

Swiss Sustainable Finance consultation response to Joint Research Center (JRC) Technical Report: Development of EU Ecolabel criteria for Retail Financial Products

1. Introduction and background

As part of the EU Action Plan on Sustainable Finance, the commission sets out to “**explore the use of the EU Ecolabel framework for certain financial products**, to be applied once the EU sustainability taxonomy is adopted”. The EU Ecolabel, established in 1992, is a label of environmental excellence that is awarded to products and services. Detailed EU Ecolabel criteria provide guidelines for awarding such a label.

Applying an Ecolabel to financial products is anticipated to have three main benefits:

- Unified labelling criteria at EU level
- Encourage investments in the sustainable economic activities of the EU Taxonomy
- Enhanced transparency and greater investors’ confidence in the market

Details on how financial offerings will be eligible for this label can be found in the [Second Technical Report](#).

The EU Ecolabel Regulation permits the label to be awarded to "goods and services" (together "products"). Financial products were determined to be considered as services for distribution or use. The Commission, therefore, initiated the policy-making process towards **the development and implementation of EU Ecolabel criteria for PRIIPs (packaged retail and insurance-based investment products) and other financial products addressed to retail investors.**

[The Second Technical Report](#) (published in December 2019) provides an update to the First Technical Report (published in March 2019), based on stakeholder input. It is currently under review and stakeholders can participate in the open consultation process until 3 April 2020. Hence, SSF has drafted a response to the consultation and will submit it to the commission. We encourage our network to send us any feedback, including any documentation to support your arguments.

Timeline for feedback

18 March 2020	Deadline for SSF members/partners to provide input
3 April 2020	SSF delivers feedback to EU

2. Summary of eligible products and criteria for EU Ecolabel

Products

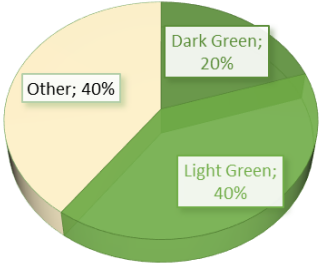
It is our understanding that the EU Ecolabel criteria for Retail Financial Products can be applied to the following, granted that the retail financial product is registered or authorised for marketing or distribution in a member State of the European Union:

- 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 includes:
 - Equity, bond and mixed investment funds, to include those referred to as UCITS and, where applicable, 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.

Criteria

It is our understanding that the EU Ecolabel will be awarded based on a list of **five mandatory criteria and one optional criterion** (EU Ecolabel information). We have summarized the most important aspects of the criteria below. Please refer to the full report for the complete list of requirements.

<p>Criteria 1 Mandatory</p>	<p>Portfolio composition, in particular in terms of green economic activities (as defined by the EU Taxonomy)</p> <p>For each type of accepted retail product, the report outlines the acceptable composition. We show here an example of an Equity fund as we feel this will be the most relevant instrument.</p> <p><i>Example Equity fund (see figure below): An equity fund can be awarded the EU Ecolabel if, at a minimum, at least 60% of the total portfolio value in terms of AuM are invested in companies whose economic activities comply with the following thresholds:</i></p> <ul style="list-style-type: none"> • <i>at least 20% AuM invested in companies deriving at least 50% of their revenue from green economic activities (Dark green)</i> • <i>The remaining proportion of AuM (0-40%) is invested in companies deriving between 20-49% of their revenue from green economic activities (Light green)</i> • <i>The remaining proportion of the total portfolio can consist of companies deriving less than 20% of their revenue from green economic activities and/or other assets or cash</i> • <i>Criteria 2-5 must still be met</i>
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	<p style="text-align: center;">EXAMPLE OF MINIMUM COMPLIANT EU ECOLABEL EQUITY FUND (IN % TOTAL PORTFOLIO VALUE)</p>  <table border="1" style="margin-left: auto; margin-right: auto;"> <thead> <tr> <th>Category</th> <th>Percentage</th> </tr> </thead> <tbody> <tr> <td>Dark Green</td> <td>20%</td> </tr> <tr> <td>Light Green</td> <td>40%</td> </tr> <tr> <td>Other</td> <td>40%</td> </tr> </tbody> </table>	Category	Percentage	Dark Green	20%	Light Green	40%	Other	40%
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Dark Green	20%								
Light Green	40%								
Other	40%								
<p>Criteria 2 Mandatory</p>	<p>Exclusions based on environmental aspects:</p> <p>The investment portfolio shall not contain equities or corporate bonds issued by companies that derive more than 5% of their revenue from the defined excluded activities. Examples of such activities can be found starting on page 49 of the second technical report and include activities in the fields of agriculture, forestry, energy, waste management, manufacturing and transportation, for example:</p> <ul style="list-style-type: none"> • 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. • Production of agricultural products using water for irrigation in areas where there is severe water scarcity. • Timber production and exploitation, unless the economic operator can demonstrate adhering to certain standards. • Solid, liquid and gaseous fossil fuel exploration, extraction and refining for fuel. This includes unconventional sources such as hydraulic fracking and shale deposits. • Production, distribution and sale of new passenger cars and light commercial vehicles, unless the company undertaking the activity complies with certain requirements. 								
<p>Criteria 3 Mandatory</p>	<p>Exclusions based on social aspects and corporate governance practices:</p> <p>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 starting on page 73 of the second technical report. These include for example:</p> <ul style="list-style-type: none"> • Exclusions based on violations of international treaties on human rights such as ILO Convention, UN Global Compact • Exclusions based on a company’s involvement in the tobacco, weapons or pornography industries • Exclusions based on a company’s poor corporate governance policy 								
<p>Criteria 4 Mandatory</p>	<p>Engagement</p> <ul style="list-style-type: none"> • The fund manager shall have a documented engagement policy describing engagement issues, their engagement methods, their voting activity and their monitoring and evaluation process. 								

	<ul style="list-style-type: none"> • The fund manager shall engage regularly with at least half of the companies that have less than 50% green activities. • 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).
Criteria 5 Mandatory	Information for retail investors <ul style="list-style-type: none"> • Information about how the fund complies with criteria 1-4 shall be made available annually by the fund manager to the consumers: • 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.
Criteria 6 Optional	Information appearing on the EU Ecolabel: If the applicant chooses to communicate about an awarded label, the applicant shall follow the instructions on how to properly use the EU Ecolabel logo provided in the EU Ecolabel Logo Guidelines.

The full details of how each of these six criteria are defined can be found in section 5 (starting on page 32) of [The Second Technical Report](#).

3. SSF feedback on Second Technical Report

General Comment

SSF commends the work done so far to attempt to bring more transparency and alignment to “green” investment products offered to retail investors. We however acknowledge that the EU Ecolabel has a very narrow scope and only a very small portion of retail products will be able to meet the specified criteria. We expect that mostly the so-called Thematic Funds focused on green activities will meet the eligibility criteria for such a label. Such thematic funds only make up a small portion of the overall sustainable investment market. It is therefore important to ensure that investors are made aware that an EU Eco-labelled fund is not the only option for one to achieve a “greener” investment. Many of the other types of sustainable investment products can also help reach certain goals (i.e. mainstream funds with structured engagement processes aiming to improve the environmental practices of large multinationals, e.g. through climate action 100+). Therefore, from our perspective, a focus should be put on increased transparency on sustainability/impact of financial products for the investors. The proposed label is also extremely dependent on data availability of, not just green activities, but also of the proposed exclusion activities.

Comments on Eligible Products (section 3)

It is our understanding that in addition to the services listed above, the commission is also evaluating the inclusion of 3rd pillar pension products. We agree that products offered for 3rd pillar type personal pension products should be included within this framework. We therefore support further investigation. The argument outlining that these only represent a small market share (Page 13) is not really valid from our perspective, as in general, retail investments are also quite small in proportion compared to all institutional investments, and therefore one could also argue to exclude all retail investments if you argue on market size.

Comments on Verification (section 4.3)

We acknowledge that there may arise issues with the value chain of the verification process. There is thus far a lack of transparency on who will evaluate the share of green activities of companies and funds. Will this be performed by country specific bodies? If so, how can one ensure unified views across all verifying bodies? Additionally, how transparent will the verification bodies be with respect to how they assess what is compliant or not?

Comments related to elements within the specified Criteria

- Concerning criterion 1 on Portfolio composition, in particular in terms of green economic activities (section 5.1):
 - The technical report of the EU Ecolabel requires all investment funds to demonstrate compliance with the requirements for a period of 12 months before application. Such a conversion period is common for physical products such as those related to organic farming, for example. In our view, however, this does not make any discernible sense in the case of financial products, as a “green” strategy can be launched or applied to an existing fund in a very short time, if necessary. Such a conversion period would only delay the application of the Ecolabel.
- Concerning criterion 2 on Exclusions based on environmental aspects (section 5.2):
 - Many of the listed exclusions for this criteria have not been typically used in the sustainable investment industry. Therefore, we would find it helpful if it was indicated from where such data could be obtained.
 - SSF members expressed the need to remove as much room for judgement as possible. Therefore, they call for clear yes/no exclusion criteria. For example, it might be quite difficult to allocate a pass/fail, depending on the data source, for “Production of agricultural products using water for irrigation in areas where there is severe water scarcity.”
- Concerning criterion 3 on Exclusions based on social and governance aspects (section 5.3):
 - Defining exclusion criteria is only the first step. When it comes down to finding the data and selecting which companies are actually involved in controversial activities and at which level (i.e. production, distribution, indirectly through supply of services/products), investors can have varying conclusions. In order for such a label to be successful, we therefore recommend some more guidance for investors on the exact depth of exclusions and if there are any “supply chain” considerations that should be made.
 - In addition, what will happen in cases where a company violated an international treaty, but has since taken measures to correct this? What will be the rules used to determine

- when companies can again be considered eligible? These should be clarified in order for investors to be able to anticipate how they will need to adjust portfolios.
- SSF members expressed the need to remove as much room for judgement as possible. Therefore, they call for clear yes/no exclusion criteria. For example, it might be quite difficult to allocate a pass/fail, depending on the data source, for “Production or trade of any printed or digital material with pornographic content.”
 - Concerning criterion 4 on Engagement (section 5.4):
 - We question the need for an engagement strategy if a considerable share (e.g. 75%) of the portfolio is invested in companies with over 50% of their revenues coming from green activities. We believe it is too strong a burden on portfolio managers who are already putting in the effort to develop and manage portfolios that have a strong tilt towards green activities compared to the overall markets.
 - In addition, not all investments that are over 50% “non-green” can be considered “bad investments” (i.e. pharma, food/beverage). The message to investors seems to be that all non 50% green investments are not good businesses, however, there may be quite a few companies that can be considered neutral and hence covering these companies through engagement would not be a necessity.

Conclusion

As an organisation concerned with promoting the use of sustainability factors for financial decisions, over the years, we have seen that there is a call for more transparency related to sustainability products. We see the Ecolabel as a valuable tool to bring transparency to the niche products which heavily invest in EU taxonomy compliant green activities. Yet, we think it is important that this greener segment of the market is not burdened too much with excessive reporting requirements that absorb a lot of resources and are difficult to prepare– in light of the limited reporting by companies.

Furthermore, we also see a danger that, based on the label, investors consider thematic green investments as the only way to contribute to a greener economy, if only those products are eligible for a green label. Other funds that invest into a broad mix of sectors and thereby focus on more sustainable companies or engage with them to improve their sustainability, may have an equally strong effect on the real economy and help align the economy to the goals of the Paris-Agreement and the SDGs. We think it is important that the EU clearly states that there are other forms of investing green.

Also, we think it is key that asset managers clearly state that the label does not express any assessment of the financial performance of funds, but is purely based on environmental criteria.

4. Further information

Links to important documents

Documents linked to the consultation can be found at:

https://susproc.jrc.ec.europa.eu/Financial_products/documents.html

Zurich, 31 March 2020