Development of the EU Ecolabel Criteria for Financial Products
1st expert sub-group meeting on criteria 1.1
Monday 3rd June 2019, 10:00-12:00

Minutes and summary

DISCLAIMER: The views expressed are purely those of the writer and are intended to reflect the discussions at the above mentioned meeting. They may not in any circumstances be regarded as stating an official position of the European Commission.

Agenda

		Schedule
1.	**Opening, welcome and tour de table**	**10:00 – 12:00**
2.	**Presentation and discussion of points 3-5 of ToR**	
3.	**Presentation and discussion of points 1-2 of ToR**	
4.	**Next steps**	
5.	**AOB**	

Participating organizations

European Investment Bank
Blackrock
UK Sustainable Investment and Finance Association
VKI
Novethic
Better Finance
Swedbank Robur
BNP Paribas
Amundi
Mirova
Raiffeisen
Development Durable
Bourse LUX
Insurance Europe

1. Introduction and background

The European Commission (EC) welcomed participants to the meeting. This was followed by a round of introduction of all participants and a brief summary of the discussions held in the last meeting on 21st May 2019.

The meeting agenda was presented and participants were thanked for their availability and willing to participate.

2. Discussion on several issues

Presentation and discussion on points 3 to 5 of ToR

The presentation assessed the need for thresholds at both the portfolio level and at the holding level, evaluated the relevance and feasibility from an operational perspective of the requirement on at least 90% of the direct holdings (in terms of number of issuers) for equities, assessed the need for different portfolio thresholds depending on the composition of the underlying assets of the funds (e.g. threshold for each specific fund category) and provided examples at company level and at portfolio level.

The sub-group was in favour of setting thresholds at both the holding and portfolio level but acknowledged that a single threshold would be simpler and easier to communicate to consumers. It was argued that thresholds at two levels would provide greater flexibility to the fund manager at the point of selecting the companies and ensuring that the overall environmental impact of the fund is positive. It was also highlighted that the EU Sustainable Finance Taxonomy (hereafter, the Taxonomy) recognises as substantially contributing to the climate change mitigation objective both activities that are already low carbon (e.g. generation of electricity from wind energy) and activities that contribute to a transition to a zero net emissions economy in 2050 although currently not yet low carbon (e.g. manufacturing of cement generating less than 0.5 tCO_2/t) as well as activities and investments that enable both types of substantial contribution (e.g. manufacturing of wind turbines, installation of energy efficient windows).

In order to accommodate companies carrying out both types of activities, the threshold at holding level should not be very high. A lower threshold at holding level will allow companies that are developing new technologies as well as big companies that are highly diversified and developing technologies that can be key on the market in the future, to qualify for the EU Ecolabel (hereafter, the Ecolabel) . It was emphasized that if the threshold is set only at portfolio level, there is a risk of having holdings whose contributions to an environmental objective of the Ecolabel are at best zero. This will undermine the credibility of the label.

The sub-group recommended having both types of thresholds (at portfolio and company level) except for bonds.

It was proposed that the threshold at the holding level be fixed at 20% so that the following types of companies could be eligible:

- Pure players (i.e. companies that are specialised in one or several taxonomy-eligible activities)

- Companies whose business includes different activities (including non-taxonomy-eligible activities) but e.g. investing heavily in the research and development (R&D) of environmental solutions and/or products, and thus developing and bringing on the market new technologies. Within this group, there are two categories: big players that are heavily diversified and represent a large share of the market, and big and small players that are developing new technologies which are yet to attain a sufficient level of maturity in the market and therefore represent a low percentage of revenues.

It was suggested that the rest of revenues should be generated from at least neutral environmental activities, ensured throughout the exclusion criterion.

With regards to the portfolio level, the sub-group considered "*the number of issuers*" a wrong metric and stated that this metric should be thought of in terms of weight. If the intention is to leave room for manoeuvre to the fund manager (to have a small percentage, e.g., 10% of the funds invested in money market investments such as cash or derivatives), all the holdings should fulfil both the holding and the exclusion criteria. However, the percentage invested in money market may depend on the type of fund. Fixed income funds might need a larger amount or room for investments in cash as opposed to equities. Therefore, it was emphasized that 10% threshold for equities and a larger percent for bond portfolios should be the right way.

At the portfolio level, the threshold for investments in the Taxonomy eligible activities should be fixed between 50 - 60% (maximum 70%) of the overall fund (weighted). An example of a green water-related technologies fund (which is quite peculiar and niche) and where the exposure to water-related technologies reached 64% of the weighted funds was presented to support the argument that the Ecolabel should adopt a maximum threshold of 60% (weighted) taking into account that there will be strict environmental standards and exclusions for the rest of the portfolio. It is also important to consider that the Ecolabel will apply not only to climate related funds but also to the other four environmental objectives (circular economy, water and air pollution and biodiversity) that are very niche technologies, and there is a need to leave room for having a decent investment universe for these types of companies. It is very rare that companies only invest in a technology specifically looking at a certain type of air pollution for instance normally it would be a diversified one, and that should definitely be taken into account.

The sub-group favoured having different portfolio thresholds for each asset class because of the very nature of bonds and private debt. For example, in bonds and private debt, where the use of proceeds can be purposely allocated to green activities/projects, the threshold could be higher (e.g. 60 - 70%). However, for bond funds where the technicalities of investing in fixed income require a larger room for manoeuvre to invest in cash and other types of money instruments is higher, the % of investments that can be invested in money instruments (threshold) is proposed to be set at lower level (e.g. 30%).

Private equity funds should also have a higher threshold as they can be easily invested in more specialized and "impact" equities. Additionally, it was proposed that for hybrid funds (combination of equities and bonds), the, the equity side should comply with the equity fund's rules and the fixed income part with the requirements set for bonds. Finally, it was proposed that for funds of funds (FoF) the underlying assets should respect the social and environmental standards and exclusions. The percentage of underlying Taxonomy eligible activities should be respected at both fund and at FoF level.

Regarding bond funds, there are two types of bonds: i) the green bonds which are marketed as green because they are compliant with the EU Green Bond Standard (EU GBS) and can be counted as related 100% to Taxonomy eligible activities, and ii) Sustainability bonds which are partially green and partially social as per the definition of the ICMA, or whose use of proceeds is only partially invested in Taxonomy eligible activities. In the latter case, only the percentage that is Taxonomy eligible will be accounted for. It was unclear how non-green corporate bonds should be addressed. A participant proposed, as a personal view, to consider only bonds that are strongly aligned to climate-aligned assets and green business lines (for example issuers where 75-95% of revenues are derived from climate-aligned assets and green business lines).

A participant noted that the first draft of the Taxonomy would not be available until June 18th. Therefore, the calculations presented which are estimated could be repeated when it is available. But only for climate-related funds, as the entire Taxonomy will take much longer to be finished.

The EC noted that the first draft of the Taxonomy will be published later in June and should provide background information for evaluating the highlighted points. One participant asked if the transition activities are included in the Taxonomy and pointed out that if this is the case, these activities would be considered as green, fitting in the percentage that is complying with Taxonomy criteria. Therefore, there would be no need to have lower thresholds. The EC confirmed that it is a valid point but it actually depends on the type of transition. There are economic activities such as cement, aluminium or steel manufacturing for which the Taxonomy thresholds set challenging CO_2 emissions thresholds (although not yet close to zero GHG emissions). Companies carrying out those activities at a level of performance that complies with the thresholds (and thus considered on a transition path towards a low carbon economy) would be taxonomy eligible from an equity perspective. There are, however, companies that are transitioning their businesses towards greener business activities by changing economic activities. This was illustrated with the example of a power generator that is transitioning its business from electricity generated from coal to electricity generated from renewable sources, and followed by a question on if such a company would qualify if only a small percentage of the total electricity that is being generated is coming from renewable sources even though it is a small but an important part of the business.

One participant pointed out that, in general, for companies that have only a small share of the total revenue coming from green economic activities, should not qualify as taxonomy eligible as this green revenue is not part of their core business. It was also remarked that according to the examples, the percentages could be different depending on the size of the companies.

A participant commented on the inclusion of government bonds in the portfolios and their assessment. It was stated that in most (investment grade) bond funds, government bonds make up a significant part of the portfolio and clarity was sought on how to verify the greenness of these bonds. It was emphasized that the bond volume is in general much larger than the equity volume in the funds. Therefore, it was suggested that a criterion to prove/measure the greenness of countries and consequently allow the government bonds to be awarded with the EU Ecolabel be developed.

Another participant clarified that government bond funds are different from other types of bond funds. One approach to deal with it could be to check if the country has signed up to any of the well-known international frameworks (e.g. the Paris agreement) because it is not possible to check the compliance at activity level for this type of bonds.

One participant replied that if the only condition is that the country issuer has signed up in one of the international frameworks, then a large share of bond funds would be automatically eligible for the EU Ecolabel. For example, all EU government bonds will be automatically eligible because the European Union has ratified the Paris Agreement. There is a need for a more detailed study regarding where the country is heading to in terms of carbon emissions. Therefore, he suggested that government bonds should be included in the EU Ecolabel scope but that a criterion should be developed for them.

The discussions on points 3- 5 concluded with a unanimous agreement on the benefits of setting two thresholds: one at portfolio and one at holding level. However, participants were not in agreement on the level of those thresholds. A participant disagreed with the low threshold at holding level proposed in the presentation because it risks the credibility of the financial product. Another commented that the threshold at portfolio level should be applied with caution until the Taxonomy is fully finalized. The EC requested examples of companies/holdings that could comply with different threshold levels as well as their respective market data.

Presentation and discussion on points 1 to 2 of ToR

The presentation on the points 1 to 2 focused on: i) a review of green investment thresholds available in existing national labels and schemes and, ii) providing clarity on the parameter applied to thresholds at the holding/company level.

The labels analysed included the following: Nordic Swan (applied in Denmark, Finland, Iceland, Norway and Sweden), Greenfin[1] (applied in France), LuxFLAG climate finance, LuxFLAG environmental and LuxFLAG ESG (in Luxembourg), Umweltzeichen (in Austria), FNG Siegel (in Germany) and Febelfin (in Belgium). The latter is technically a quality standard applied to investment funds.

The study of the labels also examined the Taxonomy used in each specific label, the thresholds at holding level and at portfolio level as well as the resulting minimum threshold of aggregated turnover from green activities. The aggregated thresholds range from 10% to 37.5%. This approach is not adopted by the Ecolabel criterion 1.1. It was observed that that the aggregated thresholds were lower than in the Ecolabel. In addition, an overview of the exclusions applied in the different labels was provided with an observation that some labels apply other types of exclusions (e.g. social and governance).

The sub-group believed that "*revenue*" is the most appropriate parameter to be applied to companies' thresholds for the purposes of assigning ecolabels. In the national schemes percentages referred to shares of revenues. Therefore, the term "revenue" is considered[2] for equity funds.

Finally, the sub-group observed that there are a number of ESG labels analysed that apply "pass or fail" criteria on ESG analysis and screening, with different approaches. All of them have exclusion lists that incorporate social and governance considerations. However, for the purpose of the assigned tasks, the sub-group focused mainly on environmental and climate considerations.

[1] *The French TEEC label has been renamed to GreenFin*
[2] *The sub-group also consider turnover to be synonymous to revenue*

Furthermore, three ESG labels also enforce a point system, either to ensure that a minimum number of requirements are met, or to distinguish funds where policies are stricter or more holistic. If this is put in sectors that are not covered by the Taxonomy but by the transition, that could provide some ideas as to how different points for different companies could be set up coming into the Taxonomy and how this could be achieved through different tools as asset managers or investors, and how the transition could be driven through investment and having different tools in different asset classes. The point system and the overall goal of what can be achieved through driving behaviours in companies and this transition is very interesting and could be explored.

Reflecting on both presentations, the EC commented that if the same approach of the existing labels is followed in the EU Ecolabel the resulting minimum threshold of aggregated turnover from green activities (at portfolio level) would be 10 - 12%.

One participant commented that this aggregated threshold is less ambitious than any of the thresholds of the existing labels on the market. It was explained by another that the current French criteria are very hard to comply with. If the Ecolabel criteria are even stricter, there is a risk that it would be difficult to build up a portfolio attractive enough to the consumers which would also be compliant with the Ecolabel criteria. According to the French label experience, having only the exclusion criteria would make the label challenging enough from the fund manager’s perspective. Therefore, if in addition to the exclusions, there is a requirement that at least 10-12% of the aggregated turnover should come from green economy activities, the challenge is enormous.

A participant asked about the geographical scope of the Greenfin label. This would mean that the Greenfin market is much smaller than the EU Ecolabel market as investment funds can be issued across Europe. It was pointed out that the French market is indeed one of the larger markets in Europe and that the percentage of funds awarded with this label account for approximately 0.01% of the total French market. The participant emphasized that by setting criteria stricter than the French criteria, the expected share of investment funds awarded with the EU Ecolabel will be negligible

The participant explained that a similar situation exists for the LuxFlag Climate finance label, for which only four funds managed to comply with the requirements. It was emphasized that the Ecolabel should not be too stringent, especially if there are other criteria to be applied such as the exclusion criteria. The participant stated that with the proposed thresholds (50-60% at portfolio level and 20% at holding level) the Ecolabel will be approximately within the range of the existing labels and will have the possibility of having an impact in the real economy.

The importance of exclusion criteria to ensure the greenness of the portfolio was reiterated by a participant who noted that customers often ask why a company is classified as green (even if it has more than 20-30% of the revenue from green economic activities, if the whole company does not look like sustainable it is more complicated). From an investment point of view, the point for diversification is an important one because an equity portfolio with an extremely limited universe, may not be considered to perform well.. Therefore being too stringent may make Ecolabel funds to underperform significantly in comparison to other funds and they may not be attractive.

Finally, the EC remarked that keeping the thresholds at the same level of those of the existing labels will not bring an added-value to the EU Ecolabel. This position was supported by some participants who pointed out that this argument is also in line with the expectations of the customers that are looking for stricter standards. Consumers are concerned that sustainable funds are not complying with any standard. Another participant suggested that the final thresholds could be set at mid-point between the levels proposed in the 1st AHWG meeting and those proposed in this meeting. This would enhance the credibility of the Ecolabel as a thorough and robust "quality-check" going beyond some already-existing national labels, while at the same time appreciating the difficulties of funds to qualify for it and therefore revisiting its original stance of being too strict in terms of eligibility thresholds. Adopting this approach would enable the Ecolabel to be awarded only to only the best sustainable funds on the European market (far much less than 10-20% of the market as recommended by the EU Ecolabel Regulation).

Finally, one participant remarked that sustainable funds are not easy to be sold because it is not possible to sell the funds when they are very risky. Consumers do not care about the technicalities and how the greenness is calculated. They also do not want a financial loss due to the narrow universe of the investment. Therefore, these numbers must be a balance between increasing the greenness of the portfolio and avoiding high financial risks. It should be kept in mind that these financial products have two aspects to consider: the greenness of the portfolio but also the possible return and risk of the fund. Another participant stated that on the contrary consumers are concerned that the products that they are investing in are not complying with high standards. They are interested in understanding how green a fund is and how its greenness was calculated. Therefore having EU Ecolabeled products that are less ambitious and with lower thresholds on the market has no added value.

Next steps and coming meetings

The EC stressed the need for additional information (examples of investment portfolios, as well as their testing with the proposed thresholds) to justify the new lower thresholds proposed. One participant offered to provide concrete examples of investments' portfolios.

Due to the lack of time, participants were requested to exchange in writing after the meeting to share any further thoughts on the levels of the thresholds at both company and portfolio. These should be supported by examples and data/information on the number of companies and investment funds that could qualify for the Ecolabel.

Additionally, they were asked to send their initial reactions to points 6-9 of the briefing note and the first three points on the verification section. Finally, they were asked to express their availability for the coming meetings proposed for the 17th and 28th of June. The latter meeting would replace that proposed for June 24th due to the stakeholder dialogue on the progress and outcomes of the technical expert group's work on sustainable finance which will also feature the launch of the final report on the EU taxonomy on June 24th.

The EC will circulate a draft proposal of criterion 1.1 that will reflect the recommendations made on points 1-5, discussions and written feedback prior to the next meeting. Additionally, the EC will compile and analyse the initial reactions on the points 6-9 and the verification points and draft an agenda for the coming meetings that will the distributed in due course.

Finally, the EC thanked all participants for their contributions. The draft meeting minutes is to be made available to the sub-group members for correction before being shared with all registered stakeholders on the official website in the coming weeks (http://susproc.jrc.ec.europa.eu/Financial_products/documents.html).