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DUFAS Position on the EU Ecolabel

To	The Joint Research Centre of the European Commission
From	Dutch Fund and Asset Management Association (DUFAS)
Date	**10 december 2020**
Subject	Comments on the "*Development of EU Ecolabel criteria for Retail Financial Products, Technical Report 3.0: Draft proposal for the product scope and criteria*"
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DUFAS (*the Dutch Fund and Asset Management Association*)[1] welcomes the opportunity to respond to the EU Joint Research Centre (JRC) consultation on the "*Development of EU Ecolabel criteria for Retail Financial Products, Technical Report 3.0: Draft proposal for the product scope and criteria*", as published by the JRC in November 2020.

In general DUFAS wishes to make the following comments:

Support to the development of an pan-European Ecolabel

- **General support & scoping: DUFAS fully supports the development of an uniform pan-European Ecolabel for investment products distributed across the EU (hereinafter referred to as the "EU Ecolabel**"). For the success of the EU Ecolabel and to ensure a sufficient diversification to properly manage risks for investors, we believe that the scope of the Ecolabel should be kept as broad as possible.

  > We therefore welcome that in the 3rd report the JRC includes retail AIFs. However, we still believe that the coverage should be as broad as possible, including real estate funds and investment products such as ELTIFS as well.

- **Pass-or-fail system**: DUFAS maintains that the pass-or-fail system of the EU Ecolabel contains flaws. We do emphasize that the aim of the EU sustainable finance package is to prevent greenwashing. **The focus thereof should be that the retail investor is informed as accurately as possible about the sustainability or ecological greenness of the investment**

[1] *The Dutch Fund and Asset Management Association (DUFAS) promotes the collective interests of asset managers, investment firms and custodians, operating on and from the Dutch market place – both Dutch and foreign parties. Dufas has a commercial focus, aimed at creating both institutional and retail business opportunities for its members. Central to this is the promotion of an optimal business climate for asset management in the Netherlands. A level playing field for free supply of investment products and asset management services within the European Union and a broadening of the market for investment products are key. Dufas represents over 95% of the Dutch asset management market, both retail and institutional business. Next to independent asset management firms, self-managed (real estate) funds and custodians, Dufas membership is comprised of asset management firms that are linked to banking, insurance and pension funds. For more information, see: www.dufas.nl*

product. Furthermore, from a liability perspective, awarding the EU Ecolabel to an investment fund which is for a substantial part not ecological sustainable in accordance with EU regulations may give rise to liability claims if not properly explained to the retail investor.

- We are therefore supportive of any points scheme or system where there is more room for indicating the greenness of an investment product within the framework of the EU Ecolabel. **Alternatively, it could be considered to address the shades of greenness of an investment fund which has obtained an EU Ecolabel by adding an Ecolabel greenness indicator into the PRIIPs KID or UCITS KIID or any similar information document. Furthermore, imposing more shades of greenness of an investment fund also benefits setting the threshold.** It is very difficult to set the right threshold for the EU Ecolabel which suits each market party needs. Therefore we still advocate to introduce a bandwidth system, so-called "*schuifsysteem*" or star system. In such system all offerors of investment products are obliged to indicate the percentage of taxonomy compliancy (e.g. in tranches of 10 or 20%). All investments funds exceeding a minimum threshold are eligible for the EU Ecolabel**.** This reduces the resistance against a high threshold, while at the same time it leads to a broader range of investment products with an EU Ecolabel. Disclosure obligations imposed upon financial market participants as envisaged by the SDFR and the Taxonomy Regulation may form the basis of such system.

We still believe that the pass-or-fail system maintained in the 3rd report does not address our concerns as mentioned. We have noticed that in the 3rd report the thresholds particularly for UCITS equity funds have been increased in comparison to the proposed thresholds in the 2nd report. This is positive and may address some of our concerns of the pass-or-fail system. However, we have noticed that the calculation of the UCITS equity funds threshold of 40% can be heavily weighted to green growth instead of green revenue. If we understand it correctly, an Ecolabel may even be awarded based on 10% green revenue only supplemented by green growth. We are concerned about the weight of this combination. The problem with calculations based on green growth is that there is no (i) reliable data available and (ii) it may be at hindsight considered by retail investors to be greenwashing if such growth has not been met. We therefore recommend to focus on green revenues and not on green growth in the formula. **In other words, the weight of green growth in calculating the threshold should be limited. Green revenues should carry most of the weight in the calculation of the threshold.**

Moreover, we understand that specific retail investor information is provided for. This is also imposed upon the financial market participant by the SFDR. However, indicators including more shades of greenness of an investment fund into the label is still not provided for. We still believe that may be of added value for a retail investor. In addition, the 3rd report seems to reflect that references to the EU Ecolabel can be included in the PRIIPs KID or UCITS KID. This may also be of added value, although we understand that the 3rd report does not refer to include indicators of greenness into the PRIIPs KID. It may however have merit to investigate whether indicators of shades of greenness may be developed and included in the PRIIPs KID on a voluntarily basis or in a similar information document.

- **<u>Product level rather than services level:</u>** We understand that the proposal for EU Ecolabel for financial products is based on the EU Ecolabel (Regulation (EC) No 66/2010 of 25 November 2009. This regulation applies to products", *either goods or services, that are supplied for distribution, consumption or use in the EU*".

  As a result hereof we have assumed that the EU Ecolabel is awarded to the financial service provider rather than to the individual specific investment product. This seems to suggest that for eligibility of the EU Ecolabel it is the financial service provider itself that needs to comply with the EU Ecolabel. Page 3 of the Report states that "*Consequently, 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."* However, the entire report sets eligibility criteria for individual investment products, including setting and defining thresholds for individual type of products, ranging from retail AIFs, UCITS equity funds to other asset classes.

  We therefore call upon to the JRC to explicitly indicate and explain what it means that the regulation applies to products", e*ither goods or services, that are supplied for distribution, consumption or use in the EU*" rather than to individual investment products. Does this imply that the criteria should be applied to the service provider, i.e. e.g. the management company of the UCITS equity funds or not? If affirmative, how should this be calculated in practice?

  But more importantly, if the EU Ecolabel should be applied to the service provider, we believe that this creates limitations of the use of the EU Ecolabel for financial investment products. Many Dutch asset managers are currently offering sustainable investment funds, which eventually may meet the ESG criteria as currently developed by the EU taxonomy. However, not all investment funds which are offered by such asset manager will meet such criteria. **If the pass-or-fail system applies to the asset manager rather than the individual investment fund of such asset manager this limits the market for ecological sustainable investment funds more significantly in comparison to the situation that the pass-or-fail system is applied to the individual investment product only.**

  In any case, we believe that the implication of the regulation that applies to either "goods or services, that are supplied for distribution, consumption or use in the EU" should be well clarified in the final report in order to avoid any misunderstanding of the issue.

- **Thresholds criteria on equity funds & bond funds:** DUFAS acknowledges that it hard to set a threshold for green activities that satisfies all financial market parties.

  <u>UCITS equity funds thresholds:</u>
  We are on one hand positive about the increase of the thresholds for equity funds, which threshold has been raised to 40 % in the 3rd report. The threshold for *equity funds* set forth in the 2nd Technical Report amounting to 17%-18% of green activities in the investment fund

was in our opinion far too low. Particularly given the fact that the label is needed to avoid greenwashing and not intended to be an overall ESG label. However, on the other hand we noticed that the calculation of the UCITS equity funds threshold of 40% may also substantially come from green growth instead of green revenue. If we understand it correctly, an Ecolabel may even be awarded based on 10% green revenue only supplemented by green growth. We are concerned about the weight of this combination. The problem with calculation on green growth is that there is no (i) reliable data available and (ii) it may be at hindsight considered by investors to be greenwashing if such growth has not been met. **We therefore recommend to focus on green revenues, green revenue (GRi) and their % Green Capex (GCi), and not on projected Green Revenue Growth (GRGi). The weight of GRGi in the calculation of the threshold should be limited.**

<u>Calculations of UCITS equity funds:</u>
On the calculations of the threshold, we do believe that the calculation for UCITS equity funds threshold has become too complex. Although we do support inclusion of the Green Revenue Growth (GRGi) in this calculation method, more emphasis and focus should be placed on the GRi and GCIG. As said, GCI should have much more weight than GRGi. GRGi should be added as small part of the combination only. Moreover where GRGi is proposed to be based on *cumulative* % projected GRG, we recommend this to be based on *average* % projected GRG instead during the forecasted period. Finally, we are of the opinion that GCi and that GRGi calculations in the UCITS equity funds formula over a period of 5 years is far too long.

We do stress to keep calculations as simple as possible. Furthermore, we see less merit in various calculation methods for various products. Why should the calculation for an UCITS equity fund be so different from a bond fund? Such differentiation may only be relevant in case of green bonds. We therefore recommend to align thresholds and calculation methods between equity and fixed income.

<u>UCITS bond funds:</u>
We are also positive about the decrease of the thresholds for bond funds, which threshold was decreased from 70% to 50%. In our comment to the 2^{nd} report, we argued that proposed threshold at 70% was too high if such bonds also needs to be full taxonomy compliant in accordance with the EU Green Bond Standard ('GBS').

<u>Corporate bonds & sovereign bonds:</u>
We also welcome the inclusion of corporate bonds. In our comment to the 2^{nd} report, **we already recommended to include all bonds issued by certain green companies rather than only green bonds that comply with the EU GBS.** Particularly, all green bonds which are based on internationally recognized standards and frameworks like the Climate Bonds Initiative (CBI) or the ICMA Green Bond Principles.

- **<u>Avoidance of a niche market:</u>** As indicated before at launch, most of our members believe that it should be ensured that a significant number of investment funds should be eligible for the EU Ecolabel. This in order not to jeopardize the viability and successfulness of the EU

Ecolabel. Other members are of the opinion that as the Ecolabel should be an (high standard) aiming point, this means that having a limited number of investment funds eligible at launch is normal and should not be a reason to lower the standard.

We welcomed therefore the market research conducted and reflected in the Report "*Testing Draft EU Ecolabel Criteria on UCITS equity funds*", report of June 2020, as conducted by the European Commission. It does reflect our concern that the EU Ecolabel may only be awarded to niche products, as we understand that only 3 out of the 101 funds were tested positive on taxonomy alignment based on the draft criterion I. This was due to data limitations (in particular limited reporting) and the limited coverage of the EU Taxonomy.

However, we have to be mindful that this market study is backward looking, not forward looking. This means that the results may not exactly reflect the outcome when the EU Ecolabel comes into force. We expect that when the EU Ecolabel kicks in and data availability will increase overtime, far more UCITS funds will be eligible for Taxonomy alignment. Time is needed in order for the EU Ecolabel market to mature.

Nonetheless, it may be of concern that when the EU Ecolabel is anticipated to kick in only a small portion of investment funds may be eligible. The EU Commission may therefore reconsider timing of implementation of the EU Ecolabel or consider whether the ultimately chosen thresholds should be increased over time. Although, the latter may pose a concern for those Ecolabels that may already be awarded and subsequently may no longer be eligible considering renewed thresholds. In any event, it is worthwhile exploring how the issue on avoiding a niche market could be well balanced against having a reliable and trustworthy Ecolabel in place with sufficiently ambitious thresholds.

- **<u>Relationship with national ecolabels:</u>** asset managers operate on a cross border basis. It is essential that rules of cross border marketing of investment funds are harmonized within the EEA, which also include cross border marketing of investment funds with emphasis on ecological sustainability. We therefore are of the opinion that the EU Ecolabel should at the long term replace similar ecolabels on a national level, assuming such national labels also take the 'ecological' approach. **Furthermore or alternatively the EU Ecolabel should also have the benefit of an European passport** and should be equal to any national Ecolabel. We call upon the legislator where necessary to include into the review of legislative pieces such as the AIFMD and UCITS the European passporting facility for investment funds which are awarded an EU Ecolabel. For the avoidance of a doubt, national labels that not merely focusses on the "E", i.e. the more general ESG investment funds, are not likely to be replaced by the EU Ecolabel.

In the 3rd report, we have seen references to national labels, but the relationship is not being further elaborated upon in the report. We therefore repeat our position as reflected above that the EU Ecolabel should at the long term replace similar ecolabels on a national level.

- **<u>Process of assessment and verification:</u>** as indicated in our comment to the 2nd report, we do acknowledge and realise that the EU Ecolabel will be subject to an assessment and verification process. First of all, **we believe, however, that the assessment and verification process as envisaged by the 2nd Technical Report will become rather labour intensive and expensive**. It will also heavily rely on data which in general needs to be provided by third parties. Moreover, we do feel that more guidance should be provided as to the process of providing updated information to the relevant competent body. It should also warranted that the 'level playing field' between member states is being ensured, also in terms of (i) consistent interpretation by national competent bodies, (ii) consistent valuation of the updated information provided and (iii) uniform review timelines for the updated information. Secondly, the assessment and verification criteria for equity and bond funds requires 12 months of portfolio holdings. As a result hereof new and innovative products do not seem to be eligible for the EU Ecolabel. If the funds' investment objective and policy are approved by the respective European regulator as part of the prospectus and explicitly meet the requirements as described by the EU Ecolabel, **we advocate that such new investment fund should be able to be awarded the EU Ecolabel**. Perhaps on a provisional basis if that is necessary. This will encourage investor flows into new products and hence scale them up more quickly. In that context, experiences with the Febelfin label regarding both new and existing investment products could be taken into consideration.

> We do appreciate that the JRC acknowledged the data issue or the lack of data necessary to meet the requirements. We also welcome the JRC proposal which provides for a solution for new products. The 3rd Report provides with respect to the assessment and verification process that for new products, i.e. products put on the market less than 12 months prior to the application, the fund manager shall provide a prospectus which details the fund strategy, the initial composition and how the greenness threshold will be met. The 2nd Report seemed to contain a requirement of a track record of at least 12 months for eligibility of the EU Ecolabel.

- **<u>Costs of data:</u>** the success of the EU Ecolabel will also depend on the availability of data which should also be reliable and be comparable. Needless to say this is not necessarily an issue that is originated from the EU Ecolabel, but more from the EU taxonomy. **In terms of costs, we believe that there should be a proactive plan to limit the costs of obtaining, but also maintaining the EU Ecolabel (updating costs by the asset manager and supervisory costs).** At the end of the day, costs or part of the costs of the EU Ecolabel will also be borne by the end-client, i.e. the retail investor. Therefore, a mechanism that limits the costs of the EU Ecolabel should be in place within the regulatory framework as this is beneficial to the retail investor.

In terms of costs, we repeat our previous position. In addition, where calculations of the various thresholds of products are being made too complex, this may also add to the aggregated costs of maintaining the EU Ecolabel.

DUFAS: Dutch Fund and Asset Management Association
Since 2003, DUFAS has been committed to a healthy asset management sector in the Netherlands. DUFAS has more than 50 members: from large asset managers who invest Dutch pension and insurance assets to smaller, specialist asset managers. DUFAS increases awareness of the social relevance of investing, helps to develop sector standards and represents the sector in the implementation of new laws and regulations. In addition, DUFAS is committed to a single European market with equal regulations.

More information
Would you like to respond, or should you have any questions? I would be pleased to hear from you.