



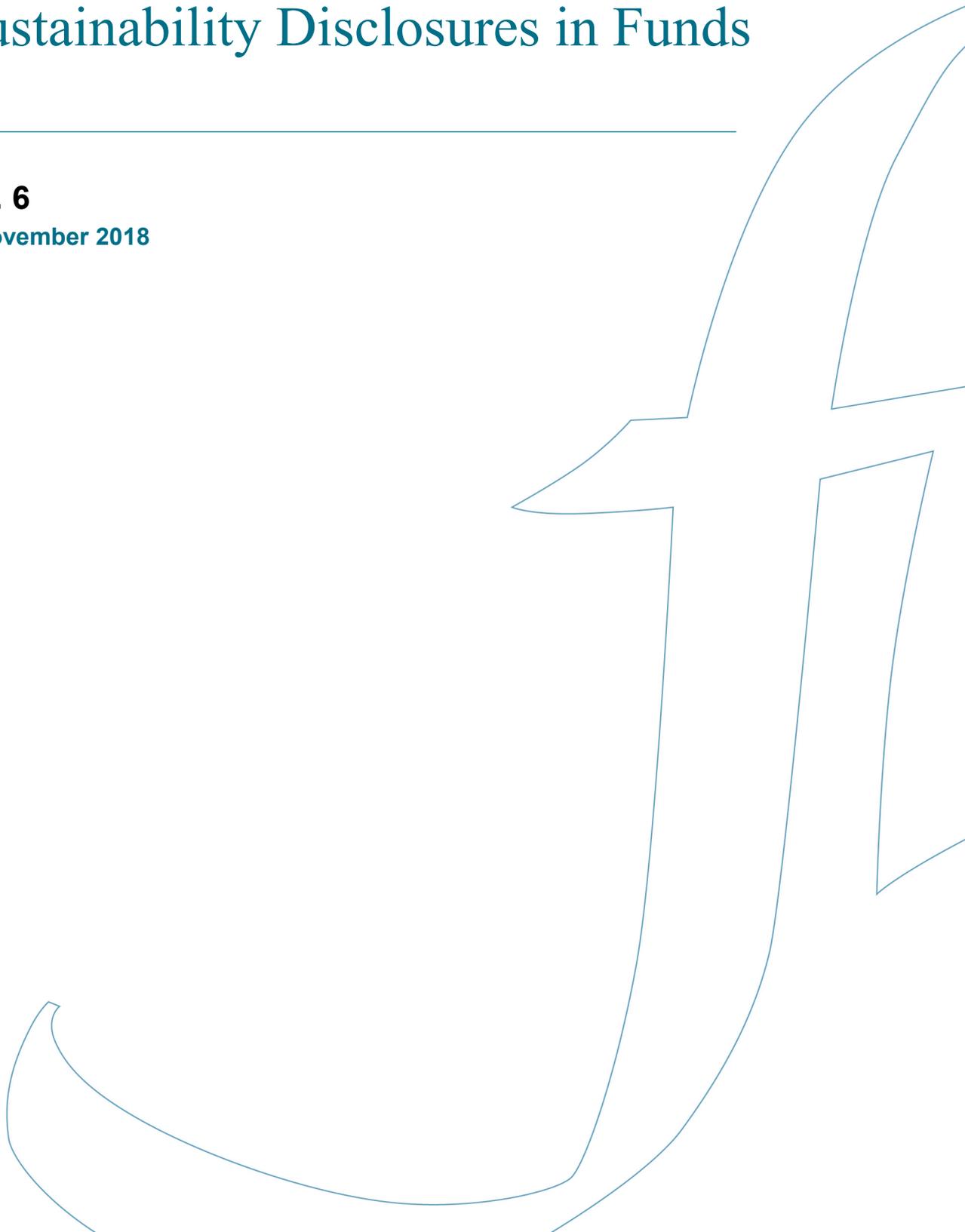
**FI Supervision**

# Sustainability Disclosures in Funds

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### **FI supervision**

Finansinspektionen frequently publishes supervision reports in a numbered series. These supervision reports are part of FI's communication. The reports describe the investigations and other supervision carried out by FI. Through these reports, FI presents its observations and assessments as well as its expectations in various matters. This information can support firms in their operations.

## Summary

The fund industry has created through its self-regulation an information standard that fund managers must use when providing the information needed for a consumer to understand a fund's management with regard to sustainability. Finansinspektionen (FI) conducted a survey in the summer of 2018 to follow up on and evaluate the industry's self-regulation in the area.

Since 1 January 2018 new disclosure requirements have been in effect to make it easier for consumers to select funds that consider sustainability issues. Good transparency in the area is a prerequisite for consumers to be able to make informed investment decisions.

As a whole, FI's survey shows that there are good conditions in place for continued self-regulation in the area. However, this assumes that the industry continues to develop the information standard and adapt it to the needs of consumers.

### ■ **The information standard is a good start**

The standard builds on extensive work carried out by specialists in sustainable investments. The methods used in the standard, for example, are established in the area. The standard is also strongly rooted in the industry, and almost 90 per cent of the fund managers in the survey who have said that they consider sustainability in at least one of their funds use the standard.

### ■ **The standard allows too much room for individual interpretation by the fund managers**

FI's survey shows that the information standard needs to be further developed to ensure uniform application by the fund managers. The industry needs to jointly establish which criteria the fund managers must fulfil to be allowed to specify the various methods in the information standard. The industry also needs to evaluate whether the threshold for claiming to consider sustainability is set too low. The standard should also be developed so the information provides the proper expectation of the sustainability work that is actually carried out in the fund.

### ■ **Adapt the information standard to the needs of consumers**

FI conducted focus group interviews with consumers. These interviews show that consumers consider the standardised information to be unclear and thus difficult to understand. The information in the standard needs to be simplified, and terms and expressions must be clarified so that the average consumer can understand them. FI therefore concludes that there is still some work for the industry to do in this area.

# What Has FI Investigated?

FI has studied how fund managers are using and applying the new standard for sustainability information that has been produced by the industry. FI conducted focus group interviews in order to gain an understanding of how consumers perceive the standardised information.

## BACKGROUND

Research shows that many consumers want to save in a sustainable way. At the same time, sustainability in funds can be a complex area and one that is not easy for a consumer to learn about and understand. The range of savings products being marketed as sustainable is also growing rapidly, and there is a risk that market participants may attempt to exploit consumers' information disadvantage. Accordingly, if consumers are to have the ability to make informed investment decisions, the sustainability information of these funds needs to be reasonably transparent. This is also a prerequisite for FI to be able to conduct supervision in this area.

Consequently, a new statutory disclosure requirement was introduced on 1 January 2018 in order to increase transparency and make it easier for consumers to choose funds in line with their preference for sustainability.

## NEW DISCLOSURE REQUIREMENTS FOR FUND MANAGERS

The new legal requirements are directed at managers of Swedish UCITS<sup>1</sup> and alternative investment funds<sup>2</sup> (subsequently referred to as fund managers) that are marketed to consumers. The requirement means that fund managers have to provide the information a consumer requires in order to understand how the fund is managed with respect to sustainability. This information has to be provided for each of the funds managed by a fund manager.

### More about the legal requirement

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According to the new disclosure requirement, the term *sustainability* primarily encompasses issues that relate to the environment, social conditions, staff, respect for human rights and anti-corruption. The information shall describe which sustainability aspects are considered in the fund's management and the method or methods used for the sustainability work. If a fund manager does not take sustainability aspects into consideration at all, the manager shall specify this instead. The information shall be available on the fund manager's website and be included in the fund's prospectus and annual report.

As of the first financial year commencing after 31 December 2017, the fund manager shall also provide information about follow-up of its sustainability work, i.e. describe what practical results the manager deems their sustainability work to have achieved. The manager shall provide this information in the fund's annual report or in a separate report.

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<sup>1</sup> UCITS Act (2004:46), Chapter 4, Section 24.

<sup>2</sup> Alternative Investment Fund Manager Act (2013:561), Chapter 10, Section 11.

## SELF-REGULATION AND FI'S ASSIGNMENT

The new disclosure requirements are not detailed and do not specify in more detail *how* the sustainability information is to be presented. Using the new disclosure requirements as a starting point, it was FI's assessment that it was feasible for the industry to further standardise the sustainability information within the scope of self-regulation. Because self-regulation is flexible and can be adapted to the development of the field of sustainability, FI encouraged the industry to produce a standard for the sustainability information provided to consumers.

In its appropriation directions for 2018, FI was tasked with following up the industry's efforts to standardise the sustainability information fund managers have to provide. This assignment also includes fostering access to relevant and comparable information in the Swedish fund market.

## THE INFORMATION STANDARD

In the autumn of 2017, the Swedish Investment Fund Association made further developments to the Sustainability Profile, the standardised information leaflet previously developed by SWESIF<sup>3</sup>, a network forum for sustainable investments in Sweden. The aim was to adapt this leaflet to the new legal requirements. The Swedish Investment Fund Association's members are to use the information standard in accordance with the association's information and marketing guidelines. Hence, this is part of the industry's self-regulation.

## OUR SURVEY

FI sent a questionnaire to all of the Swedish fund managers affected by the new legal requirements in order to investigate how many funds consider sustainability aspects in their management and the extent to which fund managers are using the information standard.

One further questionnaire was sent to the 16 largest fund managers.<sup>4</sup> In this survey, FI asked more in-depth questions about the information standard. Among the aims was to investigate how the fund managers understood the terminology in the information standard and what interpretations they had made. The survey was conducted in June 2018.

In September 2018, FI conducted two focus group interviews in order to gain an understanding of whether consumers are able to understand and compare the sustainability information presented in accordance with the new information standard. During these interviews, participants were given only the information standard – in other words, they were able to see the standardised information but none of the comments that fund managers may voluntarily provide to supplement the standardised information.

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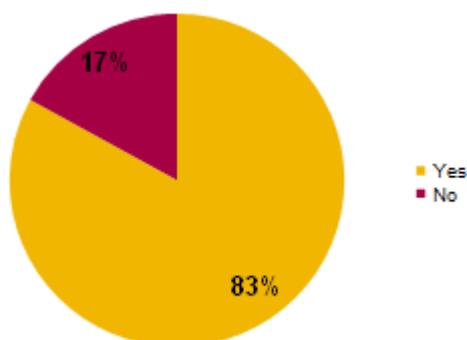
<sup>3</sup> Swedish Sustainable Investment Forum.

<sup>4</sup> These organisations manage around 85 per cent of the total capital invested in Swedish UCITS and non-UCITS funds.

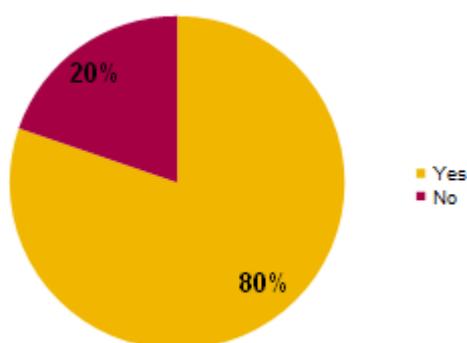
## What Were the Findings of the Survey?

A large number of funds state that they consider sustainability in their management, and many fund managers indicate that they use the industry's information standard. Among FI's conclusions are that the information standard allows fund managers to make their own interpretations and that the threshold for determining whether or not a fund considers sustainability may be set too low. Consumers feel that the standardised information is unclear and difficult to understand.

Funds that consider sustainability



Uses the information standard



### THE INFORMATION STANDARD IS A GOOD START

The fund management industry has been quick to produce a standard for sustainability information that is based on solid work conducted by experts in the field of sustainable investments. The Swedish Investment Fund Association incorporated this information standard into its existing self-regulation so that it was introduced at the same time as the new legal requirement, on 1 January 2018.

FI's survey shows that almost 85 per cent of the funds affected by the new legal requirement state that they are considering sustainability in the management of the fund. Eighty per cent of the fund managers that have funds that consider sustainability state that they use the Swedish Investment Fund Association's information standard. Those who are not using this standard state that they have chosen to present this information in their own way, or that they are using another information standard such as the UN Principles for Responsible Investment (UN PRI). The responses to the questionnaire indicate that the proportion of fund managers that are using the standard will be almost 90 per cent once those who are using the standardised information leaflet produced earlier by Swesif (the Sustainability Profile) have switched to the new standard.

FI concludes that much of the terminology used in the standard is established terminology in the field of sustainable investments, for example those concerning which methods can be used within the scope of sustainability work in funds. The industry has thus made considerable progress in its self-regulation efforts in this area.

### OBSERVATIONS ABOUT THE INFORMATION STANDARD

FI's observations concerning the information standard for sustainability, as derived from the fund managers' responses to the in-depth questionnaire<sup>5</sup>, are listed below. This section has the same structure and headings as the information standard.

<sup>5</sup> The in-depth questionnaire was sent to the 16 largest fund managers.

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### The main headings in the information standard:

- Sustainability information
- Sustainability aspects considered in the management of the fund
- Methods used for the sustainability work
- Follow-up of the sustainability work.

Under each heading, the fund manager has to mark applicable options with a cross. Brief standardised information is provided for each option in order to describe to the consumer what this option entails. The fund manager may supplement this information by writing in a comments field. To get a full picture, please refer to Appendix 3 of the Swedish Investment Fund Association's guidelines for marketing and information by fund management companies.<sup>6</sup>

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### Sustainability information

Under this heading, fund managers state whether or not the fund considers sustainability aspects. If sustainability aspects are considered by the fund, the remaining portion of the information standard shall also be filled in.

No explanation or definition of *consider* is provided in the information standard. However, the Swedish Investment Fund Association's instructions<sup>7</sup> suggest that the comments field should be used for information that facilitates an assessment of the fund in respect of sustainability.

The association's guidance<sup>8</sup> for fund managers contains a general principle for the information standard. According to this principle, the term *consider* means that the fund manager actually conducts sustainability work in the management of the fund in question. It is this work that the fund management company is to report in the information standard. In spite of some guidance in this matter, the responses to the questionnaire appear to indicate that there are some questions concerning where the boundary between *consider* and *does not consider* lies.

Two examples illustrating some of the problems concerning fund managers' interpretation and application of this term are provided below.

1. The responses to the questionnaire indicate that the fund managers are interpreting the term *consider* differently. Around 30 per cent of the managers believe that a fund may be deemed to consider sustainability if it is sustainable for reasons other than the management involving sustainability work. One example could be a pharmaceutical fund that is restricted to investing only in pharmaceutical companies. The question is whether simply the

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<sup>6</sup> Guidelines for marketing and information by fund management companies, see <http://fondbolagen.se/PageFiles/8535/Guidelines%20for%20marketing%20and%20information.pdf>.

<sup>7</sup> The information standard contains some instructions for the fund manager about how the information standard is to be filled in.

<sup>8</sup> FAQ about the standard for sustainability information, dated 20/04/2018.

fact that such a fund *cannot* contain, for example, controversial arms or coal investments means that it considers sustainability.

2. The responses to the questionnaire indicate that 85 per cent of the fund managers believe that the fund considers sustainability, provided that the manager is conducting sustainability work for those of the funds' assets for which this is possible. That is to say, apparently irrespective of how large a share of the portfolio this pertains to. The responses also indicate that the managers do not usually state what proportion of the fund considers sustainability. It may therefore be difficult to assess whether sustainability is being considered in the fund as a whole – or only for a small portion of the fund's holdings.

### Sustainability aspects considered in the management of the fund

The law provides some guidance as to what the term sustainability means by specifying some of the sustainability aspects that can be considered within fund management. In the information standard, the trade association has chosen to divide these aspects into three areas – environmental aspects, social aspects and corporate governance aspects. However, the standard does give fund managers the opportunity to supplement these with other sustainability aspects if so required.

The responses to the questionnaire indicate that the fund managers believe these three areas to be a good reflection of the sustainability aspects that are actually considered in their fund management. Nevertheless, some managers do raise the issue of whether there should be a definition of corporate governance aspects so that it is clearer what is meant by this, for example by using more descriptive terms such as *risks associated with money laundering, tax evasion or corruption*.

### Methods used for the sustainability work

The trade association has chosen to use three methods in its standard; “positive screening”, “negative screening” and the “fund management company influences”. FI concludes that the methods are a relatively good reflection of the most common methods used for sustainable investment, at least in terms of investments in shares.

#### *Positive screening*

This method normally involves a fund manager actively choosing holdings in the fund on the basis of certain sustainability criteria. This means that the method is usually more resource-intensive than the other two methods.

In the information standard, the industry has divided this method into two options. The fund manager has to state either that sustainability aspects are *critical* factors in the manager's choice of companies to invest in or that the manager *considers* sustainability issues when making investment decisions.

According to the information standard, the option *critical* denotes that *The fund has specific and explicit criteria for positive selection of companies, based on environmental, social and business ethics issues. An analysis of the companies' sustainability work is critical to the*

*selection of the companies in the fund.* The criteria specified in the standard are thus set by each individual fund manager, not by the industry collectively. The responses to the questionnaire indicate that there are also relatively large differences between the fund managers' own criteria used for this option. Consequently, the sustainability work undertaken by two different funds, both of which have specified in the standard that sustainability aspects are critical factors in the fund manager's investment decisions, may actually be completely different. This is not evident when making a comparison on the basis of the information standard.

In addition, the expression *critical* may itself give the impression that it is the sustainability aspects specifically that are determining which investments the fund makes. However, the responses to the questionnaire indicate that the majority of the fund managers interpret this expression to mean that it is sufficient for the holding/company to have a certain level of sustainability (a certain sustainability rating), but that the financial analysis is then allowed to govern the choices made. The expression *critical* thus has many different meanings in practice.

According to the information standard, the *considers* option denotes that *Sustainability issues are taken into account in the context of corporate economic analyses and investment decisions and play a part, but not necessarily a crucial one, in determining which companies are selected for inclusion in the fund.* Accordingly, under the *considers* option, there is no requirement for the fund manager to have set any criteria specifying how it considers sustainability aspects in its management. Nor does the information standard provide any other guidance concerning what minimum level has to be met.

The responses to the questionnaire show that the fund managers have different minimum levels for specifying this method, which makes it difficult to assess what the *considers* option means in practice. FI therefore concludes that not only is the bar for this option unclear, but also that it is probably set at too low a level to be considered as a method for sustainability work within fund management.

The responses to the questionnaire also indicate that there are several underlying levels and strategies within this method – positive screening – than are evident from the current division into *critical* and *considers*. Consequently, the question is whether the information standard is a sufficiently good reflection of the various levels of active work that may be conducted at the fund level within this method.

#### *Negative screening*

According to the information standard, the negative screening method involves the fund manager excluding (screening out) from the fund in question holdings/companies that are involved in certain products and services or countries, or that violate international norms and conventions.

#### Products and services

According to the trade association's instructions<sup>9</sup> for the information standard, fund managers shall state which of the twelve preselected

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<sup>9</sup> The information standard contains some instructions for the fund manager about how the standard is to be filled in.

products and services (sectors) the fund excludes. It is also possible for the fund to exclude further sectors of the manager's own choosing. Examples of the preselected products and services that can be excluded are cluster bombs or landmines, chemical and biological weapons, nuclear weapons, coal and fossil fuels.

According to the instructions for the fund manager, however, only the sectors that are excluded from the fund are visible in the information standard that is provided to the consumer. This means that the fact that the manager is able to choose to exclude additional sectors from the fund, other than those shown in the information, is not apparent, which may risk giving the consumer a distorted impression of the fund's sustainability work.

The responses to the questionnaire also indicate that fund managers differentiate between whether exclusion of a particular sector pertains to production or also to services or distribution within that sector. This differentiation does not appear on the information standard either.

#### International norms and conventions

In the information standard, the fund manager is able to choose between two options when it comes to excluding companies that are involved in violations of international norms and conventions relating to the environment, human rights, labour practices and business ethics. The manager has to select either the option *The fund avoids investing in all companies identified as failing to comply with international norms* or the option *Companies where the fund detects no willingness to change or where, in the opinion of the fund, the companies will fail to get to grips with the problems within an acceptable timeframe are excluded for investment purposes*.

The responses to the questionnaire show that the fund managers work in a more structured and consistent manner when excluding companies that violate international norms than is apparent from the information standard. Not only do the majority of managers use external suppliers for auditing norms, but the managers' responses also suggest that many of them have similar processes in conjunction with suspected and confirmed violations. Consequently, it is probably feasible to standardise this information further so that it paints a more representative picture of what sustainability work is actually being conducted within the scope of this method.

#### *The fund management company has an influence*

This method involves the fund manager actively attempting to influence the company to move in a more sustainable direction. According to the information standard, the manager has to state whether it conducts any advocacy in house, in cooperation with other managers, through external suppliers or in some other way. The manager also has to specify here whether it votes at general meetings and participates in nomination procedures to this end.

The responses to the questionnaire indicate, among other things, that the standardised information does not capture in a clear and true manner the ways different types of fund conduct advocacy work. In its current form, the standard is primarily suited to equity funds, which is expressed through, for example, the use of the term *investor influence*. For example, fixed-income funds do not provide an opportunity to exert influence by voting at general meetings and participating in

nomination procedures, but do, in some cases, allow for advocacy through engaging in a dialogue with an issuer. Another example is funds of funds, which do not provide a direct opportunity to influence the companies that the underlying funds own. Nonetheless, advocacy is still possible in these funds through the manager of the fund engaging in dialogue with the manager of the underlying fund.

The responses to the questionnaire from the fund managers also show that, in practice, advocacy differs from manager to manager – for example in terms of its scope and the managers’ differing potential to undertake such work – differences that are not apparent from the information standard. Several fund managers believe that the information in the standard focuses on *how* advocacy is conducted and that it does not give the reader an impression of *what* the subject of the fund’s advocacy is.

The responses to the questionnaire also show that many managers generally use all available options within this method and that this is also stated in the information standard. The question is: are the differences between different funds’ advocacy methods thus evident and what value does this information have to the consumer who wants to compare funds?

#### Follow-up of the sustainability work in the fund

Under the new legal requirements, the fund manager shall provide information about how the fund follows up its sustainability work for the first time in spring 2019. However, FI included a question in the questionnaire about what information concerning follow-up the fund managers themselves believe is relevant to provide to people who invest in their funds. The aim was to find out in advance what this part of the disclosure requirement will encompass.

The responses to the questionnaire indicate that many fund managers believe that this information should contain a description that gives the investor an impression of whether the fund has actually undertaken the work promised in the pre-purchase information. Several fund managers also stated in their responses that it is desirable and appropriate for this description to contain quantitative and qualitative information about the effect of the fund’s sustainability work. Furthermore, the fund managers were of the opinion that the information should be developed in line with improvements to methods used for measuring effects and improvements to the quality of the underlying data. FI shares many of the opinions expressed in the responses to the questionnaire.

#### OBSERVATIONS FROM FOCUS GROUP INTERVIEWS

The focus group interviews with consumers revealed that the participants feel the information in the information standard is unclear and difficult to relate to. The fact that the consumers have difficulty understanding the information may be due partly to the fact that some of the expression and terms mentioned in the previous chapter are unclear and partly to the fact that technical terms can appear unfamiliar. Because the consumers have difficulty understanding many expressions and terms, they also find it hard to compare the sustainability work conducted in different funds, in spite of the fact that the differences may be substantial.

For example, it emerged from the interviews that the consumers in the focus group perceive certain expressions used in relation to international norms as unclear (*avoid, willingness to change, acceptable timeframe*). This leads in turn to the consumers having difficulty evaluating the various options.

In the “positive screening section”, the fund manager can specify the *considers* option. Many of the consumers in the focus group questioned the value of this option as it is seen as too unspecific and non-committal. However, the consumers do feel that the *critical* option is more committing, and they thus have higher expectations of the sustainability work undertaken under this option.

The participants in the focus group interviews were shown and able to compare two versions of the “negative screening section” of the information standard. They were first shown a version that only shows the sectors that the fund actually excludes. The participants were then shown a version that also shows the sectors that the fund is able to exclude. The results were that the consumers felt that the information was clearer when all the sectors were shown, i.e. including the options that the fund is able to exclude.

With regard to the “fund management company influences section”, the consumers’ responses indicate that the information value of this is low as there is no indication of how much potential there actually is for the fund to influence companies in terms of their sustainability work.

## Conclusions and Follow-Up

FI concludes that there are good conditions in place for continued self-regulation of how funds' sustainability information shall be presented. FI intends to continue monitoring and evaluating the self-regulation in this area and also expects the industry to evaluate the results of its work.

### GOOD CONDITIONS FOR CONTINUED SELF-REGULATION

FI feels that the industry has had a high level of ambition when it comes to standardising the sustainability information and incorporating this into its self-regulation. Many of the terms used in the standard are established terms in the field of sustainable investments, for example which methods can be used for work with sustainability in funds.

The industry has thus made considerable progress in its work to develop self-regulation in this area. The fact that almost 90 per cent of the fund managers are using the information standard may also be seen as a good result.

Provided the level of ambition in terms of improving transparency remains high within the industry, FI believes there are good conditions for continued self-regulation in this area. FI intends to continue monitoring and evaluating the industry's efforts and also expects the industry to continually evaluate the results of its work.

### DEVELOPMENT OF THE INFORMATION STANDARD

FI is of the opinion that the industry should develop and improve the information standard further in order to make the sustainability information relevant and comparable. On the basis of the observations FI has made in the survey, there should be a specific focus on the following.

- Reduction in the scope for independent interpretations of the information standard so that fund managers apply the standard in a uniform manner. The industry needs to collectively set which criteria the fund manager is to meet in order to specify the various options in the information standard and evaluate whether these are at a sufficiently high level to be considered to constitute methods for sustainability work within fund management. Expressions that are used in the standard should be specific and terms should be clearly defined.
- Evaluation of whether the information provided in accordance with the information standard is relevant. The information should be developed so that it provides a true impression of what can be expected of the sustainability work that is actually carried out in the fund.
- Standardised versions of the sustainability information should be developed for different types of fund. The standard is currently primarily adapted to equity funds.

## ADAPT THE INFORMATION TO THE NEEDS OF CONSUMERS

The focus group interviews gave a clear impression that consumers have difficulty understanding the information provided in the information standard.

The aim of the new disclosure requirements is to make it easier for consumers to select funds in line with their preference for sustainable saving. Adapting the information standard so that this aim is achieved probably entails a challenge on the part of the industry that is of a greater scope than the improvements to the information standard proposed in the previous section.

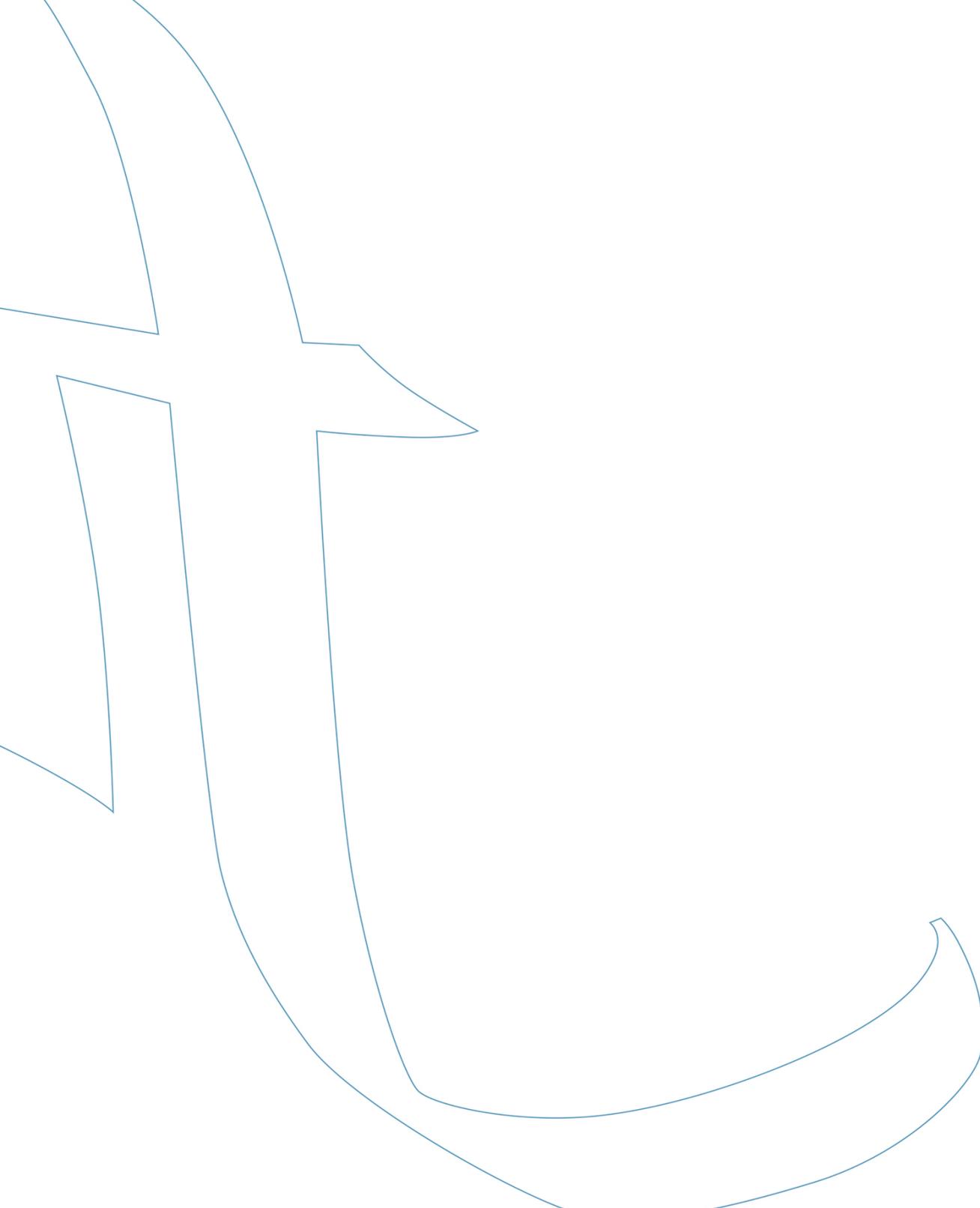
In the next stage, when the information is being adapted, it needs to be simplified so that it is based on the perspective of an average consumer who cannot be expected to have any detailed knowledge of sustainable investments.

From its own investigations<sup>10</sup>, FI has been able to establish that, in many cases, consumers lack financial capabilities, i.e. sufficient basic knowledge and skills to understand financial information. When a consumer is choosing a fund, they need to evaluate factors such as the investment focus of the fund, fees and risk. Evaluating these factors may be difficult for the average consumer. Combining these with sustainability aspects for the fund is probably even more demanding. Consumers are confronted with a mass of complex information and may also find it hard to calculate what tangible benefit the fund's sustainability work actually entails. In this respect, the industry has a lot of work ahead of it.

Something that may make it easier to adapt the information in the standard to the needs of consumers is to present it in a didactic manner with the help of digital tools. This can make a contribution to substantially improving consumers' chances of understanding and comparing the sustainability information.

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<sup>10</sup> Memorandum *Hushållens finansiella förmåga* [Households' financial capability] FI Ref. 17-21144.



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