

# Thematic review of the consideration of greenwashing risk in investment fund activities

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## 1 Background, objectives and conclusion of the thematic review

### 1.1 Background of the thematic review

The Financial Supervisory Authority (FIN-FSA) is conducting a thematic review concerning the consideration of sustainability risks and sustainability disclosures of UCITS and non-UCITS funds (hereinafter also “investment funds”). The thematic review is part of a Common Supervisory Action (CSA) coordinated by the European Securities and Markets Authority (ESMA).<sup>1</sup>

<sup>1</sup> <https://www.esma.europa.eu/press-news/esma-news/esma-and-ncas-assess-disclosures-and-sustainability-risks-investment-fund>

In June 2023, the FIN-FSA sent a survey to all management companies and Alternative Investment Fund Managers (AIFM) (hereinafter collectively also “companies”) concerning the sustainability disclosures of investment funds managed by them and the consideration of their sustainability risks. In addition, the FIN-FSA sent a more extensive survey to eight companies on the same theme, also including open-ended questions and a request to submit additional material, such as fund documentation and the company’s internal guidelines.

The thematic review is divided into two areas, comprising:

1. Questions concerning the prevention of greenwashing risk and
2. Other questions about the consideration of sustainability risks and sustainability disclosure obligations

This report, which concerns the first part of the thematic review, describes the findings of the questions about greenwashing risk. The topic areas related to greenwashing risks that are discussed in this report are:

- Consideration of greenwashing risk in the company’s activities
- Consideration of greenwashing in conflicts of interests
- Use of ESG credentials
- Quality control of data sources used and related limitations
- Investment funds’ net zero and carbon neutrality claims
- Practices and claims concerning engagement

We will report separately on the findings on the questions of the second part of the thematic review.

## 1.2 Objectives of the thematic review

The objective of the thematic review is to assess how companies comply with the Sustainable Finance Disclosure Regulation (EU 2019/2088, hereinafter the “SFDR”)<sup>2</sup> Regulation (EU) 2020/852 on the establishment of a framework to facilitate sustainable investment (EU 2020/852, hereinafter the “Taxonomy Regulation”)<sup>3</sup> and the Commission SFDR Delegated Regulation (EU 2022/1288, hereinafter the “SFDR Delegated Regulation”)<sup>4</sup>. In addition, as regards the integration of sustainability risks, the thematic review reflects on lower-level regulation issued under directly applicable Regulations.

The main objectives of the thematic review are to:

- Assess whether the companies in practice adhere to applicable regulation
- Collect additional information on greenwashing risks associated with investment funds; and
- Identify relevant supervisory and regulatory interventions to address greenwashing risk<sup>5</sup>

<sup>2</sup> Regulation (EU) 2019/2088 of the European Parliament and of the Council on sustainability-related disclosures in the financial services sector (hereinafter “the SFDR”).

<sup>3</sup> Regulation (EU) 2020/852 of the European Parliament and of the Council on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088 (hereinafter the “Taxonomy Regulation”).

<sup>4</sup> Commission Delegated Regulation (EU) 2022/1288 supplementing Regulation (EU) 2019/2088 of the European Parliament and of the Council with regard to regulatory technical standards specifying the details of the content and presentation of the information in relation to the principle of ‘do no significant harm’, specifying the content, methodologies and presentation of information in relation to sustainability indicators and adverse sustainability impacts, and the content and presentation of the information in relation to the promotion of environmental or social characteristics and sustainable investment objectives in pre-contractual documents, on websites and in periodic reports (hereinafter the “Commission SFDR Delegated Regulation”).

<sup>5</sup> <https://www.esma.europa.eu/press-news/esma-news/esma-and-ncas-assess-disclosures-and-sustainability-risks-investment-fund>

### 1.3 Summary of key findings of the thematic review

- Some shortcomings were found in various aspects of the disclosure obligations in all companies participating in the extensive survey, although the Commission SFDR Delegated Regulation defines exactly what must be disclosed in which document and on the website. Some of the information given was also at a too general level.
- The majority of the companies responded they consider greenwashing risk in their activities, but not all companies had defined the risk in their internal guidelines or risk management policies.
- ESG credentials were used also in investment funds that do not have the promotion of sustainability characteristics or sustainable investment as their objective. This may give rise to increased greenwashing risk.
- All of the companies had some shortcomings in the fund-specific information provided on the website in terms of the quality of information and data sources as well as limitations concerning the data sources.
- Most of the companies had engagement policies to achieve the sustainability objectives of the investment funds. However, the companies communicated incompletely to investors about their fund-specific engagement policies and the engagement actions taken.

### 1.4 Overview of regulation

Application of the SFDR started in main respects on 10 March 2021. The Regulation requires the disclosure of sustainability information on both fund managers and fund products. The Commission SFDR Delegated Regulation entered into force in main respects on 1 January 2023.

Disclosure obligations under the Taxonomy Regulation concerning the two first environmental objectives, i.e. climate objectives, have been in force since 1 January 2022. As of 1 January 2024, the disclosure obligation was extended to cover the other four environmental objectives under the Taxonomy Regulation, which are related to water, circular economy, pollution prevention and biodiversity. Furthermore, the Taxonomy Regulation provides standardised statements that must be used in circumstances where a fund's investments do not take into account the criteria for environmentally sustainable economic activities.<sup>6</sup>

In making sustainability-related disclosures, financial market participants and financial advisers must ensure that information required by the SFDR and the Commission Delegated Regulation are easily accessible and not misleading. The information must be made available free of charge in a manner that is non-discriminatory, prominent, simple, concise, comprehensible, fair, and clear. Financial market participants and financial advisers must present and lay out the required information in a way that is easy to read, and use characters of readable size and a style that facilitates understanding.<sup>7</sup> Financial market participants refer to management companies and AIFMs, among others.<sup>8</sup>

<sup>6</sup> Taxonomy Regulation, Art. 6–7.

<sup>7</sup> Commission SFDR Delegated Regulation 2022/1288, Article 2(1).

<sup>8</sup> SFDR, Article 2(1).

Furthermore, new obligations have been introduced for fund managers about considering sustainability risks in the company’s investment operations and risk management. These obligations are implemented in FIN-FSA regulations and guidelines 3/2011 applicable to management companies.<sup>9</sup> Obligations concerning AIFMs are provided in Commission Delegated Regulation (231/2013, hereinafter the “AIFMR”).<sup>10</sup>

Summary of investment funds’ disclosure requirements under the SFDR.

	SFDR Article 6	SFDR Article 8	SFDR Article 9
<b>Target group</b>	All investment funds and AIFs	Funds promoting environmental or social characteristics	Funds with sustainable investment as an objective
<b>Obligations</b>	To report the manner in which sustainability risks are taken into account in investment decision and impacts that sustainability risks are likely to have on the return of the fund If sustainability risks are not significant, the reasons must be stated	To provide, e.g. a description of E/S characteristics promoted, investment strategy, asset allocation and whether a sustainability-related index is designated as benchmark	To provide e.g. a description of sustainable investment objective, compliance with the no significant harm principle, investment strategy, methodologies and sustainability indicators to attain the target, proportion of Taxonomy-aligned investments, any benchmark and its consistency with the objective of the fund.
<b>Manner of disclosure</b>	Fund prospectus or material and sufficient information under chapter 12, section 4 of the AIFM Act	Fund prospectus or material and sufficient information must include a disclosure template under RTS (EU) 2022/1288 Annex II	Fund prospectus or material and sufficient information must include a disclosure template under RTS (EU) 2022/1288 Annex III
<b>Other considerations</b>	Mandatory statement under Article 7 of the Taxonomy Regulation  SFDR Article 7 on the consideration of principal adverse impacts (PAI) at fund level	Statement under Article 6 of the Taxonomy Regulation (and where necessary, disclosure requirements of Article 5 on sustainable investments) and SFDR Article 7 on the consideration of principal adverse impacts (PAI) at fund level – <i>included in the RTS disclosure template</i>	Disclosure requirements under Article 5 of the Taxonomy Regulation and SFDR Article 7 on the consideration of principal adverse impacts (PAI) at fund level – <i>included in the RTS disclosure template</i>
<b>Periodic reports</b>		As regards UCITS management companies, in annual report under chapter 15, section 7 of the Mutual Funds Act; financial statement and board of director’s report under chapter 11, section 1 of the AIFM Act, must include disclosures on promoting environmental and social characteristics (SFDR Article 11 and RTS Annex IV disclosure template)	As regards UCITS management companies, in annual report under chapter 15, section 7 of the Mutual Funds Act; financial statement and board of director’s report under chapter 11, section 1 of the AIFM Act, must include disclosures on sustainable investments (SFDR Article 11 and RTS Annex V disclosure template)
<b>Website</b>		Disclosures on environmental and social characteristics required in SFDR Article 10 (RTS Article 24–36)	Disclosures on sustainable investments required in SFDR Article 10 (RTS Article 37–49)

Chart 1. Summary of investment funds’ disclosure requirements under the SFDR.

## 1.5 Overview of funds’ sustainability information

The chart below illustrates disclosures by Finnish investment funds under the SFDR. The chart also indicates differences between the SFDR disclosures on different fund types, i.e. UCITS, non-UCITS and other alternative investment funds. The data is based on an annual survey carried out by the FIN-FSA in 2023, supplemented by information received in connection with fund applications.

<sup>9</sup> Regulations and guidelines (3/2011 Organisation of investment fund activities and code of conduct (in Finnish)).

<sup>10</sup> Commission Delegated Regulation (EU) N:o 231/2013 supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to exemptions, general operating conditions, depositories, leverage, transparency and supervision (AIFMR).

**SFDR disclosure obligations of funds in December 2023**

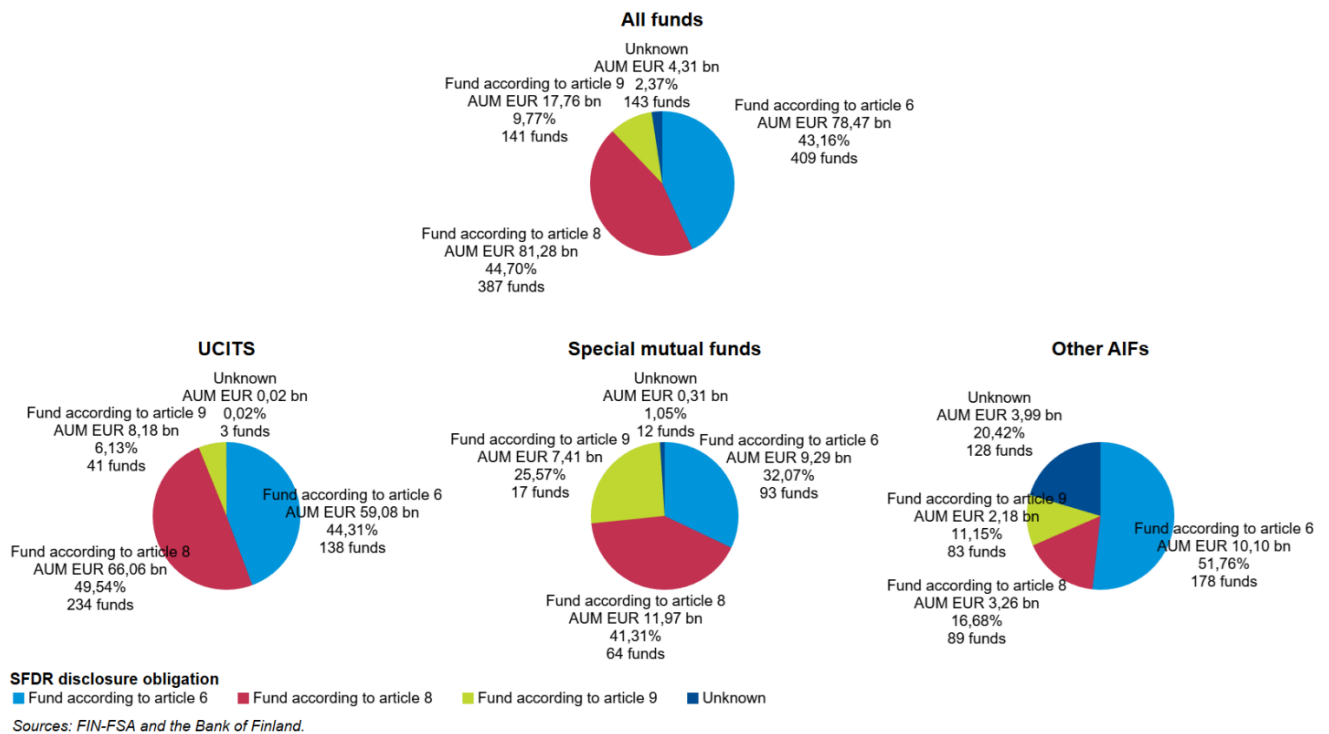


Chart 2. Investment funds' SFDR disclosure obligations in December 2023

## 2 Definition of greenwashing

The European Supervisory Authorities (ESAs), i.e. the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA) have published progress reports on the prevention of greenwashing in the financial markets. In these reports, the ESAs present, among other things, a common high-level view of the definition of greenwashing. The ESAs define greenwashing as a practice where sustainability-related statements, declarations, actions, or communications do not clearly and fairly reflect the underlying sustainability profile of an entity, that is, a company, project, financial product or financial service. This practice may be misleading to consumers, investors, or other market participants.<sup>11</sup> EU regulation makes reference to greenwashing in certain contexts<sup>12</sup>, but greenwashing has not been defined in more detail at the level of regulation.

<sup>11</sup> ESMA Progress Report on Greenwashing (31.5.2023, ESMA30-1668416927-2498).

<sup>12</sup> For example, Recital 11 to the Taxonomy Regulation, Recital 16 to Commission Delegated Regulation (2022/1288) and Recitals 7–8 to Commission Delegated Regulation (EU) 2021/1253 amending Delegated Regulation (EU) 2017/565 as regards the integration of sustainability factors, risks and preferences into certain organisational requirements and operating conditions for investment firms. This list is not exhaustive.



The purpose of the progress report was to support a better understanding and assessment of greenwashing in order to identify which areas of the sustainable investment value chain (SIVC) are more exposed to greenwashing risks. The ESAs will publish a final report on greenwashing in May 2024. The FIN-FSA invites all market participants to familiarise themselves with these reports.

### 3 Consideration of greenwashing risk in the company's activities

#### 3.1 Criterion

Management companies and AIFMs shall consider sustainability risks in fulfilling their obligations related to the organisation of activities. The organisation of activities includes, among other things, decision-making procedures and an organisational structure, personal areas of responsibilities and assignment of duties, internal and external reporting and communication as well as the maintenance of adequate and orderly records of the business. Management companies and AIFMs shall implement the requirements of this provision proportionally to the nature, extent, focus areas, complexity and risk profile of their activities.<sup>13</sup>

Management companies and alternative investment fund managers shall have an appropriate and documented risk management policy enabling the identification of risks, to which investment UCITS and non-UCITS funds under their management are exposed. The risk management policy shall be implemented in the ordinary course of the business and updated on a regular basis. The risk management policy shall comprise such procedures as are necessary to enable the management company and the AIFM to assess for each fund it manages the exposure of that investment fund to market, liquidity, sustainability and counterparty risks, and the exposure of the fund to all other relevant risks, including operational risks, which may be material for each fund it manages.<sup>14</sup>

In accordance with Article 1(22) of the SFDR, sustainability risk means an environmental, social or governance event or condition that, if it occurs, could cause an actual or a potential material negative impact on the value of the investment.

#### 3.2 Findings

##### ***Definition of greenwashing risk***

The eight companies participating in the more extensive survey were asked how they define greenwashing risk. All eight companies responded greenwashing risk is related to incorrect or misleading information provided on investment funds. Information on funds may be exaggerated or funds may be marketed as more sustainable and environmentally-friendly than they actually are.

<sup>13</sup> Regulations and guidelines 3/2011, chapter 4.2, paragraphs 9–14, and AIFMR, Article 57.

<sup>14</sup> Regulation 3/2011, chapter 8.1, paragraphs 3–4 and AIFMR, Article 40.

Greenwashing may also take place by failing to disclose relevant information or to consider the customer's sustainability preferences in an adequate manner. Some of the respondents also stated that greenwashing may stem from the company's internal activities or the fact that the company does not in reality comply with the responsibility principles it has established. One of the companies highlighted the ambiguity of regulation, as a result of which the criteria for sustainable investment by a fund may not be met when the interpretation gets clarified.

### ***Consideration of greenwashing risk by the companies and management methods***

Based on the survey, all companies except two (24/26) consider greenwashing risk in their activities.

Two out of the eight companies participating in the more extensive survey mentioned they consider greenwashing risk at all levels within the group. One of these companies considers it through group-level risk management guidance, and the other through a marketing guideline and the company's values. One company also responded it assesses the quality of external providers' ESG data and tools on a regular basis and that it highlights greenwashing risk in regular training and communication provided to the investment team and also more extensively throughout the organisation.

The majority of the eight companies acknowledged greenwashing risk in the preparation of fund documents and marketing material, but only some of them had related internal guidance. As regards the companies' internal guidelines, two companies had considered greenwashing risk in the management guidelines on conflicts of interests and two companies in their marketing guidance. Three companies had not described greenwashing risk at all in their internal guidelines.

The majority of the companies (18/26) stated they apply some safeguards or actions to mitigate greenwashing risk. Six companies had no safeguards whatsoever in place, and two companies did not consider greenwashing risks in their activities.

The following table presents what kind of safeguards or mitigants against greenwashing risk the companies professed to apply.

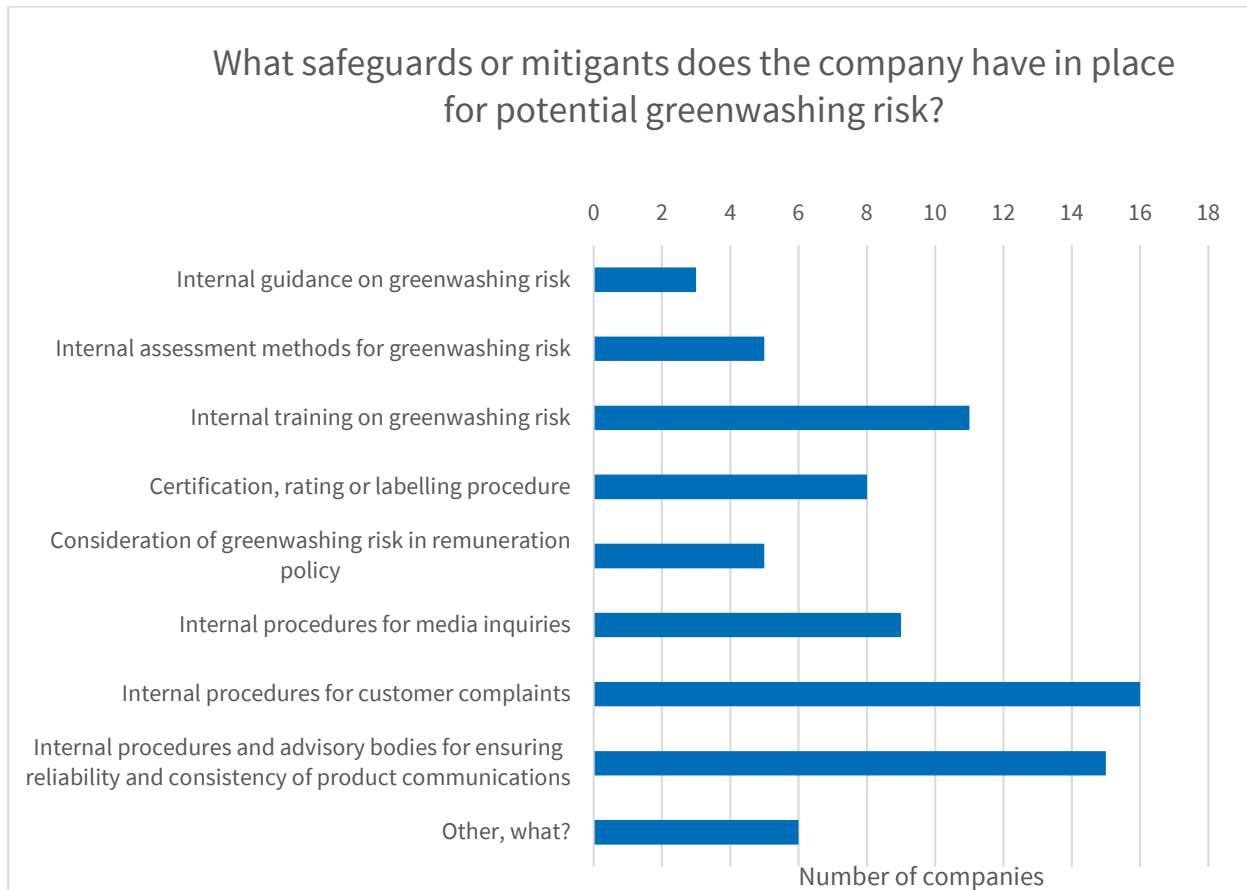


Chart 3. Safeguards and mitigants for greenwashing risk applied by the companies

Even if the majority of the companies professed to consider greenwashing risk in their activities, not all companies had defined the risk in their internal guidelines or risk assessment methodologies. Most of the safeguards were related to customer complaints processes and internal processes ensuring the reliability and consistency of information provided on the products. Not many of the companies had acknowledged greenwashing risk in their remuneration policy, although under Article 5 of the SFDR, companies must integrate sustainability risks therein.

### 3.3 FIN-FSA's view

Based on the findings, the companies do consider greenwashing risk, but in a rather limited way, which may reflect the lack of a clear definition of greenwashing risk in regulation. The SFDR provides a definition of sustainability risk, which must be considered in any investment fund activities. The FIN-FSA finds that greenwashing risk should not be assessed merely from the perspective of sustainability risk, but it should be assessed similarly to other material risks facing investment funds, including operational risks. According to the FIN-FSA, greenwashing risk may be, for example, a significant reputational risk or compliance risk affecting the company or a fund.



Companies must assess the nature of their activities more extensively and acknowledge that greenwashing risk may affect both the activities of the company and its products. The starting point for the acknowledgement is that the company has defined and assessed comprehensively any risks related to sustainability and greenwashing in its activities. It is not sufficient that the company only states it considers greenwashing risks in its activities and products if it lacks clear management and control procedures for these risks. The company must have adequate control systems and procedures to ensure that the risk is considered in accordance with the company's sustainability strategy and policies for investment decisions.

Corporate governance should have the objective that sustainability factors and risks are integrated prominently in the company's activities, internal principles and policies, and that they are managed through several different management methods. The starting point should be that greenwashing risks and related management methods are at least defined in the company's risk management principles along with other risks.

The FIN-FSA will assess the consideration of sustainability risks at a more detailed level in the second part of the thematic review.<sup>15</sup>

## 4 Conflicts of interests related to greenwashing risk

### 4.1 Criteria

Management companies and AIFMs must have policies and procedures to identify, avoid and manage conflicts of interest related to greenwashing risk. Greenwashing risks may arise, for example, when sustainability risks are being integrated into the processes, systems or internal control of the company.<sup>16</sup>

Policies concerning conflicts of interests must be made in writing and they must take into account the size of the company, the organisation of activities as well as the nature, extent and diversity of the business.<sup>17</sup>

### 4.2 Findings

The FIN-FSA assessed the companies' conflicts of interests policies only from the perspective of greenwashing risk. Almost two thirds of the supervised entities (16/26) did not consider conflicts of interests related to greenwashing risk in their policies and internal guidelines.

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<sup>15</sup> We will report separately on the findings on the questions in the second part of the thematic review.

<sup>16</sup> Regulations and guidelines 3/2011, chapter 4.9 and AIFMR, Article 30.

<sup>17</sup> Regulations and guidelines 3/2011, chapter 4.9 and AIFMR, Article 31.

The eight companies participating in the more extensive survey had also identified potential conflicts of interests in a poor manner. The companies (2/8) that had considered greenwashing risk in the first place in their guideline on conflicts of interests had identified these issues in the context of staff remuneration and personal transactions as well as investment strategies and misleading sales.

Actions indicated by the companies to detect conflicts of interest included requiring an opinion of ESG specialists in developing new products and consideration of the different roles of group companies, for example as a product developer and investment adviser.

#### 4.3 FIN-FSA's view

Companies must have procedures in place to identify conflicts of interests that may give rise to greenwashing. These may include conflicts of interests arising from remuneration or personal transactions of relevant staff, conflicts of interest that could give rise to greenwashing, mis-selling or misrepresentation of investment strategies and conflicts of interests between different funds managed by the same company.<sup>18</sup>

Companies must incorporate sustainability factors and related risks in their written policies concerning conflicts of interests. The policies must include procedures for identifying and preventing conflicts of interests as well as related control principles. The policies must be assessed on a regular basis and kept up to date.

The policies must include guidance on the actions required by an identified conflict of interests and how detected conflicts of interests are reported. In addition to guidelines concerning conflicts of interests in general, the company must have guidelines on identifying conflicts of interests related to greenwashing so that these can be identified and intervened in. As regards companies with outsourced portfolio management, the conflicts of interests policy must also include conflicts of interest related to the outsourced activity, identified from the perspective of greenwashing risk.

The FIN-FSA recommends that the board of directors of the supervised entity adopts the abovementioned policies governing the prevention and management of conflicts of interest.<sup>19</sup>

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<sup>18</sup> Commission Delegated Regulation (EU) 2021/1255 amending Delegated Regulation (EU) No 231/2013 as regards the sustainability risks and sustainability factors to be taken into account by Alternative Investment Fund Managers, preamble (5), and Commission Delegated Directive (EU) 2021/1270 amending Directive 2010/43/EU as regards the sustainability risks and sustainability factors to be taken into account for Undertakings for Collective Investment in Transferable Securities (UCITS), preamble (5).

<sup>19</sup> FIN-FSA regulations and guidelines 3/2011, chapter 4.9

## 5 Use of various ESG credentials in providing information on funds

### 5.1 Criteria

Financial market participants and financial advisers shall provide the information required by the SFDR free of charge and in a manner that is easily accessible, non-discriminatory, prominent, simple, concise, comprehensible, fair, clear and not misleading. Financial market participants and financial advisers shall present and lay out the information required by this Regulation in a way that is easy to read, use characters of readable size and use a style that facilitates its understanding.<sup>20</sup>

Financial market participants and financial advisers shall ensure that their marketing communications do not contradict the information disclosed pursuant to the SFDR.<sup>21</sup>

### 5.2 Findings

The majority of the companies (21/26) use various ESG credentials in providing information on their funds or in the marketing of the funds. In this context, ESG credentials refer to various labels, awards, ratings or certifications. Five companies stated they do not use separate ESG credentials, and three of these companies do not have funds under Articles 8 or 9 of the SFDR at all.

The table illustrates the ESG credentials the companies reported using. The use of ESG ratings was the most popular by a wide margin, but ESG labels and certifications were also used.

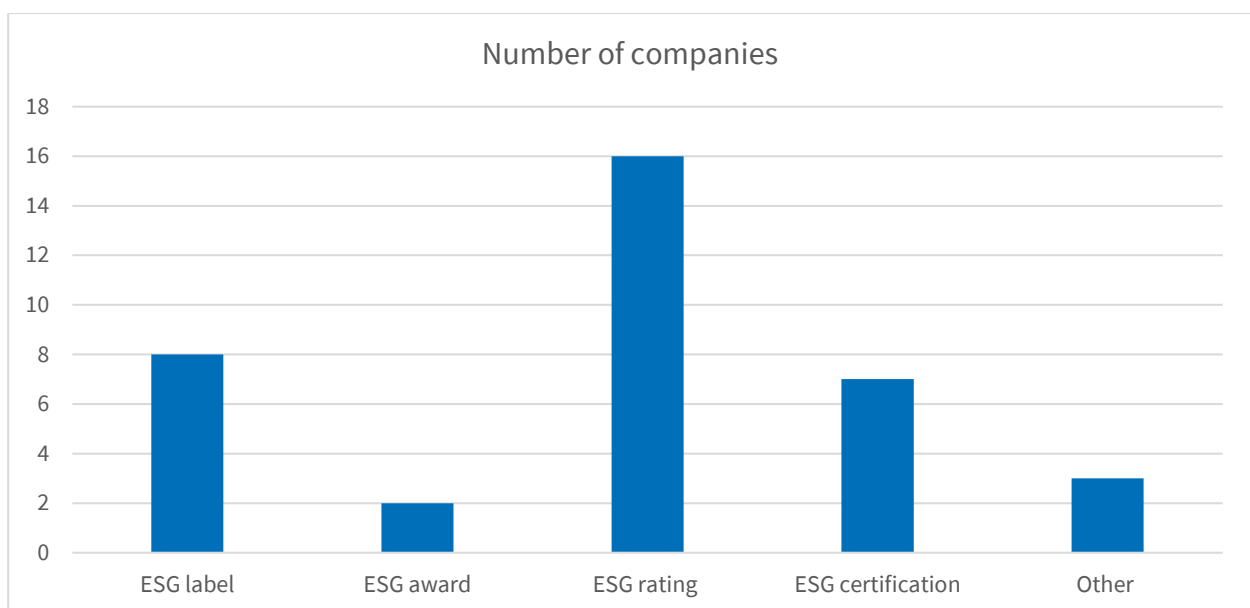


Chart 5. ESG credentials used by the companies

<sup>20</sup> Commission SFDR Delegated Regulation, Article 2(1).

<sup>21</sup> SFDR, Article 13(1).

The companies stated they use, for example, sustainability ratings assigned by MSCI and Morningstar, GRESB ratings or other certifications related to the environment, real estate or forests (such as FSC, PEFC, BREEAM, LEED). Some of the nine companies using MSCI ratings or grades had a more extensive or detailed report, while some only reported the MSCI rating as an isolated piece of information as part of other fund information (e.g. in a monthly fund report). Two companies also used Morningstar sustainability ratings in addition to MSCI ratings. As examples of ESG labels, the Nordic Swan Ecolabel (Joutsenmerkki) and Austrian Ecolabel were mentioned in the responses. A few companies also considered disclosures under Article 8 or 9 of the SFDR as an ESG label.

A good half (12/21) of the companies using ESG labels use these labels across their whole range of funds, also including those that do not have the promotion of sustainability characteristics or sustainable investment as their objective.

### 5.3 FIN-FSA's view

The SFDR as such does not define acceptable ESG credentials. The FIN-FSA finds that companies may use ESG credentials for their funds or provide more information on the sustainability of an investment fund's investments than required by regulation, insofar as they provide a true and fair view of the fund and the additional information does not mislead the investor. The companies must ensure that additional information on sustainability does not contradict with the disclosures under the SFDR.

The use of various ESG credentials or ESG awards in providing information on a fund or in the marketing of funds may be misleading if their actual significance is overstated or too much weight is assigned to them without an actual link with the fund being marketed.<sup>22</sup> Another misleading practice consists of reference to a fund's Article 8 or 9 SFDR classification as an earned ESG label and overemphasising what it actually means, because the classification alone is not sufficient to assess the degree of sustainability of a fund's investments.<sup>23</sup> Hence, companies should consider the use of ESG credentials and their appropriateness relative to the fund's investment strategy and objectives. Firstly, the information may not contradict with the information disclosed under the SFDR, and secondly, companies might also consider stating the criteria underlying the credentials in the SFDR documentation, if the company is committed to complying with them. This would improve the investors' possibility to assess the significance of the ESG credentials themselves.

The FIN-FSA finds that the presentation of ESG credentials in connection with funds other than those under SFDR Articles 8 and 9 may be misleading if it may lead the investors to perceive they are purchasing a so-called greener product than intended by the fund's investment strategy. If a company provides extensive ESG information on a fund where information under the SFDR is required, the company must assess the purpose of the ESG credentials and ESG information cited relative to the fund's investment strategy.

<sup>22</sup> ESMA Progress Report on Greenwashing (31 May 2023, ESMA30-1668416927-2498), paragraph 41.

<sup>23</sup> ESMA Progress Report on Greenwashing (31 May 2023, ESMA30-1668416927-2498), paragraph 104.

## 6 Website information on data sources, data quality control and limitations to the data

### 6.1 Criteria

Financial market participants shall recount, on a product-specific basis, in the website section “Data sources and processing” all of the following considerations: (a) data sources used to attain each of the environmental or social characteristics promoted by the financial product; (b) measures taken to ensure data quality; (c) how data are processed; (d) the proportion of data that are estimated.<sup>24</sup>

Furthermore, in the website section “Limitations to methodologies and data” financial market participants shall describe all of the following: (a) any limitations to the methodologies referred to in Article 24, point (g), and to the data sources referred to in Article 24, point (h); (b) how such limitations do not affect how the environmental or social characteristics promoted by the financial product are met.<sup>25</sup>

Chapter 4.11 of FIN-FSA regulations and guidelines 3/2011 provides that such analyses and estimates prepared by management companies that are used to make investment decisions shall only be made based on data which is both quantitatively and qualitatively reliable and up to date.<sup>26</sup>

AIFMs shall ensure that they have adequate knowledge and understanding of the assets in which the AIF is invested. AIFMs shall establish, implement and apply written policies and procedures on due diligence and implement effective arrangements for ensuring that investment decisions on behalf of the AIFs are carried out in compliance with the objectives, the investment strategy and, where applicable, the risk limits of the AIF.<sup>27</sup>

### 6.2 Findings

The findings are based on the responses given by the eight companies participating in the more extensive survey.

#### ***Findings on information provided on the website about quality control for the data and data sources***

One of the companies has not provided the fund-specific information required by regulation on its website.

Two companies failed to provide, in the fund-specific information on the website, which external data sources are used in connection with the analysis of ESG data.

<sup>24</sup> Commission SFDR Delegated Regulation 2022/1288, Articles 32 and 45.

<sup>25</sup> Commission SFDR Delegated Regulation 2022/1288, Articles 33 and 46.

<sup>26</sup> FIN-FSA regulations and guidelines 3/2011, paragraphs 73–74

<sup>27</sup> AIFMR, Article 18(2) and (3).



Two companies failed to describe the actions taken by them to ensure data quality. Some of the companies had described these actions at a very general level and briefly. Information provided by a few companies on their website under “How data are processed” was at a very general and inaccurate level, for example just that the data is treated carefully or transparently. None of the eight companies provided on the website the exact proportion of data that are estimated .

***Findings on how the consistency of the ESG indicators and data with the fund’s strategy, sustainability indicators and commitments is ensured***

The companies were requested to describe how is consistency ensured between: (a). sustainable characteristics/objectives; (b) indicators to measure the level of attainment of such characteristics/objectives; and (c) the binding elements of investment strategy. The level of detail of the companies’ responses varied greatly. A few of the companies responded that ESG data concerning the investments is analysed and monitored relative to established targets, indicators and commitments under the investment strategy regarding exclusion criteria and PAI indicators. According to four companies’ responses, monitoring is conducted both before and during investing. A few companies had set automatic limits in their systems, for example concerning companies that are uninvestable due to the exclusion criteria. One company had set clear threshold for several monitoring indicators and had, for example, analysed ESG data and used it to grade companies based on a pre-determined scale and set a minimum ESG rating for SFDR Article 8 funds.

***Findings on information provided on the website about limitations on the data and data sources***

As regards limitations on methodologies and data sources, one of the companies had not clearly identified any limitations in the description on the website. Furthermore, the description did not indicate how the company ensures that these limitations do not affect how the environmental or social characteristics promoted by the fund are met. Several other companies had also described their actions to deal with these limitations at such a general level, that the description alone was insufficient to ascertain that the limitations do not affect how the characteristics promoted by the fund are met.

In the more extensive survey, the companies were requested to describe the controls they have in place to ensure that the characteristics promoted by the fund are met. Some of the companies described these measures in more detail than in the disclosures provided on the website. The controls mentioned in the companies’ responses included cross-checking of data from different sources and the supplementation of incomplete data by other methodologies and data sources. In addition to data available directly on the assets, external service providers’ data sources are also used. A few companies highlighted in their response a due diligence review of external service providers concerning data quality, coverage, methodology and reliability. One company also requires that external service providers undertake to comply with policies specified by the company.

### **6.3 FIN-FSA’s view**

Website disclosures regarding data sources as well as their quality control and limitations are fund-specific information. The description of the information must reflect each fund’s investment policy and

nature, which may affect the use of the data sources related quality controls, limitations of the data sources and their impacts.

Regulation requires that information on an external data source is disclosed transparently in connection with fund-specific information in the website section “Sustainability-related disclosures” under “Data sources and processing”.

The company must have a process to assess the quantitative and qualitative reliability as well as up-to-datedness of available data. Ensuring each of these requirements may require the use of more than one control method. The company’s website must include a description of how the quality of data sources is tested and assessed. The description must state concrete actions to assess the quality of the data sources.

Good practices concerning concrete actions to ensure data quality include a cross-checking of data from different service providers, comparison of external data to expected levels and reasonability tests to check the operability of the data and results. Furthermore, if manual revisions are made to the data obtained, it is advisable to apply the four-eyes principle and divide the responsibilities to an adequate number of personnel.

Regulation also requires a description on the website of how the data is processed. According to the FIN-FSA’s view, the description must be clear enough and provide a sufficiently detailed description of how the data is used internally and processed. In addition, companies must state the proportion of data that are estimated. According to the FIN-FSA’s view, it is advisable for the company to state what it means by estimated data, since this may vary depending on the data used by the company in the analysis of sustainability risks and characteristics.

The FIN-FSA also finds it important that the company is able to identify potential limitations related to the data sources or methodologies used to measure how the environmental or social characteristics or objective promoted by the fund are met. If limitations are identified, the company must have a process to ensure that such limitations do not hinder the characteristics or objectives promoted by the fund. Any limitations concerning methodologies and data sources must also be described to the investors in a clear and understandable manner.

Greenwashing may also take place through the failure to disclose material information to investor in relation to underlying ESG data used and ESG metrics. The lack of clearly outlined data limitations and/or disclaimers in documentation on underlying methodologies pose a risk to investor protection and deter comparisons across products and financial market participants.<sup>28</sup>

An investment fund that promotes sustainability characteristics or objectives must monitor indicators to ensure that this investment strategy materialises. The indicators rely on data from various sources, and ensuring the quality of the data and identifying its limitations is an important part of the process. Furthermore, to ensure that the data used, the indicators measured and the investment strategy of the fund are consistent, it is important for the company to also set thresholds for selected indicators. These indicators must be analysed and monitored on a continuous basis during and before an investment.

<sup>28</sup> ESMA Progress Report on Greenwashing (31 May 2023, ESMA30-1668416927-2498), paragraph 52.

According to the FIN-FSA's view, the abovementioned information must also be described in the company's risk management policy.

## 7 Investment funds' net zero and carbon neutrality objectives

### 7.1 Criteria

Where a financial product has a reduction in carbon emissions as its objective, the pre-contractual disclosures must include a detailed explanation of the targeted low level of carbon emissions in view of achieving the long-term global warming objectives of the Paris Agreement<sup>29</sup>. Where no EU Climate Transition Benchmark or EU Paris-aligned Benchmark in accordance with Regulation (EU) 2016/1011 of the European Parliament and of the Council<sup>30</sup> is available, the pre-contractual disclosures shall include a detailed explanation of how the continued effort of attaining the objective of reducing carbon emissions is ensured in view of achieving the long-term global warming objectives of the Paris Agreement.<sup>31</sup>

The transition to a low-carbon, more sustainable, resource-efficient and circular economy in line with the Sustainable Development Goals is key to ensuring the long-term competitiveness of the economy of the EU. The Paris Agreement adopted under the United Nations Framework Convention on Climate Change (hereinafter "the Paris Agreement") seeks to prevent climate change by, among others means, by ensuring that finance flows support sustainable development that generates as little greenhouse gas emissions as possible and support climate-resilient development. The Paris Agreement entered into force on 4 November 2016.<sup>32</sup>

The website must provide, for financial products that have a reduction in carbon emissions as their objective, a statement that the reference benchmark qualifies as an EU Climate Transition Benchmark or an EU Paris-aligned Benchmark as defined in Article 3, points (23a) and (23b), of Regulation (EU) 2016/1011, and a hyperlink to where the methodology used for the calculation of those benchmarks can be found.<sup>33</sup>

If no EU benchmark on climate transition or EU benchmark under the Paris Agreement is available, this must be stated on the company's website, under section "Attainment of the sustainable investment objective". Furthermore, an explanation must be provided of the continued efforts to attain the objective of reducing carbon emissions in view of achieving the objectives of the Paris Agreement.

<sup>29</sup> Council Decision (EU) 2016/1841 of 5 October 2016 on the conclusion, on behalf of the European Union, of the Paris Agreement adopted under the United Nations Framework Convention on Climate Change (OJ L 282, 19.10.2016, p. 1).

<sup>30</sup> Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014 More detailed information on benchmarks is provided in Article 9(3) of Commission Delegated Regulation (EU) 2020/1818 supplementing Regulation (EU) 2016/1011 of the European Parliament and of the Council as regards minimum standards for EU Climate Transition Benchmarks and EU Paris-aligned Benchmarks.

<sup>31</sup> SFDR, Article 9(3).

<sup>32</sup> Preamble (2) to the SFDR.

<sup>33</sup> Commission SFDR Delegated Regulation 2022/1288, Article 49(1)(b).

Financial market participants shall explain the extent to which the financial product complies with the methodological requirements set out in Delegated Regulation (EU) 2020/1818<sup>34, 35</sup>.

Periodic reports must provide, for financial products referred to in Article 9(3) of Regulation (EU) 2019/2088, information on how the objective of a reduction in carbon emissions was aligned with the Paris Agreement, containing a description of the contribution of the financial product during the period covered by the periodic report to achieve the objectives of the Paris Agreement, including in respect of an EU Climate Transition Benchmark or EU Paris-aligned Benchmark, the ESG factors and criteria considered by the benchmark administrator in accordance with Delegated Regulation (EU) 2020/1818.<sup>36</sup>

## 7.2 Findings

Four companies (4/26) responded that the company has funds declaring a net zero or carbon neutrality objective. One of these companies responded to the question with respect to an SFDR Article 8-compliant fund managed by it, promoting the reduction of carbon emissions as an environmental characteristic. Three companies responded with respect to an SFDR Article 9-compliant fund with the objective of reducing carbon emissions.

One of these three companies responded that a fund has a carbon neutrality target but it does not benchmark the target to the achievement of the objectives of the Paris Agreement.

Where a company responded that a fund managed by it declares net zero or carbon neutrality objectives, the company was asked whether the information in the table below are presented with reference to the fund's net zero or carbon neutrality objective. The table presents the information based on the responses of the three companies with a fund compliant with Article 9 of the SFDR. In addition, the table includes findings on one company participating in the extensive survey which responded that it does not have funds declaring net zero or carbon neutrality objectives, but which does, according to the FIN-FSA's view, have a fund under Article 9(3) of the SFDR.

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<sup>34</sup> Commission Delegated Regulation (EU) 2020/1818 supplementing Regulation (EU) 2016/1011 of the European Parliament and of the Council as regards minimum standards for EU Climate Transition Benchmarks and EU Paris-aligned Benchmarks.

<sup>35</sup> Commission SFDR Delegated Regulation 2022/1288, Article 49(3).

<sup>36</sup> Commission SFDR Delegated Regulation 2022/1288, Article 59(1)(c).

Information regarding net zero or carbon neutrality claims	Companies that have answered that they have disclosed the information (in annexes III and V of EU 2022/1288)
Asset coverage/ time horizon of such claims including intermediate targets	3/4
Transparency about (and any limitations to) methodology used to measure the emissions associated to the underlying portfolio (for both the baseline and for monitoring progress)	4/4
Actions planned to achieve the net-zero targets (capital reallocation, shareholder engagement and dialogue with investee company, other)	4/4
Potential obstacles (non-responsiveness of investees) and associated mitigants	2/4
Reference points used to forecast the emission associated to the underlying portfolio	1/4

Chart 6. Information provided on funds with respect to the attainment of a net zero or carbon neutrality target

Two companies provided the information required by regulation, as described in section 7.1 Criteria, in the periodic reports and three companies did so on the website. One of the companies had not yet published a periodic report on its fund.

### 7.3 FIN-FSA's view

Regulation requires that if a fund has sustainable investments and a reduction of carbon emissions as its objective, it must provide a detailed explanation of the targeted low level of carbon emissions in view of achieving the long-term global warming objectives of the Paris Agreement. This information must be provided in the pre-contractual information, periodic review and on the website.

In accordance with the questions and answers published by the ESAs (hereinafter “the Q&A”), where a fund is passively tracking a benchmark under Article 9(3) of the SFDR, the company does not have to provide a detailed explanation of how the attainment of the objective of reducing carbon emissions is ensured in view of achieving the long-term global warming objectives of the Paris Agreement, as these products are deemed to have sustainable investments as defined in Article 2, point (17) SFDR as their objective.<sup>37</sup>

On the other hand, if the fund does not use a benchmark under Article 9(3), the information shall include a detailed explanation of how the attainment of the objective of reducing carbon emissions is ensured in view of achieving the objectives of the Paris Agreement.<sup>38</sup> Companies must explain why they consider their actively managed funds with carbon emission reduction objectives, which do not closely follow a benchmark under Article 9(3), to have the objective of sustainable investment.<sup>39</sup>

The FIN-FSA finds it good practice that the following details are provided on the fund's net zero or carbon neutrality objectives:

<sup>37</sup> Consolidated questions and answers (Q&A) on the SFDR (Regulation (EU) 2019/2088) and the SFDR Delegated Regulation (Commission Delegated Regulation (EU) 2022/1288) question V.9.

<sup>38</sup> SFDR, Article 9(3).

<sup>39</sup> Consolidated questions and answers (Q&A) on the SFDR (Regulation (EU) 2019/2088) and the SFDR Delegated Regulation (Commission Delegated Regulation (EU) 2022/1288) question V.9.



- coverage of the assets or time horizon and interim targets
- transparency about (and any limitations to) methodology used to measure the emissions associated to the underlying portfolio (for both the baseline and for monitoring progress)
- actions anticipated to achieve the net zero targets (capital reallocation, engagement and dialogue with investee companies)
- potential obstacles (non-responsiveness of investees) and associated mitigants
- reference points used to forecast the emission associated to the underlying portfolio

According to the Q&A published by the ESAs, a financial product under Article 8 of the SFDR may promote carbon emissions reduction as an environmental characteristic. However, the Q&A specifies that information provided in the disclosures may not mislead investors into thinking that this aspect is part of the product's objective and therefore that the product has sustainable investment as its objective as per Article 9(3).<sup>40</sup> Moreover, Article 13 of the SFDR requires that marketing communications do not contradict the content of disclosures made pursuant to the SFDR.

Regulation does not specify in more detail how net zero or carbon neutrality objectives should be used. However, the information given should be clear and not misleading. Fund managers may choose to consider the definitions presented in the European Sustainability Reporting Standards (ESRS), sections E1–7<sup>41</sup>. Net zero targets are defined so that they cover reductions in gross greenhouse gas emissions as well as GHG removals and storage (in the own operations of investees as well as across their value chain) but exclude carbon credits. Carbon neutrality claims are defined so that they cover both the abovementioned reductions and carbon credits.

An example of misleading claims relates to funds claiming to have a low-carbon strategy where in reality the funds' portfolios have high carbon emissions.<sup>42</sup> The lack of meaningful and clear thresholds, benchmarks or underlying assumptions related to the ESG metrics for the fund may also be greenwashing. An example would be computing the carbon footprint metric of an investment product or benchmark without Scope 3 emissions and comparing it to an aggregate peer value including Scope 3 for the majority of the peer group members.<sup>43</sup> Carbon emissions can be divided into Scope 1, Scope 2 and Scope 3 emissions. Scope 3 emissions comprise indirect emissions which are generated as a result of the company's activities but are not directly owned or controlled by the company, i.e. emissions generated in the value chain or procurement, such as the emissions of raw material purchases and emissions caused by travel and transport.

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<sup>40</sup> Consolidated questions and answers (Q&A) on the SFDR (Regulation (EU) 2019/2088) and the SFDR Delegated Regulation (Commission Delegated Regulation (EU) 2022/1288) question V.8.

<sup>41</sup> Commission Delegated Regulation (EU) 2023/2772 supplementing Directive 2013/34/EU of the European Parliament and of the Council as regards sustainability reporting standards.

<sup>42</sup> ESMA Progress Report on Greenwashing (31 May 2023, ESMA30-1668416927-2498), paragraph 96.

<sup>43</sup> ESMA Progress Report on Greenwashing (31 May 2023, ESMA30-1668416927-2498), paragraph 54.

## 8 Engagement policies

### 8.1 Criteria

In accordance with the Mutual Funds Act, a management company must have an engagement policy, which must be stated in the fund prospectus.<sup>44</sup> In accordance with the Act on Alternative Investment Fund Managers, an AIFM must prepare a policy for engagement with listed companies and publish it on its website.<sup>45</sup>

Financial market participants must prepare a statement on principal adverse impacts (hereinafter a “PAI statement”) and include in the PAI statement a summary of its engagement policy under Article 3g of Directive EU/2007/36 if the fund’s investments include shares listed on a regulated market.<sup>46</sup>

Engagement actions taken must be described on the company’s website in the context of sustainability-related fund-specific information<sup>47</sup> and in the templates included in periodic reports on financial products<sup>48</sup>.

### 8.2 Findings

A third of the companies (8/26) reported having no engagement policy for the attainment of the funds’ sustainability objectives. However, three of these companies (3/8) had funds under Article 8 of the SFDR. As engagement methods, the companies mentioned the use of voting rights in general meetings, discussions with investee company management and participation in joint investor engagement initiatives.

All eight companies participating in the extensive survey had an engagement policy to attain sustainability objectives. Engagement principles related to the funds’ sustainability objectives were, as a rule (7/8), mentioned in the funds’ investment strategy. Of the companies that had said policy in place, only one stated that engagement is not mentioned in the sustainability strategy of the funds.

Three companies (3/8) reported that the funds’ engagement policy is the same as the company-level policy. In other companies, the funds’ engagement policy differed for example by varying focus on different engagement methods on a fund-specific basis.

Three of the companies participating in the extensive survey described the engagement policy related to sustainability objectives in the PAI statement as required by regulation. The other companies’ PAI statements lacked part of the information, such as a mention of indicators of adverse sustainability impacts considered in the engagement policy and an indication of how the engagement policy is

<sup>44</sup> Mutual Funds Act (213/2019), chapter 10, section 8 and 9.

<sup>45</sup> Act on Alternative Investment Fund Managers (162/2014), chapter 7, section 6a.

<sup>46</sup> SFDR, Article 4(2)(c) and Commission SFDR Delegated Regulation, 2022/1288, Article 8c.

<sup>47</sup> Commission SFDR Delegated Regulation 2022/1288, Articles 35 and 48.

<sup>48</sup> Commission SFDR Delegated Regulation 2022/1288, Annexes IV and V.

updated or a summary of other engagement principles. One of the companies does not consider principal adverse impacts and therefore has not published information under the PAI statement.

One company published information on the engagement actions taken and their impacts in periodic reports as required by regulation. Four companies reported on engagement actions at a general level. Three of them did not provide more detailed fund-specific information on voting behaviour. Some of the companies did not report on engagement actions at all in the templates included in periodic reports.

None of the companies reported on engagement actions in the fund-specific descriptions on the website in a manner required by regulation.

### 8.3 FIN-FSA's view

The SFDR requires the provision of more detailed fund-specific information than before in disclosures under the SFDR. The SFDR requires that companies disclose their engagement policies related to the funds' sustainability objectives in PAI statements, fund-specific periodic reports and their website.

The PAI statements must provide a summary of actions used by the companies in order to have an influence on the activities of companies owned by their funds. The summary must provide information on any voting policies observed in general company meetings. In addition, the companies must indicate in the summary the main PAI indicators considered in the engagement policy and information on how the company will act if the chosen engagement methods do not work as planned. The summary must also cover other potential engagement methods than those based on shareholdings.

When engagement is part of the investment strategy, this must be communicated clearly to the investors. If engagement is part of the fund's investment strategy related to sustainability objectives, the fund's engagement objectives, methods and indicators must be described more concretely also at the fund level in the pre-contractual disclosures. This can be indicated for example in the section "What investment strategy does this financial product follow?".

The fund-specific periodic reports must recount the engagement actions and impacts concerning the fund in the same context describing actions taken during the reporting period to attain the fund's objectives. In addition, the fund-specific sustainability-related information on the website must report how any engagement actions taken have materialised in relation to the information provided in the PAI statement and pre-contractual disclosures, for example in terms of the impact on voting behaviour. Fund-specific voting behaviour can also be reported on in more detail in a separate document, to which a functional direct link is given.

According to the ESMA report, both entity-level and product-level engagement claims are seen as particularly exposed to greenwashing risk. The variety of approaches and level of detail in information provided on engagement may lead to a lack of comparability of the quality of the engagement across funds and fund managers. The reduction of greenwashing risks is contingent on the provision of clear



and consistent information about how the fund seeks to engage with its investee companies and the forms in which the engagement has taken place in practice.<sup>49</sup>

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<sup>49</sup> ESMA Progress Report on Greenwashing (31.5.2023, ESMA30-1668416927-2498) paragraphs 40, 100, 110