



J R C T E C H N I C A L R E P O R T S

Development of EU Ecolabel criteria for Retail Financial Products

Technical Report 4.0:
Draft proposal for the product scope
and criteria

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ABBREVIATIONS AND ACRONYMS

AIF	Alternative Investment Funds
AIFMD	Alternative Investment Fund Managers Directive
BIC	Bank Identifier Code
CAB	Climate Awareness Bonds
CBI	Climate Bonds Initiative
CVA	Credit Valuation Adjustment
EC	European Commission
EEA	European Economic Area
ESG	Environment, Social, Governance
ETD	Exchange-Traded Derivatives
ETF	Exchange-Traded Funds
FNG	Forum Nachhaltige Geldanlagen (Sustainable Investment Forum Germany)
GBP	Green Bond Principles
GBS	Green Bond Standard
GHG	Greenhouse Gas
ICMA	International Capital Markets Association
IDD	Insurance Distribution Directive
IDFC	International Development Finance Club
IF	Investment Fund
ILO	International Labour Organization
IPID	Insurance Product Information Documentation
JRC	Joint Research Centre
KID	Key Information Document
KPI	Key Performance Indicator
MDBs	Multilateral Development Banks
MiFID	Market In Financial Instrument Directive
MS	Member States
NFID	Non-Financial Information Directive
OTC	Over-The-Counter
OTF	Operational Trading Facility
PRIIPs	Packaged Retail Investment and Insurance-based Products
RAIF	Retail Alternative Investment Fund
RM	Regulated Markets
SPV	Special Purpose Vehicle
SRI	Socially Responsible Investment
UCITS	Undertakings For Collective Investment In Transferable Securities
TEEC	Transition Energétique Et Ecologique Pour Le Climat (Energy and Ecological Transition for the Climate (France))
TMI	Total Market Index
TR	Technical Report

FOREWORD

This report is part of the development of the EU Ecolabel criteria for financial products. Once developed, the criteria will be adopted through a Commission Decision under the EU Ecolabel Regulation. It summarises and updates the inputs received and the further research carried out by the working team and serves as a working document for the EU Ecolabelling Board (EUEB) meeting to be held on 19 March 2021 (virtual meeting). It takes as its starting point the information available in the Preliminary Report, the First Technical Report, the Second Technical Report and the Third Technical Report, available on the project website: <https://susproc.jrc.ec.europa.eu/product-bureau/product-groups/432/home>.

The Preliminary Report and the First Technical Report were published in March 2019 and provided the technical background for the product group from a legal, political and market context for the first stakeholder (1st AHWG) meeting held in April 2019 in Seville, Spain. The First Technical Report contained draft criteria proposals which were presented to stakeholders during the 1st AHWG meeting and on which stakeholders were invited to comment during the consultation period. The comments received from the stakeholders have subsequently been collated, analysed, and, following further research, addressed in the Second Technical Report.

The Second Technical Report was published in December 2019 and provided the technical background for the product group for the second stakeholder (2nd AHWG) meeting held in March 2020 (virtual meeting). The Second Technical Report contained draft criteria proposals which were presented to stakeholders during the 2nd AHWG meeting and on which stakeholders were invited to comment during the consultation period. The comments received from the stakeholders have subsequently been collated, analysed, and, following further research, addressed in the Third Technical Report.

The Third Technical Report was published in October 2020 and provided the technical background for the product group for the EUEB meeting held in November 2020 (virtual meeting). The Third Technical Report contained draft criteria proposals which were presented to EUEB members during the EUEB meeting and on which stakeholders were invited to comment during the consultation period. The comments received from the stakeholders have subsequently been collated, analysed, and, following further research, addressed in the Fourth Technical Report.

This Fourth Technical Report provides an update to the set of criteria proposals contained in the Third Technical Report based on additional research and information provided by stakeholders in the framework of the consultation and during several bilateral meetings. This report also includes an update of the initial scope and definitions.

HOW TO READ THIS REPORT

The current revised fourth technical report provides an update on the criteria development, based on new information collected during the process and provided by the involved parties (i.e. through stakeholders' discussion at the EUEB meeting in November 2020, further stakeholder inputs following the meetings and additional desk research).

This report consists of the following sections:

- **Section 1 - Introduction:** describing the goal and content of the document, and the sources of information used.
- **Section 2 - Background and Context:** presenting the process for developing EU Ecolabel criteria, the Action Plan on Sustainable Finance, the material scope of the criteria, as well as summarising the main conclusions obtained in the Preliminary Report.
- **Section 3 - Product group name, scope and definitions:** including the updated scope and definitions for the product group of financial products.
- **Section 4 - Structure and rationale for the criteria and criteria areas:** providing an overview of how the criteria set could be configured. The criteria set also includes requirements on the type of documentation required to show compliance with the criteria that shall be provided by applicants to the EU Ecolabel Competent Bodies.
- **Section 5 - Criteria proposal:** presenting the fourth draft of the proposed EU Ecolabel criteria for financial services. The proposal of the third draft is written in a box with grey text, for comparison with the fourth proposal. The proposal of the fourth draft is written in a box with black and blue text; the blue text represents the changes compared to the draft in the Third Technical Report. Under each criterion, discussions are chronologically presented under the following headings:
 - o Summary of the rationale of the criterion text, substantiating the aim and structure of the criterion.
 - o The outcomes and changes to previous criterion proposals as a result of the suggestions made by the stakeholders during previous consultations.
 - o The outcomes and suggestions made by stakeholders during the third consultation period, which run from 30th October 2020 to 11th December 2020
 - o Further research carried out on the points addressed by the stakeholders or any other point of relevance and main changes of the criterion in the fourth proposal.

Should stakeholders require more information about the EU Ecolabel criteria proposed in the First, Second and Third Technical Report, they are kindly request to download them from the project website: <https://susproc.jrc.ec.europa.eu/product-bureau//product-groups/432/documents>.

1 INTRODUCTION

The main objective of this project is the development of EU Ecolabel criteria for the financial products group. The study is being carried out by the Circular Economy & Industrial Leadership and the Finance & Economy Units of the Directorate-General Joint Research Centre (JRC) of the European Commission. The work is being developed for the European Commission's Directorate-General for the Environment (DG ENV) and in collaboration with the Directorate-General for Financial Stability, Financial Services and Capital Markets Union of the European Commission (DG FISMA).

The EU Ecolabel criteria are designed to promote the use of the most environmentally friendly products as articulated by the Regulation on the EU Ecolabel (Regulation (EC) No 66/2010 of the European Parliament and of the Council of 25 November 2009 on the EU Ecolabel), hereafter, the 'EU Ecolabel Regulation'. According to Article 2, this Regulation applies to 'products' (either goods or services) that are supplied for distribution, consumption or use on the Community market.

The main purpose of the technical report is to summarise the results of the prior analysis and propose appropriate and updated criteria in this Fourth Technical Report to serve as a background document for discussion with stakeholders during the EUEB meeting.

This technical report is supported and complemented by the Preliminary Report¹ published in March 2019. The Preliminary Report includes the scope and definition, market analysis, and technical analysis. Moreover, the First Technical Report² was published in March 2019 and formed the basis for the 1st AHWG meeting which took place in April 2019. Additionally, the Second Technical Report³ was published in December 2019 and formed the basis for the 2nd AHWG meeting which took place in March 2020. Finally, the Third Technical Report⁴ was published in October 2020 and formed the basis for the EUEB meeting which took place in November 2020.

¹ Preliminary Report. EU Ecolabel criteria for Financial Products. March 2019. Available at: https://susproc.jrc.ec.europa.eu/product-bureau/sites/default/files/contenttype/product_group_documents/1581683024/20190315%20PR%201.0%20EU%20EL%20Financial%20Products_Final%20consultation.pdf.

² First Technical report EU Ecolabel Financial Products. March 2019. Available at: https://susproc.jrc.ec.europa.eu/product-bureau/sites/default/files/contenttype/product_group_documents/1581683024/20190315%20TR%201.0%20EU%20EL%20Financial%20Products_Final%20consultation.pdf.

³ Second Technical report EU Ecolabel Financial Products. December 2019. Available at: https://susproc.jrc.ec.europa.eu/product-bureau/sites/default/files/2020-02/20191220_EU_Ecolabel_FP_Draft_Technical_Report_2-0.pdf.

⁴ <https://susproc.jrc.ec.europa.eu/product-bureau/sites/default/files/2020-11/Draft%20Technical%20Report%203%20-%20Retail%20financial%20products.pdf>

2 BACKGROUND AND CONTEXT

2.1 Process for developing the EU Ecolabel

The typical process of developing the EU Ecolabel criteria for any product group is set out in Article 7 of and Annex I to the EU Ecolabel Regulation. This entails the management of a process of stakeholder consultation to be supported by the development of the following documents by the party which is leading the process: (1) a Preliminary Report; (2) a proposal for draft criteria; (3) a Technical Report in support of the proposal for draft criteria; (4) a Final Report; and (5) manuals for potential users of the EU Ecolabel and Competent Bodies (CBs), and for authorities awarding public contracts.

Moreover, the EU Ecolabel Regulation also stipulates that a minimum of two AHWG meetings shall be held along the criteria process, the first of which took place in April 2019 and the second which took place in March 2020. At the meetings the material contained in the Preliminary Report and the two Technical Reports were discussed. Additionally, the revised criteria were presented to the EUEB members in November 2020. The feedback from these meetings, together with associated rounds of written consultations and multilateral consultations are used to further adapt the scope and criteria proposals.

This Fourth Technical Report has been drafted in accordance with Article 7 of the EU Ecolabel Regulation and will be updated during the remaining steps of the criteria development process based on new information, stakeholder feedback and input from the EUEB meeting. The Final Technical Report will incorporate all relevant scientific arguments substantiating the final criteria proposal.

2.2 Action Plan on Sustainable Finance

Sustainability has long been at the heart of the European project and the European Union (EU) is fully committed to reaching the EU 2030 climate and energy targets and to mainstreaming sustainable development into EU policies. Achieving EU sustainability goals requires major investments. A substantial part of these financial flows will have to come from the private sector, and this requires redirecting private capital flows towards more sustainable investments as well as comprehensively rethinking the European financial framework.

In this context, in December 2016, the European Commission established a High-Level Expert Group (HLEG) to develop an overarching and comprehensive EU strategy on sustainable finance. This group published its final report in January 2018. As a follow-up, on 7 March 2018, the European Commission published an Action Plan: Financing Sustainable Growth (hereafter, the 'Action Plan')⁵. This Action Plan puts forward 10 actions whose main objectives are to:

1. Reorient capital flows towards sustainable investments to achieve sustainable and inclusive growth;
2. Manage financial risks stemming from climate change, resource depletion, environmental degradation and social issues; and
3. Foster transparency and long-termism in financial and economic activity.

Action 2 of the Action Plan refers to “Creating standards and labels for green financial products”. The Action Plan recognised that “labelling schemes can be particularly useful for retail investors who would like to express their investment preferences on sustainable activities [and] could facilitate retail investors' choice [...]”. Hence, the Commission “committed to explore the use of the EU Ecolabel framework for certain financial products, to be applied once the EU sustainability taxonomy is adopted”.

⁵ European Commission. 2018. Communication from the Commission to the European Parliament, the European Council, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions Action Plan: Financing Sustainable Growth. Available from: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52018DC0097>

This action was a follow-up to the specific recommendations of HLEG to establish “a voluntary European green label to spur market growth and enable retail investors to identify products that finance the climate and ecological transition”. The HLEG report further recommended that “the Commission should develop a voluntary EU green label for green themed funds [which] should include specifications based on the use of the EU sustainable taxonomy”.

Hence, the link between the EU Ecolabel criteria for financial products and the EU Taxonomy was already contained in the HLEG recommendations and the Action Plan. The Impact Assessment accompanying the Taxonomy proposal also recognises that the EU Ecolabel is one of the potential uses of the Taxonomy and is thus one mechanism through which the Taxonomy will have an impact:

“The use of the EU taxonomy for (financial) product standards and labels would improve environmental integrity of green investments within as well as outside the EU (as the taxonomy would also apply to EU investors investing globally). As such, it would help to minimise the risk of greenwashing and avoid the negative environmental impacts from investing in assets that are not in line with the EU sustainability goals”.

A further follow-up is the preparation of a Commission Decision defining criteria to be fulfilled by financial products in order to qualify for the EU Ecolabel. This happens in the framework of the EU Ecolabel Regulation, which provides guidance as to how criteria should be developed and implemented for products and services. The EU Ecolabel is a voluntary award scheme intended to promote products with a reduced environmental effect during their entire life cycle and to provide consumers with accurate, non-deceptive, science-based information on the environmental impact of products. It is a part of a broader EU Action Plan on Sustainable Consumption and Production and Sustainable Industrial Policy (European Commission, 2008). This Action Plan was already adopted by the European Commission on 16 July 2008 and links the EU Ecolabel to other EU policies such as Green Public Procurement (GPP), the Ecodesign of energy-related products, and the EU Action Plan for the Circular Economy.

2.3 Financial services linked to a product

According to the EU Ecolabel Regulation, the label may be awarded to "goods and services" which are supplied for distribution, consumption or use on the Community market whether in return for payment or free of charge. Financial products fall within the scope of the EU Ecolabel Regulation where they can be considered as services for distribution or use. **Consequently, the EU Ecolabel will be awarded to the financial service being provided by the manufacturer of the green financial product**, rather than to the financial product. However, the EU Ecolabel logo can figure on the promotional material of the financial product itself.

Given the focus of this EU Ecolabel on a number of packaged retail and insurance-based investment products (PRIIPs) (namely Undertakings for the Collective Investment in Transferable Securities – UCITS - and Alternative Investment Funds - AIFs), on insurance-based investment products (IBIP), and on savings and deposit accounts, there is a need to provide a service definition for this additional financial product.

Consequently, the generic financial service definition will need to be clearly specified to cover the two groups of financial products that are in the scope of the EU Ecolabel, namely:

- i. The service of managing an investment product that has been packaged for retail investors in accordance with the requirements laid down in Regulation (EU) No 1286/2014 on eligible packaged retail and insurance-based investment products (PRIIPs). This shall include:
 - equity, bond and mixed investment funds, to include those referred to as Undertakings for the Collective Investment in Transferable Securities (UCITS) and, where applicable, Alternative Investment Funds (AIFs);
 - insurance-based products with an investment component, more precisely profit participation, unit-linked and Multi Option Product (MOP) life insurances.

and,

-
- ii. The service of managing a fixed-term deposit or savings deposit product as referred to in Article 2(1) point 3 of Directive 2014/49/EU on deposit guarantee schemes in order to pay interest and derive environmental benefits from the projects and economic activities to which the deposited money is loaned. The service is provided by the credit institution on whose balance sheet appears the deposits held (liabilities) and the associated loans granted as credits (assets).

An eligibility condition for the EU Ecolabel is that for retail financial products, they shall be registered or authorised for marketing or distribution in a Member State of the European Union.

The EU Ecolabel criteria will be useful for retail investors who would like to express their investment preferences in relation to the environmental sustainability of the activities funded by their money.

For financial services provided and products offered in this context to retail investors, a number of existing Regulations and Directives need to be considered. For example, the Packaged Retail Investment and Insurance Products (PRIIPs) Regulation (EU) No 1286/2014 seeks to enable investors to better understand and compare the key features, risks, rewards and costs of different PRIIPs. The definition of the products within the scope and outside the scope of the PRIIPs Regulation is provided in the next section. Directive 2009/65/EC regulates and stipulates provisions on undertakings for the collective investment in transferable securities (UCITS) which are a popular product among retail investors. Directive 2011/61/EU (AIFMD) regulates the managers of alternative investment funds, such as hedge funds and private equity⁶. The non-financial and diversity information Directive 2014/95/EU is relevant in regards to the disclosure of information about environmental protection and social responsibility by certain large undertakings and groups.

2.4 Summary of the background analysis from the preliminary report

This section presents a summary of the preliminary market and technical analysis conducted in 2018 to enable the determination of the initial proposals for the product scope, identification of criteria areas as well as development of criteria proposals for the Ecolabel for this product group.

2.4.1 Product group name, scope and definitions

The First Technical Report was drawn up based on an analysis of information and data available on green financial products. This encompassed several sources including academic literature, industry or consumer association reports, results from the first stakeholder questionnaire survey, and consultation (in the form of bilateral interviews) with selected financial label and scheme operators. While the PR identified the need for an EU Ecolabel for financial products, the First Technical Report focused on the following main aspects:

- scope, definition and relevant EU legislation;
- market analysis;
- technical analysis of existing taxonomies and existing definitions of ‘green’ financial products.

The First Technical Report summarised the analysis conducted at the preliminary stage of the development of the criteria for the financial product group. This included identification of the product’s scope and definitions, analysis of the PRIIPs market, a technical analysis of the

⁶ This Directive is only of relevance where Member States decided to allow marketing to retail investors on their territory.

existing taxonomies and the definitions of "green" financial products, as well as identification of the main criteria areas as the basis for a 1st criteria proposal.

2.4.2 Market analysis

The market analysis carried out in support of the scope and criteria proposals as presented in the First Technical Report focused on retail clients as investors. A retail client is one that is not a professional client, i.e. a client who does not possess the experience, knowledge and expertise to make its own investment decisions and properly assess the incurred risks.⁷ Retail clients are mostly composed of households, being the major contributors to the net financial wealth (i.e. all financial assets minus all financial liabilities) of the Eurozone.

Statistics show that EU-28 households own about EUR 34 trillion of cumulated assets, and their financial liabilities are equal to 30% of their financial assets. Currency and deposits, pension funds, and (life and non-life) insurance products constitute around 30%, 20%, 18%, respectively, of the EU-28's household wealth. The share of equities in households' financial portfolios is also around 18%. Investment fund shares increased from 6% in 2012 to 8% in 2017. Turning to the least represented asset categories, less than 1% of households' wealth is invested in financial derivatives.

Many of the above-mentioned products are covered by the PRIIPs Regulation. PRIIPs are packaged retail and insurance-based investment products that for example banks, insurers and asset managers typically offer to retail clients. PRIIPs⁸ include:

- a) packaged retail investment products (PRIIPs), i.e. investments, including instruments issued by special purpose vehicles, where the amount repayable to the retail investor is subject to market fluctuations;
- b) Insurance-based investment products, i.e. insurance products whose maturity or surrender value is exposed to market fluctuations.

The following products are outside the scope of the PRIIPs Regulation⁹:

- non-life insurance products as listed in Annex I to Directive 2009/138/EC;
- life insurance contracts where the benefits under the contract are payable only on death or in respect of incapacity due to injury, sickness or infirmity;
- deposits other than structured deposits as defined in point (43) of Article 4(1) of Directive 2014/65/EU;
- securities as referred to in points (b) to (g), (i) and (j) of Article 1(2) of Directive 2003/71/EC;
- pension products which, under national law, are recognised as having the primary purpose of providing the investor with an income in retirement and which entitle the investor to certain benefits;
- officially recognised occupational pension schemes within the scope of Directive 2003/41/EC of the European Parliament and of the Council or Directive 2009/138/EC;
- Individual pension products for which a financial contribution from the employer is required by national law and where the employer or the employee has no choice as to the pension product or provider.

The scope of the PRIIPs Regulation is broad and intended to cover all financial products sold on the retail market that have exposure to underlying assets (stocks, bonds, etc.), provide a return over time and have an element of risk. PRIIPs cover a range of investment products which,

⁷ See Regulation n. 1286/2014 of PRIIPs Regulation, Article 4(6) and Directive 2011/61/EU, Article (4)(1)(aj) for the definition of "retail investor". Moreover, see Directive 2014/65/EU, Article 4 (1), point (11) for the definition of "retail client" and Directive 2014/65/EU, Article 4(1), point (10) and Annex II for the definition of "professional client".

⁸ See Regulation n. 1286/2014 of PRIIPs Regulation, Article 4(1)-(3) and the Discussion Paper "Key Information Documents for Packaged Retail and Insurance-based Investment Products (PRIIPs)" n. JC/DP/2014/02.

⁹ See Regulation n. 1286/2014 of PRIIPs Regulation, Article 2 (2).

taken together, made up a market in Europe worth up to EUR 20 trillion at the end of 2017. Investment funds, unit-linked life insurance products and unit-linked pension funds taken together account for a large part of the PRIIPs market.

Depending on the source there are between 60 000 and 80 000 investment funds domiciled in the EU (EFAMA Q1 2018 and Bloomberg, October 2018), with net assets amounting to around EUR 15 trillion¹⁰. Investment funds are invested predominately in equities (28%), bonds (23%), both (21%). EU legislation distinguishes between Undertakings for Collective Investment in Transferable Securities (UCITS) and Alternative Investment Funds (AIFs). UCITS and AIFs funds reached an outstanding amount of about EUR 9 trillion and EUR 6 trillion, respectively, at the end March 2018. Some AIFs are sold to retail investors following regulation at the national level, although such funds are in principle designed for professional investors.

According to Bloomberg, 421 funds are currently marketed as green or sustainable¹¹. These funds are further classified as clean energy, climate change, environmentally friendly and environmental, social and corporate governance (ESG) funds¹². This represents about 0.01% of the total active funds corresponding to a similar share in terms of assets under management (Kahlenborn et al., 2017 on the very low market share of sustainability or environmentally themed products and green impact products).

As for other PRIIPs categories, the market for life insurance products offering non-guaranteed products linked to either investment funds (i.e. unit-linked contracts), or structured products (i.e. index-linked products) amounts to about EUR 3 trillion. Approximately 25% of households' financial assets are composed of stocks and debt securities. A particular category among bonds are "Green bonds", which finance or re-finance in part or in full new and/or existing eligible green projects. This specific product has received attention both at EU level and from private initiatives. However, the European green bond market is still very small in size compared the market of conventional bonds, corresponding to approximately 2.5% of the total bonds market in 2018. It is worthy of note that about 36% of the global green bond issuance in 2017 is associated with EU issuers.

2.4.3 Technical analysis

Green investment is generally associated within the financing of investments that provide environmental benefits such as a reduction in GHG and air pollutant emissions, without reducing the production and consumption of non-energy goods. Financial products or investments are therefore green as a result of the uses to which the money is put in terms of the underlying assets or economic activities.

Initial evidence suggests that a range of strategies are employed in order to create green or environmentally sustainable financial products. An increasing proportion of assets are currently managed based on a number of sustainable investment strategies including:

- exclusionary screening,
- positive screening or best-in-class approach,
- norms based screening approach,
- environmental, social and governance (ESG) integration,
- sustainability themed investing or thematic investing,
- impact/community investing, and
- corporate engagement and shareholder action.

¹⁰ Source: EFAMA Q1 2018.

¹¹ The Bloomberg Fund Classification System provides a fund classification grouping and compares funds with similar investment objectives. Bloomberg classifies funds based on public documents including prospectuses, fund fact sheets, and annual/semi-annual reports to determine the intended investment objective of the fund manager. The characteristics of the objective relate to both asset class specific dimensions (e.g. strategy, type of investment) and non-asset class specific dimensions (e.g. industry focus, geographic focus, general attributes, etc.).

¹² One fund can be classified into more than a category, and approximately 35% of these funds are also classified as Socially Responsible Funds. For example, 49 funds belong in the category "Socially Responsible and ESG".

Of these strategies, the prevailing and overlapping concepts of “green” used to date by investors have been developed around four main types of investment strategies: (1) socially responsible investing (SRI); (2) ESG integration / investing; (3) impact investing, and (4) thematic investing. Of these, impact investing and thematic investing focus on activities that deliver a specific and measurable social or environmental improvement. Green thematic investing will address specific environmental objectives or problems and can provide important information for the definition of green.

In the financial industry, an investment portfolio is a commonly applied term which encompasses assets such as stocks, bonds, cash, and real estate, amongst others. The most common asset classes in any portfolio are equities (stocks), fixed-income securities (bonds), real estate and cash equivalents. The share of each asset class in a portfolio is referred to as the asset allocation of that portfolio. These could be directly or indirectly invested in.

A number of labels and schemes are available in Europe to help investors assess and select from a range of financial products which are described as sustainable or green. These include the Greenfin (previously TEEC) Label¹³, FNG Siegel¹⁴, Nordic Swan¹⁵, LuxFLAG Climate Finance Label¹⁶ and the Austrian label¹⁷ amongst others. Some of these labels and schemes define the “greenness” of an investment portfolio by setting either a requirement or a threshold on:

- the minimum proportion (in percentage) of a portfolio's total assets under management mandated to be invested either in climate change mitigation and or climate change adaptation activities; or
- the percentage of revenues of the company(s) that can be attributed to “green” activities by assessing to what degree (quantified as a percentage) the company engages in sustainable economic activities which are defined in the taxonomy applied by the label or scheme.

The existing labels and schemes also make use of taxonomies to define green sectors or economic activities, in some cases with reference to screening criteria.

The different strategies, criteria and taxonomies employed by the prevailing labels and schemes, create uncertainties for investors as they are unable to compare different types of information for different financial products. It also represents an obstacle to the flow of capital towards more environmentally sustainable economic activities.

A taxonomy is a classification system that defines ‘green’ economic activities. These economic activities could be projects or activities in specific economic sectors of any economy in areas such as renewable energy and green buildings. Regional and national labels as well as schemes available in Europe have so far certified the “greenness” of financial products using any one of the following taxonomies:

- the Climate Bond Initiative (CBI) taxonomy;
- the Green Bond Principles (GBP) project categories; and
- the International Development Finance Club (IDFC) taxonomy.

These taxonomies differ in the manner in which they categorise different economic activities as environmentally sustainable. They also differ in their levels of granularity, leading to a lack of standardisation. This called for the need for a harmonised taxonomy at the EU level. The framework established by the EU Taxonomy proposal will therefore be used as a cornerstone in the development of the EU Ecolabel criteria, and the link with the EU Taxonomy will be established by taking a “look-through” approach.

¹³Energy and Ecological Transition for the Climate. Available at https://www.novethic.com/fileadmin/user_upload/divers/labels/1605-LabelTEEC_Referentiel-ENG.pdf

¹⁴ FNG – Siegel. Available at <https://www.fng-siegel.org/en/siegelkriterien-en.html>

¹⁵ Nordic Swan. Available at <https://www.nordic-EU Ecolabel.org/>

¹⁶ LuxFLAG, <https://www.luxflag.org/labels/climate-finance/>

¹⁷ The Austrian EU Ecolabel (January 2016). Eco-label Guideline UZ 49 for Sustainable Investment Products. Version 4.0. Available at: https://www.umweltzeichen.at/file/Guideline/UZ%2049/Long/Ec49_R4a_sustainable_Investment_products_2016.pdf

3 PRODUCT GROUP NAME, SCOPE AND DEFINITIONS

3.1 Revised proposal

Previous (third) proposal for the product group name:
Retail financial products
Fourth proposal for the product group name:
Retail financial products
Previous (third) proposal for the product group scope:
<p>The product group shall comprise the following products that are provided as a service to retail investors:</p> <ul style="list-style-type: none">• The service of managing an investment product that has been packaged for retail investors in accordance with the requirements laid down in Regulation (EU) No 1286/2014 on packaged retail and insurance-based investment products (PRIIPs). This shall include:<ul style="list-style-type: none">- Equity, bond and mixed¹⁸ investment funds, to include those referred to as Undertakings for the Collective Investment in Transferable Securities (UCITS) and Alternative Investment Funds (AIFs) that are marketed to retail investors upon a national discretion (according to Article 43 of Directive 2011/61/EU¹⁹);- Insurance-based investment products (IBIPs), to include unit-linked, profit participation and multi-option life insurance products.• The service of managing a fixed-term deposit or savings deposit product as referred to in Article 2(1) point 3 of Directive 2014/49/EU on deposit guarantee schemes. The service shall be provided by the credit institution on whose balance sheet the deposits held (liabilities) and the associated loans granted as credits (assets) appear. <p>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 AIF or insurance product applying for an EU Ecolabel.</p> <p>The retail financial product shall be registered or authorised for marketing or distribution in a Member State of the European Union.</p>
Fourth proposal for the product group scope:
<p>The product group shall comprise the following products that are provided as a service to retail investors:</p> <ul style="list-style-type: none">• The service of managing an investment product that has been packaged for retail investors in accordance with the requirements laid down in Regulation (EU) No 1286/2014 on packaged retail and insurance-based investment products (PRIIPs). This shall include:<ul style="list-style-type: none">- Equity, bond and mixed²⁰ investment funds, to include those referred to as Undertakings for the Collective Investment in Transferable Securities (UCITS) and Alternative Investment Funds (AIFs) that are marketed to retail investors upon a national discretion (according to Article 43 of Directive 2011/61/EU²¹);- Insurance-based investment products (IBIPs), to include unit-linked life insurance products and multi-option life insurance products only composed of unit-linked funds as

¹⁸ Mixed funds shall be considered as synonymous to hybrid funds

¹⁹ Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010

²⁰ Mixed funds shall be considered as synonymous to hybrid funds

²¹ Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010

[underlying options.](#)

- The service of managing a fixed-term deposit or savings deposit product as referred to in Article 2(1) point 3 of Directive 2014/49/EU on deposit guarantee schemes. The service shall be provided by the credit institution on whose balance sheet the deposits held (liabilities) and the associated loans granted as credits (assets) appear.

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 AIF or insurance product applying for an EU Ecolabel.

The retail financial product shall be registered or authorised for marketing or distribution in a Member State of the European Union.

Previous (third) proposal for complementary definitions:

For the purposes of this Decision, the following definitions shall apply:

‘alternative investment funds’ (AIFs) means collective investment undertakings, including investment compartment thereof, which:

- a) raise capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors; and
- b) do not require authorisation pursuant to Article 5 of Directive 2009/65/EC

‘asset’ means a resource with economic value that an individual, corporation or country owns or controls with the expectation that it will provide a future benefit;

‘bond’ means a fixed income instrument that represents a loan made by an investor to a borrower (typically corporate or governmental);

‘CapEx’ means capital expenditure (investment) made along the life cycle of a project and assigned to the year when it is incurred. Included are investments in assets used for production, transformation and distribution; as well as for refurbishment, upgrades, new construction and the replacements of capital assets. Also included are investments made in Research & Development that are directed towards the development of new assets or production technologies;

‘deposit’ means a credit balance which results from funds left in an account or from temporary situations deriving from normal banking transactions and which a credit institution is required to repay under the legal and contractual conditions applicable, including a fixed-term deposit and a savings deposit;

‘environmentally sustainable economic activity’ means an economic activity that qualifies with the criteria set out in Delegated Regulation (EU) xxxx/xxx supplementing Article 3 of Regulation (EU) 2020/852²², including transitional activities as defined in Article 10(2) and enabling activities as defined in Article 16 of Regulation (EU) 2020/852;

‘green CapEx’ means capital expenditure made in environmentally sustainable economic activities;

‘green revenues’ means financial revenues derived from the ‘environmentally sustainable economic activities’ of a company;

‘insurance-based investment product’ means an insurance product which offers a maturity or surrender value and where that maturity or surrender value is wholly or partially exposed, directly or indirectly, to market fluctuations;

‘investment fund’ means a supply of capital belonging to numerous investors used to collectively purchase securities while each investor retains ownership and control of this own shares; types of investment funds include mutual funds, exchange-traded funds, money market funds and hedge funds;

‘packaged retail and insurance-based investment product’ or ‘PRIIP’ means a product that is one or both of the following:

²² The exact wording of the legal reference to the EU Taxonomy and its Delegated Regulations is to be defined following consultation within the Commission Services.

a) a packaged retail investment product (PRIIP);

b) an insurance-based investment product;

‘packaged retail investment product’ or ‘PRIIP’ means an investment, including instruments issued by special purpose vehicles as defined in point (26) of Article 13 of Directive 2009/138/EC or securitisation special purpose entities as defined in point (an) of Article 4(1) of the Directive 2011/61/EU of the European Parliament and of the Council (19), where, regardless of the legal form of the investment, the amount repayable to the retail investor is subject to fluctuations because of exposure to reference values or to the performance of one or more assets which are not directly purchased by the retail investor;

‘pension products’ refers to non-public arrangements and investment vehicles which have an explicit objective of retirement provision (according to a national social and labour law or tax rules) irrespective whether they are of occupational or personal type;

‘portfolio’ means a grouping of financial assets;

‘portfolio management’ means managing portfolios in accordance with mandates given by clients on a discretionary client-by-client basis where such portfolios include one or more financial instruments;

‘retail investor’ means:

a) a retail client as defined in point (11) of Article 4(1) of Directive 2014/65/EU

b) a customer within the meaning of Directive 2002/92/EC, where that customer would not qualify as a professional client as defined in point (10) of Article 4(1) of Directive 2014/65/EU;

‘revenue’ means this is the amount of money that is brought into a company by its business activities;

‘share or stock’ means a type of security that signifies ownership in a corporation and represents a claim on part of the corporation’s assets and earnings;

‘sovereign bond’ means a debt security issued by a national government;

‘structured deposits’ means a deposit as defined in point (c) of Article 2(1) of Directive 2014/49/EU of the European Parliament and of the Council (1), which is fully repayable at maturity on terms under which interest or a premium will be paid or is at risk, according to a formula;

‘sub-sovereign bond’ means a debt security issued by a regional, city or local government entity, as well as government agencies;

‘transferable securities’ means:

a) shares in companies and other securities equivalent to shares in companies;

b) bonds and other forms of securitised debt (debt securities);

c) any other negotiable securities which carry the right to acquire any such transferable securities by subscription or exchange;

‘turnover’ is also used as a synonym for investments; in the investment industry, turnover is defined as the percentage of a portfolio that is sold in a particular month or year;

‘undertaking collective investment transferable securities (UCITS)’ means an undertaking for collective investment in transferable securities authorised in accordance with Article 5 of Directive 2009/65/EC;

‘unit-linked’ means that the financial benefits provided by an insurance contract are directly linked to the value of assets contained in an investment fund;

‘verification’ means a procedure to certify that a product complies with specified EU Ecolabel criteria.

Fourth proposal for complementary definitions:

1) ‘applicant’ means the fund manager, the deposit manager or the insurance undertaking applying for the EU Ecolabel, as applicable

2) ‘assets under management’ means the economic value of the underlyings included within the financial product

3) ‘CapEx’ means capital expenditure (investment) made along the life cycle of a project and

assigned to the year when it is incurred. Included are investments in assets used for production, transformation and distribution; as well as for refurbishment, upgrades, new construction and the replacements of capital assets. Also included are investments made in Research & Development that are directed towards the development of new assets or production technologies;

4) ‘environmentally sustainable economic activity’ means an economic activity that **complies** with the **relevant** criteria set out in Delegated Regulation (EU) xxxx/xxx supplementing Article 3 of Regulation (EU) 2020/852, **hereafter the ‘EU’ Taxonomy**, including transitional activities as defined in Article 10(2) and enabling activities as defined in Article 16 of Regulation (EU) 2020/852;

5) ‘green CapEx’ means capital expenditure made in environmentally sustainable economic activities;

6) ‘green **turnover**’ means **turnover** derived from the ‘environmentally sustainable economic activities’ of a company;

7) ‘**greenness of the issuer**’ means the ratio which is made up by considering the sum of **green turnover and green capex of the company divided by total turnover of the company**

8) ‘portfolio’ means a grouping of financial assets;

9) ‘**portfolio contribution**’ means the **proportion of the underlying assets by which the portfolio is made of**;

10) ‘sovereign bond’ means a debt security issued by a national government;

11) ‘sub-sovereign bond’ means a debt security issued by a regional, city or local government entity, as well as government agencies;

12) ‘**turnover**’ means **this is the amount of money that is brought into a company by its business activities**;

13) ‘verification’ means a procedure to certify that a product complies with specified EU Ecolabel criteria.

3.2 Rationale of the proposed name, scope and definitions

The main focus of the product group for the 1st set of criteria for retail financial products is on the PRIIPs products and specifically UCITS and retail AIFs. Following on from requests by stakeholders and investigation by the JRC, the scope proposal has been extended to include:

- (from the 2nd criteria proposal) Fixed-term deposit and savings deposit accounts of the kind offered by high street banks. These are mainstream products that are the depository for the majority of household savings as well as playing an important role in the economy as a source of loan finance and liquidity for investment by businesses.
- (from the 3rd criteria proposal) A number of further PRIIPs – namely the insurance-based investment products (IBIPs) referred to as Profit Participation and Multi-Option Product (MOP) life insurance. These products may be offered to retail investors as alternatives to other UCITS and retail AIF products, so are important comparable products in the retail segment of the investment and savings market.

The proposed scope of the EU Ecolabel criteria is understood from earlier market analysis done by JRC to cover the majority of the market for investment fund and savings products that may be offered to retail investors across the EU.

Following requests from stakeholders, the potential to make two further additions to the scope has been analysed – namely pension funds and professional AIFs – with the outcome reported in TR2.0. It is not considered possible to include pension funds (also referred to as institutional investors) at present because the market share of products in which retail investors can choose their fund is very limited, particularly for Pillar 1 and 2 products. Moreover, their diversified underlying assets are likely to require further attention in order to develop criteria. In regard to AIFs addressed to professional investors, these are business to business products and the result of an internal consultation within the Commission’s Services is that they cannot presently be included.

It is therefore proposed that in the 1st revision of the criteria – anticipated for 2022/23 – a review is undertaken of the potential for a further extension of the scope to include e.g. pension products where the retail investor has a choice of the fund(s), European Long Term Infrastructure Funds (ELTIFs) and real estate funds. The revision will need to include a focus on the legal aspects of their inclusion and the identification of verification needs in order to cover the possible diversity of underlying assets.

3.3 Outcomes of previous consultations and main changes in TR2 and TR3

Feedback received on TR1.0 and TR2.0 and further research conducted by JRC can be found in the previous version of the report (TR2.0 and TR3.0).

In TR2.0, the main change to the scope proposal was the addition of fixed-term deposit or savings deposit products.

The potential to add pension funds and professional AIFs to the scope has been analysed. It was not considered possible to include pension funds at present because the market share of products in which retail investors can choose their fund is very limited, particularly for Pillar 1 and 2 products. Moreover, their diversified underlying assets are likely to require further attention in order to develop potential criteria. Professional AIFs could also not be included in the scope, as these are business to business products.

The TR2.0 explored the possibility to include in the scope of the EU Ecolabel savings and deposits accounts. JRC concluded that it is feasible to add savings and deposit accounts to the initial scope of the product group. Savings/deposit accounts are a mainstream financial product that could ensure high visibility for the EU Ecolabel and diversify the current scope of financial instruments beyond equities and bonds to also include loans, which play an important role in supporting economic activity as well. Detailed rationale for the inclusion of this product in the EU Ecolabel scope can be found in the TR3.0.

Based on the themes that emerged from discussions at the 2nd AHWG meeting and in comments provided to the public consultation (via BATIS JRC tool), further research by the JRC has focussed on the following topics:

- The potential for inclusion of real estate and infrastructure funds,
- The potential for inclusion of structured products,
- The potential for inclusion of pension funds and institutional investors, and
- An evaluation of the feasibility of extending the scope of Insurance-based investment products.

Considering research on the topics mentioned above, a crucial change to the scope was the addition of other insurance-based investment products (IBIP). Apart from unit-linked insurance products the scope in the TR3.0 also includes profit participation, multi-option insurance (MOP)

and hybrid insurance products. The TR3.0 also concluded regarding real estate and infrastructure funds, structured products and pension funds for institutional investors as follows.

Inclusion of real estate and infrastructure funds

Given that the intention with this first criteria development process has been to focus initially on the feasibility of PRIIPS products and simpler savings products, it is proposed that the potential to include real estate funds shall be analysed as part of the 1st revision of the criteria. Moreover, the ELTIFs eligibility will depend on whether they are sold to a professional or directly to retail consumers, as well as on whether they can comply with the Ecolabel criteria. It is proposed that their broad inclusion is analysed as part of the 1st revision of the criteria set.

However, given that both real estate and infrastructure investments may be present as underlying assets in retail AIFs and life insurance products, it is proposed as a first step to clarify in the criteria that units or shares in ELTIFs can be present in the underlying assets of an EU Ecolabel product. In this way infrastructure that falls within the scope of the EU Taxonomy can contribute towards the greenness threshold of criterion 1.

Structured products

In general, if a product is a PRIIPS product largely investing in equities and/or bonds as underlying assets, then it is possible to include it within the current proposed products' scope and according to criterion 1, as this does not require the development of further new criteria for some of the underlying assets. Structured deposits were looked at in the 1st Technical Report on the Ecolabel for financial products and found to be of limited market relevance at present. Moreover, structured products are complex, and it is not possible to determine a level of greenness for the derivatives or money market instruments used, which may account for a significant proportion of the underlying assets.

Alternative Investment Funds (AIFs)

The market significance of professional investors was acknowledged in the 2nd Technical Report. However, as was reported, an internal consultation within the Commission Services suggested that there are difficulties to include professional AIFs within the scope of what is a consumer labelling scheme. It was also clarified that AIFs are made available to retail investors in some countries if national laws foresee this and that professional funds that form part of the underlying assets of another product that is authorised for sale to retail investors are within the proposed scope.

Pension funds and institutional investors

The market significance and the size of the assets managed by pension funds was acknowledged in the 2nd Technical Report. However, as was reported, internal consultation within the Commission Services suggested that there are difficulties in including them within the scope of what is a consumer labelling scheme because most Pillar 1 and 2 products do not provide a choice of fund products to the retail investor (see the 2nd Technical report). It is proposed that the possibility to include some initial pension products within the scope be reviewed at the time of the 1st criteria revision.

Profit Participation (with profits) products

Profit participation products offer investments by the insurance undertaking in asset classes part of fund and distribute a portion of the insurance undertakings profits to policyholders. These products fall under PRIIPs Category 4. Most profit participation ('with-profits') products are based on the insurer's own investments in the general fund (sometimes also referred to as a

general account). Following discussions with EIOPA and some Member States representatives, it appears to be possible to address main challenges for including profit participation products in the EU Ecolabel scope. In doing so, the TR3.0 suggests applying the criteria now set for UCITS mixed funds, with the necessary adaptations, to also serve as criteria for profit participation products.

Multi-option products (MOPs) with client choice of unit-linked or hybrid products configurations

Multi-option products (MOPs) offer a choice of different underlying ‘options’. These options predominantly comprise a choice of unit-linked funds or a hybrid, which is a mix of unit-linked and profit participation options. The latter typically offers one profit participation option and a wide variety of unit-linked options to be chosen on top of the profit participation fund.

For hybrid MOPs, which it is understood to largely consist of assets within a general fund, the fact that retail investors are offered a choice of unit funds suggests that, in addition to the general fund, all the chosen unit-linked funds would have to be EU Ecolabel. The EU Ecolabel is awarded to a specific product configuration and before they are sold. As a consequence, the TR3.0 suggests that multiple product configurations are only permissible if each configuration on its own meets the ecolabel criteria.

Therefore, the TR3.0 proposes that for the hybrid MOP itself to be ecolabelled, the client's choice would have to be restricted. However, it is understood that in practice, it is not feasible to restrict client's choice, but on the contrary, the choice of the client is open and can even be switched among options during the contract period, the TR3.0 proposes as the only solution for a MOP to be EU Ecolabel to have all underlying options EU Ecolabel.

3.4 Outcomes of the third stakeholder consultation

This section summarises stakeholders' comments received after the EUEB meeting held in November 2020 and the stakeholder consultation thereafter. Most of the stakeholders support JRC's suggestions to review the scope in the 1st revision of the criteria and to explore the potential for retail ELTIFs, retail AIFs, and pension products to be included. On the other side, there were opinions supporting reviewing the inclusions of profit participation, multi option and hybrid products in the scope of the EU Ecolabel in this first criteria proposal.

Profit participation products

Stakeholders recommended that the general fund shall restrict the transferability of the assets and ensure that the assets backing the product are traceable and meet the criteria of the EU Ecolabel. It is advocated that this could be done by establishing a ring-fenced fund for the Profit Participation product. The ring-fenced fund could follow the rules that are related to Article 99 of Directive 2009/138/EC of Solvency II and apply the relevant provisions of EIOPA “Guidelines on ring-fenced funds”²³. In case the insurer does not create this separate ring-fenced (segregated) fund, a specific report would need to be submitted to the Competent Body in charge of verifying compliance with the Ecolabel criteria addressing the traceability of “green” underlying assets

23 https://www.eiopa.europa.eu/content/guidelines-ring-fenced-funds_en

Other stakeholders highlighted that the proposed criteria (TR3.0) seem to be incompatible with the structure of the general fund, which does not operate in the way mixed UCITS funds do. As currently proposed, the criteria do not support the risk-sharing principle of insurance. It is also mentioned that a potential fragmentation of the pool in which risks cannot be shared, contradicts the core idea of the collective investment. Stakeholders commented that a suggestion made to create a sub-fund within the general fund, which shall be comprised by green assets only, would make diversification extremely challenging, considering also the need to include bonds - especially sovereign bonds - to achieve certain investment objectives. Additionally, the current situation in the market, might complicate an adequate return in such a restricted sub-fund.

Multi option insurance products (MOPs)

Stakeholders have recommended avoiding the inclusion of any insurance products apart from unit-linked insurance products in the EU Ecolabel scope or MOPs that are only composed of unit-linked insurance product. Especially the inclusion of profit participation, multi-option and hybrid products insurance products may impose difficulties concerning traceability of the underlying assets and assessment of their compliance with the criteria. Another stakeholder suggested changing the technical approach for MOPs not to require that all underlying options are retail products.

Hybrid products that are not MOPs

A stakeholder recommended covering in the scope, hybrid products of unit-linked and profit participation that are not MOPs. In some Member States, hybrid products are sold without to offer a choice to the consumer in terms of selecting the underlying assets, hence these products do not qualify as MOPs. Such products can for example be composed of a unit-linked and a profit participation component.

3.5 Further research and main changes in the fourth proposal

Based on the comments provided in the 3rd public consultation (via BATIS JRC tool), the JRC has considered following changes in the scope of the TR4.0:

Insurance products including the general fund

JRC has received extensive feedback from European insurers and was also engaging with other stakeholders regarding the inclusion of unit-linked, profit participation, multi option and hybrid life insurance products in the current scope of the EU Ecolabel. Since, unit-linked insurance products have a structure similar to Funds of Funds, the traceability and the potential to assess and verify compliance appears to be feasible and pragmatic. The same applies for MOPs which only consist of unit-linked insurance funds. Therefore, the TR4.0 suggests the inclusion of this kind of insurance products in the scope. However, there were major concerns regarding the possibility for the general fund to comply with the exclusions, trace its AuM, and reach a greenness threshold of equal strictness of other financial products.

The general fund uses a broad pool of assets for diversification purposes, and therefore it would be challenging to apply exclusions in its whole spectrum. It would be unrealistic to assess compliance of all underlyings of this fund, whereas if all AuM were compliant with exclusions, that might substantially compromise diversification. Nevertheless, there were alternative suggestions to only apply environmental exclusions to the EU Ecolabel part of the general fund.

JRC is made aware that an accounting procedure that could allow 'separation 'of the AuM included in the EU Ecolabel insurance product is technical not feasible. However, European

insurers have stated that a report could be provided instead, which could track all AuM of the general fund. Since, it is the responsibility of the insurer to diversify the investments in order to generate a return while controlling the risks associated with these investments. For this reason, insurers monitor the financial characteristics of each investment (identification, valuation, duration, etc.), and therefore, it would be possible to also monitor the non-financial characteristics of investments including those referring to environmentally sustainable activities.

The JRC has also considered the position of insurers that highlighted that even a very low greenness threshold for the general fund would not be possible to meet if the current structure of the general fund and the requirement for investments in environmentally sustainable activities are taken into account.

The JRC reflected on the obstacles for EU Ecolabeling of insurance products if the general in included in the scope and suggests excluding all insurance product that contain the general fund from the scope. Yet, these products could be reassessed for inclusion in the 1st criteria revision

Draft version

4 STRUCTURE AND RATIONALE FOR THE CRITERIA AND CRITERIA AREAS

This section provides an overview of how the criteria set could be configured. This includes the identification of the areas that should be covered by the criteria. The broad criteria areas are described, then the details of each specific criterion are developed further in subsequent sections. Annex 2 presents a table comparing the first and second draft proposal for criteria, across the different criteria areas.

4.1 Proposed structure of the criteria

The following criteria areas were identified with a view to enhancing the environmental benefits of investments:

1. Investment in environmentally sustainable economic activities.
2. Exclusions based on environmental aspects
3. Exclusions based on social aspects and governance practices,
4. Engagement
5. Measure taken to enhance investor impact
6. Information for retail investors
7. Information appearing on the EU Ecolabel

To facilitate the identification of ‘environmentally sustainable economic activities’ in a harmonised and consistent manner, the definition proposed for ‘environmentally sustainable activities’ refers to the Regulation (EU) 2020/852²⁴, hereafter the ‘EU Taxonomy’. In this sense, “green” will mean economic activities that qualify as ‘environmentally sustainable’ under the EU Taxonomy. In a first stage, the EU Taxonomy will focus on identifying the economic activities that significantly contribute to climate change mitigation and climate change adaptation while not harming any of the other objectives, comply with minimum social safeguards and meet the technical screening criteria. In the future, the EU Taxonomy will identify economic activities that significantly contributes to the achievement of any of the six EU Taxonomy objectives.

In addition to the identification of environmentally sustainable economic activities through reference to the EU Taxonomy, the use of exclusions which limit the flow of investments into economic activities which are considered environmentally harmful will ensure that the EU Ecolabel is awarded to the best environmental performing products.

Another aspect to take into account when linking the EU Ecolabel criteria to the EU Taxonomy is that the EU Taxonomy will cover minimum social safeguards, while the EU Ecolabel requires taking into account “where appropriate, social aspects”. The aspects that were identified (through the stakeholder survey and reviews of the existing schemes and labels) as being important issues for investors, have been further reviewed and proposed as criteria (in particular social and environmental exclusion criteria) for the EU Ecolabel.

The **portfolio composition in terms of environmentally sustainable economic activities** adopts an overall green threshold for each retail financial product, where the greenness of companies is evaluated by considering the contribution of a company's green turnover and green capex. This allows for taking into account the actual greenness of a company (green turnover) and its effort to increase their EU Taxonomy-aligned activities (green capex). The setting of a global threshold gives flexibility to the fund or deposit manager or insurance undertaking, as well as allowing diversification for risk management purposes.

²⁴ Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088

Exclusions based on environmental aspects focus on the potentially harmful environmental effects of activities financed. The need to adopt criteria that exclude a list of economic activities was identified. The criteria represent a cut-off for economic activities deemed to be detrimental or opposed to EU and international environmental policy aims. The proposed 5% threshold applies at a company level and is linked to revenues. Summarily, the criterion prevents EU Ecolabel funds from investing in activities which could harm the environment significantly (brown activities).

A **social exclusions** criterion aims to address social concerns potentially associated with investments. Changes have been introduced at both a company and sovereign state level in the criterion. The TR4.0 introduces partial exclusion, 5% revenue threshold, related to investments in two different economic sectors. In addition to the proposed changes, at the company level, exclusions apply to both transnational and other business enterprises, regardless of their size, sector, location, ownership and structure. Corporate policies on social aspects shall be established and put into practice. A due-diligence procedure in the form of a management system is also required to monitor and manage adverse impacts or potential risks. At the sovereign state level, additional human rights treaties shall be ratified, and the corruption perception index threshold is amended. The criterion, in its current form, envisages addressing stakeholder's concerns on social matters and mitigating adverse social effects of investments. In addition, exclusions based **on corporate governance practices** associated with social aspects and are followed by the companies that the financial products are invested in, have been considered.

The **engagement** criterion aims to make use of mechanisms through which investors can seek reforms that improve the quality of company activities and/or grow shareholder value. The establishment of a clear engagement policy which seeks to further the environmental objectives of the EU Taxonomy is established as the starting point. The strategy then provides the context for requiring more effective and focussed use of voting rights as well as bilateral or collective shareholder dialogue with companies to request or campaign for changes in how they are managed and investment strategies.

The **reporting on measures taken to enhance investor impact** is intended to encourage fund and asset managers to identify and actively manage opportunities to enhance the investor impact of the service they provide to retail investors. It requires fund managers to report on which mechanisms for enhancing investor impact they have addressed as a result of investment decisions, as well as identification of which of the measures they are taking to actively manage their investor impact.

Finally, **information for the consumer and information about the EU Ecolabel** stipulates the information to be communicated to consumers. Two levels of information are required. This criterion aims at communicating the singular aspects of the fund to the consumer throughout simple statements on the various criterion, i.e. portfolio composition in terms of environmentally sustainable economic activities, environmental and social exclusions, engagement aspects, etc. The criterion also stipulates a full annual report that shall be available to the consumers electronically and where they can find the details of the methodologies used for assessing and monitoring compliance with the EU Ecolabel criteria.

4.2 Rationale of the proposed general text on assessment and verification

The assessment and verification text refers to the different types of evidence that are considered relevant as proof of compliance for each criterion. The general text is presented in the box below. A separate assessment and verification text is then provided for each criterion proposal in Section 5. The frequency with which updated information is to be provided to Competent Bodies is currently proposed as 12 months, in line with other labels and industry practice.

No major comments were received on the assessment and verification section during the third stakeholder consultation.

The changes focused on removing the reference to Regulation (EC) No 765/2008, in line with the most recently voted EU Ecolabel product groups.

Third proposal of the Assessment and verification

The specific assessment and verification requirements are indicated within each criterion.

Where the applicant is required to provide declarations, documentation, analyses, or other evidence to show compliance with the criteria, these may come from the applicant and/or their supplier(s) and/or their subcontractor(s). As a prerequisite, the 'financial product' shall meet all legal requirements related to the place of product manufacture, registration and authorisation.

Competent bodies shall give preference to attestations that are issued by bodies that are accredited under the relevant harmonised standard for bodies certifying products, processes and services. Accreditation shall be carried out in line with Regulation (EC) No 765/2008 of the European Parliament and of the Council²⁵. Competent bodies may require supporting documentation and may carry out independent checks.

After being awarded the EU Ecolabel licence, the applicant is required to inform the relevant competent body of any changes pertaining to their licensed product(s). The applicant is required to provide updated information on their licensed product(s) every 6 months. Such information related to any changes or deviations should include all the evidence of proof of compliance to the proposed EU Ecolabel criteria.

The competent body may perform follow-up assessments of the applicant's financial product up to once a year during the award period.

Fourth proposal of the Assessment and verification

The specific assessment and verification requirements are indicated within each criterion.

Where the applicant is required to provide declarations, documentation, analyses, or other evidence to show compliance with the criteria, these may come from the applicant and/or other responsible actors throughout the value chain. As a prerequisite, the 'retail financial product' shall meet all legal requirements related to the place of product manufacture, registration and authorisation.

Competent bodies shall preferentially recognise attestations and verifications that are issued by bodies accredited in accordance to the relevant harmonised standard for bodies certifying products, processes and services.

After being awarded the EU Ecolabel licence, the applicant is required to provide updated information on their licensed product(s) every twelve months.

The competent body retains the right to make random checks on compliance.

²⁵ Regulation (EC) No 765/2008 of the European Parliament and of the Council of 9 July 2008 setting out the requirements for accreditation and market surveillance relating to the marketing of products and repealing Regulation (EEC) No 339/93. Available at: <http://data.europa.eu/eli/reg/2008/765/oj>

5 CRITERIA PROPOSALS

5.1 CRITERION 1: Investment in environmentally sustainable economic activities

Previous (third) proposal for Criterion 1: investment in green economic activities

The minimum proportion indicated below of the assets under management of the retail financial product are invested or loaned to environmentally sustainable economic activities. This requirement shall apply to the different retail financial products in the scope as follows:

- Investment funds and Profit Participation insurance funds: the total portfolio value or portion of the general fund invested in environmentally sustainable economic activities.
- Unit-linked funds: the investment in unit shares meeting the individual requirements to the total portfolio value invested in environmentally sustainable economic activities or the investment in EU Ecolabel investment funds.
- Multi option and hybrid insurance funds: the total portfolio value in a general fund invested in environmentally sustainable economic activities and/or the investment in unit share choices that meet the relevant total portfolio value thresholds.
- Fixed term and savings deposit accounts: the value of deposited funds loaned to environmentally sustainable economic activities.

Sub-criteria also apply to:

- the proportion of the total portfolio value invested in ‘companies investing in transition’ and ‘companies investing in green growth’, for which requirements are defined in criterion 2,
- the economic activities of the issuers of corporate bonds that form part of the assets under management (AuM), which are defined in sub-criterion 1.1.C
- The international commitments of the issuers of sovereign bonds that form part of the assets under management (AuM), which are defined in sub-criterion 3.2
- Other assets²⁶ that shall be counted in the total portfolio, when assessing compliance with the portfolio threshold, as defined in sub-criterion 1.1.I

All underlying assets that can comply with the criteria established in the Delegated Regulation (EU) xxxx/xxx supplementing Article 3 of Regulation (EU) 2020/852 ²² (‘the EU Taxonomy’) may be counted towards the total portfolio greenness, including, where applicable, real estate and infrastructure investments made by underlying funds in which unit shares are held.

1.1 Investment funds and Profit Participation insurance funds

A. Retail AIF funds

At least 70% of the total portfolio value in terms of assets under management (AuM) shall be invested in environmentally sustainable economic activities. The equity component shall be calculated according to the requirements of criterion 1.1.B and for the bonds to contribute they shall meet the requirements of criterion 1.1.C.

B. UCITS equity funds

At least 40% of the total portfolio value of the assets under management (AuM) shall be invested in environmentally sustainable economic activities, which may include a contribution from companies investing in transition or green growth, according to the formula below.

²⁶ Other assets may include as an example, derivatives or money held as cash.

$$G = \begin{cases} \sum_{i=1}^n (PCi * (0.6 * GRi + 0.4 * GCi)), & \text{if } GCi > GGRi \\ \sum_{i=1}^n (PCi * (0.6 * GRi + 0.4 * GRGi)), & \text{if } GCi < GGRi \end{cases}$$

Where:

G = % of total portfolio value invested in environmentally sustainable economic activity

i = an individual company in which portfolio equities are held

n = total number of companies in the portfolio

PCi = % Portfolio contribution of company i

GRi = % Green Revenue of company i

GCi = cumulative % Green Capex of company i over 5 years

GRGi = cumulative % projected Green Revenue Growth i over 5 years

Each company's percentage contribution shall be calculated as the weighted average of their % green revenue (GRi) and their % Green Capex (GCi) or % projected Green Revenue Growth (GRGi). The company contribution to the total portfolio value is then weighted based on the % of holdings in the total portfolio value (PCi). The sum of the weighted company contributions gives the % of total portfolio value invested in environmentally sustainable economic activity.

The eligibility requirements for green CapEx (GCi) and growth in green revenue (GRGi) are stipulated in criterion 2.

The remaining proportion of the total portfolio may include:

- companies deriving less than 5% of their revenue from environmentally sustainable economic activities and that are not excluded by criteria 3 and 4, and/or
- other assets or cash

Holdings in derivatives shall meet the requirements of sub-criterion I.

C. UCITS bond funds

At least 50% of the total portfolio value of the assets under management (AuM) shall be invested in green bonds. For corporate and sovereign bonds to contribute towards the portfolio greenness threshold, and be considered to be 'green bonds', they shall meet the following requirements:

- The green projects to be financed using the bond's proceeds shall be identified and shall be verified as environmentally sustainable economic activities.
- for corporate bonds, the issuer shall either meet the requirements of criterion 2.1 for companies investing in transition or show that their percentage of green revenue is more than 50%.
- The allocation of finance to the green projects or portfolios of projects shall be separated, tracked and reported on a 12 monthly basis following issuance.
- The value of refinanced projects within a green bond issue may only contribute to portfolio greenness if the issuer can demonstrate that the refinancing supports the creation of asset-backed securities or the recycling of funds for lending to new green projects.

Bonds verified as meeting the criteria of the EU Green Bond Standard shall be accepted as green bonds.

General purpose corporate bonds that are not green bonds may also contribute to the portfolio greenness. To contribute towards the portfolio greenness threshold, the issuer shall meet the requirements of criterion 2.1 for companies investing in transition or show that their percentage of green revenue is more than 50%. The percentage of green revenue of the issuer shall be applied as the percentage value of the bonds that contributes to portfolio greenness.

D. UCITS mixed funds

At least 50% of the total portfolio value of the assets under management (AuM) comprising bonds and equities shall be invested in environmentally sustainable economic activities. The equity component shall be calculated according to the requirements of criterion 1.1.B and for the bonds to contribute they shall meet the requirements of criterion 1.1.C.

The remaining proportion of the total portfolio may include:

- companies deriving less than 5% of their revenue from environmentally sustainable economic activities and that are not excluded by criteria 3 and 4, and/or
- other assets or cash

Holdings in derivatives that meet the requirements of sub-criterion I.

E. Fund of funds (FoFs)

At least 90% of FoFs have been invested in funds already awarded the EU Ecolabel.

The remaining proportion of the total portfolio may include:

- other assets or cash
- holdings in derivatives that meet the requirements of sub-criterion I

F. Unit-linked insurance products

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 its composition. Alternatively all underlying unit funds shall hold the EU Ecolabel.

G. Profit participation insurance products

The portfolio holdings of the general fund and any associated underlying funds shall each comply with the requirements of Criterion 1, 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 ecolabelled product shall be separated on the balance sheet of the license holder in such a way as to restrict transferability and to ensure that the assets underlying the EU ecolabelled products are traceable and correspond with money invested by the customers.

H. Multi option and hybrid insurance products

The portfolio holdings of the general fund and any associated underlying funds in which unit shares are held shall each comply with the requirements of Criterion 1, 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 Ecolabel product shall be separated on the balance sheet of the license holder in such a way as to restrict transferability and to ensure that the assets underlying the EU Ecolabelled products are traceable and correspond with money invested by the customers.

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.

I. Other assets

Derivatives

A fund may invest in derivatives according to its investment objectives. The use of derivatives shall be in line with the funds environmental investment policy. The use of derivatives shall be restricted to

the following situations:

- Hedging: Derivatives may be used for hedging purposes with regard to currency risk, duration risk, market risk or/and sensitivity to changes in interest rate structures.
- Exposure: The use of derivatives to increase exposure to the underlying assets shall be temporary and respond to significant subscriptions. The management company shall explain in the fund's periodical reports how it proceeds and, in particular, to illustrate the temporary nature of the use of derivatives for exposure purposes.

Derivatives shall not be used for the short selling of securities.

Assessment and verification

A. Retail AIFs

The applicant shall provide the following:

- i. documentation showing that the monthly averages for the 12 months preceding the application for the EU Ecolabel request, comply with the portfolio composition requirements or pre-contractual information and a portfolio statement and prospectus including:
 - complete listing of the portfolio assets, including where relevant equity, bonds, real estate and infrastructure, and
 - evidence that the fund complies with the respective minimum percentage at the time of application or in the year preceding it.
- ii. An audit report on the latest annual financial statement.
- iii. For products put on the market less than 12 months prior to the application, the fund manager shall provide a prospectus which details the fund strategy, the initial composition and how the greenness threshold will be met
- iv. For all products new and existing, an update on continuous compliance shall be provided every 12 months.

B. UCITS equity funds

The applicant shall provide the following:

- i. Documentation showing that the monthly averages for the 12 months preceding the application for the EU Ecolabel request comply with the portfolio composition requirements for equity funds or pre-contractual information and a portfolio statement and prospectus including:
 - complete listing of the portfolio assets, and
 - evidence that the fund complies with the respective minimum percentages for the equity fund.
- ii. The documentation required to demonstrate that selected companies within the portfolio that contribute towards green CapEx or green revenue growth qualify with criterion 2.
- iii. For products put on the market less than 12 months prior to the application, the fund manager shall provide a prospectus which details the fund strategy, the initial composition and how the greenness threshold will be met
- iv. For all products new and existing, an update on continuous compliance shall be provided every 12 months.

C. UCITS bond funds

The applicant shall provide the following:

- i. Documentation showing that the monthly averages for the 12 months preceding the application for the EU Ecolabel request comply with the portfolio composition requirements

- for bond funds,
- ii. the external verification for green bonds as proof of the allocation of financing to green economic activities.
 - iii. For general purpose corporate bonds, documentation that verifies the percentage green revenue of the issuer.
 - iv. For products put on the market less than 12 months prior to the application, the fund manager shall provide a prospectus which details the fund strategy, the initial composition and how the greenness threshold will be met.
 - v. For all products new and existing, an update on continuous compliance shall be provided every 12 months.

D. UCITS mixed funds

The applicant shall provide documentation as specified in B and C of this section.

E. Fund of funds (FoFs)

The applicant shall provide licence number of the EU Ecolabel licences held by each of the underlying funds

F. Unit-linked insurance products

The applicant shall provide documentation as specified in B, C and D of this section.

Where an underlying fund has the EU Ecolabel, the license number shall be provided. The prospectus and information about the management service provided to retail investors shall demonstrate the pre-selection of EU Ecolabel unit funds.

G. Profit participation insurance products

The applicant shall provide documentation as specified in B, C and D of this section, as applicable to the general fund. Where relevant, information shall be provided about the accounting practice used to separate the underlying assets of the fund that comply with the EU Ecolabel criteria, together with annual audit financial accounts that show the assets separated on the balance sheet.

Where an underlying fund has the EU Ecolabel, the license number shall be provided. The prospectus and information about the management service provided to retail investors shall demonstrate the pre-selection of EU Ecolabel unit funds.

H. Multi option and hybrid insurance products

The applicant shall provide documentation as specified in B, C and D of this section, as applicable to the general fund. Where relevant, information shall be provided about the accounting practice used to separate the underlying assets of the fund that comply with the EU Ecolabel criteria, together with annual audit financial accounts that show the assets separated on the balance sheet.

Where an underlying fund has the EU Ecolabel, the license number shall be provided. The prospectus and information about the management service provided to retail investors shall demonstrate the pre-selection of EU Ecolabel unit funds.

I. Other assets

The applicant shall provide the following documentation on the derivatives included in the funds:

- the investment or management policy governing the use of derivatives and outlining clearly how the derivatives are to be applied including information about the counterparty
- A statement on the strategy applied addressing how the use of derivatives is in line with the fund environmental policy.

- A listing of the types of derivatives and other assets used during the last 12 months preceding the application for the EU Ecolabel [where applicable], including their nature, average total amount invested (in proportion of the portfolio) and their average duration/frequency of use shall be demonstrated.
- For OTC derivatives, consumer information on all of the counterparties used over the last 12 months preceding the application for the EU Ecolabel [where applicable].

1.2. Green fixed term and savings deposit accounts

A. Green asset to deposit ratio

At least 70% of the value of the total deposits shall be used to make green loans and/or to invest in green bonds.

The value of both the assets (limited, for the purpose of criterion 1.2, to green loans and bonds) and the deposits shall be calculated based on the annual average for the time that the product has been on the market. For new products the target green asset to deposit ratio shall be stated and after a minimum of one year on the market. The license holder shall declare the ratio achieved to the Competent Body.

B. Green loans made using the deposited money

Green loans contributing to the green asset to deposit ratio shall only be granted to environmentally sustainable economic activities. The green loans may be made by partner credit institutions, provided there is traceability back to the deposited funds.

The applicant shall provide annual updates on the implementation status of the funded projects, which may be aggregated by economic activity.

C. Green bonds purchased using the deposited money

Bonds that contribute to the green asset to deposit ratio shall be green bonds or general purpose corporate bonds meeting the requirements of 1.1.C.

D. Separation of the deposited money

The money held in deposit and then granted as loans and/or used to buy bonds shall be separated within the accounts of the Credit Institution in such a way as to restrict transferability and to ensure that the funds loaned are traceable to the money deposited by the customers. The structural solution and/or internal accounting procedures used shall allow for the traceability of each retail customer's deposited money and their contribution to the total value of the green loans granted.

Assessment and verification

A. Green asset to deposit ratio

The applicant shall provide a set of declarations and supporting information to verify the declared asset to deposit ratio and to ensure that it is traceable and transparent. The information related to green loans shall comprise:

- iii. the total value of the deposits derived from individual values marked and entered into the Single Customer View (SCV) for the specific product;
- iv. the value of each green loan issued, and bonds purchased using the deposited money. This shall be recorded and declared together with the total value of the green loans and bonds for each year.
- v. The value of the deposits and green loans related to the product shall be reported annually in a dedicated EU Ecolabel report to be provided to the retail customer, to also be reflected as

itemised entries on the balance sheet in the annual report of the Credit Institution, with each entry to be clearly marked as EU Ecolabel verified deposited money and green loans.

B. Green loans made using the deposited money

The applicant shall document on an annual basis the value of green loans approved by types of projects and economic activities. The value of green loans made by associated credit institutions shall be reported on.

The applicant shall provide a declaration that the green loans approved meet the criteria for being environmentally sustainable economic activities. The Competent Body reserves the right to select projects at random from a list of the economic activities funded for verification purposes.

C. Green bonds purchased using the deposited money

The applicant shall document on an annual basis the

- i. the external verification for green bonds as proof of the allocation of financing to green economic activities.
- ii. For general purpose corporate bonds, documentation that verifies the percentage green revenue of the issuer.

D. Separation of the deposited money

The internal accounting procedures and/or structures used to separate the funds, limit transferability and how they allow for the traceability of the deposited money shall be described. This could be supported by an auditors' qualification of the effectiveness of the procedure that may be included in the annual report of the credit institution.

Fourth proposal of criterion 1: investment in environmentally sustainable economic activities

Each financial product shall comply with the threshold indicated below, defined considering the proportion of the underlying investments (securities or loans) invested in environmentally sustainable economic activities (hereafter 'portfolio greenness'). The portfolio greenness is calculated as the weighted average of the greenness of each investment, with weights corresponding to the share of the portfolio value relating to that investment. Error! Bookmark not defined.

1.1 Investment funds

A. UCITS equity funds

At least 50% of the total portfolio value of the assets under management (AuM) shall be invested in environmentally sustainable economic activities, through purchasing shares of companies undertaking such activities, according to the formula below.

$$G = \sum_{n=i}^0 PCi * \frac{GTi+GCI}{Ti}$$

Where:

G = % of total portfolio value invested in environmentally sustainable economic activity (or 'portfolio greenness')

i = an individual company in which portfolio equities are held

n = total number of companies in the portfolio

PCi = % Portfolio contribution of company i

GTi = Green Turnover (EUR) of company i of the last year prior the application

Gci = the highest annual Green Capex (EUR) of company i over the past 3 years prior the application

Ti = Turnover (EUR) of company i of the last year prior the application

Other assets or cash can also be included in the portfolio, subject to their compliance with criteria 2 and 3.

Investments in derivatives shall meet the requirements of sub-criterion 1.1.H.

B. UCITS bond funds

At least 70% of the total portfolio value of the assets under management (AuM) shall be invested in environmentally sustainable economic activities, through purchasing bonds that finance such activities, in accordance with the requirements below.

1. Use-of-proceeds corporate and sovereign bonds contribute towards portfolio greenness in proportion of the share of the portfolio contribution of the bond if they meet the following requirements:
 - The green projects to be financed using the bond's proceeds shall be identified and shall be verified as environmentally sustainable economic activities.
 - The allocation of finance to the green projects or portfolios of projects shall be separated, tracked and reported on a 12 monthly basis following issuance.
 - For use-of-proceeds corporate bonds, the value of refinanced projects within a green bond issue may only contribute to portfolio greenness if the issuer can demonstrate that the refinancing supports the creation of asset-backed securities or the recycling of funds for lending to new green projects.
2. General purpose corporate bonds (i.e. that are not use-of-proceeds bonds) contribute to the portfolio greenness in proportion to the share of the greenness of the issuer, provided that the company shows positive green capex (last financial year)

Other assets or cash can also be included in the portfolio, subject to their compliance with criteria 2 and 3.

Investments in derivatives shall meet the requirements of sub-criterion 1.1.H.

C. UCITS mixed funds

At least 50% of the total portfolio value of the assets under management (AuM) comprising bonds and equities shall be invested in environmentally sustainable economic activities. The

equity component shall be calculated according to the requirements of criterion 1.1.A and for the bonds to contribute they shall meet the requirements of criterion 1.1.B.

Other assets or cash can also be included in the portfolio, subject to their compliance with criteria 2 and 3.

Investments in derivatives shall meet the requirements of sub-criterion 1.1.H.

D. Retail alternative investment funds (AIFs)

At least 70% of the total portfolio value in terms of assets under management (AuM) shall be invested in environmentally sustainable economic activities. The equity component shall be calculated according to the requirements of criterion 1.1.A. The bond component shall be calculated according to the requirements of criterion 1.1.B.

Investments in derivative shall meet the requirements of sub-criterion 1.1.H.

E. Fund of funds (FoFs)

At least 90% of the total portfolio value in terms of assets under management (AuM) of the FoF shall be invested in funds that have been awarded the EU Ecolabel.

Other assets or cash can also be included in the portfolio, subject to their compliance with criteria 2 and 3.

Investments in derivatives shall meet the requirements of sub-criterion 1.1.H.

F. Unit-linked insurance products

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

G. Multi option insurance product

All the underlying options shall only include unit-linked insurance funds which comply with the requirements under sub-criterion 1.1.F. Alternatively, all the underlying unit-linked funds shall hold the EU Ecolabel

H. Derivatives if included in sections A to G

A fund may invest in derivatives according to its investment objectives. The use of derivatives shall be in line with the funds environmental investment policy. The use of derivatives shall be restricted to the following situations:

- *Hedging*: Derivatives may be used for hedging purposes with regard to currency

risk, duration risk, market risk or/and sensitivity to changes in interest rate structures.

- *Exposure:* The use of derivatives to increase exposure to the underlying assets shall be temporary and respond to significant subscriptions. The management company shall explain in the fund's periodical reports how it proceeds and, in particular, to illustrate the temporary nature of the use of derivatives for exposure purposes.

Derivatives shall not be used for the short selling of securities.

Assessment and verification

A. UCITS equity funds

The applicant shall provide the following:

- v. *For new funds: Evidence that the fund complies with the greenness threshold at the time of application based on the prospectus*
- vi. *For existing funds, annually and once a 12-months database for the fund is available: the prospectus, the annual report, the complete listing of the portfolio assets and the contribution of individual assets to portfolio greenness. [a spreadsheet will be included in the User Manual] If data proxies are used, the methodology for deriving such proxies and the link with the EU Taxonomy must be provided to the Competent Body.*

B. UCITS bond funds

The applicant shall provide the following:

- iii. *For new funds: Evidence that the fund complies with the greenness threshold at the time of application based on the prospectus*
- iv. *For existing funds each year and starting once a 12-months database is available for the fund, the prospectus, the annual report, the complete listing of the portfolio assets and the contribution of individual assets to portfolio greenness. [a spreadsheet will be included in the User Manual] If data proxies are used, the methodology for deriving such proxies and the link with the EU Taxonomy must be provided to the Competent Body.*
- v. *For use of proceeds bonds, the external verification according to international assurance standards, as proof of the financing to environmentally sustainable economic activities.*
- vi. *For general purpose corporate bonds, documentation that verifies the issuer complies with the requirements stated in point 2.*

C. UCITS mixed funds

The applicant shall provide documentation as specified in points A and B of this section.

D. Retail AIFs

The applicant shall provide the following:

- i. For new funds: Evidence that the fund complies with the greenness threshold at the time of application based on the rules or instruments of incorporation or, where applicable, the prospectus,
- ii. For existing funds, each year and starting once a 12-months database is available for the fund, the document defined under i) and, the annual report, the complete listing of the portfolio assets and the contribution of individual assets to portfolio greenness. *[a spreadsheet will be included in the User Manual]* If data proxies are used, the methodology for deriving such proxies and the link with the EU Taxonomy must be provided to the Competent Body.

E. Fund of funds (FoFs)

The applicant shall provide licence number of the EU Ecolabel licences held by each of the underlying funds

F. Unit-linked insurance products

The applicant shall provide documentation as specified in the assessment and verification for 1.1.A, B, C and D, as applicable.

Where an underlying fund has the EU Ecolabel, the license number shall be provided. The prospectus and information about the management service provided to retail investors shall demonstrate the pre-selection of EU Ecolabel unit funds.

G. Multi option insurance products

The applicant shall provide documentation as specified in the assessment and verification for 1.1.A, B, C and D, as applicable.

Where an underlying unit-linked fund has the EU Ecolabel, the license number shall be provided. The prospectus and information about the management service provided to retail investors shall demonstrate the pre-selection of EU Ecolabel unit-linked funds.

H. Derivatives if included in sections A to G

The applicant shall provide the following documentation on the derivatives included in the funds:

- the investment or management policy governing the use of derivatives and outlining clearly how the derivatives are to be applied including information about the counterparty
- A statement on the strategy applied addressing how the use of derivatives is in line with the fund environmental policy.
- A listing of the types of derivatives and other assets used during the last 12 months preceding the application for the EU Ecolabel [where applicable], including their nature, average total amount invested (in proportion of the portfolio) and their average duration/frequency of use shall be demonstrated.

- *For over-the-counter derivatives, consumer information on all the counterparties used over the last 12 months preceding the application for the EU Ecolabel [where applicable].*

1.2. Fixed term and savings deposit accounts

Deposits **loaned or invested** shall **only** be used to make and/or to invest in:

- loans granted to **finance** environmentally sustainable economic activities. These loans may be made by partner credit institutions, provided there is traceability back to the deposited funds;
- **Use-of-proceeds bonds meeting the requirements of 1.1.B**

The value of both the assets (limited, for the purpose of criterion 1.2, to loans and bonds) and the deposits shall be calculated based on the annual (financial year) average for the time that the product has been on the market.

The money held in deposit and then granted as loans and/or used to buy bonds shall be separated within the accounts of the Credit Institution, **or otherwise tracked**, in such a way as to (i) restrict transferability and to (ii) ensure that the funds loaned are traceable to the money deposited by the customers.

The structural solution and/or internal accounting procedures used shall allow for the traceability of each **of the** retail customers' deposited money and their contribution to the total value of the loans granted.

In the case tracking is used instead of separation, a specific report shall be submitted to the Competent Body addressing the traceability of loans granted to finance environmentally sustainable economic activities and use-of-proceeds bonds meeting the requirements of 1.1.B.

Assessment and verification

*The applicant shall provide a set of declarations and supporting information to verify the **compliance with the criteria** and to ensure that it is traceable and transparent.*

*The information related to loans shall comprise, **on an annual basis**:*

- a declaration that the loans approved **finance environmentally sustainable economic activities**. If data proxies are used, the methodology for deriving such proxies and the link with the EU Taxonomy must be provided to the Competent Body.*
- the total value of the deposits derived from individual values marked and entered into the Single Customer View (SCV) for the specific product;*
- the value of each loan issued **by type of projects and economic activities**. This shall be recorded and declared together with the total value of the loans.*

*The information related to use-of-proceeds bonds shall comprise, **on an annual basis**:*

- the external verification according to international assurance standards, as proof of*

the financing to environmentally sustainable economic activities.

- ii. The internal accounting procedures and/or structures used to separate the funds, limit transferability and how they allow for the traceability of the deposited money shall be described. This could be supported by an auditors' qualification of the effectiveness of the procedure that may be included in the annual report of the credit institution.*

For new products, evidence shall be provided that the deposit manager has in place a framework to compile a deposit account meeting the requirements in 1.3

5.1.1 Rationale of the proposed criterion text

This criterion ensures that a certain proportion of the retail financial product is invested in environmentally sustainable economic activities, as defined by the EU Taxonomy. For each retail financial product under the scope of the EU Ecolabel, a minimum threshold of 'greenness' is proposed.

5.1.2 Summary of the main changes introduced to criterion 1 in TR2.0 and TR3.0

Feedback received on TR1.0 and TR2.0 and further research conducted by the JRC can be found in the previous versions of the technical report (TR2.0 and TR3.0).

In the TR2.0, the main changes to criterion 1 are summarised as follows:

- A criterion aligned to the most updated version of the EU Taxonomy was proposed. Nevertheless, given the time gap with the adoption of the 1st Delegated Act, there will be active monitoring on the development of the EU Taxonomy in order to align with it.
- Listed real estate was not proposed to be included as a specific asset class within the EU Ecolabel portfolio, due to the different requirements of relevant energy performance across Member States, the limited presence of real estate in PRIIPs portfolios, the varying criteria in the available real estate-related standards and labels, and the limited volume of investment opportunities.
- Assets such as derivatives and cash were proposed to be excluded as an eligible green asset class. Still, they were proposed to be included in the calculation of total portfolio value.
- One type of assessment and verification was proposed for all financial products under the scope, to decrease the costs and the complexity of assessment and verification.
- The assessment and verification requirement was reviewed to clarify as much as possible the relevant documentation required as proof of compliance, which is proposed to be based on compliance with the requirement.
- The greenness threshold of UCITS equity funds was lowered, compared to the one proposed in TR1.0.
- A criterion was developed for the newly added to the scope savings and deposit accounts. The criterion requires the verification of the balance sheet of a bank and identifying and reconciling deposit value with loan value (the 'green loan to deposit' value).

In the TR3.0, the main changes to criterion 1 are summarised as follows:

-
- Given that the scope of retail financial products has been expanded to encompass a number of more complex insurance products, specific rules are provided that are tailored to the structures and underlying assets of the newly included insurance products, i.e. Profit Participation and Multi Option and hybrid insurance products.
 - The greenness threshold for retail AIFs was raised to 70%, based on feedback that the ability to put together a compliant portfolio is easier, due to a larger investable universe.
 - The threshold for UCITS equity funds was raised in the TR3.0 to 40% (compared to the 18% in TR2.0), based on feedback that the investible universe for equities can be expanded by making the following changes to the criteria:
 - Remove the pocket approach as it restricts asset managers and portfolio managers ability to put together compliant and suitably diversified portfolios, particularly in the case of large capitalisation companies;
 - Inserting a portfolio greenness calculation equation that considers CapEx and/or projected growth in green revenue of companies that are investing in transition and companies investing in green growth (as defined in a separate criterion). Capex has been introduced as a metric for investment in green economic activities, at the request of the majority of the sub-group members on criterion 1²⁷~~OBJ~~. However, there was also a consensus that it cannot be used in isolation and that instead it should be seen in the context of a forward looking investment plan that will ultimately result in growth in green revenue.
 - The greenness threshold for UCITS bond funds was decreased to 50% (compared to the 70% in the TR2.0), to take into account that a large part of the green bonds currently on the market cannot prove compliance with the EU Taxonomy. The criterion takes into account the main underlying criteria of the EU Green Bond Standard, and a condition on the refinancing of the proceeds. Moreover, it was clarified that both sovereign and corporate general purpose bonds may contribute to portfolio greenness, in proportion to the greenness of the issuer.
 - The greenness threshold for UCITS mixed funds was set at 50%.
 - The criteria proposed for deposit accounts were largely unchanged, except for the reference to ring fencing, which was replaced by a requirement to report on accounting practices used to ensure ‘separation’ and to limit transferability of the funds for other purposes.
 - The assessment and verification section has been carefully revised to make it more comprehensive and straightforward
 - A new criterion 2 was proposed, which complements the requirements for UCITS equity funds and defines the qualifying criteria for both ‘companies investing in transition’ and ‘companies investing in green growth’. The criteria were developed based on a consensus within the criterion 1 sub-group and with reference to literature and the recommendations of other initiatives. Companies shall provide evidence of the projected growth in their green revenue base in the form of an investment plan. The plan may be supported by commitments to CapEx and growth in green revenue over a 7-year time frame, consisting of a 2 year look back and 5 years forward looking investment and growth.

5.1.3 Outcomes of the third stakeholder consultation

This section summarises stakeholders' comments received during the third stakeholder consultation, ended on December 11th 2020. The JRC received in total 144 comments on the environmental exclusions from 47 stakeholders. The major comments have been clustered and are summarised below. Based on these comments, the JRC identified the needs for further research.

²⁷ More details on the subgroup can be found in Section 5.1.4.1

1) Greenness formula for UCITS equity funds

While the opinion of stakeholders was that the criterion has improved compared with previous versions, many stakeholders believed that the greenness formula was too complicated. Stakeholders overall welcomed the inclusion of “green capex” as an indicator used for the calculation of the greenness of the portfolio. On the contrary, stakeholders believed that the indicator “green revenue growth” should not be used because: 1) too uncertain, 2) a solid methodology does not exist for its calculation, 3) it integrates into the formula a forward looking element that is already taken into account into green capex (green capex can be seen as a promise of future green revenue). The forward looking element should be limited also with respect to the green capex indicator, which should be calculated only based on past capex, without taking into account future green capex.

2) Greenness threshold for UCITS equity funds

Stakeholders had split views on the suggested threshold. A part of the stakeholders believed that the proposed threshold was unattainable for a fund manager, as demonstrated by the studies mentioned in TR3.0. This should be done not to jeopardize the viability of the EU Ecolabel. Another part of the stakeholders considered the proposed threshold not sufficient to live up with the expectations that consumers have of a label of expectations, supporting a 50% threshold. These stakeholders believed that the current lack of data does not enable a robust assessment of the investable universe, because the Taxonomy has not been adopted yet and moreover companies currently do not disclose on their green activities.

Stakeholders also recommended to not incorporate future expectations in making up the portfolio greenness since that would be challenging to assess. Moreover, the monitoring requirement could create additional costs for the applicant, which might be transferred to the retail investor, and therefore make the EU Ecolabel a less preferred option.

3) Structure and strictness of the criterion for UCITS bond funds

Corporate bonds – Threshold

Many stakeholders welcomed the proposed 50% threshold, under the condition of grandfathering and an investment of the grandfathering proceeds into EU Taxonomy compliant activities. It is also argued on the importance of grandfathering for diversification and risk hedging, since even if there were sufficient green assets in the market, the size of the green pool corresponding to the EU Ecolabel products would be very small and still not enable proper diversification. On the opposite, some stakeholders suggested to increase the threshold strictness to at least at 70% if existing green bonds were to be eligible for inclusion. It is advocated that contrary to equity funds, for UCITS bonds funds there is no technical issue in having a very high share of green underlyings.

Corporate bonds – criteria referring to the transition period

A stakeholder argued that the four conditions proposed in the TR3.0 for bonds to be eligible as green bonds could compromise the quality of the EU GBS and possibly create inconsistencies between the different frameworks of the Sustainable Finance Action plan. Stakeholders also stated that the inclusion of general-purpose corporate bonds might negatively affect the credibility of the EU Ecolabel scheme. Nevertheless, stakeholders acknowledge the market immaturity to deal with demand. There were opinions that supported the inclusion of bonds

issued by “green” companies with EU Taxonomy-aligned earmarked projects, which do not have to comply with the EU GBS to qualify for the EU Ecolabel. Some stakeholders supported the 50% threshold for green bonds, under the EU GBS, the GBP or the other four conditions in case the bonds are not GBS/GBP compliant as that would allow a welcome flexibility in the management of the funds.

Corporate bonds – refinancing

Stakeholders mentioned that the requirements relating to refinancing are very restrictive and at odds with the current market practice. It is highlighted that a very significant portion of existing green bonds are used for refinancing purposes, but not to finance new green projects or create of asset-back securities. It is prevalent for corporate issuers to fund green projects via loans, which are then refinanced by corporate green bonds. This very common financing structure would fail to meet the refinancing requirement set in the TR3.0.

Corporate & Sovereign bonds – Grandfathering

Some stakeholders mentioned the possibility to allow for grandfathering of green bonds issued by other ecolabel schemes. They argued that in doing so, the eligible universe will be enhanced whereas greenness won't be compromised. In line with this suggestion, it is asked to specify in the TR4.0 the transitional period for allowing grandfathering. A stakeholder also mentioned the need to allow for grandfathering of bonds for a period of 3-5 years in the case that the EU Taxonomy updates the spectrum of environmentally sustainable activities very fast, and the market responds accordingly.

However, many stakeholders highlighted that several years would be necessary before the EU Taxonomy provide a sufficient amount of eligible economic activities. Therefore, in line with the suggestion above, it is proposed exploring the introduction of a transitional period of a few years during which also other green bonds apart from not existing bonds complying with the future EU GBS could potentially be accepted subject to their alignment with the EU Taxonomy and having in place tracking and reporting requirements

Bonds – Exclusions

Many of the stakeholders have commented on the application of environmental and social exclusions applied to the issuer of corporate and sovereign bonds. The TR3.0 proposes extensive environmental and social exclusions, thus if this requirement applies it might restrict the eligible bond universe considerably. In terms of sovereign bonds, there are requirements, such as e.g. the ratification of the Paris Agreement that could exclude sovereigns necessary to diversify and compose eligible bond funds. In that case, it is proposed to apply limitations in the number and type of exclusions, which apply to the issuer.

The global export potential of EU Ecolabel funds would be very limited in several G20 countries who apply exclusions to sovereign bonds issued by countries who have not ratified the Treaty on the Non-proliferation of Nuclear Weapons (Israel, India, Pakistan, South Sudan and others), are subjected to EU restricted measures (Russia, Belarus) or retain forms of capital punishment (USA, China, Egypt, Saudi Arabia). Should these criteria be applied, therefore it is suggested introducing a central data source where the list of countries meeting the label's criteria could be accessed.

It is commented that the application of exclusions on the issuer at corporate level could further restrict compliance since use-of-proceeds and general-purpose corporate bonds are mainly issued by energy and car manufacturers. The same stakeholder suggests exclusions to apply to the proceeds of the bond instead on the issuer. Additionally, it is mentioned that the proposed exclusions are much more restrictive compared to other national labels.

Stakeholders recommended exclusions to not apply to the issuer in the case of corporate, sovereign, and sub-sovereign use-of proceeds bonds. Yet, environmental exclusions to be

applicable to general purpose bonds. This latter category shall be eligible to the extent they comply with the minimum percentage for EU Taxonomy alignment of the fund.

In the case exclusions apply to the issuer, it is proposed to increase the partial threshold up to 10% and thus make more pragmatic the issuance of eligible bonds. Additionally, it is pinpointed that the EU Ecolabel is a green and not an SRI label, and that social exclusions shall not apply to the issuer of use-of-proceeds bonds.

Stakeholders mentioned that the issuer of general-purpose bonds shall not only meet criteria 2.1 but also comply with the exclusions. It is not comprehensible why, when it comes to financing instead of investment, the criterion should be less strict for financing (bond) than for investment (equity). Green bonds issued by “neutral” companies are currently not considered for making up the greenness of bond funds.

4) Retail AIFs

Few stakeholders commented on the greenness threshold for retail AIFs, asking to decrease it to 50%, aligning it with the other retail financial products, while committing to revise the criteria and the threshold every three years.

5) Assessment and verification

To support an effective assessment in terms of a fund’s underlying assets conformity, stakeholders argued that criterion 1 requirements should be kept simple and straight-forward. To increase confidence, it is suggested that only third parties should carry out the assessment. In doing so, relevant EU-wide standards for independent assessment need to be developed. Moreover, third party institutions other than the national Competent Bodies should assess EU Taxonomy compliance. It was also questioned whether a potential corporate revenues breakdown should be certified independently as required for EU Green Bonds. Additionally, the frequency of the assessment was highlighted, and it is advocated that it shall be done annually.

Further on, regarding the assessment procedure, it is argued that EU Taxonomy-related corporate data, subject to the NFRD Directive and the disclosures requirements of the EU Taxonomy, shall only be based on company-disclosed data, and not on estimates

The need for a record should be dropped, at least for new funds. The requirement to provide evidence of the monthly averages for the 12 months preceding the application may substantially delay the application submission and would not allow for new and innovative products to be eligible, such as those including, e.g. derivatives, which have very short lifetimes. Moreover, the EU Ecolabel could adopt a more forward-looking approach. In doing so, it needs to establish procedures which ensure that the fund will be managed during the validity period of the license as documented when the license is granted. It is also commented that at the current stage, it is not clear whether the assessment is performed by fund managers, competent bodies or independent evaluators.

Verification requirements need to be homogenous across the EU to facilitate dissemination of the EU Ecolabel funds. Additionally, no national labels should be asked for accessing local markets, but funds can do so if they comply with the EU Ecolabel criteria. The opposite could increase costs and harm the EU Ecolabel uptake.

Stakeholders pointed out that data for assessment of compliance will be mostly purchased from ESG data providers. That could increase the costs of obtaining the EU Ecolabel significantly. The quality of the received information and the methodology behind could also influence the assessment outcomes.

Stakeholders expressed their concern about the possibility to retrieve data for the forward-looking elements of the formula, such as the ‘green revenue growth’ since the ESG data providers do not provide with this kind of information neither companies disclose it. It was also mentioned that estimations and projections would require a harmonised methodology, which

might include calculations of high uncertainty. Even if forward looking data would be available, the right level of granularity would be challenging to achieve.

6) *Insurance products*

Insurers do not always have detailed information about the underlying investments of each unit-linked account of the product. Considering this, stakeholders suggested a similar approach to funds of funds for life insurance products. 100% of unit-linked funds shall comply with the criteria of the EU Ecolabel for retail financial products as no liquidity buffer is needed in this case (compared to funds of funds). A similar approach can take place in the case of MOPs that consist only of unit-linked insurance funds.

In terms of a look-through approach for unit-linked insurance products, insurers mentioned that its application would be challenging.

7) *Savings and deposit accounts*

Development of products and market implementation of the criteria

It was considered by one stakeholder that it will take some time before green funds/savings accounts will emerge as a market reality due to the initial lack of qualified green assets. It was considered by another stakeholder that there would need to be testing in the market of the concept of traceability and how this functions in practice. Many stakeholders considered the green loan to deposit ratio as a requirement that complicates the criterion, creates confusion and makes assessment more challenging. Therefore, it is argued to streamline the criterion by dropping this requirement. On the other hand, other stakeholders commented that even the current 70% would be difficult to achieve due the lack of availability of green projects, and some stakeholders proposed to set it to 50% to align it with the other products. In addition, loans financed to and bonds issued by companies deriving more than 50% of their revenues from taxonomy-compliant activities should also be allowed to contribute to the greenness of the deposit account.

Finally, some stakeholders were concerned of the traceability requirements, pointing to the impossibility of imagining a structural solution and/or internal accounting procedures to allow for the traceability of each retail customers' deposited money and their contribution to the total value of the green loans granted, as there are no legal obligations that prevent the mobilisation of money deposited and used to ensure 'separation' and to limit transferability of the funds for other purposes.

5.1.4 Further research and main changes in the fourth proposal

In order to address the comments received from stakeholders, additional research was conducted. These are presented below.

1) Structure and ambition level of the criterion for UCITS equity funds

As explained in the previous section, the formula presented in TR3.0 was criticised by stakeholders for its complexity and its reliance on the too uncertain indicator "green revenue growth". Moreover, it was commented that the bonus for companies in transition and in green growth was too loose, possibly rewarding companies with only 6% green revenue (in this TR4.0, the terms 'revenue' and 'turnover' are used interchangeably, while the legal text only refers to 'turnover', in accordance with the Taxonomy Regulation).

With respect to the ambition level, a large part of the stakeholders called for a 50% greenness threshold, pointing to the dynamic nature of the financial market which will need to adapt to the

growing demand for green investment products. On the contrary, other stakeholders highlighted that all available studies so far have estimated a very low EU Taxonomy alignment. However, stakeholders also commented that the very low EU Taxonomy alignment was due to the non-disclosure of most of the data needed for the assessment, leading to the need not to consider such studies as a robust estimate of the current financial products.

A coalition of stakeholders suggested an alternative formula for the greenness of the portfolio, relying only on the parameters “green turnover” and “green capex”, as described below:

$$G = \sum (PC_i * (GT_i + GC_i)/T_i)$$

Where:

G = % of total portfolio value invested in environmentally sustainable economic activity (or ‘portfolio greenness’)

i = an individual company in which portfolio equities are held

n = total number of companies in the portfolio

PC_i = % Portfolio contribution of company i

GT_i = Green Turnover (EUR) of company i of the past (financial) year

GC_i = the highest annual Green Capex (EUR) of company i over the past 3 (financial) years

T_i = Turnover (EUR) of company i of the past (financial) year

This formula was considered promising for a number of reasons that are detailed here:

- The complexity is drastically reduced;
- It avoids the reference to “companies investing in transition” and “companies investing in green growth” that, as described in the next chapter, was largely criticised by stakeholders;
- It relies only on parameters that are referred to in the EU Taxonomy and for which disclosure will be mandatory under the EU Taxonomy and the Non-Financial Disclosure Regulation (NFDR);
- It relies only on parameters that indicate the performance of the company of the past year(s), without introducing parameters on the expected performance of the company for which a standard methodology does not exist;
- It incorporates a forward-looking element, as green capex can be seen as a promise of future green revenue;
- It gives a “bonus” to all companies that are investing towards increasing their EU Taxonomy-aligned activities.

The feasibility of using this formula was tested, as explained in the next sections, together with the feasibility of increasing the ambition level.

Availability and alignment of data: green revenue and green capex

In order to assess the availability of the parameters green revenue and green capex, the EU Taxonomy alignment of the activities of reporting companies needs to be evaluated. In general, determining the EU Taxonomy alignment of an economic activity follows a four-steps process²⁸, with every step requiring different data points:

1- Eligibility: whether the activity fits a defined NACE macro-sector category for an environmental objective (currently, for climate change mitigation and adaptation)

²⁸ Climate Strategy and Climate & Company (2020). “Applying the EU Taxonomy”: Lessons from the Front Line. Available at: <https://www.climateandcompany.com/applying-eu-taxonomy>

- 2- Alignment: whether the activity makes a substantial contribution to the environmental objective (currently, for climate change mitigation and adaptation)
- 3- DNSH: whether the activity respects the Do No Significant Harm (DNSH) to the other five environmental objectives
- 4- Compliance: whether the activity complies with the Minimum Social Safeguards (MSS).

To assess the availability of green revenue and green capex, publicly listed firms from the MSCI ESG and ISS ESG universe were explored. ISS ESG universe covers 6680 firms. MSCI ESG universe covers 9270 firms, representing over a fifth of the global universe of publicly listed firms, resulting into nearly two thirds of global market capitalization. Table 1 shows the sectoral and geographical distribution of MSCI firms. The NACE code, obtained from the Thomson Reuters database, refers to the primary revenue segment of each firm. Over one third of firms primarily operates in the manufacturing sector with most of them being based in Asia (41%) and North America (30%).

Table 1 - MSCI ESG companies' data overview by selected sectors and region

Nace Sector	Description	no. of companies	%	Region	no. of companies	%
A	Agriculture, Forestry	43	0.47	Europe	1712	18.55
C	Manufacturing	3328	36.05	Northern America	2730	29.57
D	Electricity, Gas, ...	254	2.75	LAC	545	5.90
E	Waste Management	55	0.60	Asia	3748	40.61
F	Construction	440	4.77	Africa	129	1.40
H	Transportation	320	3.47	Oceania	366	3.97
J	Inform. & Communication	841	9.11			
K	Financial and Insurance	1256	13.61			
L	Real Estate	518	5.61			

To proxy for the EU taxonomy-aligned revenue share, green revenue data (estimates) from MSCI and ISS-ESG were evaluated. ISS ESG evaluates the screening criteria where possible and derives estimates based on proxy data otherwise. The same is true for MSCI's Sustainable Impact Metric Assessment (which is not a 1:1 application of the EU Taxonomy though large overlaps exist). It is important to note that the proposed formula for the portfolio greenness of UCITS equity funds relies green capex for the last three years. However, for the time being, MSCI and ISS-ESG do not provide green revenue time series (and solutions on green capex are still under development). Hence, only data from one single year were considered.

MSCI's Sustainable Impact Metric Assessment derives green revenues corresponding to six different themes (alternative energy, energy efficiency, green buildings, pollution prevention, sustainable agriculture, and water). To ensure comparability with the EU Taxonomy on climate change mitigation four of them are included (alternative energy, energy efficiency, green buildings, sustainable agriculture) into the assessment as a they fall under the EU Taxonomy's current scope²⁹. The themes pollution prevention and water are therefore not considered, also to ensure comparability with ISS-ESG's draft Taxonomy solution. Since the MSCI approach does not explicitly build on the screening criteria recommended by the TEG, there are some potential areas of concern, such as the "green building sector", which is based on "green building certificates" that are not necessarily EU Taxonomy-aligned. Furthermore, technologies in transition (e.g., in the manufacturing sector) are not extensively considered by the current MSCI

²⁹ Furthermore, "other" alternative energies since this includes gas (variable name "ct_alt_energy_other_max_rev") are excluded. MSCI's green revenue are derived from the following formula: green revenue = ct_alt_energy_max_rev + ct_energy_eff_max_rev + ct_green_bldg_max_rev + ct_sust_ag_max_rev - ct_alt_energy_other_max_rev

methodology³⁰. With respect to the DNSH assessment and the MSS, MSCI ESG Controversies can be applied as a proxy (see paragraph below on DNSH assessment). Despite these drawbacks, the MSCI green revenue estimates provide a reasonable indication of the alignment with the EU Taxonomy on climate change mitigation. Some of the 37 “EU Taxonomy alignment case studies” by the PRI Taxonomy practitioners group, which have applied the EU Taxonomy to a selected financial product³¹, describe how the MSCI ESG Controversy Screening can be used as a proxy for the DNSH assessment. While some institutions used single indicators, such as the screening on “water stress”, others simply adopt the overall “environmental controversy” grading and exclude firms with a “non-green” rating³². Unfortunately, there were limitations in retrieving these data points. Therefore, the MSCI green revenue estimates assessed here do not include a DNSH/MSS assessment and must be interpreted with due caution.

ISS-ESG provided access to their draft EU Taxonomy assessment for 6,600 firms including the DNSH and MSS assessment, which relies on: a) aligned revenue (i.e., the revenue from activities fulfilling the substantial contribution criteria plus DNSH and MSS); b) likely aligned revenue (in the absence of data, proxies for substantial contribution, DNSH and MSS are used to assess alignment); c) potentially aligned (i.e., substantial contribution criteria are likely to be met but DNSH and MSS are “likely not aligned” - but cannot be ruled out). For the assessment, the sum of a), b), and c) was considered, which is a firm’s maximum (estimated) EU taxonomy-aligned revenue. Data retrieved from ISS-ESG clearly differentiate between the revenue share that passed the DNSH & MSS assessment (“aligned”/“likely aligned”) and the revenue share that meets the substantial contribution criteria, however, the DNSH is likely not aligned or could not be evaluated (“potentially aligned share”). The interpretation of the final results should take this into consideration.

Figure 1 and Figure 2 illustrate the distribution of green revenues provided by MSCI and ISS ESG. Both data providers estimate 0% green revenues for the majority of the firms – ISS ESG does so for almost 90% as compared to 75% given by MSCI. When examining green revenue estimates larger than zero, in about 50% of these cases this value ranges between 0-5% for both MSCI and ISS ESG database. All in all, MSCI estimates for less than 10% and ISS-ESG for less than 5% green revenues above 10%.

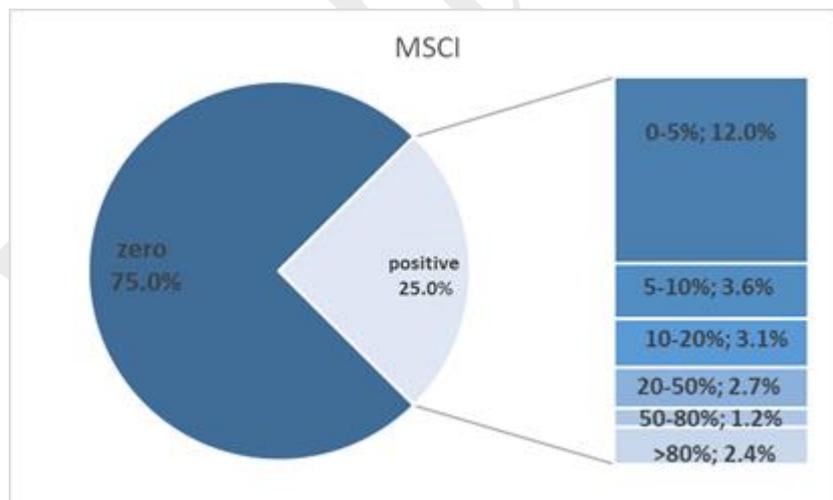


Figure 1 - Distribution of estimated green revenue by MSCI (n = 9270)

30 Williams and Peterson, 2020, “EU Taxonomy Screening Guide”

31 <https://www.unpri.org/policy/eu-sustainable-finance-taxonomy/eu-taxonomy-alignment-case-studies>

32 See for instance the case study provided by La Financiere de l’Echiquier. (link)

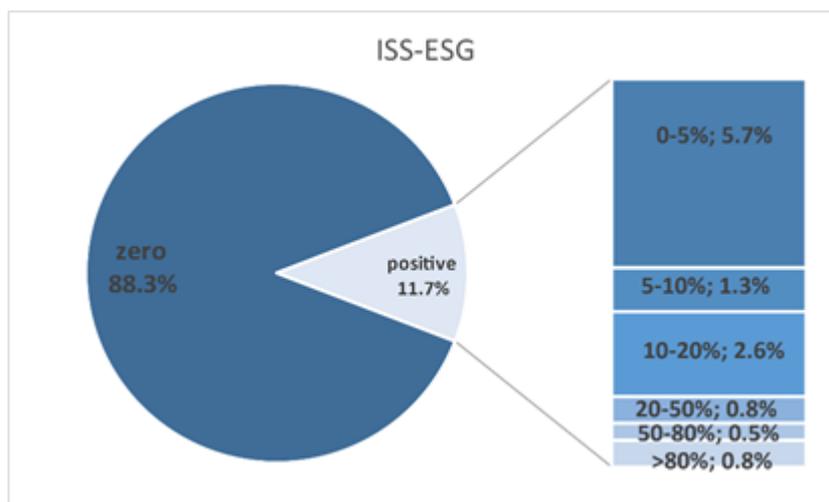


Figure 2 - Distribution of estimated green revenue by ISS ESG (n = 6680)

With respect to the link between capex and revenue segments (if reported) to the EU Taxonomy activities, a mapping table from a commercial provider³³ is used, connecting the segments classified via the SIC (Standard Industry Classification) nomenclature to NACE Rev 2 codes. Building on the NACE classification, the disclosed disaggregated capex segments from the MSCI universe was assessed with respect to the EU Taxonomy. Segments that are “per se” EU taxonomy-aligned as no screening criteria is given in the TEG report (e.g. manufacturing of solar panels) were identified. Furthermore, a buzzword screening was applied to rule out some activities, where possible³⁴. For electricity-producing firms data points on renewable energy production over time and the share of revenue generated from coal³⁵ are used. For IT activities, the study leverages on a buzzword-screening whether any IT firms is pursuing activities “exclusively” aimed at GHG emission monitoring. As this was not the case, IT activities are categorically excluded since their (potential) eligible share is high, but their actual alignment is likely to be extremely low³⁶.

Figure 3 presents the scope of the assessment of capex segments for disclosing firms. In the MSCI-ESG universe (~9.300 firms), 52% disclosed about disaggregated capex, and about 16.5% of the disaggregated capex, weighted by total assets, has exposure to the EU Taxonomy and is thus EU Taxonomy eligible. The majority of eligible capex is invested in manufacturing (33.4%), real estate and construction (25.6%) and information and communication (19.3%).

33 <https://classification.codes/>

34 For example, consider the activity “Infrastructure for low carbon transport (land transport)”. Any highways or roads are excluded, following the TEG report, whereas railway infrastructure qualifies.

35 Source: Coal Exit List. The study largely follows the methodology explained in European Commission (2020). Testing draft EU Ecolabel criteria on UCITS equity funds. (link).

36 Furthermore, shares invested in the Taxonomy activity “Transmission and Distribution of Electricity” as EU taxonomy-eligible are considered if the firm is based in the EU27.

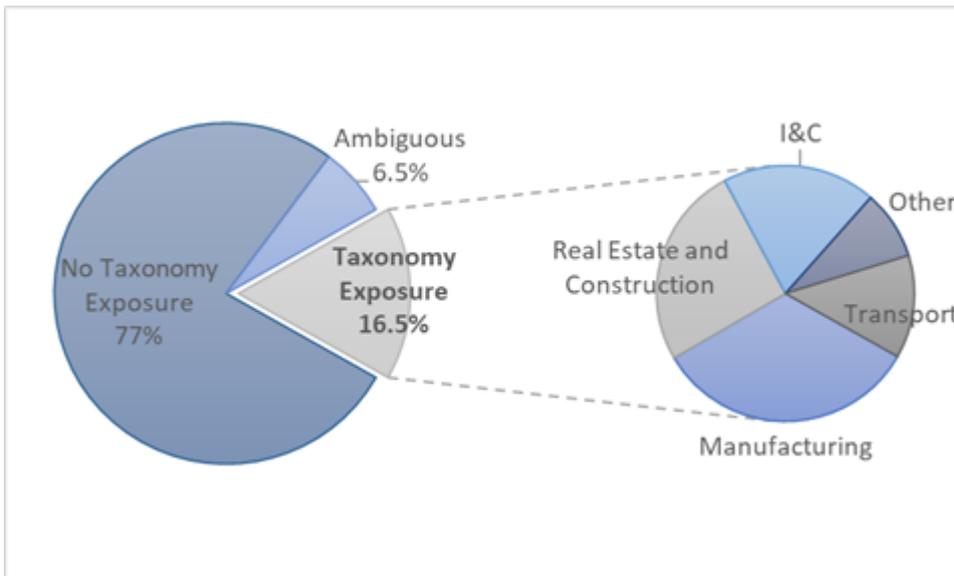
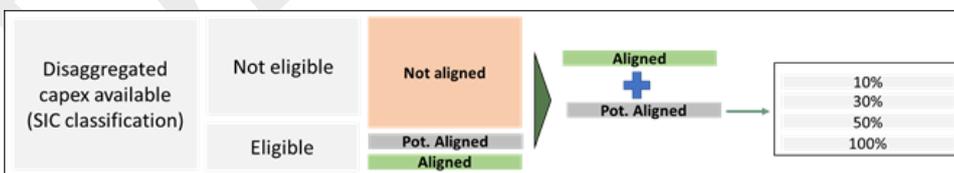


Figure 3 - MSCI universe: EU Taxonomy assessment by capex segment (n=4,834), weighted by total assets

However, the figures on EU Taxonomy exposure present an upper bound. An illustrative example are NACE codes J61-63³⁷, belonging to the macro sector Information and Communication. The EU Taxonomy defines “Data-driven solutions for GHG emission reductions” as an enabling activity, which can fall under a variety of different four-digit NACE codes, which are, therefore, potentially eligible. However, the TEG report states that activities must be “exclusively” aimed at enabling GHG emission reductions and reduces thereby the actual EU Taxonomy exposure for these NACE codes significantly³⁸. Furthermore, for some of the segments, the differences in the SIC and NACE nomenclature did not allow an unambiguous mapping and identifying clear EU Taxonomy exposure. This leads to a share of ambiguous exposure of 6.5% (weighted by total assets)³⁹.

As a result of all the above, the majority of the capex share is “not aligned” simply because activities that don’t fall under the EU Taxonomy cannot qualify as “EU taxonomy-aligned”.

However, it remains a block of capex shares falling under the EU Taxonomy, where the substantial contribution criteria could not be evaluated. This block is labelled “potentially aligned” capex share and different alignment coefficients (10-100%) were applied to estimate ranges of EU Taxonomy-aligned shares (see Figure 4).



37 J61: Telecommunications, J62: Computer programming, consultancy and related activities; J63: Information service activities

38 Other examples are, for instance, the manufacturing of vehicles (Tesla being EU taxonomy-eligible vs. car manufacturers with no electronic vehicles).

39 Note that this share is significantly lower compared to the previous study commissioned by DG FISMA, where a manual crosswalk from SIC to NAICS to NACE was applied.

Figure 4 - Capex assessment methodology for disclosing firms

For non-disclosing companies, the approach to assess capex substantially differs since there is no starting point. Potential variables that address the forward-looking perspective and may allow for estimating firms' current green capex share are discussed in Figure 5 below.

Starting Point	Rationale	Translation into Capex?
A) Green Revenue	Unsurprisingly, there is some correlation between revenue and capex. A company generating 100% of its revenue in SIC sector XYZ is certainly investing in SIC sector XYZ as well. We derive the correlation from the scatterplot above.	In scenarios, we define green capex as 60-100% of the currently generated green revenue. [Considered]
B) Low Carbon Management Score	A robust, well-established governance system may point at lower emissions in the future [some evidence for that]	A potential indicator for lower emissions. But no link to capex. [Not considered]
C) Green Patents.	Proxy for future green revenue.	No link to capex. [Not considered]
D) Commitments & Targets	If a company is serious about fulfilling its target (e.g. signatory of SBTi), it will lead to "green capex" in the near future.	Certainly an indicator but difficult to quantify in the absence of data. [Not considered]
E) Future carbon scores	Evidence shows that forward-looking scores by data providers don't have any predictive power (for carbon not for capex)	Not considered.

Figure 5 - Methodology: Assessing green capex for non-disclosing firms

A) Deriving capex from currently generated green revenue. Examining the entire universe of globally publicly listed firms on Thomson Reuters database (44000 firms⁴⁰), the amount of reported disaggregated capex is around one quarter, compared to the 55% of firms reporting disaggregated revenue (see Table 2). Examining the correlation between capex and revenue segments within the global universe, a positive correlation was found with a correlation coefficient of 0.817 for the whole sample. This means that if a firm generates 100% of its revenues in a certain segment, it invests on average 81.7% of its capex in the same sectoral segment based on the SIC classification. The correlation coefficients are nearly the same for different subsamples (i.e. revenue and capex splits a) are exposed to the taxonomy, b) are not exposed to the taxonomy and c) cannot unambiguously be linked to the EU Taxonomy based on their SIC codes⁴¹). This also holds for the sectoral perspective, except for a lower correlation in the construction sector (slightly higher than 0.6). Figure 6 shows a scatterplot of all disclosed revenue and capex splits, clustered by EU Taxonomy exposure (highlighted in red, green and blue according to their potential EU Taxonomy exposure).

Given the average correlation of revenue and capex of 0.8 (see scatterplot in Figure 2 above), it can be assumed that a firm's green revenue is accompanied by a certain share of green capex. In a range of scenario calculations, different coefficients between 60-100% of green revenue are considered to proxy for green capex in the absence of disaggregated reporting.

40 Source: Worldscope

41 With EU Taxonomy exposure: 0.79; without EU Taxonomy exposure: 0.83; ambiguous: 0.81

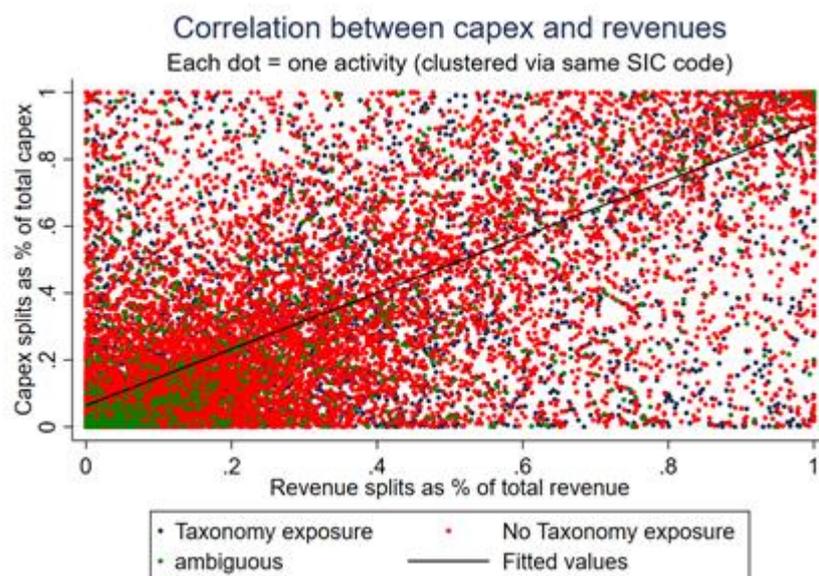


Figure 6 – Correlation assessment between capex and revenue, based on firms’ reported disaggregated data

B) Low Carbon Management Scores. Data providers, such as MSCI or FTSE have derived indicators, measuring a firm’s governance of GHG emissions plus their ability/capacity to manage risks and opportunities related to the low carbon transition. To date, no significant relationship between a firm’s climate governance and its current emissions could be found. However, robust and well-established climate management practices can lead to lower future emissions in some cases⁴².

C) Green or low-carbon patents. Possessing a certain amount of “low-carbon patents” may point at exposure to future green revenue. The Carbon Delta database (MSCI) contains variables on a company’s patents⁴³ such as the number of “low carbon patents” and the “total patents count”.

D) Commitments to reach carbon-neutrality or setting science-based targets. The number of signatories of the Science-Based Target Initiative (SBTI) increased in recent years. While one still needs to separate between firms just paying lip service and firms with an actual interest in decarbonizing their business model, it may serve as a proxy for future green capex. The MSCI ESG universe, for instance, contains 380 firms of the SBTN with 177 firms being “committed” and 203 firms with a target already set. As it is difficult to translate that into capex figures, this indicator is not considered in this study.

E) Forward-looking carbon scores. Investors are interested in the future change of carbon emissions in order to identify firms in transition. Data providers have responded to that need and developed (future) carbon emissions scores (which is a score/rating and not an evaluation of GHG in tons). However, one study has analyzed the explanatory power of carbon emissions scores by popular data providers and found no predictability with regard to future changes in GHG emissions⁴⁴.

42 source: TPI methodology. <https://www.transitionpathwayinitiative.org/publications/65.pdf>

43 For example: the ratio of low carbon patents score to the total patents; the number of low-carbon patents held by the firm; the number of total patents held by the firm and more.

44 Kalesnik, V., Wilkens, M., & Zink, J. (2020). Green Data or Greenwashing? Do Corporate Carbon Emissions Data Enable Investors to Mitigate Climate Change? (link)

Greenness performance of UCITS equity funds

To determine the implications for retail financial products, data points were fed into the portfolio compositions of a previous study⁴⁵ with portfolio weights for 101 green UCITS equity funds retrieved from March 2020 and a resulting sample of ~1,800 distinct firms.

The following scenarios needed to be developed:

- **Two scenarios from two data providers (MSCI vs. ISS-ESG) and non-overlapping universes of constituents.** Though both data providers cover a relatively large universe, they both don't perfectly match the universe of ~1800 distinct constituents. Identifying and removing duplicates results in a universe of ~10.600 distinct firms. Some constituents are covered by both data providers, some by one and some others by none. Therefore, the study runs both a "MSCI" and "ISS" scenario. In the former scenario, MSCI's green revenues are inserted first, with remaining gaps filled by ISS ESG's draft Taxonomy solution. For constituents not covered by both data providers, estimates from the baseline scenario of the previous study on 101 UCITS equity funds were applied. The "ISS scenario" prioritizes ISS ESG's estimates (followed by MSCI and the previous study, in respective order⁴⁶). In the "MSCI scenario", MSCI revenue estimates were prioritized, and remaining gaps filled with ISS-ESG and further estimates based on a previous study in respective order.
- **Further scenario calculations of varying assumptions on EU taxonomy-aligned capex.** As explained above, the methodology differs for firms with disaggregated capex available and those without. For the first group, the uncertainty is the coefficient applied to the capex share that is "potentially aligned" (i.e. assuming that "X%" is actually aligned, with X% varying between 10% and 100%). For the second group, where green capex is derived from currently generated green revenue, the uncertainty is the coefficient applied to green revenue (i.e. an assumption based on the correlation of ~0.8 derived from the scatterplot in Figure 6). As the default option, 10% (first) and 70% (second) were applied (different scenarios were additionally considered).
- **Additional tests on changes in the EU Ecolabel formula.** Two portfolio greenness formulas were tested: the one presented in TR3.0 ("formula 1", see Box 1 for the assumptions taken) and the one suggested by stakeholders during the last consultation period and explained at the beginning ("formula 2").

Correspondingly, different results ranging from I.1.a (i.e. currently proposed formula used, with predominantly MSCI revenue estimates in use plus "modest" assumptions regarding green capex) over I.2.d (i.e. formula 1, ISS data and extremely optimistic capex assumptions) to II.2.d (i.e. formula 2, ISS data and extremely optimistic capex assumptions) were obtained (Figure 7).

45 European Commission (2020). Testing draft EU Ecolabel criteria on UCITS equity funds. (link)

46 The "MSCI scenario" uses 1492 green revenue estimates from MSCI, 85 from ISS ESG and 245 from the previous study. The "ISS scenario" uses 1412 green revenue estimates from ISS ESG, 165 from MSCI and 245 from the previous study.

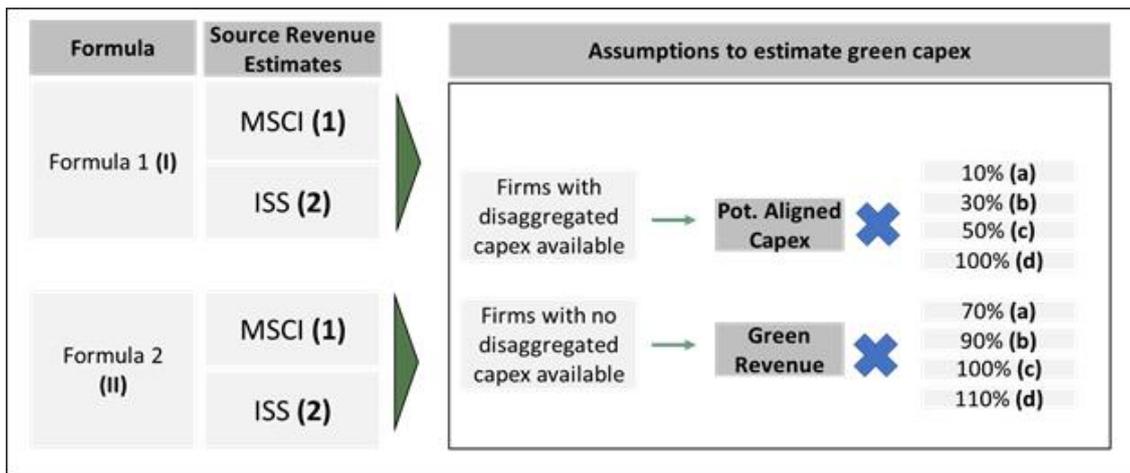


Figure 7 - Overview of different test runs

Box 1 - Applying “formula 1” (TR3.0 version) against the background of data restrictions

The proposed Ecolabel v3 formula requires data points on projected green revenue growth, projected investments as well as backward looking (EU taxonomy-aligned) revenue and capex data. As of now MSCI and ISS-ESG provide the green revenue assessment for one year only, which restricts our analysis. Furthermore, projected green revenue growth and investments cannot be obtained from data bases.

Against this background and following the explanation in TR3.0, the formula was applied as follows:

$$G_i = PC_i \times (0.6 \times GR_i + 0.4 \times GC_i) \quad (1)$$

$$G_i = PC_i \times GR_i \quad (2)$$

with PC_i defined as portfolio contribution
with GR_i defined as green revenue
with GC_i defined as green capex
with G_i defined as the firm’s individual contribution to the portfolio threshold

Equation 1 applies if a firm is defined as a company investing in transition (95% of revenue derived in NACE sector C,D,E or H and green revenue >5% but <50%) or green growth (same NACE sectors but green revenue > 50%) and if the green capex share exceeds the green revenue share (). In all other cases, only the green revenue share is considered and multiplied by the constituent’s portfolio contribution.

The results are summarised below.

Scenario I.1.a (formula 1, MSCI data, 10% of potentially aligned capex assumed EU Taxonomy-aligned for disclosing firms, 70% of green revenue assumed EU Taxonomy-aligned for non-disclosing firms)

Eight funds scored a portfolio threshold “G” higher than 40%, the proposed threshold to receive the EU Ecolabel in TR3.0 (see Figure 8). Interestingly, increasing the threshold would not have

a drastic effect, as even a greenness threshold of 50% would be met by around 6 funds, since the MSCI revenue estimates do neither contain a DNSH nor a MSS^{47(OB)}.

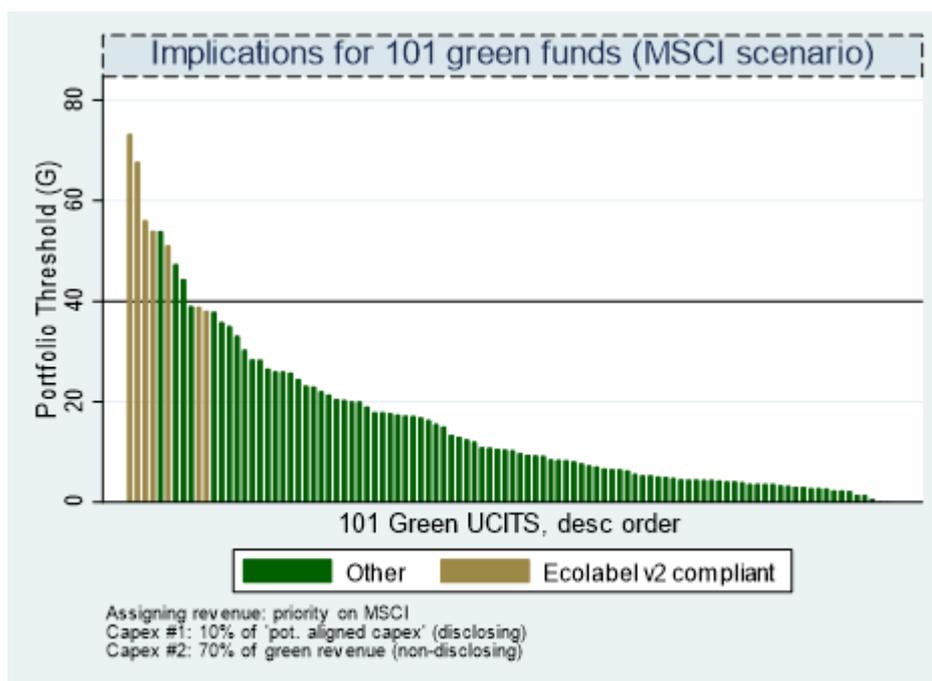


Figure 8. Scenario I.1.a - results. The funds that were compliant with the previous version of the EU Ecolabel criterion (v2) are highlighted.

Given that the weighted formula ($0.6 \times \text{revenue} + 0.4 \times \text{capex}$, see box above) only applies to companies investing in transition or green growth (i.e. belonging to NACE sector C, D,E H and green revenue $> 5\%$) and if the share of green capex exceeds the share of green revenue, the firm's green capex share is only considered for a fraction of firms. Table 2 presents the average share of firms where the capex share was considered in the formula across various scenarios at fund-level. In the default option⁴⁸, that is calculation I.1.a, this share is only 2.8% per fund on average. This number increases with more optimistic assumptions since the share of firms where green capex share exceeds green revenue also increase, thus, leading to more constituents falling under the "weighted formula".

Table 2 - The importance of capex in the currently proposed formula

Assumption on EU taxonomy-aligned capex (MSCI Scenario)	Avg. weight of firms in Transition/Green Growth and green capex $>$ green revenue on fund-level (%)	Std. Deviation	Confidence Interval (95%)	# of funds with $G > 40$

47 While the green revenue figures do not contain any DNSH or MSS evaluation, this is possible with MSCI ESG Controversy Scores. Unfortunately, it was not feasible to obtain these required data points.

48 i.e. in the case where disaggregated capex is available: 10% of potentially aligned capex share is actually aligned; and in the case where disaggregated capex is not available, it is assumed that green capex is 70% of the currently generated green revenue.

Calculation I.1.a	2.79	0.42	1.96 – 3.62	8
Calculation I.1.b	4.20	0.59	3.03 – 5.38	8
Calculation I.1.c	4.72	0.62	4.38 – 5.96	10
Calculation I.1.d	19.57	1.86	15.88 – 23.26	12

As stated above, the figures based on MSCI green revenue data do not include a DNSH and MSS screening. With access to MSCI ESG controversy scores as a proxy, this step could be done manually. The ISS ESG draft Taxonomy solution, however, states the revenue share that is (likely) meeting the substantial contribution criteria but where the DNSH and MSS assessment is (likely) not aligned or could not be evaluated.

Scenario I.2.a (formula 1, ISS ESG data, 10% of potentially aligned capex assumed EU Taxonomy-aligned for disclosing firms, 70% of green revenue assumed EU Taxonomy-aligned for non-disclosing firms)

Figure 9 shows that 4-5 funds exceed the threshold of 40%, whilst a greenness threshold of 50% would be met by 3 funds. However, deducting the share of G subject to DNSH (the dark brown “s.t. to DNSH” part of the bar) places the funds far below the threshold of 40% (i.e. <20%). This highlights that the “share of G” that is subject to a DNSH and MSS assessment leads to a completely different picture.

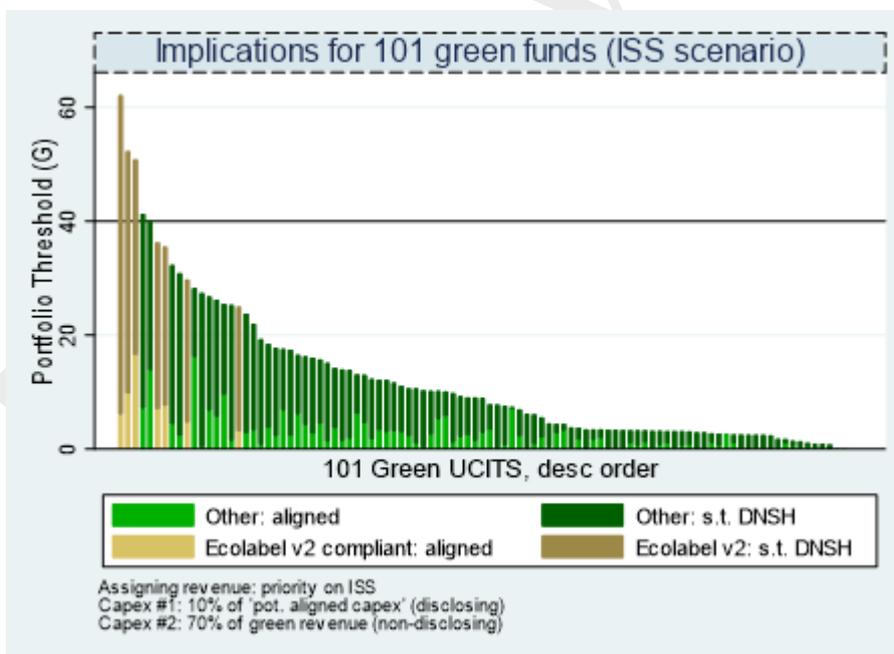


Figure 9. Scenario I.2.a - results. The funds that were compliant with the previous version of the EU Ecolabel criterion (v2) are highlighted.

Scenarios II.1.a and II.2.a (formula 2)

As a result of applying the newly proposed formula, significantly more funds exceed the threshold of 40% - 13 in the MSCI scenario (Figure 10) and 8 in the ISS-ESG scenario (Figure 11). EU Ecolabel Criteria for Retail financial products

11), without considering DNSH and MSS. This result is driven by the new formula, in which the numerator can exceed the denominator and therefore overweighting the firm's portfolio contribution (PC). Capping the numerator to 1 is discussed in the following section. With a threshold of 50%, 9 funds in the MSCI scenario and 5 funds in the ISS ESG scenario would still comply.

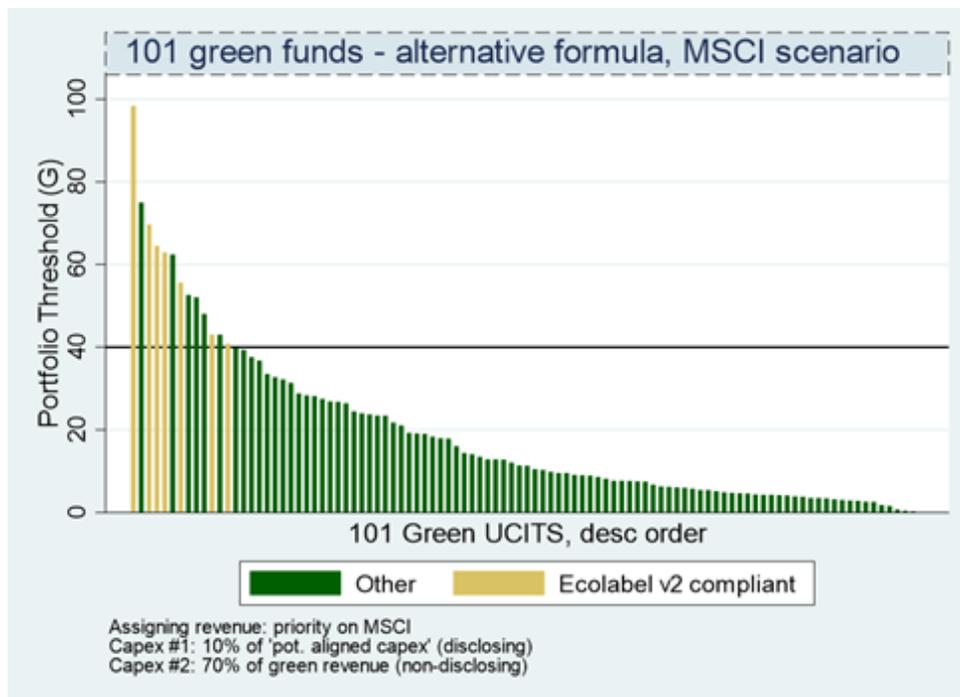


Figure 10 - Scenario II.1.a - results.

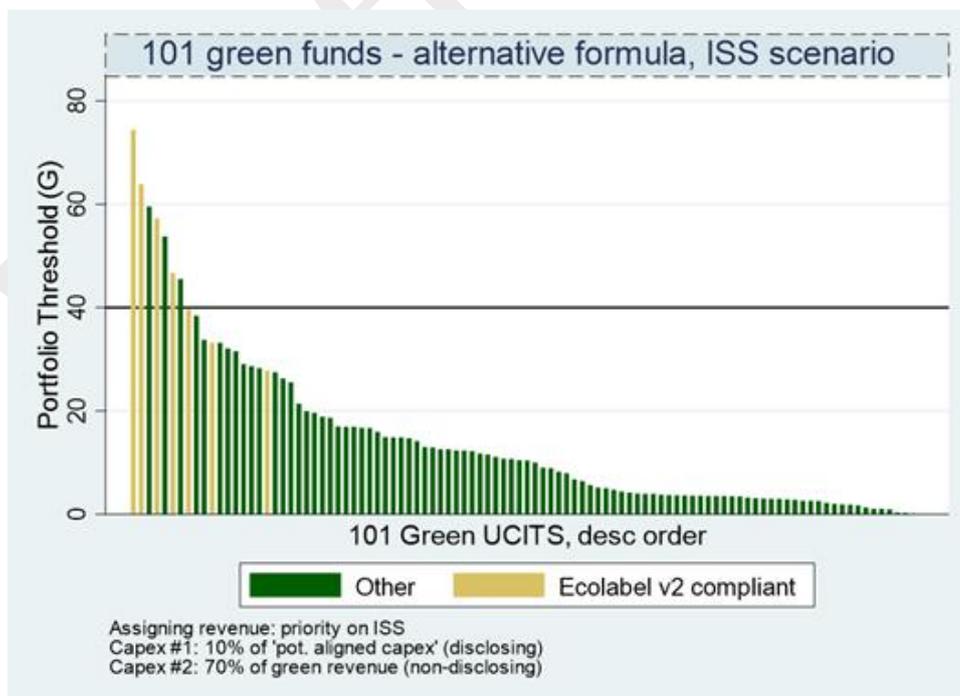


Figure 11 - Scenario II.2.a - results.

The results for the remaining scenarios are reported in Annex I.

Testing capex sensitivities for Formula 1

Since defining green capex in the absence of reported data (and even estimates by data providers) relied on two coefficients, further test runs are applied to explore the range of potential outcomes (see Table 3). The columns a-d refer to the assumptions stated in Figure 7. Even given the most “optimistic” assumption that 100% of the potentially aligned capex share is actually taxonomy-aligned (disclosing firms) and that green capex equals 110% of generated green revenue (non-disclosing firms), the number of funds with “G” exceeding the proposed portfolio threshold of 40% ranges between 6-12.

As stated above, capex is not the deciding factor given the current formula. Therefore, a different revenue/capex weighting does not affect the outcomes significantly.

Table 3 - Number of Ecolabel compliant funds, current formula, capex sensitivities

Formula in use	Scenario	Capex Assumptions			
		A	B	C	D
Formula 1; 60/40 weighting	MSCI	8	8	10	12
	ISS	4	5	5	6
Formula 1; 80/20 weighting	MSCI	8	8	8	10-11
	ISS	4	4-5	5	5-6

Testing capex sensitivities regarding the alternative formula

Since capex is part of every firm's individual contribution to “G”, one would expect that changing parameters in the capex assessment has a stronger impact. This is the case if the right-hand side of the equation can exceed 1, which bloats the individual contribution of some firms with a green revenue share of 100% since any contribution of green capex >0 on the numerator increases the weight. This even leads two funds with “G” exceeding 100%.

However, capping the right-hand side of the equation to 1, has a drastic effect and changes in the capex assumptions are similar to the currently proposed formula (i.e., 10-14 for MSCI, 7-9 for ISS-ESG).

Table 4 - Number of Ecolabel compliant funds, alternative formula, capex sensitivities

Formula in use	Scenario	Capex Assumptions			
		A	B	C	D
Formula 2	MSCI	13	15	17	21
	ISS	7	8	9	11

Formula 2; capped at 1	MSCI	10	12	14	14
	ISS	7	7	7	9

In summary, the key results are as follows:

- A full-fledged Taxonomy assessment incl. DNSH and MSS has severe implications for the market coverage of the EU Ecolabel. Subtracting the “share of G” that is still subject to a DNSH/MSS assessment, following ISS-ESG’s draft Taxonomy solution, presents a different picture. None of the funds would be even close to the proposed portfolio threshold of 40%. The changes between the TEG report and the EU Taxonomy Delegated Act may or may not change the implications.
- Nonetheless, the market coverage will broaden given that large parts of the EU Taxonomy are still to be developed. Following a strict DNSH and MSS assessment, the scope seems strict (i.e. the greenest funds have a “G” of ~20). However, none of the funds were constructed with the focus of “maximizing G” to obtain the Ecolabel. Additionally, further sustainable economic activities related to other environmental objectives (i.e., biodiversity, water, pollution and circular economy) are currently defined and they will definitely broaden the scope. Same applies for the existing criteria for climate change adaptation, which are not considered in this study.
- The formula introduced in TR3.0 does not substantially change market coverage of the EU Ecolabel as compared to TR2.0. In a previous study seven funds, across different scenarios, were deemed “EU Ecolabel compliant”, abstracting from the DNSH assessment and Ecolabel exclusion criteria. Whereas in this study, 4-8 (formula 1) and 7-10 (formula 2) exceed the threshold of 40, and 4-8 (formula 1) and 7-10 (formula 2) exceed the threshold of 40. These numbers increase up to 14 funds if extremely optimistic (and unrealistic) assumptions regarding capex estimates are in place.
- Addressing the forward-looking perspective is crucial to allow companies investing in the green transition to be part of EU Ecolabel compliant funds. However, given the currently proposed formula, capex is not a deciding factor. The weighted formula, which includes revenue and capex, only applies to around 2-6%⁴⁹ of a fund’s portfolio on average. However, defining “companies investing in transition” is a difficult exercise at the moment since the green capex shares of this study rely on a range of assumptions. Moreover, the funds that are considered are “green funds” without a particular focus on transition aspects.
- Relying on future revenue and capex projections, as suggested in the current formula, is a limiting factor for practitioners. Since forward-looking revenue and capex are not available in any database, these datapoints entirely rely on a very engaging approach (see the TR3.0 on corporate investment plans). Furthermore, this data would remain highly speculative. A use of backward-looking capex data should suffice to cover the forward-looking perspective.
- In the absence of reported data, data providers have an important gap to fill. While both tested data providers seem to be roughly in line (even though an evaluation of the impact of DNSH/MSS on MSCI green revenue figures was not possible), picking one

⁴⁹ Given the 95% confidence intervals of calculations a,b,c. Calculation d is excluded due to unrealistic assumptions.

provider can have implications for determining EU Ecolabel compliance. Furthermore, to broaden the coverage of estimates, having access to more than one data provider is useful to extend the universe of potential constituents.

- A broad coverage of green capex estimates may not be available in the nearer future. While some data providers currently work on assessing green capex for selected sectors, challenges and obstacles are widely acknowledged. Therefore, a broad coverage of green capex estimates cannot be expected soon. Furthermore, the definition of capex remains somewhat unclear, which may require the cooperation with regulators⁵⁰.
- Against the background of policy regulations (Taxonomy Delegated Act and NFRD) and the EU Taxonomy (environmental objectives 3-6) being still under development, setting a greenness threshold for UCITS equities funds is quite complex. Therefore, adjusting the threshold over time and in particular, once the definition of sustainable economic activities (and their screening criteria) for environmental objectives 3-6 are finalized, shall be considered since this will broaden the scope to construct EU Ecolabel compliant portfolios.

Construction of hypothetical portfolios

Further tests were conducted to showcase hypothetical UCITS equity portfolios that would fulfil the EU Ecolabel criterion 1, considering different constraints (e.g. geographical or sectoral focus as well as varying portfolios or firm sizes) and additionally looking at the return of such portfolios might be at or above market returns. A risk classification of the portfolios was not conducted.

The study builds on the findings on green revenue and green capex presented in the previous sections, which as a way of reminding, focused on; (i) two scenarios for estimates of green revenue and green capex from two data providers (MSCI and ISS ESG); (ii) two scenarios differentiating between the revenue share that passed the DNSH & MSS assessment (“aligned”/“likely aligned”) and the revenue share that meets the substantial contribution criteria but where the DNSH & MSS assessment is likely not aligned or could not be evaluated (“potentially aligned share”); a number of sensitivities to estimate green capex.

In order to develop and construct hypothetical but possible portfolios, interviews with asset managers on the common practice from the industry were run. The following relevant aspects were identified:

- Investment style: the investment style differs between active asset managers in terms of degree of active investment and investment strategies. While some active managers follow a benchmark for the sectoral or geographical composition of their portfolios, others use the benchmark as a reference value for their performance only. A variety of investment strategies exist in the asset management industry with value investing and growth investing being the two most relevant for the study. According to some asset managers, sustainable funds will show growth investing tendencies as sustainable markets and economies are just evolving.

50 See for instance: ESMA (2020). Consultation Paper. Draft advice to the European Commission under Article 8 of the EU Taxonomy Regulation. (link)

- Bottom-up vs. top-down strategies for stock picking: asset managers follow different strategies for portfolio composition. In practice, many asset managers either apply a bottom-up or a top-down approach. A top-down approach is usually referred to as picking stocks based on a pre-defined geographical and/or sectoral distribution, which is often based on the underlying index. On the contrary, the geographical and sectoral distributions are the result of stock picking in a bottom-up approach. This finding indicates for our study that the sectoral and geographical distributions can be manipulated to test for compliance with the EU Ecolabel.
- Portfolio size: a large spectrum of number of stocks in an equity fund exists. The interviews with asset managers indicated that a hypothetical portfolio would represent common market practice when taking around 30-80 for each portfolio.
- Benchmarking: useful index providers for this study that are used by a broader range of asset managers include MSCI and S&P. It is important to note that indices change every 180 days, which means that back testing with applying fixed sectoral and geographical distribution might not be completely representative.
- Use of back testing: the opinions on back testing vary between asset managers. Some regard back testing as a useful technical tool for portfolio building while others argue that back testing does not reflect future trends and is therefore of limited value to portfolio building. This ambivalent picture leads us to the conclusion that back testing is relevant for this study but should not be overestimated in terms of predictive capacity on hypothetical EU Ecolabel eligible equity fund performances.

Five different scenarios were defined to address different relative sectoral or geographical constituent allocation with the overall aim of maximizing G, (i.e. maximize the performance under the EU Ecolabel formula for UCITS equity funds). These scenarios were mirrored against different settings regarding the number of constituents (30,50,80) in a portfolio and the size of constituents, i.e. “large caps” or also “mid- and small caps” (large caps only, equally mixed, mid and small caps only). This results in a matrix of 5 x 9 different combinations.

Table 5 highlights the set of different variations for the analysis. While scenarios I – III contain the sectoral or geographical distribution of the MSCI World Index, scenario IV and V double the sectoral weighting for energy (IV) and manufacturing (V) compared to the MSCI World benchmark (and reduce the weight of remaining sectors evenly). All scenarios except scenario II pick stocks from a global universe of stocks as defined above. Scenario II is further restricted to firms domiciled in EU27 countries only.

For each scenario, different number of constituents (~ 30, 50, 80) are considered. The lower boundary of 30 represents a portfolio that is at least sufficiently diversified across sectors and regions. Further, an upper limit of 80 firms is set to prevent from simply replicating a broad market index. For each run (sectoral and geographical distribution plus portfolio size), three further restrictions regarding the type of constituents are set. That is a) a portfolio consisting of large caps only, b) a portfolio equally mixed between large and small/mid-caps and lastly c) a small/mid cap portfolio. Combining all different possibilities, 45 different portfolio combinations are tested for each source of EU Taxonomy-aligned revenue data (i.e. MSCI and ISS-ESG).

Table 5 – Overview of scenarios considered

Scenario	I. MSCI World sectoral distribution	II. Geo-focus: EU only MSCI World Sectoral Distribution	III. MSCI World geographical distribution	IV. Sect-focus energy (+200% as compared to MSCI World)	V. Sect-focus manufacturing (+200% as compared to MSCI World)
Stock Universe	globally	EU27	globally	globally	globally

Portfolios Sizes	~ 30, 50, 80	~ 30, 50, 80	~ 30, 50, 80	~ 30, 50, 80	~ 30, 50, 80
Stock Composition	Large only, Mixed 50/50, Small&Mids only				
Related Distribution	Sectoral (MSCI)	Sectoral (MSCI)	Geographical (MSCI)	Sectoral (MSCI) but modified	Sectoral (MSCI) but modified

As a starting point for constructing several “high G-value portfolios”, the sectoral or geographical distribution of fund TNAs within each of the given scenarios is used (based on the MSCI world with modification in scenario IV and V, see table 1 above). To keep an equal weighting of constituents within the portfolios and to fill the desired sectoral or geographical distribution, the number of firms per “group” (i.e. sector or region) is determined by applying the following formula⁵¹:

$$\text{Number of Firms}_i = \text{Number of Firms (total)} * \text{Group Weight}_i$$

Following the G formula as in the TR3.0 version, the n firms for “group” i are then selected according to the highest results of the respective EU Ecolabel formula where each firm obtains a “G-value” (e.g. 0.6 x 100% green revenue + 0.4 x 100% green capex = 1). In the last step, the weight of each firm within one group is calculated by dividing the group weight by the number of firms within this group as the following formula shows:

$$\text{Weight of Firm}_i = (\text{Group Weight}_i) / (\text{Number of Firms}_i)$$

Although this is not a fully-fledged maximization approach of “G”, it provides valuable insights into the feasibility of composing EU Ecolabel compliant portfolios under various limitations.

For the purpose of comparing the return profile of the retrieved portfolios against a those of a benchmark, some broad market indices were selected from the MSCI and Dow Jones (DJ) index universe. The following subsection briefly describes the sectoral and geographical distribution of selected indices.

MSCI World. The MSCI World index captures large and mid-cap representation across 23 developed market countries (Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, the UK and the US). With 1,582 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

⁵¹ The results are rounded commercially. Combinations resulting in 0 firms per subgroups (e.g.,) are replaced with a value of one manually. This ensures that the underlying distribution can be kept.

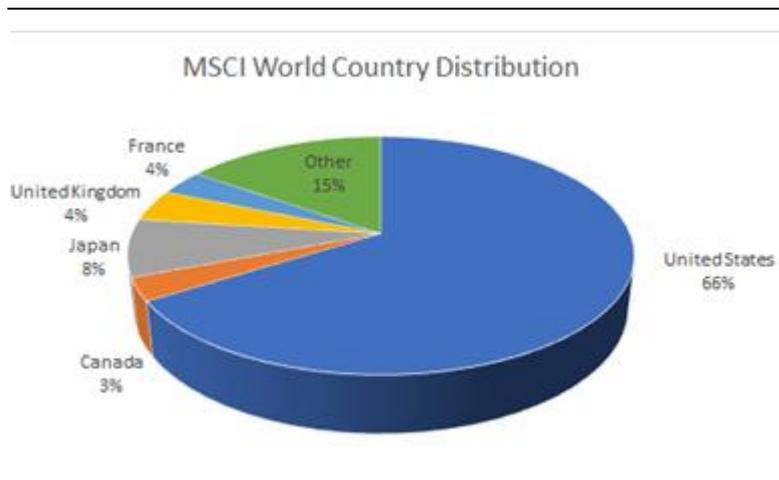


Figure 12 - MSCI World Country Distribution

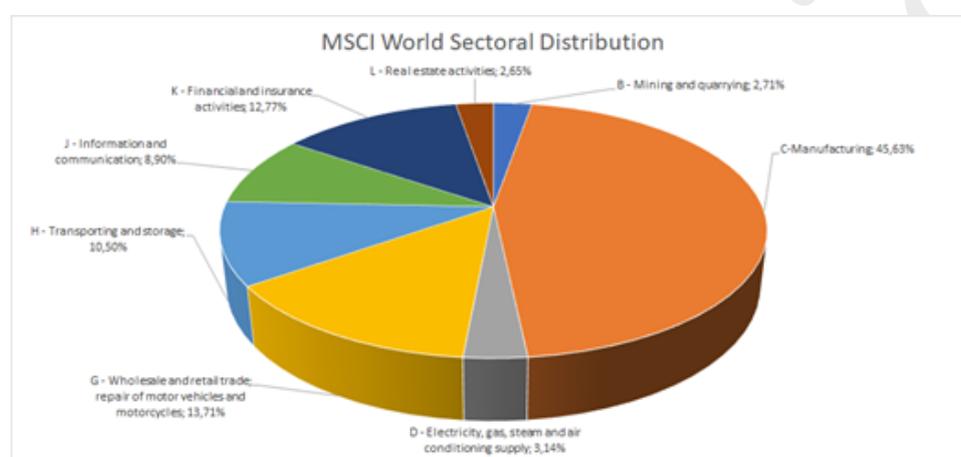


Figure 13 - MSCI World Sectoral Distribution

Dow Jones Sustainability Index (DJSI). Additionally, the DJSI World fund was also included as a benchmark. The Dow Jones Sustainability World Index comprises global sustainability leaders. It represents the top 10% of the largest 2,500 companies in the S&P Universe based on long term economic, environmental and social criteria. See Annex I for the sectoral and geographical distribution.

S&P Global Clean Energy. Besides, the S&P Global Clean Energy Index which measures the performance of 30 companies from around the world that are involved in clean-energy related business, is also included as a reference index, comprising a diversified mix of clean energy production and clean energy equipment and technology companies. This index is of particular relevance since mostly manufacturing and electricity production is aligned with the EU Taxonomy on climate change mitigation. See Annex I for the sectoral and geographical distribution.

Descriptive statistics of the universe. The geographical and sectoral composition of the sample looks as presented in the following tables. Both the whole universe and the subsample of firms with green revenues larger than zero, consist of a large share of firms from the manufacturing sector. For most of the NACE macro sectors the share of firms is similar for both samples.

However, firms with green revenues from information and communication are over-represented and firms from the financial sector under-represented compared to the total sample of over 10,000 firms. With respect to the geographical distribution, the share of Northern American firms is relatively smaller in the subsample of the firms with green revenues.

Table 6 – sectorial distribution

NACE Sector	Description	share of companies (%) weighted by market capitalization	
		whole universe (n=10,667)	green revenues > 0 (n=2,533)
A	Agriculture, Forestry	0.2	0.1
C	Manufacturing	36.3	39.2
D	Electricity, Gas, ...	3.4	9.3
E	Waste Management	0.4	0.9
F	Construction	2.5	5.6
H	Transportation	3.4	2.0
J	Inform. & Communication	12.8	19.2
K	Financial and Insurance	18.6	5.4
L	Real Estate	2.9	5.2

Table 7 – Geographical distribution

Region	share of companies (%) weighted by market capitalization	
	whole universe (n=10,667)	green revenues > 0 (n=2,533)
Europe	21.9	22.9
Northern America	42.6	38.6
LAC	4.2	5.6
Asia	27.8	31.2
Africa	0.9	0.5
Oceania	2.5	1.2

While the full dataset of results is reported in Annex II of this document, Table 8 gives an overview of the results

Table 8 – Overview of results

	Content/Objective	Scenarios by data provider	Formula	# of portfolios with G > 40	Average Value across scenarios	G-

Table 1 in Annex II	Resulting G-value at portfolio level incl. range of potential outcomes given different capex assumptions	One calculation with MSCI revenues assigned first; one with ISS-ESG values assigned first.	Formula I	35 (MSCI) 28 (ISS)	57 % (MSCI) 46 % (ISS)
Table 2 in Annex II			Formula II	36 (MSCI) 29 (ISS)	60 % (MSCI) 49 % (ISS)
Table 3 in Annex II	Compare the results if a DNSH assessment is considered to derive EU Taxonomy-aligned revenue estimates.	ISS-ESG data assigned first, since their data structure allows to differentiate between DNSH vs. no-DNSH.	Formula I	9 (incl. DNSH)	22 % (incl. DNSH assessment)
			Formula II	14 (incl. DNSH)	27 % (incl. DNSH assessment)

The following observations stand out:

- **General finding:** The construction of EU Ecolabel-compliant portfolios seems feasible, especially given the fact that an equal weighting of constituents is applied and there are plenty of more options available to optimize the portfolio construction (e.g. apply different weighting strategies; target a different index; pick stocks beyond the MSCI/ISS universe; ...).
- **Effect of number of constituents:** A higher number of constituents in a given portfolio leads to a higher G-value. This effect was expected as the methodology was based on a best-in-class approach. This finding still indicates that only a limited number of firms are available to construct an EU Ecolabel compliant UCITS equity fund. The ability for an asset manager to differentiate its EU Ecolabel products from competitors is therefore limited.
- **Effect of geographical focus EU:** The geographical focus on the EU27 was chosen due to the fact that EU Taxonomy related information will most likely become available in this geography first. This means for the asset management industry that legal/compliance risks of estimating EU Taxonomy shares will decline in this area at a higher pace, increasing the attractiveness to develop EU-focused EU Ecolabel compliant UCITS equity funds. However, the analysis shows that EU-focused portfolios tend not to meet the required G-value of 40 (triggered by a smaller investable universe). Therefore, an EU advantage for the rollout of the EU Ecolabel might not be realistic.
- **Effect of large caps only:** A large cap only focus tends to result in lower G-values. This might be problematic as large caps are perceived as lower risks and are generally better known by the general public as small and mid-caps. Therefore, large cap portfolios should be a highly relevant setup for retail products.
- **Effect of DNSH:** A fully-fledged DNSH assessment reduces the G-values significantly. However, a few hypothetical portfolios still qualify for the EU Ecolabel even under the application of DNSH (as provided by ISS-ESG). Note that ISS-ESG is known for a rigorous assessment of environmental and social criteria. Applying other assessments by data providers might lead to less stark results.

Following the section above, a further test was conducted focusing on the return profile of the hypothetical constructions. Even though return maximization is not the only priority for sustainable retail investors, profitable investments are important for an uptake of EU Ecolabel compliant funds.

Backtracking in the context of this study. While backtracking is a method that is used in practice to validate assumptions during the portfolio construction process, it has limited, if any, predictive power in regard of the future risk/return profile of a specific portfolio. What it tells us is that if we had invested in a certain portfolio composition in 2017, the return by the end of 2019 would have been X%. For the purpose of backtracking, total returns are used. These returns represent the growth rate of a theoretical index of the share price including further payments (Total Return Index) such as dividends being reinvested.

Compare the historical financial return of hypothetical EU Ecolabel compliant portfolios with selected indices. In the following the financial return of portfolios with a G-value > 40 are compared against the MSCI World Index (to reflect the development of the world's capital markets), the Dow Jones Sustainable Index (to reflect the performance of a “sustainable” universe, which is likely to differ from companies with a high share of EU Taxonomy-aligned revenues due to its current focus on climate change mitigation only) and the S&P Clean Energy Index (to reflect on green energy producing firms and manufacturer of low carbon technologies in particular).

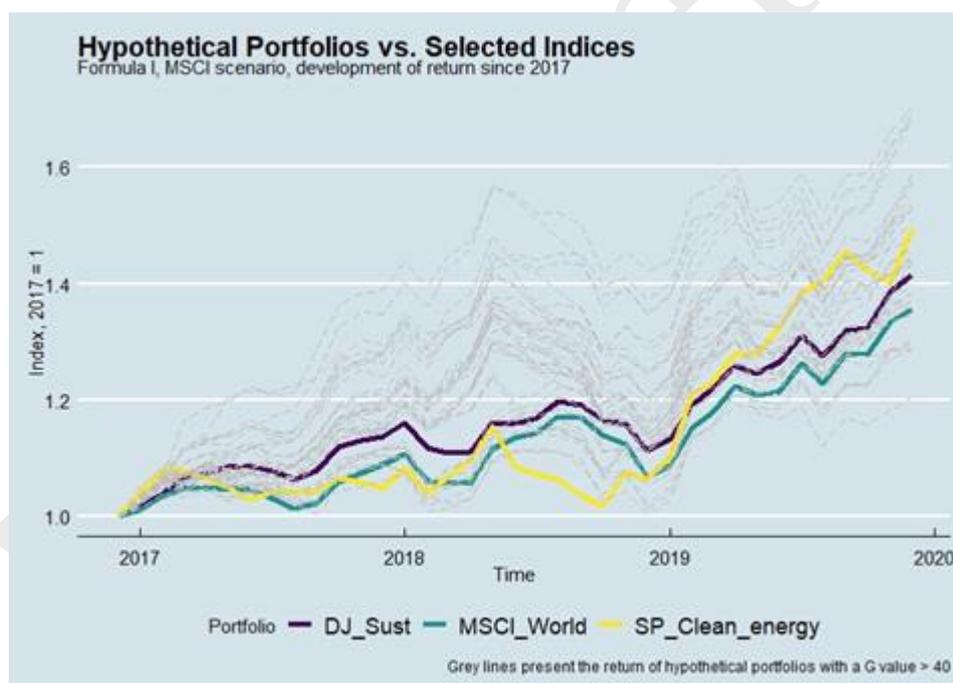


Figure 14 - Financial return, Formula I, MSCI scenario

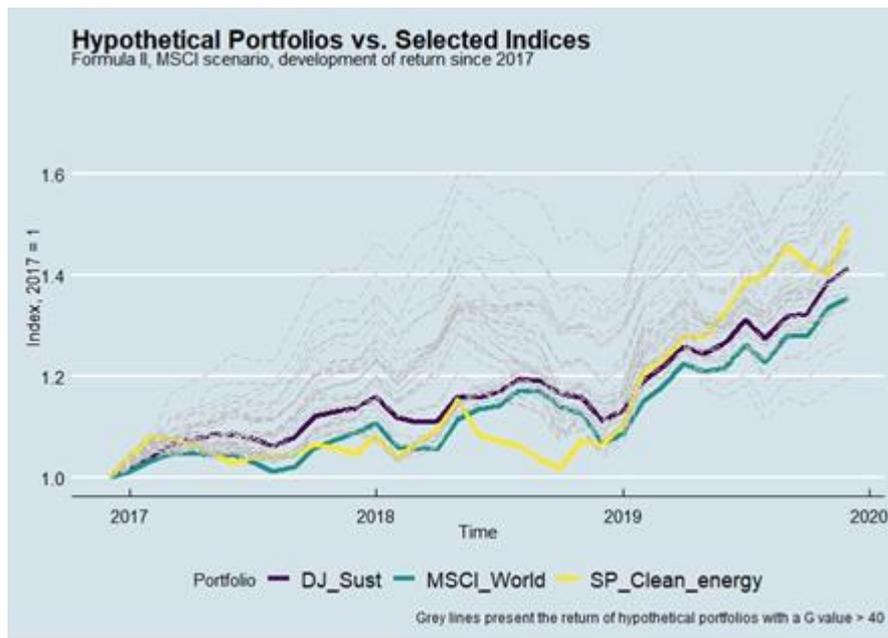


Figure 15 - Financial return, Formula II, MSCI scenario

The hypothetical portfolios in the figures above experienced a return between 20% and 70% over three years (January 2017 – December 2019). While some portfolios had a lower return than the MSCI World Index, most of them yielded a higher return or at least the same. It is important to note that this assessment does not include any risk considerations.

The results indicate that the total index return (i.e. theoretical return index including a reinvestment of other payments such as dividends) of predominantly renewable energy firms and manufacturer of low carbon technologies experienced high growth rates in the given time period. This is backed by the observation that the S&P Clean Energy had the highest return among the three selected benchmark indices.

While showing a tendency for higher returns, the returns of the hypothetical portfolios also tend to follow the return profile of the indices. The relatively similar return profile to the MSCI world index might result from the fact that the development of the hypothetical portfolios is based on the geographical and sectoral distribution of MSCI world.

In summary, from the analysis we can derive the following key takeaways:

1. **Building new portfolios under the EU Ecolabel version three from the impact perspective under criterion one and only looking at data for one year is possible.** A restricted investable universe, which might be the result of specific investment strategies or large number of constituents required in a fund and the application of DNSH criteria lead to decreasing G-values. A strong differentiation of EU Ecolabel compliant UCITS equity funds does not seem feasible given the current formula (and its alternative).
2. **The investable universe will most likely broaden given that large parts of the Taxonomy are still to be developed, which might support the restrictions under point 1.** Further sustainable economic activities related to other EU environmental objectives (i.e., biodiversity, water, pollution and circular economy) are currently being developed and they will definitely broaden the investable universe for asset managers wishing to apply the EU Ecolabel. EU Taxonomy criteria for climate change adaptation are not considered in this study and might enlarge the universe.

-
3. **Relying on future revenue and capex projections, as suggested in the current formula, is a limiting factor for practitioners.** Since forward-looking revenue and capex are not available in any database, these data points entirely rely on a very active engagement approach by asset managers and the data would remain highly speculative. Interviewed asset managers have repeatedly highlighted that backward-looking capex data should suffice to cover a forward-looking perspective. Furthermore, they highlighted that applying green revenue/capex projections would lead to future compliance risks for them (i.e. what to do if the companies fail to deliver on projections? How would an auditor react? Etc.).
 4. **A broad coverage of green capex estimates may not be available in the nearer future.** While some data providers currently work on assessing green capex for selected sectors, challenges and obstacles are widely acknowledged. Therefore, we do not expect a broad coverage of green capex estimates until companies' report this number themselves. Furthermore, the definition of capex remains somewhat unclear, which may require cooperation with regulators⁵².

Based on the results of the studies above, it is proposed to introduce in this fourth proposal of the criteria the use of formula 2, based on green revenue and green capex in absolute values, and to raise the portfolio greenness threshold to 50%.

The possibility of introducing a cap of 100% to the right part of the formula was not introduced at this stage of the process. Indeed, it is believed that it does not occur often that the expenditure of a company exceeds its turnover. This may happen for small companies that finance themselves through loans, and which are more likely to be 'greener' than large companies. Comments from the EUEB members will be accepted on this topic.

Moreover, the JRC considered the possibility to insert an entry level for companies to contribute to the greenness threshold, in particular to require that if a company has green turnover below 10%, then it must have some green capex (to demonstrate that it is working on increasing its exposure to green activities). However, given the figures reported in Figure 1 and 2 and the difficulty in retrieving green capex data, this condition has been taken out. To complement for this, the engagement criterion now includes the requirement for fund managers to engage in the first place with companies having green turnover below 10% and no green capex.

Structure and strictness of the greenness criterion on bonds

A small number of key issues have been raised by stakeholders in relation to bonds. These issues mainly relate to the scope of bonds covered and the certification of green bonds against the background of the EU Green Bond Standard development.

However, some other fundamental issues have also been raised in relation to exposure of bond holders to the activities of the issuer and to the investor impact of holding specific types of bonds.

Based directly on the discussions in the AHWG2 and the written feedback, which was received during the consultation periods, the following issues have therefore been addressed by the JRC in its follow-up research:

- The strictness of the bond fund threshold, which in the TR3.0 was proposed as being 50% of the value of assets under management;

52 ESMA (2020). Consultation Paper. Draft advice to the European Commission under Article 8 of the Taxonomy Regulation. ([link](#))

- The possibility for the EU Ecolabel to accept, during a transitional period certified green bonds;
- The need for clarity on the inclusion of sovereign and corporate (general purpose) bonds in the scope of criterion 1;
- The potential for the exposure of investors to the economic activities of bond issuers, with particular reference to Use of Proceeds green bonds

Threshold for green bonds in a portfolio and acceptance of existing certified green bonds

Few stakeholders suggested to set a 70% greenness threshold for bond funds during the 3rd consultation. They argue that the market for green bonds is growing relatively rapidly and there is an increasing diversity of bond issuers. This can be also seen in the growth of green bonds issuance since 2012/13 to 2015/2016 displayed in Figure 16, although to put this growth in context, in 2015/16 green bonds still only accounted for around 0.13% of the value of the bond market.

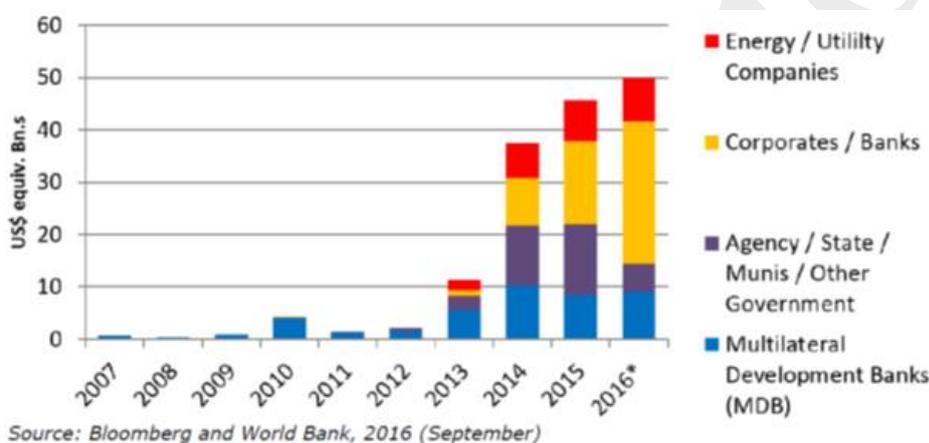


Figure 16 - Growth in annual green bond issuance by issuer type
Source: European Commission (2016)

A concern was, however, raised from the asset management side as to the feasibility of obtaining sufficient green bonds in the case the currently existing green bonds won't be considered as eligible. To date, a vast proportion of the market consists of unlabelled green or climate bonds⁵³, as well as green bonds issued and/or certified by four main bodies – the Climate Bonds Initiative (CBI), the International Capital Market Association (ICMA), the International Finance Corporation (IFC) and the European Investment Bank (EIB). A breakdown of the form of assurance for the green bonds issued in 2019 can be seen in Figure 17, where SPO stands for 'Second Party Opinion' and means that an issuer pays for an external audit⁵⁴.

⁵³ European Union, *Study on the potential of green bond finance for resource-efficient investments*, Luxembourg, November 2016

⁵⁴ See Climate Bonds Initiative, *External review – pre-issuance reviews*, <https://www.climatebonds.net/market/second-opinion>

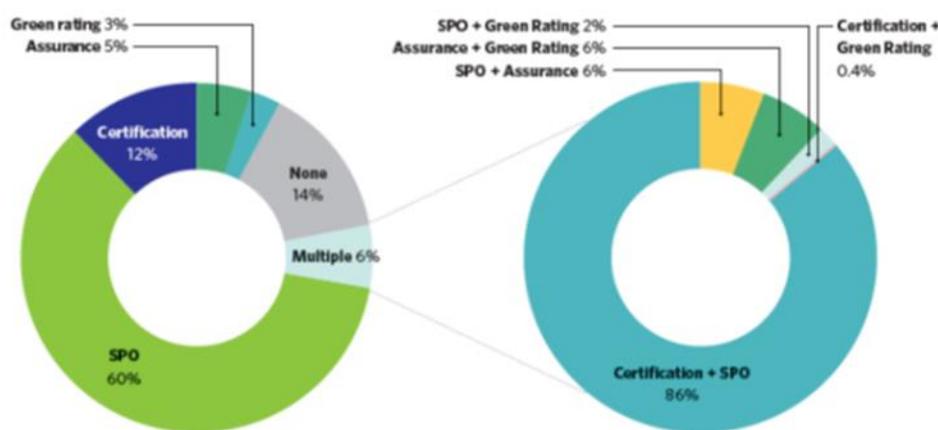


Figure 17 - breakdown of the form of assurance for the green bonds issued in 2019
Source: Climate Bonds Initiative (2020)

Indeed, certified green UoP bonds according to other schemes (ICMA, CBI...) can be eligible for an EU Ecolabel product only if it can be demonstrated that the proceeds were used to finance EU Taxonomy aligned projects/activities; that a tracking practice is in place; and that the proceeds are used for the creation of asset-backed securities or the recycling of funds for lending to new green projects. As shown in Table 9, there are some differences in the existing schemes compared to EU GBS, the most significant ones being:

- The underlying taxonomies form the basis for accrediting whether activities to be financed are ‘green’,
- The introduction of additional requirements, such as company compliance with the core ILO conventions as a safety net, and
- How the use of proceeds is monitored and disclosed, before being included within an impact report.

Moreover, especially the last requirement of the EU Ecolabel (the refinancing), while very important in terms of investor impact, will imply that most of the existing green bonds will not comply, as bonds are typically a refinancing instrument. Finally, it is understood from feedbacks from stakeholders that it will be very challenging for existing green bonds to demonstrate compliance to these EU Ecolabel requirements, especially because of the issue of back separating and/or tracking of the financed activities.

Table 9 - Comparison of the underlying green bond criteria of the EU GBS, CBI and ICMA

Indicative design aspects	EU GBS	ICMA	CBI
<i>Green projects definition</i>	EU Taxonomy	Investment in specific economic categories	CBI Taxonomy
<i>Project evaluation and selection</i>	As described in the green bond framework. Alignment with the EU Taxonomy	Alignment with the ICMA green project categories External review encouraged	Alignment with CBI Taxonomy
<i>Methodology description</i>	As described in the green bond framework	Description of methodology and assumptions	Description of methodology and assumptions
<i>Metrics documentation</i>	Impact metrics	Quantitative performance metrics and indicators	Quantitative performance metrics and indicators

<i>Use of proceeds</i>	Tracking Documentation of allocation	Separation of proceeds Tracking Documentation of allocation Monitoring Auditor for documentation	Separation of proceeds Tracking Documentation of allocation
<i>Reporting</i>	Impact report Allocation report	Impact report Allocation report Project impact shall be evaluated by the issuer	Impact report Allocation report Project impact shall be evaluated by the issuer
<i>Reporting granularity</i>	Project and portfolio	Project and portfolio	Project and portfolio
<i>Documentation of compliance with objectives</i>	Environmental objectives	Environmental sustainability objectives	Environmental objectives
<i>Documentation of refinancing</i>	As described in the green bond framework	Description of proceeds allocation for refinancing purposes	Description of proceeds allocation for refinancing purposes
<i>Verification</i>	Issuer appoints external verifier Compliance with green bond framework Allocation of proceeds	Third party verification of proceeds allocation	Third party verification of proceeds allocation

Moreover, it is to be taken into account the EU Ecolabel requirements for UCITS bond funds cannot refer to nor accept the EU Green Bond Standard (GBS) bonds, as there is no legal reference yet that could be used in the legal text. While it is the intention of the EU Ecolabel to accept EU GBS bonds as EU Ecolabel compliant (and thus 100% green), this will only be possible through an amendment or a revision of the criteria once the EU GBS will be adopted.

Finally, although not stated in criterion 1, the environmental and social exclusions (criteria 2 and 3) apply to the issuer of the bonds, restricting even further the investment universe.

In conclusion, considering a potential development of green bonds in the market and the inclusion of existing bonds if they meet the criterion requirements, it is suggested to adapt the ambition level to 70%. The threshold would be revised after the adoption of EU GBS and/or at the next revision process.

It is also suggested that the green bonds, as defined in the criterion, shall allocate the use of proceeds in EU Taxonomy aligned activities and comply with the exclusion criteria.

The proposed requirements apply to those cases where the use of proceeds can be identified, which in turn forms the basis for verification and monitoring. However, if the bond is issued in order to raise general finance for the public or private issuer, then EU Ecolabel verification would need to be solely based on the issuer. A mechanism is therefore needed to determine the portfolio greenness contribution of corporate general-purpose bonds. Regarding general purpose sovereign bonds, JRC concluded that it would be challenging to propose a method for evaluating greenness of sovereigns and sub-sovereigns, and if doing so it might create controversies. Therefore, for the time being general purpose sovereign and sub-sovereign bonds are not considered in making up greenness of UCITS bond and mixed funds.

For general purpose corporate bonds, significant concerns were raised by several stakeholders about exposure of the portfolio to the balance sheet of companies, in particular for companies that may operate significant holdings in excluded economic activities. From an investment perspective, this is technically correct and may be particularly the case in the energy sector where, the majority of green bonds are issued (non-financial corporate issuers). Buildings are

also a significant target for the allocation of use of proceeds and where there could be potential for exposure to real estate funds with poor performing assets.

On the other hand, green bonds may provide issuers with a verified route to invest in a low carbon transition, so stakeholders have argued that this route should not be precluded since a high percentage of green bonds are used for refinancing purposes and if refinancing is excluded, the demand for green bonds would drop drastically. However, refinancing raises issues in relation to whether there is additionality, since generally to issue green bonds a company must have sufficient financial resources and a credit rating that will permit them to issue investment grade corporate bonds.

In this fourth version of the criteria, building up on the third draft proposal, it is proposed to evaluate the contribution of the general purpose corporate bonds to the greenness threshold in proportion to the greenness of the issuer. The requirements therefore refer to criterion 1 for UCITS equity funds, where the greenness of the issuer is expressed, for each company as $(\text{green turnover} + \text{green capex})/(\text{turnover})$. This definition has also been included in the supplementary definitions at the beginning of the legal Annex.

Retail AIFs

It is understood based on feedback from stakeholders that the investable universe of retail AIFs is generally larger than the one of a UCITS fund. Indeed, retail AIFs comprise both listed and unlisted equities, where these last ones can include 'pure player' green companies. Moreover, they can include illiquid assets, which can include renewable energy projects, real estate and infrastructure projects. Illiquid assets can be verified by the relevant EU Taxonomy criteria and where the activities are included within the scope (e.g. wind farms, office buildings, rail infrastructure). These products have the potential to achieve a high level of ambition under criterion 1.

Moreover, due to the general trend of the third consultation, where it was not commented on the impossibility to manufacture a 70% green retail AIFs, the criterion has not been changed.

Insurance products

The TR4.0 considers unit-linked insurance products and MOPs with unit-linked insurance funds as the only underlyings possible. The criterion principally requires the underlyings to be EU Ecolabelled. However, for unit-linked insurance products and during the transition period only, they AuM could contribute towards meeting the greenness threshold if they meet the EU Ecolabel criteria.

Assessment and Verification

JRC has reflected on the comments received in the 3rd consultation and based on that has developed a more solid assessment and verification procedure, which is now specific for the different assets under management and also simple and straightforward. By excluding the forward-looking requirements to evaluate greenness, the need for projections and estimations is limited and therefore assessment and verification are feasible. Nevertheless, proxies will be necessary in terms examining compliance with environmental and social exclusions. It is expected that as long as corporates disclosures are not available, the applicant to obtain this information from ESG data providers.

It is suggested the fund applying for the EU Ecolabel is not subject to the national label's rules, as this could increase the cost significantly. The TR4.0 also proposes the verification procedures are similar across the EU member states. d. There are still challenges in the assessment and verification process that are linked to the disclosure requirements for corporates, such as the granularity of green revenues and Capex. To address these issues, the TR4.0 proposes the applicant to provide the method and the proxies used to gather relevant information. This information will increase transparency and facilitate the verifier.

Moreover, clarity has been made for what concerns new products applying for the EU Ecolabel.

Fixed term and savings deposit accounts

Stakeholders had opposite opinions with respect to the amount of money that the Credit Institution should use to finance green loans and/or green bonds. It needs to be clarified that the criterion in TR3.0 required that 100% of the money invested should be used to finance green loans and/or green bonds; however, 30% of the money could remain uninvested in the deposit account for liquidity purposes. In order to improve the clarity of the criterion, the reference to the asset to deposit ratio was removed. Moreover, it has been specified that the assets that the Credit Institution can finance are loans granted to finance environmentally sustainable economic activities and use-of-proceeds (UoP) bonds meeting the requirements in 1.1.B.

Moreover, the criterion has been significantly shortened and simplified.

Finally, due to the difficulties expressed by stakeholders to create separated accounts, it is introduced the possibility to track the money deposited and then granted as loans and/or used to buy bonds, still allowing for the traceability of each of the retail customers' deposited money and their contribution to the total value of the loans granted. In this case (if tracking is used instead of separation), the applicant is requested to create and submit a report tracing the money financed to the assets.

5.2 EX CRITERION 2 – Companies investing in transition and in green growth (removed)

The 3rd criteria proposal for the EU Ecolabel introduced under criterion 2 the concept of transition. This referred to the potential to include in the EU Ecolabel financial product investments to companies that can be verified as investing in a transition towards a higher proportion of green revenues on their balance sheet. The concept can have two potential benefits for the EU Ecolabel:

1. **Investor impact:** It would recognise and support the investment being made, particularly by large capitalisation companies, to contribute towards meeting EU Taxonomy environmental objectives. It therefore contrasts with capital allocation to support SMEs with a high proportion of environmentally sustainable economic activities, where the objective would be growth rather than transition.
2. **Investable universe:** It could expand the investable universe because current analyses (see Section A) suggest that currently the size of the environmentally sustainable economy may constitute a major constraint on putting together an EU Ecolabel compliant portfolio. Moreover, although substantial investment is being made by mid to large capitalisation companies, particularly in the utility sector, their green revenue share tends still to be low. The recent analysis carried out for DG FISMA by Climate Company and the Frankfurt School of Finance and Management, as well as findings presented by MSCI (see sections A.1 and A.2), suggests that the manufacturing sector in particular would merit attention, being the most significant economic activity within UCITS equity holdings.

A small part of stakeholders welcomed the criterion, highlighting the relevance to increase the size of the investment universe and at the same time giving attention to those companies that are undergoing efforts to transition to a greener economy.

However, a large part of stakeholders criticised this criterion, asking for its removal, due to:

- The reference to forward-looking elements, that would require data not available, difficult to verify and possibly leading to greenwashing;
- The insufficient level of stringency of the criterion;
- The confusion with how transition is addressed in the EU Taxonomy Regulation.

Given the general trend that emerged out of the third stakeholder consultation, it was decided to remove this criterion. Some of its elements have been moved (and made stricter) to the criterion on environmental exclusions, where the fund or deposit manager or the insurance undertaking can invest in companies that committed to an ambitious transition in the sectors of energy, waste management and transport. Moreover, the criterion on engagement has been strengthened, focusing especially on companies that could increase their at present low green revenue.

5.3 CRITERION 2: Exclusions based on environmental aspects

Previous (third) proposal for criterion 2: Excluded activities – Environmental aspects

3.1 Exclusions relating to economic activities

Investment funds and insurance products shall not contain equities or bonds issued by companies that derive more than 5% of their revenue from the excluded activities listed below.

For fixed-term and savings deposit accounts, green loans shall not be made to companies whose activities are in the list of excluded activities and project loans shall not finance the excluded activities. Bonds held shall not be issued by companies whose activities are in the list of excluded activities.

3.1.1 List of excluded activities

A. Agriculture

- A.1** Use of pesticides, including plant protection products, identified in the Rotterdam Convention Prior Informed Consent (PIC) procedure or in classes Ia or Ib in the World Health Organization Recommended Classification by Hazard.
- A.2** Production, distribution and use of agricultural products, including vegetable oils, and livestock on land obtained as a result of conversion, fragmentation or unsustainable intensification of high-nature-value land, wetlands, peatland, forests, or other areas of high-biodiversity value or high-carbon stock in or after 2008, where high-biodiversity value and high-carbon stock land is defined according to Directive 2018/2001.
- A.3** Cultivation of crops (for agricultural products) that does not minimise the use of pesticides and does not favour alternative approaches or techniques, according to Directive 2009/128/EC or the UN FAO International Code of Conduct on the Distribution and Use of Pesticides.

B. Forestry

- B.1** Forestry management for production of timber as well as the production of timber-derived products, where the economic operator cannot demonstrate the following:
 - That the timber is covered by valid FLEGT or CITES licences and/or is controlled by a due diligence system which provides the information set out in Regulation (EU) 995/2010; and
 - That the forests are not located on land obtained from the conversion, fragmentation or unsustainable intensification of high-nature-value land, wetlands, peatlands, forests, or other areas of high-biodiversity value and/or high-carbon stock in or after 2008.

C. Energy sector

- C.1** Solid, liquid and gaseous fossil fuel exploration, extraction, refining and production of derivative products. This includes unconventional sources such as hydraulic fracking, arctic drilling, oil sands and shale deposits.
- C.2** The supply of solid, liquid and gaseous fossil fuel for fuel or electricity generation using these fuels, unless the company operating the activity:
 - is a company investing in transition, and :
 - The company revenue from these excluded activities is below 30%, and
 - The company has set a phase-out, closure or fuel-switching plan for natural gas and coal power stations on a ten-year timeframe.
- C.3** Transportation, distribution and storage of fossil fuels.
- C.4** All activities relating to the nuclear fuel cycle, including power generation.

D. Waste Management

D.1 Waste management facilities and services without any form of material segregation of non-hazardous waste, including waste handling, landfill and incineration, unless the company operating the activity:

- Is a company investing in transition, and
- The company revenue from these excluded activities is below 30%.

E. Manufacturing

E.1 Production, trade, distribution and use of chemicals and mixtures of chemicals that are listed or identified in the following:

- Regulation (EU) 2019/1021 on persistent organic pollutants (for companies domiciled in the EU) or the Stockholm Convention (for companies domiciled outside the EU),
- Regulation (EU) 649/2012 concerning the export and import of hazardous chemicals (for companies domiciled in the EU) or the Rotterdam Convention Prior Informed Consent (PIC) procedure (for companies domiciled outside the EU),
- Class Ia or Ib in the World Health Organization Recommended Classification by Hazard (for all companies),
- The candidate list of Substances of very high concern (SVHC) and Annex XVII under the Regulation (EC) 1907/2006 on the Registration, Evaluation, Authorisation and Restriction of Chemicals (for all companies),
- Regulation 1005/2009 on substances that deplete the ozone layer (for companies domiciled in the EU) or the Montreal Protocol on Substances that Deplete the Ozone layer (for companies domiciled outside the EU),
- Regulation (EU) 2017/852 on mercury (for companies domiciled in the EU) or the Minamata Convention (for companies domiciled outside the EU),
- Fluorinated greenhouse gases that are listed in Regulation (EU) 517/2014 and with a Global Warming Potential (GWP) according to the thresholds by product group listed in Annex III (for all companies).

E.2 The mining, processing, production, trade and use of asbestos and asbestos-based products.

F. Transportation

F.1 Production, distribution and sale of new passenger cars and light commercial vehicles with engine technology based on combustion of fossil fuels, unless the company operating the activity:

- is a company investing in transition, or
- is a company investing in green growth.

Assessment and verification

The applicant shall provide a declaration of compliance for the fund or deposit account as a whole for each of the specific exclusions that are relevant because of the economic activities of holdings in the portfolio. In support of this declaration, information shall be provided on each company's link (tie) to each of the excluded activity, any related corporate actions at the moment of application, and ownership information if the company has links (ties) to the excluded business activity through a subsidiary or parent company.

Supporting evidence shall be submitted in one of the forms below:

- Company screening using controversy proxies;
- Business involvement indicators;

- Company environmental reports;
- Company compliance reports.

To demonstrate compliance with criterion C.2, a strategic plan shall be made available. The plan shall include a time plan of the phasing-out, closure or fuel-switching for natural gas and coal power stations, important intermediate milestones for meeting the plan, and expected increase in renewable energy capacity. An official communication of the plan shall moreover be made available on the company's website.

Further to the initial verification by the Competent Body, the fund manager shall carry out assessment on compliance with environmental exclusions at least once per year and communicate any inconsistencies to the Competent Body.

If the fund manager receives information or identifies the existence of severe and/or systematic allegations in terms of conformity with environmental exclusions, then as a response the company shall be requested to develop within three months a plan and list of actions to resolve the issue. If the issue remains unresolved after 1 year, the respective assets shall be sold.

The Competent Body retains the right to make random checks on compliance.

3.2 Exclusions relating to sovereign and sub-sovereign bonds

The following exclusions apply to sovereign and sub-sovereign bonds and their issuers.

3.2.1 Ratification of the Paris Agreement on Climate Change

Sovereign bonds shall be excluded from being held by the portfolio if:

- the issuer or the supranational organisation to which it belongs is not party to the Paris Agreement on climate change, and
- the issuer has not published a credible CO₂ reduction trajectory compatible with a 2 degrees scenario.

An exemption shall be made for sub-sovereigns in the case that they can demonstrate a formally adopted political commitment to meet the same targets and requirements.

3.2.2 Ratification of other international environmental agreements

Sovereign bonds shall be excluded from being held by the portfolio if the issuer or the supranational organisation to which it belongs are not party to the following international agreements:

- the UN Convention for Biological Diversity;
- the Convention on International Trade of Endangered Species of Wild Fauna and Flora(CITES);
- the United Nations Convention to Combat Desertification in those Countries Experiencing Serious Drought and/or Desertification (where applicable);
- the Ramsar Convention on the conservation and wise use of wetlands of international importance and their resources;
- the Cartagena Protocol on Biosafety to the Convention on Biological Diversity;
- the Basel Convention (transboundary movements of hazardous wastes and their disposal);
- the Rotterdam Convention on the Prior Informed Consent Procedure for Certain Hazardous Chemicals and Pesticides in International Trade;
- the Stockholm Convention on Persistent Organic Pollutants;
- The Montreal Protocol on Substances that Deplete the Ozone layer;
- The Minamata Convention.

Assessment and verification

The issuers of the sovereign and sub-sovereign bonds that are held shall be identified. The applicant shall then provide a declaration of compliance for the fund or deposit account. For sovereign carbon reduction trajectories relevant information and data contained within a sovereign climate risk rating shall be accepted as a form of verification. For sub-sovereign bonds, additional information on equivalent political commitments shall be provided.

Further to the initial verification, internal checks shall be performed by the licence holder at least once per year and any changes in the fund composition, together with revised declarations of compliance, shall be communicated to the Competent Body which also retains the right to make random checks on compliance.

Fourth proposal for criterion 2: Excluded activities – Environmental aspects

2.1 Exclusions relating to economic activities

Financial products shall not contain equities, bonds **nor loans** issued/loaned by/to companies that derive more than 5% of their **turnover** from the excluded activities listed below.

3.1.1 List of excluded activities

A. Agriculture

A.1 Use of pesticides, including plant protection products, identified in the Rotterdam Convention Prior Informed Consent (PIC) procedure or in classes Ia or Ib in the World Health Organization Recommended Classification by Hazard.

A.2 Production, distribution and use of agricultural products and livestock on land obtained as a result of conversion, fragmentation or unsustainable intensification of high-nature-value land, wetlands, peatland, forests, or other areas of high-biodiversity value or high-carbon stock in or after 2008, where high-biodiversity value and high-carbon stock land is defined according to Directive 2018/2001⁽⁵⁵⁾.

A.3 Cultivation of crops that does not minimise the use of pesticides **and fertilisers** and does not favour alternative approaches or techniques, according to Directive 2009/128/EC⁽⁵⁶⁾, **Directive 91/676/EEC⁽⁵⁷⁾** or the UN FAO International Code of Conduct on the Distribution and Use of Pesticides.

A.4 **Livestock production that does not apply emission mitigation or reduction techniques for feeding and housing of livestock and for manure storage and processing, according to the UNECE Framework Code for Good Agricultural**

55 Directive (EU) 2018/2001 of the European Parliament and of the Council of 11 December 2018 on the promotion of the use of energy from renewable sources

56 Directive 2009/128/EC of the European Parliament and of the Council of 21 October 2009 establishing a framework for Community action to achieve the sustainable use of pesticides

57 Council Directive 91/676/EEC of 12 December 1991 concerning the protection of waters against pollution caused by nitrates from agricultural sources

Practice for Reducing Ammonia.

B. Forestry

B.1 Forestry management for production of timber as well as the production of timber-derived products, where the economic operator cannot demonstrate the following:

- That the timber is covered by valid FLEGT or CITES licences and/or is controlled by a due diligence system which provides the information set out in Regulation (EU) 995/2010⁽⁵⁸⁾; and
- That the forests are not located on land obtained from the conversion, fragmentation or unsustainable intensification of high-nature-value land, wetlands, peatlands, forests, or other areas of high-biodiversity value and/or high-carbon stock in or after 2008.

C. Energy sector

C.1 Solid, liquid and gaseous fossil fuel exploration, extraction, refining and production of derivative products. This includes unconventional sources such as hydraulic fracking, arctic drilling, oil sands and shale deposits.

C.2 The supply and use of solid, liquid and gaseous fossil fuels for fuel, energy generation in the form of electricity and/or heat, heating and cooling using these fuels, unless:

- The company turnover from these excluded activities is below 30%, and;
- The company has published a strategic plan to reduce their GHG emissions to a 1,5 C Paris Agreement aligned level and to achieve net zero carbon emissions by 2050. The plan shall include the phase-out, closure or fuel-switching of the activities described under C.2 on a ten-year timeframe. In the case the plan includes fuel-switching to biomass, the biomass activity shall be EU Taxonomy-aligned, and;
- The company has zero CapEx on the expansion of activities described under C.2, and zero OpEx in maintenance costs that either increase the lifetime or the value of the assets used in those activities during the last financial year, and;
- The GHG emissions (as a minimum scope 1 emissions) of the company decrease annually by at least 7%.

C.3 Transportation, distribution and storage of fossil fuels.

58 Regulation (EU) No 995/2010 of the European Parliament and of the Council of 20 October 2010 laying down the obligations of operators who place timber and timber products on the market

C.4 All activities relating to the nuclear fuel cycle, including power generation.

D. Waste Management

D.1 Waste management facilities and services without any form of material segregation of non-hazardous waste, including waste handling, landfill and incineration, unless:

- The company has published a strategic plan that aims to increase the level of material segregation from non-hazardous waste, and;
- The company **turnover** from these excluded activities is below 30%.

E. Manufacturing

E.1 Production, trade, distribution and use of chemicals and mixtures of chemicals that are listed or identified in the following:

- Regulation (EU) 2019/1021⁽⁵⁹⁾ on persistent organic pollutants (for companies domiciled in the EU) or the Stockholm Convention (for companies domiciled outside the EU),
- Regulation (EU) 649/2012⁽⁶⁰⁾ concerning the export and import of hazardous chemicals (for companies domiciled in the EU) or the Rotterdam Convention Prior Informed Consent (PIC) procedure (for companies domiciled outside the EU),
- Class Ia or Ib in the World Health Organization Recommended Classification by Hazard (for all companies),
- The candidate list of Substances of very high concern (SVHC) and Annex XVII under the Regulation (EC) 1907/2006⁽⁶¹⁾ on the Registration, Evaluation, Authorisation and Restriction of Chemicals (for all

59 Regulation (EU) 2019/1021 of the European Parliament and of the Council of 20 June 2019 on persistent organic pollutants

60 Regulation (EU) No 649/2012 of the European Parliament and of the Council of 4 July 2012 concerning the export and import of hazardous chemicals

61 Regulation (EC) No 1907/2006 of the European Parliament and of the Council of 18 December 2006 concerning the Registration, Evaluation, Authorisation and Restriction of Chemicals (REACH), establishing a European Chemicals Agency, amending Directive 1999/45/EC and repealing Council Regulation (EEC) No 793/93 and Commission Regulation (EC) No 1488/94 as well as Council Directive 76/769/EEC and Commission Directives 91/155/EEC, 93/67/EEC, 93/105/EC and 2000/21/EC

companies),

- Regulation 1005/2009⁽⁶²⁾ on substances that deplete the ozone layer (for companies domiciled in the EU) or the Montreal Protocol on Substances that Deplete the Ozone layer (for companies domiciled outside the EU),
- Regulation (EU) 2017/852⁽⁶³⁾ on mercury (for companies domiciled in the EU) or the Minamata Convention (for companies domiciled outside the EU),
- Fluorinated greenhouse gases that are listed in Regulation (EU) 517/2014⁽⁶⁴⁾ and with a Global Warming Potential (GWP) according to the thresholds by product group listed in Annex III (for all companies).

E.2 The mining, processing, production, trade and use of asbestos and asbestos-based products.

F. Transportation

F.1 Production, distribution and sale of new passenger cars and light commercial vehicles with engine technology based on combustion of fossil fuels, unless:

- The company turnover from these excluded activities is below 30%, and;
- The company has published a strategic plan that aims at phasing out the production of new passenger cars and light commercial vehicles with engine technology based on combustion of fossil fuels by 2030.
- The company has zero CapEx on the expansion of activities described under F.1

2.2 Exclusions relating to financing institutions

Financial products shall not contain:

- bonds nor loans issued by financial institutions that finance the expansion of coal activities; nor
- bonds nor loans issued by financial institutions that have not publicly committed to stop financing coal energy activities and the expansion of oil and gas activities by 2025.

62 Regulation (EC) No 1005/2009 of the European Parliament and of the Council of 16 September 2009 on substances that deplete the ozone layer

63 Regulation (EU) 2017/852 of the European Parliament and of the Council of 17 May 2017 on mercury, and repealing Regulation (EC) No 1102/2008

64 Regulation (EU) No 517/2014 of the European Parliament and of the Council of 16 April 2014 on fluorinated greenhouse gases and repealing Regulation (EC) No 842/2006

Assessment and verification

The applicant shall provide evidence that the fund complies with the environmental exclusions at the time of application.

Supporting evidence shall be submitted in one of the forms below:

- Company screening using proxies (e.g. controversy indicators);*
- Business involvement indicators;*
- Company environmental reports;*
- Company compliance reports;*
- Financial institution reports;*
- Financial institution official communications.*

If data are provided by third party data providers, the methodology for obtaining these data and the used proxies, if any, shall be documented.

To demonstrate compliance with criterion C.2, the following shall also be provided:

- A strategic plan. The plan shall include the actions to achieve a 1,5 C scenario goals of the Paris Agreement and the actions to achieve net zero carbon emissions by 2050. The plan shall also include a time plan of the phasing-out, closure or fuel-switching of the activities described under C.2, important intermediate milestones, expected capital expenditure to achieve the objectives of the plan, and expected increase in renewable energy capacity. An official communication of the plan shall moreover be made available on the company's website.*
- A proof of the company's zero capex on the expansion of activities described under C.2 and of the company's zero opex in maintenance costs as described under C.2.*
- Evidence of the annual reduction of the company's GHG emissions as expressed in C.2.*

To demonstrate compliance with criterion D.1, the following shall also be provided:

- A strategic plan. The plan shall include the actions to achieve an increased material segregation. The plan shall also identify the materials that will be targeted for further segregation, and the technology which is expected to use; the plan shall moreover include a time plan, important intermediate milestones, and expected capital expenditure to achieve the objectives of the plan.*

To demonstrate compliance with criterion F.1, the following shall also be provided:

- *A strategic plan. The plan shall include the actions to achieve the phase out of the production of new passenger cars and light commercial vehicles with engine technology based on combustion of fossil fuels by 2030. The plan shall also identify the materials that will be targeted for further segregation, and the technology which is expected to use; the plan shall moreover include a time plan, important intermediate milestones, and expected capital expenditure to achieve the objectives of the plan.*
- *A proof of the company's zero capex on the expansion of activities described under F.1*

Further to the initial verification by the Competent Body, the applicant shall monitor or assess compliance with environmental exclusions for existing or new investments.

The applicant shall provide evidence on the methodology to identify and evaluate allegations in terms of conformity with environmental exclusions (including the case of deviations from the strategic plans mentioned in points C2, D1 and F1) and take appropriate actions, including communication with the company to develop within three months a plan to resolve the issue and, if relevant, to divest. In addition, the applicant should inform the Competent Body.

2.3 Exclusions relating to sovereign and sub-sovereign bonds

The following exclusions apply to sovereign and sub-sovereign bonds and their issuers.

2.3.1 Ratification of the Paris Agreement on Climate Change

Sovereign bonds shall be excluded from being held by the portfolio if:

- the issuer or the supranational organisation to which it belongs is not party to the Paris Agreement on climate change, and
- the issuer has not published a CO₂ reduction trajectory to reach the objective of the 1,5⁰ degrees scenario of the Paris Agreement.

An exemption shall be made for sub-sovereigns in the case that they can demonstrate a formally adopted political commitment to meet the objectives of the 1,5⁰ degrees scenario of the Paris Agreement.

2.3.2 Ratification of other international environmental agreements

Sovereign bonds shall be excluded from being held by the portfolio if the issuer or the supranational organisation to which it belongs are not party to the following international agreements:

- the UN Convention for Biological Diversity;
- the Convention on International Trade of Endangered Species of Wild Fauna and Flora (CITES);
- the United Nations Convention to Combat Desertification in those Countries Experiencing Serious Drought and/or Desertification (where applicable);
- the Ramsar Convention on the conservation and wise use of wetlands of international importance and their resources;
- the Cartagena Protocol on Biosafety to the Convention on Biological Diversity;
- the Basel Convention (transboundary movements of hazardous wastes and their disposal);
- the Rotterdam Convention on the Prior Informed Consent Procedure for Certain Hazardous Chemicals and Pesticides in International Trade;
- the Stockholm Convention on Persistent Organic Pollutants;
- The Montreal Protocol on Substances that Deplete the Ozone layer;
- The Minamata Convention.

Assessment and verification

*The issuers of the supranational, sovereign and sub-sovereign bonds that are held shall be identified. The applicant shall then provide a declaration of compliance for the **financial product**. For sovereign carbon reduction trajectories relevant information and data contained within a sovereign climate risk rating shall be accepted as a form of verification. For sub-sovereign bonds, additional information on the political commitments **to meet the same targets and requirements the objectives of the 1,5^o degrees scenario of the Paris Agreement** shall be provided.*

Further to the initial verification by the applicant and the Competent Body, the applicant shall monitor or assess compliance in its existing investments or new investments.

5.3.1 Rationale of the proposed criterion text

This criterion focuses on the potentially harmful environmental effects of activities financed. The needs for a requirement that excludes a list of economic activities was identified from existing financial product labels and has been requested by stakeholders, who have commented on which activities they consider should be in the list of exclusions. Applying a negative screening (i.e. a set of exclusions) has the consequence of creating a portfolio allocation that differs from the market portfolio. This may in turn shift asset prices and create incentives for companies that fulfil exclusion criteria to enact sustainability-driven reforms. Evidence also

suggests that the more specific the exclusions and screening are, the more effective they can be in driving changes in companies' practices and new investments.

5.3.2 Outcomes of the previous consultations and main changes in TR2 and TR3

Feedback received on TR1 and TR2 and further research conducted by JRC can be found in the previous version of the report (TR2 and TR3).

The environmental exclusions included in TR1 were solely for the purpose of discussion with stakeholders and needed to be further checked for their applicability and consistency. Therefore, criterion 3 in TR2 differed quite substantially from the previous version by developing the exclusions further and ensuring their operational feasibility.

In summary, the main changes introduced to criterion 2 in TR2.0 were:

- It was specified how the exclusions apply to equities, bonds, fixed-term and saving deposit accounts;
- Additional activities were proposed to be excluded: genetically modified food or feed, production of agricultural products causing deforestation, without the use of integrated pesticide management or leading to severe water scarcity, nuclear energy, production of hazardous chemicals, fluorinated greenhouse gases, mining of asbestos;
- Exclusion areas proposed in TR1 were made operational in TR2 by specifying the reference to legislation or to specific activities or to the means of verification the activities;
- Transitional criteria were developed for the transportation sector, in order to support the transition of the sector to a low carbon economy;
- A new section was created, defining the exclusions for sovereign and sub-sovereign bonds. The requirements included the ratification of several international environmental agreements and a climate or environmental risk rating.

In TR3, the list of exclusion was extensively revised, aligning as much as possible with the Do-No-Significant-Harm (DNSH) under the EU Taxonomy and with available data in the form of proxies/indicators supplied by major data providers and ESG rating agencies.

In summary, the main changes introduced to criterion 2 in TR3.0 were:

- The alignment of the requirements in criterion 2.1 for equities and bonds, i.e. the exclusions were set to apply also to the issuer of the bonds;
- In criterion 2.1, exemptions were set for companies operating fossil-fuel electricity generation activities, waste management activities and car manufacturing activities, provided that the company fulfilled a number of back-looking and forward-looking conditions;
- In criterion 2.2, the following international environmental agreements were added to the list: the Cartagena Protocol on Biosafety to the Convention on Biological Diversity, the Montreal Protocol on Substances that Deplete the Ozone layer, and the Minamata Convention;
- In criterion 2.2, the requirement of a climate risk rating for the issuer of a sovereign bond was removed;
- The assessment and verification section was revised in accordance with the changes to the criterion.

5.3.3 Outcomes of the 3rd stakeholder consultation

This section summarises stakeholders' comments received during the third stakeholder consultation, ended on December 11th 2020. The JRC received in total 117 comments on the environmental exclusions from 57 stakeholders. The comments overall welcomed the revised list of exclusions but called for further improvements. The major comments have been clustered and are summarised below. Based on these comments, the JRC identified the needs for further research.

1) Alignment of requirements for equities and bonds

Some stakeholders commented that the alignment of the exclusion criterion for equities and bonds, and therefore the application of the exclusions to the issuers of bonds, would limit the investable universe for the EU Ecolabel and prohibit the possibility of financing the transition of companies.

2) Flexibility for exclusions in the sectors of energy generation, waste management and transportation

Stakeholders overall welcomed the concept of allowing some flexibility for fossil fuel plants, waste management and transportation activities for companies that are improving the exposure of their activities to achieve EU Taxonomy compliance. However, stakeholders did not welcome the introduction of a criterion on companies investing in transition and in green growth, and asked to remove the reference in the environmental exclusions. It was proposed that the flexibility to be given to companies should be based on clear, strict and monitorable back-looking and forward-looking requirements.

3) Nuclear power generation

Many stakeholders commented on the need to align the EU Ecolabel with the EU Taxonomy, therefore not taking a decision on the exclusion of nuclear power generation before the publication of the study commissioned to JRC to evaluate the Do No Significant Harm (DNSH) potential of nuclear power. Another group of stakeholders made clear that independently of the outcome of the JRC expert study, a non-exclusion of nuclear power generation would lead to a rejection of the Ecolabel at political level.

4) Changes to the list of economic activities to be excluded

Some stakeholders asked to amend the list of excluded activities, focusing on:

- The exclusion of heat generation and heat and cooling using fossil fuels: this was requested by a large number of stakeholders. On the other hand, some stakeholders asked to withdraw the exclusion of natural gas, and align with the EU Taxonomy;
- Factoring farming, unless organic or extensive, or livestock which is fed with soya and other crops imported from countries where their cultivation leads to deforestation and other negative land use changes;
- Mineral fertilizers;
- Banks that finance (via lending, bond issuance, underwriting) companies and projects that expand their fossil energy activities (upstream, midstream, downstream, power production and distribution) with more than EUR 1 billion (annually);
- The aviation sector, or airport expansion; biofuels and natural gas used in transport.

5) Assessment and verification method

Stakeholders acknowledged the improvement of the assessment and verification sections and called for further precision, especially on the methodology that the fund manager should adopt in case of allegations.

6) Sovereign and sub-sovereign bonds

Stakeholders generally welcomed the third version of criterion 2.2, however pointing to:

- The need for the sovereign to have published a CO2 reduction trajectory in line with a 1,5°C scenario, and not a 2°C scenario
- The confusion and room for interpretation caused by the word “credible”

5.3.4 Further research and main changes in the fourth proposal

Alignment of requirements for equities and bonds

The approach used in the EU Ecolabel criteria for equities and bonds was not revised in this fourth proposal, and the list of exclusions is to be applied to the issuers of bonds also. This is an important point to avoid confusion for the retail investors; indeed, if criterion 2 would not apply to bond issuers, the EU Ecolabel would be awarded differently within the same company issuing both equities and bonds (e.g., a company may qualify in a bond fund but not in an equity fund). Financial flows would still be allowed to companies that are transitioning within an EU Ecolabel financial product, considering that some flexibility has been given to companies operating excluded activities in the economic sectors of energy, waste management and transportation, as explained in the next section.

No changes have been made to the criterion text.

Flexibility for exclusions in the sectors of energy generation, waste management and transportation

The proposal in the TR2 set the threshold at 5% of the revenue from excluded activities at the company level. This threshold serves as a screening threshold for portfolio managers. However, this threshold implies that companies investing in transition cannot be eligible for an EU Ecolabel, cutting out a large part of the investment universe, especially for companies in the energy sector. Therefore, in TR3 it was proposed to allow assets and/or bonds issued by companies that fulfilled a number of requirements set to demonstrate the commitment of the company to transitioning, i.e. to close down non-EU Taxonomy compliant activities and increase the revenue from environmentally sustainable activities. These additional requirements were criticised by stakeholders who asked for improvements.

For companies operating in the energy sector, stakeholders welcomed the maximum threshold proposed in TR3 of 30% of revenue from the activities of supplying of solid, liquid and gaseous fossil fuel for fuel and electricity generation, which is also in line with other national labels (see Table 8 in TR3). However, this higher flexibility should be backed with stricter requirements on the past and future operations of the company. In particular, it was proposed to refer to zero CapEx investment in the expansion of fossil fuel activities. The TEG's recommendations also point out that to achieve a net zero economy, zero OpEx is required in maintenance costs that either increase the lifetime or the value of the assets. Moreover, it was proposed to set an additional requirement monitoring the annual reduction of the GHG emissions from the company. Such GHG emissions should decrease by 7% annually, in line with the Benchmark Regulation and the amendments to introduce the Paris Aligned and Climate Transition Benchmarks. Finally, the requirement of having set a strategic plan to close down the fossil fuel activities (detailed in C.2) by 2030 was accepted. This last requirement has the implicit

consequence that the flexibility allowed in an EU Ecolabel product to companies operating the activities in C.2 is temporary and will decrease as 2030 gets closer. Another condition asked from stakeholders was that the company should have set a plan to reduce their GHG emissions in alignment with a 1,5°C Paris Agreement scenario.

In order to align the ambition level of the EU Ecolabel with the Green Deal, the criterion in C.2 has been made stricter, in line with the suggestions received. Moreover, it has been specified that if the company has committed to fuel switching to biomass, the biomass activity is environmentally sustainable under the EU Taxonomy (i.e. complies with the technical screening criteria and the DNSH criteria).

For companies operating in the waste management sector, the maximum threshold proposed in TR3 of 30% from the activities of waste management without any form of material segregation was also welcomed by stakeholders. However, it was requested that for companies to be allowed flexibility, it should be demonstrated that they are investing in technologies to recover materials from non-hazardous waste suitable for recycling.

In order to align with the level of ambition of the new Circular Economy Action Plan and to align the type of requirements with those requested for the activities in C.2 (i.e. past and future looking), the criterion in D.1 has been modified, in line with the suggestion received.

For companies operating in the transportation (car manufacturing) sector, the TR3 did not set any maximum revenue threshold for companies to be allowed flexibility, provided that they complied with the requirements for companies investing in transition or in green growth. However, this flexibility was criticised by stakeholders, who considered the requirement unambitious considering policy, legal and market developments. Indeed, to achieve climate neutrality, a 90% reduction in transport emissions is needed by 2050 (compared to 1990). Table 8 below summarises the GHG emissions reduction measures adopted by different governments, whereas Table 9 summarises the public commitments undertaken by the major car manufacture industries.

Table 8. Overview of electric vehicles target by country. NEV: new electric vehicles

Country	Target
European Union	30 million zero-emission vehicles by 2030 ⁶⁵ EU fleet-wide average emission target for new cars in place for 2021: 95 g CO ₂ /km ⁶⁶ Carbon neutrality to be achieved by 2050
France	Planned ban of fossil fuel powered car by 2040 ⁶⁷
Germany	10 million electric vehicles by 2030 ⁶⁸
UK	Ban of the sale of petrol and diesel cars by 2030 ⁶⁹
Norway	⁷⁰

⁶⁵ In 2019 there were 1.8 million electric and plug-in hybrid vehicles registered in Europe, according to the International Council on Clean Transportation. Hybrids are not zero-emission vehicles.

⁶⁶

https://ec.europa.eu/clima/policies/transport/vehicles/cars_en#:~:text=2020%2D21%20target,l%2F100%20km%20of%20diesel.

⁶⁷ <https://www.reuters.com/article/us-france-autos-idUSKCN1TC1CU>

⁶⁸ <https://www.cleanenergywire.org/news/germany-needs-10-million-e-cars-2030-climate-targets-transport-minister>

⁶⁹ <https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/uk-bans-petrol-diesel-car-sales-from-2030-germany-agrees-8364-5b-auto-industry-aid-61347098>

⁷⁰ Battery electric vehicles held a 54 % market share in 2020. <https://elbil.no/english/norwegian-ev-policy/#:~:text=The%20Norwegian%20Parliament%20has%20decided%20on%20a%20goal%20that%20all,tax%20system%2C%20not%20a%20ban.>

Table 9. Overview of commitments by car manufacturing firm ⁷¹

Car firm	Target
Volvo	Purely electric car to represent 50% of sales by 2025
Renault	Purely electric car to represent 30% of sales by 2025
BMW	Battery cars and plug-ins to represent 50% of sales by 2030
Volkswagen	Electric vehicles to account for more than 30% of total sales by 2030
Toyota	More than 5.5 million electric vehicles by 2030
General Motors	30 purely electric models globally by 2025. No commitments in terms of sales

In order to align with the level of ambition of the commitment of several countries and car manufacturing firms, the requirement has been made more stringent, excluding companies with more than 50% of revenue from vehicles with an engine based on combustion of fossil fuels that have not published a strategic plan which details the path to achieve a commitment of full electrification of vehicles by 2030.

Finally, it is important to highlight that the flexibility granted in requirements C.2, D.1 and F.1 is meant to be temporary and is expected to be reviewed in the next revision of the criteria, as the objectives of the Green Deal and the Circular Economy Action Plan approaches.

Nuclear power generation

As mentioned in the TR3, the EU Taxonomy was ‘inconclusive’ with respect to the overall evaluation (significant contribution to climate change mitigation and adaptation and DNSH to any of the other environmental objectives) of nuclear power generation. In order to analyse the DNSH aspects of nuclear energy, the JRC has been tasked with conducting a review to assess nuclear energy generation under the DNSH criterion of the EU Taxonomy, including a specific assessment on the current status and perspectives of long-term management and disposal of nuclear waste. Such a review has not been concluded yet. Therefore, at the moment there is no technical basis for including or excluding nuclear energy generation in the EU Ecolabel. The current exclusion of nuclear is proposed on the basis of the comments received during the EUEB meeting and the stakeholders consultation and in order to harmonise with the approach of the ecolabels for financial products already existing on the market.

Additional economic activities

The JRC reviewed the activities suggested by stakeholders as additional exclusions.

Livestock farming

In the March 2020 report, the TEG recommendations highlight that it is still an open question if net-zero carbon emissions could be met solely in agriculture, as it may not be possible to reach

⁷¹ Adapted from <https://www.spiegel.de/auto/vw-bmw-mercedes-und-co-wie-sich-die-autohersteller-vom-verbrennungsmotor-verabschieden-a-5af42a43-26b3-418e-8d83-421f223dec50>

net-zero emissions on an individual farm holding. While acknowledging that livestock production is a significant source of emissions in the agriculture sector, the emissions reduction achieved through good practices on the farm should be coupled with changes in consumption patterns. Enteric fermentation contributes to 42.9% of GHG emissions in agriculture in the EU.

Some of the DNSH criteria of livestock activities refer to practices that are already mentioned in the EU Ecolabel list of excluded activities, e.g. the use of harmful pesticides, or the “conversion, fragmentation or unsustainable intensification of high-nature-value land, wetland, forests or other areas of high-biodiversity value”. Also, the suggestion of stakeholders to exclude livestock fed with soy products leading to deforestation is implicitly already covered in the list of exclusion (point A.2 refers also to the use of agricultural products, including for feed purposes; this can be made clearer in the user manual). Some other DNSH criteria are quite general and refer to case-specific conditions, which cannot be directly used in the EU Ecolabel, e.g. “identify and manage risks related to water quality and/or water consumption at the appropriate level”. The suggestion of stakeholders to refer to livestock production which is not organic nor extensive is not aligned with the EU Taxonomy. However, the EU Taxonomy makes reference to the UNECE Framework Code for Good Agricultural Practice for Reducing Ammonia, which could be used for the EU Ecolabel.

A new requirement A.4 has been added excluding the “livestock production that does not apply emission mitigation or reduction techniques for feeding and housing of livestock and for manure storage and processing, according to the UNECE Framework Code for Good Agricultural Practice for Reducing Ammonia”.

Mineral fertilizers

Both mineral and organic fertilisers have an important role to play in EU agriculture. Indeed, mineral fertilisers are also needed to feed close to 8 billion people worldwide, especially with the current dietary standards.

The relationship between agricultural yield and fertiliser application rates is mostly logarithmic; an initial steep increase in yields in response to low fertiliser doses after which the curve flattens towards a maximum at higher fertiliser application rates. Hence, without fertilisers we would produce much less food/feed on the same area of land, potentially causing lack of food, or deforestation elsewhere. At the other end of the spectrum, excessive fertiliser application rates result in nutrient losses and environmental harm, for both organic and inorganic fertilisers: this is where the 20% reduction in fertiliser use mentioned in the Farm-to-Fork Strategy has its origin. Key is to use mineral fertilisers according to sound management practices, and to increase efficiency/yield per unit of fertiliser applied. Moreover, no bans of mineral fertilisers could be found in the TEG recommendations nor in other regulatory instruments, apart from the regulatory limits for manure (organic fertilisers) laid down within the Nitrates Directive.

The new requirement A.4 addresses also manure storage and processes, implicitly addressing fertilisers. Moreover, the requirement A.3 was complemented by including the good practice in the use of fertilisers according to Directive 91/676/EEC⁽⁷²⁾. While it is true that this type of data are currently not available among those provided by data providers, it is mentioned in the DNSH criteria as proposed in the draft Delegated Act⁷³ published in November for stakeholder consultation. Once the Delegated Act will be adopted, the wording of the EU Ecolabel requirements will be aligned to the exact wording in the DNSH criteria.

Heating and cooling using fossil fuels

72 Council Directive 91/676/EEC of 12 December 1991 concerning the protection of waters against pollution caused by nitrates from agricultural sources

73 https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12302-Climate-change-mitigation-and-adaptation-taxonomy#ISC_WORKFLOW

The exclusion of heating and cooling was requested by a large number of stakeholders. Indeed, these activities play a crucial role in the EU's ambition to transition into a clean and carbon-neutral economy by 2050. Heating and cooling in buildings and industry accounts for around half of the EU's energy consumption (the biggest energy end-use sector ahead of both transport and electricity, with the 66% of final energy for heating and cooling supplied by fossil fuels⁷⁴).

Therefore, the exclusion of heating and cooling was added to the point C.2.

New hydropower infrastructure

The TEG recommendations (in the final report of March 2020) set out, in the DNSH of the activity "production of electricity from hydropower" to the Water environmental objective that for new projects "construction of small hydropower (<10 MW) should be avoided". For new larger installations, a River Basin Management Plan (as outlined in the EU Water Framework Directive) must have been implemented. Moreover, the environmental impacts stemming from the project have been identified and mitigated.

However, this criterion was deleted in the draft Delegated Act published in November for stakeholder consultation, showing that the discussions evolved in a different direction, and more complex DNSH criteria were proposed. Therefore, the exclusion of energy supply from new small (<10 MW) hydropower cannot be justified in the EU Ecolabel.

Banks that finance fossil energy activities

Some stakeholders proposed to set an exclusion on financial institutions focusing on their policies or forward-looking commitment to stop financing fossil fuels-related activities. Another proposal was to focus on banks that finance fossil energy activity expansion with more than EUR 1 billion annually.

Financial institutions are an important fund provider, and their contribution to financing a low carbon economy is crucial to achieve the objectives of the EU Green Deal. It is true that while setting exclusionary criteria on companies carrying out fossil fuels activities, the retail investor may still be indirectly exposed to these activities through to the link with financial institutions.

Some banks have already committed to the support the transition towards a low carbon economy. For example, Nordea⁷⁵ launched a new net-zero commitment by 2050 with an interim target of reducing the financed emissions by 40-50% by 2030 (considering 2019 as a baseline year). Barclays⁷⁶ committed to net zero emissions by 2050 not only from the its core operations, but also by reducing the client emissions that it finances. Moreover, the Collective Commitment to Climate Action (CCCA) brings together a leadership group of 38 banks from across all six continents who have committed to align their loan portfolios (i.e., finance businesses committed to the environment) with the global climate goal to limit warming to well-below two degrees, striving for 1.5 degrees Celsius⁷⁷.

Therefore, it is proposed to exclude in an EU Ecolabel bonds and loans issued by financial institutions that (1) finance the expansion of coal activities and (2) have not publicly committed to stop financing coal energy activities and the expansion of oil and gas activities by 2025.

⁷⁴ Mapping and analyses of the current and future (2020 - 2030) heating/cooling fuel deployment (fossil/renewables). March 2016. Available at: <https://ec.europa.eu/energy/sites/default/files/documents/Summary%20WP1%20and%20WP2.pdf>

⁷⁵ <https://www.nordea.com/en/sustainability/sustainability-in-nordea/ambitions-and-objectives/> Accessed: 05.03.2021

⁷⁶ <https://home.barclays/society/our-position-on-climate-change/> Accessed: 05.03.2021

⁷⁷ https://www.unepfi.org/wordpress/wp-content/uploads/2020/12/CCCA_Year-One-in-Review_December-2020.pdf

The aviation sector

Aviation or airport expansion activities have not been assessed by the TEG for inclusion in the Taxonomy. At the moment, there is no reference point in the EU Taxonomy nor its DNSH criteria which can form the basis for establishing an exclusionary approach in the EU Ecolabel. Therefore it is proposed that these activities are considered in the first revision of the EU Ecolabel criteria, as by then there may be a clearer outlook on what basis form the exclusion.

Biofuels and natural gas used in transport

The TEG recommendations consider biofuels and renewable synthetic fuels as a relevant mitigation option for the transport sector in the medium term. While no DNSH has been set on biofuels to be used on transport, biofuels are considered as making a significant contribution to climate change mitigation. It is moreover to stress that the environmental impacts of the use of land for the cultivation of crops and induced deforestation are avoided in the EU Ecolabel through criterion A.2, which refers to cultivation and use of agricultural products not only for food, but for any use (including, therefore, for transport; this will be made clearer in the User Manual).

Similarly, for natural gas to be used in transport no recommendations were made by the TEG as for the DNSH caused by such activity.

Assessment and verification method

The assessment and verification paragraph was revised with the aim of improving the structure and the clarity of the requirements. Moreover, some of the wording has been changed to take into account that it is the service which is awarded the EU Ecolabel, and therefore the focus should be on the system that should be set in place by the fund manager to monitor compliance with the exclusions and act in case of allegations.

Sovereign and sub-sovereign bonds

In the criterion 2.2.1 on sovereign and sub-sovereign ratifying the Paris Agreement, reference has been made to the publication of CO₂ reduction trajectory to reach the objective of the 1,5⁰ degrees scenario of the Paris Agreement, aligning to the highest level of ambition.

Moreover, the word ‘credible’ has been removed from the criterion in order to limit the room for interpretation of the criterion.

5.4 CRITERION 3: Social and governance aspects

Previous (third) proposal for criterion 3: exclusions based on social and governance aspects

4.1 Exclusions applying to companies

The investment portfolio shall not contain equities, corporate bonds or use-of-proceeds bonds issued by companies excluded on the basis of social or corporate governance aspects as defined below. For fixed-term and savings deposit accounts, loans shall not be made to these companies.

A company is excluded on the basis of **social aspects** if, throughout its business activities, it does not comply with the following conditions:

- Respect⁷⁸ the protection of internationally proclaimed human rights and relevant domestic laws and regulations of the country in which it operates and from which it sources raw materials. [UN Global Compact, OECD Guidelines for Multinational Enterprises, UN Guiding Principles on Business and Human Rights, International Humanitarian Law]
- Ensures it is not complicit in human rights abuses. [UN Global Compact]
- Upholds the freedom of association and the effective recognition of the right to collective bargaining. [ILO Convention, UN Global Compact]. Only in reference to that point, if the excluded company is part of a holding that operates elsewhere, the other activities of the holding are not excluded subject of their compliance.
- Ensures the elimination of all forms of forced and compulsory labour. [ILO Convention, UN Global Compact]
- Upholds the effective abolition of child labour. [ILO Convention, UN Global Compact]
- Ensures the elimination of discrimination in respect of employment and occupation. [ILO Convention, UN Global Compact]
- Abides by local legislation that addresses corruption, bribery and extortion, and works against corruption in all its forms, including extortion and bribery by formulating and operationalising adequate business policies. [UN Global Compact, UN Convention against Corruption]

A company is also excluded on the basis of **social aspects** if it derives revenues from following activities:

- Tobacco production or any tobacco-related activities at any stage from raw material to sale of the final products to consumers.
- The production or trade of controversial weapons that are covered by the following international treaties:
 - o Chemical Weapons Convention,
 - o Biological Weapons Convention,
 - o Ottawa Convention (Ban on Anti-Personnel Mines),
 - o Oslo Convention (Ban on Cluster Munition)
 - o and the Treaty on the Non-Proliferation of Nuclear Weapons.
- The production or trade of conventional weapons and/or military products used for combat if

⁷⁸ Respect in this context means: Companies should avoid causing or contributing to adverse human rights impacts through their own activities, and address such impacts when they occur. It also means that companies should seek to prevent or mitigate adverse human rights impacts directly linked to their operations, products or services by their business relations, even if they have not contributed to those impacts.

there is evidence of sales in countries under EU restrictive measures

- Corporate activities which violate minorities' and indigenous communities' rights with reference to the World Bank's Social Safeguard Policies.

A company is excluded on the basis of **governance aspects** if, throughout its business activities, it does not have in place:

- corporate policies on social aspects and operational procedures necessary to embed them throughout the business activities;
- an up-to-date management system covering all business activities with the capability to identify, evaluate, prevent, mitigate and remediate adverse social impacts.

At a company level, exclusions apply to both transnational and other business enterprises, regardless of their size, sector, location, ownership and structure.

4.2 Exclusions applied to sovereign bonds

The investment portfolio shall not contain sovereign bonds issued by countries that:

- have not ratified the following international conventions on labour rights and corruption:
 - the eight fundamental conventions identified in the International Labour Organisation's declaration on Fundamental Rights and Principles at Work;
 - ILO Declaration on Social Justice for a Fair Globalization;
- have ratified less than half of the 18 Core International Human Rights Treaties⁷⁹;
- are subject to EU or UN restricted measures (including sanctions);
- achieve a score worse than 40, when evaluated according to the Corruption Perception Index;
- produce, trade or possess controversial weapons that are subject to EU or international restrictions, including non-ratification of:
 - Chemical Weapons Convention,
 - Biological Weapons Convention,
 - Ottawa Convention (Ban on Anti-Personnel Mines),
 - Oslo Convention (ban of cluster munition) and
 - Treaty on the Non-Proliferation of Nuclear Weapons.

Assessment and verification

The fund manager shall demonstrate to the Competent Body that followings have been assessed, with respect to companies in which investments are held and/or the issuers of sovereign debt that is held:

- Excluded activities: The status of each country and company shall be checked against the exclusions list.
- Compliance of corporate policies on social matters with social exclusions.
- Compliance of risk identification, evaluation, prevention, mitigation and remediation targets, as included in the management system, with corporate policies on social matters.

For use-of-proceeds bonds, the EU GBS may be used as proof of compliance.

⁷⁹ United Nations. *The Core International Human Rights Treaties and their monitoring bodies*. Oct 2019, <https://www.ohchr.org/EN/ProfessionalInterest/Pages/CoreInstruments.aspx>. Compliance can be checked using the United Nations Human Rights interactive dashboard, available at: <https://indicators.ohchr.org/>

All companies shall disclose information about their social responsibility, human and labour rights and their anti-corruption policies, approved at the most senior management level. If data are provided by third party data providers, the methodology for obtaining these data and the used proxies, if any, shall be documented.

For large companies, reporting under the Non-financial Reporting Directive (2014/95/EU⁸⁰) shall be accepted as basis for verification if it is sufficient to prove compliance with the social exclusions criterion.

Further to the initial verification by the Competent Body, the fund manager shall carry out assessment on compliance with social exclusions at least once per year and communicate any inconsistencies to the Competent Body.

If the fund manager receives information or identifies the existence of severe and/or systematic allegations in terms of conformity with social exclusions, then as a response the company shall be requested to develop within three months a plan and list of actions to resolve the issue. If the issue remains unresolved after 1 year, the respective assets shall be sold.

The Competent Body retains the right to perform random checks on compliance.

Fourth proposal for criterion 3: exclusions based on social and governance aspects

3.1 Exclusions applying to companies

Financial products shall not contain equities or bonds issued by

- companies that do not comply with the conditions listed below on social aspects
- companies that derive their revenue from the listed activities as described below; nor
- companies that do not comply with the requirements on governance aspects described below.

At a company level, social exclusions apply to all enterprises, regardless of their size, sector, location, ownership and structure.

A company is excluded on the basis of **social aspects** if, throughout its business activities, it does not comply with the following conditions:

- Respect⁸¹ the protection of internationally proclaimed human rights and relevant domestic laws and regulations of the country in which it operates **any activity of its supply chain, including the sourcing of raw materials**. [UN Global Compact, OECD Guidelines for Multinational Enterprises, UN Guiding Principles on Business and Human Rights, International Humanitarian Law]
- Ensures it is not complicit in human rights abuses. [UN Global Compact]
- Upholds the freedom of association and the effective recognition of the right to collective bargaining. [ILO Convention, UN Global Compact]. Only in reference to that **this requirement**, if the excluded company is part of a holding that **also** operates

⁸⁰ Directive 2014/95/EU of the European Parliament and of the Council. Available at <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0095&from=EN>

⁸¹ Respect in this context means: Companies should avoid causing or contributing to adverse human rights impacts through their own activities, and address such impacts when they occur. It also means that companies should seek to prevent or mitigate adverse human rights impacts directly linked to their operations, products or services by their business relations, even if they have not contributed to those impacts.

elsewhere, the other activities of the holding are not excluded subject of their compliance.

- Ensures the elimination of all forms of forced and compulsory labour. [ILO Convention, UN Global Compact]
- Upholds the effective abolition of child labour. [ILO Convention, UN Global Compact]
- Ensures the elimination of discrimination in respect of employment and occupation. [ILO Convention, UN Global Compact]
- Abides by local legislation that addresses corruption, bribery and extortion, and works against corruption in all its forms, including extortion and bribery by formulating and operationalising adequate business policies. [UN Global Compact, UN Convention against Corruption]

A company is also excluded if it derives:

- **Turnover from** tobacco production or any tobacco-related activity from raw materials to production
- **Turnover from** the production or trade of controversial weapons that are covered by the following international treaties:
 - o Chemical Weapons Convention,
 - o Biological Weapons Convention,
 - o Ottawa Convention (Ban on Anti-Personnel Mines),
 - o Oslo Convention (Ban on Cluster Munition)
 - o and the Treaty on the Non-Proliferation of Nuclear Weapons.
- **Turnover from** activities which violate minorities' and indigenous communities' rights with reference to the World Bank's Social Safeguard Policies.
- **More than 5% turnover from retail trade of tobacco products, provided it is not a holding company**
- **More than 5% turnover from the production or trade of conventional weapons and/or military products used for combat.**

A company is excluded on the basis of **governance aspects** if, throughout its business activities, it does not have in place:

- corporate policies on social aspects and operational procedures necessary to embed them throughout the business activities;
- an up-to-date management system covering all business activities with the capability to identify, evaluate, prevent, mitigate and remediate adverse social impacts.

3.2 Exclusions relating to sovereign and sub-sovereign bonds

Sovereign and sub-sovereign bonds are excluded if their issuers:

- Have not ratified the following international conventions on labour rights and corruption:
 - o the eight fundamental conventions identified in the International Labour Organisation's declaration on Fundamental Rights and Principles at Work;
 - o ILO Declaration on Social Justice for a Fair Globalization;
- Have ratified less than 12 Core International Human Rights Treaties⁸².
- Are subject to EU or UN restricted measures (including sanctions);
- Achieve a score worse than 40, when evaluated according to the Corruption Perception Index;
- **Apply the death penalty. An exemption shall be made for sub-sovereigns that do not apply the death penalty following the local regulations which in this case prevail the national law.**
- Produce, trade or possess controversial weapons that are subject to EU or international restrictions, including non-ratification of:
 - o Chemical Weapons Convention,
 - o Biological Weapons Convention,
 - o Ottawa Convention (Ban on Anti-Personnel Mines),
 - o Oslo Convention (ban of cluster munition) and
 - o Treaty on the Non-Proliferation of Nuclear Weapons.

Assessment and verification

The applicant shall demonstrate to the Competent Body that followings have been assessed, with respect to companies in which investments are held and/or the issuers of sovereign debt that is held:

- *Excluded activities: The status of each company shall be checked against the exclusions list.*
- *Compliance of corporate policies on social matters with social exclusions.*
- *Compliance of risk identification, evaluation, prevention, mitigation and remediation targets, as included in the management system, with corporate policies on social matters.*
- *For sovereign, compliance of each country shall be checked against the exclusions*

⁸² United Nations. *The Core International Human Rights Treaties and their monitoring bodies*. Oct 2019, <https://www.ohchr.org/EN/ProfessionalInterest/Pages/CoreInstruments.aspx>. Compliance can be checked using the United Nations Human Rights interactive dashboard, available at: <https://indicators.ohchr.org/>

list.

All companies shall disclose information about their social responsibility, human and labour rights and their anti-corruption policies, approved at the most senior management level. If data are provided by third party data providers, the methodology for obtaining these data and the used proxies, if any, shall be documented.

For companies, reporting under the Non-financial Reporting Directive (2014/95/EU⁸³) shall be accepted as basis for verification if it is sufficient to prove compliance with the social exclusions criterion.

Further to the initial verification by the applicant and the Competent Body, the applicant shall monitor or assess the compliance with social exclusions for its existing investments or new investments.

The fund or deposit manager shall provide evidence on the methodology to identify and evaluate allegations in terms of conformity with social exclusions and take appropriate actions including communication with the company to develop within three months a plan to resolve the issue and, if relevant, to divest. In addition, the fund or deposit manager should inform the Competent Body

5.4.1 Rationale of the proposed criterion text

The need for a social exclusions criterion was imposed by the requirements laid down in Regulation (EC) 66/2010 of the European Parliament and of the Council on the EU Ecolabel. Article 6(1) of this Regulation specifies that EU Ecolabel criteria shall be based on the environmental performance of products, taking into account the latest strategic objectives of the Community in the field of the environment, yet it also requires – in Article 6(3e) – that in determining EU Ecolabel criteria, where appropriate, social aspects are also be considered.

Apart from the EU Ecolabel Regulation, the Taxonomy Regulation was also consulted to articulate the social exclusions criterion. Article 13 of the Taxonomy Regulation requires ‘environmentally sustainable economic activities’ to comply with minimum social safeguards. The review clause in Article 17 also refers to a potential extension to activities contributing to social objectives.

The first proposal for a social exclusions criterion was formulated to address societal concerns associated with sustainable investments considering the EU Ecolabel Regulation and stakeholders’ opinions. Consequently, it was drafted accordingly and expressed in the First Technical Report. Further on, the criterion is updated reflecting the outcomes of the 1st and the 2nd AHWG meeting and the consultation processes which had followed. In that frame, relevant stakeholders’ suggestions have been considered, additional research carried out to tackle any remaining issues, and social exclusions were revised at a company and country level. At the national level, the social exclusions refer to sovereign bonds while at the company level the investment portfolio may contain diverse assets as defined in the scope of this study.

⁸³ Directive 2014/95/EU of the European Parliament and of the Council. Available at <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0095&from=EN>

5.4.2 Outcomes of the previous consultations and main changes

Detailed feedback received on TR1 & TR2 and further research conducted by JRC can be found in the previous version of the report (TR2 & TR3).

In the frame of the consultation process, there were comments referring to specific features of the social exclusion criterion which are focusing on

- The term '**Ethical**' is not considered as a social exclusion requirement due to the subjectivity of the term and the difficulty to reach consensus on its definition.
- In terms of controversial **weapons**, TR3.0 excludes their production, trade and possession and provides a list of treaties that are associated with them.
- Exclusions requirements on **corruption and bribery** at corporate level. Stakeholders stated that this is subject of further review and that the corruption perception index at sovereign level needed further research. JRC reviewed this section. Hence, the corruption perception index is updated while a compliance score of 38 was suggested. Moreover, corporate policies against corruption and a respective management system to address any corruption attempts are required in the TR3.0, which shall be approved by the highest management level of the company. At corporate level, anti-bribery requirements are set similar to those of corruption. Nevertheless, at sovereign level, JRC could not identify a bribery metric that is officially approved and implemented by the EC.
- The TR3.0 excludes investments in **tobacco-related activities** due to the respective EU policies against smoking and its adverse health effects.
- The stakeholder review revealed that the requirement on **human and labour rights** need to consider international treaties and local regulations and that existing SRI labels could serve as a source of inspiration. On this topic JRC has updated the requirements so they refer, in the TR3.0 to all business operations undertaken by the company and not only to revenues from specific activities. Moreover, corporate operations should respect minorities and indigenous communities' rights.
- After the 3rd stakeholder consultation, there still were contradictory opinions as to whether the social exclusions shall be aligned with the **requirements set in the EU Taxonomy** or shall go beyond this stringency level, and if local regulations shall also be considered. This version of the technical report in line with the previous, suggests social exclusions beyond those of the EU Taxonomy as these are referring to minimum social safeguards only. Yet, the EU Ecolabel suggests setting social exclusions that extend beyond minimum safeguards. In doing so, the EU Ecolabel acts as a label of excellence and provides protection from socially negative impacts and adverse effects.
- Many of the stakeholders asked if possible, the exclusion requirements to not refer to **governance issues** such as poor corporate management and/or poor human capital development as these issues are not uniformly defined across board and potential reference to these matters could raise controversies. Additionally, verification can be extremely challenging. On the opposite, there were stakeholder supporting the idea of setting requirements for governance matters as that could increase transparency on business policies and improve decision-making whereas any potential mismanagement and reputation risks could be avoided. JRC suggested to include a requirement on good governance to prevent/address broader social issues that could emerge in practice, although not to develop a separate criterion on governance. That is in alignment with the Regulation (EC) 66/2010 of the European Parliament and of the Council on the EU Ecolabel does not explicitly refer to governance criteria.

The main changes applied to the TR4.0 are as follows:

- The TR4.0 suggests excluding tobacco-related investments, yet it sets a partial 5% turnover threshold for retail trade of tobacco products, provided it is not a holding company;

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- A partial exclusion threshold of 5% turnover applies for the production or trade of conventional weapons and/or military products used for combat;
 - The T4.0 suggest excluding sovereigns that apply the death penalty. However, where sub-sovereigns do not adopt this, they are eligible for inclusion;
 - In the TR4.0, the JRC has also reviewed human rights exclusions at sovereign level by suggesting a higher number of relevant treaties ratifications;
 - Finally, the corruption perception index threshold is amended.

5.4.3 Outcomes of the 3rd stakeholder consultation

This part of the report describes the stakeholders' comments which were received during the 3rd stakeholder consultation with reference to social exclusions. In total, the JRC received 54 comments from 21 stakeholders. The comments were clustered into specific categories and are described below. Based on this, the JRC has identified needs for amendments.

Stringency level of social exclusions

Also, during this consultation round stakeholders kept on, commenting that the proposed social exclusions are very detailed and restrictive and believe that only very few funds in the market will be eligible for the EU Ecolabel. Therefore, it is suggested once more to adapt the ambition level and to consider the necessity to encourage the transition towards a climate neutral EU Economy by 2050. Following that, the proposal to align requirements on social aspects with the minimum social safeguards as described in the EU Taxonomy remained in place. The rationale of this argument was supported by referring to the main characteristics of the EU Ecolabel, which is in a first place a label awarded to environmental excellence.

Stakeholders have also argued that strict social exclusions would better fit in a label that mainly focuses on social aspects and that social exclusions should be supported by a respective EU Taxonomy on social matters. Other stakeholders suggested the asset managers to manage controversies and not to set strict social exclusions. .

Exclusionary requirements on weapons

In terms of conventional weapons, comments were focusing on the need to either totally exclude them or set a partial exclusion threshold. This is suggested since conventional weapons are deemed essential for materialising sovereign defence policies. Social exclusions shall also affect other conventional military products, which can be used for conventional combat.

Issues relating to tobacco

Tobacco production or any tobacco-related activities at any stage from raw material to sale of the final products with a zero tolerance is considered unintentionally too strict by many stakeholders. Therefore, it is advocated exclusions on tobacco shall be focusing on tobacco production only. The respective requirements as they stand in the TR3.0 would in fact exclude all retailer's/supermarkets, airlines, gas stations etc. that sell tobacco products. Therefore, a partial exclusion on trade of tobacco products is recommended.

Corruption & bribery

A stakeholder mentioned that the CPI index is based on a weighting of different underlying indicators, which means that countries with the same overall scores might have quite different levels of democratic administration and corruption. That could lead to a false decision for a country's performance.

Issues relating to corporate governance

Stakeholders commented that the existing requirements for corporate governance provide broad room for interpretation and they are not directly linked to main governance aspects, such as e.g., gender equality, equal remuneration, board independence etc. In line with this, it is proposed to list governance aspects and examine compliance instead of only applying a management system associated with social aspects.

Social exclusion on sovereigns

It is strongly recommended to exclude sovereign bonds of countries that apply the death penalty. However, it is also recommended sub-sovereigns to be derogated, if they do not apply the death penalty in their jurisdiction.

Assessment & verification issues.

It is highlighted the difficulty, given the ESG information currently disclosed, for applicants to gather data on social matters. Further on, the credibility of ESG information was questioned as well as the use of proxies by obtaining data on social aspects. Asset managers do not have often the means to assess whether disclosed or provided data on social issues are correct. It is also commented that the sample check process, carried out by the Competent Bodies, must be quite extensive, in order to create strong incentives for fund managers to address issues voluntarily. Moreover, they suggested that reporting should be carried out annually and reports shall be publicly available.

Stakeholders highlighted that extensive social exclusions may impose additional costs and therefore discourage an application for the EU Ecolabel. It is mentioned that data availability will be one of the main issues in the assessment and verification procedure.

Furthermore, it is suggested the fund manager reports on all allegations against companies in the fund that could indicate a violation of the normative criteria. This report shall state all possible actions, including an engagement to deal with these allegations. On the same topic, stakeholders mentioned that one year might not be sufficient for actions against allegations to materialise, and more time might be needed. Some stakeholders noted that the time to deal with allegations should be left to the fund manager.

It is also proposed the Competent Body to annually review 5% of the funds' holdings to check if the fund manager has reported severe or repeatedly occurring allegations. For this an ESG research provider can be used. If the Competent Body finds severe or repeatedly occurring allegations which have not been reported, the fund manager firstly receives a warning. If after the warning no action is undertaken in the next three months and the issue remains unresolved for more than 6 months the license can be withdrawn.

Other comments of relevance

There are also comments on specific social aspects that could not be allocated to the existing clusters, and therefore a new cluster is created. In the written consultation stakeholders suggested testing the impact of social and governance exclusions on the eligible universe of the assets under management.

Regarding norms-based screening or screens aiming at UN Global Compact compliance: it should be noted that ESG rating providers classify violations of international conventions with varying degrees of magnitude: from allegations to confirmed violations and severe confirmed violations. It should be made clear that at least only confirmed violations are in scope.

Stakeholders mentioned that the right for collective bargaining could exclude companies that show a high alignment of the activities with the EU Taxonomy, indicate a high greenness score, or are transitioning fast to be excluded. This exclusion is imposed due to local laws, which in this case prevail international treaties.

5.4.4 Further research and main changes in the fourth proposal

Stringency level of social exclusions

In the 3rd consultation, stakeholders have commented, the criteria to focus on the environmental dimension of the EU Ecolabel and to align social exclusions with the EU Taxonomy social safeguards.

The legal framework of the Taxonomy Regulation is different to the EU Ecolabel, and only deals with minimum social safeguards. However, ESG data providers can already release data that extend beyond those required in the EU Taxonomy. Hence, aligning social requirements with those in the EU taxonomy could cause harm to the EU Ecolabel reputation as it is a label of excellence.

Moreover, the EU Taxonomy is a tool for incentivising disclosures at the activity level, whereas the EU Ecolabel aims at best-in-class retail financial products. Taking into the account all the above, JRC keeps on suggesting that the updated criterion shall include more enhanced social exclusions than the EU Taxonomy's minimum social safeguards.

In the specific case which refers to the right for collective bargaining that could be prohibited due to local regulations, the TR4.0 suggest the following: although the company cannot be held responsible, the international treaties prevail local laws, and therefore this company is excluded. However, if the company is part of a holding, which operates elsewhere, the other entities of the holding are not affected, subject to their compliance with the social exclusion criterion.

Exclusionary requirements on weapons

Regarding conventional weapons, countries are not excluded, considering the necessity to have in place defence policies and support civil protection. However, companies that are involved in production and/or trade of conventional weapons and military products for combat will be excluded if they derive more than 5% of their revenues from these activities. The strictness of the partial threshold is defined in accordance with other national labels.

Issues relating to corporate governance requirement

The previous versions of the technical report consider corporate governance aspects, based on recommendations of some stakeholders, although the EU Ecolabel Regulations 66/2010 does not explicitly refer to these aspects. Additionally, in the written consultations, many stakeholders referred to the inherent subjectivity of governance aspects. They have pinpointed the potential divergences that might arise in defining good corporate practices at a national level, and the diverse interpretations of the term across different countries. Therefore, the TR4.0 sets requirements on governance aspects only if they are closely relating to social issues, maintaining alignment with the TR3.0. Considering the above, it is proposed that the possibility of criteria with a broader focus on good corporate governance are explored as part of the first revision of the EU Ecolabel criteria.

Assessment and verification issues

In terms of assessment and verification the quality of disclosed data and the relevant information, which is mainly received from ESG providers, are the main issues along with a method to address severe and repeatably occurring allegations on potential breaches of conformity. The JRC has further explored a way to consider allegations while taking into account how national labels address this topic and concluded in the updated form of this criterion. JRC has also investigated the existence of potential proxies that can be used to provide data, and acknowledges that third party data providers may use different methodologies and

proxies to assess social aspects and that the quality of disclosed data is difficult to be assessed. For the time being, it is the responsibility of companies to disclose info that accurately reflects the subject matter. Additionally, an EU Ecolabel fund needs to cite the ESG data provider.

Other comments of relevance

The JRC has carried out additional research to address specific comments not assigned to one of the existing clusters of social aspects as follows.

The corruption perception index is maintained although it is a weighted indicator. This metric is an indicator used by Eurostat to assess corruption.

The TR4.0 set a requirement to deal with allegations in the case they are severe or they occur repeatedly. Only this type of allegations is in the scope of the social exclusions.

The application of international standards and treaties prevails local laws as the former are the outcomes of a consensus at an international level on how issues on social matters can be addressed.

To the best of the authors' knowledge, currently, there is no published study on how social exclusions affect the eligible universe. That would be challenging to access due to the use of different methodologies and the application of various proxies for obtaining data on social aspects.

5.5 CRITERION 4: Engagement

Previous (third) proposal for criterion 5: Engagement

5.1 Engagement policy

This criterion applies to investment funds and life insurance products with a general fund.

The fund manager shall have a documented engagement policy describing at least:

-Objective: How the environmental objectives of the EU Taxonomy will be used as the basis on which to engage with companies including, as a minimum, contributions to one of the six objectives;

-Strategy: How they plan to target and engage with companies to grow their green revenue share and their market share for environmentally sustainable economic activities in order to contribute to the medium to long-term performance of their assets.

-Methods: How they seek to use their influence, including by exercising their voting rights, increasing their influence by working with other shareholders, using differing intensities and frequencies of dialogue with investee companies and using other means, such as campaigns, to achieve their objective(s).

-Monitoring: The means of regular monitoring and reporting on the outcomes of their engagement with companies.

5.2 Exercising voting rights

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.

They shall provide the following information to show how their rights have been used in relation to resolutions addressing these two areas:

- The numbers of resolutions raised, either singularly or in co-operation with other shareholders.
- How they have cast votes in the general meetings of companies in which they hold shares.
- Those cases where proposals were carried.

5.3 Dialogue with investee companies

5.3.1 Requirements for UCITS funds

The fund manager shall actively regularly engage at management level with at least one company or 10% of companies in the portfolio (whichever is greater) that are 'companies investing in transition' according to the requirements of criterion 2 or which have <20% green revenue and have responded positively to offers of management support to make a transition. These companies shall be selected from amongst those with the lowest % green revenue in the portfolio.

5.3.2 Requirements for retail AIF funds

The fund manager shall actively engage at management level with at least one company or 10% of companies (whichever is greater) that qualify as: 'companies investing in green growth' according to criterion 2. These companies shall be selected from amongst those:

- with the most significant prospects for % green revenue growth in the portfolio,
- or that are considered to not yet demonstrate their growth potential or are considered to require support to realise their potential

5.3.3 The engagement process used to achieve outcomes

Once engagement with a company has been initiated the process followed and the progress achieved shall be monitored and reported on. The following information shall be provided for each company:

- The specific topics raised via engagement with each company in planning strategic activities and investments within a specific period of time,
- The goals and targets discussed and raised with each company to achieve environmental objectives, which are as a minimum suggested to be measured based on:
 - Commitments made to green CapEx over a minimum 5 year period and associated plans to raise capital,
 - Targets set and measures taken to achieve projected increases in green revenue over a minimum 5 year period,
 - Targets set and measures taken to achieve growth their market share in key market segments relating to the economic activities that they carry out over a minimum 5 year period.
- The intermediate steps or milestones to achieving these goals and targets, including the development of plans and investment strategies,
- The frequency and means of ongoing communication and dialogue with the company, such as board meetings, analyst conferences, meetings with business field managers, or controlling tools,

In addition the measures that will be taken by the fund or asset manager shall be reported in the case that a company:

- deviates from or does not meet the proposed goals and targets.
- is considered to require a change in how the company is managed of in its investment strategy in order to meet proposed goals and targets.

Assessment and verification

The fund manager shall provide the verifier with the following information:

- 1.The fund or asset managers engagement policy structured to clearly address the points in section 5.1
- 2.Documentation of how their voting rights have been used, including the tracking of resolutions raised and proposals made by the fund manager or product provider, as well as their voting record on proposals and resolutions of relevance to the engagement policy.
- 3.Documentation of which companies have been engaged with, as well as the information as specified for each point in section 5.3.3,

Ongoing reporting of progress against the goals and targets established with each company engaged shall be provided on a 12 month basis to the Competent Body and also made available in the public domain. Any regulatory restrictions on engagement activities in specific EU or international jurisdictions will be taken into account in the assessment and verification.

Fourth proposal for criterion 4: Engagement

[This criterion applies to UCITS funds and retail AIFs.](#)

4.1 Engagement policy

The fund manager shall have a documented engagement policy describing at least:

- Objective: How the environmental objectives of [Regulation \(EU\) 2020/852](#) will be used as the basis on which to engage with companies including, as a minimum, contributions to one of the six [environmental](#) objectives of [Regulation \(EU\) 2020/852](#)
- Strategy: How they plan to target and engage with companies to grow their green [turnover](#), to [grow](#) their market share for environmentally sustainable economic activities in order to contribute to the medium to long-term performance of their assets, to [decrease the share of their activities that do not meet the Do Not Significant](#)

Harm criteria under the EU Taxonomy and, where relevant, to reduce/phase out the share of activities listed under criterion 2.1.C.2, 2.1.D.1 and 2.1.F.1.

- Methods: How they seek to use their influence, including by exercising their voting rights, increasing their influence by working with other shareholders, using differing intensities and frequencies of dialogue with investee companies and using other means, such as campaigns, to achieve their objective(s).
- Monitoring: The means of regular monitoring and reporting on the outcomes of their engagement with companies.

4.2 Exercising voting rights

The fund manager shall exercise their voting rights and other rights attached to shares in order to fulfil the objectives of their engagement policy. They shall use these rights in the first place to try to orientate those companies in the portfolio with green turnover < 10% and no green capex, and then of those companies with green turnover < 30% of turnover derived from activities with the NACE codes covered by the EU Taxonomy to:

- Achieve alignment of company strategies with the environmental objectives of Regulation (EU) 2020/852,
- Achieve alignment of investment strategies with the need to grow green turnover and market share for environmentally sustainable economic activities, and upgrading or phasing out activities not yet complying with the EU Taxonomy technical screening or Do No Significant Harm criteria,
- Reduce or close down activities described under criterion 2.1.C.2, D.1 and F.1.

They shall provide the following information to show how their rights have been used in relation to resolutions addressing these two areas:

- The numbers of resolutions raised, either singularly or in co-operation with other shareholders.
- How they have cast votes in the general meetings of companies in which they hold shares.
- Those cases where proposals were carried.

4.3 Dialogue with investee companies

4.3.1 Requirements for UCITS funds and retail AIFs

The fund manager shall actively regularly engage at management level with at least 10% of companies in the portfolio. The fund manager shall engage in the first place with companies specified under criterion 2.C.2, 2.D.1 or 2.F.1, or companies in the portfolio with green turnover < 10% and no green capex, and then with companies with green turnover < 30% of turnover derived from activities with the NACE codes covered by the EU Taxonomy.

4.3.2 The engagement process used to achieve outcomes

Once engagement with a company has been initiated the process followed and the progress achieved shall be monitored and reported on. The following information shall be provided to Competent Bodies for each company:

- The specific topics raised via engagement with each company in planning strategic activities and investments within a specific period of time,
- The goals and targets discussed and raised with each company to achieve environmental objectives, which **should** be based on:
 - upgrading their existing activities that are not EU Taxonomy-aligned (to bring them up to the Technical Screening Criteria under the EU Taxonomy or to meet the Do-No-Significant-Harm criteria under the EU Taxonomy that they are not yet meeting)
 - expanding their existing activities that are EU Taxonomy-aligned
 - starting new activities that are EU Taxonomy-aligned
 - closing existing activities that are not EU Taxonomy-aligned
- The intermediate steps or milestones to achieving these goals and targets, including the development of plans and investment strategies,
- The frequency and means of ongoing communication and dialogue with the company, such as board meetings, analyst conferences, meetings with business field managers, or controlling tools.

In addition, the measures that will be taken by the fund or asset manager shall be reported in the case that a company deviates from or does not meet the proposed goals and targets.

Assessment and verification

The fund manager shall provide the verifier with the following information:

- 1. The fund or asset managers engagement policy structured to clearly address the points in section 4.1*
- 2. Documentation of how their voting rights have been used, including the tracking of resolutions raised and proposals made by the fund manager or product provider, as well as their voting record on proposals and resolutions of relevance to the engagement policy.*
- 3. Documentation of which companies have been engaged with, as well as the information as specified for each point in section 4.3.2,*

Ongoing reporting of progress against the goals and targets established with each company engaged shall be provided on a 12 month basis to the Competent Body and also made available in the public domain. Any regulatory restrictions on engagement activities in

specific EU or international jurisdictions will be taken into account in the assessment and verification.

For new products, this requirement does not apply. The reporting as outlined above starts after the first year of existence of the product.

5.5.1 Rationale of the proposed criterion text

Engagement, as a strategy, represents a means that can be used to propose, request and even drive improvements in the environmental performance of a company, as suggested by some stakeholders. In addition, existing market practices support the inclusion of engagement requirements in the Ecolabelling criteria. For example, the criteria of the Nordic and the Austrian labels include engagement as a separate criterion. The most recent existing market studies (EUROSIF, 2018 SRI Study) indicate that the employment of sustainable investment strategies continues to grow in the market. Engagement, including the exercising of voting rights, has increased, showing that there is a greater commitment of investors to work with companies (more than a 14% increase). Moreover, literature provides evidence that shareholder engagement can be an effective mechanism through which investors can seek reforms that improve the quality of company activities and/or grow shareholder value.

5.5.2 Outcomes of previous consultations and main changes in the third proposal

Feedback received on TR1.0 and TR2.0 and further research conducted by JRC can be found in the previous versions of the report (TR2.0 and TR3.0).

The criterion on Engagement was added to the EU Ecolabel set of criteria in TR2.0. This originated from various comments received by stakeholders that engagement was an important strategy used by fund managers and asset managers to influence company's activities.

In TR3.0, the main changes with respect to TR2 are as follows:

- In-line with the approach taken in the Shareholder Rights Directive and by the engagement criteria in existing labels, the criterion has been restructured to focus in turn on 1) the overall engagement policy, 2) use of voting rights and 3) dialogue with companies in which shares are held.
- The requirement to provide a documented engagement policy has been restructured to make it more methodical, focussing in turn on the objective, strategy, methods and monitoring.
- The overall objectives of engagement have been aligned with the environmental objectives of the EU Taxonomy and the monitoring of outcomes, linked to the main metrics with which to monitor and track progress at company level have, been defined in accordance with the revised proposals for criteria 1 and 2 – namely % green revenue, % green CapEx and the % growth in green revenue.
- The companies in the portfolio that shall be the target for exercising voting rights shall be defined based on <20% green revenue, reflecting comments that those companies are likely to require more re-orientation.
- A distinction has been made in how companies shall be targeted for dialogue based on fund type. UCITS shall focus on companies investing in transition, given their likely use of this criterion 1 requirement, and retail AIFs are required to focus on companies

investing in green growth as they must meet in criterion 1 more ambitious threshold for portfolio green revenue.

- The number of companies in the portfolio that shall be targeted for dialogue has been set at conservative level (1 company or 10% of companies, whichever is greatest) reflecting other label criteria and feedback from stakeholders. This will reduce the number of companies to enter into dialogue with, reflecting the resource intensity of dialogue.
- A specific structure for the engagement process that must be followed and reported on, has been updated and restructured, now including the topics raised, how goals and targets will be measured, the intermediate steps or milestones to achieving these goals and targets, and the means of ongoing communication and dialogue with the company.

5.5.3 Outcomes of the third stakeholder consultation

This section summarises stakeholders' comments received after the 2nd AHWG meeting. The JRC received in total 39 comments on engagement from 25 stakeholders. In general, stakeholders were highly supportive of the improvements made to the engagement criterion in TR3.0 compared to TR2.0.

The most recurring comment has been to improve even more the link with companies in transition. Some stakeholders suggested that the asset manager should focus on at least 50% of companies in transition.

5.5.4 Further research and main changes in the fourth proposal

The link with companies that are transitioning to a green economy is very important for the EU Ecolabel as it gives retail investors the reassurance that those companies with lower green revenue are being engaged with to increase their exposure to EU Taxonomy aligned activities. Such a link is especially important in this fourth revision of the criteria, since the removal of the criterion on companies investing in transition and in green growth implies the need to find a new way to define and target companies that are transitioning.

A definition of transitioning based exclusively on the company's green turnover may not be comprehensive, considering that some of these companies may carry out neutral (i.e. non-taxonomy relevant) activities. For these companies it would be impossible to foster towards transition. Therefore it is proposed that the fund manager should focus on:

- Companies with less than 10% green turnover and no green capex;
- Companies that carry out activities expressed in criterion 2.1.C.2, 2.1.D.1. and 2.1.F.1 (where relevant), and;
- Companies whose green revenue < 30% of total revenue derived from activities with the NACE codes covered by the EU Taxonomy.

The inclusion of such companies in an EU Ecolabel portfolio must be subject to a requirement of engaging with such companies. Therefore, it is proposed that at least 10% of such companies shall be engaged with.

Moreover, to strengthen the link with the transition, the objectives required by an engagement strategy have been detailed further, mentioning the upgrading of companies' existing activities that are not EU Taxonomy-aligned (to bring them up to the Technical Screening Criteria under the EU Taxonomy or to meet the Do-No-Significant-Harm criteria under the EU Taxonomy that they are not yet meeting), the expansion of companies' existing activities that are EU

Taxonomy-aligned, the starting of new activities that are EU Taxonomy-aligned, and the closing of existing activities that are not EU Taxonomy-aligned.

These changes have been carried out in 4.1, 4.2 and 4.3.

Draft version

5.6 CRITERION 5: Measures taken to enhance investor impact

Previous (third) proposal for criterion 6: Measures taken to enhance investor impact

This criterion applies to UCITS and AIF investment funds, profit participation life insurance products with a general fund and to bonds held by deposit accounts.

Fund managers shall make available a report on the investor impact of the product. The report shall provide information on which of the measures described in table 1 have been taken to enhance the investor impact. Supporting information shall be provided to describe how each measure has been implemented. A summary of the report shall be provided as information to prospective retail investors.

Table 1. Measures that can be taken by portfolio managers to enhance the investor impact of the product

EU criterion	Ecolabel	Investor impact enhancement measures
1. Investment in environmentally sustainable economic activities	1.1 Capital allocation to equities	1.1.1 Investments are made in new start-ups and/or unlisted companies.
		1.1.2 Investments are made in new listings – Initial Public Offerings (IPOs).
		1.1.3 Activities or market segments in need of more capital are actively identified and invested in.
		1.1.4 Activities in mainstream market segments with the potential for green growth are actively identified and invested in.
	1.2 Capital allocation to bonds	1.2.1 Bonds are purchased that are asset backed securities and/or support the recycling of funds to make new loans.
		1.2.2 Use of Proceeds bonds are used to provide loan facilities for investment in environmentally sustainable activities and/or companies investing in transition or green growth.
		1.2.3 The allocation of funds to new projects is monitored and each project impact is quantified and reported on.
		1.2.4 Use of Proceeds bonds are used to provide new financing for projects and the funds are allocated to a Special Purpose Vehicle.
2. Investment in companies investing in transition and green growth	2.1 Identifying opportunities and monitoring change	2.1.1 Opportunities to invest in companies investing in transition are actively identified.
		2.1.2 Frequent reporting is provided on the green capex and the change in % green revenue of companies in which equities are held or which have issued the bonds held.
		2.1.3 Opportunities to invest in companies investing in green growth are actively identified.
		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.
	2.2 Taking a long-term outlook	2.2.3 The fund manager can provide evidence that a long position has been taken on the specific shareholdings of companies investing in transition and/or green growth (as per criterion 2).

3. Environmental exclusions	3.1 Committing to transition	3.1.1 The fund manager can provide evidence that they have required phase out strategies with milestones for specific harmful activities. 3.1.2 The fund manager can provide evidence that they have linked requirements for the phase out of excluded activities (as defined in criterion 3) to active engagement activities.
4. Engagement	4.1 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.
	4.2 Engaging to increase shareholder value from companies in transition	4.1.2 The fund manager can provide evidence of the bilateral or collective engagement of shareholders with the management of companies to shift their investment strategies, complemented by a threat of divestment, action at shareholder level or public campaigns.

Assessment and verification

The fund manager shall provide an impact report detailing the measures taken to enhance the investor impact of the product and its associated investment strategy. The report shall include material that is presented in an accessible form for retail investors. For each measure, the type and portfolio value of the holdings addressed shall be detailed and information on the specific economic activities related to the holdings shall be provided. This information can be provided within the impact report.

Fourth proposal for criterion 5: Measures taken to enhance investor impact

This criterion applies to UCITS funds, AIFs, and bonds held by the deposit accounts.

Fund or deposit managers shall make available a report on the investor impact of the product and take at least one of the measures described in Table 1 to enhance investor impact. The report shall provide information on the measures described in Table 1 that have been taken. Supporting information shall be provided to describe how each measure has been implemented and a rationale for those measures that was not possible to implement to enhance the investor impact. A summary of the report shall be provided as information to prospective retail investors.

Table 1. Measures that can be taken to enhance the investor impact of the product

EU Ecolabel criterion	Investor impact enhancement measures	
1. Investment in environmentally sustainable economic activities	1.1 Capital allocation to equities	1.1.1 Investments are made in new start-ups and/or unlisted companies.
		1.1.2 Investments are made in new listings – Initial Public Offerings (IPOs) that are undersubscribed.
		1.1.3 Activities or market segments in need of more capital are actively identified and invested in.
	1.2 Capital allocation to bonds	1.2.1 Activities or market segments in need of more capital are actively identified and invested in through the direct subscription

		of bonds
	1.3 Identifying opportunities and monitoring change	1.3.1 Opportunities are actively identified to invest in companies that seek to increase their green turnover. 1.3.2 Frequent reporting is provided on the green capex and the change in % green turnover of companies in which equities are held or which have issued the bonds held. 1.3.3 Opportunities are actively identified to purchase sustainability-linked bonds
	1.4 Taking a long-term outlook	1.4.1 Evidence can be provided that a long position has been taken on the specific shareholdings of companies with green turnover < 10% and no green capex, and then with companies with green turnover < 30% of turnover derived from activities with NACE codes covered by the EU Taxonomy.
2. Environmental exclusions	2.1 Committing to transition	2.1.1 Evidence can be provided that they have required phase out strategies with milestones for activities under 2.1.C.2, D.1, or F.1. 2.1.2 Evidence can be provided that they have linked requirements for the phase out of excluded activities (as defined under 2.1.C.2, D.1, or F.1) to active engagement activities.
3. Engagement	3.1 Engaging to increase shareholder value	3.1.1 Evidence can be provided in relation to the bilateral or collective engagement of shareholders with the management of companies to shift their investment strategies, complemented by a threat of divestment, action at shareholder level or public campaigns.
4. Measures taken to enhance investor impact	4.2 Tracking of enhancement measures	4.2.1 Investigation of impact through the adopted measures, for example by collaborating with researchers, or by surveying corporate managers.

Assessment and verification

The applicant shall provide at the time of application an impact report detailing the measures taken to enhance the investor impact of the product and its associated investment strategy. The report shall include material that is presented in an accessible form for retail investors. For each measure, the type and portfolio value of the holdings addressed shall be detailed and information on the specific economic activities related to the holdings shall be provided. This information can be provided within the impact report.

For new products, this requirement is not applicable. Impact reporting starts after the first year of existence of the products and needs to comply with the requirements outlined above.

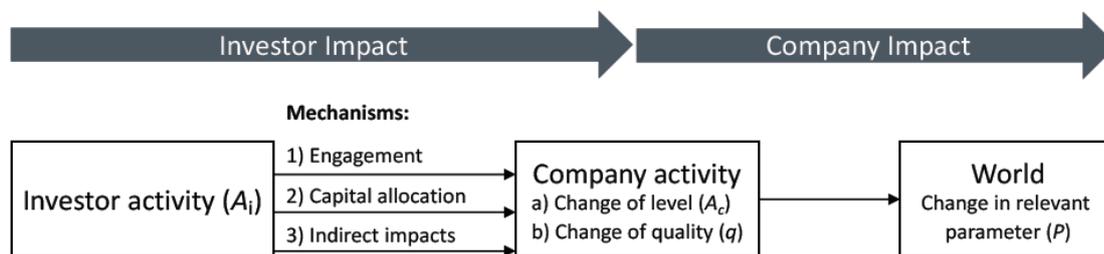
5.6.1 Rationale of the proposed criterion text

This criterion seeks to encourage fund and asset managers to identify and actively manage opportunities to enhance the investor impact of the service they provide to retail consumers. In this context, investor impact has been previously defined⁸⁴ as ‘the change that investor activities achieve in company impact’, which in turn is defined as ‘the change that company activities achieve in social and economic parameters’. Furthermore, investor impact has been identified as having three defining characteristics:

1. It is based on change as measured relative to a baseline;
2. It relates to a clearly defined parameter;
3. It has implied causality, sometimes also referred to as additionality.

At the same time, this criteria proposal acknowledges that the understanding of the causal relationship between investment decisions and the potential impact on company activities and on the environment is still relatively limited (see *Figure 1*). However, literature⁸⁵⁸⁶ shows indications of a positive correlation between sustainability activities, the impact and the financial performance of companies. Moreover, practices identified as having the strongest evidence of investor impact may only be applicable in specific contexts. For example, the monitoring of the impact of specific projects may be feasible for an AIF fund holding illiquid but not readily substitutable assets but is less feasible for a UCITS fund holding the more readily substitutable shares of large capitalisation companies.

Figure 1 - Mechanisms for achieving investor impact and company impact on parameters related to environmental performance and impact



Source: Koelbel et al (2019)⁸⁷

The proposed approach for the EU Ecolabel is based on the state of the art in investor impact management, as developed by the Impact Management Project in collaboration with industry⁸⁸. The approach would require fund managers to report on which signals and mechanisms for enhancing investor impact they have addressed and which can be evidence by their investment strategies and decisions, as well as identification of which of the measures they are taking to actively manage and enhance their investor impact. In this way fund managers would be

⁸⁴ Kölbel, JF., Heeb, F., Paetzold, F., Busch, T. (2020). Can Sustainable Investing Save the World? Reviewing the Impact of Investors on Companies. Available at SSRN: <https://journals.sagepub.com/doi/full/10.1177/1086026620919202>

⁸⁵ Weber, O., Koellner, T. (2008). The relation between GRI indicators and the financial performance of firms. *Progress in Industrial Ecology*, Vol 5. No 3.

⁸⁶ De Angelis, Tiziano and Tankov, Peter and Zerbib, Olivier David, *Environmental Impact Investing* (July 14, 2020). Available at SSRN: <https://ssrn.com/abstract=3562534> or <http://dx.doi.org/10.2139/ssrn.3562534>

⁸⁷ JF Kölbel, F Heeb, F Paetzold, T Busch. Can Sustainable Investing Save the World? Reviewing the Impact of Investors on Companies. Available at SSRN: <https://journals.sagepub.com/doi/full/10.1177/1086026620919202>

⁸⁸ The Impact Management Project, <https://impactmanagementproject.com/>

introduced to the concept of investor impact whilst retail investors can also be provided with information about which measures they can expect from a product.

The mechanisms for achieving investor impact have been identified from the findings of literature and from expert input from stakeholders. In the criterion proposal they have then been mapped onto the other proposed criteria 1 to 4, which themselves now include specific requirements that address some of these investor impact mechanisms. For example, the requirements to identify and opportunities and monitor change include a requirement to seek companies, which actively try to increase their green revenue. On the other hand, for some sub-criteria, such as the green revenue thresholds for UCITS under criterion 1, it is not considered possible yet to include investor impact measures because of identified difficulties in applying the measures recommended in literature to this type of product.

5.6.2 Outcomes of the previous consultations and main changes in TR3

This section summarises stakeholders' comments received after the 2nd AHWG meeting. Although the topic was only commented on by a small number of stakeholders, and in discussion with some stakeholders it was not attributed as much importance, the issue of causality in relation to the environmental improvement potential of the EU Ecolabel criteria set is considered of sufficient importance to warrant further detailed investigation.

Interpreting and applying the findings of academic research

Following on from comments that there had been a misinterpretation of the findings of the review paper on investor impact authored by researchers from MIT, the University of Zurich and the University of Hamburg, a further review was made of their findings and related research in this field. The aim was to ensure a clear understanding of the opportunities and limitations associated with the principle mechanisms that can be mapped onto the proposed EU Ecolabel criteria – namely:

- Criterion 1 - Capital allocation
- Criterion 2/3 – Incentivising improvements and affecting growth
- Criterion 4 – Shareholder engagement and stigmatisation

Table 1 summarises what are understood to be the main mechanisms identified by Koelbel et al (2019) and the main findings by mechanism. There then follows a review of each mechanism and what can be inferred from the state of the art in terms of academic research. For each mechanism the link is then made to corresponding revisions made to the criteria set.

Table 1 - Mapping the investor mechanisms identified in literature onto the EU Ecolabel criteria proposals

Mechanism identified in literature	2 nd EU Ecolabel criteria proposal	Findings from Koelbel et al (2019)
1. Shareholder engagement	Criterion 4: Engagement	<i>Strong evidence</i> for: <ul style="list-style-type: none"> - funds seeking to increase shareholder value - for subsequent ESG ratings and ‘quality’ of company activities
2. Capital allocation 2.1 Incentivising improvements 2.2 Affecting growth	Criterion 1: Investment in environmentally sustainable economic activities	<i>Partial evidence</i> with stronger effect: <ul style="list-style-type: none"> - on non-substitutable (illiquid) and less mature substitutable assets - where growth is dependent on external finance - young smaller firms in immature markets

	Criterion 3: Environmental exclusions Criterion 4: Social exclusions	<i>Some evidence</i> for a screening effect on asset prices, but requires exertion of the same exclusions by a threshold % of investors
3. Indirect impacts 3.1 Stigmatisation 3.2 Endorsement 3.3 Benchmarking 3.4 Demonstration	Criterion 3: Environmental exclusions Criterion 7: Retail investor information	<i>Unproven</i> due to lack of empirical evidence, with some evidence of improvements against low initial ESG ratings

Adapted from Koelbel et al (2019)

Mechanism 1 - Evidence for the impact of shareholder engagement

There is understood to be more research evidence of investor impact in this area because it is easier to study the causal effects. However, this conclusion should be treated with caution because the success achieved is dependent on three main factors:

1. The cost of the reform being requested: Requests relating to environmental issues had the lowest success rate, attributed to the type of reforms tending to entail greater costs.
2. The extent of the investors influence: The larger the shareholding the greater the chance of success. Groups of investors and large international asset managers can also exert greater influence.
3. The company's level of ESG experience: Previous compliance with ESG requests and/or high ESG ratings improve the success rate.

The probability of success of engagement is observed to be negatively correlated with the importance (or impact) of a proposed reform/measure. Thus, most successful engagement actions concern small changes, such as improvement of reporting requirements.

It is also understood that change will tend only to be implemented with the support of a company's management and not directly by the investor due to the limitations of its influence. Moreover, there are also legal boundaries to the extent an investor can influence corporate strategy and drive change, which vary by country. Nevertheless, the existing academic evidence suggests that the potential impact of engagement is stronger than for capital allocation mechanisms.

How have these findings been taken into account in the 3rd criteria proposal?

- The engagement criteria (5) has been reconfigured to incorporate clearer strategic objectives for engagement that are aligned to the environmental objectives of EU Taxonomy.
- The company dialogue sub-criterion (5.2) has been reconfigured to focus on bilateral and/or collective engagement to at company level in order to achieve outcomes. The revised proposal is modelled on examples where shareholder value creation has been the driving force rather than ESG-related improvements (see chapter 5).
- The outcomes of engagement are aligned with the metrics of % green revenue, % green capex and % change in green revenue, so that monitoring and targeting of outcomes can be setup on a company-by-company basis.

Mechanism 2.1 – Capital allocation incentivising improvements

There is some evidence of the impact of 'negative screening' and 'norm-based screening', which equate to the proposal for environmental and social exclusions. For these types of

screening to work the evidence is that the requirements shall be specific and be implemented by a critical mass of investors, with between 8-20% of shareholders cited in literature. The important effect of screening is that a portfolio has an allocation that is different from benchmark portfolios.

Criteria on exclusions can also be more effective by considering practice-based exclusions rather than industry wide or sectoral exclusions. This is because practice-based exclusions create the scope for incremental change and are potentially more accessible, whereas if a whole sector is excluded, a company undertaking activities in that sector will not have scope for change.

How have these findings been taken into account in the 3rd criteria proposal?

- Where possible practice-based screening criteria or norm-based screening criteria linked to the phasing out of certain activities or substances have been set (see criterion 3).
- Specific rules have been included in criterion 3 addressing energy generation, waste management and car manufacturing activities that could be incentivised to investment in a transition to environmentally sustainable activities, accepting that the signals from a critical mass of investors may be needed for this to strongly incentivise additional new investment.

Mechanism 2.2 – Capital allocation affecting growth

Capital allocation allows investors to benefit from interest payments, dividend payments and/or fluctuations in the value or yield derived from investments made. If companies are well managed and succeed in maintaining or improving their market position then they will generate sufficient returns to be able to repay debtors, pay out dividends and make new investments. Shareholders may therefore seek to benefit from the success and stability offered by green (or greener) companies, but because the equity share of debt, they are purchasing is likely to have already been issued their impact as an investor may be limited unless, in the case of equities, they then choose to use their shareholder rights (see mechanism 1). This is because the capital has already been raised from the equity shares (or bonds) issued and the company may subsequently have achieved a credit rating that facilitates ease of access to debt instruments.

In the context of the EU Ecolabel, recent market research has shown that retail investors may be interested in the growth of companies greener than market average and/or in incentivising a change (transition) from brown towards environmentally sustainable activities. In order to contribute to the growth of companies, research evidence suggests that the companies targeted must have constrained access to capital. In this sense, capital allocation can be a vehicle to support change, but this more usually associated with higher risk investments of the kind supported in the early stages of growth by venture capital funds or unlisted equity shares.

Capital allocation may also be more effective for small capitalisation companies making their first public listing. Models suggest that companies may be incentivised to implement changes so that they become eligible for finance. If the EU Ecolabel criteria require an investment strategy that actively identifies companies with a clear direction of travel to become listed (i.e. make an initial public offering), this could help to support companies seeking to grow and invest to increase their market share.

There is also the potential to identify activities that are projected to have a shortfall of capital investment and to support mechanisms designed to overcome any associated barriers – for example, the aggregation of many small projects in order to mitigate risks and improve their access to finance. These types of investments can be packaged to manage their risk profile in a way that makes them more suitable for investors, e.g. in the case of renewable energy investment vehicles.

On the other hand, and considering the focus of the EU Ecolabel on UCITS equity funds, there is limited research evidence to date that capital allocation has an effect on firm growth in very

liquid markets such as publicly listed equity or for large capitalisation companies. This is in part because these companies may already have access to the financial markets and therefore are not affected by green requirements linked to capital allocation. However, there is some theoretical evidence that green investors can affect asset prices and the cost of capital (see Tiziano et al 2020). The problem is, that it is very difficult based on current evidence to say how relevant this impact would be, or what the ideal parameters and incentives are.

Theoretical models are understood to focus on the change-effect of capital allocation (see Heinkel et al 2001) and show that if a sufficiently large share of investors has a preference for green, there would be an incentive for non-green companies to become greener. That could also incentivise large capitalisation companies to change through a marginal increase in share prices or a reduction in the cost of capital for a company. This would require the level of take-up of the EU Ecolabel to be sufficient to generate beneficial effects. The alignment with the EU Taxonomy could also play an important role as it will provide a formal list of positive screening criteria.

How have these findings been taken into account in the 3rd criteria proposal?

- The thresholds for retail AIF and deposit products have been raised in order to ensure a high ambition level for those products that provide the greatest flexibility in being able to support SMEs as well as new green enterprises and projects that require access to capital.
- Given that it is structurally difficult to require UCITS to play a substantial role in raising new capital, other than via the purchase of bonds, the potential to support clearly defined ‘companies in investing in transition’ and ‘companies investing in green growth’ has been introduced, accompanied by a requirement for an investment pathway and clearly defined metrics.
- The green bond requirements have been updated to ensure that there is a focus on the monitoring of allocation and the financing of new projects. The issuer must also be a company investing in transition, so as to ensure that the green bond forms part of a concerted investment strategy.
- Where refinancing using bonds is supported, then this shall be used for the purposes of recycling funds for loans and/or creating asset-backed securities, given their significant identified potential to expand the availability of capital.

The current state of the art in fund impact management

Although impact funds have existed in various forms for since the 1990s, they only account for a very small portion of the market. This may in part be because they require holdings in illiquid assets and a more resource intensive process of monitoring to provide assurance to the investor that funds have been allocated to specific investments and that there has been an evaluation of the associated impacts.

As has been discussed earlier in this chapter, there is the potential for initiatives to enhance investor impact can encompass a broader range of activities than project-level monitoring. A new initiative has been highlighted by stakeholders that appears to represent the state of art in the assessment, management and disclosure of investor impact. The IMP+ACT Classification System (ICS) was launched in July of 2020 by The IMP+ACT Alliance. The Alliance is supported by the City of London Corporation, Deutsche Bank, the Impact Management Project (IMP) and Bridges Insights. It is designed to enable asset owners to:

- understand and compare the types of impact created by the holdings in their multi-asset class investment portfolios,
- describe, in a simplified and comparable format, how they currently manage, measure and assess their social and environmental impacts.

- market a fund as 'impact' in a standardised way, according to an investor involved in developing the system.

It is, moreover, understood to have been tested from the industry side by Aberdeen Standard, BlackRock, Bridges Fund Management, M&G and Nuveen.

The ICS is of potential relevance to the EU Ecolabel because it is one of the first systems to standardise the reporting of 'impact'. As illustrated in *Table 2*, this in turn requires the types of activity that are deemed to contribute to impact to be defined. The ICS is based on the Impact Management Project's ABC system, which focussed on three main areas of activity:

- 'Act to avoid harm';
- 'Benefit stakeholders'; and
- 'Contribute to solutions'.

Impact classes bring together the impact performance (or goals) of the assets being invested in (x-axis) and the strategies that the investor uses to contribute to that impact (y-axis). The 'signals' given by a fund manager to the market are an important feature of the approach.

Table 2. Impact classes used to group investment products with similar impact characteristics.

INVESTOR'S CONTRIBUTION		ACT TO AVOID HARM		
			BENEFIT STAKEHOLDERS	CONTRIBUTE TO SOLUTIONS
Signal that impact matters + Engage actively + Grow new/undersupplied capital markets + Provide flexibility on risk-adjusted return	1	E.g. Ethical bond fund	E.g. Positively-screened / best-in-class ESG fund	E.g. Sovereign-backed bonds (secondary market) funding vaccine delivery to underserved people or renewable energy projects
Signal that impact matters + Engage actively + Grow new/undersupplied capital markets + Provide flexibility on risk-adjusted return	2	E.g. Shareholder activist fund	E.g. Positively-screened / best-in-class ESG fund using deep shareholder engagement to improve performance	E.g. Public or private equity fund selecting and engaging with businesses that have a significant effect on education and health for underserved people
Signal that impact matters + Engage actively + Grow new/undersupplied capital markets + Provide flexibility on risk-adjusted return	3	E.g. Anchor investment in a negatively-screened real estate fund in a frontier market	E.g. Positively-screened infrastructure fund in a frontier market	E.g. Bond fund anchoring primary issuances by businesses that have a significant effect on environmental sustainability, access to clean water and sanitation
Signal that impact matters + Engage actively + Grow new/undersupplied capital markets + Provide flexibility on risk-adjusted return	4	<i>Investment archetype not widely observed</i>	E.g. Positively-screened private equity fund making anchor investments in frontier markets	E.g. Private equity fund making anchor investments in businesses that have a significant effect on income and employment for underserved people
Signal that impact matters + Engage actively + Grow new/undersupplied capital markets + Provide flexibility on risk-adjusted return	5	<i>Investment archetype not widely observed</i>	<i>Investment archetype not widely observed</i>	E.g. Below-market charity bonds, or an unsecured debt fund focused on businesses that have a significant effect on employment for underserved people
Signal that impact matters + Engage actively + Grow new/undersupplied capital markets + Provide flexibility on risk-adjusted return	6	<i>Investment archetype not widely observed</i>	<i>Investment archetype not widely observed</i>	E.g. Patient VC fund providing anchor investment and active engagement to businesses that have a significant effect on energy access for underserved people

Source: Impact Management Project (2020)

Retail investor expectations of claims associated with sustainable fund products

Evidence was put forward by a stakeholder that had conducted market research into retail investor perceptions. A survey was conducted of 4,000 potential investors in Germany and France during 2019. The findings which are illustrated in *Figure 2* revealed that:

- around 20% of potential investors favour a strategy that can be classified as ‘do no harm’ and which takes a strong symbolic stance.
- another 40% are interested in the environmental benefit of how their money is used.

Those falling into the first category favoured more symbolic gestures to demonstrate commitment, such as divesting from a certain activity. Those falling into the second category expect ‘*strong evidence that the product is effective in delivering environmental benefits*’. This suggests that these investors would need to be provided with information that tracks in some form the tangible outcomes from the activities, decisions and strategies adopted by their fund or deposit product.

Similarly with green bonds, evidence from the same survey was presented and showed either that there is an expectation that either:

- the issuers are pure green players,
- have the objective to become a pure player, or
- have the objective to align with climate or environmental goals.

These findings support to some extent the new proposed approach under criterion 1 and linked to criterion 2 to define companies investing in transition and green growth, so that the status of issuers and their trajectories can then be reported.

Both of these aspects of the findings suggest that there are a high proportion of potential retail investors who are interested in the ‘impact’ that they can have.

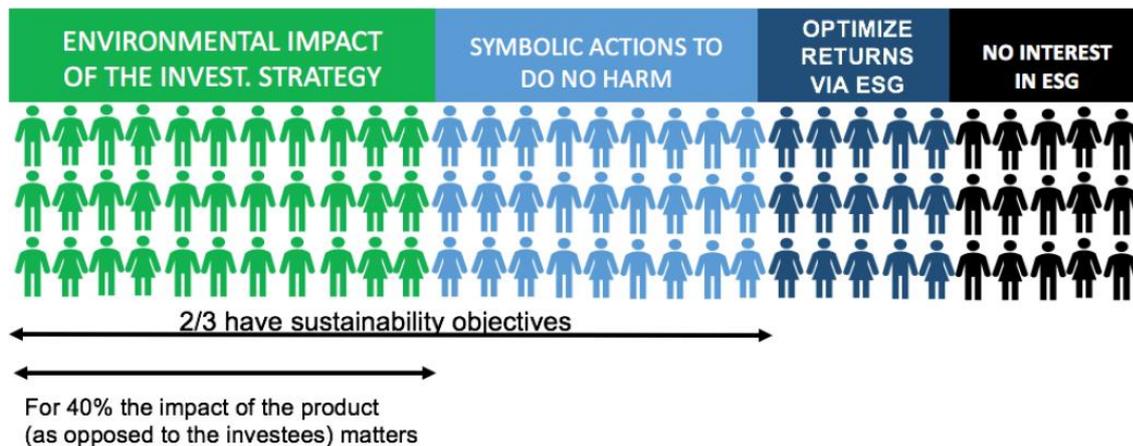


Figure 2 Categorisation of retail consumers based on survey results
 Source: 2 Degrees Investing Initiative

The investor impact of purchasing use of proceeds bonds

Analysis by the 2 Degree Investing Initiative has identified some potential weaknesses in the use of proceeds bond model as a means to achieve investor impact, as well as opportunities to enhance the model and where to focus attention in order to use bond issuance to expand access to capital. Two main obstacles to use of proceeds green bonds have been identified:

- Bonds are primarily refinancing instruments.
- Green bonds issuers are not constrained in their investment practices and do not necessarily invest in a greener way overall.

The first point highlights one of the main functions of bonds in the capital markets, which is to allow for the recycling of funds for loan finance by financial institutions. Whilst disclosure of the financing of new or existing projects forms part of the existing bonds schemes, opportunities have been identified to specifically support vehicles such as project bonds and Asset Backed Securities (ABS). ABS vehicles have traditionally been used to package many small loans, such as mortgages, and so could play a future role in the recycling of capital for domestic green loans.

The second of the points above questions the value of the green bond. It is asserted that this is because there is no accompanying requirement to track actual changes in issuers' investment plans, nor the alignment of these investment plans with climate goals. In this respect the investor, as highlighted in the follow-up research related to criterion 1, is exposed to the wider activities of the issuer.

The issue of investment potentially taking place in isolation is in part illustrated in *Figure 3*, where it can be seen that use of proceeds green bonds may initially only result in the segregation or ring fencing of green projects that would anyhow have received investment. The counter argument made by those involved in the development of green bond certification is that green bonds have and continue to play an important role in raising awareness of the potential for investments in green economic activities and in driving for greater transparency on the investment strategies of large multinational companies.

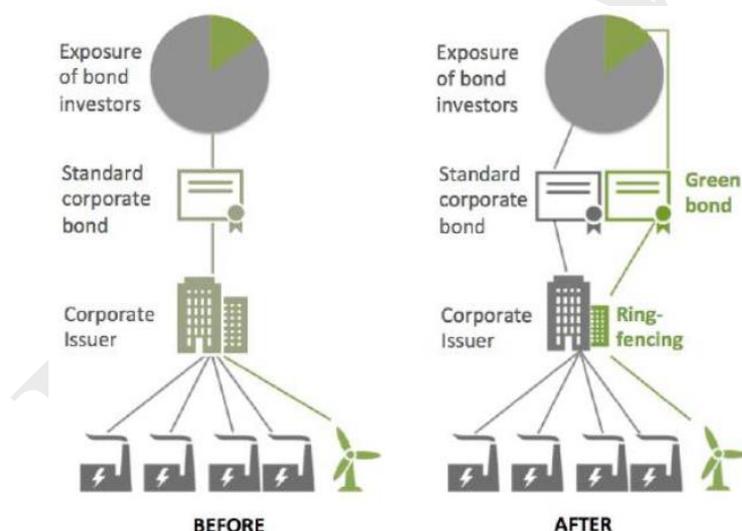


Figure 3 - Relationship of green bond issuance to investment plans and investor exposure
 Source: 2Dii Investing Initiative (2018)

In order to address the concerns related to exposure of retail investors it could therefore be possible in the case of corporate bonds to apply criteria to the issuer, but attention would need to be paid to whether this form of verification is readily available and whether it would constrain the number of bonds available from which portfolios could be constructed.

A number of existing labelling schemes already adopt this approach, focusing on exclusions related to company activities. However, if the aim is to provide retail investors with an

opportunity to make forward looking investments, as suggested by market research on consumer expectations, then it could be possible instead to focus on how the green bonds issued will contribute to either a progressive increase in verified % green revenue or investment to maintain a carbon reduction trajectory.

5.6.3 Outcomes from the 3rd stakeholder consultation

Stakeholders have commented and provided suggestions during this 3rd consultation on how to improve criterion 5 and make it more effective. Suggestions are mainly focusing on the need for simplifying the requirements, make them more flexible, achieve alignment with other EC initiatives and make the criterion more dynamic. The specific comments are summarised below.

The necessity to maintain the criterion

Some stakeholders consider that this criterion could create unnecessary obstacles since it only adds new reporting obligations, which may act confusing instead of providing clarifications to retail investors. They are already extensive reporting requirements in the other criteria, which may overlap with those in criterion 5. Stakeholders have also advocated that the EU Ecolabel is meant as a simple way for retail investors to facilitate their investment decisions, and this new criterion may therefore undermine this very successful aspect of the EU Ecolabel scheme. Stakeholders have proposed, in the case criterion 5 is maintained in the TR4.0, to adopt a more flexible approach for investor impact reporting, where, for example, case studies could be used to show impact.

Reporting requirements and alignment with the SFDR regulation

Stakeholder mentioned that some of the reporting requirements may overlap with those in criterion 4 or create additional complexity in terms of disclosures. Therefore, it is recommended to align, whenever possible, with the provisions on product disclosures in SFDR. The SFDR will provide with some investor impact reporting requirements for funds and insurance products qualifying under the EU Ecolabel. Therefore, replicating or complicating those requirements may increase complexity and would add costs that may ultimately be transferred to the retail investors. While stakeholders recognise the importance of the EU Ecolabel, they consider crucial to ensure balance between added value due this criterion inclusion and the associated burdens. The SFDR combined with other financial legislation already requires a lot of information reporting which has yet to come into effect.

Potential of the criterion to achieve impact

In terms of impact, stakeholders argued that it is the criterion on engagement that can potentially achieve impact, yet not criterion 5. The latter only focuses on qualitative reporting. Stakeholders suggested to enhance investor impact, it would be necessary to expand criterion 5 by including a set of specific targets and objectives that need to be implemented, monitored, evaluated and reported. In the case that some of the objectives cannot be implemented, the rationale for this shall be provided. For each of the non-implemented objectives, it shall be explained how the asset manager aims to overcome implementation barriers in the following year.

Introduce scientific based targets to achieve impact enhancement

For the sake of reducing complexity and promoting a precise and scientifically backed investor impact, stakeholders argued that the report imposed by criterion 5 shall be simplified. They suggested to make it more reader-friendly by providing a list of measures to be reported and make the reporting exercise mandatory under each impact mechanism, and by including at least

two measures respectively. The identified measures shall be left to the asset manager who can define them by taking into account the specificities of the financial product.

Assessment and Verification

Stakeholders ask to define when the first report shall be produced and how often it is deemed to be updated. They also argued that the current format does not provide a definition of how to report on the measures and what is needed to achieve compliance. This lack of reporting guidelines may impose confusion on how to achieve compliance and leave room for diverse interpretations

5.6.4 Further research and main changes in the fourth proposal

The JRC considers important to include the criterion on investor impact in the TR4.0. This criterion goes beyond the respective criterion on engagement since it applies all investor impact mechanisms that are reflected on the scientific evidence. However, the JRC acknowledges that its complexity may set additional obstacles in meeting the requirements. Therefore, the TR4.0 simplifies the criterion requirements by also considering modification in the other criteria. Thus, the overall structure which links the criterion reporting mechanisms with the other criteria is kept, yet it is modified reflecting updates across board.

Although the SFDR regulation aims to provide the framework for disclosures, it is deemed necessary to link the investor impact measures with the existing criteria and not to add environmental KPIs since the environmental dimension of the EU Ecolabel is expressed through the link to the EU Taxonomy and by setting greenness threshold on the different financial products.

The reporting requirements of criterion 5 are linked to specific actions which aim to enhance investor impact. To set up a management system for implementing, monitoring and evaluating the specific actions for impact enhancement might on one side improve the outcomes of investor impact activities. However, on the other side, it might raise the efforts to maintain active such a management system, which its turn will require additional resources and may increase the total costs. Finally, in terms of assessment and verification, the TR4.0 keeps in place the requirements of the previous report, yet the updated criterion 4 sets an additional condition for an annual update of the impact enhancement report. The EU Ecolabel User Manual will further specify how the reports will be provided.

5.7 CRITERION 6: Retail investor information

Previous (third) proposal for criterion 6: Retail investor information

5.1 Equity, bonds and mixed funds

As a minimum the following information shall be made available annually by the fund manager to the consumers:

- Information about the percentage of the total portfolio value in terms of assets under management (AuM) invested in companies whose economic activities comply with the requirements of criterion 1, i.e.:
 - o share of AUM in shares of companies with >50% green activities;
 - o share of AUM in shares of companies with 20%<x<50% green activities;
 - o share of AUM invested in green bonds;
 - o share of AUM going (indirectly) to green activities.
- Information on how the fund manager actively engages with companies on sustainability issues.
- Information about the type of exclusions considered. In the case of environmental exclusions, the applicant shall specify if they are total or partial exclusions, and report the percentage.
- Information the main principles for the selection of the companies.
- An electronic link to the full annual report described below.

Where the financial product is required to publish a prospectus, key investor information document (KIID) or key information document (KID) in accordance with European or national laws, only such information which is additional to that contained in the abovementioned documents needs to be disclosed separately or as additional information in the prospectus, KIID or KID.

As a minimum, the financial product manager shall issue a report annually to be uploaded on the financial product's manager website describing the environmental, social and engagement aspects as well as the activities and environmental performance of the financial product. The report shall be published on the fund manager's website. The report shall include at least the following:

- A description of the green economic activities in which the money held by the financial product was invested in during the reporting period, including the investment policy and how the companies are selected.
- A description of the main engagement activities (including voting and cooperating with other shareholders) and results within companies.
- A description of the methodology used for estimating the most relevant indicator (e.g. carbon footprint (GWP)) of the financial product and of the financial benchmark product. In the event that the GWP is the most relevant indicator, this description shall include the scope of the GHG emission covered. Additionally, the rationale for choosing the selected indicator and why it is relevant for the financial product shall also be included.
- The report shall include the engagement policy followed by the fund manager or an electronic link to it.
- Information on management and internal control procedures to identify and correct any non-compliance with EU Ecolabel criteria.

5.2 Sovereign bonds (*where held*)

As a minimum, the following information shall be made available annually to consumers by the fund or deposit manager:

- A climate or environmental risk rating for each sovereign issuer for which bonds are held.

5.3 Deposit accounts

As a minimum, the following information shall be made available annually to consumers by the deposit manager:

- An itemised list of projects and green economic activities for which loans have been approved, including their value. This may take the form of a selected list in a report together with a link to a website where a full list can be consulted.
- An annual report that as a minimum includes: details of the projects to which loans have been granted, their implementation status, the deposit account balance sheet showing the annual and historical deposit to loan ratio and the auditor's qualification of the ring fencing

procedure for the deposited money.

In the event of any observed deviations from any of the following the fund or deposit manager shall without delay communicate and publish the updated information and/or the updated report:

:

- changes in the methodology of computing the portfolio or deposit ratio;
- changes in the objectives / investment policy of the fund;
- relevant changes in the investment portfolio.

5.4 Monitoring

The consumer information should be updated regularly and therefore be based on regular monitoring of the portfolio.

Assessment and verification

The applicant shall provide a sample of the information to be provided to the consumers that clearly complies with the requirements of the criterion. The information can be added on the prospectus, KID or KIID or be provided as a separate information brochure.

Fourth proposal for criterion 6: Retail investor information

As a minimum the following information shall be made **annually** available by the fund or deposit manager or insurance undertakings to the retail investors, where applicable:

- Information about **the assets included in the retail financial product and their percentage to the total portfolio value in terms of assets under management (AuM)**
- The share of AuM **invested in equities of companies with >50% green turnover**
- The share of **AuM in companies indicating green Capex**
- The details of the projects to which loans have been granted and their implementation status;
- The share of AuM going to environmentally sustainable activities **through investment in other funds.**
- Information on how the fund manager engages with companies on sustainability issues. The information provided shall comply with the requirements laid down in criterion 4.
- Information on the measures that have been taken to enhance the impact of the financial product **in accordance with criterion 5**
- **Information on how the fund or deposit manager or insurance undertaking monitors compliance of the financial product with the EU Ecolabel criteria**
- An electronic link to the **product's website providing a full annual report, which describes at least the information above.**

The information shall be accompanied by **the following disclaimer:** *“The EU Ecolabel is the official European Union label for environmental excellence aiming to capture the best products available on the Community market in terms of environmental performance. It is*

awarded to financial products that invest to a certain degree in environmentally sustainable economic activities as defined under the EU Taxonomy. However, the currently available methodologies and evidence do not allow to evaluate the environmental and social impacts of a particular fund.”

Where the financial product is required to publish a prospectus, this prospectus shall contain information, **which is more detailed than** that contained in the key investor information document (KIID), or key information document (KID), in accordance with European or national laws. According to art. 8(3c)(ii) of the Regulation (EU) No 1286/2014 the KID includes information on specific environmental or social objectives targeted by the PRIIPs product. Neither the PRIIPs Level 1 nor the PRIIPs RTS prohibit manufacturers of PRIIPs products to add a sign suggesting the product’s adherence to an environmental quality label. In this context reference to EU Ecolabel could be made in the “What is this product?” section of the KID.

In the event of any observed allegations for violating compliance with the exclusions, the fund or deposit manager or insurance undertaking shall communicate it by publishing in the annual report and on the fund's website the undertaken actions to address the issues and the outcomes (when available).

Assessment and verification

By submitting the application, the applicant shall hand over to the Competent body a sample of the information to be provided to the retail investors. The information can be added on a prospectus along with the respective KID or KIID or be provided as a separate information brochure.

For new products, the applicant should submit a formal commitment of compliance with this criterion no later than one year from the start of the fund.

5.7.1 Rationale of the proposed criterion text

There is a need to provide retail investors with clear information on the environmental and social performance of financial product(s). These requirements will allow them to take a well-informed decision and also enhance transparency. Such actions will enhance the credibility of the EU Ecolabel.

5.7.2 Outcomes of the stakeholders consultations and main changes in TR2 and TR3

Feedback received on TR1&TR2 and further research conducted by JRC can be found in the previous version of the report (TR2 and TR3).

The main changes adopted in the TR3.0 are as follows:

- It is requested that retail investor information on the EU Ecolabel to be provided as a separate document or in a prospectus, which would also include the KID and KIID documents.

-
- A disclaimer on environmental and social impacts is included. In line with the introduction of the disclaimer, JRC dropped out the requirement to provide information about specific environmental indicators.
 - Capex and green revenue information requirements are introduced. This information is provided for green and companies in transition separately.
 - TR3.0 now contains a requirement for the fund manager to make publicly available the breakdown of portfolio holdings by value of AuM. It also states that the fund manager shall inform retail investors on how the fund engages with companies on sustainability issues. In accordance with the new criterion 6 on engagement, the fund manager should make available to consumers the measures that have been considered to enhance the impact of the fund.
 - A description of the investment policy and the objectives of the fund are required. The fund shall also describe the activities of companies in transition, and how these companies aim to increase green revenues. A similar level of information is required for companies investing in green growth.
 - TR3.0 suggests that the fund manager provides retail investors with information every time he/she changes the methodology, investment portfolio or the investment objective or policy.

5.7.3 Outcomes of the 2nd AHWG meeting and the stakeholder consultation

Stakeholders have provided with their suggestions in the public consultations. Their comments have served as the basis for further research and potential improvements. The main outcomes of the consultation are summarised as follows.

Information additional to KID and KIID documents

They highlighted the constraints to included additional information to the KID and KIID documents since the information included in these documents is dictated by the PRIIPs regulation, and therefore not subject of any modifications. Moreover, they stated that the KID and KIID documents are quite dense and any additional information could increase complexity.

The need to include a disclaimer

One stakeholder has recommended adding a disclaimer in criterion 6. It is argued that the EU Ecolabel does not carry out evaluation of environmental and/or social impacts and therefore not including a disclaimer could act misleading to the retail investors.

Information about green revenue and capex and further alignments with the Sustainable Finance Disclosure Regulation (SFDR)

Some few comments pinpointed the need to inform retail investors on green capex and green revenue shares while considering their total value in the portfolio and the economic activity they are refer to. Stakeholders also mentioned that it would be useful to provide to the retail investor information linked to the SFDR regulation by adopting environmental KPI for reporting.

It is also argued that the information provided to the retail investor shall be simple and not add confusion with an adverse impact in its decision making. Any additional reporting requirement may impose cost, which could be transferred to the retail investor and thus make the EU

Ecolabel application less attractive from an economic point of view. Therefore, stakeholders suggest striking a right balance between reporting and additional costs.

Stakeholders have also argued to simplify the information provided to the retail investor. This info shall be easy to understand, provide valuable insights, and facilitate decision making.

Information associated with deposits accounts

Regarding deposit accounts, stakeholders found that the reporting requirements on banks are disproportionate and needlessly complex for the depositors. This requirement would demand banks to present a full list of all individual green loans, provide details about the green projects and the loans that have been granted. Additionally, one should note that companies might not disclose details on green projects and loans directly to retail investors.

5.7.4 Further research and main changes in the fourth proposal

JRC has considered the stakeholders' contributions that are provided in the consultation period and has performed additional research to update criterion 6. This criterion 6 updates take into account the applied modifications on the other existing criteria that are contained in the previous versions of the technical report. The main changes introduced in criterion 6 are the followings.

The JRC has recognised the constraints to add information on KID and KIID documents and suggested any retail investor information on the EU Ecolabel to be provided as a separate document or in a prospectus, which would also include the KID and KIID documents.

In terms of introducing a disclaimer, JRC deemed this requirement as justified and included a disclaimer. In line with the introduction of the disclaimer, JRC dropped out the requirement to provide information about specific environmental indicators, since the greenness of funds is defined by considering the degree investments are aligned with the EU Taxonomy environmental activities, the green turnover and green capex. Thus, adding other environmental indicators could create confusion on the way greenness is evaluated

The JRC has also updated criterion 6 to include green capex and green revenue information. This information refers to the AuM associated with companies that have more than 50% green revenue and to the respective AuM of those companies that indicate green capex. The JRC suggests maintaining the requirement to inform retail investors about loans made and the status of the projects financed since that could act as an additional incentive for the retail consumer to invest in this specific financial product.

TR4.0 contains the requirement for the fund manager to make publicly available the breakdown of portfolio holdings by value of AuM. It also states that the fund manager shall inform retail investors on how the fund engages with companies on sustainability issues. In accordance with the new criterion 5 on engagement, the fund manager should make available to consumers the measures that have been considered to enhance the impact of the fund. The criterion requires the fund manager to provide information to the retail investor on how severe and/or reoccurring allegation will be treated.

In general, in the TR4.0, criterion 6 is simplified in terms of reporting requirements whereas it provides all crucial information to the retail consumer that is linked criteria 1-5. Additionally, this information is provided on the webpage of the fund as a short report to be easily accessible and understandable by the retail investor.

5.8 CRITERION 7: Information appearing on the EU Ecolabel

Previous (third) proposal for criterion 7: Information appearing on the EU Ecolabel

The applicant shall follow the instructions on how to properly use the EU Ecolabel logo provided in the EU Ecolabel Logo Guidelines available at:

<https://ec.europa.eu/environment/ecolabel/documents.html>

If the optional 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

Assessment and verification

The applicant shall provide a signed declaration of compliance along with a sample of the product label or product documentation where the EU Ecolabel is placed that clearly shows the label, the registration/licence number and, where relevant, the statements that are displayed together with the label.

Fourth proposal for criterion 7: Information appearing on the EU Ecolabel

The applicant shall follow the instructions on how to properly use the EU Ecolabel logo provided in the EU Ecolabel Logo Guidelines available at:

<https://ec.europa.eu/environment/ecolabel/documents.html>

If the optional label with text box is used, it shall contain the following statements:

- Investing in activities that contribute to a green and low carbon economy
- Avoiding investments in environmentally and socially harmful activities
- **Enhancing investor impact**

The following additional statement may be used for investment funds and insurance products (replacing one of the statements above):

- Engaging with companies to become **more environmentally sustainable**

5.8.1 Rational of the proposed criterion text

Information on the label is useful for reinforcing messages that endorse the consumer's choice of an EU Ecolabel product over alternatives that are not labelled. According to Article 8 (3b) of Regulation 66/2010, for each product group, three key environmental characteristics of the EU Ecolabel product may be displayed in the optional label text box. The guidelines for the use of the optional label with a text box can be found in the "guidelines for the use of the EU Ecolabel logo" available on the EU Ecolabel website.

5.8.2 Outcomes of previous consultations and main changes in TR2 and TR3

Feedback received on TR1.0 & TR2.0 and further research conducted by the JRC can be found in the previous version of the technical report (TR3.0). This section provides an overview of the issues addressed in the TR4.0.

In TR3, the main changes with respect to TR2 were as follows:

- Sentence 1 focused on the mandatory minimum investments to activities that contribute to a green and low carbon economy
- Sentence 2 focused on the mandatory minimum investments to activities that significantly contribute to climate change mitigation and adaptation (thus linking to the EU Taxonomy)
- Sentence 3 focused on the mandatory exclusion of activities that are environmentally or socially harmful
- In addition, one extra sentence was included, that could replace one of the sentences above. This sentence referred to the engagement criterion. This sentence was made optional since it would not apply to all retail financial products (the engagement criterion does not apply to fixed term and savings and deposit account).

5.8.3 Outcomes of the third stakeholder consultation

This section summarises stakeholders' comments received after the 3rd stakeholder consultation. No comments were received from stakeholders.

5.8.4 Further research and main changes in the fourth proposal

The sentences have been slightly modified, to streamline the major characteristics of the EU Ecolabel in a language easy for the retail investor.

Sentence 2 on the contribution to climate change mitigation and adaptation was removed. Indeed, this sentence was communicating the same concept as sentence 1 on the contribution to a green and low carbon economy. A third sentence was added referring to the enhancement of the investor impact, since the criterion has been made more stringent in this fourth version of the criteria.

Finally, it was clarified in the legal text that the fourth sentence is optional and should replace one of the three above, as the EU Ecolabel Regulation allows only three sentences to be used in the long version of the logo.

ANNEX I – STUDY ON GREEN REVENUE AND GREEN CAPEX ESTIMATES. FURTHER SENSITIVITIES

This annex complements section 4.2 with figures presenting the entire distribution of the 101 green UCITS equity funds.

Tables are inserted again for a better readability of this section:

Formula	Scenario	Capex Assumptions			
		A	B	C	D
Current formula (60/40)	MSCI	8	8	10	12
	ISS	4	5	5	6
Current formula (80/20)	MSCI	8	8	8	10-11
	ISS	4	4-5	5	5-6

Formula	Scenario	Capex Assumptions			
		A	B	C	D
Alternative Formula	MSCI	13	15	17	21
	ISS	7	8	9	11
Alternative Formula (capped at 1)	MSCI	10	12	14	14
	ISS	7	7	7	9

Overview current formula ISS vs. MSCI

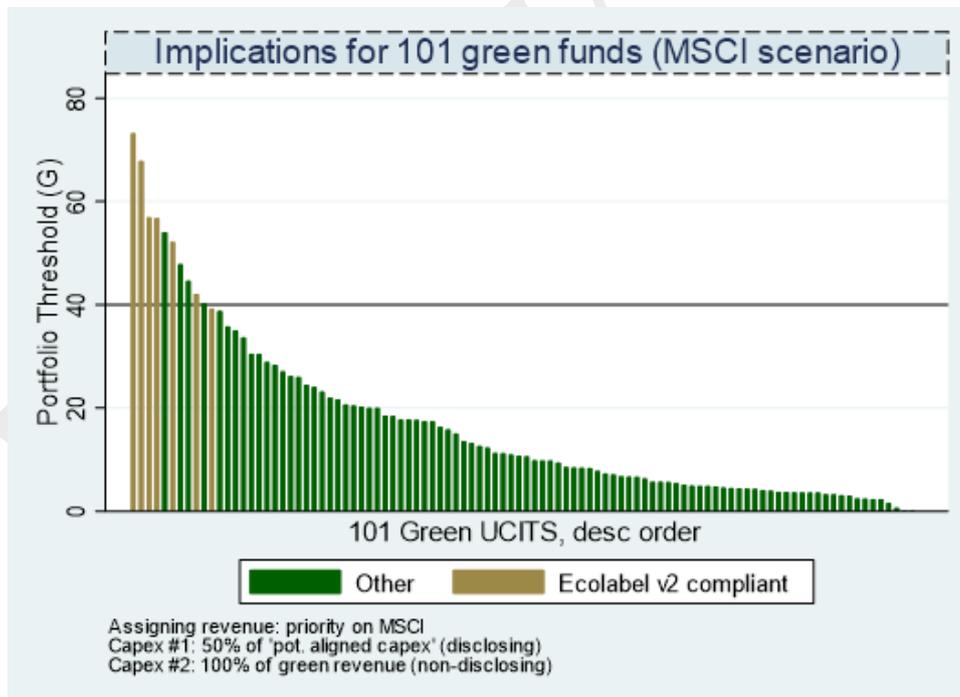


Figure 1 - Calculation I.1.c

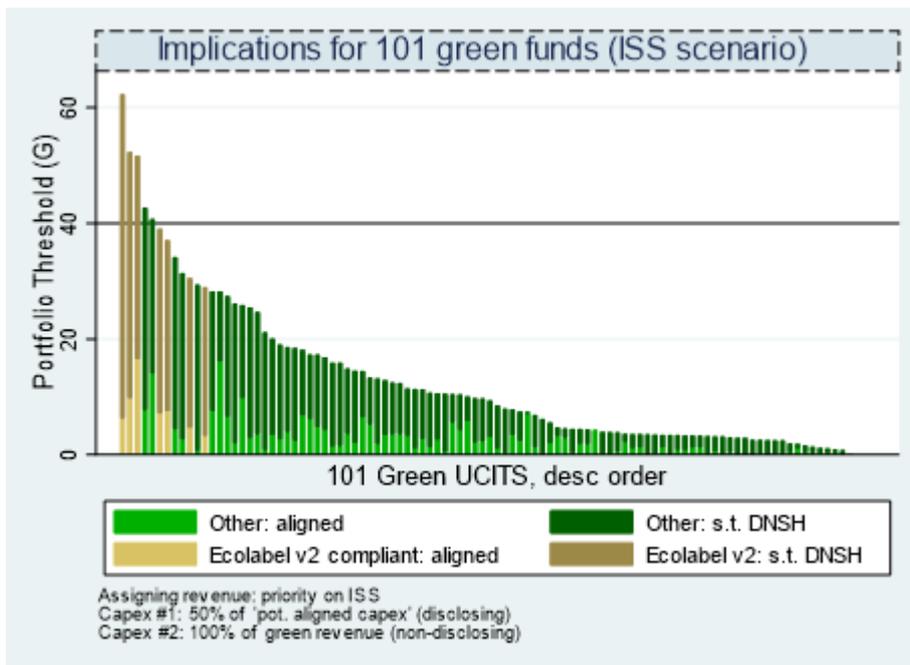


Figure 2 - Calculation I.2.c

Overview different revenue/capex weightings (current formula)

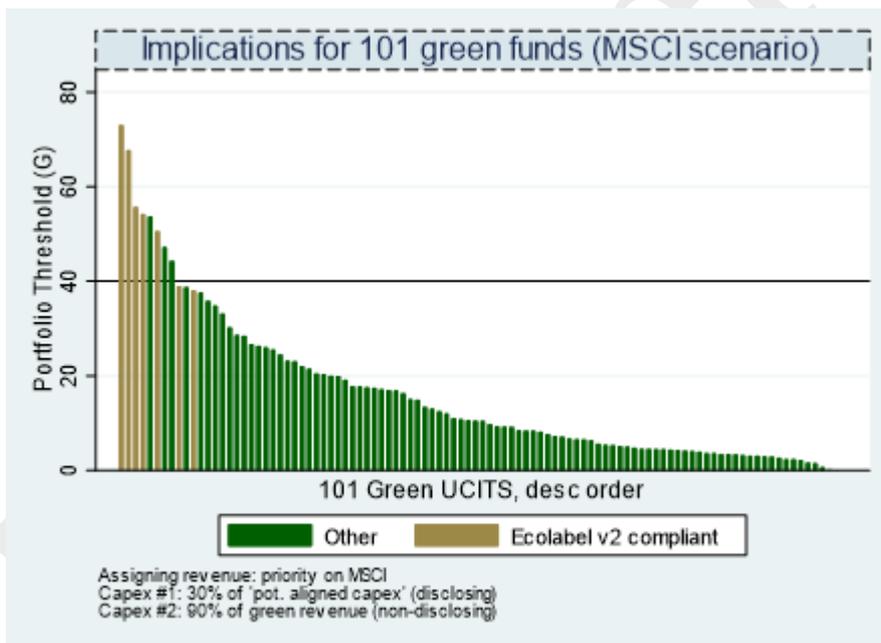


Figure 3 - Calculation I.1.a with 80/20 weighting

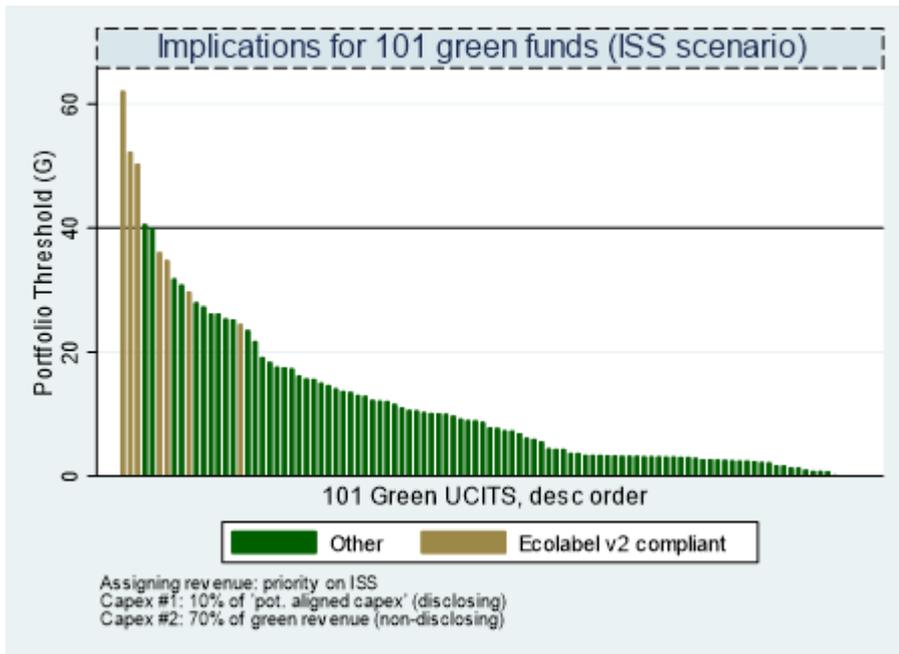


Figure 4 - Calculation with I.2.a 80/20 weighting

Overview alternative formula – not capped vs. capped

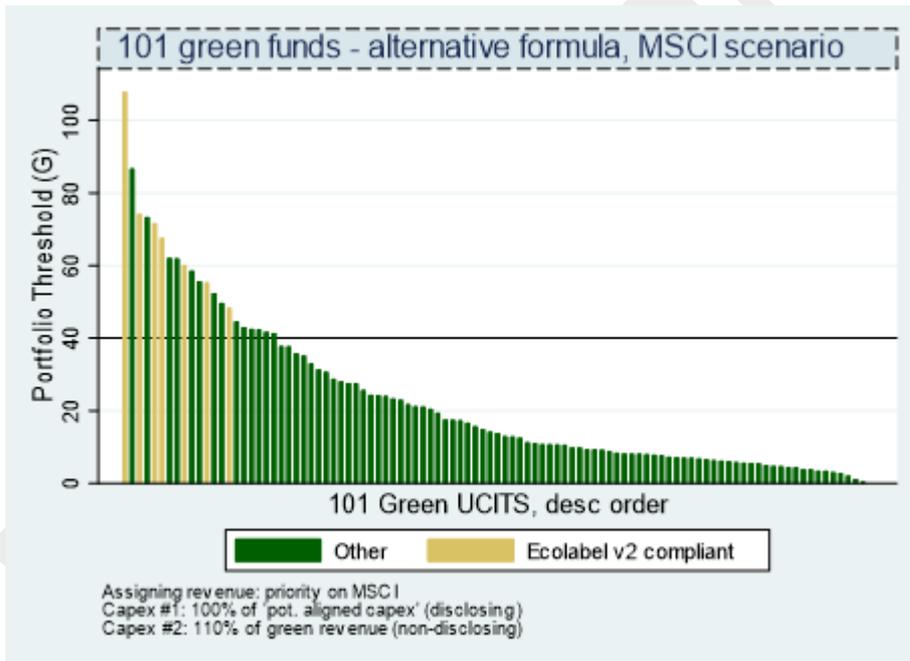


Figure 5 - Calculation II.1.d – right-hand side of the equation not capped

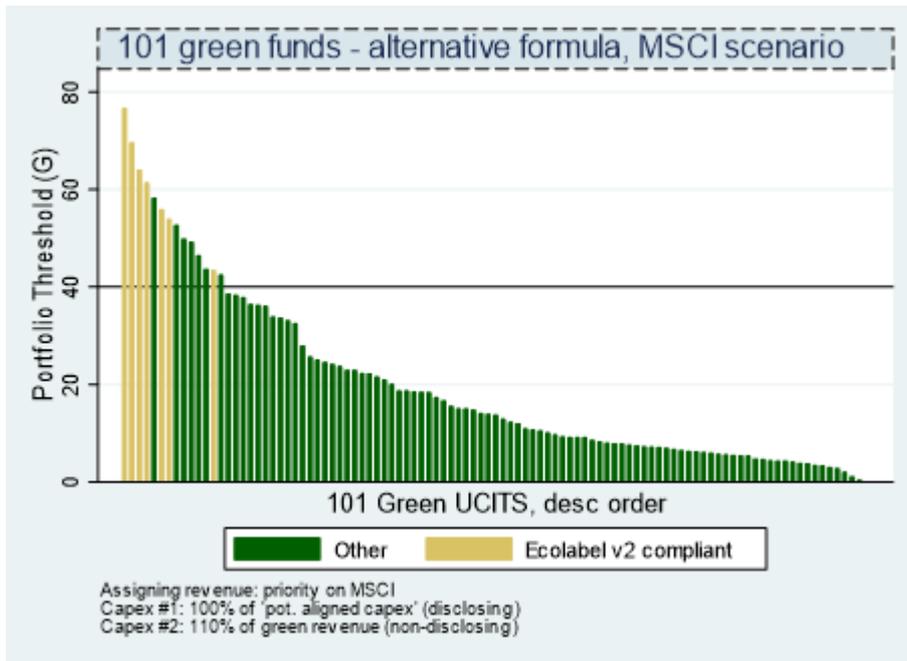


Figure 6 - Calculation II.1.d – right-hand side of the equation capped

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ANNEX II – CONSTRUCTION OF HYPOTHETICAL PORTFOLIOS. FULL RESULTS DATASET

Table 1 - Baseline results

		Max Taxonomy MSCI distribution		EU World		Geo-focus: only MSCI Distribution		EU Sector		Geo-focus distribution MSCI World		Sect-focus energy (+200% compared to MSCI World)		Sect-focus manufacturing (+200% compared to MSCI World)	
		MSCI	ISS	MSCI	ISS	MSCI	ISS	MSCI	ISS	MSCI	ISS	MSCI	ISS	MSCI	ISS
30 Caps	Large	61.95 (61.94 - 61.96)	46.94 (46.94 - 47.47)	33.15 (33.15 - 33.36)	19.52 (19.45 - 20.64)	59.92 (59.92 - 60.9)	45.6 (45.59 - 49.31)	63.01 (63.01 - 63.1)	49.58 (49.58 - 49.92)	61.96 (61.96 - 62.19)	43.15 (43.15 - 44.74)				
50 Caps	Large	50.62 (50.62 - 50.76)	35.63 (35.63 - 36.67)	23.8 (23.74 - 24.59)	13.68 (13.64 - 14.33)	50.71 (50.65 - 52.95)	35.87 (35.85 - 39.67)	51.52 (51.52 - 51.68)	37.71 (37.71 - 38.73)	46.89 (46.89 - 48.22)	31.53 (31.52 - 33.69)				
80 Caps	Large	39.66 (39.65 - 40.39)	27.49 (27.49 - 29.04)	16.69 (16.65 - 17.23)	9.37 (9.35 - 9.83)	42.04 (42 - 44.65)	27.06 (27.02 - 30.37)	40.69 (40.69 - 41.38)	29.45 (29.45 - 30.92)	35.7 (35.7 - 38.52)	22.6 (22.55 - 24.03)				
15 Caps & Mid/Small Caps	Large & 15	76.01 (76.01 - 76.02)	67.35 (67.35 - 67.46)	44.63 (44.63 - 44.67)	35.97 (35.97 - 36.36)	80.8 (80.8 - 81.11)	75.04 (75.04 - 76.69)	76.48 (76.48 - 76.5)	68.41 (68.41 - 68.51)	87.57 (87.57 - 87.57)	76.18 (76.18 - 76.68)				
25 Caps & Mid/Small Caps	Large & 25	71.75 (71.75 - 71.91)	60.05 (60.05 - 60.17)	36.05 (36.05 - 36.09)	27.75 (27.75 - 28.86)	73.38 (73.38 - 73.71)	59.58 (59.57 - 62.71)	72.01 (72.01 - 72.2)	61.02 (61.02 - 61.13)	76.82 (76.82 - 76.87)	63.05 (63.05 - 63.84)				
40 Caps & Mid/Small Caps	Large & 40	64.11 (64.11 - 64.34)	51.28 (51.28 - 51.92)	27.36 (27.36 - 28.26)	20.65 (20.63 - 21.82)	65.85 (65.83 - 66.66)	50.21 (50.21 - 53.16)	64.67 (64.67 - 64.91)	52.69 (52.69 - 53.31)	64.96 (64.96 - 65.39)	50.85 (50.85 - 51.84)				
30 Mid/Small Caps		75.16 (75.16 - 75.48)	65.54 (65.54 - 65.74)	30.45 (30.45 - 30.54)	28.58 (28.58 - 29.93)	81.43 (81.43 - 81.43)	66.17 (66.17 - 68.95)	76.1 (76.1 - 76.4)	67.05 (67.05 - 67.24)	84.07 (84.07 - 84.07)	74.75 (74.75 - 74.75)				
50 Mid/Small Caps		68.1 (68.1 - 68.48)	57.54 (57.48 - 58)	22.93 (22.91 - 24.17)	21.83 (21.82 - 22.98)	71.73 (71.73 - 71.74)	55.09 (55.09 - 57.13)	69.3 (69.3 - 69.68)	59.39 (59.34 - 59.84)	71.75 (71.75 - 71.83)	58.24 (58.24 - 59.09)				
80 Mid/Small Caps		58.3 (58.3 - 58.81)	47.32 (47.29 - 48.11)	16.73 (16.7 - 17.51)	14.9 (14.9 - 15.62)	59.96 (59.95 - 60.81)	45.73 (45.73 - 47.39)	60.13 (60.13 - 60.62)	49.69 (49.65 - 50.45)	58.04 (58.04 - 58.54)	44.09 (44.09 - 46.17)				

Notes: The single figures present the G-value derived from the Ecolabel formula II, following assumptions XYZ. The figures in parentheses indicate the range of results, following different assumptions regarding green capex ranging from 0% to 50% of capex in total.

Table 2 - Results - formula 2

		Max Taxonomy MSCI distribution		EU World		Geo-focus: only MSCI Distribution		EU Sector		Geo-focus distribution MSCI World		Sect-focus energy (+200% compared to MSCI World)		Sect-focus manufacturing (+200% compared to MSCI World)	
		MSCI	ISS	MSCI	ISS	MSCI	ISS	MSCI	ISS	MSCI	ISS	MSCI	ISS	MSCI	ISS
30 Caps	Large	65.24 (64.51 - 67.9)	49.39 (48.76 - 54.65)	34.71 (34.56 - 35.9)	21.2 (20.93 - 23.36)	65.32 (62.64 - 78.55)	48.75 (46.54 - 66.26)	66.41 (65.67 - 69.13)	52.64 (53.23 - 61.09)	64.9 (64.53 - 66.85)	46.36 (44.7 - 48.36)				
50 Caps	Large	53.03 (52.43 - 55.75)	37.88 (37.29 - 42.48)	24.92 (24.68 - 25.95)	14.81 (14.53 - 16.61)	55.91 (53.54 - 67.4)	39.02 (36.83 - 54.12)	54.13 (53.52 - 56.89)	40.37 (39.78 - 44.88)	48.8 (48.51 - 50.77)	32.94 (32.56 - 36.32)				

80 Caps	Large	41.57 (41.13 - 43.8)	29.55 (29.07 - 33.63)	17.69 (17.49 - 18.49)	10.3 (10.02 - 11.72)	47.5 (45.02 - 58.49)	30.84 (28.13 - 44.82)	42.62 (42.13 - 45.22)	31.73 (31.23 - 35.78)	36.99 (36.72 - 39.22)	23.69 (23.25 - 26.87)
15 Caps & Mid/Small Caps	Large	77.82 (77.65 - 78.67)	69.48 (69.09 - 71.99)	46.12 (45.94 - 46.85)	37.39 (37.25 - 38.28)	87.68 (84.79 - 95.54)	80.21 (78.3 - 90.97)	78.53 (78.36 - 79.36)	70.47 (70.1 - 72.9)	91.21 (90.67 - 92.44)	80.59 (80.01 - 83.51)
25 Caps & Mid/Small Caps	Large	74.15 (73.58 - 76.01)	63.26 (62.56 - 66.65)	37.23 (37.09 - 38.01)	28.96 (28.82 - 30.28)	79.79 (77.41 - 89.3)	66.42 (64.21 - 81.01)	74.46 (73.9 - 76.31)	64.43 (63.69 - 67.73)	80.12 (79.7 - 82.02)	68.06 (67.63 - 71.31)
40 Caps & Mid/Small Caps	Large	66.59 (66.1 - 68.55)	54.44 (53.88 - 57.99)	28.31 (28.16 - 29.09)	21.76 (21.57 - 23)	71.58 (69.59 - 81.64)	56.27 (54.1 - 70.31)	67.21 (66.7 - 69.23)	56.04 (55.44 - 59.6)	67.7 (67.33 - 70.11)	54.98 (54.61 - 59.13)
30 Mid/Small Caps		77.18 (76.8 - 78.04)	68.98 (68.43 - 70.74)	30.98 (30.89 - 31.35)	29.33 (29.22 - 29.79)	88.53 (86.67 - 94.98)	76.08 (74.11 - 87.23)	78.13 (77.75 - 78.94)	70.22 (69.66 - 71.9)	87.11 (86.7 - 89.29)	82.23 (81.65 - 86.32)
50 Mid/Small Caps		70.24 (69.91 - 71.66)	62.39 (61.91 - 64.88)	23.65 (23.54 - 24.11)	22.63 (22.49 - 23.15)	77.83 (76.1 - 85.79)	63.14 (60.84 - 74.52)	71.46 (71.13 - 72.79)	64.01 (63.55 - 66.43)	74.88 (74.49 - 78.22)	64.4 (63.85 - 70.12)
80 Mid/Small Caps		60.53 (60.17 - 62.75)	51.51 (51.11 - 55.02)	17.37 (17.22 - 18.26)	16.38 (16.12 - 17.07)	65.38 (63.37 - 74.96)	53.24 (50.56 - 64.28)	62.46 (62.09 - 64.52)	54.03 (53.64 - 57.33)	60.29 (59.91 - 64.3)	48.56 (47.96 - 53.87)

Notes: The single figures present the G-value derived from the Ecolabel formula II, following assumptions XYZ. The figures in parentheses indicate the range of results, following different assumptions regarding green capex ranging from 0% to 50% of capex in total.

Table 3- Results ISS data - DNSH vs without DNSH – formula 1

		Max Taxonomy MSCI distribution	EU World	Geo-focus: only MSCI Distribution	EU Sector	Geo-focus distribution MSCI World	Sect-focus energy (+200% as compared to MSCI World)	Sect-focus manufacturing (+200% as compared to MSCI World)			
		ISS s.t. DNSH	ISS	ISS s.t. DNSH	ISS	ISS s.t. DNSH	ISS	ISS s.t. DNSH	ISS		
Panel a) Proposed Formula											
30 Caps	Large	11.53	46.94	0.23	19.52	0.54	45.6	12.18	49.58	11.17	43.15
50 Caps	Large	7.26	35.63	15	13.68	0.35	35.87	7.46	37.71	6.74	31.53
80 Caps	Large	4.52	27.49	0.1	9.37	0.24	27.06	4.66	29.45	4.41	22.6
15 Caps & Mid/Small Caps	Large	43.5	67.35	10.44	35.97	17.28	75.04	43.8	68.41	44.81	76.18
25 Caps & Mid/Small Caps	Large	36.65	60.05	7.84	27.75	15.19	59.58	36.99	61.02	35.73	63.05
40 Caps & Mid/Small Caps	Large	30.03	51.28	5.83	20.65	13.28	50.21	30.75	52.69	27.4	50.85
30 Mid/Small Caps		55.49	65.54	13.24	28.58	28.58	66.17	57.14	67.05	54.6	74.75
50 Mid/Small Caps		46.41	57.54	8.84	21.83	24.08	55.09	48.21	59.39	41.1	58.24

80 Mid/Small Caps		35.95	47.32	5.68	14.9	20.42	45.73	38.11	49.69	31.06	44.09
Panel b) Alternative Formula											
30 Caps	Large	16.66	49.39	2.64	21.2	11.23	48.75	17.65	52.64	14.91	45
50 Caps	Large	11.41	37.88	1.85	14.81	8.5	39.02	12.11	40.37	9.66	32.94
80 Caps	Large	7.77	29.55	1.27	10.3	6.63	30.84	8.37	31.73	6.75	23.69
15 Caps & 15 Mid/Small Caps & 25 Mid/Small Caps & 40 Mid/Small Caps & 30 Mid/Small Caps & 50 Mid/Small Caps & 80 Mid/Small Caps	Large	49.89	69.48	12.35	37.39	36.8	80.21	50.34	70.47	53.05	80.59
	Large	42.36	63.26	9.44	28.96	29.74	66.42	42.94	64.43	42.04	68.06
	Large	34.65	54.44	7.28	21.76	25.01	56.27	35.68	56.04	31.92	54.98
		61.32	68.98	14.03	29.33	44.67	76.08	63.36	70.22	62.24	82.23
		50.45	62.39	9.59	22.63	36.19	63.14	52.49	64.01	45.91	64.4
		38.84	51.51	7.19	16.38	30.16	53.24	41.13	54.03	34.3	48.56

Notes: The single figures present the G-value derived from the Ecolabel formula I (Panel a) and Ecolabel formula II (Panel b). DNSH assessment included vs. no DNSH assessment.

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