Comments to criterion 1 and 2 of the EU Ecolabel for Retail Financial Products, Technical Report 3.0

The Commission has presented an updated proposal of the EU Ecolabel for Retail Financial Products. Ahead of its discussion at the EUEB, we would like to share our preliminary assessment of the draft and raise strong concerns that the approach taken provides a real risk for greenwashing financial products, misleading consumers and harming the reputation of the EU Ecolabel scheme beyond finance.

Under the previous draft proposal, investment funds deriving only 18% of total revenue from environmentally sustainable activities could qualify for the label. Voices from some Member States, MEPs Co-rapporteurs of the Taxonomy Regulation in the European Parliament, NGOs (see our previous positions from March 2020 and June 2020) and other stakeholders considered this approach as unacceptable for a label of environmental excellence.

Following this, a subgroup was set up to discuss the approach and increase the ambition level. However, the result weakens even further the ambition level of the EU Ecolabel below the 18% threshold for green revenues.

We believe that this has not been the aim of the work undertaken by the Commission and stakeholders involved in the subgroup. We therefore call on the Commission to address the shortcomings of the proposal, by more comprehensively analyzing its implications involving stakeholders and organizing an additional working group. A delay of the process would also allow a better alignment with the development of the Taxonomy Regulation Delegated Acts.

Although the new draft appears to integrate some of the elements of the NGOs proposal, a detailed assessment of criterion 1, the formula proposed to calculate the level of greenness of the investment fund and the new criterion 2 on transition companies lead to a further weakening of the label. We would like to draw the attention to the following aspects:

a) Equity portfolio threshold

The **portfolio threshold should be set at 51% at least**. Given that the investment universe is enlarged by integrating capex (and projected green revenues) as an additional indicator for determining the overall greenness of the portfolio, 40%is not an acceptable threshold. We reiterate that consumers would expect that a majority of the activities covered by the fund are sustainable. In this regard, consumer organisations and environmental NGOs would find it very hard to promote products that are not even “half green”, not now nor in the future.

The threshold should in addition be revised upwards and grow every year as we would expect that a larger part of the portfolio builds on green activities (e.g. 5% every 3 years so resulting 55% in 2023, 60% in 2026,…). We insist that this threshold refers to a wide universe of taxonomy compliant activities which include, in addition to green activities, enabling and transitional activities[1].

b) Untransparent formula that lowers even further the ambition level

The formula proposed alters dramatically the greenness of the portfolio because it integrates several erroneous factors which should be corrected:

1. The inclusion of **projected capex** as a promise of future investments can double the greenness of companies, inflating and disturbing the calculation.
2. **The weighting of 60% green revenues and 40% green capex** (or green projected revenues) gives a too high premium to companies with very low level of green revenues.
3. The **inclusion of projected green revenues,** and in particular based on the **annual growth of percentages** and using a **cumulative calculation method** (not average like the capex factor) will multiply dramatically the greenness of the holding. For instance, if a company increases its projected green revenues from 1% to 2% during a five-year period, this is calculated as a 100% green improvement and is rewarded as much as if the company had 100% green capex during all five years. It means also that the very inflated factor *projected growth of green revenues* will outperform average capex and therefore be the basis for the forward-looking aspect in the formula, which is also the case in the calculation examples from JRC.
4. There is **no cap on how many transition companies can be included** in the portfolio fund, while the greenness of this companies as defined in criterion 2 is far from acceptable (see below).

The above elements result in a dramatic weakening of the EU Ecolabel even further below the ambition level of the first proposal set at 18%. If all the factors are combined, it would be possible to build portfolios complying with the 40% threshold while relying mainly on companies with circa 10% of real green revenues.

Therefore, we conclude that the formula is an unacceptable device to greenwash unsustainable corporations/investments and does not increase the 'ambition' of the label to the slightest.

The annex to this letter includes two simulations for investment funds that through the proposed formula would meet criterion 1 although we would not expect them to be rewarded with the Ecolabel. Example 1 presents a case with green revenues going from 6% up to 12% in 5 years and low green capex at 20% which can meet the 43% threshold. A second example presents green revenues low and stable at 6% and an (unlikely) high green capex at 100% which the formula rewards with a 43% threshold as well.

[1] According to the Paris-aligned S&P Index, a majority of existing funds could potentially comply with the first two objectives of the taxonomy and, while excluding carbon intensive utilities and transport operators, retain profitability without increasing the risk profile.

c) Unacceptable inclusion and definition of companies in transition

Criterion 2 is fundamentally weakening the proposal and the threshold calculations in criterion 1. Investment in companies made eligible for application of the Ecolabel thanks to this criterion are only providing a very limited and very late contribution to addressing sustainability.

If retained, criterion 2 would allow a company with only 6% green revenues and which will be only 20% green or have a 20% green capex in 2027 to be eligible for an Ecolabelled fund. This does not match the scale and timing of the systemic transformation that the EU needs to achieve a carbon neutral economy which fits planetary boundaries.

In addition, the verification of eligibility criteria such as a "formal commitment" to close down capital assets that would otherwise be excluded under criterion 3.1 is in our view not practically enforceable.

We would like to propose the following solutions to address the shortcomings of the proposal:

1. ***Return to a simpler, transparent formula whereby green revenues and green capex are computed: 0.8 X GRi + 0,2 X GCi.***
2. ***Limit the contribution of capex to the portfolio "greenness" to 20%.*** *While capex is a helpful indicator to create incentives for investee companies, it should have a* ***subordinate role to green revenues****. Greening capex is relatively easier and faster than greening the revenues and it has limitations to ensure the full sustainability of the company – which depends on other factors, notably the potential need to address existing assets and to decommission older assets with a long lifespan, in some sectors at least (e.g. existing coal plant, oil and gas pipeline, steel plant, etc.).*
3. ***Do not use projected capex*** *as this is a promise of future investments with difficult enforcement and artificially inflates the greenness of the portfolio.*
4. ***Rely on capex but not on projected green revenues.*** *The reason for introducing capex is to create incentives for companies to green their business. Given the annual mandatory reporting requirement and granular definition of green capex in the Taxonomy regulation, it provides much more robust verification than "projected change in green revenue". While forward-oriented, capex is measured today, it is not a "promise" to invest, it is an actual investment. The introduction of "projected change in green revenue" could create incentives for gaming the system as investee companies make promises that are not verifiable or sanctionable once the label has been awarded.*
5. ***Delete criterion 2 altogether,*** *as this creates an additional layer of unnecessary complexity for the approach and leads to weakening of criterion 1.*

We call on the Commission and Members States to consider this input and further assess and improve the proposal.

While the aim of the EU Ecolabel should be guiding retail investors towards truly sustainable financial products, and at the same time avoiding the greenwashing of unsustainable investments, the current proposal creates the exact opposite scenario for the label. It is labelling unsustainable investments as "green" and not sufficiently promoting targeted and genuine sustainable investments. As a result, the proposal is at odds with the urgency and systemic transformation needs to meet the Paris Agreement, the Sustainable Development Goals and the European Green Deal.

Annex. Simulation of application of criterion 1 to two examples of portfolio composed of transition companies

Criterion 1 - Equity fund greenness

				Projection					Historic record			Projection								
			Green Revenue over 5 years						Green Capex over 5 years						Formulas					
	Type of company	Portfolio contribution	GR2020	GR2021	GR2022	GR2023	GR2024	GR2025	GC2018	GC2019	GC2020	GC2021	G2022	GC2023	Green Revenue GRi	GRGi	GCi	Greeness contribution without formula	Greeness contribution with formula	
Other Assets		0.0%																0%	0%	Other assets
Firm1		0.0%	3%												3%			0.00%	0.00%	Equities
Firm2	Company investing in transition	25.0%	6%	6%	6%	6%	6%	12%	20%	20%	20%	20%	20%	20%	6%	100%	20%	1.50%	10.90%	
Firm3	Company investing in transition	25.0%	6%	6%	6%	6%	6%	12%	20%	20%	20%	20%	20%	20%	6%	100%	20%	1.50%	10.90%	
Firm4	Company investing in transition	25.0%	6%	6%	6%	6%	6%	12%	20%	20%	20%	20%	20%	20%	6%	100%	20%	1.50%	10.90%	
Firm5	Company investing in transition	25.0%	6%	6%	6%	6%	6%	12%	20%	20%	20%	20%	20%	20%	6%	100%	20%	1.50%	10.90%	
Firm6			40%	40%	40%	50%	50%	50%	20%	13%	17%	10%	13%	10%	40%	25%	14%	0.00%	0.00%	
Firm7			40%	40%	40%	50%	50%	51%	20%	19%	15%	18%	12%	10%	40%	27%	16%	0.00%	0.00%	
Firm8			40%	40%	50%	50%	50%	52%	20%	19%	19%	17%	15%	20%	40%	29%	18%	0.00%	0.00%	
Firm9	Company investing in green growth		55%	55%	56%	58%	60%	61%	20%	19%	10%	15%	13%	10%	55%	11%	15%	0.00%	0.00%	
Firm10	Company investing in green growth		52%	54%	55%	60%	65%	70%	12%	10%	15%	13%	13%	17%	52%	31%	13%	0.00%	0.00%	

Total PC	**100.0%**

GCi: This term is the average Green Capex across the 5 years looking period

GRGi: There is a cap of 100%

EXAMPLE 1

PORTFOLIO COMPOSED OF TRANSITION COMPANIES

WITH 94% OF NON GREEN REVENUES GOING DOWN TO 88% IN 5 YEARS

WITH ONLY 20% STABLE GREEN CAPEX

Portfolio Greenness	6.00%	43.60%

Criterion 1 - Equity fund greenness

					Projection				Historic record			Projection							
			Green Revenue over 5 years						Green Capex over 5 years						Formulas					
	Type of company	Portfolio contribution	GR2020	GR2021	GR2022	GR2023	GR2024	GR2025	GC2018	GC2019	GC2020	GC2021	G2022	GC2023	Green Revenue GRI	GRGI	GCI	Greeness contribution without formula	Greeness contribution with formula	
Other Assets		0.0%																0%	0%	Other assets
Firm1		0.0%	3%												3%			0.00%	0.00%	Equities
Firm2	Company investing in transition	25.0%	6%	6%	6%	6%	6%	6%	100%	100%	100%	100%	100%	100%	6%	0%	100%	1.50%	10.90%	
Firm3	Company investing in transition	25.0%	6%	6%	6%	6%	6%	6%	100%	100%	100%	100%	100%	100%	6%	0%	100%	1.50%	10.90%	
Firm4	Company investing in transition	25.0%	6%	6%	6%	6%	6%	6%	100%	100%	100%	100%	100%	100%	6%	0%	100%	1.50%	10.90%	
Firm5	Company investing in transition	25.0%	6%	6%	6%	6%	6%	6%	100%	100%	100%	100%	100%	100%	6%	0%	100%	1.50%	10.90%	
Firm6			40%	40%	40%	50%	50%	50%	20%	13%	17%	10%	13%	10%	40%	25%	14%	0.00%	0.00%	
Firm7			40%	40%	40%	50%	50%	51%	20%	19%	15%	18%	12%	10%	40%	27%	16%	0.00%	0.00%	
Firm8			40%	40%	50%	50%	50%	52%	20%	19%	19%	17%	15%	20%	40%	29%	18%	0.00%	0.00%	
Firm9	Company investing in green growth		55%	55%	56%	58%	60%	61%	20%	19%	10%	15%	13%	10%	55%	11%	15%	0.00%	0.00%	
Firm10	Company investing in green growth		52%	54%	55%	60%	65%	70%	12%	10%	15%	13%	13%	17%	52%	31%	13%	0.00%	0.00%	

Total PC	100.0%

GCI: This term is the average Green Capex across the 5 years looking period

GRGI: There is a cap of 100%

EXAMPLE 2

PORTFOLIO COMPOSED OF TRANSITION COMPANIES
WITH 94% OF NON GREEN STABLE REVENUES
WITH 100% GREEN CAPEX

Portfolio Greenness	6.00%	43.60%

END