# Consultation Paper

**Dutch Banking Association - Consultation reaction on Ecolabels for Financial Products**[1]

The Dutch Banking Association ('Nederlandse Vereniging van Banken' or 'NVB') welcomes the work of the European Commission on Sustainable Finance. This work includes the current proposals of the Technical Expert Group ('TEG') on the Taxonomy and proposals of the Joint Research Centre in ('JRC') on Ecolabels for financial products.

The Netherlands currently doesn't have a national Ecolabel scheme for investment funds. In this consultation paper we would like to share our view on the proposal of the JRC to create Ecolabels on a European level.

The NVB believes a well-designed Ecolabel could be an useful tool in reaching the European Commission's goal of steering assets towards more sustainable economic activities. We consider finding the right balance for a future financial product Ecolabel the main challenge. If requirements to qualify for an EU Ecolabel are too high, a limited amount of assets will be in scope, which would decrease the impact as only a very narrow selection of funds would receive an Ecolabel. If the requirements are too low, clients of financial market participants might re-allocate less capital to more sustainable economic activities. In all cases greenwashing should be avoided.[2]

Below are some suggestions the NVB would like to share with the JRC in this consultation paper:

- We would suggest that focusing on institutional investors (like pension funds) instead of retail investors in the initial phase would increase its feasibility;
- If the Ecolabel's ambitious aim is to label the 10%-20% best environmentally performing products available in the market the JRC should consider to significantly lower the proposed 70% threshold at portfolio level to a level that could be defined by a newly composed subgroup. Furthermore we would suggest a model in which all funds are rated (for example 1 to 5 stars) so consumers can make well informed decisions. After an initial lower threshold the JRC could aim to set the bar higher again at a later stage;
- We suggest to integrate the Ecolabel goals in the current PRIIPs regulation and especially in the Key Investor Information Document ('KIID') that is currently under review by the European Supervisory Authorities. Integrating sustainability firmly in the KIID would also avoid double implementation and information burdens for fund managers;
- The Ecolabel, with its link to taxonomy, focuses on environmental sustainability. For the purpose of transparency to retail investors and flexibility for asset managers, we believe the Ecolabel should avoid incorporating social and governance aspects to the extent possible;
- We have some remarks around scope The scope (UCITS, (R)AIF's and Real Estate Funds) would require more guidance from the JRC;
- We suggest to provide evidence and research on the impact of an Ecolabel on ongoing costs. Costs are the key detriment on retail investors' performance across Europe;
- We suggest to provide consumer testing. We believe information alone will most probably not be a game changer. The proposed Ecolabel is a step in the right direction but legislators and policy-makers should not expect too much impact from information as a stand-alone feature.

[1] More specifically, on the Technical Report with scope and criteria proposals that the Joint Research Centre of European Commission has published.

[2] Greenwashing refers to the practice of gaining an unfair competitive advantage by marketing a financial product as environment-friendly, when in fact it does not meet basic environmental standards. See also the taxonomy regulation page 17 here.

Gustav Mahlerplein 29-35 • 1082 MS Amsterdam • +31(0)20 55 02 888 www.nvb.nl

16 april 2019

*Focus on institutional instead of retail*
Moving assets to more sustainable economic activities should be done step-by-step. We believe the European Commission should start with legislation for highly sophisticated and institutional investors instead of retail investors. The goal of the Ecolabel Regulation clearly states its intended target audience is retail. One could also argue that an Ecolabel would make no difference for institutional investors as they are already highly sophisticated and consider environmental aspects and social and governance aspects already in their investment process.[3]

*Threshold*
The Ecolabel regulation states that criteria should be based on the best products available on the Community market in terms of environmental performance throughout the life cycle and that they should correspond indicatively to the best 10-20% of the products available in the market. With the current proposals the JRC sets out, the Ecolabel is arguably very far from covering even 1% of the fund market. We believe the investable threshold at portfolio level should be lowered significantly to create more impact to increase sustainable economic activities. Otherwise portfolio managers will only be able to invest in a very narrow subset of securities. This could impose liquidity risk, market movements and could be contrary to the purpose of MiFID II investor protection[4]. If the JRC lowers the threshold, they could mainstream sustainable finance instead of creating a label for a niche. Along the road, the threshold could always be altered again if we have ascertained what works and what not.

Preferably all UCITS and AIF's funds should receive a label (for example 1 to 5 stars) so consumers can compare ecological performances of funds that perform well versus funds that underperform. Retail investors should be thoroughly informed about the 'green' character of a fund, preferably in a PRIIPs KIID.

*PRIIPs*
Besides the threshold, the NVB believes the JRC should use existing regulations like the PRIIPs Regulation to inform investors about the sustainability of a fund that presents itself as sustainable. The Ecolabel regulation itself should then not per se be necessary for UCITS or AIF's because a link could be made in the PRIIPs KIID to the Taxonomy regulation (to avoid greenwashing). PRIIPs already aims to encourage investments in sustainable investments, enhance transparency by means of information (KIID), and increase EU Harmonisation. These are the same goals that the Ecolabel regulation for financial products tries to achieve.[5] The PRIIPs review planned for the end of this year could be a good starting point for the JRC to integrate the two regulations for financial products.

*Environmental Ecolabel*
The Ecolabel, with its link to taxonomy, focusses on environmental sustainability. For the purpose of transparency to retail investors and flexibility to asset managers we believe the Ecolabel should avoid incorporating social and governance aspects as much as possible. Incorporating arbitrary S and G safeguards could blur the purely ecological character of the Ecolabel, especially because a more encompassing framework for S and G is currently absent and not due in the upcoming period.

*Costs*
Besides some questions around scoping, for example with regards to UCITS, (R)AIF's and Real Estate Funds, we would like to urge the JRC to conduct further research on costs. We believe there should be an impact analysis by the JRC on total costs of a fund that meets all the criteria to apply for an Ecolabel. Retail investors will have to bear these (most likely higher) costs. In case a fund manager receives an Ecolabel he will probably have made more costs than an average fund manager that hasn't applied for an Ecolabel.[6] Costs are the number one drain on return for retail investors throughout Europe. ESMA's Steven Maijoor underlined this recently in his speech at better finance: "..total costs of

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[3] Within the SF Action plan, asset managers are also obliged to integrate these ESG risks (MiFID II) and to disclose them (Disclosure regulation);
4 From a risk-return standpoint
[5] See also the presentation of the First AHWG Meeting, Seville April 4th, p.17
[6] For example expanded research costs, employment costs, costs for ESG data providers. An active fund manager now also charges extra for his management style compared to passive investments. Receiving an Ecolabel seems only possible for Active fund managers in general; which undeniably will lead to higher costs for retail investors.

a fund represent a significant drain on fund performance, with on-going costs constituting over 80% of the total cost paid by customers and impacting retail investors to a much greater extent than institutional investors".[7] This argument underlines the important to start with institutional investors and only after include retail investors. We should make very clear to retail investors that investing in sustainable projects could have a serious effect on costs, and therefore on return.[8]

*Consumer testing*
Unfortunately, no consumer testing has been conducted. There is a risk that the Ecolabel as a standalone feature would have limited added value for the client,. Legislators and policy-makers might expect too much from informing a client with pre-contractual information. Information could ultimately prove not to be a key decisive element when a client is deciding whether to buy a financial product or not. Clients are persuaded by several other elements, proved by several behavioural finance studies. Providing more information seems a logical and purposeful business, but it might actually hamper retail investors to enter the financial markets as they cannot process the amount of information that is provided to them.

[7] Please also see ESMA speech page 3. https://www.esma.europa.eu/press-news/esma-news/steven-maijoor-delivers-key-note-speech-better-finance-10th-anniversary
[8] Too clarify this: we don't state that sustainable investments yield more or less than none- or less sustainable investments. We are writing about the effects that higher costs could have on yield.

**1.1 Do you agree with the proposal of a set of mandatory criteria for the EU Ecolabel for this Product Group?**

The NVB believes that a proposal with a set of flexible criteria should be used for the Ecolabel. We therefore do not agree with the proposal of a set of mandatory criteria. In the initial questionnaire we also highlighted that a set of mandatory criteria, at the initial stage, would entail the risk of narrowing down the fund landscape that could receive an Ecolabel significantly. Making all criteria mandatory for applicants, could mean in practice that only a very small set of funds could apply for an Ecolabel. This very small set of funds will only have a very marginal impact on shifting assets in the right direction to provide for a transition to a more sustainable economy.

As mentioned in the introduction, finding a right balance with a future Ecolabel could prove very problematic. In short: if the requirements for receiving an EU Ecolabel are too high, not a lot of impact can be expected as only a very narrow selection of funds will receive an Ecolabel (as the JRC now proposes). If the requirements are too low, we admit that we are not re-allocating capital to more sustainable economic activities and actually could provide for greenwashing. A balance should be found between certainty and transparency on the one hand and arguably more impact on the other hand.

Indeed, EU standards and labels for sustainable financial products would protect the integrity of and trust in the sustainable financial markets, as well as enable easier access for investors seeking products. But we believe that the binary proposal that the JRC now has submitted (a fund either receives a label or not instead of labelling all funds) is a proposal that seems out of balance. We prefer a more flexible, points based system where the complete fund landscape could receive an Ecolabel based on a rating of, for example, 1 to 5 stars.

Around social and ethical exclusions as a mandatory criterium, we believe it could blur the pure ecological character of an Ecolabel. In general we therefore don't support social and ethical exclusions in the Ecolabel, at a minimum we propose to narrow the social and ethical exclusion list as much as possible. Financial market participants are by law already obliged to safeguard some social and ethical aspects in their investment process.

**2.1 Do you agree with initial proposed scope for the EU Ecolabel?**

Within the scope of the Ecolabel regulation, we agree with the initial proposed scope of certain PRIIPs (i.e. UCITS and certain insurance-linked investment products). On a more overarching level we believe that focussing on retail investors (with the Ecolabel regulation) instead of institutional investors could prove to be a missed opportunity. The clear emphasis of the Commission to use the Ecolabel regulation (that is clearly not constructed to cover retail financial products) seems therefore artificial and out of balance as it doesn't entail the possibility to include institutional investors.

If the JRC would like proceed with incorporating financial products into the Ecolabel regulation, we would like to highlight the below remarks:

1. PRIIPS

If JRC aims for retail, they should use existing retail regulation like PRIIIPs to inform investors. The Ecolabel regulation should then not need to be applied to UCITS or RAIF's because a link could be made between the PRIIPs KIID and the taxonomy to avoid greenwashing. PRIIPs already aims to encourage investments in sustainable investments, enhance transparency by means of information (KIID) and increase EU Harmonisation. These are more or less the same goals that the Ecolabel regulation tries to achieve. The Ecolabel goals are to create unified labelling criteria at EU level, to encourage investments in the sustainable economic activities (EU Taxonomy), and to create enhanced transparency and greater investors' confidence in the market. As the goals of the PRIIPs regulation and the Ecolabel Regulation overlap significantly, we believe the JRC should focus more on integrating sustainability in PRIIPs instead of framing UCITS into the Ecolabel regulation. With the upcoming review of the PRIIPs regulation at the end of 2019, there could be a good opportunity to integrate the two regulations.[9]

2. Information bias

With providing an Ecolabel in addition to the KIID to retail investors, we might expect too much from relatively low-informed groups of investors. As sustainable finance is complex, expecting the customer to make an informed decision might prove unrealistic. Information might be not a key decisive element when a client decides to buy a financial product or not. Clients could be persuaded by several other elements. Providing more information seems a logical and purposeful undertaking, but it might actually hamper retail investors to enter the financial markets as they cannot process the amount of information that is provided to them (this is also called the 'information overload'). This is another reason why we would argue to integrate the Ecolabel (or the sustainability of the fund) in the PRIIPs KIID instead of awarding funds an Ecolabel separately.

It does not mean we don't support the Ecolabel on itself at all. Like the PRIIPs KIID, an Ecolabel could prove useful. But not too much effect can be expected by legislators and policy designers.[10] Especially as there has been not been any consumer testing yet.

3. Level of labelling

The proposed product group in scope comprises financial products that are provided as a **service** by a fund manager and have been packaged for retail investors in accordance with the requirements laid down in Regulation (EU) No 1286/2014 on packaged retail and insurance based investment products (PRIIPs).

The Ecolabel thus foresees in **labelling the service instead of the fund**. The aimed service group shall comprise the *management* of UCITS and Retail AIF's that are provided as a **service** by a fund manager and have been packaged for retail investors in accordance with the requirements laid down in the PRIIPs regulation. So, in the area of UCITS, the UCITS management company would apply for an Ecolabel because the asset manager is providing the service of the management of the fund, to the product (the fund itself). The fund itself is not labelled. This could be seen as a weaving error that could provide for greenwashing. We believe that at fund level a label should be awarded (and not at the management company level).

4. UCITS

A UCITS can be divided by compartments (or "sub-funds") that can be sub-divided by share classes.[11]

The compartments or sub-funds are separate parts of a common fund vehicle, subject to fund rules in their own right, and having **their own investment objective**.[12] Furthermore, compartments are usually legally segregated from other compartments, meaning that a liability arising in one compartment cannot be offset by the assets in other compartments of the fund. This is a key point, as the Ecolabel regulation and the proposals by the JRC now foresee only at providing an Ecolabel at the management company level instead of the fund level.

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[9] PRIIPs del. Reg. art 19. Increasingly, retail investors pursue, along with the financial returns on their investment, additional purposes such as social or environmental goals. However, information on social or environmental outcomes sought by the PRIIP manufacturer can be difficult to compare or may be absent. Therefore, anticipated sustainable environmental and social developments in financial investments, as well as the application of Regulation (EU) No 346/2013 of the European Parliament and of the Council could allow for such aspects to be more appropriately integrated into and further fostered by, Union law.

[10] See also Carien de Jager's recent study on PRIIPs. In her introduction she writes: "information documents for financial products are ineffective because the legislator cannot influence many very relevant factors such as financial literacy and the way in which investors make decisions"

[11] A UCITS or one or more of its compartments can be sub-divided by share classes. See ESMA's discussion paper on UCITS share classes 2016 here

[12] See also art. 49 of the UCITS Directive.

Share classes, in contrast, are not compartments but different types of units or shares belonging to the same UCITS. Even though all investors in a fund invest in a common pool of assets, share classes attribute different rights or features to sub-sets of investors in relation to their investment. Thus, share classes allow for a certain level of customisation for investors with special characteristics or requirements, e.g. the distribution of revenues, a particular tax treatment under national law, or a different minimum investment amount.[13] There is no legal segregation of assets between share classes. However, any costs arising in a given share class are attributed to the investors in that share class only. Any investment outcome relating to specific arrangements in a given share class is credited to that share class only. There are currently several types of UCITS share classes set up throughout the EU, which provide investors with different features. Some share classes have been set up to differentiate between groups of investors. One of the biggest differentiators between share classes, is a retail share class versus an institutional share class. We believe the JRC should look into UCITS deeper, as it could include institutional share classes as well. We do support the latter, but it could be an unintended consequence of scoping by the JRC, as the JRC wants to use the Ecolabel Regulation to focus on retail only.[14]

5. RAIF's and AIF's

As was stated during de JRC AHWG meeting at the 4th of April by several attendees, most hedge funds or impact investing opportunities are not open to retail investors. This means that only a very small amount of AIF's that could obtain a future Ecolabel, is open to retail investors. Therefore the impact of this category can be seen as marginal. Not only RAIF's but institutional hedge funds and impact funds should be included in the scope as well.

**2.2 Do you think other financial products/services should be included that are not covered in the initial proposed scope?**

We believe it should not be extended any further.

If any other products or services are to be included, we suggest the EC should produce a roadmap to inform stakeholders about upcoming extensions of the scope.

**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'?**

On the one hand we believe the scope should not be extended any further at this point. On the other hand, not including current Dutch green saving schemes[15] in the Ecolabel proposals of the Commission, could entail unfair competition. A retail investor could argue that only certain UCITS and AIF's are green, whilst the green saving schemes are not green.

**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?**

We believe, in principle, that once a (retail) bond is green as defined by the green bond principle/standard, it could apply to an Ecolabel as well. On a more fundamental level, retailed bond products themselves should be subject to the same criteria under the Ecolabel regulation as equities. A more definite link with the GBS is therefore not indispensable in our view.

**2.5 Are there any other financial products or retail investment opportunities that could be considered for a future scope?**

[13] Please see ESMA's discussion paper on UCITS share classes 2016 here
[14] As stated before, JRC's choice for the Ecolabel regulation makes its aimed at retail, not institutional. But by including UCITS, you include institutional share classes as well.
[15] Please see the Green Funds Scheme here. The scheme includes deposits and saving schemes as well as green funds.

We believe that the JRC and the European Commission should aim to start with a relatively small scope, and deduct lessons learned from this. After UCITS and AIF's, other financial products could come into scope but only after thorough review.

As mentioned in 2.2, if any other products or services are to be included, we suggest the EC should produce a roadmap to inform stakeholders about upcoming extensions of the scope.

**3. Some remarks around criterion one (70% of the total portfolio asset value shall be invested in green economic activities as defined in point 1.2).**

We believe a threshold of 70% is not realistic if we are truly aiming to deliver some impact, and shift assets towards more sustainable economic activities. A proposed threshold of 70% could have a major impact on the flexibility of a portfolio manager, who besides in servicing the client in his/hers sustainability needs is trying to weigh risk versus return. Diminishing the investable landscape by a large percentage could actually mean the portfolio manager may be acting on the best interest of the client in the sense of sustainability needs, but not in the sense of delivering a proper risk/return balance.

The Ecolabel regulation states that criteria shall be based on the best products available on the Community market in terms of environmental performance throughout the life cycle and they shall correspond indicatively to the best 10-20% of the products available in the market. With the current proposals the JRC sets out, the Ecolabel is arguably very far from covering even 1% of the fund market. Lowering the threshold could have as a result that we are not awarding just 1% (or less) of the fund landscape with an Ecolabel but an arguably higher percentage. The sub-group that is allocated with the task of setting criterion 1a should define how much the threshold should be lowered in order to reach our common goal of shifting assets to more sustainable economic activities.

Besides lowering the threshold, it is our preference that all funds should receive a label (for example 1 to 5 stars) so consumers can compare ecological performances. Lowering the threshold and awarding non-environmentally sustainable funds with a rating as well (with for example only 1 star) could create a more solid and comprehensive ground for retail investors to make informed decisions.

**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?**

At this point it is appropriate to only include economic activities that substantially contribute to environmental activities that have a taxonomy and cause no significant harm to any other environmental objectives. By the end of 2019, only climate change adaptation and mitigation will be defined by the Technical Expert Group ('TEG'). As the TEG has not yet developed a framework of sustainability definitions around i.e. pollution prevention and control, a circular economy, water resources or healthy ecosystems it would be premature to address economic activities that are not yet featured in the – by then – current version of the EU taxonomy.

**3.2 How could the revenue for a parent group with number of daughter companies and their share be handled?**

The revenue should only be analysed at the parent group level. Parent groups need to disclose consolidated reporting, we therefore see no added value in handling revenues of daughter companies separately.

**3.3 How should assets held in other investment funds be treated within this criteria? Do they require any special form of verification?**

We are not sure. On the one hand, we think it might be too wide-encompassing to include Fund of Funds ('FoF's') from the start of the Ecolabel implementation. On the other hand, as the focus as of now is almost purely on retail and a lot of retail investors use UCITS FoF's to invest we believe these funds should be able to obtain an Ecolabel as well. FoF's in general don't need a special form of verification, we have a preference for a same way of application and implementation as with regular equity or bond funds.

**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?**

Please note that most real estate is neither listed equity nor directly available to retail investors. Because of this nature of real estate investments we believe it contrasts the goal of the Ecolabel regulation that is aimed at retail investors. As with AIF's, our advice to the JRC would be to look at how to include institutional real estate investors in the Ecolabel regulation.

If the JRC considers real estate as a specific asset within the portfolio verification, performance measurement should be aligned as much as possible with (current) international standards like:

- The EU taxonomy on real estate should be followed. Making assumptions without the taxonomy will lead to a wait-and-see attitude of investors;
- BREEAM. Has been used in multiple member states; [16]
- Green Building Standards and Certification Systems (GBS); [17]

Please note that the Real Estate stocks themselves, as investable securities underlying in a fund, do not have a very significant impact on greenhouse gas emissions.[18] The construction sector on the other hand has a rather significant impact on greenhouse gas emissions. But construction companies don't always comprise the majority of stocks within Real Estate Funds.

**3.5 Should assets for which verification of greenness is not required be included within the total portfolio asset value?**

We don't believe the total portfolio asset value, and therefore also assets for which verification of greenness cannot be analysed, should be included. Not including those assets, will leave portfolio managers with more flexibility to construct a portfolio.

**3.6 Should any type of criteria on trading practices and/or use of funds be applied to derivatives and cash?**

We see no direct reason why there should be criteria on trading practices that are to applied to derivatives and cash.

**3.7 Does the assessment and verification require any specific parts to be tailored to individual products within the scope?**

No, we don't believe so.

**3.8 Do you think the proposed environmental exclusions should be expanded to include more economic activities?**

If the inclusion threshold is lowered from 70% to a much lower level, we believe there could be more room for expanding the list of environmental exclusions. If the inclusion threshold is not lowered significantly, we believe a minimum set of exclusions leave portfolio managers with some flexibility.

**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?**

[16] https://www.breeam.nl/content/breeam-nl-english
[17] https://www.wbdg.org/resources/green-building-standards-and-certification-systems
[18] Please see Maarten Vleeschouwer's presentation on Sustainable Finance at DNB, 28th of March 2019. Page 26 (upon request)

We believe the partial exclusions on a company's activity level should only include environmental activities and should not be set differently for specific sectors.

**3.10 Do you think the proposed exclusions list on the basis of social & ethical aspects should be enriched with more activities?**

Although we firmly believe in anchoring social and ethical aspects into investment processes, we believe at this point the list with regards to environmental exclusions in the Ecolabel should not be further expanded.[19]

More fundamentally, the Ecolabel has a strong focus on environmental aspects, with only safeguarding some basic social and ethical aspects. The term "Ecolabel" is clearly focusing on environmental aspects since this label is to be awarded to financial products with the best *environmental* performance. If it were to take into account other aspects it could be misleading for the investor. Expanding the list of social and ethical exclusions will change the identity of the Ecolabel to a more ESG-sort-of label. As we have no taxonomy yet on the majority of environmental topics in general it would be unwise to include more social and ethical exclusions at this point in particular as there is no taxonomy for those parts yet.[20]

It is worth noting, that although corruption could be a relevant activity for exclusion, the proposed threshold (<50) may exclude quite some EU member states government bonds (e.g. Croatia's level is 48, Greece's 45, Bulgaria 42).

**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?**

It might be appropriate to exclude poor corporate management and/or poor human capital development. But with the current lack of definitions and data it would be very difficult to verify such exclusions. Furthermore, poor corporate management could not be defined as a environmental aspect and should therefore not be included in the exclusion list.

**3.12 What will be a reasonable interval for monitoring and reporting information to the consumers?**

As we proposed to align the goal of the EC/JRC as much as possible with the existing PRIIPs regulation, we believe the interval should be aligned with PRIIPs regulation as well. This means that the Ecolabel should be updated at least annually.

[19] Anchoring these aspects will already be provided for by the amendments to MiFID II (integrating sustainability risks and factors in MiFID II) and by the Disclosure Regulation (for vote April 2019)

[20] If social and ethical aspects are to be included, the inclusion should be timed with the introduction of a social sustainability taxonomy under the EU Taxonomy Regulation.

**Contact details**
Dutch Banking Association
Robert Jan Prins
Policy Advisor Financial Markets & Retail