RECLAIM Finance

Ecolabel for financial products
Reclaim Finance's comments on the third technical report

The EU is exploring the possibility of creating an Ecolabel for financial products (investment funds, savings products, fixed-term deposit, and savings deposit accounts) and tasked its research committee – the Joint Research Committee or JRC - to work on it.

The JRC has published three successive reports that set out the possible criteria for this new Ecolabel. While these reports' content is quite technical, the first two reports required all certified products to exclude financial support to the most polluting activities – listed and defined in "Criteria 3" - including fossil fuels. Requirements have been lowered in this third report, and we have described below our analysis and recommendations.

<u>I/ Two new transition categories that allow for companies that still conduct or invest in polluting activities to be included, without requiring Paris-Aligned phase-out plans</u>

The Third technical report allows some companies to conduct activities excluded by the Ecolabel framework (and listed in Criterion 3) to be included in labeled financial products if they satisfy some specific criteria.

These companies are divided into two categories (defined in Criterion 2):

1. "Companies investing in transition," allegedly demonstrating a real will to transition by investing in green activities.
2. "Companies investing in green growth," allegedly already mostly involved in green activities and leaving polluting activities behind.

The existence of these two categories can be justified to push companies in carbon-intensive sectors to transition and not penalize companies that are already on a credible transition path, but they must be clearly and carefully defined to avoid creating major loopholes.

However, **the current criteria proposed in the third technical report are insufficient:**

1. **Both "in transition" and "in green growth" categories do not ensure the end of investment into the most polluting activities:**

The framework does not bar companies from investing in the activities excluded from the Ecolabel (Criterion 3). As the current criteria only require companies to increase their "green" revenues and CapEx over time (Criterion 2), they allow companies to keep on investing in polluting activities as long as they scale up green activities. This is especially problematic regarding fossil fuels, as any new fossil fuel project is incompatible with the Paris-Agreement. The report should specifically mention that companies in these categories should not plan any investment in new fossil fuel capacity.

2. **The "companies investing in transition" category does not ensure a Paris-aligned phase-out of fossil fuel activities:**

Reclaim Finance expects any company financed through Ecolabelled financial products to respect a Paris-Aligned phase-out trajectory. For fossil fuels, this means phasing-out coal by 2030 in the EU and OECD and 2040 worldwide and oil and gas ten years later.

At first glance, the "companies investing in transition" category seems to integrate this necessity: it requires companies to "set a phase-out, closure or fuel-switching plan for natural gas and coal power stations on a ten-year timeframe" (Criterion 3). Nonetheless, this wording is too unprecise to ensure this important objective. It should be added that such exit plans should be adopted soon and before 2030, as the coming years will be decisive in responding to the climate crisis.

Reclaim Finance stresses that the phase-out trajectory is as important as the exit date; therefore, the Ecolabel text should require companies to start closing gas and coal plants immediately and progressively until the exit date. Beyond fossil fuels, it is worth noting that "companies investing in transition" are only required to adopt a "formal commitment" to phase-out other activities excluded from the Ecolabel (under criterion 3.1).

3. **The "companies investing in green growth" category does not require the phase-out of polluting activities:**

Unlike "companies investing in transition," "companies investing in green growth" are not required to adopt fossil fuel phase-out plans. They do not have to commit to close their polluting activities and infrastructures concretely. The JRC seems to assume that these companies are "already green" and would naturally end all their polluting activities. This assumption is dangerous, especially when it comes to fossil fuels, and a phase-out of all activities excluded under the taxonomy framework (Criterion 3.1) must be required to be considered "in green growth."

<u>Recommendations:</u>

- **Both "in transition" and "in green growth" categories should exclude companies that invest in new projects in activities excluded under Criterion 3.**
- **Companies in transition should be required to adopt plans to close – and not sell or convert – all their fossil fuel infrastructures and plants on a ten-year timeframe. The report should specify that the plans should be adopted in the near future and before 2030, as exiting should start now. It should also be required to adopt plans to phase-out all activities under criterion 3.1.**
- **Companies in green growth should be required to adopt plans to close – not sell or convert – their fossil fuel infrastructures and plants on a ten-year timeframe, and to adopt such plans before 2030. They should also be required to adopt plans to phase-out all activities excluded under criterion 3.1.**

II/ "Ecolabelled" deposit accounts should not be used to grant loans to companies excluded from the framework

The second technical report specifically banned "Ecolabelled" savings accounts to grant loans to companies conducting activities excluded from the framework. However, the third report has loosened this ban, and the requirement is now only for the share of the accounts that must go to "green loans," which is the share that must go to companies with activities aligned with the EU taxonomy.

Providing that labeled savings accounts can be used at up to 30% for granting "non-green" loans, **about a third of the money deposited could go to polluting companies that are otherwise excluded from the Ecolabel (under Criterion 3), including fossil fuel companies**. This is a major issue: Ecolabelled savings accounts could continue to finance climate-destructive activities, thus clearly misleading European savers.

Furthermore, for fixed-term and savings deposit accounts, the third technical report rightfully bans project loans to excluded activities and forbids the holding of bonds issued by companies whose activities are in the list of excluded activities (Criterion 3). Extending the ban on all loans would be fully consistent with these other criteria.

Recommendation:

- **For fixed-term and savings deposit accounts, loans shall not be granted to companies whose activities are in the list of excluded activities.**

III/ Lowered requirements for the "greenness" of financial products

The third technical report has introduced changes that significantly lower the "green" ambition of the Ecolabel:

- **UCITS equity funds:**
  The percentage of the total portfolio value of the assets under management that shall be invested in environmentally sustainable activities dropped from 60 to 40%. More than half of the portfolio could still go to "non-green" activities. If we understand that this decision has been motivated by the will to preserve a vast-enough investment universe, we underline that the responsibility is for companies to meaningfully transition and not for the European supervisor to lower the bar. This percentage should be completed with a requirement to increase the share of environmentally sustainable activities from year to year, as the investment universe will grow.
- **Fund of Funds:**
  The framework required at least 90% of the Fund of Funds to be invested in funds already awarded the EU Ecolabel. A 100% threshold would be problematic, as this type of financial product could require the holding of cash and derivatives that cannot be certified. However, it is worth noting that the JRC also allows fund of funds to hold non-certified assets within the 10% limit.
- **Derivatives:**

The framework simply abandons the idea of verifying the application of the Ecolabel criteria to derivatives as these products are difficult to assess. Without any verification methodology, the inclusion of derivatives in certified products is questionable. The current framework allows for derivatives to be broadly included, even for exposure purposes (speculation), thus discreetly increasing the certified financial products' potential negative impacts.

Recommendations:

- **For UCITS equity funds, raise the requirement to at least 50% of the total portfolio value of assets under management (cash, derivatives included) and increase this share overtime.**
- **For Fund of Funds, suppress the possibility to include assets into the fund (only cash, derivatives, and other funds).**