Brussels, 3rd May 2019

Development of EU ECOLABEL criteria for Retail Financial Products

EU Commission - Draft criteria proposal for the product scope and ecological criteria – Questionnaire

Introduction

The European Association of Co-operative Banks (EACB) is the voice of the co-operative banks in Europe. Co-operative banks form decentralised 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. With 3.135 locally operating banks and 58.000 outlets co-operative banks are widely represented throughout the enlarged European Union, playing a major role in the financial and economic system. They have a long tradition in serving 209 million customers, mainly consumers, retailers and communities. The co-operative banks in Europe represent 80.5 million members and 749.000 employees and have an average market share of about 20%.

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 Preliminary Report of the JRC.

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 questionnaire from the point of view of "distributors".

Following the analysis of the Preliminary Report on EU ECOLABEL for Retail Financial Products and of the (Draft) Technical Report on criteria proposals for the development of EU ECOLABEL for Retail Financial Products, published last March, please find our detailed answers, based on the consultation questions, below.

QUESTIONS:

TOWARDS THE EU ECOLABEL CRITERIA

Q. 1.1 Do you agree with the proposal of a set of mandatory criteria for the EU Ecolabel for this Product Group (p. 11)?

A.1.1 The adoption of a (closed) set of mandatory criteria is too strict. As outlined in report, one of the main disadvantages is that only very small market of products could be certified. This heading for a niche contradicts the basic idea of the Action Plan. Even worse, a perception that the vast majority of existing ESG-/SRI funds is excluded from certification might even risk the so far successful development of this market.

We therefore strongly recommend an approach that combines a mandatory (pass/fail) system for certain criteria with a point-based system (similar to the Austrian Ecolabel): we would like to

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suggest, for instance, an Eco label whereby the different products are classified on an eco-continuum ranging. The Eco label should be constructed in a way that is open to all (or at least most) already existing sustainability investment approaches. By this the Eco-label could serve as a starting point for a SRI label that we see as a must in a medium-term perspective.

PRODUCT SCOPE AND DEFINITION

Q. 2.1 Do you agree with initial proposed scope for the EU Ecolabel (p. 17)?

A 2.1 Yes.

Q. 2.2 Do you think other financial products/services should be included that are not covered in the initial proposed scope (p. 17)?

A. 2.2 Simply for reasons of size (and by this overall impact) we recommend to include institutional assets and pension products. Savings/deposits and structured products are rather optional.

Q. 2.3 To what extent could savings and deposits be included within the scope in the future given the need to be able to identify specific uses of the money held in them as being 'green' (p. 17)?

A 2.3 It is possible to include savings and deposits, not directly but indirectly: a bank must "earmark" credits/mortgages that are compliant with the (forthcoming) taxonomy or Green Bond Standard and be able to balance these two (assets and liabilities).

Q. 2.4 While bonds are included as underlyings to investment funds, to what extent could retailed bond products themselves be included within the scope in the future, with verification of their greenness based on the Green Bond Standard (p. 17)?

A 2.4 Bonds are not underlying to funds but part of the portfolio. We highly recommend to include retail bond funds. Other bond products can be included given the mentioned verification.

Q. 2.5 Are there any other financial products or retail investment opportunities that could be considered for a future scope (p. 17)?

A 2.5 No.

CRITERIA PROPOSALS

Relating to green economic activities

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Q. 3.1 Is there a way to address economic activities not yet featured in the current version of the EU Taxonomy and its technical criteria (p. 27)?

A 3.1 [Given the shifting framework on the EU Taxonomy, and the work that has to be done on the classification of activities, upon which the TEG is working, it results very complicated to answer to this question]

Relating to green investment portfolio value

Q. 3.2 How could the revenue for a parent group with number of daughter companies and their share be handled (p. 27)?

A 3.2 If the scope of the label is the direct positive ecological impact of a company, the turnover of a parent company is irrelevant for the assessment of a daughter company in which an investor wants to invest in. In case the investor seeks an investment of a parent company the turnover of the daughter company (companies) is attributed identically to the applied (financial) accounting rules.

Beyond that, it is questionable whether "turnover" is the correct basis for calculations. This becomes obvious especially for e.g. retailing companies where a large part of environmental impact lies in the supply chain. The more appropriate calculation basis therefore is the economic value-added.

Q. 3.3 How should assets held in other investment funds be treated within this criteria? Do they require any special form of verification (p. 27)?

A 3.3 The most pragmatic approach would be to tolerate these funds as long as the overall thresholds are still met (keeping in mind that due to UCITS regulation these funds are limited to 10% of a fund's portfolio).

Q. 3.4 To what extent should real estate also be considered as a specific asset within the portfolio verification? If so, how could its performance be verified (p. 27)?

A. 3.4 Single real estate investments are untypical for investment funds. Sustainable real-estate funds do invest either in listed real-estate companies (REITs) or directly into real-estate. In the second case, the application of a wide set of sustainability criteria (with EPCs and labels being just one) is common.

Q. 3.5 Should assets for which verification of greenness is not required be included within the total portfolio asset value (p. 27)?

A 3.5 No.

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Q. 3.6 Should any type of criteria on trading practices and/or use of funds be applied to derivatives and cash (p. 27)?

A 3.6 No.

Q. 3.7 Does the assessment and verification require any specific parts to be tailored to individual products within the scope (p. 27)?

A 3.7 The assessment depends upon the asset class. Otherwise: no.

EXCLUSIONS

Q. 3.8 Do you think the proposed environmental exclusions should be expanded to include more economic activities (p. 36)?

Q. 3.9 Do you think the partial exclusions threshold should apply to each company's activities or to the portfolio as a whole? If it should apply at portfolio level, should it be set differently for specific sectors (p. 36)?

CRITERIA AREA: SOCIAL AND ETHICAL ASPECTS

Q. 3.10 Do you think the proposed exclusions list on the basis of social & ethical aspects should be enriched with more activities (p. 41)?

A 3.10 No. As a comment to the ones proposed:

- For sovereign bonds the **possession** (and not the use) of controversial weapons should be the exclusion criterion. The exclusion criterion could also focus on the signing of important conventions like the Ottawa convention (Convention on the prohibition of the use, stockpiling, production and transfer of anti-personnel mines and their destruction) or the Oslo convention (Convention on Cluster Munitions)
- Non ratification of international conventions on social and ethical matters e.g. ILO conventions: This is too generic as there are many conventions and not all have the same impact/importance. A well defined list of necessary conventions would be better.
- The 50 points threshold for corruption is arbitrary. First, the typically used index is a corruption **perceptions** index. Perception does not necessarily reflect the real situation. (s. Nicholas Charron: Do corruption measures have a perception problem? In: European Political Science Review. 8, Nr. 1, 2016, S. 147–171.) Secondly, it is not clear why there is the cut at 50.

Q. 3.11 Do you think it may be appropriate to also exclude poor corporate management practices and/or poor human capital development? If yes, how it will be possible to verify such exclusions (p. 41)?

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A 3.11 This is an important indicator for ESG/sustainability funds but does not directly fit into a framework based on turnover considerations (positive as well as negative) as these are characteristics of processes and not products/services (=economic activities). An integration of this as an exclusion criterion could only be based on a broader ESG analysis.

INFORMATION

Q. 3.12 What will be a reasonable interval for monitoring and reporting information to the consumers (p. 44)?

A 3.12 As the label is heavily relying on carbon emissions a yearly monitoring and information is reasonable as this is also the reporting interval for companies.

Additional comments to the EU ECOLABEL Questionnaire:

1) It is absolutely essential to understand that different sustainability approaches have so far developed in order to serve different financial needs. The Best-in-class approach was (historically speaking) the answer to the failing thematic approaches of the 1980s (from a performance point of view speaking). It allows to invest broadly diversified across many industries. As a result the investment risk is comparable to conventional approaches - making it useful to use it as a core investment in a well structured portfolio.
   Sustainable investment strategies like thematic and impact investment will – due to their inherent higher investment risk – always remain only a minor part of a prudent investor's portfolio.
   Therefore, if the EU Eco Label will – as proposed in the report – focus on exclusion criteria, thematic approach and impact investment, it will focus on a niche market with only limited impact on the economy as a whole.
   Besides that such a rather tight definition might have a detrimental effect on the overall ESG/SRI market as the current ESG/SRI strategies would be excluded from certification (in a worst case from continuing to call themselves sustainable) thus unsettling current investors.

2) An important topic that has not been reviewed is the (voluntary) transparency of sustainability funds that is emphasizing the openness of the concept of sustainable finance on the one hand and giving an investor the possibility to choose a product according to his values. **The European SRI Transparency Code**, followed by 700+ funds in Europe, **is the current gold standard and an adaptation/integration of this reporting standard should be considered**.
3) **It is not clear who can provide the necessary data in order to define whether** (and to what portion of turnover) a company is providing "green activities". If it is the companies themselves (which is just natural as they are the only ones having the data on turnover on that granular level), the label opens up a loophole for green washing.

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