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Development of EU Ecolabel criteria for Retail Financial Products

Technical Report 2.0: Draft proposal for the product scope and criteria

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ABBREVIATIONS AND ACRONYMS

AIF	Alternative Investment Funds
AIFMD	Alternative Investment Fund Managers Directive
BIC	Bank Identifier Code
CAB	Climate Awareness Bonds
CBI	Climate Bonds Initiative
CVA	Credit Valuation Adjustment
EC	European Commission
EEA	European Economic Area
ESG	Environment, Social, Governance
ETD	Exchange-Traded Derivatives
ETF	Exchange-Traded Funds
FNG	Forum Nachhaltige Geldanlagen (Sustainable Investment Forum Germany)
GBP	Green Bond Principles
GBS	Green Bond Standard
GHG	Greenhouse Gas
ICMA	International Capital Markets Association
IDD	Insurance Distribution Directive
IDFC	International Development Finance Club
IF	Investment Fund
ILO	International Labour Organization
IPID	Insurance Product Information Documentation
JRC	Joint Research Centre
KID	Key Information Document
KPI	Key Performance Indicator
MDBs	Multilateral Development Banks
MiFID	Market In Financial Instrument Directive
MS	Member States
NFID	Non-Financial Information Directive
OTC	Over-The-Counter
OTF	Operational Trading Facility
PRIIPs	Packaged Retail Investment and Insurance-based Products
RAIF	Retail Alternative Investment Fund
RM	Regulated Markets
SPV	Special Purpose Vehicle
SRI	Socially Responsible Investment
UCITS	Undertakings For Collective Investment In Transferable Securities
TEEC	Transition Energétique Et Ecologique Pour Le Climat (Energy and Ecological Transition for the Climate (France))
TMI	Total Market Index
TR	Technical Report

FOREWORD

This report is part of the development of the EU Ecolabel criteria for financial products. Once developed, the criteria will be adopted through a Commission Decision under the EU Ecolabel Regulation. It summarises and updates the inputs received and the further research carried out by the working team and serves as a working document for the second ad-hoc working group (2nd AHWG) meeting to be held on 30 January 2020 in Brussels. It takes as its starting point the information available in the Preliminary Report and the First Technical Report, available on the project website: https://susproc.jrc.ec.europa.eu/Financial_products/documents.html.

Both, the Preliminary Report and the First Technical Report were published in March 2019, and provided the technical background for the product group from a legal, political and market context for the first stakeholder (1st AHWG) meeting held in April 2019 in Seville, Spain. The First Technical Report contained draft criteria proposals which were presented to stakeholders during the 1st AHWG meeting and on which stakeholders were invited to comment during the consultation period. The comments received from the stakeholders have subsequently been collated, analysed, and, following further research, addressed in this Second Technical Report.

This Second Technical Report provides an update to the initial set of criteria proposals contained in the First Technical Report based on additional research, and information provided by stakeholders including the subgroup set up to address issues on criterion 1 related to the thresholds on the green investment portfolio and EU taxonomy-eligible economic activities. This report also includes an update of the initial scope and definitions.

HOW TO READ THIS REPORT

The current revised second technical report provides an update on the criteria development, based on new information collected during the process and provided by the involved parties (i.e. through stakeholders' discussion at the 1st AHWG meeting, further stakeholder inputs following the meetings and additional desk research).

This report consists of the following sections:

- **Section 1 - Introduction**: describing the goal and content of the document, and the sources of information used.
- **Section 2 - Background and Context:** presenting the process for developing EU Ecolabel criteria, the Action Plan on Sustainable Finance, the material scope of the criteria, as well as summarising the First Technical Report and the main conclusions obtained in the Preliminary Report.
- **Section 3 - Product group name, scope and definitions**: including the updated scope and definitions for the product group of financial products.
- **Section 4 - Structure and rationale for the criteria and criteria areas**: providing an overview of how the criteria set could be configured. This section also explains the potential environmental benefits of setting an EU Ecolabel for financial products. It links those benefits to several actions that can be promoted in the context of the management of the financial products such as engagement by the fund manager. The criteria set also includes requirements on the type of documentation required to show compliance with the criteria that shall be provided by applicants to the EU Ecolabel Competent Bodies.
- **Section 5 - Criteria proposal:** presenting the second draft of the proposed EU Ecolabel criteria for financial services. The proposal is written in a blue box and subsequently a rationale is given. Under each criterion, discussions are chronologically presented under the following headings:
  - Summary of the rationale and technical data discussed in the Preliminary Report and the first stakeholder questionnaire that led to the first criteria proposal, presented in the 1st AHWG meeting.
  - The outcomes of and suggestions made by the stakeholders during the 1st AHWG meeting and the subsequent commenting period.
  - Further research carried out on the points addressed by the stakeholders or any other point of relevance and main changes of the criterion in the second proposal.

Background on the EU Taxonomy and a comparison between the 1st and 2nd (revised) criteria proposals are provided in Annexes 1 and 2 respectively.

Should stakeholders require more information about the EU Ecolabel criteria proposed in the First Technical Report, they are kindly request to download this First Technical Report from the project website: https://susproc.jrc.ec.europa.eu/Financial_products/documents.html.

1 INTRODUCTION

The main objective of this project is the development of EU Ecolabel criteria for the financial products group. The study is being carried out by the Circular Economy & Industrial Leadership and the Finance & Economy Units of the Joint Research Centre (JRC) of the European Commission. The work is being developed for the European Commission's Directorate-General for the Environment (DG ENV) and in collaboration with the Directorate-General for Financial Stability, Financial Services and Capital Markets Union of the European Commission (DG FISMA).

The EU Ecolabel criteria are designed to promote the use of the most environmentally friendly products as articulated by the Regulation on the EU Ecolabel (Regulation (EC) No 66/2010 of the European Parliament and of the Council of 25 November 2009 on the EU Ecolabel), hereafter, the 'EU Ecolabel Regulation'. According to Article 2, this Regulation applies to ‘products’ (either goods or services) that are supplied for distribution, consumption or use on the Community market.

The main purpose of the technical report is to summarise the results of the preliminary analysis and propose appropriate and updated criteria in this Second Technical Report to serve as a background document for discussion with stakeholders during the 2nd AHWG meeting.

This technical report is supported and complemented by the Preliminary Report[1] published in March 2019. The Preliminary Report includes the scope and definition, market analysis, and technical analysis. Moreover, the First Technical Report [2] was published in March 2019 and formed the basis for the 1st AHWG meeting which took place in April 2019.

[1] Preliminary Report. EU Ecolabel criteria for Financial Products. March 2019.
See: https://susproc.jrc.ec.europa.eu/Financial_products/documents.html.

[2] Draft Technical report EU Ecolabel Financial Products. March 2019.
See: https://susproc.jrc.ec.europa.eu/Financial_products/documents.html.

2 BACKGROUND AND CONTEXT

2.1 Process for developing the EU Ecolabel

The typical process of developing the EU Ecolabel criteria for any product group is set out in Article 7 of and Annex I to the EU Ecolabel Regulation. This entails the management of a process of stakeholder consultation to be supported by the development of the following documents by the party which is leading the process: (1) a Preliminary Report; (2) a proposal for draft criteria; (3) a Technical Report in support of the proposal for draft criteria; (4) a Final Report; and; (5) manuals for potential users of the EU Ecolabel and Competent Bodies (CBs), and for authorities awarding public contracts.

Moreover, the EU Ecolabel Regulation also stipulates that a minimum of two AHWG meetings shall be held along the criteria process, the first of which took place in April 2019 and the second will take place in January 2020. At the meetings the material contained in the Preliminary Report, together with the scope and criteria proposals contained in the supporting Technical Reports, are discussed. The feedback from these meetings, together with associated rounds of written consultations and multilateral consultations are used to further adapt the scope and criteria proposals.

This Second Technical Report has been drafted in accordance with Article 7 of the EU Ecolabel Regulation and will be updated during the criteria development process based on new information, stakeholder feedback and input from the 1st AHWG meeting. The Final Technical Report will incorporate all relevant scientific arguments substantiating the final criteria proposal.

2.2 Action Plan on Sustainable Finance

Sustainability has long been at the heart of the European project and the European Union (EU) is fully committed to reaching the EU 2030 climate and energy targets and to mainstreaming sustainable development into EU policies. Achieving EU sustainability goals requires major investments. A substantial part of these financial flows will have to come from the private sector and this requires redirecting private capital flows towards more sustainable investments as well as comprehensively rethinking the European financial framework.

In this context, in December 2016, the European Commission established a High-Level Expert Group (HLEG) to develop an overarching and comprehensive EU strategy on sustainable finance. This group published its final report in January 2018. As a follow-up, on 7 March 2018, the European Commission published an Action Plan: Financing Sustainable Growth (hereafter, the 'Action Plan')[3]. This Action Plan puts forward 10 actions whose main objectives are to:

1. Reorient capital flows towards sustainable investments to achieve sustainable and inclusive growth;
2. Manage financial risks stemming from climate change, resource depletion, environmental degradation and social issues; and
3. Foster transparency and long-termism in financial and economic activity.

Action 2 of the Action Plan refers to "Creating standards and labels for green financial products". The Action Plan recognised that "labelling schemes can be particularly useful for retail investors who would like to express their investment preferences on sustainable activities [and] could facilitate retail investors' choice […]". Hence, the Commission "committed to explore the use of the EU Ecolabel framework for certain financial products, to be applied once the EU sustainability taxonomy is adopted".

[3] European Commission. 2018. Communication from the Commission to the European Parliament, the European Council, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions Action Plan: Financing Sustainable Growth. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52018DC0097

This action was a follow-up to the specific recommendations of HLEG to establish “a voluntary European green label to spur market growth and enable retail investors to identify products that finance the climate and ecological transition”. The HLEG report further recommended that “the Commission should develop a voluntary EU green label for green themed funds [which] should include specifications based on the use of the EU sustainable taxonomy”.

Hence, the link between the EU Ecolabel criteria for financial products and the EU Taxonomy was already contained in the HLEG recommendations and the Action Plan. The Impact Assessment accompanying the Taxonomy proposal also recognises that the EU Ecolabel is one of the potential uses of the Taxonomy and is thus one mechanism through which the Taxonomy will have an impact:

“The use of the EU taxonomy for (financial) product standards and labels would improve environmental integrity of green investments within as well as outside the EU (as the taxonomy would also apply to EU investors investing globally). As such, it would help to minimise the risk of greenwashing and avoid the negative environmental impacts from investing in assets that are not in line with the EU sustainability goals”. Annex 2 provides more details about the Taxonomy.

A further follow-up is the preparation of a Commission Decision defining criteria to be fulfilled by financial products in order to qualify for the EU Ecolabel. This happens in the framework of the EU Ecolabel Regulation, which provides guidance as to how criteria should be developed and implemented for products and services. The EU Ecolabel is a voluntary award scheme intended to promote products with a reduced environmental effect during their entire life cycle and to provide consumers with accurate, non-deceptive, science-based information on the environmental impact of products. It is a part of a broader EU Action Plan on Sustainable Consumption and Production and Sustainable Industrial Policy (European Commisison, 2008). This Action Plan was already adopted by the European Commission on 16 July 2008 and links the EU Ecolabel to other EU policies such as Green Public Procurement (GPP), the Ecodesign of energy-related products, and the EU Action Plan for the Circular Economy.

2.3 Material scope: financial services linked to a product

According to the EU Ecolabel Regulation, the label may be awarded to "goods and services" which are supplied for distribution, consumption or use on the Community market whether in return for payment or free of charge. Financial products fall within the scope of the EU Ecolabel Regulation where they can be considered as services for distribution or use. **Consequently, the EU Ecolabel will be awarded to the financial service being provided by the manufacturer of the green financial product,** rather than to the financial product. However, the EU Ecolabel logo can figure on the promotional material of the financial product itself.

Given the inclusion of savings accounts and deposits in the expanded scope of this revised criteria proposal due to their relevance to consumers and their market significance in terms of household money, there is a need to provide a service definition for this additional financial product.

Consequently, the generic financial service definition will need to be clearly specified to cover the two groups of financial products that are in the scope of the EU Ecolabel, namely:

i. The service of managing an investment product that has been packaged for retail investors in accordance with the requirements laid down in Regulation (EU) No 1286/2014 on eligible packaged retail and insurance-based investment products (PRIIPs). This shall include:
    - equity, bond and mixed investment funds, to include those referred to as Undertakings for the Collective Investment in Transferable Securities (UCITS) and, where applicable, Alternative Investment Funds (AIFs);
    - insurance-based products with an investment component, more precisely unit-linked life insurances.

   and,

ii. The service of managing a fixed-term deposit or savings deposit product as referred to in Article 2(1) point 3 of Directive 2014/49/EU on deposit guarantee schemes in order to pay interest and derive environmental benefits from the projects and economic activities to which the deposited money is loaned. The service is provided by the credit institution on whose balance sheet appears the deposits held (liabilities) and the associated loans granted as credits (assets).

An eligibility condition for the EU Ecolabel is that for retail financial products, they shall be registered or authorised for marketing or distribution in a Member State of the European Union.

The EU Ecolabel criteria will be useful for retail investors who would like to express their investment preferences in relation to the environmental sustainability of the activities funded by their money.

For financial services provided and products offered in this context to retail investors, a number of existing Regulations and Directives need to be considered. For example, the Packaged Retail Investment and Insurance Products (PRIIPs) Regulation (EU) No 1286/2014 seeks to enable investors to better understand and compare the key features, risks, rewards and costs of different PRIIPs. The definition of the products within the scope and outside the scope of the PRIIPs Regulation is provided in the next section. Directive 2009/65/EC regulates and stipulates provisions on undertakings for the collective investment in transferable securities (UCITS) which are a popular product among retail investors. Directive 2011/61/EU (AIFMD) regulates the managers of alternative investment funds, such as hedge funds and private equity[4]. The non-financial and diversity information Directive 2014/95/EU is relevant in regards to the disclosure of information about environmental protection and social responsibility by certain large undertakings and groups.

2.4 Summary of the background analysis from the first technical report and the preliminary report

This section presents a summary of the relevant market and technical analysis conducted to enable the determination of the product scope, identification of criteria areas as well as development of criteria proposals for the Ecolabel for this product group.

2.4.1 Product group name, scope and definitions

The First Technical Report was drawn up based on an analysis of information and data available on green financial products. This encompassed several sources including academic literature, industry or consumer association reports, results from the first stakeholder questionnaire survey, and consultation (in the form of bilateral interviews) with selected financial label and scheme operators. While the PR identified the need for an EU Ecolabel for financial products, the First Technical Report focused on the following main aspects:

- scope, definition and relevant EU legislation;
- market analysis;
- technical analysis of existing taxonomies and existing definitions of ‘green’ financial products.

The First Technical Report summarised the analysis conducted at the preliminary stage of the development of the criteria for the financial product group. This included identification of the product’s scope and definitions, analysis of the PRIIPs market, a technical analysis of the existing taxonomies and the definitions of "green" financial products, as well as identification of the main criteria areas as the basis for a 1st criteria proposal.

[4] This Directive is only of relevance where Member States decided to allow marketing to retail investors on their territory.

2.4.2 Market analysis

The market analysis carried out in support of the scope and criteria proposals as presented in the First Technical Report focused on retail clients as investors. A retail client is one that is not a professional client, i.e. a client who does not possess the experience, knowledge and expertise to make its own investment decisions and properly assess the incurred risks.[5] Retail clients are mostly composed of households, being the major contributors to the net financial wealth (i.e. all financial assets minus all financial liabilities) of the Eurozone.

Statistics show that EU-28 households own about EUR 34 trillion of cumulated assets, and their financial liabilities are equal to 30% of their financial assets. Currency and deposits, pension funds, and (life and non-life) insurance products constitute around 30%, 20%, 18%, respectively, of the EU-28's household wealth. The share of equities in households' financial portfolios is also around 18%. Investment fund shares increased from 6% in 2012 to 8% in 2017. Turning to the least represented asset categories, less than 1% of households' wealth is invested in financial derivatives.

Many of the above-mentioned products are covered by the PRIIPs Regulation. PRIIPs are packaged retail and insurance-based investment products that for example banks, insurers and asset managers typically offer to retail clients. PRIIPs[6] include:

a) packaged retail investment products (PRIPs), i.e. investments, including instruments issued by special purpose vehicles, where the amount repayable to the retail investor is subject to market fluctuations;
b) Insurance-based investment products, i.e. insurance products whose maturity or surrender value is exposed to market fluctuations.

The following products are outside the scope of the PRIIPs Regulation[7]:

- non-life insurance products as listed in Annex I to Directive 2009/138/EC;
- life insurance contracts where the benefits under the contract are payable only on death or in respect of incapacity due to injury, sickness or infirmity;
- deposits other than structured deposits as defined in point (43) of Article 4(1) of Directive 2014/65/EU;
- securities as referred to in points (b) to (g), (i) and (j) of Article 1(2) of Directive 2003/71/EC;
- pension products which, under national law, are recognised as having the primary purpose of providing the investor with an income in retirement and which entitle the investor to certain benefits;
- officially recognised occupational pension schemes within the scope of Directive 2003/41/EC of the European Parliament and of the Council or Directive 2009/138/EC;
- Individual pension products for which a financial contribution from the employer is required by national law and where the employer or the employee has no choice as to the pension product or provider.

The scope of the PRIIPs Regulation is broad and intended to cover all financial products sold on the retail market that have exposure to underlying assets (stocks, bonds, etc.), provide a return over time and have an element of risk. PRIIPs cover a range of investment products which, taken together, made up a market in Europe worth up to EUR 20 trillion at the end of 2017. Investment funds, unit-linked life insurance products and unit-linked pension funds taken together account for a large part of the PRIIPs market.

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5 See Regulation n. 1286/2014 of PRIIPs Regulation, Article 4(6) and Directive 2011/61/EU, Article (4)(1)(aj) for the definition of "retail investor". Moreover, see Directive 2014/65/EU, Article 4 (1), point (11) for the definition of "retail client" and Directive 2014/65/EU, Article 4(1), point (10) and Annex II for the definition of "professional client".

6 See Regulation n. 1286/2014 of PRIIPs Regulation, Article 4(1)-(3) and the Discussion Paper "Key Information Documents for Packaged Retail and Insurance-based Investment Products (PRIIPs)" n. JC/DP/2014/02.

7 See Regulation n. 1286/2014 of PRIIPs Regulation, Article 2 (2).

Depending on the source there are between 60 000 and 80 000 investment funds domiciled in the EU (EFAMA Q1 2018 and Bloomberg, October 2018), with net assets amounting to around EUR 15 trillion[8]. Investment funds are invested predominately in equities (28%), bonds (23%), both (21%). EU legislation distinguishes between Undertakings for Collective Investment in Transferable Securities (UCITS) and Alternative Investment Funds (AIFs). UCITS and AIFs funds reached an outstanding amount of about EUR 9 trillion and EUR 6 trillion, respectively, at the end March 2018. Some AIFs are sold to retail investors following regulation at the national level, although such funds are in principle designed for professional investors.

According to Bloomberg, 421 funds are currently marketed as green or sustainable[9]. These funds are further classified as clean energy, climate change, environmentally friendly and environmental, social and corporate governance (ESG) funds[10]. This represents about 0.01% of the total active funds corresponding to a similar share in terms of assets under management (Kahlenborn et al., 2017 on the very low market share of sustainability or environmentally themed products and green impact products).

As for other PRIIPs categories, the market for life insurance products offering non-guaranteed products linked to either investment funds (i.e. unit-linked contracts), or structured products (i.e. index-linked products) amounts to about EUR 3 trillion. Approximately 25% of households' financial assets are composed of stocks and debt securities. A particular category among bonds are "Green bonds", which finance or re-finance in part or in full new and/or existing eligible green projects This specific product has received attention both at EU level and from private initiatives. However, the European green bond market is still very small in size compared the market of conventional bonds, corresponding to approximately 2.5% of the total bonds market in 2018. It is worthy of note that about 36% of the global green bond issuance in 2017 is associated with EU issuers.

2.4.3 Technical analysis

Green investment is generally associated within the financing of investments that provide environmental benefits such as a reduction in GHG and air pollutant emissions, without reducing the production and consumption of non-energy goods. Financial products or investments are therefore green as a result of the uses to which the money is put in terms of the underlying assets or economic activities.

Initial evidence suggests that a range of strategies are employed in order to make investment portfolios more attractive to customers seeking green or environmentally sustainable financial products. An increasing proportion of assets are currently managed based on a number of sustainable investment strategies including:

- exclusionary screening,
- positive screening or best-in-class approach,
- norms based screening approach,
- environmental, social and governance (ESG) integration,
- sustainability themed investing or thematic investing,
- impact/community investing, and
- corporate engagement and shareholder action.

Of these strategies, the prevailing and overlapping concepts of "green" used to date by investors have been developed around four main types of investment strategies: (1) socially responsible

[8] Source: EFAMA Q1 2018.

[9] The Bloomberg Fund Classification System provides a fund classification grouping and compares funds with similar investment objectives. Bloomberg classifies funds based on public documents including prospectuses, fund fact sheets, and annual/semi-annual reports to determine the intended investment objective of the fund manager. The characteristics of the objective relate to both asset class specific dimensions (e.g. strategy, type of investment) and non-asset class specific dimensions (e.g. industry focus, geographic focus, general attributes, etc.).

[10] One fund can be classified into more than a category, and approximately 35% of these funds are also classified as Socially Responsible Funds. For example, 49 funds belong in the category "Socially Responsible and ESG".

investing (SRI); (2) ESG integration / investing; (3) impact investing, and (4) thematic investing. Of these, impact investing and thematic investing focus on activities that deliver a specific and measurable social or environmental improvement. Green thematic investing will address specific environmental objectives or problems and can provide important information for the definition of green.

In the financial industry, an investment portfolio is a commonly applied term which encompasses assets such as stocks, bonds, cash, and real estate, amongst others. The most common asset classes in any portfolio are equities (stocks), fixed-income securities (bonds), real estate and cash equivalents. The share of each asset class in a portfolio is referred to as the asset allocation of that portfolio. These could be directly or indirectly invested in.

A number of labels and schemes are available in Europe to help investors assess and select from a range of financial products which are described as sustainable or green. These include the Greenfin (previously TEEC) Label[11], FNG Siegel[12], Nordic Swan[13], LuxFLAG Climate Finance Label[14] and the Austrian label[15] amongst others. Some of these labels and schemes define the "greenness" of an investment portfolio by setting either a requirement or threshold on:

- the minimum proportion (in percentage) of a portfolio's total assets under management mandated to be invested either in climate change mitigation and or climate change adaptation activities; or
- the percentage of revenues of the company(s) that can be attributed to "green" activities by assessing to what degree (quantified as a percentage) the company engages in sustainable economic activities which are defined in the taxonomy applied by the label or scheme.

The existing labels and schemes also make use of taxonomies to define green sectors or economic activities, in some cases with reference to screening criteria.

The different strategies, criteria and taxonomies employed by the prevailing labels and schemes, create uncertainties for investors as they are unable to compare different types of information for different financial products. It also represents an obstacle to the flow of capital towards more environmentally sustainable economic activities.

A Taxonomy is a classification system that defines ‘green’ economic activities. These economic activities could be projects or activities in specific economic sectors of any economy in areas such as renewable energy and green buildings. Regional and national labels as well as schemes available in Europe certify the “greenness” of financial products using any one of the following taxonomies:

- the Climate Bond Initiative (CBI) taxonomy;
- the Green Bond Principles (GBP) project categories; and
- the International Development Finance Club (IDFC) taxonomy.

These taxonomies differ in the manner in which they categorise different economic activities as environmentally sustainable. They also differ in their levels of granularity. This led to call for a harmonised taxonomy at the EU level. The framework established by the EU Taxonomy proposal will therefore be used as guidance in the development of the EU Ecolabel criteria, and the link with the EU Taxonomy will be established by taking a “look-through” approach.

Therefore the EU Ecolabel defines criteria for determining whether the underlying assets of financial products offered to retail investors are sufficiently “green” (linked to environmentally

[11] Energy and Ecological Transition for the Climate. Available at https://www.novethic.com/fileadmin/user_upload/divers/labels/1605-LabelTEEC_Referentiel-ENG.pdf

[12] FNG – Siegel. Available at https://www.fng-siegel.org/en/siegelkriterien-en.html

[13] Nordic Swan. Available at https://www.nordic-EU Ecolabel.org/

[14] LuxFLAG, https://www.luxflag.org/labels/climate-finance/

[15] The Austrian EU Ecolabel (January 2016). Eco-label Guideline UZ 49 for Sustainable Investment Products. Version 4.0. Available at: https://www.umweltzeichen.at/file/Guideline/UZ%2049/Long/Ec49_R4a_sustainable_Investment_products_2016.pdf

sustainable economic activities) to be awarded the label. To achieve this, the following aspects were carefully considered:

- The scope of financial products to which the EU Ecolabel criteria is applicable.
- The potential for the product to deliver environmental benefits and to attract retail investors.
- Operational issues and product verification.
- Identification of optimal strategies to be considered in the EU Ecolabel criteria in order to promote environmentally sustainable investments based on definition of "greenness" provided by the criteria.
- How the EU Taxonomy will be used in the context of the EU Ecolabel.
- Options for compliance with the requirements of proposed EU Ecolabel criteria for the purpose of awarding the label, e.g. mandatory requirements, or optional requirements with a points-based scoring system.

2.5 Mandatory vs optional criteria

The EU Ecolabel is a pass-or-fail system (binary). In other words, the label is either awarded (if criteria are fulfilled) or it is not. Two products with the EU Ecolabel may have different levels of environmental performance, but the EU Ecolabel does not distinguish between them.

However, there are two types of criteria – 'mandatory' and 'optional'. If a criterion is mandatory, complying with it is a necessary condition for the label to be awarded. 'Optional criteria' function within a points-based system. In a points system, a number of points are attributed to each optional criterion. The product receives a number of points depending on which optional criteria it complies with. Then, the total number of points is calculated and there is a minimum threshold that needs to be achieved in order to be awarded the label. A points system can be used as a stand-alone system or in combination with mandatory minimum criteria.

EU Ecolabel criteria for other product groups have used both mandatory criteria and optional criteria, including a combination of both.

2.5.1 Pros and cons of the criteria types

The main benefit of a points approach is that it allows for flexibility, i.e. there are various ways in which the green financial product can be awarded the EU Ecolabel. This may allow for a greater volume of products to be potentially eligible and encourage mainstream financial actors to apply for the label[16].

When all criteria are mandatory, if the product does not fulfil each of the criteria, it fails and cannot be awarded the EU Ecolabel. On one hand, the fact that all criteria are mandatory and all EU Ecolabel products fulfil all of them in the same way can be perceived as a more transparent system and could enhance investor confidence. On the other hand, this type of system has the disadvantage of not providing flexibility to the applicant to comply with the criteria. This could result in a smaller market for the EU Ecolabel. An overview of the advantages and disadvantages of both systems is briefly presented in ***Table 1***.

[16] Product volume in this context refers to the potential number of EU Ecolabel licences for the product group.

Table 1 - Summary evaluation of mandatory criteria system vs optional with points for the EU Ecolabel criteria

System	Advantages	Disadvantages
Mandatory criteria	**Strict compliance with all requirements**	**No prioritisation of criteria and no flexibility**
Optional criteria with a points system	Possibility of prioritising criteria (if combined with a mandatory approach) and flexibility in the application of criteria	If unsupported by some mandatory criteria could result in very poor performance in some aspects, e.g. the environmental ones.

2.5.2 Stakeholder views

The feasibility of applying the points system to the EU Ecolabel for financial products was explored with the stakeholder questionnaire survey prior to the 1st AHWG meeting. The outcome of the survey indicated that stakeholders had a mixed reaction to the suggestion that the EU Ecolabel should adopt a points-based system. Although the same issue was heavily debated during the 1st AHWG meeting, an analysis of the written responses provided by stakeholders following the meeting also reflected a mixed response to the issue.

2.5.3 Conclusion

Based on the responses received and considering that applying a points based system approach could result in different levels of importance being applied to varying aspects of the criteria, this option is not pursued further in this technical criteria revision proposal. A system with all mandatory criteria is therefore proposed, except for the criterion on EU Ecolabel information which refers to the text that can be displayed with the EU Ecolabel logo, and is an optional requirement according to the EU Ecolabel Regulation.

3 PRODUCT GROUP NAME, SCOPE AND DEFINITIONS

3.1 Revised proposal

Product group name:
Financial products
Second proposal for the product group scope:
The product group shall comprise the following products that are provided as a service to retail investors: • The service of managing an investment product that has been packaged for retail investors in accordance with the requirements laid down in Regulation (EU) No 1286/2014 on packaged retail and insurance-based investment products (PRIIPs). This shall include: - Equity, bond and mixed[17] investment funds, to include those referred to as Undertakings for the Collective Investment in Transferable Securities (UCITS) and, where applicable[18], Alternative Investment Funds (AIFs); - Insurance-based products with an investment component, more precisely unit-linked life insurances. • The service of managing a fixed-term deposit or savings deposit product as referred to in Article 2(1) point 3 of Directive 2014/49/EU on deposit guarantee schemes. The service shall be provided by the credit institution on whose balance sheet the deposits held (liabilities) and the associated loans granted as credits (assets) appear. The retail financial product shall be registered or authorised for marketing or distribution in a Member State of the European Union.

Second proposal for complementary definitions:
For the purposes of this Decision, the following definitions shall apply 1. 'packaged retail and insurance-based investment product' or 'PRIIP' means a product that is one or both of the following: a) a packaged retail investment product (PRIP); b) an insurance-based investment product; 2.'packaged retail investment product' or 'PRIP' means an investment, including instruments issued by special purpose vehicles as defined in point (26) of Article 13 of Directive 2009/138/EC or securitisation special purpose entities as defined in point (an) of Article 4(1) of the Directive 2011/61/EU of the European Parliament and of the Council (19), where, regardless of the legal form of the investment, the amount repayable to the retail investor is subject to fluctuations because of exposure to reference values or to the performance of one or more assets which are not directly purchased by the retail investor; 3. 'insurance-based investment product' means an insurance product which offers a maturity

[17] Mixed funds shall be considered as synonymous to hybrid funds

[18] AIFs may be marketed to retail investors upon a national discretion (art. 43 of AIFMD).

Second proposal for complementary definitions:
or surrender value and where that maturity or surrender value is wholly or partially exposed, directly or indirectly, to market fluctuations; 4. 'retail investor' means: a) a retail client as defined in point (11) of Article 4(1) of Directive 2014/65/EU b) a customer within the meaning of Directive 2002/92/EC, where that customer would not qualify as a professional client as defined in point (10) of Article 4(1) of Directive 2014/65/EU; 5. 'alternative investment funds' (AIFs) means collective investment undertakings, including investment compartment thereof, which: a) rise capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors; and b) do not require authorisation pursuant to Article 5 of Directive 2009/65/EC 6. 'undertaking collective investment transferable securities (UCITS)' means an undertaking for collective investment in transferable securities authorised in accordance with Article 5 of Directive 2009/65/EC 7. 'transferable securities' means; a) shares in companies and other securities equivalent to shares in companies; b) bonds and other forms of securitised debt (debt securities); c) any other negotiable securities which carry the right to acquire any such transferable securities by subscription or exchange; 8. 'share or stock' means a type of security that signifies ownership in a corporation and represents a claim on part of the corporation's assets and earnings; 9. 'bond' means a fixed income instrument that represents a loan made by an investor to a borrower (typically corporate or governmental); 10. 'investment fund' means a supply of capital belonging to numerous investors used to collectively purchase securities while each investor retains ownership and control of this own shares; types of investment funds include mutual funds, exchange-traded funds, money market funds and hedge funds; 11. 'portfolio' means a grouping of financial assets; 12. 'asset' means a resource with economic value that an individual, corporation or country owns or controls with the expectation that it will provide a future benefit; 13. 'verification' means a procedure to certify that a product complies with specified EU Ecolabel criteria; 14. 'portfolio management' means managing portfolios in accordance with mandates given by clients on a discretionary client-by-client basis where such portfolios include one or more financial instruments; 15. 'deposit' means a credit balance which results from funds left in an account or from temporary situations deriving from normal banking transactions and which a credit institution is required to repay under the legal and contractual conditions applicable, including a fixed-term deposit and a savings deposit;

Second proposal for complementary definitions:

16. ‘structured deposits’ means a deposit as defined in point (c) of Article 2(1) of Directive 2014/49/EU of the European Parliament and of the Council (1), which is fully repayable at maturity on terms under which interest or a premium will be paid or is at risk, according to a formula;

17. ‘unit-linked’ means that the financial benefits provided by an insurance contract are directly linked to the value of assets contained in an investment fund;

18. ‘revenue’ means this is the amount of money that is brought into a company by its business activities;

19. ‘turnover’ is also used as a synonym for investments; in the investment industry, turnover is defined as the percentage of a portfolio that is sold in a particular month or year;

20. 'Pension products' refers to non-public arrangements and investment vehicles which have an explicit objective of retirement provision (according to a national social and labour law or tax rules) irrespective whether they are of occupational or personal type.

3.2 Rationale of the proposed name, scope and definitions

In the first proposal for the product group scope a focus was put on certain PRIIPs, and in particular UCITS and retail AIFs. Following on from the stakeholder feedback, the inclusion of a number of PRIIPs is to be clarified in the scope – namely insurance-based products with an investment component, more precisely individual unit-linked life insurances - and the potential to make three potential new additions to the scope has been analysed – namely pension funds, professional AIFs and savings/deposit accounts.

As a conclusion of the analysis, it is proposed to add the "**service of managing savings/deposit accounts"** to the initial scope of the product group. The following rationale has been identified for their inclusion within the scope of the EU Ecolabel:

- A mainstream product: Savings and deposit accounts have traditionally played an important role in the economy, accounting for the majority of retail bank funds and providing liquidity for investment by businesses. If the aim of the EU Ecolabel is to contribute to directing investment towards green economic activities, the inclusion of such products could have an important role to play.
- Diversification of the product scope: Savings and deposits accounts play an important role in the financing of projects and economic activities, particularly at a local/regional level where the funds can be used to provide loans. Green loans funded by such products can complement the tradable securities (largely bonds and equities) that make up the majority of investment fund portfolios.
- Simplified verification: The loans granted to projects and economic activities are in general straightforward to verify. This is because each loan can be identified and has to have been approved and then reported on by the relevant credit institution. Each loan has to pass through a bank’s credit approval process via specific credit committees in the credit institution. Verification would therefore rely on compliance with green criteria at the point of approval, creating a more discrete checking and accounting process that can be audited.

Moreover, as has already been highlighted, savings and deposit accounts represent a simple product that is widely understood and accessible. If this product is included in the scope, it could provide a high level of visibility for the EU Ecolabel.

On the other hand, following consideration of the technical and legal potential, it is not considered possible to include **pension funds** in the proposed criteria set. Products that correspond to the so-called three pillars – namely pillar 1 (public sector funds), pillar 2 (occupational pension funds) and pillar 3 (personal pension products) – have been taken into consideration. Three main reasons can be cited for not including pension funds at present:

- Presently their inclusion poses an issue for interpretation of the EU Ecolabel Regulation because the predominant types of funds, namely those of Pillars 1 and 2 (see Section 4.1.4), are provided indirectly to retail investors and particularly in the case of Pillar 2 there is no consistency across the EU in the extent to which an employee is able to choose their provider.
- Whilst Pillar 3 type personal pension products have the greatest potential for inclusion, being provided directly to retail investors, their market share is currently estimated to be very small (<7%), greatly limiting the potential impact of the EU Ecolabel.
- The diversified underlying assets of pension funds would require the development of further forms of verification in order to ensure that all possible compositions across the EU could be catered for.

It is proposed that their possible inclusion in the scope is evaluated again in the context of the criteria revision, with a focus on the legal aspects of their inclusion and the identification of verification needs in order to cover the possible diversity of underlying assets, including professional AIFs.

The inclusion of **professional AIFs** is not considered to be possible at present due to two main reasons:

- They are a business-to-business product (B2B) and professional funds are not understood to be also open to direct retail investors. This is in contrast with the overall aim of the EU Ecolabel of being a tool mainly addressed to final retail consumers. In other cases under the EU Ecolabel where B2B products can be awarded they are available to both professional and retail consumers (e.g. textiles intermediaries).
- To fully cover the range of professional AIFs and to expand the range of EU Ecolabel master AIF funds available to feeder funds would require an expansion of the verification requirements under Criteria 1. Based on European Securities and Markets Authority (ESMA)'s analysis the current criteria for equities and bonds would, however, still enable a considerable number of AIFs to qualify.

It is therefore not recommended to include them in the proposed EU Ecolabel criteria.

3.3 Outcomes of the 1st AHWG meeting

This section summarises stakeholders' comments on the scope of the product group received after the 1st AHWG meeting. The JRC received 163 comments in total on the scope proposal from 44 stakeholders. This included responses to the specific questions posed in the first draft of the Technical Report. Based on these comments, the JRC has investigated further the potential for expanding the scope to a number of specific products.

a) Do you agree with the initial proposed scope for the EU Ecolabel?

The majority of stakeholders partially agreed with the initial proposed scope, welcoming the focus on PRIIPs for the first criteria set but then splitting into broad bodies of opinion:

i. Those who considered that the criteria should be designed to include all PRIIPs, including all insurance product variants such as hybrid funds.
ii. Those who considered that the scope should be extended beyond just PRIIPs to include institutional funds, professional funds and savings (deposit) accounts.

Some stakeholders also commented on the need for coherence in how the EU Ecolabel is awarded. It would not make sense to focus on one activity of a bank only for their other activities to be contradictory – for example, if a bank offered both investment funds and deposit products. It would also need to be clear how/if different elements of complex products are to be labelled – for example, where a hybrid insurance products consists of a general fund and several unit-linked accounts.

A breakdown of the additional products proposed under an extended scope is provided below.

> *b) Do you think other financial products/services should be included that are not covered in the initial proposed scope?*

The majority of stakeholders requested the extension of the scope to include further specific products. The three most commonly requested products were savings accounts (also referred to as deposits), pension funds (as 'institutional' products) and all types of alternative investment funds (professional AIFs). Stakeholders also emphasised the importance of institutional or professional investments, which is understood to be a further indirect reference to, for the most part, pension funds and AIFs. An overview of the response for these products is provided in *Table 2*.

One of the overarching points made by the majority of stakeholders was that the label should not focus only on retail products – arising from the request for professional AIFs and institutional funds to be included based on their market significance.

Table 2 - Analysis of the main specific requests for an extension of the scope

Scope extension request	**Number of stakeholders**	**% of stakeholders who asked for an extension**	**Summary rationale for comments**
Savings & deposits	15	34%	Because of consumer significance. They are particularly relevant in some Member States, e.g. Germany, France.
'Institutional' or 'professional' investments	14	32%	Because of their significance in the financial market, to support the availability of labelled assets and as part of underlying assets to support a look through approach. Reference to products offered to professional and institutional investors used interchangeably.
Pension products	12	27%	As institutional investors, drivers of demand for responsible investment and because of their market significance.
'Professional' AIFs	8	18%	AIFs as an important vehicle for professional investors, important as the main type of 'green fund, they form underlying fund assets to support a 'look-through' approach and they are important for illiquid asset classes.

The most commonly cited product for inclusion was savings accounts, with the majority of stakeholders in favour of this product being included in the first criteria set. Stakeholders cited in particular their relevance to consumers as a 'basic' financial product and their market significance in terms of where household money is held. EU Ecolabel criteria would directly influence the basis on which money is lent to projects in particular.

Pension products were the next most cited product, being identified directly or indirectly with reference to 'institutional' investment products. According to stakeholder, pension funds should be included because of both their long-term focus, their dominance of demand for 'responsible' investment and their market significance (particularly in some Member States). Stakeholders referred in most cases to the importance of providing the option to label the funds of institutional investors, including public sector funds. It was emphasised that pension products exist in the market as both retail and institutional products and that for this reason the EU Ecolabel scope cannot just be retail-focused. One stakeholder also made reference to Pan-European personal pension products (PEPPs) as a further variant that could be eligible in the future.

The need to allow for the labelling of professional AIFs - those that are invested in by professional or institutional investors - was identified by a significant number of stakeholders. It was noted that several examples of the most forward looking ‘responsible’ investment funds are in fact AIFs, including leading impact investment funds. They are also a necessary fund structure in order to cover investments in illiquid assets such as real estate and infrastructure.

In regards to AIFs, it is firstly relevant to note that there was some concern about the introduction of the term RAIF (Retail AIFs), with some stakeholders noting that it was new to them and that it does not have a formal definition. Several stakeholders considered that such a term and distinction should not be made and that AIFs for professional or institutional investors should also be explicitly included in the scope. This would in turn allow for AIFs to be present within funds of funds (feeder fund) structures and for specific illiquid asset classes, such as real estate and infrastructure, to be addressed.

In respect of illiquid assets, ELTIFs (European Long-term Investment Funds) were specifically cited by some stakeholders. Funds investing directly in renewable energy projects are all AIFs because they invest in illiquid assets.

c) To what extent could savings and deposits be included within the scope in the future given the need to be able to identify specific uses of the money held in them as being ‘green’?

Amongst the reasons why stakeholders proposed the inclusion of this type of product, there appears to be clear potential to identify specific uses or to ‘ring fence’ or ‘earmark’ the money held in deposit accounts. It was noted that products would require a distinct form of verification because the funds sit on the balance sheet of the bank, on both the assets and liabilities side. So some form of tailored reporting on the balance sheet allocation of funds would be required for verification purposes. Some stakeholders referred to the (green) loans made using the money deposited and the identification of a project-based approach to the use of the loans.

Various working examples and precedents were cited, including Triodos Bank, the Dutch Green Funds scheme (involving several banks), Raiffeisenkasse Bozen (Italy) and Umweltcenter Gunskirchen (Austria). Reference was also made to the planned expansion of the scope of the Austrian EU Ecolabel to include savings and deposits during 2020.

d) While bonds are included as underlyings to investment funds, to what extent could retailed bond products themselves be included within the scope in the future, with verification of their greenness based on the Green Bond Standard?

Six stakeholders responded specifically to this question. There was agreement on the need to align verification with the Green Bond Standard; however, in general they were not considered to be attractive as direct investments by retail consumers, with the need for risk diversification cited by some stakeholders. An exception cited was that of High Net Worth individuals.

e) Are there any other financial products or retail investment opportunities that could be considered for a future scope?

There were limited further products or opportunities cited beyond those that can be found within the scope of the PRIIPs Regulation and that have already been referred to. One stakeholder referred to green mortgages. A small number of stakeholders also cited a series of structured products, starting with structured deposits (a PRIIP) but also including examples such as mortgage-backed securities and securitisation vehicles. A range of different underlying assets were also cited, some in reference to professional AIFs. These included corporate bonds, unlisted private equities, green ‘covered’ bonds, real estate funds and infrastructure funds.

f) Other issues raised

Clarity was requested as to whether the label would be awarded to the product manufacturer or at the product level; otherwise *'this would unnecessarily limit products that can receive the EU Ecolabel only to those that are offered by asset managers that specialise solely in products that would meet the requirements of the EU Ecolabel.*'

3.4 Further research and main changes in the second proposal

By way of a follow-up to the stakeholder comments received on the product scope proposal, the focus of attention for the follow-up analysis has been on the three products identified most frequently by stakeholders - pension funds, professional AIFs and savings/deposits.

3.4.1 Pension funds

The term pension fund or pension product encompasses a diverse range of products that are intended to provide an income in old age. The European Insurance and Occupational Pensions Authority (EIOPA) defines pension products as *'those non-public arrangements and investment vehicles which have an explicit objective of retirement provision (according to a national social and labour law or tax rules) irrespective whether they are of occupational or personal type'*.

Pension products have, since the 1980s, been a focus for the development of more responsible investment policies by fund managers. In particular, public and private institutional funds are understood to have played the most significant role[19]. Currently, the provision of pensions in the EU is dominated by public sector and occupational pension schemes. The way in which occupational pension schemes are structured and function is regulated at Member State level, resulting in a diversity of different models for their provision. A third type of pension provision exists which is commonly referred to as a 'personal pension product'. They are defined by Regulation (EU) 2019/1238 as follows:

'personal pension product' means a product which:

> *(a) is based on a contract between an individual saver and an entity on a voluntary basis and is complementary to any statutory or occupational pension product;*
>
> *(b) provides for long-term capital accumulation with the explicit objective of providing income on retirement and with limited possibilities for early withdrawal before that time;*
>
> *(c) is neither a statutory nor an occupational pension product.*

In some Member States there is not yet a market for personal pension products and these products have a limited degree of portability.

In order to further understand which broad types of pension products exist in the market and how they are provided to retail consumers it is important to refer to the 'three pillars'. An analysis of pension schemes by the European Parliament attempted to define the 'three pillar' concept, originating from World Bank and OECD taxonomies (***Figure 1***):

i. 1st Pillar: Avoiding poverty in old age. This covers mandatory public (PAYG) pension plans, which aim at ensuring a minimum standard of living for all pensioners.

[19] Global Sustainable Investment Alliance, Global Sustainable Investment Review 2016.

ii. 2nd Pillar: Occupational schemes. This covers employment-related pension plans - either earnings-related PAYG Defined Benefit plans (public or private), or occupational Defined Contribution schemes.

iii. 3rd Pillar: Individual plans. This covers personal savings plans consisting of voluntary contributions by individuals. They are often privately managed, but can be part of voluntary extra contributions to occupational schemes and managed in the same way.

The 3rd Pillar is considered the best fit for the EU Ecolabel because it is contracted on a private basis between the individual and the financial institution, whereas in the case of Pillars 1 and 2 either a public employer – central, regional or local government, or possibly also a government agency – or private employer acts as an intermediary between the fund provider and individual retail consumers.

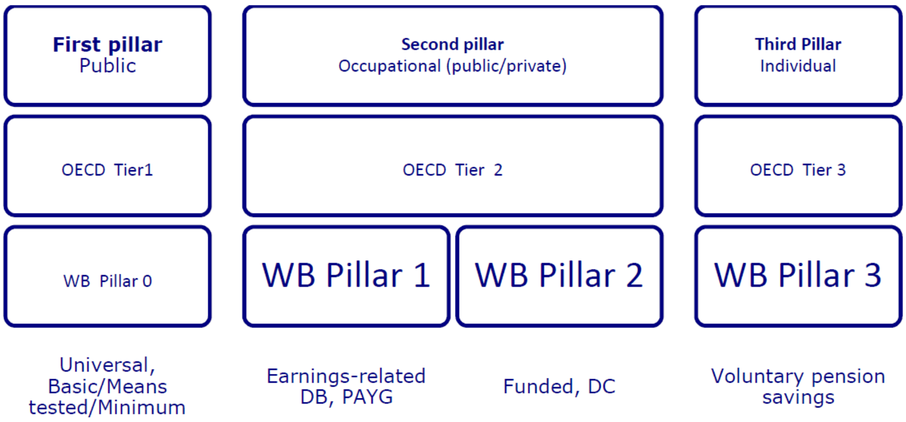


Figure 1 - World Bank/OECD taxonomy of retirement income provisions

Source: OECD (2005b, 2013), World Bank (1994)

Whilst Pillar 3 (personal pension products) would appear to be the best fit for the EU Ecolabel scope, being marketed directly to retail consumers, its market share is considerably less than that of Pillars 1 and 2. Pensions Europe estimate that Pillar 3 pensions had in 2016 a value of EUR 139 billion, representing 3.4% of all pension fund assets[20], although the new Pan-European personal pension products (PEPPs) may serve in the future to expand the market[21]. Moreover, in certain Member States other products substitute their function – for example, insurance products such as annuities in France and Denmark.

A further consideration is the ability to verify the "greenness" of the underlying assets of such services. The first EU Ecolabel criteria set for financial products is proposed as having criteria for portfolio 'greenness' that focus, among other assets, on equities and bonds. Market data available from sources such as European Insurance and Occupational Pensions Authority (EIOPA) and Pensions Europe suggest that Pillar 1 and 2 pension funds in particular are diversified and commonly include other illiquid assets such as real estate and infrastructure, which would require specific sub-criteria and verification (see ***Figure 2*** and ***Figure 3***). Limited information is available about Pillar 3 funds. The importance of illiquid assets seems to be particularly prevalent in Member States such as the Netherlands, Portugal and France.

[20] Pensions Europe, *Pension fund statistics for 2017*, December 2017

[21] European Commission, *The pan-European personal pension product (PEPP) – overview*, https://ec.europa.eu/info/business-economy-euro/banking-and-finance/insurance-and-pensions/personal-pension-products_en

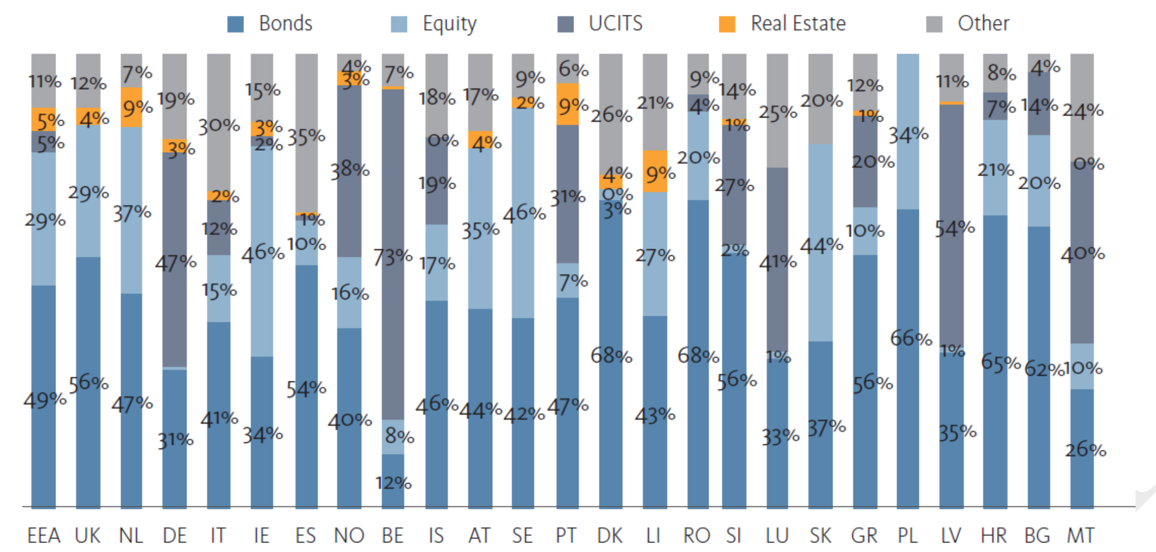


Figure 2 - Pension product investment allocation per country for 2017 (Pillar 2)

Source: EIOPA (2017)

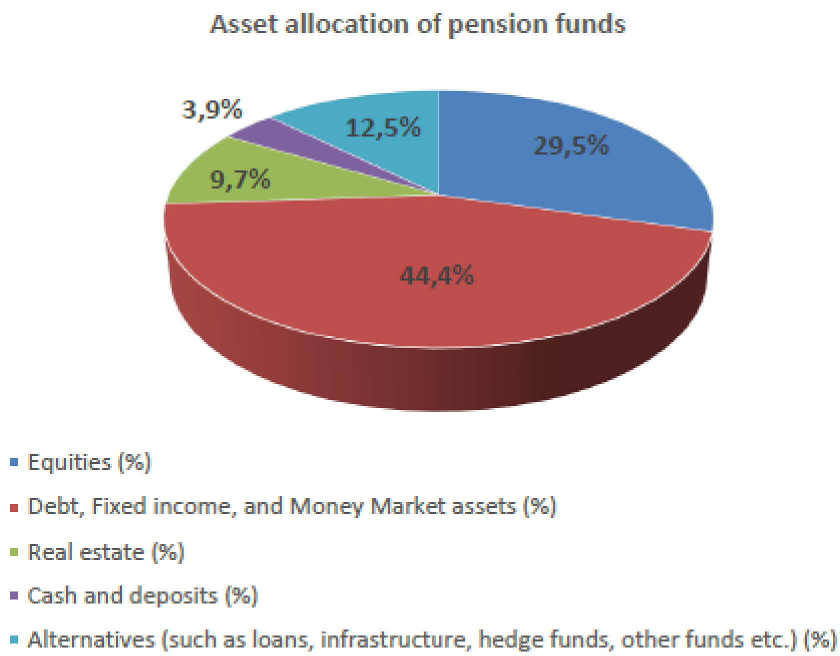


Figure 3 - Asset allocation of Pillar 2 pension funds

Source: Pensions Europe (2018)

In conclusion, given that within the provisions of the EU Ecolabel Regulation ((EC) No 66/2010) the label is specifically targeted at 'consumers' it appears difficult from a legal perspective to contemplate labelling pension services provided under Pillars 1 and 2. This is because the service is provided to the consumer indirectly and via a diverse range of structures that vary between Member States.

Whilst Pillar 3 (personal pension products) would therefore seem a natural focus, being directly marketed to retail consumers, their market share is currently very limited and their inclusion may still entail the development of additional verification to cover illiquid assets. This is due to the geographical and organisational variation in the composition of funds as reflected in the investment strategies adopted in different Member States. It is therefore not recommended to include pension funds in the first criteria set, but instead that further investigation is carried out at a later stage into the legal aspects of their inclusion and the identification of the verification needs in order to cover the necessary diversity of underlying assets.

3.4.2 Professional AIFs

Alternative investment funds (AIFs) are a fund structure that is responsible for investment in a diverse range of liquid and illiquid assets, being less restricted than UCITS. They may be retail funds or they may be funds targeted at professional investors and as a result their unit shares may form part of the assets held by another fund. Stakeholders have highlighted the important role that AIFs currently play as vehicles for investment in green economic activities.

A breakdown of AIF investors for 2018 shows that approximately 80% are professional investors (***Figure 4***). Looking further at the types of investors (***Figure 5***), it can be seen that EU-level pension funds (26%) are the most significant, followed by insurance funds (17%) and banks (8%). The role of retail consumers (households) is relatively small, emphasising the overall role of institutional investors in supporting the AIF market.

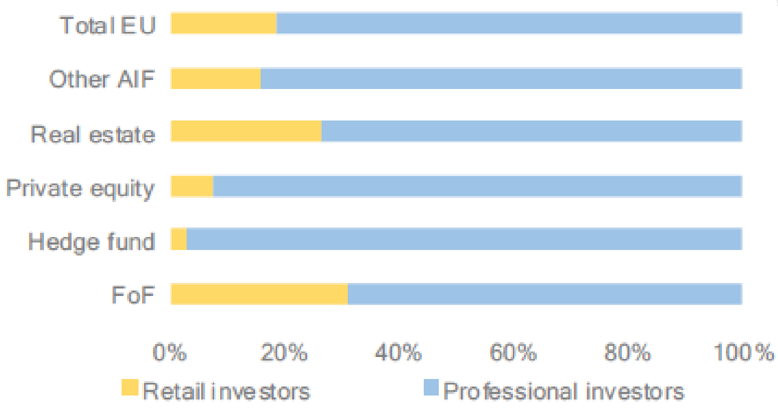


Figure 4 - Breakdown of AIF investors

Source: ESMA (2019)

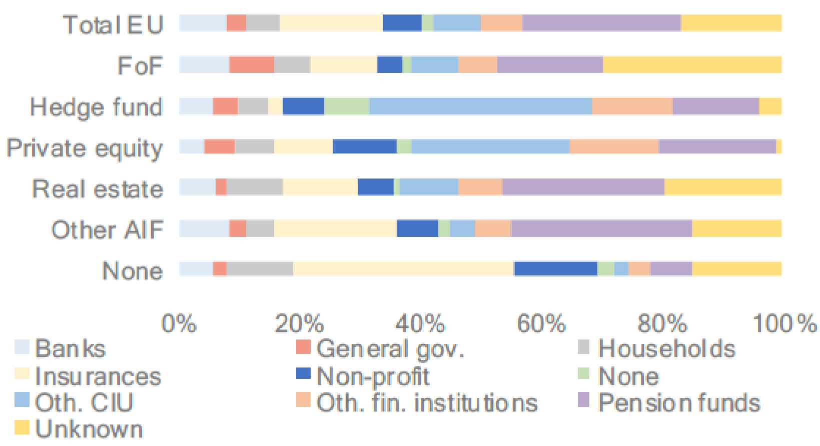


Figure 5 - Breakdown of AIF investor types

Source: ESMA (2019)

Turning to the types of AIFs in the market, ***Figure 6*** shows that, in relation to assets that can be directly related to economic activities, real estate and private equity funds account for 15%. However, most AIFs are categorised as 'other' in the survey response reported by ESMA. They note that these fund types may be accounted for by simple equity or bond funds with investment strategies similar to UCITS.

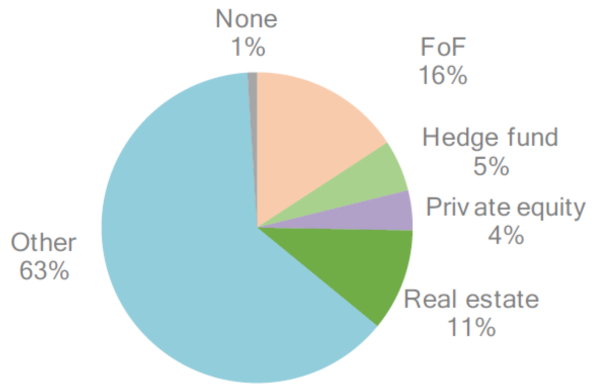


Figure 6 - AIFs by type

Source: ESMA (2019)

In conclusion, the analysis suggests that the majority of AIFs provide services to professional or institutional investors, although for some types of AIFs retail consumers assume a greater significance (e.g. real estate, funds of funds). The investors and the types of assets managed are diversified and include several for which specific forms of verification would be needed (for example, real estate) or for which verification was considered in the First Technical Report to be too complex (for example, derivatives).

The inclusion of professional AIFs therefore poses a twofold problem for inclusion in the EU Ecolabel, as already commented in this section:

- They are a B2B product and professional funds are not understood to be also open to direct retail investors. This is in contrast to other cases under the EU Ecolabel where B2B products have been possible to label – such as textile intermediates that are available to both professional and retail consumers.
- To fully cover the range of professional AIFs and to expand the range of EU Ecolabel master AIF funds available to feeder funds would require an expansion of the verification requirements under Criteria 1. Based on ESMA's analysis, the current criteria for equities and bonds would, however, still enable a considerable number of AIFs to qualify.

It is therefore not recommended to include them in the first criteria set.

3.4.3 Savings and deposit accounts

The stakeholders' proposal to extend the scope to savings and deposit products has been further investigated with reference to legal definitions, EU banking best practice and consultation with the Commission's Legal Services. The latter has enabled the identification of specific aspects of the product that require more legal certainty before such a product can be awarded the EU Ecolabel.

Market data show that across the EU the majority of households surveyed by the European Central Bank (97%) hold financial assets in simple savings and deposit accounts (***Figure 7***). Of the total value of household financial assets, approximately 44% was, at the time, held in deposits. The funds held in these accounts are in turn largely used by banks to provide loans to businesses.

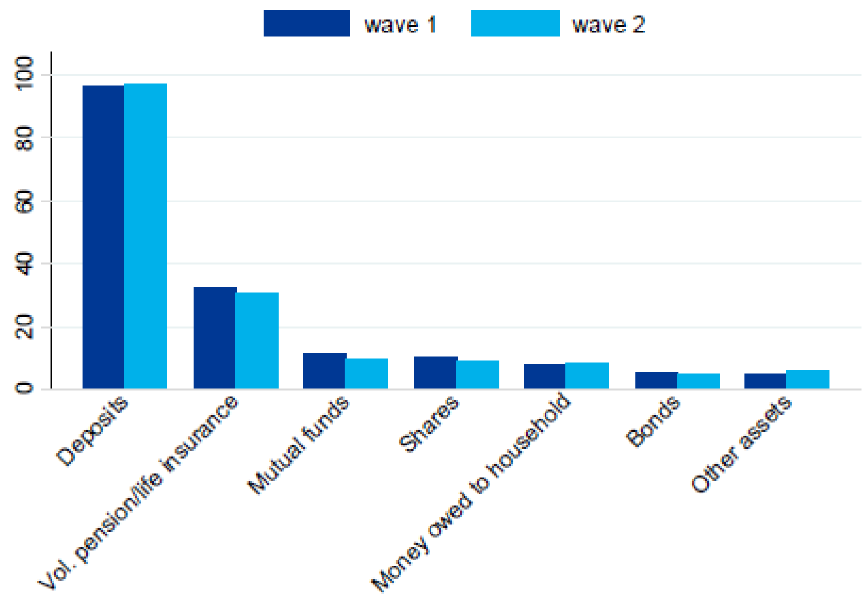


Figure 7 - Participation rates of households in financial assets (wave 1 = 2010, wave 2 = 2014)

Source: European Central Bank (2016)

Defining deposit accounts and credit institutions

An initial definition of the product is provided by the recast Directive 2014/49/EU on Deposit Guarantee Schemes:

> *(3) 'deposit' means a credit balance which results from funds left in an account or from temporary situations deriving from normal banking transactions and which a credit institution is required to repay under the legal and contractual conditions applicable, including a fixed-term deposit and a savings deposit, but excluding a credit balance where:*
>
> *(a) its existence can only be proven by a financial instrument as defined in Article 4(17) of Directive 2004/39/EC of the European Parliament and of the Council (1), unless it is a savings product which is evidenced by a certificate of deposit made out to a named person and which exists in a Member State on 2 July 2014;*
>
> *(b) its principal is not repayable at par;*
>
> *(c) its principal is only repayable at par under a particular guarantee or agreement provided by the credit institution or a third party.*

This definition makes a distinction between fixed-term deposits and savings deposits. Formal reference should therefore be made to these two types of accounts.

Traditionally, a savings deposit account is a deposit with limited restrictions on withdrawals whereas a fixed-term or 'time deposit' account would usually have a maturity date or a minimum term during which the money should remain in the account at the disposal of the bank. Some forms of fixed-term deposit accounts may also offer an interest rate upon maturity based on the purchase of bonds. In general, the longer the money is held the higher the interest rate offered by the bank.

The 2014 definition also makes reference to the role of 'credit institutions' in providing deposit accounts. A definition of a 'credit institution' can be found in Article 4 of Directive 2006/48/EC:

> *(1) 'credit institution' means:*
> *(a) an undertaking whose business is to receive deposits or other repayable funds from the public and to grant credits for its own account; or*

(b) an electronic money institution within the meaning of Directive 2000/46/EC (1).

The term ‘credit institution’ provides a broader definition encompassing not just banks but potentially also mutual societies and credit unions.

Market experience to date in verifying the greenness of a deposit account

Based on the JRC’s follow-up research to date, green savings accounts can be identified as niche products that were initially developed by specialist and regional banks, such as Raiffeisenkasse Bozen (Italy) and Triodos (the Netherlands). The Netherlands has become an important focal point for the commercial development of green savings accounts as a result of the Dutch Green Funds scheme, with Rabobank and ABN Amro amongst the banks offering retail green savings accounts. An increasing number of larger mainstream retail banks are now seeking to establish accounts as an extension of their green loan activities – for example, La Caixa and BBVA in Spain.

From the examples to date it has also been possible to identify three variations in how the product (and related services) can be provided and structured:

- The credit institution providing the product to the consumer and managing the assignment of green loans is the same entity (e.g. Triodos, Rabobank);
- The credit institution managing the account and assigning the loans is one entity and the savings product is marketed/provided to consumers by a subsidiary (e.g. ABN Amro and Moneyou).
- The savings product is marketed/provided to consumers by a parent bank that manages the accounts but the assignment/management of the loans is by different partner institutions, each with specialist knowledge of the green projects and economic activities to which the loans are assigned (e.g. Raiffeisenkasse Bozen, whose partners specialise in renewable energy, energy efficient buildings, agriculture, etc.)

The initial findings from analysis of the products of these banks have been used to analyse how the assessment and verification could work in practice for the EU Ecolabel.

In practice, what makes a savings or deposit account ‘green’ is the earmarking of ‘green loans’ (credit) to green projects or companies engaged in green economic activities. Not all money in the account is used at all times for loans as there must be some liquidity to cover withdrawals, but a specific percentage of that which is assigned to loans should be used for green projects/activities. The minimum percentage that can be used as the basis for an EU Ecolabel criterion is therefore to be determined.

As was emphasised by stakeholders, fundamental to being able to verify the extent to which a deposit account is ‘green’ is the possibility to identify and trace the link between the money that is placed in deposit and how that money is then used by a credit institution to provide (green) loans to applicants for credit. In terms of how this could function in practice, the following observations can be made based on real examples:

1. *On the liability side*, the money deposited will need to be ring fenced by the bank in its accounting and the terms and conditions of the deposit account will need to identify the green deposit to loan ratio or percentage. For example, the green savings products offered by Rabobank and ABN Amro under the Dutch Green Funds scheme refer to a minimum threshold of 70% - meaning that 70% of the money deposited is used to make loans to green companies/projects engaged in green economic activities.
2. *On the asset side*, applicants requiring credit (loans) must present a business plan for the green project to be financed and provide security (collateral, covenants and forward contracts) to the bank. The green loan application will then be analysed by a credit committee to evaluate its economic sustainability. In the case of a ‘green’ loan, then compliance with specific criteria on the greenness of the project/company’s activity to

be financed by the bank will also need to be assessed, in addition to the economic and credit quality assessment. For example, the green savings products of Rabobank and ABN Amro comply with the Dutch Green Funds criteria[22]. Compliance of each project with the green criteria is then externally audited by the Netherlands Enterprise Agency (RVO).

The principles and verification process for ‘green loans’ is an emerging concept in the financial community. The green loan principles developed by the Loan Market Association are a notable reference point – see the box below[23]. Rather like Green Bonds, the principles highlight the importance of clearly identifying and evaluating how the money borrowed will be used.

The Green Loan principles

Four core components

1. Use of proceeds: The fundamental determinant of a green loan is the utilisation of the loan proceeds for Green Projects which should be appropriately described in the finance documents. All designated Green Projects should provide clear environmental benefits, which will be assessed, and where feasible, quantified, measured and reported by the borrower.

2. Process for project evaluation and selection: The borrower of a green loan should clearly communicate to its lenders:

1. their environmental sustainability objectives;
2. the process by which the borrower determines how its projects fit within the eligible categories set out in Appendix 1 of the Green Loan principles[23]; and
3. the related eligibility criteria, including, if applicable, exclusion criteria or any other process applied to identify and manage potentially material environmental risks associated with the proposed projects.

3. Management of proceeds: The proceeds of a green loan should be credited to a dedicated account or otherwise tracked by the borrower in an appropriate manner, so as to maintain transparency and promote the integrity of the product.

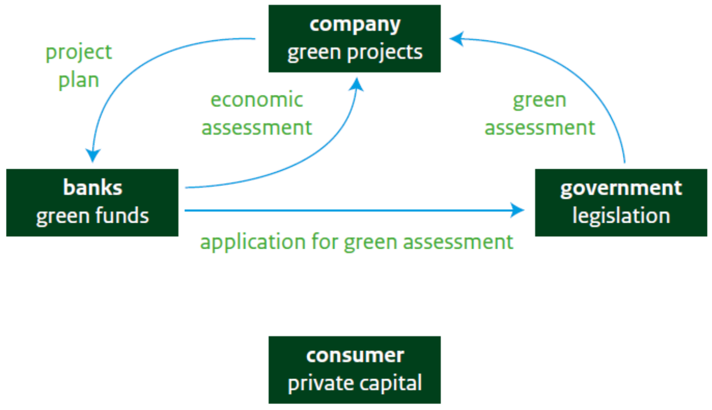
4. Reporting: Borrowers should make and keep readily available up-to-date information on the use of proceeds to be renewed annually until fully drawn, and as necessary thereafter in the event of material developments. This should include a list of the Green Projects to which the green loan proceeds have been allocated and a brief description of the projects and the mounts allocated and their expected impact.

Source: Loan Market Association (2018)

The Dutch Green Funds model for the coupling of green loans to funds obtained from a bank/credit institution’s green deposit account is illustrated in ***Figure 8***. In Figure 8a, the economic and green assessment process is illustrated, with the banks credit committee acting as the gateway and link between the green funds and, in this case, green projects. In Figure 8b, the circulation of funds post-approval is illustrated, with the cycle of deposits and redemption with interest added.

[22] Ministry of Housing, Spatial planning and the Environment (2010) The Green Funds Scheme - A success story in the making, the Netherlands.
[23] Loan Market Association (2018) *Green loan principles - Supporting environmentally sustainable economic activity*.

a. Procedural processes



b. Circulation of funds

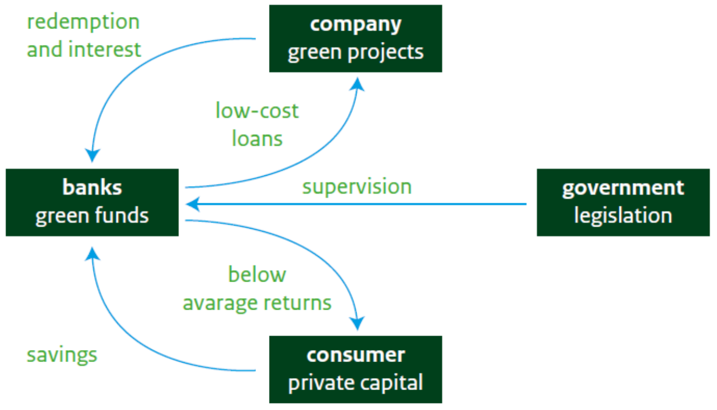


Figure 8 - Procedural processes and circulation of funds in the Dutch Green Funds scheme

Source: Netherlands Ministry of Housing, Spatial planning and the Environment (2010)

The value of the deposits held and the loans granted are both reported on the balance sheet of a bank/credit institution in their financial reporting. Depending on the conditions set by a bank/credit institution, a proportion of the money deposited will need to be kept available to fulfil customer requests to withdraw money upon notice. This is referred to as liquidity risk.

A "green" deposit to loan ratio will be an important consideration in setting green criteria for these accounts. Banks tend to report on this ratio and in some cases front runner green savings schemes have established or have had to comply with target ratios. For example, the Netherlands Green Fund scheme has a target of a 1.43 (70%) green deposits to loans ratio and in practice banks participating in the scheme have reported achieving lower ratios (reflecting more green projects being financed). For example, Rabobank reports on its balance sheet a ratio of 1.25 (80.3%) in 2018. Of the EUR 1.851 million of deposits held by Rabobank in green customer accounts, EUR 1.486 million was used for green loans. As has already been noted, the green loans can be verified on an itemised, project-by-project basis from a documented external audit procedure.

Triodos Bank, which applies screening criteria to all loans as it is a sustainable bank in all its activities, has a target green deposit to loan ratio of 1.18 (85%). The ratio can be checked by scrutinising the bank's annual financial report and because all projects that Triodos finances need to comply with their green screening criteria then there is, in theory, no need to ring fence and have separate lines of reporting for the 'green' products. The projects receiving loans can each be identified by Triodos; however, it does not currently seem possible to determine the deposit to loan ratio for individual deposit and savings products offered.

A project-based model is used by Raiffeisenkasse Bozen (Italy) and Umweltcenter Gunskirchen (Austria). In the case of a bank that only uses a small proportion of the money held in deposit to grant green loans, there would need to be a clear identification and ring fencing of both sides of the balance sheet – namely the deposited and loaned funds.

In all of the examples of green savings accounts analysed to date by the JRC, the value of the deposits held is also dictated by the capacity of the bank to make green loans. In practice, this has meant that during some periods of time deposit accounts have had to be closed to both new customers and to additional deposits made by existing customers. This is in order to maintain the green deposit to loan ratio threshold/target which in turn is fundamental to be able to keep paying the interest rates offered to customers.

Table 3 provides a summary of the findings to date of the follow-up research in relation to specific aspects of the operation of green savings deposits and fixed-term deposit accounts.

Table 3 - Aspects of the operation of deposit accounts that have been the focus of attention

Aspect	**Questions for clarification**	**Practices identified to date**
Product terms and conditions	How is the link between funds deposited and the funds loaned communicated and verified to customers?	Either by stating that: 1. all loans made with the money deposited will be made in accordance with green criteria, or 2. a specific percentage of the money deposited will be used for green loans.
Balance sheet reporting and traceability	Is the link between funds deposited (liabilities) and the funds loaned (assets) reported on the balance sheet in annual reports?	In the case of banks participating in the Dutch Green Funds scheme and the banks under study considered to be ‘pioneers’, the green liabilities and green assets can be identified. However, in the case of the latter there may be a need to improve reporting depending on whether some/all of their multiple savings products are Ecolabelled and also in order to make the distinction between loans made against social and/or environmental criteria.
Green deposit to loan ratio	What proportion of: 1. the money deposited is used to provide loans? 2. the loans made using the money deposited are green?	Reference can be made to a green deposit to loan ratio. The Dutch Green Fund scheme has a target of 70% of the money deposited to be used for green loans. In practice the banks under study are achieving 75–85% of the money deposited being used for green loans.

Banking structure	Who provides the customer interface and is this the same as the credit institution/entity with a banking license?	In most cases they are likely to be one and the same. Some exemptions can be identified: 1. In the case of ABN Amro the subsidiaries ABN Groenebank and Moneyou (an internet bank) are involved, although in practice the former is responsible for the funds. 2. In the case of Raiffeisenkasse Bozen, loans are made by local partner credit institutions who have local knowledge of the projects to which loans are made, with a reconciliation made between corresponding deposit accounts.

<u>Conclusion and proposed definition of savings and deposit accounts</u>

In conclusion, it is feasible to add savings and deposit accounts to the initial scope of the product group. It is in fact possible to verify the balance sheet of a bank and to identify and reconcile deposit value with loan value. This relationship can be expressed as a green loan to deposit threshold percentage. Green loan lending criteria would then to be applied by a bank's credit committee at the point of making decisions on the granting of loans. This decision-making process and the compliance of the projects or economic activities with the green loan criteria would also need to be verified. Moreover, savings/deposit accounts are a mainstream financial product that could ensure high visibility for the EU Ecolabel and diversify the current scope of financial instruments beyond equities and bonds to also include loans, which play an important role in supporting economic activity as well.

Based on the analysis to date, an initial definition has been developed for the products under study. This is based on an existing definition of deposit account within EU law and the notion that a bank provides a service to retail customers that provides both economic and environmental benefits[24]:

> *The service of managing a fixed-term deposit or savings deposit product as referred to in Art. 2(1) point 3 of Directive 2014/49/EU on deposit guarantee schemes in order to pay interest and derive environmental benefits from the projects and economic activities to which the deposited money is loaned. The service is provided by the credit institution on whose balance sheet the deposits held (liabilities) and the associated loans granted as credits (assets) appear.*

This definition includes a distinction between a fixed-term deposit account and a savings deposit account. These two types of deposit differ based on the ease of withdrawal of the funds by the consumer, as previously explained.

[24] Note that, instead of paying interest green savings, account providers under the Dutch Green Fund initiative offer tax benefits to account holders.

4 STRUCTURE AND RATIONALE FOR THE CRITERIA AND CRITERIA AREAS

This section provides an overview of how the criteria set could be configured. This includes the identification of the areas that should be covered by the criteria. The broad criteria areas are described, then the details of each specific criterion are developed further in subsequent sections. Annex 2 presents a table comparing the first and second draft proposal for criteria, across the different criteria areas.

4.1 Proposed structure of the criteria

The following criteria areas were identified with a view to enhancing the environmental benefits of investments:

1. Portfolio composition, in particular in terms of green economic activities (as defined by the EU Taxonomy).
2. Exclusions based on environmental aspects
3. Exclusions based on social aspects and corporate governance practices,
4. Engagement
5. Information for retail investors
6. Information appearing on the EU Ecolabel

To facilitate the identification of 'green economic activities' in a harmonised and consistent manner, the definition proposed for 'green activities' refers to the EU Taxonomy. In this sense, "green" will mean economic activities that qualify as 'environmentally sustainable' under the EU Taxonomy. In a first stage, the EU Taxonomy will focus on identifying the economic activities that significantly contribute to climate change mitigation and climate change adaptation while not harming any of the other objectives. In the future, the EU Taxonomy will identify economic activities that significantly contributes to the achievement of any of the six EU Taxonomy objectives. Annex I provides further details on the EU Taxonomy, its timeline, and the link with the EU Ecolabel.

In addition to the identification of green economic activities through reference to the EU Taxonomy, the use of exclusions which limit the flow of investments into economic activities which are considered environmentally harmful will ensure that the EU Ecolabel is awarded to the best environmental performing products.

Another aspect to take into account when linking the EU Ecolabel criteria to the EU Taxonomy is that the EU Taxonomy will cover minimum social safeguards, while the EU Ecolabel requires taking into account "where appropriate, social aspects". The aspects that were identified (through the stakeholder survey and reviews of the existing schemes and labels) as being important issues for investors, have been further reviewed and proposed as criteria (in particular social and environmental exclusion criteria) for the EU Ecolabel.

The **portfolio composition in terms of green economic activities** adopts a three pocket approach to better distinguish between companies investing principally in green activities, to enable investment in transition activities and also to leave room for diversification.

These changes reflect the need for the EU Ecolabel to provide asset/fund managers with the flexibility necessary to invest in transition activities and also diversify their portfolio.

Exclusions based on environmental aspects focus on the potentially harmful environmental effects of activities financed. The need to adopt criteria that exclude a list of economic activities was identified. The criteria represent a cut-off for economic activities deemed to be detrimental or opposed to EU and international environmental policy aims. The proposed 5% threshold applies at a company level and is linked to revenues. Summarily, the criterion prevents EU Ecolabel funds from investing in activities which could harm the environment significantly (brown activities).

A **social exclusions** criterion aims to address social concerns potentially associated with investments. Changes have been introduced at both a company and sovereign state level in the criterion. In addition to the proposed changes, at the company level, exclusions apply to both transnational and other business enterprises, regardless of their size, sector, location, ownership and structure. Corporate policies on social aspects shall be established and put into practice. A due-diligence procedure in the form of a management system is also required to monitor and manage adverse impacts or potential risks. At the sovereign state level, additional human rights treaties shall be ratified, and the corruption perception index threshold is amended. The criterion, in its current form, envisages addressing stakeholder's concerns on social matters and mitigating adverse social effects of investments. In addition, exclusions based **on corporate governance practices** followed by the companies that the financial products invest in, have been considered.

The **engagement** criterion has been introduced and can actually drive positive environmental improvements through encouraging companies to change their activities and behaviour.

Finally, **information for the consumer and information about the EU Ecolabel** stipulates the information to be communicated to consumers. Two levels of information are required. The first level aims at communicating the singular aspects of the fund to the consumer throughout simple statements on the various criterion, i.e. portfolio composition in terms of green economic activities, environmental and social exclusions, engagement aspects, etc. The second level of information requires a full annual report that shall be available to the consumers electronically and where they can find the details of the methodologies used for estimating the portfolio composition in terms of green economic activities, environmental and social exclusions, engagement aspects, etc.

4.2 Rationale for criteria structure – environmental impact

The EU Ecolabel Regulation refers to concepts of "environmental impact" and "environmental performance". According to its recitals, the EU Ecolabel is intended to promote products with a reduced negative environmental impact during their entire life cycle. Article 6 of the Regulation states that criteria shall be based on the environmental performance of products, based on the most significant environmental impacts. While these terms are defined in a general manner, it is necessary to "translate" them for each product group.

Koelbel et al. (2018) [25] and Brest and Born (2013) [26] offer a conceptual framework for the impact of sustainable investment. According to these authors, "investors affect the real world though the companies they interact with". Hence, 'investment impact' consists of two components:

- the company impact: the impact of the company on the natural and social environment;
- the investor impact: the impact of the investor on the company.

Regarding **company impact**, Koelbel et al. (2018) identify two mechanisms through which it takes place: (1) directly through the company's operations (e.g. emissions during production) and (2) indirectly through the products and services the company provides or purchases.

Importantly, these two mechanisms are likely to be captured by the future EU Taxonomy. Article 14(f) of the Taxonomy Regulation stipulates that technical screening criteria shall "*take into account the life cycle, including evidence from existing life cycle assessments, by considering the environmental impacts of the economic activity itself, as well as of the products and services provided by that economic activity, notably by considering their production, use and end-of-life*". On this basis, the TEG Taxonomy report distinguishes between 'greening of' activities – for which the technical screening criteria focus on improving the environmental

[25] Koelbel JF, Heeb F., Paetzold F., Busch T., 2018, Beyond returns: investigating the social and environmental impact of sustainable investing.

[26] Brest P., Born K. 2013, unpacking the impact in impact investing, Stanford social innovation review 11(4) : 22-31

performance of the economic activity – and 'greening by' or 'enabling' activities – which enable improved environmental performance in other sectors of the economy . Hence, a link to the EU Taxonomy and its criteria will ensure that company impact is addressed.

Focusing on **investor impact**, these authors identified three possible mechanisms through which investor impact can be achieved:

- Shareholders' engagement: this refers to influencing company behaviour and practices with respect to environmental and other issues through various communication mechanisms that are open to investors. This includes the right to vote on shareholders' proposals during annual general meetings, discussions during informal meetings with management, as well as criticising corporate activities in news outlets, threats of selling the companies' assets[5].
- Capital allocation refers to the investors' activity of supporting a company by providing capital, or inhibiting a company by denying the provision of capital.
- Indirect impact includes a range of impact mechanisms where investor activities do not directly affect company activities, but where the activity of investors influences a third party instead, which in turn affects company activities.

Through these mechanisms, the investors can achieve two types of changes in company activities: either cause a company to scale up its sustainable activities or cause a company to change its activities to improve their quality from a sustainability point of view. Whether such a changing or scaling of activities propagates into real-world impact depends in turn on the external impact of these activities (the company impact).

Setting a criterion on investment in green activities could lead to the following **capital allocation impacts**:

- increased demand for shares and bonds from companies with green activities;
- facilitates access to capital, by diversifying investor base and possibly lowering cost of capital;
- allows companies with green activities to further expand and increase their share of green activities.

Setting exclusion criteria will have the opposite effect:

- exclusion criteria may make it more difficult for companies with excluded activities to finance themselves.

It must be noted that Koelbel et al. (2018) highlight that the evidence available so far for capital allocation impact is only indirect. Nevertheless, these authors note that the total effect size increases with the fraction of wealth commanded by sustainable investors: "the effect of an individual investor's decisions depends on how many others invest according to the same non-financial preferences". Given the harmonisation provided by the EU Taxonomy, many sustainable investors will be behaving in the same way.

In addition, **indirect impacts** are expected from the link to the EU Taxonomy. The strong interest from stakeholders (both industry and civil society) around the EU Taxonomy demonstrates that these stakeholders see it as providing an important **reputational incentive**, as well as a potential economic incentive. The EU Taxonomy will help the market to disclose in a harmonised way by setting metrics for each economic activity covered, but also clear reference points for evaluating performance (thresholds). Linking the EU Ecolabel criteria to the EU Taxonomy will reinforce its use a reference tool. In that sense, the proposed criteria do not define 'thematic funds' in the traditional sense, i.e. investing in a company active in a sector such as renewable energy or waste water treatment (which may not provide an incentive for companies to improve). Instead, the proposed criteria are built around 'Taxonomy investment', i.e. investing in companies with activities that comply with the technical criteria of the EU Taxonomy. This encourages companies to:

- upgrade their existing economic activities to make them compliant with Taxonomy criteria;

- expand those of their existing economic activities that are already Taxonomy-compliant;
- stop economic activities that are not Taxonomy-compliant by selling or closing related assets.

Also, funds have the possibility to invest in each sector that will be covered by the EU Taxonomy, allowing for diversification: the TEG Taxonomy report published in June already contains 67 activities, and future updates and development of criteria for the other environmental objectives will further broaden the investment universe.

The causal chain through which the purchase of a fund with an EU Ecolabel can have an investment impact could be conceptualised as follows:

- The fund increases the demand for shares of companies that have green economic activities (e.g. company A has 70% green activities, company B has 25% green activities).
- This increase in demand can facilitate access to capital for such companies, and may even lower their cost of capital.
  - There would also be a potential reputational benefit for these companies.
  - This would help companies to further expand their activities, and it is likely that they will increase their share of green activities given the easier access to capital and reputational benefit.
- At the same time, such incentives would motivate companies with activities that are close to meeting the EU Taxonomy criteria to upgrade their activities.
  - For example, company C is active in cement manufacturing and its activities' GHG emissions are slightly above the threshold defined by Taxonomy criteria. It would improve its production processes to reduce the GHG emissions from its activities.
  - For example, company D has manufacturing activities with low GHG emissions but significant air pollutant emissions and thus does not comply with the 'do no significant harm' criteria under the Taxonomy. The company could place filters to reduce air pollutant emissions.
- Also, there would be reduced demand for shares of companies with activities that are excluded or far from meeting the EU Taxonomy criteria (e.g. company E is active in oil refining and all its activities are on the exclusion list).
  - This would constrain access to capital, possibly through an increase in cost of capital. These companies may have to close down some of their activities or reconsider their strategy in order to maintain access to finance.

4.3 Rationale of the proposed general text on assessment and verification

The assessment and verification text refers to the different types of evidence that are considered relevant as proof of compliance for each criterion. The general text is presented in the box below. A separate assessment and verification text is then provided for each criterion proposal in Section 5. The frequency with which updated information is to be provided to Competent Bodies is still to be finally determine. An overall frequency of 6 months is currently stated, as the basis for discussion with stakeholders.

The EU Ecolabel Regulation indicates that competent bodies shall preferentially recognise verifications performed by bodies which are accredited under EN 45011. However, this standard has been substituted by ISO/IEC 17065:2012: *Conformity assessment - Requirements for bodies certifying products, processes and services*. For this reason, certification bodies are no longer accredited in accordance with these requirements. Therefore, a statement has been included in the text making reference to Regulation (EC) 765/2008 of the European Parliament and of the Council.

Assessment and verification
The specific assessment and verification requirements are indicated within each criterion. Where the applicant is required to provide declarations, documentation, analyses, or other evidence to show compliance with the criteria, these may come from the applicant and/or their supplier(s) and/or their subcontractor(s). As a prerequisite, the 'financial product' shall meet all legal requirements related to the place of product manufacture, registration and authorisation. Competent bodies shall give preference to attestations that are issued by bodies that are accredited under the relevant harmonised standard for bodies certifying products, processes and services. Accreditation shall be carried out in line with Regulation (EC) No 765/2008 of the European Parliament and of the Council[27]. Competent bodies may require supporting documentation and may carry out independent checks. After being awarded the EU Ecolabel licence, the applicant is required to inform the relevant competent body of any changes pertaining to their licensed product(s). The applicant is required to provide updated information on their licensed product(s) every 6 months. Such information related to any changes or deviations should include all the evidence of proof of compliance to the proposed EU Ecolabel criteria. The competent body may perform follow-up assessments of the applicant's financial product up to once a year during the award period.

[27] Regulation (EC) No 765/2008 of the European Parliament and of the Council of 9 July 2008 setting out the requirements for accreditation and market surveillance relating to the marketing of products and repealing Regulation (EEC) No 339/93. Available at: http://data.europa.eu/eli/reg/2008/765/oj

5 CRITERIA PROPOSALS

5.1 CRITERION 1: Investment in green economic activities

Second proposal for Criterion 1: investment in green economic activities

Definition: green economic activity
A 'green economic activity' is an environmentally sustainable economic activity as defined by the Taxonomy Regulation, i.e. an economic activity that complies with the relevant technical screening criteria adopted under the Taxonomy Regulation.

1.1 Investment funds

A. Equity funds

At least 60% of the total portfolio value in terms of assets under management (AuM) shall be invested in companies whose economic activities comply with the following threshold:

i. At least 20% of AuM shall be invested in companies deriving at least 50% of their revenue from green economic activities.

ii. The remaining proportion of AuM (0-40%) shall be invested in companies deriving between 20% and 49% of their revenue from green economic activities.

The remaining proportion of the total portfolio shall consist of

- companies deriving less than 20% of their revenue from green economic activities and not excluded by criteria 2 or 3, or
- other assets or cash.

B. Bond funds

At least 70% of the total portfolio asset value shall be invested in bonds that comply with the EU GBS.

If the bond fund comprises sovereign and sub-sovereign bonds, these shall not be excluded by criteria 2.2.

C. Mixed funds

For mixed funds, the equity part shall comply with the requirement for equity funds in (A), and the bond part shall comply with the requirement for bond funds in (B).

D. Funds of funds (FoFs) For funds of funds (FoFs), at least 90% of the AuM shall be invested in funds that have been awarded the EU Ecolabel.

E. Feeder funds

Feeder funds shall have a master fund that has been awarded the EU Ecolabel[28].

Derivatives

A UCITS or Retail AIF may invest in derivatives according to its investment objectives. The use of derivatives shall be in line with the funds environmental investment policy. The use of derivatives shall be restricted to the following situations:

- *Hedging:* Derivatives may be used for hedging purposes with regard to currency risk, duration risk, market risk or/and sensitivity to changes in interest rate structures.
- *Exposure:* The use of derivatives to increase exposure to the underlying assets shall be temporary and respond to significant subscriptions. The management company shall

[28] The feeder fund shall comply with the same requirements as other funds (stand-alone funds).

explain in the fund's periodical reports how it proceeds and, in particular, to illustrate the temporary nature of the use of derivatives for exposure purposes.

The underlying assets shall comply with EU Ecolabel criteria, including on environmental and social exclusions as well as consumer information.

Derivatives shall not be used for the short selling of securities.

Other assets

Other assets[29] shall be counted in the total portfolio, when assessing compliance with the portfolio threshold in terms of AuM.

Assessment and verification

A. Equity funds

The applicant shall provide:

i. documentation showing that the monthly averages for the 12 months preceding the application for the EU Ecolabel comply with the portfolio composition requirements for equity funds or pre-contractual information and portfolio statement and prospectus including:

- complete listing of the portfolio assets, and
- evidence that the fund complies with the respective minimum percentages for the equity fund and bond funds as specified in A and B.

ii. An audit report on the latest annual financial statement.

B. Bonds funds

The applicant shall provide the following:

- documentation showing that at least 70% of the total portfolio asset value complies with the EU GBS, based on the monthly averages for the 12 months preceding the application for the EU Ecolabel and,
- the EU GBS certificates for the bond funds as proof of projects financing in green economic activities

C. Mixed funds

The applicant shall provide documentation showing that the fund complies with the respective minimum percentages for the equity and bond shares as specified in A and B of this section, based on monthly averages for the 12 months preceding the application for the EU Ecolabel.

D. Fund of funds (FoFs)

The applicant shall provide the portfolio statement and prospectus indicating that:

- at least 90% of FoFs have been invested in funds already awarded the EU Ecolabel.

E. Feeder funds

The applicant shall provide the portfolio statement and prospectus indicating the following:

- portfolio's composition showing that the underlying fund has been awarded the EU Ecolabel

Derivatives

The applicant shall provide the following documentation on the derivatives included in the funds:

- The investment or management policy governing the use of derivatives and outlining clearly how the derivatives are to be applied including information about the counterparty.
- A statement on the strategy applied addressing how the use of derivatives is in line with the fund environmental policy and how the derivatives comply with the EU Ecolabel criteria,

29 Other assets may include as an example, derivatives or money held as cash.

including on environmental and social exclusions.

- -A listing of the types of derivatives and other assets used during the last 12 months preceding the application for the EU Ecolabel, including their nature, average total amount invested (i.e. share of the portfolio) and their average duration/frequency of use shall be demonstrated.
- For OTC derivatives, compliance with the EU Ecolabel criteria on environmental and social exclusions, and consumer information on all of the counterparties used over the last 12 months preceding the application for the EU Ecolabel.

1.2 Unit-linked insurance products

Unit-linked insurance products consisting of a UCITS or Retail AIF shall, on a look-through basis, comply with the requirements set out in sub-criterion 1.1 for investment funds for equities in A. for the equity share, and for bonds in B. for the bond part, as well as for derivatives and other assets.

Where the unit-linked insurance product consists of several UCITS and/or Retail AIFs, the requirements for equities and bonds shall apply at the level of the sum total, over all relevant UCITS and/or Retail AIFs, of the values of the equity shares and bond parts, respectively.

Assessment and verification

The applicant shall provide documentation showing that the monthly averages for the 12 months preceding the application for the EU Ecolabel request comply with the respective minimum percentages for the equity and bond shares as specified in A and B assets, as well as for derivatives and other assets, in sub-criterion 1.1.

1.3. Green fixed-term and savings deposit accounts

Requirement 1. Green loan to deposit ratio

At least 70% of the value of the total deposits shall be used to make green loans and/or to invest in green bonds.

The value of both the loans and the deposits shall be calculated based on the annual average for the time that the product has been on the market. For new products the target ratio shall be stated and after a minimum of one year on the market. The licence-holder shall declare the ratio achieved to the Competent Body.

Requirement 2. Green loans made using the deposited money

Loans contributing to the green loan to deposit ratio shall only be granted to green economic activities. The applicant shall provide annual updates on the implementation status of the funded projects or activity.

The list of projects and green economic activities funded shall be disclosed in a dedicated EU Ecolabel report to be provided to the retail customer and/or a dedicated web-based portal to which retail customers will be provided access.

Requirement 3. Internal ring fencing of the deposited money

The money held in deposit and granted as loans shall be strictly ring fenced within the accounts of the Credit Institution. The structural solution and/or internal procedures used shall allow for the traceability of the each retail customer’s deposited money and their contribution to the total value of the green loans granted.

Assessment and verification

The applicant shall provide on an annual basis an itemised list of the green loans approved for projects and activities. The value and type of projects and/or green economic activities funded shall be identified for each loan. This listing shall be provided and/or updated year on year. The applicant shall provide a declaration that the green loans list is in compliance with the EU Taxonomy requirements for green economic activities. Competent Bodies reserve the right to select projects at random from a loans list for verification purposes.

The applicant shall provide a set of declarations and supporting information to verify the declared loan to deposit ratio and to ensure that is traceable and transparent. They shall comprise the following:

i. The total value of the deposits derived from individual values marked and entered into the Single Customer View (SCV) for the specific product.
ii. The value of each green loans and bonds granted using the deposited money. This shall be recorded and declared together with the total value of the green loans and bonds for each year.
iii. The internal procedures and/or structures used to ring fence the funds and how they allow for the traceability of the deposited money shall be described. This could be supported by an auditors' qualification of the effectiveness of the procedure which may be included in the annual report of the credit institution.
iv. The value of the deposits and green loans related to the product shall be reported annually in a dedicated EU Ecolabel report to be provided to the retail customer, to also be reflected as itemised entries on the balance sheet in the annual report of the Credit Institution, with each entry to be clearly marked as EU Ecolabel-verified deposited money.

5.1.1 Rationale of the proposed criterion text

The feedback from stakeholders during and after the 1st AHWG meeting called for an expansion of the initially proposed scope to cover three additional products – pension funds, professional AIFs and savings/deposit accounts. To address this, additional research was carried out. The outcome of this research was that savings/deposit products should be brought into the scope. The supporting technical analysis behind the first criterion proposal for this product, which is presented as part of Criterion 1, can also be found in Section 4.

In respect of the PRIIPs within the scope, the First Technical Report proposed a criterion with thresholds at two levels: company (>50% revenues from green economic activities) and portfolio (>70% of AuM financing green economic activities). It was argued that having these two thresholds would provide greater flexibility to the fund manager at the point of selecting the companies and ensuring that the overall potential environmental impact of the fund is positive.

Stakeholders provided feedback on this proposal at the 1st AHWG meeting, as well as in writing after the meeting. The stakeholders could not agree on a quantitative threshold at the company level. Some agreed it should be kept high in order to include only companies with a high share of green activities ('green companies') and thus preserve the credibility of the label. Others said it should be lowered to capture highly diversified companies engaged in the development of new environmental technologies ('companies in transition'). The stakeholders also argued that failing to capture such companies would make it very difficult for fund managers to comply with risk diversification requirements for retail products. However, it was pointed out by the former that a lower threshold would not adequately distinguish between companies with a high share of green activities and companies in transition.

Some stakeholders argued that having two thresholds at company level similar to the approach adopted by the French Greenfin label would provide a better distinction between these two types of companies. Moreover, it was argued that such an approach would also facilitate compliance with the risk diversification requirements by fund managers, which should lead to a higher uptake of the EU Ecolabel.

A review of the data provided by asset managers was conducted to assess the potential for adopting this approach. Although detailed data were available for six funds, this could be considered a limitation with respect to the size of the sample set.

To enable the analysis, the following definitions were applied:

– the green pocket is composed of companies that have more than 50% of revenue from green economic activities;
– the transition pocket composed of companies that have:
    - either 20-49% of revenue from green economic activities (small transition);
    - or 15-49% of revenue from green economic activities (medium-sized transition);
    - or 10-49% of revenue from green economic activities (large transition);
– the diversification pocket is the balance of companies which are not in the "green pocket or the transition pocket" or other assets or cash.

The data from the six funds obtained from asset managers were analysed to check for the proportion of the portfolio corresponding to each of the defined pockets. A simplified approach to the analysis was adopted which entailed assessing the proportion of the portfolio corresponding to each of the defined pockets based on the reporting of green revenues. The results obtained are presented in *Table 4*.

Table 4 - Results from analysis of investment funds

Pocket size		Fund A	Fund B	Fund C	Fund D	Fund E	Fund F	Average
Green (at least 50%)		55	39	31	24	56	67.5	45.4
Transition pocket	Small transition (20-49%)	42	16	10	38	21.5	22.4	22
	Medium-sized transition (15-49%)	42	18	19	38	23.4	24.6	25
	Large transition (10-49%)	42	21	42	57	23.4	32.9	35
Total (green pocket + small transition)		97	55	41	62	63	89	67.8
Diversification pocket		3	45	59	38	37	11	32.2

These results are considered to be purely indicative and should be interpreted with care due to some identified limitations which include the following:

1. The relatively small sample size (number of funds analysed).
2. The lack of diversity in the sample set of funds analysed – three of them, although provided by different asset managers, are labelled by the same national scheme/label. The effect of this is evident in the criteria proposed informed by the results of the analysis.
3. Compliance with the EU Taxonomy was not fully assessed.

Concerning this third limitation, several factors are at play:

- The Technical Expert Group (TEG) report on the Taxonomy (published in June 2019) ('TEG Taxonomy report') only provides *recommendations* on technical screening criteria. These recommendations may not all be followed when the criteria are adopted in a Delegated Act under the Taxonomy Regulation.
- The TEG Taxonomy report contains criteria defining when a given economic activity makes a substantial contribution to climate change mitigation or adaptation (criteria on 'substantial contribution'), while not significantly harming the other four environmental objectives[30] (criteria on 'do no significant harm' or 'DNSH'). Criteria for economic activities that make a substantial contribution to the other four environmental objectives will only be developed at a later stage.

[30] Sustainable Use and Protection of Water and Marine Resources, Transition to a Circular Economy, Pollution Prevention and Control, and Protection and Restoration of Biodiversity and Ecosystems.

- In assessing whether activities were green or not, it was not clear whether asset managers that provided the data on the funds estimated:
    - the share of a given company's activities that complied with the substantial contribution and DNSH criteria proposed by the TEG (e.g. hydropower with less than 100 g CO_2e/kWh and complying with the relevant DNSH criteria),
    - or the share of activities for which criteria were developed by the TEG, without checking whether they comply with relevant criteria (e.g. all hydropower, including if emissions are greater than 100 g CO_2e/kWh or if DNSH criteria are not respected).

These limitations also prevent the proposal of ranges in the criterion requirement. A comparison of the transition pockets for the funds analysed showed the marginal increase in the proportion of companies in the portfolio of a medium-sized or large transition pocket. Therefore, it is considered more practical to focus on a small transition pocket and have a differentiation only between two types of issuers depicted in *Table 4*:

- the green pocket for companies that have at least 50% of green activities and,
- the transition pocket for companies that have between 20 - 49% of green activities (small transition pocket)

The averages are considered as suitable initial thresholds for the alternative dual threshold criteria proposed below.

5.1.2 Outcomes of the 1st AHWG meeting

Comments received from stakeholders during and after the 1st AHWG meeting were directed at various aspects of criterion 1 including: the EU Taxonomy, assessment and verification of other assets, trading practices applied in particular to derivatives, as well as the greenness thresholds. A few comments were received on the need to be more specific on the assessment and verification requirements. These comments are presented below.

1) *Is there a way to address economic activities not yet featured in the current version of the EU Taxonomy and its technical criteria?*

Numerous comments were received from stakeholders on the linkage between the EU Ecolabel and the EU Taxonomy, and the differing timelines for their completion. Concern was expressed that the progressive approach for the development of the latter might restrict the financial market for the EU Ecolabel and it was emphasised that a finalised and confirmed EU Taxonomy is important for the integrity and uptake of the EU Ecolabel. Others questioned how the EU Ecolabel criteria could be updated to reflect the staged adoption of Commission delegated acts which are to cover all the environmental objectives of the EU Taxonomy.

It was therefore suggested that the work on the EU Ecolabel be delayed until at least the adoption of the EU Taxonomy framework at level 1. Some stakeholders offered suggestions for addressing green economic activities not yet featured in the EU Taxonomy through the application of other market methodologies or existing taxonomies such as the French Greenfin[31] taxonomy which could serve as a temporary framework. For some other stakeholders, it was unclear how economic activities not yet featured in the TEG Taxonomy report and its technical criteria could be addressed. However, they emphasised that, to avoid creating confusion in the market, the scope of economic activities should be clearly aligned with the EU Taxonomy, and follow any future changes to it.

[31] The French TEEC label is now called the Greenfin label.

2) *How could the revenue for a parent group with a number of daughter companies and their share be handled?*

Stakeholders provided varying responses to this issue but an overwhelming majority (~ 64%) voted in favour of using the consolidated revenue (at the parent group level) especially for investments in equity. The main reason given for this suggestion was that parent groups are obliged according to standard accounting rules to disclose consolidated reporting so revenues from green economic activities would normally be reported at group level including subsidiaries under financial control. Therefore, there is no added value in handling revenues of daughter companies separately.

There was some concern from some stakeholders about the practical challenges for investee companies in establishing which percentage of turnover is attributable to each economic activity they undertake due to the "as the requested company reporting on economic activities does not reflect current market reporting practices". As a solution, it was suggested to consult issuers.

3) *How should assets held in other investment funds be treated within this criterion? Do they require any special form of verification?*

A number of stakeholders supported the idea of applying the same assessment and verification criteria for equities and bonds to funds of funds (FoFs) because they do not require a special form of verification. Others stated that, in order to qualify for the EU Ecolabel, assets held in other investment funds should be within the scope, and that the label should be awarded at the fund level, and should cover the entire portfolio. It was the opinion of a few other stakeholders that it would be very challenging to apply the look-through approach in order to determine the degree of greenness at the funds of funds level and it was suggested that a simplified treatment should be envisaged for target funds certified under the EU Ecolabel or any national label.

As a solution to overcoming the difficulty of applying the look-through approach to FoFs, it was suggested that at least 90% of the value of FoFs be required to be invested in funds with the EU Ecolabel. The remaining 10% should not be invested in unlabelled funds but in transferable securities or money market instruments in line with Article 50 (2) (a) of the UCITS Directive.

4) *To what extent should real estate also be considered as a specific asset within the portfolio verification? If so, how could its performance be verified?*

Stakeholders favoured the inclusion of listed real estate as a specific asset class within the portfolio verification. They suggested that it could apply specific criteria and thresholds available in the EU Taxonomy, and existing green building and energy performance standards (e.g. RICS (Royal Institution of Chartered Surveyors) or GRESB (Global Real Estate Sustainability Benchmark)) to verify its performance. However, some stakeholders noted that most real estate is neither listed equity nor directly available to retail investors, although some AIFs marketed to retail investors may invest in real estate. Others noted that the technical screening criteria proposed by the TEG for the assessment of real estate is only applicable for the construction of new buildings and renovation of existing buildings, and ownership of these.

5) *When calculating portfolio greenness, should assets for which verification of greenness is not required be included within the total portfolio asset value?*

Varying responses were provided by stakeholders as to whether assets for which verification of greenness is not required (i.e. cash, derivatives, etc.) should be included within the total portfolio asset value. Those favouring the inclusion of assets for which verification of greenness is not required argued that it is essential as it would be the basis for the calculation of the greenness of the portfolio. Their exclusion would result in a portfolio with only a very small portion of qualifying green assets which could still obtain a label. It was also pointed out that this could lead to inconsistency in the 'greenness' between funds obtaining the label.

Those opposed to the inclusion of assets (e.g. cash, derivatives, etc.) for which verification of greenness is not required argued that the conditions are already too strict. This is because, depending on the investment strategy and liquidity conditions, investment funds might have to hold larger amounts of cash over a longer period of time or extend their use of derivatives for hedging purposes. This will therefore provide the portfolio managers more flexibility to construct a portfolio. Therefore, it was suggested to either relate the portfolio threshold only to the cumulative value of assets for which the degree of greenness could be assessed. An alternative proposal was to lower the overall portfolio threshold (to 51% as an example).

6) *Should any type of criteria on trading practices and/or use of funds be applied to derivatives and cash?*

Most respondents did not favour the idea and argued that i) derivatives and cash are used for risk management practices of the portfolio, and ii) the UCITS Regulation permits UCITS funds to invest in transferable securities or in other liquid financial assets (such as money market instruments, bonds, shares, etc.).

Some stakeholders supported this position, stressing that the practical implications of such criteria would make assessment and verification of underlying assets more complex but suggested that as these assets are limited in terms of their proportional contribution in portfolios, they could be considered in the calculation of the total portfolio value. A suggestion was received that the criteria guidelines available in some national schemes and labels could be applied as they provide a well-functioning set of rules.

7) *Does the assessment and verification require any specific parts to be tailored to individual products within the scope?*

Stakeholders who responded to this question noted that there is a need for specific parts of the assessment and verification to be tailored to individual products within the scope. It was suggested that: i) specific rules regarding the quality of the funds' impact reporting could be introduced for green bond funds, ii), the verification process should allow for some flexibility in the format of the verification data of the underlying asset classes and potentially different assessment frameworks, iii), the assessment and verification requirements should be dependent on the different types of issuers (e.g. large-cap issuers, mid-cap issuers), especially for equity portfolios.

However, a large majority of the stakeholders (55%) noted that tailoring specific parts of the assessment and verification to individual products would result in an increase in the cost and complexity of the process, which might decrease the potential for the success of the EU Ecolabel. They expressed an overall preference to keep the existing proposed assessment and verification process for all products.

A variety of responses were provided by other stakeholders who recommended that 70% of the portfolio needs to be invested in green activities and stated that the cash position should not exceed 30% of the portfolio. Another stakeholder questioned why the green investment policy is connected to the applicant instead of the product and noted that some of the documents required for assessing and verifying compliance such as the "the green investment policy of the applicant"; and "portfolio statement and prospectus" are not applicable to insurance products because they are not covered by the Prospectus Directive but rather by the pre-contractual information and key information documents (KIDs).

8) *Thresholds*

Feedback and comments received on the draft proposal on sub-criterion 1.1 related to the thresholds for the greenness of an investment portfolio indicated that most of the stakeholders considered the criterion proposal to be 'strict' and therefore counterproductive to the uptake of the EU Ecolabel.

Without consideration of the specific thresholds in the criterion 1.1, about 44% of stakeholders (34) favoured lower thresholds (when no distinction is made based on the responses provided either for the portfolio threshold or listed equity company revenue threshold or the threshold required for bonds complying with the EU GBS).

A total of 29% of the respondents were of the opinion that the threshold at the portfolio level should be lower than the proposed 70% given the diversified nature of companies and that new technologies require time before they can generate a high level of returns. Other stakeholders (about 18%) supported the proposed threshold at the portfolio level and some called for a higher threshold beyond 70%.

The majority of stakeholders (63%) who provided comments on the EU Ecolabel requirements for listed equities were in favour of company revenue thresholds lower than the proposed 50%. Others were of the opinion that the proposal appeared to be correct with some even advocating a slightly higher threshold.

With respect for direct holdings and their proportion in the criteria requirement for equities, the majority of stakeholders (83%) who commented did not agree that such a requirement is needed and recommended that the requirement be removed in future versions of the Technical Report.

Overall, most stakeholders did not agree with the proposed criterion requirement relating to equities and observed that it would be difficult to set up funds which would comply with the criterion requirements.

Moreover they considered the thresholds too ambitious and not achievable in the current state of the market. The company threshold would limit the number of eligible companies that can be selected by the fund managers. They expressed concerns that it could result in the EU Ecolabel becoming a niche product which would be counterproductive to its intent – to stimulate sustainable investments. Alternative threshold proposals and comments[32] received from the stakeholders included the following:

- A 50% portfolio threshold and 20% return on company revenue.
- The portfolio threshold should be maintained (in value) but a uniform threshold value for both listed equities and bonds should be applied.
- The criterion proposal should be reformulated to ensure that the portfolio threshold is applied to the number of issuers that integrate a share of green activities in their revenue (at least 10%), and not to the total of assets held in the portfolio; and to evaluate the potential for declining thresholds for equities.
- A labelling system should be applied rather than thresholds to enable investors to compare mainstream products with reference to a specific indicator (e.g. GHG emissions).

Stakeholders suggested that, to ensure that the proposed thresholds especially at the portfolio level and for listed equities are implementable from both the technical and operational perspective, they should be extensively tested on eligible financial products. In addition, it was recommended that an expert subgroup be set up to determine the limits for the thresholds to be proposed.

[32] For a comprehensive listing of the comments provided by stakeholders and the corresponding JRC response, please refer to Annex I.

Less than half of the stakeholders (about 37.5%) who provided comments on the criterion requirement for bonds agreed that the proposed threshold reflects the state of the market, with some proposing even higher thresholds. Others (25%) commented that it was too high whilst the remainder (62.5%) emphasised that it would be premature to require all bonds contributing to the greenness threshold to comply with the requirements of the EU GBS because it is a voluntary standard and its acceptability in the market cannot be currently assessed.

9) *Assessment and verification*

There was a call for the assessment and verification to be more stringent, and clear on the documentation that applicants would be asked to provide as "evidence" to prove compliance with the criteria. It was recommended that the EU Ecolabel could require such documentation to be supplied by major ESG research providers, and that the relevant national Competent Bodies should be supported by external independent auditors.

5.1.3 Further research and main changes in the second proposal

In order to address the comments received from stakeholders, additional research was conducted. These are presented below.

1) *Is there a way to address economic activities not yet featured in the current version of the EU Taxonomy and its technical criteria?*

In addressing the comments on the alignment between the EU Ecolabel criteria and the EU Taxonomy, the JRC has reviewed all background documentation related to the work of the latter and concluded that adopting a temporary framework to address economic activities not yet featured in the current version of the EU Taxonomy and its technical criteria would not serve to improve the transparency of the financial sector (i.e. improve the BAU situation) but might also be perceived as an endorsement by the Commission of one specific taxonomy over others.

As the EU Taxonomy is meant to provide a harmonised framework for the definition of 'green economic activities' over existing "taxonomies", it will be used as guidance in the development of the EU Ecolabel criteria, and the link with the EU Taxonomy will be established by taking a “look-through” approach. The EU Ecolabel will monitor work on the development of the EU Taxonomy and align with it to reflect any potential changes through amending decisions.

2) *How could the revenue for a parent group with number of daughter companies and their share be handled?*

No additional research is considered necessary. The consolidated revenue (at the parent group level) especially for investments in equity is appropriate.

3) *How should assets held in other investment funds be treated within this criterion? Do they require any special form of verification?*

Considering that Article 50 (2) (a) of the UCITS Directive limits the proportion of these funds to 10% of a fund’s portfolio, it is considered pragmatic and efficient to set requirements in the EU Ecolabel that are aligned to the Directive. Therefore, a threshold based on the Directive has been introduced to cap the proportion of the portfolio to be invested in transferable securities or money market instruments to 10% with the condition that the overall thresholds are complied with.

4) *<u>To what extent should real estate also be considered as a specific asset within the portfolio verification? If so, how could its performance be verified?</u>*

Additional research was conducted on the potential for the inclusion of listed real estate as a specific asset class within the portfolio verification. The information obtained confirmed the position of some stakeholders that most real estate is not directly available to retail investors, although some AIFs marketed to retail investors may invest in real estate (***Figure 9***).

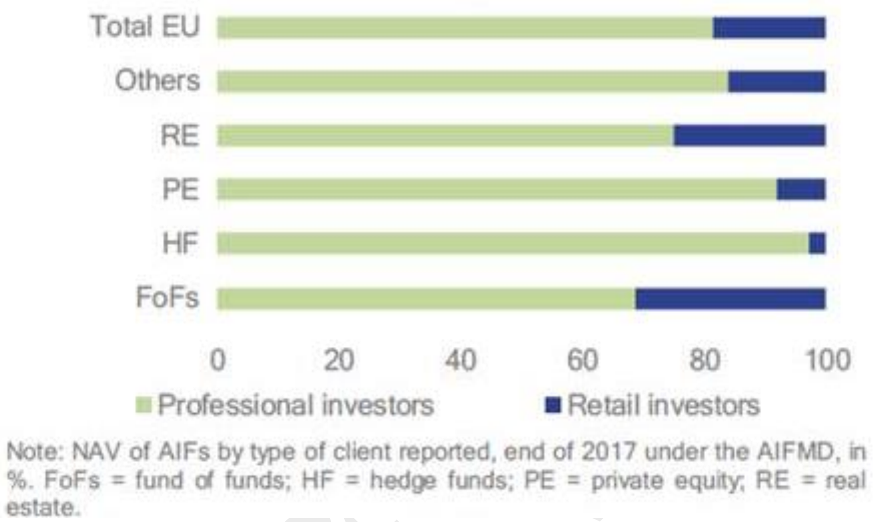


Figure 9 - Retail investors focusing on real estate[33,34]

The initially proposed scope of the EU Ecolabel does not cover institutional investors and AIFs. Also, not only does the current draft Taxonomy proposal[35] refer to real estate funds as a subset of AIFs but it has also adopted existing EU policy instruments as proxies for thresholds and metrics. This may result in different shares of the market being eligible under the Taxonomy criteria depending on the location as both the nearly zero energy buildings (NZEB) requirements and energy performance certificate (EPC) ratings have differing levels of underlying ambition depending on the Member State. Given the latter, together with the more limited presence of real estate in PRIIPs portfolios, the varying criteria in the available real-estate-related standards and labels, and the limited volume of investment opportunities, the suggestion to include listed real estate as a specific asset class within the portfolio verification has not been carried forward.

5) *<u>Should assets for which verification of greenness is not required be included within the total portfolio asset value? Should any type of criteria on trading practices and/or use of funds be applied to derivatives and cash?</u>*

[33] https://ec.europa.eu/info/sites/info/files/180425-retail-investment-products-distribution-systems_en.pdf
[34] https://www.esma.europa.eu/sites/default/files/library/esma50-165-731-asr-performance_and_costs_of_retail_investments_products_in_the_eu.pdf
[35] https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/190618-sustainable-finance-teg-report-taxonomy_en.pdf

Investment funds typically include specific assets classes (e.g. derivatives or cash) which are used by asset managers to maintain investment flexibility and to hedge risks, as documented in investment policy or fund prospectuses[36,37,38,39,40,41,42,43] in compliance with the UCITS Directive[44]. It has been highlighted that assessing and verifying criteria developed for these asset classes could be very complex and challenging as it would be difficult to relate them to EU-Taxonomy-eligible activities or capital investment. However, excluding these assets for which verification of greenness is not required from the total portfolio asset value would result in a portfolio with only a very small portion of qualifying green assets which could qualify for the EU Ecolabel. Existing financial labels and schemes adopt varying approaches to derivatives with some, e.g. the LuxFLAG Environment Label, considering this asset class as part of the portfolio total asset value but excluding them as an eligible green asset class. In some others[45], e.g. the Greenfin label, derivatives are not considered part of the portfolio total asset value for funds.

Therefore, derivatives and cash are excluded as an eligible green asset class but they are included in the calculation of total portfolio value (see the First Technical Report). This is in line with the suggestion of some asset managers[46].

Given the high level of concern raised by stakeholders on the need to limit the use of derivatives, reporting requirements linked to Regulation (EU) No 648/2012 on over-the-counter (OTC) derivatives, central counterparties and trade repositories[47] aimed at reducing the risks associated with derivatives through requiring mandatory reporting are proposed. Moreover, given that similar reporting requirements are available for derivative instruments in some national labels such as the French Greenfin label, the German FNG label, the Austrian scheme (see the Preliminary Report and First Technical Report), as well as the Eurosif transparency code[48], their introduction is not expected to add an additional burden to the EU Ecolabel.

6) *Does the assessment and verification require any specific parts to be tailored to individual products within the scope?*

The individual products (investment funds which include UCITS and, where applicable, RAIFs) and insurance-based products with an investment component (e.g. individual unit-linked life insurances) in scope possess a common denominator which is investment in bonds and equity. The feedback during and after the 1st AHWG meeting confirmed that tailoring specific parts of the assessment and verification to these individual products would increase the cost and

[36] https://www.fuchsgroup.com/wp-content/uploads/2015/06/ITI-Funds-UCITS-ETF-SICAV-Prospectus-dated-December-2017-incl-UK-adden.pdf
[37] https://www.bankoa.es/documentos/fondos/FCOMPLE/FCOMPLE362.pdf
[38] https://www.fuchsgroup.com/wp-content/uploads/2015/06/ITI-Funds-UCITS-ETF-SICAV-Prospectus-dated-December-2017-incl-UK-adden.pdf
[39] http://abante-web-wp.s3-eu-west-1.amazonaws.com/wp-content/uploads/Documentacion%20Legal/Folletos%2C%20DFIs%20y%20KIIDs/Prospectus%20Abante%20Global%20Funds.pdf
[40] https://www.manulifeam.com/de/Funds/Documents/Manulife-Asset-Management-UCITS-Series-Interim-Financial-Statements/
[41] https://sebgroup.lu/globalassets/prospectus-for-seb-fund-1---seb-sustainability-nordic-fund-aug2018-pdf.pdf
[42] https://pi.bnpparibas.es/pdf/fondos/4604_12.pdf
[43] https://sebgroup.lu/globalassets/prospectus-for-seb-fund-1---seb-sustainability-nordic-fund-aug2018-pdf.pdf
[44] https://www.mhc.ie/uploads/Overview_of_Long-Short_Equity_UCITS_June_15.PDF
[45] Personal communication with Commissariat général au développement durable
[46] https://www.schroders.com/getfunddocument/?oid=1.9.3230321
[47] Regulation (EU) No 648/2012 of the European Parliament and the Council of 4 July 2012 on OTC derivatives central counterparties and trade repositories
[48] European SRI Transparency Code available at: http://www.eurosif.org/wp-content/uploads/2014/05/5.-transparency-code-english.pdf

complexity of the assessment and verification and result in a limited uptake of the EU Ecolabel. As the purpose of the EU Ecolabel is to stimulate the financing of environmentally sustainable investments, this suggestion is not considered further. Therefore only one type of assessment and verification would apply to all.

7) *Thresholds*

Feedback and comments received related to the thresholds for the greenness of an investment portfolio highlighted the concerns of stakeholders that the criterion proposal is 'strict' and might not encourage the EU Ecolabel to target a potential market share of 10-20% of all available retail financial products within the defined scope. To ensure that subsequent proposals are implementable, testing of the impacts of the proposed portfolio and company thresholds on eligible funds has been carried out.

This testing has been carried out in parallel in consultation with a working subgroup set up following a call for expression of interest addressed to all stakeholders to test portfolio thresholds and their verification and to advise the JRC on appropriate thresholds. More information on the composition and mandate of the working subgroup as well as meeting minutes can be found at: https://susproc.jrc.ec.europa.eu/Financial_products/documents.html

The subgroup held three meetings. In these, a review of green investment thresholds available in existing national labels and schemes (see *Table 5*) examined the EU Taxonomy and the thresholds at holding level and at portfolio level as well as the resulting minimum threshold of aggregated turnover from green activities and found that the aggregated thresholds range from 10% to 37.5%. This approach is not adopted by the EU Ecolabel criterion proposed. It was observed that the aggregated thresholds from the labels/schemes are lower than in the EU Ecolabel, with the implication that the criteria requirements of the EU Ecolabel are too strict.

The architecture of the criteria - thresholds at the portfolio and company activity levels was not seriously contended. The subgroup also agreed that thresholds at both the holding and portfolio level should be required even if a single threshold would be simpler and easier to communicate to consumers. Thresholds at two levels would provide greater flexibility to the fund manager at the point of selecting the companies (i.e. including those in transition) and ensuring that the overall environmental impact of the fund is positive. It was emphasised that having only one threshold at the portfolio level elevates the risk of having holdings (outside of cash, derivatives, etc.) whose contribution to an environmental objective is at best zero. This will undermine the credibility of the label.

Therefore, the architecture is retained as the portfolio threshold enables a comparison with the thresholds available in national labels and schemes which measure the portfolio threshold in holding weight. Adopting this approach in the EU Ecolabel would help retail investors and consumers to compare the aggregated turnover from eco-activities in the portfolio with that of other labels and schemes. In addition, it would also simplify understanding of the EU Ecolabel requirements by Competent Bodies and Market Surveillance Authorities.

Several potential configurations of both thresholds (portfolio and company revenue) were suggested by subgroup members. Although the majority agreed that a potential threshold at the portfolio level could lie between 50% and 70% (with most suggesting 60%), there was no consensus on what value could be required to enable eligible funds to comply and also simultaneously encourage divestment at the company level. Additionally the proposed thresholds for the company level threshold during the subgroup meetings required some additional validation through testing.

Although some subgroup members considered it better to have different thresholds depending on the company (i.e. mid-cap and large-cap) and the type of assets at the company level, some others did not. The results of the stakeholder survey documented in the First Technical Report indicated that the majority of stakeholders would prefer only one threshold at the company level.

With regards to the portfolio level, the subgroup considered “the number of issuers” the wrong metric and stated that this metric should be thought of in terms of weight

The subgroup considered the term revenue the most appropriate parameter to be applied to companies’ thresholds for the purposes of assigning the EU Ecolabel. In the national schemes, percentages referred to shares of revenues. Therefore, the term "revenue" is considered for equity funds. It was recommended that hybrid/mixed funds should be reflected in the revised criteria proposal as they could also be eligible for the EU Ecolabel, and that the criteria should require the equity share to comply with the requirement for equities, and the bond part to comply with the requirement for bonds.

Table 5 - Review of green investment thresholds[49]

Label/Scheme	Taxonomy	Thresholds at holding level (green company)	Thresholds at portfolio level (weighted by holding sizes)	Resulting minimum threshold of aggregated turnover from eco-activities (at portfolio level)	Number of dual+ labelled funds[50]
LuxFLAG Climate Finance	IDFC	Company with a turnover of at least 50% turnover from eco-activities	75% of green companies	**37.5%** (i.e. 50% x 75%)	**0**
LuxFLAG Environment	Taxonomy derived from the main environmental classification systems	Company with a turnover of at least 20% turnover from eco-activities	75% of green companies. Within this pocket, companies must derive 33% of turnover from eco-activities in aggregate	**24.75%** (i.e. 33% x 75%)	**0**
French Greenfin	CBI taxonomy (slightly modified)	Three types of companies (I: more than 50% from eco-activities, II: between 10 and 50%, III: less than 10%)	Portfolio made up of at least 20% of Type I companies and no more than 25% of Type III	**15.5%** (i.e. 50% x 20% + 55% x 10%). Not measured per se, but in practice often much higher than 15.5% because of the number of pure players within (Type I)	**4**
Nordic Swan	ICMA	No threshold at holding level	No mandatory threshold, but the point system rewards portfolios that can demonstrate a share of 10 / 22 / 35 or 50% of aggregated turnover from eco-activities	At least **10%** to be considered as an (ecofund)	4

+ Funds labelled according to both ESG and green criteria.

<u>Testing hypothesis and results</u>

To ensure that the revised EU Ecolabel thresholds proposed for the 2nd AHWG meeting are robust and applicable to eligible funds in the market, testing was performed based on a draft variant of the reference criterion 1.1, presented during the 1st AHWG meeting below:

49 This overview was developed by the EU Ecolabel working sub-group on criterion 1.1.
50 Redon, N. et al, 2019. Overview of European sustainable finance labels. Novethic 2019

"at least 60% of the total portfolio value (weighted) shall be invested in companies whose economic activities comply with the thresholds for equities and bonds below:

> a. *Equities: At least 50% of company revenue(weighted) shall be from EU Taxonomy eligible activities*
> b. *Bonds: At least 70% of all bonds must comply with the EU Green Bond Standard*
> c. *Mixed funds: the equity share must comply with the requirement for equities in (a), and the bond part must comply with the requirement for bonds in (b)."*

Several asset managers were contacted to test the eligibility of at least two to three funds against the proposed criteria thresholds based on the following five-step approach for the implementation of the taxonomy:

i. Identify the activities conducted by the company or issuer or those covered by the financial product (e.g. projects, use of proceeds) that could be eligible.
ii. For each potentially eligible activity, verify whether the company or issuer meets the relevant screening criteria, e.g. electricity generation.
iii. Verify that the DNSH criteria are being met by the issuer. Investors using the EU Taxonomy would most likely use a due-diligence-like process for reviewing the performance of underlying investees and would rely on the legal disclosures of eligibility from those investees.
iv. Conduct due diligence to avoid any violation of the social minimum safeguards stipulated in Article 13 of the Taxonomy Regulation.
v. Calculate alignment of investments with the EU Taxonomy and prepare disclosures at the investment product level.

Most of the asset managers contacted reported that they were only able to carry out the testing based on the first step of the implementation stages. They also reported that, in order to determine which activities in the EU Taxonomy might be eligible for a specific company as "green" activities, "highly granular company-level research would need to be conducted" and that this process is rather time- and resource-intensive.

In addition, activities categorised as climate change adaptation within the EU Taxonomy are not often considered because there are very few companies within the portfolio active in this sphere. To overcome these issues, some of them resorted to their 'proxy or in-house' taxonomies which did not exactly match the EU Taxonomy classification of activities with the implication that the analysis and subsequent test results did not fully comply with the approach for the implementation of the Taxonomy.

Of the fund managers contacted, only a few provided testing results of portfolios of funds which were dominated by equity funds (more than 90%) with cash and money market instruments (MMIs) making up the remaining share. None of the funds tested complied with the hypothetical threshold (60%) at the portfolio level (***Table 6***).

Although it was extremely challenging to assess compliance with the TSC and DNSH criteria of the EU Taxonomy, for the funds where it was possible to conduct this analysis, it was possible to apply the DNSH and social criteria[51], a decrease of about 25% was observed relative to the proposed threshold. None of the portfolios met the defined thresholds for the testing but the majority of tested funds (6 out of 7) would meet thresholds of "at least 50% of portfolio (weighted)…" combined with "at least 50% of revenue from eco-activities….".

It is foreseen that if the full requirements of the EU Taxonomy as well as the exclusions (environmental and social) of the EU Ecolabel are applied, the proportion of the investable universe of investment funds eligible for the EU Ecolabel will further decrease, indicating that it would be difficult for currently available investment portfolios to comply with the proposed criterion.

[51] These 'social criteria' are defined by the asset manager.

Table 6 - Testing results of portfolios

Fund	Investment in companies with a min. of 50% green eco- activity	Threshold of 60% of portfolio met (Y/N)	Threshold of 50% of portfolio met (Y/N)
A	55.2%	N	Y
B	51%	N	Y
C	55.1%	N	Y
D	29.4%	N	N
E	51.4%	N	Y
F	64%	Y	Y
G	52%[52]	N	Y

A fund manager commented that "as the proportion of listed equity thematic investment funds is small, simply adopting the results of the testing would "cut-off" a huge proportion of investment funds which adopt related investment strategies such as sustainable investment funds from being able to qualify for the EU Ecolabel"[53]. This would result in the label being awarded to "niche" products. It would therefore be necessary to also adjust the 50%/50% combined threshold to minimise the risk of non-diversification, and also make the EU Ecolabel more accessible to a larger proportion of investment funds.

The following suggestions on potential configurations of portfolio threshold and company revenue from eco-activities were received:

- thresholds of between 20% and 30% of revenue and covering at least 50% of the portfolio (weighted);
- thresholds of at least 20% of revenue and covering at least 80% of the portfolio (weighted);
- thresholds of at least 15% of the revenue and covering at least 60% of the portfolio (weighted).

Although these thresholds would enable the minimum aggregated threshold of the EU Ecolabel greenness criteria to be approximately within the range of that of existing labels, it was pointed out that the two-threshold approach would not sufficiently distinguish between companies actively engaging principally in green activities and those in transition, and also make a provision for diversification.

Therefore the three-pocket approach was considered and the data available in the fund set analysed and documented as presented in the rationale for the second criteria proposal.

On bonds, the JRC is of the opinion that the proposed threshold is achievable in the financial sector because it still allows a certain proportion of other types of bonds to be included in the portfolio. Moreover, as the feedback from the stakeholders supported the threshold, no revision is considered necessary.

Based on additional research conducted on exclusions of environmental aspects, a criterion for sovereign bonds is also reflected in the updated criteria 1.1.

8) Assessment and verification

The assessment and verification requirement has also been reviewed to clarify as much as possible the relevant documentation required as proof of compliance. It is extremely difficult for the EU Ecolabel to require that 'evidence' or proof of compliance be provided only by "major ESG providers" because these materials could also be prepared internally by applicants. Currently, it is envisaged that the EU Ecolabel will not evaluate documentation/materials

52 Relative to the equity pocket of the mixed fund assessed.

53 Confidential personal communication

provided by the applicants as proof of compliance based on the source but rather on compliance with the requirement.

5.2 CRITERION 2: Exclusions based on environmental aspects

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 [55], 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.

[54] UNEP and FAO, *Annex III Chemicals*, the Rotterdam Convention http://www.pic.int/TheConvention/Chemicals/AnnexIIIChemicals/tabid/1132/language/en-US/Default.aspx

[55] Third party forest and forest products certification systems that meet the due diligence criteria set out in Article 6 of the Regulation may therefore be used as a tool within a due diligence system.

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.[54]
- 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.

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 CO_2/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 CO_2 emissions target.

<u>Assessment and verification</u>

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.

2.2 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;
- the Stockholm Convention on Persistent Organic Pollutants.

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.

5.2.1 Rationale of the proposed criterion text

The overall aim of this criterion is that investment in activities that are environmentally harmful is avoided. The need to include criteria that exclude a list of economic activities was identified from existing financial product labels and has been requested by stakeholders, who have commented on which activities they consider should be included in the list. These criteria therefore represent a cut-off for economic activities that are deemed to be detrimental or opposed to EU and international environmental policy aims.

The **current exclusions have been reviewed and restructured** in line with the detailed list of economic activities in the current TEG Taxonomy report[56]. In the majority of cases they have been made more specific, either to refer to legislation or specific activities or to link to the means of verification. Some new proposals made by stakeholders, such as coverage of car manufacturing, have also been incorporated. The majority of stakeholders were of the view that, to facilitate verification, the exclusions shall be applied at a company level.

As regards **partial exclusions** – being exclusions that still allow for the presence of a minor share excluded activities in the portfolio – a 5% revenue threshold was supported by the majority of stakeholders, including those involved in the operation and verification of a number of national Ecolabel schemes in Germany, Austria, the Nordic countries and France. Moreover, there was a consensus that it should be applied at a company level linked to revenue.

As regards **transitional criteria** based on environmental performance thresholds (e.g. GHG emissions) rather than on revenue, these have been analysed by the JRC for two activities that are of particular importance in terms of their contribution to CO_2 emissions – namely power generation and car manufacturing. A threshold for car manufacturing is proposed, as it represents a sector that is fast-moving, consumer-focused and with a regulatory reference point for the setting of performance thresholds. However, a threshold for fossil-fuelled power generation is not proposed, for the reasons that are set out below.

[56] EU Technical Expert Group on sustainable finance, *Technical Report on Taxonomy*, June 2019

Incentives for companies to transition

Although a **transition threshold** for fossil-fuelled power generation emissions could be identified, it is not proposed to include a transitional threshold for this activity. Indeed, it is considered that such a transitional exclusion could undermine the credibility of the EU Ecolabel, since retail investors' perception of what a green investment is would strongly exclude fossil fuels or nuclear power. This is evidenced by current market practices and existing labels which apply strict exclusions to these two areas of activity, and this was also reflected in the stakeholder feedback received. In addition, the disadvantages of a strict exclusion can be addressed through other means (see sections below addressing the stakeholder arguments in favour of transitional exclusion for the energy sector).

Stakeholders argued that the EU Ecolabel should provide incentives for companies to transition. While such incentives are indeed important, it is unclear whether EU Ecolabel criteria *for equity funds* are the appropriate tool for providing them. First, there are **other tools** in the Sustainable Finance Action Plan to incentivise companies to transition. Notably, financial market participants that have to comply with the recently published 2019/2088 Regulation on **sustainability-related disclosures in the financial services sector**[57] and the related disclosure obligation under the Taxonomy Regulation will ask companies to report their green activities. Companies will therefore be able to demonstrate that they are transitioning, even if they also undertake environmentally harmful activities.

Secondly, it is important to highlight that **exclusions apply to equity** (and corporate bonds) but **not to use-of-proceeds green bonds or deposits** (where there is ring-fencing). Thus, under a strict exclusion, equity funds[58] seeking an EU Ecolabel would not be able to hold shares of companies that undertake excluded activities. However, these companies can still issue green bonds, and bond funds[59] seeking an EU Ecolabel could well hold these bonds. In such a case, the use-of-proceeds condition (ring-fencing) prevents the retail investor's money from going to excluded activities. At the same time, the possibility to issue green bonds could provide an incentive for companies to transition, even if they are still undertaking excluded activities, although it is recognised that they do not currently appear to be a significant source of financing for renewables in the EU power generation sector[60].

Size of investment universe and risk diversification

Stakeholders also argued that a strict exclusion for the energy sector would unduly restrict the investment universe. It could be argued that the size of the investment universe is important to enable risk diversification (although stakeholders were not explicit in making this argument). This is particularly true for retail products, given the legal requirements around diversification.

However, it is not clear that without such a transition exclusion for power generation the investment universe would shrink to such an extent that it would impact on the options for risk diversification in products with the EU Ecolabel. In addition, the EU Taxonomy includes **activities across many sectors** (including 'enabling activities' and 'transition activities' for sectors where no low-carbon alternatives are available). The development of Taxonomy criteria for activities contributing to other environmental objectives[61] will **further expand the green investment universe**.

Finally, the size of the investment universe is potentially constrained by **other criteria** as well. Given the sensitivity of the exclusions, the expectations of retail investors and the current market practice, it is considered preferable to adapt the ambition level of these other criteria before compromising on exclusions relating to the use of fossil fuels.

[57] Still to be formally adopted and published in the Official Journal of the EU. See https://data.consilium.europa.eu/doc/document/PE-87-2019-INIT/en/pdf

[58] Or mixed funds for the part invested in equity.

[59] Or mixed funds for the part invested in bonds.

[60] EurObserver, *The state of renewable energies in Europe*, 2018 edition

[61] Circular economy, Sustainable use of water resources, pollution prevention and control, and biodiversity and ecosystem services.

5.2.2 Outcomes of the 1st AHWG meeting

This section summarises stakeholders' comments received after the 1st AHWG meeting. The JRC received in total 116 comments on environmental exclusions from 52 stakeholders. Based on these comments, the JRC has identified the needs for further research to improve the environmental exclusions criterion.

The comments reflect on the proposed environmental exclusions criterion and also respond to the JRC's associated questions. Stakeholders responded on whether the proposed environmental exclusions should be expanded to include more economic activities. They have also provided suggestions on activities-specific exclusions, the link between the EU Ecolabel and the EU Taxonomy, the necessity to introduce partial exclusions and to define transition requirements. Finally, their answers covered the question of whether exclusions should be applied at company or fund level.

1) *Do you think the proposed environmental exclusions should be expanded to include more economic activities?*

Of those that responded whether the exclusions list should be more comprehensive, it was stated in general that it might be challenging at the current stage, since the effect of environmental exclusions on the uptake cannot be critically assessed, with particular reference to the energy sector. Thus, it was felt in general that the current list is comprehensive, and no further exclusions should be added.

The majority of the responses recommended some form of alignment with the EU Taxonomy proposals in seeking to define the exclusions. However, in doing so, any further extension of the exclusions would be difficult to justify as the EU Taxonomy is under development and the real impact of the exclusions is challenging to evaluate. Also, the Taxonomy is about defining 'green' activities. If an economic activity is not included in the Taxonomy or if it does not comply with Taxonomy criteria (substantial contribution to one objective, and 'do no significant harm' to any objective), it is not 'green', but that does not imply it is 'brown'. In this sense, automatically adding activities that are not in the Taxonomy to the exclusion list would go against the intention of the Taxonomy. It would also not be feasible, since it would mean the portfolio should be composed exclusively of shares of companies whose activities are all Taxonomy-compliant. While alignment should be sought where appropriate, it should not be automatic.

Many of the respondents referred to internationally recognised norms/guidelines, as recommended by international institutions (such as the World Bank and also the EIB), to form the basis for environmental exclusions. Some proposed only to include environmental exclusions which are legally binding.

As regards the exclusion of specific economic activities, it is proposed that any potential exclusions be carefully considered, including with regard to both public perception and the exclusions already applied by labels and schemes in the market. Comments on specific activities can be summarised as follows:

- Nuclear energy generation and all nuclear-life-cycle-supporting activities should be excluded. This exclusion is also widely applied to the labels already in the market which it was considered the EU Ecolabel should take into account.
- Fossil fuel energy generation should also be reflected in the exclusions list as a significant contributor to climate change; however, energy generation using natural gas could accelerate the transition and contribute to climate change mitigation and indeed it was noted that it is supported by the EU energy policy and assumed to play an important role in projected scenarios. Therefore it shall not be totally excluded. Related to this, the idea of establishing technical thresholds for energy sector exclusions was proposed (see below in relation to 'transition criteria')
- Deforestation should be addressed, yet the EU Ecolabel should consider further the role of sustainable forest management in formulating the exclusion. Illegal deforestation as

an activity cannot be included in a fund portfolio by definition because it would be an illegal activity.

- Pesticides, genetic modified organisms (GMOs) and unsustainable palm oil production were proposed again as requiring exclusions. Some stakeholders considered that GMOs should be excluded based on the precautionary principle, which is a valid consideration in EU legislation, and also based on public perception of the EU Ecolabel. Yet, on the other hand other stakeholders considered that as currently no negative impacts have been identified from GMOs already in the market, there is no substantial reason to exclude GMOs totally. Moreover, a potential total exclusion might undermine research and innovation in biotechnology, a significant innovation driver in the EU. A stakeholder suggested considering the European Food and Safety Risk Assessment approach to form possible GMO-related exclusions.

Amongst the other possible exclusions that would extend the scope, the following were proposed by a smaller number of stakeholders:

- aviation because it was considered that there is no technological alternative that can make it greener;
- the automotive industry in the event that the products are based on the combustion engine;
- mining should also be addressed due to its link to biodiversity loss;
- the production of gases with significant global warming and ozone depletion potential;
- waste management activities which do not promote materials recovery according to the waste hierarchy.

As a general point, it was emphasised by several stakeholders that carbon-intensive products and sectors shall be excluded unless they are transitioning. What constitutes ‘transitioning’ would need to be precisely defined for the relevant economic sectors.

2) *Do you think the partial exclusions threshold should apply to each company’s activities or to the portfolio as a whole? If it should apply at portfolio level, should it be set differently for specific sectors?*

In regard to the questions as to whether to define a partial exclusion threshold, apply a threshold at company or fund level, and to define ‘transition’ criteria, the responses are summarised as follows.

The general view was that a partial exclusion percentage is practical and will allow for diversification in the portfolio and encourage transition. Some stakeholders considered that the proposed 5% threshold would only be acceptable if certain activities with very negative impacts were to be totally excluded. Others felt that it could be applied to all exclusions.

Partial exclusions at portfolio level could only practically be applied at stock (equity) level by considering controversial revenues, so they would have to be applied at company level. The percentage threshold shall be carefully set to avoid that the EU Ecolabel can only be achieved by a limited number of portfolios.

At a fund or portfolio level, to set a threshold would be challenging due to the price fluctuations and the specific weighting of the underlying assets. Moreover, if a threshold were to apply at fund level that would allow companies with significant climate change impacts to qualify for fund inclusion; this would consequently undermine the credibility of the EU Ecolabel. It was therefore recommended to apply a partial threshold to all companies included in the portfolio. On the other side, some stakeholders advocated a threshold at portfolio level because it could enhance uptake due to diversification.

The idea of having technical ‘transition’ criteria emerged from several stakeholders’ comments as a linked proposal – mainly focused on energy generation. Respondents highlighted the potential difficulty to create EU Ecolabel fund portfolios without having ‘transition’ criteria. This type of criteria was defined by several stakeholders as requiring a basis in CO_2 emission thresholds or other technical performance requirements. Sectors that could significantly contribute to climate change mitigation shall not be excluded in the event that they are transitioning, i.e. improving their overall performance. Transition criteria should only be introduced for specific sectors and case-specific thresholds would need to be set.

3) Links with the EU Taxonomy

The link between the EU Ecolabel and the EU Taxonomy was also commented on. It was recommended that the EU Ecolabel align with the EU Taxonomy in a non-binding form while it was emphasised that the possibility to have different stringency levels between the two schemes should remain open. The EU Ecolabel should be updated in line with the EU Taxonomy requirements and any contradictions should be avoided. It was also pointed out by one stakeholder that one should keep in mind that the EU Taxonomy specifies what is green. However, activities not included in the EU Taxonomy are not necessarily deemed environmentally harmful.

4) Treatment of sovereign and corporate bonds

Sovereign bonds emerge as a smaller, separate issue to be addressed, in which case an alignment to the Green Bonds Standard GBS is proposed along with a better definition of the exclusion criterion requirements for this type of bond. There were some suggestions that considering a wider range of international environmental treaties could be referred to, such as the UN Convention on Biological Diversity, so as to broaden the environmental aspects addressed. Additionally, when considering the relationship between sovereign and sub-sovereign levels, any climate change mitigation commitment needs to be taken into account when formulating the criterion. The EU Ecolabel therefore needs to consider sub-sovereign bond issuers, such as regions or municipalities. In terms of treaty ratification, there were contradictory opinions as some stakeholders strongly support an exclusion based on the ratification of relevant treaties while others pointed out that it could considerably restrict the number of EU Ecolabel funds and the number of sovereign state issuers whose bonds would be eligible, with a specific reference made to the United States.

In relation to corporate bonds, a stakeholder pointed out that it could be controversial if green bonds were to be issued to companies carrying out other core business activities with negative environmental impacts. It is also suggested by a stakeholder that green corporate bonds should be exclusion-compliant.

5.2.3 Further research and main changes in second proposal

The exclusions presented in the first proposal have been further reviewed and comprehensively revised in the light of the stakeholder comments received. Each area of exclusion is taken in turn and the relevant EU and international controls, restrictions and procedures have been briefly reviewed. In the case of the proposed transitionary criteria, the technical basis for establishing thresholds has also been investigated. The exclusions as a whole have also been restructured to better align with the economic activities proposed to be covered by the EU Taxonomy.

1) Agriculture

Exclusions that relate to the agricultural sector are proposed to address two main areas of concern raised by stakeholders – the production of harmful pesticides and the use of genetically modified (GMO) crops and seeds.

The production of pesticides

An exclusion that can be applied to pesticide production has initially been considered within the context of the EU approval process. Pesticides used as plant protection products require approval at EU level for their use. The European Food Safety Authority (EFSA) is responsible for the peer review of the risk assessment of active substances used in plant protection products in the EU. To be approved, each active substance (the active component against pests/plant diseases contained in the plant protection product) has to be proven safe in terms of human health, animal health and impact on the environment. At a global level, however, the production of active substances whose use is restricted in the EU continues. This indicates that an exclusion would have value by ensuring that investment is not made in the continued production of active substances of concern.

The Prior Informed Consent (PIC) Procedure of the Rotterdam Convention on the Prior Informed Consent Procedure for Certain Hazardous Chemicals and Pesticides in International Trade is another mechanism that can be referred to in order to ensure that investment is not made in the manufacturing of pesticides of global concern.

The PIC procedure was adopted at the Rotterdam Convention in 1998. The PIC procedure is voluntary - it has been unanimously accepted by member countries to the FAO and UNEP and is supported by the leading chemical industry associations and a variety of non-governmental organisations. According to the procedure, pesticides and industrial and consumer chemicals that have been banned or severely restricted for health or environmental reasons by the participating governments can be proposed as candidates for listing in order to recommend their listing under Article III of the Convention. In addition, acutely toxic pesticide formulations, which may present a hazard under the conditions of use in developing countries, may also be included. Annex III to the Convention lists the substances that have been identified by the procedure[62]. The list currently comprises 35 pesticides, as well as 16 industrial chemicals and 1 substance that falls into both categories.

The PIC procedure helps participating countries learn more about the characteristics of potentially hazardous chemicals that may be shipped to them. It also encourages exporting countries to take measures to ensure that unwanted exports do not occur. It initiates a decision-making process on the future import of these chemicals by the importing countries themselves. It therefore provides a reference list of hazardous chemicals and pesticides at the international level.

<u>Genetically modified (GMO) crops and seeds</u>

The first proposal did not exclude genetically modified (GM) crops and seeds (together genetically modified organisms or GMOs), pending further input from stakeholders. Even though the balance of stakeholder opinion was found to be in favour of excluding GMOs on a precautionary basis, it is still considered important to identify the scientific basis for such an exclusion. The JRC has therefore examined further the current risk assessment processes that are in place at EU level.

At EU level there is a complex decision-making process behind the authorisation of the use of GM crops for cultivation or the import of food or feed containing GM substances[63]. This process involves Member States, the European Food Safety Authority (EFSA) and the Commission. Fundamental to this process is the risk assessment done according to the procedure and conditions described in Annex II to Regulation EN 503/2013[64].

The risk assessment for crops, food and feed includes field trials and a comparative analysis with an equivalent non-GM crop. The procedure pays special attention to two specific aspects of the genetic modification that can cause adverse effects to human health and the environment:

i. Insertion of marker genes and other nucleic acid(s) sequences not essential to achieve the desired trait: In order to facilitate the risk assessment, the applicant shall endeavour to minimise the presence of inserted nucleic acid(s) sequences not essential to achieve the desired trait.
ii. Genetically modified food and feed containing stacked transformation events: A risk assessment of the following aspects of each single transformation event:

[62] UNEP and FAO, *Annex III Chemicals*, the Rotterdam Convention http://www.pic.int/TheConvention/Chemicals/AnnexIIIChemicals/tabid/1132/language/en-US/Default.aspx

[63] European Commission, *GMOs: EU decision making process explained*, https://ec.europa.eu/food/plant/gmo/authorisation/decision_making_process_en

[64] Regulation (EU) No503/2013. Available at https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX%3A32013R0503

i. stability of the transformation events;
ii. expression of the transformation events;
iii. potential synergistic or antagonistic effects resulting from the combination of the transformation events shall be subject to an assessment in accordance with Sections 1.4 (Toxicology), 1.5 (Allergenicity) and 1.6 (Nutritional assessment).

The results of each assessment must be taken into account in any decision making for authorisation. It is considered that it represents a detailed scientific process and that any GMO passing the assessment has had the potential nature of any hazards characterised and shall demonstrate a low potential environmental risk.

Vegetable oil production

In the First Technical Report it was noted that unsustainable vegetable oil production can contribute to a range of environmental issues, including impacts arising from land use change and related deforestation. EU GPP criteria for food and catering have been published in 2019 that include criteria requesting sustainable vegetable oil in public contracts. The criteria ask for certification of compliance with environmental criteria and are written with reference to the Common Agricultural Policy:

> *If vegetable oil is purchased, at least Y% of the vegetable oil purchased as raw ingredients must have been produced from crops complying with environmental criteria regarding soil, biodiversity, land-use change and organic carbon stocks by meeting the requirements of a certification scheme covering these issues, of Article 93 of Regulation (EU) No 1306/2013, or by other equivalent means.*

With the exception of organic production standards, a challenge for implementing such a criterion is the lack of consistent, equivalent certification for the broader environmental criteria referred to. A relatively flexible approach to verification must therefore be adopted. Moreover, these represent 'green' criteria rather than forming the basis for exclusion.

In terms of an exclusionary criterion, there is the potential to focus on avoidance of deforestation and the loss of primary forest – a focus of attention for palm oil – but other areas of attention may be required for oils grown in temperate climates such as olive, rapeseed or sunflower oil.

In terms of schemes addressing primarily deforestation it is noted that those based on organisations with a broad multi-stakeholder membership, including NGOs, industry and government such as the Roundtable on Sustainable Palm Oil - RSPO, the Palm Oil Innovation Group - POIG, the Roundtable on Responsible Soy - RTRS, the Soybean Sustainability Assurance Protocol - SSAP or Pro-Terra can show compliance provided that they cover the environmental principles cross referenced from the CAP. Other schemes, including at country level, shall also be considered equivalent if they comply with the environmental principles mentioned.

2) Forestry

In the 1st AHWG meeting and subsequent written comments concern was raised about a limited focus on only the legality of timber harvested. This was because it was considered that this aspect is already addressed by EU legislation. The role of Sustainable Forestry Management (SFM) was also emphasised and the potential to make reference to it raised. It is considered important to first review whether there still exists in the international market the risk of economic activities based on illegally harvested forestry products. The Timber Regulation ((EC) 995/2010)[65] introduced new requirements for the sourcing of timber products from 2013. It

[65] Regulation (EU) No 995/2010 of the European Parliament and of the Council of 20 October 2010 laying down the obligations of operators who place timber and timber products on the market

prohibits illegally harvested timber from being placed on the EU market and introduces requirements for 'due diligence', which it defines as comprising:

> *(a) measures and procedures providing access to the [origin of] the operator's supply of timber or timber products placed on the market;*
>
> *(b) risk assessment procedures enabling the operator to analyse and evaluate the risk of illegally harvested timber or timber products derived from such timber being placed on the market.*
>
> *(c) except where the risk identified in course of the risk assessment procedures referred to in point (b) is negligible, risk mitigation procedures which consist of a set of measures and procedures that are adequate and proportionate to minimise effectively that risk and which may include requiring additional information or documents and/or requiring third party verification.*

Valid EU FLEGT (Forest Law Enforcement Governance and Trade) and UN CITES licenses are deemed to provide assurance of legality. FLEGT is based on bilateral agreements between the EU and timber producing countries. However, despite the obligations from the Timber Regulation, there is still a risk that at a global level investments may be made in timber operations based on non-legal sources[66]. It is therefore still considered relevant to refer to timber that has FLEGT and also CITES licenses.

The aspect of legality is also addressed by major SFM certifications such as FSC and PEFC by subsets of criteria addressing timber from what are referred to as 'controlled sources' or establishing 'compliance requirements'. These establish minimum criteria for avoiding unacceptable sources and these may form part of due diligence systems as described in the Timber Regulation. Recital 19 of the Timber Regulation states that:

> *'In order to recognise good practice in the forestry sector, certification or other third party verified schemes that include verification of compliance with applicable legislation may be used in the risk assessment procedure.'*

Third-party forest and forest products certification systems that meet the due diligence criteria set out in Article 6 of the Regulation may therefore be used as a tool within a due diligence system. Given that SFM forms the proposed basis for defining what is EU-Taxonomy-compliant, it is therefore proposed that reference is made to the potential role of these systems in supporting due diligence.

An approach based on a combination of FLEGT, CITES and due diligence systems is proposed by the report '*The Draft proposal: GPP / Ecolabel criteria for timber and timber products*' which was carried out by EFECA for the Commission in August 2018. It is therefore proposed to mirror this reference in the exclusions given the risks still identified in monitoring reports.

Of particular concern at a global level is also the exploitation of existing primary, old growth forests. The need to protect primary forest has recently been highlighted by the Commission's Communication COM (2019) 352 on 'Stepping up EU Action to Protect and Restore the World's Forests'. The Communication identifies that primary forests require special attention because they have '*high carbon stocks, and are characterised by their great age, unique ecological features and the established protection they provide to biodiversity'*. They are also addressed in the sub-criteria of existing SFM certifications that require, for example, that *'land must not have been converted from high carbon stock land (e.g. primary forest…)*'. It is considered that this issue is therefore also important to include within the set of specific exclusionary requirements.

The recommendations in the TEG Taxonomy report have also been reviewed for consistency with the EU Ecolabel. They currently set out three main mitigation criteria to address

[66] European Commission, *Overview of timber source countries*, DG Environment, http://ec.europa.eu/environment/forests/timber_regulation.htm

greenhouse gases sequestration, as well as soil and biodiversity maintenance and/or improvement related to forestry:

a) Compliance with Sustainable Forest Management (SFM) requirements.
b) The establishment of a GHG balance baseline for above-ground carbon pools, based on growth yield curves.
c) The demonstration of permanence and steady progress with respect to the other two criteria shall be reported through a forest management plan or equivalent instruments.

Each type of forestry-related activity within the Taxonomy has these three criteria applied to it. It is considered that the aforementioned focus on due diligence and the protection of old growth, high-carbon-stock forests can complement these green criteria.

3) Energy sector

Nuclear power generation and fuel cycle

Concerning the exclusion of nuclear energy, the TEG Taxonomy report[67] emphasises the long-term nuclear waste management with regard to the ‘do no significant harm principle’. The report states that the following:

> *Regarding the long-term management of High-Level Waste (HLW), there is an international consensus that a safe, long-term technical solution is needed to solve the present unsustainable situation. Given this limitation, it was not possible for the TEG to conclude that the nuclear power energy value chain does not cause significant harm to [environmental] objectives [other than climate] on the time scales in question. Therefore, nuclear energy is not included in the Taxonomy at this stage.*

The Taxonomy Regulation, in its Article 12, also stipulates that an economic activity is considered to do significant harm to the circular economy “where the long term disposal of waste may cause significant and long-term harm to the environment”.

Significant concerns have also arisen as a result of the small number of major accidents at power station sites, the most recent having taken place at Fukushima in Japan. Moreover, given that the majority of recent new investments in nuclear power generation internationally has only been possible with majority public sector investment, it is notable that most of the examples of green sovereign bond issues to date have excluded nuclear power (see Section 2.1.6).

As a result, it is proposed to exclude nuclear power and related activities along the nuclear fuel cycle on a precautionary basis. In the specific case of energy utilities, this exclusion may need to be adjusted to ensure it provides the proper incentives. The rationale for such an adjustment is discussed later in this subsection.

Fossil fuel power generation

The need for exclusions that encourage a transition towards electricity generation from lower emission sources was also identified by stakeholders. The first exclusionary criterion proposed in the First Technical Report of February 2019 would have excluded all utilities with more than 5% of their revenue from fossil fuels. Upon closer analysis, this exclusion would cover the majority of the largest EU electricity generators, as identified by their annual power generation.

Stakeholders set out a number of options as to how this exclusion could be adjusted or made dynamic. The options set out fell into broadly two categories:

1. Revenue-based thresholds for activities or capital expenditure in low-carbon forms of electricity generation,
2. Thresholds for GHG emissions from a power station portfolio.

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[67] EU Technical Expert Group on sustainable finance, *Technical Report on Taxonomy*, June 2019

Whilst these could both provide a robust means of further distinguishing between power generators, it must also be taken into account that they introduce further complexity into the verification process and also the extent to which retail investors can understand what they mean in practice.

The main examples of existing criteria that were cited are those of the French Greenfin scheme, the Nordic Swan criteria and the Belgian Febelfin quality standard. The sub-criteria are presented and compared in *Table 7* below.

Table 7 - Comparison of the partial and transitionary exclusions and exemptions of existing labelling schemes for fossil fuel electricity generation

Scheme	*Investment and revenue-based*	*Technical threshold-based*
French Greenfin	Companies making 33% [inclusive] or more of their turnover from one of the following activities are excluded: • Storage and landfill centres without GHG capture; • Incineration without energy recovery; • Energy efficiency for non-renewable energy sources and energy savings linked to optimising the extraction, transportation and production of electricity from fossil fuels.	n/a
Nordic Swan	Companies that fulfil all of the following criteria are exempt and may be included in the fund. • At least 75% of the company's energy sector investments on average for the last three consecutive years are in the renewable energy sector. • Revenue from renewable energy comprises at least 50% of the company's total revenue. This ratio may be calculated on average over the course of 1, 2 or 3 of the last financial years. • The company has less than 0.1% revenue from tar sand, shale oil or shale gas, or other fracking activities and/or mining of oil shale.	n/a

Febelfin (Belgium)	• The product manager shall have in place a corporate engagement and/or shareholder action policy with the aim of accelerating transition of electricity utilities to a low-carbon business model and of supporting their R&D in sustainable energy technologies. • A socially responsible product shall not finance electricity utilities with expansion plans that would increase their negative environmental impact or that would be contrary to the achievement of the 2 degrees scenario. • A sustainable product shall not finance electricity utilities constructing additional coal- or nuclear-based power production installations.	The product manager shall include in his ESG due diligence process the monitoring and evaluation of companies involved in coal-, oil-, gas- or nuclear-based power production. The evaluation should make use of forward-looking metrics like the level and the management of carbon-related risk, and the transition plans towards low carbon and renewable energy. • A socially responsible product shall not finance electricity utilities with a carbon intensity that is not aligned with a below 2 degrees scenario. • In the event that carbon intensity data are not available, a socially responsible product shall not finance: – electricity utilities of which more than 10% of the power production is based on coal; this requirement will be further refined in a 2020-2025 timeframe; – electricity utilities of which more than 30% of the power production is based on oil and gas; – electricity utilities of which more than 30% of the power production is based on nuclear sources.

Considering the first option – a revenue or investment-based approach - the thresholds would be complex to establish in a way that captures the diversity of different starting points for transition. Taking the example of the Nordic Swan exemptions, the 50% revenue threshold could be too high in order to incentivise a transition by a large utility. In regard to the 75% investment threshold, it could also be possible to comply by making only minimal, small-scale new investments in the previous three years when expressed in real terms relative to the value of existing generating assets.

Given that the overall criterion is focused on an exclusionary approach, it could also be considered whether divestment from fossil fuel generation or the closure of fossil-fuelled power stations could form the basis for a requirement. No current examples of criteria could be found to reflect this approach. However, in looking at the power generators analysed in *Table 8* it can be seen that in some cases a substantial improvement in the carbon factor of a portfolio has been achieved, for example in the case of Drax which has achieved emissions reductions by switching to biomass. It should be avoided that utilities respond to any divestment requirement by selling high-emission assets to other utilities.

The French Greenfin exclusions refer to specific configurations of technologies which are to be disincentivised. The latter are proposed as being added to the waste management exclusions, where they appear to be more directly relevant as options related to the waste hierarchy (see Section 2.1.4).

A threshold based on the CO_2 emissions from a utility company's power generating plant portfolio, as included within the Belgian Febelfin requirements, could provide a more meaningful overall assessment of performance using a metric that relates directly to the contribution of the sector to climate change. Moreover the CO_2 emissions from large point sources such as coal-fired power stations have become an increasing focus of attention in the public eye in the last years, notwithstanding EU legislation dating back to the 1990s that has sought to address coal emissions. The Belgian Febelfin scheme includes year-on-year reference emission thresholds (see Table 8). An alternative set of thresholds is provided if this data are not available. These refer to the percentage of power production from coal (<10%), oil and gas (<30%) and nuclear (<30%).

Table 8 - Belgian Febelfin scheme: Carbon intensity of electricity generation thresholds

	2019	2020	2021	2022	2023	2024	2025
Max. (g CO_2eq/kWh)	429	408	393	374	354	335	315

PwC undertook an analysis of the largest 20 EU utilities with electricity generating capacity for the period 2013–2015[68]. This analysis provides an outlook on the CO_2 emissions per MWh generated and the percentage of renewables in their power station portfolios. Given that renewable electricity will already incentivised by the EU Taxonomy (linked to the greenness of an investment portfolio in criterion 1), it may therefore be more effective to complement the EU Taxonomy threshold for greenness by exempting from the exclusion the better performing utilities as measured by their CO_2 emissions/MWh generated. A threshold of 400 kg CO_2eq/MWh would cut off half of the largest utilities, based on 2015 data (***Figure 10***), and would equate to a generating mix with a low proportion of coal and a high proportion of natural gas.

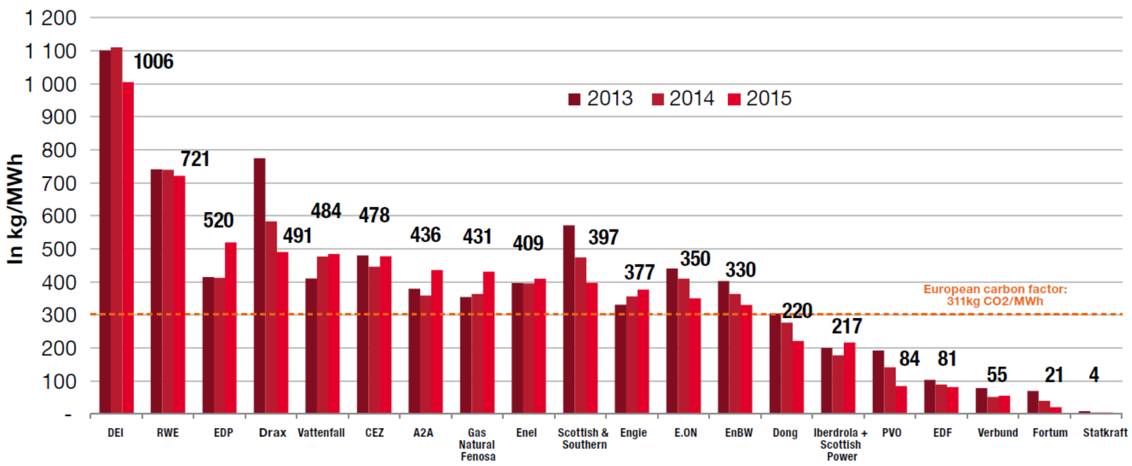

Figure 10 - CO_2 emission factors of the top 20 EU utilities

Source: PWC (2016)

An important related finding is that for the transition criterion to work the proposed 5% partial exclusion threshold for nuclear power would also need to be raised in tandem with the CO_2 emissions threshold. This is because upon analysis of the generating mix for the eight largest utilities that would currently be able to comply with the 400 kg CO_2/MWh threshold it can be seen that the five for which data could be obtained have between 6% and 71% nuclear power in their generating mix. higher (i.e. less stringent) exclusion threshold is therefore likely to be required in order to allow equities from the top 20 utilities to form part of an EU Ecolabel portfolio. To take an example, Iberdrola in Spain obtained 36% of its supply mix from renewables in 2017, resulting in CO_2 emissions below the suggested threshold, but also 19.6% from nuclear power. It would therefore be excluded despite substantial investment in renewable capacity, a low proportion of coal-generating capacity (15.9%) and a low emissions figure

[68] Price Waterhouse Coopers, *Climate Change and Electricity European carbon factor Benchmarking of CO_2 emissions by Europe's largest electricity utilities*, November 2016

(217 kg CO_2/MWh). Its daughter company Scottish Power also has 10% nuclear power in its supply mix, so would also be excluded despite a similar overall generating mix. The acceptability of adjusting the partial exclusion threshold for nuclear power is therefore to be seen.

4) Transport

Transport accounts for a significant and growing share of the EU's CO_2 emissions with road transport accounting for 70% of these emissions. Passenger vehicles are the subject of specific EU legislation to reduce their emissions which establish a framework of performance metrics and emissions targets for specific classes of vehicles technology. At this stage, it is recognised that there are other modes in the transport sector, such as aviation and shipping, but these have a smaller contribution to overall CO_2 emissions and are therefore only to be addressed in future work on the EU Taxonomy. Unlike road transport, aviation and shipping do not yet have a framework of metrics and targets that can be used to reflect the improvement potential and technological innovation.

EU legislation addressing the performance of passenger vehicles is focused on two areas of performance improvement and market development:

- The average CO_2 emissions in grams per km of new passenger cars and light commercial vehicles that are registered each year. From 2021, phased in from 2020, the EU fleet-wide average emission target for new cars will be 95 g CO_2/km. Targets extend to 2030.
- Zero- and low-emission vehicle (ZLEV) technologies, such as plug-in hybrid or electric motors, defined as having emissions lower than <50 g CO_2/km. From 2025 the specific CO_2 emission target of a manufacturer is relaxed if its share of ZLEV registered in a given year exceeds specific benchmarks.

Reflecting this approach, the TEG Taxonomy report includes technical screening criteria for passenger cars, light commercial vehicles and category L vehicles. The technical screening criteria proposed are as follows:

For passenger cars and light commercial vehicles (LCV):

- Zero tailpipe emission vehicles (including hydrogen, fuel cell, electric). These are automatically eligible.
- Vehicles with a tailpipe emission intensity of maximum 50 g CO_2/km (WLTP) are eligible until 2025.
- From 2026 onwards only vehicles with an emission intensity of 0g CO_2/km (WLTP) are eligible.

For category L (two- and three-wheel vehicles and quadricycles) vehicles:

- Zero tailpipe emission vehicles (including hydrogen, fuel cell, electric).

On this basis, and in the same way as has been proposed for energy generation, an exclusionary approach is proposed with thresholds to encourage those vehicle manufacturers that are reducing the CO_2 emissions of their current fleet, for example by introducing more environmentally friendly technologies.

In the area of **passenger cars**, as defined by Regulation (EU) 2018/858, the proposal is that two conditions must be met:

1. A car manufacturer should have placed on the market a commercially available model with emissions of less than 50 g CO_2/km. This limit is based on the targets established by the European Commission for the introduction of zero- and low-emission vehicle (ZLEV) technologies.
2. A manufacturer's new passenger car fleet shall have an annual average emissions profile of at most 5% lower than the EU target applicable at the time. This is to ensure the manufacturer strives to improve its new passenger car fleet efficiency in terms of

CO_2 emissions. The latter limit ensures that new passenger cars meet the existing targets set by the European Commission while taking into account future target updates.

Light commercial vehicles, as defined in Regulation (EU) 2018/858, currently have an average CO_2 emission level at 158 g CO_2/km according to the latest EEA statistical data[69]. At the same time, the EU has an average emissions target of 147 g CO_2/km for the vehicles registered by each manufacture by the year 2020[70]. Considering the existing and any future EU CO_2 emission target for LCV, it is proposed to set this specific threshold 5% lower than the existing target for 2020 considering each time the new LCVs registered in the previous year. This threshold shall be adjusted according to the latest EU CO_2 emission targets for LCVs.

In the event that a manufacturer produces passenger cars and LCVs both thresholds have to be met simultaneously for the company not to be excluded. The targets for these two types of vehicle and the regulatory procedure are distinct and separate, so manufacturers will already have to report on their performance.

It is also important to note that the **L vehicles category** represents a niche polluter in the European market in terms of EU-wide transport CO_2 emissions (approximately 1%)[71]. Moreover, currently there are not sufficient statistical data or transitional emission targets for those specific vehicles. These two limitations do not allow for defining an environmental exclusion threshold.

5) Waste management

The Waste Framework Directive (2008/98/EC) has the high-level aim of moving towards a '*European recycling society with a high level of resource efficiency*'. It introduces the concept of waste hierarchy, with accompanying reuse, recycling and recovery targets to be achieved by 2020: 50% preparation of waste for reuse and recycling of certain waste materials from households and other origins similar to households, and 70% preparation for reuse, recycling and other recovery of construction and demolition waste.

Activities in support of the circular economy

More recently the concept of the 'circular economy' has been formally introduced as a strategic objective for the EU. It focuses on measures to address the whole materials cycle, from production and consumption through to waste management and the use of recycled (secondary) raw materials, with the aim of contributing to 'closing the loop' of product lifecycles through greater recycling and reuse.

Both the Waste Framework Directive and circularity emphasise the importance of source segregation of waste in order to support resource efficiency and to achieve high-value reuse and recycling. Following on from these, particular efforts have been made to promote at Member State level source segregation activities at a municipal level and in the construction sector.

Accordingly, the TEG Taxonomy report now includes criteria addressing a range of waste management activities, with a specific sector classification for *"Separate collection and transport of non-hazardous waste in source segregated fractions"* for which the screening criteria focus on *'Separate collection and transport of non-hazardous waste in single or comingled fractions aimed at preparing for reuse and/or recycling'*. To complement this approach, it is therefore proposed to update the exclusion so that a more precise reference is made to the segregation of materials and/or the inclusion of energy recovery directly or indirectly as part of the processing or stabilisation of waste.

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[69] EU average CO2 emissions target for 2020 according to Regulation (EU) 2019/631 of the European Parliament and of the Council available at https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32019R0631

[70] European Environmental Agency. Average emissions for new passenger cars and vans registered in the EU and in Iceland in 2018. Available at: https://ec.europa.eu/clima/policies/transport/vehicles/vans_en

[71] European Environmental Agency. Report No 15/2018. Monitoring of CO_2 emissions from passenger cars and vans in 2017. Available at https://www.eea.europa.eu/publications/monitoring-co2-emissions-from-new-2

Mitigating the impact of waste management activities

Two specific cases of waste management practices that can result in higher CO_2 emissions were highlighted by stakeholders and are specifically excluded by the French Greenfin label. The exclusions exempt cases where appropriate technical solutions have attracted investment. The two specific cases identified are:

- landfill sites without methane gas capture;
- incineration without energy recovery;

It is therefore proposed to exempt companies that have investments in landfill gas capture for energy recovery and incineration technology *with* a high level of energy recovery. The latter could include incinerators able to operate in heat recovery, electricity generation or cogeneration modes. Thresholds for a high primary efficiency for these technologies are defined in EU waste and energy legislation.

A further consideration is the range of harmful emissions to the environment from incinerators. In the EU, Directive 2000/76/EC on the incineration of waste sought to address the harmful emissions by imposing operating requirements. The Directive set emission limit values and monitoring requirements for pollutants to air such as dust, nitrogen oxides (NO_x), sulphur dioxide (SO_2), hydrogen chloride (HCl), hydrogen fluoride (HF), heavy metals and dioxins and furans. The Directive also set controls on releases to water resulting from the treatment of the waste gases. These limits can be considered as a minimum standard for the operation of a modern facility. Reference could be made in the criteria to equivalent internationally recognised standards for the control of emissions.

6) Manufacturing

The focus on manufacturing has been limited at this stage to five priority areas that are the subject of EU and international environmental legislation and where, at an international level, there is the possibility that manufacturing of substances of concern may still continue.

For each of these four areas the proposals have been refined based on a review of the current legislative framework and, for fluorinated greenhouse gases with a Global Warming Potential (GWP), the technical state of the art:

- Production of pesticides that are not authorised for use in the EU or, in accordance with international treaties, for import to the EU (see Section 2.1.1).
- The production of hazardous chemicals that are not authorised for use in the EU or, in accordance with international treaties, for import to the EU.
- Production of substances with a high Ozone Depletion Potential (ODP) listed as controlled and as prohibited by the Ozone Regulation (EC) No 1005/2009.
- Production of fluorinated greenhouse gases with a Global Warming Potential (GWP) as controlled by Regulation (EU) No 517/2014 on F-Gases.
- The mining, processing and production of asbestos and asbestos-based products.

Following comments from the stakeholders, the general reference to industrial gases in the first proposal has been changed to a specific reference to fluorinated greenhouse gases. This is because ‘industrial gases’ has a much wider scope and amongst the possible gases with priority environmental impacts only hydrogen is identified by the TEG Taxonomy report. In the cases of pesticides, hazardous chemicals and substances with a high ODP, the exclusions are proposed as being linked to international conventions and protocols. In each case, listings of the specific substances of concern are provided in international or EU legislative instruments.

Hazardous chemicals

The restriction and substitution of hazardous chemicals that pose a risk to human health and the environment is an EU policy objective and is a specific performance aspect to be addressed by the EU Ecolabel. Reference is made in the EU Ecolabel Regulation to substances identified as hazards under the European REACH and CLP systems, with a focus on substances classified as being '*toxic, hazardous to the environment, carcinogenic, mutagenic or toxic for reproduction (CMR)*' and which have been entered onto the REACH candidate list of substances of very high concern.

As in the case of pesticides, the Prior Informed Consent (PIC) Procedure of the Rotterdam Convention on the Prior Informed Consent Procedure for Certain Hazardous Chemicals and Pesticides in International Trade is a useful mechanism to which an exclusion can be linked. Reference can be made to the list so as to ensure that at an international-level investment is not made in the manufacturing of hazardous chemicals identified as being of global concern.

Ozone-depleting substances (ODS)

Regulation (EC) No 1005/2009[72] implements the Montreal Protocol on substances that deplete the ozone layer and states that continued emissions of ozone-depleting substances (ODS) can cause significant damage to the ozone layer. As a result of this action, there is clear evidence of a decrease in the atmospheric burden of ODS and some early signs of stratospheric ozone recovery have been observed[73]. However, the recovery of the ozone layer to the concentration level existing before 1980 is not projected to take place before the middle of the 21st century.

Increased UV-B radiation resulting from ozone depletion therefore persists as a significant threat to health and the environment. At the same time, most of these substances have a high global warming potential and are contributory factors towards increasing the temperature of the planet and accelerating climate change. Therefore, further efficient measures need to be taken in order to protect human health and the environment against adverse effects resulting from such emissions and to avoid risking further delay in the recovery of the ozone layer. Adopting this perspective, it is proposed to exclude the production of ODS from the EU Ecolabel.

Mining, processing and production of asbestos

Asbestos is a particularly dangerous agent which may cause cancer and is specifically damaging to the human lungs. As a consequence, it may cause serious disease in cases where there is potential for exposure in workplaces or at sites where it is required to remove asbestos from, for example, old buildings[74].

Asbestos exists in six different types which are already banned in the EU territory. Moreover, some 14 specific uses of chrysotile or white asbestos were also banned. However, a number of uses for which no acceptable substitute had been found were still permitted. Therefore, a new EU regulation signed on June 22, 2016 has amended Annex XVII to REACH[75] to ensure the complete phase-out of asbestos products in Member States by setting a deadline of 1 July 2025. Internationally, however, it is still manufactured and used on an industrial scale in markets which have not yet put in place the same stringent controls.

Considering the adverse effect of asbestos to human health, and the respective EU policies, the EU Ecolabel suggests setting an exclusion criterion on the mining, processing and production of asbestos.

Fluorinated gases

Fluorinated gases used as a refrigerant or for fire-fighting purposes are a specific focus of legislation at international and EU level. Because their fugitive emissions do not damage the

[72] European Commission. Regulation (EC) No 1005/2009 of the European Parliament and of the Council on substances that deplete the ozone layer. Available at: https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32009R1005&from=EN

[73] Montreal Protocol. *A global agreement to protect the stratospheric ozone layer by phasing out the production and consumption of ozone-depleting substances (ODS).*

[74] European Commission. Directive 2009/148/EC of the European Parliament and of the Council on the protection of workers from the risks related to exposure to asbestos at work.

[75] European Commission. Corrigendum to Regulation (EC) No 1907/2006 of the European Parliament and of the Council of 18 December 2006. Available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32006R1907R(01)

atmospheric ozone layer, they are often used as substitutes for ozone-depleting substances such as chlorofluorocarbons (CFCs), hydrochlorofluorocarbons (HCFCs) and halons, which are being phased out under the Montreal Protocol and EU legislation.

Regulation (EU) No 517/2014 on F-Gas specifies requirements to prevent leakages and to reduce the use of F-Gases, which includes restrictions on the marketing and use of some of these gases. The Regulation prohibits the use of such gases if their total Global Warming Potential (GWP) exceeds 750 CO_2eq under certain conditions. In practice, this means that the remaining HFCs identified in the Annex I to the Regulation with a GWP of between 12 and 750 will be reduced but will not be totally removed. It is thus proposed to adopt an exclusionary approach which goes further than the GWP reduction threshold in the Regulation.

The Commission's preparatory study on certain fluorinated greenhouse gases estimated market penetration rates by 2030 of alternative refrigerants, blowing agents and fire protection/technical aerosols with low GWP profiles. For air conditioning systems, the following alternatives were expected to be used in the EU market and to completely replace other refrigerants with higher GWP profiles:

- R-290;
- R-717;
- R-744;
- HFO 1234yf;
- HFO 1234ze.

All of them have a CO_2eq GWP in the range of 0 to 11 GWP. Data compiled by DG CLIMA have shown that by 2030 the impact of the Regulation would be substantial, with a high uptake of low-GWP alternatives in the market. More recent data for some market segments, such as commercial refrigeration, has shown a more rapid uptake, partly because of the Kigali amendment to the Montreal Protocol and partly because of the effect of Regulation (EU) No 517/2014. However, in the medium term to 2030 it does not mean that F-gases with a GWP between 11 and 750 will cease to be manufactured internationally. F-gases with a GWP of 11-150 have been categorised by industry as 'intermediate' and the upper limit of 150 would exclude those alternatives with the highest GWP, thereby further incentivising the reduction initiated by the Regulation.

7) Exclusions relating to sovereign bonds

Sovereign bonds are issued by national governments as a means to raise capital to invest in public services and infrastructure. They are an important underlying asset within investment portfolios. EU Ecolabel criteria have the potential to reward those countries that are committed to environmental objectives. Conversely, the criteria have the potential to restrict access to finance for countries that, as a minimum, have not ratified international environmental conventions or which are harming environmental objectives, e.g. by promoting fossil fuel exploitation or deforestation. It is therefore considered important to further analyse current best practice within the sector.

The first criterion proposal focused only on ratification of the Paris Agreement on climate change. It did not, however, include any criteria evaluating the actions of a sovereign state to address climate change or other environmental concerns. In this section, two possible ways of going beyond a simple focus on international agreements are explored:

1. Green sovereign bonds: The issuing of green bonds would be a clear way of demonstrating the allocation of public investment to green economic activities and projects.
2. Sovereign bond risk ratings: An emerging market can be identified for sovereign bonds that have a climate risk rating. Disclosure of these risks could encourage greater differentiation of sovereign bonds based on specific plans and actions.

Sub-sovereign bond issuance

Concern was raised by some stakeholders as to how to address **sub-sovereign bonds** in the event that at national level the bonds of a sovereign issuer were excluded. 'Sub-sovereign'-level bonds or municipal bonds, are those issued by regional, city and local governments.

The USA was cited as an example, having pulled out of the Paris Agreement on Climate Change, whilst at the same time activities at state level have created a major focus for technological innovation and investment in clean technologies. States can be identified that have public works loan boards and are able to issue bonds and that have received ratings from the major agencies such as Standard & Poor's. Moreover, individual US states have continued to pursue the commitments enshrined within the Paris Agreement. For example, California has informally signed up to the Paris Agreement as part of the United States Climate Alliance[76]. In becoming an Alliance member, states commit to:

- implement policies that advance the goals of the Paris Agreement, aiming to reduce greenhouse gas emissions by at least 26-28 % below 2005 levels by 2025;
- track and report progress to the global community in appropriate settings, including when the word convenes to take stock of the Paris Agreement; and
- accelerate new and existing policies to reduce carbon pollution and promote clean energy deployment at a state and federal level.

Hence, in practical terms the sub-sovereign bonds of some US states could be exempted from the federal exclusion, as there is strong evidence of a political commitment having been made that is equivalent to the Paris Agreement.

Environmental treaties and agreements

The first criteria proposal published in the First Technical Report of February 2019 focused only on the ratification by sovereign states of major international environmental treaties and agreements, such as the Paris Agreement on climate change. Stakeholders suggested an **extension** of the exclusions **to encompass a broader range of environmental priorities**, including treaties and agreements designed to protect habitats and biodiversity as well the production, shipment and disposal of hazardous substances. This would reflect the commitment of a state to consensus environmental objectives. A short list of treaties and agreements has therefore been considered that map onto the environmental objectives of the Taxonomy Regulation. This list is provided in *Table 9*.

A major gap in international treaties is the **protection of forests**. The importance of protecting these habitats has been emphasised by the recent international concerns raised in relation to accelerated deforestation in Brazil. The Earth Summit of 1992 had as an intention to establish a forest convention but since then no comprehensive, legally binding instrument has been forthcoming or possible to negotiate. The most significant treaties and agreements identified by UN FAO research as having an overlapping contribution to the protection of forests[77] have therefore been included in the revised proposal – namely the UN convention for biological diversity, the Convention on International Trade of Endangered Species of Wild Fauna and Flora (CITES) and the United Nations Convention to Combat Desertification in those Countries Experiencing Serious Drought and/or Desertification (where applicable).

Using the list presented in *Table 9* as a starting point, a further check has been made on the potential impact of excluding sovereign states based on it. *Table 9* identifies the countries that are party to each convention. It can be seen that in general there are a limited number of countries that are 'non-parties'. The only major economic power that can be identified as a consistent non-party is the United States of America. Such a broader set of exclusions would therefore only have limited impact and would probably only play a symbolic role. Given that

[76] US Climate Alliance, https://www.usclimatealliance.org/
[77] FAO, *No forest convention but ten tree treaties*, http://www.fao.org/3/y1237e/y1237e03.htm

the USA is a non-party to the Paris Agreement on climate change, the same exclusionary effect can currently be achieved by reference to the Paris Agreement without the need to list the other conventions.

Table 9 - Ratification status of the major international conventions proposed for inclusion

Convention	**Ratification status**
The UN Convention for Biological Diversity	Ratified by 196 countries, excluding the USA
The Convention on International Trade of Endangered Species of Wild Fauna and Flora (CITES)	Ratified by all UN member states except for: 1. Andorra 2. Democratic People's Republic of Korea 3. Federated States of Micronesia 4. Haiti 5. Kiribati 6. Marshall Islands, 7. Nauru, South Sudan 8. East Timor 9. Tonga 10. Turkmenistan and Tuvalu
United Nations Convention to Combat Desertification in those Countries Experiencing Serious Drought and/or Desertification (where applicable)	Ratified by 190 countries plus the European Union
The Ramsar Convention on the conservation and wise use of wetlands of international importance and their resources	Every contracting country should have at least one Ramsar site. In 2018 the convention counted 170 contracting countries.
The Basel Convention (transboundary movements of hazardous wastes and their disposal)	The United State of America is a Non-Party of the convention, having signed in 1990 but not having ratified.
The Rotterdam Convention on the Prior Informed Consent Procedure for Certain Hazardous Chemicals and Pesticides in International Trade	Countries not ratified by: – Angola – Barbados – Saint Lucia – Serbia – Seychelles – Tajikistan – United States of America
The Stockholm Convention on Persistent Organic Pollutants	Countries not ratified by: – Brunei – Darussalam – Haiti – Israel – Italy – Malaysia – United States of America

Sovereign bond climate risk ratings

Research has shown that currently the market for sovereign bonds accompanied by disclosures of environmental performance and risks is less developed than for corporate bonds and equities and that changes in trading behaviour are not yet evident[78]. Nonetheless, there is emerging market interest in obtaining risk ratings with a strong initial focus on climate change and also other ESG aspects which may bring in other environmental issues[79]. The use of these ratings to make distinctions between different sovereign states is increasing, as evidenced by the development by Moody's of a climate risk rating methodology[80] and by Fitch Ratings of an ESG relevance scoring system[81].

This additional information disclosure could form the basis for further exclusions or requirements to be applied to sovereign or even also sub-sovereign bonds issuers. In line with the sequencing of Delegated Acts under the Taxonomy Regulation (see Annex 2), these exclusions or requirements could be used make an additional distinction related to the actions of issuers to mitigate climate change. At a later stage ESG ratings could also support a broader focus on other environmental aspects. For example, the Fitch ESG relevance score addresses water resources, biodiversity and natural resource management.

In order to understand the environmental aspects currently addressed by current rating methodologies, three leading examples of sovereign bond climate risk ratings developed by different types of analysts have been identified and studied. These ratings focus predominantly on 'climate risk'. This is because the link between climate change and potential exposure to economic risks from, for example, extreme weather incidents or investment in assets that are projected to be 'stranded' (obsolete) in the future is already considered to be present and to have significant potential financial implications that are increasingly being considered by investors:

- Moody's (rating agency): A Climate Change & Sovereign Bond credit risk methodology has been developed as was launched in 2016[82]. It has four main rating factors:
    1. Impact on economic activity: The impact, temporary or long-lasting, on livelihoods resulting from the physical impact of various events ('climate shocks') including drought, fire, floods and storms.
    2. Damage to infrastructure: The impact on a country's infrastructure, including supply chains and critical services, resulting from the physical impact of various events ('climate shocks') including drought, fire, floods and storms.
    3. Social costs: The broader social costs of physical changes, which can include incidences of disease, changes in sanitary conditions, access to drinking water and food security.
    4. Population shifts: The potential for the forced displacement of human settlements and the timescale for the associated shifts and their impact on labour markets.
- Finance for Change (NGO): With the involvement of a working group of stakeholders from the investment community, a carbon disclosure method has been developed and was launched in 2016[83]. It has three main 'dimensions':
    1. Transition risk: Measurement of the 'carbon exposure' in terms of the carbon intensity of production, consumption and trade.
    2. Policy response: Elements of an integrated response, starting with targets, then their monitoring and tracking, followed by measures to ensure the necessary

[78] Verisk Maplecroft, *The role of ESG factors in sovereign debt investing*, May 2019

[79] Financial Times, *Credit rating agencies turn attention to ESG risk*, 23rd February 2019, https://www.ft.com/content/c1f29e0c-6012-3ac5-9a05-13444b89c5ec

[80] Reuters, *Moody's warns of climate change impact on sovereign ratings*, 7th November 2016, https://www.reuters.com/article/markets-ratings-climatechange-idUSL8N1D841H

[81] Fitch Ratings, *Sustainable finance and sovereigns special report*, 8th April 2019

[82] Moody's Investors Service, *How Moody's Assesses the Physical Effects of Climate Change on Sovereign Issuers.* 7th November 2016.

[83] Finance for Change, *Carbon disclosure and climate risk in sovereign bonds*, December 2016

investment. Intended Nationally Determined Contributions (INDCs) are proposed as providing a basis.

  3. Physical climate change: A specific method is not proposed; instead reference is made to the potential use of a number of frameworks, including the Notre Dame Country-GAIN Index (see below for more details), the HSBC climate risk report, the S&P Global Rating and the Swiss Re catastrophic weather event effect estimation.

- FTSE Russell (data analysts): A Climate Risk-Adjusted World Government Bond Index been developed which was launched in 2019 and which has three main 'pillars'[84]:
  1. Transition risk: Measurement of the economic impact of 'required efforts' to meet Paris Agreement requirements. Metrics include GDP per capita, energy intensity of GDP and carbon intensity of energy production.
  2. Physical risk: Potential risks from the physical effects of climate change, including sea level rise, agricultural losses and extreme weather.
  3. Resilience: Actions and preparedness to cope with future climate change at institutional, social and economic level.

The three ratings studied share a number of commonalities, with the most significant being a dual focus on:

- '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.

If the priority were to complement a political focus for the exclusions (ratification) then 'transition risk' would seem to be a natural focus, as in the three ratings it encompasses actions within the economy to mitigate climate change.

The current scope of the ratings' coverage varies with, for example, the FTSE Russell index only currently providing benchmarks for 22 developed countries. So at this stage it would be appear to be difficult to consider applying such ratings to both sovereign and sub-sovereign issuers.

Other initiatives have been identified that form part of the underlying methodologies for these ratings. For example, Moody's' methodology makes use of the Notre Dame Global Adaptation Initiative (ND-GAIN) vulnerability country indices[85] which measure the degree of possible stress on different parts of a society under projected future climates. This suggests that in the future, as these types of ratings mature and their underlying basis becomes more standardised, quantitative criteria based on them could eventually be considered.

Green sovereign bonds

The market for green sovereign bonds was until recently substantially less developed than that of green corporate (use-of-proceeds) bonds. Based on data for the green bonds verified by the Climate Bonds Initiative in 2019, those bonds issued by sovereigns, government-backed entities and local government appear to account for over a quarter of the total value issued[86] The most recent briefing by the Climate Bonds Initiative[87] identifies a number of EU examples of green sovereign bonds issuers citing France, Poland and Belgium, as well as sub-sovereign green bonds issues in Australia (Victoria State), the USA (California), Germany (North Rhine-

[84] FTSE Russell, *FTSE Russell launches first climate risk government bond index*, 18th July 2019, https://www.ftserussell.com/press/ftse-russell-launches-first-climate-risk-government-bond-index
[85] Notre Dame Global Adaptation Initiative, *Country index*, University of Notre Dame, https://gain.nd.edu/our-work/country-index/
[86] Climate Bonds Initiative, *Green Bonds market summary*, July 2019
[87] Climate Bonds Initiative, *Sovereign Green Bonds briefing*, March 2018

Westphalia) and France (Île-de-France). Nuclear, military and fossil related investments were excluded in all cases by the sovereign bonds issues.

The case studies compiled by the Climate Bond Initiative highlight the complexity of issuing this type of green bonds, including:

- changes needed to the legal framework of financing in order earmark projects;
- the need to bring together different ministries in order to earmark projects;
- the establishment of processes and eligibility criteria for the directing or proceeds to projects in regions, agencies and departments; and
- the establishment of internal mechanisms for verification, monitoring and reporting.

It is, however, noteworthy that some of these complexities appear to have been overcome relatively quickly with sufficient political will. In fact, in most of the cases there was significant demand, and even oversubscription, that led to an increase in the value of the bonds issued.

A final issue to consider in relation to green sovereign bonds is whether exclusions relating to political commitments apply to them. On one hand, this could send the wrong signal to sovereign states that have decided, despite non-participation in international initiatives, to channel investment into new green projects. On the other hand, applying the exclusion would send a consistent message that it is not sufficient to fund green projects in isolation from strategic and internationalised efforts to tackle major environmental problems such as climate change.

5.3 CRITERION 3: Social and governance aspects

Second proposal for criterion 3: exclusions based on social and governance aspects

3.1 Exclusions applying to companies

The investment portfolio shall not contain equities, corporate bonds or use-of-proceeds bonds issued by companies excluded on the basis of social aspects or corporate governance practices as defined below. For fixed-term and savings deposit accounts, loans shall not be made to these companies.

A company is excluded on the basis of **social aspects** if it, throughout its business activities, does not comply with the following conditions:

– Respect[88] the protection of internationally proclaimed human rights and relevant domestic laws and regulations of the country in which they operate and from which they source raw materials. [UN Global Compact, OECD Guidelines for Multinational Enterprises]
– Ensure they are not complicit in human rights abuses. [UN Global Compact]
– Uphold the freedom of association and the effective recognition of the right to collective bargaining. [ILO Convention, UN Global Compact]]
– Ensure the elimination of all forms of forced and compulsory labour. [ILO Convention, UN Global Compact]
– Uphold the effective abolition of child labour. [ILO Convention, UN Global Compact]
– Ensure the elimination of discrimination in respect of employment and occupation. [ILO Convention, UN Global Compact]
– Abide by local legislation that addresses corruption, bribery and extortion, and work against corruption in all its forms, including extortion and bribery by formulating and operationalising adequate business policies. [UN Global Compact, UN Convention against Corruption]

A company is also excluded on the basis of **social aspects** if it derives revenues from following activities:

- Tobacco production or any tobacco-related activities at any stage from raw material to sale of the final products to consumers.
- The production and trade of weapons.
- Production or trade of any printed or digital material with pornographic content.
- Corporate activities which violate minorities' and indigenous communities' rights with reference to the World Bank's Social Safeguard Policies.

A company is excluded on the basis of **corporate governance practices** if they, throughout its business activities, do not have in place:

- corporate policies on social aspects and operational procedures necessary to embed compliance throughout the business activities;
- an up-to-date management system covering all business activities with the capability to identify, evaluate, prevent, mitigate and remediate existing adverse impacts or potential risks on social aspects;
- good corporate governance practices.

At a company level, exclusions apply to both transnational and other business enterprises, regardless of their size, sector, location, ownership and structure.

3.2 Exclusions applied to sovereign bonds

The investment portfolio shall not contain sovereign bonds issued by countries that:

- have not ratified the following international conventions on labour rights and corruption:

[88] Respect in this context means: Companies should avoid causing or contributing to adverse human rights impacts through their own activities, and address such impacts when they occur. It also means that companies should seek to prevent or mitigate adverse human rights impacts directly linked to their operations, products or services by their business relations, even if they have not contributed to those impacts.

- the eight fundamental conventions identified in the International Labour Organisation's declaration on Fundamental Rights and Principles at Work;
- ILO Declaration on Social Justice for a Fair Globalization;

- have ratified less than half of the 18 Core International Human Rights Treaties[89];
- are subject to EU or UN financial sanctions for special social violations;
- achieve a score worse than 38, when evaluated according to the Corruption Perception Index;
- produce, trade or possess controversial weapons that are subject to EU or international restrictions, including non-ratification of:
    - Chemical Weapons Convention,
    - Biological Weapons Convention,
    - Ottawa Convention (Ban on Anti-Personnel Mines),
    - Oslo Convention on Cluster Munition and Arms Trade Treaty), and
    - the Non-Proliferation of Nuclear Weapons.

Assessment and verification

The fund manager shall demonstrate to the Competent Body that following have been assessed, with respect to companies in which investments are held and/or the issuers of sovereign debt that is held:

- Excluded activities: The status of each country and company shall be checked against the exclusions list.
- Compliance of corporate policies on social aspects with social exclusions.
- Compliance of risk identification, evaluation, prevention, mitigation and remediation targets, as included in the management system, with corporate policies on social aspects.
- Compliance of good management practices to Corporate Governance (CoGo) codes and standards.

For use-of-proceeds bonds the EU GBS may be used as proof of compliance.

For large companies, reporting under the Non-financial Reporting Directive (2014/95/EU[90]) shall be accepted as basis for verification. Small and medium-sized enterprises (SMEs) shall disclose information about their social responsibility, human and labour rights and their anti-corruption policies, approved at the most senior management level.

Further to the initial verification by the Competent Body, the fund manager shall carry out assessment on compliance with social exclusions at least once per year and communicate any inconsistencies to the Competent Body. Furthermore, the Competent Body retains the right to perform random checks on compliance.

5.3.1 Rationale of the proposed criterion text

The need for a social exclusions criterion was imposed by the requirements laid down in Regulation (EC) 66/2010 of the European Parliament and of the Council on the EU Ecolabel. Article 6(1) of this Regulation specifies that EU Ecolabel criteria shall be based on the environmental performance of products, taking into account the latest strategic objectives of the Community in the field of the environment, yet it also requires – in Article 6(3e) – that in determining EU Ecolabel criteria, where appropriate, social aspects also be considered.

Apart from the EU Ecolabel Regulation, the Taxonomy Regulation was also consulted to articulate the social exclusions criterion. Article 13 of the Taxonomy Regulation requires 'environmentally sustainable economic activities' to comply with minimum social safeguards. The review clause in Article 17 also refers to a potential extension toactivities contributing to social objectives.

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[89] United Nations. T*he Core International Human Rights Treaties and their monitoring bodies*. Oct 2019, https://www.ohchr.org/EN/ProfessionalInterest/Pages/CoreInstruments.aspx. Compliance can be checked using the United Nations Human Rights interactive dashboard, available at: https://indicators.ohchr.org/

[90] Directive 2014/95/EU of the European Parliament and of the Council. Available at https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0095&from=EN

The first proposal for a social exclusions criterion was formulated to address societal concerns associated with sustainable investments considering the EU Ecolabel Regulation and stakeholders' opinions. Consequently, it was drafted accordingly and expressed in the First Technical Report. Further on, the criterion is updated reflecting the outcomes of the 1st AHWG meeting and the consultation process which has followed. In that frame, relevant stakeholders' suggestions have been considered, additional research carried out to tackle any remaining issues, and social exclusions were revised at a company and country level. At the national level, the social exclusions refer to sovereign bonds while at the company level the investment portfolio may contain diverse assets as defined in the scope of this study.

To improve the criterion, the reference to the term 'ethical' is avoided following stakeholders' recommendations on the controversy the definition of the term and its interpretation could create. Additionally, it is proposed to strike a balance between including broader societal concerns on one side and focusing on the EU Ecolabel's environmental aspects on the other. Social concerns, as expressed in the Taxonomy Regulation, were adopted and reflected in the criterion requirements.

Moreover, the specific exclusion requirements of investments in weapons have been made more precise and comprehensive. Corruption and bribery evaluation is amended at both corporate and sovereign level. Furthermore, to better define the social exclusions criterion, the work carried out in the United Nations, ILO, OECD and other international institutions and initiatives has been analysed and the outcomes and conclusions fed into the criterion along with the results of the consultation process.

Exclusion requirements for human and labour rights have been improved. The Eight Fundamental Conventions of the International Labour Organisation along with the 18 Core Human Rights conventions of the United Nations form the backbone of the social exclusions. On top of that, minority and indigenous people's rights are also examined and adopted in the criterion.

In addition, this criterion requires that companies follow good governance practices, with respect to sound management structures, employee relations, remuneration of staff and tax compliance by complying with corporate governance codes and standards. This is in line with the recently published Regulation 2019/2088 on sustainability-related disclosures in the financial services sector and with the Taxonomy Regulation, that contain requirement that companies where sustainable products invest in, following good governance practices.

The verification system is strengthened further, envisaging facilitating the work of the EU Ecolabel awarding authorities. Ratification of international treaties is suggested for verifying sovereign bonds. The operationalisation of business policies for human and labour rights, corruption and bribery at a company level was also considered. In conclusion, the adoption of an appropriate management system has been suggested to facilitate verification of compliance at a corporate level.

5.3.2 Outcomes of the 1st AHWG meeting

The following paragraphs focus on the main outcomes of the 1st AHWG meeting and the consultation process while the exact stakeholders' comments are included in Annex 1.

In the frame of the consultation process, there were comments referring to specific features of the social exclusion criterion which are summarised as follows:

- Weapons: It is stated that the term "Controversial weapons" may vary significantly from one institution to another, and therefore a consensus on that matter will be difficult to reach. At a company level, the exclusion on weapons is suggested to be extended beyond production to also cover trade activities. At a sovereign level, the production, trade and possession of controversial weapons are recommended to be excluded along with the non-ratification of relevant international treaties.

- Corruption and bribery: On corruption and bribery, stakeholders pointed out the necessity to better define the respective exclusion requirements. Firstly, at a company level, stakeholders indicated that the evaluation of these aspects shall be better outlined and therefore further research is needed. Secondly, at sovereign level, they have recommended reviewing the corruption perception index threshold.
- Human and labour rights: As regards, human and labour rights many stakeholders noted the necessity to consider international treaties and local regulations to better incorporate this aspect in the social exclusions criterion. Additionally, it was proposed that SRI labels could serve as a source to obtain human and labour rights-related exclusions.
- Verification requirements: Stakeholders suggested reviewing and strengthening the verification requirements of the social exclusions criterion.

Stakeholders have also responded to particular questions facilitating the better definition of the social exclusions criterion.

They were asked to provide their opinions on whether the proposed social exclusions list should be broadened considering additional social concerns. Responding to that, some stakeholders suggested following a normative approach in defining social exclusions and considering the work of international institutions, such as the United Nations, the International Labour Organisation and OECD. According to this suggestion, specific requirements set by these organisations at a company and a sovereign level could be sufficient in defining social exclusions. Yet, some stakeholders recommended also contemplating the local regulations.

Some stakeholders suggested to focus more on the environmental dimension and to only maintain a minimum of social aspects. Therefore it is recommended that the Taxonomy Regulation requirements on social aspects are used to define that minimum. They advocated that, in doing so, crucial social concerns can be addressed, whereas the scope of eligible funds would not be further restricted.

Meanwhile, it is suggested that social exclusions are defined more broadly at the corporate and sovereign level following the EU Ecolabel Regulation which advocates doing so where relevant. The current market practice indicates the importance of more detailed social exclusions than the minimum social safeguards of the Taxonomy Regulation, making it relevant to define social exclusions in more detail. Additionally, it is recommended to set broader exclusions since no weighting or rating of social matters, which would have facilitated the prioritisation of some social aspects over others while adequately addressing major societal concerns, is available.

A possible exclusion of companies with poor corporate management and/or poor human capital development from the social exclusions criterion along with an indication of its verification possibilities, was covered in the next questions to stakeholders. In response, it was mentioned that many labels define governance aspects separately to environmental and social issues and thus create ESG metrics. In accordance with this reality, which is highlighted in the consultation process, stakeholders suggested excluding poor corporate management and poor human capital development from the social exclusions criterion and develop a separate governance criterion that would examine in more detail the specific governance aspects. Moreover, as the notion for poor capital development and poor corporate management may strongly differ across companies the inclusion of these topics in an exclusion criterion may raise controversies. It was also pointed out that the verification of those aspects will be challenging.

As reference to the term ethical was discussed in the 1st AHWG meeting, stakeholders were asked to provide their opinion on that particular matter. Reflecting on that, many discouraged the adoption of the "ethical" concept. The term 'ethical' is not precisely defined and that could potentially lead to various interpretations ranging from "business ethics" to a "moral approach". Both interpretation edges are ambiguous since they are directly linked to individual perceptions which are far from being universally shared among European countries. Thus, the basis for defining the term ethical is not robust.

Stakeholders had divergent views on the need for the introduction of governance criteria in the EU Ecolabel. Several stakeholders were of the opinion that including governance criteria is important because:

- corporate governance can be easily measured compared to other criteria;
- corporate practices are very important for investors interested in firms that have a transparent business policy concerning decision-making and operation openness to employees and shareholders;
- governance minimises mismanagement and reputational risks, and provides some minimum safeguards to a product's social and governance-related sustainability.

5.3.3 Further research and main changes in the second proposal

The JRC has carried out additional research to explore the best possible way to address all emerging issues in terms of social exclusions. The amendments to the social exclusions criterion can be summarised as follows:

- The category **'Ethical'** is removed as it stands for a broader and subjective term and therefore it would be challenging to reach an agreement between stakeholders on the definition.

- The JRC has also investigated treaties referring to **human and labour rights**. As regards human and labour rights, not only is it a prerequisite that there shall not be revenues from activities that contravene these rights, but the overall operations of the company should not violate them. Moreover, corporate operations should respect minorities and indigenous communities' rights. On top of that, the list of relevant treaties has been reviewed and updated. As regards human rights exclusions at state level, the EU Ecolabel suggests a minimum number of ratifications to ensure a sufficient degree of compliance.

- On **corruption**, the Corruption Perception Index[91] was reviewed. The European Commission considers this index as a metric to quantify the UN SDG goal 16[92] on peace, justice and strong institutions. Apart from corruption-related information, the index reports on the degree of a country's democratic governance as ***Figure 11*** shows. The compliance threshold is suggested to be set at 38 points, which indicates democratic administration and a satisfactory level of anti-corruption.

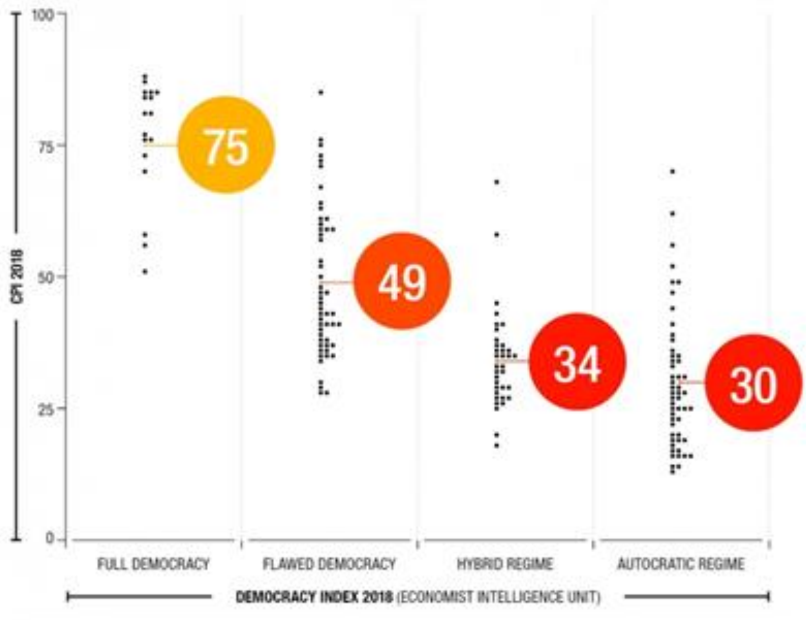

Figure 11 - Corruption Perception Index

[91] Transparency International. Corruption Perception Index available at https://www.transparency.org/
[92] https://ec.europa.eu/eurostat/web/sdi/peace-justice-and-strong-institutions

Source: Transparency International, (2017)

At a corporate level, a policy commitment against any corruption attempt, approved by the highest management level, is proposed to be laid down in addition to the anti-corruption laws in the countries where business operations take place. The company shall operationalise the anti-corruption policy into its daily business activities and establish a management system to prevent/eliminate any corruption attempts. This management system could be a part of a broader risk management system already set up at the corporate level.

- A potential **bribery** measurement has also been investigated. Bribery could be measured, at a state level, following the Bribe Payers Index[93]. However, in contrast to the Corruption Perception Index, the Bribe Payers Index is not used officially by governments or the EC. Consequently, bribery, as a social concern, is currently only considered at a corporate level, yet not at a state level. At a corporate level, measurements against bribery, analogous to those of corruption, shall be established to address the issue.

- **Tobacco** consumption is the single largest avoidable health risk and the most significant cause of premature death in the EU[94]. Hence, the EC has already implemented various tobacco control measures in the form of legislation[95], recommendations and information campaigns on tobacco consumption and its adverse effects on human health. Such measures include restrictions of advertisements for tobacco products, the creation of a smoke-free environment and also tax measures. Additionally, current market practices suggest sustainable funds to exclude tobacco. For instance, the Eurosif Transparency Code[96] refers to tobacco as a possible sustainable fund exclusion, and following this many of the existing national labels exclude investments in tobacco-relevant activities[97] Following the EC measures on tobacco, and considering the current market practices, the updated social exclusion criterion proposes the exclusion of **tobacco-relevant activities** from the investment portfolio.

- In terms of **weapons** at a corporate level, trade of weapons, as well as their production, is added to the social exclusion. The treaties related to **controversial weapons** have also been reviewed and updated. Consequently, apart from production and trade, controversial weapons possession is also a reason for sovereign bonds not to qualify.

- The JRC has also identified ways to facilitate **assessment and verification** of the social exclusions criterion at a corporate level by suggesting the adoption of policy statements and the implementation of due diligence procedures as means of proof. In the long term, a balance between critical societal concerns and the acceleration of sustainable growth is envisaged. Therefore, this updated proposal mainly addresses major social concerns.

- The JRC has explored the possibility to include **governance requirements** in the frame of social exclusions or separately. This research pointed out that there are regulations and directives at the EU level including the Non-Financial Reporting Directive

93 Transparency International Bribe Payers Index. Available at https://www.transparency.org/research/bpi/overview
94 European Commission policy priorities related to tobacco available at https://ec.europa.eu/health/tobacco/overview_en
95 Tobacco Products Directive (2014/40/EU) available at https://ec.europa.eu/health//sites/health/files/tobacco/docs/dir_201440_en.pdf
96 Eurosif Transparency Code. Available at: http://www.eurosif.org/wp-content/uploads/2018/04/Transparency-Code-4.0.pdf
97 Nordic Ecolabel on Investment Funds. Available at : https://www.nordic-ecolabel.org/product-groups/group/?productGroupCode=101 & Oestereichishes Umweltzeichen: Available at https://www.umweltzeichen.at/de/produkte/finanzprodukte

(NFRD)98 or Directive (EU) 2017/82899 which aim at increasing the transparency obligations of institutional investors and asset managers. Following these directives, governance-related exclusions and even separate governance criteria could have been proposed. However, Regulation (EC) 66/2010 of the European Parliament and of the Council on the EU Ecolabel does not explicitly refer to governance criteria; therefore it is suggested to include a requirement on good governance to prevent/address broader social issues that could emerge in practice, although not to develop a separate criterion on governance.

[98] Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups. OJ L 330, 15.11.2014, p. 1–9. http://data.europa.eu/eli/dir/2014/95/oj

[99] Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement (Text with EEA relevance) OJ L 132, 20.5.2017, p. 1–25 ELI: http://data.europa.eu/eli/dir/2017/828/oj

5.4 CRITERION 4: Engagement

Second proposal for criterion 4: Engagement

The fund manager [100] shall have a documented engagement policy describing at least:

1. clearly identified key environmental issues on which to engage with companies;
2. the method and reasons for selecting companies and specific key issues on which to engage;
3. submission and voting of resolutions at AGM to address these issues;
4. regular monitoring and evaluation of companies and the achievement of specific environmental outcomes.

The fund manager shall engage regularly with at least half of the companies that have less than 50% green activities.

Engagement activities shall include voting at general assemblies and other related actions such as communication and dialogue with the company and other shareholders/stakeholders (to push a climate resolution, for instance), with a clearly stated aim of improving the environmental performance of the company, notably to encourage companies to:

- upgrade, improve the quality (from an environmental point of view) or change their existing economic activities to make them compliant with EU Taxonomy criteria;
- expand their existing economic activities that are already EU-Taxonomy-compliant;
- reduce and stop economic activities that are not EU-Taxonomy-compliant by selling or closing those activities;
- measure and assess the impact on the environment of their activities and change their behaviour with respect to environmental issues;
- take steps to respond to shareholders/stakeholders' engagement with respect to the companies' environmental strategies.

The fund manager shall set specific key topics raised via engagement with the companies in planning actions in terms of environmental strategies and green activities within a specific period of time, failing which the fund manager may decide to sell (some of the) shares from the company (or reconsider inclusion of the company within the fund).

Assessment and verification

The fund manager or product provider applying for the EU Ecolabel shall provide the verifier with the following information:

1. Evidence showing the percentage of companies with which the manager has engaged.
2. Specific key environmental topics raised via engagement.
3. Voting behaviour in compliance with the engagement policy.
4. Use of other engagement mechanisms with the companies, such as evidence of a constructive company dialogue developing a business case for change and keeping up a good level of interaction with companies.
5. Other engagement practices with other shareholders/stakeholders (e.g. cooperating with other shareholders to push a specific climate resolution.

[100] For unit-linked insurance products this policy shall be obtained by the insurance company from relevant underlying investment fund managers.

5.4.1 Rationale of the proposed criterion text

Engagement, as a strategy, represents a way to deliver environmental improvements and to tackle social aspects, as suggested by some stakeholders. In addition, existing market practices support the inclusion of engagement requirements in the Ecolabelling criteria. For example, the criteria of the Nordic[101] and the Austrian[102] labels entail engagement as a separate condition. Because the EU Ecolabel focuses mainly on environmental performance and social aspects are already addressed under social exclusions, this criterion should focus on engagement on environmental issues specifically.

The most recent existing market studies (EUROSIF, 2018 Sri Study) indicate that most sustainable investment strategies continue to grow. Engagement and voting have increased, showing the greater commitment of investors to work with companies (more than 14% increase). Moreover, recent literature provides strong evidence that shareholder engagement is an effective mechanism through which investors can trigger reforms that improve the quality of company activities.

The JRC therefore considers engagement an essential criterion towards better achieving the goals of the EU Ecolabel, and this is why it is proposed as a separate criterion.

5.4.2 Literature on engagement and main changes in the second proposal

As explained in section 4.2, the evidence found in the literature (Koelbel et al. (2018)[103] and Brest and Born (2013)[104]) shows that 'investment impact' consists of two complementary components:

- the 'investor impact': i.e. the effect of investors on companies; and
- the 'company impact': i.e. the effect of companies on the environmental impact that is ultimately desired.

Focusing on investor impact, which is of interest for the engagement criterion, these authors identified three possible mechanisms through which investor impact can be achieved:

- Shareholder engagement; this
- Capital allocation impact; and
- Indirect impact.

Shareholder engagement refers to influencing company behaviour and practices with respect to environmental and other issues through various communication mechanisms that are open to investors. This includes the right to vote on shareholders' proposals during annual general meetings, discussions during informal meetings with management, as well as criticising corporate activities in news outlets, threats of selling the companies' assets[5].

Investigating the impacts of shareholder engagement, there are four empirical studies that analyse the extent to which companies comply with shareholder engagement requests on specific key ESG issues. The data are summarised in Koelbel et al. (2018) (see ***Table 10***).

[101] Nordic Ecolabel for Investment Funds: Available at http://www.nordic-ecolabel.org/product-groups/group/?productGroupCode=101

[102] The Austrian Ecolabel for Sustainable Finance: Available at https://www.umweltzeichen.at/en/products/sustainable-finance

[103] Koelbel JF, Heeb F., Paetzold F., Busch T., 2018, Beyond returns: investigating the social and environmental impact of sustainable investing

[104] Brest P., Born K. 2013, unpacking the impact in impact investing, Stanford social innovation review 11(4) : 22-31

Table 10 - Share of shareholders' requests implemented

Reference research	Number of shareholders' requests	Sample period covered	% of requests implemented
Dimson et al. 2015[105]	215	1999-2009	18
Hoepner et al. 2016[106]	682	2005-2014	28
Barko et al. 2017[107]	847	2005-2014	60
Dimson et al. 2018[108]	1 671	2007-2017	42

Together, these results show that there is a reasonable probability ranging from 18% to 60% that shareholder engagement requests succeed in affecting companies' behaviour with respect to environmental and other related issues. **Engagement** is an effective mechanism through which investors can affect and change a company's behaviour and activities.

5.4.3 Conclusion

Engagement has the potential to increase the positive environmental impact of companies' behaviour and activities. Hence, the proposed criteria include requirements concerning engagement. Asset managers often do not own the majority or a significant stake of shares of a given company; however, evidence indicates that engagement can change a company's environmental, social and governance behaviour. In particular, engagement is especially important for companies in transition, and hence that the engagement criterion should be strengthened and made more concrete for these companies.

The combination of criterion 4 on engagement with criterion 1 and the associated exclusions will maximise the potential environmental impact of EU Ecolabelled financial products.

[105] Dimson E, Karakas O., Li X., 2015, Active Ownership. Review of Financial studies 28 (12) 3225-3268
[106] Hoepner A., Starks LT., Sautner Z., Zhou X., Oikonomou I. 2016, ESG shareholder engagement and downside risk, available at: https://www.q-group.org/wp-content/uploads/2018/02/SHAREHOLDER-ENGAGEMENT-2018-01-31.pdf
[107] Barko T., Cremers M., Renneboog L., 2017, Shareholder engagement on environmental, social and governance performance, available at: https://ecgi.global/sites/default/files/working_papers/documents/5092017_1.pdf
[108] Dimson E, Karakas O., Li X., 2018, Coordinated engagements, available at: https://ssrn.com/id=3209072

5.5 CRITERION 5: Retail investor information

Second proposal for criterion 5: Retail investor information

5.1 Equity, bonds and mixed funds

As a minimum the following information shall be made available annually by the fund manager to the consumers:

- Information about the percentage of the total portfolio value in terms of assets under management (AuM) invested in companies whose economic activities comply with the requirements of criterion 1, i.e.:
  - share of AUM in shares of companies with >50% green activities;
  - share of AUM in shares of companies with 20%<x<50% green activities;
  - share of AUM invested in green bonds;
  - share of AUM going (indirectly) to green activities.

- Information on how the fund manager actively engages with companies on sustainability issues.
- Information about the type of exclusions considered. In the case of environmental exclusions, the applicant shall specify if they are total or partial exclusions, and report the percentage.
- Information the main principles for the selection of the companies.
- An electronic link to the full annual report described below.

Where the financial product is required to publish a prospectus, key investor information document (KIID) or key information document (KID) in accordance with European or national laws, only such information which is additional to that contained in the abovementioned documents needs to be disclosed separately or as additional information in the prospectus, KIID or KID.

As a minimum, the financial product manager shall issue a report annually to be uploaded on the financial product's manager website describing the environmental, social and engagement aspects as well as the activities and environmental performance of the financial product. The report shall be published on the fund manager's website. The report shall include at least the following:

- A description of the green economic activities in which the money held by the financial product was invested in during the reporting period, including the investment policy and how the companies are selected.
- A description of the main engagement activities (including voting and cooperating with other shareholders) and results within companies.
- A description of the methodology used for estimating the most relevant indicator (e.g. carbon footprint (GWP)) of the financial product and of the financial benchmark product. In the event that the GWP is the most relevant indicator, this description shall include the scope of the GHG emission covered. Additionally, the rationale for choosing the selected indicator and why it is relevant for the financial product shall also be included.
- The report shall include the engagement policy followed by the fund manager or an electronic link to it.
- Information on management and internal control procedures to identify and correct any non-compliance with EU Ecolabel criteria.

5.2 Sovereign bonds *(where held)*

As a minimum, the following information shall be made available annually to consumers by the fund or deposit manager:

- A climate or environmental risk rating for each sovereign issuer for which bonds are held.

5.3 Deposit accounts

As a minimum, the following information shall be made available annually to consumers by the deposit manager:

- An itemised list of projects and green economic activities for which loans have been approved, including their value. This may take the form of a selected list in a report together with a link to a website where a full list can be consulted.
- An annual report that as a minimum includes: details of the projects to which loans have been granted, their implementation status, the deposit account balance sheet showing the annual and historical deposit to loan ratio and the auditor's qualification of the ring fencing

Second proposal for criterion 5: Retail investor information
procedure for the deposited money. In the event of any observed deviations from any of the following the fund or deposit manager shall without delay communicate and publish the updated information and/or the updated report: : – changes in the methodology of computing the portfolio or deposit ratio; – changes in the objectives / investment policy of the fund; – relevant changes in the investment portfolio. **5.4 Monitoring** The consumer information should be updated regularly and therefore be based on regular monitoring of the portfolio. **<u>Assessment and verification</u>** The applicant shall provide a sample of the information to be provided to the consumers that clearly complies with the requirements of the criterion. The information can be added on the prospectus, KID or KIID or be provided as a separate information brochure.

5.5.1 Rationale of the proposed criterion text

There is a need to provide consumers with clear information on the environmental and social performance of financial product(s). These requirements will allow consumers to take a well-informed decision and also enhance transparency. Such actions will enhance the credibility of the EU Ecolabel.

5.5.2 Outcomes of the 1st AHWG meeting

Stakeholders recommended 12 months as a very reasonable interval for fund asset managers or portfolio managers for monitoring and reporting information to the consumers as well as other issues.

In addition, they recommended that this period of time should be reduced if any of the following occur:

- changes in the methodology of computing the portfolio;
- changes in the objectives of the awarded fund;
- relevant changes in the investment portfolio.

Stakeholders pointed out the benefits of aligning this criterion on consumer information to the requirements of other regulations the financial products could be covered by.

5.5.3 Further research and main changes in the second proposal

Two levels of provision of information are suggested in this EU Ecolabel criterion for financial products, especially in the case of investment funds. The first one aims at communicating to end consumers the most relevant aspects of the fund related to environmental and social aspects. This is proposed to be done through simple statements that can be included in the prospectus, KID or KIID given to the consumers at the time of purchasing. This information can be also annually revised and sent to the end consumers by email or any other media. This information is proposed to be accompanied by a link to an extensive and updated annual report addressing the requirements of the criteria.

The second level of information is related to environmental and social aspects that will be checked annually by the Competent Bodies to ensure compliance with the criteria. Therefore, the fund will regularly, at least annually, issue a report describing the state of the investment, its performance as well as aspects related to the environmental and social issues. This report will be published on the fund manager's website.

The additional section to be included in the prospectus, KID or KIID related to the relevant information should inform the consumers about the following points.

- *Sustainability aspects taken into account*: this section introduces the areas where sustainability analyses have been taken into account by the manager of the awarded fund. These areas can be: environmental issues and social aspects. Additionally, the investment policy that covers the investment fund should be indicated (e.g. including the link to the investment policy document).
- *The fund company influences*: this section informs about whether the fund company actively engages with companies on sustainable issues and how the company carries out this engagement (e.g. company engagement on own account, company engagement in collaboration with other investors, voting at annual general meetings, participation in nomination committees, etc.).
- *Carbon footprint:* this section informs about the measures that reflect the amount of carbon dioxide emissions or equivalent, relative to revenue matching the fund's ownership share in the companies. The measure of a benchmark investment fund can be provided for the sake of comparison.
- *The fund excludes:* this section informs about companies that the fund manager avoids investing in, or deriving more than 5% of their revenue from selling goods and services to (other limits can be included in brackets after the category).
- *The fund selects:* this section informs on specific aspects that are key for the manager's stock selection (e.g. only companies with a certain share of activities that comply with the EU Taxonomy, only companies that have a good environmental[109] profile based on other risk analyses, only companies that do not invest in excluded economic activities may be selected for this fund).
- *EU Ecolabel:* this section informs about the registration number for the EU Ecolabel and includes the logo.

Further research was carried out to identify information that could be provided in the brochures and later on annually about an investment fund awarded by the EU Ecolabel in line with the requirements proposed in the EU Ecolabel criterion for consumer information and applicable regulation. Some examples are provided below:

- UCITs funds and their share classes should be accompanied by a key investor information document (KIID). This is a factsheet style document which constitutes the pre-contractual information which must be provided to the investor prior to the investment. The points covered are: objectives and investment policy, risk and reward profile, charges, past financial performance and practical information. KIIDs are not required to include information on environmental, social and engagement aspects.
- The PRIIPs Regulation requires that basic pre-contractual information be provided through the key information document (KID) on the nature, risks, costs and potential gains and losses of the financial product. The sections included in the KID address the identification of the manufacturer and its regulator, an alert on complex products, information on the objectives, target consumers, details of any insurance benefits and terms, risk-reward profile of the product, guarantee schemes, costs, holding periods and consequences of cashing in early. The KID does not need to include information on environmental, social and engagement aspects.

[109] Good environmental profile in this context refers to the carbon footprint measured in GWP

5.6 CRITERION 6: Information appearing on the EU Ecolabel

Second proposal for criterion 6: 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:

http://ec.europa.eu/environment/EU Ecolabel/documents/logo_guidelines.pdf

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

The EU Ecolabel product:

- Invests in activities contributing to environmental objectives
- Does not invest in environmentally harmful activities
- Encourages companies to become greener

Assessment and verification

The applicant shall provide a signed declaration of compliance along with a sample of the product label or product documentation where the EU Ecolabel is placed that clearly shows the label, the registration/licence number and, where relevant, the statements that can be displayed together with the label.

5.6.1 Rational of the proposed criterion text

Information on the label is useful for reinforcing messages that endorse the consumer's choice of an EU Ecolabel product over alternatives that are not labelled. According to Article 8 (3b) of Regulation 66/2010, for each product group, three key environmental characteristics of the EU Ecolabel product may be displayed in the optional label text box. The guidelines for the use of the optional label with a text box can be found in the "guidelines for the use of the EU Ecolabel logo" available on the EU Ecolabel website.

5.6.2 Outcomes of the 1st AHWG meeting

The first proposal for a criterion on information appearing on the label aimed at reflecting improvements in the six environmental objectives of the Taxonomy Regulation is as follows:

- reduced impact on climate change;
- enhanced climate change adaptation;
- enhanced sustainable use and protection of water and marine resources;
- enhanced transition to circular economy, waste prevention and recycling;
- enhanced pollution prevention and control;
- enhanced protection of healthy ecosystems.

Additionally, a statement on respecting social principles was included along with a second one that states that the EU Ecolabel fund requires transparency in reporting environmental performance.

Stakeholders commented that the statements in the first proposal were very general and could be misleading as only climate change mitigation and adaptation will be covered by the Delegated Act adopted under the Taxonomy Regulation, at least for the year 2021 (see Annex 1, including explanation on timeline).

Stakeholders also commented that the statements should highlight the specific contribution the EU Ecolabel product will make to the environment or climate change if the retail investor decides to invest in that specific product. The stakeholders asked to be free to adapt the statements considering the characteristics of each EU Ecolabel product.

The proposal of the stakeholders has the advantage of communicating more accurately the environmental benefits of the financial products. However, it does not mean that it will be better understood by the average consumer and it does not provide harmonisation among the awarded financial products. Therefore, it is considered that the proposed statements could fit better with the purpose of communicating the environmental benefits that the investment fund can bring.

5.6.3 Further research and main changes in the second proposal

This second proposal for criterion 6 has modified the information appearing on the label by considering the 1st AHWG meeting results and the consultation process outcomes. Additionally, it altered the criterion statements to better reflect the expected improvements on environmental aspects.

Thus, criterion 6 is amended as follows:

- Instead of providing information about a broader reduction of negative impacts, criterion 6 now focuses on communicating that EU Ecolabel fund investments contribute towards climate change mitigation.
- Investments in environmentally harmful activities are avoided.
- EU Ecolabel fund investments are encouraging companies to become greener.

Considering the strong environmental dimension of the EU Ecolabel and the requirement set by Regulation 66/2010 Article 8(3b) to only reflect three main achievements on the label, it is suggested to consider only environmental information and avoid reference to social aspects and to disclosure requirements.

6 ANNEXES

6.1 Annex 1 - Taxonomy

a. Action Plan and Taxonomy Regulation

Action 1 of the Action Plan on Sustainable Finance is "establishing an EU classification system for sustainable activities" ('Taxonomy'). In May 2018, the Commission put forward a proposal for *a Regulation on the establishment of a framework to facilitate sustainable investment*[110] (hereafter the '**Taxonomy Regulation'**). In December 2018, the Council and the European Parliament reach a political agreement on the proposal.

This Regulation establishes the conditions and the framework to gradually create a unified classification system of economic activities that can be considered environmentally sustainable or 'green'. The Taxonomy itself, i.e. the **list of green economic activities**, will be adopted through delegated acts.

The Taxonomy Regulation defines environmentally sustainable ('green') economic activities as those that:

- substantially contribute to one environmental objective;
- do not significantly harm any other environmental objective;
- respect minimum social safeguards; and
- comply with technical screening criteria.

The Taxonomy Regulation empowers the Commission to adopt **Delegated Acts** containing a list of economic activities and associated **technical screening criteria** ('Taxonomy criteria'). These Taxonomy criteria would define when the relevant economic activities are considered to make a **substantial contribution** towards one objective ("substantial contribution criteria") without **significantly harming** any objective ("do no significant harm criteria" or "DNSH criteria").The **six environmental objectives** defined in the proposal are as follows:

1. climate change mitigation;
2. climate change adaptation (together the "climate objectives");
3. sustainable use and protection of water and marine resources;
4. transition to a circular economy;
5. pollution prevention and control; and
6. protection and restoration of biodiversity and ecosystems (together "objectives 3 to 6", or the "other environmental objectives").

The Taxonomy Regulation specifies a sequence in developing Taxonomy criteria. The criteria defining under what conditions economic activities substantially contribute to one of the climate objectives, including related DNSH criteria, will be developed first and adopted in Delegated Act by 31 December 2020. The Delegated Act containing Taxonomy criteria for economic activities that substantially contribute to one of the other environmental objectives will be adopted by 31 December 2021.

b. Technical Expert Group recommendations on Taxonomy criteria

In parallel to the legislative proposal, in June 2018, the Commission set up a **Technical Expert Group** on sustainable finance (TEG). One of the tasks of the TEG related to the Taxonomy and consisted of providing recommendations on the criteria for **activities contributing substantially to the climate objectives** (as per sequencing specified by the Taxonomy proposal). The TEG published its report on Taxonomy in June 2019 and opened a call for

[110] COM(2018) 353/2

feedback. Its mandate has been extended until February 2020, to integrate the responses to the call for feedback and finalise its recommendations.

c. Taxonomy criteria for activities contributing to the other four environmental objectives – Transition period

The Taxonomy proposal also requires the development of technical screening criteria for **activities contributing substantially to each of the remaining four environmental objectives.** Whilst the TEG was mandated to develop criteria for the climate-related objectives, the development of criteria for the other four objectives will be taken up by the Platform on Sustainable Finance, a body that would be established under the Taxonomy Regulation once adopted.

The Delegated Act on activities substantially contributing to the climate objectives will be adopted by 31 December 2020, and, in the first instance, the EU Ecolabel criteria will refer to it. The Delegated Act on the other environmental objectives will be adopted by 31 December 2021, after the EU Ecolabel criteria are adopted. Therefore, there will be a **transition period** (1 January 2021 to 31 December 2021) where the green investment universe relevant for the EU Ecolabel (i.e. the universe defined by the Taxonomy) will be limited to activities substantially contributing to the climate objectives. Once the other objectives are covered, this will expand the green investment universe.

6.2 Annex 2 - Comparison of the criteria between the 1st and 2nd proposals

Table 11 – Comparison of criteria structure

<table>
<tr><th></th><th>Criteria 1st proposal</th><th>Criteria 2nd proposal</th></tr>
<tr><td>Criteria area</td><td colspan="2">Thresholds on green investment portfolio</td></tr>
<tr><td>Environmental aspects</td><td>1.1 Investment portfolio greenness thresholds

The investment portfolio of the financial product shall meet the below mentioned threshold for the proportion of total portfolio asset value invested in green activities. This proportion of total portfolio asset value shall be verified based on the company economic activities related to the equities or bonds that are held and the use of proceeds of the bonds that are held.

Portfolio holdings

70% of the total portfolio asset value shall be invested in green economic activities as defined in point 1.2. All portfolio assets must be included in the total.

Assets held by the portfolio

Equities and bonds shall comply with the following thresholds:

a. Equities: At least 90% of the direct holdings (in terms of number of issuers) of the company have a turnover of at least 50% from green economic activities as defined by point 1.2

b. Bonds: At least 70% of value of all the bonds held in the portfolio shall be green and those bonds that contribute to greenness thresholds must be fully compliant with the EU GBS

Verification of greenness is not required for any other assets but they must still be included in the total portfolio asset value that must meet the portfolio threshold[111].

1.2 Green economic activities

For an economic activity within an investment portfolio to be considered green it shall meet the following requirements:</td><td>1.1 Investment funds

<u>A. Equity funds</u>

At least 60% of the total portfolio value in terms of assets under management (AuM) shall be invested in companies whose economic activities comply with the following threshold:

iii. At least 20% of AuM shall be invested in companies deriving at least 50% of their revenue from green economic activities.

iv. The remaining proportion of AuM (0-40%) shall be invested in companies deriving between 20% and 49% of their revenue from green economic activities.

The remaining proportion of the total portfolio shall consist of

• companies deriving less than 20% of their revenue from green economic activities and not excluded by criteria 2 or 3, or

• other assets or cash.

<u>B. Bond funds</u>

At least 70% of the total portfolio asset value shall be invested in bonds that comply with the EU GBS.

If the bond fund comprises sovereign and sub-sovereign bonds, these shall not be excluded by criteria 2.2.

<u>C. Mixed funds</u>

For mixed funds, the equity part shall comply with the requirement for equity funds in (A), and the bond part shall comply with the requirement for bond funds in (B).</td></tr>
</table>

[111] Other assets may include as an example, derivatives or money held as cash.

	(a) It shall contribute substantially to at least one of the EU Taxonomy's Environmental Objectives, for which technical screening criteria are available: (i) climate change mitigation, (ii) climate change adaptation, (iii) sustainable use and protection of water and marine resources, (iv) transition to a circular economy, waste prevention and recycling; (v) pollution prevention and control and (vi) protection of healthy ecosystems, (b) while not significantly harming any of the other objectives, and (c) it shall comply with the minimum social safeguards represented by the principles and rights set out in the eight fundamental conventions identified in the International Labour Organisation's declaration on Fundamental Rights and Principles at Work [112] **Assessment and verification** The applicant shall provide the following documentation showing the minimum percentage to be invested in green activities: - the green investment policy of the applicant, - portfolio statement and prospectus including: a) complete listing of the portfolio assets for the financial product, and b) evidence that at least 70% of the listed portfolio assets are invested in green activities, c) an audit report on the latest annual financial statements. EU GBS certificates shall be accepted as proof of compliance to criterion 1.	**<u>D. Funds of funds (FoFs)</u>** For funds of funds (FoFs), at least 90% of the AuM shall be invested in funds that have been awarded the EU Ecolabel. **<u>E. Feeder funds</u>** Feeder funds shall have a master fund that has been awarded the EU Ecolabel[113]. **<u>Derivatives</u>** A UCITS or Retail AIF may invest in derivatives according to its investment objectives. The use of derivatives shall be in line with the funds environmental investment policy. The use of derivatives shall be restricted to the following situations: • *<u>Hedging:</u>* Derivatives may be used for hedging purposes with regard to currency risk, duration risk, market risk or/and sensitivity to changes in interest rate structures. • *<u>Exposure:</u>* The use of derivatives to increase exposure to the underlying assets shall be temporary and respond to significant subscriptions. The management company shall explain in the fund's periodical reports how it proceeds and, in particular, to illustrate the temporary nature of the use of derivatives for exposure purposes. The underlying assets shall comply with EU Ecolabel criteria, including on environmental and social exclusions as well as consumer information. Derivatives shall not be used for the short selling of securities. **<u>Other assets</u>** Other assets[114] shall be counted in the total portfolio, when assessing compliance with the portfolio threshold in terms of AuM.

112 The scope of the social safeguards under the EU Taxonomy may be expanded to include other references such as the OECD Guidelines for Multinational Enterprises and UN Guiding Principles on Business and Human Rights.

113 The feeder fund shall comply with the same requirements as other funds (stand-alone funds).

114 Other assets may include as an example, derivatives or money held as cash.

		Assessment and verification **A. Equity funds** The applicant shall provide: i. documentation showing that the monthly averages for the 12 months preceding the application for the EU Ecolabel comply with the portfolio composition requirements for equity funds or pre-contractual information and portfolio statement and prospectus including: • complete listing of the portfolio assets, and • evidence that the fund complies with the respective minimum percentages for the equity fund and bond funds as specified in A and B. ii. An audit report on the latest annual financial statement. **B. Bonds funds** The applicant shall provide the following: • documentation showing that at least 70% of the total portfolio asset value complies with the EU GBS, based on the monthly averages for the 12 months preceding the application for the EU Ecolabel and, • the EU GBS certificates for the bond funds as proof of projects financing in green economic activities **C. Mixed funds** The applicant shall provide documentation showing that the fund complies with the respective minimum percentages for the equity and bond shares as specified in A and B of this section, based on monthly averages for the 12 months preceding the application for the EU Ecolabel. **D. Fund of funds (FoFs)** The applicant shall provide the portfolio statement and prospectus indicating that: • at least 90% of FoFs have been invested in funds already awarded the EU Ecolabel. **E. Feeder funds** The applicant shall provide the portfolio statement and prospectus indicating the following:

		• portfolio's composition showing that the underlying fund has been awarded the EU Ecolabel **<u>Derivatives</u>** The applicant shall provide the following documentation on the derivatives included in the funds: • The investment or management policy governing the use of derivatives and outlining clearly how the derivatives are to be applied including information about the counterparty. • A statement on the strategy applied addressing how the use of derivatives is in line with the fund environmental policy and how the derivatives comply with the EU Ecolabel criteria, including on environmental and social exclusions. • -A listing of the types of derivatives and other assets used during the last 12 months preceding the application for the EU Ecolabel, including their nature, average total amount invested (i.e. share of the portfolio) and their average duration/frequency of use shall be demonstrated. • For OTC derivatives, compliance with the EU Ecolabel criteria on environmental and social exclusions, and consumer information on all of the counterparties used over the last 12 months preceding the application for the EU Ecolabel. **1.2 Unit-linked insurance products** Unit-linked insurance products consisting of a UCITS or Retail AIF shall, on a look-through basis, comply with the requirements set out in sub-criterion 1.1 for investment funds for equities in A. for the equity share, and for bonds in B. for the bond part. Where the unit-linked insurance product consists of several UCITS and/or Retail AIFs, the requirements for equities and bonds shall apply at the level of the sum total, over all relevant UCITS and/or Retail AIFs, of the values of the equity shares and bond parts, respectively. **<u>Assessment and verification</u>** The applicant shall provide documentation showing that the monthly averages for the 12 months preceding the application for the EU Ecolabel request comply with the respective minimum percentages for the equity and bond shares as specified in A and B assets in sub-criterion 1.1.

		1.3. Green fixed-term and savings deposit accounts **Requirement 1. Green loan to deposit ratio** At least 70% of the value of the total deposits shall be used to make green loans and/or to invest in green bonds. The value of both the loans and the deposits shall be calculated based on the annual average for the time that the product has been on the market. For new products the target ratio shall be stated and after a minimum of one year on the market. The licence-holder shall declare the ratio achieved to the Competent Body. **Requirement 2. Green loans made using the deposited money** Loans contributing to the green loan to deposit ratio shall only be granted to green economic activities. The applicant shall provide annual updates on the implementation status of the funded projects or activity. The list of projects and green economic activities funded shall be disclosed in a dedicated EU Ecolabel report to be provided to the retail customer and/or a dedicated web-based portal to which retail customers will be provided access. **Requirement 3. Internal ring fencing of the deposited money** The money held in deposit and granted as loans shall be strictly ring fenced within the accounts of the Credit Institution. The structural solution and/or internal procedures used shall allow for the traceability of the each retail customer's deposited money and their contribution to the total value of the green loans granted. **Assessment and verification** The applicant shall provide on an annual basis an itemised list of the green loans approved for projects and activities. The value and type of projects and/or green economic activities funded shall be identified for each loan. This listing shall be provided and/or updated year on year. The applicant shall provide a declaration that the green loans list is in compliance with the EU Taxonomy requirements for green economic activities. Competent Bodies reserve the right to select projects at random from a loans list for verification purposes. The applicant shall provide a set of declarations and supporting information to

		verify the declared loan to deposit ratio and to ensure that is traceable and transparent. They shall comprise the following: v. The total value of the deposits derived from individual values marked and entered into the Single Customer View (SCV) for the specific product. vi. The value of each green loans and bonds granted using the deposited money. This shall be recorded and declared together with the total value of the green loans and bonds for each year. vii. The internal procedures and/or structures used to ring fence the funds and how they allow for the traceability of the deposited money shall be described. This could be supported by an auditors' qualification of the effectiveness of the procedure which may be included in the annual report of the credit institution. viii. The value of the deposits and green loans related to the product shall be reported annually in a dedicated EU Ecolabel report to be provided to the retail customer, to also be reflected as itemised entries on the balance sheet in the annual report of the Credit Institution, with each entry to be clearly marked as EU Ecolabel-verified deposited money.

<table>
<tr><td>Criteria area</td><td colspan="2">Environmental Exclusions</td></tr>
<tr><td></td>
<td>
Excluded activities – Environmental aspects

Companies that derive their revenue from the following activities shall be excluded from investment portfolios.

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.

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 environnemental protection
Internationally funded projects that could damage valuable and /or protected natural areas

<u>Please note:</u> The environmental exclusions included within this proposal are solely for the purpose of discussion with stakeholders and are to be further checked for their applicability and consistency.

Moreover, the exclusions will need to be further checked against the EU
</td>
<td>
2.1 Exclusions relating to economic activities

The investment portfolio shall not contain equities or corporate bonds issued by companies that derive a certain share of their revenue from the excluded activities listed. These exclusions shall also apply to the activities funded by loans but not to use-of-proceeds bonds.

These exclusions shall apply to the economic activities of each company in which equity investments and corporate bonds are held within an investment portfolio. In the case of green loans, the activities shall not be funded.

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 [115]
The development, distribution and cultivation for food or feed of genetically modified varieties of plants that have not passed a risk assessment carried out according to the criteria in Annex II of Regulation EN 503/2013 or equivalent.
Production of agricultural products, including vegetable oils, on land obtained as a result of a 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 is excluded if the economic operator cannot 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 [116], or
That the harvest is not from the clear felling or unsustainable

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</table>

[115] UNEP and FAO, *Annex III Chemicals*, the Rotterdam Convention http://www.pic.int/TheConvention/Chemicals/AnnexIIIChemicals/tabid/1132/language/en-US/Default.aspx

[116] Third party forest and forest products certification systems that meet the due diligence criteria set out in Article 6 of the Regulation may therefore be used as a tool within a due diligence system.

	taxonomy to ensure there are no contradictions with the logic of how it is designed. **<u>Assessment and verification</u>** The applicant shall provide the investment policy, investment portfolio and the allocation of proceeds to the Competent Body to support compliance with the environmental exclusions list as provided by the EU Ecolabel scheme and with the 5% threshold. Next to the initial verification, monitoring activities, shall be internally performed at least once per year and communicated to the Competent Body who also retains the right to make random checks on compliance.	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, with exceptions to support the transition to a low carbon economy in sub-criterion 2.1.2. *Waste management* – Waste management facilities and services that do not operate any form of material segregation for the purposes of preparation for re-use, 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 [54] – 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 *2.1.2 Exclusionary requirements to support a transition to a low carbon economy* *Transportation* Tailpipe emissions limits shall apply to the production, distribution and sale of new passenger cars and light commercial vehicles:

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- *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 CO_2/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 CO_2 emissions target.

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 loan 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.

2.2 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 of 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) – 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 – The Stockholm Convention on Persistent Organic Pollutants **Assessment and verification** The sovereigns and sub-sovereigns issuers of which bonds are held shall be identified. The applicant shall then provide a declaration of compliance for the fund or deposit account. For sub-sovereigns 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 who also retains the right to make random checks on compliance.

Criteria area	Exclusions based on social aspects/issues and governance practices	
	Social and Ethical related exclusions Investments made by the portfolio management shall not be made in activities that are in conflict with the following social and ethical exclusions: - Contraventions of the ILO's eight fundamental labour conventions and the United Nations Global Compact's' Principles on Human rights and Labour' - Tobacco production at any stage from raw material to final products for consumers - The production of weapons These exclusions shall apply to all activities within an investment portfolio. 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: - The use of controversial weapons - A corruption index reported to be less than 50 - Non ratification of international conventions on social and ethical matters e.g. ILO conventions - Country is subject to EU or UN financial sanctions for special social or ethical violations **<u>Assessment and verification</u>** The applicant shall provide the investment policy, investment portfolio and the allocation of proceeds to the Competent Body to support compliance. Next to the initial verification, monitoring activities, at least one per year, shall be internally performed and communicated to the Competent Body who shall also reserve the right for periodical or random assessments of compliance. Random checks of compliance can be set up considering the relevance of the investment.	**3.1 Exclusions applying to companies** The investment portfolio shall not contain equities, corporate bonds or use-of-proceeds bonds issued by companies excluded on the basis of social aspects or corporate governance practices as defined below. For fixed-term and savings deposit accounts, loans shall not be made to these companies. These exclusions shall apply to the economic activities of each company in which equity investments and corporate bonds are held within an investment portfolio. In the case of green loans, the activities shall not be funded. The investment portfolio shall exclude companies if they, through their business activities, do not: – Respect[117] the protection of internationally proclaimed human rights and relevant domestic laws and regulations of the country in which they operate and from which they source raw materials [UN Global Compact, OECD Guidelines for Multinational Enterprises] – Ensure they are not complicit in human rights abuses [UN Global Compact] – Uphold the freedom of association and the effective recognition of the right to collective bargaining [ILO Convention, UN Global Compact]] – Ensure the elimination of all forms of forced and compulsory labour [ILO Convention, UN Global Compact] – Uphold the effective abolition of child labour [ILO Convention, UN Global Compact] – Ensure the elimination of discrimination in respect of employment and occupation [ILO Convention, UN Global Compact] – Abide by local legislation that addresses corruption, bribery and extortion, and work against corruption in all its forms, including extortion and bribery by formulating and operationalising adequate business policies [UN Global Compact, UN Convention against Corruption] Moreover, companies that derive their revenues from following activities shall be excluded from the investment portfolio

[117] Respect in this context means: Companies should avoid causing or contributing to adverse human rights impacts through their own activities, and address such impacts when they occur. It also means that companies should seek to prevent or mitigate adverse human rights impacts directly linked to their operations, products or services by their business relations, even if they have not contributed to those impacts.

- Tobacco production or any tobacco-related activities at any stage from raw material to sale of the final products to consumers
- The production and trade of weapons
- Production or trade of any printed or digital material with pornographic content
- Corporate activities which violate minorities and indigenous communities' rights with reference to the World Bank's Social Safeguard Policies.

Companies shall also be excluded from the investment portfolio, if they, throughout their business activities, do not have in place:

- corporate policies on social aspects and operational procedures necessary to embed compliance throughout the business activities
- an up-to-date management system covering all business activities with the capability to identify, evaluate, prevent, mitigate and remediate existing adverse impacts or potential risks on social aspects.
- good corporate governance practices.

At a company level exclusions apply to both transnational and other business enterprises, regardless of their size, sector, location, ownership and structure.

3.2 Exclusions applied to countries

The product shall exclude investments in sovereign bonds issued by countries that

- Have not ratified the following international conventions on labour rights and corruption:
    - The eight fundamental conventions identified in the International Labour
      Organisation's declaration on Fundamental Rights and Principles at Work
    - ILO Declaration on Social Justice for a Fair Globalization
- Have ratified less than half of the 18 Core International Human Rights Treaties[118].
- Are subject to EU or UN financial sanctions for special social violations

[118] United Nations. T*he Core International Human Rights Treaties and their monitoring bodies*. Oct 2019, https://www.ohchr.org/EN/ProfessionalInterest/Pages/CoreInstruments.aspx. Compliance can be checked using the United Nations Human Rights interactive dashboard, available at: https://indicators.ohchr.org/

- Achieve a score worse than 38, when evaluated according to the Corruption Perception Index
- Produce, trade or possess controversial weapons that are subject to EU or international restrictions, including non-ratification of
  - Chemical Weapons Convention,
  - Biological Weapons Convention,
  - Ottawa Convention (Ban on Anti-Personnel Mines),
  - Oslo Convention on Cluster Munition and Arms Trade Treaty)
  - and the Non-Proliferation of Nuclear Weapons

<u>Assessment and verification</u>

The fund manager shall demonstrate, with respect to companies in which investments are held and/or the issuers of sovereign debt that is held, to the Competent Body that followings are assessed

- Excluded activities: The status of each country and company shall be checked against the exclusions list. :
- Compliance of corporate policies on social aspects with social exclusions
- Compliance of risk identification, evaluation, prevention, mitigation and remediation targets, as included in the management system, with corporate policies on social aspects
- Compliance of good management practises to Corporate Governance (CoGo) codes and standards

For use-of-proceeds bonds the EU GBS may be used as proof of compliance.

For large companies, reporting under the non-financial reporting directive 2014/95/EU[119] shall be accepted as basis for verification. Small and Medium Enterprises (SMEs) shall disclose information about their social responsibility, human and labour rights and their anti-corruption policies, approved at the most senior management level.

Further to the initial verification by the Competent Body, the fund manager shall carry out assessment on compliance with social exclusions at least once per year and communicate any inconsistencies to the Competent Body. Furthermore, the Competent Body retains the right to perform random checks on compliance.

[119] Directive 2014/95/EU of the European Parliament and of the Council. Available at https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0095&from=EN

Criteria area	Engagement	
		The fund manager shall have a documented engagement policy describing at least: 1. clearly identified key environmental issues on which to engage with companies 2. the method and reasons for selecting companies and specific key issues on which to engage 3. submission and voting of resolutions at AGM to address these issues 4. regular monitoring and evaluation of companies and the achievement of specific environmental outcomes The fund manager shall engage regularly with at least half of the companies that have less than 50% of green activities. Engagement should include voting at general assemblies and other related actions such as communication and dialogue with the company and other shareholders/stakeholders (to push a climate resolution, for instance), with a clearly stated aim of improving the environmental performance of the company, notably to encourage companies to: - upgrade, improve the quality (from environmental/social point of view) or change their existing economic activities to make them compliant with TEG Taxonomy criteria, - expand their existing economic activities that are already TEG Taxonomy-compliant. - reduce and stop economic activities that are not TEG Taxonomy-compliant by selling or closing those activities. - Measure and assess the impact on the environment of their activities and changes their behaviour with respect to

		environmental issues; – take steps to respond to shareholders/stakeholders engagement with respect to the companies' environmental and social strategies The fund manager shall set specific key topics raised via engagement with the companies in planning actions in terms of environmental strategies and green activities within a specific period of time, failing which the fund manager may decide to sell [some of the] shares from the company [or reconsider inclusion of the company within the fund] **Assessment and verification** the fund manager applying for the EU Ecolabel shall provide to the verifier the following information: 1. Evidence showing the percentage of companies with which the manager has engaged 2. Specific key environmental topics raised via engagement 3. Voting behaviour in compliance with the engagement policy 4. Use of other engagement mechanisms with the companies, such as evidence of a constructive company dialogue developing a business case for change and keeping up a good level of interaction with companies. 5. Other engagement practices with other shareholders/stakeholders (e.g. cooperating with other shareholders to push a specific climate resolution.

Criteria area	Retail investor information	
	Consumer Information The following information shall be provided by the applicant fund to the consumers on an annual basis: 11. Investor information and investment policy which shall detail the following: – the methodology for computing the portion of turnover in accordance with Criterion 2. – its environmental objectives of the portfolio – the financial objectives[120] 12. Information on corporate activities and governance structures of the company managing the portfolio detailing how social and ethical issues are managed 13. Information on management and internal control procedures which detail a monitoring mechanism for addressing the potential risks of excluded activities in the investment portfolio. **Assessment and verification** The applicant fund shall provide the latest annual reports and or documentation to the Competent Body: the green investment policy of the applicant, portfolio statement and prospectus including complete listing of the portfolio assets for the financial product and management and internal control procedures for ensuring compliance to non-financial performance indicators.	**Retail investor information** **5.1 Equity, bonds and mixed funds** As a minimum the following information shall be made available annually by the fund manager to the consumers: – Information about the percentage of the total portfolio value in terms of assets under management (AuM) invested in companies whose economic activities comply with the requirements of criterion 1, i.e.: o share of AUM in shares of companies with >50% green activities; o share of AUM in shares of companies with 20%<x<50% green activities; o share of AUM invested in green bonds; o share of AUM going (indirectly) to green activities. – Information on how the fund manager actively engages with companies on sustainability issues. – Information about the type of exclusions considered. In the case of environmental exclusions, the applicant shall specify if they are total or partial exclusions, and report the percentage. – Information the main principles for the selection of the companies. – An electronic link to the full annual report described below. Where the financial product is required to publish a prospectus, key investor information document (KIID) or key information document (KID) in accordance with the European or national laws, only such information which is in addition to that contained in the above mentioned documents needs to be disclosed separately or as additional information in the prospectus, KIID or KID.

[120] The financial objectives could be indicated in the form of e.g, risk reduction policies, etc

		At least annually, the financial product manager shall issue a report to be uploaded on the financial product's manager website describing the environmental, social and engagement aspects as well as the activities and performance of the financial product. The report shall be published on the fund manager's website. The report shall include at least: – A description of the green economic activities where the financial product invested in during the reporting period, including the investment policy and how the companies are selected – A description of the main engagement activities (including voting and cooperating with other shareholders) and results within companies. – A description of the methodology used for estimating the most relevant indicator (e.g. carbon footprint (GWP)) of the financial product and of the financial benchmark product. In the case, GWP is the most relevant indicator, this description shall include the scope of GHG emission covered. Additionally, the rational for choosing the selected indicator and why it is relevant for the financial product shall be also included. – The report shall include the engagement policy followed by the fund manager or an electronic link to it. – Information on management and internal control procedures to identify and correct any non-compliance with EU Ecolabel criteria **5.2 Sovereign bonds (*where held)*** At least the following information shall be made annually available by the deposit manager to the consumers: - A climate or environmental risk rating for each sovereign issuer for which bonds are held. **5.3 Deposit accounts** At least the following information shall be made annually available by the deposit manager to the consumers: – itemised list of projects and green economic activities for which

		loans have been approved, including their value – Electronic link to an annual report that at least includes: details on the projects to which loans have been granted, the lifetime of the projects or green economic activities and their implementation status and the deposit account balance sheet. In the case of any observed deviations from any the following: – Changes in the methodology of computing the portfolio – Changes in the objectives / investment policy of the awarded fund – Relevant changes in the investment portfolio. the fund manager shall without delay communicate and publish the updated information and/or the updated report. **5.4 Monitoring** The consumer information should be updated regularly and therefore be based on a regular monitoring of the portfolio **<u>Assessment and verification</u>** The applicant shall provide a sample of the information to be provided to the consumers that clearly complies with the requirements of the criterion. The information can be added on the prospectus, KID or KIID or be provided as a separate information brochure.
Criteria area	**Information appearing on the EU Ecolabel**	
	Information appearing on the EU Ecolabel The logo should be visible and legible. The EU Ecolabel registration/licence number shall appear on the brochure/document of the retail financial product and shall be legible and clearly visible. The applicant may choose to include an optional text box on the label that may contain wording selected from the following (maximum three statements): • A statement or statements reflecting the environmental objectives for the greenness of the product selected from the following: 1. reduced impact on climate change	**6. 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: http://ec.europa.eu/environment/EU Ecolabel/documents/logo_guidelines.pdf If the optional label with text box is used, it shall contain the following statements: The EU Ecolabel product: – Invests in activities contributing to environmental objectives

	2. enhanced climate change adaptation 3. enhanced sustainable use and protection of water and marine resources 4. enhanced transition to circular economy, waste prevention and recycling 5. enhanced pollution prevention and control 6. enhanced protection of healthy ecosystems. • Respects social and ethical principles • Transparent reporting on environmental performance **Assessment and verification** The applicant shall provide a signed declaration of compliance along with a sample of the product label or product documentation where the EU Ecolabel is placed.	– Does not invest in environmentally harmful activities – Encourages companies to become greener **Assessment and verification** The applicant shall provide a signed declaration of compliance along with a sample of the product label or product documentation where the EU Ecolabel is placed that clearly shows the label, the registration/licence number and, where relevant, the statements that can be displayed together with the label.

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