EU Ecolabel for retail financial products
Session 2, 25th March 2020
EU Ecolabel for retail financial products

Criterion 2: Exclusions based on environmental aspects
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
General background - exclusions

- Sustainable investors may shift asset prices by applying screening approaches such as:
  - negative screening (excluding certain harmful industries)
  - norm-based screening (excluding companies that do not adhere to widely accepted norms of business conduct)
  - best-in-class screening (allocating capital to companies that have the best ESG performance relative to their industry peers).

- All approaches have in common that they result in a portfolio allocation that differs from the market portfolio.

- Investors may create incentives for companies that fulfill exclusion criteria to enact reforms.

General background – exclusions in EU Ecolabel

• Negative screening: certain general exclusions apply to assure that no products harming the objectives of the EU Ecolabel may be included in a product

• Restrict/divest flow of investments from sectors which are generally accepted as 'unsustainable', environmentally unfriendly, or which do not meet the general level of ambition set by the EU Ecolabel.

• These hard exclusions act as a cut-off for the worst in class.

• Harmonising the screening approaches in order to increase effects on asset prices and/or incentives for companies
General background - exclusions in EU Ecolabel

- Exclusions were firmly asked for by stakeholders
- Existing national labels (e.g. the FNG Siegel, the LuxFlag Climate Finance Label, the Greenfin Label, the Nordic Swan Ecolabel and lastly the Austrian Ecolabel Umweltzeichen) set exclusion criteria
- From a broad list of exclusionary topics…
- …to a detailed list of specific and verifiable excluded activities
- Link to EU Taxonomy where relevant but EU Ecolabel can be stricter
- **Not an attempt to create a brown taxonomy**
General background - exclusions in EU Ecolabel

Non-inclusion in Taxonomy does not necessarily imply the activity should be part of the EU Ecolabel exclusion list.

<table>
<thead>
<tr>
<th>Examples</th>
<th>Included in Taxonomy</th>
<th>Not included in Taxonomy nor excluded under EU Ecolabel</th>
<th>Excluded under EU Ecolabel</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Electricity production from hydropower with $&lt;100$g CO2e/kWh</td>
<td>Electricity production from hydropower with $&gt;100$g CO2e/kWh</td>
<td>Electricity production from coal</td>
</tr>
<tr>
<td>Agriculture enhancing soil carbon stocks</td>
<td>Agriculture enhancing soil carbon stocks</td>
<td>Production of pesticides approved for use in EU</td>
<td>Production of pesticides not approved for use in EU</td>
</tr>
</tbody>
</table>
Methodology for setting up exclusions

1. Broad list of thematic areas based on other ecolabelling schemes

2. Stakeholders’ opinions

3. EU/international policy reference

4. Complementarity with TEG Taxonomy (wherever possible)

Ecolabel as voluntary instrument for excellence in the market

Perception of green investment

Specific and verifiable criterion
Methodology for setting up exclusions

- An evaluation of the harmfulness of an economic activity (or its risk) was not conducted.
- Also, a screening of all economic activities which could potentially be excluded was not conducted.
- The aim was to turn into specific and verifiable criteria the economic activities that stakeholders/EU policy-makers believe should be excluded by EU Ecolabel criteria.
### 1st Proposal for Criterion 3: Excluded activities – Environmental aspects

Companies that derive their revenue from the following activities shall be excluded from investment portfolios of the financial product:

- Coal, natural gas and crude oil exploration and extraction
- Coal, natural gas and crude oil refining for fuel
- Forms of energy generation from fossil fuels that are excluded from the EU Taxonomy
- Waste management facilities without materials or energy recovery
- Production of pesticides that are not authorised for use or import to the EU
- Production of industrial gases with a high Global Warming Potential and/or Ozone Depletion Potential
- Illegal deforestation

These exclusions shall apply to all activities within an investment portfolio. A cut off threshold 5% of the total revenue derived from each company may be associated with these excluded activities.

### Sovereign bonds

In the case of sovereign bonds or bonds issued by international organisations the following exclusions shall apply either to the issuing country or the economic activity:

- Non ratification of the Paris Agreement
- Non ratification of the UN Convention for Biological Diversity
- Non ratification of international conventions on environmental protection
- Internationally funded projects that could damage valuable and/or protected natural areas
Stakeholder feedback after the 1st AHWG meeting

Partial exclusions

- 116 comments from 52 stakeholders
- A partial exclusion percentage is practical, allows for diversification in the portfolio and encourages transition
- Should be carefully chosen, general consensus on the 5% threshold
  - Applied at company level
  - Applied to all companies in the portfolio
    - Challenges to set it at fund or portfolio level:
      1. Price fluctuations and specific weighting of underlying assets
      2. Companies with significant climate change impacts could qualify for fund inclusion
- Some stakeholders agreed only on the condition to totally exclude the activities believed to have very negative impacts
Stakeholder feedback after the 1st AHWG meeting

Excluded activities

• Difficult to address as the effect of proposed environmental exclusions on the uptake cannot be critically assessed (especially energy sector)

• Additional activities proposed for exclusion:
  • Aviation sector
  • Automotive industry
  • Mining activities
  • Production of gases with significant GWP and ODP
  • Waste management not promoting material recovery

• General consensus on exclusion of carbon-intensive products and sectors unless they are transitioning
Stakeholder feedback after the 1st AHWG meeting

Transitionary exclusions

- Many stakeholders suggested to include technical transition criteria
- Sectors that could significantly contribute to climate change mitigation shall not be excluded in the event they are transitioning
- Only for specific sectors and with case-specific thresholds
- Based on environmental performance thresholds rather than revenues, e.g. CO$_2$ emissions threshold
- Stakeholders suggestions mainly focused on energy generation
Summary rationale for the major changes

- The text has been clarified into specific requirements for each retail financial product type
- New retail financial products covered by the scope have been taken into account
- The list of exclusions has been comprehensively revised content-wise and restructured
- Transitionary exclusions have been introduced
- Coverage of sovereign bonds has been expanded
## 2nd proposal of criterion text

### Second proposal for criterion 2: Excluded activities – Environmental aspects

#### 2.1 Exclusions relating to economic activities

The investment portfolio shall not contain equities or corporate bonds issued by companies that derive more than 5% of their revenue from the excluded activities listed below.

The investment portfolio may contain use-of-proceeds bonds issued by such companies, provided that the proceeds are not used to finance excluded activities.

For fixed-term and savings deposit accounts, corporate loans shall not be made to these companies and project loans shall not finance the excluded activities.

#### 2.1.1 List of exclusions

**Agriculture**

- Production of pesticides, including plant protection products, that are not approved for use in the EU and which are identified in the Rotterdam Convention Prior Informed Consent (PIC) procedure.\(^{54}\)
- The development, distribution and cultivation of food or feed from genetically modified varieties of plants that have not passed a risk assessment carried out according to the criteria in Annex II to Regulation EN 503/2013 or equivalent.
- Production of agricultural products, including vegetable oils, on land obtained as a result of deforestation of primary forest or the drainage of peatlands or wetlands after the year 2000.
- Production of agricultural products without the use of integrated pest management systems and procedures.
- Production of agricultural products using water for irrigation in areas where there is severe water scarcity.
Forestry

- Timber production and exploitation, unless the economic operator can 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 \textsuperscript{32}, or
  - that the harvest is not from the clear-felling or unsustainable exploitation of old growth, primary forests that have a high biodiversity value and/or carbon stock.

Energy sector

- Solid, liquid and gaseous fossil fuel exploration, extraction and refining for fuel. This includes unconventional sources such as hydraulic fracking and shale deposits.
- Use of solid, liquid or gaseous fossil fuels for electricity generation.
- All activities relating to the nuclear fuel cycle, including power generation.

Waste management

- Waste management facilities and services that do not operate any form of material segregation for the purposes of preparation for reuse, recycling and/or energy recovery, as well as the processing or stabilisation of organic waste.
- landfill sites without leachate and methane gas capture.
- Incineration not equipped with flue-gas treatment that complies with Directive 2000/76/EC on the incineration of waste or equivalent internationally recognised standards and without a high level of heat recovery and/or power generation.

Manufacturing

- Production of hazardous chemicals that are not authorised or registered for use in the EU and which are identified in the Rotterdam Convention Prior Informed Consent (PIC) procedure\textsuperscript{34}.
- Production of fluorinated greenhouse gases with a Global Warming Potential (GWP) of >150.
- Production of substances with a high Ozone Depletion Potential (ODP) listed as controlled and as prohibited by the Ozone Regulation (EC) No 1005/2009.
- The mining, processing and production of asbestos and asbestos-based products.
2nd proposal of criterion text

2.1.2 Transitionary exclusions

Transportation

Production, distribution and sale of new passenger cars and light commercial vehicles, unless the company undertaking the activity complies with the following requirements:

- *For new passenger cars:* Manufacturers shall have made available to consumers at least one zero- and low-emission vehicle (ZLEV) model with tailpipe emissions of <50 g CO₂/km and the average tailpipe emissions of all models that they have registered in the last calendar year shall be 5% lower than the respective EU target applicable at the time.

- *For light commercial vehicles:* The average tailpipe emissions of all models that a manufacturer registered in the last calendar year shall be 5% lower than the respective tailpipe CO₂ emissions target.
1\textsuperscript{st} criteria proposal
Assessment and Verification for 2.1

\textbf{Assessment and verification}

The applicant shall provide the investment policy, investment portfolio and the allocation of proceeds to the Competent Body. Further to the initial verification, internal checks shall be performed at least once per year and any changes communicated to the Competent Body who also retains the right to make random checks on compliance.
Summary of the major changes

• The text has been clarified
• The assessment method for the newly proposed transitional exclusions has been added
• Focus on company level information
✓ Declaration of compliance for the fund based on knowledge of the underlying companies in which equity is held
2nd criteria proposal
Assessment and Verification for 2.1

Assessment and verification

Holdings or loans relating to any of the economic activities to which exclusions apply shall be clearly identified on a company basis. The applicant shall then provide a declaration of compliance for the fund or deposit account as a whole for each of the specific exclusions as they relate to the economic activities.

For the transitional exclusions a company report or specific technical reports which show overall compliance with the thresholds shall be required for each company in which equity is held or to which loans have been granted.

Further to the initial verification, internal checks shall be performed at least once per year and any changes communicated to the Competent Body who also retains the right to make random checks on compliance.
2\textsuperscript{nd} (revised) criteria proposal

2.1 Exclusions relating to economic activities

- Threshold: 5% in terms of company revenue
- Applies to: equities and corporate bonds
- **Use-of-proceeds bond** issued by companies that derive more than 5% of their revenues from excluded activities are allowed, provided that the proceeds do not finance excluded activities
- For **fixed-term and savings deposit** accounts:
  - Corporate loans to these companies are not allowed
  - Project loans to these activities are not allowed
Stakeholder feedback after the 1\textsuperscript{st} AHWG meeting

**Agriculture**

- Stakeholders were in favour of excluding pesticides, GMOs and unsustainable palm oil production

- Contrasting views on GMOs:
  - GMOs should be excluded based on the precautionary principle and based on public perception of EU Ecolabel
  - No negative impacts have been identified from GMOs already in the market and exclusion may undermine research and innovation
2\textsuperscript{nd} criteria proposal

\textbf{Agriculture}

- Production of \textit{pesticides}, including plant protection products, that are not approved for use in the EU and which are identified in the Rotterdam Convention Prior Informed Consent (PIC) procedure.

- The development, distribution and cultivation of food or feed from \textit{genetically modified} varieties of plants that have not passed a risk assessment carried out according to the criteria in Annex II to Regulation EN 503/2013 or equivalent.

- Production of \textit{agricultural products}, including vegetable oils, on land obtained as a result of deforestation of primary forest or the drainage of peatlands or wetlands after the year 2000.

- Production of \textit{agricultural products} without the use of integrated pest management systems and procedures.

- Production of \textit{agricultural products} using water for irrigation in areas where there is severe water scarcity.
Findings from further research

Agriculture (pesticides)

TR1 starting point: “Production of pesticides that are not authorised for use or import to the EU are excluded”

Checkpoint: EU/international policy reference

✓ In the EU approval required for active substances (pesticides) used in plant protection products

✓ Prior Informed Content (PIC) Procedure of the Rotterdam Convention (voluntary) Annex III lists 35 pesticides

➢ Excluded if not approved for use in the EU and/or if identified in the Rotterdam Convention Prior Informed Consent (PIC) procedure
Findings from further research
Agriculture (GMO crops)

TR1 starting point: *further discussion/feedback was required*

Main checkpoint: **EU/international policy reference**

- Authorisation required for the use of GM crops for cultivation or the import of food or feed containing GM substances

- Excluded if failure to pass a risk assessment carried out according to the criteria in Annex II to Regulation EN 503/2013 or equivalent
Findings from further research
Agriculture (Agricultural products)

TR1 starting point: *vegetable oil focus considered to be too narrow*

Main checkpoint: **EU/international policy reference**

✓ Common Agricultural Policy ensures minimum impacts in terms of deforestation, land use change, organic carbon stock, biodiversity loss

➢ Specific focus on land obtained as a result of deforestation of primary forest or the drainage of peatlands or wetlands after the year 2000

➢ Reference to IPM farming techniques as minimum practice for controlling pesticide use
For discussion: ‘…production using water for irrigation in areas where there is severe water scarcity.’

Checkpoint: EU policy reference point

✓ Blueprint on water resources focus on agricultural water use

Checkpoint: EU Taxonomy

✓ Establishes future focus in Delegated Acts on the protection of water resources

Challenges to make it specific and verifiable

- mapping granularity, % of holdings farmed
Stakeholder feedback after the 1st AHWG meeting
Forestry

• Stakeholders were concerned that focusing on the illegal aspects of timber activities only would be a limited proposal

• Stakeholders recommended reference to Sustainable Forest Management

• Stakeholders recommended alignment with the EU Taxonomy
Timber production and exploitation, unless the economic operator can demonstrate the following:

- That the timber is covered by valid FLEGT or CITES licenses and/or is controlled by a due diligence system which provides the information set out in Regulation (EU) 995/2010, or

- That the harvest is not from the clear felling or unsustainable exploitation of old growth, primary forests that have a high biodiversity value and/or carbon stock.
Findings from further research

Forestry

TR1 starting point: “Illegal deforestation is excluded”

Checkpoint: EU/international policy reference

- Timber Regulation, EU FLEGT, UN CITES, EC COM (2019) 352, SFM certifications such as FSC and PEFC

Checkpoint: EU Taxonomy

- Compliance with SFM requirements and steady progress in terms of GHG balance baseline for above-ground carbon pools

- Excluded if cannot demonstrate sustainability licenses or not exploitation of primary forests
Stakeholder feedback after the 1<sup>st</sup> AHWG meeting

Energy sector

- Fossil fuel energy generation should be excluded.
- Natural gas is supported by the EU energy policy as a contributor to climate change mitigation.
- A transition criteria should be assessed (<i>this will be taken up later</i>).
- Nuclear energy and nuclear-life-cycle-supporting activities should be excluded, as it is in other labelling schemes and based on the precautionary principle.
2nd criteria proposal
Energy sector

• Solid, liquid and gaseous fossil fuel exploration, extraction and refining for fuel. This includes unconventional sources such as hydraulic fracking and shale deposits.

• Use of solid, liquid or gaseous fossil fuels for electricity generation.

• All activities relating to the nuclear fuel cycle, including power generation.
Findings from further research
Energy sector (fossil fuels)

TR1 starting point:
“Coal, natural gas and crude oil exploration and extraction”
“Coal, natural gas and crude oil refining for fuels”

Main checkpoint: EU/international policy reference
✓ net-zero CO$_2$eq commitment by 2050

Checkpoint: other ecolabelling schemes
✓ Excluded in all reviewed existing schemes
➢ All forms (solid, liquid or gaseous) of fossil fuel exploitation are excluded
Findings from further research
Energy sector (fossil fuels)

TR1 starting point: “Forms of energy generation from fossil fuels that are excluded from the EU Taxonomy”

Main checkpoint: EU Taxonomy

✓ substantial contribution to climate change mitigation if below 100g CO$_2$eq / KWh for electricity generation

Checkpoint: other ecolabelling schemes

✓ Excluded in all reviewed existing schemes

➢ All forms (solid, liquid or gaseous) of fossil fuel use for electricity generation are excluded
Findings from further research
Energy sector (nuclear energy)

TR1 starting point: *further discussion/feedback was required*

Checkpoint: EU/international policy reference
- No current EU policy position, diverging policies of MSs

Checkpoint: EU Taxonomy
- TEG recommendation inconclusive

Checkpoint: other ecolabelling schemes
- Excluded in all reviewed existing schemes

Checkpoint: green investment perception by retail consumers
- All activities related to the nuclear fuel cycle are excluded
Landfill sites without methane gas capture and incineration without energy recovery flagged as needing for exclusion due to high GHG emissions.

Moreover these two activities are excluded in the French Greenfin Label.

Such exclusions would exempt cases where appropriate technical solutions have attracted investments.
2nd criteria proposal
Waste management

- Waste management facilities and services that do not operate any form of material segregation for the purposes of preparation for reuse, recycling and/or energy recovery, as well as the processing or stabilization of organic waste

- Landfill sites without leachate and methane gas capture

- Incineration not equipped with flue-gas treatment that complies with Directive 2000/76/EC on the incineration of waste or equivalent internationally recognized standards and without a high level of heat recovery and/or power generation
Findings from further research

Waste management (material recovery)

TR1 starting point: “Waste management facilities without materials or energy recovery”

Checkpoint: EU/international policy reference

✓ WFD: 50% preparation for reuse/recycling from HH waste, 70% from C&D waste by 2050; Circular Economy Action Plan

Checkpoint: EU Taxonomy

✓ Material recovery from waste included in the Taxonomy

➢ Excluded if no form of material segregation for the purposes of preparation for reuse, recycling and/or energy recovery, as well as the processing or stabilization of organic waste
Findings from further research

Waste management (energy recovery)

TR1 starting point: “Waste management facilities without materials or energy recovery”

Checkpoint: EU/international policy


Checkpoint: EU Taxonomy

✓ Any activity leading to a significant increase of incineration, with exception of non-recyclable hazardous waste

➢ Excluded if not equipped with flue-gas treatment that complies with Directive 2000/76/EC or without a high level of heat recovery and/or power generation

○ High level of heat recovery and/or power generation? (e.g. R1)
Findings from further research
Waste management (landfill)

TR1 starting point: “further discussion/feedback was required”

Main checkpoint: EU Taxonomy

- Landfill gas capture and utilisation in permanently closed landfills using new (or supplementary) dedicated technical facilities

- Landfill sites without leachate and methane gas capture
Stakeholder feedback after the 1st AHWG meeting

Manufacturing

- Stakeholders suggested to extend the scope of the exclusions also to:
  - Production of gases with significant GWP and ODP
  - Mining activities
- The reference to industrial gases should be more specific
• Production of **hazardous chemicals** that are not authorized or registered for use in the EU and which are identified in the Rotterdam Convention PIC procedure

• Production of **fluorinated greenhouse gases** with a Global Warming Potential of > 150

• Production of substances with a high **Ozone Depletion Potential** listed as controlled and as prohibited by the Ozone Regulation(EC)1005/2009

• The mining, processing and production of **asbestos** and asbestos-based products
Findings from further research
Manufacturing

TR1 starting point: “Production of industrial gases with a high GWP and/or ODP”

Main checkpoint: EU/international policy reference

✓ Hazardous chemicals: REACH, PIC Procedure of the Rotterdam Convention

✓ Fluorinated gases: Regulation (EU) 517/2014 on F-gas


✓ Mining of asbestos: Corrigendum to Annex XVII to REACH
Findings from further research

Manufacturing

- Hazardous chemicals: reference to REACH authorization/registration and the PIC Procedure of the Rotterdam Convention
- Fluorinated gases: specific reference to a CF threshold of GWP of 150 CO$_{2}$eq
- Ozone-depleting substances: specific to substances controlled and prohibited by the Ozone Regulation
- Mining of asbestos: excluded from EU Ecolabel according to REACH
Stakeholder feedback after the 1st AHWG meeting
2.1.2 Transitionary exclusions

- Stakeholders strongly supported that EU Ecolabel should provide incentives for companies to transition

- Sectors flagged as important are power generation and transportation

- Unclear whether EU Ecolabel criteria for equity funds are the appropriate tool. Alternative tools can be found:
  - In the Sustainable Finance Action Plan
  - In the Regulation 2019/2088 on sustainability-related disclosures in the financial services sector
  - In the disclosure obligation set by the Taxonomy Regulation
Stakeholder feedback after the 1st AHWG meeting
Power generation

• Stakeholders proposed two main suggestions as metrics:
  • Revenue-based thresholds for activities or capital expenditure in low-carbon forms of electricity generation
  • Thresholds for GHG emissions from a power station portfolio
• Further complexity introduced
Findings from further research

Power generation

Revenue or investment-based approach

- Thresholds would be complex to establish in a way that captures the diversity of different starting points for transition

- Nordic Swan:
  - > 75% of the company’s energy sector investments on average for the last 3 years are in the renewable energy sector
  - Revenue from renewable energy comprises > 50% of the company’s total revenue
  - < 0.1% revenue from unconventional fossil fuels

- 75% possible to comply with minimal investments

- 50% could be too high to incentivise transition by a large utility
Findings from further research

Power generation

CO₂ emissions-based approach

- Would relate directly to the contribution to climate change
- Febelfin: year-on-year emission thresholds (408 g CO₂eq/kWh in 2020)

Largest compliant utilities have >5% nuclear power in their electricity mix (as of 2019)
Findings from further research

Transport

Focus on the overall sales of major manufacturers – models placed on EU market analysed

- EU legislation (Regulation 2018/858) of passenger vehicles and light commercial vehicles focuses on:
  - g CO₂ emissions/km new passenger car each year (95 g CO₂/km from 2021)
  - Zero and low emission vehicle (ZLEV) technologies

- Projections of ‘fleet’ emissions based on mix of vehicle technologies – progressive improvement in performance

- TEG Taxonomy also includes technical screening criteria for vehicles – extent to which mainstream manufacturers are offering them
Production, distribution and sale of new passenger cars and light commercial vehicles, unless the company undertaking the activity complies with the following requirements:

- **For new passenger cars**: Manufacturers shall have made available to consumers at least one zero- and low-emission vehicle (ZLEV) model with tailpipe emissions of < 50 g CO2/km and the average tailpipe emissions of all models that they have registered in the last calendar year shall be 5% lower than the respective EU target applicable at the time.

- **For light commercial vehicles**: The average tailpipe emissions of all models that a manufacturer registered in the last calendar year shall be 5% lower than the respective tailpipe CO2 emission target.
EU Ecolabel for retail financial products

Any questions?
EU Ecolabel for retail financial products

Criterion 2.2: Exclusions relating to sovereign and sub-sovereign bonds
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
2.2 Exclusions relating to sovereign and sub-sovereign bonds

• Issued by national governments to raise capital over fixed terms to invest in public services and infrastructure.

• An important underlying asset within investment portfolios and fixed interest savings

Rationale for exclusionary criteria?

• Identify bonds of those countries that are committed to environmental objectives.

• Influence access to finance for countries that, as a minimum, have not ratified international environmental conventions or which are harming environmental objectives
In the case of sovereign bonds or bonds issued by international organisations the following exclusions shall apply either to the issuing country or the economic activity:

- Non ratification of the Paris Agreement
- Non ratification of the UN Convention for Biological Diversity
- Non ratification of international conventions on environmental protection
- Internationally funded projects that could damage valuable and/or protected natural areas
Stakeholder feedback after the 1st AHWG meeting

- Alignment to the Green Bonds Standard GBS proposed
- Better definition of the exclusion criterion requirements
- Consider a wider range of international environmental treaties *e.g. UN Convention on Biological Diversity.*
- Request for more exclusions based on treaties, but some views that they could be overly restrictive *e.g. case of USA*
- Sub-sovereign bond issuers, such as regions or municipalities require consideration - climate change mitigation commitments to be taken into account
Filtering of the list of treaties and agreements and mapping onto the environmental objectives of the Taxonomy Regulation.

- A major gap in international treaties is the protection of forests - no comprehensive, legally binding instrument
  - most significant overlapping treaties and agreements identified by UN FAO research have been included

- Check on the potential impact of excluding sovereign states:
  - In general there are a limited number of countries that are ‘non-parties’
  - In case of USA same exclusionary effect can be achieved by reference to the Paris Agreement
### Findings from further research

#### Ratification status of international conventions

<table>
<thead>
<tr>
<th>Objective</th>
<th>Convention</th>
<th>Ratification status</th>
</tr>
</thead>
<tbody>
<tr>
<td>Biodiversity and ecosystems</td>
<td>The UN Convention for Biological Diversity</td>
<td>196 countries, excluding the USA</td>
</tr>
<tr>
<td></td>
<td>CITES Convention on International Trade</td>
<td>All UN member states except for 10 exceptions.</td>
</tr>
<tr>
<td>Water and marine resources</td>
<td>United Nations Convention to Combat Desertification</td>
<td>Ratified by 190 countries plus the European Union</td>
</tr>
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<td></td>
<td>The Ramsar Convention</td>
<td>In 2018 the convention counted 170 ‘contracting’ countries.</td>
</tr>
<tr>
<td>Hazardous substances and waste</td>
<td>The Basel Convention</td>
<td>The United State of America is a Non-Party of the convention, having signed in 1990 but not having ratified.</td>
</tr>
<tr>
<td></td>
<td>The Rotterdam Convention and PIC Procedure</td>
<td>Not ratified by 7 countries.</td>
</tr>
<tr>
<td></td>
<td>The Stockholm Convention on POPs</td>
<td>Not ratified by 7 countries, including Italy.</td>
</tr>
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</table>
Findings from further research
Going beyond a treaty-based approach

• Simple treaty approach does not evaluate actions to address climate change or other environmental concerns.

• Two further possible ways identified and analysed:
  1. Green sovereign bonds: Demonstrating the allocation of public investment to green economic activities and projects.
  2. Sovereign bond risk ratings: An emerging market for disclosure, could encourage greater differentiation of sovereign bonds based on specific plans and actions.
Findings from further research

Green bonds

Green bonds issued by sovereigns, government-backed entities and local government account = 25% of total value issued (CBI 2019)

- EU green sovereign bonds issuers: France, Poland and Belgium,
- Sub-sovereign green bonds issuers: Australia (Victoria State), the USA (California), Germany (North Rhine-Westphalia) and France (Île-de-France)

Should exclusions relating to political commitments apply to green bonds?

- Sends wrong signal: non-participation in international initiatives, but investment into new green projects.
- Sends a consistent message: not sufficient to fund green projects in isolation from strategic and internationalised efforts
Findings from further research

Climate risk ratings

Market for disclosures less developed but evidence of the use of ratings is for climate risk and ESG aspects increasing.

Three leading examples of sovereign bond climate risk ratings have been reviewed:

• Moody’s (rating agency): A Climate Change & Sovereign Bond credit risk methodology has been developed as was launched in 2016.

• Finance for Change (NGO): Working group of investment stakeholders, a carbon disclosure method has been developed and was launched in 2016.

• FTSE Russell (data analysts): A Climate Risk-Adjusted World Government Bond Index been developed which was launched in 2019.
Commonalities that could form basis for minimum compliance requirements?

- ‘Transition risk’ as a measure of potential impacts on financial performance of investments resulting from proactive, policy-driven efforts to mitigate climate change; and

- ‘Physical risk’ or ‘resilience’ as a measure of possible exposure to physical damage as well as efforts to put in place adaptation measures.

‘transition risk’ in the three ratings encompasses actions within the economy to mitigate climate change.

Ratings’ scope also varies e.g. FTSE Russell index: 22 developed countries. Appears difficult to apply to both sovereign and sub-sovereign issuers.
Summary rationale for the major changes

- Primary focus on Paris Agreement to address climate change mitigation
- Sub-sovereign exemptions where they can demonstrate formal and equivalent political commitments
- Broadening of environmental treaties in three key areas to complement EU Taxonomy environmental objectives
- Sovereign requirement for climate transition risk rating to signal the need for disclosure
2.2 Exclusions relating to sovereign and sub-sovereign bonds

The investment portfolio shall not contain sovereign and sub-sovereign bonds excluded by the conditions below, except if the bonds comply with the EU GBS.

2.2.1 Ratification of the Paris Agreement

Bonds held by the portfolio shall be excluded if the issuer has not ratified the Paris Agreement on climate change. An exception shall be made where a sub-sovereign, which may include municipal authorities at regional, city or local level, has a formally adopted political commitment to meet the same targets and requirements.

2.2.2 Climate or environmental risk rating

Bonds held by the portfolio shall be excluded unless they are accompanied by a climate risk rating of the issuer or an environmental risk rating that addresses climate change. The risk rating aspect addressing climate shall include, as a minimum, a transition risk assessment of economic actions or structural progress in the economy to implement the Paris Agreement.
2.2.3 Ratification of other international environmental agreements

Sovereign bonds held by the portfolio shall be excluded if the issuer or the country has not ratified 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 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;
Assessment and verification

The applicant shall provide a list of the sovereign and sub-sovereign bonds held and their issuers. The applicant shall then provide a declaration of compliance for the fund or deposit account. For sub-sovereign bonds, additional information on equivalent commitments shall be provided. An additional declaration shall be made for each bond of the climate risk rating obtained and the agency that made the rating.

Further to the initial verification, internal checks shall be performed at least once per year and any changes communicated to the Competent Body which also retains the right to make random checks on compliance.
Thank you

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