Ecolabel technical report 3.0

The positions of Finance Denmark

FINANS DANMARK

Notat

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General comments and overall positions

The Ecolabel report 3.0 was released in October 2020 by the EU Joint Research Centre (JRC). This is the third and last version. The final report will be updated based on input from the EU Ecolabelling Board (EUEB) meeting and the written stakeholder consultation with deadline on the 11 of December 2020. The positions of Finance Denmark in this note will constitute the input for the written stakeholder consultation on behalf of the Danish Banks and Asset Managers.

Finance Denmark welcomes the objectives of the Ecolabelling of financial products, appreciates the great efforts taken to include the proposed amendments from the second draft version to this third one, and thanks for the opportunity to comment on this report.

The EU Ecolabel has great potential in facilitating environmentally sustainable investments and projects to retail clients and thereby unlocking finance from the retail investor segment to finance the green transition of the European economy.

To achieve the overall objectives of the EU Ecolabel the criteria and framework still needs calibration. We highly welcome the changes made in the limits of criterion 1 for funds since the criteria must allow for a sufficiently large pool of investable assets which was not the case in the second version of the report. This was proven in the Commission report from June 2020 testing 101 green labeled UCITS funds by the Commission. It is highly important to strike the right balance here for two reasons that are interdependent. Firstly, to leave room for diversification and thereby optimal allocation and risk disbursement for end-investors. Secondly, for the Ecolabel brand to reach a significant market share and branding value. These are crucial elements, if the Ecolabel is to capture market share and thereby contribute significantly to the transition of the economy.

We highly support the changes made for measuring green activity for equity, since including green transition (CapEx) and green growth will impose much more balanced asset management incentives and ensure a forward looking approach, offering retail investors a portfolio that both invests in current green economic activities and that commits to future growth in green revenue, contributing to the transition towards a low carbon economy.

Whether the new limits and measurement strikes the right balance is difficult to validate, however, we will continue to underline that it is crucial not to launch the Ecolabel on financial products with too strict limits and requirements. It is better to start with rather wide limits and then tighten requirements over time, since branding value has been established. We would therefore suggest setting a firm date for the first revision of the Ecolabel criteria and provide clarity on the future governance for revisions of the EU Ecolabel for retail financial product. We would also urge the Commission to decide upon updates at regular intervals to provide transparency and predictability to the market.

Despite the amendments in report 3.0 the exclusions are still rather restrictive, and report 3.0 comes with added requirements on assessment, verification and reporting. We would suggest that these added administrative requirements are imposed with great consideration. It would be very unfortunate, if the costs associated with the Ecolabel makes the label unmarketable towards retail investors.

We would strongly advise that regulators are mindful of the fact that ESG legislation needs to be consistent across product regulation, labels, regulation governing distribution and disclosure. In our opinion this means that there must be consistency between the EU Taxonomy, NFRD, the Ecolabel, the Disclosure Regulation and MiFID ESG implementation. In this regard, we would suggest that Ecolabel products by definition should be considered article 9 products according to the Disclosure Regulation and thereby distributed to retail clients with ESG preferences according to MiFID. A situation where and Ecolabel product is not an article 9 product would not work in a practical world where regulation and processes are interdependent.

As previously stated ESG data are not available on a sufficient number of companies and these are not going to be available near-term. The Non-Financial Reporting Directive (NFRD) is the legislative solution to solve this but much uncertainty remains on availability of data in the near and distant future.

Scope and usage

We support the amendments in the scope and the specific mentioning of the ELTIF. It is our hope that the review of ELTIF will channel green and sustainable less liquid retail investments though ELTIF in the future, whereby the ELTIF should be within the scope of the Ecolabel.

We also support the scoping of green savings and deposit accounts since they have the potential to enable more retail savers to channel significant funds towards green projects. However, there are still significant practical and operational challenges to solve in order to honor the rather complicated and highly costly governance processes suggested around green savings and deposits.

Particular one highly important problem must be solved for the Ecolabel green deposits to work in practice. It seems that the governance setup proposed entails a direct link between the loans granted by the bank and the green deposits in the bank by the retail investor. The green loans granted for the green deposits should, however, not be limited to the loans granted by the bank. The bank should be able to create a pool of taxonomy qualified activities/assets from different credit institutions and issuers.

With regards to further widening the scope, we are puzzled why pensions and in particular PEPP are not in scope. These seem to be the logical next steps in the widening of the Ecolabel scope. Whether these products should be scoped in ought to be decided before the label is launched.

EU Ecolabel Criterion 1 – Investment in sustainable green activities

Equities

We highly support the changes made in measuring green equity investments and lowering of the green criteria in this third draft. We acknowledge that the taxonomy-compliant investment universe will be rather small to begin with and that it will likely grow over time. Therefore, we strongly support the changes made including green capex and green expected revenue growth, however we would propose analyzing the new criteria on a sample of sustainable UCITS funds as was done on the criteria in the second draft report. It is of paramount importance to make sure that a significant number of funds will be able to comply. It is highly important that the thresholds are evidence-based, aligned with EU taxonomy, and revised over time in that context.

Corporate bonds

With regards to corporate bonds we also welcome the changes made from the second to the third draft. It is important that the bonds are not solely compliant if they comply with EU Green Bonds Standard (EU GBS), since the EU GBS only apply in Europe and since there needs to be a pool of investable bonds to begin with. Whether the new requirements for green bonds delivers enough green investable bonds or whether the requirement leaves room for too many bonds should be tested. We would also encourage the Commission to clarify how covered bonds should be evaluated. Do the Commission see covered bonds issued by financial institutions as corporate bonds with regards to the Ecolabel criteria? Covered bonds financing real estate is a huge market in Denmark and without clear guidance in this regard we fail to see how any bond or mixed products would be labeled in the Danish Market. The link between the bonds criteria and the taxonomy is not fully transparent for us and in this sense, we propose that the criteria 1 for bonds is given more attention.

From an investor point of view there must be assets to deliver diversification within the product and in particular geographical allocation and thereby risk dispersion. From a global transition perspective, the most urgent green financing needs are placed in developing economies and outside Europe. It is in the developing countries the green finance initiatives and the Ecolabel can have the largest impact on a global scale.

Sovereign bonds

Sovereign and sub-sovereign bonds are excluded based on a number of criteria. From an asset management perspective, the list of criteria needs re-calibration. The proposed criteria will for instance in practice exclude US government bonds and Italian government bonds.

With regards to practicality and transparency for end investors we would recommend that a common list would be defined and maintained at EU level to simplify operational implementation and to ensure transparency for end-clients.

Criterion 2 – Investment in companies investing in transition and in green growth

It is not clear how criterion 2 works in relation to criterion 1. Criterion 2 defines whether a company as such is defined as investing in transition or investing in green growth and in this regard the company either fulfills the requirement(s) or does not. While in the examples in the report and as criterion 1 also stipulates the green CapEx and the green expected growth are percentages for each company. In this regard, it is unclear how criteria 1 and 2 are linked as elsewhere stated in the report and therefore it is our understanding that criteria 2 is not relevant after the publication of the publication of the JRC criteria 1 clarification note – if this is not the case the link between the two criteria should be clarified further. We also propose analyzing the effect of the combination of criteria 1 and 2 on a sample of sustainable UCITS funds.

Criterion 3 & 4 – Exclusions based on Environmental, Social and Governance aspects

According to the proposal the investment portfolio cannot contain equities or corporate bonds issued by companies excluded on the basis of social aspects or governance practices. Overall, we support the exclusions based on the environmental, social and governance criteria. However, the proposed criteria are very detailed and restrictive, also when compared to existing labels. As an example, where exclusion criteria seem too restrictive, there is a zero tolerance for tobacco production or any tobacco-related activities at any stage from raw material to sale of the final products to consumers. This criterion will exclude many industries and sub-industries where just a very small fraction consists on tobacco distribution. Current definitions would thus limit all retailer's/supermarkets, airlines, gas stations etc. that sell tobacco products. Also, several exclusions for the agricultural sector i.e. on pesticides, forestry and manufacturing are very detailed and go beyond the taxonomy. Here we fear that data coverage will be poor. In practice we fear that too few funds (in combination with criteria 1 and 2 requirements) will be eligible to obtain the label. We propose a review of the criteria aiming to strike a better balance between the ambitions of a high standard and the need to have a sufficient number of funds eligible to obtain the label. Tightening requirements over time can then be considered as the transition af the economy evolves.

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Criterion 5 – Engagement

We fully support the changes made on the engagement criteria from the second to the third draft. We support the requirement to have an engagement policy and the requirement to deliver transparency with regards to the exercise of voting rights. It is likewise very positive that the requirements for dialogue with investee companies have been recalibrated to a realistic though ambitious level. The new requirements on engagement are more relevant than in the previous reports, and is much more process and disclosure focused, which we support.

Criterion 6 & 7 – Measures taken to enhance investor impact and retail investor information

We fully support the inclusion of this new criteria which provides transparency with regards to the investor impact of the product and the enhanced requirements on retail investor information. However overall, the combination of requirements aimed at reporting, at compliance and governance around the label have increased significantly. With regards to deposit accounts, we find that the information requirements for banks are disproportionate, and needlessly complex for depositors. As we see the requirements banks must present a full list of all individual green loans, details about the green projects the loans have been granted for however companies are not likely to approve disclosing details about green projects and loans directly to retail investors.

We are supportive of transparency and strong governance to support investor confidence in the label; however, it comes at an added administrative cost for asset managers and investors must be willing to pay this added cost for the label to be commercially viable. Striking this balance is difficult, but crucial for the Eco-label to reach its potential.