CONSULTATION DRAFT March 2022 – WORK IN PROGRESS

About

The 2° Investing Initiative (2DII) is an international, non-profit think tank working to align financial markets and regulations with the Paris Agreement goals.

Working globally with offices in Paris, New York, Berlin, London, and Brussels, 2DII coordinates some of the world's largest research projects on climate metrics in financial markets. In order to ensure our independence and the intellectual integrity of our work, we have a multi-stakeholder governance and funding structure, with representatives from a diverse array of financial institutions, regulators, policymakers, universities and NGOs.

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Annex 1: Client explanatory materials

Recommendation for client explanatory materials

(1) Investment firms "should explain the term and the distinction between the different elements of the definition of sustainability preferences under a) to c) and also between these products and products without such sustainability features in a clear manner, avoiding technical language. Firms should also explain what environmental, social and governance aspects mean."[1] The information should be provided on non-technical terms understandable for retail clients.

(2) It is the investment firm's choice as to how to provide an explanation of sustainability preferences and wider sustainability motivations.

(3) We believe, investment firms should develop client explanatory materials to ensure the explanation of sustainability preferences and wider sustainability motivations is harmonised and effective and enables controls to check if the explanation of sustainability preferences was adequately provided.

(4) Set out below are key considerations which we believe should inform the design of the client explanatory materials and key content which should be included in the client explanatory materials. The key content articulated below can be used as a default option for an investment firm to transpose into its own client explanatory materials. However, investment firms should bear in mind that the regulatory framework in this area is constantly developing and evolving. Investment firms should ensure they stay up to date with relevant regulatory developments.

Key considerations for client explanatory materials

(5) Investment firms are free to choose the format of the client explanatory materials, which may consist of one or more of the following (or any other format chosen by the investment firm):

a) a script which an investment firm can use to provide an explanation of sustainability preferences in open dialogue during the client meeting;
b) E-learning or short videos which provide an explanation of sustainability preferences and may either be watched in advance of the client meeting or during the client meeting itself; or
c) a leaflet which provides an explanation of sustainability preferences and may either be circulated in advance of the client meeting or during the client meeting itself.

(6) In all cases the client explanatory materials should provide accurate and sufficient information on the key features associated with an explanation of sustainability preferences and wider sustainability motivations.

(7) Client explanatory materials should be designed to accommodate differing levels of financial literacy and/or levels of interest in sustainability issues by the client.

(8) In terms of differing levels of interest in sustainability issues by the client, the Questionnaire and Guidance accommodates this through introducing three levels of assessment in *Step 2: Identification of*

[1] Guidelines on certain aspects of the MiFID II suitability requirements

client sustainability preferences – Short Assessment, Medium Assessment and Long Assessment. For example, if the client does not have any interest in sustainability at the end of the Short Assessment, then no further assessment of sustainability preferences is necessary, and the investment firm can proceed to *Step 3: Financial product recommendation*. If on the other hand, the client expresses any interest in sustainability or a need for further information, the investment firm should proceed to the Medium Assessment which focusses on assessing sustainability preferences and wider sustainability motivations for the client.

(9) The key content for client explanatory materials below is structured in a way which provides a minimum degree of explanation of sustainability preferences to all clients. This minimum degree of explanation will allow the client to decide if he or she has any interest on sustainability issues linked to the investment. Then further explanation and details are provided for clients who express interest in sustainability issues.

Key content for client explanatory materials

(10) Increasing societal awareness of environmental and social issues raises the need to assess client sustainability preferences for how they want to invest their money.

(11) For clients to take informed decisions and advocate effectively in relation to their own sustainability preferences, investment firms should provide an explanation of sustainability preferences to enable clients to understand the different degrees of sustainability which are possible for financial instruments.

(12) This explanation of sustainability preferences is structured so that there is a minimum level of explanation which must be provided to all clients, and then further detail can be provided for those clients who have sustainability preferences for their investments and want to know more.

(13) We also believe the client should be able to express wider sustainability motivations (goals, values, and priorities) we therefore include in the key content explanation going further than the mere explanation of regulatory categories and preferences and explanation of ESG aspects.

(14) The figure below illustrates the key content which investment firms should cover in the explanation of sustainability preferences and wider sustainability motivations.

Step 1: Explanation of sustainability preferences	**Explanation to be provided to all clients**	Investment firms should provide an explanation of sustainability preferences to enable the client to understand the different degrees of sustainability which are possible for financial instruments. The explanation should provide accurate and sufficient information to enable clients to take informed decisions and advocate effectively in relation to their own sustainability preferences and wider sustainability motivations. At this stage, investment firms should provide an explanation in relation to: • link between financial investment and the environment and society • explanation on what environmental, social and governance aspects mean; • different types of sustainable financial instruments available on the market; • different categories of sustainability preferences; • articulation between sustainability preferences and other investment objectives.
Step 2: Identification of client sustainability preferences	**Additional information depending on the level of interest of the client**	**Specific to the Short assessment** The Short Assessment is required for all clients and is designed to identify those who have no interest in sustainability. At this stage, the investment firm need not provide any further explanation of sustainability preferences and wider sustainability motivations beyond what is given under Step 1 above.
		Specific to the Medium Assessment If at the end of the Short Assessment, the client expresses any interest in sustainability or a need for further information, the investment firm should proceed to the Medium Assessment which focusses on assessing sustainability preferences and wider sustainability motivations for the client. At this stage, the investment firm should provide an explanation in relation to: • main sustainability goals; • specific explanation to be provided to all clients who have an interest in impact; • further explanation on the different categories of sustainability preferences when needed.
		Specific to the Long Assessment If at the end of the Medium Assessment if the client wants to provide more information on specific values or priorities for his or her investment, the investment firm should proceed to the questions in the Long Assessment which relate to sustainability values and priorities. At this stage, the investment firm should provide further explanation in relation to values and priorities.

(15) The content below applies the following interpretive principles: :

a) ‘I’ or ‘we’ refers to the investment firm (or advisor) which is carrying out the suitability assessment
b) ‘you’ refers to the client or potential client
c) ‘client’ refers to client or potential client as applicable

Step 1: Explanation of sustainability preferences

Explanation to be provided to all clients

Link between financial investment and the environment and society

(16) Climate change and environmental degradation are defining global challenges of our time. Countries across the world are working to limit climate change, reverse biodiversity loss and broader degradation of the environment and to leave nobody behind in the process. Sustainable finance means taking sustainability considerations into account when making investment decisions.

(17) A sustainable finance approach leads to sustainable economic activities and projects. It can support economic growth while reducing pressures on the environment and considering social and governance aspects. Sustainable finance therefore has a key role to play in delivering the climate, environmental and social policy objectives of governments around the world.

Environmental, social and governance aspects

(18) Sustainability considerations of investment decisions can be linked to different environmental, social, and governance aspects.

(19) Environmental considerations might include climate change mitigation and adaptation, preservation of biodiversity, pollution prevention and the circular economy etc.

(20) Social considerations might include issues of inequality, inclusiveness, labour relations, human rights issues etc.

(21) Governance considerations might include topics such as diversity of structures of corporate governance, fight against corruption and bribery, tax transparency etc.

Different types of sustainable financial instruments available on the market

(22) You can decide to invest your money considering ESG aspects of financial instruments. It is important to note that on the market you will find several types of financial products with various degrees of ambitions in terms of sustainability.

(23) Some financial instruments merely consider ESG aspects, for example by calculating and disclosing negative externalities of investments on the environment or society, while other financial products aim to make a real contribution to the improvement of society.

(24) Moreover, certain products will take account at the same time of environmental, social and governance considerations, while others will focus on only one or two of these aspects.

(25) You should also know that in case our range of product offer does not meet your expectations in term of sustainability characteristics, you still have the possibility to consult other investment firms or publicly available platforms to know more about other sustainable products available on the market (ex: MyFairMoney).

The different categories of sustainability preferences

(26) Under the current regulatory framework, a client's sustainability preferences are understood as a client's preferences for three categories of financial instrument.

Category A	Financial instruments which invest in economic activities providing a substantial contribution to one or more of the following environmental objectives: • climate change mitigation; • climate change adaptation; • sustainable use and protection of water and marine resources; • transition to a circular economy; • pollution prevention and control; • protection and restoration of biodiversity and ecosystems.
Category B	Financial instruments which pursue sustainable investments more broadly. This is a wider category of financial instruments because it includes economic activities that contribute to other environmental objectives and/or to social objectives.
Category C	Financial instruments that consider negative externalities of investments on the environment or society in terms of principal adverse impacts on sustainability. Principal adverse impacts on sustainability are impacts of investment decisions and advice that result in negative effects on environmental, social and employee matters, respect for human rights, anti-corruption, and anti-bribery matters. Contrary to category A and B, here the financial instrument does not aim at any positive contribution but merely consider negative impacts of the investment on sustainability.

(27) You may also wish to express wider sustainability motivations such as general sustainability goals or more precise values and priorities.

Articulation between sustainability preferences and other investment objectives

(28) I will first consider your traditional investment objective before assessing your preferences in term of sustainability. Thus, you can feel free to express any sustainability preferences you may have (or other wider sustainability motivations) since it will only be considered as a top up to the other investment objectives you already expressed. i.e., it cannot affect the financial investment objectives you expressed.

Step 2: Identification of client sustainability preferences

Additional information depending on the level of interest of the client

Short Assessment

(29) Having provided the explanation of sustainability preferences in *Step 1: Explanation of sustainability preferences*, the Short Assessment is required for all clients and is designed to identify those who have no interest in sustainability. If the client has no interest in sustainability at the end of the Short Assessment, then no further explanation or assessment of sustainability preferences is required, and I can proceed to *Step 3: Financial product recommendation*. If the client expresses any interest in sustainability or a need for further information, then I should provide further explanation during the Medium Assessment.

Proceed to Q1 of the Questionnaire. If the client answers a) or b), please provide the explanations below related to Medium Assessment.

Medium Assessment

(30) As you have expressed an interest in sustainability or a need for further information, I can now provide an overview of the different sustainability goals observed among investors and further detail in relation to sustainability preferences if needed. This information should help you form and opinion and express your sustainability goals and preferences.

Main sustainability goals

(31) Investors deciding to incorporate ESG criteria in their investment usually pursue three main goals (in addition to the initial objective of achieving a financial return). It should be underlined that some investors can have several goals for their investment.[2]

(32) **Impact:** You may want to have a positive impact on society and the environment through your investments.

(33) **Value alignment:** You may want to align your investments with your personal values – either by prioritising financing specific economic activities or by avoiding financing specific economic activities.

(34) **Financial performance through ESG:** You may want to invest in a manner which takes account of sustainability factors because you believe it will improve the risk/return profile of the investment.

[2] This categorization is also recommended for instance by the Center for Sustainable Finance and Private Wealth or the Swiss Asset Management Association and SSF: https://www.sustainablefinance.ch/upload/cms/user/RecommendationsforSustainableInvestmentProducts_AMAS_SSF.pdf

Sustainability goals of retail clients in purchasing financial products taking into account environmental criteria

Having an impact in the real economy (43%)

■ I want to have a positive environmental impact in the real economy by investing in the financial product. I want the investment strategy behind the financial product to be designed and managed in such a way that the more money invested the more positive environmental impacts are generated.

Value alignment (19%)

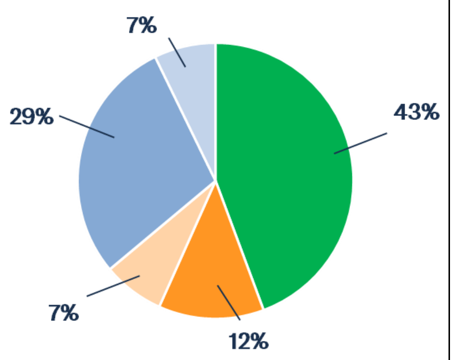
■ I want to invest in companies that have positive environmental impact (e.g. operators of windfarms) even if my investment does not change anything to their activity, because it is a way to symbolically show my support to the environmental cause.

■ I want to avoid investing in any company that has a negative environmental impact, even if my choice does not affect their activities, because it is a way to show my support to the environmental cause.

Financial performance (36%)

■ I want to invest in companies that have positive environmental impacts (e.g. operators of windfarms) even if my investment does not change anything in their activities, because I believe these companies will have a better financial performance.

■ I want to avoid investing in any company that has a negative environmental impact, even if my choice does not change anything in their activities, because I believe these companies will have a bad financial performance in the future.



Aggregated survey results: n=1000 German and n=1000 French

Source: 2DII (2020) A Large Majority of Retail Clients want to Invest Sustainably

(35) For clients who want to have a clear positive impact on the society and/or the environment with their investments some specific explanations should be provided:

(36)

Specific explanation to be provided to all clients who have an interest in impact

Investor impact is not the same as company impact. Investor impact is the change in a company's activities caused by the investor - in other words it is the effect the investor has through its actions or with its money on the company's decisions (which then impact on environment and society).

The impact of an investor can be defined as the change that the investor has caused in the activities of the company benefiting from his investment. In the context of climate change mitigation, this change can either take the form of a growth in a "green" company' activities (e.g. a growth of its green power production) or of a change in the quality of a company's activities (e.g. an increase in the energy efficiency of a plant)."[3]

Currently, the level of evidence of investor impact available for financial products is generally low and thus cannot be guaranteed.

For example, companies need money from third parties to finance their activities and have shareholders who own a portion of the company and can influence company decisions. Shareholder pressure or lack of financing can force companies to close unsustainable factories or invest in sustainable activities.

[3] Kölbel et al. (2020), The investor guide to impact

Both changes impact on environment and society through for example reducing emissions. But it can be very difficult to measure the individual impact of an individual shareholder or third party on a company's activities. If an energy company closes a coal-fired power plant, it is easy to measure the emissions saved. But measuring how much of this decision is attributable to an individual shareholder or third party is complicated. An investor's individual influence may have helped push the company to close the plant – but the collective influence of all investors is more determinative. And other factors – coal becoming more expensive, carbon taxes being introduced - may have also played a part. It is very difficult to know how important an investor's individual actions are in the decision of the energy company to close the coal plant. This shows that it is very difficult to prove investor impact.

However, certain sustainability strategies have higher potential of impact than others (such as stewardship, impact investing, income-sharing) and help to identify products which are more suitable for impact-oriented clients.

(27) As explained before, in addition to your main sustainability goal(s), I will collect information on your sustainability preferences for certain types of financial instruments. Do you need more explanation on the three categories of sustainability preferences?

(28) **Nota bene**: At this point, if the client request so, I should provide explanation on concepts linked to the definition of sustainability preferences, such as environmental vs. social aspects, climate change mitigation / adaptation, explain principal adverse impact indicators…

(29) Once you express your sustainability goal(s) and sustainability preferences, I will be able to choose the most relevant sustainability strategies to achieve your target and already look for suitable financial products in our range of offer. Please note that you will also have the possibility to provide more information on your values and priorities if you wish to do so.

Proceed to Q2-5 of the Questionnaire. If the client answers a) to Q5 please provide explanations below related to the Long Assessment.

Long Assessment

(37) As you have expressed an interest in providing more detail regarding your values and priorities, I can provide further explanation in relation to other elements of your potential sustainability motivations.

Values and priorities

Values and priorities leading to promotion of certain sectors and companies

(38) If you want to be more detailed about specific values and priorities you want to advance through your investments, the United Nations Sustainable Development Goals (**SDGs**) can be used to provide more precision on the values and priorities you wish to prioritise. The SDGs establish 17 global goals to achieve a better and more sustainable future for all by 2030 and were adopted by all United Nations Member States in 2015.

a) Environmental matters captured by the SDGs include conservation and protection of marine and land resources, ensuring access to affordable, reliable, sustainable and modern energy for all and taking urgent action to combat climate change.

b) Social and governance matters captured by the SDGs include combating hunger worldwide, ensuring that all people can go to the doctor when they are ill, ensuring quality education for all or achieving gender equality and empowering all women and girls.

Using the SDGs allows you to identify the personal values and priorities which are most important to you and where you would like to see progress.

Values and priorities leading to exclusion of certain sectors and companies

(39) If you want to be more detailed about economic activities you refuse to be financially exposed to, it is possible to define negative screening criteria to specify what a financial instrument must avoid investing in.

a) Environmental matters where negative screening criteria can include pesticides and biocides, animal testing, genetic engineering, coal, factory farming etc.
b) Social and ethical matters where negative screening criteria can include weapons and armaments, tobacco, alcohol, gambling, and pornography.
c) Breach of international norms where negative screening criteria can include for example principles of the UN Global Compact.

(40) Equally, you may want to be more detailed about countries you refuse to be financially exposed to. For example, you may want to avoid being financially exposed to countries involved in the following controversies: nuclear weapons, wars, corruption…

Proceed to Q6-9 of the Questionnaire.

Optional: information on sustainability strategies

There are many different types of sustainable financial instruments which rely on different sustainable financial strategies, including:

ESG integration: financial instruments which include sustainability information alongside financial information in the process of selecting assets;

Stewardship (voting or engagement): financial instruments that seek to use shareholder or investor power to influence corporate behaviour. For example: Communicating with senior management and/or boards of companies), filing or co-filing shareholder proposals, and proxy voting guided by comprehensive ESG guidelines;

Sector/Norm based exclusion: financial instruments which exclude from a fund or portfolio certain sectors, companies or countries based on certain criteria. Exclusion criteria can be based on product categories (e.g. weapons, tobacco), company practices (e.g. animal testing, violation of human rights, corruption) or controversies;

Best in class/positive screening: financial instruments which use positive screening techniques to select companies or countries with the best practices in sustainability topics;

Thematic investing: financial instruments that invest in companies because they positively contribute to the advance of a certain sustainability topic, either environmental or social;

Impact investing: Investing to achieve positive, social and environmental impacts - requires measuring and reporting against these impacts, demonstrating the intentionality of investor and underlying asset/investee, and demonstrating the investor contribution.

Income-sharing: investments that include a mechanism to donate part of the generated income to charities or NGOs.

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The Finance ClimAct project contributes to the implementation of France's National Low Carbon Strategy and the European Union's Sustainable Finance Action Plan. It aims to develop tools, methods and new knowledge that will enable (1) savers to integrate environmental objectives into their investment choices, and (2) financial institutions and their supervisors to integrate climate issues into their decision-making processes and align financial flows with energy and climate objectives.

Finance ClimAct is a first-of-its-kind program with a total budget of €18 million and €10 million in funding from the European Commission.

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