Comments to the JRC's Update on the EU Ecolabel for Retail financial Products and discussion points for the EUEB, June 2020

The Commission is currently developing the EU Ecolabel for Retail Financial Products within the framework of the Sustainable Finance Action Plan. The Joint Research Centre (JRC) has presented an update and discussion document for the EU Ecolabelling Board meeting on 23-24 June 2020.

We appreciate that the Discussion Paper is moving in the right direction to deliver an Ecolabel that finds the right balance between meeting consumer expectations and creating sufficient opportunities for financial product issuers. We do however remain concerned that some design choices put forward in the latest JRC Paper would lead to misleading consumers and reputational damage to the Ecolabel beyond financial products. This briefing lists our key concerns and feedback to the JRC's five key discussion questions, as a follow-up to the more detailed input in our briefing from March 2020.

Key issues from a consumer perspective

- Consumers expect more **ambition on the threshold (Criterion 1) and absolute exclusions in Criterion 2.** Consumer organisations and environmental NGOs would find it easier to support products that make significant investments in green companies, and completely exclude investment in activities with negative ESG impacts that consumers would not expect and accept in "green" funds at all.
- Environmentally friendly products should **not come with concessions on social and governance aspects (Criterion 3);** there should be no trade-off between ecological (E) and other (SG) standards.
- Consumers expect that **national supervisors can and will act** if products do not respect thresholds, exclusions, minimum standards or engagement requirements**,** as well as expect a **good supervision system**.

Feedback on the JRC's horizontal questions

1. Given the divergent views of stakeholders, what should be the key considerations in setting the ambition level of the whole criteria set and in particular criterion 1?

- In the legislative process, the Taxonomy Regulation was not only extended to include "transition" activities in addition to "pure play" green activities, but also to "enabling" activities. The final text does not make a distinction between these three categories of "green" investments. This change significantly enlarges the investment universe and is not sufficiently integrated in the current draft.

- In our view, this **enlargement of eligible economic activities** should lead to a much higher base ambition. From a consumer perspective, it is **not acceptable** that a fund with **18% exposure to Taxonomy-compliant activities** (which could merely be enabling activities) is eligible for the EU Ecolabel. We believe that this **threshold needs to be increased substantially**[1] and we have made a proposal with a flexible approach to achieve this (see our March 2020 briefing).

- Consumer organisations and environmental NGOs will be keen to **promote a label** that has a **strong ambition level** and **meets consumer expectations**; this could in turn help increase the market demand.

- The JRC should make a thorough assessment of the market coverage that the adopted Taxonomy Regulation's scope including transition and enabling activities would imply, the amount of eligible investments, and the amount of Ecolabelled products to be expected.

- In this context, we still support the idea that having **10-20%** of products covered should be a **long-term target**, as the financial sector has made relatively little progress in the integration of sustainability objectives until now. Therefore, calibrating the criteria in such a way that 10-20% of the *current* market is covered would fail to meet consumers expectations and would not signal environmental excellence, which is the primary goal of the EU Ecolabel Regulation. Especially, as demand from private investors is increasing and the **market for (retail) sustainable finance products is expected to develop significantly** within 1 to 2 years[2], i.e. ahead of the next revision cycle. We caution against allowing too many products to be labelled in the first criteria set given the inherent **risk of greenwashing** and **reputational damage to the Ecolabel** as a whole.

- We would encourage a **short review period** (2-3 years) considering expected market development.

2. Under what circumstances could companies investing significantly in a transition towards reduced CO2 emissions or other greener activities, but which may still carry out excluded activities, be included in an ecolabelled fund? (relevant to Criteria 1, 2 and 4)

- We think transitioning investments should be taken into account for reduced CO2 emissions. In terms of *how* the eligibility is measured (Criterion 1), we have proposed a **mixed assessment system of turnover and investments** (capital expenditure[3]), e.g. in an 80/20 proportion. Including capital expenditure helps to ensure that companies have an incentive to invest in greening their business, while at the same time protecting consumers against a situation where their money is used to finance non-green products and services.

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[1] This concern has also been raised by MEPs Bas Eickhout and Sirpa Pietikäinen, Co-rapporteurs of the European Parliament on the *Regulation on the establishment of a framework to facilitate sustainable investment (Taxonomy Regulation)* in in a letter addressed to Vice President Dombrovskis, Commissioner Sinkevičius and Commissioner Gabriel.

[2] Research by FNG shows that private investments in sustainable financial products have nearly doubled from 2018 to 2019 in Germany (96%) and Austria (77%). *Source: http://fng-marktbericht.org/wp-content/uploads/2020/05/FNG_Marktbericht2020.pdf*

[3] Capital expenditure (capex) is the money an organization or corporate entity spends to buy, maintain, or improve its fixed assets, such as buildings, vehicles, equipment, or land (…) Capital expenditures contrast with operating expenses (opex), which are ongoing expenses that are inherent to the operation of the asset. Opex includes items like electricity or cleaning. The difference between opex and capex may not be immediately obvious for some expenses; for instance, repaving the parking lot may be thought of inherent to the operation of a shopping mall. The dividing line for items like these is that the expense is considered capex if the financial benefit of the expenditure extends beyond the current fiscal year. *Source: https://en.wikipedia.org/wiki/Capital_expenditure*

- For companies that are investing significantly in a transition, but are still involved in excluded activities, we think it is only possible to make **exceptions if the excluded activity (Criterion 2) is related to reduced CO2 emissions**. Because then the criteria can refer to established frameworks for phasing out high-carbon activities. To be eligible for an exception the company must have adopted transition plans in line with science-based climate targets, which means that the excluded activity will be phased out in a sufficient amount of time.

- We **do not support exceptions for other types of excluded activities** (Criterion 2), like the manufacture of military weapons or human rights violations. It would be less acceptable to consumers and since there are no external standards or frameworks, it would require that the Ecolabel sets time frames for the necessary phase-out of each type of activity, which may be tricky.

- As the threshold for Taxonomy-compliant products and services is not likely to be set at 100%, Ecolabelled funds will by definition include companies that consumers might not expect in those funds, such as major players in traditional industries (energy, transport, consumer goods) with a small share of "green" activities. We think that inclusion of such companies should be mostly on the basis of their investments, not because they are already providing Taxonomy-compliant services, as this ensures that companies are transitioning towards a more sustainable business model with the money from Ecolabelled funds and not just "labelling" their existing business.

- We accept a **technical threshold of 5% excluded activities at fund level (Criterion 2),** which is common industry practice[4]. This allows fund managers to deal with changes in company activities, sudden changes in valuation, mergers & acquisitions or negative ESG impact events in a responsible way without immediately having to fire sale the relevant assets or risk losing the label in the short term. However, this **technical tolerance** should not become a permanent feature of sustainable investment funds, which is why we advise against further grace periods or tolerance measures; a fund manager who chooses to operate on the limit of the technical tolerance on a permanent basis to maximize financial returns runs the risk of losing the Ecolabel if an event suddenly pushes the fund above the 5% threshold for excluded activities.

- We do **not see any necessity for a higher technical threshold** as some in the industry advocate for the reasons outlined above. A higher tolerance needlessly increases the reputational risk of consumers being exposed to excluded activities[5]; consumers are not looking for products that have a positive environmental impact but ignore social and governance impacts.

- A **clear methodology** must be developed to define **how allegations of criteria violation shall be considered;** this would facilitate national competent bodies' decision-making on when they should withdraw the label**.** Consumers expect Member States to act in case of documented violations. In our March 2020 briefing, we have made a proposal for a methodology to ensure that fund managers address allegations proactively with time-bound objectives, transparent reporting and sample checks by Competent Bodies.

- We strongly acknowledge the added value of engagement policies (Criterion 4), especially in combination with divestment as a fallback, but note that **engagement policies can never "compensate" for the retention of "brown" companies in a portfolio**. As such, engagement is not

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[4] As reflected in national standards such as the Austrian Ecolabel, the German FNG Ecolabel and the Nordic Swan Ecolabel.

[5] As was recently demonstrated in a Belgian RTBF documentary, which showed consumer reactions to greenwashing in retail finance products sold as "sustainable" with exposures to companies involved in environmental scandals, human rights abuses, and unethical activities such as commercial prisons.

Video: https://www.rtbf.be/auvio/detail_investigation?id=2629669

Article: https://tinyurl.com/rtbf-investigation-banques a relevant criterion for determining eligibility. In addition, it is hardly possible to verify the environmental impact of engagement.

3. For bond funds should the criteria on exclusions be extended in some way to cover the activities of the issuer of the bonds, in order to reduce the possible reputational risk to the EU Ecolabel? (relevant to Criterion 1 and 2)

- Yes, we agree with the JRC that the **criteria for bonds** should be extended and **aligned with the requirements for equities**. This should avoid high reputational risk situations such as the labelling of a bond by an energy company for the purpose of developing windmills or solar panels whereas nearly all the company's revenues come from excluded activities (e.g. coal).

4. How far should we go in seeking to improve the investor impact of the criteria, given that it is difficult to prove that financial products meeting the criteria as currently proposed can lead directly to positive environmental change? (relevant to Criterion 1,2 and 4)

- The difficulty of documenting impact is a fundamental underlying concern with the Taxonomy: investing in a sustainable company or bond does not guarantee a sustainable impact but can only act as a proxy.

- To make sure that consumers understand that investment does not guarantee impact, we have suggested in our March 2020 briefing that a **systematic disclaimer or warning label** when there is no impact objective, or if there is an impact objective but no measurement / KPIs to check it (as part of Criterion 5), on all Ecolabelled funds explaining this to consumers is needed. It would also warn consumers of potential misleading information in marketing material, e.g. unsubstantiated impact claims.

5. Should criterion 3 be retained in its current form, given that it goes further than the minimum social safeguards as proposed in the Taxonomy and as reflected in the EU Green Bond Standard proposal?

- We believe **Criterion 3 should be expanded** rather than removed. To correctly reflect the Taxonomy Regulation, Criterion 3 should not only include a reference to the OECD Guidelines for multinational enterprises, but also to the **UN Guiding Principles on Business and Human Rights**.

- References should also be added to include basic consumer expectations about social and ethical aspects as defined in the Ecolabel Regulation, e.g. on ensuring that requirements apply to supply chains in general and not only sourcing of raw materials, avoiding military products used in combats and not only controversial arms, excluding States that have not applied the death penalty or human rights conventions, paying a living wage and not just the local minimum wage.

- Finally, the Taxonomy Regulation defines sustainable activities, not sustainable companies. But for the purpose of the application of the Ecolabel, the entire company invested in must respect the minimum safeguards. Therefore, **the minimum social (and governance) safeguards** must be explicitly copied and integrated into Ecolabel Criterion 3, so that they **apply to the issuing company as a whole.**

16 June 2020