PRESS RELEASE

SUSTAINABLE FINANCE PRODUCTS MUST FULLY COMPLY WITH CONSUMER PROTECTION RULES AND REALLY CREATE "*LONG-TERM AND SUSTAINABLE VALUE*"

13 July 2017 - BETTER FINANCE welcomes the Interim Report of the High-Level Expert Group on Sustainable Finance of the European Union, which highlights the need to "*incorporate long-term and sustainable value creation*".

EU savers and sustainable finance are natural partners

Indeed, EU citizens as savers are by nature mostly long-term driven since 67% of their total assets are deployed in long-term investments[1] (versus only 37% for pension funds - despite their purely long-term horizon - and 11% for insurers) and their main saving goals are long-term: retirement, housing, children's studies, transmission of wealth, etc. For these reasons EU citizens as savers have a great need for "sustainable finance" products.

Accordingly, sustainable finance needs to acquire and retain the trust of EU citizens, as they are the main source of long-term funding for the EU economy. This is a challenge given the current very low confidence of EU consumers in finance as a whole. However, EU citizens as long-term and pension savers so far remain absent from the EU policy work on sustainable finance. Indeed, this Report does not even mention savers and individual investors, and ignores the contribution and proposals (below) from BETTER FINANCE, who, at its own request, has been heard by the High-Level Expert Group.

What does sustainable finance mean for EU savers?

Sustainable finance suffers from a lack of clear, consistent and mutually agreed definitions. For EU savers it means:

1. Finance that ensures "*long-term and sustainable value creation*" and pension adequacy (i.e. with the highest probability of providing decent real returns to EU citizens as savers and current or future pensioners over the long-term).

   "Decent" returns are returns that at the very least do not destroy the value of their lifetime's savings: i.e. net (after charges) real (after inflation) returns that are positive over the long-term, and sufficiently high to allow EU citizens to get an adequate pension replacement income. The advice to save early and amply – always put forward by the financial industry as well as Public Agencies as the solution – misses an even more crucial prerequisite for pension adequacy: returns. Our research[2] demonstrates that real net pension returns have too often been negative.

[1] Property and equity (directly and indirectly through investment funds, life insurance and pension products); Eurozone only; Sources : ECB statistics and BETTER FINANCE estimates

[2] "Pension Savings: The Real Return", 2016 Edition, BETTER FINANCE

The European Federation of Investors and Financial Services Users
76, rue du Lombard, 1000 Brussels - Belgium
Tel. (+32) 02 514 37 77 - Fax. (+32) 02 514 36 66
E-mail: info@betterfinance.eu - http://www.betterfinance.eu

2. Finance that first of all applies ESG criteria to its own activities, especially governance and transparency ones; and that is therefore exemplary in terms of compliance with EU consumer and investor protection rules, in particular information and disclosure ones.

Consumer protection warning

Indeed, sustainable finance products should not mislead long-term and pension savers about real long-term returns. Those that have repeatedly failed to deliver on their advertised objectives, and destroyed the real value of their clients' savings, must not hide it from EU citizens, but on the contrary give "*a fair and prominent indication of any relevant risks*" and "*not disguise, diminish or obscure important items, statements or warnings*" (article 27.2 of the MiFID I implementation directive). These products should also really do what they claim, in particular regarding "active" management claims as well as those claiming to make a difference by applying ESG criteria to their investments.

Unfortunately BETTER FINANCE has found evidence (see annex) that some investment products labelled as "socially responsible" don't meet these basic requirements, quite the contrary.

BETTER FINANCE key recommendations to the High-Level Expert Group

- Ensure sustainable finance is not seen as just a marketing gimmick and come up with independently validated common definitions and standards for "SF", "ESG", "SRI", "2° investing", "green" bonds, etc. at least at the EU level, preferably at the UN one.
- Recognise long-term and pension savers as major stakeholders in sustainable finance, who are not only there to pay the fees and bear the risks but also to get a fair share of the long-term rewards and benefit from fully transparent information including on risks, failures and weaknesses.
- Put an end to short-termism, which means the financial industry and EU regulators must adjust their goals, metrics and disclosure requirements to the mostly long-term horizon of EU savers and investors.
- It also means that Professional investors must dramatically increase their holdings in long-term assets.
- Measure and clearly inform EU savers about the impact of applying ESG criteria on the actual long-term real performance: simply comparing long-term actual performance with corresponding mainstream capital markets' benchmarks, and avoiding using newly created ESG specific benchmarks that will not address this issue, will only add to the confusion and complexity for EU savers.
- Be the most compliant with EU rules on fair, clear and non-misleading information (see annex on BF research findings on SRI-labelled products); checking this exemplary compliance with investor and consumer protection rules should a fortiori be a key requisite for granting any ESG label.

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Contact: Chief Communications Officer | Arnaud Houdmont | +32 (0)2 514 37 77 | houdmont@betterfinance.eu

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76, rue du Lombard, 1000 Brussels - Belgium
Tel. (+32) 02 514 37 77 - Fax. (+32) 02 514 36 66
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ANNEX

ANNEX ON SRI[3]-LABELLED FUNDS (FROM BETTER FINANCE RESEARCH ON "CLOSET INDEXING")

BETTER FINANCE researched potential "Closet Index" (falsely active) funds using the methodology developed by ESMA (European Securities and Markets Authority) in 2016.[4]

BETTER FINANCE found that some of the funds with the highest probability of being falsely active according to ESMA's quantitative criteria were "SRI" funds… not only do they show the "SRI" acronym in their name, but they also got a third party SRI label.

We found very worrying issues related to at least one of these funds:

- Although advertised as an actively managed fund – and therefore charging much higher fees than index (passively managed) funds, it has one of the highest potentials of being a closet index fund following ESMA's quantitative methodology.
- Although advertised as using ESG (Environmental, Social and Governance) criteria to select stocks, its historic performance before fees over five years very closely mimics, at any given time, that of the corresponding "mainstream" benchmark (i.e. that include all stocks, including those excluded by any ESG selection approach); in other words, there was no significant difference in performance at any given time between the SRI fund and the mainstream equity market segment. There seems to be no impact of the ESG criteria stock selection over that period.
- Over the last 10 years (the timeframe required for past performance disclosure in the KIID or Key Investor Information Document), the fund did not only fail to reach its objective of achieving a performance equal or superior to that of its mainstream benchmark, but it achieved less than half of the performance of this benchmark, and even failed to beat inflation, generating a real value 10 year loss for the fund investors.
- Last but not least, it is impossible for the average fund investor to be aware of all these issues: none of these important items and risks have been clearly disclosed to the investors in the KIID and there is no warning or clear disclosure on its actual failure to meet objectives and on its real loss incurred over the last ten years. In our view, this does not comply with EU rules on fair, clear and not misleading information, which require:

    - "*a fair and prominent indication of any relevant risks*",
    - not to "*disguise, diminish or obscure important items, statements or warnings*",
    - and to present such information "*in a way that is likely to be understood by the average member of the group to whom it is directed, or by whom it is likely to be received*".

[3] SRI: Socially Responsible Investment
[4] Press Release: BETTER FINANCE Replicates and Discloses ESMA Findings on Closet Indexing

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(Article 27.2 of the MiFID I implementation directive, and article 44.2 of MiFID II delegated regulation)

Below please find the evidence we found relative to this SRI-named and -labelled Eurozone equity fund.

WARNING: BETTER FINANCE will not disclose the name of this fund, as it is not its objective to point fingers at specific fund managers, but rather to improve savers' and investors' protection and to restore trust in capital markets and in finance in general. Furthermore, BETTER FINANCE research is still ongoing, and we feel it would not be fair to highlight only one fund manager, as there may be several others facing similar issues.

1. A high probability of being a falsely active fund (following ESMA criteria)

ESMA used three metrics to identify potential "closet index" funds:

- Active Share (which measures the percentage amount the fund's holding differs from the benchmark's holding):
- Tracking Error (which quantifies how closely a fund's return pattern follows that of its benchmark's return pattern):
- R- Squared (which measures how well a fund's return can be predicted using the index return):

ESMA designed three categories of suspicious active UCITS equity funds. The most suspicious category being "Classification 3" in which one finds funds with an active share below 50%, a tracking error below 3% and a R square above 0,95 over the researched period of five years (2010-2014).

The metrics for this "Classification 3" SRI fund are among the lowest of all funds sampled:

- Active Share: 36,21%
- Tracking Error: 0,94%
- R-Squared: 0.9972

Besides, BETTER FINANCE also graphically analysed how close the fund performance before fees mimicked the corresponding ETF before fees as well (Graph A below): the two are hardly distinguishable from each other.

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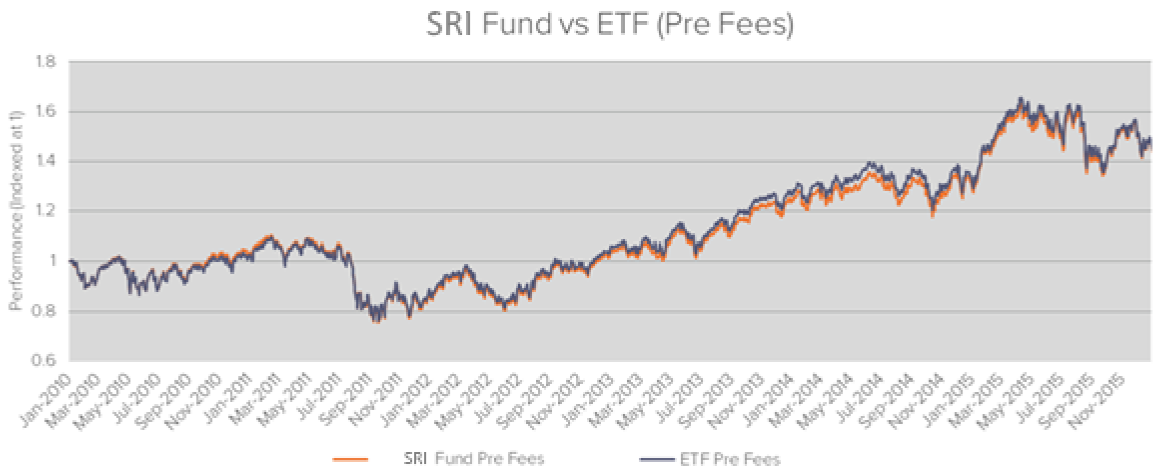
Graph A - Eurozone "SRI" equity fund versus corresponding ETF (MSCI EMU) Pre-Fees



2. Very similar behaviour to a "mainstream" passive fund before fees

Graph A above shows that the evolution of the market value of the fund is almost the same as that of the corresponding index ETF (Exchange-Trade Fund that aims at reproducing the performance of its capital market benchmark). The benchmark chosen is, rightly, a "mainstream" one, not SRI or ESG specific: therefore it enables investors to identify the impact (if any) of the stock selection following ESG criteria. The problem here is that there was no identifiable impact over this five year period: any investor would have gotten the nearly identical performance evolution (before fees) by investing in a "mainstream" passive fund that is not following any ESG criteria at all, but investing in all stocks, whether deemed "sustainable" or not.

3. Post fees: Long term failure to even remotely meet its objective and real value destruction

Graph B below shows that over the last ten years - after charging ongoing annual fees (1,32%) but excluding entry fees - this SRI fund not only didn't reach its investment objective advertised in its two-pager KIID of equalling or over-performing that of its benchmark (MSCI EMU dividends reinvested) , but did not even achieve half of its index performance (less than 7% versus 16%), and has not even matched the consumer price index (+16%) as measured by the HICP (Harmonised index of consumer prices; source: Eurostat). This means, that over the last ten years (2007-2016), investors in this SRI fund have lost money in real terms (purchasing power).

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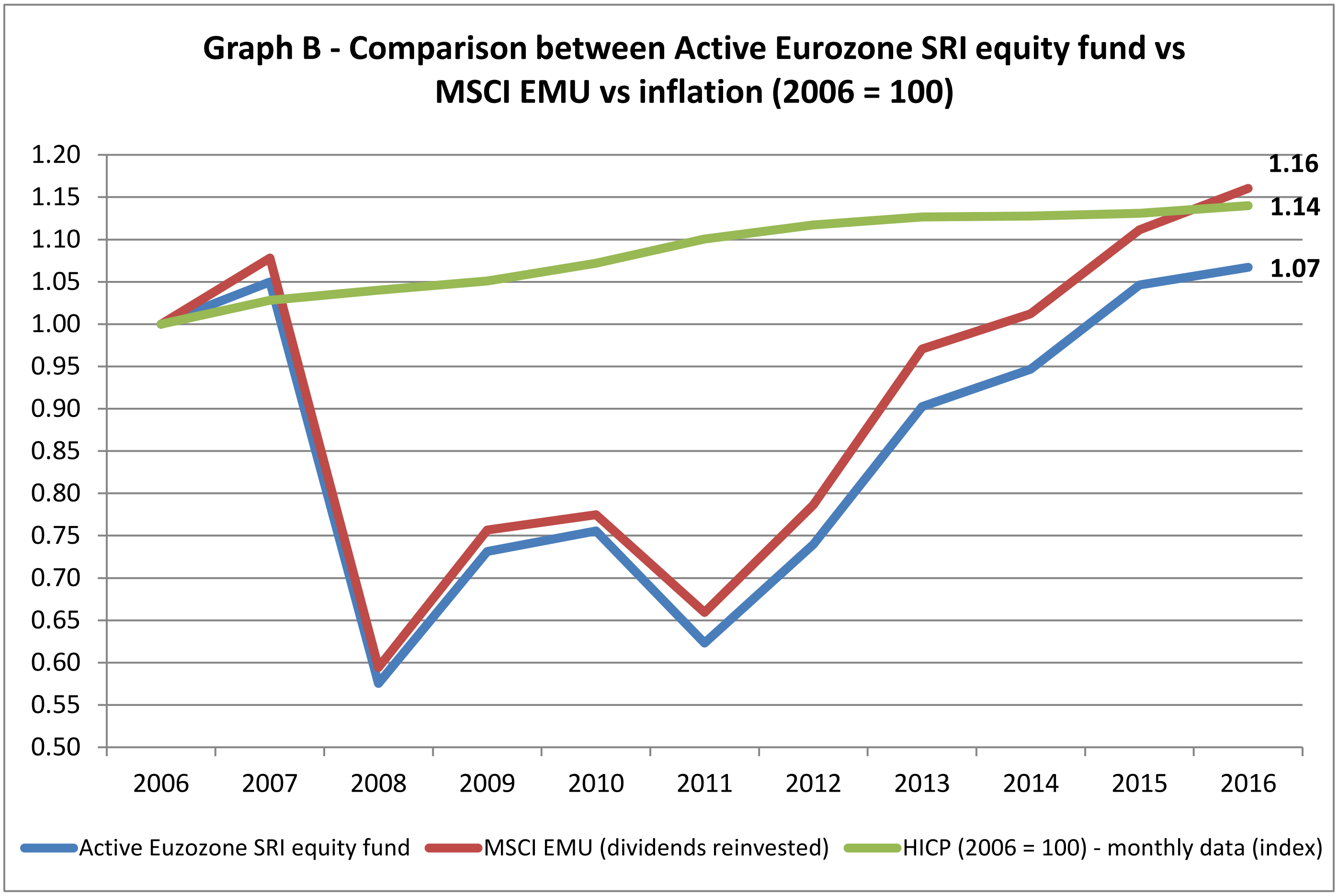

<u>Source</u>: Fund KIID

4. The fund's KIID[5] fails to clearly disclose important items, risks and warnings

Of course, not achieving a fund's advertised investment objective over the last ten years is not per se proof that this fund is not "sustainable", but that it fails to clearly warn investors about this major issue and risk. More generally, not fully complying with EU investor protection rules should prohibit such retail investment product from being advertised as "sustainable", "SRI" or "ESG"… even more so with regards to labelling by a third party.

This "SRI" fund KIID indeed fails to clearly disclose all the issues mentioned above. BETTER FINANCE believes this is not compliant with current EU investor information rules that require "*a fair and prominent indication of any relevant risks*", and not to "*disguise, diminish or*

[5] KIID: the Key Investor Information Document is a summarized and standardised document that is mandatory for all UCITS funds since 2010. Most unfortunately, all past performance and benchmark disclosures will be eliminated by the entry into force of the new « PRIIPs » (Packaged Retail Regulation in 2018: BETTER FINANCE will no longer be able to conduct such research and analysis, and fund investors will be totally in the dark.

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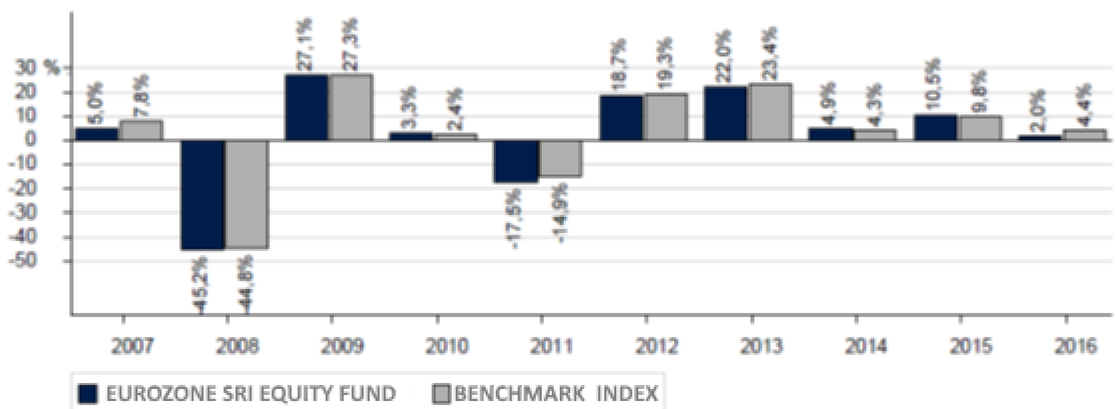
obscure important items, statements or warnings". SRI labelled funds should be fully compliant with such rules and even more so… they should be exemplary.

One could argue that the performance disclosures in the fund's KIID do meet the requirements of fair, clear and non-misleading information. Graph C below shows the past performance of the SRI fund alongside the past performance of its benchmark, as disclosed in its KIID. It is showing past performances in annual bars. This presentation does not comply with the EU information rule requiring such information to be presented "*in a way that is likely to be understood by the average member of the group to whom it is directed, or by whom it is likely to be received*".

Indeed, OECD research and surveys have demonstrated that a large majority of EU citizens do not know how to compute simple compounded returns (the test given was +2% every year over five years). Even supposing they have the necessary skills and do take the time to do it, most EU citizens just cannot compute the much more complex 10 year compounded returns of this fund and of its benchmark as we did in the previous Graph B. Therefore, they have no way to find out from the fund's KIID that the fund has massively missed its investment objective over the last ten years and that it has even generated a real loss over the same period. Accordingly, the average EU investor reading the fund's KIID cannot know that the fund - despite its advertised use of ESG criteria – has actually behaved very much like a mainstream passive fund before fees.

Graph C – SRI Eurozone equity fund performance as disclosed in the KIID



BETTER FINANCE is happy to report that – following our published findings on closet indexing – the German Regulator BAFIN has decided to ask German-domiciled funds to disclose compounded returns, and not only annual ones. All other funds – especially those seeking sustainability labels - should do the same. As sustainability is about long-term horizons, and since consumers are subject to the "monetary illusion", those compounded long-term returns should include the evolution of consumer prices (inflation).

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