

**EFAMA's COMMENTS ON JRC's TECHNICAL REPORT ON EU ECOLABEL  
DRAFT CRITERIA PROPOSAL FOR THE PRODUCT SCOPE AND ECOLOGICAL  
CRITERIA**

**6 May 2019**

**SUMMARY**

EFAMA welcomes the European Commission's initiative to develop an EU Ecolabel for retail financial products. We see this as an opportunity to create a coherent European approach and promote sustainable investments among retail investors.

Given the wider context and current focus of the "Ecolabel", we believe it makes most sense to confine the label to environmental sustainability. Nevertheless, we agree that some minimum safeguards pertaining to a product's social and governance-related sustainability should be provided for.

We would like to stress the need for the clarity of purpose and objectives this label is trying to achieve. Also, the EU Ecolabel criteria should strike the right balance between promoting the best practice and ensuring that the criteria are realistic so that asset managers can build a diversified portfolio. Appropriately calibrated thresholds may be necessary to avoid green-washing and ensure that the label promotes the best practices on the market. However, it is important to avoid an approach that would be too stringent and prescriptive hence leading to box-ticking and insufficient supply of funds that meet the criteria. This would create the risk that the Ecolabel may not mobilize capital on the scale necessary to meet the Sustainable Finance and Sustainable Development targets.

To ensure the success of the EU Ecolabel, it is of utmost importance that the JRC has a comprehensive understanding of the impact that the EU ecolabel proposal is likely to have on the market, including how many products and issuers would likely be eligible for the label. To that end, we suggest appropriate testing / a feasibility study is performed to probe the market to analyse the impact of proposed thresholds and exclusions on a range of eligible financial products. To have a full picture, all concerned stakeholders, including retail investors, issuers (both large and small and mid-caps) should also be properly consulted.

While we are supportive of creating an EU Ecolabel to promote channelling of funds into sustainable investments and facilitate choice for retail investors, there are some concerns around increased costs EU Ecolabel will entail. It should be considered how to design the label so that it provides sufficient value-added for investors, whilst having to absorb the cost of requisite safeguards and verifications processes.

Lastly, we would welcome a clarification on some aspects. We would like to inquire whether the Commission intends to develop additional labels on other aspects of sustainability, for instance an overarching "ESG" label, or perhaps a targeted "social label". We are also wondering how the Commission sees the EU Ecolabel interacting with existing labels across the EU.

Please see our detailed responses to the questions for more details.

## Criteria proposal and criteria structure

Q 1.1 Do you agree with the proposal of a set of mandatory criteria for the EU Ecolabel for this Product Group?

We agree in principle with the proposed set of mandatory criteria as a structure for the envisage EU Ecolabel for financial products. However, some of our members have concerns that strict mandatory criteria, and especially thresholds, may result in capturing too limited part of the funds universe. Therefore, while we acknowledge that any labelled fund must comply with some minimum requirements, an appropriate balance between mandatory and aspirational criteria must be found. The criteria have to be realistic so that asset managers can build a diversified portfolio and respect a balance between ESG and financial risk and ensure positive returns for investors. It is therefore crucial that thresholds are tested in practice and properly assessed once the taxonomy is finalised.

Some of the industry participants are not convinced about the exclusions based on social or ethical aspects. It is understood that the purpose of the EU Ecolabel, as the name suggests, is to promote ecologically sustainable investments. Many members also believe it should be left to the end-investors to decide what is ethically acceptable for them and what products to invest in. Nevertheless, in general there is consensus that some minimum safeguards pertaining to a product's social and governance-related sustainability should be provided for.

## Proposal for the Retail Financial Products scope

Q 2.1 Do you agree with initial proposed scope for the EU Ecolabel?

We support that the retail funds, including UCITS and AIFs, shall be in the scope of the EU Ecolabel. However, we would recommend using legal terms established under the relevant EU frameworks to define the scope of application. We fear that creating new terms like “Retail Alternative Investment Funds (RAIF)” could lead to confusion and legal uncertainty.

Our understanding is that the insurance-based investment products, in the meaning of Article 4(2) of the PRIIPs Regulation, will be also captured in the scope of the EU Ecolabel. We would like to point out that this would include a wide range of insurance contracts with an investment element, not limited to unit-linked insurance contracts. The product manufacturer responsible for issuance of insurance-based investment products is always the relevant insurance company. Therefore, the description of the Retail Financial Product scope should be adjusted. We would suggest the following wording for the box on page 17 of the Technical Report to reflect this:

*“This product group shall comprise the following **retail** financial products that are provided as a service by a **UCITS management company, an AIFM or an insurance undertaking** and have been packaged for retail investors in accordance with [...]:*

- **UCITS and, where applicable, AIFs offered to retail investors**
- **Insurance-based investment products**

*The retail financial product shall be **notified** or authorised for marketing or distribution in a member state of the European Union.”*

We would also like to clarify whether the EU Ecolabel would apply at the product manufacturer or the product level. We understand that the EU Ecolabel may be awarded to “goods and services” which are

supplied for distribution, consumption or use on the Community market pursuing the EU Ecolabel (Regulation (EC) No 66/2010 of 25 November 2009. Financial services products seem to well fall within the category of “a good or service”. At the workshop in Seville, we understand it was explained that “it is the financial services being provided by the product manufacturer of the green financial product which would be ecolabelled, while the EU Ecolabel logo may figure on the promotional material of the green product itself”. This has created some confusion and concerns among the industry that emphasises that **ecolabel can only be appropriate at the product, and not at the manager level**. Otherwise, this would unnecessarily limit products that can receive the EU Ecolabel only to those that are offered by asset managers that specialise solely in products that would meet the requirements of the EU Ecolabel. We assume this is not the intended objective and we suggest that the JRC clarifies that.

Q 2.2 Do you think other financial products/services should be included that are not covered in the initial proposed scope?

ELTIFs could be included in the proposed scope.

Q 2.3 To what extent could savings and deposits be included within the scope in the future given the need to be able to identify specific uses of the money held in them as being ‘green’?

No comment

Q 2.4 While bonds are included as underlyings to investment funds, to what extent could retail bond products themselves be included within the scope in the future, with verification of their greenness based on the Green Bond Standard?

No comment

Q 2.5 Are there any other financial products or retail investment opportunities that could be considered for a future scope?

Green loans could be considered for a future scope.

### **Proposal for Criterion 1: thresholds on green investment portfolio and economic activities**

#### *Relating to green economic activities*

Q 3.1 Is there a way to address economic activities not yet featured in the current version of the EU Taxonomy and its technical criteria?

Investing in carbon credits could be included to address economic activities not yet featured in the current version of the EU Taxonomy and its technical criteria.

Due to the alignment with the EU Taxonomy, we would suggest to wait at least until the adoption of the Taxonomy framework at Level 1 before the EU Ecolabel becomes applicable.

#### *Relating to green investment portfolio value*

Q 3.2 How could the revenue for a parent group with number of daughter companies and their share be handled?

We suggest to discuss that with the issuers.

Q 3.3 How should assets held in other investment funds be treated within this criteria? Do they require any special form of verification?

We believe that a 50% plus is a reasonable threshold at portfolio level while 70%, as suggested, is excessive given the diversified nature of many companies.

However, for **equities held in the portfolio**, we would suggest a lower threshold than the proposed 50% at company level. This could possibly be complemented with more stringent exclusions for the rest of revenues/turnover (activities of the company). This is critical because what is important is the overall positive impact of the company, and to foster the right technologies and activities.

A higher threshold for assets held by portfolio (meaning at company level for equities) would lead to practically excluding two types of companies:

- Companies that are developing new, cutting edge technologies which need to be encouraged. New technologies will hardly make up 50% or more of their revenues from green economic activities.
- Large companies that are key players and represent a sizeable share of the market. Because of their size and diversification, it may be difficult to achieve that their activities account for 50% green economic activities.

Nonetheless, any thresholds set for determining the greenness of an investment portfolio or assets held in the portfolio, as well as exclusions, should be tested with regard to their impact on a range of eligible products. Our members flagged that very few funds currently available on the market would qualify for the EU Ecolabel on the basis of the proposed thresholds. The EU Ecolabel becoming a niche product would run against the objective of stimulating the financing of environmentally sustainable projects.

Moreover, it would be useful to have a clearer picture of the technical criteria for the green economic activities to be set up by the EU Taxonomy.

For **bonds**, we would advise that complying with the EU GBS should not be a compulsory element of qualification for the EU Ecolabel. The EU GBS is still being discussed and it is not possible to assess at this stage how popular and successful it will be. In case the EU GBS would turn out to serve a niche market, the bond investment opportunities of funds wishing to qualify for the EU Ecolabel would be severely constrained. Moreover, acceptance of EU GBS certificates as a proof of compliance with the greenness requirements should already incentivize for such investments as compared to investments in other green bonds.

For **assets held in other investment funds (target funds)**, it would be very difficult to apply a look-through approach to determine the degree of greenness at the fund-of-fund level. If at all, such look-through should be limited to specific points in time, e.g. linked to the end of the fiscal year of the target fund and publication of its financial statement. Under such approach, it would be sufficient to look into target fund holdings in equities and bonds once a year in order to calculate their contribution to the greenness of the overall portfolio. A simplified treatment should be envisaged for target funds certified under the EU Ecolabel or any national label.

Q 3.4 To what extent should real estate also be considered as a specific asset within the portfolio verification? If so, how could its performance be verified?

It seems appropriate to include investments in real estate in the range of assets potentially eligible for the assessment of greenness. Such assessment should also be based on the EU Taxonomy. The TEG is

about to propose technical criteria for a taxonomy for buildings. However, the proposal under consultation seemed to be very narrow and not taking into consideration the existing buildings. This would make it problematic for the outstanding green bonds. We are looking forward to see the TEG's final proposal and we hope that, if properly calibrated, it could serve as a foundation. Performance should be verified by the Energy Performance Certificates where available.

Q 3.5 Should assets for which verification of greenness is not required be included within the total portfolio asset value?

We deem it overly ambitious to include all assets in the total value for calculating the threshold in case the overall portfolio threshold of 70% as regards investments in green economic activities is maintained. Depending on the investment strategy and liquidity conditions, investment funds might be prompted to hold larger amounts of cash over a longer period of time (or to extend their use of derivatives for hedging purposes). Therefore, we would suggest to relate the portfolio threshold only to the cumulative value of assets for which the degree of greenness can be assessed. Otherwise, we would suggest to lower the overall portfolio threshold to e.g. 50%.

Q 3.6 Should any type of criteria on trading practices and/or use of funds be applied to derivatives and cash?

We would suggest to exclude short selling and derivatives on soft commodities (on agriculture).

Q 3.7 Does the assessment and verification require any specific parts to be tailored to individual products within the scope?

We do not see the need for further tailoring of the requirements. We would suggest to keep it simple, as cost and complexity of assessment will heavily impact the success of the label.

### **Proposal for Criterion 3: Excluded activities – Environmental aspects**

Q 3.8 Do you think the proposed environmental exclusions should be expanded to include more economic activities?

The taxonomy is still being developed, and therefore for the moment it is hard to evaluate the impact of the proposed environmental exclusions since they are based on specific economic activities to be determined by the EU Taxonomy.

Nevertheless, tentatively we would support the following environmental exclusions:

- Full exclusions for those activities that breach EU laws E.g. illegal forestry
- Partial exclusions (we would propose 10% instead of 5% revenues threshold) for all other activities proposed to be excluded at company level. This includes fossil fuels (with the exception of special types of gases e.g. hydrogen gas).

In case of electric powers the metric for exclusion should be carbon intensity and not % of revenues to ensure as it is important to look at transition and encourage companies to reduce carbon intensity. The carbon intensity of electric utilities should be aligned with the well below 2 degrees IEA scenario.

As stated above, we insist that an extensive analysis of such impact is performed before taking any decision about specific exclusions and possible cut-off thresholds. In particular, we suggest to examine how many issuers from the energy sector in the EU would qualify for investments by EU Ecolabel certified funds if the proposed exclusions were in place.

Q 3.9 Do you think the partial exclusions threshold should apply to each company’s activities or to the portfolio as a whole? If it should apply at portfolio level, should it be set differently for specific sectors?

Our members’ views are diverging. Some believe they should be applied at company level for all companies within the portfolio. Others believe that the partial exclusion threshold should be set at the level of the overall portfolio which should allow for a potentially wider range of eligible assets and rebalancing of holdings within the portfolio.

**Proposal for Criterion 3: Social and Ethical related exclusions**

Q 3.10 Do you think the proposed exclusions list on the basis of social & ethical aspects should be enriched with more activities?

We would like to suggest caution with exclusions. We hear that market analyses performed on ESG products shows that exclusions as investment strategy tend to have very low impact on sustainability of companies as funds tend to avoid certain companies or sectors instead of engaging with them on ESG issues. It can also lead to lower performance in financial terms. Exclusions also limit the scope of eligible investments and thus might impede proper diversification.

As regards the exclusions proposed for criterion 3, we do not believe it is appropriate to apply purely ethically motivated exclusions for products certified under the EU Ecolabel. The concept of the EU Ecolabel, as the name suggest, should focus on promoting environmentally sustainable investments. It should be left to the end investor to decide what moral choice he/she wishes to make. Impose selected ethical values upon European investors would limit freedom of choice.

Nevertheless, we are supportive of some minimum safeguards pertaining to a product’s social and ethical aspects. Stricter criteria could be applied in case of an ESG label.

Q 3.11 Do you think it may be appropriate to also exclude poor corporate management practices and/or poor human capital development? If yes, how it will be possible to verify such exclusions?

As explained above, we believe the EU Ecolabel should focus on the environmental aspects as the name suggest. The definition of sustainable investments in Article 2(o) of the Disclosure Regulation already requires that “the investee companies follow good governance practices, in particular with respect to sound management structures, employee relations, remuneration of relevant staff and tax compliance”. These criteria of good governance could be included in the framework for the EU Ecolabel but we would warn against adding others.

**Proposal for Criterion 4: Consumer information**

Q 3.12 What will be a reasonable interval for monitoring and reporting information to the consumers?

We think that overall providing information to retail investors annually is reasonable. However, a lot of the information suggested for reporting is already subject to disclosure rules under e.g. the Disclosure Regulation or SRD II. In particular:

- The environmental and financial objectives of the portfolio are already part of product information in either UCITS KIID or national KIIDs and in the fund prospectus. Disclosure on environmental objectives of sustainable funds will be further enforced by the Disclosure Regulation and provided both on the website (Article 6(1) of the Disclosure Regulation) and in the fund prospectus (Article 4a(1), 5(1) in connection with Article 4(1) and (3) of the Disclosure Regulation). Therefore, there is no need to duplicate such disclosures for products certified under the EU Ecolabel. In any case, environmental and financial objectives are part of the contractual terms/articles of association of a fund and will change on rare occasions only. They should not be subject to annual disclosures.
- Information on corporate activities undertaken by the fund management company in relation to the portfolio undertakings will be disclosed by all fund managers under Article 3g(1)(b) of SRD II. It is unclear, however, whether the proposed item 2 of criterion 4 aims at disclosure of corporate activities and governance structures of the fund management company itself which is clearly of much lower relevance in terms of qualification of the fund portfolio for the EU Ecolabel.

We would like to warn against any duplication or overlap of regulatory requirements as this is not only burdensome for the industry, but also unhelpful to investors, as the example of MiFID II shows. Any duplication, overlap or inconsistency of disclosures in the context of the EU Ecolabel should thus be avoided.

As regards verification of compliance with the EU Ecolabel, it seems reasonable to perform annual checks based on the portfolio composition at a specific record date. This corresponds with the current verification practice with regard to the national labels.

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