AMIC response
EC consultation on the EU Ecolabel for retail financial products
11 December 2020

AMIC welcomes the opportunity to comment on the third draft version of the EU Ecolabel for retail financial products.

In our previous response, we had stated our support for a well calibrated EU Ecolabel for investment funds, which could add significant value to investors, while flagging some important areas of concern. When looking at the specific provisions proposed by the JRC, we shared our concerns regarding the combination of high portfolio thresholds and stringent screening criteria which could shrink the eligible investment universe and therefore limit considerably the amount of funds (in particular those investing in equities) able to qualify within these requirements. We therefore advocated to keep the proposed Taxonomy portfolio thresholds but invited the JRC to review the Taxonomy alignment requirement for investee companies, and consider potential implementation challenges linked to exclusion criteria and engagement requirements.

With this third draft, our concerns are reinforced by new provisions setting the bar higher than in the second draft and we fear that, at best, only a residual portion of the greenest of sustainable funds will be able to meet these requirements. One important challenge resides in both the green threshold levels and the new conditions attached for investee companies to be eligible for the green threshold. Likewise new exclusion requirements could further restrict the eligible universe of the green and diversification buckets, which is a point of concern from a risk management point of view. The engagement criterion is not yet reflecting current market practices and considering legal hurdles as highlighted in our previous response.

We would therefore suggest to :

- **Recalibrate the green thresholds as previously proposed by AMIC** considering that data now confirms (i.e. EC[1], Novethic[2] and UNPRI case studies[3]) that it is not possible for the 'greenest' investment funds to comply with the proposed requirement. Based on these

[1] An EC study looking at the ability of existing 'green' equity funds to meet the Taxonomy portfolio thresholds (putting aside other requirements like exclusions, engagement etc) confirmed that only 3 funds out 101 would be able to meet the second draft proposal.

2 In a recent study led by Novethic shows that 29% of the assets of of 159 'green' equity funds studied (€50bn AUM) are Taxonomy compatible, while 84% of the assets of the 46 'green' bond funds (€8.5bn AUM) are invested in greens bonds (which does mean that they are necessarily Taxonomy compliant). The average share of portfolios from sustainable activities listed by the Taxonomy does not exceed 30%. Less than 20 funds have a 'taxo-compatible' share greater than 50%. It must be noted that for Novethic study that key Taxonomy criteria including thresholds and metrics, respect for social safeguards, and DNSH were not applied and 'this study employs a rather broad acceptance of taxo-compatibility, to put into perspective similar studies based on estimates for threshold and metric verification'.

[3] Please see annex

findings our members estimate that most 'green' funds would fail to meet the first criterion of the reviewed EU Ecolabel requirements and that the largest part of the market (i.e SRI selection : Best-in-class, Best-in-universe, Best-effort) would surely be excluded. The challenges with the first criterion go beyond the portfolio Taxonomy alignment requirement (40% for equity and 50% for bonds) which were lowered comparing to the first version on the one hand but raised on the other hand given the new investee companies requirements (see following bullet points).

- **Strictly align the EU Ecolabel on the EU Taxonomy framework and drop new definitions on companies 'investing in green growth' and 'investing in transition'** which further restrict the investment universe and hinder the chances of success of the EU Ecolabel**.** Green companies need to have at 50% of Taxonomy-aligned revenues which will be difficult to meet for most issuers (not to mention requirements on companies' strategic investment plans). Transition companies need to have at least 5% of Taxonomy-aligned turnover but have to commit to green revenue (> 20% in the next 5 years) and green capex objectives (20% on average in the next 3 years and last 2 years) and close down capital assets that would otherwise be excluded under the criterion on environmental exclusion (e.g. end of fossil fuels energy, end of fossil fuels cars etc...). This will considerably restrict the eligible green investments beyond what is foreseen by the Taxonomy framework. Furthermore, some of these concepts (such as green CapEx) are yet to be detailed in the upcoming delegated act regarding the implementation of article 8 of the EU Taxonomy (i.e. ESMA consultation) and should not be preempted by the EU Ecolabel.

- **Review UCITS bond funds requirements :** To be eligible for the green thresholds, vanilla and green bonds, such as the ones aligned with the Green Bond Principles (GBP), would need to be issued by green companies and companies in transition. The reference to green companies or a company in transition should be deleted (as explained above) or at least it should not apply to use-of-proceeds bonds. The only requirements for green bonds aligned to the GBP should be the funding of one of the activities identified by the EU Taxonomy Regulation and the tracking and reporting obligations. The requirements regarding refinancing are very restrictive and at odds with current market practice. A very significant portion of existing green bonds are used for refinancing purposes but not to fund new green projects or for the creation of asset-back securities. It is very common for corporate issuers to fund green projects via syndicated loans for example which are then refinanced by green bonds issued by corporate issuers. This very common financing structure would not meet the **refinancing requirement set under the Ecolabel and as a result many green bonds issued by corporate issuers would have to be excluded.**

- **Finetune environmental exclusions:**
    - According to the third draft, bonds issued by companies, which are engaging in activities listed under criterion 3, are to be excluded from investment funds. This would rule out the possibility to invest in vanilla but also green use-of-proceeds bonds such as the one aligned with the GBP issued by most **energy companies (**32% of use-of-proceeds bonds in 2019) **and car manufacturers** given the conditions attached (e.g. fossil fuels phasing out commitment). We strongly encourage the JRC to reintroduce the sentence which was dropped in the third iteration: 'The investment portfolio may contain use-of-proceeds bonds issued by such companies, provided that the proceeds are not used to finance excluded activities.' Asset managers should be allowed to invest in projects allowing companies to transition to low-carbon business models. Asset managers may want to additionally use ESG screening allowing them to select specific types of issuers of green bonds.

- We welcome in principle the **additional requirement for sovereign bonds** (i.e. Paris agreement signatories and credible CO2 reduction trajectory compatible with a 2 degrees scenario). But this would require the EC to issue a list of eligible sovereign issuers and a standard methodology.
- Regarding the exclusion of **nuclear energy**, we suggest to stick to the decision yet to be made under the EU Taxonomy framework.

- **Clarify social and governance exclusions :**
  - **Scope**: It remains unclear whether the social and governance exclusion criteria will have to be applied looking **through the supply chain** ('The investment portfolio shall exclude companies if they, through their business activities […]').
  - **Collective bargaining:** It is required that a company shall be excluded unless it upholds the freedom of association and the effective recognition of the right to collective bargaining (ILO Convention, UN Global Compact). We flagged in our previous response that with this proposal, there is a risk of seeing some global companies participating in the taxonomy objectives and operating in certain third countries excluded from the EU Ecolabel (e.g. Tesla). Not all third countries have indeed signed up to the ILO Declaration on Fundamental Principles and Rights at Work, allow freedom of association or recognise collective bargaining. Since the JRC added one sentence: 'Only in reference to that point, if the excluded company is part of a holding that operates elsewhere, the other activities of the holding are not excluded subject of their compliance.' It is unclear to us whether or not this clarification will allow investment in equities/vanilla bonds issued by companies operating in some key third country markets.
  - **Obligation to sell 1 year after controversy/allegations regarding social exclusions:** we believe that this should be left at the discretion of the asset managers especially given the lack of clarity on the points mentioned above.

- **Modify the engagement requirement taking into account legal hurdles and current market practices (i.e. firm level vs fund level)** as proposed previously. New engagement requirements have been introduced in the second draft. If engagement is to be encouraged, the JRC should refrain from being too prescriptive and favour more general requirements (i.e. documented engagement strategy, transparency on exercise of voting rights). It is important to understand that at this stage most asset managers engage at firm level and not at fund level and are not in a position to require firms to shift revenues in one direction or another. We would also suggest leaving it to asset managers to decide which companies to engage with. At some point in time asset managers may want to focus on companies at risk of breaching thresholds and at another point in time it may want to engage with green companies. Mandatory engagement with specific companies might divert resources where they are most needed at a specific point in time. Furthermore, some of the engagement activities required are not always feasible: AGM voting processes and filing of resolutions on a cross-border basis can be very cumbersome in some EU countries. Lastly, cooperating with other shareholders to push a specific resolution is not always possible from a legal standpoint.

Annex. AMIC : UNPRI Taxonomy case studies and the EU Ecolabel portfolio threshold

Investment fund tested	HQ region	Asset class /geography	Taxonomy alignement	Ecolabel portfolio alignment
1	Europe	Listed equity Global	2.17%	No
2	Europe	Listed equity Concept fund	38% but subject to DNSH qualifications	No
3	Europe	Fixed income Concept fund 170 of GBs	67% of GBs potentially aligned but subject DNSH and MSS qualifications	Potentially but DNSH and MSS not tested and % is based only on GBs (i.e. excluding diversification assets)
4	Europe	Listed equity	0.24%	No
5	Europe	Listed equity/ fixed income (corporate, general)	NA	No
6	North America	Fixed income Concept Index	50%-60% of GBs aligned	Potentially but DNSH and MSS not tested and % is based only on GBs (i.e. excluding diversification assets)
7	Europe	Fixed income (corporate, general)	<3%	No
8	Europe	Listed equity	NA	No
9	Europe	Real assets (real estate)	NA	No
10	Europe	Listed equity	NA	No
11	Europe	Fixed income	20%	No

Investment fund tested	HQ region	Asset class /geography	Taxonomy alignement	Ecolabel portfolio alignment
		(green bonds)		
12	Europe	Real assets (infrastructure)	NA	No
13	North America	Fixed income (corporate, general)	NA	NA
14	North America	Fixed income (corporate, general)	NA	NA
15	Europe	Listed equity	NA Based on 5 companies not a fund	No
16	Europe	Real assets (forestry)	> 50%	No, because retail AIFMD need to reach at least 70%
17	North America	Listed equity	NA	No
18	Europe	Listed equity	0%	No
19	Europe	Listed equity	5%	No
20	Europe	Listed equity	16.3%	No
21	Europe	Listed equity	5.8%	No
22	Europe	Fixed income (corporate, general)	NA Based on three companies not a fund	No
23	North America	Listed equity/ fixed income (green bonds)	6.30%	No

Investment fund tested	HQ region	Asset class /geography	Taxonomy alignement	Ecolabel portfolio alignment
24	North America	Listed equity	20%	No
25	Europe	Fixed income (corporate, general)	NA	No
26	Europe	Listed equity	Not based on a fund but 50 electricity producing companies (average alignment of 23%)	No
27	Europe	Fixed income (green bonds)	Not based on a fund but on green bonds under a mandate (49% potentially aligned)	No
28	Europe	Fixed income (green bonds)	NA	No
29	Europe	Fixed income (private debt)	Not based on a fund but on selected financial institutions providing loans (76% aligned)	No : loans don't seem to be an eligible asset under the ecolabel for retail AIF
30	Europe	Fixed income (green bonds)	NA	No
31	Europe	Listed equity	Only 34% is eligible (ie not necessarily aligned)	No
32	Europe	Listed equity	9.1%	No
33	North America	Real assets	NA (test performed across funds)	No
34	Europe	Listed equity	Fund % NA 35% average for 9 companies selected	No

Investment fund tested	HQ region	Asset class /geography	Taxonomy alignement	Ecolabel portfolio alignment
35	Europe	Fixed income (corporate, general)/ fixed income (green bonds)	Based on fixed income including Gbs by asset owner 1-5%	No
36	North America	Listed equity Concept portfolio	Based on an portolio of equities issued by companies enabling climate change mitigation/adaption 51.7%	Potentially but DNSH and MSS not tested and % seems only based on green companies (i.e. excluding diversification assets)
37	North America	Fixed income (corporate, general)	NA	No

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