

## Green Finance Observatory comments on the Draft criteria proposal for the product scope and ecological criteria (Development of EU Ecolabel criteria for Retail Financial Products)

Brussels, 6<sup>th</sup> May 2019

The Green Finance Observatory is an independent non-profit association set up in 2017. Our mission is to analyse sustainable finance legislative proposals and related market-based solutions in European environmental policies, to assess whether they can meet their stated environmental, economic and social objectives. The Green Finance Observatory is registered under the EU Transparency Register with ID 852329329251-06. Only the questions that are relevant to GFO are reproduced here. We agree to the publication of this response.

Q2.4 Given the range of possible investments in a portfolio and the different combinations of criteria, it might be beneficial to examine a point system for the Ecolabel. To what extent would this be appropriate for this product group?

It would be appropriate to set clear ex ante principles building on and going beyond the taxonomy to ensure the robustness and credibility of the framework with a pass or fail test. A point system could open the door to excessive complexity and regulatory arbitrage and is therefore not suitable in our view. As importantly, it could provide an illusion of substitutability between social, environmental and governance factors (see next question), whereas these dimensions are complementary.

Q4.1 What types(s) of strategies should be reflected in the EU Ecolabel criteria?

Only exclusionary screening based on the taxonomy should be allowed in order to ensure consistency with the taxonomy.

While such an approach may have an adverse impact on existing ESG strategies, it would yield great benefits in building environmental credibility for the label and thus ensure buy-in from investors.

As the Ecolabel will apply to complex products sold to retail investors, it should go beyond the taxonomy and green bond standard as it involves a higher risk of mis-selling. This argues in favour of strict criteria.

Q4.2 To what extent do you consider that the EU Ecolabel should have criteria that address social issues?

Social issues are intertwined with environmental issues, therefore key social factors should be included to ensure that social detriment is not caused by environmental projects. There is indeed documented evidence of human rights abuse linked to some carbon offset and biodiversity offset projects (e.g. land use and ownership conflicts, land grabs and human rights violations against communities – See Carbon Market Watch, The Clean Development Mechanism: Local Impacts of a Global System, October 2018)

Q4.3: In relation to Q4.2, which of the following social aspects do you consider relevant for the EU Ecolabel for financial products?

The investment products should respect all the European legislations on human rights, labour rights, non-discrimination, health and safety and respect for the rights of the communities.

Q4.4 To what extent do you consider that the EU Ecolabel should have criteria that address how ethical are corporate activities and governance structures?

We believe that the EU Ecolabel should have governance criteria. It is however unclear how governance issues could be included when no taxonomy will be developed on governance due to its 'horizontal nature'. Including governance without a sound taxonomy might be a recipe for ethical-washing.

Q4.5 In relation to Question 4.4, which of the following governance aspects do you consider should be relevant for the EU Ecolabel for financial products?

Tax evasion, anti-corruption, director employee pay ratio and transparency are obviously very important.

Lobbying activities and tax avoidance may also be relevant for any ESG framework, including the future Ecolabel.

Q5.1 Should the EU Ecolabel have exclusions for specific activities on the basis of their environmental impact?

We believe that the EU ecolabel should have exclusions. All the activities above should be excluded. In addition, carbon offsets and biodiversity offsets should also be excluded in our view as their environmental and social track record is not compatible with being part of an ecolabel.

Q5.2 Should the EU Ecolabel have exclusions for specific activities on the basis of their social and ethical impact?

Human rights and labour rights violations, corruption and rights of indigenous communities should be excluded.

Q5.3 If exclusions are included in the EU Ecolabel, should they be total or partial?

We believe that the exclusions should be total: total exclusions would strengthen the environmental and social integrity of the framework by ensuring that only sound financial instruments get the label. They would also reduce the risk of mis-selling.

It be also be remembered that products excluded are not banned and can continue to be sold, they merely wouldn't be able to display the ecolabel.

Q5.5 At what level do you consider the EU Ecolabel will need to work in order to verify the product's greenness?

The most effective, simplest and cheapest option is to look at the root level, i.e. activity and use of proceeds. In addition, the label would also need to work at company level to ensure consistency, i.e. prevent a company with a bad environmental, social or governance track record to issue a financial instrument with an ecolabel for a small green activity.

Q5.6.1 Based on your selection of 'portfolio' in Q5.5, what minimum percentage should be invested in green activities for product to qualify for the EU Ecolabel?

100% of the proceeds should be invested in green activities for products to qualify for the EU ecolabel. There is no justification to require less than 100%. Again, we must bear in mind the context of the question: this is not about allowing or banning any product, but merely to attribute an ecolabel to particularly outstanding environmental and social projects.

Any level below 100% would risk undermining public trust in the ecolabel in our view.

Q5.9 Focussing on specific asset classes, please describe technical criteria that could apply to the following:

Looking at project / use of proceeds level means it is possible to use the same criteria for all asset classes. This would further harmonize and strengthen the integrity of the framework. Financial derivatives instruments would however require additional criteria to ensure that financial engineering is not be used to enhance artificially the greenness of an underlying instrument.

Q5.11 To what extent should the greenness of the issuer of the bonds is taken into account?

Very great extent, as explained above.

Q6.1 To what extent would the following financial products require their own specific form of verification?

If the principles are sound and applied at root level, then there is no need for specific forms of verification, with the exception of structured products as explained above.

Q6.2 To what extent would the following asset classes require their own specific form of verification?

Same answer as above. Only financial derivatives and other instruments embedding derivatives would require additional forms of verification.

Q6.3 How can the cost and complexity of assessment and verification be minimised?

The cost and complexity of assessment and verification could be minimized by having simple harmonized principles applied at root level.

Q6.4 To what extent, and under what conditions, should private verifiers be permitted to assess compliance with the EU Ecolabel criteria?

Experience from the crisis shows that the risks of delegating due diligence to third parties, leading to higher risk taking, uniformity of views on risk leading to herding behaviour, reduced accountability and potentially systemic risks.