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EBF views on the Ecolabel Report

Introduction / general remarks

As expressed in our previous positions, the EBF is supportive of the efforts undertaken for the development of the EU Ecolabel, as we see it having a great potential to facilitate the engagement of retail clients in unlocking the transition to a low carbon economy.

The EU ecolabel criteria and framework are still in need of further calibration to ensure that a sufficiently large pool of investable assets is available. In addition, the critical challenges on disclosures and access to sufficiently available data (in accordance to NFRD revision) needs to be taken into account – this lack of information critically impacts the way both core banking activities can be performed and how better products can be put forward for retail investors.

Scope and usage

We would encourage to clarify whether the label is to be awarded to the product manufacturer, the product or to the financial service itself, given that it could be very difficult to provide retail financial services (investments and management) without the previous existence of a financial product (fixed-term deposits / savings deposits).

Therefore, clarification is needed for whether the label should be awarded to the “source” - the product – (preferable) or the “management” – the service.¹

Deposits

We support the amendments in the scope and the inclusion of deposits offering and enabling more retail savers to channel significant funds towards green projects.

Bank deposits generally offer a higher return in exchange for a longer fixed term money is left in the account (that is eventually more visible in savings accounts). The money deposited becomes part of the bank’s assets and in return the account becomes a liability to the bank. Because of their wide distribution among European retail customers, it qualifies certainly as one of the most appropriate tools to involve the highest number of

¹ Given that the report indicates both that

“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”.E.g. “The service of managing a fixed-term deposit or savings deposit product as referred (...)”

“(…) 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. (...)”

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users. Yet, how money is invested behind the curtains is not easily reduced in clusters because of the many deposit related products available. The return offered to customers often derives from investments made on government and corporate bonds. While corporate bonds, can be more easily tracked, governmental bonds are not easy to value, as there are no standardized approaches to define a sustainable nation.

It would be highly merited to ensure that banks have appropriate tools and resources to sieve through the cost structure of each deposit virtually involved in this evaluation.

In order to simplify the highly complicated and costly operational challenges, as well as the governance processes suggested in the draft report - which entails a direct link between the loans granted by the bank and the green deposits in the bank by the retail investor - we suggest for banks to be able to create a pool of taxonomy qualified activities from different credit institutions and issuers - not limited to the loans granted by the bank.

With regards to reporting and traceability on deposits, on top of requesting further clarity on the draft, taking into account the key changes included in Article 4 delta of the EU Framework regulation and the expected changes to the NFRD, we see the following points:

- It would be critical not to create too much complexity regarding the allocation of money, as with revolving facilities or short-term loans, the money can move quite quickly from project A to project B or C, adding complexity to possible reporting.
- To describe on an aggregated level the sector to which credit has been allocated seems a better option that disclosing deal by deal. A pool of green assets can also be mapped and reported per sector or according to sustainability goals.
- The idea of a green asset ratio as proposed by EBA, and a general division by sector on traceability would be merited, as it is not possible to " earmark " a certain kind of credits that are connected to certain deposits.
- Bank secrecy also needs to be observed, as banks are not able to reveal that a certain company is a client to a bank without having the consent from the company.

Other retail products not currently in scope

In particular, we see PEPP and AIFs as financial products that are logically 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.

These are key retail products that need to be looked at in order to clearly generate higher interest in retail customers and ensure that they take more informed decisions on sustainability.

In addition, for structured products, it is important to take into consideration the highly sophisticated nature of the investment strategy to meet very specific investors' needs. What would be relevant for structured products marketed as ESG would be to rely on EU Ecolabels for underlying assets and sustainability certification for activities and uses of proceeds (use of the funding raised by the banks from the structured products). An EU Ecolabel on the whole investment strategy may indeed be very complex to define and lead to a too simplistic or irrelevant criteria that would limit the flexibility that is needed for this specific type of products. However, the absence of an EU Ecolabel for structured products is not inconsistent with very clear client documentations that clearly describe: i) the alignment of the investment strategy with the clients' ESG preferences; ii) the type of data used to support that alignment and iii) the use of proceeds.

EU Ecolabel Criterion 1 – Investment in sustainable green activities

We remain aligned with our position that the thresholds for green investments should be set at 50%.

Corporate bonds

The suggested 70% threshold of total portfolio asset value of bond funds to be invested in bonds that comply with the EU Green Bonds Standard (EU GBS) is more restrictive than the threshold for equity, since green bonds in line with EU GBS by definition needs to be 100% taxonomy compliant.

While the EU GBS application covers the possibility for both non-EU issuers and projects located outside of the EU to issue Green Bonds aligned with the EU taxonomy, it is highly likely that the majority of EU Green Bonds issuance will be concentrated in Europe (and European issuers), limiting the investment universe quite considerably. . This is highly problematic for investors as they are left with less room to diversify and disperse risks. In addition, the most urgent financing needs to take place beyond EU borders, in developing economies, that would not be covered by the current wording.

It would therefore make sense to lower the threshold and allow a part of the portfolio to be invested in non-labelled issuers which are compliant with respect to the taxonomy and exclusions. It is not clear what provisions are applied to the remaining 30 percent of the portfolio, if any, besides the negative screening criteria. These provisions should be clarified, as there is a high risk of reputational issues if that 30 percent of the portfolio does not follow sound provisions – jeopardizing the reputation of the label itself.

We would also suggest including within the 70% threshold:

- Use of proceeds bonds which are not necessarily in line with the EU GBS but issued in accordance with a recognised market standard as long as their proceeds are at least 20% taxonomy-compliant, and the rest of proceeds meet the Ecolabel social and environmental standards; as well as
- regular corporate bonds (i.e. not green bonds) issued by companies that would be at least 20% taxonomy-compliant and respect the social and environmental standards of the label.

Sovereign bonds

Sovereign and sub-sovereign bonds are excluded on the basis of a number of criteria. The list of criteria seems both very long and from an investment perspective it needs calibration (e.g. exclusion criterion 2.2.3. could be altered to: "(...) if the issuer or the country has not ratified at least two of the following international agreements (...)"). 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 should be defined and maintained at EU level to simplify operational implementation and to ensure transparency for end-clients.

Derivatives

Derivatives are an efficient low-cost tool for investment firms to manage their portfolio risks and they enable capital to be freed up for investments. As a tool, they can support both long-term and shorter-term investment strategies, thus having an important role to play as a risk management tool to support the EU's long-term sustainable finance strategy goals, and their use should not be prevented or restricted by market participants.

Criterion 2 – Exclusions based on environmental aspects

We welcome the introduction of the “partial exclusions” even if we would like to see further clarifications.

Criterion 3 – Social and Governance aspects

According to the proposal, an 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 social and governance criteria. However, the proposed criteria are very detailed and restrictive, and it may entail in practice that very few funds will be eligible to obtain the label. Striking a balance between the ambitions of a high standard and the need to have a sufficient number of funds eligible to obtain label. Raising the bar over time can then be considered as the economy transitions progress.

For the sake of consistency and clarity for end-investors, we recommend to align the minimum safeguards with the EU taxonomy. It is worth noting how comprehensive the OECD MNEs Guidelines, the ILO conventions and the UN GPs are. The former includes all social issues plus governance such as bribery and corruption.

Criterion 4 – Engagement

While recognising the importance of engagement with investee companies in transitioning to a more sustainable economy, we question whether the requirement to engage regularly with half of companies that have less than 50% EU Taxonomy-compliant activities is the right way forward.

Effective engagement is highly resource-intensive, and requires extensive dedicated teams. Engagement should focus first and foremost on those companies that are exposed to polluting and unsustainable activities, which do not respond to all those not taxonomy complaint.

The report states that investors should encourage companies to “change their existing economic activities to make them compliant with EU Taxonomy criteria”, and “reduce and stop economic activities that are not EU-Taxonomy- compliant by selling or closing those activities”.

Activities that are not EU taxonomy compliant are not necessarily not sustainable. It is worth highlighting that, given the environmental exclusions that will be applied, the vast majority of activities will fall in the category of neither contributing significantly to an environmental objective (taxonomy-compliant) nor harming any environmental objective. In other words, they will be under the category of “neutral”. The exception is for those

companies whose activities fall under the category of “transitioning” but that are not fully aligned e.g. cement company with only a 20% taxonomy-compliance.

It would also be useful to cross-check with the requirements in the Shareholder Rights Directive II to avoid inconsistencies or overlaps. Allowing cross-referencing would be useful.

Our recommendations:

- Engagement should be encouraged in the following cases:
 - o A potential breach has been identified e.g. one of the Do Not Significant Harm in an activity or a breach on minimum social safeguards (remember that remediation is encouraged by all international frameworks as opposed to simple divestment when it comes to social and labour rights).
 - o For companies whose activities fall under the scope of the taxonomy but do not comply with them or only a small part, and are not taken the necessary steps (e.g. capex investments do not comply either).
 - o To improve disclosures in some areas e.g. qualitative DNSH or minimum safeguards, for example.
- It would be useful to cross-check with the requirements in the Shareholder Rights Directive II to avoid inconsistencies or overlaps. Allowing cross-referencing would be useful.

Liquidity

The criteria proposed in the draft report may lead to increased liquidity risk due to the possible need to focus more on small- and mid-cap companies for funds to meet the criteria. Similarly, there may be a need to include less liquid green bonds as green bond issuance is still limited compared to expected demand, although more green eligible bonds will be issued over time.