

The Draft criteria of the Ecolabel on financial products and the second technical report are still misaligned with the requirements of the Ecolabel Regulation

Feedback on the second version of the Ecolabel criteria for financial products (April 2020)



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Legend:

“*quote*”: extract from the JRC Technical Report / Ecolabel Draft Criteria

“*quote*”: extract from EU regulation and plans

“*quote*”: extract from an academic paper or another non-EC source

Role of the Ecolabel in the EC sustainable finance action plan

Developing financial products with a reduced/positive environmental impact. With its Action Plan on Financing Sustainable Growth, the European Commission (EC) has set itself the ambitious goal of “*reorienting capital flows towards sustainable investment*”. Retail investors appear to be the perfect allies to achieve this goal, as their interest in social and environmental impact-oriented financial products has never been stronger than now. As demonstrated in surveys and academic research¹, a majority of retail investors are concerned about sustainability and want to leverage their power as shareholders and investors to generate positive change in the real economy.

The concurrent evolution of regulatory requirements at EU level, including the extension of the suitability assessment to ESG-related preferences², the integration of sustainability factors to the target market assessment of investment entities³, and the introduction of sustainability-related disclosure requirements for financial institutions⁴, appears to support this trend. The stated objective is to enable retail investors to find financial products matching their impact-related expectations and to support the emergence of such products on the mass market. In this context, the Ecolabel scheme is one of the first concrete tools that the EC plans to launch to help achieve this objective. According to the EC, “*a credible labeling scheme for financial products should (i) allow retail investors concerned with the environmental impact of their investment to make informed choices and contribute to the Green transition and (ii) provide incentives to industry to develop financial products with a reduced environmental impact or a positive environmental impact*” ([EC Staff Working document on Sustainable Products in a Circular Economy, p. 11 - 2019](#)).

The EU Ecolabel: identifying products with reduced/positive environmental impact. The stated goal of the Ecolabel scheme is to help consumers identify the 10-20% share of products (Regulation 66/2010, Annex 1)⁵ that deliver the best ‘*environmental performance*’ of their category, defined via an evidence-based scientific assessment of such performance (Regulation 66/2010, Art. 6)⁶. ‘*Environmental performance*’ is defined as the “*manufacturer's management of those characteristics of a product that cause environmental impact*”, and the environmental impact is defined as “*any change to the environment resulting wholly or partially from a product during its life cycle*” (Regulation 66/2010, art. 3).

The apparent alignment of this goal with the consumers’ expectations and regulatory evolutions identified above should make the Ecolabel for financial products appear as a most promising avenue to achieve the “*reorientation of capital flows towards sustainable investment*” sought by policy makers.

¹ Compliance of environmental impact claims associated with ‘sustainable’ retail funds - Analysis of a sample of 230 funds against the compliance criteria of the EU Multi-Stakeholder Dialogue on Environmental Claims, 2Dii March 2020

² [Draft delegated regulation amending Regulation 2017/565](#)

³ [ESMA’s and EIOPA’s technical advice to the European Commission on integrating sustainability risks and factors in MiFID II](#)

⁴ [Regulation \(EU\) 2019/2088 on sustainability-related disclosures in the financial services sector](#)

⁵ The draft criteria (...) 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 on the Community market in terms of environmental performance at the moment of their adoption.

⁶ EU Ecolabel criteria shall be determined on a scientific basis considering the whole life cycle of products (Article 6); The technical report shall include at least the following elements: the scientific explanations of each requirement and criterion, a quantitative indication of the overall environmental performance that the criteria are expected to achieve in their totality, when compared to that of the average products on the market, an estimation of the expected environmental/economic/social impacts of the criteria as a whole, the relevant test methods for assessment of the different criteria (...) Annex 1.

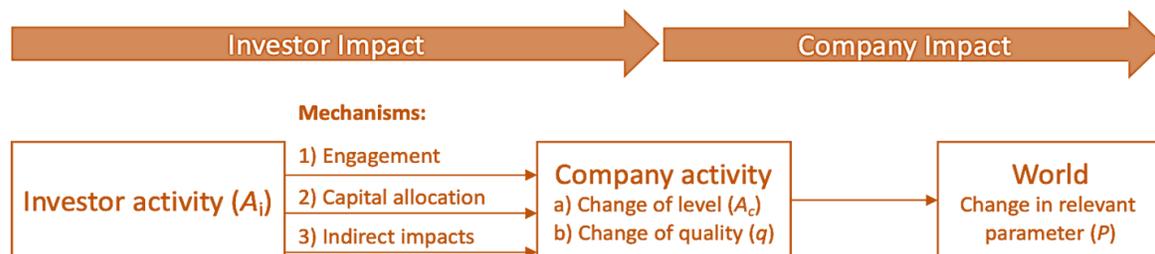
The focus of the Ecolabel: ‘investor impact’

Labeling the asset management service. The EC presents the Ecolabel for Financial Products⁷ as means to “allow retail investors concerned with the environmental impact of their investment to make informed choices and contribute to the Green transition and (ii) provide incentives to industry to develop financial products with a reduced environmental impact or a positive environmental impact.”.

The first technical report has defined the product to be labeled in this way “It is the financial service as such being provided by the product manufacturer of the green financial product which would be Ecolabeled.” (Draft Technical Report v1). In other words, the focus of the label is the ‘asset management service’, broadly defined since the label will also cover banking accounts.

Focus on the ‘investor impact’. According to the Ecolabel regulation (Annex 1), “The technical report shall include at least the following elements: the scientific explanations of each requirement and criterion, a quantitative indication of the overall environmental performance that the criteria are expected to achieve in their totality”.

With respect to “scientific explanations”, it has to be noted that academic and professional⁸ literature on the topic establish a distinction between the impact of the asset management service (called investor impact) and the impact of the companies in a portfolio (called company impact): “We define investor impact as the change that investor activities achieve in company impact, and company impact as the change that company activities achieve in social and environmental parameters” (Kölbel et al. 2019) and “(...) a particular investment has impact only if it increases the quantity or quality of the enterprise’s social outcomes beyond what would otherwise have occurred” (Brest et al⁹).



Given the focus of the Ecolabel on the asset management service, the Ecolabel is supposed to focus on the environmental performance of this service, that corresponds to the concept of ‘investor impact’ in academic literature.

⁷ EC Staff Working document on Sustainable Products in a Circular Economy, p. 11 - 2019

⁸ State of the art review conducted in 2018-2020 by Kölbel & al. [Can Sustainable Investing Save the World? Reviewing the Mechanisms of Investor Impact – 2019](#). NB: these authors and papers are also the only scientific references quoted by the JRC in the second technical report.

⁹ Brest (P.) & al., [Unpacking the impact in impact investing – 2013](#)

The first Draft Technical Report on the Ecolabel criteria (April 2019)

The recommended approach. The first technical report on the EU Ecolabel criteria for financial products was discussed at the Ad'hoc Working Group in April 2019.

The Draft Technical Report on the Ecolabel was developed under the assumption that *“financial products or investments in themselves cannot be green. Greenness is derived from the uses to which they are being put in underlying assets or activities”* (Draft Technical Report, p. 56). In other words, in light of the framework described by Kölbel & al., the criteria would focus on the ‘company impact’ rather than the ‘investor impact’.

Following this logic, the first draft criteria defined a list of eligible green economic activities, based on the EU taxonomy, and used the exposure of portfolio to these activities as a proxy for measuring the environmental impact of the asset management service (Criteria 1).

The first Draft Technical Report recommended that 70% of constituents derive at least 50%¹⁰ of their revenues from green economic activities as defined by the EU taxonomy. A rough estimate based on MSCI data suggested that it would represent 200 companies and below 1% of the market, for listed equities¹¹.

For bonds, the first Draft Technical Report recommended to invest in green bonds, as defined by the upcoming EU Green Bond Standard.

A second criteria set a threshold of 5% for the exposure of the portfolio to a list of ‘brown’ activities such as coal mining, oil & gas extraction, etc. However, it was not clear whether green bonds issued by companies that derived more than 5% of their turnover from ‘brown’ activities would be eligible for the Ecolabel or not.

2DII feedback on the first version. 2DII technical and legal analysis, communicated to the JRC in May 2019, concluded that the proposed draft criteria were misaligned with the EU’s policy objectives and the Ecolabel Regulation. The related feedback paper has been published in June 2019.

The analysis highlighted five flaws¹²:

1. Confusion between investor and company impact. Although the focus of the label is the asset management service, the draft criteria proposed were focused on the environmental impact of companies (see definition of ‘company impact’ above) rather than the environmental impact of the investment strategy (see definition of ‘investor impact’ above).

2. No evidence supporting the theory behind the criteria. Although the Ecolabel regulation requires the criteria for labeling to be based on accurate, non-deceptive, science-based information on the environmental impact of products, the first Technical Report did not reference any scientific evidence supporting the assumption that an increased exposure of a group of investors to equities exposed to green activities or green bonds led to changes of companies behavior and better environmental outcomes. More critically, the existing evidence suggests that it is unlikely to be the case (see discussion below).

¹⁰ The thresholds of 30% was also discussed.

¹¹ See our 2Dii’s feedback paper [‘Impact washing gets a free ride - An analysis of the draft EU Ecolabel criteria for financial products’](#), page 38.

¹² See the [paper](#) for details and sources

3. No scale up possible. According to the Ecolabel Regulation, labeled products should target a 10-20% market share. However, given the focus on a limited sub-set of the investment universe, the initial proposal equated to create a label for environmental thematic funds, that currently represent about 0.1% of UCITS and 0.05% of total assets under management in Europe (EFAMA). Indeed, the lack of sector diversification and the implication on the risk profile of the products make them unsuitable for the large majority of retail investors.

4. Stewardship ignored. Although the Ecolabel Regulation requires taking into account all the relevant dimensions of the environmental performance of a product, the draft criteria discarded the most popular investment technique used by institutional investors managing their ‘investor impact’ for diversified portfolios: the use of shareholder rights and other means of influence to push investee companies toward a trajectory consistent with environmental goals.

5. Inconsistency with the Unfair Commercial Practices Directive. Last but not least, based on the first draft criteria, the Ecolabel would relieve fund managers of the obligation to back environmental impact-related claims with evidence that the investment strategy is effective in delivering environmental benefits or even intended to do so. In doing so, the EU Ecolabel would potentially promote marketing practices that violate the Unfair Commercial Practices Directive (UCPD): *“In accordance with the UCPD, any claim or information in advertising and marketing (whether it is environmental or not) must be correct and not misleading. As such, claims should be based on robust, independent, verifiable and generally recognized evidence which takes into account the latest scientific findings and methods¹³.”*

In conclusion, our feedback paper recommended the development of criteria based on evidence, focused on the deployment of a management system for measuring and improving the ‘investor impact’, in compliance with the Ecolabel Regulation.

¹³ Interpretative guidelines from [EU Multi-Stakeholder Dialogue on Environmental Claims \(MDEC\)](#), 2016

The second technical report on the Ecolabel criteria (January 2020)

Main changes. The second draft criteria have been circulated by the EC to the participants to the ad’hoc working group on January 2020. The main changes in this second version are fourfold:

- The thresholds regarding the exposure of the constituents to green activities were significantly reduced;
- Criteria on ‘Engagement’ were added;
- The rule regarding the exposure of green bond issuers to brown activities have been clarified: there is no limit;
- A discussion of the available scientific evidence has been introduced, in an attempt to comply with the obligations of the Ecolabel Regulation.

Integration of our feedback into the second version. 2DII is, to our knowledge, the only organization that produced a technical and legal paper specifically dedicated to commenting on the technical report. Our research was entirely financed by EC research funding, and since the publication we have been granted another €2.5M from various EC research programs to further explore the legal and technical issues we raised. This situation suggests that our organization and research are credible enough to meet the EC criteria when it comes to financing research.

The second version of the technical report seems to respond to some of our criticism, but it never acknowledged the existence of our publication directly, despite referencing three dozens of other non-governmental sources and publications. This approach allows the authors of the report to address certain dimensions of the criticism and entirely ignore others. Consistently with this approach the JRC did not answer our suggestions to hold technical meetings.

Non-compliance with the Ecolabel Regulation. The Ecolabel regulation requires consulting non-governmental organisations, taking into consideration their views and responding to all comments in the context of drafting the criteria. As far as 2DII’s comments are concerned, the JRC appears not to comply with the requirements:

“For the acceptance by the general public of the EU Ecolabel scheme, it is essential that environmental non-governmental organisations (NGOs) and consumer organisations play an important role and be actively involved in the development and setting of EU Ecolabel criteria.” (Preamble – Recital 8).

“The Commission shall ensure that, in the conduct of its activities, the EUEB observes a balanced participation of all relevant interested parties in respect of each product group, such as competent bodies, producers, manufacturers, importers, service providers, wholesalers, retailers, notably SMEs, and environmental protection groups and consumer organisations.” (Article 5).

“Proposal for draft criteria and associated technical report (...) they shall take into consideration the views of all interested parties involved in the consultation process, (...) “Responses shall be given to all comments received during the criteria development process, indicating whether they are accepted or rejected and why.”

“Critical and controversial issues shall be reported in detail and evaluated” (Annex 1)

The second technical report does not comply with the legal requirements regarding the consideration of stakeholders’ feedback.
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Acknowledgement that the Ecolabel regulation is about environmental impact

In our feedback paper we stressed that the Ecolabel Regulation obliges the criteria to focus on the environmental performance of the product/service, which in this context involves measuring the ‘investor impact’ (as defined above). This obligation is further clarified by the EC “fitness check” on the EMAS and the EU Ecolabel (2017)¹⁴: *“the EU Ecolabel is achieved when the scheme is able to shift choice (professional or private) towards more environmentally friendly consumption. (...) Under the EU Ecolabel, the environmental benefit should be achieved when the product replaces another product with a worse environmental profile. In other words, the final environmental effect depends on consumer choice.”*

Responding to 2DII’s feedback (without referencing it though) on the first version of the criteria, the second technical report acknowledges that the Ecolabel regulation obliges the eligible product (i.e. the asset management service) to have a better environmental impact than standard products: *“The EU Ecolabel Regulation refers to concepts of “environmental impact” and “environmental performance”. According to its recitals, the EU Ecolabel is intended to promote products with a reduced negative environmental impact during their entire life cycle. Article 6 of the Regulation states that criteria shall be based on the environmental performance of products, based on the most significant environmental impacts. While these terms are defined in a general manner, it is necessary to “translate” them for each product group.”* (page 28).

However, the second technical report still fails to comply with another requirement of the Ecolabel Regulation (Annex 1): *“The technical report shall include at least the following elements: the scientific explanations of each requirement and criterion, a quantitative indication of the overall environmental performance that the criteria are expected to achieve in their totality, when compared to that of the average products on the market, an estimation of the expected environmental/economic/social impacts of the criteria as a whole, (...)”*.

The second technical report acknowledges that the Ecolabeled products must have a better environmental impact than the average product in their category, but it is still not aligned with the EU Ecolabel Regulation, since it does not provide any quantitative indication regarding the environmental performance and impact expected from the implementation of the criteria.

Reference to academic research but inaccurate interpretations

The Ecolabel regulation (Annex 1) requests the criteria to be based on scientific evidence, and the technical report to include *“the scientific explanations of each requirement and criterion”*. It also specifies that *“Critical and controversial issues shall be reported in detail and evaluated”*.

The main comment from 2DII on the first version of the criteria was that the approach was exclusively based on increasing the exposure of the underlying portfolios to green economic activities, without any scientific evidence that this mechanism actually leads to a better environmental impact of the product (i.e. the service of managing the assets). This approach was summarized as *“Financial products or investments in themselves cannot be green. Greenness is derived from the uses to which they are being put in underlying assets or activities.”* (First Technical Report, p. 56). In other words, the Technical report replaced the requested scientific evidence by an imprecise theory, that turns out (see below) to contradict available scientific findings.

¹⁴ [Fitness Check - Review of implementation of Regulation \(EC\) No 122/2009 and \(EC\) No 66/2010.](#)

The second report seems to keep the same logic as its core principle: “the EU Ecolabel defines criteria for determining whether the underlying assets of financial products offered to retail investors are sufficiently “green” (linked to environmentally sustainable economic activities) to be awarded the label.” (page 17).

However, to respond to this criticism, and justify the core logic based on scientific evidence, as requested by the Ecolabel Regulation, the second report references relevant academic research on the topic: “Kölbel et al. (2018) and Brest and Born (2013) offer a conceptual framework for the impact of sustainable investment. According to these authors, “investors affect the real world through the companies they interact with”. Kölbel & al. define the concept of ‘investor impact’ applicable to asset management, based on a state-of-the-art review of existing literature, notably the conceptual framework developed by Brest and Born. We have spoken with the main authors in the context of the preparation of this paper to prevent any misinterpretation of their findings.

However, and as we noted it in our first feedback paper, this conceptual framework turns out to be in complete contradiction with the ‘greenness is derived from the greenness of underlying assets’ logic adopted by the EC so far.

“We define investor impact as the change that investor activities achieve in company impact, and company impact as the change that company activities achieve in social and environmental parameters” (Kölbel et al¹⁵) and (...) “a particular investment has impact only if it increases the quantity or quality of the enterprise’s social outcomes beyond what would otherwise have occurred” (Brest et al¹⁶).

In an attempt to reconcile the academic research findings with the assumption that ‘greenness is derived from the greenness of underlying assets’, the second technical report seems to misinterpret the definition, by describing the impact of the investment as the results of “two components” rather than as investor impact: “Hence, ‘investment impact’ consists of two components:

- the company impact: the impact of the company on the natural and social environment;
- the investor impact: the impact of the investor on the company.” (page 18)

However, in their academic papers, Kölbel & al. even explicitly warn about the risk of such a confusion: “The concept of investor impact is only beginning to take root in the SI industry. Currently, most SI funds either exclude firms operating in harmful industries or focus on companies that have in the past performed well on metrics of ESG performance. This is a static approach, which ignores that impact is fundamentally about change. Companies can and do change over time, and investors make an impact by triggering or accelerating such change. Due to a lack of suitable metrics for investor impact, however, very few investors analyze how their activities cause companies to change. As a result, the majority of the USD 30 billion that are deployed in SI today (GSIA, 2018) is invested in ways that promise only modest and perhaps even negligible investor impact.” The same authors further clarify the difference, in a non-published note “Impact is change in the real world that is caused by your activities. Your impact as an investor is not the impact of the companies in your portfolio. It is the change in companies’ impact that you cause. This is what we call investor impact.”

In this regard, it is also worth noting that Julian Kölbel, who attended the March 25th AHWG of the JRC, personally expressed reservations about the current approach to the Draft Criteria by posting the following comment in the AHWG chatbox:

¹⁵ Kölbel & al., [Beyond returns: Investigating the Social and Environmental Impact of Sustainable Investing](#) (2018); updated version: [Can Sustainable Investing Save the World? Reviewing the Mechanisms of Investor Impact](#) (2019)

¹⁶ Brest & al., [Unpacking the impact in impact investing](#) (2013)

“University of Zurich - Julian Kölbel 11:25

Julian Kölbel, University of Zurich: Having authored the review of investor impact that was referred to, I would like to point out that there are still important research gaps. I think there is a real risk that the Ecolabel will not spur more "green activity", because the investor impact mechanisms are not well understood, and are somewhat confused with company impact (...)" (Extract from the 2nd AHWG Chatbox).

While the first technical report ignored scientific research, the second misinterprets the findings. Such an approach is misaligned with both the letter and the spirit of the Ecolabel Regulation.

Misinterpretation of the academic research findings as to the exposure criteria

Green exposure presented as a proxy for investor impact. Based on the inaccurate interpretation of the definition provided by academic research, the technical report continues using the exposure to green activities as a proxy for the environmental impact of the asset management service, based on the following reasoning:

“Through these mechanisms, the investors can achieve two types of changes in company activities: either cause a company to scale up its sustainable activities or cause a company to change its activities to improve their quality from a sustainability point of view. Whether such a changing or scaling of activities propagates into real-world impact depends in turn on the external impact of these activities (the company impact).

*Setting a criterion on investment in green activities could lead to the following **capital allocation impacts**:*

- increased demand for shares and bonds from companies with green activities;*
- facilitates access to capital, by diversifying investor base and possibly lowering cost of capital;*
- allows companies with green activities to further expand and increase their share of green activities.*

Setting exclusion criteria will have the opposite effect: exclusion criteria may make it more difficult for companies with excluded activities to finance themselves.”(...)

*“The causal chain through which the purchase of a fund with an EU Ecolabel can have an investment impact could be conceptualised as **follows**:*

- The fund increases the demand for shares of companies that have green economic activities (e.g. company A has 70% green activities, company B has 25% green activities).*
- This increase in demand can facilitate access to capital for such companies, and may even lower their cost of capital.*
- There would also be a potential reputational benefit for these companies.*
- This would help companies to further expand their activities, and it is likely that they will increase their share of green activities given the easier access to capital and reputational benefit.*

At the same time, such incentives would motivate companies with activities that are close to meeting the EU Taxonomy criteria to upgrade their activities.

- For example, company C is active in cement manufacturing and its activities' GHG emissions are slightly above the threshold defined by Taxonomy criteria. It would improve its production processes to reduce the GHG emissions from its activities.*

- For example, company D has manufacturing activities with low GHG emissions but significant air pollutant emissions and thus does not comply with the ‘do no significant harm’ criteria under the Taxonomy. The company could place filters to reduce air pollutant emissions.
- Also, there would be reduced demand for shares of companies with activities that are excluded or far from meeting the EU Taxonomy criteria (e.g. company E is active in oil refining and all its activities are on the exclusion list).
- This would constrain access to capital, possibly through an increase in cost of capital. These companies may have to close down some of their activities or reconsider their strategy in order to maintain access to finance.” (Technical report page 30).

A theory instead of scientific evidence. In its technical report, the EC is supposed to comply with the following regulatory requirement (66/2010 Annex 1): *“The technical report shall include at least the following elements: the scientific explanations of each requirement and criterion; a quantitative indication of the overall environmental performance that the criteria are expected to achieve in their totality, when compared to that of the average products on the market; an estimation of the expected environmental/economic/social impacts of the criteria as a whole; the relevant test methods for assessment of the different criteria, (...)”*

This regulatory constraint was ignored in the first technical report, and we pointed it out. In an attempt to address this shortcoming, the second technical report refers to the findings of the same authors: *“It must be noted that Köelbel et al. (2018) highlight that the evidence available so far for capital allocation impact is only indirect. Nevertheless, these authors note that the total effect size increases with the fraction of wealth commanded by sustainable investors: “the effect of an individual investor’s decisions depends on how many others invest according to the same non- financial preferences”. Given the harmonisation provided by the EU Taxonomy, many sustainable investors will be behaving in the same way.”* (Technical report page 29)

It is interesting to notice that other environmental labelling schemes, among those studied by the JRC in its first report, adopt much more cautious positions on this particular issue.

For instance, the Background document 1.2. of the Nordic Swan label on investment funds – even though not subject to the EU Ecolabel’s regulation stringent requirements – explicitly acknowledges, regarding the “Environmental Focus” of its “Inclusion Criteria”, related to exposure, that:

“The aim is to stimulate business with products and services that have a positive environmental impact. Nordic Ecolabelling is aware that there are no direct links between the investment undertaken by individual investors in a fund and the company, and that the possible positive environmental impact can be questioned. Nordic Ecolabelling nonetheless still has this point requirement because we believe that, in the long run, there is an environmental impact”¹⁷.

The Nordic Swan’s straightforward acknowledgement that its background theory on this particular point is based on a belief rather than on evidence explicitly addresses an issue that has been essentially overlooked by the technical reports. It also reveals, among other things, how far the current draft criteria are from the scientific evidence-based demonstration of environmental performance required by the EU Ecolabel Regulation.

In addition, the JRC’s demonstration suffers from two major flaws:

- First, there is no demonstration, that *“Given the harmonisation provided by the EU Taxonomy, many sustainable investors will be behaving in the same way.”* This assumption is not backed by

¹⁷ [Nordic Swan Label on investment funds - Background document Version 1.2](#), p. 24

any further reasoning, and seems largely inconsistent with the single-digit market share of existing green labels, and entirely ignores the weight of ‘non sustainable investors’ in financial markets and the international dimension of them.

- Second, the conclusions of academic research are again misinterpreted and even reversed.

Indeed, the authors of the academic paper quoted¹⁸ conclude that:

*“While the impact of capital allocation may seem intuitive at first sight, it touches upon a rather fundamental question, namely to what extent the decisions of investors influence the course of the real economy. We were not able to find studies that relate the capital allocation decisions of sustainable investors to corporate investment activities or operational practices. Hence, **direct empirical evidence for the capital allocation impact is lacking.**” (Kölbel & al. (2018), page 9)*

“There is no empirical evidence that explicitly links sustainable investors’ screening approaches to changes in ESG practices. There is some evidence that screening approaches affect asset prices, and theoretical models that predict an effect on ESG practices. There remains, however, considerable uncertainty as to whether the model assumptions hold in practice”. (Kölbel & al. (2019), page 12)

“Taken together, the literature provides evidence that the capital allocation of sustainable investors can affect asset prices. However, it leaves open two important questions. First, there is no agreement on the size of the effect sustainable investors have on asset prices, making it difficult to judge whether the effect is material. Second, while there is evidence that the capital allocation of sustainable investors has affected asset prices in some cases, there is so far no evidence that such changes in asset prices have translated into changes in ESG practices.” (Kölbel & al. (2019), p. 15)

*“However, while effects of capital allocation on asset prices and the cost of capital are supported in the empirical literature, associated changes in growth are not” (Kölbel & al., p. 17). **“Indirect impacts are mostly unproven** due to a lack of empirical studies that indicate their effectiveness.” (Kölbel & al. (2019), page 22)*

And Julian Kölbel explicitly reiterated this position in the AHWG, by posting the following comment in the AHWG chatbox:

“University of Zurich - Julian Kölbel 11:25

(...) For instance, setting the threshold should be done in a way that creates the maximum incentive for many companies to implement changes. This is a function of the label's market penetration and the affected company's dependence on financing. But this "optimal threshold" would need to be studied empirically” (Extract from the 2nd AHWG Chatbox)

Omission of inconvenient academic findings in the technical report. The technical report also fails to note that the authors conclude that the allocation (to green activities) mechanism is unlikely to work when applied to liquid assets, even in theory:

“Secondly, the effect of investors’ screening approaches is likely to be higher for companies whose assets are not easily substitutable. The models of Heinkel et al. (2001) and Fama and French (2007) show that

¹⁸ Kölbel & a., [Beyond returns: Investigating the Social and Environmental Impact of Sustainable Investing](#) (2018); updated version: [Can Sustainable Investing Save the World? Reviewing the Mechanisms of Investor Impact](#) – 2019

the capital allocation of sustainable investors has a stronger effect on the prices of assets whose returns are only weakly correlated with the market portfolio—that is, assets that are not easily substitutable.” (...)

“Regardless of how investors alter a company’s financing conditions, the literature points to several company characteristics that determine whether a change in financing conditions translates into accelerated growth of company activities. A non-fundamental movement in stock prices, such as the one created by the demand of sustainable investors, only translates into corporate investment activity when the company depends on external capital to finance these investments (Baker, Stein, & Wurgler, 2003).

For seasoned publicly listed companies, stock prices seem not to have a substantial effect on corporate investment activity (Morck et al., 1989; Blanchard, Rhee, & Summers, 1993). Accordingly, Hadlock and Pierce (2010) find that financing constraints decrease with increasing size and age of companies. While a number of studies show that large companies with good ESG ratings enjoy a lower cost of capital (e.g., Chava, 2014), it is ambiguous whether this is due to investor demand—and, thus, an investor impact—or to the superior risk characteristics of those companies.”

The other author quoted in the technical report in this section also shares the same conclusions: *« Most economists agree that it is virtually impossible for a socially motivated investor to increase the beneficial outputs of a publicly traded corporation by purchasing its stock. Suppose that a socially motivated investor buys stock in a publicly traded enterprise to increase its socially beneficial outputs. Especially if—as is generally the case—stock is purchased from existing shareholders, any benefit to the company is highly attenuated, if it exists at all »* (Brest et al. [Unpacking the impact in impact investing](#) – 2013).

Finally, practitioners also seem to agree on this conclusion: *“the consensus of investors in public equity markets is that the widely distributed nature of those markets means that purchases and sales of small blocks of shares do not generally influence the market prices of securities or the behaviour of the underlying enterprises. In such circumstances, it is not reasonable to expect public equities transactions to meet the above definition of “growing new or undersupplied capital markets.”* (Impact Management Project, [Investor contribution in public and private markets - Discussion document](#), Jan 2019).

Combining a misinterpretation of the academic findings and critical omissions, the technical report therefore ends up supporting a thesis largely inconsistent with the conclusions of the authors referenced. Such a practice also seems misaligned with the Ecolabel Regulation.

Green bonds: ‘Use-of-proceeds’ logic still not justified

For bonds, the first and second version are both based on the exposure of the portfolio to so-called ‘green bonds’. The second version however clarifies that the issuer is not subject to any constraint regarding its exposure to brown activities.

Confusion between earmarking and exposure. Based on the EU Green Bond Standard, a so-called ‘green bond’ can be issued by an oil major or a coal mining company even if the company’s exposure to green activities (e.g. renewable power) is insignificant, below market average, aligned with a 5°C scenario and declining. The only constraint is to have some past or future green projects that can be ‘earmarked’ and associated with a level of investment matching the volume of the ‘green’ bond issuance.

Technically, a green bond does not finance the green projects; the earmarking is only ‘virtual’. With such a mechanism the investor is financially exposed to the entire balance sheet of the issuer rather than the

earmarked projects: in other words, the investment (re)finances the entire balance sheet, and is exposed the risk of all activities, not only green ones.

The first and the second Technical reports seem to ignore this fact and confuse the exposure to green bonds with an ‘investment in a green activity’. This confusion is notably visible in the above-quoted section describing the reasoning. This omission is not consistent with the requirements of the Ecolabel Regulation (Annex 1), which explicitly specifies that *“Critical and controversial issues shall be reported in detail and evaluated”* in the technical report.

Consequently, a bond fund exposed to green economic activities, but operated by companies that do not issue ‘EU Green bonds’: for instance a bond issued by the electric car manufacturer Tesla, would not be eligible¹⁹, even though Tesla is the only car manufacturer and one of the only companies with a significant size that meet the requirements of the EU taxonomy.

This situation seems to fundamentally contradict the thesis presented in the second report itself: indeed the criteria for bonds is completely disconnected from the exposure of the portfolio to green economic activities.

Lack of evidence on the environmental impact of green bonds. A second problem relates to the absence of scientific evidence that green bonds have a better environmental impact than any other bond.

2DII 2018 paper dedicated to the topic, *“Shooting for the moon in a hot air balloon, measuring how green bonds contribute to scaling up investments in green projects”*, concludes that there is no evidence of such a better environmental impact:

- Indeed, the issuers have no obligation to verify that their level of investment in green projects is aligned with the Paris Agreement, above market average, significant, or growing. Nothing prevents the level of investment in green projects from being aligned with a 5°C scenario and compensated by massive investments in fossil fuels by the same issuer at the same time.
- Although papers have studied the ‘green premium’ on secondary markets, there is no scientific evidence that the issuance of green bonds has any consequence on the investment decisions of the issuers.

It can even be argued that the development of green bonds could have a negative environmental impact: indeed earmarking allows brown companies with investment plans misaligned with environmental goals to present their bonds as “green”, creating unfair competition for actual green companies. Assuming that the logic of ‘capital allocation impact’ described by the technical report would work, then the development of green bonds would artificially reduce the cost of capital for brown companies making limited efforts and prevent green investors to channel their investments on actual green companies or actually finance green projects via project bonds. Our analysis even suggests that the use of the term “green” associated with the confusing earmarking mechanism might be seen as a potential breach of the Unfair Commercial Practices Directive in itself (see discussion hereafter).

The second technical report fails to discuss the lack of evidence on the environmental impact of green bonds, as well as the feedback received by stakeholders on the topic, being therefore misaligned with the requirements of Ecolabel Regulation on this topic as well.

¹⁹ See [Bloomberg, Tesla Skipping Green Bond Label Keeps Market Limited](#) (2017)

Consequence of loosening the green exposure thresholds

New thresholds inconsistent with the ‘capital allocation’ theory. As described above, the thesis behind the Ecolabel criteria is that higher exposure to green activity and lower exposure to brown activity on liquid assets can be used as a proxy for environmental impact. In the previous version of the technical report, it was summarized as *“Financial products or investments in themselves cannot be green. Greenness is derived from the uses to which they are being put in underlying assets or activities.”* The second report keeps the same logic as its backbone: *“the EU Ecolabel defines criteria for determining whether the underlying assets of financial products offered to retail investors are sufficiently “green” (linked to environmentally sustainable economic activities) to be awarded the label.”* (page 17).

In the new version of the technical report however, the authors have considerably loosened the thresholds which appears to jeopardize the consistency with its own thesis. As the report notes, *“these changes reflect the need for the EU Ecolabel to provide asset/fund managers with the flexibility necessary to invest in transition activities and also diversify their portfolio.”*

As a result, the combination of broad definition of green activities, narrow exclusion list, loose thresholds and the concept of use-of-proceeds for bonds provide the possibility to apply the label to products that have an exposure to pollutant activities considerably greater than the market average, and an exposure to *underfinanced* green activities (the only sub-category that matters given the policy objective) lower than the market.

In a reductio ad absurdum, the next pages illustrate this evolution with extreme cases of hypothetical portfolios that could be awarded the Ecolabel based on the criteria outlined in the second technical report. We also illustrate the loophole with more realistic examples of potential eligible funds.

Equity funds. To receive the ecolabel, an equity fund needs to meet 3 criteria in terms of exposure:

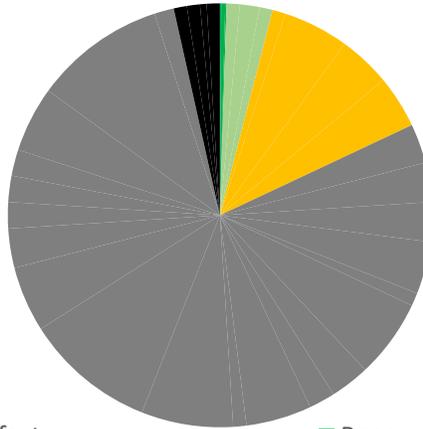
- 1) Certain exposure of the companies’ sales to ‘*green economic activities*’ as defined by the EU taxonomy, which include both environmental solutions (e.g. renewable power, electric cars) and best-in-class in high carbon activities (such as cement, steel, water treatment). The combination of criteria leading to a minimum of 18% of total sales at portfolio level²⁰.
- 2) A maximum of 5% exposure to very polluting activities such as coal mining, asbestos, palm oil...for each company (and therefore the portfolio as a whole)
- 3) No exposure to activities breaching human rights or highly controversial (e.g. porn).

It should be noted that the criteria allow for up to 82% of total portfolio sales from ‘brown’ business activities that are not part of the exclusion list, such as airlines, coal transport, oil trading, metal mining, etc.

²⁰ This ratio is based on the total sales of the companies included in the portfolio, the sales for each company being broken down by business activity/product lines as defined by the EU Taxonomy.

Based on these thresholds, an equity portfolio like the one below could receive the Ecolabel.

Possible exposure of the total sales for an ecolabeled equity fund (revenues of the companies)



- | | |
|---|---------------------------------------|
| ■ Electric car manufacturer | ■ Renewable power |
| ■ Green building | ■ Freight river transport (efficient) |
| ■ Railways | ■ Hydropower |
| ■ Water utility | ■ Cement production (efficient) |
| ■ Steel production (efficient) | ■ Data centers (efficient) |
| ■ Cement production (high carbon) | ■ Steel production (high carbon) |
| ■ Data centers (not efficient) | ■ ICE small car production |
| ■ Freight river transport (inefficient) | ■ Airlines |
| ■ Aircraft manufacturer | ■ Air freight |
| ■ Highway operation | ■ Beef production |
| ■ Construction | ■ Oil & coal Trading |
| ■ Airport operator | ■ Oil and gas pipeline operator |
| ■ Gasoline storage and distribution | ■ Coal transport |
| ■ Road freight | ■ Metal mining |
| ■ Real estate (high carbon) | ■ Coal mining |
| ■ Tar sands extraction | ■ Production of pesticides |
| ■ Asbestos production | ■ Palm oil production |

Although the design of a fund focused on the above-mentioned polluting activities seems unlikely, the Ecolabel (as described in the v2 of the technical report) could be awarded to more realistic thematic funds such as:

- An ‘energy fund’ (18% renewable, 5% coal, 77% storage, transportation, distribution and trading of fossil fuels)
- A ‘transport fund’ (18% rail and electric car manufacturing, 82% ICE cars, airlines, airports, highway operations...)
- A utilities fund (3% renewable power, 15% water utilities, 5% coal power, 77% gas transport and distribution).

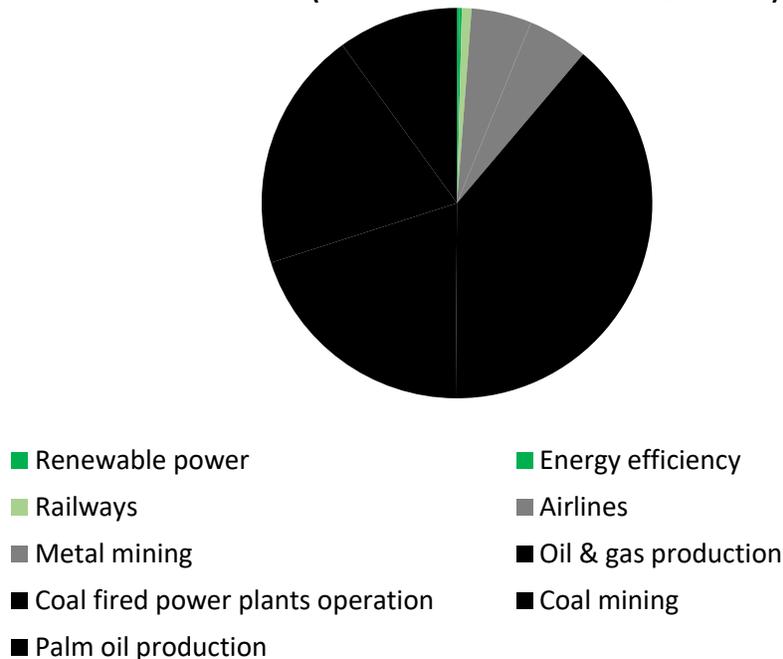
Bond funds. To receive the ecolabel, a bond fund needs to meet 3 criteria in terms of exposure

- 1) 70% exposure to green bonds based on the EU Green Bond Standard.
- 2) A maximum of 5% of very polluting activities such as coal mining, asbestos, palm oil...for each ‘standard bond issuer’. However this limit does not apply to the issuers of green bonds.
- 3) No exposure to activities breaching human rights or highly controversial (e.g. porn).

Based on the EU Green Bond Standard, a so-called ‘green bond’ can be issued by an oil major or a coal mining company even if the company’s exposure to the green activities (e.g. renewable power) is insignificant, declining and below market average. The only constraint is to have some past or future green projects that can be ‘earmarked’ and associated with a level of investment matching the volume of the ‘green’ bond issuance. With such a mechanism the investor is exposed to the entire balance sheet of the issuer rather than the earmarked projects.

Based on these criteria, a bond portfolio like the one below would receive the Ecolabel:

Possible actual exposure of the issuers' activities composing an ecolabeled bond fund (based on the revenues of the entities)



According to the technical reports, “Greenness is derived from the uses to which they are being put in underlying assets or activities.” and “the EU Ecolabel defines criteria for determining whether the underlying assets of financial products offered to retail investors are sufficiently “green” (linked to environmentally sustainable economic activities) to be awarded the label.”. However, the criteria allow funds almost exclusively exposed to polluting, high carbon activities to be awarded the Ecolabel.

The draft criteria are not only inconsistent with the available scientific evidence, but they also appear inconsistent with the very logic described in the technical report.

Engagement criteria

Addition of the ‘engagement’ criteria. In our comments on the first technical report, we highlighted that the engagement mechanism was completely ignored by the EC, despite its potential relevance in the context of impact management on liquid assets (notably listed equities) and the market dynamic on the topic.

Without explicitly acknowledging our comments, the second technical report has taken it into account, and added a new criterion related to engagement with investee companies on environmental issues.

To support the decision, the report quotes the same academic researchers (Kölbel et al.), but this time in a way that is relatively consistent with their actual findings:

“Investigating the impacts of shareholder engagement, there are four empirical studies that analyse the extent to which companies comply with shareholder engagement requests on specific key ESG issues. The data are summarised in Kölbel et al. (2018) (see Table 10).

Table 10 - Share of shareholders’ requests implemented

Reference research	Number of shareholders’ requests	Sample period covered	% of requests implemented
Dimson et al. 2015 ¹⁰⁵	215	1999-2009	18
Hoepner et al. 2016 ¹⁰⁶	682	2005-2014	28
Barko et al. 2017 ¹⁰⁷	847	2005-2014	60
Dimson et al. 2018 ¹⁰⁸	1 671	2007-2017	42

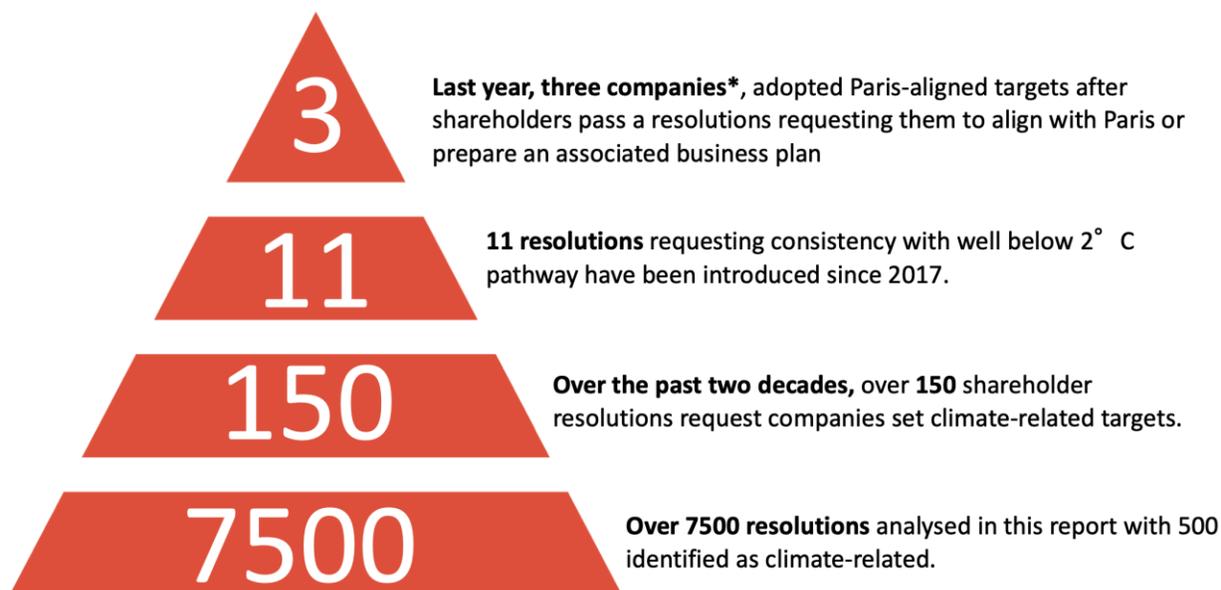
*Together, these results show that there is a reasonable probability ranging from 18% to 60% that shareholder engagement requests succeed in affecting companies’ behaviour with respect to environmental and other related issues. **Engagement** is an effective mechanism through which investors can affect and change a company’s behaviour and activities.”*

Over interpretation of research findings. Like for other criteria, the technical report however omits a very critical dimension of the research it references. Indeed Kölbel et al. insist on the fact that their optimistic findings only apply to shareholder requests of limited ambition:

“A consistent finding of the reviewed studies is that requests in the environmental domain tend to have lower success rates compared to requests in the social domain, and that requests in the corporate governance domain have the highest rate of success. Dimson et al. (2015) attribute this to the fact that reforms in the environmental domain are likely to be costlier than those in the governance domain. More explicitly, Barko et al. (2017) show that requests that require some form of costly reorganization have lower success rates compared to requests that entail lower costs. Taken together, these findings indicate that the chances of success decrease as the costs of the requested reform rise.”

To dig a bit deeper, we have analyzed the success of shareholder voting activities on climate²¹, and more precisely on resolutions requesting companies to align their strategies with the Paris agreement, given that the topic is highly relevant in the context of the sustainable finance action plan.

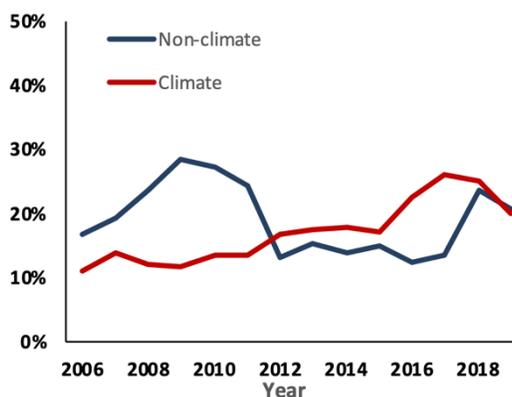
²¹ [Passing the Baton – Climate-related shareholder resolutions and their contribution to investor climate pledges – 2Dii 2020](#)



Among the 500 climate-related resolutions we identified, only 11 resolutions requested consistency with a below 2°C pathway, and only 3 succeeded. On average, the level of support for such resolutions was well below 50%. Our research concludes that the approach is promising, but its success is far from being guaranteed and related environmental impact cannot be assumed based on ex ante evidence.

AVERAGE SUPPORT FOR NON- MANAGEMENT SUPPORTED SHAREHOLDER RESOLUTIONS

(Source: authors, based on own analysis and Proxyimpact)



No obligation on ambition nor results. Given these considerations on the link between the ambition and the effectiveness of engagement activities, it is interesting to notice that the criteria do not set any constraint in terms of ambition nor results.

The obligation only relates to the mobilization of means: *“the existence of a “a documented engagement policy”, the obligation to “engage regularly with at least half of the companies that have less than 50% green activities”, and a clearly stated aim of improving the environmental performance of the company”*,

Although the introduction of this criterion constitutes progress in terms of ‘intentionality’, it does not provide any guarantee regarding the effectiveness of the engagement nor the ambitiousness of the requests. An investor can therefore comply with this criterion with a very low level of ambitions or/and a completely unsuccessful approach.

Such a criteria is therefore likely to encourage investors to adopt ‘box ticking’ approaches including the drafting of a general engagement policy document, and the implementation of soft engagement actions targeting a large number of companies such as sending letters.

Combination of criteria: no guarantee of environmental impact. Based on academic literature, this ‘engagement criteria’ is the only approach that can be backed by some (limited) scientific evidence on its effectiveness. However, the requirements being too soft, there is no evidence that the actions would have any effect.

As a result, with the combination of all criteria, it is in theory possible for an asset manager to build a portfolio primarily exposed to pollutant economic activities, conduct superficial and ineffective engagement activities and still obtain the Ecolabel.

Based on the (limited) scientific evidence available ex-ante, there is no reason to assume that such a product would have a better environmental impact than any other financial products on the market. Based on the “*Greenness is derived from the uses to which they are being put in underlying assets or activities*” theory exposed by the technical report, those products can even have an environmental impact worse than the average product on the market.

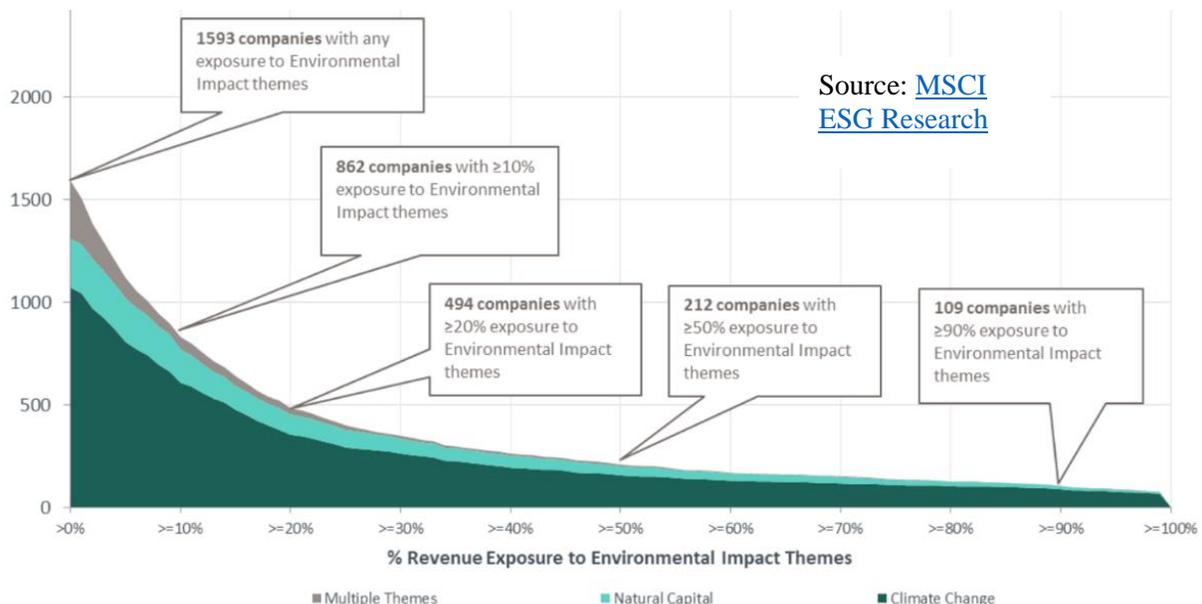
The proposed set of criteria in this second technical report therefore fails to meet the basic requirements of the Ecolabel Regulation: *“to base the assessment of environmental performance on scientific evidence.”* (article 6) and potentially undermines the goal of the Ecolabel Scheme, which is to *“provide consumers with accurate, non-deceptive, science-based information on the environmental impact of products”* (Preamble).

Practical possibility to develop and sell the eligible products

Technical ability to develop eligible products. As of today, to our knowledge, no ESG data provider is able to calculate the exposure of companies to the activities of the EU taxonomy. According to MSCI, less than 5% of companies in the MSCI ACWI universe are disclosing in a way that would enable this calculation.

It is to be noted that if the effective application in a near future of the upcoming Taxonomy regulation and the Disclosure regulation might eventually lead to better corporate disclosure, the experience in Europe (Non-Financial Disclosure Directive) and France (NRE Law, Grenelle Law, Article 173 of the Energy Transition Law) suggests that a limited level of compliance is to be expected in the first few years. Besides, the disclosure requirements only apply to European issuers, which represent only 15-20% of the global investment universe²². There is no reason to believe that issuers from other countries will comply with European regulations. Such a gap creates a situation in which no products compliant with the Ecolabel criteria exist today; and there is uncertainty on the technical ability of product manufacturers to develop compliant funds when the Ecolabel will be adopted. This issue is overlooked in the Technical report, which seems to lead to another misalignment with the Ecolabel regulation that specifies: *“The draft 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 on the Community market in terms of environmental performance at the moment of their adoption.”*

Size of the equity universe. Based on MSCI’s analysis of companies’ exposure to relevant business segments, a “flexible approach” to the taxonomy could lead to the conclusion that up to 20% of the companies are exposed to the taxonomy. However, according to MSCI this is not a proxy for the exposure to green activities, but only an upper limit: MSCI does not estimate the level of exposure of companies sales. Another proxy is provided by the environmental categorizations (not aligned with the Taxonomy) developed by ESG data providers such as MSCI and FTSE. The following chart shows the number of companies with different levels of sales exposure to environmental categories in the MSCI AQWI IMI universe (8,582 companies):



²² For instance continental Europe represent 17% of market capitalization and 16% of sales of the [MSCI AQWI](#).

In the first technical report, based on the exposure thresholds, the investment universe was limited to 200 to 300 companies representing about 1% of the market, based on our estimates (also using MSCI environmental data as a proxy). With the new 20% threshold, using the same proxy, the universe can be extended to about 500 companies (5.8% of the universe constituents). Overall, MSCI estimates that the equity universe (MSCI AQWI) exposure to environmental activities (Climate and Natural capital on the above chart) is 2.5%.

FTSE Russell has developed a similar dataset, the [green revenues classification](#). A more generous categorization leads to 7.2% exposure for the FTSE Global Equity Index Series (8,000 stocks).

Size of the bond universe. Broadly defined, the overall green bond issuance represented about 5% of total bond issuance in 2019²³. The eligible bond universe is a subset, composed of bonds that will be certified based on the upcoming EU Green Bond certification. That will exclude ‘use-of-proceeds’ bonds that receive other certifications only, and bonds issued by companies that are highly exposed to the taxonomy activities but do not issue certified green bonds (see discussion of the Tesla bonds above). It also excludes non-certified green project bonds.

It should be noted, that this criteria seems to be designed to favour EU green bond standard certification holders, rather than to be based on technical criteria exclusively, which might possibly be seen by some competitors as discriminatory.

Diversification. The limited size of the market and the uncertainty regarding the availability of data for the green category, cast doubts on the ability of product manufacturers to develop funds that will be diversified enough to reach the mass market. This issue is not discussed in detail in the Technical Report and no simulation is provided to determine if the product will meet the standard liquidity and risk ratios expected by financial advisors before recommending a product to the average retail investors.

This situation might lead to an impossibility – even in theory – to reach the 10-20% market share targeted by the Ecolabel Regulation, in a context in which scale is necessary for the ‘capital allocation’ theory exposed by the EC to work.

On this topic again the technical report does not meet the Ecolabel Regulation requirement that *“Critical and controversial issues shall be reported in detail and evaluated”*

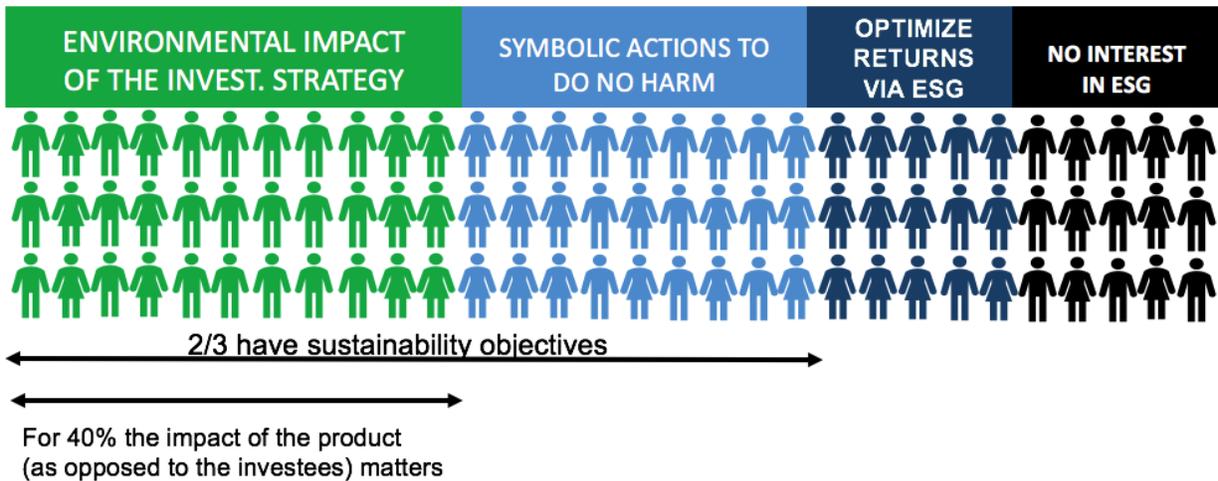
²³ Source: [BBVA](#).

Consistency with consumers' investment objectives

To identify the needs of European retail investors and beneficiaries targeted by the Ecolabel, 2DII recently reviewed publicly available consumer surveys, and academic research, and conducted its own consumer survey on 2,000 German retail clients and 2,000 retail French clients.

Fig 1: Categorization based on survey results

(multiple questions, 4,000 individuals, France, Germany 2019, 2DII/Splendid)



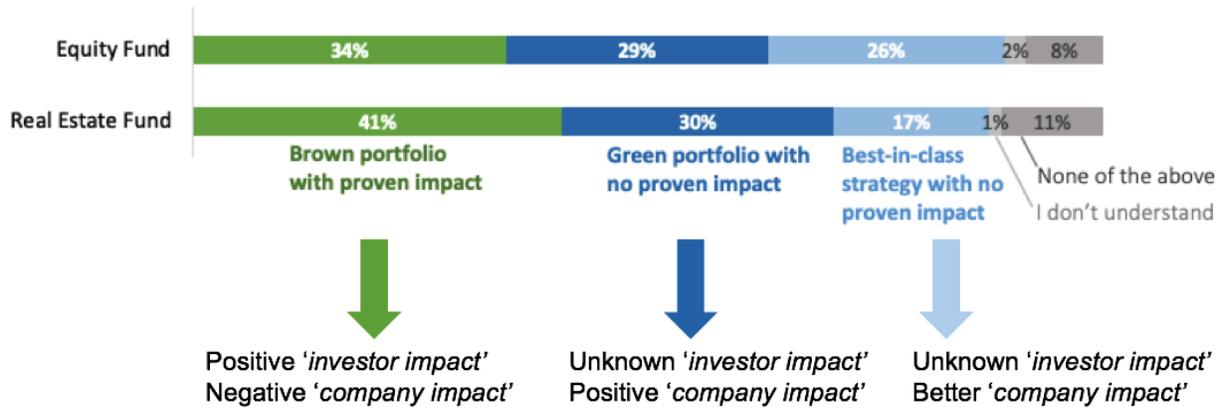
The detailed results and the questionnaires have been published²⁴, leading to the identification of two categories of sustainability-oriented clients that are relevant targets for the EU Ecolabel:

- Impact retail investors.** Clients belonging to this category are the main target of what Eco-labeled products are supposed to be according to the Ecolabel Regulation. These clients want to “have an environmental impact with their money” (i.e. corresponding to the concept of ‘investor impact’ outlined page on page 4) and they expect strong evidence that the product is effective in delivering environmental benefits (which the Ecolabel is supposed to ensure). When asked if they would prefer investing in funds exposed to green companies with no proven ‘investor impact’, or in funds invested in brown companies but with a proven positive environmental impact, they choose the latter (see chart below). Based on those survey results in France and Germany, we estimate that this category represents about 40% of retail clients. Given the lack of scientific evidence that Eco-labeled products will deliver a better ‘environmental performance’ than other products, this category of clients is likely to be misled almost systematically by the Ecolabel (see next page).
- ‘Do no harm’ retail investors.** Based on the same survey results, this category represents about 20% of retail investors. For various reasons (including the belief that an investment product cannot possibly deliver real impacts in the real economy), they favor actions that have a strong symbolic dimension (e.g. divesting from fossil fuel equities, investing in Tesla’s equities) even if they are told that these actions are likely to have no proven impact in the real economy. This category of client would be a relevant target for products based on a “*Greenness is derived from the uses to which they are being put in underlying assets or activities*” logic. Unfortunately, due to the combination of rules that enable high level of exposure to polluting activities (see page 16-17) for both equities and bonds, this category is likely to be misled as well by the future EU Ecolabel.

²⁴ Compliance of environmental impact claims associated with ‘sustainable’ retail funds - Analysis of a sample of 230 funds against the compliance criteria of the EU Multi-Stakeholder Dialogue on Environmental Claims, 2Dii March 2020

Indeed, while some Eco-labeled products might be suitable for this category of clients, the loophole highlighted page 15 also enables the creation of products that are not suitable.

Fig 2: ‘Investor impact’ or ‘company impact’? Question: Which product would you prefer? (Assuming that it is recommended for reaching your financial objectives to invest a part of your savings in this category. The following products (see table) are equal from a financial risk and returns perspective, only the environmental characteristics are different). Source: 4,000 individuals, France, Germany 2019, 2DII/Splendid.



Based on the results of consumer surveys, the Ecolabel is likely to mislead all categories of sustainability-conscious retail investors.

Encouragement to misleading marketing practices

Our analysis suggest that most sustainability-minded consumers are likely to be misled by the Ecolabel itself, since the label provides a government-endorsed guarantee on a benefit (better environmental performance) that will not necessarily be associated with eco-labeled products.

Besides, the draft criteria are directly encouraging the use of marketing techniques that are currently used by asset managers to reinforce the deceptive nature of environmental impact claims.

Carbon footprint calculation. The first prescribed technique is the communication of the carbon footprint (e.g. tons of CO₂ per € invested). Our review of 230 sustainability retail funds in Europe suggests that this approach happens to be used with environmental impact claims in order to reinforce the (deceptive) claim that the clients' investments will have an additional and *measurable* impact in the real economy (i.e. investor impact), while the metric only captures the CO₂ emissions of the investee companies compared to their sector or another baseline (i.e. 'company impact').

Examples of claims using carbon footprint as a 'fake' measurement²⁵:

"The equity fund directly responded for 1,417 tons of CO₂ emissions based on this calculation. It is an excellent result, as when compared to the MSCI index, our fund has a significantly lower impact on climate"

"What is the result of this for you as an investor? An investment of 100,000 euros in the fund allows avoiding CO₂ emissions by 200 tons, or the equivalent of 50 trips around the world with a car."

"Invest 25,000€ in this fund and you save the CO₂ emissions equivalent to: Flying 5,300 km, Eating 530 steaks, using your washing machine 5,000 times"

"A 5 million Euro investment in the fund, for one year would reduce polluting emissions by 4,200 tons of CO₂, which is equivalent to taking 1,900 cars off the road for a year."

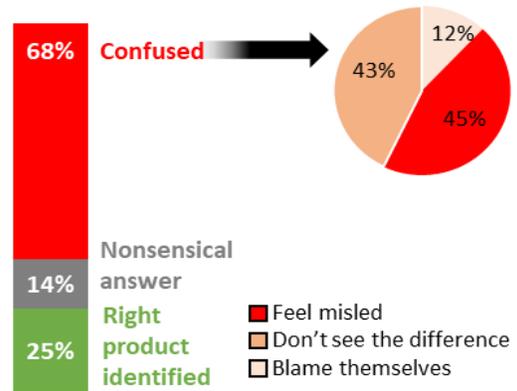
In Q3 2019, 2,000 German retail investors and 2,000 French retail investors were asked to associate a typical misleading claim with a technical description of the product and its environmental benefits:

Based on this description, which of the following sentences most accurately describe(s) your understanding of the environmental characteristics associated with this product?"

The technique happens to be very effective in confusing clients. When asked to select a product associated with the claim in a list, 68% interpret statements as 'investor impact' claims and pick the wrong product (see chart below). Then when the reality is revealed, most consumers either feel misled or confused.

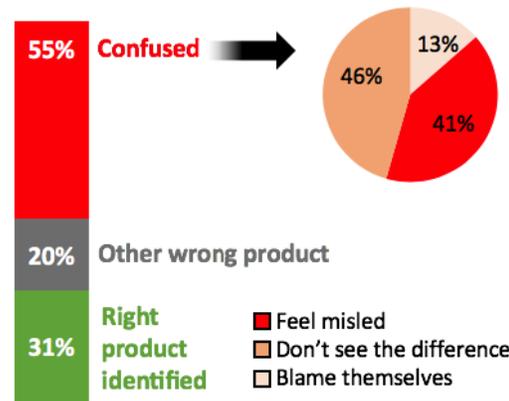
²⁵ **Source:** analysis of marketing material of retail funds distributed in Europe, by 2DII legal team (2020). The wording has been slightly modified to ensure the anonymity of the quote.

Claim: “The Equity Fund” allows investors to have a real impact on climate change. The design of the fund aims at generating a real impact on the environment and create solutions for climate change: For example, a 5 million Euro investment in the fund, for one year would reduce polluting emissions by 4,200 tons of CO₂, which is equivalent to taking 1,900 cars off the road for a year. These figures are reported every year and audited.”



Use of proceeds. The same issue applies to the ‘use-of-proceed’ logic of green bonds. When asked to pick a product, based on a typical green bond fund claim, a majority of consumers (incorrectly) understand that their money will *finance* the projects directly, rather than the balance sheet of issuers with an ‘earmarking’ mechanism. When the ‘trick’ is revealed, most consumers feel misled or confused.

Claim: “The Green Bond fund allows you to finance the energy transition. You assess your actual impact via the tons of CO₂ avoided or reduced. The proceeds of the bonds are earmarked to finance specific environmental projects with a positive environmental impact”.

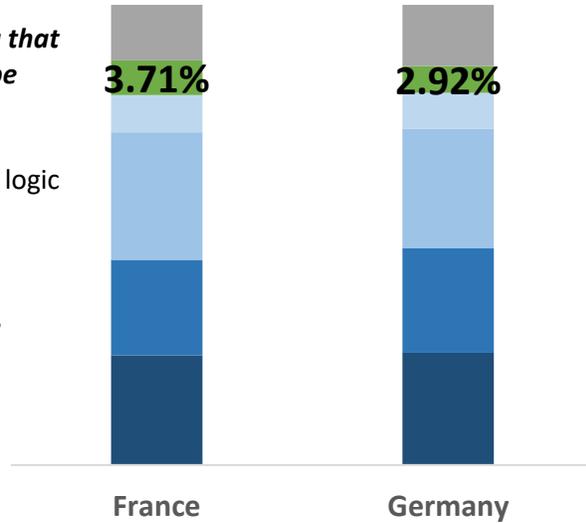


More critically, when asked to choose a minimum criteria applicable to justify calling a bond “green”, only 3-4% of consumers consider the earmarking/use-of-proceed logic to be relevant as illustrated below²⁶.

²⁶ Survey conducted on 2,000 individual investors in France and Germany (2019). The survey provide definition for each term and a detailed description of each criteria (that is summarized on the chart). Source: 2DII/Splendid Research.

In your opinion, what is the minimum criteria that a green bond need to meet in order for it to be allowed to call itself a “green bond”?

- Earmarking green projects/use of proceeds logic
- Pure green player
- Objective to become a pure green player
- Objective to align with climate/enviro goals
- Objective to become greener
- No constraint associated with the claim



The qualitative interviews conducted in the same countries reveal that earmarking is interpreted as a ‘marketing trick’ or a ‘scam’: a communication technique used to pretend a green project is financed, when the investment could actually finance a polluting company.

Our conclusion is that, based on the current criteria, the EU Ecolabel will not only fail to prevent misleading green marketing, but will legalize and encourage those practices. The draft criteria appear fundamentally inconsistent with the Unfair Commercial Practices Directive and the key recommendations of the EU regulatory guidance to prevent misleading environmental claims.

2DII's key recommendations are still ignored in the second version of the technical report

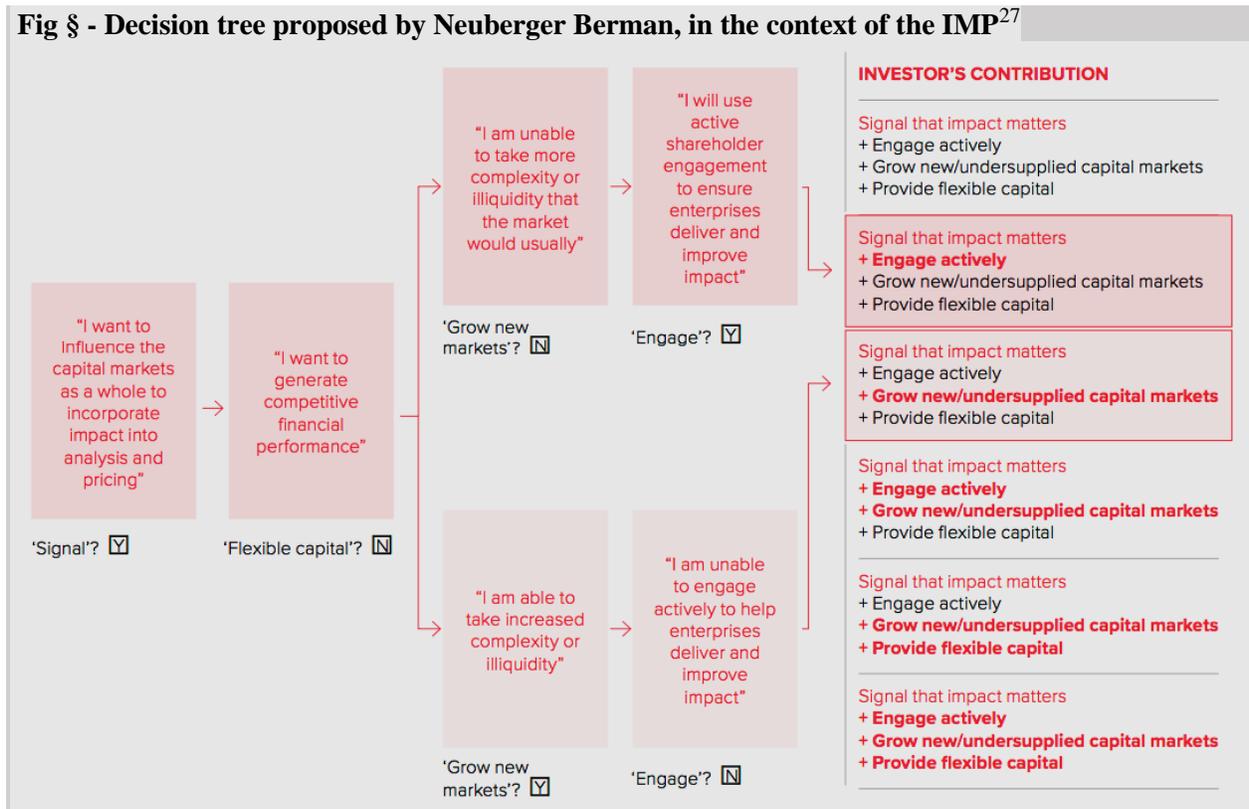
In our recommendations for addressing the flaws of the approach envisioned in the first technical report, we focused on two building blocks:

1. Require the implementation of an *environmental impact management system* based on the latest ex-ante evidence on which mechanisms work and which do not;
2. Introduce an obligation to collect ex-post evidence on the effectiveness and environmental impact of the approach, analyze it and report results to consumers.

Implement an Environmental Impact Management System. Our first recommendation is neither acknowledged nor considered in the second report. It is however interesting to notice that meanwhile, a collaborative international initiative involving about 2000 organizations – *The Impact Management Project* - has been developing the exact thing we recommend in our feedback report.

This initiative is not acknowledged neither in the second technical report.

Fig § - Decision tree proposed by Neuberger Berman, in the context of the IMP²⁷



²⁷ Impact Management Project, [Having a positive impact through public markets investments - The Investor's Perspective](#) (2019)

Collect ex-post evidence. Our second recommendation, an obligation to collect ex-post evidence on the environmental impact of the approach, is not explicitly acknowledged, but has partly been taken into account in the second report.

Indeed, the new criteria on engagement are associated with an obligation to disclose the “Results of engagement activities” to consumers. However, at this stage no guidance is provided or envisioned on the content and granularity of the reporting, letting investor free to only publish vague statements.

Like in the first technical report, no impact assessment requirement is associated with the criteria related to “investment in green” and “exclusion”: the future labeled fund manager will have no obligation to collect ex-post evidence on whether their actions influence the behavior of targeted investee companies or not. No other mechanism - such as an observatory – is envisioned to assess whether the theory described in the technical report works or not in reality.

Extract from Hermes SDG Engagement Equity fund leaflet

*“Launched in January 2018, the Hermes SDG Engagement Equity Fund has the dual purpose of **delivering attractive returns and measurable real-world impact**. We seek this by targeting both investment outperformance and positive social and environmental change by **engaging with companies to help deliver the Sustainable Development Goals (SDGs)**.”*

*“We use narratives to communicate how our corporate engagement has generated real changes within companies. (...) Importantly, the companies will corroborate the narratives after meeting any of the SDG objectives – ensuring integrity and adding credibility to our **claims of effective engagement and additionality**.”*



Conclusions

- 1) **Conclusion #1: The envisioned Ecolabel on financial products is misaligned with the Ecolabel regulation.** According to the principles recalled by the regulation (preamble), the Ecolabel scheme is *“intended to promote products with a reduced environmental impact during their entire life cycle and to provide consumers with accurate, non-deceptive, science-based information on the environmental impact of products”*. Based on the envisioned criteria, the future Ecolabel would potentially achieve the opposite, by enabling and encouraging unsubstantiated and potentially deceptive environmental ‘investor impact’ claims, based on no scientific evidence and no assessment of the environmental impact of the products.

- 2) **Conclusion #2: the second technical report approach is misaligned with the regulatory requirements either.** Indeed, according to the Annex 1 of the Ecolabel regulation, *“The technical report shall include at least the following elements: the scientific explanations of each requirement and criterion; a quantitative indication of the overall environmental performance that the criteria are expected to achieve in their totality, when compared to that of the average products on the market; an estimation of the expected environmental/economic/social impacts of the criteria as a whole; the relevant test methods for assessment of the different criteria, (...) (Regulation 66/2010, Annex 1).* Besides, the European Commission services are subject to an obligation to *“take into consideration the views of all interested parties involved in the consultation process”, provide responses to “all comments received during the criteria development process, indicating whether they are accepted or rejected and why.” and “report in detail” and evaluate “Critical and controversial issues”*. As far as the issues we raised are concerned, none of these requirements has been respected.

- 3) **Conclusion #3: the conditions are not met for the drafting criteria for an Ecolabel.** The Ecolabel regulation specifies that *“The preliminary report must contain (...) the current and future potential for market penetration of the products bearing the EU Ecolabel” and “The draft criteria shall (...) correspond indicatively to the best 10-20 % of the products available on the Community market in terms of environmental performance at the moment of their adoption.”*. No product meeting the requirements of the draft criteria exist on the market today, and we did not find²⁸ any retail product available on the market today that would fully meet the requirements of a future Ecolabel consistent with the Ecolabel Regulation neither (i.e. delivering a measurable investor impact). It does not mean that such a product does not exist for institutional investors or could not be developed rapidly for retail clients. But at this stage, the Ecolabel regulation and related rules do not plan for the development of labelling criteria when no measurement of environmental impact has been done and no product with better performance can be identified. The development of an Ecolabel for financial products would therefore require ignoring or adapting the existing regulation.

²⁸ Compliance of environmental impact claims associated with ‘sustainable’ retail funds - Analysis of a sample of 230 funds against the compliance criteria of the EU Multi-Stakeholder Dialogue on Environmental Claims, 2Dii March 2020

Recommendations

Recommendations #1: Put the Ecolabel for financial products on hold. The current approach pursued by the JRC is putting the integrity of the Ecolabel Regulation at risk, with potential knock-on effects on other product categories and the enforcement of existing regulations (Unfair Commercial Practices Directive) to protect consumers from misleading environmental claims.

There seem to be no viable path for the development of an Ecolabel for financial products in the timeframe envisioned by the EC.

Recommendations #2: Explore the development of an environmental impact label. Although several national labels exist for identifying green themed funds (ex. GreenFin in France, Luxflag), there is no label for products that seek to deliver a measurable environmental ‘investor impact’ as defined by the above-mentioned academic literature.

The EC has certainly initiated a dynamic that provides a good opportunity for the development of such a label (public or private). The Impact Management Project, the GIIN, the University of Zurich and others are currently developing methodological frameworks that can provide the backbone of such a label, and the IMP is even developing an international ‘investor impact management’ standard.

Recommendations #3: Discontinue political interference in technical work. The difficulties of the JRC to properly take into account scientific evidence in its work, and comply with the Ecolabel regulation, after two technical reports provides a good illustration of the outcome of political interference into what is supposed – by law – to be purely technical work taking into account the inputs from a broad range of stakeholders based on their merits. The same dynamic is currently at play in the work of the EC TEG and leads to the same kind of outcome on the first pieces of the regulatory package:

- The Green Bond Standard aims at promoting market practices that appear to be inconsistent with the Unfair Commercial Practices Directive, without any evidence that they will be associated with the expected environmental benefits (see discussion above and in 2DII dedicated paper).
- Similarly, the original version of the *‘Climate Transition Benchmarks, EU Paris-aligned Benchmarks and sustainability-related disclosures for benchmarks’* presented ETFs as impact investing instruments, in contradiction with the scientific evidence available on the matter.
- Finally, the definition of ‘sustainable investments’ applied to financial products and instruments across the EC regulatory package is based on the same confusion between ‘investor impact’ and ‘company impact’ that is discussed in the present document.

In each case, the environmental impact associated with the financial instrument is necessary to the achievement of the policy objective. However, a simple theory, largely contradicted by existing scientific evidence, is replacing the necessary evidence. Such an approach not only channels public and private resources away from potentially more effective instruments but also undermines evidence-based policymaking more broadly.

In our view, it is urgent that the European Commission puts an end to this drift, which fundamentally contradicts the Better Regulation Principles that are to apply to EU policy-making.