

## „Finance needs to be sustainable in order to become a solution to our current challenges“



*Responsibility, transparency, sustainability, and independence – founded around these core values in 2006, the Luxembourg Finance Labelling Agency (LuxFLAG) is an independent and international non-profit association supporting the financing of sustainable development. By awarding a recognisable label to eligible investment vehicles such as ESG, Environment, Green Bonds, Microfinance, and Climate Finance, LuxFLAG provides clarity for investors and aims to promote raising capital for sustainable investments, while at the same time reassuring investors that those investment bodies labelled invest in the responsible investment sector themselves. Ahead of the LuxFLAG Sustainable Investment Week 2021, FondsTrends spoke with LuxFLAG's Chairwoman Denise Voss and its General Manager Sachin Vankalas about the current state of ESG in Luxembourg, and the quest for more transparency.*

**FondsTrends:** Denise, Sachin – please give us a brief introduction to the philosophy behind LuxFLAG. What is the enterprise's declared mission?

**Sachin Vankalas:** LuxFLAG, the **L**uxembourg **F**inance **L**abelling **A**gency, is a not-for-profit founded here in Luxembourg in 2006 with the aim to promote transparency within the financial sector. We issue five labels (or certifications) which can be classified into Impact and ESG, and we issue them for investment products, i.e. funds as well as active bonds in the field of Sustainable Finance. Our main mission is to bring more transparency and credibility for investors, particularly on the topic of Sustainable Finance through our independent la-

bels and certification process. Moreover, the expertise and knowledge we have gained in this field is made accessible for the industry through our Associate Members Platform where we organize events with working groups to share knowledge and to raise awareness of issues pertaining to Sustainable Finance. So, you have our labeling process as a tool to promote transparency for investors and asset managers on one side, and sharing knowledge, sharing expertise, and creating this momentum for the growth of Sustainable Finance on the other. This is LuxFLAG's mission and this is what we are living in terms of platform membership and the labeling side alike.

**Denise Voss:** From a context point of view, it is interesting to note that LuxFLAG and Luxembourg, as a country and a financial center, have been fairly early actors in the Sustainable Finance journey, which shows the commitment from both the government and the financial sector. The tremendous growth especially over the last two years (92% in the last 12 months alone) can be found in the regulatory push behind e.g. the EU's Sustainable Finance Action Plan or its Green Deal, but also in demand from investors. We are convinced there will be even more growth in the future.

LuxFLAG also has a cross-border international flavor which stems from the domicile of the investment funds we have so far labeled. To date, we have investment funds in ten different jurisdictions, most of them domiciled in Luxembourg, but investment funds from nine other countries, and then asset managers from 17 countries. That is how LuxFLAG sets itself apart from its competitors.

**FondsTrends:** Luxembourg is home to the Luxembourg Green Exchange (LGX), the world's first dedicated platform for green, social and sustainable securities, and eminent representatives of the country's financial industry such as Laetita Hamon (Luxembourg Stock Exchange) and Nicolas Mackel (Luxembourg for Finance) [recently called for a sustainable post-pandemic stimulus](#). Will ESG continue to play such an important role for Luxembourg in particular and on national levels in general?

**Sachin Vankalas:** The objective we have set as an internationally active financial center is that all finance must be sustainable – there is no way that finance continues its past trajectory. Particularly in the context of the current pandemic, finance is not an end in and of itself. It is part of a community, part of all challenges which we are facing on the social, the environmental, and the healthcare side. Finance should and needs to be part of the solu-



*Denise Voss*



*Sachin Vankalas*

tion to these challenges, and it is therefore high time for the industry to reconsider its role towards its contribution to society and our planet.

However, we should also distinguish between those players who positively contribute to the environment and the social side, and those who at least do not do any substantial harm. The essential distinction to make here is: “We do things right”, i.e. the ESG side of things where we clean up all processes, policies, and holdings, putting them together with the intention to grow towards a sustainable society and financial system, but also “we do the right things” bit, meaning e.g. proactively investing in certain sectors and activities which have a positive contribution.

**Denise Voss:** Once again, there is a Luxembourg aspect to this. ESG / Sustainable Finance, as is the phrase these days, is not new for the country, and the government has been clear about further developing its role as an international platform for Sustainable Finance. Luxembourg is already the second-greenest financial center globally in terms of financial depth, and according to the latest study, a third of the responsible investment funds in Europe are domiciled in Luxembourg. In terms of turning all finance into Sustainable Finance, as is the trend, Luxembourg is very well-placed to be a huge part of that movement, and it is a priority for the government and all the Ministries. So, for LuxFLAG business is booming and we are part of multiple working groups created in the industry and government level: In terms of education, we need to educate the people in the financial center about Sustainable Finance, but also public investors.

**FondsTrends:** How can ratings agencies such as LuxFLAG help support this trend?

**Sachin Vankalas:** Let us break down what a LuxFLAG label is: For asset managers, it is a tool providing a possibility to showcase their sustainability or impact credentials. For investors or asset owners, it is a tool to differentiate between those who merely claim and those who truly ‘walk the talk’. So, it facilitates investment choices for investors. Labeling agencies play an eminent and prominent role in facilitating investment decisions. If both sides stick to this mission of bringing more clarity, transparency, and credibility to investors on the products they are labeling, and if labels encompass all current market trends and challenges while at the same time anticipating the future and reflecting all that in the criteria, that is already a huge contribution from a labeling perspective to facilitating investor choices on a large scale. Retail investors are also going to significantly drive this whole ESG momentum; if we could make their jobs easier in achieving their aims, that would already be a big achievement from our side.

**Denise Voss:** Especially as we go forward here. At its most basic, a label will tell an investor: Someone has looked at this fund and it therefore complies with the criteria of the ESG label, of a climate label etc. – in other words, what you are buying does what it says on the

tin. Particularly interesting in the Sustainable Finance context is that there is a growing push from investors. Traditionally, it has been institutional investors such as pension funds, but now more and more retail investors, and especially the younger generation, will absolutely demand that all financial products they buy be Sustainable Finance products. Younger players will probably influence the older generation as well in this respect.

**FondsTrends:** ESG ratings have not had a shortage of criticism in the past, with US Securities and Exchange Commission (SEC) Chairman Jay Clayton even [calling them ,imprecise'](#). Quality and quantity of ESG data in particular have been cited as a weak point, as company disclosures on ESG practices are voluntary, rarely audited and not standardised. On the level of transparency, how can ratings agencies and national legislature help to confront this criticism?

**Sachin Vankalas:** One distinction to make off the bat is that Jay Clayton's comment is more concerned with the ESG ratings of individual companies such as Amazon or Google. We, on the other hand, do not rate companies as such, we rate financial products. However, there is enough evidence available to see that the ESG / sustainability perspective has allowed companies to identify certain risks and opportunities, and that process has started to become more formalized. And that leads us to ratings.

The stock universe contains 50,000 stocks, so right away there is a limitation on how frequently these ratings can and will be conducted. Next is the issue of data: At present, hardly any rating agency's methodology is anticipatory, asking e.g. which data protection laws might be following with the new US administration, or what impact that might have for Facebook or Google. Another aspect concerns the frequency of data: ESG is not something you check in on once or twice a year. It is a day-to-day business and, again, very difficult for rating agencies to take into consideration. Finally, there is the issue of methodology: As of now, each rating agency has their own respective methodology, so the same company could be investable from an ESG point of view, and non-investable from another provider's perspective. Lots to be done, then, for all of us as an industry rather than just blaming it on rating agencies alone.

**Denise Voss:** The data from rating agencies is important for asset managers, and it keeps getting better as the companies themselves do more work around aspects such as carbon footprint. Asset managers or investors in general obviously need to use the rating data, but they should not just rely entirely on the rating agencies but look for additional information. Asset managers now integrate ESG into their investment analysis process and investment decision making process. But it is not just about I'll take that rating, or I'll take those three ratings and I'll take the average of them to come up with a score – it needs to be a thoughtful process. And regulators hence are expecting them as well to not just blindly take ratings. There is also an interesting discussion going on, with asset managers saying they prefer the

raw data to ratings from a rating agency. You can understand where the asset managers are coming from, but understandably, rating agencies are saying, well, no because that's our business. Luckily, this development includes all parties and each aspect of the value chain for the entire industry.

**FondsTrends:** For the second edition of its [Sustainable Investment Week \(#LSIW20\)](#), your event series on all things sustainable such as climate finance, ESG, impact investing, and Sustainable Development Goals, LuxFLAG hosted about 22 sessions including over 1000 participants and 50 speakers over the course of five days. This tremendous demand shows the importance of your mission – supporting and promoting sustainable finance. And there is more to come in the upcoming months - especially with regard to the EU Action Plan for Financing Sustainable Growth. What can we expect and what will be the “Green Outlook” for 2021?

**Denise Voss:** We are very happy to see that the LuxFLAG Sustainable Investment Week has already gained a certain recognition, even just after two editions. But it is important to note that a lot of that is also on the back of the 90-plus LuxFLAG associate members, so it is an opportunity for them to showcase, to help the community see what they are doing, and to engage in discussion about how we can become better. That is the spirit in which the Sustainable Investment Week has been developed and I think that is why it has been so successful as well. People really feel they can learn and see what others are doing. Sustainable Finance is a journey, and people are in different stages of that journey. Moreover, this “let's work together” attitude is another very Luxembourgish trait. It allows for industry players to be competitors while at the same time sharing information for the greater good. LuxFLAG Sustainable Investment Week is another good example of that spirit, and there are many of them here in Luxembourg.

**Sachin Vankalas:** LuxFLAG is very much the right place to bring this community together. We have been in touch with these organizations for over ten years, particularly and exclusively on the topic of Sustainable Finance, and we particularly have an eye on organizing these events as content-heavy rather than promotion-heavy. It's about market trends, about helping each other, about having the common ground which allows progress for everybody. In other words, the whole idea of the week is about providing a platform and putting the topic of sustainability at the forefront of finance.

As a reasonable-size asset manager, you simply can no longer afford to not know about Sustainable Finance, and 2021 will see more regulation and standardization. As Europeans, we have spent five years trying to understand and pinpoint what we mean when we talk about Sustainable Finance, and I think we are getting there. As in any other industry, there will be exploiters, but there will be market pressure as well. Yes, there will probably be greenwashing and SDG washing – yet, the more greenwashing there is, the more important LuxFLAG becomes.

Moreover, people are choosing their lifestyles more and more sustainably, and that puts a little bit of pressure on everyone: If the general public start doing this, it puts pressure on politics, on businesses, and – eventually – the financial industry. The key drivers, the citizens or individuals, are already playing a big role.

**FondsTrends:** To conclude on a more personal note: How have you both experienced the COVID-19 pandemic and the impact it has so far had on work life? Which changes are here to stay, which are more hype than trend?

**Denise Voss:** Oddly enough, my retirement from Franklin Templeton coincided with the COVID lockdown. No longer going into the office every day would have been a big change, had it not happened to everybody. My transition into being an independent director was a virtual one, then, which is interesting given that a board of directors is a college of individuals and expertise, coming together to oversee investment funds in this case. On a personal note, I feel very happy and very lucky to be in Luxembourg. Given the resources we have, we are eminently privileged to be here at this point in time. Professionally, the pandemic has pushed forward certain things from an ease-of-doing-business perspective, such as e-signatures for documents. Companies will also have to decide whether to stick with working in offices and/or providing flexibility at home. There is obviously an important aspect of face-to-face and the human element that you do not get via PC screen, but we are still experiencing the situation and so still lots of work needs to be done in this respect.

**Sachin Vankalas:** Managing an organization such as LuxFLAG, with the kind of passion, ambition and motivation towards a sustainable future at its core, requires a certain amount of human contact, which has been a bit challenging these past few months. At the same time, this has been an opportunity to restructure and redevelop areas where we could identify certain amounts of efficiency, such as fostering digitalization, doing work through common shared platforms, so all is not lost. At the end of the day, after working the way we have been for almost a year now, the ultimate result will be positive or even surprisingly positive in some ways. Though the last months have been challenging for everyone, particularly on the human connection side, we as a small, agile organization have adopted and are now also more resilient towards this new way of working. On the personal side, similarly, it has been difficult. I do agree with Denise, however, being in Luxembourg is the best thing that could happen to you in this pandemic in terms of personal safety, health and confidence. Another positive outcome: Our topic is tangibly becoming more important due to this crisis.

**Denise Voss:** Also, in terms of the privilege mentioned, it was quite interesting to see how easy it was – relatively speaking – for the financial services industry to switch to virtual working from home. But clearly, there are plenty of issues out there for individuals who do not have the kind of privilege that we enjoy. Lots to do, but it all comes down to “build back better” – even in the EU green deal they talk about making that transition to green

in an inclusive way. So, hopefully that happens, and we could be part of that. This is quite exciting!

**FondsTrends:** Denise, Sachin, thank you very much for the interview, and all the best to you both!

## Sustainable Investment Week #LSIW21

LuxFLAG is happy to announce #LSIW21, the platform to Associate Members to showcase their commitment and concrete actions in advancing Sustainable Finance. Find out more about our future events and how to join LuxFLAG's event series #LSIW21. For any enquiries regarding LuxFLAG Associate Membership, please reach out to [communications@luxflag.org](mailto:communications@luxflag.org). For more information on labels and the labelling process, feel free to contact [info@luxflag.org](mailto:info@luxflag.org).

### LuxFLAG Sustainable Investment Week 2021 #LSIW21



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