PRESS RELEASE

BETTER FINANCE WELCOMES EC ROADMAP TOWARDS A MORE SUSTAINABLE ECONOMY BUT ONCE AGAIN DEPLORES FAILURE TO TAKE THE INTERESTS OF EU CITIZENS AS PENSION SAVERS AND INDIVIDUAL INVESTORS INTO ACCOUNT

2 February 2018 – Whereas BETTER FINANCE welcomes the report of the European Commission's High-Level Expert Group (HLEG) on Sustainable Finance as a step in the right direction to promote a cleaner and fairer economy, it is also disappointed in the fact that the report essentially fails to address information and governance issues for sustainable finance products.

BETTER FINANCE and EU citizens as pension savers and individual investors, by their very nature, are strong supporters of 'sustainable finance': they are parents and citizens who want to leave a greener and better planet for their children, whose main saving goals - such as retirement, housing and transmission of wealth - are long-term oriented and need a sustainable economy and environment.

Whereas the final HLEG report rightly widens the scope of sustainable finance to include social and governance issues besides criteria on environment and climate change, it fails to include any reference to the most basic of requirements for sustainable finance, i.e. fair, transparent, clear and non-misleading investor information. This is unfortunate since BETTTER FINANCE had been heard by the Group at its request and had also publicly stressed this issue at the time of the Interim Report.

The report does little to improve the trust of EU citizens as savers and investors. For EU citizens, the concept of sustainable finance should translate into products that are exemplary in complying with EU investor protection rules. BETTER FINANCE would support the idea of an EU sustainable finance product label, as long as such compliance be a key requisite for granting any ESG or SRI label.

Unfortunately, as already flagged in its response to the HLEG Interim Report in July 2017, BETTER FINANCE research reveals that some products already labelled as "sustainable" by Public Authorities do not comply with EU investor protection rules (see **annex**). Therefore any design of an EU-level "label" should learn from experience and not repeat these serious flaws.

It is essential that ESG-based finance be trustworthy and reliable. What should be avoided at all cost is for ESG criteria to be misused in order to circumvent investor protection rules or, worse, engage in falsely active management. Also in this respect the final HLEG report ignored the advice from BETTER FINANCE to avoid using ESG-specific benchmarks with individual investors, since there are almost as many definitions of sustainable investments as there are investors. This can only create further complexity and lead to confusion and misleading information. Sustainable finance providers should instead ensure that EU savers are clearly informed about the impact of using ESG criteria on their actual long-term real performance by benchmarking it to that of a corresponding, far better known and simpler mainstream capital market benchmark. After all, the performance of sustainable finance investments should prove to be better in the long run.

Regarding these "mainstream" benchmarks, we are happy to note that the HLEG is also recommending the use of broad equity indices[1] instead of the very narrow ones typically referred to by the industry, by the Authorities and by the media. This has been a longstanding demand from BETTER FINANCE within the European CMU initiative[2]. There are in fact broader European equity indices than the one mentioned by the HLEG report, that enable savers to invest more into listed European SMEs in a diversified way, like the STOXX All Europe Total Market Index (nearly 1500 stocks instead of the 50 in the much more widely known and used STOXX Europe 50).

Guillaume Prache, Managing Director of BETTER FINANCE, said that "s*ustainable finance must refer to retail financial products that indeed ensure "long-term and sustainable value creation", as stressed by the Commission's High Level Group, and that applies ESG criteria, especially **governanc**e and **transparenc**y ones, to its own practices. Such a sustainable finance would therefore be exemplary in terms of compliance with EU consumer and investor protection rules, in particular information and disclosure ones.*"

***

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

[1] HLEG Final Report, January 2018, page 53

[2] BETTER FINANCE CMU Briefing Paper, April 2015, page 22

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]

It 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 incorporate the "SRI" acronym in the fund name, these funds also got a SRI label from a national Public Authority.

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

- Although advertised as an actively managed fund – and therefore charging far 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 given 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 have been no impact from the ESG criteria on the 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 10 year loss in real value 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 non-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*".

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

[3] SRI: Socially Responsible Investment

[4] Press Release: BETTER FINANCE Replicates and Discloses ESMA Findings on Closet Indexing

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

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):

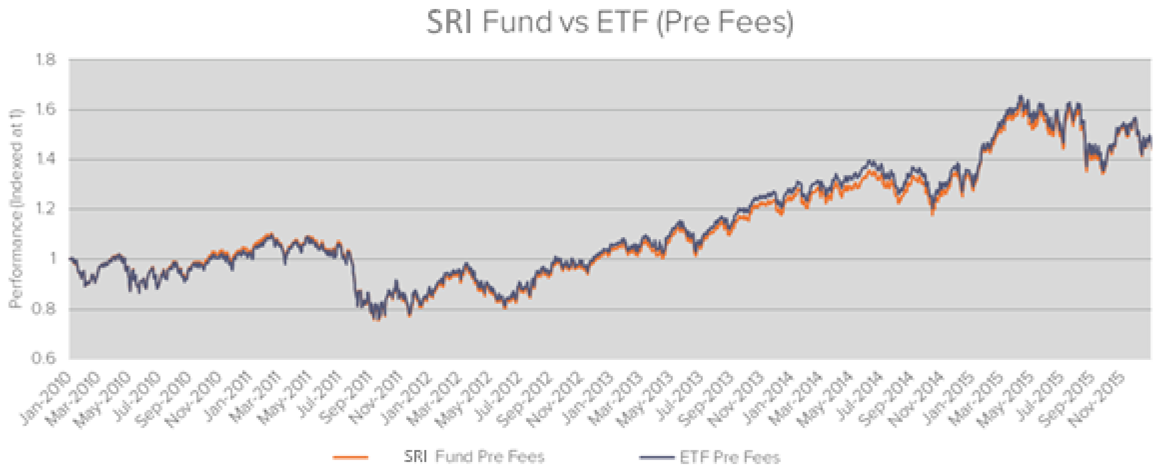
ESMA designed three categories of suspicious active UCITS equity funds. The most suspicious category being "Classification 3" in which one finds funds with an active share below 50%, a tracking error below 3% and a R square above 0,95 over the researched period of five years (2010-2014).

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 closely the fund performance before fees mimicked the corresponding ETF also before fees (Graph A below): the two are hardly distinguishable from each other.

Graph A - Eurozone "SRI" equity fund versus corresponding ETF (MSCI EMU) –pre-fees



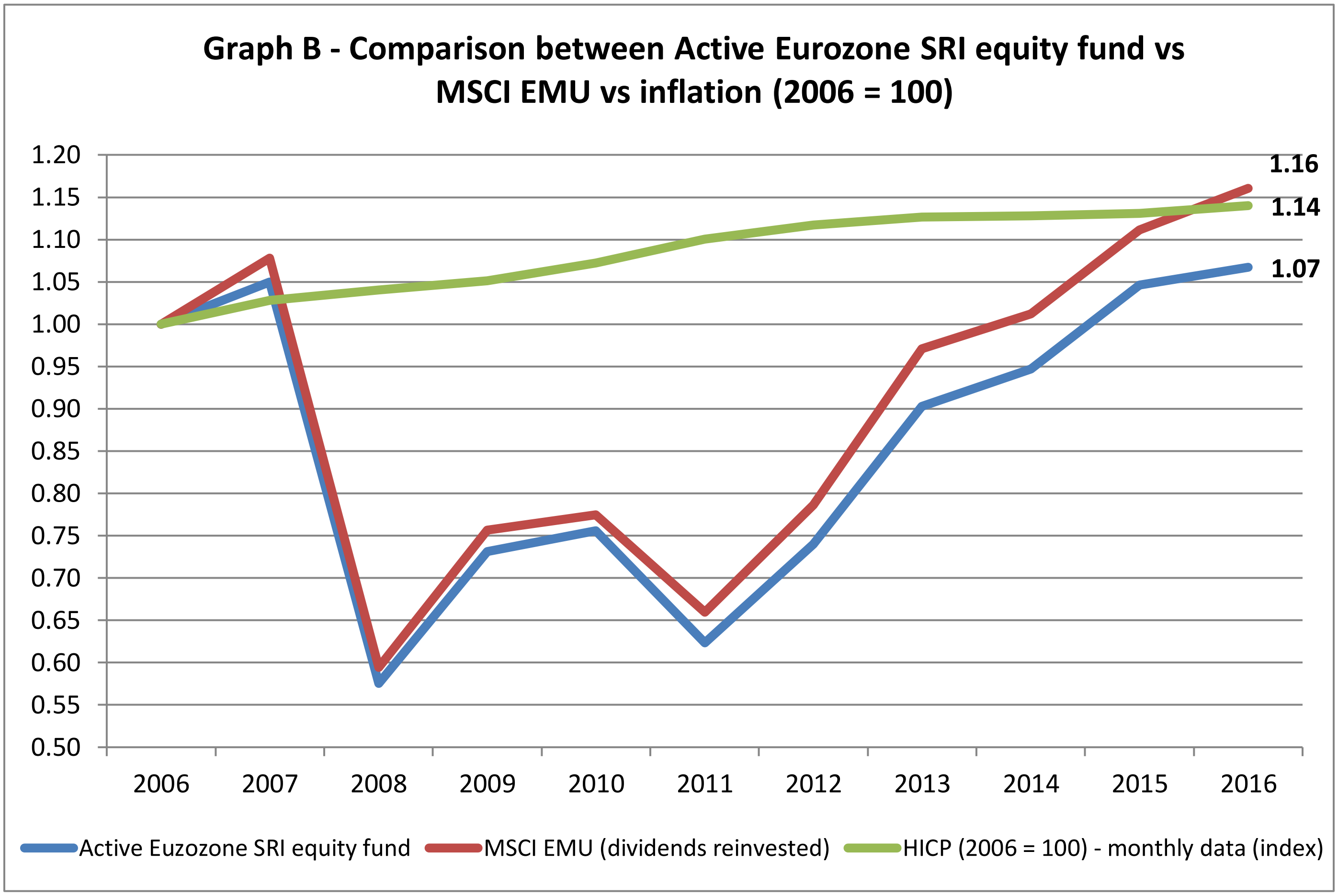
2. Very similar behaviour to a "mainstream" passive fund before fees

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).

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



Source: 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*

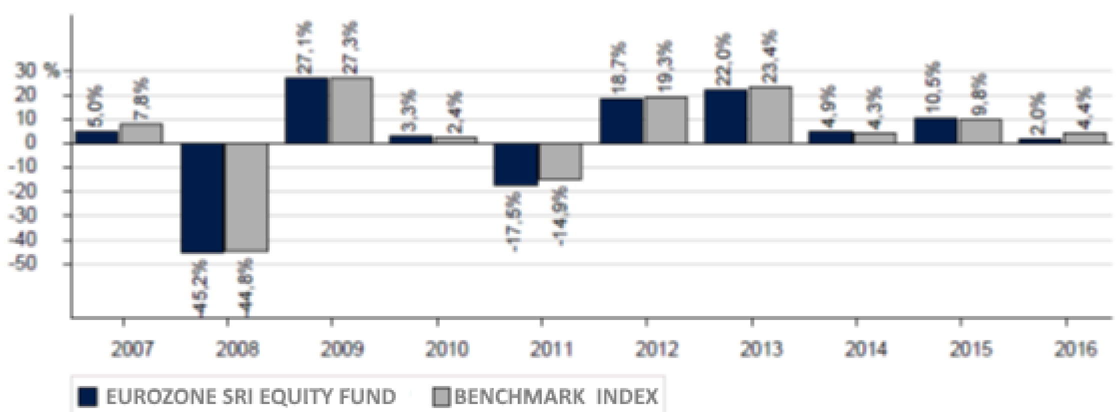
[5] KIID: the Key Investor Information Document is a summarized and standardised document that is mandatory for all UCITS funds since 2010. Most unfortunately, all past performance and benchmark disclosures will be eliminated by the entry into force of the new « PRIIPs » (Packaged Retail Regulation in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

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 far 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).

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