

## ***Evaluation of LuxFLAG***

### ***Executive summary***

#### **LuxFLAG**

The Luxembourg Finance Labelling Agency (LuxFLAG) is an independent, non-profit association whose objective is to promote and mobilise capital for the Responsible Investment sector. LuxFLAG offers four different labels for funds investing in social impact and sustainability related areas (microfinance, environment, ESG, climate finance), as well as a label for green bonds. The labels aim to reassure investors that the labelled investment vehicle actually invests, directly or indirectly, in the Responsible Investing sector.

#### **Evaluation objective**

The evaluation of LuxFLAG aims to assess the results and impacts achieved by LuxFLAG during the period of the two agreements (“conventions”) between the Government of the Grand Duchy of Luxembourg and LuxFLAG (2014-2016 and 2016-2018). In particular, the evaluation assesses the performance of the Agency based on the evaluation criteria of effectiveness, efficiency, relevance, impact achieved and sustainability. In addition to this backwards-looking assessment, the evaluation is meant to provide recommendations on the future development of LuxFLAG, taking into account the general objectives of the conventions to have an effective and efficient organisation that can eventually become autonomous and financially self-sustaining and in anticipation of the impact of future market and regulatory developments at national and European level.

#### **Evaluation findings**

As at June 2018, LuxFLAG has issued labels to a total of 85 investment vehicles. On average, the Agency has added 7 to 8 new vehicles to its portfolio each year since its creation, with the exception of 2017, when the number of labels grew by 53.8% due to the award of 21 Green Bond labels to the EIB’s Climate Awareness Bonds. The original label provided by LuxFLAG – the Microfinance label – remains the most popular one to date, with 29 labelled investment vehicles.

Almost all LuxFLAG fund labels are issued to funds domiciled in Luxembourg, but the majority (84%) of asset managers/investment advisors for the funds labelled by LuxFLAG are based outside of Luxembourg. The total assets under management of the labelled funds currently amount to EUR 19bn.

The increasing number of labelled funds indicates that the demand for and recognition of LuxFLAG’s labels has been growing. However, LuxFLAG fell short of the targets for issued labels per year that are set in the conventions with the government. A number of factors have contributed to this, including the limited resources of the Agency and the focus on introducing new labels, but also the small, if growing, size of the Responsible Investment industry overall.

In terms of **relevance**, the different labels offered by the Agency are seen as relevant and responding to developments in the market. The eligibility criteria for awarding the fund labels are overall judged to be

in line with industry standards and a reliable basis for avoiding cases of “greenwashing”. In the case of the Microfinance label, it is considered necessary to revise the label to reflect market development towards the broader field of inclusive finance and impact investing. The other label which requires a review is the Green Bond label, which is currently not generating any commercial success, and appears to suffer from an unclear value proposition and lack of integration with the Luxembourg Green Exchange.

As regards the value provided by the LuxFLAG labels (**effectiveness**), feedback from consulted stakeholders indicates that there is a broad consensus that LuxFLAG is a credible entity which provides independent third-party assurance. The Luxembourg government’s support for the Agency is seen as a contributing factor to the perception of the Agency as credible and independent from the industry. At the same time, if LuxFLAG is to become a reference point for labelling at European level, the geographical association in the name of the Agency with Luxembourg could be considered a limiting factor for marketing the labels abroad.

The representatives of the funds labelled by LuxFLAG generally considered that LuxFLAG labels give additional confidence and comfort to investors. This reputational effect is stronger for smaller funds which do not have an established reputation in the Responsible Investment industry globally or at European level. Conversely, the reputational effect of these labels is less pronounced for top fund managers who are already well established and already have a certain credibility of their own.

Labelled funds use the labels in different types of marketing activities, but overall, there is limited awareness of the labels among investors. This is particularly the case for institutional investors outside of Luxembourg and for retail investors in general. There is underlying lack of clarity about whether retail investors are a target group for the information provided by the labels, especially since there are currently no marketing activities towards them. Overall, there is consensus that LuxFLAG needs to improve its value proposition and targeting while increasing its communication and marketing activities abroad.

LuxFLAG delivers **impact** in two distinct ways. Firstly, the funds labelled by the Agency generate positive social and environmental impact through their investment in Europe and abroad. Secondly, the Agency itself contributes to the development of the sustainable finance industry in Luxembourg by acting as a knowledge centre in different fora and through its associate member activities. LuxFLAG also contributes to the growing awareness of Luxembourg’s commitment to supporting sustainable finance.

In general, there is consensus among LuxFLAG’s stakeholders that the Agency’s core business at the moment is that of labelling financial products. A number of stakeholders considered that there is a need to clarify the purpose for and extent to which LuxFLAG should develop its associate member, knowledge centre and promotional activities. There are clear synergies between these and its labelling activities, but the Agency has limited resources and other industry actors in Luxembourg (can) play a similar role. Therefore, many stakeholders consider that there is need for more clarity about LuxFLAG’s role as a centre for knowledge and promoter for responsible investment within the overall ecosystem of sustainable finance industry associations and government initiatives in Luxembourg, and as a potential coordinator for these. The Board of Directors of the Agency is comprised of key public and private sector decision-makers in the area of sustainable finance in Luxembourg, which makes it particularly well-suited to guide the future development of the Agency’s role.

At the organisational level, LuxFLAG's set-up is characterised by a relatively small number of permanent staff members – three full-time employees as of 2018. At the same time, key operational procedures are based on informal processes and ad-hoc arrangements. As a result, in the event of a change in the team there could be a business continuity risk for the Agency, which needs to be addressed.

In terms of **efficiency**, the evaluation finds that overall, the Agency's operations appear to have been efficient. The contributing factors to this outcome are LuxFLAG's focus on financial discipline that has kept the team small and the adopted approach of leveraging the support of Charter and Associate Members for the implementation of key operational processes at no cost to the Agency.

The analysis of **sustainability** considers the extent to which LuxFLAG could become a self-sufficient organisation – specifically, whether it could generate the same or improved outputs and outcomes in a scenario where it does not receive a government subsidy. The performed analysis of different scenarios for growth indicates that although the increasing interest in responsible investment can lead to higher growth over the coming years, there is little evidence to substantiate an expectation that the Agency can sustainably expand its operations (in terms of revenue-generating labelling activities) to the levels required for self-sufficiency by 2020, while addressing its current challenges and investment needs.

## Conclusions & recommendations

The results of the evaluation can be summarised in the following **main conclusions**:

- There is increasing interest in Responsible Investment and **the relevance of LuxFLAG is bound to grow**.
- **LuxFLAG is at a turning point** – building on the progress made so far, there is potential for further growth. However, this growth seems unlikely in the event that the Agency needs to become self-sufficient in the short/medium term. Rather, the growth is contingent on the Agency's ability to focus on **consolidating its labelling offer and activities** as well as **adequate investment** in human resources and IT tools/infrastructure in support of future growth objectives.
- Key stakeholders are **generally satisfied with LuxFLAG's performance** to date, but the **value proposition** of the Agency's labelling activities and **awareness of the labels** within Europe need **to further improve**. This could bring additional value to clients and allow the Agency to grow further.
- In terms of the current label offer, the **Microfinance label** needs to be updated and the relevance of the **Green Bond label** needs to be reviewed, in particular if no suitable cooperation with the Luxembourg Green Exchange is established with regards to its deployment.
- There is a need to **clarify the role** of LuxFLAG within the Sustainable Finance ecosystem in Luxembourg in terms of its current knowledge centre and promotional activities and its potential coordination activities.
- **Changes at the organisational level should be considered** in terms of internal resources, procedures' development and the use of external resources.

The conclusions lead to the formulation of five main recommendations towards the Agency.

### **Recommendation 1 – Mission & Vision**

A high-level strategy development process should be undertaken to define LuxFLAG's mission and vision within the context of the Luxembourg sustainable finance ecosystem and align its business model and product offer to these. The result of this process should be reflected in the new convention for the Agency, which should thereby clarify its mission, targeted impact, specific objectives and ensuing tasks.

### **Recommendation 2 – Product offer**

The product offer of the Agency should undergo a strategic review that will address underlying inconsistencies in its value proposition and marketing approach. This will help the Agency develop a systematic and effective marketing approach that targets strategically the different customer and target audience segments that the agency needs to engage with to deliver value.

### **Recommendation 3 – Communication**

A new communication concept should be defined, including an institutional communication strategy and dedicated communication strategies for each label. The concept should specify the objectives of the communication activities for each of the main stakeholder groups, define the main messages to be delivered and the channels to be used.

### **Recommendation 4 – Governance & Organisation**

A number of key aspects related to the governance, organisational structure and processes should be revised to improve the operational efficiency and sustainability of LuxFLAG. The recommended revisions concern the definition of governance and organisational roles, the development of procedure descriptions and the potential replacement of current third-party assurance procedures.

### **Recommendation 5 – Financing & Resources**

Considering the industry evolution and the credibility of LuxFLAG today, there is a case for increasing its operational capacity and investing strategically to position the Agency effectively for the future, while ensuring its long-term viability. In the short-to-medium term, the government should maintain its subsidy to the Agency to support the investments needed in staff and IT tools/infrastructure. The recruitment of additional full time employees should be considered to allow for scalability and to address the present business continuity risk.

The steps required for implementing the recommendations are summarised in an implementation roadmap that is shared at the end of this report.