

Comments on JRC's 2nd Technical Report on Development of EU Ecolabel Criteria for Retail Financial Products

17 April 2020

Introduction

A well-designed EU Ecolabel has a great potential to channel retail investors' savings to environmentally sustainable projects. To achieve this goal, the EU Ecolabel needs to be attractive enough both for the industry and retail investors alike. We need a **smart EU Ecolabel**, with a clear purpose that strikes the right balance between the strictness of the criteria and enables sufficient diversification, having **retail investor protection** in mind.

However, based on the available assessment¹ and feedback from our members, EFAMA² believes the proposed **criteria would result in too-narrow a pool of qualifying investments and funds** that are suitable for the retail market. This risks undermining the success of the EU Ecolabel, reducing its capacity to raise funds for the transition, and increases the risks faced by the end-investors.

As a way forward, we suggest to **enlarge the scope** and **adjust the proposed criteria** to ensure sufficient diversification to protect investors' savings and satisfy regulatory requirements.

Reconciling between the high-level of ambition driven by the NGOs, civil society organisations, and the need for appropriate risk management to protect the end-investors' savings, we **suggest a progressive approach** regarding the thresholds. We propose to **start with realistic criteria**, ensuring that currently there is **at least 10-20% of the existing funds and other investments that are eligible**. Then, the market development should be closely monitored and with an **increased provision** of the EU Ecolabel eligible investments, the **criteria can be revised**. After an initial period of market adjustment, designing **a clear transitioning path** would help to provide clarity and certainty to the industry.

We fully support an alignment with the **minimum social and governance safeguards** provided for in the **EU taxonomy**. However, as this is a proposal for the EU green label criteria, we believe that the **focus** should be on the **environmental aspects**. Therefore, the proposed approach with **abundant social and ethical exclusions** does not seem appropriate.

While we recognise the importance and great potential of **stewardship**, the proposed criteria on engagement are not only **unrealistic**, but **risk shifting the resources of asset managers away from the companies that need to be encouraged to transition**, to companies that are already green.

Please see below our detailed comments and suggestions for revising the EU Ecolabel technical screening criteria, which we hope will contribute to a design of a successful EU Ecolabel.

¹ See the annex for our analysis regarding the current availability of EU Taxonomy compliant activities & ESG data

² EFAMA is the voice of the European investment management industry, representing 28 member associations, 59 corporate members and 22 associate members.

1. OBJECTIVES & PURPOSE

We believe that a **clarity of purpose** is important for retail investors to understand what the EU Ecolabel stands for. As the EU Ecolabel is aimed at promoting **environmentally** sustainable investments, it **should not be confused with 'ESG' labels** promoting not only environmental but also social and governance aspects. As this is not an ESG label, we **do not find the social and ethical exclusions appropriate**. However, we **support the minimum social and governance safeguards in line with the EU taxonomy**, which would also result in consistency and more clarity for retail investors.

Our recommendation:

Ensure that the design of the EU Ecolabel clearly reflects its purpose by focusing on the **environmental criteria**. Social and governance aspects should be aligned with corresponding provisions in the EU Taxonomy Regulation.

2. INVESTOR PROTECTION & DIVERSIFICATION

We believe that the proposal, given that the products are intended for retail investors, raises serious questions about **investor protection**.

For European funds aimed at retail investors (UCITS and certain retail AIFs), protection rules are based on the principles that **funds should be a) liquid and b) broadly diversified**. Based on feedback from our members we understand that given 1) the current stage of the EU Taxonomy development, and 2) the presently available ESG data disclosures, the proposed rules are likely to imply that the 60% of equity would primarily need to be invested in small caps in few sectors. That would pose liquidity challenges (as small and mid-caps' markets tend to be much less liquid) and would make it hard to ensure a sufficient diversification 1) to ensure the investor protection, and 2) to meet the regulatory requirements (for instance for UCITS there are specific diversification rules that need to be followed³).

Our recommendation: We suggest to carefully consider the design of the Ecolabel not only from an environmental but also an **investor protection** point of view. Rules should allow for a sufficient diversification and liquidity necessary for the products destined for retail investors.

3. SCOPE

The scope of eligible products should be **as broad as possible** under the Ecolabel framework. This is to ensure a **sufficiently large pool of eligible investments** enabling an appropriate diversification to protect end-investors' savings, ensure the success of the EU Ecolabel and satisfy the regulatory requirements (e.g. UCITS diversification requirements)⁴.

We would suggest to **include all types of investment funds that are available to retail investors** under applicable EU and national rules. Therefore, we would suggest to reconsider including **pension funds (including saving-schemes), ELTIFs, real estate funds⁵ and private assets'** funds to the extent permitted by the EU Ecolabel Regulation.

We understand that **ELTIFs** raise concerns as they are not by default destined to retail investors, as well as seen as not sufficiently liquid. However, going to the origins of ELTIFs, this vehicle was created to facilitate retail investors' investment in non-listed assets.

Quoting the ELTIF Regulation, "while providing less liquidity than investments in transferable securities, ELTIFs can provide a steady income stream for individual investors that rely on the regular cash flow

³ see Undertakings for the collective investment in transferable securities (UCITS) - Directive 2009/65/EC

⁴ Idem

⁵ As real estate funds are very different and are treated differently across the Member States, it is important that the criteria for the real estate funds are carefully calibrated. A transition period could be useful for the already existing real estate funds.

that an ELTIF can produce. ELTIFs can also offer good opportunities for capital appreciation over time for those investors not receiving a steady income stream.”⁶

Furthermore, “In order to incentivise investors, in particular retail investors, who might not be willing to lock their capital up for a long period of time, an ELTIF should be able to offer, under certain conditions, early redemption rights to its investors.”⁷

Even though **real estate investments by retail investors** might not be equally popular throughout the EU, in some Member States they constitute a significant segment of the retail market (e.g. Germany). Moreover, acquisition and holding of real estate is **directly recognised as an eligible sustainable activity under the EU Taxonomy**. This will result in easier assessment of the compliance with thresholds and criteria, as well as a better alignment between the EU Ecolabel and the EU Taxonomy.

However, currently real estate funds are diverse and are treated differently across the Member States. Equally, there are various energy and building efficiency standards. This will change with the EU taxonomy. Nevertheless, it is important that the **criteria for real estate funds are carefully calibrated**. A transition period would be useful for the already existing real estate funds.

Pensions schemes have significant power to change markets and move capital. We therefore believe there are merits to include in the scope of the Ecolabel those **pension funds which are available for retail investors**. For instance, FCPE which is a French pensions saving-scheme, despite being distributed through a corporate company, final holders are retail investors who can choose the fund they will invest in.

Our recommendation:

We propose to **include all types of investment funds that are available to retail investors** under applicable EU and national rules. In this respect, we suggest to include **pension funds (including saving-schemes), ELTIFs, real estate funds⁸ and private assets’ funds** to the extent they are available to retail investors.

4. THRESHOLDS

Equity

We appreciate that the new draft provides for lower **thresholds for equity funds**, allowing 40% of the fund to be invested more freely to cater for diversification and liquidity requirements inherent to retail products. However, on the basis of currently available assessments⁹ and feedback from our members, we understand that the **EU Taxonomy-compliant investment universe is expected to be rather small in the early stages of its implementation**. As a result, the current thresholds are very likely to result in a very small number of companies eligible for inclusion, not matching the objective set by the EU Ecolabel Regulation to target the best 10-20% of the products available on the Community market in terms of environmental performance.

Our understanding is that in terms of transitioning activities, the EU Taxonomy targets roughly 10% of activities (please also refer to the annex for more analysis re data), while overall there are many activities which are EU Taxonomy-neutral or simply not included yet. Difficulties with obtaining data on companies that do not report under the Non-Financial Reporting Directive (NFRD) and/or are based outside the EU should also be considered.

⁶ Recital 2 of ELTIF Regulation

⁷ Recital 36, see also Art 18.2 of ELTIF Regulation

⁸ As real estate funds are very diverse and are treated differently across the Member States, it is important that the criteria for the real estate funds are carefully calibrated. A transition period would be useful for the already existing real estate funds.

⁹ See the annex for our analysis regarding the current availability of EU Taxonomy compliant activities & ESG data

We therefore very much appreciate the study commissioned by DG FISMA, aimed at testing the proposed thresholds on the currently available funds. However, we are concerned that the exclusions and stewardship criteria will not be applied. Consequently, we would like to highlight that the **effective investable universe will be smaller than indicated by the study**.

Please note that the disclosure obligations on companies within the scope of the NFRD, provided for in the EU Taxonomy Regulation, will not apply before 2020. Further disclosures stemming from the upcoming revision of the NFRD cannot be expected before 2023. Therefore, we would suggest performing appropriate studies and impact assessments after each of those landmarks.

Subsequently, the thresholds could be revised, while also designing a clear transitioning path towards 2030 and 2050, aligning with the Paris agreement targets.

Revenues vs CAPEX

Currently JRC proposals provide for a use of revenues from EU taxonomy compliant activities as a metric. To include transitioning companies, which have few or no EU taxonomy aligned activities, we would suggest including the use of CAPEX as a future-oriented metric. For equities, we would suggest that if a company has less than 10% of revenues from EU Taxonomy aligned activities, CAPEX could be used as an alternative, as long as it provides for at 50% of investments in EU Taxonomy compliant activities.

Our recommendation:

- We suggest that the EC Ecolabel should **start with realistic thresholds**, based on a thorough market assessment, to ensure sufficient investor protection and a success of the label to be a real alternative to other existing labels. We would recommend that the **assessment / testing is done against all the EU Ecolabel criteria**.
- Following the entry into application of the disclosures resulting from the EU taxonomy Regulation, as well as from the upcoming review of the Non-Financial Information Directive, **subsequent impact assessments / studies should be done**. Based on market development, improved ESG data disclosure and increased provision of products matching the criteria, **thresholds can be tightened**. However, at a certain moment a **clear transitioning path, specifying progressive targets** (e.g. towards 2030 and 2050) should be provided for. Such path would provide more clarity and certainty for the industry.
- For equities, we would suggest that if a company has less than 10% of revenues from EU Taxonomy aligned activities, CAPEX could be used as an alternative, as long as it provides for at 50% of investments in EU Taxonomy compliant activities.

Bonds

Regarding the **thresholds for bonds**, the JRC proposal provides for a 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). Such approach is very likely to severely narrow down the investment universe, leaving out the majority of green or use of proceeds bonds issued outside of Europe.

The EU GBS has not been finalised yet and the market uptake of this future European standard is very uncertain. Besides the concerns regarding how many non-EU issuers will use it, we also hear of some scepticism from many Eastern European countries that see the related costs, e.g. audit, as disproportionately high for their market and companies' funding needs.

Meanwhile, it would be a missed opportunity to reduce all other green or sustainable bonds only to a proportion of 30% in a EU Eco-labelled fund. Green "use of proceeds" project bonds invested in EU taxonomy-aligned activities can be a direct source of finance for the transition.

We would suggest to follow the same approach regarding the “use of proceeds” sovereign or sub-sovereign bonds and those issued by supranational authorities. We believe it is important to distinguish between sovereign debt (financing a debt of a country) and green “use of proceeds” bonds issued by a country to finance a specific green project. While we understand that certain stringent social and ethical criteria may apply to sovereign debt, for “use of proceeds” bonds we would suggest to follow an approach focused on what the proceeds finance and their alignment with the EU Taxonomy.

Last but not least, the probability that the EU Green Bonds Standard is finalised before completion of the EU Ecolabel technical criteria is low. This creates legal issues regarding incorporating the reference to a legislative act, which may not be finalised beforehand.

Given all of the above, we would suggest the following solution.

Our recommendation:

To remedy the legal challenge described above and to ensure a sufficient availability of eligible investments, we would suggest to **include within the 70% threshold:**

- **green bonds** which are not necessarily in line with the EU GBS but issued in accordance with a recognised market standard, as well as
- **regular corporate bonds** (i.e. not green bonds) issued by companies that would meet the necessary criteria to see their equity instruments eligible under the thresholds for equity funds.
- **green “use of proceeds” bonds issued by a sovereign** based on what the proceeds finance and to which extent they are aligned with the EU Taxonomy

Revenues vs CAPEX

We think that CAPEX could be a useful metric especially for green bonds as they are usually evaluated based on the expenditures. However, on corporate bonds the CAPEX metric may not be always available.

Where in one fund there are both corporate and green bonds, to calculate the % of alignment, the same metric should be used across the board. Therefore, either % of expenditures or % of revenues should be used consistently.

But when revenues and CAPEX were to be used as metrics for evaluating different bonds within a fund, the disclosures should be done separately.

Our recommendation:

- We suggest to allow the use of CAPEX which is a very relevant metric especially for green bonds. However, if within one fund both revenues and CAPEX metrics were to be used, disclosures should be done separately.

Fund of funds

To ensure sufficient availability of funds that can qualify, at least in the initial stage, we **would suggest to decrease the proposed threshold** of 90% (for investments in target funds that have been awarded the Ecolabel) **to 50% of AuM** in funds being awarded the Ecolabel (or other national green label).

5. TRANSITION

We believe that the definition of transition proposed in this document is likely to lead to confusion, considering that it differs from the definition of “transition” in the EU Taxonomy. Under the Taxonomy Regulation, a transition activity is one where there are currently no actors who are currently operating at a level that would be considered aligned with a 2 degree scenario but are in the process of

transitioning towards that level, with intermediate thresholds established that will be tightened over time. However, the JRC has proposed that “transition” be defined as companies where only a certain percentage of their revenues come from Taxonomy-aligned activities.

We think this is likely to confuse the landscape and needs to be reconsidered. As per our comments above, we believe that even companies who might meet the Taxonomy criteria for economic activities currently covered may only have a small fraction of their revenues that are Taxonomy compliant where they have other business lines not covered by the Taxonomy or where they operate internationally.

Our recommendation:

We suggest to align the definition of a “transition” in line with the EU Taxonomy Regulation to ensure consistency.

6. EXCLUSIONS

As a general comment, we believe that for the sake of consistency and clarity towards the end investors, it would be useful to **align the exclusions with the EU taxonomy**.

Environmental exclusions

We welcome the introduction of the “partial exclusions”. However, it would be useful to consider a 10% threshold instead of 5%. Too strict exclusions would risk prohibiting investments in companies that are transitioning to a higher “ESG level”.

At the same time we believe that the list of exclusion should not be too extensive not to exclude companies that are in transition, as well as to ensure for appropriate risk diversification. Given strong interconnections between the EU Ecolabel and the EU Taxonomy, we believe that the EU Ecolabel exclusions should be aligned with the EU Taxonomy. This would ensure a consistent and science-based approach.

Social, Ethical & Governance exclusions

As the name suggests, an EU Ecolabel is aimed at promoting environmentally sustainable investments. Hence, we would like to re-iterate our request to focus the exclusions primarily on the environmental aspects. We do agree there is a **need for minimum social and governance safeguards**. For the sake of consistency and clarity for end-investors, we recommend to **align them with the EU taxonomy** which refers to the International treaties providing for very comprehensive and stringent safeguards, amongst others dealing with bribery and corruption and excluding controversial weapons.

We very much welcome the study testing the thresholds, commissioned by DG FISMA. However, **we regret that the exclusions will not be part of the criteria to be tested**. Exclusions will further reduce the investable universe. Moreover, as recognised by the JRC in the assessment of the EU taxonomy, currently verifying whether companies meet the DNSH criteria is very difficult or often even impossible given the ESG information currently disclosed by companies. Furthermore, asset managers often do not have the means to verify that this information is correct.

Exclusion for sovereigns

The list of exclusions for sovereigns seems lengthy and poses certain practical challenges. We would **propose that a common list is defined and maintained at EU level** to simplify operational implementation and ensure clarity for end-clients.

Our recommendations:

- We suggest to align the exclusions (especially social, governance and ethical ones) with the EU taxonomy.
- We propose to adjust the “partial exclusions” from 5% to 10%.
- We would propose that a common list with exclusions for sovereigns is defined and maintained at EU level.

7. ENGAGEMENT

While recognizing 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 the companies that have less than 50% EU Taxonomy-compliant activities, as well as other criteria proposed regarding the engagement, are the right way forward. Please see below our arguments in that respect:

- **Asset managers are not in position to micromanage companies.** Capital allocation is a decision of management and the board. The role of stewardship is to encourage mechanisms that foster good decision making by companies themselves.
- **Engagement is very resource-intensive.** It requires an ongoing dialogue with companies in their portfolio holdings, which can sometimes run into the hundreds of companies. Engagement can be quite costly and affordable only for large fund managers which would disadvantage small and medium local EU providers in terms of qualifying for the Ecolabel.
- The EU Taxonomy is still in the early stages of its development covers a fairly limited number of activities, and many neutral activities. As a result, we understand that currently even companies with 20% of EU Taxonomy compliant activities can be considered as leaders in terms of sustainability. Meanwhile, to transform the economy to a more sustainable one, **engagement is most needed with the most polluting companies.** Therefore, it would be **counter-productive to require engagement with all companies with less than 50% EU Taxonomy-compliant** activities. This would divert the **resources** much needed to engage with companies that need to improve to companies that are on the right path.
- Among asset managers, there are different approaches to engagement. The predominant approach is for a firm level approach to be taken, whereby engagement is undertaken on key material issues with companies cross-held by multiple fund managers within the firm. Some managers are also now moving to fund level engagement approaches – where engagement is part of the value proposition for end investors.
- Effective engagement requires significant investment while not all asset managers are large enough to have the necessary resources. While all engagement is undertaken in light of the duty to act in the best interests of investors, cost is a major consideration for firms. In addition, mixed messages from different asset managers to investee firms could prevail, diluting the overall impact that the asset manager may have. This is why increasing collaboration between asset managers on engagement issues is being seen and should be encouraged. An example of such collaboration includes the global Climate Action 100+ Initiative, which is targeting the biggest global greenhouse gas emitters in an effort to persuade them to align their businesses with the terms of the Paris Agreement on Climate Change.
- The criterion on engagement should recognize that **companies in some markets are not very engageable** due to poor minority shareholder protection (e.g. poor corporate governance

policies, ownership structures that give limited or no rights to minority shareholders, burdensome requirements to file shareholder resolutions).

- While engagement on ESG is important and should be encouraged, it is important to note that **engagement does not and should not happen on one particular aspect in isolation**, but needs to cover all of the Environmental ('E'), Social ('S') and Governance ('G') pillars. **A holistic 'E', 'S' and 'G' approach is crucial** as we believe that the 'G' is often a key driver to achieve 'E' and 'S' objectives. How a company approaches and executes its governance will determine how it manages environmental and social material risks and opportunities. In other words, a well-run company is more likely to grasp the social and environmental challenges and opportunities for its long-term success.

As explained in the EFAMA stewardship code¹⁰, asset managers should engage with investee companies on business strategy and its execution; risk management; environmental and social concerns; corporate governance issues such as board composition and the election of independent directors, together with executive remuneration; compliance, culture and ethics; and performance and capital structure.

- The engagement objectives stipulated in the report are **not adequate in many cases**. For instance, the report mentions 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". While **activities that are not EU taxonomy compliant are not necessarily not sustainable**.

In some cases there is a clear rationale and business case for companies to step out of certain activities (e.g. energy generation from coal), but this is not always clear-cut for certain activities. Often, companies should be working towards developing a transition roadmap with a multi-year action plan and key milestones to be achieved in the short- (2025), mid- (2030s) and long- (2050-70) term.

When a company has set out a comprehensive transition plan, then to ask it to shut down non-taxonomy activity and begin taxonomy activity might not align with that, and therefore could undermine the corporate strategy of the board which would not be in investors' interests.

Also, many companies will never make a substantial contribution to one of the taxonomy objectives, but nonetheless their activities might not be harming those objectives and may be an important part of the transition, so asking for a change of corporate approach would not be an effective use of stewardship.

Therefore, **specific ESG engagement objectives should not be imposed**. Instead, a **more flexible approach should be adopted to better reflect diversity of companies, activities and the necessary transition**.

- **More should be done to facilitate engagement**. In that respect, we suggest to **facilitate investors' AGM voting process, especially across borders, and filing of the resolutions**. The latter is a very cumbersome process in some countries (e.g. Italy) and overall in cross-border situations. However, **shareholder resolutions should be used as the last resort** and only in the absence of any progress shown by the company after a period of engagement.
- We would also like to point out that **selling off should always be an approach of last resort** as this does not result in companies becoming more sustainable but in simply passing the ownership to other investors. Please refer to the EFAMA stewardship code¹¹ where we elaborate on that and explain the recommended escalation path in case the initial engagement does not bring the intended results.

¹⁰ https://www.efama.org/Publications/Public/Corporate_Governance/EFAMA%20Stewardship%20Code.pdf

¹¹ Idem

- Please also note that **selling off is not always possible**. For instance in case of index investment, the fund manager is obliged to follow an index and does not have the discretion to sell the assets.
- Lastly, the **revised Shareholder Rights Directive** already provides for disclosures of the engagement policy and report. **Inconsistencies and / or overlaps should be avoided**. We also suggest to allow incorporation by reference of the existing disclosures stemming from other regulatory requirements.

Our recommendations:

- The engagement criteria should be adjusted to reflect the diversity of companies and be made more flexible regarding objectives of the engagement. For the reasons stated above, we do not believe that a specific threshold for engagement should be set, primarily as it may divert resources from companies that are least green, and are not necessarily part of this fund.
- Engagement should only be required in the following cases:
 - A potential breach has been identified e.g. one of the Do Not Significant Harm (DNSH) 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).
 - For companies whose activities fall under the scope of the taxonomy but do not comply with them or only for a small part, and have not taken the necessary steps (e.g. capex investments do not comply either).
 - To improve disclosures in some areas e.g. qualitative DNSH or minimum safeguards, for example.
- However, if any threshold were to be set, we would suggest targeting 10% of least green assets managed by the fund.
- Any **inconsistencies and / or overlaps** with the requirements in the **Shareholder Rights Directive II** should be **avoided**.
- We suggest to allow incorporation by reference of the disclosures stemming from other regulatory requirements.
- The existing obstacles to engagement between companies and investors should be removed. For instance, we suggest to facilitate investors' AGM voting process, especially across borders, and filing of the resolutions.

8. EU vs NATIONAL LABELS

We believe there is a need for clarification on the interplay between the EU Ecolabel and the national labels. We understand that the EU Ecolabel will not replace national labels, which makes sense since many of the national labels have a broader purpose (e.g. ESG) compared to the Ecolabel which is intended as an environmental label.

However, we are concerned that even in cases where a fund obtains the EU Ecolabel, distributors may still ask for the national label for accessing local markets. Such situation would be defeating the purpose of having a European label and result in high costs which, at least to an extent, are passed on to the end-investor.

Meanwhile, national labels (provided by national law) will have to use the EU Taxonomy as the basis as stated by the EU Taxonomy Regulation. This means that the main differences between green labels will be the thresholds and other criteria e.g. exclusions.

Our recommendation:

We would suggest to clarify that, **for funds that have been awarded an EU Ecolabel, local labels** (provided by national law) **should not be requested** to enter a new market.

9. DERIVATIVES

The JRC's 2nd proposals attempt to limit usage of derivatives for investment purposes which could raise technical issues, for instance usage of bond futures and IRS in fixed income portfolios, as well as for equitisation of cash in open ended funds which is not temporary. This may also raise problems with the compliance of the index derivatives with the EU Ecolabel (due to lack of available and/ or liquid contracts). Meanwhile, their usage can be beneficial for risk management purposes (in particular in outcome oriented and/or risk managed products).

Our recommendation: We would therefore suggest not to limit the use of derivatives for investment purposes.

10. ASSESSMENT AND VERIFICATION

While it is obvious that the assessment and verification are part of the set-up of the EU Ecolabel, it is important that they remain as efficient and cost-effective as possible for the successful uptake of the EU Ecolabel, as well as to reduce costs.

In line with the EU Ecolabel regulation, national bodies are in charge of the assessment and verification, and awarding the label. While we understand in countries with the existing national labels it seems to work well, it would be useful to reflect on how the level playing field, consistent interpretation and valuation of provided information can be assured.

The requirement to provide evidence of the monthly averages for the 12 months preceding the application to conform to the criteria may have the following negative consequences:

- may substantially delay the submission of the first applications for the Ecolabel.
- would not allow for new and innovative products to be eligible for the label.

Regarding the requirement to provide updated information to the relevant competent body every 6 months, we would like to know what time delay will be for a review of updated information.

We would like to highlight the comments of a majority of the stakeholders (55%) made during the 1st AHWG meeting. They 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. Thus, assessment and verification should be efficient and as simple as possible, to avoid increasing the costs and time-to-market. The conclusion that only one type of assessment and verification would apply to all products is therefore welcome.

Our recommendations:

To ensure relatively simple and costs-efficient assessment and verification, we recommend:

- to reflect on how the level playing field, consistent interpretation and valuation of provided information can be assured
- to reconsider the requirement to provide evidence of the monthly averages for the 12 months preceding the application to conform to the criteria. When the funds' investment objective and policy are approved by the relevant national regulator as part of the prospectus and explicitly meet the requirements as described by the EU Ecolabel, we would suggest that these be

awarded the label. This could be, for instance, done on a provisional basis to encourage flows into new products and hence scale them up more quickly.

- that only one type of assessment and verification should be applied to all products.
- to clarify the timeline that competent authorities will follow to review the updated information submitted by market participants every six months.

11. CROSS-BORDER DISTRIBUTION

We would also like to flag that there are still many existing **barriers to cross-border investment**. It is **important that funds with an EU Ecolabel can be easily disseminated** within the EU. We understand that the products that can apply for an EU Ecolabel are governed by the sectorial legislation (e.g. UCITS, AIFMD) which also provides or not for a “passport”. However, we would like to stress that the success of the EU Ecolabel amongst others depends on an easy dissemination of the EU Ecolabelled funds across the borders.

12. RETAIL INVESTORS INFORMATION

The disclosures proposed to be added to the prospectus, KID or KIID are extensive and would require a considerable amount of space, which is not available under the current 3-page limit applicable to the current PRIIPs KID. Therefore, we would appreciate **a clarification whether the information can be included in the prospectus** offering much more flexibility, and whether any information needs to be included in a KID or KIID. However, bearing in mind that the PRIIPs KID does not offer flexibility and that the current page limit is very restrictive and already used up by the existing information provided.¹² Requiring to include any comprehensive information in the PRIIPs KID **entails a change to the level 1 of the PRIIPs Regulation** to extend the number of pages.

We would suggest to check whether there may be any disclosure inconsistencies or overlaps with the Sustainability Disclosures Regulation (SFDR). Please allow incorporation by references of the information already disclosed in line by other regulatory requirements, e.g. in annual report, or in line with the Sustainability-related Financial Disclosures Regulation.

Concerning annual updates and sharing the revised documents with the end consumers by email or any other media (page 84, last paragraph), we would prefer to **align this with the current practice**. For instance the PRIIPs KID is a pre-disclosure document which means clients receive it once before their investment decision. They usually do not receive updates although they can consult the document on the website of the provider. Any ongoing disclosures should be considered through either MiFID or IDD which provide investors with ongoing ex-post cost information on (at least) annual basis.

Alignment with the current regulatory requirements and practice also concerns the **annual verification by the competent authorities. Consistent interpretation, timelines and alignment between different regulatory requirements is of crucial importance.**

¹² UCITS KID offers a bit more flexibility

Our recommendations:

- Clarification is needed whether the proposed disclosures can be included in a prospectus instead of a KID or KIID. Consideration should be given to the space restriction especially in case of the PRIIPs KID.
- We would suggest to check whether there may be any disclosure inconsistencies or overlaps with the Sustainability Disclosures Regulation (SFDR). We propose to allow cross-references in the annual report to information published in line with SFDR and also other rules.
- We would also suggest to **align the provisions on the annual updates and sharing the revised documents with the end consumers**,¹³ as well as on the **annual verification with the current regulatory requirements and practice**.

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¹³ suggested in the JRC report by email or any other media

ANNEX

Availability of EU Taxonomy-compliant activities & ESG data

Currently there is insufficient availability of ESG data on investee companies necessary for screening against EU Taxonomy, making it difficult to check which companies and what percentage of their activities are Taxonomy-compliant. This is reflected in the Financial Impact Assessment of the EU Taxonomy¹⁴ done by the JRC, confirming that: *“We can identify companies involved in activities covered by the Taxonomy. However, understanding the relative share of activities aligned with it is much harder.”*

The EU Ecolabel Regulation mentions that the criteria shall “correspond indicatively to the best 10-20% of the products available on the Community market in terms of environmental performance at the moment of their adoption”. Meanwhile, according to various estimates and initial testing, the thresholds as proposed would result in an investable universe which is much lower and largely insufficient to ensure a proper risk diversification.

According to the analysis by MSCI, approx. 9% of MSCI ACWI IMI constituents are likely to be involved in eligible activities and meet ‘no harm’ requirements. Approximately 17% of bonds (by market value) in the Bloomberg Barclays MSCI Green Bond Index would meet EU Taxonomy eligibility criteria. The testing performed by a company from our membership shows that barely 2% of all companies in the MSCI World index would potentially qualify as investments meeting the first criterion for equity under the 2nd JRC proposal¹⁵. When accounting for the second threshold¹⁶, the investment universe would still be restricted to less than 10% of MSCI world.

Moreover, we note that during the testing of the thresholds by the JRC within the dedicated subgroup, some fund managers used their own taxonomies given that screening criteria for EU Taxonomy was still being developed. We also note that most of the asset managers who volunteered to test the criteria, found it difficult to determine which activities were Taxonomy-compliant and could not verify that the DNSH were met by the investee company.

In the above mentioned report on a Financial Impact Assessment of the EU Taxonomy¹⁷ published at the end of last year, the JRC identifies an “upper bound” for the financial value of securities that may be associated with Taxonomy-eligible activities, by providing the percentage of outstanding equity and issued bonds that are ‘covered’ (and not necessarily ‘eligible’) by the Taxonomy:

- 13% of equity issued by NFCs is covered by the EU Taxonomy.
- 17% of bond outstanding amount issued by NFCs is covered by the EU Taxonomy.

However, **the JRC**, due to the challenges experienced, **simply identifies companies that have ANY EU Taxonomy-eligible activities, and summed up all their equity and outstanding bonds.** Meanwhile, **this is NOT the approach followed by the JRC for the EU Ecolabel criteria**, where there are specific **thresholds regarding the amount of activities** financed by the EU Taxonomy within a company for this company to be eligible. And according to our understanding, to-date, **there has not been any proper impact assessment conducted that would reliably estimate the current investment universe.**

This is further exacerbated by the fact that EU Taxonomy is still in the process of being developed. The latest TEG report proposes the screening criteria for climate mitigation and climate adaptation. But it

¹⁴ <https://publications.jrc.ec.europa.eu/repository/handle/JRC118663>

¹⁵ the requirement to invest 20% of a portfolio in companies deriving at least 50% of their revenues from green economic activities

¹⁶ 40% of AUM in companies with at least 20-49% of their turnover deriving from green activities

¹⁷

https://publications.jrc.ec.europa.eu/repository/bitstream/JRC118663/2020.01.10_technical_report_commission_Taxonomy_published.pdf

will take at least another year to develop the criteria for the activities in line with the remaining objectives. As a result, there is plenty of neutral activities for the moment, which are not meeting the criteria of eligibility. This also limits eligible companies to very specific sectors only.

For example, if we look at the cement sector, only LafargeHolcim and one other company are expected to operate at the threshold set by the TEG in the foreseeable future. If we look specifically at LafargeHolcim, only 24% of their sales in Europe is derived from cement (the rest come aggregate and concrete that are not covered by the screening criteria to date) and only 25% of their revenues are derived in Europe from their European sites, which would be able to verify that they meet the DNSH criteria, given that these are based on European environmental standards. This means that for this company, despite it operating at the Taxonomy level for the relevant segment, it could be that only 6% of revenues are Taxonomy-compliant.

All of the above confirms that at least in the short-to-medium term, there will be a **scarce amount of funds that will be eligible for the EU Ecolabel**. This may have a **negative impact on the value and usage of the EU Ecolabel**. Distributors seem to be interested in the label, as it is a clear indicator for retail clients, but the supply of such funds is dependent on the existence of underlying investments in eligible activities and companies, on the feasibility of the EU Ecolabel criteria and on a cost-benefit analysis of applying for such label.

We are hoping that the data availability will improve with the application of the EU Taxonomy Regulation. However, provisions requiring disclosures for companies within the scope of the Non-Financial Reporting Directive will only apply as of 1 January 2022 for climate change mitigation and climate change adaptation, and as of 1 January 2023 for the remaining environmental objectives. While the disclosures by financial participants are expected to kick in at the same time.

We understand that the shortage of ESG data shall be also addressed with the upcoming review of the Non-Financial Reporting Directive, but it may take several years before we see improved disclosures resulting from it.

In the short to medium term, all of the above will pose serious challenges. Asset managers and investors will be reliant on the companies providing ESG data and research, which also currently raise a number of concerns (including insufficient transparency, questions around quality and reliability a lack of regulation in this area), and on the direct engagement with the investee companies. While direct engagement can be a useful tool to try to persuade investee companies to become more sustainable, it can be questioned how much of the outreach resources should be spent on simply persuading companies to disclose certain data in a certain format over getting them to change their business practices. Furthermore, companies do not always provide the data as requested, this is particularly true for requests emanating from smaller asset managers and investors. Furthermore, as the NFDR will apply only to EU firms, funds with an EU focus may have easier access to the Ecolabel than geographically diversified funds.

Therefore, it is imperative to further **adjust the proposed thresholds, relax certain exclusions and enlarge the scope** to ensure that there is a sufficiently large investable universe for the asset managers to properly diversify the risks, to protect their clients' investments, and satisfy regulatory requirements (e.g. UCITS diversification requirements)¹⁸.

¹⁸ See Undertakings for the collective investment in transferable securities (UCITS) - Directive 2009/65/EC