# Development of EU Ecolabel criteria for ‘retail financial products’

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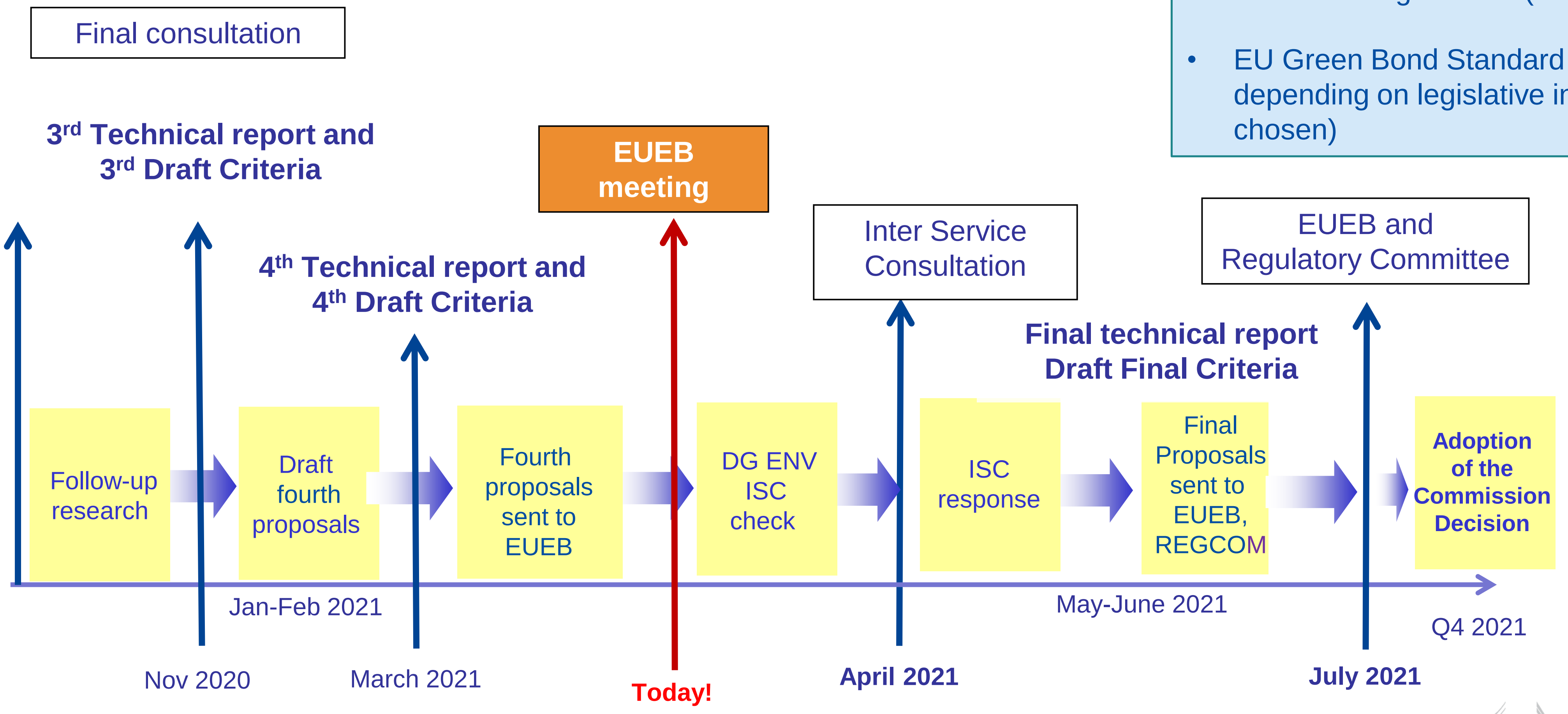
European Commission

# Agenda

- Process update
- How the criteria works as a whole
- Key changes and criteria proposals after the third stakeholder consultation
- Next steps

# Criteria development process

Parallel processes:
- EU taxonomy:
  - 1st Delegated Act (April 2021)
  - 2nd Delegated Act (Dec 2021)
- EU Green Bond Standard (timing tbc depending on legislative instrument chosen)



# Structure of the main proposed criteria

Product scope:

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

Validity period: 3 years

(amendment foreseen to make reference to 2nd DA)

Criterion 1: Investment in environmentally sustainable economic activities

Criterion 2: Exclusions based on environmental aspects

Criterion 3: Social and governance aspects

Criterion 4: Engagement

Criterion 5: Measures taken to enhance investor impact

# Product group scope
## Considerations for scope modifications

### Outcome of stakeholder consultation

- The requirements on the general fund can compromise the risk sharing option. Transferability of assets difficult to check.
- A separated sub-fund  will be of little interest
- Multi-option insurance products (MOPs) – Concerns are expressed regarding traceability and assessment of compliance
- Issues of  compliance with the UCITS Reg as MOPs may be only offered in a predetermined structure
- MOPs that are composed only by unit-linked insurance products could be eligible for inclusion

### Main overall changes to the criterion

✓ Insurance-based investment products (IBIPs), that contain the general fund are not eligible

✓ Scope contains, UCITS funds, RAIFs, Unit-linked insurance products, MOPs with only Unit-linked products as underlyings, fixed term savings and deposits accounts

# Potential future scope extension

- *Future extension of the scope to other financial products*
- *Future extension to include financial products for professional investors*

# Criteria investment strategies

| Investment strategy | EU Ecolabel criteria proposal |
|---|---|
| **Capital allocation to green activities** | Criterion 1: Investment in environmentally sustainable economic activities |
| **Negative screening for environmentally and socially harmful activities** | Criterion 2: Environmental exclusions<br>Criterion 3: Social and governance aspects |
| **Fostering change of corporate strategies and action** | Criterion 4: Engagement |
| **Seeking to maximise investor impact to company activities** | Criterion 5: Measures taken to enhance investor impact |

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# How the investment strategies work together

## Example of a traditional mixed fund

| | |
|---|---|
| Equity in Company A with 50% green | Bond issued by Company A |
| Equity in Company B with 60% green | |
| Equity in Company C with 40% green | Bond issued by Company C |
| Equity in Company D with 20% green | |
| Equity in Company E with 80% green | Bond issued by Company F |
| Equity in Company F with 20% green | |
| Equity in Company G with 3% green | |
| Equity in Company H with 3% green | Bond issued by Company H |
| Equity in Company I with 50% green | Bond issued by Country X |

# How the investment strategies work together

**Example of an EU Ecolabel mixed fund next to EU Ecolabel criteria application**

Strategy to enhance the **investor impact** of the portfolio

**Engagement** to increase EU Taxonomy alignment

Equity in Company A with 50% green

Equity in Company B with 60% green

Equity in Company C with 40% green

Equity in Company D with 20% green

Equity in Company E with 80% green

Equity in Company F with 20% green

Equity in Company G with 3% green

Equity in Company H with 3% green

Equity in Company I with 50% green

Bond issued by Company A

Bond issued by Company C

Bond issued by Company F

Bond issued by Company H

Bond issued by Country X

Greenness criterion

Environmental/social exclusions

# EU Taxonomy – Overview and link with EU Ecolabel

## What is it?

A list of **economic activities** that are environmentally sustainable.
To be included in the Taxonomy, an economic activity must meet the following conditions:

Substantially Contribute to one objective + Do not significantly harm any of the other 5 obj. + Minimum social safeguards

Detailed by

Technical Screening Criteria

**Six environmental objectives**

1. **Climate change mitigation**
2. **Climate change adaptation**
3. Sustainable use & protection of water
4. Circular economy
5. Pollution prevention and control
6. Protection and restoration of biodiversity and ecosystems

Criterion 2

Criterion 3

# EU Taxonomy – Overview and link with EU Ecolabel

## What is it?

A list of **economic activities** that are environmentally sustainable.
To be included in the Taxonomy, an economic activity must meet the following conditions:

Criterion 1

Substantially Contribute to one objective + Do not significantly harm any of the other 5 obj. + Minimum social safeguards

Detailed by

Technical Screening Criteria

Criterion 4

**Six environmental objectives**

1. **Climate change mitigation**
2. **Climate change adaptation**
3. Sustainable use & protection of water
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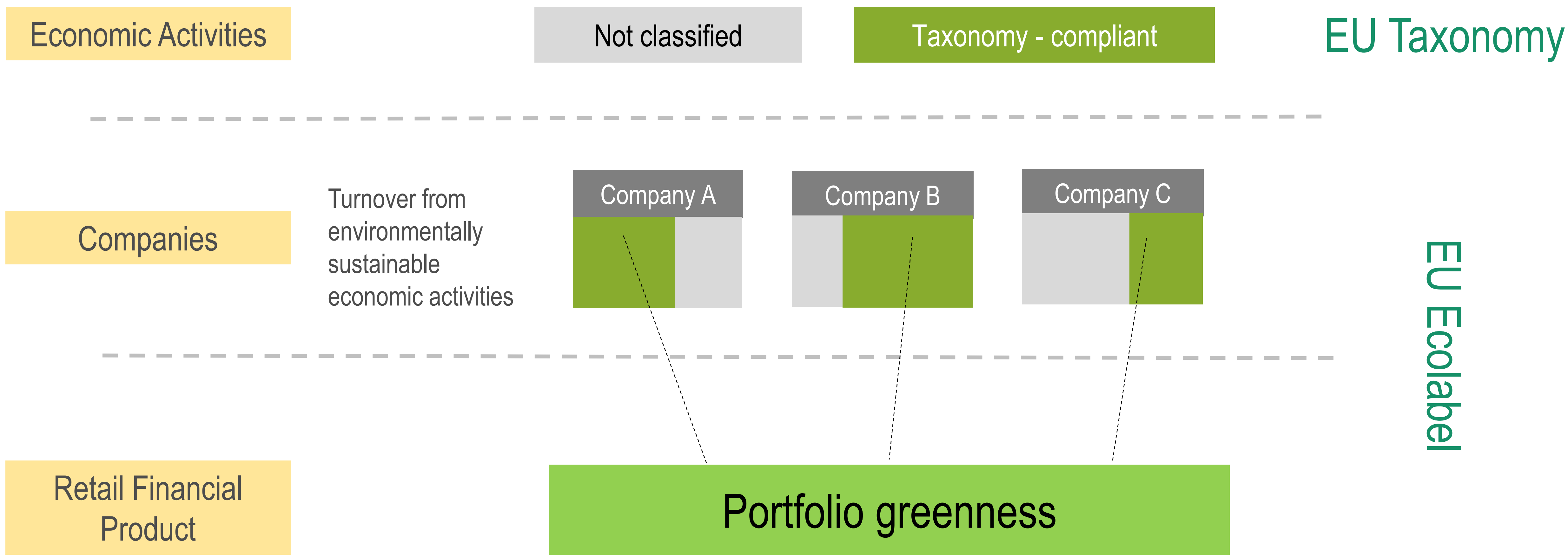
5. Pollution prevention and control
6. Protection and restoration of biodiversity and ecosystems

# Use of Taxonomy: criterion 1



# Criterion 1: Investments in environmentally sustainable economic activities
# **UCITS equity funds**

**Outcome of stakeholder consultation**

- Ambition level of criterion 1. Split views remained also in the 3rd consultation
- The formula for evaluating the equity funds greenness is heavily criticised
- The potential for using forward looking aspect to evaluate greenness is questioned

**Main changes in TR4.0**

- ✓ Additional research is carried out to investigate potential changes of ambition level.
- ✓ Formula to evaluate greenness for equities investment funds is modified, following the stakeholders' proposal
- ✓ Grenn capex is included by considering a backward-looking period.
- ✓ Forward-looking elements are excluded from the formula

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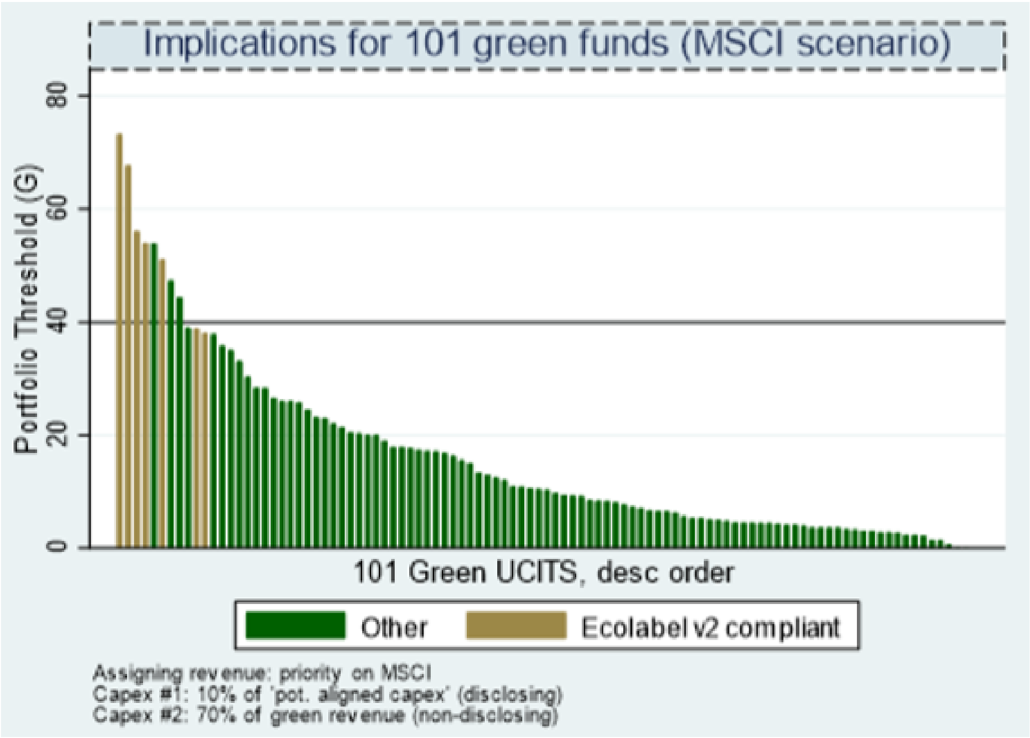
# Criterion 1: Investments in environmentally sustainable economic activities
# **UCITS equity funds**

- The formula considers green turnover, total turnover, and green capex **in absolute values** weighted by the portfolio contribution, and calculates greenness as follows

$$\sum_{i=1}^{n} PCi * \frac{GTi + GCi}{Ti}$$

- PCi: Portfolio contribution (%)
- GTi: Green turnover (EUR)
- GCi: Green capex (EUR)
- Ti: total turnover (EUR)

# Criterion 1: Investments in environmentally sustainable economic activities
# **UCITS equity funds**




- ✓The market is expected and needs to move towards more greenness in the next years to fulfill the objectives of the Green Deal
- ✓Data disclosure will improve after adoption of the EU Taxonomy DAs
- ✓The greenness threshold for UCITS equity funds is proposed to be set at 50%

# Criterion 1: Investments in environmentally sustainable economic activities
# **UCITS bond funds**

### Outcome of stakeholder consultation

- The threshold for bond funds was considered not ambitious
- Comments/suggestions as to whether the greenness of the issuer/company (corporate level) shall be considered for issuing bonds?
- Eligibility of certified green bonds?
- Application of exclusions to the issuer is also debated
- Refinancing requirement is questioned since availability of green projects may not be enough.

### Main changes in TR4

✓ The greenness threshold is increased up to 70%

✓ Greenness of the corporate issuer is considered only in the case of general purpose corporate bonds

✓ Compliance with EU Taxonomy is required for the proceeds financing activities or projects

✓ Reference to the EU GBS is removed until it is adopted.

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# Criterion 1: Investments in environmentally sustainable economic activities
# **Fixed term and savings deposit accounts**

## Outcomes of the stakeholder consultation

- Concerns are expressed regarding the lack of qualified green assets in the market
- It is argued to modify the green asset/deposit ratio. Some stakeholders argued that this ratio is complicated and can be a source of misinterpretation
- Traceability of the proceeds might be challenging as accounting procedures shall be established

## Main changes in TR4

✓ The criterion is simplified

✓ It is suggested loans granted or/and bonds purchased shall be 100% EU Taxonomy compliant

✓ The 'green asset to deposit ratio' requirement is deleted

✓ Cross-reference to bond requirements in sub-criterion 1.1.B.

✓ Tracking is proposed as an alternative of separation of the deposited money

# Criterion 1: Investments in environmentally sustainable economic activities
## **Other financial products**

The requirements for the following financial products were **not subject of change**

- Retail Alternative Investment Funds (RAIFs)
- Mixed funds
- Funds of Funds
- Insurance products

# Criterion 1: Investments in environmentally sustainable economic activities
# **Assessment and Verification**

## Outcome of stakeholder consultation

- Stakeholders asked for more clarity with respect to documentation and new products

## Main changes in TR4

✓ Changes are made according to the changes on the criteria

## Example: Assessment & Verification of UCITS equity funds

v. *For new funds: Evidence that the fund complies with the greenness threshold at the time of application based on the prospectus*

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

# Points of discussion for EUEB members

- *The greenness threshold and the greenness formula for UCITS equity funds*
- *The greenness threshold for UCITS bond funds*
- *For UCITS bond funds, the feasibility of the requirement on refinancing of use-of-proceeds bonds*

# Ex Criterion 2: Investment in companies investing in transition and green growth (REMOVED)

**Outcome of stakeholder consultation**

- Few stakeholders welcomed the criterion
- A large part of the stakeholders asked to remove the criterion, due to:
  - Confusion with transition under the EU Taxonomy
  - Forward-looking element difficult to verify and no data available
  - Criterion not stringent enough

**Main changes in TR4**

✓ This criterion has been removed

✓ However, the majority of elements has been kept:
  - CAPEX contribution to greenness for all companies
  - Strategic plan for some otherwise excluded activities
  - Engagement

# Criterion 2: Environmental exclusions

**Outcome of stakeholder consultation**

- Overall welcome of the draft as an improvement
- Flexibility for energy, waste management and transportation sectors was welcomed, but should not be linked to the criterion on companies investing in transition
- Some requests for more exclusions, e.g. heating and cooling, fertilisers, livestock production, hydropower, aviation sector

**Main changes in TR4**:

✓ Flexibility requirements modified and made stricter, focusing on:
  - Turnover
  - Strategic plan
  - CapEx

✓ Some new exclusions, also depending on availability of data: heating, fertilisers, livestock

✓ <u>Final wording will depend on the DA of the EU Taxonomy</u>

# Criterion 2: Environmental exclusions

| Fourth proposal for criterion 2: Excluded activities – Environmental aspects |
|---|
| C.2 The supply and use of solid, liquid and gaseous fossil fuels for fuel, energy generation in the form of electricity and/or heat, heating and cooling using these fuels, unless:<br>- The company turnover from these excluded activities is below 30%, and;<br>- The company has published a strategic plan to reduce their GHG emissions to a 1,5 C Paris Agreement aligned level and to achieve net zero carbon emissions by 2050. The plan shall include the phase-out, closure or fuel-switching of the activities described under C.2 on a ten-year timeframe. In the case the plan includes fuel-switching to biomass, the biomass activity shall be EU Taxonomy-aligned, and;<br>- The company has zero CapEx on the expansion of activities described under C.2, and zero OpEx in maintenance costs that either increase the lifetime or the value of the assets used in those activities during the last financial year, and;<br>- The GHG emissions (as a minimum scope 1 emissions) of the company decrease annually by at least 7%. |

# Criterion 2:  Environmental exclusions

**Outcome of stakeholder consultation**

- Split views from stakeholders on nuclear power activities
- Exclusion of banks financing fossil fuels expansion with > 1 billion annually

**Main changes in TR4**:

✓ Opinion at the last EUEB meeting + other national labels → no change

✓ Some banks are already committing to stop financing fossil fuels expansion and GHG emissions from the activities they finance → new exclusion introduced

**2.2 Exclusions relating to financing institutions**

Financial products shall not contain:

- bonds nor loans issued by financial institutions that finance the expansion of coal activities; nor

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

# Criterion 2: Environmental exclusions

## Assessment and verification

### Outcome of stakeholder consultation

- More clarity in terms of proxies, new products and methodology to deal with allegations

### Main changes in TR4:

✓ Assessment and verification modified and made clearer

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

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

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

# Criterion 3: Social and governance aspects

**Outcome of stakeholder consultation**

- Social exclusions at sovereign level - Dealing with the death penalty
- Exclusionary requirements on conventional weapons
- Exclusionary requirements on trade of tobacco
- International laws and local legislation complementarity or controversy?

**Main changes in the TR4.0**

- ✓ At sovereign and sub-sovereign level, the avoidance of applying the death penalty is required
- ✓ Conventional weapons are excluded. Partial exclusion applies at a state level only
- ✓ Partial exclusion is referring to retail trade of tobacco only
- ✓ Corporates are excluded if they cannot comply due to local regulations. Yet, business activities elsewhere are not affected

# Criterion 3: Social and governance aspects

**Outcome of stakeholder consultation**

- Human rights shall also be respected along the supply chain
- Dealing with allegations
- The corruption perception index and its sufficiency to deal with corruption at state level is questioned
- Governance aspects and their functionality is commented

**Main changes in the TR4.0**

- ✓ The TR4.0 refers to human rights along the supply chain
- ✓ An approach for dealing with allegations is suggested
- ✓ The corruption perception index is kept as it is officially used by the Eurostat
- ✓ Governance requirements are linked to corporate social issues

# Criterion 3: Social and governance aspects
## Criterion updates

More than 5% turnover from retail trade of tobacco products, provided it is not a holding company

More than 5% turnover from the production or trade of conventional weapons and/or military products used for combat.

Apply the death penalty. An exemption shall be made for sub-sovereigns that do not apply the death penalty following the local regulations which in this case prevail the national law.

Respect[81] the protection of internationally proclaimed human rights and relevant domestic laws and regulations of the country in which it operates any activity of its supply chain, including the sourcing of raw materials. [UN Global Compact, OECD

# Criterion 3: Social and governance aspects

## Assessment and Verification

### Outcome of stakeholder consultation

- More clarity in terms of proxies, new products and methodology to deal with allegations – ***<u>Similar to environmental exclusions</u>***

### Main changes in TR4:

✓Assessment and verification is improved

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

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

# Criterion 4: Engagement

## Outcome of stakeholder consultation

- Overall welcome of an improved criterion
- Few comments on the amount of companies the fund manager shall engage with

## Main changes in TR4

✓ Clarity as to what products it applies

✓ The focus of the fund manager should be on:

- Companies with GT<10% and no CapEx
- Companies specified under 2.C.2, D.1, F.1
- Companies with GT<30% of T from Taxonomy-eligible activities

*4.3.1 Requirements for UCITS funds and retail AIFs*

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

# Criterion 4: Engagement

## Main changes in TR4

✓ Focus of the engagement better linked to EU Taxonomy:

- upgrade existing activities that are not EU Taxonomy-aligned
- expanding existing activities that are EU Taxonomy-aligned
- starting new activities that are EU Taxonomy-aligned
- closing existing activities that are not EU Taxonomy-aligned

The goals and targets discussed and raised with each company to achieve environmental objectives, which should based on:

– upgrading their existing activities that are not EU Taxonomy-aligned (to bring them up to the Technical Screening Criteria under the EU Taxonomy or to meet the Do-No-Significant-Harm criteria under the EU Taxonomy that they are not yet meeting)

– expanding their existing activities that are EU Taxonomy-aligned

– starting new activities that are EU Taxonomy-aligned

– closing existing activities that are not EU Taxonomy-aligned

# Criterion 5: Measures taken to enhance investor impact

## Outcome of stakeholder consultation

- Stakeholders commented on the necessity to maintain this criterion
- It is proposed, instead of reporting on measures taken to require a management system
- Recommendations to set specific targets for enhancing investor impact
- Environmental KPIs could be used in alingment with the SFRD
- To specify time and frequency of reporting

## Main changes in the TR4.0

✓ Criterion is maintained since it applies all investor impact mechanisms and obliges the fund manager to consider specific aspects by compiling financial products

✓ Structure of the criterion is kept reflecting all impact mechanisms, yet requirements are updated according to the criteria modifications

✓ A requirement to track the impact enhancement measures is added

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# Criterion 5: Measures taken to enhance investor impact

| EU Ecolabel criteria | Specific areas to apply the measures |
| --- | --- |
| Investment in environmentally sustainable economic activities | Capital allocation to equities |
| | Capital allocation to bonds |
| | Identifying opportunities and monitoring change |
| | Taking a long-term outlook |
| Environmental exclusions | Committing to transition |
| Engagement | Engaging to increase shareholder value |
| Measures taken to enhance investor impact | Track measures taken to enhance investor impact |

# Criterion 6: Retail Investor information

## Outcome of stakeholder consultation

- Reporting requirements may overlap with those included in the criteria – Reporting shall be simplified
- Disclaimer on impacts shall be included
- Annual reporting that includes info on top of that provided in the KID and KIID document
- Information on deposit accounts shall be provided to the retail investor

## Main changes in TR4

- ✓ Reporting requirements are simplified
- ✓ Criterion 6 considers the changes in criteria 1-5. New elements are introduced such as share of companies with green capex, engagement activities, and actions to enhance investor impact
- ✓ Prospectus shall include KID, KIID and additional report on investor relevant information
- ✓ Report shall be uploaded to the fund website
- ✓ Disclaimer is introduced
- ✓ Allegations and actions to address them shall be included in the investor information report

# Criterion 6: Retail Investor information

## Outcome of stakeholder consultation

- More clarity in terms of new products

## Main changes in TR4:

✓ Assessment and verification is improved

*For new products, the applicant should submit a formal commitment of compliance with this criterion no later than one year from the start of the fund.*

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# Criterion 7: Information appearing on the EU Ecolabel

**Criterion 7: Information appearing on the EU Ecolabel**

The applicant shall follow the instructions on how to properly use the EU Ecolabel logo provided in the EU Ecolabel Logo Guidelines available at:

https://ec.europa.eu/environment/ecolabel/documents.html

If the optional label with text box is used, it shall contain the following statements:

– Investing in activities that contribute to a green and low carbon economy

– Avoiding investments in environmentally and socially harmful activities

– Enhancing investor impact

The following additional statement may be used for investment funds and insurance products (replacing one of the statements above):

- Engaging with companies to become more environmentally sustainable

# Points of discussion for EUEB members

- *The proposed criterion for exclusion of financial institutions investing in fossil fuels;*
- *The proposed text of a disclaimer as follows;*

The information shall be accompanied by the following disclaimer: *"The EU Ecolabel is the official European Union label for environmental excellence aiming to capture the best products available on the Community market in terms of environmental performance. It is awarded to financial products that invest to a certain degree in environmentally sustainable economic activities as defined under the EU Taxonomy. However, the currently available methodologies and evidence do not allow to evaluate the environmental and social impacts of a particular fund."*

# Next steps

- Remaining comments can be sent by email to: jrc-b5-financial-products@ec.europa.eu
- Deadline for comments: Wednesday 24th March 2021
- April: Inter Service Consultation
- End of May: Final documents
- End of June: EUEB and Reg Com meetings
- Beginning of July: Written Vote