmental benefit** or improvement and this should be **communicated in a precise manner to consumers**."*
- *"When making a claim, traders should consider the **main environmental impacts of the product** (good or service) over its life cycle, including its supply chain. The environmental claim should relate to aspects that are significant in terms of the product's environmental impact."*
- *"The claim should be clear and unambiguous **regarding which aspect(s) of the product** or its life cycle the claim refers to: **the whole product, the whole company/ organisation, or specific elements**"*
- *"Once the content of the claim has been established, it should be **presented in a way that is accurate, clear, specific and unambiguous** to ensure consumers are not **misled about the intended meaning, and are thus able to make informed purchasing choices**"*
- *"Plain language should be used that is clear and easy for consumers to understand. Traders should **avoid using vague, ambiguous and broad "general environmental benefit" claims** which are difficult, if not impossible, to substantiate."*
- *"The scope and boundaries of the claim should be clear from the way it is presented. It should be evident whether a claim is referring to the whole product or organization, or just specific aspects. The particular environmental impact or process it addresses should also be clear"*
- *"In accordance with the UCPD, any claim or information in advertising and marketing (whether it is environmental or not) must be correct and not misleading. As such, claims should be **based on robust, independent, verifiable and generally recognized evidence which takes into account the latest scientific findings and methods."***

INTERNATIONAL CHAMBER OF COMMERCE FRAMEWORK FOR ENVIRONMENTAL CLAIMS (FEC)

In many countries, marketing and advertising claims are self-regulated. To ensure a level playing field, the International Chamber of Commerce published a general code and a specific framework for environmental claims (2018), which includes the following principles:

- "*Marketing communication should not contain any statement or visual treatment likely to mislead consumers in any way about the environmental aspects or advantages of products, or about actions being taken by the marketer in favour of the environment. Overstatement of environmental attributes,* (...) *are examples. Marketing communications that refer to specific products or activities should not imply, without appropriate substantiation, that they extend to the whole performance of a company, group or industry*" **ICC Code art. 1D**.
- "*In particular, claims such as "environmentally friendly" or "ecologically safe," implying that a product or an activity has no impact – or only a positive impact – on the environment, should not be used unless a very high standard of proof is available*". **ICC FEC, p. 15**
- "*All environmental benefit information and claims should be supported by reliable scientific evidence*". **ICC FEC, p. 15**
- *"**Even apparently simple environmental claims** may require qualification or explanation. (...) Advertisers should consider whether qualifiers should be integrated into the advertisement to ensure that the claim is clear to the consumer".* **ICC FEC, p. 16**

TYPES OF IMPACT-RELATED CLAIMS OF GREEN FUNDS

Claims in KIDS	Claim in the other marketing documents
The Fund has the objective to increase its value over the long term by investing in companies which activities are focused on climate change mitigation.	*With this fund, investors can have a real impact on global warming. The fund strategy is designed to allows them to have an actual impact on the environment and global warming.*
The Fund's objective is to maximize return. It invests at least 70% of its total assets in shares of sustainable companies *A specific index provides exposure to major actors of climate mitigation.*	*Sustainable investing is a way to achieve impact as well as financial returns.* *With this fund, the investor will be able to get something more than just an investment.* *The design of the fund allows it to be as efficient as traditional investments, while also achieving specific impact goals.*
Our research process is based on a selection of companies which income is generated by sustainable activities and the exclusion of those which are not compliant with our principles.	*This fund's objective is to create a positive impact as well as good returns. Our research methodology and analysis put impact at the center of our decisions.*
The fund invests in shares of companies which income is largely generated from sustainable activities and have a good ESG performance	*With our SRI funds we play a role in the limitation of negative impacts on the environment.*
The Fund is exposed to sustainable companies which activities have a positive impact in light of SDGs.	*The design of our investment strategies allows our funds to have a measurable impact.*

Methodology. 2°ii reviewed Key Investor Information Documents (KIID) and supplementary materials of 100 sustainable, impact, and green funds available to German and French retail investors. Funds' marketing claims were assessed on their compliance with a set of responsible environmental marketing principles based on the framework established by the EU's Multi Stakeholders Dialogue for Environmental Claims Report of 2016 ("MDEC Report"), and adapted by 2°ii to the context of financial products.

98% of funds that made impact claims were non-compliant with the MDEC framework. These funds represent 85% of the funds reviewed.

3 – THE PROPOSED APPROACH TO THE EU ECOLABEL: A DEAD END

3.1 EC PROPOSED APPROACH FOR THE ECOLABEL

DRAFT ECOLABEL: A LABEL FOR GREEN THEMATIC FUNDS

Based on the Draft Technical Report presented on April 4th 2019 by the EC, it is 2°ii's understanding that the EC aims at developing a label for thematic funds invested in all types of financial assets with a focus on liquid assets (listed equity and bonds).

The EC plans to define a list of green economic activities (via its work on a taxonomy) and a minimum threshold of exposure of Ecolabeled funds to these aims. In parallel, a threshold will be defined to limit exposure to controversial activities (such as polluting technologies).

The label will apply to investment strategies as services rather than products, even if the label is applied to products' marketing materials.

Based on the existing categories of sustainable investment, **the proposal of the EC could be categorized as a label for green themed funds, as opposed to a label for impact investing funds**: the envisioned criteria do not include any of the core requirements for impact investing (i.e. intentionality, additionality, and measurement) and clearly do not address the issue of impact measurement associated with investment in liquid assets.

APPARENT LOGIC: INFLATE THE PRICE OF GREEN STOCKS AND BONDS

Assuming that the objective is to support a reorientation of investments in the real economy from unsustainable to sustainable activities, the investment thesis behind the EC's proposal can be summarized as follows:

- The Ecolabel will promote green thematic funds to retail clients.
- It will increase the assets under management of these funds (0.25% of the market today).
- This increase in demand will drive an increase in the market price of the underlying assets (at 86% of listed equity today).
- This increase in price will translate into a lower cost of capital for issuers (about 200-300 companies in the investible listed equity universe according to MSCI).
- The issuers will therefore issue more equity and/or bonds.
- As a result, they will increase their capital expenditure.
- These decisions will foster the growth of green activities.
- This growth will lead to positive environmental outcomes.

This investment thesis is however only implicit in the Draft Technical Report. It is simply **assumes that thematic investing is the one and only approach to deliver environmental outcomes**, without discussing or substantiating this assumption: "*Summarily, financial products or investments in themselves cannot be green. Greenness is derived from the uses to which they are being put in underlying assets or activities*" (Draft Technical Report, p. 56).

APPROACH BASED ON FLAWED ASSUMPTIONS

2°ii's review of the existing evidence suggests that this assumption is inaccurate and ill-informed:

- On the one hand, other techniques exist that aim at generating environmental impact (e.g. shareholder stewardship), which are used more frequently by asset managers, more scalable, and more aligned with the preferences expressed by retail investors in surveys (see pg. 20).
- On the other hand, there is no evidence that the above-described investment thesis (artificially inflating the price of green listed equities and bonds) works in practice, and there are several reasons suggesting that it cannot possibly work (see discussion of the green claims of thematic funds on pg. 26).

As a result, 2°ii believes that the EU Ecolabel, as planned today, will not address any of the needs described on pg. 8, and will rather produce the opposite result by enabling more impact washing and creating barriers for the development of genuine environmental impact investing products.

The following sections discuss the inconsistency of the Ecolabel approach from technical, legal, marketing and supervisory perspectives.

3.2 TECHNICAL FLAWS IN THE APPROACH

THREE DEADLY FLAWS

The main concern 2°ii has with the EC's proposal is its lack of relevance from a technical perspective. More specifically, the proposal suffers from three flaws:

- It confuses the means (thematic investing) with the ends (reorienting investments in the real economy).
- It is based on an investment thesis that is both unsubstantiated and largely inconsistent.
- It does not address the main challenges surrounding retail investors' information on the sustainability features of financial products.

The means become the ends

In the HLEG's recommendation as well as the EC's action plan, increasing investment in sustainable financial products serves as a means to support a reorientation of investments in the real economy. In the Ecolabel proposal, the means become an end in itself; that is, the goal is to increase investment in sustainable financial products without considering the impact on the real economy. Its framing stifles the need for evidence that the means is an effective way of delivering the desired outcome.

Flawed investment thesis

As a direct consequence, the investment thesis behind the proposal remains implicit and is not discussed in the Draft Technical Report.

A closer look at the investment thesis suggests that it inconsistent:

- As the proposal applies to products designed for retail investors, asset managers will favor investments in liquid assets (listed equity and bonds);
- The entities issuing these types of securities inherently do not face difficulty in accessing finance; in fact, access to the financial market can be considered synonymous with liquidity.
- Multiple factors limit issuers' ability to invest, including limited demand for their products, unfavorable regulation, and debt level, but shortage of demand for their equity and bonds is not among them. These issuers limit the issuance:
    - of new shares to avoid diluting their equity and destroying shareholder value;
    - of new bonds to limit their debt level, preserve their credit rating, and keep their stock price and cost of debt under control.
- As a consequence, it is difficult to understand how boosting the demand for equity and bonds artificially will lead to more investment by issuers. No scientific evidence supports this assumption.

Misalignment with retail investors' expectations and stakeholder feedback

No rationale is provided in the Draft Technical Report to justify the decision to prioritize thematic green funds over impact investing products in terms of labeling products. Impact investing is discussed briefly, but not explored in depth despite the fact that 36% of stakeholders consulted by the JRC point to it (vs. 44% for thematic investing).

THE OVERALL APPROACH UNDERMINED

As a result, investment strategies that comply with the Ecolabel definition do not have to hold evidence that they are effective at delivering environmental impacts. The managers of Ecolabeled funds will for instance be able to:

- Vote against all climate-related resolutions in AGMs;
- Pressure the management of investee companies to increase dividends, develop share buy-back programs, and cut capital expenditure.

All investment strategies that aim at delivering environmental impacts but are not green thematic funds will not be eligible for Ecolabeling. Examples include:

- Diversified listed equity funds pushing climate-related resolutions at AGMs (e.g. Climate Action 100+ approach);
- Real estate funds investing in low energy-efficiency buildings to refurbish them.

These flaws have several implications that make the proposed approach irrelevant, counter-productive, and non-compliant with various regulations.

3.3 LEGAL ISSUES WITH THE APPROACH

"EU Ecolabel criteria for financial products are under development, as a follow-up to the Commission action plan: financing sustainable growth[25], aimed at reorienting capital flows towards sustainable investments to achieve sustainable and inclusive growth, managing financial risks stemming from climate change, resource depletion, environmental degradation and social issues, and fostering transparency and long-termism in financial and economic activity. ***The aim is to allow retail investors[26] concerned with the environmental impact of their investment to rely on a trusted and credible (third party verified) label when investing in Green financial products[27] (those leading to a reduced environmental impact), thus avoiding "Greenwashing"****. A credible labeling scheme for financial products should (I) allow retail investors concerned with the environmental impact of their investment to* ***make informed choices and contribute to the Green transition*** *and (ii) provide incentives to industry to* ***develop financial products with a reduced environmental impact or a positive environmental impact."***

EC staff working document, *sustainable products in a circular economy-towards an EU product policy framework contributing to the circular economy*, p. 11.

INCONSISTENCY IN THE EC'S STRATEGIC OBJECTIVES

Regulation 66/2010 on the EU Ecolabel "*is part of the sustainable consumption and production policy of the Community, which aims at reducing the negative impact of consumption and production on the environment, health, climate and natural resources*" (Regulation 66/2010, recital 5).

As such, it is referred to in the EU's *Action Plan for the Circular Economy* as one of the most relevant tools to achieve the objectives of that policy. See *Closing the Loop - An EU Action plan for the Circular Economy (COM (2015) 614)* and *Commission staff working document, sustainable products in a circular economy-towards an EU product policy framework contributing to the circular economy*.

This long-term EU policy launched in 2008 (COM (2008) 397, *Sustainable Consumption and Production and Sustainable Industrial Policy Action Plan*) is focused on transforming **the real economy** by pursuing sustainability objectives through different mechanisms, including Ecolabeling.

Based on this Action Plan, the EC has been leading (with the JRC's insight) an ambitious reflection to create a methodology for evaluating the environmental footprint of products (PEFCR – Product Environmental Footprint Category Rules) since 2013. Its objective is to apply the methodology to future policy development.

The Ecolabel for Financial Products is presented by the EC as means to "*allow retail investors concerned with the environmental impact of their investment to make informed choices and* ***contribute to the Green transition*** *and (ii) provide incentives to industry to* ***develop financial products with a reduced environmental impact or a positive environmental impact."***

Therefore, as an essential part of the sustainable consumption and production strategy of the EU, the Ecolabel for Financial Products **can only be designed in accordance with the objectives of that specific policy**.

The Ecolabel objective is therefore fully aligned with the objectives of impact investing as defined on pg. 12, and is largely disconnected from green thematic investment strategies that are not designed with the objective to deliver environmental impacts. Contradicting the relevant regulation, the draft ecolabel criteria are aligned on the latest approach.

INCONSISTENCY IN THE ECOLABEL REGULATION

The regulation 66/2010 on the EU Ecolabel intends to *"promote products with a reduced environmental impact during their entire life cycle and to provide consumers with accurate, non-deceptive, science-based information on the environmental impact of products."* The approach proposed by the EC is misaligned with the regulation.

Article 3: Environmental impact of the investment strategy

Article 3 of the regulation states that *"environmental performance means the result of a manufacturer's management of those characteristics of a product that cause environmental impact"* and that *"environmental impact means any change to the environment resulting wholly or partially from a product during its life cycle."*

According to the Technical Report and the information provided by the EC during the first ad-hoc Working Group (April 4th, 2019), the EU Ecolabel applies to product management as a service. The **definitions are therefore applicable to the investment strategy developed and executed by asset managers for the labeled product.**

The definitions provided in Article 3 therefore imply that the label must focus on the environmental performance of the investment strategy, i.e. how the investment strategy reduces environmental impact.

Furthermore, the fitness check published by the EC indicates that *"under the EU Ecolabel, the environmental benefit should be achieved when the product replaces another product with a worse environmental profile. In other words,* ***the final environmental effect depends on consumer choice."*** As a consequence the decision by the retail client to invest more money in the Ecolabeled investment strategy must increase the environmental impact of the selected investment strategy: *"EU Ecolabel is achieved when the scheme is able to shift choice (professional or private) towards more environmentally friendly consumption."*

Contradicting these requirements, **the proposed approach exclusively focuses on the environmental performance of the underlying companies/issuers, irrespective of how the investment strategy contributes (positively or negatively) to the evolution of their performance.**

The Draft Technical Report puts it simply: "*Summarily, financial products or investments in themselves cannot be green. Greenness is derived from the uses to which they are being put in underlying assets or activities.*" An assumption that is not substantiated or discussed in the report and appear to be completely wrong.

Article 6: Evidence-based, whole life cycle

Article 6 states that *"EU Ecolabel criteria shall be determined on a scientific basis considering the whole life cycle of products."* Applied to asset management as a service, this article suggests:

- "to consider all the dimensions of the service";
- "to base the assessment of environmental performance on scientific evidence."

The proposed approach does not comply with those two requirements, for the following reasons:

"It is ***the financial service*** *as such being provided by the product manufacturer of the green financial product* ***which would be Ecolabeled."*** **Draft Technical Report**

"*Environmental performance means the result of a manufacturer's management of those characteristics of a product that cause environmental impact" and that "environmental impact means any change to the environment resulting wholly or partially from a product during its life cycle. (...) Environmental impact means any change to the environment resulting wholly or partially from a product during its life cycle.*" **Ecolabel Regulation**

"Under the EU Ecolabel, the environmental benefit should be achieved when the product replaces another product with a worse environmental profile. In other words, the final environmental effect depends on consumer choice."

"EU Ecolabel is achieved when the scheme is able to shift choice (professional or private) towards more environmentally friendly consumption." **Ecolabel Fitness Check**

"Summarily, financial products or investments in themselves cannot be green. Greenness is derived from the uses to which they are being put in underlying assets or activities."
Draft Technical Report

"*Just because an investee is doing great things doesn't mean that your investment will help it do more or better.*"
Paul Brest, "The G8 Task Force Report: Making Impact or Making Believe?" ***Stanford Social Innovation Review*** **(2014)**

EQUITY FINANCING VS. STEWARDSHIP

In a study[1] on the contribution of retail investors to the energy transition, the French PM think tank “France Strategy” and 2° Investing Initiative estimate the financing footprint of French retail investors by assessing the net issuance of equity on one hand, and the profits reinvested (influenced via voting rights) attached to the share they own on the other hand. The results show that:

- The annual issuance of new equity represented about 0.7% of the outstanding amount owned by investors.
- The profits reinvested by the companies annually represented 8 times this amount, and was 30% higher than the annual capital expenditure of these companies.

The study concluded that the retail investors’ main lever for shifting the investment made by listed companies is to **use their shareholder rights to influence the allocation of reinvested profits**.

[1] Fiscalité de l’épargne financière et Orientation des investissements - Adapter les mécanismes actuels aux besoins de financement de long terme – France Strategie/ADEME/2Dii (2015). Data 2013.

Reason #1: Stewardship ignored

The EC’s current approach ignores a major aspect of the asset management service: the use of shareholder voting rights. More broadly it ignores any attempt by the product manufacturer to use his/her influence as a shareholder or debtholder to improve the practices of investee companies.

This omission is not a minor issue. Indeed, good stewardship is seen by many financial institutions as the **main avenue for combining impact and scale**:

- For large asset owners (like pension funds) and managers of mainstream retail funds, who are constrained to holding diversified portfolios, the use of shareholder rights (soft influence, proxy voting, seat at the board of investees) is the main approach for seeking climate and environmental outcomes, as exemplified by the Climate Action 100+ coalition (see pg. 15).
- Similarly, banks that committed to climate and other environmental targets see engagement with their clients and the deployment of incentives (e.g. conditional lending) as one of the main avenues, if not the main avenue.

According to the consumer surveys 2°ii conducted (see pg. 20), a large majority of **retail clients concerned with the environmental impact of their investment also prioritizes the use of voting rights** over thematic impact investing, screening and divestment.

Irrespective of the effectiveness of current stewardship practices, they happen to be **easier than others to evaluate from an environmental impact perspective**. Indeed the investment thesis is simpler: The connection between the actions of the investors and the expected changes in the real economy is more direct and easier to document. For this reason, the use of voting rights to support climate resolutions (Climate Action 100+) will be the first pilot application of the ISO 14097 standard (see pg. 15).

Given that stewardship is the main best practice of product manufacturers targeting the mass market as well as the primary expectation of retail investors, it appears difficult to justify that its omission is compatible with the Article 6 obligation "*to consider all the dimensions of the service.*" The EC provides no explanation for this choice, neither in the Technical Report nor during the Ad-hoc Working Group meeting, where the issue was raised by participants. Lastly, correcting this omission would undermine the EC’s entire approach: Indeed, pushing climate actions through stewardship is **an approach that primarily applies to "brown" economic activities,** as discussed on page 31. Introducing stewardship in the context of green thematic investing would therefore make little sense.

Reason #2: Absence of scientific evidence

The only justification of the abovementioned omission and the focus on green thematic investment found in the Draft Technical Report (p. 56) is that *"financial products or investments in themselves cannot be green, Greenness is derived from the uses to which they are being put in underlying assets or activities."* This statement is not substantiated in the report, not supported by scientific evidence, and thus appears to be completely inaccurate.

In addition, **2°ii did not identify any scientific evidence** establishing that thematic green investing in liquid assets leads to tangible environmental benefits satisfying Article 3 definitions. The conclusion in the Draft Technical Report that thematic investing has better environmental performance than other techniques appears to be arbitrary and unsubstantiated by evidence.

Finally, the Draft Technical Report is **not based on a comprehensive market analysis** and notably disregards the literature on impact investing, the conclusions of consumer surveys, the approaches based on shareholder activism, the standardization work done on impact investing (GIIN, ISO 14097, Science Based Target Initiative, etc.), and the results of the stakeholder consultation where 36% of respondents recommended taking this approach into account.

Therefore, the Draft Technical Report and the current approach to the Ecolabel more broadly seem inconsistent with the obligations of Article 6.

THE JRC IGNORED THE CONCLUSIONS OF DG ENVIRONMENT'S REPORT

Context

In parallel to the work of the High Level Expert Group on Sustainable Finance (that included the CEO of 2° Investing Initiative), DG Environment commissioned a group of experts to "define green in the context of green finance" through "*literature review, interviews and a survey with stakeholders of the European and international financial community, including asset owners, asset managers and others*." The report warns the EC about applying an approach that is too simplistic, and recommends a process-based approach for "*untargeted investments.*"

Key Excerpts

"If one takes a view of green finance not as an objective in itself but rather as a tool to improve environmental conditions, the focus is on the potential impact of green investments. The expected or real environmental impact of targeted finance can be determined by assessing the impacts of (the portfolio of) projects that are being financed. (...). ***Assessing impact for untargeted finance and investment is more difficult. Within the sustainable investment universe, impact investment is one investment approach that is based on specifically assessing and reporting on the impacts of an investment*** *(Eurosif 2016). (...) Assessing impact for the other sustainable investment approaches (positive or negative screening, ESG integration, etc.) is much more difficult. While it is possible to evaluate the environmental performance of companies via ESG research,* ***it is very hard to determine whether green investment (in alignment with the results of such ESG assessments) has caused a company to better manage environmental risks and opportunities and exactly which environmental impact this has. Even the green impact of investment into specialist green companies is difficult to evaluate,*** *since it is not transparent for which purposes the money is used exactly."*

"One of the critical questions is: how can it be ensured that an investment (and the values conveyed through it) contributes to moving the company in which it is invested towards a greener path? ***The impact of green investments depends not only on the investment object (the activity or the entity which receives money), but also on the type of financial product (bonds, shares, funds, etc.), and the processes applied in generating these products.*** *Moreover, the environmental impact of an investment is not always closely related to the amount of the green investment (oekom research 2013)."*

"In conclusion, although there is a link between 1) the content of the investment and 2) its impact, there is no strong correlation in the sense that the "greener" the sector, technology or activity is, the more environmental impact the invested money has. ***Basing a green finance definition only on 'what' is financed thus neglects other mechanisms (e.g. information exchange, shareholder activism) through which investment products might exert influence on the environmental impact of the companies in which they are invested."***

"Definition of environmentally friendly activities through the use of taxonomies*, complemented by overall objectives, exclusion criteria, indicators and thresholds and/or ratings, as outlined in the previous options, can provide orientation mainly for targeted financing that is provided to specific green projects or companies.* ***For untargeted investments such an approach encounters numerous obstacles. Here, a more process-oriented approach seems more suitable. In addition, if framed in the right way, process criteria substantially strengthen the environmental impact of investments and are therefore – from an environmental policy point of view – often even more relevant than content-oriented criteria (for both targeted and untargeted financing)."***

"If well designed, ***process criteria can steer investors towards becoming more involved with companies*** *on environmental matters and exchanging information, raising awareness for the growing importance of environmentally-friendly behavior.* ***This option is thus likely to have the highest environmental impact*** *of the options presented here.* ***The approach can be used for the large market segment of untargeted investments, and will have an environmental impact on industry, especially in areas which still need further greening.*** *The approach directly stimulates the necessary transformation towards a green economy."*

European Commission, DG Environment, *Defining "green" in the Context of "green" Finance*, Oct. 2017

ENABLING UNFAIR COMPETITION

The proposed Ecolabel would create a competitive advantage for Ecolabeled products due to:

- the credibility attached to public labels,
- the support these products are likely to receive from public advertising campaigns[1],
- and potential tax breaks and other public incentives mobilized by governments.

These advantages are likely to have a limited impact on sales in the current context, but with the forthcoming reform of the suitability assessment test, products claiming sustainability impact may become the default recommendation for 60-70% of retail investors (see pg. 20).

Given the aforementioned focus on thematic green funds, the Ecolabel will create two consumer protection concerns:

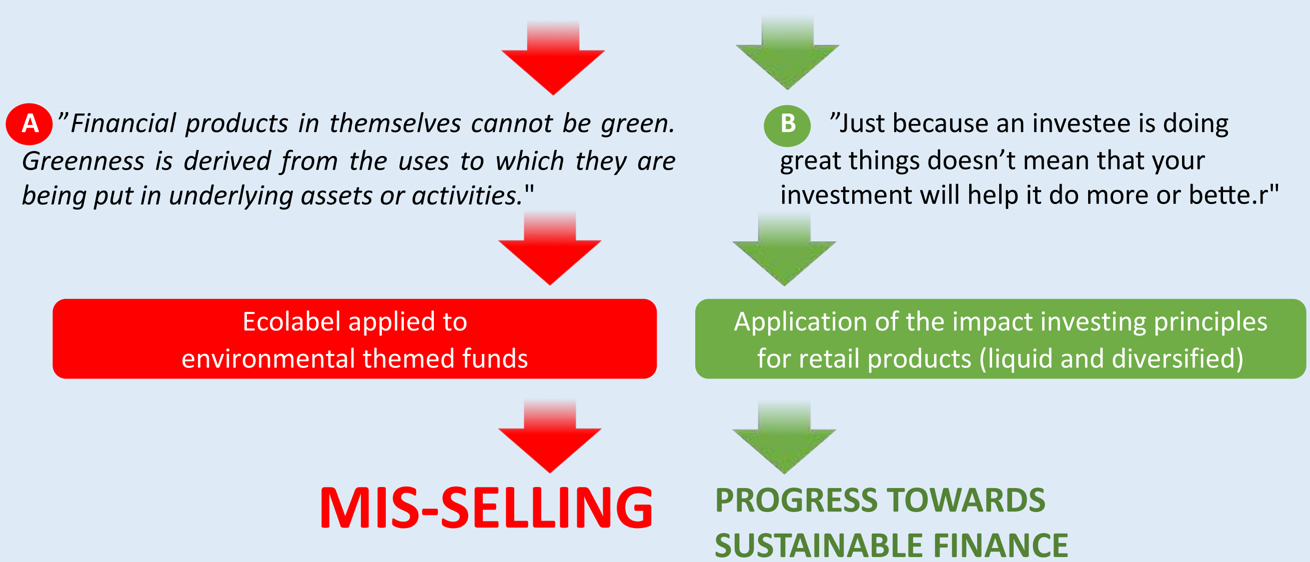
- It will create a **competitive disadvantage** for impact investing funds that are not thematic funds, even when these funds are more effective at delivering environmental outcomes. Page 37 presents four fictitious examples that show via *reductio ad absurdum* how even established impact investment products may be excluded from the Ecolabel. On the other hand, the Ecolabel scheme will include a fund that can be considered in violation of current marketing regulations (see pg. 26). As a result, the draft Ecolabel criteria conflict with the Unfair Competition Directive that *"directly protects consumer economic interests from unfair business-to-consumer commercial practices. Thereby, it also indirectly protects legitimate businesses from their competitors who do not play by the rules in this Directive and thus guarantees fair competition in fields coordinated by it."* (UCPD, Recital 8)
- The label will **suppress the legal obligation to provide evidence** that an investment strategy is associated with real environmental impacts when impact-related claims are made by asset managers of labeled funds. The Unfair Competition Directive (UCPD, Annex 1) categorizes *"misleading commercial practices"* as "*practices which are in all circumstances considered unfair,*" and identifies *"displaying a trust mark, quality mark or equivalent without having obtained the necessary authorization*" as a misleading practice. The possibility to apply **the EU Ecolabel will therefore act as a shield against critics while "legalizing" and even encouraging so-called impact washing.**

We anticipate these loopholes to constitute a major barrier to the commercial development of genuine impact investing products, and a roadblock to innovation from asset managers aiming to adapt impact investing to the mass market (liquid and sartorially diversified products) while preventing a mission drift.

1 - As an example, in the context of a project co-funding by the EC, the French authorities will invest several million euros in a communication campaign to promote the ecolabel on financial products from 2020 onwards

DOGMATIC APPROACH VS EVIDENCE-BASED APPROACH

ECOLABEL REGULATION: "Environmental performance means the result of a manufacturer's management of those characteristics of a product that cause environmental impact"



EXAMPLES OF UNFAIR COMPETITION FOR IMPACT INVESTMENT PRODUCTS

THE CLIMATE BOND FUND

This thematic fund is invested at 70% in investment grade "standard" bonds issued by state-owned railway companies and renewable power utilities.

The fund manager communicates on the avoided GHG emissions contributed by the companies, calling them *"the real and measurable impact of the product"* in its marketing materials. Specifically, they communicate on the "CO2 emissions avoided per euro invested by the client."

Since the fund provides no evidence that the investment strategy materially influences the activities of the investee companies, it has been the target of a class action by environmentally conscious retail clients for mis-selling. The fund received the EU Ecolabel just before the trial, which led the judge to conclude that *"the plaintiffs have provided compelling economic analysis showing that additional investments in this fund have no material effect on the capacity of the investees to invest in green activities. On the other hand, the fact that the fund has been awarded the EU Ecolabel provides in itself evidence that the approach is reliable and compliant with best practices. With the Ecolabel certifying that the approach delivers an environmental impact, the case is dismissed."* The fund continues to benefit from the Ecolabel.

ZERO-CARB TECH FUND

The Zero-Carbon technology fund invests in early stage zero carbon technologies in sectors "lost in transition" that do not have zero carbon alternatives, such as cement, steel, aviation, etc. The fund combines seed and venture capital investments, IPOs, and private debt investment, covering about 400 companies.

The fund has a 15 year investment horizon. Most investments being highly illiquid, it takes significant time for the asset manager to invest the funds raised from new clients. Given the expected success of the fund, new capital is raised every month at the beginning. The funds waiting to be invested in target technologies will be temporarily invested in investment-grade sovereign bonds to ensure safety and liquidity.

As a result, the the fund will not necessarily be able to receive and keep EU Ecolabel certification, since the weight of sovereign bonds may often exceed the 30% threshold.

THE GREENFURBISH FUND

This real estate fund is specialized in purchasing old buildings with low energy efficiency from owners who don't have an incentive to invest in refurbishment (landlords of old buildings) or limited access to credit (low income families). The fund invests in high efficiency insulation and installs solar panels to eventually sell the assets with a premium. Investing more euros in this fund enables the acquisition and refurbishment of more buildings. The fund communicates the average savings to clients. The results are audited: Most assets in this fund have a low environmental performance (they are not green). As a result, the fund is not eligible to the EC Ecolabel.

CLIMATE ACTION 100+ FUND

The CA fund is a diversified equity fund with a strong exposure to high-carbon companies that are targeted by Climate Action 100+.

The fund manager uses the shareholder voting rights of the investors to introduce and support proxy resolutions that request the companies to align their investment plans with a 1.5° scenario, emphasizing early retirement of coal fired power plants. The fund reports annually on the proxy activities: the results of the votes, the changes in companies' capex plans, and estimates of how much GHG emissions are subsequently avoided. A report from an independent consultant discusses the link between the shareholder actions and the evolution of companies' plans.

As the exposure of the fund to brown assets exceeds the 5% threshold significantly, the fund is not eligible for the Ecolabel.

3.4 A MICROSCOPIC NICHE MARKET

INVESTMENT UNIVERSE: 200 COMPANIES OR 1.1% OF THE EQUITY MARKET

Based on the Draft Technical Report, 70% of constituents are supposed to derive a least 50% (or 30%) of their revenues from green economic activities selected in the forthcoming EC Green Taxonomy. Based on the current version of the Taxonomy, and after application of the filters used by asset managers to ensure liquidity and coverage by ESG data providers, this would represent a very small universe.

According to Novethic[1], listed equities represent 86% of the assets under management in green thematic funds. According to the data and index provider MSCI (member of the EC TEG), the application of the Green Taxonomy (which is described by them as close to the envisioned EU Taxonomy) to their largest index the ACWI IMI (which captures 99% the global investable equity opportunity set) leads to the selection of 300 companies with a 30% threshold on green turnover and only **200 companies with a 50% threshold**.

This selection has been turned into an index by MSCI (the Global Environment Index), which can be used as a proxy for the investment universe of future labeled equity funds. As of March 29th, 2019, the market capitalization of this investment universe represented $586,345M or **1.1% of the global investible universe.**

2°ii did not perform the analysis on the bond market, but the universe of issuers complying with the criteria is likely to have the same magnitude for corporate bonds and a much smaller magnitude for the whole bond universe, given the absence of pure green players among banks and sovereign issuers.

Based on the Draft Technical Report and discussions at the Ad-hoc Working Group, it is not clear whether green bonds issued by companies that derive more than 5% of their turnover from brown activities will be eligible for the Ecolabel or not. In 2016, green bonds represented about 5% of assets under management in European green thematic funds (Novethic), but they benefited from a positive dynamic. If they become eligible for the EU Ecolabel, the investment universe will likely extend slightly. This would generate additional concerns from a greenwashing and consumer protection perspective[2].

CURRENT MARKET SHARE OF GREEN THEMATIC FUNDS: 0.1%

According to the “fitness test” on Ecolabeling and the stated goals of the Ecolabel for Financial Products, Ecolabeled products are ultimately supposed to reach a market share of 10% to 20%.

Based on the currently proposed criteria, this scale will likely not be reached: Green thematic funds currently represent a very small niche, even in the sustainable product landscape. In 2016, Novethic identified 168 of these funds in Europe (compared to 70 funds in 1998) with a total of €22Bn of assets under management. Based on Novethic’s analysis, only half of these funds are eligible under the Ecolabel criteria, which represent about **0.1% of UNCITS** and 0.05% of total assets under management in Europe (EFAMA).

Given the constraints related to the universe of investible assets and the lack of sector diversification, Ecolabeled products are unlikely to become mass market products, even if the Ecolabel is a success.

The French Energy Transition Label serves as an example:

- The Label’s criteria are similar to those proposed for the EC Ecolabel.
- In 2016, according to Novethic, the TEEC-labeled funds represented **0.02% of the market**: €0.7Bn for a total €4.7Bn of green thematic funds, and total assets under management of €3.971Tn in France (EFAMA).

1. Le marché des fonds verts européens, Mars 2017
2. For a discussion on the environmental of green bonds, see *Shooting for the Moon in a hot air balloon* (2° Investing, 2018)

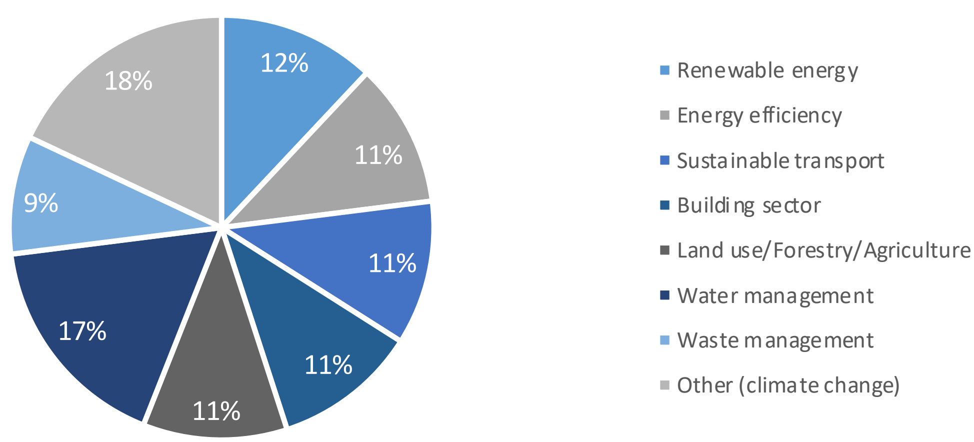
LIMITED SUITABILITY TO RETAIL INVESTORS' FINANCIAL CONSTRAINTS

Investment products designed for the mass retail market must have certain characteristics in order to match with retail investors' constraints, such as limited volatility and broad diversification. Green thematic funds and the associated equity investment universe have the opposite characteristics: They are concentrated in certain industries and tend to be quite volatile.

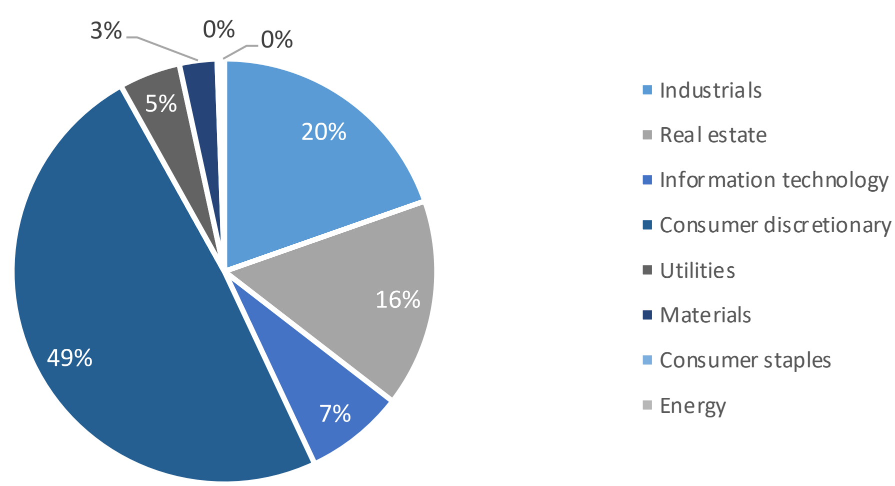
As a consequence, the Ecolabeled funds will likely be niche products representing a small fraction of the average retail investor's portfolio, with no potential to replace the mainstream products (i.e. diversified funds, life insurance products, etc.) identified in the Technical Report. This outcome is a direct consequence of the Ecolabel's design flaws, which make the **objective of reaching a market share of 10-20% unrealistic.**

On the other hand, impact investment approaches (i.e. the use of shareholder rights, products based conditional loans, etc.) that are scalable and compatible with the liquidity constraints of retail investors are excluded from the scope. **The technical approach of the Ecolabel is therefore inconsistent with the policy objective in terms of adoption.**

Sector exposure of thematic funds (Eurosif, 2017)



Sector exposure of the MSCI Global Environmental Index (2019)



3.5 ENGINEERING AN ASSET BUBBLE

"Asset bubble: When the prices of securities or other assets rise so sharply and at such a sustained rate that they exceed valuations justified by fundamentals, making a sudden collapse likely - at which point the bubble 'bursts.'" Financial Time lexicon

"With regards to clients wanting to make a difference and ensuring that the products that they are buying actually help them reach these objectives, I think that the work here is more on the Commission's realm than on ours, because again as you perfectly know the Commission is working on the taxonomy, on the labelling of products, i.e. deciding when will a product have the right to issue a label saying that it satisfies these objectives. And so we have not been involved, we are sort of observers in this role, we are not leading on that. And as you know we don't have any direct supervisory powers of firms. So at this stage we recognize the issue, the Commission is working on it and we can only agree on the importance that the labelling work is done correctly in order to insure that there is no miss-selling in order to ensure that clients can actually buy the products that best allow them to reach the objectives that they want to reach."
ESMA Public Hearing on Sustainable Finance –
4 February 2019, Paris

THE EC PLANS TO ENGINEER AN ASSET BUBBLE

Based on 2°ii's understanding of the investment thesis behind the proposed Ecolabel, the EC's goal is to generate artificial growth in demand for certain financial assets based on the Taxonomy, and irrespective of the economic fundamentals of the underlying activities. This artificial growth in demand is a prerequisite for any environmental impact to materialize.

Given the fact that most financial assets will be liquid assets traded on secondary markets, the expected direct effect will be a rise in market prices (with influence on the issuance of equity or debt being a potential secondary effect at best), **disconnected from the fundamentals** of the companies, which are primarily driven by factors like the growth of demand for their products, regulatory changes and the price of commodities. **The phenomenon that the EC intends to generate is the exact definition of an "asset bubble."**

THREAT TO INVESTOR PROTECTION

Based on the stated goal of the EC to reach 10-20% market share for labeled funds and the current size of the investment universe, the magnitude of the bubble is a targeted overpricing of 900% to 1,900%.

This raises several questions for financial supervisors, and notably the ESMA:

Does this plan represent a threat for financial stability?
Considering the stated goal alone, this would certainly be a concern. However, taking into account the likelihood of success of the scheme (see pg. 39), this concern is very limited in reality.

Is it a concern from an investor protection perspective?
Here, the answer may be more grim:

- Taking into account the lower end of the 10-20% target market share for Ecolabeled products, the stated policy objective of the EC is to **grow the green fund market by 9 900%**.
- Given the very limited size of the universe (i.e. 1% or 200 stocks for equity investments) and its volatility, a large growth in demand at European level may **lead to overpricing.** This effect may also be amplified temporarily by hedge funds anticipating the effect of the regulation, until the disconnect with the fundamentals becomes too high and the market sentiment changes, thus triggering the bubble to burst.
- According to Novethic's research, the green fund market has already collapsed once in the aftermath of the financial crisis (-37% between 2009 and 2011) and has not yet fully recovered.

Given its mandate (see pg. 41), the implication of this scenario would be **an obligation for the supervisor (ESMA) to prevent the development of the EC Ecolabel and issue warnings to consumers,** much like the supervisor did for digital currencies in 2018. At this stage, ESMA has mostly acted as observer in the process.

Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority, art. 9
"The Authority shall take a leading role in promoting transparency, simplicity and fairness in the market for consumer financial products or services across the internal market (…)

The Authority may also issue warnings in the event that a financial activity poses a serious threat to the objectives laid down in Article 1(5)."

ESMA Strategic Orientation 2016-2020, p. 6
"ESMA's mission is to: Enhance investor protection and promote stable and orderly financial markets.
This mission is derived from ESMA's founding Regulation and encompasses three objectives:

1. *Investor protection: to have the needs of financial consumers better served and to reinforce their rights as investors while acknowledging their responsibilities;*

2. *Orderly markets: to promote the integrity, transparency, efficiency, and well-functioning of financial markets and robust market infrastructures; and*

3. *Financial stability: to strengthen the financial system in order to be capable of withstanding shocks and the unravelling of financial imbalances while fostering economic growth."*

ESMA Strategic Orientation 2016-2020, p. 7
"The purpose of assessing risks to investors, markets and financial stability is to spot emerging trends, risks and vulnerabilities, and where possible opportunities, in a timely fashion so that they can be acted upon. ESMA uses its unique position to identify market developments that threaten financial stability, investor protection or the orderly functioning of financial markets (…)

Externally, we promote transparency and investor protection by making information available to investors via our public registries and databases and, where needed, by issuing warnings to investors."

4 – THE ALTERNATIVE: AN ENVIRONMENTAL MANAGEMENT SYSTEM FOR ASSET MANAGEMENT

4.1 CONSTRAINTS

LABELING INVESTMENT STRATEGIES THAT SEEK IMPACT

Based on 2°ii's analysis of the market and interpretation of the EU Ecolabel Regulation, the Ecolabel for Retail Financial Products should aim at identifying investment strategies that *intend* and *succeed* in delivering environmental impacts.

The definition of environmental impacts should be the **reorientation of investments in the real economy** from unsustainable (e.g. coal-fired power production) to sustainable activities (e.g. renewable power production) in order to contribute to GHG emission reductions and other sustainability outcomes.

The assessment should consider how asset managers and banks use of their **influence as shareholders, bond investors and lenders to support this goal.** Multiple techniques can be mobilized to reach this objective, including investment in activities facing a financing gap, use of shareholder rights, conditional lending, targeted divestment, etc.

NO EVIDENCE TO DEFINE EX-ANTE WHAT WORKS

As of today, there is no scientific evidence to determine which technique is the most effective, and under which conditions each can deliver environmental outcomes.

Indeed, this is the reason why **impact investing is defined by the intent and process to be applied, not by the use of a single technique.**

When implementing Article 6 of the Ecolabel Regulation, **the EC should therefore avoid making assumptions about and prescribing certain approaches without any scientific evidence**. On the contrary, the Ecolabel should be designed as a way to acquire evidence over time and stimulate innovation by the asset management industry.

Similarly, there is no established methodological framework for measuring the environmental impact of investment strategies (as opposed to measuring the environmental impact of the underlying companies). The Ecolabel should therefore encourage the development of such frameworks.

BUILDING ON THE PROPOSED EU TAXONOMY

Based on 2°ii's understanding of European Commission's action, maximizing the use of the proposed EU Taxonomy seems to be a political objective *in itself* (i.e. irrespective of the need of the Taxonomy in the different contexts). This political objective appears to be a strong driver behind the design of the proposed approach for the Ecolabel.

The proposed Ecolabel's objective would be to mobilize different asset management techniques (including shareholder votes, conditional lending, investments in real assets, etc.) to **contribute to the growth of economic activities included in the EU Taxonomy** at the expense of brown activities, whether these activities are developed by pure players, diversified organizations or individuals.

"A definition of environmentally friendly activities through the use of taxonomies, complemented by overall objectives, exclusion criteria, indicators and thresholds and/or ratings, as outlined in the previous options, can provide orientation mainly for targeted financing that is provided to specific green projects or companies. ***For untargeted investments such an approach encounters numerous obstacles****. Here, a more process-oriented approach seems more suitable. In addition, if framed in the right way,* ***process criteria substantially strengthen the environmental impact of investments and are therefore – from an environmental policy point of view – often even more relevant than content oriented criteria*** *(for both targeted and untargeted financing)."*

EC Report, Defining "green" in the context of green finance, 2017

4.2 SOLUTION

ENVIRONMENTAL ASSET MANAGEMENT SYSTEM FOR IMPACT INVESTING

Given the diversity of approaches deployed by investors to generate impact, the uncertainty surrounding the effectiveness of different techniques, the lack of preexisting measurement frameworks and metrics, and the fact that the labeling approach applies to a service (i.e. the design and implementation of an investment strategy), the best solution seems to be developing **a label based on a process-based approach**.

This approach builds on three elements:

- The **EMAS** (EU Eco-Management and Audit Scheme) provides the definitions (see below) and describes the necessary actions to develop an "environmental management system," and is already applicable to financial organizations. In addition, the Scheme benefits from an existing pool of consultants and auditors as well as an established registration system.
- **Impact investing** (as defined by the GIIN and World Bank) provides a set of best practices, investment-specific definitions, and examples of performance metrics that allow specifying how the EMAS applies to the management of an environmental impact-oriented investment strategy.
- **The EU Green Taxonomy** (to be defined by the EC) will provide an indication of the type of economic activities that should be prioritized in labeled investment strategies.

The core criteria of this type of environmental asset management system would include the following elements:

1. An **explicit intent/objective** for generating environmental impact, formally described in the Key Information Document (making it legally binding);
2. An obligation to mobilize **means consistent** with this objective, based on existing best practices and an ex-ante review of scientific evidence on the effectiveness of these practices. This obligation comes with requirements to describe the investment thesis and evidence analyzed in an annex of the prospectus, and to document the actions used to influence investees/borrowers in annual reporting to clients.
3. An obligation to assess and report the results of the approach in terms of the **effectiveness in delivering changes in the real economy and environmental impacts.** This report starts out qualitative and becomes more quantitative with experience.
4. A mechanism to ensure **continuous improvement**, based on ongoing assessments of the state-of-the-art of research on the topic.

The management system would then be tied to a labeling scheme based on a binary approach (applied/not applied) or a **scoring system** assessing the depth and quality of each dimension. After a few years of implementation, the effectiveness of the approach will be evaluated based on an analysis of the results. If necessary, the criteria can be made stricter by **setting thresholds on relevant impact indicators.**

Sustainability for DUMMIES

The EU Eco-Management and Audit Scheme (EMAS) has been developed by the European Commission for companies and other organizations to evaluate, report, and improve their environmental performance. It is applied to both manufacturing and services sectors. A review of the EMAS registration database reveals that only two fund managers are registered (0.05% of registrations).

However, available materials suggests that the management system focuses on the operational impacts rather than the environmental impacts of investment strategies. No best practice guidance exist for portfolio management activities, but the key principles and definitions provided in the general regulation and guidance appear to be relevant to managing the environmental impact of an investment strategy.

KEY DEFINITIONS FROM EMAS REGULATION

Environmental performance refers to the measurable results of an organization's management of its environmental activities.

Environmental impact refers to any change to the environment, whether adverse or beneficial, wholly or partially resulting from an organization's activities, products or services.

Indirect environmental aspect refers to an environmental aspect resulting from the interaction of an organization with third parties, which can to a reasonable degree be influenced by an organization.

Environmental statement refers to the comprehensive information directed at the public and other interested parties regarding an organization's:

- structure and activities;
- environmental policy and environmental management system;
- environmental aspects and impacts;
- environmental program, objectives and targets;
- environmental performance and compliance with applicable legal obligations.

Environmental program refers to a description of the measures, responsibilities and means taken or envisaged to achieve environmental objectives and targets as well as the deadlines for achieving the environmental objectives and targets.

Best environmental management practice refers to the most effective way to implement the environmental management system by organizations in a relevant sector that can result in the best environmental performance given certain economic and technical conditions.

Environmental objective refers to an overarching environmental goal, arising from the environmental policy that an organization sets defines for itself. It should be quantified where practicable.

KEY DEFINITIONS FROM GIIN GUIDANCE

Every investment contributes to short and long term positive and negative social and environmental effects. All investors shape these effects through investment decisions. Impact investing is an approach used by investors to **harness the power of their investment capital** to actively contribute to improvements in people's lives and the environment.

Impact investments are defined as investments made with the intention to generate positive, measurable social and environmental impact alongside a financial return.

Impact investing is marked by an **intentional desire to contribute** to measurable social or environmental benefit. Impact investors aim to solve problems and address opportunities. This is a key difference between impact investing and other investment approaches that incorporate impact considerations to some extent.

Impact investing should involve setting transparent financial and impact goals, and **articulating an investment thesis that is explicit about the goals** and strategies used to realize them.

Impact investing should be evidence-based, and needs to use data to drive intelligent investment design that is be useful in contributing to social and environmental benefits.

Investors' approaches to **impact measurement** will vary based on their objectives and capacities, and the choice of what to measure usually reflects investors' individual goals and intentions.

While not exclusive to impact investing, the **direct and measurable effects** achieved through impact investing often distinguish this approach from other categories of responsible investment (e.g. ESG integration and ESG-screened funds), which tend to be more indirect difficult to measure.

Impact investing involves setting an intention and managing progress toward that intention. This may include **feedback loops** to communicate performance information to support others in the investment chain to manage toward impact.

THE IFC OPERATINGPRINCIPLES FOR IMPACT MANAGEMENT

In February 2019, the International Finance Corporation, a branch of the World Bank Group, published the set of guidelines as a practical framework for implementing impact management. They are summarized below:

Principle 1: Define strategic impact objective(s) consistent with the investment strategy.

- *Definition of strategic impact objectives aligned with SDGs or other accepted goals (not necessarily shared by the investee), consistent with the investment strategy and proportional to the size of the portfolio.*

Principle 2: Manage strategic impact on a portfolio basis.

- *Definition of a process to establish and monitor impact achievement for the whole portfolio (while recognizing that impact may vary across individual investments in the portfolio).*
- *Consideration given to the alignment of staff incentive systems with the achievement of impact, as well as with financial performance.*

Principle 3: Establish the manager's contribution to the achievement of impact.

- *Establishment of a credible narrative on manager's financial and/or non-financial contribution to the achievement of impact for each investment.*

Principle 4: Assess the expected impact of each investment based on a systematic approach.

- *Assessment and quantification, for each investment, of the concrete, positive impact potential deriving from the investment, through suitable results measurement framework aiming to answer: (1) What is the intended impact? (2) Who experiences the intended impact? (3) How significant is the intended impact?*
- *Assessment of the likelihood of achieving the investment's expected impact and of the significant risk factors that could result in the impact varying from ex-ante expectations.*
- *Consideration for opportunities to increase the impact of the investment and to indirect and systemic impacts.*

Principle 5: Assess, address, monitor, and manage potential negative impacts of each investment.

- *Systematic and documented process of identification, avoidance/mitigation and management, for each investment, manage of ESG risks.*
- *Where appropriate, engagement with the investee to seek its commitment to take action to address potential gaps.*
- *Monitoring of investee ESG risks and, if relevant, engagement.*

Principle 6: Monitor the progress of each investment in achieving impact against expectations and respond appropriately.

- *Use of the results framework (referenced in Principle 4) to monitor progress toward the achievement of positive impacts in comparison to the expected impact for each investment.*
- *Data sharing with the investee.*
- *Pursuit of appropriate action when monitoring indicates that the investment is no longer expected to achieve its intended impacts.*

Principle 7: Conduct exits considering the effect on sustained impact.

- *Consideration for the effect of an exit on the sustainability of the impact.*

Principle 8: Review, document, and improve decisions and processes based on the achievement of impact and lessons learned.

- *Review and documentation of each investment, comparing the expected and actual impact, and other positive and negative impacts, and using these findings to improve operational and strategic investment decisions, as well as management processes.*

Principle 9: Publicly disclose alignment with the Principles and provide regular independent verification of the alignment.

- *Public disclosure, on an annual basis, of the alignment of the impact management systems with the Principles.*

Source: IFC, Investing for impact: Operating principles for Impact Management

RESPONSIBLE MARKETING PRINCIPLES

The debate on the design of the Ecolabel raises a number of issues and questions regarding what constitutes a responsible marketing practice on impact-related claims about financial products or the strategy of financial institutions. 2°ii believes that the development of the Ecolabel and the regulation of green marketing claims will necessitate the development of a set of **generally accepted principles as well as a best practice framework.**

Building on the existing body of regulation, industry standards in the field of responsible marketing, and the aforementioned definitions, 2°ii proposes a set of principles for financial organizations making impact-related claims. They apply to financial organizations setting environmental targets and reporting on environmental impact, as well as products claiming environmental benefits. They are also indirectly applicable to financial policymakers, financial supervisors, standard setters, and NGOs promoting or advocating for the use of sustainable finance tools and techniques.

REALITY-BASED

Financial institutions should ensure that all information reported and documented is built around fact-based assumptions in order to limit misleading communication, in particular:

- Financial institutions are expected to avoid ambiguous statements equating the deployment of a sustainable investment strategy (the means) with environmental impacts in the real economy (the ends).
- Financial institutions should refrain from equating an evolution of the boundaries of their asset portfolio (e.g. divestment from an entity owning a coal-fired power plant) with environmental impacts in the real economy (e.g. closure of a coal-fired power plant replaced by renewables) as a direct consequence of their actions.
- Financial institutions should refrain from equating an increase in their allocation to certain financial assets (e.g. increase in green bond exposure, or assets under management in green funds) with an increase of investments in the real economy (e.g. increase in capital expenditure in green projects) as a consequence of their actions.

EVIDENCE-BUILDING

Any institution that believes the deployment of an investment/lending approach (such as divestment from certain assets, the increase in allocation to other assets or the deployment of certain tools) will lead directly or indirectly to environmental impacts in the real economy should substantiate its claims by collecting evidence supporting the causal link between the financier's actions and the outcomes. For this purpose, the institution should:

- Lay out each assumption made for the specific cause and the evidence available (ex-ante) to support the investment thesis.
- Collect further evidence (ex-post) and report how it supports—or contradicts—its thesis; this evidence-based approach aims to avoid any ambiguity between assumptions (i.e. divestment from coal mining companies prevents new coal projects from being financed) and facts, and to build evidence on an ongoing basis to improve the investment thesis continuously.

ADDITIONALITY

An institution should refrain from suggesting that the environmental impacts of its investees and borrowers can automatically be credited to its investment/lending strategy and from reporting these impacts as if the financial institution itself was delivering them. A financier cannot automatically take credit for the investee's climate impact (i.e. low level and/or reductions of GHG emissions in the real economy) if there is no evidence that the financier's climate action was a key driver for the GHG emissions change. This involves refraining from suggesting that:

- The provision of financing to green activities brings a critical contribution to their development, if these activities do not face difficulties accessing finance in the first place;
- Its refusal to finance brown activities prevents the institution's access to finance, if the evidence suggests that the effect is fully offset by other financial sector players;
- Its strategy triggered the environmentally friendly practices of investees/borrowers, if their decision was already made or has been primarily driven by other factors.

LEADERSHIP

The absence of scientific evidence on the effectiveness of various investment techniques in delivering real impact should not prevent leading financial institutions from implementing best practices and experimenting with new ones. Leading impact investors assess the effectiveness of their approach, acknowledge shortcomings, and learn from their mistakes to fine tune their investment thesis and approach.

BRIDGING THE GAP

As discussed in the box on the right, there is currently a large gap between the scientific level of evidence requested by marketing and Ecolabel regulations, and the level of evidence currently available.

This gap and the potential responses were discussed in June 2019 during a *2° Investing Initiative* seminar that gathered about 20 participants (large retail banks, investors, governments and NGOs).

While a majority of the participants acknowledged the issue of impact washing, no consensus was reached on the most relevant means to address the issue. Some participants emphasized the potential risk of seeing asset managers refrain from offering impact-oriented products if the standard of proof related to such commercial propositions became too demanding. However, a majority of participants excluded the status quo as a viable option.

This feedback suggest that the R.E.A.L. Principles presented above are still outside the Overton window in the sustainable finance community, but that the situation may evolve rapidly.

THE LEVELS OF EVIDENCE

2° Investing Initiative is currently conducting research to collect the existing evidence on the effectiveness of various impact investing techniques and, where relevant, rate the level of evidence. Many disciplines (medicine, pharmacology, criminology, climatology, etc.) use scales for assessing the strength of evidence used to inform decision-making. The schema below provides an example of such a scale.

Based on this scale, 2°ii's preliminary analysis concludes that the evidence provided by fund managers to back impact-related marketing claims (see pg. 26) and the evidence given in the Technical Report on the Ecolabel proposal does not even reach Level 1.

The only exception seems to be microfinance and seed capital investing. Some impact investors managed to prove additionality at an individual level by being present where market friction occurs (imperfect information, small deal size, limited exit strategies, etc) or where capital returns are below the market level.

In microfinance, several studies have been done using randomized evaluation. This methodology aims to compare, two years after a program's implementation, the people who did not benefit from the program to the people who did. The results have shown far less impact than expected, but they provided evidence showing where the program was efficient and not.

4.3 CONCLUSION

TECHNICAL ANALYSIS

Based on 2°ii's analysis of the market and interpretation of the EU Ecolabel regulation, the Ecolabel on financial products should aim to identify **investment strategies that explicitly intend and succeed at delivering environmental impacts.**

The definition of environmental impacts should be the reorientation of investments **in the real economy** from unsustainable (e.g. coal-fired power production) to sustainable activities (e.g. renewable power production), in order to contribute to GHG emission reductions and other sustainability outcomes.

The assessment should consider how asset managers and banks use their influence as shareholders, bond investors and lenders to support this goal. **Multiple techniques can be mobilized to reach this objective**, including investment in green activities facing a financing gap, use of shareholder rights, conditional lending, targeted divestment, etc.

As of today, there is **no scientific evidence to determine which technique is the most effective** and under which conditions. The EC should therefore avoid making assumptions and prescribing certain approaches without any evidence. On the contrary the Ecolabel scheme should be designed as a way to build the necessary evidence over time and stimulate innovation.

Similarly, there is **no established methodological framework for measuring the environmental impact of investment strategies** (as opposed to measuring the environmental impact of investee companies). The Ecolabel scheme should therefore encourage the development of such frameworks and build on emerging initiatives such as the ISO 14097 and SBTi for Financial Institutions.

LEGAL ANALYSIS

From a legal perspective, the design of an EU Ecolabel through unfitted criteria could create legal insecurity across Europe and critical adverse outcomes regarding the EU's environmental agenda. From a consumer protection perspective, green impact-related marketing claims by financial institutions already raise serious questions as to their compliance with UCPD rules, which might lead to **consumer-related litigation** (either by class action, or by action led by organizations defending consumers' rights or the environment).

One of the purposes of a well-designed EU Ecolabel should be to **create a level playing field for environmental claims,** and thus enhance consumers' confidence in products presented as environmentally impactful. This would aid in achieving the mainstreaming of impact-related products, increasing their effect globally. There is no doubt that **these objectives will not be achieved if the EU Ecolabel** moves further in the direction suggested in the Draft Technical Report. In fact, the proposed Ecolabel is likely to undermine consumer protection, fair competition and orderly markets by **encouraging misleading marketing and the creation of an asset bubble.**

2°ii's analysis suggests that the flaws in the EC's approach to sustainable finance are not limited to the Ecolabel, a situation that may create **legal risk for the EU and individual member states**. Beyond the legal actions that would most likely be brought before the courts of the EU or its member states against the proposed legislative/regulatory acts (as infringing on the environmental highest principles contained in treaties and other relevant legal sources), the risk is significant for the EU to face myriad legal actions of the nature currently promoted by diverse civil society stakeholders to bring policymakers to justice for their failure to fix climate and environmental degradation through rational actions.

FEEDBACK

This draft has been submitted for feedback to about 50 stakeholders from different backgrounds, including most of the organizations mentioned in the document, and the relevant contacts at the European Commission, such as DG FISMA and the JRC. These organizations have been offered the opportunity to include formal feedback in this report and either did not respond, declined, or only provided informal verbal comments. The paper has nevertheless been presented to and discussed with about 40 stakeholders, including leading asset managers, retail banks, supervisors, policymakers and NGOs. The main takeaways from informal feedback are threefold:

- **The technical and legal analyses have not been challenged**. None of the individuals consulted pointed to a flaw in 2°ii's reasoning, found an inaccuracy, or presented new facts that were not yet reflected in this paper. Should a gap be identified in the future, the paper will be updated accordingly.
- **The knowledge and skill gap is significant**. Based on 2°ii's understanding, most individuals who are involved in designing and enforcing the Ecolabel and related policies have a limited level of awareness of the technical and legal issues discussed in this paper. Most of the individuals contacted were unable to form an informed opinion about the matter due to a gap in knowledge on the underlying investment practices and regulations: They tended either to adopt the views in this paper because of stated trust in the authors, or to reject them because they would not believe that the EC could be this misguided. This suggests that current policymaking on this topic is based largely on beliefs rather than science and facts, which is cause for concern beyond the Ecolabel alone.
- **The issue still lies outside the Overton window.** Overall, the consultation revealed that the idea that impact-related market claims and the Ecolabel should be grounded in scientific evidence is not popular in the sustainable finance community. The most common piece of feedback received was that 2° Investing Initiative is targeting a problem that is currently not a priority. More specifically, some stakeholders argued that setting the bar "too high" may slow down the EU's legislative pace on sustainable finance, and lead to a decline in green product sales. In addition, some were intimidated by the methodological challenges associated with measuring impact. At the same time, none of the stakeholders consulted suggested that financial products should be made an exception to existing regulations on green marketing claims. This paradox suggests that the sustainable finance community (i.e. industry, policymakers, supervisors, experts, NGOs, etc.) is likely to set aside the issue highlighted in this paper for years, but that the Overton window is likely to shift rapidly when the issue has finally made it on the agenda.

NEXT STEPS

The EC set itself the goal of reforming financial regulation in order to "*reorient capital flows towards sustainable investment."* Doing so represents a significant challenge that will likely require inventing a new scientific field rather than relying on dogma and outdated beliefs. 2° Investing Initiative looks forward to taking on a leadership role in creating this new field.

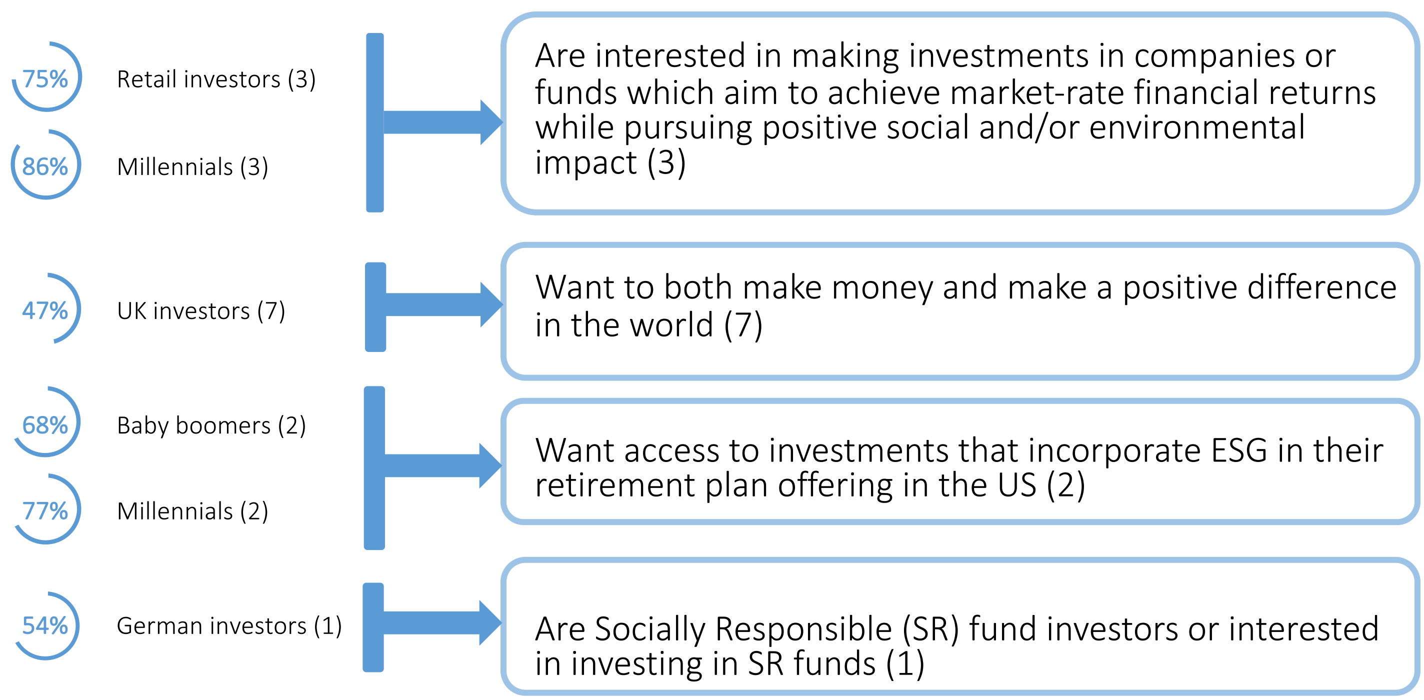
In terms of a research agenda, 2°ii's concrete next steps are as follows:

- A paper discussing how consumers interpret misleading impact-related claims on financial products;
- A state-of-the-art review of the scientific evidence available on different impact investment techniques;
- A methodology and online tool to allow investors to design evidence-based, climate-related claims;
- A policy paper on the broader issues associated with the EC's flawed definition of "sustainable investment."

Annex 1: Existing surveys on investor preferences

(1)	Gutsche et al, 2017	Characterizing German (Sustainable) Investors	1001 representative German respondents	Link 1
(2)	Natixis, 2016	Mind shift: getting past the screens of responsible investing	7100 respondents, 22 Countries	Link 2
(3)	MorganStanley, 2017	Sustainable Signals: new data from the individual investor	1000 respondents USA	Link 3
(4)	Schroeders, 2017	Global Perspectives on sustainable investing	22000 respondents 30 countries	Link 4
(5)	Wisdom Council, 2017	Insights: responsible investing	1000 respondents	Link 5
(6)	Arabesque, 2017	The investing Enlightenment	600 institutional investors 759 individual investors	Link 6
(7)	Wisdom Council/ UKSIF, 2017	Attitudes to Ethical and Sustainable Investment and Finance in the UK	1000 respondents UK	Link 7
(8)	HLEG, 2018	Financing a Sustainable European Economy	-	Link 8
(9)	EU, 2018	Distribution systems of retail investment products across the European Union	-	Link 9

Retail investors want to make a difference



Annex 2: Results from focus groups

Two test focus groups in Germany
Two test focus groups in France in partnership with Dauphine University

Focus groups, Germany

- 2 focus groups conducted in August 2018
- 2 x 7 Participants
- All genders
- All households
- Professional situations :
  - Student (1)
  - Consultant (4)
  - Public services (5)
  - Retired (2)
  - Education professionals (2)

- **Focus group 1 :**
Age from 22 to 40 years

- **Focus group 2 :**
Age above 40 years

Focus groups, France

- 2 focus groups conducted in November 2018
- 2 x 10 Participants, all gender
- Bias towards high-skilled, Paris-based

Focus Group 1 :
Age from 22 to 40 Years Old

- Professional situations :
  - Lawyer (1)
  - Engineer (1)
  - Communication (2)
  - Finance (2)
  - Architect (1)
  - Biologist (1)
  - Project manager (1)
  - Retired (1)

Focus Group 2 :
Age from 23 to 58 Years Old

- Professional situations (all related to CHANEL):
  - Human resources (5)
  - Supply chain (1)
  - Purchasing department (1)
  - Finance (1)
  - IT (1)
  - Marketing(1)

The focus groups reveal that the fear of greenwashing and the lack of trust in financial institutions and advisors is a key obstacle.

"We can all design beautiful marketing documents with appetizing titles and nice sounding paragraphs and at the end you ask yourself but what did he want to say exactly?"

"Maybe this is the problem, that it is a total black box between the investment and… there is no proof of impact"

"I don't have confidence in banks (...) you are all alone in front of a huge institution. The financial adviser is changing every 6 months (...) I believe they don't even understand the details of it themselves."

"There are no ways to know where the money is invested, and even if would be offered green financial products, there is a suspiciousness on the quality of the product"

ABOUT 2° INVESTING INITIATIVE

The 2° Investing Initiative is a multi-stakeholder think tank working to align the financial sector with sustainability policy goals. The organization is not-for-profit and non-commercial. It helps develop the regulatory frameworks, performance metrics, data and tools to support this evolution.
Thanks to its EU-funded research programs, 2° Investing Initiative has introduced the climate scenario analysis of investment and lending portfolios into regulatory frameworks (France, EU, California), investors' and banks' practices (for more than 600 users and €20Tn of assets) and supervisory practice (UK, EU, California, Japan).
2° Investing Initiative research on the suitability assessment test in Europe triggered, via the HLEG, the reform of MIFID and IDD introduced by the EC regulatory package on sustainable finance.

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