Development of EU Ecolabel criteria for retail financial products

2nd Ad Hoc Working Group (web)meeting

25th – 26th March 2020

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European Commission

EU Ecolabel for retail financial products
Structure of the web-meeting

Day 1

Session 1: 10:00 – 12:30	Product scope, criterion 1
Session 2: 14:30 – 16:30	Criteria 2 and 3

Day 2

Session 3: 10:30 – 12:30	Criteria 4, 5 and 6

Development of EU Ecolabel criteria for retail financial products

Political context and objectives of the EU Ecolabel

DG Environment and DG Fisma

European Commission

Action Plan on Sustainable Finance
‘Financing Sustainable Growth’ – March 2018

[…]the lack of labelled financial products may prevent investors from directly channelling their funds into sustainable investments.

The Commission sees the potential merit in the use of the EU Ecolabel Regulation to create a voluntary EU-wide labelling scheme. Criteria would have to be identified for specific financial products offered to retail investors (such as Packaged Retail Investment and Insurance Products). […]

Financing the Green Transition

Ambition

Delivering on the European Green Deal, notably reaching climate neutrality by 2050 while ensuring that the transition is just and fair

Large-scale Investment

EU Budget

Commission's target = at least 25% of EU expenditure contributing to climate objectives for the 2021-2027 Multi-Annual Financial Framework

Blended Finance

Invest EU & European Fund for Sustainable Development (EFSD)

Private Finance

Commission Action Plan on financing Sustainable Growth

Commission Action Plan on financing sustainable growth

Reorient capital flow towards more sustainable investments

1. Establish a Taxonomy of environmentally sustainability activities
2. Create standards and labels for green financial products
3. Fostering investment in sustainable projects
4. Incorporate sustainability in providing investment advice
5. Develop sustainability benchmarks

Mainstreaming sustainability in risk management

6. Better integrate sustainability in ratings and market research
7. Clarify institutional investors' and asset managers' duties
8. Incorporate sustainability in prudential requirements

Foster transparency & long-termism

9. Strengthen corporate sustainability disclosure
10. ↑sustainable corporate governance and ↓ short-termism

Action plan on financing sustainable growth -overview

Commission's actions stretch across the whole investment chain

1	**Taxonomy**	Develop an EU classification system for environmentally sustainable economic activities
2	Standards and labels	Develop EU standards (such as EU Green Bond Standard) and labels for sustainable financial products (via Ecolabel) to protect integrity and trust of sustainable finance market
3	Fostering investment in sustainable projects	Exploring measures to improve the efficiency and impact of instruments aiming at investment support. Mapping on investment gaps and financing.
4	Incorporating sustainability in financial advice	Amend MiFID II and IDD delegated acts to ensure that sustainability preferences are taken into account in the suitability assessment.
5	Developing sustainability benchmarks	Develop climate benchmarks and ESG disclosures for benchmarks
6	Sustainability in research and ratings	Explore how credit rating agencies could more explicitly integrate sustainability in to their assessments. Study on sustainability ratings and research and exploring possible measures to encourage their uptake.
7	Disclosures by financial market participants	Enhance transparency to end-investors on how financial market participants consider sustainability
8	Sustainability in prudential requirements	Explore the feasibility of reflecting sustainability in prudential rules (where justified from a risk perspective)
9	Strengthening sustainability disclosures and improving accounting	Enhance climate and sustainability-related information provided by corporations
10	Fostering sustainable corporate governance	Collect evidence of undue short-term pressures from capital markets on corporations and consider steps for promoting corporate governance that is more conducive to sustainable investments.

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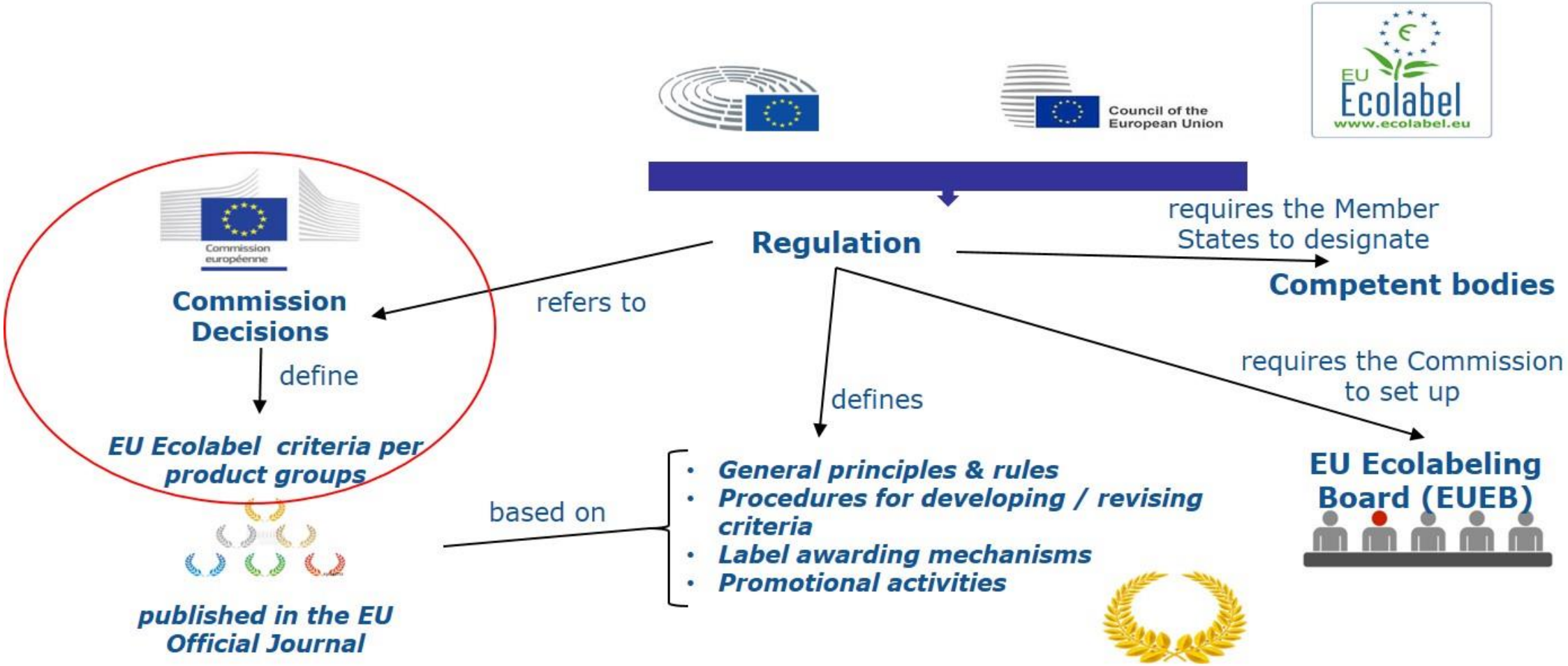
Legal framework of the EU Ecolabel

Regulation (EC) No 66/2010 of the European Parliament and of the Council of 25 November 2009 on the EU Ecolabel



Financial products are in the scope of the Regulation

Article 2 - Scope

‘This Regulation shall apply to any goods or services which are supplied for distribution, consumption or use on the Community market whether in return for payment or free of charge (hereinafter ‘products’).’

Article 3 - Definitions

- ‘operator’ means any producer, manufacturer, importer, service provider, wholesaler or retailer
- ‘environmental impact’ means any change to the environment resulting wholly or partially from a product during its life cycle

Impact of the use of the EU Ecolabel Regulation

- **Focus on retail investors**
  - B2B products cannot be included
- **Focus on best existing products on the market**
  - As opposed to a focus on the creation of a new generation of products
- **Changes of EU Ecolabel criteria require a revision of the Commission Decision**
  - No automatic tightening of the criteria over time, but a revision clause can be already included in the first Commission Decision

Operators apply to Competent Bodies

Any operator who wishes to use the EU Ecolabel shall apply to the **Competent Body (CB)** depending on where the products originates:

- ✓ in a single MS: to a CB of that MS
- ✓ in several MSs (in the same form): to a CB in one of those MSs
- ✓ outside the Community: to a CB in any of the MS in which the product is to be or has been placed on the market

Originates: where the management company has its head office and/or registered office or where the insurance company has its head office.

EU Ecolabel is awarded by MS Competent Bodies

- The Competent Bodies ensure that the verification process is carried out in a consistent, neutral and reliable manner by an independent third party
- The applicant has to present the documentation proving compliance with EU Ecolabel criteria
- Competent Bodies can charge a fee
- Competent Bodies sign a contract with the successful applicants for the use of the EU Ecolabel
- Some Member States have nominated new Competent Bodies

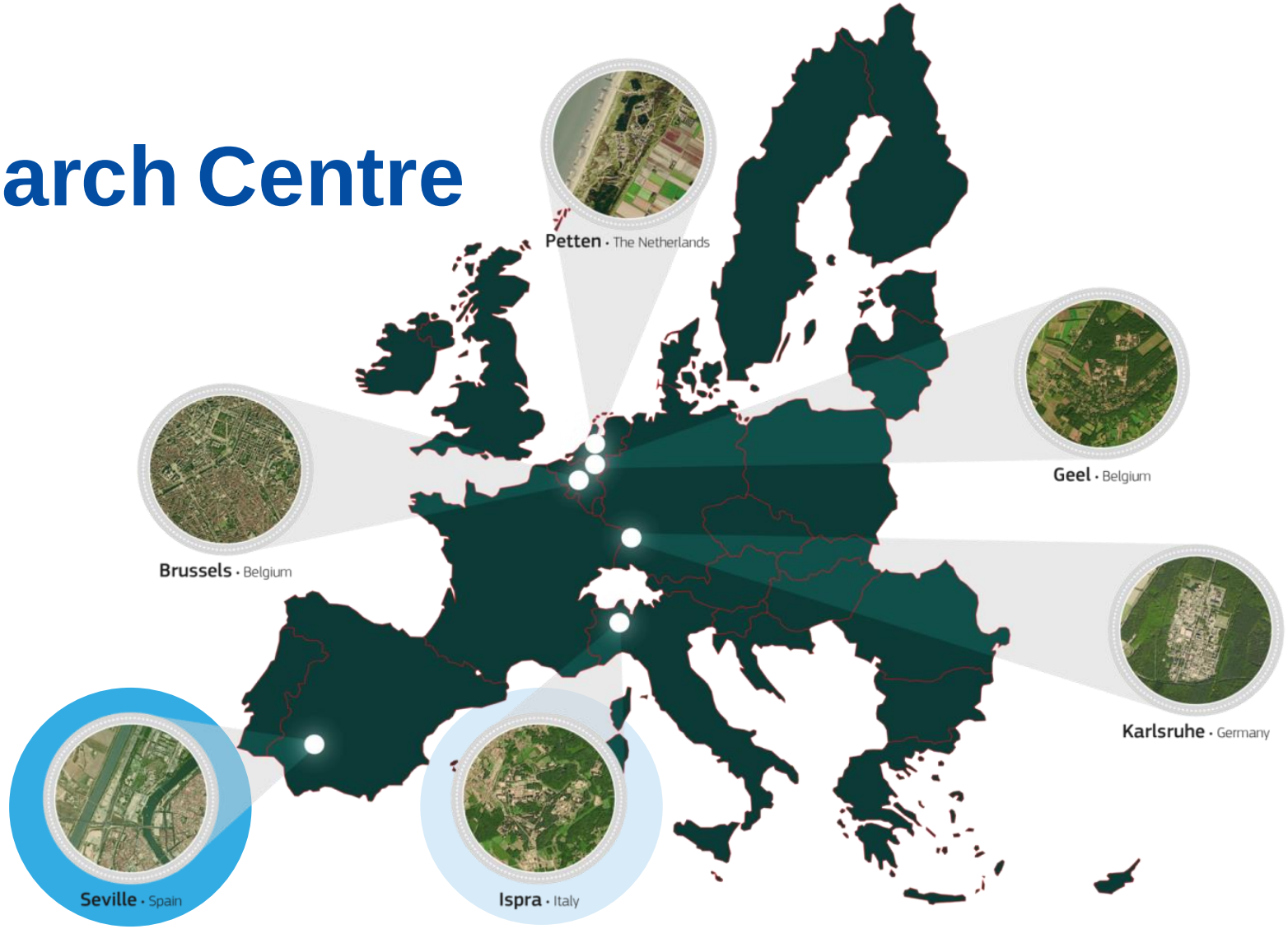
Development of EU Ecolabel criteria for retail financial products

Work programme and project timeline

DG JRC

European Commission

DG Joint Research Centre



JRC Sevilla – B5 Unit

- Overall coordination
- Day to day communication with DG ENV /DG FISMA
- Management of stakeholder engagement process
- Technical analysis of criteria and verification

JRC Ispra – B1 Unit

- Technical support on products, financial markets and asset classes
- Direct point of liaison and participation in the TEGs

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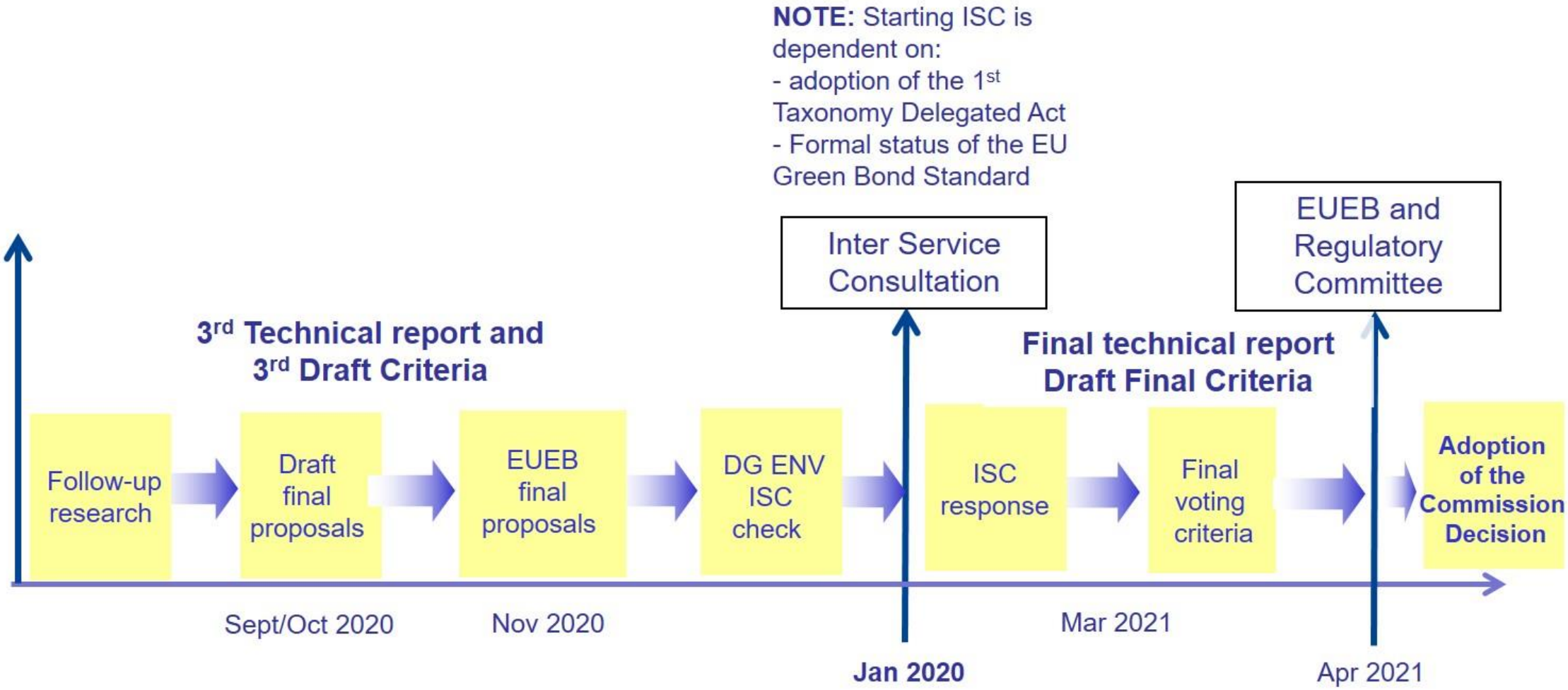
Project timeline

Project timeline



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Stakeholder consultation

- Comments can be submitted via the BATIS online consultation platform
- Registration required to obtain access
- Deadline for comments in BATIS: Friday 3rd April 2020
- Following analysis may organise follow-up bilaterals and/or sub-groups

Queries?

Registration: jrc-b5-financial-products@ec.europa.eu

BATIS: jrc-b5-product-bureau@ec.europa.eu

EU Ecolabel criteria for retail financial products

Any questions?

European Commission

EU Ecolabel for retail financial products

Session 1, 25th March 2020

Product scope and definitions

European Commission

1st scope proposal

This product group shall comprise the following financial products that are provided as a service by a fund manager and have 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):

- Investment funds, to include those referred to as Undertakings for the Collective Investment in Transferable Securities (UCITS) and, where applicable, Retail Alternative Investment Funds (RAIFs);
- Insurance-based products with an investment component, such as individual unit-life insurances.

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

Stakeholder feedback after the 1st AHWG meeting

163 comments in total on the scope proposal from 44 stakeholders.

- Majority welcomed focus on PRIIPs for the first criteria set, with reservations:
  - Those who considered that the criteria should be designed to include all PRIIPs, including all insurance product variants such as hybrid funds.
  - Those who considered that the scope should be extended beyond just PRIIPs to include institutional funds, professional funds and savings (deposit) accounts.
- Coherence needed in EU Ecolabel award - would not make sense to focus on one activity of a bank only for their other activities to be contradictory.

Stakeholder feedback after the 1st AHWG meeting

- Inclusion of a number of PRIIPs is to be clarified in the scope – individual unit-linked life insurances
- Clarity needed on how/if different elements of complex products are to be labelled – *e.g. hybrid insurance products consists of general fund and several unit-linked accounts*.

Do you think other financial products/services should be included in the initial scope?

Scope extension request	Number of stakeholders	% of stakeholders who asked for an extension	Summary rationale for comments
Savings & deposits	15	34%	Because of consumer significance. They are particularly relevant in some Member States, e.g. Germany, France.
'Institutional' or 'professional' investments	14	32%	Because of their significance in the financial market, to support the availability of labelled assets and as part of underlying assets to support a look through approach. Reference to products offered to professional and institutional investors used interchangeably.
Pension products	12	27%	As institutional investors, drivers of demand for responsible investment and because of their market significance.
'Professional' AIFs	8	18%	AIFs as an important vehicle for professional investors, important as the main type of 'green fund, they form underlying fund assets to support a 'look-through' approach and they are important for illiquid asset classes.

Proposed scope extension to **pension funds**

A diverse range of products that are intended to provide an income in old age.

‘….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’.

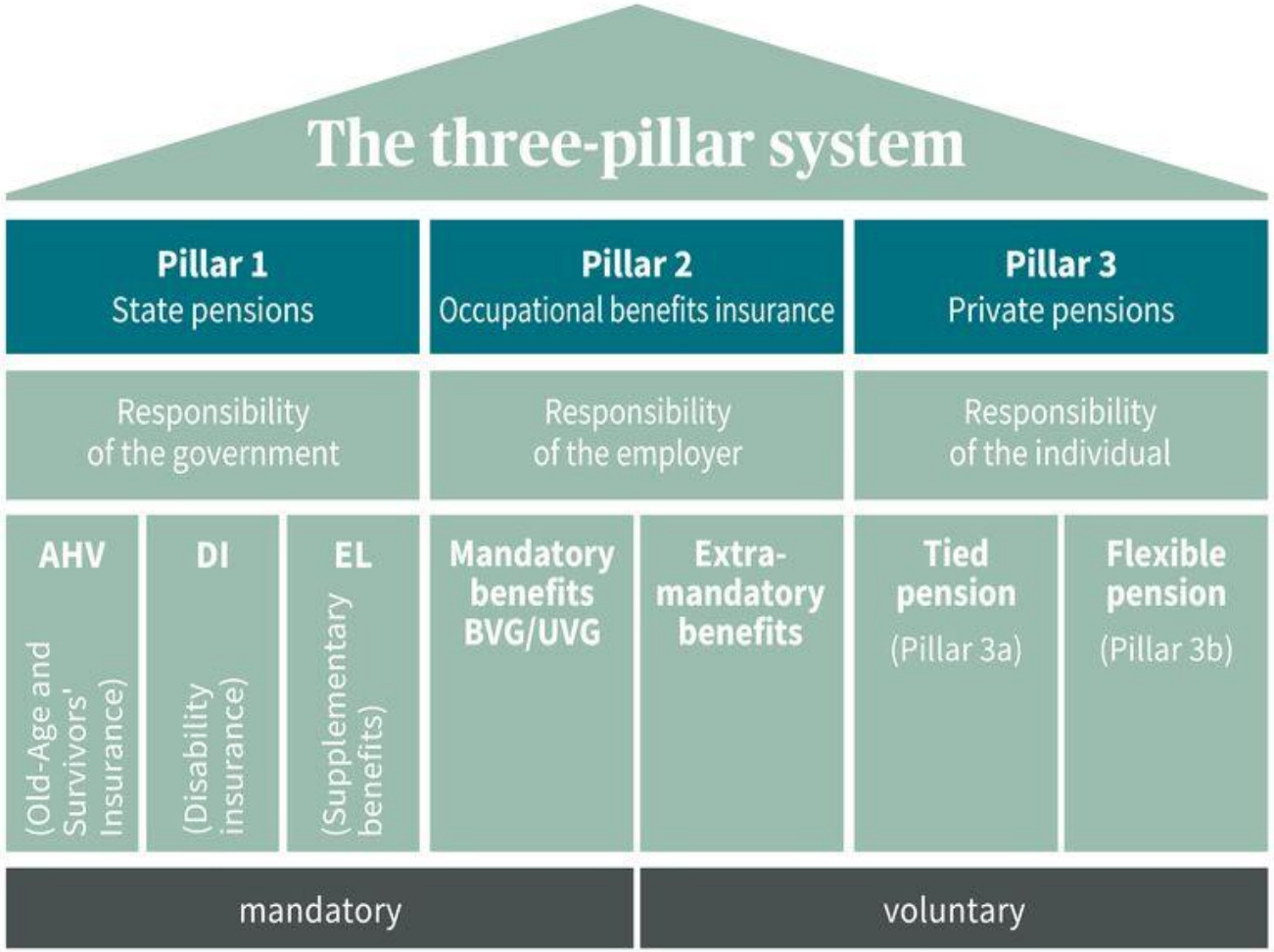
European Insurance and Occupational Pensions Authority (EIOPA)

Findings from further research
Pension funds

Pension products have, since the 1980s, been a focus for the development of more responsible investment policies by fund managers.

- Provision of pensions in the EU is dominated by public sector and occupational pension schemes.
- Annual contribution value of 122 billion EUR (2017) - approximately 27% of the European GDP
- Structure and function is regulated at Member State level - diversity of different models for their provision.

Findings from further research
Pension funds



Axa (2019)

Legal services 'test': direct or indirect provision of the labelled service that retail consumers can choose?

1st Pillar:
Mandatory public (PAYG) pension plans

- A public service which aims at ensuring a minimum standard of living for all pensioners.
- Financed based on taxes, not generally capital based with limited actual investment

There exist *some* examples of non-PAYG funds with choice of fund composition – Swedish AP fund

2nd Pillar: Employment-related DB plans or DC schemes

- Consist of defined benefit schemes (DB) and defined contributions schemes (DC)
- Can include unit-linked funds with an investment element
- Large numbers of trade association and sectoral schemes with limited or no choice of fund/provider
- Corporate schemes may include fund choices

  e.g. HSBC DC scheme provided by Legal & General

3rd Pillar:
Personal pension products

Most promising as they are chosen by individual retail customers

- Some respond to a reduction in the pillar one statutory retirement cover

  e.g. German ‘Riester Rente’, Austrian ‘Prämienbegünstigte Zukunftsvorsorge’

- In some Member States there is not yet a market and they have a limited degree of portability.

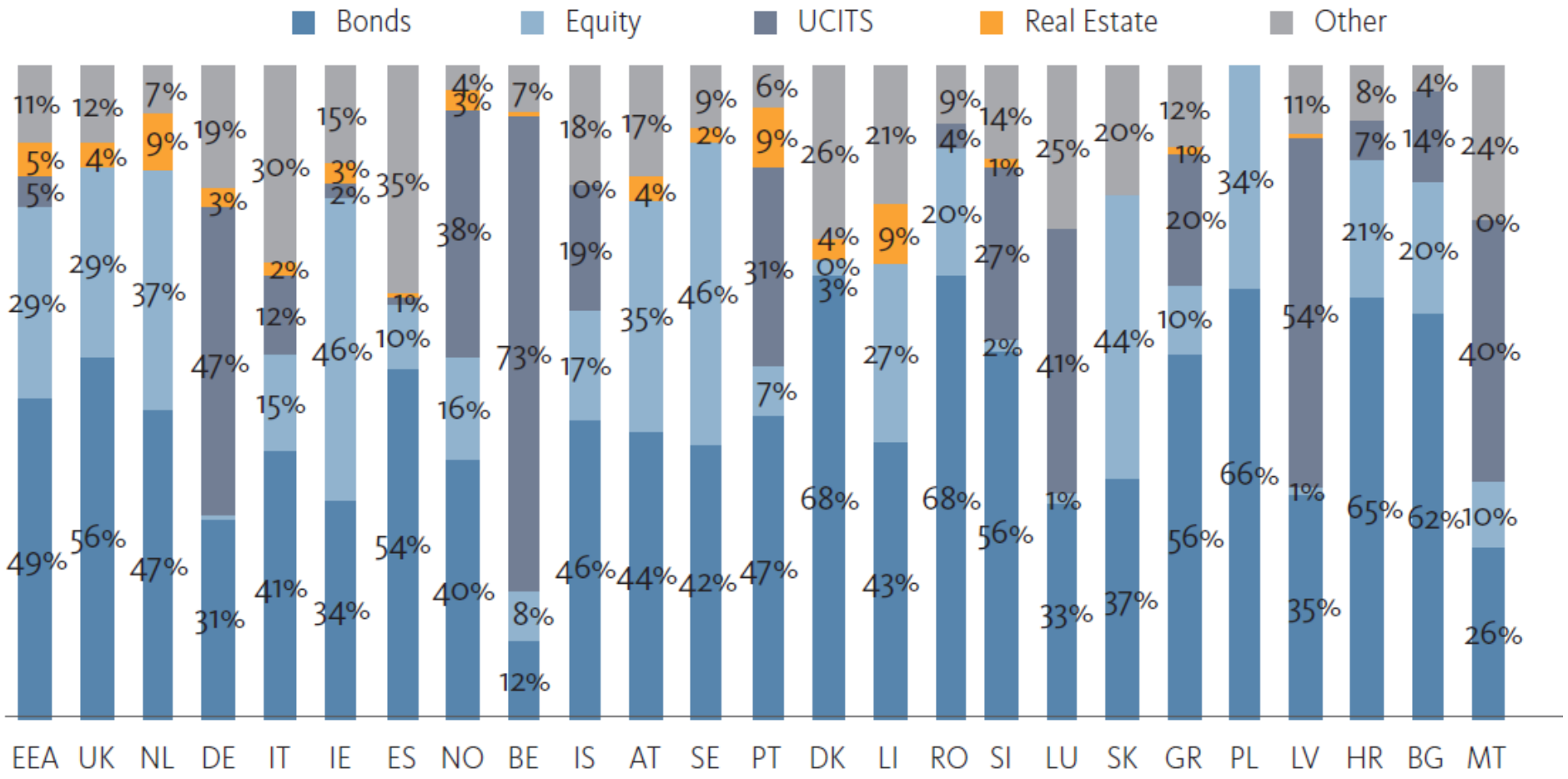
  Asset value of 3.4% EU market (Pensions Europe 2016)

- Will include the new EU-wide PEPP products

Verification of pension fund underlying assets

- Pillar 1 and 2 pension funds are diversified and commonly include other illiquid assets such as real estate and infrastructure
- Overall the ratio of liquid assets (debt, equity and UCITS) to illiquid assets (derivatives, loans, real estate and other investments) was approximately 5:1 (EIOPA 2017)
- Illiquid assets more important in certain Member States such as the Netherlands, Portugal and France.
- Less information is available for Pillar 3 pension funds

Pillar 2 pension product investment allocation per country (2017)



Source: EIOPA (2017)

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Scope conclusion: pension funds

Not currently considered possible to include *at present* :

- Pillar 1 and 2 - interpretation of the EU Ecolabel Regulation
  - The predominant types of funds and are provided indirectly to retail investors.
  - No consistency in extent of employee choice of Pillar 2 funds or providers.
- Pillar 3 products have greatest future potential for inclusion
  - Provider and fund(s) chosen by retail investors, but market share is currently estimated to be very small (<7%), greatly limiting their potential impact.

Scope conclusion: pension funds

- Diversified underlying assets: The inclusion of illiquid assets would require further forms of verification to support all possible fund compositions across the EU.

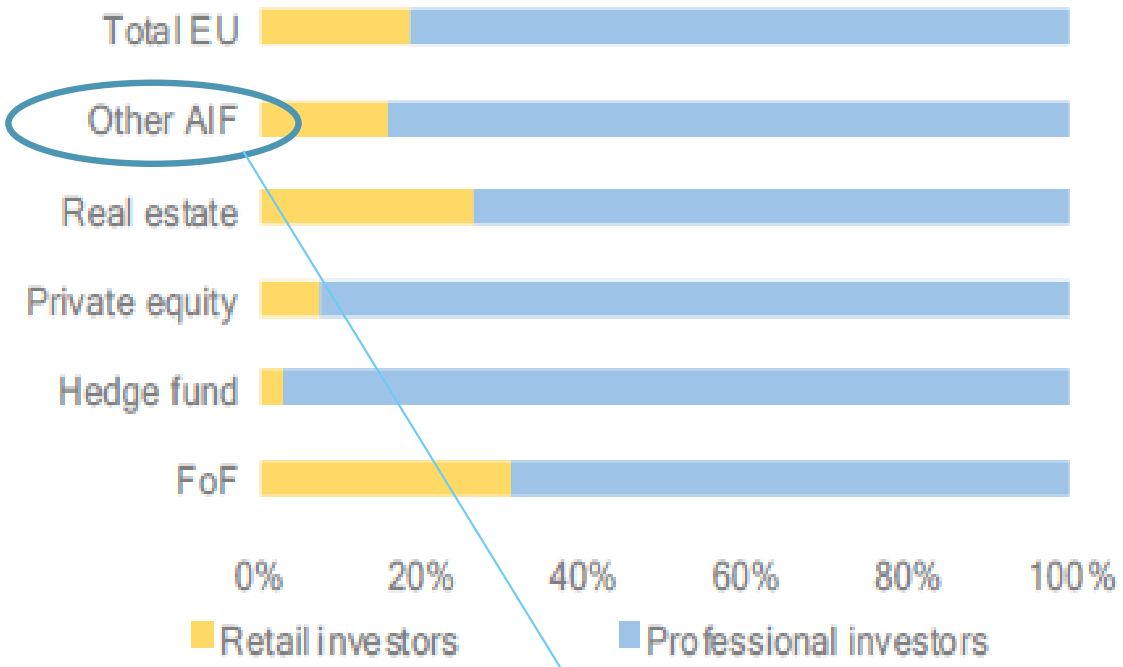
Proposal: **re-evaluate their inclusion in the scope at the 1st criteria revision.**

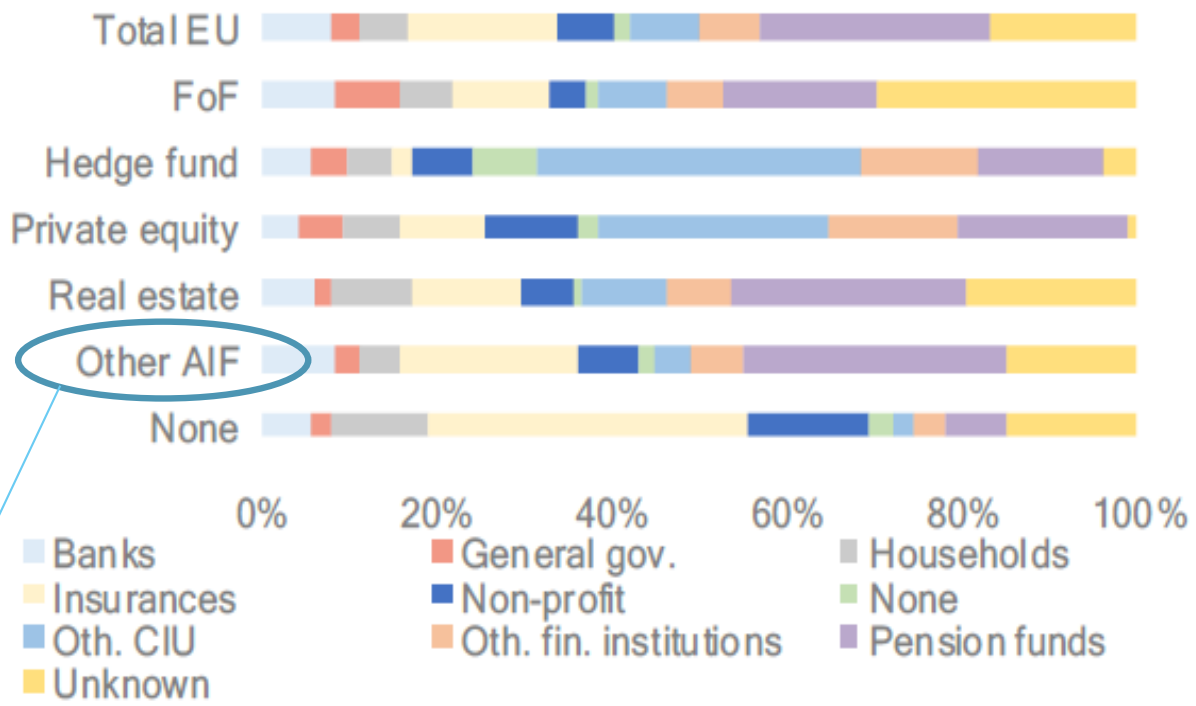
Proposed scope extension to **Professional AIFs**

Account for a diverse range of liquid and illiquid assets, with less transparent regulation and disclosure requirements than UCITS.

- AIFs account for approximately a third of the EU fund industry.
- Typically they are funds targeted at professional investors
- Many different types of AIFs - most commonly cited are Hedge Funds, Funds of Funds, Private Equity funds and Real Estate funds,
- Potential to invest in asset classes that are restricted for UCITS, such as illiquid assets that include property.
- Many renewable energy funds are AIFs

AIF investments and investors





Source: ESMA (2019)

Predominant AIF fund type (63% in 2019)

European Commission

Scope conclusion: **professional AIFs**

Not currently considered possible to include at present

- Business-to-business product (B2B):
  - Not understood to be offered/accessible to retail investors, with exception of 'high net worth individuals' – thought they may be underlyings.
- Need for expanded verification:
  - To fully cover the range of professional AIFs and to expand the range of EU Ecolabel master AIF funds available would require an expanded criterion 1.

Proposal: **re-evaluate their inclusion in the scope at the 1st criteria revision alongside pension funds.**

Proposed scope extension to **deposit accounts**

Directive 2014/49/EU (recast) on Deposit Guarantee Schemes:

> *(3) '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, but excluding a credit balance…*

Distinction between fixed-term deposits and savings deposits:

- **Savings deposit account**: a deposit with limited restrictions on withdrawals
- **Fixed-term account**: usually have maturity date or minimum term for holding in deposit.

Stakeholder feedback after the 1st AHWG meeting

- Potential to identify specific uses or to ‘ring fence’ or ‘earmark’ the money held in deposit accounts
- Verification of greenness is linked to the (green) loans made using the money deposited and use-of-proceeds identification.
- Would require a distinct form of verification because the funds sit on the balance sheet of the bank, on both the assets and liabilities side

Examples and precedents?

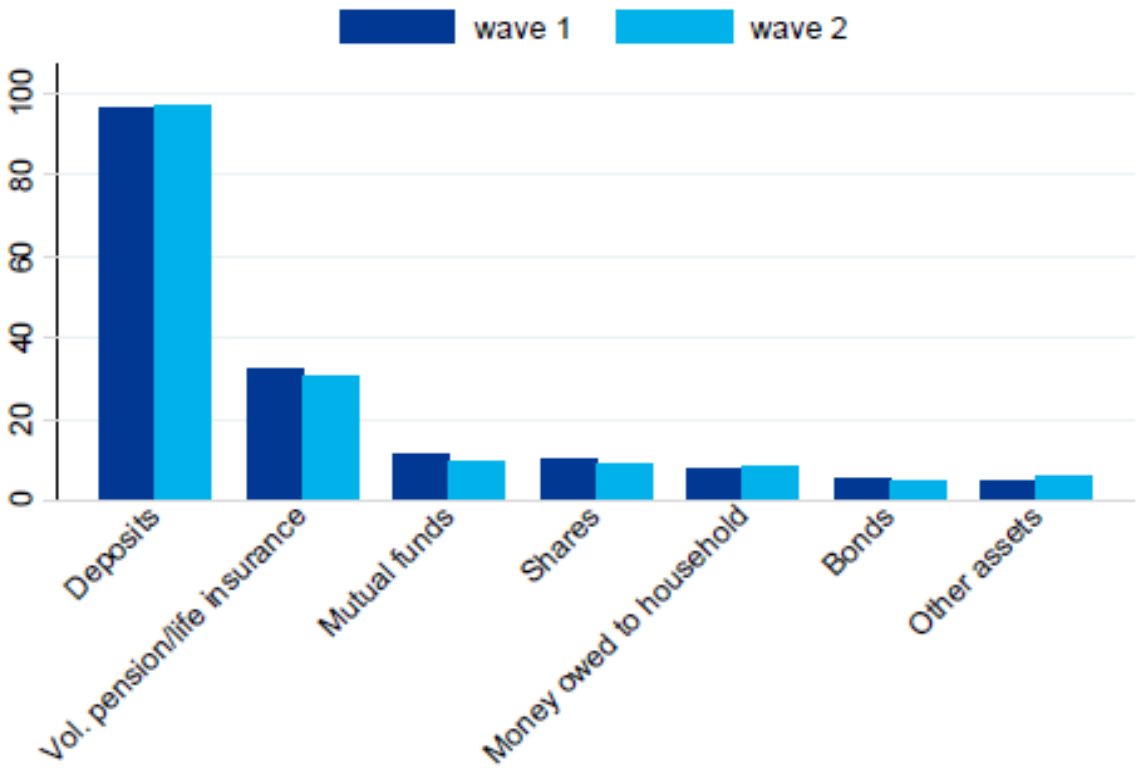
Triodos Bank, the Dutch Green Funds scheme (involving several banks), Raiffeisenkasse Bozen (Italy), Umweltcenter Gunskirchen (Austria).

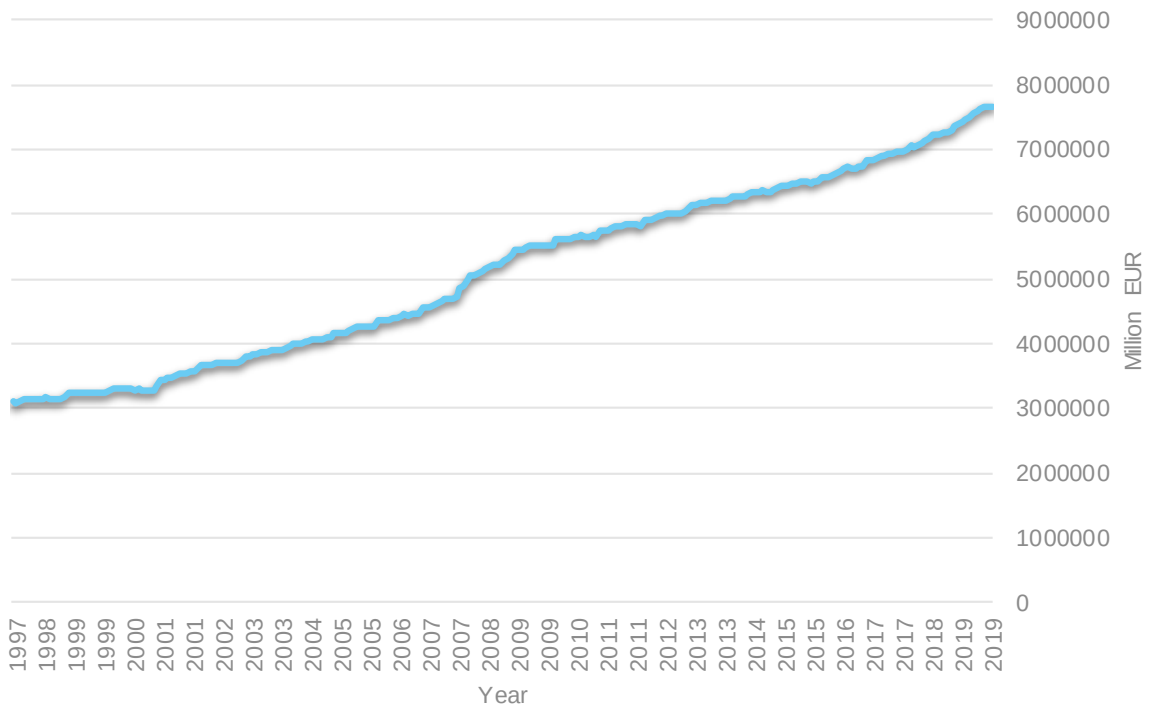
Follow-up research required

Further has been carried out with reference to:

- Legal definitions
- Views from the Commission's Legal Services.
  - Specific aspects of labelling the 'service' require more legal certainty before such a product can be awarded the EU Ecolabel.
- EU banking best practice
  - In order to address specific aspects of labelling such a services

Market significance of the service?





Source: ECB (2016,2019)

Scope conclusion: **savings/deposit products**

Proposal: Add "**service of managing savings/deposit accounts"**

- A mainstream product
  - Savings and deposit accounts play an important role in the economy, providing liquidity for investment by businesses.
- Diversification of the product scope
  - Green loans funded by such products can complement the tradable securities (largely bonds and equities) that make up the majority of investment fund portfolios. Bank loans play an important economic role at local and regional level.

Scope conclusion: **savings/deposit products**

- Simplified verification
  - The loans granted to projects and economic activities may be more straightforward to verify. Each loan can be identified and has to pass through a bank's credit approval process.
- Simple and easy to understand
  - A simple product that is widely understood and held by the majority of retail customers. It could provide a high level of visibility for the EU Ecolabel.

2nd (revised) criteria proposal

The product group shall comprise the following products that are provided as a service to retail investors:

- 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:
  - 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 unit-linked life insurances.
- 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.

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

European Commission

EU Ecolabel criteria for retail financial products

Overview of the criteria set

European Commission

Structure of the proposed criteria

Initial product scope:

- ✓ UCITS
- ✓ (R)AIFs
- ✓ Unit-linked insurance
- ✓ Deposit accounts

Criterion 1: Investment in green economic activities

Criterion 2: Exclusions based on environmental aspects

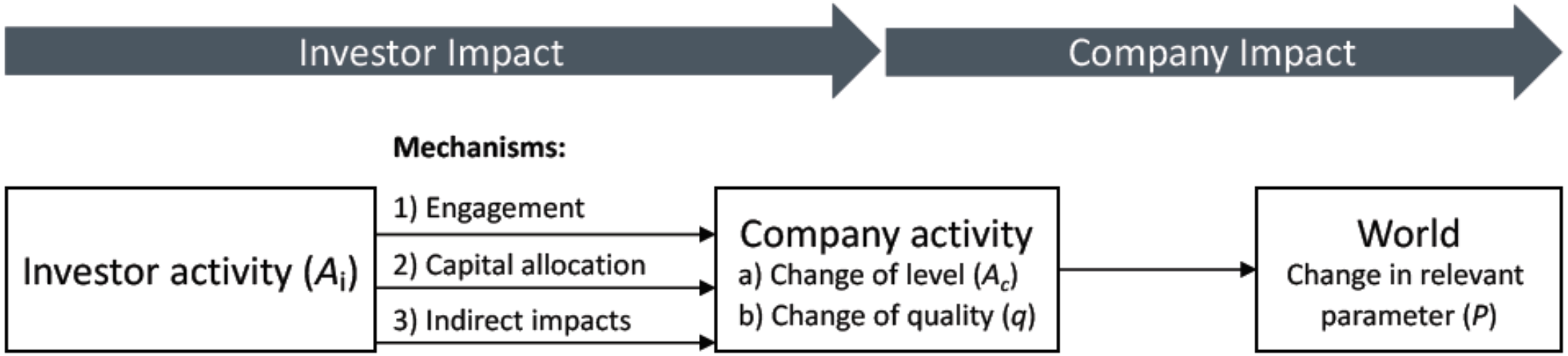
Criterion 3: Social and governance aspects

Criterion 4: Engagement

Criterion 5: Retail investor information

Investor impact leading to **company impact**

EU Ecolabel as proposed would seek to achieve **investor impact**



Source: Koelbel et al (2019)

Reflecting evidence of investor impact

Mechanism identified in literature	2nd EU Ecolabel criteria proposal	Findings from Koelbel et al (2019)
1. Shareholder engagement	Criterion 4: Engagement *New*	***Strong*** *evidence* for: - funds seeking higher returns - for ESG ratings and company activities
2. Capital allocation ***2.1 Incentivise improvements*** ***2.2 Affect growth***	Criterion 2: Environmental exclusions Criterion 3: Social exclusions Criterion 1: Investment in green economic activities	***Some*** *evidence* for screening effect on asset prices, requires exertion of a threshold % of investors ***Partial*** *evidence* with stronger effect on: - non-substitutable, less mature assets - where growth dependant on external finance
3. Indirect impacts ***3.1 Stimatisation*** ***3.2 Endorsement*** ***3.3 Benchmarking*** ***3.4 Demonstration***	Criterion 2: Environmental exclusions Criterion 5: Retailer investor information	***Unproven*** due to lack of empirical evidence, some evidence of improvements against low initial ESG ratings

Reflecting evidence of 'investor impact'

Mechanism identified in literature	2nd EU Ecolabel criteria proposal	Findings from Koelbel et al (2019)
1. Shareholder engagement	Criterion 4: Engagement *New* Encourage larger holdings and combined action	***Strong** evidence* for: - funds seeking higher returns - for ESG ratings and company activities
2. Capital allocation **2.1 Incentivise improvements** **2.2 Affect growth**	Criterion 2: Environmental exclusions Criterion 3: Social exclusions Criterion 1: Investment in green economic activities Taxonomy and NFRD establish market conditions Use 'green pocket' but more likely to be targeted by unregulated investors?	***Some** evidence* for screening effect on asset prices, requires exertion of a threshold % of investors ***Partial** evidence* with stronger effect on: - non-substitutable, less mature assets - where growth dependant on external finance
3. Indirect impacts **3.1 Stimatisation** **3.2 Endorsement** **3.3 Benchmarking** **3.4 Demonstration**	Criterion 2: Environmental exclusions Criterion 5: Retailer investor information	***Unproven*** due to lack of empirical evidence, some evidence of improvements against low initial ESG ratings

Potential to introduce investor impact metrics

EU Ecolabel for retail financial products

Criterion 1.1/1.2:Investment in green economic activities

European Commission

Criterion 1: Investment in green economic activities

Criterion 2: Exclusions based on environmental aspects

Criterion 3: Social and governance aspects

Criterion 4: Engagement

Criterion 5: Retail investor information

Criterion 6: Information provided on the EU Ecolabel

1st criterion proposal

1.1 Investment portfolio greenness thresholds

The investment portfolio of the financial product shall meet the below mentioned threshold for the proportion of total portfolio asset value invested in green activities. This proportion of total portfolio asset value shall be verified based on the company economic activities related to the equities or bonds that are held and the use of proceeds of the bonds that are held.

Portfolio holdings

- 70% of the total portfolio asset value shall be invested in green economic activities as defined in point 1.2. All portfolio assets must be included in the total.

Assets held by the portfolio

Equities and bonds shall comply with the following thresholds:

a. Equities: At least 90% of the direct holdings (in terms of number of issuers) of the company have a turnover of at least 50% from green economic activities as defined by point 1.2

b. Bonds: At least 70% of value of all the bonds held in the portfolio shall be green and those bonds that contribute to greenness thresholds must be fully compliant with the EU GBS

Verification of greenness is not required for any other assets but they must still be included in the total portfolio asset value that must meet the portfolio threshold

1st criterion proposal

1.2 Green economic activities

For an economic activity within an investment portfolio to be considered green it shall meet the following requirements:

(a) It shall contribute substantially to at least one of the EU Taxonomy's Environmental Objectives, for which technical screening criteria are available:

(i) climate change mitigation,

(ii) climate change adaptation,

(iii) sustainable use and protection of water and marine resources,

(iv) transition to a circular economy, waste prevention and recycling;

(v) pollution prevention and control and

(vi) protection of healthy ecosystems,

(b) while not significantly harming any of the other objectives, and

(c) It shall comply with the minimum social safeguards represented by the principles and rights set out in the eight fundamental conventions identified in the International Labour Organisation's declaration on Fundamental Rights and Principles at Work

European Commission

1st criterion proposal

Assessment and verification

The applicant shall provide the following documentation showing the minimum percentage to be invested in green activities:

- the green investment policy of the applicant
- portfolio statement and prospectus including:
    a) complete listing of the portfolio assets for the financial product, and
    b) evidence that at least 70% of the listed portfolio assets are invested in green activities,
    c) an audit report on the latest annual financial statements.

EU GBS certificates shall be accepted as proof of compliance to criterion 1.

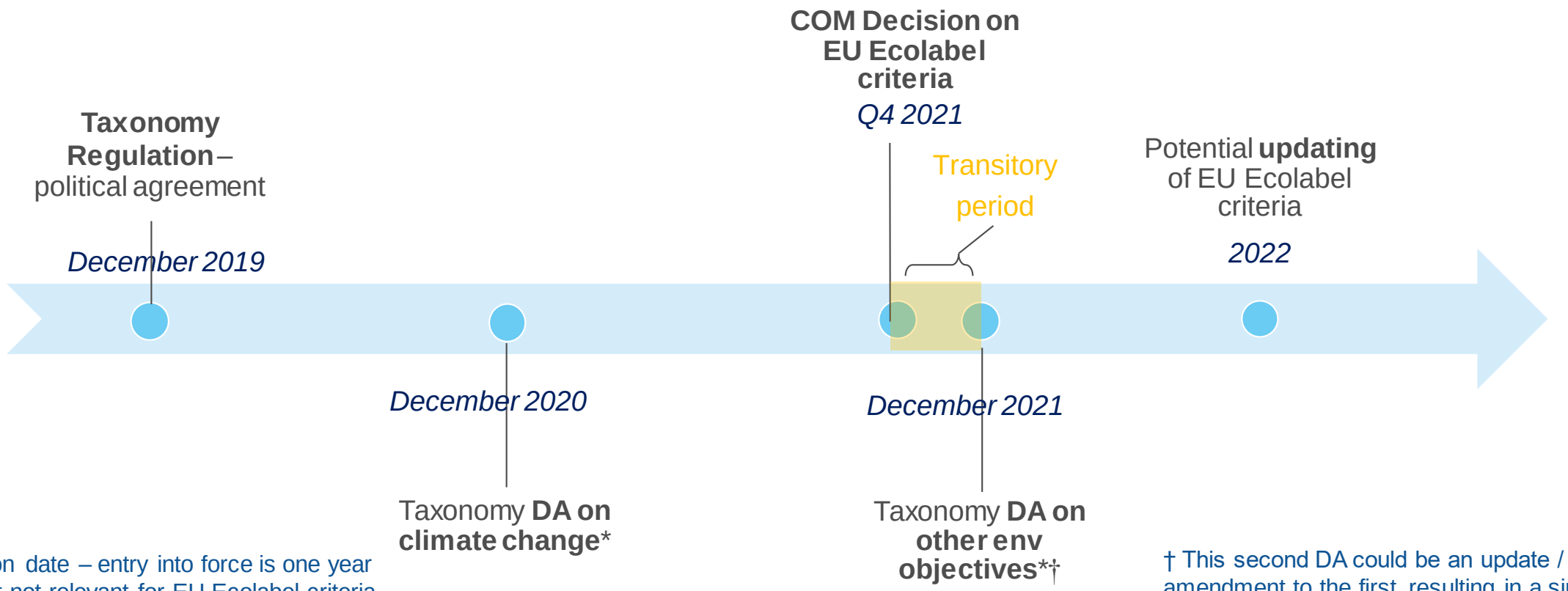
Stakeholder feedback: EU taxonomy

The links between the EU Ecolabel and the EU Taxonomy

- Numerous comments were received on the link between the EU Ecolabel and the EU Taxonomy, and the differing timelines for their completion
- The EU Ecolabel to be put in place after the adoption of the EU Taxonomy delegated act on climate mitigation

Timelines of Taxonomy DAs vs. Decision on EU Ecolabel

- Difference in timelines imply a transitory period, during which the investment universe for EU Ecolabel criteria is smaller (climate-only)



* Adoption date – entry into force is one year later, but not relevant for EU Ecolabel criteria

† This second DA could be an update / amendment to the first, resulting in a single DA.

Stakeholder feedback: EU taxonomy

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

- Suggestions made on using a temporary framework based on other market methodologies or existing taxonomies

Findings from further research: EU taxonomy

- Adopting a temporary framework to address economic activities not yet featured in the current version of the EU Taxonomy would not serve to improve the transparency of the financial sector

- Adoption of existing taxonomies might also be perceived as an endorsement by the EC of one specific taxonomy over others

Stakeholder feedback: assets in other funds

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

- To apply the same assessment and verification criteria for equities and bonds to funds of funds (FoFs) because they do not require a special form of verification
- Assets held in other investment funds should be within the scope, and that the label should be awarded at the fund level, and should cover the entire portfolio
- It would be very challenging to apply the look-through approach in order to determine the degree of greenness at the funds of funds level and it was suggested that a simplified treatment should be envisaged for target funds certified under the EU Ecolabel
- It was suggested that at least 90% of the value of FoFs to be invested in funds with the EU Ecolabel. The remaining 10% should not be invested in unlabeled funds but in transferable securities or money market instruments

Findings from further research: assets in other funds

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

- The UCITS Directive limits the proportion of these funds to 10% of a fund's portfolio.
- Consequently, this percentage is introduced as a cap in the portfolio to be invested in transferable securities or money market instruments to 10% with the condition that the overall thresholds are complied with

Stakeholder feedback: real estate

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

- The inclusion of listed real estate as a specific asset class within the portfolio verification is supported from some stakeholders
- However, others noted that most real estate is neither listed equity nor directly available to retail investors
- Suggestions to apply specific criteria and thresholds available in the EU Taxonomy, and existing green building and energy performance standards to verify its performance

Findings from further research: real estate

- UCITS can not include illiquid assets
- Most real estate (80%) is not directly available to retail investors

<20%

Stakeholder feedback: portfolio greenness

When calculating portfolio greenness, should assets for which verification of greenness is not required be included within the total portfolio asset value?

- Suggestions to include these assets arguing that it is essential as it would be the basis for the calculation of the greenness of the portfolio
- Their exclusion would result in a portfolio with only a very small portion of qualifying green assets which could still obtain a label
- Those opposed their inclusion, suggested to either relate the portfolio threshold only to the cumulative value of assets for which the degree of greenness could be assessed
- An alternative proposal was to lower the overall portfolio threshold

Findings from further research: portfolio greenness

- Investment funds typically include specific assets classes (e.g. derivatives or cash) which are used by asset managers to maintain investment flexibility and to hedge risks
- It has been highlighted that assessing and verifying criteria developed for these asset classes could be very complex and challenging as it would be difficult to relate them to EU-Taxonomy-eligible activities or capital investment
- However, total exclusion would restrict the investment portfolio and lead to lower uptake of the EU Ecolabel
- Existing financial labels and schemes adopt varying approaches to derivatives

Stakeholder feedback: criteria on trading practices

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

- Most respondents did not favour the idea and argued:

  i) Derivatives and cash are used for risk management practices of the portfolio

  ii) The UCITS Regulation permits UCITS funds to invest in transferable securities in other liquid financial assets

- Some stakeholders supported this position, stressing that the practical implications of such criteria would make assessment and verification of underlying assets more complex but suggested that as these assets are limited in terms of their proportional contribution in portfolios, they could be considered in the calculation of the total portfolio value

Findings from further research: criteria on trading practices

- Derivatives and cash are excluded as an eligible green asset class but they are included in the calculation of total portfolio value (TR1.0). This is in line with the suggestion of some asset managers
- Given the high level of concern raised by stakeholders on the need to limit the use of derivatives mandatory reporting is proposed
- Similar reporting requirements are available for derivative instruments in some national labels and in Eurosif's transparency code.
- The UCITS Directive provides a reference point for making restrictions on how derivatives can be used. CESR guidelines for UCITS also provide a reference point.

Stakeholder feedback: tailored verification

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

- A large majority of the stakeholders noted that in doing so it would result in an increase in the cost and complexity of the process
- A variety of responses were provided by other stakeholders who recommended that 70% of the portfolio needs to be invested in green activities and stated that the cash position should not exceed 30% of the portfolio

Findings from further research: tailored verification

JRC is also the opinion that tailoring specific parts of the assessment and verification for bonds and equities of:

- investment funds which include UCITS
- where applicable, RAIFs
- Insurance-based products with an investment component e.g. individual unit-linked life insurances

would increase the cost and complexity of the assessment and verification and result in a limited uptake of the EU Ecolabel. That is contradictory to the EU Ecolabel goal to stimulate the financing of environmentally sustainable investments, this suggestion is not considered further

JRC suggests only one type of assessment and verification to apply to all individual products

Stakeholder feedback: portfolio greenness

Feedback related to the greenness of the investment portfolio (1)

- The criterion proposal is considered 'strict' and therefore counterproductive to the uptake of the EU Ecolabel, so many favoured lower thresholds
- Threshold at the portfolio level should be lower than the proposed 70% given the diversified nature of companies and that new technologies require time to generate a high level of returns
- The majority supported a company revenue thresholds lower than the proposed 50%
- Only few supported the proposed threshold at the portfolio level and some called for a higher threshold beyond 70%

Stakeholder feedback: portfolio greenness

Feedback related to the greenness of the investment portfolio (2)

- To ensure that the proposed thresholds are implementable they should be tested on eligible financial products
- It was recommended that an expert subgroup to be set up to determine the limits for potential thresholds
- The majority of comments on the criterion requirement for bonds agreed that the proposed threshold reflects the state of the market, with some proposing even higher thresholds.
- A majority emphasised that it would be premature to require all bonds contributing to the greenness threshold to comply with the requirements of the EU GBS because it is a voluntary standard and its acceptability in the market cannot be currently assessed

Stakeholder feedback: portfolio greenness

Feedback related to the greenness of the investment portfolio (3)

Alternative threshold proposals and comments included the following:

- 50% portfolio threshold and 20% return on company revenue
- The portfolio threshold should be maintained (in value) but a uniform threshold for both listed equities and bonds should be applied
- A labelling system should be applied rather than thresholds to enable investors to compare mainstream products with reference to a specific indicator e.g. GHG emissions

Stakeholder feedback: portfolio greenness

Feedback related to the greenness of the investment portfolio (4)

- As to direct holdings and their proportion in the criteria requirement for equities, the majority recommended that the requirement shall be removed
- The thresholds too ambitious and not achievable in the current state of the market

Findings from further research: portfolio greenness

- JRC analysed the consultation process results, which have highlighted the strictness of the criterion
- A working subgroup was set up following a call for expression of interest addressed to all stakeholders to test portfolio thresholds and their verification
- It was recommended by stakeholders and the sub-group to only have thresholds at portfolio and company level
- The sub-group suggested a potential threshold at the portfolio level could lie between 50% and 70%
- The sub-group considered the term revenue the most appropriate parameter to be applied to companies' thresholds.

Findings from further research: portfolio greenness

Portfolio and company level thresholds in the European market

Label/Scheme	Taxonomy	Thresholds at Company level (green company)	Thresholds at portfolio level (weighted)	Resulting minimum threshold of aggregated turnover from green activities at portfolio level
LuxFLAG Climate Finance	IDFC	Company with a turnover of at least 50% turnover from eco-activities	75% of green companies	**37.5%**
LuxFLAG Environment	Taxonomy derived from the main environmental classification systems	Company with a turnover of at least 20% turnover from eco-activities	75% of green companies. Within this pocket, companies must derive 33% of turnover from eco-activities in aggregate	**24.75%**
French Greenfin	CBI taxonomy (slightly modified)	Three types of companies (I: more than 50% from eco-activities, II: between 10 and 50%, III: less than 10%)	Portfolio made up of at least 20% of Type I companies and no more than 25% of Type III	**15.5%**
Nordic Swan	ICMA	No threshold at holding level	No mandatory threshold, but the point system rewards portfolios that can demonstrate a share of 10 / 22 / 35 or 50% of aggregated turnover from eco-activities	**At least 10%**

Findings from further research: portfolio greenness

Initial test parameters

*At **least 60% of the total portfolio value (weighted)** shall be invested in companies whose economic activities comply with the thresholds for equities and bonds below:*

- *a. Equities: At least 50% of company revenue(weighted) shall be from EU Taxonomy eligible activities*
- *b. Bonds: At least 70% of all bonds must comply with the EU Green Bond Standard*
- c. Mixed funds*: the equity share must comply with the requirement for equities in (a), and the bond part must comply with the requirement for bonds in (b).”*

Findings from further research: portfolio greenness

Five-step approach for testing double threshold

i. Identify the activities conducted by the company or issuer or those covered by the financial product (e.g. projects, use of proceeds) that could be eligible

ii. For each potentially eligible activity, verify whether the company or issuer meets the relevant Taxonomy technical screening criteria (difficult to verify)

iii. Verify that the DNSH criteria are being met by the issuer (difficult to verify)

iv. Conduct due diligence to avoid any violation of the social minimum safeguards stipulated in the Taxonomy Regulation (difficult to verify)

v. Calculate alignment of investments with the EU Taxonomy and prepare disclosures at the investment product level (difficult to verify)

Findings from further research: portfolio greenness

Test results

Fund	Investment in companies with a min. of 50% green eco- activity	Threshold of 60% of portfolio met?	Threshold of 50% of portfolio met?
A	55.2%	N	Y
B	51%	N	Y
C	55.1%	N	Y
D	29.4%	N	N
E	51.4%	N	Y
F	64%	Y	Y
G	52%	N	Y

Findings from further research: portfolio greenness

Test results interpretation

Further suggestion to adjust the 50%/50% threshold

Proposals are a result of an analysis to maintain greenness and to minimise the risk of non-diversification

- Threshold 20%-30% of revenue at company level and covering at least 50% of the portfolio (weighted)
- Thresholds of at least 20% of revenue at company level and covering at least 80% of the portfolio (weighted)
- Thresholds of at least 15% of the revenue and covering at least 60% of the portfolio (weighted)

Findings from further research: portfolio greenness

A review of the data provided by asset managers was conducted to assess the potential for adopting this approach – **Indicative results** - **small sample** - **limitations**

Pocket size		Fund A	Fund B	Fund C	Fund D	Fund E	Fund F	Average
Green pocket (at least 50%)		55	39	31	24	56	67.5	45.4
Transition pocket	Small transition (20-49%)	42	16	10	38	21.5	22.4	22
	Medium-sized transition (15-49%)	42	18	19	38	23.4	24.6	25
	Large transition (10-49%)	42	21	42	57	23.4	32.9	35
Total (green pocket + small transition)		97	55	41	62	63	89	67.8
Diversification pocket		3	45	59	38	37	11	32.2

Further testing: external study commissioned by DG FISMA

- ‘Climate and Company’ has been selected.
- The academics will test draft criterion 1 for financial products for a representative sample of 100 “green” UCITS equity investment funds
  - they will analyse UCITS equity investment funds portfolios and identify the level/portion of the activities of the issuers of the equities in which the funds invest that are compliant with the new EU taxonomy for green activities
- The study will provide an additional basis for the potential adjustment of the draft criterion.
- The results will be published in June 2020.

Findings from further research: portfolio greenness

- A comparison of the transition pockets for the funds analysed showed the marginal increase in the proportion of companies in the portfolio of a medium-sized or large transition pocket.

- It is considered more practical to focus on a small transition pocket and have a differentiation only between two types of issuers depicted
  - Green pocket - Companies at least 50% revenues of green activities
  - Transition pocket - Companies that have 20% - 49% revenues of green activities

Summary rationale for the major changes

- The direct holdings threshold is excluded
- At least 90% of the value of FoFs to be invested in funds with the EU Ecolabel
- Derivatives and cash verification of greenness is not required, they shall comply with environmental and social exclusions
- One type of assessment and verification will apply to all individual products
- A three-pocket approach was considered and the data available in the fund set analysed and documented as presented in the rationale for the second criteria proposal

2nd (revised) criteria proposal

Definition: green economic activity

A 'green economic activity' is an environmentally sustainable economic activity as defined by the Taxonomy Regulation, i.e. an economic activity that complies with the relevant technical screening criteria adopted under the Taxonomy Regulation

1.1 Investment funds

A. Equity funds

At least 60% of the total portfolio value in terms of assets under management (AuM) shall be invested in companies whose economic activities comply with the following threshold:

i. At least 20% of AuM shall be invested in companies deriving at least 50% of their revenue from green economic activities

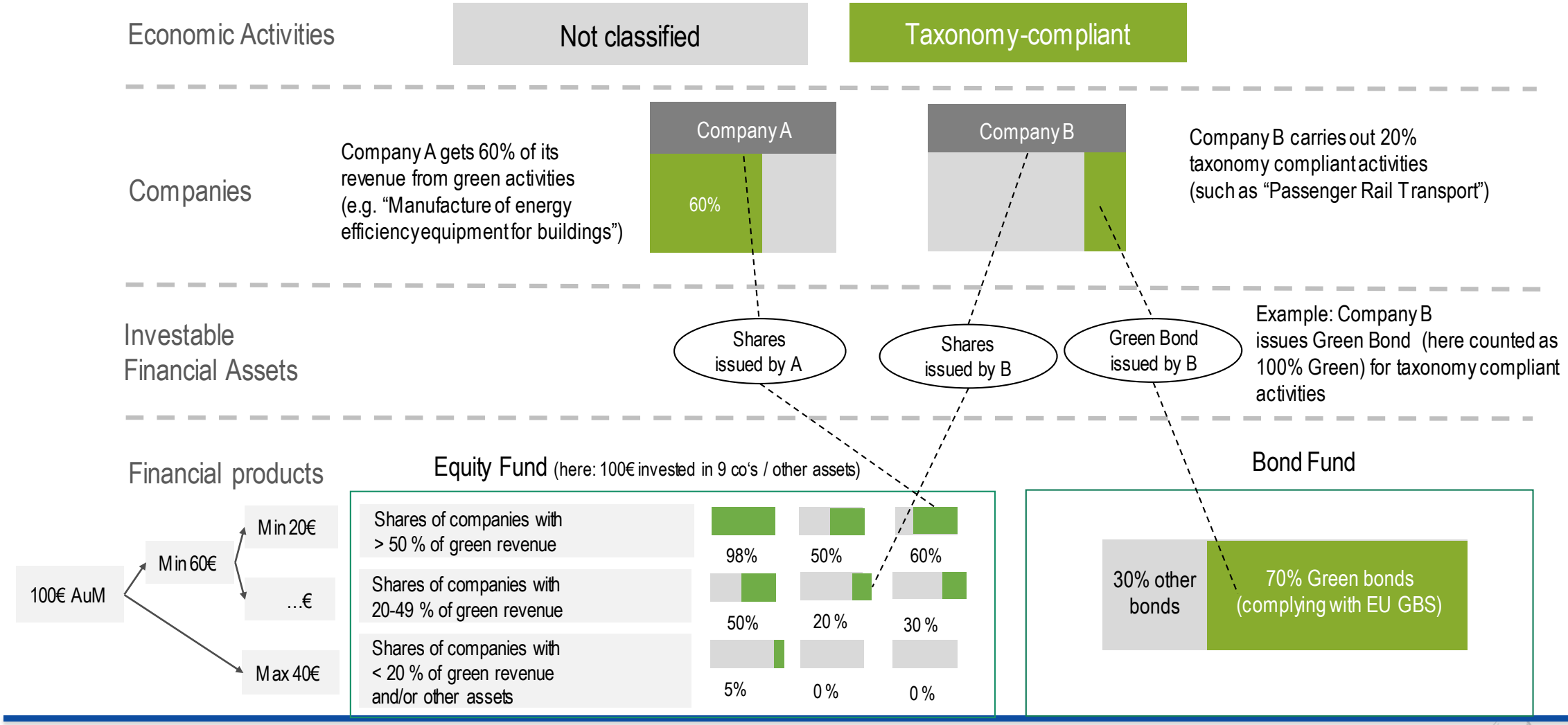
ii. The remaining proportion of AuM (0-40%) shall be invested in companies deriving between 20% and 49% of their revenue from green economic activities

The remaining proportion of the total portfolio shall consist of

- companies deriving less than 20% of their revenue from green economic activities and not excluded by criteria 2 or 3, or
- other assets or cash

European Commission

Minimum investment in Taxonomy-aligned activities



European Commission

2nd (revised) criteria proposal

B. Bond funds

At least 70% of the total portfolio asset value shall be invested in bonds that comply with the EU GBS

If the bond fund comprises sovereign and sub-sovereign bonds, these shall not be excluded by criteria 2.2

C. Mixed funds

For mixed funds, the equity part shall comply with the requirement for equity funds in (A), and the bond part shall comply with the requirement for bond funds in (B)

D. Funds of funds (FoFs)

For funds of funds (FoFs), at least 90% of the AuM shall be invested in funds that have been awarded the EU Ecolabel

E. Feeder funds

Feeder funds shall have a master fund that has been awarded the EU Ecolabel

2nd (revised) criteria proposal

Derivatives

A UCITS or Retail AIF 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.

The underlying assets shall comply with EU Ecolabel criteria, including on environmental and social exclusions as well as consumer information.

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

Other assets

Other assets shall be counted in the total portfolio, when assessing compliance with the portfolio threshold in terms of AuM.

Stakeholder feedback after the 1st AHWG meeting

Assessment and verification

- There was a call for the assessment and verification to be more stringent, and clear on the documentation
- The EU Ecolabel could require documentation to be supplied by major ESG research providers
- Competent Bodies should be supported by external independent auditors

Findings from further research

Assessment and Verification

JRC has reviewed A&V to clarify as much as possible the relevant documentation required as proof of compliance

- It is challenging for the EU Ecolabel to require that 'evidence' or proof of compliance be provided only by "major ESG providers" because these materials could also be prepared internally by applicants
- Currently, it is envisaged that the EU Ecolabel will not evaluate documentation/materials provided by the applicants as proof of compliance based on the source but rather on compliance with the requirement

2nd (revised) criteria proposal

Assessment and verification

A. Equity funds

The applicant shall provide:

i. documentation showing that the monthly averages for the 12 months preceding the application for the EU Ecolabel comply with the portfolio composition requirements for equity funds or pre-contractual information and 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 and bond funds as specified in A and B.

ii. An audit report on the latest annual financial statement

2nd (revised) criteria proposal

B. Bonds funds

The applicant shall provide the following:

- documentation showing that at least 70% of the total portfolio asset value complies with the EU GBS, based on the monthly averages for the 12 months preceding the application for the EU Ecolabel and,
- the EU GBS certificates for the bond funds as proof of projects financing in green economic activities

C. Mixed funds

The applicant shall provide documentation showing that the fund complies with the respective minimum percentages for the equity and bond shares as specified in A and B of this section, based on monthly averages for the 12 months preceding the application for the EU Ecolabel.

D. Fund of funds (FoFs)

The applicant shall provide the portfolio statement and prospectus indicating that:

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

E. Feeder funds

The applicant shall provide the portfolio statement and prospectus indicating the following:

- portfolio's composition showing that the underlying fund has been awarded the EU Ecolabel

2nd (revised) criteria proposal

Derivatives

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 and how the derivatives comply with the EU Ecolabel criteria, including on environmental and social exclusions.
- A listing of the types of derivatives and other assets used during the last 12 months preceding the application for the EU Ecolabel, including their nature, average total amount invested (i.e. share of the portfolio) and their average duration/frequency of use shall be demonstrated.
- For OTC derivatives, compliance with the EU Ecolabel criteria on environmental and social exclusions, and consumer information on all of the counterparties used over the last 12 months preceding the application for the EU Ecolabel.

European Commission

2nd (revised) criteria proposal

1.2 Unit-linked insurance products

Unit-linked insurance products consisting of a UCITS or Retail AIF shall, on a look-through basis, comply with the requirements set out in sub-criterion 1.1 for investment funds for equities in A. for the equity share, and for bonds in B. for the bond part

Where the unit-linked insurance product consists of several UCITS and/or Retail AIFs, the requirements for equities and bonds shall apply at the level of the sum total, over all relevant UCITS and/or Retail AIFs, of the values of the equity shares and bond parts, respectively

Assessment and verification

The applicant shall provide documentation showing that the monthly averages for the 12 months preceding the application for the EU Ecolabel request comply with the respective minimum percentages for the equity and bond shares as specified in A and B assets in sub-criterion 1.1

EU Ecolabel for retail financial products

Any questions?

European Commission

EU Ecolabel for retail financial products

Criterion 1.3: Investment in green economic activities

European Commission

Criterion 1: Investment in green economic activities

Criterion 2: Exclusions based on environmental aspects

Criterion 3: Social and governance aspects

Criterion 4: Engagement

Criterion 5: Retail investor information

Criterion 6: Information provided on the EU Ecolabel

Proposed scope extension to deposit accounts

*The service of managing a **fixed-term deposit or savings deposit product** as referred to in Art. 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 the deposits held (liabilities) and the associated loans granted as credits (assets) appear.*

- **Savings deposit account**: a deposit with limited restrictions on withdrawals
- **Fixed-term account**: usually have maturity date or minimum term for holding in deposit.

Stakeholder feedback after the 1st AHWG meeting

- Potential to identify specific uses or to ‘ring fence’ or ‘earmark’ the money held in deposit accounts
- Would require a distinct form of verification because the funds sit on the balance sheet of the bank, on both the assets and liabilities side
- Reference to the (green) loans made using the money deposited and a project-based approach to the use of the loans.

Examples and precedents?

Triodos Bank, the Dutch Green Funds scheme (involving several banks), Raiffeisenkasse Bozen (Italy), Umweltcenter Gunskirchen (Austria).

What makes a savings or deposit account ‘green’?

- The earmarking of ‘green loans’ (credit) to green (EU Taxonomy compliant) projects or companies engaged in green economic activities.
- Traceability of the link between the money that is placed in deposit and how that money is then used by a credit institution to provide (green) loans to applicants for credit.
- Monitoring and disclosure of the status of the green loans – has the loan facility been used and have the projects in the business plan proceeded?
- Reporting and disclosure to retail consumers of the projects that have been granted loans and financed using the money held in deposit

Key aspects to analyse following consultation with the Commission's Legal Services

Aspects of the product terms and conditions	How is the link between funds deposited and the funds loaned communicated and verified to customers?
Balance sheet ring fencing and traceability	Is the link between funds deposited (liabilities) and the funds loaned (assets) reported on the balance sheet in annual reports? *What structures and accounting procedures are used*?
Green deposit to loan ratio	What proportion of: 1. the money deposited is used to provide loans? 2. the loans made using the money deposited are green?
Impact monitoring and reporting	How is the drawdown of loan facilities monitored and is reporting on projects financed reported to retail customers?
Banking and service structure	Who provides the customer interface and is this the same as the credit institution/entity who provides the service?

Follow-up research
Market experience in traceability and verification

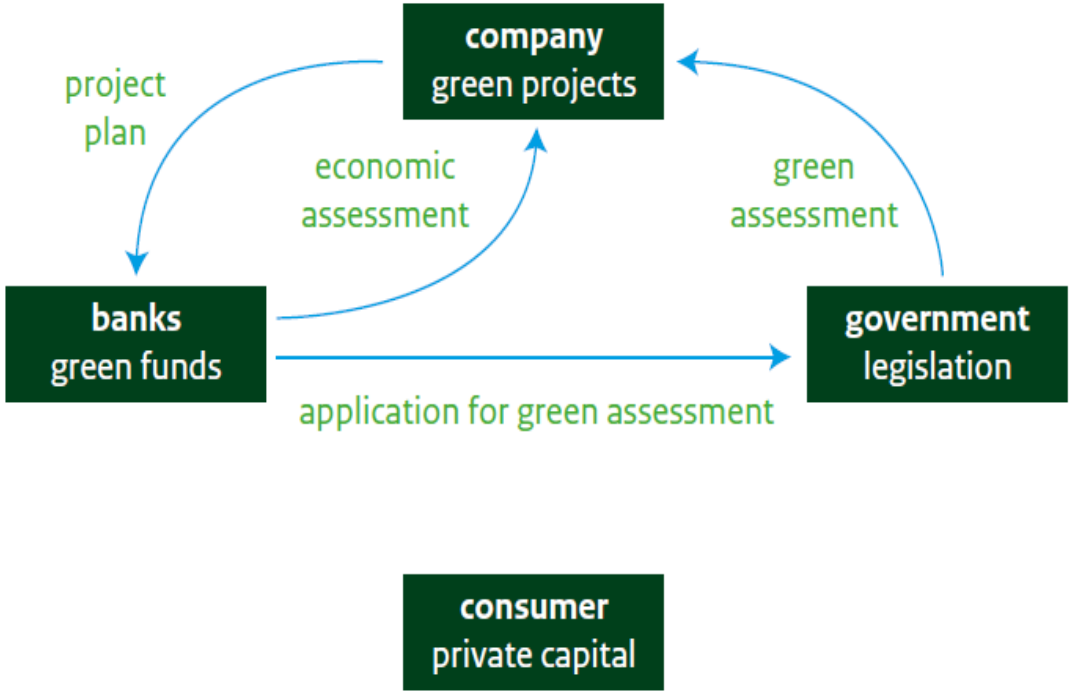
- Niche products were initially developed by specialist and regional banks
- The Netherlands as focal point - the Dutch Green Funds scheme
- Larger mainstream retail banks seeking to extend green loan activities – La Caixa, BBVA (Spain)

Analysis of precedents

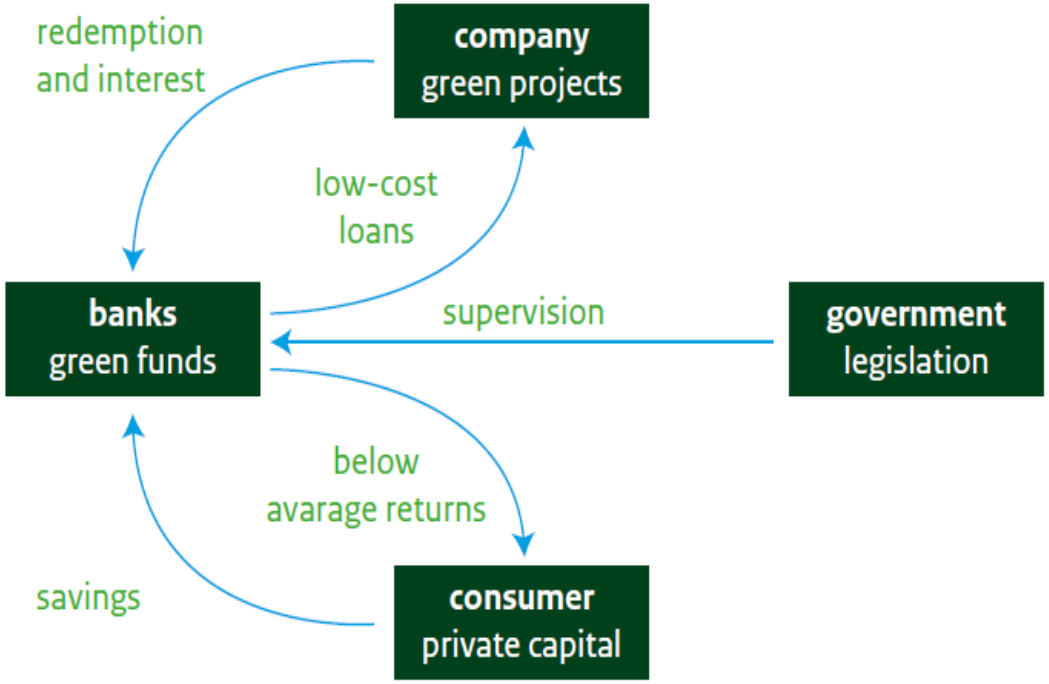
- *Banks analysed:* ABN Amro, Rabobank, Triodos, Raiffeisenkasse Bozen (Italy) and Umweltcenter Gunskirchen (Austria).

Dutch Green Fund scheme as potential model?

Concession of 'green loans'



Link to money held in deposit



Source: Netherlands Ministry of Housing, Spatial planning and the Environment (2010)

Legal Services' 'tests'
Product terms and conditions

How is the link between funds deposited and the funds loaned communicated and verified to customers?

- All loans made with the money deposited will be made in accordance with green criteria, or
- A specific percentage of the money deposited will be used for green loans.

Legal Services ‘tests’
Balance sheet ringfencing and traceability

Is the link between funds deposited (liabilities) and the funds loaned (assets) reported on the balance sheet in annual reports?

- Green ‘deposit to loan’ ratio can be checked/reported in bank’s annual financial report – value of earmarked deposits and verified green loans
- The banks under study are achieving 75–85% of the money deposited being used for green loans.
  - Triodos Bank target ratio 1.18 (85%)
  - Netherlands Green Fund scheme: target of 1.43 (70%)

Example: Rabobank balance sheet reports 1.25 (80.3%) in 2018

Legal Services ‘tests’
Balance sheet ringfencing and traceability

Green ‘deposit to loan’ ratio influenced in practice by:

- Need to maintain to cover withdrawals – accounts may have notice or fixed term
- The capacity of the bank to attract clients/make green loans - may lead to temporary closure to new customers and/or additional deposits by existing customers.

Legal Services ‘tests’
Impact monitoring and reporting

How is the drawdown of loan facilities monitored and is reporting on projects financed reported to retail customers?

- Green loans can be verified on an itemised, project-by-project basis from a documented external audit procedure.
- Literature on project’s or activities financed can be provided on the internet and in product-specific communications
- Internal monitoring of loan facilities would have to be used for disclosure – minimum every 12 months

Legal Services ‘tests’
Banking and service structure

Who provides the customer interface and is this the same as the credit institution/entity who provides the service?

- Case 1: Credit institution managing the account and assigning green loans is the same entity, with some ringfencing (e.g. Triodos, Dutch Greenbanks);
- Case 2: The savings product (service) is marketed/provided by a subsidiary (e.g. ABN Amro Greenbank and Moneyou)
- Case 3: Marketed/provided by a parent bank with loans assigned by different partner institutions, each with specialist knowledge of green projects (e.g. Raiffeisenkasse Bozen)

Summary rationale for 1st proposal

It appears possible to verify the balance sheet of a bank and to identify and reconcile deposit value with loan value

Very structured approach to traceability and verification needed:

- Relationship expressed as a green loan to deposit ratio or percentage.
- Green loan lending criteria applied by a bank's credit committee.
- Verification of decision-making process and the compliance of the projects or economic activities with the green loan criteria.
- Transparency provided by monitoring and reporting on projects and economic activities in an accessible format.

1st criteria proposal

1.3. Green fixed-term and savings deposit accounts

Requirement 1. Green loan 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 loans 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 ratio shall be stated and after a minimum of one year on the market the licence-holder shall declare the ratio achieved to the Competent Body.

1st criteria proposal

Requirement 2. Green loans made using the deposited money

Loans contributing to the green loan to deposit ratio shall only be granted to green economic activities. The applicant shall provide annual updates on the implementation status of the funded projects or activity.

The list of projects and green economic activities funded shall be disclosed in a dedicated EU Ecolabel report to be provided to the retail customer and/or a dedicated web-based portal to which retail customers will be provided access.

1st criteria proposal

Requirement 3. Internal ring fencing of the deposited money

The money held in deposit and granted as loans shall be strictly ring fenced within the accounts of the Credit Institution. The structural solution and/or internal procedures used shall allow for the traceability of the each retail customer's deposited money and their contribution to the total value of the green loans granted.

1st criteria proposal

Assessment and verification

The applicant shall provide on an annual basis an itemised list of the green loans approved for projects and activities. The value and type of projects and/or green economic activities funded shall be identified for each loan. This listing shall be provided and/or updated year on year. The applicant shall provide a declaration that the green loans list is in compliance with the EU Taxonomy requirements for green economic activities. Competent Bodies reserve the right to select projects at random from a loans list for verification purposes.

The applicant shall provide a set of declarations and supporting information to verify the declared loan to deposit ratio and to ensure that is traceable and transparent. They shall comprise the following:

1st criteria proposal

i. The total value of the deposits derived from individual values marked and entered into the Single Customer View (SCV) for the specific product.

ii. The value of each green loans and bonds granted using the deposited money. This shall be recorded and declared together with the total value of the green loans and bonds for each year.

iii. The internal procedures and/or structures used to ring fence the funds 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 which may be included in the annual report of the credit institution.

iv. 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.

Thank you

Contact

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