4 – INCLUSION

Overarching recommendations

> The European Commission should ensure that retail investors are asked about their sustainability preferences and that sustainable investments are labelled for impact.

> New policies should be put in place to ensure that European citizens’ can exercise their right to sustainability-related data that is relevant to their lives and communities.

> The European Commission should develop an Action Plan to address financial exclusion that is linked to sustainability issues.

Under a European Green Deal, European citizens should have equal access to finance and should be able to decide their own financial investments and risks.

The public reputation of the financial sector has not recovered from the last financial crisis, and Europe is now headed into a much greater recession. The Renewed Sustainable Finance Strategy offers an opportunity to shift the focus to the real economy to ensure that companies, citizens and public authorities have the tools they need to finance the green transition in a more inclusive way.

Technocratic solutions which appear to benefit financial institutions at the expense of citizens will not be politically palatable in the 2020s. Financial reforms must enable individuals to select the impact of their pensions and savings, to have access to information about the environmental risks their communities face, and to be protected from financial exclusion as a result of risks that are not under their control.
Enabling citizens to invest according to their sustainability preferences

Most retail investors want to invest more sustainably. Over 70% of retail investors consider it important to invest in companies with a positive social and environmental impact. The majority of investors are also ready to accept trade-offs on financial returns with an increase in sustainable investments.

However, most retail investors lack the opportunity to invest according to their sustainability preferences. Retail sustainable investing assets represented 12% of the total assets managed in the European market in 2018. Evidence shows that the majority of financial advisers do not approach their clients about their sustainability preferences. Many financial advisers still perceive sustainably-denominated products as presenting a negative trade-off with returns, despite multiple studies indicating the opposite. Around half of retail investors want their financial advisor to communicate more about sustainable investing.

The Sustainable Finance Action Plan included an action to improve the integration of sustainability into financial advice. In June 2020 the European Commission published the draft Delegated Acts to incorporate the sustainability preferences of investors into the EU financial services regulatory framework based on the technical advice issued by the European Securities and Markets Authority and the European Insurance and Occupational Pensions Authority in 2019, requiring investment advisors to ask retail investors about their sustainability preferences and take these preferences into account in the financial products that are offered.

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138 Nataxis Investment Managers (2019) *Mind Shift: Getting past the screens of responsible investing*
139 Bauer, Ruof, Smeets (2020) *Get Real! Individuals Prefer More Sustainable Investments*; 2 Degrees Investing Initiative (2020) *A Large Majority of Retail Clients Want to Invest Sustainably*
140 Schroders (2019) Schroders Global Investor Study 2019: *People’s sustainable investment ambitions fail to reflect their actions*
142 Eccles, Kastrapeli (2018) *The Investing Enlightenment*
143 Eurosif (2018) *European SRI Study 2018*
144 Ref 167
146 Nevzat, van den Bogart (2020) *Commission publishes draft delegated acts on the introduction of ESG considerations*
The European Commission should ensure that retail investors are asked about their sustainability preferences and offered sustainable funds and products as a default option.

> Guidance for financial advisors in retail financial services should be provided in order to integrate sustainability and fully incorporate customer preferences into advice.

> The European Supervisory Authorities Joint Committee should be mandated to develop a template questionnaire to introduce a consistent assessment framework for financial advisors.

> Retail investors should be systematically offered sustainable investment products as a default option at a comparable cost and if those products meet the suitability assessment test.

> These rules should be replicated across the insurance and banking sectors by reviewing and amending all relevant elements of the EU financial services regulatory framework to incorporate investment advice that can respond to consumer preference on sustainability.

Member States should offer retail investors a stake in Europe’s sustainable future by developing policy measures that incentivise sustainable investment.

> Retail investors could be incentivised to make sustainable investments through measures such as preferential interest rates on savings accounts, or income tax relief.
Protecting retail investors from greenwashing

The presence of greenwashing practices in the market has led to scepticism among retail investors about environmental and social information.\textsuperscript{147} This, in turn, could undermine their confidence in sustainable finance, leading to unsatisfied demand and reduced participation.\textsuperscript{148} This could reduce incentives for asset managers to design suitable products and lead to insufficient investment in sustainability.

There is a wide variety of products on the market for sustainable financial assets offered under various denominations. The products with denominations such as ‘ESG’ (Environmental, Social and Governance), SRI (Socially Responsible Investing), ‘sustainable’ or ‘impact’ are often used interchangeably by the industry.

\begin{itemize}
  \item \textbf{Info: Sustainable investing terminology}\textsuperscript{149}
  \item Environmental, Social and Governance (ESG), Socially Responsible Investing (SRI) and impact investing are often used interchangeably by the industry.
  \item \textbf{ESG integration} considers how Environmental, Social and Governance factors impact financial performance, both positively and negatively. An oil and gas company could be considered a responsible investment if it is working to reduce its emissions, has a strong safety record and is giving back to local communities.
  \item \textbf{Socially Responsible Investing} involves actively selecting or eliminating investments according to a set of specific criteria such as positive or negative screening or the level of corporate engagement and shareholder engagement. With screening, investors may eliminate a company if it is involved in weapons contracting. Negative screening is most prominent in Europe.
\end{itemize}

\textsuperscript{147} 2 Degrees Investing Initiative (2020) \textit{EU Retail Funds’ Environmental Impact Claims Do Not Comply with Regulatory Guidance}
\textsuperscript{148} UK Financial Conduct Authority (2019) \textit{Climate Change and Green Finance: summary of responses and next steps}
\textsuperscript{149} Zhou (2019) \textit{ESG, SRI, and Impact Investing: What’s the Difference?}
Impact investing seeks to maximise societal impact by investing in an organisation completing a project or programme with a positive environmental or social impact.

While these descriptions enable the creation of tailored products to the needs of lenders and investors, it can be difficult for retail investors to compare the climate, environmental and social impacts of projects. This ambiguity can enable greenwashing and may weaken retail investor protection, given that financial literacy remains low in some Member States.\(^{150}\)

The European Commission should protect retail investors from greenwashing by establishing minimum standards and disclosure requirements for sustainably denominated funds.

> The European Commission should establish minimum standards for sustainably denominated funds based on the EU taxonomy and should require the disclosure of standardised sustainable impact information for retail funds and products.

The European Commission should take steps to improve financial literacy and raise awareness of sustainable finance among citizens and finance professionals.

> The European Commission should promote the inclusion of sustainability and sustainable finance in the curricula of finance graduates and professionals.

> The European Commission should promote the inclusion of sustainability and sustainable finance in the curricula of school students in the context of a wider effort to raise awareness about climate action and sustainability.

> The European Commission should stimulate cooperation between Member States to ensure that there are sufficient initiatives to educate citizens beyond school education to reduce their environmental

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\(^{150}\) Batsaikhan, Demertzis (2018) *Financial literacy and inclusive growth in the European Union*
footprint also through their investment decisions. Member States should also continue wider efforts to raise the financial literacy of EU citizens.

Mandating the disclosure of environmental impact claims

The savings of European households represent over 40% of financial assets in the EU.\textsuperscript{151} Currently, 40% of retail investors want to have a measurable environmental impact in the real economy with their savings.\textsuperscript{152} However, they are not given the means to select the real sustainable impact of financial products offered to them in their pensions and savings.

There is ample evidence of greenwashing taking place in the market. Most ESG products are not explicitly designed to deliver a measurable impact and often fail to provide evidence that they do. Yet, a significant number of actors in the financial sector continue to promote those funds by making environmental impact claims. For example, a study of marketing claims of 230 retail funds across Europe found that 52% of the funds made environmental investor impact claims, 99% of which do not comply with existing regulatory guidance.\textsuperscript{153}

Currently, there is no label for financial products seeking to deliver a measurable environmental investor impact.\textsuperscript{154} A number of organisations such as the Impact Management Project and the Global Impact Investing Network are currently developing frameworks that can provide the basis for such a label.\textsuperscript{155} So far there has not been any in-depth analysis on how investment products and strategies have an impact on the real economy.\textsuperscript{156}

\textsuperscript{151} High-Level Expert Group on Sustainable Finance (2018) \textit{Final Report}
\textsuperscript{152} 2 Degrees Investing Initiative (2020) \textit{EU Retail Funds’ Environmental Impact Claims Do Not Comply with Regulatory Guidance}
\textsuperscript{153} 8% of the claims are incorrect, 61% are unclear, 81% are too broad, and 99% have at least one of those characteristics. 2 Degrees Investing Initiative (2020) \textit{EU Retail Funds’ Environmental Impact Claims Do Not Comply with Regulatory Guidance}
\textsuperscript{154} 2 Degrees Investing Initiative (2020) \textit{Feedback on the second version of the Ecolabel criteria for financial products}
\textsuperscript{155} Ibid.
\textsuperscript{156} 2 Degrees Investing Initiative (2020) \textit{EU Retail Funds’ Environmental Impact Claims Do Not Comply with Regulatory Guidance}
The Sustainable Finance Action Plan included an action to explore the use of the EU Ecolabel framework for certain financial products. The EU Ecolabel for Financial Products is currently being developed to define the minimum environmental performance of financial products. The European Commission presents the Ecolabel as a means to allow retail investors concerned with the environmental impact of their investment to make informed choices and contribute to the green transition. The Joint Research Centre published the second version of the Ecolabel criteria for financial products in April 2020.

However, evidence shows that the draft criteria of the Ecolabel on financial products and the second technical report are misaligned with the requirements of the Ecolabel Regulation. The draft criteria allow funds deriving only 18% of revenue from environmentally sustainable activities to obtain the label, which can hardly be considered sustainable and will only perpetuate greenwashing practices. Furthermore, the technical report omits the concept of ‘investor impact’. This creates a significant risk of non-impactful financial products relating to sustainability characteristics being offered to impact-focused clients.

The European Commission should revise the Ecolabel for financial products to match sustainability preferences and should establish a new sustainability impact label

> In order to maintain quality standards and policy ambition, development of the Ecolabel for financial products should be postponed until the taxonomy is implemented and revised in order to increase the percentage of green investment in the fund to at least 70% and tighten the exclusion criteria.

> A voluntary sustainability impact label should be established for green or sustainable funds, and for products that seek to deliver a measurable sustainability impact. This should be developed in partnership with impact investment firms, drawing on their expertise in measuring impact and identifying best practice and common approaches.

158 European Commission 2019 Sustainable Products in a Circular Economy - Towards an EU Product Policy Framework contributing to the Circular Economy
159 2 Degrees Investing Initiative (2020) Feedback on the second version of the Ecolabel criteria for financial products
Building on the EU taxonomy, a science-based sustainability impact measurement framework could be developed and used to define a set of standardised impact measurement requirements which would apply to all funds and products to enable an assessment of coherence with the sustainable investment preferences of retail investors.

Supporting the development of digital finance solutions for citizens

In recent years, an increasing number of innovative financial technology (fintech) companies have appeared in Europe. Few of these have a business model that focuses on sustainability.

New models of financing and inclusion can be developed through fintech and digital technologies such as artificial intelligence and blockchain. Crowdcube is a crowdfunding platform to raise early stage finance for start-ups.\textsuperscript{160} Enerchain is a peer-to-peer energy trading platform to enable individuals to generate their own energy and trade the excesses.\textsuperscript{161} Enfuce will enable consumers in Finland to trace the carbon footprint of their purchases upon payment.\textsuperscript{162}

Financial institutions are also starting to realise the benefits of fintech solutions. Spanish bank BBVA recently issued a green bond using blockchain with a platform for verification and reporting.\textsuperscript{163} Munich Re has partnered with PrecisionHawk, a drone data platform, to improve reporting following a natural disaster.\textsuperscript{164}

The fintech agenda presents new opportunities to support the implementation of the Renewed Sustainable Finance Strategy and the democratisation of finance through solutions enabling retail investors to select their pensions and saving plans.

\textsuperscript{160} High (2020) \textit{FinTech profile: Crowdcube - innovation in crowdfunding}
\textsuperscript{161} Ponton (2017) \textit{European Energy Trading Firms Test Peer-To-Peer Trading Over The Blockchain}
\textsuperscript{162} Tan (2020) \textit{Fintech for sustainability: turning awareness into action}
\textsuperscript{163} BBVA (2019) \textit{‘Blockchain’ set to shape future of green bonds}
\textsuperscript{164} KPMG (2019) \textit{Forging the future How financial institutions are embracing fintech to evolve and grow}
The European Commission should support the development of digital finance solutions to advance the sustainable finance agenda.

- The European Commission should support initiatives providing citizens with access to comparable information on the sustainability of investment products and companies to enable them to make more informed financial decisions based on their sustainability preferences.

- The European Commission should advance the uptake of regulatory use cases supporting the ambitions of the sustainable finance agenda by fintech companies, including defining the requirements for digitalising the taxonomy, supporting pilot schemes on green bond and SDG-related reporting and verification and digitalising public corporate reporting.

- Member States should stimulate local initiatives that allow citizens to identify and jointly finance local sustainable projects. Even though some projects might be limited in scale, using digital tools avoids excessive dependency of local sustainable projects on market intermediaries and supports efficient pricing and transparency.

Ensuring the right to sustainability-related financial data

Democracy in Europe encompasses a wide range of tools beyond the European Parliament including access to information, public participation and access to justice, which can be used to safeguard the interests of European citizens.

The Aarhus Regulation was created in 2006 to implement the Aarhus Convention, which is the main international legal instrument regulating access to information, public participation in decision-making and access to justice in environmental matters. The involvement of citizens in these matters is crucial to the success of the European Green Deal.

The European Commission set out in the European Green Deal Communication that it will consider revising the Aarhus Regulation to improve access to justice for citizens and NGOs who have concerns about the legality of decisions related to environment and sustainable development.

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to the environment.\textsuperscript{166} This follows a complaint from civil society questioning the consistency of the EU system on access to justice in environmental matters with the Aarhus Convention.\textsuperscript{167} The European Commission also plans to launch a European Climate Pact to engage with the public on climate action.\textsuperscript{168}

Another source of concern is the limited access to environmental information and in particular data on physical climate risks and second and third order impacts.\textsuperscript{169} European communities which are exposed to physical climate risks are at risk of capital flight, which could deprive vulnerable citizens from access to finance. Their ability to access environmental data will be important to be able to understand these risks and participate in public decision-making. Barriers to public participation are numerous and continue to grow in the EU.\textsuperscript{170}

Revision of the Aarhus Regulation under the European Green Deal work programme\textsuperscript{171} would provide an opportunity to address these matters.

New policies should be put in place to ensure that European citizens’ can exercise their right to sustainability-related data that is relevant to their lives and communities.

- The EU should ensure that all European citizens are able to exercise their Aarhus Convention rights: to receive environmental information that is held by public authorities; to participate in preparing plans, programmes, policies and legislation that may affect the environment and to review procedures when these rights have been violated.
- Relevant financial data might for example include information about present and future climate change impacts which may affect citizens’ future access to credit or insurance or may affect the value of their personal assets.

\textsuperscript{166} European Commission (2019) Communication on the European Green Deal
\textsuperscript{167} Milieu Consulting (2019) Study on EU implementation of the Aarhus Convention in the area of access to justice in environmental matters
\textsuperscript{168} Ibid.
\textsuperscript{169} European Environment Bureau (2019) Still too hard to access environmental information in the EU – EEB report; European Commission (2020) Adaptation to Climate Change Blueprint for a new, more ambitious EU strategy; E3G (2020) Roadmap for an Updated EU Strategy on Adaptation to Climate Change
\textsuperscript{170} Soffer (2019) To meet its climate commitments, the EU must involve its people
\textsuperscript{171} European Environment Bureau (2020) ‘Green Deal Commission’ overlooks environmental rights in 2020 work programme
Avoiding financial exclusion due to sustainability risks

Sustainability risks that could directly affect access to finance now and in the future include physical climate risk (e.g. exposure to flood risk or sea level rise), future access to resources such as water, and (for companies) dependence on unsustainable supply chains. Awareness and understanding of sustainability risks remain inadequate within financial firms that offer services to businesses and individuals. There is also a low level of understanding of climate risk within corporations, despite efforts by the Task Force for Climate-Related Financial Disclosure to mainstream climate risk disclosure.\textsuperscript{172}

Achieving resilience to climate risk requires investments to be based on a data-driven assessment of risk. However, the information costs related to mapping climate risks are considered high.\textsuperscript{173} There is a huge amount of data in existence but some of the most valuable is proprietary e.g. held by Bloomberg and insurance companies and not open to the market, let alone available to citizens. An even bigger problem is inconsistencies or usability of data which would benefit from public sector coordination effort.\textsuperscript{174}

Asset managers and investors still prioritise acting on transition risks over physical climate risks.\textsuperscript{175} Although investors are starting to assess portfolio-related climate risks, they are not adapting their investment strategies accordingly.\textsuperscript{176} Insurance companies are experienced at climate risk assessment, but not all of them take a preventive and resilient approach to their investment strategies and client interactions, despite the fact that climate will hit them both in terms of their asset base and liabilities.

Nevertheless, greater awareness of sustainability risks is now affecting access to finance. For example, European banks are already discriminating between borrowers based on their exposure to sustainability risks.\textsuperscript{177} The price, credit worthiness and insurability of real estate in affected regions is changing as financial firms make use of real-time flood data.\textsuperscript{178} Further impacts on asset

\begin{footnotesize}
\begin{enumerate}
\item[172] Alliance for Corporate Transparency (2019) \textit{2019 Research Report}
\item[173] Pillay et al. (2017) \textit{Mobilizing Adaptation Finance in Developing Countries}
\item[174] Financial Stability Institute (2019) \textit{Turning up the heat – climate risk assessment in the insurance sector}
\item[175] Sjöblom et al. (2018). \textit{Climatic Risks and Opportunities in Real Estate Portfolio Management}
\item[176] Burgess, K. and Rapoport, E. (2019). \textit{Climate Risk and Real Estate Investment in Decision-Making}
\item[177] Bank of Italy (2018) \textit{Natural catastrophes and bank lending: the case of flood risk in Italy}
\item[178] Ambiental Risk Analytics (2020) \textit{Europe FloodScore}
\end{enumerate}
\end{footnotesize}
value are likely to materialise as episodes of extreme heat become more common in Europe.

Citizens and small businesses are likely to have little or no control of the financial risks that they face from sustainability impacts and Europe does not yet have a plan to support them. The Adaptation Blueprint\textsuperscript{179} noted in the context of international development that “climate finance needs to be better targeted to those countries and communities that are particularly vulnerable to the impact of climate change and have less capacity to address them” but failed to note that the same is true within Europe’s borders. These risks are likely to fall in an uneven way, disproportionately affecting communities which are already economically disadvantaged.

The European Commission and the European Supervisory Agencies should develop an Action Plan to protect small businesses and citizens from financial exclusion resulting from unavoidable sustainability risks

> The European Commission should commission research into the present and future scale of reduced access to finance for citizens and small and medium-sized enterprises as a result of sustainability risks, with a view to developing an Action Plan to support those who are exposed to sustainability-related risks that cannot be avoided, through no fault of their own.

> The EU and European Supervisory Agencies (e.g. EIOPA) can help ensure a standardised approach to sustainability risk across the financial services sector, and ensure that better sustainability risk assessment by financial services companies translates into greater awareness together with options for action for customers, e.g. through the provision of education, information and specialised products.

> As sustainability risk quantification techniques mature and sustainability risk assessments become more accurate the EU could consider policy measures to support financial inclusion, e.g. restrictions on refusals to insure, or caps on prices.

\textsuperscript{179} European Commission (2020) \textit{Adaptation to Climate Change: Blueprint for a new, more ambitious EU strategy}