Brussels, 11th December 2020

EACB position paper on the EU Ecolabel for Retail Financial Products

Background:

The European Association of Co-operative Banks (EACB) is the voice of the co-operative banks in Europe. Co-operative banks form decentralized networks which are subject to banking as well as co-operative legislation. Democracy, sustainability and proximity are the three key characteristics of their business model.

The European Association of Co-operative Banks considers the work on EU ECOLABEL for Financial Products as an important step and welcomes the possibility to comment on the 3rd Draft technical report of the JRC. The EACB has already expressed the co-operative banks' point of view answering to the first two consultations on the preliminary reports and welcomes some of the novelties proposed in the third version of the report.

Given the fact that Co-operative Banks are typically retail banks, who interface mostly with households and SMEs clients, we are answering to this specific consultation from the point of view of "distributors". Please find below our detailed comments.

EACB comments on the JRC Technical Report on the Development of EU Ecolabel criteria for Retail Financial Products:

1. Rationale of the threshold proposed in criterion 1 (pp.30-31): The greenness threshold for retail AIFs has been raised to 70%, based on feedback that the ability to put together a compliant portfolio is easier. Indeed, the investable universe of retail AIFs is larger than the one of a UCITS fund, as it comprises both listed and unlisted equities, which can include 'pure player' green companies, as well as illiquid assets, which can include renewable energy projects, real estate and infrastructure projects.
The threshold for UCITS equity funds has been raised to 40%, based on feedback that the investible universe for equities can be expanded by making the following changes to the criteria:

1) Remove the pocket approach as it restricts asset managers and portfolio managers ability to put together compliant and suitably diversified portfolios, particularly in the case of large capitalization companies;
2) That the CapEx and/or projected growth in green revenue of 1) companies that are investing in transition (5-50% green revenue) and 2) companies investing in green growth (>50% green revenue) may contribute on weighted basis towards calculating the portfolio compliance.

This proposal for UCITS equity funds would ensure a forward looking approach, offering retail investors a portfolio that both invests in current green economic activities and that commits to

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future growth in green revenue, contributing to the transition towards a low carbon economy.

EACB views:

General remarks: We welcome the idea of a forward-looking approach. At the same time we foresee some difficulties about the reliability as this projected growth can – by definition – be only a "forward-guessing". This in turn opens up the questions what the potential consequences are if this growth projections aren't met. Especially in very young industries the projection of growth rates is not very reliable.

As Technical Report points into the direction that non-financial data won't be available before the NFRD Directive entering into force in 2022, so that this data might be available in 2023. No indication is given how this severe lack of data could be tackled until then. Additionally, this data will then be available for European companies only creating a problem for globally investing funds that – if based on e.g. an MSCI World-like benchmark – invest only approximately 40% in EU domiciled companies.

Moreover, it seems not clear why the Green Revenue Growth (GRGi) is capped at 100%. Exactly those companies that are early stage would be attractive for portfolio managers.

We welcome the new possibility for funds to apply for the Ecolabel also without a 12 month track-record. One question arises regarding the **continuous** compliance when it comes to the thresholds: What happens e.g. when – like during the "Covid crash" especially high growth stocks plummet and simply due to this effect the Greeness of the portfolio dips below the threshold?

Additional topics

Criterion 1: Regarding the UCITS bond funds (letter c, page 31) we believe that the 4 conditions proposed for bonds eligibility as green bonds in case they are not GBS-compliant could limit the quality of the EU GBS and possibly create inconsistencies between the different framework that are being developed. Likewise, we believe that the possibility for general-purpose corporate bonds to qualify for the EU Ecolabel for Financial products without meeting the GBS criteria could deviate from the original scope of a labelling regime.

At the same time, we acknowledge that these 2 possibilities would allow a welcome flexibility in the management of the funds. For this reason, we would like to propose to introduce a phase-in clause whereby after 5 years, the 50% threshold could only be met with green bonds aligned with the EU GBS or the GBP. For the remaining 50%, if the corporate bond wants to participate in the greenness of the fund, then the conditions proposed in the draft DA for general purpose corporate bonds would apply.

Criterion 1+2: Regarding companies in transition and green growth: we would like to highlight the fact that, concretely, it is hard to believe that portfolio managers will be able and available to provide strategic investment plans from the companies they are invested in, due to the strategic sensitivity of such information. Moreover, we believe that, in the case those plans are not meet in one year, a company might e.g. be tempted to "outweigh" an insufficient green capex in one year with an increase in year+3.

Criterion 3: We welcome the new draft as a significant improvement. The threshold of 5% for each criterion is very sensible. What is not customary and comes as a surprise is to take the

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parent company into account when it comes to exclusion criteria as the "responsibility" for the economic activity is limited to the company and its subsidiaries – and not the parent. It seems that this differs from criterion 4 where only the company is in focus (see below).

Criterion 4: With regard to the criterion proposed in page 107: "Upholds the freedom of association and the effective recognition of the right to collective bargaining. [ILO Convention, UN Global Compact]" we believe this could exclude the PRoC as the country neither the Freedom of Association and Protection of the Right to Organize Convention, 1948 (No. 87) (C.87) nor the Right to Organize and Collective Bargaining Convention, 1949 (No. 98) (C.98).

With regard to the comment at page 112: "*Although the company cannot be held responsible, the international treaties prevail local laws, and therefore this company is excluded. However, if the company is part of a holding, which operates elsewhere, the other entities of the holding are not affected, subject to their compliance with the social exclusion criterion*." we believe it could create inconsistencies with what established under criterion 3 (see above).

Criterion 5: No. 5.2 at page 116: We would like to underline that it could be very difficult that a fund manager can bring companies from outside the EU to align company strategies with the environmental objectives of the EU Taxonomy.

2. Inclusion of savings accounts (pp. 35-38): It was found feasible to add savings accounts to the initial scope of the product group (the EACB was in favour of this proposal). These are a mainstream financial product that could ensure high visibility for the EU Ecolabel and diversify the current scope of financial instruments beyond equities and bonds to also include loans, which play an important role in supporting economic activity as well.

The criteria proposed for deposit accounts are largely unchanged in this third draft technical proposal, **except for the reference to ring fencing**, which has been replaced by a requirement to report on accounting practices used to ensure 'separation' and to limit transferability of the funds for other purposes.

The requirement for itemised reporting of each loan for verification purposes and in a report provided to retail customer has been modified to refer instead to reporting on loans at a more general level of detail. Following the rationale proposed, **the money held in deposit and then granted as loans and/or used to buy bonds shall be separated within the accounts** of the Credit Institution in such a way as to restrict transferability and to ensure that the funds loaned are traceable to the money deposited by the customers. The structural solution and/or internal accounting procedures used shall allow for the traceability of the retail customers' deposited money and their contribution to the total value of the green loans granted.

EACB view: EACB members have already expressed their support on the possibility to include savings accounts in the scope of the EU Ecolabel for Financial Products. However, some key general considerations and remarks should be taken into account when it comes to the traceability, earmarking, data quality to assess the eligibility of projects and transparency of the process.

From an ALM perspective, these conditions (traceability etc.) create operational difficulties as banks' ALM does not allocate resources to specific uses, banks manage their balance sheet items globally. The balance sheets of banks are fungible, so one cannot tie that liability to that asset. Moreover, savings accounts are not in themselves sustainable or unsustainable. Thus the savings collected today, even if not "ecolabelled", can already finance sustainable projects. What makes

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savings sustainable is the existence of sustainable financing on the asset side of the balance sheet. In addition, whereas banks control their financing (assets), they have a limited control over their deposits which depend on their customers. For instance, during the covid crisis, deposits rose sharply, while sustainable investments stagnated. In fact, there are several different typologies of savings accounts, some of them very liquid and oriented to a short-term perspective. For these types of accounts, **it is not possible to imagine structural solution and/or internal accounting procedures to allow for the traceability of each retail customers' deposited money and their contribution to the total value of the green loans granted**, due to the fact that there are no legal obligations that prevent the mobilisation of money deposited and used to ensure 'separation' and to limit transferability of the funds for other purposes. We believe that the final report should clarify better how this process could be established in practice. As a possible solution to solve this issue, we believe that for similar reasons, this problem has already been solved by the "sustainable capital markets" community, via the market practices on Green/Social/Sustainability bonds. In fact, in the ICMA's *Green Bond Principles, Voluntary Process Guidelines for Issuing Green Bonds*[1], and more precisely in the chapter related to the Management of Proceeds, it is stated that: *the net proceeds of the Green Bond, or an amount equal to these net proceeds, should be credited to a sub-account, moved to a sub-portfolio or otherwise tracked by the issuer in an appropriate manner, and attested to by the issuer in a formal internal process linked to the issuer's lending and investment operations for Green Projects.* According to this already tested market practice, the Green-bond issuing bank can track and attest these proceeds. This process does not require a "legal ringfencing" of any kind but simply the commitment to invest or reinvest the green bond proceeds to existing or new "green loans", ensuring, at the same time, transparency in the whole process. The same arguments could be used when designing deposits inclusion in the EU Ecolabel framework.

For these reasons, we believe that the process to identify, trace, and report on the pool of eligible green bonds for the purpose of green deposits "issuance" should follow the same principles already existing for green/social/sustainability bonds.

3. Additional remarks:

- **Interdependencies with other legislative initiatives**: Following the exchange of views the EACB had with the JRC and DG FISMA on the Commission's understanding of the interdependency of the EU Ecolabel with the 'sustainability preferences' regime under the MiFID Delegated Act, DG FISMA have advised us that the EU Ecolabel does not exempt from applying sectorial legislation (e.g. the ESG preferences integration under the MiFID Delegated Acts) according to the fact it is a voluntary label to just be added on top of current legislation. According to what said, there is no negative interrelation because Ecolabel products satisfy the definition of sustainability preferences. Although we acknowledge that the EU Ecolabel is a post-sectoral legislation voluntary label, we still believe it is unclear which ESG products (including in this case EU Ecolabelled products) the

[1] https://www.icmagroup.org/assets/documents/Regulatory/Green-Bonds/Green-Bonds-Principles-June-2018-270520.pdf

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industry will be able to distribute to retail clients depending on their preferences. Whilst the EU Ecolabel product should be able to apply sectorial legislation, it is not evident how that will be achieved due to misalignment of concepts and definitions of ESG products between the SFDR (Article 8 and 9) and the MiFID draft Delegated Acts. Moreover, the Commission has highlighted that EU Ecolabel products are not necessarily Article 9 products, which means that they are in general Article 8 products but could be, in some cases which remain to be determined, Article 9 products. As it stands, we believe the proposed regulatory framework could represent a source of uncertainty. For those reasons, our Members are concerned about the practicability of the envisaged proposal, as it might lead to a situation where a client can be offered Ecolabelled-products that would be categorized in both Article 8 and Article 9. This could create confusion among the market and defeats the scope of a labelling regime.

- As a general comment, Members have highlighted the importance to link the process put in place for the evaluation of the creation of the Eu Ecolabel for Financial Products, with the implications that this process could have in relation to the prudential perspectives. According to the framework that will be developed, banks could start changing the way they originate loans. We have to ensure that the prudential dimension should be considered in this respect.

- Finally, as it is stated in the report under criterion 1 (page 30): "*All underlying assets that can comply with the criteria established in the Delegated Regulation (EU) xxxx/xxx supplementing Article 3 of Regulation (EU) 2020/852 21 ('the EU Taxonomy') may be counted towards the total portfolio greenness, including, where applicable, real estate and infrastructure investments made by underlying funds in which unit shares are held*". The Commission has recently launched a very important consultation on the proposed Delegated Acts to the taxonomy regulation (climate change mitigation and adaptation activities). We believe that some of the new criteria introduced in the Commission's proposal will have a huge impact on the possibility for banks to finance green activities. In our view, the Taxonomy can promote green financing and increase capital flows to environmentally sustainable activities if, and only if, the criteria are achievable for a reasonable amount of assets. With the proposed change in criteria related to the acquisition and ownership of buildings built before 2021, for example, the Taxonomy would most likely be ignored in financing of residential buildings and in funding the mortgages with covered bonds in many Member States. Those criteria are unachievable and risk to limit the availability of Ecolabeled financial products.
  In this context it has to be considered that, at this point of time, we could face a potential lack of diversification within the "Taxonomy compliant portion" (i.e. 40% for UCITS equity funds) of the portfolio: in fact, this will largely depend on the final adoption of the technical screening criteria that will determin the eligibility of economic activities according with the provisions of the taxonomy regulation.

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