Update on: **Development of EU Ecolabel criteria for ‘retail financial products’**

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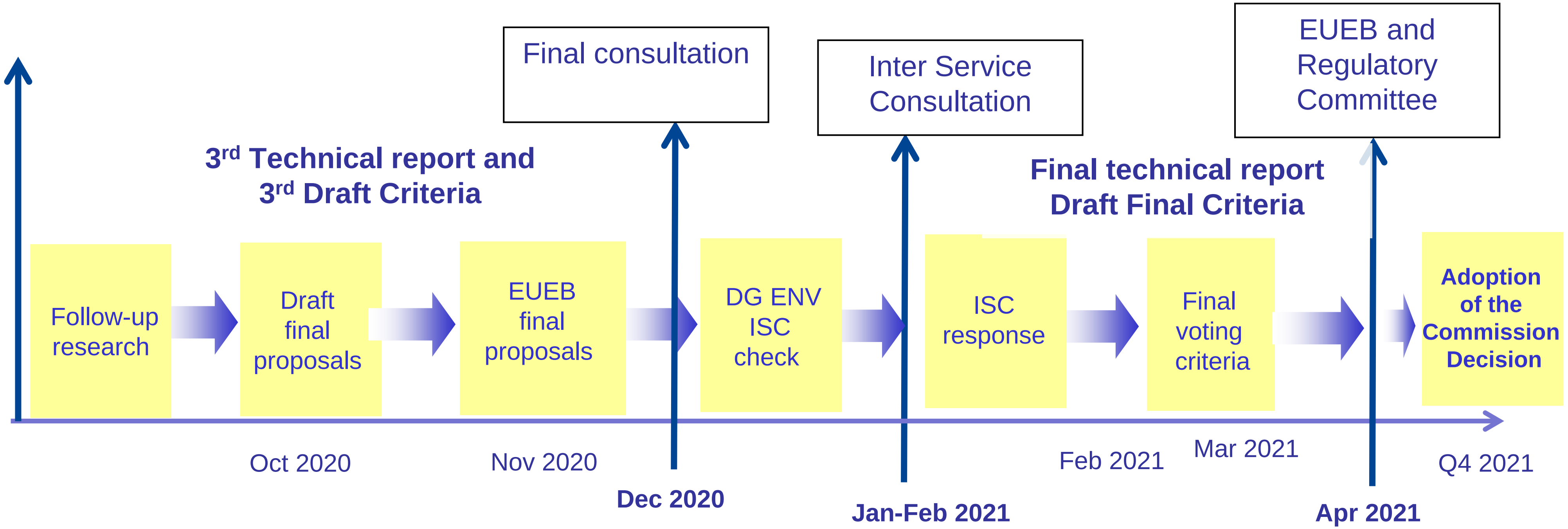
Agenda

- Process update
- Key changes and proposals after AHWG2
- Next steps

Criteria development process

Parallel processes:
EU taxonomy: 1st Delegated Act (Q1-2, 2021)
EU Green Bond Standard (dependent on legislative instrument chosen)



Structure of the main proposed criteria

Initial product scope:

- ✓ UCITS
- ✓ (R)AIFs
- ✓ Life insurance products
- ✓ Deposit accounts

Validity period up to 3 years (*subject of discussion)*

Criterion 1: Investment in environmentally sustainable economic activities

Criterion 2: Companies investing in transition and green growth

Criterion 3: Exclusions based on environmental aspects

Criterion 4: Social and governance aspects

Criterion 5: Engagement

Criterion 6: Measures taken to enhance investor impact

Product group scope
Considerations for the proposed scope extension

Inclusion of real estate funds and European Long Term Infrastructure Funds (ELTIFs)

- Retail funds investing in real estate are important investment vehicles in certain MS.
- ELTIFS established under the auspices of Regulation (EU) 2015/760 was requested.

Clarifications on the inclusion of insurance products

- Clarity requested on the scope of the insurance products included in the scope.
- Profit Participation and hybrid products. ,

Main overall changes to the criterion

Insurance-based investment products (IBIPs), to include unit-linked, profit participation and multi-option life insurance products (*ensuring equal treatment of all IBIPs*).

Units or shares in European Long Term Infrastructure Investment Funds (ELTIFs) and real estate funds can be present in the underlying assets of a Retail Alternative Investment Funds (AIF) or insurance product applying for an EU Ecolabel.

Product group scope
Insurance–based investment products

Profit participation products

It is considered possible to apply the UCITS mixed funds criteria because these products invest via a mixed general investment fund

Issue of traceability:

- Where the general fund is to be labelled, a specific report would be needed to verify traceability of “green” underlying assets.
- An insurer may need to create a separate (segregated) “sub-fund” to the general fund only investing in ‘green’ underlying assets for those insurance products applying for the ecolabel.

Multi-option and hybrid products (MOPs)

These products allow clients to choose among different underlying investment options

In addition to the general fund, all the chosen unit-linked funds have to be EU ecolabelled.

- Multiple product configurations are only permissible if each configuration on its own meets the ecolabel criteria.
- For the hybrid MOP itself, all the underlying options would have to be ecolabelled or the clients choice would have to be restricted to ecolabelled funds.

Criterion 1: Investments in environmentally sustainable economic activities
Key issues that have been addressed

Post-AHWG2

1. Stringency of criterion 1 is heavily debated in the 2nd stakeholder meeting
2. The green pockets approach and threshold at asset and portfolio level are questioned.
3. The potential for green capital expenditure (capex) and companies that are investing in transition will be taken into account – particularly large caps
4. Thresholds for different fund portfolios need to be reviewed

Main overall changes to the criterion

1. Sub-group is created and two meetings are carried out debating on greenness evaluation
2. Formula to evaluate greenness for equities investment funds is introduced. Excel template with the calculation procedure is provided
3. Companies' green capex and green revenue growth are now considered as part of the calculation procedure and linked to the eligibility under a new criterion 2
4. Thresholds for different fund portfolios balance label reputation and market situation and reflect test performed

Criterion 1: Investments in environmentally sustainable economic activities
Key issues that have been addressed

Post-AHWG2

6. Comments/suggestions as to whether the greenness of the issuer/company (corporate level) shall be considered for issuing bonds?
7. Can bonds other than EU Green bonds considered in making up the portfolio greenness?
8. Insurance products will require solution for general funds and hybrid products
9. Need to introduce requirements for savings deposit accounts. Not enough green projects to invest in.

Main overall changes to the criterion

6. Greenness of the corporate issuer/companies is considered to issue green bonds
7. The criterion provides with simplified compliance requirements to characterize a bond as green. EU GBS can be used for compliance
8. New sub-criteria for insurance products
9. Requirements for traceability of green projects financed are specified. Requirements for projects are introduced

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Criterion 1: Investments in environmentally sustainable economic activities

Criterion stringency and greenness evaluation

- A sub-group is created to provide support for defining and evaluating greenness
- Two sub-group meetings are carried out one in July 2020 and the second in Sep 2020
- Sub-group advised on UCITS equities and bond funds greenness evaluation
- Tests are performed to examine strictness and eligible universe (Snapshot of the current market situation)
- Potential uptake and a possible EU Ecolabel reputation damage are considered
- Criterion 1 considers companies' environmental economic activities (EU Taxonomy compliance), green revenues, green capex and green revenues growth to evaluate greenness for both UCITS equities and bond funds
- Sub-group composition, discussion papers and outcomes are published on the JRC webpage https://susproc.jrc.ec.europa.eu/product-bureau//product-groups/432/documents

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Criterion 1: Investments in environmentally sustainable economic activities

Greenness evaluation at portfolio level

- Sum of the equities and bonds greenness makes the portfolio greenness
- Forward looking period (5yrs) for green revenue growth. Back(2 yrs) and forward (3yrs) looking period for the evaluation of green capex
- Other assets (e.g. derivatives) do not make up greenness
- 5yrs Cumulative green revenues growth cap = 100%

Thresholds at portfolio level

- UCITS AIFs portfolio greenness 70%
- UCITS bond funds portfolio greenness 50%
- UCITS mixed funds portfolio greenness 50%
- UCITS equity funds portfolio greenness 40%

Criterion 1: Investments in environmentally sustainable economic activities

Greenness evaluation at asset level

Equities - companies investing in green growth or in transition

- The formula considers green revenue and portfolio contribution, weighted to take into account green capex or green revenue growth to calculate greenness.

- It applies weighting 60% (Green revenue) to 40% (Green capex or Green revenue growth). It takes into account
  - either the average green capex (2 yrs back + 3 yrs forward)
  - or the cumulative green growth (5 yrs forward).

Bonds greenness

- Issuer must first have green revenue>50% or be a company investing in transition
- For green UoP bonds (sovereign or corporate): Greenness equals portfolio contribution
- General purpose bonds (corporate): Greenness = green revenues x portfolio contribution

Criterion 1: Investments in environmentally sustainable economic activities

Criterion 1 - Mixed fund greenness

	Type of company	Portfolio contribution	Green Revenue GRi	Cummulative Green Revenue Growth (5yrs forward) 'GRGi	Average Green Capex (2yrs back and 3 yrs forward) GCi	Greeness contribution without formula	Greeness contribution with formula	
Other Assets		5.0%				0%	0%	Other assets
Firm1		5.0%	3%			0.15%	0.15%	Equities
Firm2	Company investing in transition	7.0%	10%	100%	17%	0.70%	3.22%	
Firm3	Company investing in transition	7.0%	10%	100%	17%	0.70%	3.22%	
Firm4	Company investing in transition	4.0%	10%	100%	15%	0.40%	1.84%	
Firm5	Company investing in transition	6.0%	20%	100%	15%	1.20%	3.12%	
Firm6		5.0%	40%	25%	14%	2.00%	2.00%	
Firm7		5.0%	40%	27%	16%	2.00%	2.00%	
Firm8		5.0%	40%	29%	18%	2.00%	2.00%	
Firm9	Company investing in green growth	10.0%	55%	11%	15%	5.50%	5.50%	
Firm10	Company investing in green growth	15.0%	52%	31%	13%	7.80%	7.80%	
Sovereign Green bonds		10.0%				10.00%	10.00%	Bonds
Corporate green bonds		10.0%				10.00%	10.00%	
Sovereign bonds		2.0%				0.00%	2.00%	
Corporate bonds general purpose	Company investing in transition	4.0%				0.80%	0.80%	
Total PC		**100.0%**						
					Portfolio Greenness	43.25%	53.65%	

Criterion 1: Investments in environmentally sustainable economic activities
1.1.G/H **Insurance–based investment products**

G. Profit participation products

The portfolio holdings of the general fund and any associated underlying funds shall each comply with the requirements of Criterion 1 for mixed UCITS funds, as relevant to the type of fund and its composition.

Where the general fund of the product is shared with other products, then the assets held in relation to the EU ecolabelled product shall be separated on the balance sheet of the license holder, in such a way as to (1) restrict transferability and to (2) ensure that the assets underlying the EU ecolabelled product~~s~~ are traceable and correspond with money invested by the customers.

H. Multi-option and hybrid products (MOPs)

General fund requirements are the same as for Profit participation product.

All the underlying unit funds in which shares are held, shall comply with the requirements in Criterion 1, as relevant to the type of fund and the composition. Alternatively, all underlying unit funds shall hold the EU Ecolabel.

Criterion 1: Investments in environmentally sustainable economic activities
1.2 Fixed term and savings deposit products

Stakeholder comments

Initial lack of products and green assets suggests the need for a transitionary period.

Underlying assets are broader than just loans, including bonds - ‘green asset to deposit ratio’

Ability to earmark, connect and trace credits to deposits – ring-fencing has regulatory implications in terms of prudential requirements for banks and a less formal ‘tagging’ of assets is possible.

Reporting for each loan and credit – per sector or activity instead of loan by loan, as there are disclosure issues.

Main changes

- Replacement of term ‘ring fencing’ - ensure ‘separation’ and limit transferability of the funds for other purposes.
- Green loan reporting at a more general level on the types of project and economic activity.
- Cross-reference to bond requirements in sub-criterion 1.1.C.
- Reference to a ‘green asset to deposit ratio’ instead of a ‘green loan to deposit ratio’.
- Ability to pool loan assets allocated by credit institutions working in association with the license holder.

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New Criterion 2: Investment in companies investing in transition and green growth

Post-AHWG2

- Not many companies existing are fully dark green. To provide flexibility for companies making investments to increase their green revenue and strengthen impact dimension.

New criterion

- Despite mainly relying on not environmentally sustainable activities, invest in their transition towards taxonomy compliant activities triggering change → companies investing in transition
- Increasing their already high % green revenue → companies investing in green growth

Eligibility criteria	Companies investing in transition	Companies investing in green growth
>95% energy, mobility, manufacturing, waste management	✓	✓
% green revenue	5-50%	>50%
Commitment to close down excluded activities	✓	
Strategic investment plan to be disclosed	✓	✓

Criterion 3: Environmental exclusions
Key issues that have been addressed

Post-AHWG2

- Alignment with the EU Taxonomy Regulation, especially the do-no-significant-harm (DNSH) criteria
- Many economic sectors lack data availability

"Checkpoint revision" of exclusions in TR2:

✓ DNSH criteria under the EU Taxonomy

✓ EU/international reference

✓ Proxies/indicators used by ESG rating agencies or other relevant databases

Excluded economic activity (TR2)	*Issue/comments received*	*Main focus of further research*	*Outcome of the further research*
Pesticides Production of pesticides, including plant protection products, that are not approved for use in the EU and which are identified in the Rotterdam Convention Prior Informed Consent	Strictness of the exclusion: • It was requested to make the exclusion stricter in order to exclude a larger number of chemicals • It was requested to expand the exclusion in order to cover also the distribution and use of pesticides, as the TR2 version of the exclusion together with the exclusion of non-Integrated Pest Management (IPM) practices would not effectively exclude the use of pesticides	Existing international standards were reviewed to identify those substances that have been agreed on at an international level to be the most hazardous. In addition to the UN Rotterdam Convention (mentioned in TR2 already), the WHO Recommended Classification of Pesticides can be used. Both agreements are in the form of negative lists and both are mentioned in the TEG's 'Do No	• Reference is made to pesticides included in the UN Rotterdam Convention and in class Ia or Ib of the WHO Recommended Classification of Pesticide. This change ensures that the requirement is aligned with the TEG's DNSH criteria and with existing data proxies; that the coverage of the requirement is made international; that more substances are covered by the requirement.

Criterion 3: Environmental exclusions
Main changes to the list of exclusions

Exclusion in TR2	Main comments from stakeholders	Changes in TR3	
Pesticides	Make it stricter + verifiable	Aligned with DNSH + international reference + scope expanded	Aligned
GMOs	Remove vs keep the criterion + make it verifiable	Not possible to make it verifiable + no alignment with DNSH.	Removed
Agricultural products 1	Expand the exclusion	Aligned with DNSH and REDII + expanded	Aligned
Agricultural products 2	Make it verifiable	Aligned with DNSH + EU and international reference	Aligned
Water scarcity	Make it clearer + verifiable	Not possible to make it verifiable + no alignment with DNSH.	Removed
Forestry	Expand the exclusion + make it verifiable	Aligned with DNSH and REDII + scope expanded	Aligned
Fossil fuels 1	Expand the exclusion + make it clearer	Expanded + clarified	Expanded

Criterion 3: Environmental exclusions
Main changes to the list of exclusions

Exclusion in TR2	Main comments from stakeholders	Changes in TR3	
Fossil fuels 2	Open up to companies investing in transition	Permitted to companies in transition if complying with further requirements	Modified
Nuclear energy	Remove vs keep the criterion	No technical recommendation available (DNSH not completed yet)	Pending discussion
Waste management	Make it stricter	Permitted to companies in transition if complying with further requirements	Modified
Hazardous chemical manufacturing	Expand the exclusion + make it stricter	Aligned with DNSH + EU and international reference + made stricter/scope expanded	Aligned New
Mining of asbestos	Expand the exclusion	Scope slightly expanded	Expanded
Transportation	Align with EU Taxonomy	Removal of performance-based exclusion. Permitted to companies in transition and green growth	Modified

Criterion 3: Environmental exclusions
Companies investing in transition and in green growth

Post AHWG2

- 5% exclusion threshold would cut out companies transitioning towards low carbon and green economy – Need for flexibility for these companies

Main overall changes to the criterion

- Energy generation, waste management and transportation key sectors quickly changing

Energy sector	**Waste management sector**	**Transportation sector**
Companies investing in transition may produce fuels or generate electricity from fossil fuels if: • <30% revenue from these activities • Phase-out, closure or fuel-switching plan on a 10y timeframe	Companies investing in transition that do not have waste segregation in place if: • <30% revenue from these activities	Companies investing in transition and in green growth may produce vehicles with engine technology based on fossil fuels

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Criterion 4: Social and governance aspects
Key issues that have been addressed

Post-AHWG2

1. Stringency of the social exclusions - Alignment with the EU Taxonomy minimum social safeguards
2. International laws and local legislation complementarity or controversy?
3. Exclusionary requirements on conventional weapons
4. Social exclusions at sovereign level - dealing with the death penalty

Main overall changes to the criterion

1. EU Ecolabel is a label of excellence. Risk of damaging the EU Ecolabel reputation
2. International treaties prevail local regulations. Yet business activities elsewhere are not affected
3. Excluded only at corporate level - Evidence of sales in countries under EU restrictive measures
4. Ethical dimension of this requirements led to not be considered

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Criterion 4: Social and governance aspects
Key issues that have been addressed

Post-AHWG2

6. Different requirements for disclosure for SME's and large companies
7. Dealing with allegations
8. The corruption perception index score of 38 excludes less than 50% of the sovereigns
9. Governance aspects

Main overall changes to the criterion

6. Horizontal disclosure requirements across companies
7. An approach for dealing with allegations is suggested (Pending)
8. The corruption perception exclusion threshold is updated
9. Governance requirements are linked to corporate social issues

Criterion 5: Engagement
Key issues that have been addressed

Post-AHWG2

- Need for clearer objectives
- Alignment with the provisions of the Shareholder Rights Directive
- Quality not quantity – clear process needed to identify companies to engage with
- Establish process for defining and monitoring tangible outcomes
- Take into account state of the art in terms of maximising investor impact of use of voting rights and company dialogue

Main overall changes to the criterion

- Focus on EU Taxonomy Objectives
- Restructured to address:
  - Engagement policy (5.1)
  - Effective use of voting rights (5.2)
  - Company dialogue (5.3)
- Minimum targets for company dialogue aimed at transition and green growth
- More specific on processes, outcomes, monitoring and reporting

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Criterion 5: Engagement
5.2 Exercising voting rights

Focus: ambition, coherence and success in using their voting rights, individually or collectively, to orientate companies

- Tabling climate resolutions at Annual General Meetings may not always be an effective means of orientating a company.
- Outcomes are uncertain and in many cases the objectives are not sufficiently aligned with medium to long term environmental policy objectives e.g. carbon reduction trajectories.
- Ability to make proposals at AGMs or for shareholders to ‘act in concert’ may be restricted in some Member States.

3rd criterion proposal

The fund manager shall show how they exercise their voting rights and other rights attached to shares in order to fulfil the objectives of their engagement policy. They shall show how they use these rights to try to orientate those companies in the portfolio with <20% green revenue to:

- Achieve alignment of company strategies with the environmental objectives of the EU Taxonomy ,
- Achieve alignment of investment strategies with the need to grow green revenue and market share for environmentally sustainable economic activities.

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Criterion 5: Engagement
5.3 Dialogue with investee companies

Focus: careful targeting of resources on companies that have made a commitment to transition or green growth.

- Distinction based on fund type.
  - UCITS focus on companies investing in transition,
  - Retail AIFs focus on companies investing in green growth.
- Targeted at 1 company or 10% of companies in the portfolio, whichever is greatest
- Monitoring linked to % green revenue, % green Capex and the % growth in green revenue.

The engagement process used to achieve outcomes

- The specific topics raised
- The goals and targets discussed and raised with each company
- The intermediate steps or milestones to achieving these goals and targets
- The frequency and means of ongoing communication and dialogue with the company

In addition the measures that will be taken if a company does not meet goals/targets or change is needed to meet them

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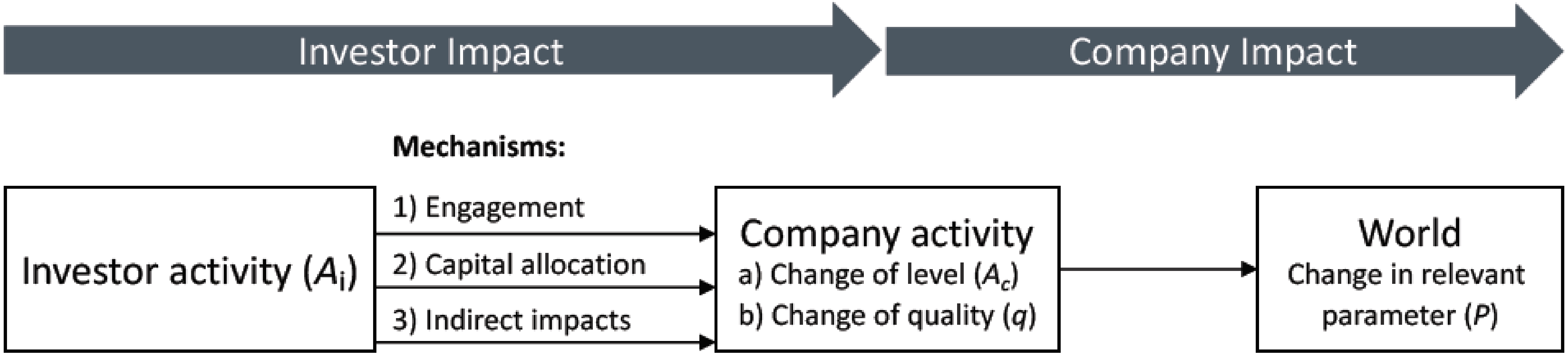
New criterion 6
Measures taken to enhance investor impact

Potential retail investors look for *'strong evidence that the product is effective in delivering environmental benefits'*. What are the tangible outcomes from the activities, decisions and strategies adopted by their chosen fund or deposit product?



Source: Koelbel et al (2019)

New criterion 6
Reporting on the measures taken

EU Ecolabel criteria	Investor impact enhancement measures	
1. Investment in environmentally sustainable economic activities	1.1 Capital allocation to equities	– New startups – Unlisted companies and IPOs – Actively identify activities/segments in need of capital
	1.2 Capital allocation to bonds	– Monitoring/reporting on projects financed – Asset back securities/recycling of funds for loans – Funds are used for revolving loans
2. Investment in companies investing in transition and green growth	2.1 Identifying opportunities and monitoring change	– Actively identify investment opportunities – Frequent monitoring/reporting of investment strategies and change in green revenue/growth
	2.2 Taking a long-term outlook	– Takes long positions on shareholdings
3. Environmental exclusions	3.1 Committing to transition	– Evidence of phase out requirements with milestones – Linking of investor requirements with company engagement
4. Engagement	4.1 Engaging to increase shareholder value from green growth	– Individual/collective use of voting rights to change company direction – Individual/collective dialogue at management level to grow green shareholder value – Dialogue complemented by threat of divestment, action at shareholder level and/or public campaigns.
	4.2 Engaging to increase shareholder value from companies in transition	

New criterion 6
Measures taken to enhance investor impact

Based on the state of the art in investor impact management, including research findings and the system developed by the Impact Management Project

Proposed as requiring fund managers to report on:

- which signals and mechanisms for enhancing investor impact they have addressed
- which can be evidenced by their investment strategies and decisions,
- identification of the specific measures they are taking to actively manage and enhance their investor impact.

Expected outcome

- Reporting for UCITS and AIF investment funds, profit participation life insurance products with a general fund and green bonds held by deposit accounts.
- Fund managers are introduced to the concept of investor impact and can identify specific measures
- Retail investors are provided with information about which impact enhancement measures are associated with a product.

New criterion 6
Example measures selected by a fund manager

Criterion 1
1.1 Capital allocation to equities

1.1.4 Activities in mainstream market segments with the potential for green growth are actively identified and invested in.

Criterion 2
2.1 Identifying opportunities and monitoring change

2.1.4 Frequent reporting is provided on the % green market share of companies in which equities are held or which have issued the bonds held.

Criterion 5
Engaging to increase shareholder value from green growth

4.1.1 The fund manager can provide evidence of bilateral or collective engagement of shareholders with the management of companies in order to grow their green revenue share or market share in mainstream market segments.

Criterion 7: Retail Investor information
Key issues that have been addressed

Post-AHWG2

1. Request for provision of the portfolio breakdown
2. Disclaimer on environmental and social impacts
3. Loans - Projects documentation and info about their environmental sustainability compliance
4. Communication of deviations
5. Annual reporting and info additional to KID & KIID documents
6. Reflect criteria updates

Main overall changes to the criterion

1. Fund makes publicly available the portfolio breakdown (holdings in value of AuM, bond issuers etc.)
2. Need for a disclaimer in terms of environmental and social impact is added
3. Listing and provision of environmental sustainability compliance of project is now required
4. Fund web-page shall communicate any changes on methodology, portfolio content, objectives and/or investment policy, deposit ratio
5. Fund web-page – annual report. Prospectus that contain KID, KIID and additional info.
6. Criterion 7 reflects the changes in criteria 1,2,5,6

Criterion 8: Information on the EU Ecolabel

Post-AHWG2

- Extend the focus also to the social aspect

Main changes to the criterion

If the ~~o~~ptional label with text box is used, it shall contain the following statements:

- Investing in activities that contribute to a green and low carbon economy
- Investing in activities contributing to climate change mitigation and adaptation
- Avoiding investments in environmentally and socially harmful activities

The following additional statement may be used for investment funds and insurance products:

- Engaging with companies to become greener

Next steps

- Final consultation round ongoing
- Comments can be submitted via the BATIS online consultation platform
- Deadline for comments in BATIS: Friday 11th December 2020

Queries?

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