Frankfurt am Main,
6. May 2019

JRC Technical Report v1.0 – Draft criteria proposal for the product scope and ecological criteria

BVI[1] welcomes the European Commission's initiative for development of an EU Ecolabel for retail financial products. We agree that a uniform European label will be helpful for promoting a common understanding of sustainable investments and their attractiveness especially in terms of cross-border distribution. However, in order to attain this goal, the technical criteria for the EU Ecolabel must be viable for a broader range of products. Hence, it is very important to adopt a cautious approach when setting quantitative thresholds for the level of "greenness" in product qualifying for the EU Ecolabel and in particular, to probe the market in order to analyse the impact of the envisaged thresholds on the range of eligible investment assets. We provide more detailed suggestions in this regard in our responses to the questions for consultation.

Criteria proposal and criteria structure

Q 1.1 Do you agree with the proposal of a set of mandatory criteria for the EU Ecolabel for this Product Group?

We agree in principle with the proposed set of mandatory criteria as a structure for the envisaged EU Ecolabel for financial products, save for the following two elements:

- Mandatory vs. optional criteria: We prefer a more flexible system which allows for various ways of complying with the Ecolabel criteria. More flexibility could be especially granted with regard to exclusions which should apply under the EU Ecolabel. By applying a mandatory set of rigid criteria, there will clearly be the risk that only very few products would be able to meet those criteria. As a result, the relevance of the EU Ecolabel for in terms of reorienting capital flows towards sustainable investments might be very limited.
- Exclusions based on ethical aspects: We deem it questionable to require extensive exclusions of investments in very selective business activities such as tobacco or weapon production for purely ethical reasons. The purpose of the EU Ecolabel should be to promote ecologically sustainable investments, not to enforce certain moral concepts upon EU citizens (cf. also our reply to Q 3.10).

Moreover, we have significant reservations with regard to the proposed quantitative thresholds which we explain in more detail below.

[1] BVI represents the interests of the German fund industry at national and international level. The association promotes sensible regulation of the fund business as well as fair competition vis-à-vis policy makers and regulators. Fund companies act as trustees in the sole interest of the investor and are subject to strict regulation. Funds match funding investors and the capital demands of companies and governments, thus fulfilling an important macro-economic function. BVI's over 100 members manage assets of more than 3 trillion euros for private investors, insurance companies, pension and retirement schemes, banks, churches and foundations. BVI's ID number in the EU Transparency Register is 96816064173-47. For more information, please visit www.bvi.de/en.

Proposal for the Retail Financial Products scope

Q 2.1 Do you agree with initial proposed scope for the EU Ecolabel?

We agree with the inclusion of retail funds, both UCITS and AIFs marketed to retail investors, in the initial scope of the EU Ecolabel. However, we recommend using legal terms established under the relevant EU frameworks in order to define the scope of application. Invention of new terms like "Retail Alternative Investment Funds (RAIF)" should be avoided in order to prevent legal uncertainties. Moreover, we understand that it is intended to cover also insurance-based investment products in the meaning of Article 4(2) of the PRIIPs Regulation. In this case, however, it is important to notice that the range of affected products will cover insurance contracts with an investment element in general and not be limited to unit-linked insurance contracts. Also, the product manufacturer responsible for issuance of insurance-based investment products will be always the relevant insurance company. The description of the Retail Financial Product scope should be complemented in order to reflect this responsibility.

On these grounds, we suggest the following new wording to the box on page 17 of the Technical Report:

> *"This product group shall comprise the following **retail** financial products that are provided as a service by a **UCITS management company, an AIFM or an insurance undertaking** and have been packaged for retail investors in accordance with […]:*
>
> - ***UCITS** and, where applicable, **AIFs offered to retail investors***
> - ***Insurance-based investment products***
>
> *The retail financial product shall be **notified** or authorised for marketing or distribution in a member state of the European Union."*

Q 2.2 Do you think other financial products/services should be included that are not covered in the initial proposed scope?
Q 2.3 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'?
Q 2.4 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?
Q 2.5 Are there any other financial products or retail investment opportunities that could be considered for a future scope?

N/A

Proposal for Criterion 1: thresholds on green investment portfolio and economic activities

Relating to green economic activities

Q 3.1 Is there a way to address economic activities not yet featured in the current version of the EU Taxonomy and its technical criteria?

Since green economic activities shall be defined in accordance with the EU Taxonomy, it is at the very least necessary to have the final agreement on the Taxonomy framework at Level 1 before the EU Ecolabel can go live. In our view, the Level 1 framework could be used as the basis for determining the greenness of economic activities for which technical criteria will be established at a later stage. Such approach would facilitate a broader investment choice for products eligible for the EU Ecolabel and thus, would enable proper diversification of investments. However, in this case it is important to provide for appropriate grandfathering or at least transitional provisions for any activities for which new technical criteria will apply at a certain point of time. The same applies by the way to economic activities for which the technical requirements under the Taxonomy will evolve over time.

Relating to green investment portfolio value

Q 3.2 How could the revenue for a parent group with number of daughter companies and their share be handled? Q 3.3 How should assets held in other investment funds be treated within this criteria? Do they require any special form of verification?

First of all, we would like to comment on the general approach for determining the greenness of an investment portfolio by way of thresholds. In this regard, we must caution the JRC against setting up quantitative thresholds at the portfolio and/or asset level without having analysed their impact on the range of eligible products. A very first preliminary analysis by our members has shown that hardly any funds currently available in the market would be able to qualify for the EU Ecolabel on the basis of the proposed thresholds. There is a serious risk that too ambitious thresholds will render the EU Ecolabel a niche product which will not achieve the objective of filling the financing gap for environmentally sustainable projects. Hence, before discussing specific quantitative requirements in terms of greenness, it is very important (1) to have a clearer picture of the technical criteria for green economic activities (which might be obtained on the basis of the first round of TEG recommendations due in June 2019) and (2) to probe the market in order to analyse, based on the envisaged thresholds, how many companies are able to meet the criteria for eligible equities.

As regards the first proposal for specific criteria, our views are as follows:

- For equities, it will be very challenging to establish which percentage of turnover is attributable to green economic activities. Realistically, such assessment will be contingent upon reliable non-financial reporting by companies and should be more feasible for small, potentially non-listed companies than for large caps with complex corporate structures and a variety of business lines. However, investment funds launched for the wider retail market do not generally invest on a large scale in private equity or small caps since such investments are not aligned with the typical risk profiles of retail investors.
- For bonds, we think it is far too early to require that all bonds contributing to the greenness threshold must be fully compliant with the EU Green Bond Standard (GBS). Since the EU GBS is being currently discussed as a voluntary standard, the level of acceptance in the market cannot be validly assessed at this stage. If the EU GBS turns out to be overly ambitious and will only serve a niche market, the bond investment opportunities of funds wishing to qualify for the EU Ecolabel would be severely constrained. Moreover, investments in bonds complying with the EU GBS should not be a compulsory element of qualification for the EU Ecolabel. Acceptance of EU GBS certificates as a proof of compliance with the greenness requirements should already create some incentives for such investments as compared to investments in other green bonds.

- For assets held in other investment funds (target funds), it would be very difficult to apply some kind of a look-through approach in order to determine the degree of greenness at the fund-of-funds level. If at all, such look-though should be limited to specific points of time, e.g. linked to the end of the fiscal year of the target fund and publication of its financial statement. Under such approach, it would be sufficient to look into target fund holdings in equities and bonds once a year in order to calculate their contribution to the greenness of the overall portfolio. A simplified treatment should be envisaged for target funds certified under the EU Ecolabel or any national label.

Q 3.4 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?

In our view, it is appropriate to include investments in real estate in the range of assets potentially eligible for the assessment of greenness.. However, the technical criteria so far proposed by the TEG for the assessment of real estate shall apply only for construction of new buildings and renovation of existing buildings (cf. section 13 of the Taxonomy pack for feedback and workshops invitations). On this basis, application of the Taxonomy would mean that only funds investing in Nearly Zero Energy Buildings (NZEB) or value-adding renovation/redevelopment projects could qualify for the Ecolabel. It is however highly unlikely that funds will only consist of such buildings in the mid- to long-term. Also from a portfolio (fund) perspective it would have to be considered how new acquisitions that are purchased for value-add (renovation) would affect the overall portfolio in the mid-term. CO2(e) benchmarks could cover entire portfolios in a far more practical way and we strongly suggest to make use of benchmarks for a total portfolio approach. Such benchmarks should be developed following the recent changes to the EU Benchmark Regulation. We think that a benchmark-based approach would be more effective for the use at the fund level and could encourage more providers to launch environmentally sustainable real-estate funds.

Q 3.5 Should assets for which verification of greenness is not required be included within the total portfolio asset value?

Under the assumption that the overall portfolio threshold of 70% as regards investments in green economic activities will be uphold, we deem it overly ambitious to include all assets in the total value for calculating such threshold. Depending on the investment strategy and liquidity conditions, investment funds might be prompted to hold larger amounts of cash over a longer period of time [or to extend their use of derivatives for hedging purposes]. Therefore, we would suggest to relate the portfolio threshold only to the cumulative value of assets for which the degree of greenness can be assessed. As an alternative, the overall portfolio threshold could be lowered to e.g. 51%.

Q 3.6 Should any type of criteria on trading practices and/or use of funds be applied to derivatives and cash?

We are not aware of any criteria which could be relevant in this respect.

Q 3.7 Does the assessment and verification require any specific parts to be tailored to individual products within the scope?

From the perspective of the fund industry, there is no need for further tailoring of the requirements.

Proposal for Criterion 3: Excluded activities – Environmental aspects

Q 3.8 Do you think the proposed environmental exclusions should be expanded to include more economic activities?

At the current stage, it is very difficult to assess the impact of the proposed environmental exclusions since they are based on specific economic activities the relevance of which still needs to be determined by the EU Taxonomy. As stated above, we deem it crucial that an extensive analysis of such impact is performed before taking decisions about specific exclusions and possible cut-off thresholds. In particular, the JRC should examine how many listed undertakings from the energy sector in the EU would qualify for investments by EU Ecolabel certified funds if the proposed exclusions were in place.

Q 3.9 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?

We prefer to apply the partial exclusion threshold at the level of the overall portfolio which should allow for a potentially wider range of eligible assets and rebalancing of holdings within the portfolio.

Proposal for Criterion 3: Social and Ethical related exclusions

Q 3.10 Do you think the proposed exclusions list on the basis of social & ethical aspects should be enriched with more activities?

In general, we suggest being cautious with exclusions. Market analyses performed on ESG products show quite clearly that exclusions as investment strategy tend to have very low impact on sustainability of companies (because funds generally avoid certain companies or sectors instead of engaging with them on ESG issues) and to achieve lower performance in financial terms. Exclusions also necessarily limit the scope of eligible investments and thus might impede proper diversification.

As regards the exclusions proposed for criterion 3, we deem it not appropriate to apply purely ethically motivated exclusions for products certified under the EU Ecolabel. The concept of the EU Ecolabel should focus on promoting environmentally sustainable investments while warranting certain standards in social and governance terms (ESG investments). It should not purport to impose certain selected ethical values upon European citizens wishing to invest in sustainable products. Considering the specific activities envisaged for extensive exclusions, we deem it highly questionable to exclude any activities associated with tobacco production while not referring to the production of strong alcoholic beverages or cannabis. Similarly, we disagree with the general prohibition of investments in activities associated with the production of weapons. This would mean that also weapon production for democratically legitimised armed forces of the EU Member States or for providing equipment to police forces would exclude a company from investments by EU Ecolabel certified funds.

Q 3.11 Do you think it may be appropriate to also exclude poor corporate management practices and/or poor human capital development? If yes, how it will be possible to verify such exclusions?

As explained above, we are not in favour of imposing even more exclusions, also in governance terms, for products seeking certification under the EU Ecolabel. The definition of sustainable investments in Article 2(o) of the Disclosure Regulation already requires that “the investee companies follow good governance practices, in particular with respect to sound management structures, employee relations, remuneration of relevant staff and tax compliance”. These positive criteria of good governance could be also included in the framework for the EU Ecolabel.

Proposal for Criterion 4: Consumer information

Q 3.12 What will be a reasonable interval for monitoring and reporting information to the consumers?

Provision of annual information to retail investors is generally reasonable. However, many of the details suggested for reporting purposes are already subject to disclosure rules under either the Disclosure Regulation or SRD II. In particular:

- The environmental and financial objectives of the portfolio are already part of product information in either the UCITS KIID or a national KIID and in the fund prospectus. Disclosure on environmental objectives of sustainable funds will be further enforced by the Disclosure Regulation and provided both on the website (Article 6(1) of the Disclosure Regulation) and in the fund prospectus (Article 4a(1), 5(1) in connection with Article 4(1) and (3) of the Disclosure Regulation). Hence, there is no need to duplicate such disclosures for products certified under the EU Ecolabel. In any case, environmental and financial objectives are part of the contractual terms/articles of association of a fund and will change on rare occasions only. They should not be subject to annual disclosures.
- Information on corporate activities undertaken by the fund management company in relation to the portfolio undertakings will be disclosed by all fund managers under Article 3g(1)(b) of SRD II. It is unclear to us, however, whether the proposed item 2 of criterion 4 aims at disclosure of corporate activities and governance structures of the fund management company itself which is clearly of much lower relevance in terms of qualification of the fund portfolio for the EU Ecolabel.

In any case, the recent experience under MiFID II clearly shows that information overload or duplication is counterproductive for the engagement of retail investors in capital markets. Duplicative disclosures in the context of the EU Ecolabel should thus be avoided by any means.

As regards verification of compliance with the EU Ecolabel, we deem it reasonable to perform annual checks based on the portfolio composition at a specific record date. This corresponds with the current verification practice with regard to the national labels.