The Impact of the EU Taxonomy

A Qualitative Study Exploring the Impact of the EU Taxonomy on Actively Managed Sustainable Funds in the Swedish Market

GUSTAV INGRE
CARL VICTOR PASSBURG
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Gustav Ingre
Carl Victor Passburg
Effekterna av EU Taxonomin

En Kvalitativ Studie som Undersöker Effekterna av EU Taxonomin på Aktivt Förvaltade Hållbara Fonder i den Svenska Marknaden

av

Gustav Ingre
Carl Victor Passburg
Abstract

The European Union (EU) is attempting to steer capital towards environmentally friendly investments by implementing a new classification system for sustainable investments, the EU Taxonomy. However, the classification system may be ineffective in countries such as Sweden where similar systems already exist. This thesis attempts to understand the effects of the EU system in Sweden by investigating how the investment strategies of actively managed sustainable funds in the Swedish markets are affected. First, the EU Taxonomy was compared to a selection of existing systems for sustainable investments commonly used by sustainable funds in the Swedish markets. The comparison was conducted with respect to six aspects: environmental, social, governance, general, ethical and design. Second, fourteen semi-structured interviews were conducted with employees from various fund companies that manage the targeted funds. The comparison showed that the EU Taxonomy differs greatly from the existing systems. The most significant dissimilarities are that (1) the EU Taxonomy is more extensive in the environmental aspect and that (2) the EU system requires the fund companies to conduct more voluminous compliance work. The interview results displayed that (1) the fund companies are generally positive towards the implementation of the EU Taxonomy, (2) they might struggle to conduct the compliance work and (3) the demand from the funds’ investors will be a crucial factor for the success of the classification system. The authors concluded that the new classification system has a substantial potential of being effective among actively managed sustainable funds in the Swedish markets. Yet, it is highly dependent on the demand from the funds' investors and on third-party data providers that can facilitate the compliance work. The expected effects are naturally that the funds adjust their investment strategies in line with six environmental objectives defined in the EU Taxonomy.

Key-words: EU Taxonomy, ESG, Sustainable investments, Sustainable funds
Sammanfattning


Nyckelord: EU Taxonomi, ESG, Hållbara investeringar, Hållbara fonder
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Carl Victor Passburg
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1 Introduction

The 2030 Agenda for Sustainable Development and the Paris Agreement are two global multi-stakeholder initiatives that help tackle global sustainability issues. They are two essential drivers for the interest in environmental, social, and governance issues (ESG issues). The 2030 Agenda for Sustainable Development defines seventeen global goals that cover all three dimensions of sustainability while the Paris Agreement focuses on the environmental dimension. However, these goals require substantial enhancement or over-delivery by additional national, sub-national, and non-state actions to maintain a decent chance of being achieved (Rogelj et al., 2016). It is clear that current investments of public capital are not sufficient to support an environmentally sustainable system, and that private capital must be steered towards sustainable investments. According to the Intergovernmental Panel on Climate Change (IPCC), the world needs to invest approximately $1,100 B annually in renewable energy to comply with the Paris Agreement (Rogelj, Shindell, & Jiang, 2018). That is three to four times more investments into the global renewable energy sector as were made in 2018 (IEA, 2019). Further, $14,075 B was invested in sustainable assets in Europe in 2018, which represented 48.8% of Europe’s total managed assets. This sheds light on the large amount of capital that can be reallocated towards sustainable alternatives contributing to the goals of the Paris Agreement and the Agenda 2030.

A major global industry that can aid the steering of private capital towards sustainable investments is the financial sector. The European Commission has recognized the need for sustainability improvements in the financial sector and decided to publish an action plan for sustainable finance. The main objectives with this action plan are (1) to reorient capital flow towards sustainable investments, (2) manage financial risks stemming from climate change and social issues and also (3) to foster transparency and long-termism in financial and economic activities (European Commission, 2019a). The action plan consists of several actions, including the development of a unified European Union (EU) classification system (‘Taxonomy’) that sets standards and labels for green financial products and strengthens sustainability disclosures and reporting.

Eighteen of the twenty most sustainable countries in the world are located in Europe (SolAbility, 2019), which is the targeted group of the EU’s action plan for sustainable finance. Hence, the EU Taxonomy may quickly become a standard and further increase the sustainable efforts towards the United Nation’s (UN) Sustainable Development Goals (SDGs) and the Paris Agreement within this
region. On the other hand, these countries have achieved top sustainability ratings since they already have well-working sustainability systems in place, which may imply that these markets are challenging to break into. As a result, it might be a difficult task to introduce the new EU Taxonomy and have the market adapt to it.

1.1 Problem Statement

Many countries in Europe already have established systems for sustainable investments that are integrated into their financial markets. The systems differ in various degree from each other, but the common purpose is to allocate capital and interest to sustainable investments and to help investors identify these alternatives. They are often designed as certifications, frameworks or ratings that assess sustainability efforts and performance. In some financial markets, such as the Swedish market, the systems are well-integrated and trusted by the financial society. Sweden’s financial sector is one of the front-runners within sustainability (SSFC, 2019). For example, its financial institutions were among the first to be active in the green bond market and Sweden was the sixth largest issuer of such bonds in 2018 (Handelsbanken, 2018). Sweden also has several development agencies, such as SIDA, that are exploring public-private partnerships within sustainable investments and have strong research programs within this area (e.g. VINNOVA) (SSFC, 2019). Moreover, Sweden has integrated multiple systems for sustainable investments including frameworks, ratings and certifications such as Hållbarhetsprofilen, Morningstar’s Sustainability Rating and the Nordic Swan Ecolabel.

The presence of well-integrated systems for sustainable investments in the markets creates uncertainties regarding the effects of the forthcoming EU Taxonomy. The magnitude of the effects is questionable in markets such as Sweden, where similar systems already are well-established. However, investors have indicated that there is a large discrepancy in quality between sustainability systems in general (Schneeweß, 2014) and it is still uncertain how they relate to the EU Taxonomy. Similarly, Dorfleitner, Halbritter, and Nguyen (2015) have identified that there is small convergence between the sustainability systems, causing confusion and mistrust for these systems from an investor’s perspective. The lack of convergence and quality of these systems may potentially allow a faster integration and acceptance of the EU Taxonomy. For that reason, the systems for sustainable investments in Sweden are yet to be compared with the EU Taxonomy. If the existing systems and the EU classification system are relatable and show many similarities, the EU system might be redundant and thus ineffective in the market. On the other hand, if EU Taxonomy differs greatly
from Sweden’s current systems, it may prove to be highly effective.

1.2 Purpose

This thesis narrows down the problem by focusing on the EU Taxonomy’s effects on funds only. More specifically, the focus will lie on actively managed sustainable funds in Sweden, since such funds already utilize well-established systems for sustainable investments. One way of understanding the effects of the EU Taxonomy on funds is to investigate how the investment decisions will be affected. Thus, the purpose of this thesis is to understand how the investment strategies of Swedish actively managed sustainable funds will be affected by the EU Taxonomy. The authors will compare the EU classification system with existing systems for sustainable investments in Sweden and gather qualitative data from interviews with fund companies to attain this purpose.

1.3 Research Question

This thesis will attempt to answer the following research question:

“How will the EU Taxonomy affect the investment strategies of actively managed sustainable funds in the Swedish markets?”

The research question is constructed in a manner that fulfills the purpose of the thesis. Three specific areas of the research question are further clarified: why the question focuses on funds in the Swedish markets, why they have to be actively managed and how sustainable funds are defined in this thesis.

An issue identified with the launch of the EU Taxonomy is to what extent it will integrate into financial markets in Europe. Investors in many European countries already invest in a sustainable manner and have well-established systems in place, which consequently may hinder the EU Taxonomy from getting foothold in such markets. Sweden is a good example of such a market, where systems such as Hållbarhetsprofilen and the Nordic Swan Ecolabel are popular among the funds and their investors. These systems tend to cover similar areas as the EU Taxonomy, which ultimately makes the Swedish market interesting to investigate in this context.

Actively managed funds were chosen since the managers have the power to adjust the investment
strategy to fit the EU Taxonomy. Passively managed funds are outside of the scope since they follow an index and can by definition not change the investment strategy to fit the EU Taxonomy. Specific EU Taxonomy indices can potentially emerge with time and thus enable passive funds to follow them, but that is not included in the scope of this thesis.

In this thesis, all funds that consider sustainable aspects in their investments are considered to be sustainable funds. The funds are not required to have a thematic focus or invest specifically in sustainable solutions such as renewable energy or clean technologies. Sustainable funds are targeted since they are affected the most by the EU Taxonomy and already use systems for sustainable investments. Funds that do not consider sustainable aspects are less likely to adhere to the new EU Taxonomy.
2 Literature Review

This thesis conducts a literature review on the existing research in the field of sustainable investments and the effects of systems for sustainable investments (i.e. certificates, frameworks and ratings). Systems for sustainable investments refer to both existing systems available today and the forthcoming EU Taxonomy. The approach of this literature review is inspired by the work of Durach, Kembro, and Wieland (2017) that consists of structured steps to identify gaps in the existing literature and to deduce the originality of the research question. The goal of this literature review is to evaluate the state of knowledge in the particular topic of sustainable investments and consequently deduce the originality of the research question. This goal is achieved by researching the field of sustainable investments and successively narrowing down to its subtopics. The literature review finishes by investigating the EU Taxonomy and deducing the originality of the research question.

2.1 Sustainable Investments

Sustainability is a growing topic that spills over to nearly all industries and actors. In recent years, the term has been increasingly acknowledged in the financial markets (Jeucken, 2005). This has created a research interest for the topics deriving from the merger of sustainability and finance, such as sustainable investments. Today, many investors desire that their investments have a higher purpose. The investments should reflect important values or counteract global issues, which is the core of value-based or sustainable investing (Landier & Nair, 2008). Schueth (2003) shares a similar view of this phenomena and refers to them as “feel-good” investors. He further divides investors with a sustainable approach into two groups: investors that invest in alignment with personal values and investors that invest in projects and firms that improve the quality of life and support the society.

Equally, or even more importantly, investors strive to acquire an attractive return. It is therefore of high interest for investors to understand how returns from sustainable investments compares to returns from regular investments. Over the last two decades, sustainable and value-based investing has gained much popularity (Capelle-Blancard & Monjon, 2012) and Friede, Busch, and Bassen (2015) state that they actually outperform regular investments in many cases. Several researchers support the claims of outperforming, while other researchers argue that such claims are not reliable. One underlying reason is that such research papers often consider a period of 10 years or less, though investors of sustainable funds generally invest over a longer time period (Talan & Sharma,
2019). Some researchers even argue that sustainable funds yield lower returns compared to that of conventional funds. An argument provided by RBC Global Asset Management (2012) that strengthens this view is that sustainable funds have smaller investment universes, which leaves these funds with less high-return investment options. It is evident that the beliefs are scattered in this field, and that there is a lack of research in many areas. Busch, Bauer, and Orlitzky (2015) shares the opinion that the time frame of current research papers is too short, and suggest that it needs to be a reorientation to a long-term paradigm for sustainable investments. Research supporting the claim that sustainable investments perform in line with non-sustainable investments in the long term is relatively scarce. This could potentially be one of the factors slowing down the growth and interest of sustainable investments. As suggested by Schueth (2003), information about equal returns is a major driver for sustainable investments and therefore the lack of evidence might refrain investors from making long-term sustainable investments.

The spread of topics covered under the umbrella of sustainable investments is extensive, although financial performance is the most covered area (Widyawati, 2019) (Talan & Sharma, 2019). Other frequently appearing topics are transparency, availability of ESG data and financial reporting. Questions regarding the financial performance of sustainability funds are certainly relevant, nonetheless, it is necessary to not only focus on one area. One can thus argue that there is a demand for more research on a conceptual and theoretical ground. In particular on the aspirations of sustainable investors, the relationship between regulation and sustainability, as well as on the assessment of ratings, certification, and frameworks.

2.2 Frameworks, Ratings and Certifications

In the last couple of decades, both transparency and availability of sustainability data has been limited. However, as our society is now entering a data era, the availability of data is becoming far greater. Third-party actors, institutes, and non-governmental organizations have capitalized on this opportunity by creating frameworks, certifications, and ratings that aid investors in deducing whether an investment is sustainable or not (Vogel, 2005). Examples of such systems include Morningstar’s Sustainability Rating, the Nordic Swan Ecolabel, and Hållbarhetsprofilen. These systems share a common purpose: to determine the sustainability level of investment products. In despite of that these systems share much ground, they are built on contrasting methods and criteria which separates them in practice. Potential investors find it difficult to keep track of the various funds and
investment products and to find reliable comparative information to guide their choices (Koellner, Weber, Fenchel, & Scholz, 2005). There is an evident lack in the convergence of ESG measurement concepts (Dorfleitner et al., 2015) and there are considerable differences in quality regarding sustainability ratings (Schneeweiß, 2014).

In the book Fiduciary Law and Responsible Investing (Richardson, 2013), Benjamin Richardson highlights the differences between prescriptive and discretionary approaches. A prescriptive approach is rule-based while the discretionary approach is more general and not as threshold-focused. Stringent standards and methods, as many of the prescriptive methods are built on, are shunned by many asset managers who instead favor discretionary methods such as self-reporting. Examples of self-reporting instruments include UN’s Principles for Responsible Investments and Hållbarhetsprofiler. Self-reporting instruments often lack independent monitoring, robust performance metrics and are not certifiable. Some of the more prescriptive methods include certifications and ratings where the sustainability performance is assessed by a third party.

Dorfleitner et al. (2015) argues that sustainability ratings are highly relevant to managers and investors comprising ESG issues into their decision-making process. The ratings serve to help investors to distinguish sustainable investments from regular investments (i.e. to conduct a reliable comparative assessment). Further, rating systems are also used on company level as a tool to improve firm reputation and to identify sustainability trends. Häßler (2013) states that firms commonly use rating systems to monitor the implementation of sustainability management measures, to promote the company through external communication and to attract key personnel.

Approximately 90% of companies believe that it is important to be awarded a positive sustainability rating or to be included in sustainability funds or indices (Häßler, 2013). Correspondingly, Chatterji and Toffel (2010) argues that firms with poor environmental performance and ratings can experience reduced employee morale, innovativeness, and willingness to participate in problem solving. Managers at these firms are more likely to suffer from public humiliation (Graham, 2020) and therefore become motivated to implement robust environmental managerial practices (Chatterji & Toffel, 2010). Chatterji & Toffel further claim that firms with poor environmental ratings are also perceived to be operating with a higher risk profile. These risks include not only risks in the daily operations, but also legal costs and erosion of relationships with regulators and local communities.
As stated by Richardson (2013), successful systems for sustainable investments are argued to have two important attributes: they are drafted through multi-stakeholder processes and embedded in institutional regimes for ongoing dialogue, education and monitoring. The EU Taxonomy, which is one of the EU’s actions within sustainable finance, includes both attributes and will be a new system to evaluate sustainability performance in firms.

2.3 The EU Taxonomy for Sustainable Investments

The literature on the EU Taxonomy is scarce, perhaps because it is in the middle of an iterative process and is only available as a draft report. The available and accessible literature discusses the difficulties to transition the financial sector in alignment with the Paris Agreement, that the EU system might reduce sustainable innovation and that larger firms may align better with the EU Taxonomy due to lobbying. Additionally, existing literature criticizes the classification system’s activity-based approach. This section focuses on the literature regarding the EU Taxonomy. A description of the EU Taxonomy and its structure is available in section 4.1 The EU Taxonomy.

The technical screening criteria of the EU Taxonomy is connected to the environmental goals defined by the Paris Agreement. Some researchers have found that the transition of the financial sector in alignment with the Paris Agreement is a complex issue. The transition will be challenging from a methodological, implementation and transparency perspective (Clark, Choi, Tonkonogy, Micale, & Wetherbee, 2019) (Cochran & Pauthier, 2019). Schoenmaker (2018) is skeptical of the implementation of the EU Taxonomy. He argues that the classification system will stifle innovation in sustainable investments. Although the EU system might provide clarity to certain markets, the general approach to sustainable investments should be market-led. He suggests that investors and banks are better suited for assessing which companies that are prepared for the transition to a sustainable economy, since their assets are exposed to the risk. Further, Schoenmaker (2018) argues that large incumbent firms will have the capacity to lobby the EU Commission to consider their current business practices as sustainable. Small firms lack the resources and time to lobby the EU Commission and might thus be undermined by the large firms. This might further stifle innovation since small firms often are more innovative in the sustainability context.

Möslein and Sorensen (2018) introduces benefits and drawbacks from using an activity-centered
approach. They criticize that the EU Taxonomy’s focus is on the types of economic activity that are performed and not on the manner in which they are performed. This directs companies to pursue certain activities and to refrain from pursuing others, which could change the business drastically. On the other hand, they emphasize that this method is structured and objective, which prevents companies from greenwashing.

Given the above, the research question that this thesis addresses is unique. No other research has been done on the topic of how the new EU Taxonomy for sustainable investments will affect the strategy of Swedish sustainable funds. The originality of the research question is thus high and the report will fill a gap in the existing literature by providing useful insights regarding the EU Taxonomy.
3 Methodology and Overview

This chapter presents the research design and highlights the methods and theories that are included in the design. The research design consists of problem definition, research question, literature study, data collection, data analysis and conclusion.

3.1 Research Design

The following research design was established with consideration to the research question, the available information in response to the research question, and the nature of the thesis. According to Corbin and Strauss (2008), an emerging field of study such as the EU Taxonomy is best investigated with a qualitative methodological approach. Further, there is a lack of data to be analyzed with a quantitative approach since the EU Taxonomy has not been implemented nor tested yet. Therefore, this thesis integrates a qualitative research design.

Figure 1: Research design

The research design is inspired by a scientific method that consists of six steps: identifying a problem, examining literature relating to the problem, constructing research questions, collecting data, analyzing the data and finally concluding the findings (Helmenstine, 2020). However, the authors of this thesis have chosen to construct the research question before conducting the literature review (as illustrated in Figure 1). This adjustment enables the authors to use the literature review for deducing the originality of the research question.
The constructed research design is of emergent nature, entailing that the authors are allowed to alter the initial research plan throughout the process (e.g. change the research question or alter the data collection process) (Pailthorpe, 2017). The reason for the emergent design is conditioned by the fact that new material regarding the EU Taxonomy may be released during the period of writing this thesis. The authors must thus be allowed to alter the research plan with consideration to the eventual changes. The research design is outlined in Figure 1.

3.2 Problem Definition

The problem definition is part of the introduction to the thesis, and its purpose is to define the problems that the research question will be based on. The introduction was established by using the funnel approach, where the problem definition is one of the steps in the model. The funnel approach is a theory for writing introductions in theses, which consists of four steps: background, problem definition, purpose and research question (Axelsson, Merkel, Thunborg, & Önnegren, 2018) (Björklund & Paulsson, 2012). It starts in general terms and successively narrows down to the specific. The problem definition specifies the research topic further than the background section and sets the tone for the purpose and research question. The funnel approach was chosen because it contextualizes the main topic and makes the introduction easy to follow.

Since EU Taxonomy is the focus of this thesis, the problem definition section aspires to investigate the roots of the EU Taxonomy. Not only to identify what motivates the implementation, but also to question it and be critical towards the reasons for it. The section begins with a presentation of the 2030 Agenda for Sustainable Development and the Paris Agreement. It then continues by narrowing down the topic to the steering of capital to sustainable investments, and finally arrives at the research question and the purpose of this thesis.

3.3 Research Question

The methodology of the research question is based on an iterative approach. An original research question was constructed in the beginning of the research process. The question was then continuously tested and revised according to existing literature and the data collection.
3.4 Literature Review

The literature review is an analytical summary of existing theories and research within a specific research topic. There are several purposes for conducting a literature review, such as identifying research gaps or responding to the research question (Easterby-Smith, Thorpe, & Jackson, 2015). The aim of this literature review is to evaluate the state of knowledge in the particular topic of sustainable investments and consequently deduce the originality of the research question. The review was conducted throughout the entirety of the research process and was accordingly constructed in an iterative manner. The iterative approach was chosen because the research relating to the EU Taxonomy is scarce and ongoing. Hence, it was possible to integrate additional research articles addressing the EU Taxonomy, as they were published.

Three main areas were embraced in the literature review: sustainable investments, existing systems for sustainable investments and the impact of the EU Taxonomy. The three areas are all related and interlinked. Sustainable investment is the general research topic, with research on systems for sustainable investments as a subtopic. Next, research on the EU Taxonomy is a subtopic to the systems for sustainable investments. The literature review starts with research on sustainable investments and successively narrows down to investigate the subtopics. This approach was chosen since it reveals the overall knowledge within the field, but also more specific knowledge related to the research question.

All articles included in the literature review were retrieved using Google Scholar, Web of Science and KTHB Primo. The articles were retrieved by searching for keywords such as “sustainable investments”, “sustainability rating” or “EU Taxonomy”. Combination searches were also performed to further increase the sphere of relevant articles. That includes searches such as “EU Taxonomy AND funds”. Once the relevant literature was explored, the bibliographies of these papers were examined in order to dig deeper and find more relevant articles.

3.5 Data Collection

The collection of data derived from two channels. The first data channel was synthesis of textual data relating to the sustainability ratings, frameworks and certifications in Sweden. The data that was extracted were these systems’ criteria, assumptions, thresholds etc. as well as data on
the EU Taxonomy. The second channel of data was from semi-structured interviews with relevant employees (e.g. fund managers and ESG analysts) from fund companies that manage sustainable funds accessible in the Swedish markets.

### 3.5.1 Existing systems for sustainable investments & the EU Taxonomy

The data relating to the inclusion and exclusion criteria, and the other aspects of the existing systems for sustainable investments were found on company websites. All relevant information was extracted and compiled into one data file. Once all the data was in a separate file, the file was again cross checked with the information displayed on the company websites. The cross checking was performed since it increases the validity of the data collection (Thyer, 2000).

The data relating to the EU Taxonomy was extracted from a primary source: the official EU documentation. No other sources regarding the classification system were used to extrapolate data, as official EU documentation is the most reliable source on this topic. On an important notice, the EU Taxonomy report is still a draft and is therefore subject to future changes. When this study is published, parts of the EU Taxonomy may therefore already be outdated.

### 3.5.2 Interviews

The second data source is empirical data from semi-structured interviews, which is a mixture of structured and unstructured interviews (Rowley, 2012). The semi-structured interviews, as per definition, follow a base structure with questions and may deviate from the structure to fit the situation and accommodate the interviewee (Kallio, Pietilä, Johnson, & Kangasniemi, 2016). The interview questions were divided into three parts; the first focusing on the fund company and the interviewee, the second on the existing systems for sustainable investments, and the third on the EU Taxonomy. The questions were sent to the interviewees in advance of the scheduled interview. This allowed the fund company to find a relevant representative of the firm and also enabled the interviewee to prepare, which hopefully resulted in richer and more accurate answers. To ensure clear and comparable answers, the main interview questions did not change throughout the research process.

The interview structure included both open and close-ended questions. Open-ended questions invite the interviewee to provide nuanced and long-stretched answers (Grindsted, 2005). The answers to these questions provided data that formed an interesting discussion on the results. The closed ques-
tions served to invite the interviewee to provide short and minimal responses. Receiving the answers in a standardized format facilitated the process of comparing them in an adequate and structured manner.

Since the research question is focused on sustainable funds in the Swedish markets, employees at these fund companies became the interview targets. All fund companies included in this study fulfills that criteria, conducts business in Sweden and manage funds that utilize systems for sustainable investments that are common in the Swedish markets. The interviewees’ job titles varied and included fund managers, ESG analysts and product specialists. The interviewee diversity proved to be beneficial since it resulted in diverse answers originating from different perspectives. Finally, the interview quality was improved by following suggestions from McGrath, Palmgren, and Liljedahl (2018) to test the interview schedule with a peer. In line with their suggestions, a mock interview was conducted with a peer prior to the real interviews. All interviews were then transcribed using the intelligent verbatim transcription method (Streefkerk, 2020).

3.6 Data Analysis

The data analysis is split into two sections. The first section analyzes system thresholds, assumptions and criteria for the existing systems as well as for the EU Taxonomy. The second section analyzes the empirical interview data.

The system specific data was categorized into six categories, environmental (E), social (S), governance (G), general, ethical and design. The categories were defined partially using the Global Reporting Initiative (GRI), which simplified the categorization of the system specific data. The systems were compared with respect to the six categories and the results were compiled into a table for each specific category.

The empirical data analysis from the semi-structured interviews were performed using a narrative analysis. That involves reformulation of answers presented by respondents, taking into account the context of each case and different opinions of each respondent (Allen, 2017). The transcribed data was re-organized to align the interview answers with the interview questions. The data from the open-ended questions were categorized into themes and similar responses were merged into the same theme. The themes were presented in a table, with example responses representing each theme.
The close-ended questions had a more standardized and binary respondent structure, e.g. yes or no answers. These results were presented in pie charts and bar charts.

Last, the results of the two sections were analyzed independently. The key insights from each section were stated. Two supporting sections were also created, that discuss the potential consequences of the EU Taxonomy and the significance of good market conditions.

3.7 Conclusion

In order to form a conclusion, all information retrieved from the four data analysis sections were synthesized together. The authors focused on understanding how the sections were connected and how they affected each other. Some parts of the overall analysis were covered by both the system specific data and the interview data, which brings up the concept of triangulation. The combination of these two variants of data increases the validity and reliability of the findings, if there is convergence between the results. The concept suggests that the research is based on multiple sources of evidence to identify convergence between the data sources (Creswell, 2009). By triangulating the data sources, the authors could compare findings across data sets and identify synergies, which improved the confidence in findings and reduced the potential of bias (Turner, Cardinal, & Burton, 2015).
4 Institutional Setting

This section presents the EU Taxonomy and describes the fundamental characteristics that are required in order to understand the outcome of this thesis. A full description of the EU classification system is available in the TEG's final report on the EU Taxonomy (TEG, 2019a). This section also includes an introduction and a description of all existing systems for sustainable investments that are considered in this thesis.

4.1 The EU Taxonomy

The EU published an action plan for sustainable growth in March 2018 (European Commission, 2019a). The first action of the plan was to establish a classification system for sustainable investments, i.e. a Taxonomy. A Technical Expert Group (TEG) was elected by the EU to develop that classification system. In June 2019, the TEG published its technical report on the EU Taxonomy which sets out the basis for a future Taxonomy legislation (European Commission, 2019c). The information about the EU Taxonomy presented in this thesis is based mainly on the TEG’s technical report. In consequence, this information is subject to change and may deviate from how the final EU Taxonomy will be designed.

4.1.1 Purpose and Benefits

In order to adhere to the 2030 Agenda for Sustainable Development, the Paris Agreement commitments and other environmental goals, the EU reckons that substantial investments are required. The EU estimates that €175 B is required each year to help Europe respond to the climate mitigation challenge alone (TEG, 2019b). Since such investments cannot be financed from the public sector alone, the EU seeks to allocate private capital to such investments by developing the EU Taxonomy. The EU system will provide a common language among sustainable investments by classifying which economic activities that are considered to be environmentally friendly. Further, the TEG states that the EU Taxonomy will facilitate the translation of commitments to the Paris Agreement and the 2030 Agenda for Sustainable Development, save time and money for investors and issuers, support different investment styles and strategies, put environmental data in context, avoid reputational risk, deepen the sustainability conversation and reward companies (TEG, 2019b).
4.1.2 EU Taxonomy Structure

According to the TEG, “a Taxonomy is a classification tool to help investors and companies make informed investment decisions on environmentally friendly economic activities” (TEG, 2019b).

Essentially, it is a list of economic activities that contribute to six environmental objectives defined by the EU:

1. Climate change mitigation
2. Climate change adaptation
3. Sustainable use and protection of water and marine resources
4. Transition to a circular economy, waste prevention and recycling
5. Pollution prevention and control
6. Protection of healthy ecosystems

The economic activities must contribute substantially to at least one of the environmental objectives and do no significant harm (DNSH) to the other environmental objectives in order to be included in the EU Taxonomy. In addition, it must also comply with the minimum safeguards (described in section 4.1.2.4 Minimum Safeguards) and comply with technical screening criteria. A set of technical screening criteria has been established for each economic activity. The criteria cover the substantial contribution and DNSH to the environmental objectives.

All technical screening criteria are established through a series of delegated acts. The first act will cover economic activities generating a substantial contribution to climate change mitigation and adaptation. The TEG has so far only delivered recommendations regarding these objectives and their technical criteria, including criteria for assessing significant harm on objective 3-6. Since the specific economic activities of objective 3-6 are yet to be defined, this thesis cannot dig deeper into those objectives. The continuation of this chapter will thus only describe the economic activities and criteria for objective 1 and 2.

4.1.2.1 Climate Change Mitigation

The TEG established a framework for understanding the substantial contributions to the climate change mitigation objective (TEG, 2019a):
An economic activity shall be considered to contribute substantially to climate change mitigation where that activity substantially contributes to the stabilization of greenhouse gas concentrations in the atmosphere at a level which prevents dangerous anthropogenic interference with the climate system by avoiding or reducing greenhouse gas emissions or enhancing greenhouse gas removals through any of the following means, including through process or product innovation:

(a) generating, storing or using renewable energy or climate-neutral energy (including carbon-neutral energy), including through using innovative technology with a potential for significant future savings or through necessary reinforcement of the grid;

(b) improving energy efficiency;

(c) increasing clean or climate-neutral mobility;

(d) switching to use of renewable materials;

(e) increasing carbon capture and storage use;

(f) phasing out anthropogenic emissions of greenhouse gases, including from fossil fuels;

(g) establishing energy infrastructure required for enabling decarbonisation of energy systems;

(h) producing clean and efficient fuels from renewable or carbon-neutral sources.

The TEG has further recognized carbon neutrality by 2050 as the desired outcome, in line with the goal of the European Commission’s long-term decarbonization strategy. Both economic activities that are decarbonized and economic activities that enable decarbonization in other sectors are necessary in order to achieve that goal. The TEG therefore assumed the following concepts when developing the economic activities and their screening criteria:

- **Greening ‘of’ activities:** The technical screening criteria focus on improving the environmental performance of the activity. If the environmental performance fulfills the criteria, its revenues or expenditures may be considered to be EU Taxonomy-aligned.

- **Greening ‘by’ activities:** Activities that enable improved environmental performance in other sectors and are themselves performed to avert substantial negative impact on the environment. A ‘greening by’ activity may count as EU Taxonomy-eligible even if the target economic activity is not brought in line with its technical screening criteria.

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1Decarbonization refers to the reduction or elimination of carbon dioxide from energy sources.
The transition to a net-zero emissions economy requires a shift from high emitting activities to low emitting activities. The EU Taxonomy incentivizes the growth of low emitting activities by considering three kinds of activities making substantial contribution to climate change mitigation:

- **Activities that are already low carbon.** These activities are already compatible with a 2050 net-zero carbon economy and the technical criteria are likely to be stable and long-term. These activities are ‘green’.

- **Activities that contribute to a transition to a zero net emissions economy by 2050** but are not currently operating at that level. The technical screening criteria are likely to be subject to regular revision, tending towards zero emissions. These activities are ‘greening of’.

- **Activities that enable those above.** The technical screening criteria will depend on the criteria for the enabling activities (stable for activities that are low carbon and subject to change for activities that contribute to a transition). These activities are ‘greening by’.

The EU used the NACE system\(^2\) as a starting point when selecting which economic activities to include in the EU Taxonomy. The NACE system is an industrial classification system of economic activities previously established by EU law. It is comprehensive in its coverage of EU economic sectors and is used by EU institutions such as Eurostat and has already been implemented by some financial institutions. Activities from the following sectors have been identified to make a substantial contribution to climate change mitigation:

- Agriculture and forestry
- Manufacturing
- Electricity, gas, steam and air conditioning supply
- Water, sewerage, waste and remediation
- Transport
- Information and Communication Technologies (ICT)
- Buildings

\(^2\)Nomenclature des Activités Économiques dans la Communauté Européenne (NACE) is a European industry standard classification system.
Due to the extensiveness of the EU’s descriptions of all economic activities and their technical criteria, they are not presented in this report. Please read the descriptions in the EU’s Taxonomy Technical Report (TEG, 2019a) for information regarding specific activities and their technical criteria.

### 4.1.2.2 Climate Change Adaption

The TEG established a framework for understanding the substantial contributions to the climate change mitigation objective (TEG, 2019a):

An economic activity shall be considered to contribute substantially to climate change adaptation where that activity contributes substantially to reducing the negative effects of the current and expected future climate or preventing an increase or shifting of negative effects of climate change, through the following means:

(a) preventing or reducing the location- and context-specific negative effects of climate change, which shall be assessed and prioritized using available climate projections, on the economic activity;

(b) preventing or reducing the negative effects that climate change may pose to the natural and built environment within which the economic activity takes place, which shall be assessed and prioritized using available climate projections.

The negative effects of climate change that are considered are both chronic or slow onset climate related hazards and rapid or acute climate related hazards. The prior refers to hazards such as temperature increase and sea level rise. The latter refers to hazards such as rainfall, storm surges and flooding.

The EU Taxonomy considers two types of economic activities to make substantial contribution to climate adaptation (TEG, 2019b):

1. Activities that are made more climate resilient by integrating measures to perform well under a changing climate; for example, enhancing soil water retention to reduce potential yield losses of non-perennial crops resulting from increased severity of droughts.

2. Activities that enable adaptation in other economic activities: for example, the production of satellite systems for weather and climate related observation.
The following three guiding principles are proposed in the EU Taxonomy for identifying economic activity that substantially contribute to climate change adaptation:

1. **Principle 1: The economic activity reduces all material physical climate risks to the extent possible and on a best effort basis.** The activity must integrate measures aimed at reducing all material physical climate risks posed by current weather variability and future climate change, or it must reduce material risks to other economic activities and/or address systemic barriers to adaptation.

2. **Principle 2: The economic activity does not adversely affect adaptation efforts by others.** Activities should be consistent with adaptation needs in the applicable sector or region. Adaptation activities should not hinder adaptation by others.

3. **Principle 3: The economic activity has adaptation-related outcomes that can be defined and measured using adequate indicators.** When possible, the outcomes of adaptation activities should be monitored and measured against defined indicators for adaptation results.

The climate-related hazards considered by the EU are divided into four groups: temperature-related, wind-related, water-related and solid mass-related. Each group contains both acute and chronic hazards. A classification table can be observed below:

**Figure 2: Classification table for climate-related hazards**

| Changes in climate patterns and in the frequency/severity of climate-related events that are: |
|-----------------------------------------------|-------------------------------|
| **Temperature-related**                      | **Wind-related**              |
| Changing temperature (air, fresh water, marine water) | Changing wind patterns |
| Heat stress                                   |                              |
| Temperature variability                       |                              |
| Permafrost thawing                           |                              |
| **Water-related**                             |                              |
| Changing precipitation patterns and types (rain, hail, snow/ice) |                              |
| Precipitation and or hydrological variability |                              |
| Ocean acidification                          |                              |
| Saline intrusion                             |                              |
| **Solid mass-related**                        |                              |
| Coastal erosion                               |                              |
| Soil degradation                             |                              |
| Soil erosion                                 |                              |
| Sotification                                 |                              |
| **Sea level rise**                            |                              |
| **Water stress**                              |                              |
| **Acute**                                     |                              |
| Heat wave                                    | Cyclone, hurricane, typhoon |
| Cold wave/frost                               | Storm (including blizzards, dust and sandstorms |
| Wildfire                                      | Tornado                       |
| **Drought**                                   |                              |
| **Avalanche**                                 |                              |
| **Landslide**                                 |                              |
| **Flood (coastal, fluvial, pluvial, ground water)** |                              |
| **Subsidence**                                |                              |
| **Glacial lake outburst**                     |                              |
4.1.2.3 Do No Significant Harm (DNSH)

Economic activities may not cause significant harm to any of the six environmental objectives. The purpose of this requirement is to ensure that progress against some objectives are not made at the expense of others. Thus, additional DNSH practices and criteria are added to each economic activity. The approach for identifying such practices and criteria focused on mitigating potential harm to environmental objectives. Activities where such practices and criteria cannot be identified are excluded from the EU Taxonomy.

Most practices and criteria are based on existing EU regulations. It should therefore be simple for companies to demonstrate that they meet these requirements if they already have compliance and environmental management procedures in place. Remaining criteria are qualitative or quantitative thresholds proposed to supplement the regulatory requirements. Full criteria are presented in the EU’s Taxonomy Technical Report (TEG, 2019a).

4.1.2.4 Minimum Safeguards

The EU Taxonomy essentially attempts to assess and measure environmental criteria. However, it does not neglect the importance of social and governance aspects. The minimum safeguards are therefore included in the EU Taxonomy to ensure that the fundamental criteria of these aspects are fulfilled. Unlike the assessment of environmental criteria, the minimum safeguards are not measured in numbers. Instead, they are based on compliance and adherence with several well-established guidelines and initiatives. The following guidelines and initiatives are included:

- OECD Guidelines for Multinational Enterprises
- UN Guiding Principles on Business and Human Rights
- International Labour Organisation’s (ILO) Declaration on Fundamental Rights and Principles at Work
- ILO Core Conventions
- International Bill of Human Rights

Companies and other issuers complying with the EU Taxonomy will be required to assess their compliance with the minimum safeguards. An activity may only become Taxonomy-compliant if it complies with the minimum safeguards. Further, the TEG states that more stringent requirements in EU law still apply, where applicable (TEG, 2019a).
4.1.2.5 Disclosure

The EU Taxonomy Regulation targets three groups:

1. Financial market participants offering financial products in the EU, including occupational pension providers.

2. Large companies who are already required to provide a non-financial statement under the Non-Financial Reporting Directive.

3. The EU and Member States, when setting public measures, standards or labels for green financial products or green (corporate) bonds.

This thesis focuses on sustainable funds belonging to the first group, financial markets participants. In this group, the disclosure is mandatory for certain types of products or offerings, and on a comply-or-explain basis for all others. The disclosure should include the following three statements for each relevant product:

- How and to what extent they have used the EU Taxonomy in determining the sustainability of the underlying investments.

- To what environmental objective(s) the investments contribute.

- The proportion of underlying investments that are EU Taxonomy-aligned, expressed as a percentage of the investment, fund or portfolio. This disclosure should include details on the respective proportions of enabling and transition activities, as defined under the Regulation.
The disclosure requirements differ for each fund type respectively. The Regulation of Sustainability-Related Disclosures in the Financial Sector (SDR) creates three fund categories based on the approach to environmental objectives within the investment or fund (European Commission, 2019d):

<table>
<thead>
<tr>
<th>Description</th>
<th>Obligation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial products which have sustainable investment as their objective</td>
<td>Must complete the EU Taxonomy disclosures where the investment concerns activities that contribute to an environmental objective</td>
</tr>
<tr>
<td>Financial products which promote environmental or social characteristics of</td>
<td>Must complete the EU Taxonomy disclosures where environmental characteristics are promoted</td>
</tr>
<tr>
<td>the investment, either alone or in combination with other characteristics</td>
<td></td>
</tr>
<tr>
<td>All other financial products</td>
<td>Must complete the EU Taxonomy disclosures or carry a disclaimer that “the investment(s) underlying this financial product do not take into account the EU criteria for environmentally sustainable investments”</td>
</tr>
</tbody>
</table>

Further, the EU Taxonomy Regulation presents an additional disclosure requirement for the second target group (large companies that already are required to provide a non-financial statement under the Non-Financial Reporting Directive). The additional disclosure requirement forces these companies to report how their businesses relate to the EU Taxonomy (i.e. report EU Taxonomy data).

4.1.2.6 Using the EU Taxonomy

The TEG states that investors using the EU Taxonomy should be able to identify:

1. The percentage of holdings pertaining to companies carrying out environmentally sustainable economic activities.

2. The share of the investment funding environmentally sustainable economic activities as a percentage of all economic activities.

In order for investors to understand how to practically use the EU Taxonomy, the TEG has developed a five-step approach. The five steps are:

1. Identify the activities conducted by the company, issuer or covered by the financial product (e.g. projects, use of proceeds) that could be eligible.
2. For each activity, assess whether the company or issuer meets the relevant criteria for a substantial contribution e.g. electricity generation <100g CO2/kWh.

3. Verify that the DNSH criteria are being met by the issuer. Investors using the EU Taxonomy would most likely use a due-diligence like process for reviewing the performance of underlying investees.

4. Conduct due diligence to avoid any violation to the social minimum safeguards stipulated in the EU Taxonomy regulation (article 13).

5. Calculate alignment of investments with the EU Taxonomy and prepare disclosures at the investment product level.

The EU Taxonomy alignment of investments for a fund is calculated based on the proportion of revenue or turnover each company receives from EU Taxonomy-aligned activities. Each proportion is weighted into the fund’s portfolio with respect to the company’s proportion of AUM (Assets Under Management) to calculate the portfolio’s EU Taxonomy alignment. See example below.

Figure 4: Alignment calculation example

**Proportion of company revenue or turnover from EU Taxonomy-aligned activities**

- Company A – 40% of AUM
- Company B – 25% of AUM
- Company C – 35% of AUM

![Alignment Calculation Diagram](image)

4.1.2.7 EU Taxonomy Data

An investor using the EU Taxonomy must also retrieve all data needed for the five-step approach. The TEG envisages that companies will provide such data and that data markets for ESG-related research will be developed for that purpose. The necessary data includes:
(A) Revenue breakdown by EU Taxonomy-eligible activities, or expenditure allocation to each EU Taxonomy-eligible activity.

(B) Performance against the technical screening criteria, or environmental management data where this is an acceptable proxy for compliance with the technical screening criteria - including DNSH assessment.

(C) Management data on social issues: Labour rights policies, management systems, audits, reporting.

Data availability is essential for the EU Taxonomy to function adequately. The main challenge that the EU Taxonomy faces is that very few companies break out revenues from green activities as of today. Many listed companies report revenues broken down by activity or business line. However, the reporting format is not standardized and may be hard to access (TEG, 2019a). The TEG suggests that one way of addressing this problem is to encourage companies to report revenue in line with the system that the EU Taxonomy’s economic activities are based on, NACE. In addition, large companies who are already required to provide a non-financial statement under the Non-Financial Reporting Directive will also be obligated to report EU Taxonomy data.

The EU Taxonomy user must also gather data on what proportion of the economic activities that meets the specified technical criteria. Fortunately, carbon reporting is one of the most increasingly common metrics disclosed by companies in developed and emerging markets. However, a large share of companies reporting carbon emissions today does not report it fully or does not make it available in a format that can be processed and analysed (TEG, 2019a). Moreover, the EU Taxonomy user must perform the DNSH assessment. The TEG suggests that this process will require the user to run their own due diligence process. Finally, the EU Taxonomy user will have to run a labor standards due diligence process using management data on social issues. This data is reported more extensively by companies today compared to previously mentioned data.

4.2 Existing Systems for Sustainable Investments

This section describes six major systems for sustainability information that sustainable funds in the Swedish markets use or are subject to today. Most systems differ in terms of format and purpose but all of them are used for rating or assessing the sustainability level of a fund. The first systems were retrieved from Avanza’s website (Avanza Bank, 2020b) (Avanza is a Swedish online stock broker
that holds a market share of 8% of Sweden’s population (Avanza Bank, 2020a). The list of systems was then extended with systems frequently found in sustainability reports from randomly selected Swedish sustainable funds. Further, the list was then revised by excluding all systems that did not assess the funds’ sustainability efforts in a clear way. Examples of such systems are the UN Principles for Responsible Investments and the UN’s Sustainable Development Goals. Although these systems may affect the funds, they are high-level and most funds can claim to comply with them since it is hard to verify or make a fair assessment of it. Thus, analyzing such systems would likely not contribute substantially to this study. The systems’ relevance was further confirmed when all of them were mentioned by at least half of the fund companies interviewed later in this study. Some additional systems were mentioned occasionally by the interviewees, but not to the extent that they should be included in this study (the most frequent relevant additional system was mentioned by two out of fourteen interviewees).

4.2.1 Hållbarhetsprofilen

Swesif is an independent association that brings together the forces working for and with sustainable investments in Sweden. The goals of the association are mainly to support the development of sustainable investments and to increase the knowledge about it (SWESIF, 2020b). Swesif has therefore developed the framework Hållbarhetsprofilen which was first launched in 2013 and has been updated regularly since. The framework is currently managed by Swesif and the Swedish Investment Fund Association together.

Hållbarhetsprofilen (SWESIF, 2020a) is a standardized information sheet that describes how a fund relates to the integration of sustainable investments. The purpose is to show investors and the general public, in a simple and understandable manner, how the fund applies sustainability criteria in its management. The standardized format also enables investors to compare sustainability integration between funds.

The information sheet is a self-declaration, meaning that the information is provided by the fund company and is not verified or approved by Swesif. Swesif is only responsible for the format and the guidelines of Hållbarhetsprofilen. The information sheet is not a certification or quality seal of any kind. It shall only be considered an information standard giving fund companies the opportunity to present their sustainability efforts in a standardized format.
Hallbarhetsprofillen contains general sustainability information, information regarding engagement
efforts of the fund company, information on resources allocated to sustainability work and further
mixed sustainability information.

4.2.2 The Nordic Swan Ecolabel

The Nordic Swan Ecolabel was established in 1989 by the Nordic Council of Ministers as a voluntary
ecolabeling scheme for the Nordic countries Denmark, Finland, Iceland, Norway and Sweden. The
purpose of the label is to reduce the environmental impact of the production and consumption of
goods. In addition, it facilitates the process of choosing the most environmentally friendly goods
and services for consumers and professionals (Nordic Ecolabelling, 2020).

The Nordic Swan Ecolabel can be achieved by a fund if certain sustainability criteria are met.
In order to achieve the certification, the fund must comply with requirements within three areas;
exclusion, inclusion and transparency and ownership (Nordic Ecolabelling, 2017).

For the exclusion area, most criteria are related to ESG. In addition, it also encloses criteria re-
lated to ethical issues such as producing tobacco and manufacturing conventional weapons. The
inclusion criteria require the fund to be mainly invested in companies with a strong sustainable
rating and also promote companies that are in transition to a more sustainable business. Moreover,
the fund must conduct a sustainable assessment for at least 90% of its holdings. The transparency
and ownership area requires that the fund discloses a quarterly report on all holdings, publishes a
performance report each year, and promotes active ownership and engagement through voting and
dialogue. Some of the criteria are mandatory and others are optional.

In order to achieve the Nordic Swan Ecolabel, the fund must comply with all mandatory crite-
rria, score at least 6 out of 16 points on the optional criteria, pay an initial application fee and an
annual fee. Nordic Ecolabelling will typically perform an on-site audit when a fund applies to the
Nordic Swan Ecolabel. Further, annual compliance checks are conducted to maintain the validity of
the license.
4.2.3 Söderberg & Partners Sustainability Rating

Söderberg & Partners is a financial advisor who channels their offering through several different services. Their offering includes services such as occupational pension advice, insurance consultancy, and insurance mediation, as well as wealth management and asset management services. They also develop and offer digital tools for services such as financial advice, payroll and benefit management and employee development (Söderberg & Partners, 2018).

Söderberg & Partners has developed their own sustainability rating (Söderberg & Partners, 2019). The rating is based on positive screening and responsible ownership. Positive screening involves the following areas: access to sustainability analysis, ESG-integration, follow-up on sustainability level of portfolio, incentives and education on sustainability and sustainability/theme focus. Responsible ownership involves the following areas: engagement through dialogue, proactive impact efforts and collaborations. The positive screening and responsible ownership assessments are presented on the fund platform available for clients, analysts, advisors, and portfolio managers. A fund receives a red, yellow, or green rating in each assessment perspective. The score and rating in each perspective are weighted equally in a total final sustainability rating of the fund, also according to a traffic light system. If a fund performs well within those areas, it also achieves a green rating. Further, clients may use the fund platform to filter funds on these criteria or by specific exclusion criteria (e.g. weapons or international conventions). However, the exclusion criteria of a fund is not part of the sustainability rating and is thus not considered in this thesis. The assessment is also presented in Söderberg & Partners sustainability report that is available to public. Although, the rating in the sustainability report summarises each fund company’s fund ratings instead of each specific fund. The summary for each fund company shows the proportion of funds that have received green, yellow, and red rating. The summary is thus based on how each individual fund managed by the company performs and the summary is presented as a percentage in each color. For example, a fund company may be 100% green, 0% yellow and 0% red. Another fund company may be 50% green, 30% yellow and 20% red.

4.2.4 Morningstar Sustainability Rating

Morningstar is the world’s largest independent provider of fund data. Since 1999, Morningstar provides reliable, comparable and easily accessible information about Swedish and international funds (Morningstar, 2020).
In 2016, Morningstar introduced the Morningstar Sustainability Rating (Morningstar, 2016). The rating is a measure of the financial material ESG risks in a portfolio relative to a portfolio’s peer group. The rating is based on ESG risk ratings on company level on historical and current holdings. It is calculated by Sustainalytics, a leading provider of ESG research (Morningstar, 2019). Morningstar does not disclose exactly how the rating is calculated but mentions that it measures the degree to which a company’s economic value may be at risk driven by ESG issues. Further, the ESG issues vary depending on industry, group and company.

The measurement is presented by Morningstar as a rating between 1 and 5 globes, where 5 globes is considered to be the best value (lowest ESG risk). Morningstar also presents the following measurements as parts of the Sustainability Rating:

- Percentual ranking in global category
- Historical ESG risk
- Current ESG risk
- Separate scores for each element in ESG (Environmental, Social and Corporate Governance)

### 4.2.5 Morningstar CO2 Risk

In 2018, Morningstar introduced an additional sustainability measure that assesses a fund’s exposure to carbon dioxide (Morningstar, 2018). The measure is not focused on how much carbon dioxide the owned companies emit. Rather, it focuses on how large the risk is that the fund is affected negatively if the world economy would readjust to a low CO2 emission environment. The measure, called CO2 risk, is calculated based on the CO2 risk on each of the companies that the fund invests in. In order for the measure to be calculated, at least 67% of the fund’s holdings must have a CO2 risk value. Moreover, Morningstar also presents how exposed the fund’s holdings are to fossil fuels.

To enable investors to easily find funds with low CO2 risk, a low CO2 risk certification has been implemented in combination with the measures. The low CO2 risk certification is acquired by having a low CO2 risk (below 10 on a scale between 1 and 100) during the past 12 months in combination with exposure to fossil fuels below 7%.
4.2.6 Carbon Footprint

The industry organization The Swedish Investment Fund Association recognized in 2016 that many funds in Sweden presented, or intended to present, their carbon footprint. The industry organization therefore developed a common formula for calculating a fund’s carbon footprint. The purpose was to standardize the carbon footprint format in order to enable funds’ carbon footprints to be compared fairly. The formula is (Fondbolagens förening, 2019):

\[
\sum_{i} \left( \frac{\text{Holding’s value}}{\text{Total portfolio value}} \cdot \frac{\text{Portfolio company’s CO2e emissions}}{\text{Portfolio company’s revenue (in fund currency)}} \right)
\]

The ratio shows the portfolio’s exposure towards carbon dioxide intensive companies expressed as the portfolio company’s yearly CO2e in ton/company’s yearly revenue in fund currency, distributed on portfolio weight, i.e. the holding’s value/total portfolio value.

Third-party companies provide the carbon dioxide data needed for the calculations. Estimates are used for companies that do not report their carbon dioxide data. Some gases that also affect the environment, such as methane and nitrous oxide, are converted into carbon dioxide equivalents in order to cover a larger portion of the environmental impact.
5 Results and Discussion

This chapter presents the results of this thesis, together with a discussion throughout the whole chapter. The first section presents a comparison between the EU Taxonomy and the existing systems for sustainable investments. The second section presents the results from the interviews with the fund companies. The third section consists of discussions and interpretations of the results. Further, the fourth and the fifth sections discuss the consequences of the EU Taxonomy and how the system is affected by market conditions, respectively.

5.1 Comparison of the EU Taxonomy and the Existing Systems

This section provides a comparison of the EU Taxonomy and the existing systems for sustainable investments included in this study. A separate comparison is conducted for each of the sustainability categories Environmental (E), Social (S), Governance (G), Ethical, Design and General.

Since the ESG concept is a well-established standard for analyzing sustainability, it is natural to compare the systems with respect to these aspects. The ESG concept can either be analyzed with respect to each individual dimension, or it can be analyzed with respect to all dimensions together. The individual analysis of the E, S, and G dimensions in this comparison includes thresholds and criteria that are interlinked to one specific ESG dimension. The more general ESG analysis, where the criteria are on a general ESG level rather than broken down into the individual dimensions, falls under the general category in this comparison. Other areas that are included under the general category are active ownership, transparency and engagement efforts. These are sustainability traits that do not fit into any of the other categories, but nonetheless are of importance for this comparison. Further, ESG does not cover the ethical aspect, which is commonly included in other definitions of sustainability. Hence, the ethical aspect is added into the comparison. Another fruitful aspect to consider is how the systems are designed in terms of who is responsible for conducting the work and how the final assessment is presented (e.g. as a rating or certification). Such traits are compared under the design category.
5.1.1 Environmental (E)

Most of the existing systems consider the environmental aspect of sustainability, although some are more extensive than others. Hållbarhetsprofilen and the Nordic Swan Ecolabel exclude extrapolation and use of fossil fuels and uranium. In addition, they also consider whether the fund has a general environmental focus or not. Another common approach is to observe the carbon dioxide emission levels from companies. Carbon Footprint and Morningstar CO2 Risk are based on that approach. Likewise, Morningstar Sustainability Rating also includes CO2 emission level in its carbon intensity parameter. On top of that, Morningstar Sustainability Rating identifies engagement of firms in environmental sustainability contexts, for example renewable energy programs and environmental management systems.

Most of the existing systems’ criteria focus on that the companies should conduct their activities in a sustainable manner and focus less on what type of activity it is. Consequently, a fund may invest in almost any industry if the company works in a sustainable manner. The only exception is a few negative screening criteria (i.e. exclusion criteria) that focus on specific industries or resources that are considered to be environmentally unsustainable. Fundamentally, the existing systems specify
which industries that are excluded and consider all other industries to be potentially sustainable.

The EU Taxonomy focuses not only on that the activities should be carried out in a sustainable manner, but also on what kind of activity it is. The EU system specifies all activities that are considered to be sustainable, and provides measurable thresholds for all of them to ensure that they are carried out in a sustainable manner. Contrary to the existing systems, the EU Taxonomy specifies which areas that are included and consider all other areas to be unsustainable. The only exception is that an activity is instantly excluded if it causes significant harm to any of the six environmental objectives.

In practice, both the existing systems and the EU Taxonomy focus on how activities are being carried out. But in addition, the EU system also considers what type of activity it is. The activities defined so far are relatively few and they all have thresholds for being EU Taxonomy-compliant. Thus, not only does the classification system include less industries than the existing systems, it also forces the activities in each industry to meet the thresholds. As a result, meeting the requirements of the existing systems or receiving high sustainability ratings is very different from achieving a high EU Taxonomy alignment. The only funds that will achieve high alignment are those who invest specifically in companies carrying out activities that contribute to the six environmental objectives defined in the EU Taxonomy.
5.1.2 Social (S)

Figure 6: Comparison of the systems with respect to the social aspect

<table>
<thead>
<tr>
<th>EU Taxonomy</th>
<th>Hållbarhetsprofilen</th>
<th>Nordic Swan Ecolabel</th>
<th>Morningstar Sustainability Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Social</strong></td>
<td></td>
<td>Social areas that are covered by these guidelines:</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Positive Screening</td>
<td>- Human Rights</td>
<td>- Companies violating the</td>
</tr>
<tr>
<td></td>
<td>- Companies complying with UN</td>
<td>- Employment &amp; Industrial Relations</td>
<td>International Labor Organization’s fundamental principles</td>
</tr>
<tr>
<td></td>
<td>- Companies complying with OECD Guidelines for Multinational Enterprises</td>
<td>- Consumer Interests</td>
<td>- Companies violating Human Rights</td>
</tr>
<tr>
<td></td>
<td>- Companies complying with International Labor Organization’s declaration on Fundamental Rights and Principles at Work</td>
<td>- Labor Rights</td>
<td>- Social areas covered by these guidelines:</td>
</tr>
<tr>
<td></td>
<td>- Companies complying with International Bill of Human Rights</td>
<td></td>
<td>- Labor Rights</td>
</tr>
<tr>
<td></td>
<td>- Companies complying with more stringent EU law where applicable</td>
<td></td>
<td>- Human Rights</td>
</tr>
<tr>
<td></td>
<td>Social areas that are covered by these guidelines:</td>
<td></td>
<td>- Employment &amp; Industrial Relations</td>
</tr>
<tr>
<td></td>
<td>- Human Rights</td>
<td></td>
<td>- Consumer Interests</td>
</tr>
<tr>
<td></td>
<td>- Employment &amp; Industrial Relations</td>
<td></td>
<td>- Labor Rights</td>
</tr>
<tr>
<td></td>
<td>- Consumer Interests</td>
<td></td>
<td>- Human Rights</td>
</tr>
<tr>
<td></td>
<td>- Labor Rights</td>
<td></td>
<td>- Employment &amp; Industrial Relations</td>
</tr>
</tbody>
</table>

No specific social related criteria: Söderberg & Partners Sustainability Rating, Carbon Footprint and Morningstar CO2 Risk

Only three of the existing systems consider social aspects. The criteria from Hållbarhetsprofilen and the Nordic Swan Ecolabel are based on compliance with established social initiatives such as the OECD Guidelines for Multinational Enterprises and the International Labour Organization’s (ILO) fundamental principles. The approach by Morningstar Sustainability Rating stand out by measuring specific social areas such as discrimination, diversity and data security and privacy.

The EU Taxonomy has a strong focus on environmental measurements. Nonetheless, it also includes the minimum safeguards. The safeguards are based on compliance with established initiatives, similar to the approach of Hållbarhetsprofilen and the Nordic Swan Ecolabel. The social areas that are covered overlap between the EU Taxonomy, Hållbarhetsprofilen and the Nordic Swan Ecolabel. Consequently, if a fund complies with those existing systems’ social criteria, it is likely to comply with the EU Taxonomy as well. Although the Morningstar Sustainability Rating covers similar social areas as the EU system, it is on a measurement basis instead of a comply-or-not basis. For this reason, it is difficult to conclude how these two systems relate to each other with respect to the social aspect. However, it is important to notice that all other systems assess the social aspect on a
comply-or-not basis, or do not assess it at all.

5.1.3 Governance (G)

Equally as with the social aspect, only three existing systems consider the governance aspect. There is a discrepancy between the three systems on how they approach this aspect. Hållbarhetsprofilen has a comply-or-not approach with established initiatives, the Nordic Swan Ecolabel excludes corrupt companies and the Morningstar Sustainability Rating measures specific governance areas such as bribery, corruption and board structures.

The EU Taxonomy’s minimum safeguards also include the governance aspect. Again, the safeguards are based on compliance with established initiatives such as the OECD Principles of Corporate Governance, which is similar to the approach of Hållbarhetsprofilen. The initiatives cover the corruption aspect which is the only governance aspect considered by the Nordic Swan Ecolabel. Hence, if a fund complies with those existing systems’ governance criteria, it is likely to comply with the EU Taxonomy as well. Although the Morningstar Sustainability Rating covers similar governance areas as the EU classification system, it is on a measurement basis instead of a comply-or-not basis. For this reason, it is difficult to conclude how these two systems relate to each other with respect to the governance aspect. However, it is important to notice that Morningstar Sustainability Rating is the
only system with this approach to the governance aspect.

5.1.4 General (active ownership, engagement, transparency etc.)

Figure 8: Comparison of the systems with respect to the general aspect

<table>
<thead>
<tr>
<th>General</th>
<th>Höllbarhetsprofilen</th>
<th>Söderberg &amp; Partners Sustainability Rating</th>
<th>Nordic Swan Ecolabel</th>
<th>Morningstar Sustainability Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>General</td>
<td>- The fund influences portfolio companies on sustainability issues - The fund votes in General Meetings - The fund has resources for analysis, follow-up and control - The fund publishes sustainability information - Investments in countries/interest-bearing securities issued by certain states</td>
<td>Positive screening 1. ESG factors - The fund has access to ESG-data and analysis tools - The fund considers risks and opportunities relating to ESG-data - The fund performs follow-ups on sustainability risks and levels - The fund has sustainability directives or sustainability incentives for managers. - The fund has a sustainability theme / focus 2. Responsible ownership - The fund performs follow-ups on engagement dialogues - The fund performs proactive engagement efforts - The fund cooperates with peers if needed</td>
<td>Positive screening 1. ESG factors - The fund conducts an ESG analysis for at least 90% of holdings - The fund is mainly invested in companies with a strong sustainability rating - The fund promotes companies that are in transition to a more sustainable business 2. Active ownership - The fund votes regularly - The fund engages in companies and has company dialogues 3. Reporting and transparency - The fund publishes reports on sustainability, performance and holdings</td>
<td>Assesses the fund’s portfolio companies in the following categories: - Ownership and shareholders - Voting - Engagement - Risks and opportunities relating to ESG-data</td>
</tr>
</tbody>
</table>

Many of the existing systems consider traits that are not included in the ESG dimensions. Such traits are included in the general aspect and examples of such are active ownership, engagement and transparency.

As illustrated in Figure 8, the EU Taxonomy does not consider any general aspects at all. The observant reader may notice that four of the existing systems consider general aspects and that some of them consider plenty of traits. However, since the EU classification system do not consider the traits, complying with them does not contribute to a better EU Taxonomy alignment.
5.1.5 Ethical

Figure 9: Comparison of the systems with respect to the ethical aspect

<table>
<thead>
<tr>
<th></th>
<th>Hållbarhetsprofilen</th>
<th>Nordic Swan Ecolabel</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ethical</td>
<td>Investments in companies involved in various weapons (cluster bombs, landmines, chemical and biological weapons, nuclear weapons, ammunition)</td>
<td>Negative Screening</td>
</tr>
<tr>
<td></td>
<td>Investments in companies involved in alcohol and tobacco</td>
<td>- Companies involved in weapons (controversial and conventional weapons)</td>
</tr>
<tr>
<td></td>
<td>Investments in companies involved in commercial gambling operations</td>
<td>- Companies involved in tobacco</td>
</tr>
<tr>
<td></td>
<td>Investments in companies involved in pornography</td>
<td>- Companies involved in genetically modified organisms (GMOs)</td>
</tr>
<tr>
<td></td>
<td>Investments in companies involved in genetically modified organisms (GMOs)</td>
<td>No specific ethical related criteria: EU Taxonomy, Söderberg &amp; Partners Sustainability Rating, Carbon Footprint and Morningstar CO2 Risk and Morningstar Sustainability Rating</td>
</tr>
</tbody>
</table>

Hållbarhetsprofilen and the Nordic Swan Ecolabel are unique to consider the ethical aspect. They consider specific unethical investments such as weapons, alcohol, tobacco, gambling, pornography and genetically modified organisms. The EU Taxonomy does not cover any ethical aspects. The only ethical aspects are therefore those provided by Hållbarhetsprofilen and the Nordic Swan Ecolabel. Equally to the general criteria, complying with ethical criteria does not contribute to a better EU Taxonomy alignment.
5.1.6 Design

Figure 10: Comparison of the systems with respect to the design aspect

<table>
<thead>
<tr>
<th>EU Taxonomy</th>
<th>Hilfbarhetaprofile</th>
<th>Söderberg &amp; Partners Sustainability Rating</th>
<th>Nordic Swan Ecolabel</th>
<th>Morningstar Sustainability Rating</th>
<th>Morningstar CO2 Risk</th>
<th>Carbon Footprint</th>
</tr>
</thead>
<tbody>
<tr>
<td>Design</td>
<td>The analysis or compliance work is conducted by the fund</td>
<td>The system is a rating</td>
<td>The analysis or compliance work is conducted by a third-party</td>
<td>The system is a rating</td>
<td>The analysis or compliance work is conducted by a third-party</td>
<td>The system is a rating</td>
</tr>
<tr>
<td></td>
<td>The system is an information sheet</td>
<td></td>
<td>The system is a certification</td>
<td>The system is a rating</td>
<td>The system is a rating</td>
<td>The system is a rating</td>
</tr>
</tbody>
</table>

No specific design related criteria:

The existing systems’ designs vary between certifications, information sheets and ratings. The latter design is the most frequent one since four out of the existing six systems are ratings. Additionally, the systems vary with respect to who is responsible for conducting the analysis and compliance work. Half of the systems assess the funds on their own while the other half require the fund companies to conduct the work.

The EU Taxonomy is a classification system that ultimately results in a EU Taxonomy alignment percentage for each fund. Hence, from a fund company’s perspective, the EU Taxonomy is classified as a rating system which is the most common design. Similar to half of the existing systems, the EU Taxonomy expects the fund companies to conduct the necessary compliance work. However, the work efforts required by the EU Taxonomy is more extensive than for most other systems.
5.2 Interview Results

This section provides the results from fourteen semi-structured interviews conducted with employees from multiple fund companies. A full list of interview questions can be observed in Appendix A. All company contacts were provided by Söderberg & Partners and all fund companies manage at minimum one sustainable fund accessible in the Swedish markets. The fund companies, interview dates and interviewee titles are presented in Appendix B.

The authors of this thesis contacted twenty-one fund companies and fourteen of them chose to participate in the interviews. Although most fund companies were positive towards the idea of participating, several explained that they lacked time due to increased workloads originating from the ongoing covid-19 pandemic.

Fund companies of different sizes were contacted since size was expected to influence their answers. Having a mixture of fund companies of different sizes enabled the authors to gather nuanced answers from varying perspectives which consequently generated a holistic view of the industry. In line with the EU’s definition, the included fund companies may be categorized into three categories: micro/small companies (<50 employees), medium-sized companies (<250 employees) and large enterprises (250 employees or more) (European Commission, 2020). The following table categorizes the included fund companies with respect to this definition:

<table>
<thead>
<tr>
<th>Company Size</th>
<th>Micro/Small</th>
<th>Medium-Sized</th>
<th>Large Enterprises</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fund Companies</td>
<td>4</td>
<td>2</td>
<td>8</td>
</tr>
</tbody>
</table>

Figure 11: Fund company sizes
5.2.1 Part 1: Existing Systems for Sustainable Investments

All funds use multiple systems for sustainable investments and the distribution of systems can be observed in Figure 12. The distribution between the systems is relatively equal and Hållbarhetsprofilen is the only system used by all fourteen fund companies. However, several interviewees pointed out that some systems are used only to communicate their sustainability efforts and do not affect their investment decisions (e.g. Hållbarhetsprofilen). Further, nine out of fourteen interviewees mentioned that they have also designed an internal system for sustainable investments.
As shown in Figure 13, six out of fourteen interviewees could not choose one single system to be most important. Three interviewees picked their own self-developed system and six interviewees were distributed on high-level UN guidelines and other systems. This suggests that many fund companies do not prioritize one superior system, but instead consider multiple systems together in their investment decisions. Moreover, some of the highly frequently used systems, such as Hållbarhetsprofilen, were not chosen to be the most important system by any interviewee. This is reasonable since it confirms that some systems are used only to communicate sustainability efforts and do not affect the investment decisions, while other systems guide the investment decisions. Only three interviewees picked their own self-developed system to be most important, though nine fund companies have developed such systems. This shows that external systems are of great importance to the fund companies and that they do not only focus on their own internal systems for sustainable investments. Without being asked, eight fund companies also shared that they prioritize different systems depending on what their investors demand and that it may vary over time.
Figure 14 illustrates that 57% of the fund companies consider all aspects of ESG to be equally important and that the rest prioritize either the environmental or the governance aspect. Nobody prioritizes the social aspects and some interviewees argued that it may be due to data limitations and the complexity of measuring social aspects. The governance aspect was prioritized by 29% of the companies, arguing that governance often spills over to the overall performance of the company. According to them, having governance issues often damage the company as a whole which consequently reduces the financial return.

65% of all companies stated that their systems for sustainable investments relate equally to all ESG aspects. That is in line with the 57% stating that their strategy focuses equally on all aspects in Figure 14. Only 14% stated that their systems relate mostly to the governance aspect, compared to the 28% stating that their strategy focuses on the governance aspect. This might imply that it is hard to find rigid sustainability systems focused on the governance aspect or that you have to construct such systems yourself.
As shown in Figure 16, 64% of the companies claimed that the systems have not affected their investment strategy. A common explanation was that the funds would invest sustainably regardless of the systems’ existence and that the systems’ only purposes are to communicate the sustainability efforts and function as sounding boards. Among the 36% claiming that the strategy was affected, a majority explained that they have made adjustments to comply with certain criteria required by the systems.
Approximately one third of all companies claimed to have resources for conducting the work that the EU Taxonomy requires, and approximately one third was uncertain. Regardless of the given answer, a majority emphasized that the EU Taxonomy data must be provided to them by the companies themselves or a third-party. Most of them were comfortable with conducting the work if that would be that case. If the data would not be provided to them, many of the interviewees claimed that they did not have enough resources to calculate it or conduct all estimations by themselves.
As observed in Figure 19, more than half of the funds (58%) claimed that the EU Taxonomy will affect their investment strategy. Half of them claimed that they are likely to be affected because they will try to achieve a good EU Taxonomy alignment. The other half did not believe that they would change any investments in order to achieve good alignment. Instead, the EU system would affect them by introducing new investment areas that would be easy to claim as sustainable (i.e. increasing the investible universe for the funds). The companies that were uncertain explained that a critical factor is whether their investors find EU Taxonomy alignment important or not.

A vast majority of the interviewees, 72%, answered that EU Taxonomy data provided by the companies will not influence which companies to invest in. The interviewees expected the required data to be provided by a third-party instead, and that estimations would be provided for companies lacking data. Some interviewees also stated that companies lacking EU Taxonomy data would be subject to engagement work and be encouraged to provide this data in the future, which would consequently make them an attractive investment from that perspective.
Almost one third of the fund companies expect the EU Taxonomy to become a main system for sustainable investments. However, one half of all fund companies expects it to only become a complement to existing systems. This was mainly due to the belief that investors will still find the existing systems to be satisfying and not prioritize EU Taxonomy alignment. Further, 71% of the companies answered that the disclosure requirements are important for the classification system’s impact and that they will increase the effect. The 29% that were uncertain were split among companies believing that the EU Taxonomy will have large effects, and companies believing that the EU system will have small effects, regardless of the disclosure requirements.
Figure 23: Interview Question 3.7

<table>
<thead>
<tr>
<th>Can you identify any problems related to conducting the EU Taxonomy work on your own?</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>5 out of 14 fund companies</strong></td>
</tr>
<tr>
<td><strong>3 out of 14 fund companies</strong></td>
</tr>
<tr>
<td><strong>3 out of 14 fund companies</strong></td>
</tr>
<tr>
<td><strong>2 out of 14 fund companies</strong></td>
</tr>
</tbody>
</table>

Figure 23 presents paraphrases of how the interviewees responded to an open-ended question regarding potential problems. Naturally, the responses varied but they could be categorized into four groups: data availability and transparency, resource limitations, time consumption and data inconsistency.

The most common response regarded the scarce ESG data availability and transparency from companies. They were worried about companies not providing the required data, especially smaller companies that must focus on the core business and companies outside the EU that do not find it important enough. This problem was more apparent for smaller fund companies since they have less resources to generate estimates and calculations on their own. On the contrary, larger fund companies commonly answered that they are positive towards the EU Taxonomy and that they have the resources and time to do the extra work. Some even prefer to keep the work inhouse so that they can acquire deeper knowledge of the EU Taxonomy and the underlying analysis. Another common response was that the EU Taxonomy work will demand extra resources that they do not have, and that some will have to hire consultants or buy the EU Taxonomy analysis from a third-party (e.g. MSCI or Sustainalytics). Last, two fund companies mentioned the problem of reduced comparability between funds as a result of the EU Taxonomy work being conducted differently by each fund company. They also claimed that different data providers may provide different data since they calculate or estimate differently, which consequently hinders fair comparisons between the funds. They request a praxis for the industry so that funds can become more comparable.
Figure 24 presents paraphrases of how the interviewees responded to an open-ended question regarding the long-term effects of the EU Taxonomy. Most of the interviewees believed that the EU Taxonomy will have positive effects in the long-run. Only three of the interviewees were skeptical of the EU Taxonomy and did not believe it would have any larger effects in the long-run. From the interviewees with an opportunistic view of the EU Taxonomy, the long-term effects of the EU Taxonomy were identified as reduced greenwashing, capital being steered to EU Taxonomy-aligned companies and funds, higher demands of data availability and transparency, and that the EU Taxonomy will become a main system that sets the definition of a sustainable investment.

### 5.3 Interpretation of the Results

#### 5.3.1 Interpretation of the Comparison Results

The EU Taxonomy has a prominent focus on the environmental aspect and the compliant activities overlap with some of the existing systems’ criteria. The existing systems’ fundamental focus is on how an activity is conducted. The EU Taxonomy also considers how an activity is conducted, even more stringent with specific compliance-thresholds for each activity. Moreover, the EU Taxonomy
also considers what type of activity that is conducted. However, only a few activities have been defined which consequently narrows down the EU Taxonomy-compliant investible universe. As a result, complying with the existing systems’ environmental criteria is far different from complying with the EU Taxonomy. If a fund manager strives for good EU Taxonomy alignment, the investment strategy will likely require adjustments with respect to the compliant activities.

The social and governance aspects are included in the EU Taxonomy through the minimum safeguards. The safeguards are based on compliance with established initiatives such as OECD Guidelines for Multinational Enterprises and ILO’s fundamental principles. The compliance criteria of the initiatives are fairly basic and easy to comply with. Some of the existing systems also consider these initiatives. This suggests that complying with the safeguards will not require drastic changes of the investment strategy for most funds.

Some existing systems consider the ethical aspect and other traits that do not fit under ESG nor ethics. These traits are included under the general aspect in this thesis. The EU Taxonomy does not consider any of these traits or any ethical aspects. This suggests that investments in EU Taxonomy-compliant activities might cannibalize investments in the ethical or general aspects (i.e. that increased investments in EU Taxonomy-compliant activities results in decreased investments in companies complying with the ethical or general criteria). Cannibalization will occur if a fund that considers ethical or general aspects today prioritizes compliance with the EU Taxonomy and therefore reallocates investments made with general och ethical criteria to EU Taxonomy-compliant investments.

The EU Taxonomy is designed as a classification system for economic activities that ultimately provides an alignment percentage for each portfolio. The compliance work (e.g. finding EU Taxonomy-aligned investments and calculating alignment percentage) shall be conducted by the fund companies, which will potentially require high work efforts. The EU has pointed out that third-party data providing companies play an important role in this and that they are expected to provide EU Taxonomy data in the future (TEG, 2019a). However, that will not be the case in the beginning since the data will be limited from the companies performing the economic activities. Thus, the work efforts for retrieving the EU Taxonomy data will be even higher in the early stages. Half of the existing systems also require the fund company to conduct the analysis and compliance work. However, most exist-
ing systems’ analysis and compliance work is not as extensive as the EU Taxonomy’s work efforts. Accordingly, the EU system will require more resources than the existing systems and be more time consuming.

Two fundamental insights were retrieved from the comparison section. If the fund companies will focus on achieving good EU Taxonomy alignment, they will be required to:

1. Adjust their investment strategy to focus more on companies performing EU Taxonomy-aligned activities. The activities are focused on environmental aspects and are measured precisely, and therefore many investments complying with existing systems will not be EU Taxonomy-compliant.

2. Allocate resources to conduct the required work efforts. More resources will likely be required in the early stages after the EU Taxonomy has been implemented.

5.3.2 Interpretation of the Interview Results

Although many systems for sustainable investments exist in the Swedish market, some are used only to communicate ESG efforts or as sounding boards, and not for guiding the funds’ investment decisions. Two out of three fund companies claim that the systems have not affected their investment strategy at all. Their good ESG ratings and certifications are merely a result of their prominent ESG efforts, and functions as proof of it. The choice of systems and to what extent they are used are highly driven by the demand from their investors. If the investors request high ratings or a certification from a specific system, the fund companies are likely to put in efforts to achieve that. The same argument was provided when determining whether the EU Taxonomy will affect the investment strategies or if the classification system will become a main system for sustainable investments. To what extent the EU Taxonomy will be embraced by the fund companies is highly dependent on how satisfying it is to their investors.

Only a small portion of the fund companies (14%) are prioritizing the environmental aspect of ESG. Those funds are naturally more prone to committing to the EU Taxonomy since it is focused on the environmental aspect. Other funds might have more resistance to committing to the EU Taxonomy since it only includes the most basic and fundamental requirements for governance and social aspects.
There are several potential issues among the fund companies, mostly data related. A requirement for many of them is that third-party companies will provide EU Taxonomy data and estimations where such data is non-existing. Accessible and unified data will be crucial in order for the EU system to be effective. Some fund companies are worried that small companies or companies outside of the EU will not provide EU Taxonomy data, and will therefore be excluded from the classification system even though they would be compliant. Funds that invest in such companies will thus receive a low EU Taxonomy alignment if estimates are not provided.

Most fund companies are positive towards the EU Taxonomy, although some interviewees expressed scepticism. Expected long-term effects are reduced greenwashing, increased engagement, simplified comparisons of funds and steering capital towards more climate-friendly activities. However, a prominent opinion among the fund companies was to wait and observe how other fund companies treated the EU Taxonomy.

Based on the interpretation of the interviews, six key insights are defined:

1. In order for the EU Taxonomy to be effective, the system must influence the investment decisions and not only function as a communication tool or sounding board as many existing systems do today.

2. Most fund companies consider all dimensions of ESG and will likely need other systems for assessing the governance and social dimensions.

3. EU Taxonomy data and estimations provided by third-party companies are crucial for many fund companies.

4. The fund companies are generally positive towards the effects of the EU Taxonomy. A majority believes that the classification system will affect their investment strategy. In addition, half of the majority believe that they will try to achieve a good EU Taxonomy alignment.

5. A majority of the fund companies want to observe how their peers treat the EU Taxonomy before making a move.

6. The dominant factor determining the magnitude of the EU system effects is how large the demand for a good EU Taxonomy alignment will be from the fund companies’ investors.
5.4 Good Alignment and its Consequences

As observed in the interview results, several funds will likely strive to achieve good alignment with the EU Taxonomy. However, the EU has not yet defined any alignment standards or percentage guidelines. In the absence of such definitions, good alignment becomes a subjective and relative term. Funds will thus have to compare their alignments with their competitors in order to assess how good their alignments are.

In the early stages, most funds will likely receive a low alignment and the definition of “good alignment” will therefore be a relatively low percentage. In later stages, more funds have likely achieved higher alignments which causes the definition of “good alignment” to become a higher percentage. Likewise, the percentage that constitutes good alignment will likely differ between industries since the mean alignment will vary between them. Industries including many EU Taxonomy-aligned activities will have a higher mean alignment than industries including few EU Taxonomy-aligned activities, and vice versa. Moreover, the percentage is likely to differ between geographical areas depending on which industries that are present in each specific region. As a clear example, it might be easier to find companies performing EU Taxonomy-aligned activities in a developed country, compared to a developing country.

The assumption that the general alignment level will differ between industries and geographical areas does not only entail different definitions of good alignment. Companies that strive to increase their alignment might reallocate their investments towards industries or areas that have a generally high alignment. This may lead to a bias towards companies within certain industries or geographical areas and ultimately steer more capital to such investments. If the bias becomes large enough and the value of such investments overinflate greatly, an asset bubble effect might also occur. Further, there is a risk that EU Taxonomy data availability will cause similar effects as well since companies without data are considered non-compliant. Large companies may consequently be favored over small companies since the latter might struggle to report EU Taxonomy data due to resource limitations. Additionally, large EU companies will be obligated to report EU Taxonomy data and therefore such companies might also be favored.

Reallocating investments to increase the alignment will be more challenging for some funds than for others. For example, a fund with a national focus will have less investment options than a global
fund. Likewise, a small cap fund might experience difficulties in finding companies that report EU Taxonomy data. Funds with a thematic focus might even find it impossible to increase the alignment if the theme does correspond to the defined EU Taxonomy activities. Admittedly, the investment opportunities are expected to differ between each fund type. However, the overall investment opportunities are expected to increase as more companies start to report data and thus become compliant with the EU Taxonomy.

While the EU has not yet defined any EU Taxonomy alignment standards, they are developing the EU Ecolabel for Financial Products (European Commission, 2019b). The Ecolabel is a voluntary award scheme that is expected to establish thresholds at holding and/or portfolio level. If the Ecolabel defines separate thresholds for each industry/area, the bias effect can likely be minimized. On the other hand, if the Ecolabel only defines a general threshold across all industries/areas, funds are more likely to reallocate their investments towards the highly aligned. However, the Ecolabel is still under development and researching its outcome is not included in the scope of this thesis.

5.5 Market Conditions

Sustainable investments have been present for decades but have blossomed substantially during the most recent years. Before 2008, during the pre-financial crisis period, the ESG focus in the financial markets was significantly smaller compared to today. The investments decisions were mainly driven by return, alphas and other financial criteria (Fidelity, 2018). When the financial crisis began, the banks received heavy criticism and were pointed out as the root of the problems. Several actors, including governments and the public, issued strong opinions about the banks’ capital allocation policies. As a result, the mistrust of the banks benefitted actors with an ESG focus. After the crisis, the global economy entered a recovery phase, and a couple of years later it evolved into an expansion phase. Both phases were characterized by high economic growth and low interest rates. The financial climate was highly beneficial and more capital was invested in the markets, specifically in companies considering ESG criteria (Fidelity, 2018).

A report from the Global Sustainable Investment Alliance (GSI Alliance), the Global Sustainable Investment Review, illustrates how sustainable investments have grown in comparison to conventional investments during the most recent years (GSI Alliance, 2018). The report provides data on sustainable investments, such as the ratio of global sustainable investing assets compared to the total
global managed assets (sustainable investing assets refer to asset classes which use an ESG strategy in the investment decisions). In 2018, the ratio of sustainable investing assets to total managed assets in Europe amounted to 49%. During the period 2014-2018, the compounded annual growth rate (CAGR) of sustainable investing assets was 6% in Europe, 16% in the US and 308% in Japan. The heaviest growth of this investment class occurred earlier in Europe, which explains the lower CAGR for that region. According to GSI Alliance, 46% of all global sustainable investing assets are European. However, the growth of sustainable investments have occurred during beneficial market conditions. The research on how the market conditions affect sustainable investments in particular is limited. It remains unknown how the expansion of sustainable investments will proceed if the market would enter a recession or a new crisis. Thus, it is arguable that the rise of sustainable investments is merely a consequence of the generous market conditions, and that they will decrease if the beneficial market conditions vanish.

The International Finance Corporation (IFC) conducted a study showing that 42% of fund managers believe that a financial crisis would result in a more extensive use of ESG criteria. Another 35% stated that it would temporarily decrease the ESG efforts (i.e. reduce their use of ESG criteria in the short-term), but have no effect in the long-term. Only 10% believed that it would reduce the ESG focus among investors (Witlin & Carnemark, 2009). Correspondingly, Ellis and Bastin (2010) found that during periods of financial crises, there is an increased awareness and more discussions about sustainability and sustainable business practices. According to the findings of Nofsinger and Varma (2014), sustainable funds using ESG criteria do not exhibit any out- or underperformance during crisis years. This view is further reinforced by several other studies, for example by Gangi and Trotta (2015). There is also research showing that the financial performance of sustainable funds was better than that of conventional funds during the financial crisis, and that they also recovered faster (Wu, Lodorfors, Dean, & Gioulmpaxiotis, 2015).

The opinions of ESG investments and their dependency on market conditions are scattered. Some argue that ESG investments will decrease as the market conditions toughens. Others argue that tougher market conditions will aid the expansion of ESG investments. Finally, an additional common belief is that tougher market conditions will reduce the ESG focus temporarily, but have no effect on ESG from a long-term perspective. Since the beliefs of market condition dependency are scattered, it is difficult to determine how the EU Taxonomy effects would be affected by tougher
market conditions. Nonetheless, it is important to keep in mind that there exists research supporting each belief. Determining the market condition dependencies is not included in the scope of this thesis and the authors will thus not attempt to formulate an answer to it. For this reason, the interested reader may research the field himself/herself to form a stronger belief.
6 Conclusion

As concluded in the comparison of the systems, the EU Taxonomy has a prominent focus on the environmental dimension of ESG. Further, the system’s environmental criteria differs greatly from the existing systems' environmental criteria and is highly transparent and measurable. As a result, complying with the existing systems’ criteria will not be sufficient in order to acquire a good EU Taxonomy alignment. A good alignment will thus require adjustments of the investment strategy for the vast majority of sustainable funds. Fortunately, there is a positive attitude towards the EU system and a will to adapt to it among the interviewed fund companies. A majority of the fund companies believe that their investment strategy will be affected; either by trying to achieve good EU Taxonomy alignment or by smaller means such as obtaining an increased investible universe.

In spite of the EU Taxonomy’s environmental focus, it also includes basic social and governance criteria that are fairly easy to comply with. It is important to include social and governance criteria as well since most sustainable funds consider all dimensions of ESG. The social and governance criteria are in line with most of the existing systems’ criteria and may thus be satisfying enough for many sustainable funds. However, some sustainable funds have developed their own systems for assessing these two dimensions more thoroughly, and they are likely to find the EU Taxonomy’s criteria insufficient. Funds that find the EU Taxonomy’s criteria insufficient will be forced to consider multiple systems for assessing ESG criteria, which refrains them from relying solely on the EU Taxonomy. It is unlikely that the EU system will become a main system for sustainable investments if a large proportion of the funds consider multiple systems. This issue was also expressed by the interviewees, where only 29% believed that the EU Taxonomy would become a main system for sustainable investments.

The EU Taxonomy work will require the companies to perform considerable amounts of data retrieving and analysis, and third-party data providers may significantly reduce the required resources for this. Large companies may have resources to conduct the work without third-party data providers. However, most small/medium sized fund companies interviewed for this thesis claimed that they will not be able to conduct the EU Taxonomy work without third-party data providers. Thus, a vital condition for a majority of the funds is that the EU Taxonomy data will be available via third-party companies.
The most dominant opinion among the interviewed fund companies was that the demand from their investors forms the foundation of all decisions. The systems are selected with respect to what their investors desire, and the demand for good EU Taxonomy alignment will thus determine to what extent the funds will adjust their investment strategies. The demand is also likely to influence whether the EU Taxonomy becomes a main system for sustainable investments or a complement to existing systems. If the demand grows large enough, the funds will be forced to use the EU Taxonomy as their main system in order to remain competitive.

As a result of the scattered beliefs regarding the sustainable investments’ dependency on market conditions, it is difficult to conclude how a potentially tougher market climate would affect the EU Taxonomy. It is yet to be determined if sustainable investments are affected differently than conventional investments during tougher market conditions. Further, the market’s definition of "good alignment” will definitely play an important role for the effects of the EU Taxonomy. This percentage is likely to be low in the early stages, only to increase as time passes, and eventually be defined by the EU through the Ecolabel. As the percentage increases, funds will be forced to adjust their investment strategies further which consequently increases the EU Taxonomy’s effects. Another characteristic of the early stages is that only few companies will have sufficient resources to report EU Taxonomy data. As time passes, more companies will establish EU Taxonomy routines and report the required data. These factors indicate that regardless of how effective the EU system will prove to be, it will be a slow process.

In conclusion, the results of this thesis clearly indicates that the EU Taxonomy has a substantial potential of affecting the strategies of the sustainable funds in the Swedish markets. However, the magnitude of the effects is mainly determined by the two following factors:

- Third-party companies providing EU Taxonomy data.
- The demand for a good EU Taxonomy alignment from the fund companies’ investors.

The next step is to conclude how the investment strategies will be affected by an adjustment towards the EU Taxonomy. The natural effect is that the sustainable funds will invest in companies conducting EU Taxonomy-compliant activities. Since activities for only the two first environmental objectives are defined yet, more capital will likely be invested in activities supporting those objectives. In the early stages, third-party data providers will not be present and small companies may
not have established EU Taxonomy data routines yet. Accordingly, the sustainable funds may favor large companies with sufficient resources for reporting EU Taxonomy data and becoming compliant. This effect should decrease with time as smaller companies manage to adapt and report EU Taxonomy data. Moreover, large EU companies will be obligated to report EU Taxonomy data which may cause a bias for them if their competitors do not report similar data.

Compliant activities will appear more frequently in some industries and geographical areas than in others. Hence, the alignment level will vary between industries and geographical areas. Simultaneously, adjusting the investment strategy to achieve a good EU Taxonomy alignment logically infers investments in companies with good alignments. It follows that sustainable funds that strive for good EU Taxonomy alignment will thus likely increase their investments in industries and geographical areas with good alignment. However, the general level of alignment of each particular industry and geographical area is yet to be defined. Further, adjusting the investment strategy to achieve a good alignment may prove to be highly challenging for certain fund types. For example, small cap funds may struggle to find companies with sufficient data and funds with a national or thematic focus may experience limited compliant investment options.

Since the EU Taxonomy focuses on the environmental aspect and does not overlap with all sustainability criteria that are considered by sustainable funds today, it reduces the definition of sustainability. A potential consequence is that sustainable funds reallocate capital from investments that are considered sustainable with today’s criteria, to investments that are considered sustainable by the EU Taxonomy’s criteria (i.e. cannibalization effect). Yet, there is no suggestion that EU Taxonomy-compliant investments are in fact more sustainable. They are merely measured differently with respect to other criteria. Admittedly, a dilemma emerges since the sustainable funds may be required to reduce certain sustainable investments in favor of EU Taxonomy-compliant investments. To what extent this will occur is determined by how high alignment the sustainable funds will strive for. Moreover, the reduced sustainability definition may also reduce the investible universe for funds that strive for high EU Taxonomy alignment. Consequently, such sustainable funds may limit their portfolio diversifications.
7 Limitations and Further Studies

7.1 Limitations

The accuracy of this thesis relies on the choice of systems for sustainable investments and on the interview quality. The systems included in this thesis were chosen based on findings from Avanza and numerous sustainability reports from fund companies. While the authors attempted to include the key systems of the industry, there is no guarantee that they succeeded. A poor choice of systems will likely yield skewed results and it is therefore paramount that the systems were chosen accurately.

Only fourteen representatives from different fund companies were interviewed for this thesis. Since that is only a small fraction of all sustainable funds in the Swedish market, the generalizability is limited. The interview contacts were provided by Söderberg & Partners which may consequently have caused biases in their favor. In addition, the knowledge level varied between the interviewees which also may have affected the accuracy of their answers.

Lastly, this thesis is based on draft reports of the EU Taxonomy. The finalized EU Taxonomy might deviate from what is described in the draft report, which may invalidate some of the analyses and arguments in this thesis.

7.2 Further Studies

In order to increase the generalizability of the results, a continuation or extension of this study could be conducted with more data points. First, the comparison of the existing systems for sustainable investments and the EU Taxonomy may be extended with more systems. Second, more interviews and surveys may be conducted. This would increase the data set and the representation of sustainable funds in the Swedish markets.

Further studies may also focus on the finalized EU Taxonomy and thus reach more accurate conclusions. In addition, it would be of high interest to research other areas of the EU action plan. For example, research based on the disclosure regulations or the green bonds may yield highly interesting results. That would also provide a more holistic view of the EU action plan, reflecting how the connected parts of the action plan will function in symbiosis.
Moreover, similar studies on other EU member countries would be of interest. This would allow for cross-country comparison of the effects of the EU Taxonomy, and it could further validate the success or the failure of the EU Taxonomy.
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A Interview Questions

Part 1: The interviewee and the fund(s)

1. What type of sustainable fund(s) does your fund company manage?

2. What are your work tasks and job title?

Part 2: Existing Systems for Sustainable Investments

1. Which systems for sustainable investments do(es) your fund(s) use?

2. Which system is most important for your sustainable fund(s)?

3. Which ESG aspects do(es) your fund sustainable fund(s) prioritize?

4. How do your systems for sustainable investments relate to ESG?

5. Have the systems directly affected your investment strategy?

Part 3: The EU Taxonomy

1. Do you have knowledge about the EU Taxonomy?

2. Do you believe that you have enough resources to conduct the work required by the EU Taxonomy?

3. Will the EU Taxonomy affect the strategy of your sustainable fund(s)?

4. Do you believe limited EU Taxonomy data provided by companies may influence which companies you choose to invest in?

5. Do you believe that the EU Taxonomy will become the main system for sustainable investments or become a compliment to existing systems?

6. Do you believe that the disclosure requirements are important for the EU Taxonomy’s impact?

7. Can you identify any problems related to conducting the EU Taxonomy work on your own?

8. What do you believe will be the long-term effects of the EU Taxonomy?

N.B. 13 of 14 interviews were conducted in Swedish and the questions were thus translated.
## Interviews

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<th>Date</th>
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<th>Interviewee title</th>
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<td>April 14, 2020</td>
<td>Lånsförsäkringar</td>
<td>Head of Sustainability</td>
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<td>April 14, 2020</td>
<td>Carnegie Fonder</td>
<td>Sustainability Analyst</td>
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<td>April 15, 2020</td>
<td>Didier &amp; Gerge</td>
<td>Sustainability Coordinator</td>
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<td>April 24, 2020</td>
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