

A QUALITY STANDARD FOR SUSTAINABLE AND SOCIALLY RESPONSIBLE FINANCIAL PRODUCTS

Final text

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A. Introduction

1. Context

On 31 January 2018 the European Commission's High-Level Expert Group (HLEG) on Sustainable Finance published its Final Report¹. In this report it formulates 8 strategic recommendations for a financial system that supports sustainable investments.

The fourth recommendation tackles the challenge of retail investment in socially responsible and sustainable investment products.

“Citizens with savings to invest should be empowered to invest in portfolios that reflect their sustainability and ethical preferences. The direct result would be to bring a substantial part of the EU's financial assets into pools of capital contributing to sustainable finance.”

Among others, it recommends that the Commission and the European Securities and Markets Authority (ESMA):

- Require investment advisers to ask about, and then respond to, retail investors' preferences about the sustainable impact of their investments, as a routine component of financial advice.
- Facilitate retail investor choice by increasing transparency on the sustainability impact and processes of retail funds.
- Protect retail investors by establishing minimum standards for sustainably denominated funds.

Similar concerns are expressed in the report² on sustainable finance of the European Parliament Committee on Economic and Monetary Affairs.

Based on the HLEG's recommendations, the Commission presented in March 2018 an action plan³ on financing sustainable growth.

In May 2018, the Commission adopted a package⁴ of measures implementing several key actions announced in its action plan. The package includes 3 proposals aimed at:

1. establishing a unified EU classification system of sustainable economic activities ('taxonomy')
2. improving disclosure requirements on how institutional investors integrate environmental, social and governance (ESG) factors in their risk processes
3. creating a new category of benchmarks which will help investors compare the carbon footprint of their investments.

¹ See <https://ec.europa.eu/info/publications/180131-sustainable-finance-report>

² See <http://www.europarl.europa.eu/sides/getDoc.do?type=REPORT&reference=A8-2018-0164&format=XML&language=EN>

³ https://ec.europa.eu/info/publications/180308-action-plan-sustainable-growth_en

⁴ https://ec.europa.eu/info/publications/180524-proposal-sustainable-finance_en

In this context and in line with the European proposals⁵, this quality standard for socially responsible financial products seeks to provide a practical interpretation of what it could mean for a financial product to be called 'socially responsible' or 'sustainable'. Therefore, it determines a floor (minimum norm) for all such products and an aspirational and prominent label.

2. Ambition

The niche of socially responsible and sustainable financial products should lead by example and show in a pragmatic, realistic but ambitious way how financial performance and a high standard of societal performance can be reconciled.

The objective of the quality standard is to qualitatively and quantitatively increase the level of socially responsible and sustainable financial products, and to mainstream its principles towards traditional financial products.

Socially responsible and sustainable financial products are currently somewhat a niche market. Socially responsible investment products (SRI) have a market share of about 5-10% (depending on the scope and definition used), while socially responsible savings products have a share of about 1% of total savings.

It is evident that to have any meaningful impact on the transition towards a sustainable economy and society, the integration of sustainability considerations (ESG⁶) should also go beyond this niche and into mainstream financial products and services.

This mainstreaming is already happening as more and more financial institutions implement group-wide ESG policies that are applicable to all their credit and investment decisions. Other notable developments are the industry-led Task Force on climate-related financial disclosures set up by the Financial Stability Board⁷, the work of the High-Level Group on Sustainable Finance⁸ established by the European Commission, and regulations on non-financial reporting (non-financial reporting directive 2014/95/EU⁹, IORP 2¹⁰, SRD 2¹¹, France's Art. 173¹², etc.)

3. Approach

The benchmark for this quality standard are the needs of society and the expectations of the fast-growing group of savers and investors with a special interest in the responsible and sustainable character of their savings and investments.

⁵ For the position of the quality standard in the context of the EU initiatives on Sustainable Finance, see Appendix 3

⁶ Environmental, social and governance (ESG): three central factors in measuring the sustainability and ethical impact of an investment in a company or business.

⁷ <https://www.fsb-tcfd.org/>

⁸ <https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance>

⁹ <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32014L0095>

¹⁰ Directive 2016/2341/EU on the activities and supervision of institutions for occupational retirement provision <http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32016L2341>

¹¹ Directive 2017/828/EU amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017L0828>

¹² Article 173-VI of France's Law on Energy Transition and Green Growth (LTECV) concerning investor climate reporting.

Clients should be able to rely upon the assumption that the money they put into a 'socially responsible' financial product shall not be used to finance activities and practices generally accepted as 'unsustainable', and shall, to a greater or lesser extent, be used to finance activities with a positive contribution to society.

With that objective, the quality standard requires exclusion of the financing of a limited number of practices that are widely regarded as unsustainable. The focus however lies on transparency and the provision of relevant and helpful information, by which potential clients can determine if the policy of a specific product is in line with their personal convictions.

The quality standard stipulates a set of portfolio and process level requirements which a financial product should at least fulfil to receive the label. However, distributors and product managers are strongly encouraged to formulate their own approach and objectives regarding sustainability that go beyond the minimal requirements stated in the standard.

The standard does not pretend to define or enshrine what it means to be a 'sustainable' financial product, as that would fail to acknowledge the evolutive and aspirational character of sustainability. Compliance with the principles of the standard should rather be interpreted as a sign that a product is on the road towards sustainability. The progress made on that road and so also the degree of sustainability will differ between products, depending on their strategy and level of ambition. However, being in line with the standard implies that a manager is taking up its social responsibility by having in his decisions particular and substantiated consideration for social, environmental and governance issues thus also safeguarding long term financial performance.

4. Practical implementation

The quality standard does not stipulate how the requirements should be fulfilled in practice: this is left to the expertise of the product manager. The product manager should put in place the internal organisation, processes and resources he deems necessary to be able to comply with the requirements, on a best effort basis. Based on his best judgement and expertise, he should select the most appropriate instruments, data providers, third-party exclusion lists, etc. This might, in some cases, lead to diverging interpretations by different product managers on the eligibility of a specific company. This does not however, need to be problematic, if the manager is accountable, open and transparent about his decision-making process.

Accountability is key. It is the preparedness to give an explanation or justification to stakeholders for one's judgments, intentions, and actions. It is a readiness to have one's actions judged by others and, where appropriate, accept responsibility for errors or misjudgements, and recognition for competence, conscientiousness and excellence. It is associated with responsiveness to the views of all stakeholders, which includes a willingness to explain, defend, and justify actions or decisions.

The quality standard uses a principles-based approach. Key characteristics and features that are essential for a credible socially responsible product are formulated. These principles are accompanied by implementing guidelines that specify how the principles should be interpreted and that give guidance when implementing them in specific portfolios, always keeping in mind the investors' expectations that the money they invest in socially responsible financial products should not flow to or benefit unsustainable activities.

The standard provides a mix of exclusion, impact, engagement, transparency and accountability. The balance of these elements and the specific requirements associated, will evolve and be adapted over time to reflect the evolving expectations of investors and the needs of society, and the

legislative translation of these needs and expectations. As such, the quality standard is not fixed and shall be evaluated regularly in a multi-stakeholder context, as to assure its relevance to society.

5. Label

A prominent label aims to instil trust and reassure potential investors that the financial product is managed with sustainability in mind and is not exposed to very unsustainable practices, without requiring of investors to do a detailed analysis themselves. However, transparency on all elements needed for such an analysis should be present.

Financial products compliant with the quality requirements of the standard will be listed on a dedicated website and will be granted the label.

All distributors and managers, domestic and foreign, of socially responsible or sustainable financial products can apply for the label.

While tailor-made and discretionary portfolios are not strictly speaking in scope, they could obtain the label if compliant with the standard.

The quality standard and its label are a not-for-profit initiative. However, a fee per labelled product will be determined to cover the costs of e.g. the management of the central labelling agency, the supervision procedure and the dedicated website.

6. Scope

The main scope of the quality standard is all standardised products that are actively marketed as being socially responsible or sustainable, towards primarily retail, but also private and institutional clients in Belgium.

Products of Belgian law and of foreign law, commercialised in Belgium, by domestic or foreign distributors are in scope.

The notion of 'financial products' covers investment products (e.g. mutual funds, life-insurance products, structured notes) and savings products.

The standard applies to financial products that are marketed as 'sustainable', 'socially responsible', 'ethical', 'SRI' or equivalent denominations¹³.

Custom-made portfolios¹⁴, tailored to the specific financial and sustainability expectations of individual private or institutional clients are not strictly in scope; although the principles laid out in this quality standard could be inspirational.

The quality standard does not limit the commercialisation of 'traditional' products but does set a framework for products explicitly marketed as 'socially responsible', 'sustainable' or alike. Neither does the standard limit the financing of companies by way of traditional products (i.e. products not marketed as being socially responsible or sustainable).



¹³ E.g. being presented as such in publicity, website, advice etc.

¹⁴ E.g. in discretionary or advisory management

The standard is not legally binding. As such, for transitional or technical reasons, products could be marketed as socially responsible or sustainable without being compliant with the quality standard. This is of course not encouraged as a structural situation. It will moreover not benefit from promotion and sectoral support and is likely to be subject to additional societal scrutiny.

The use of the quality standard is not mandatory. However, the institution using the label is under the obligation to comply with the terms and requirements of the label. Non-compliance with the requirements of the label may result in the label not being renewed or the withdrawal of the label by the central labelling agency. In addition, a number of legal rules will need to be complied with when using the label.

The use of the label may fall under the rules relating to information obligations of financial institutions and in particular the rules regarding the marketing of financial instruments towards non-professional clients (e.g. the so-called Transversal Royal Decree).

Under Belgian law, the FSMA can bring actions including administrative penalties against financial institutions not complying with the information obligations, set forth in the act of 2 august 2002 on financial supervision.

If a product uses the label but is in fact not compliant with the quality standard, clients or competitors could bring legal action, namely a cease and desist order against the relevant financial institution, administrative penalties and exceptionally criminal penalties. If a judge sees fit, an entity could be subjected to a prohibitory injunction or fines. Belgian law also provides for the possibility for consumers and SME's to initiate class actions.

7. Signatory

Distributors and product managers are encouraged to become a signatory of the quality standard, so as to show their engagement and ambition in this field.

Becoming a signatory means that the signing entity voluntarily accepts the quality standard as binding for its socially responsible product offering in Belgium. By signing, a distributor undertakes to only actively commercialise socially responsible products if they are compliant with the quality standard. A signing product manager undertakes to manage its socially responsible products, intended for active public commercialisation in Belgium, in line with the quality standard.¹⁵

A product manager or distributor could apply for the label for some of its products without being able to become a signatory. This might be the case for some multi-national asset managers.

Signatories will advocate the principles of the quality standard and use the label in the publicity for compliant products.

Signatories are encouraged to set targets on the relative size of socially responsible products in the whole of their offer in Belgium.

¹⁵ Becoming a signatory implies no engagement for the distribution or management of traditional products (not marketed as socially responsible or sustainable), non-public products, or products not intended for the Belgian market.

8. Transition period

As of 3 months after publication of the quality standard, the label can be requested by compliant products.

Products currently marketed as 'socially responsible' on the Belgian market, by signatories, can do so until 9 months after publication of the quality standard, without being fully compliant. They will however not receive the label until full compliance.

Products newly marketed as 'socially responsible' on the Belgian market, by signatories, should be compliant from the start.

9. Review

A quality standard dealing with sustainability is dynamic and evolutive by nature. As such, it will need to be reviewed on a regular basis.

A first review is planned in 2020. This review will aim to fine-tune and upgrade the quality standard taking into account, among others:

- the evolution of societal needs and client's expectations
- the implementation of the EU action plan on sustainable finance and specifically the EU classification system of sustainable economic activities ('taxonomy') regarding environmental and esp. climate-related indicators
- new academic research and the increased availability of consistent, uniform and qualitative data on specific metrics
- market conditions related to the segment of socially responsible and sustainable financial products

B. Requirements of the quality standard

High-level context

The landscape of sustainable and socially responsible finance is shaped by global principles and international frameworks such as:

- the UN Global Compact (UNGC)¹⁶
 - Principles on Human rights, Labour rights, Environment and Corruption
- the UN Principles for Responsible Investing (UN PRI)¹⁷
 - Principles on ESG (risk) approach, engagement, impact reporting, performance measurements
- The UN Principles for Responsible Banking¹⁸
 - Framework for the banking industry that embeds sustainability at the strategic, portfolio and transactional levels and across all business areas
- the UN Sustainable Development Goals (SDG's)¹⁹
 - Global goals for thematic investment, impact and SDG investment
- the United Nations Framework Convention on Climate Change (UNFCCC): Paris Agreement²⁰
 - Mobilizing finance for climate change mitigation and adaptation
- the OECD Guidelines for Multinational Enterprises: Responsible Business Conduct for Institutional Investors²¹
 - Considerations for institutional investors in carrying out due diligence that will help to identify and respond to environmental and social risks
- the United Nations Guiding Principles on Business and Human Rights (UNGPs)²²
 - Global standard for preventing and addressing the risk of adverse impacts on human rights linked to business activity

Although these high-level frameworks are not always straight-forward to put into practice and have different fields of application, providers and managers of socially responsible financial products shall use them as guidance.

¹⁶ 10 principles: <https://www.unglobalcompact.org/what-is-gc/mission/principles>

¹⁷ 6 principles: <https://www.unpri.org/about/the-six-principles>

¹⁸ 6 principles: <http://www.unepfi.org/banking/bankingprinciples/>

¹⁹ 17 goals: <https://sustainabledevelopment.un.org/sdgs>

²⁰ The Paris Agreement's central aim is to strengthen the global response to the threat of climate change by keeping a global temperature rise this century well below 2 degrees Celsius above pre-industrial levels and to pursue efforts to limit the temperature increase even further to 1.5 degrees Celsius.

<https://unfccc.int/resource/docs/2015/cop21/eng/10a01.pdf>

More specifically on climate finance, see:

http://unfccc.int/cooperation_and_support/financial_mechanism/items/2807.php

²¹ <http://mneguidelines.oecd.org/rbc-financial-sector.htm>

²² https://www.ohchr.org/Documents/Publications/GuidingPrinciplesBusinessHR_EN.pdf

ESG due diligence and analysis

ESG due diligence and analysis processes form the basis for implementing sustainability objectives and strategy, at the product and the management level.

Product managers shall have in place an ESG due diligence processes to identify, prevent, mitigate, and account for how they address any adverse ESG impacts in the value chain of their activities.

Such an ESG due diligence encompasses:

- Assessing actual and potential ESG risks
- Integrating and acting upon the findings
- Tracking the effectiveness of responses
- Communicating how impacts are identified and addressed²³

ESG due diligence is risk-based, i.e. the policies and processes put in place should be appropriate to the industry, region, size and type of the involvement within the value chain.

Besides risk analysis, the ESG processes can also identify opportunities and manage and measure any positive impact that the product manager might aim for.

Based on his best judgement and expertise, the product manager should select the most appropriate instruments, research, data providers, third-party exclusion lists, etc. to meet its ESG due diligence and analysis requirements.

Considering the challenge to gather the data required to get a complete picture of the sustainability of a company, product managers should stress the importance detailed ESG reporting in their contacts with the companies they finance.

Product managers shall describe the key elements of their ESG due diligence implementation. The Eurosif Transparency Code²⁴ can serve as guidance when providing this description.

The inherent complexities in the financial sector such as extensive and complex business relationships or the rapidity of transactions make practical application of effective due diligence systems challenging. The OECD Guidance on Responsible Business Conduct for Institutional Investors²⁵ explains the application of the OECD Guidelines for Multinational Enterprises in the context of institutional investors. The paper highlights key considerations for institutional investors in carrying out due diligence that will help to identify and respond to environmental and social risks.

²³ This also includes procedures on dealing with controversies regarding specific companies in a portfolio.

²⁴ <http://www.eurosif.org/transparency-code/>

²⁵ <http://mneguidelines.oecd.org/rbc-financial-sector.htm>

Key Principles

The quality standard is built around 5 key principles:

1. Sustainability strategies: A multi-faceted approach to sustainability
2. Avoiding harm: Some companies do not belong in a socially responsible portfolio
3. Transparency: What is taken into account and how?
4. Information: Helpful information for the client
5. Supervision: Walk the talk

The requirements following from these principles, and guidelines for interpretation and implementation are provided below.

1. Sustainability strategies

A financial product puts into practice its socially responsible character by using at least the following two strategies:

- Integration of ESG factors, and
- Negative/exclusionary screening

And one or more of the following additional strategies:

- Positive/best-in-class screening
- Norms-based screening
- Sustainability themed investing
- Impact/community investing

All assets in the portfolio shall be evaluated on their degree of sustainability.

1.1 Implementing guidelines

1.1.1 Use of sustainability strategies

- The Global Sustainable Investment Alliance (GSIA)²⁶ and Eurosif identify 7 sustainability strategies:
 1. Negative/exclusionary screening
 2. Positive/best-in-class screening
 3. Norms-based screening
 4. Integration of ESG factors (ESG: Environmental, Social, Governance)
 5. Sustainability themed investing²⁷
 6. Impact/community investing
 7. Corporate engagement and shareholder action
- A socially responsible product shall make use of the following strategies:
 1. Integration of ESG factors: All dimensions of sustainability (Environmental, Social, Governance) shall be considered in the management of the products. E.g. a 'green fund' with an exclusive focus on the environment and not taking into account social or governance factors, will not do.

²⁶ Global Sustainable Investment Review 2016, p.6 <http://www.gsi-alliance.org/members-resources/trends-report-2016/>. See also the book (Dutch) *Ethisch beleggen is voor iedereen*, Dirk Coeckelbergh, Siem de Ruijter, Staf Lavergne, Herwig Peeters, LannooCampus, 2016.

²⁷ See also the mapping of the United Nations Sustainable Development Goals (SDGs) against the draft framework Sustainable Taxonomy in annex 3 of the report of the HLEG on Sustainable Finance: Informal supplementary document on the sustainability taxonomy https://ec.europa.eu/info/sites/info/files/180131-sustainable-finance-final-report-annex-3_en.pdf

2. Negative/exclusionary screening: see Principle 2
 3. At least one additional strategy
However, corporate engagement and shareholder action shall not be the only additional strategy
- Corporate engagement and/or shareholder action is encouraged as a strategy and is expected with regard to the non-renewable energy and electricity utility sector (See 2.2.5.5 and 2.2.5.6)

1.1.1.1 BEST-IN-CLASS SCREENING

- When using this strategy, the product manager selects only the best performers on the level of sustainability within a sector or subsector.
- The product manager shall be transparent about its methodology and about the percentages used as the threshold for determining the best performers.

1.1.1.2 CORPORATE ENGAGEMENT AND SHAREHOLDER ACTION

- Corporate engagement and shareholder action mean that the product manager engages in a dialogue with the companies in which it invests and, as an institutional shareholder, makes use of its voting rights at general meetings.
- When using corporate engagement and shareholder action as a sustainability strategy, the product manager shall have a formal policy and publish an engagement report, on the company or on the product level, indicating on what topics shareholder action is carried out and how.
- The report should, when relevant, provide a general view on:
 1. the voting policy per (category) of topics
 2. the internal organisation of corporate engagement
 3. the actual voting (issues, number, ...)
 4. the targets for evaluating the effectiveness of continuing corporate engagement
 5. the questions asked in general assemblies
 6. dialogue and other actions towards issuers (type, outcome, ...)
- The UN Principles for Responsible Investing provide guidance²⁸ on engagement reporting. It lists:
 - Best practice disclosure on engagement activities
 - Elements of good quality reporting on voting activities
- The use of specific portfolio management techniques shall not preclude engagement when chosen as a strategy or when required by the quality standard.

1.1.2 Evaluating the eligibility of financial assets for a socially responsible portfolio

- Depending on the situation, evaluating assets for their eligibility can be done on different levels:
 - a) *Evaluation on the level of the asset*

²⁸ UN PRI Practical Guide to Active Ownership in Listed Equity: <https://www.unpri.org/listed-equity/a-practical-guide-to-active-ownership-in-listed-equity/2717.article>

1. Consideration of the use of the asset
 - As a source of return
 - As a tool for hedging risks
 - As a technical tool in the context of efficient portfolio management²⁹: e.g. duration management, ensuring liquidity
2. Consideration of the issuer of the asset³⁰
 - a corporate (incl. a financial institution)
 - a government
3. If the asset represents a collection of assets (fund, index, special purpose entity, basket or pool), consideration of the underlying assets
4. If the asset is a derivative, consideration of the derived assets and, when appropriate, the counterparty

Not all considerations are equally relevant for each type of asset (equity, bonds, money market instruments, cash).

b) Evaluation on the level of the portfolio

1. Consideration of the share of a group of assets in the total portfolio
 - A socially responsible portfolio shall not systematically (structurally and permanently) contain assets that cannot be evaluated on their sustainability in any way, i.e. not by any possible internal or external methodology. Temporary derogations for technical reasons are allowed³¹.
 - In general, assets in a portfolio do not have to be evaluated if their only purpose is purely technical or for the temporary hedging of risks. When assets are structurally held with an investment purpose, they should be evaluated on their sustainability.
 - As a guideline, when evaluating a more complex portfolio, one should look through the intermediate structures until the entities in the real economy that are being financed by the investment are reached, i.e. corporates and/or governments.

1.1.3 Evaluating specific assets and portfolio's

1.1.3.1 DERIVATIVES

- Derivatives can be used as a technical portfolio management tool, for hedging risks or as a source of return. In any case, the use of derivatives cannot be at odds with the socially responsible character of the product.
- If used as a source of return, the issuer of the derived assets shall be evaluated. When the underlying of the derivative is an index, see 1.1.3.6
- Additionally, the product manager is encouraged to perform an ESG due diligence on the counterparties.

²⁹ For investment funds, 'Efficient portfolio management' as described in the UCITS Directive.

³⁰ In most cases, this is the party that finally benefits from the financing via the socially responsible product.

³¹ For example: temporary unavailability of ESG data on bond IPO's, small caps, etc. or the temporary absence of sufficient and suitable derivatives in the market.

- Derivatives shall only be used in addition to other assets. A socially responsible portfolio cannot primarily consist of derivatives.
- The product manager shall be transparent on the use of derivatives. To do this, the product manager shall provide a description of the type and function of the derivatives used, their share in the portfolio, and the ESG analysis made of the derived assets and, where appropriate, of the counterparties.

1.1.3.2 FIXED-INCOME INSTRUMENTS

- To evaluate the eligibility of a fixed-income instrument, the issuer of the instrument shall be evaluated.
- If the issuer is a corporate or a government, the appropriate sections of the standard shall be considered.
- Likewise, if the issuer is a financial institution, the product manager shall base the eligibility based on his ESG due diligence, in line with the requirements of the quality standard. Special care should be taken to illustrate the objectivity and independence of the ESG source data and the evaluation model. The endorsement of the UNEP FI Principles for Responsible Banking should be an element in the evaluation.
- If the issuer is a Special Purpose Vehicle (SPV), the issuers of underlying assets shall be evaluated.

1.1.3.3 GREEN BONDS

- Green bonds are financial instruments where the proceeds are invested exclusively (either by specifying the use of the proceeds, direct project exposure, or securitization) in green projects that generate climate or other environmental benefits.³²
- The product manager shall include in his ESG due diligence process, the monitoring and evaluation of the issuer and the beneficiaries of the green bond.
- A green bond cannot finance activities excluded by the quality standard (See 2.)³³
- When investing in green bonds, the social and governance aspects of the financed programs should also be taken into account, not only the environmental aspect.
- For a green bond to be eligible for investment by a socially responsible financial product, it must be compliant with one of the following green bond standards:
 - The Green Bond Principles of the International Capital Markets Association (ICMA)³⁴

³² <http://www.undp.org/content/sdfinance/en/home/solutions/green-bonds.html>

³³ E.g. a green bond should not be used to improve the energy efficiency of tobacco production (even if this would reduce operational CO₂ remissions) but could be used to finance the transition to more sustainable business lines.

³⁴ <https://www.icmagroup.org/green-social-and-sustainability-bonds/green-bond-principles-gbp/>

- The Climate Bond Standard & Certification Scheme of the Climate Bond Initiative (CBI)³⁵
- This compliance should be assessed by an independent external review: Third party verification or Second Party Opinion.

1.1.3.4 CASH

- In principle, cash positions do not have to be evaluated if their only purpose is technical (e.g. to provide liquidity) or for the temporary hedging of risks.
- When cash is structurally held with an investment purpose, the bank where the cash is deposited shall be evaluated on its sustainability.

1.1.3.5 FUNDS OF FUNDS

- In principle, all subfunds in a socially responsible fund of funds need also be socially responsible and thus comply with the quality standard. This does not necessarily mean that all underlying subfunds need to have the sustainability label. A fund of funds manager could alternatively have a formal commitment of the subfund managers to be compliant with the quality standard.
- A 'look-through' approach, in which the consolidated fund of funds portfolio is assessed by the fund of funds manager on compliance with the standard, is considered to be equivalent in cases where compliance by each subfund is not enforceable in practice³⁶.
- The fund of fund manager shall be fully accountable and responsible for the fund of funds' compliance with the quality standard and the consolidated screening should be done on a regular basis and be externally audited.
- The fund of funds manager should clearly state to the subfund managers his expectations regarding the sustainability implementations at the subfund level and remains responsible for the compatibility of these implementations with the quality standard.

1.1.3.6 INDEX FUNDS AND EXCHANGE TRADED FUNDS (ETF'S)

- Index-funds or ETF's are compliant with the quality standard when the composition of the underlying index is compliant.
- In the case of structured products of which the performance is based on the evolution of a socially responsible index, the index but also the actual asset portfolio should be compliant with the quality standard.
- While custom or enhanced indices can be compliant, there are currently no off-the-shelf indices that are fully compliant with the standard. Therefore, an index-fund or ETF based on a partially compliant but commonly used SRI index, can to a limited

³⁵ <https://www.climatebonds.net/standard>

³⁶ E.g. when subfund managers have no formal policies on some of the exclusions required by the quality standard, the assessment can be based on the actual list of companies in the portfolio instead of on the available policies.

extent be used as an underlying³⁷ asset in a socially responsible product. In 2019 this limit is 30% of the portfolio. Each year it is reduced by 10% to reach 0% in 2022, when all underlying indices should be fully compliant.

In any case, the product manager shall describe to what extent the underlying indices are compliant with the quality standard.

- The product manager shall include in his ESG due diligence process, the evaluation of the sustainability strategies used in the index composition methodology of the index provider.

1.1.3.7 STRUCTURED PRODUCTS

- Structured products typically consist of an asset portfolio, providing the funding, and a derivatives part, providing the return. In principle, both parts of the portfolio need to be evaluated on their sustainability.
- For the evaluation of the derivatives part, see 1.1.3.1. The evaluation of the asset portfolio depends on the types of the assets³⁸ in the portfolio.
- The quality standard compliance of the portfolio is evaluated only once, at the start of the subscription period. The product is considered to be compliant (and can keep the label) until maturity, as long as no further subscription is possible. If, however, the underlying assets change as a consequence of the manager's decision (e.g. a periodical, dynamic change in the securities basket), or subscription is reopened, compliance with the quality standard needs to be reassessed.

1.1.3.8 UNSEGREGATED ASSET POOLS

- The quality standard is also applicable to financial products without a delimited or compartimentalised underlying asset pool, e.g. savings accounts, branch 21 insurance products and some types of structured products.
- Like socially responsible products in general, this type of products should a) comply with the principle that the product is managed with a clear and distinct sustainability strategy and ambition, and b) support the claim that for each euro invested by a client in the product, there is at least one euro reinvested in socially responsible assets.
- When the reinvestment is not done in a legally separated pool of assets, a virtually delimited pool of assets that is fully compliant with all the requirements of the quality standard, should be defined within the larger pool of assets.
- The total asset value of the virtually delimited pool should be at least as large as the total value of all socially responsible products that are reinvested in the unsegregated asset pool.

³⁷ An index-fund or ETF that itself wants to be labelled as socially responsible, can only be based on a fully compliant underlying index.

³⁸ In products with some kind of capital protection feature, the asset portfolio often consists of fixed income instruments. For the evaluation of this fixed income part, see 1.1.3.2.

- Additionally, the percentage of corporate-issued securities in the virtually delimited pool should, as far as technically possible, be at least as high as the percentage of corporate-issued securities in the total unsegregated asset pool.
- The verification of the compliance of this type of products shall consist of
 - an assessment of the management of the virtually delimited pool assets with regard to its asset value and asset allocation
 - a verification of the compliance of the virtually delimited pool with all the requirements of the quality standard

2. Avoiding harm

A socially responsible financial product shall not finance:

- UN Global Compact violations
- Weapons
- Tobacco
- Coal
- Unconventional oil & gas

Financing of transitional energy sources like conventional oil & gas and nuclear energy, is limited and is the subject of corporate engagement or shareholder action.

2.1 General comments

- Financial products with a sustainability focus shall not finance or support companies that are continuing or not phasing out practices that are widely regarded as unsustainable.
- The quality standard intentionally includes not only process level requirements (e.g. ESG integration/due diligence, reporting) but also portfolio level requirements (e.g. exclusions and exposure limits).
- The aim and the intended effect of excluding specific companies and industry sectors is not to drain their financing, but rather to send a clear message that the activities of the excluded companies are deemed not to have a place in a sustainable future-proof society.
- To have a meaningful impact on the transition towards a sustainable economy and society, the integration of sustainability considerations (ESG) should also go beyond a niche and into mainstream financial products and services, thus supporting and encouraging companies in their transition to more sustainable business practices. The niche of socially responsible financial products, however, favours companies that have made significant progress to becoming sustainably future-proof.
- The exclusions are selective and limited. They are only applied on a company-by-company basis, to activities that are considered very harmful to the environment and society, and especially when engagement is no longer an effective or useful strategy³⁹. E.g. the conventional oil & gas sector is not as such excluded, but selectivity and engagement are required. Contrary to companies that keep building new coal plants, engagement can still be considered a useful strategy with conventional oil & gas companies.

³⁹ On the balance between exclusion and engagement, see also the concept of the 'investor's degree of leverage' in the OECD Guidance on Responsible business conduct for institutional investors <https://mneguidelines.oecd.org/RBC-for-Institutional-Investors.pdf>

2.2 Implementing guidelines

2.2.1 The exclusion of harmful activities shall be implemented on multiple levels

1. A product manager shall use exclusion criteria and lists to filter out the most harmful companies.
2. A product manager shall have in place specific internal/proprietary due diligence processes to (possibly) further filter out additional harmful companies, not previously excluded. This due diligence should be supported by adequate internal and/or external resources.
3. Product managers can use a sustainability strategy to select only the least harmful or most beneficial companies. E.g. best-in-class strategy, thematic or impact investing (See Principle 1).

This combined approach should result in a portfolio without a significant exposure to unsustainable activities.

2.2.2 Value chain

- When evaluating companies, activities by the company itself or through entities under its control⁴⁰ should be taken into account.
- It is encouraged to not only consider the production of harmful or unsustainable resources or products, but also their development, processing and wholesale distribution.
- Companies providing tailor-made, dedicated or specialised components, accessories or services for the excluded activities, should also be considered for exclusion.
- Companies providing multi-purpose or generic services or materials to excluded companies are not targeted.

2.2.3 Thresholds

- The quality standard sets thresholds above which a company should be excluded. When setting the current level of the thresholds, consideration was given to:
 - the ESG risk and impact of the exposure
 - the need for diversification within a sector and on the portfolio level
 - the impact on performance of the portfolio
 - the currently available granularity of the company data
- Company level thresholds should be interpreted as reference values to be used in the due diligence process. Actual values, are the result of a best effort analysis subject to the availability and quality of sources and data at a specific moment. If data points for a specific requirement are not available, estimations or proxy values can be used as far as these are aligned with the spirit and objective of the requirement.
- By definition the exposure to an excluded activity at the portfolio level is much lower than the exposure allowed at the company level.

⁴⁰ Through ownership of shares (>50%) or, according to the legal definitions in the market it operates, by being in a position to exercise control of the entity.

- The Sustainability ID (See Principle 4) will show the reference values of the thresholds that are actually used in the management of the product.

2.2.4 Transition path

- For most exclusions multiple levels of involvement (thresholds) are mentioned. The decreasing thresholds on company and portfolio level present a transitional perspective in a 2020-2025 timeframe. These thresholds should also be used as a guide for corporate engagement targets. See Appendix 1.
- The thresholds have an evolutive nature, as has the whole of the quality standard, and will need to be reviewed and reassessed periodically. See A. 9.
- The starting level of the thresholds take into account the objective of quantitatively growing the share of socially responsible products and thus mainstreaming the quality standard to all financial products.
- The expectations and interpretations of socially responsible investments as well as the constraints regarding fiduciary duty and financial returns can differ greatly between retail, private and institutional investors. The quality standard however, has the objective to allow for a socially responsible investment product to be the default offer to all potential investors.

2.2.5 Excluded activities and practices⁴¹

2.2.5.1 UN GLOBAL COMPACT VIOLATIONS

Corporate sustainability starts with a company's value system and a principles-based approach to doing business. This means operating in ways that, at a minimum, meet fundamental responsibilities in the areas of human rights, labour, environment and anti-corruption. Companies that seriously or systematically violate these principles should not be financed by a socially responsible financial product.

2.2.5.1.1 REQUIREMENTS

- The product manager shall include in his ESG due diligence process, the monitoring and evaluation of companies, based on their involvement in violations of one or more of the 10 principles of the UN Global Compact⁴².
- A socially responsible product shall not finance companies that pose an unacceptable risk to contribute to or be responsible for:
 - a) serious or systematic human rights violations, such as murder, torture, deprivation of liberty, forced labour and the worst forms of child labour
 - b) serious violations of the rights of individuals in situations of war or conflict

⁴¹ All requirements are cumulative.

The criteria listed under the heading 'requirements' take precedence over any specific approaches or exclusion lists that might be mentioned as background. The product manager should take the responsibility to comply with the requirements. This cannot be evaded by blindly following an external approach or list.

⁴² The Ten Principles of the United Nations Global Compact are derived from: the Universal Declaration of Human Rights, the International Labour Organization's Declaration on Fundamental Principles and Rights at Work, the Rio Declaration on Environment and Development, and the United Nations Convention Against Corruption. See <https://www.unglobalcompact.org/what-is-gc/mission/principles>

- c) severe environmental damage
 - d) acts or omissions that on an aggregate company level lead to unacceptable greenhouse gas emissions
 - e) gross corruption
 - f) other particularly serious violations of fundamental ethical norms
- The severity of the violation and the structural character of the involvement should be considered when deciding the appropriate action⁴³ with regard to companies involved in incidents.

2.2.5.1.2 BACKGROUND

- The following initiatives and sources can be inspirational when developing due diligence to fulfil this requirement:
 - The OECD Guidelines for Multinational Enterprises: Responsible Business Conduct for Institutional Investors⁴⁴
 - The United Nations Guiding Principles on Business and Human Rights (UNGPs)⁴⁵
 - The Corporate Human Rights Benchmark (CHRB)⁴⁶
 - The Norges Bank Investment Management (NBIM)⁴⁷ Ethical exclusions list, section Conduct-based exclusions⁴⁸ and the GPF Global Guidelines⁴⁹, Section 3
 - The exclusion list⁵⁰ of the Luxembourg 'Fonds de compensation commun au régime général de pension' (FDC)⁵¹

2.2.5.2 WEAPONS

Weapons that are indiscriminate or do disproportionate harm cannot be financed. The commercial arms industry poses too high a risk for a sustainable and peaceful society and should not be financed by a socially responsible financial product.

2.2.5.2.1 REQUIREMENTS

- The product manager shall include in his ESG due diligence process, the monitoring and evaluation of companies in the arms industry.

⁴³ Actions could be: engagement, marking as high risk (watchlist), exclusion.

⁴⁴ <http://mneguidelines.oecd.org/rbc-financial-sector.htm>

⁴⁵ https://www.ohchr.org/Documents/Publications/GuidingPrinciplesBusinessHR_EN.pdf

⁴⁶ The Corporate Human Rights Benchmark is a collaboration led by investors and civil society organisations dedicated to creating an open and public benchmark of corporate human rights performance: <https://www.corporatebenchmark.org/>

⁴⁷ Norges Bank Investment Management (NBIM): <https://www.nbim.no/en/>. Manager of Norway's Government Pension Fund Global (GPF Global).

⁴⁸ <https://www.nbim.no/en/responsibility/exclusion-of-companies/>

⁴⁹ Guidelines for observation and exclusion from the Government Pension Fund Global: http://etikkradet.no/files/2017/04/Etikkradet_Guidelines-eng_2017_web.pdf

⁵⁰ http://www.fdc.lu/fileadmin/file/fdc/Liste_d_exclusion_20171204.pdf

⁵¹ FDC socially responsible policy <http://www.fdc.lu/en/socially-responsible-investment/>.

- A socially responsible product shall not finance companies with weapons-related activities that cannot be financed in Belgium (anti-personnel mines, cluster munition, depleted uranium, biological/chemical weapons)⁵².
- A socially responsible product shall not finance companies that derive more than 10% of their revenues from the production of weapons or tailor-made components thereof⁵³. This requirement will be further refined in a 2020-2025 timeframe.
- A socially responsible product shall not finance companies that manufacture or sell nuclear weapons or tailor-made components of nuclear weapons to countries that have not signed the non-proliferation treaty.

2.2.5.2.2 BACKGROUND

- The Belgian law banning any financing of companies involved in anti-personnel mines, submunition or depleted uranium⁵⁴.
- Study on customary international humanitarian law conducted by the International Committee of the Red Cross (ICRC)⁵⁵

2.2.5.3 TOBACCO

Tobacco production results in serious health problems and poses unacceptable societal risks. This should not be financed by a socially responsible financial product.

2.2.5.3.1 REQUIREMENTS

- The product manager shall include in his ESG due diligence process, the monitoring and evaluation of companies in the tobacco industry.
- A socially responsible product shall not finance companies that derive more than 10% of their revenues from the production of tobacco, products that contain tobacco or the wholesale trading of these products. This requirement will be further refined in a 2020-2025 timeframe.

2.2.5.3.2 BACKGROUND

- The following initiatives and sources can be inspirational when developing due diligence to fulfil this requirement:

⁵² There is no official list of these companies. However, to support compliance with the Belgian Weapons Law (the ban on financing controversial weapons) BEAMA concluded a screening contract for the whole sector with the research agency ISS Ethix. BEAMA members subscribed to this service have access to a list of excluded companies: https://www.issgovernance.com/file/products/iss-ethix_controversial-weapons-screening.pdf. Also, KBC Group publishes a list of controversial weapons companies: https://www.kbc.com/en/system/files/doc/sustainability-reponsability/FrameworkPolicies/CSD_KBCBlacklist.pdf.

⁵³ Weapons are defined as products or basic components of products that have been 'designed to injure/kill' and are used exclusively for military purposes. Tailor-made components are components that are developed primarily in order to be integrated into a weapon system.

⁵⁴ Act of 8 June 2006 regulating economic and individual activities involving weapons. (also called 'Weapons Act') – Art 8:
http://www.ejustice.just.fgov.be/cgi_loi/loi_a1.pl?language=nl&caller=list&cn=2006060830&la=n&fromtab=wet&sql=dt='wet'&tri=dd+as+rank&rech=1&numero=1#LNK0005

⁵⁵ Customary IHL Database <https://ihl-databases.icrc.org/customary-ihl/eng/docs/home>

- The WHO Framework Convention on Tobacco Control (FCTC)⁵⁶
- The UN Global Compact measure on tobacco companies⁵⁷
- The Tobacco Free Portfolios initiative⁵⁸
- The NBIM Ethical exclusions list, section Product-based exclusions - Production of tobacco⁵⁹

2.2.5.4 COAL & UNCONVENTIONAL OIL & GAS EXTRACTION

Coal and unconventional oil and gas pose unacceptable environmental, climate and societal risks. Investments in these industries could retard investments in transitional and renewable energy sources and thus should not be part of a socially responsible financial product.

2.2.5.4.1 REQUIREMENTS

- The product manager shall include in his ESG due diligence process, the monitoring and evaluation of companies involved in coal extraction or unconventional oil & gas extraction.
- A socially responsible product shall not finance companies⁶⁰ that derive more than 10% of their revenue⁶¹ from thermal⁶² coal extraction or unconventional oil & gas extraction⁶³. This requirement will be further refined in a 2020-2025 timeframe.
- A socially responsible product shall not finance companies with expansion plans⁶⁴ for coal extraction or unconventional oil & gas extraction.

2.2.5.4.2 BACKGROUND

- The following initiatives and sources can be inspirational when developing due diligence to fulfil this requirement:
 - The Global Coal Exit List (CGEL)⁶⁵ and the Global Coal Exit List (CGEL) 120 Top Coal Plant Developers⁶⁶

⁵⁶ <http://www.who.int/fctc/en/>

⁵⁷ Effective 15 October 2017, the UN Global Compact has implemented new integrity measures, including delisting of companies whose business involves manufacturing or production of tobacco.

⁵⁸ <http://www.tobaccofreeportfolios.org/>

⁵⁹ <https://www.nbim.no/en/responsibility/exclusion-of-companies/>. Definition of tobacco producer: <https://nettsteder.regjeringen.no/etikkradet-2017/files/2017/02/Rec-tobacco-English2009.pdf>

⁶⁰ Companies targeted are at least those generating revenue from exploration, extraction, processing or exclusively providing dedicated equipment & services.

⁶¹ Alternatively, production capacity and/or actual production can be used as a measure.

⁶² The exclusion on production is limited to thermal coal (meaning that metallurgical coal, 'cokes', is not excluded), if this distinction on the company level can be made. However, if the distinction cannot be made, the whole coal production should be taken into account.

⁶³ By unconventional oil & gas extraction methods is meant: the extraction of tar/oil sands, shale oil, shale gas and Arctic drilling. If sufficiently detailed data on a specific unconventional extraction method is not available, it should be marked as a specific point of concern in corporate dialogue and engagement.

⁶⁴ Having expansion plans can be interpreted as a situation whereby the projected increase of revenue from the activity is greater than the projected growth of global revenue.

⁶⁵ Database established by Urgewald, a German Environment & Human Rights NGO
<https://coalexit.org/database-full>

⁶⁶ <https://coalexit.org/database>

- The Carbon Underground Coal 100⁶⁷
- The Carbon Underground Tar Sands 20⁶⁸
- The NBIM Ethical exclusions list, section Product-based exclusions - Production of coal or coal-based energy⁶⁹

2.2.5.5 CONVENTIONAL OIL & GAS EXTRACTION

Conventional oil and gas products have an important role in our current economy and are expected to do so in the next decades. This sector is key in the transition to a low-carbon economy. In that way it can have a place in a socially responsible portfolio. However, it should be approached cautiously and selectively to value positive evolution and to limit negative impacts.

2.2.5.5.1 REQUIREMENTS

- The product manager shall include in his ESG due diligence process, the monitoring and evaluation of companies involved in conventional oil & gas extraction. The evaluation should make use of forward-looking metrics like the level and the management of carbon related risk, and the transition plans towards low carbon and renewable energy.
- A socially responsible product shall not finance oil & gas extraction companies that derive less than 40% of their revenue⁷⁰ from activities related to natural gas extraction or renewable energy sources.⁷¹ This requirement will be further refined in a 2020-2025 timeframe.
- The product manager shall have in place a corporate engagement and/or shareholder action policy with the aim of accelerating the transition of energy companies to a low carbon business model and of supporting their R&D in sustainable energy technologies.

2.2.5.5.2 BACKGROUND

- The United Nations Framework Convention on Climate Change (UNFCCC): Paris Climate Agreement⁷²
- European Parliament resolution of 4 October 2017 on the 2017 UN Climate Change Conference in Bonn, Germany (COP23)⁷³

⁶⁷ List established by Fossil Free Indexes LLC <http://fossilfreeindexes.com/research/the-carbon-underground/>. This list is used by divestment movements such as 350.org and Divest/Invest.

⁶⁸ <http://fossilfreeindexes.com/research/tar-sands/>

⁶⁹ <https://www.nbim.no/en/responsibility/exclusion-of-companies/>

⁷⁰ Alternatively, installed production capacity and/or actual production can be used as a measure.

⁷¹ Pending credible, reliable and sufficiently available metrics and data on the degree in which conventional oil & gas energy companies are aligned with a below 2 degrees target, companies are evaluated by importance of natural gas, as a transitional energy source, and renewable energy source in their activities. Future research and the EU taxonomy that is under development may provide more metrics, e.g. a below 2 degrees scenario based on carbon intensity kgCO₂/MJ.

⁷² <https://unfccc.int/resource/docs/2015/cop21/eng/10a01.pdf>

⁷³ The EP calls on governments and public and private financial institutions, including banks, pension funds and insurance firms, to make an ambitious commitment to aligning lending and investment practices with the

- The following initiatives can be inspirational when developing due diligence to fulfil this requirement:
 - The global primary energy mix scenarios of the International Energy Agency⁷⁴
 - The Transition Pathway Initiative⁷⁵ and the Carbon Disclosure Project⁷⁶
 - The Carbon Underground 200⁷⁷

2.2.5.6 ELECTRICITY GENERATION

Electricity utility companies that are on a transition path in line with the Paris agreement goals are eligible to be financed by a socially responsible financial product.

2.2.5.6.1 REQUIREMENTS

- The product manager shall include in his ESG due diligence process, the monitoring and evaluation of companies involved in coal-, oil-, gas- or nuclear-based power production.
The evaluation should make use of forward-looking metrics like the level and the management of carbon related risk, and the transition plans towards low carbon and renewable energy.
- A socially responsible product shall not finance electricity utilities with a carbon intensity that is not aligned with a below 2 degrees scenario⁷⁸:

	2019	2020	2021	2022	2023	2024	2025
Max. gCO ₂ /kWh	429	408	393	374	354	335	315

- In the case that carbon intensity data is not available, a socially responsible product shall not finance:
 - electricity utilities of which more than 10% of the power production⁷⁹ is based on coal. This requirement will be further refined in a 2020-2025 timeframe

global average temperature target of well below 2°C and wants them to commit to “divesting from fossil fuels, including by phasing out export credits for fossil fuel investments”.

<http://www.europarl.europa.eu/sides/getDoc.do?type=TA&language=EN&reference=P8-TA-2017-0380>

⁷⁴ International Energy Agency, ‘Energy Technology Perspectives 2017’, OECD/IEA

<https://www.iea.org/etp/etp2017/>

⁷⁵ Transition Pathway Initiative (TPI), ‘Carbon Performance Assessment in Oil and Gas: Discussion paper’,

<http://www.lse.ac.uk/GranthamInstitute/tpi/wp-content/uploads/2018/11/Oil-and-gas-discussion-paper.pdf>

⁷⁶ Carbon Disclosure Project (CDP), ‘Beyond the cycle: which oil & gas companies are ready for the low-carbon transition?’ <https://www.cdp.net/en/investor/sector-research/oil-and-gas-report>

⁷⁷ The Carbon Underground 200TM is a list of the 100 largest public oil and gas and the 100 largest public coal companies globally, as measured by the potential CO₂ emissions of their reported fossil fuel reserves. See <http://fossilfreeindexes.com/research/the-carbon-underground/>.

⁷⁸ The most frequently used scenario is the International Energy Agency (2017), ‘Energy Technology Perspectives 2017’, OECD/IEA, Paris, Figure 6.7 Global electricity generation in the B2DS. Figures are offset by 1 year to account for data availability.

⁷⁹ Depending on data availability, this can be measured by installed energy production capacity, actual energy production or revenue from generating power.

- electricity utilities of which more than 30% of the power production⁸⁰ is based on oil & gas
- electricity utilities of which more than 30% of the power production⁸¹ is based on nuclear sources
- The product manager shall have in place a corporate engagement and/or shareholder action policy with the aim of accelerating transition of electricity utilities to a low carbon business model and of supporting their R&D in sustainable energy technologies.
- A socially responsible product shall not finance electricity utilities with expansion plans that would increase their negative environmental impact or that go contrary to below 2 degrees scenario alignment.
- A sustainable product shall not finance electricity utilities constructing additional coal- or nuclear-based power production installations.

2.2.5.6.2 BACKGROUND

- The United Nations Framework Convention on Climate Change (UNFCCC): Paris Climate Agreement⁸²
- European Parliament resolution of 4 October 2017 on the 2017 UN Climate Change Conference in Bonn, Germany (COP23)⁸³
- The following initiatives can be inspirational when developing due diligence to fulfil this requirement:
 - The beyond 2 degrees scenario (B2DS) in the International Energy Agency, 'Energy Technology Perspectives 2017', OECD/IEA
 - The Transition Pathway Initiative⁸⁴

2.2.5.7 PHASE-OUT FOR UNALIGNED OIL & GAS EXTRACTION & ELECTRICITY GENERATION

Some companies are currently not yet aligned with the requirements of the quality standard but are nevertheless within the best of their peer group in transitioning their business model. A socially responsible financial product can finance these companies selectively and to a limited extent.

⁸⁰ See footnote 79.

⁸¹ See footnote 79.

⁸² <https://unfccc.int/resource/docs/2015/cop21/eng/10a01.pdf>

⁸³ The EP calls on governments and public and private financial institutions, including banks, pension funds and insurance firms, to make an ambitious commitment to aligning lending and investment practices with the global average temperature target of well below 2°C and wants them to commit to “divesting from fossil fuels, including by phasing out export credits for fossil fuel investments”.

<http://www.europarl.europa.eu/sides/getDoc.do?type=TA&language=EN&reference=P8-TA-2017-0380>

⁸⁴ Transition Pathway Initiative, 'The state of transition in the coal mining, electricity and oil and gas sectors: TPI's latest assessment' <http://www.lse.ac.uk/GranthamInstitute/tpi/wp-content/uploads/2018/06/TPI-July-2018-report.pdf>

2.2.5.7.1 REQUIREMENTS

- The portfolio of the socially responsible product can consist for no more than 5%⁸⁵, of companies not in line with the requirements for conventional oil & gas extraction or electricity generation. This requirement will be further refined in a 2020-2025 timeframe.
- Until end 2020, this portfolio level margin can exceptionally also contain companies not in line with the requirements for unconventional oil & gas extraction. This exception will be indicated in the Sustainability ID and in the label⁸⁶.
- The companies within this margin shall still be subject to ESG due diligence and evaluated in line with the chosen sustainability strategies.
- Additionally, companies within this margin shall be subject to a best-in-class selection⁸⁷ that retains only the top 50% companies best performing on sustainable energy transition within their peer group.
The best-in-class evaluation could consider: the percentage of natural gas and renewables in the production mix, absolute emissions and emissions intensity, the amount of investments in R&D on energy efficiency and renewables, etc.
- In line with the general principle, distributors and product managers are encouraged to formulate their own approach and objectives concerning the energy sector, going beyond the provisions of the quality standard.

2.2.6 Interpretation of exclusions with regard to countries

2.2.6.1 REQUIREMENTS

- A socially responsible product shall not finance countries (via government debt or indirectly via state-owned companies) subject to international sanctions, or that violate basic principles like those mentioned in the UN Global Compact (See 2.2.5.1).
- The product manager shall include in his ESG due diligence process, the monitoring and evaluation of countries and companies active in those countries.
 - The evaluation of OECD countries and non-OECD/emerging countries can be based on different criteria.
 - In the overall evaluation of countries not only the level of political rights can be considered, but also the level of well-being⁸⁸: e.g. education, health care.
 - Regarding climate change, the national reports on implementation of the Convention to the Conference of the Parties (COP)⁸⁹ should be considered.

⁸⁵ Combined, and measured in net asset value.

⁸⁶ The use of this exception shall be evaluated using a look-through approach. E.g. if one of the underlying funds in a fund of funds makes use of the exception, the fund of funds is considered to be making use of the exception.

⁸⁷ See 1.1.1.1

⁸⁸ E.g. by using the Human development index (HDI) or HDI growth as a metric

<http://hdr.undp.org/en/content/human-development-index-hdi>

⁸⁹ http://unfccc.int/national_reports/items/1408.php

2.2.6.2 BACKGROUND

- The following initiatives and sources can be inspirational when developing due diligence to fulfil this requirement:
 - The Freedom House 'Freedom in the World'⁹⁰ report on political rights and civil liberties
 - The Transparency International⁹¹ Corruption Perceptions Index
 - The UN Development Programme International Human Development Indicators⁹² per country
 - The Gapminder World indicators and tools⁹³

⁹⁰ <https://freedomhouse.org/report-types/freedom-world>

⁹¹ <https://www.transparency.org/>

⁹² <http://hdr.undp.org/en/countries>

⁹³ <https://www.gapminder.org/tools/>

3. Transparency

A socially responsible financial product shall provide an overview of its position towards potentially unsustainable practices and issues that are the subject of societal debate or controversy, e.g.:

- Non-renewable energy
- Biodiversity
- Oppressive regimes
- Tax evasion
- Etc.

3.1 Implementing guidelines

- The product manager or distributor shall formalise and publish their policy on at least the following issues⁹⁴:
 - Activities excluded by the quality standard:
 - UN Global Compact violations: Human Rights, Labour Rights, Environment, Anti-corruption
 - Weapons
 - Tobacco
 - Coal
 - Unconventional oil & gas
 - Other material issues:
 - Conventional oil & gas
 - Nuclear energy
 - Biodiversity
 - Water use
 - Taxation
 - Oppressive regimes (government and company level)
 - Death penalty
 - Forward contracts on agricultural commodities
- If the product manager or distributor additionally have a policy on other issues (e.g. mining, palm oil, alcohol, fur, animal testing, etc.), these can also be provided.

⁹⁴ The current list is based on the UN PRI ESG Issues investor guidance (<https://www.unpri.org/esg-issues>), the 'environmental objectives' as listed in the EC legislative proposals on sustainable finance, and the issues deemed most material according to a limited survey that was part of the public consultation on the quality standard.

- The specific issues included in the list can change over time, depending on the current societal debate.
- The product manager or distributor shall provide one or more policy documents that succinctly describe its policy on these issues. One document can be applicable to multiple products. Reference can be made to existing published general and specific policies.
- In general, a policy on an issue should explain how potential negative impact is avoided or minimized.
- A policy document shall describe the policy on the issue and by which processes and criteria the issue is evaluated, e.g.: a description of the metrics, thresholds, exemptions and the sources used in the evaluation.
- Reference can be made to the general ESG due diligence process, but a useful level of detail on the specific issue should be provided.

4. Information

All information on the sustainable character of the product, that is relevant to the potential client, shall be available in a clear, understandable and comparable way.

This information shall be centralised on a dedicated website, in the form of a standardised 'Sustainability ID' for each product.

For commercial and legally required information, reference shall be made to the distributor or manager of the product.

4.1 Implementing guidelines

- The socially responsible character of the product shall be clearly stated in the prospectus or other official product description.
- The product manager or distributor shall provide all relevant information needed by a client to make an informed decision as to whether the product meets their personal expectations on sustainability.
- The dedicated website and the Sustainability ID's are managed by the central labelling agency (See Principle 5).

4.1.1 Sustainability ID

- The sustainability ID is a uniform online factsheet for each labelled product, that lists in a uniform, comparable and easy to read format the key sustainability elements of the product. By way of this ID the client can determine the level of sustainability of a socially responsible product and if it is in line with their own personal concerns and convictions.
- It contains inter alia:
 - the name of the distributor(s) and the product manager
 - the sustainability strategies used by the product (See 1)
 - a description of the compliance with the required exclusions, e.g. the actual thresholds on company and on portfolio level used (See 2)
 - an overview of the policies on controversial activities (See 3)
 - a link to required documentation:
 - ESG due diligence description (See p.10)
 - Policies on controversial activities (See 3.1)
 - Engagement report, when relevant (See 1.1.1.2)
 - the independent third party that verified the compliance with the quality standard
 - a contact address where more detailed information can be requested
- The sustainability ID does not contain legally required or commercial information. For this, reference is made to the website of the distributor or the product manager.

5. Supervision

The compliance of the management and the portfolio of a product with its advertised sustainability policy shall be assessed by an independent and qualified third party.

A separate central labelling agency shall:

- Select and appoint the independent third party
- Evaluate the compliance of the policy used to manage a sustainable product with the requirements of the quality standard
- Grant the label

Compliance shall be verified on an annual basis.

5.1 Implementing guidelines

5.1.1 Supervision procedure

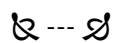
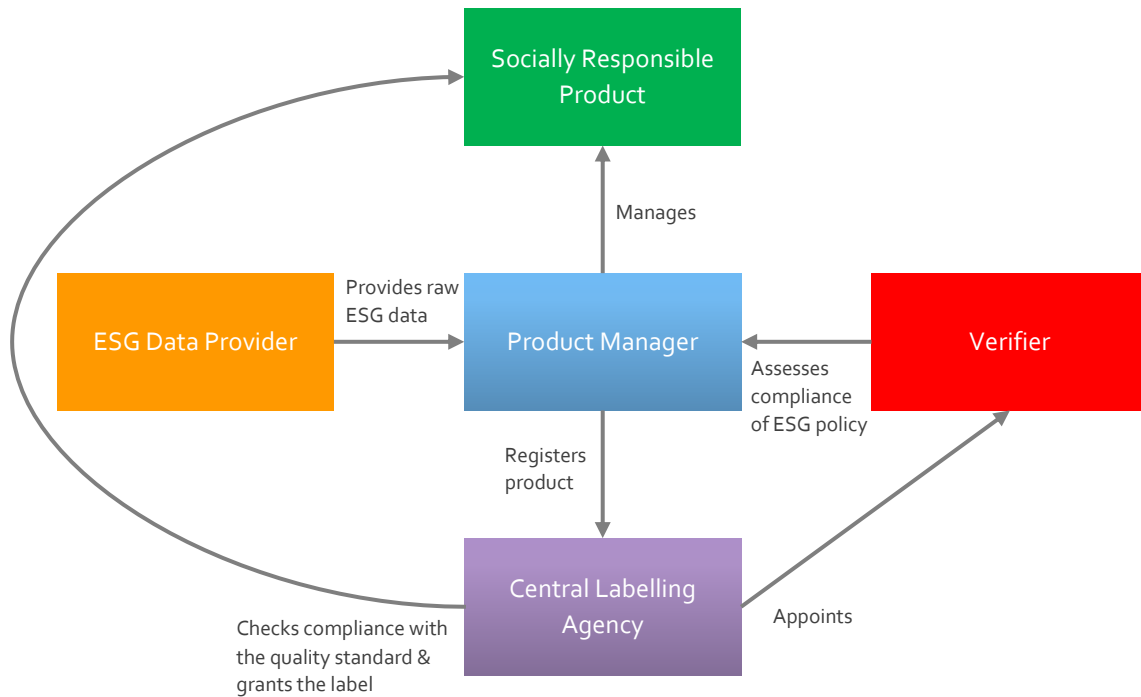
- The compliance of the portfolio with its sustainability policy and with the quality standard shall be assessed by a qualified independent third party ('the Verifier').
- The verifier shall be independent from the distributor and the product manager and have the necessary expertise and resources to conduct the assessment.
- The verifier shall be appointed by the central labelling agency. The selection shall in general be based on:
 - Independence from the product manager and distributor
 - Expertise in sustainability screening
- The ESG data provider and the verifier cannot be the same organisation.
- The central labelling agency shall decide to grant the label, based on:
 - The assessment report provided by the verifier
 - The fulfilment of the transparency requirements of the quality standard

5.1.2 Compliance

- In case of changes to a portfolio at the initiative of the product manager, that are significant to its socially responsible character, a period of 3 months is granted to re-establish compliance with the quality standard.
- In case of temporary non-compliance of specific assets in the portfolio beyond the control of the product manager, the product manager shall evaluate the source, the degree, the impact and the expected duration of the non-compliance. He shall have in place procedures with corrective measures aimed at re-establishing compliance as soon as reasonably possible. A temporary, non-structural non-compliance with certain provisions of the quality standard will not lead to a suspension or withdrawal of the label.

- The product manager shall keep a record of significant cases of non-compliance and of the corrective measures taken.

Graphical presentation of involved parties



Appendix 1 – Thresholds for eligibility for a socially responsible portfolio

ENERGY SECTOR COMPANIES	2019	2020	2021 ⁹⁵	2022	2023	2024	2025
Coal and unconventional oil & gas supply							
Max. % revenue from thermal coal extraction	10	10	10	5	5	5	0 ⁹⁶
Max. % revenue from unconventional oil & gas extraction	10	10	10	5	5	5	0
Conventional oil & gas supply							
Min. % revenue based on natural gas or renewable energy	>40	>40	Review	Review	Review	Review	Review
Electricity generation							
Max. carbon emission intensity (gCO ₂ /kWh)	429	408	393	374	354	335	315
If carbon emission intensity data is not available:							
Max. % power production based on coal	10	10	10	10	10	10	0
Max. % power production based on oil & gas	30	30	30	30	30	30	30
Max. % power production based on nuclear sources	30	30	30	30	30	30	30
Max. % portfolio allowed in top 50% best companies exceeding conventional oil & gas extraction or electricity generation thresholds ⁹⁷	5	5	Review	Review	Review	Review	Review
OTHER SECTOR COMPANIES	2019	2020	2021	2022	2023	2024	2025
Weapons							
Max. % revenue from illegal & controversial weapons	0	0	0	0	0	0	0
Max. % revenue from other weapons	10	10	10	10	10	10	10
Tobacco							
Max. % revenue from tobacco production & trading	10	10	10	5	5	5	0

⁹⁵ Thresholds as of 2021 are indicative. Final thresholds will be determined in a 2020 review. See A. 9.

⁹⁶ "0%" is to be understood as a best effort minimal, non-significant exposure, subject to data availability.

⁹⁷ This margin can until end 2020 exceptionally also contain companies exceeding the unconventional oil & gas extraction threshold.

Appendix 2 – Comparison with other labels

Comparison of the requirements on exclusion

The following table gives an overview of the exclusions required by other labels or standards. Other requirements e.g. on procedures and transparency are not included. It should be noted that not all these labels have the same ambition: some approach sustainability in general, like the current quality standard, others have a specific focus on environmental issues.

The figures are provided in a simplified and summarised manner and as far as publicly available on the websites dedicated to the labels. When multiple figures are given for a threshold, they refer to different parts of the value chain. For more details, see footnotes.

Items marked in green indicate equivalence with the quality standard, orange would require further consideration, and red seems unlikely to be compliant. Anyhow, each product should be evaluated case by case.

	LuxFLAG ESG ⁹⁸	Label ISR ⁹⁹	EET4C Label ¹⁰⁰	FNG Siegel ¹⁰¹	Nordic Swan Ecolabel ¹⁰²	Ethibel Label ¹⁰³	MSCI SRI indices ¹⁰⁴	Febelfin OS
Unconventional weapons	?	-	-	0	0	0	0	0
Conventional weapons	?	-	-	5	5	0/5	0/5/15	10
Coal	?	-	0	5/30	5/5	10	30/30	10/10

⁹⁸ LuxFLAG ESG (Luxembourg): Eligibility criteria - <https://www.luxflag.org/labels/esg/obtaining-label-esg/>

⁹⁹ Label ISR (France): Eligibility criteria - <https://www.tresor.economie.gouv.fr/Ressources/File/420171>

¹⁰⁰ EET4C label ('Energy and Ecological Transition for the Climate') (France): Eligibility criteria - https://www.ecologique-solidaire.gouv.fr/sites/default/files/Label_TEEC_Criteria%20Guidelines.pdf

¹⁰¹ FNG Siegel (Germany, Austria, Switzerland): Eligibility criteria - <http://www.fng-siegel.org/de/siegelkriterien.html>

¹⁰² Nordic Swan Ecolabel (Sweden): Eligibility criteria - <http://www.svanen.se/en/Featured-campaigns/Funds/For-investors/Q--A/What-requirements-must-the-fund-fulfil/>

¹⁰³ Ethibel label (Belgium): Eligibility criteria - http://forumethibel.org/content/het_verloop_van_het_onderzoek_in_grote_lijnen.html?lang=en

¹⁰⁴ MSCI SRI indices methodology - https://www.msci.com/eqb/methodology/meth_docs/MSCI_May18_SRI_Methodology.pdf

	LuxFLAG ESG ⁹⁸	Label ISR ⁹⁹	EET4C Label ¹⁰⁰	FNG Siegel ¹⁰¹	Nordic Swan Ecolabel ¹⁰²	Ethibel Label ¹⁰³	MSCI SRI indices ¹⁰⁴	Febelfin QS
Unconventional oil & gas	?	-	0	5	5	10	-	10*
Conventional oil & gas	?	-	0	-	5	-	-	Min. 40% natural gas or renewables*
Electricity generation	?	-	0	-	5	469 gCO ₂ /kWh	-	IEA B ₂ DS or energy mix*
Nuclear energy	?	-	0	5	5	5/-	5/15	30*
Tobacco	?	-	-	-	5/-	0/10	0/5	10/10
Gambling	?	-	-	-	-	5/10	5/15	-**
Alcohol	?	-	-	-	-	-	5/15	-**
Pornography	?	-	-	-	-	0/10	5/15	-**
Hazardous chemicals	?	-	-	-	-	0/5	-	-**
UNGC violations	?	?	-	✓	✓	✓	✓	✓

Required, subject to review by Eligibility Committee

Tobacco: only on production

* Limited % of portfolio may (temporary) derogate
** Optional

Legend: Figures generally refer to maximum % of company revenue; "?" no details available on the requirement; "-" no requirement

Appendix 3 – The quality standard within the EU initiatives on Sustainable Finance

Dimensions of sustainability

In May 2018, the European Commission adopted a package¹⁰⁵ of measures implementing several key actions announced in its action plan on financing sustainable growth of March 2018. The package includes 3 proposals aimed at:

1. establishing a unified EU classification system of sustainable economic activities ('taxonomy')
2. improving disclosure requirements on how institutional investors integrate environmental, social and governance (ESG) factors in their risk processes
3. creating a new category of benchmarks which will help investors compare the carbon footprint of their investments.

In the context of the quality standard, the first legislative proposal for a regulation¹⁰⁶ on the establishment of a framework to facilitate sustainable investment, is the most pertinent. This regulation establishes the conditions and the framework to gradually create a unified classification system ('taxonomy') on what can be considered an environmentally sustainable economic activity. This is seen as a first and essential step in the efforts to channel investments into sustainable activities and lies at the basis of other initiatives like a European green bond standard and incentives for green or sustainable investments.

The proposed regulation focusses on the environmental dimension of sustainability and sets conditions for environmentally sustainable economic activities. The timing for setting in place the environmental aspects is 2019-2022. Further guidance on activities contributing to other sustainability objectives, including social objectives, may be developed at a later stage. However, no clear timing is set for this.

The quality standard aspires to take into account from the start, key elements of all three dimensions of sustainability (environment, social, governance).

Setting minimum safeguards

The proposed regulation contains cumulative criteria for economic activities, that will ultimately determine the degree of environmental sustainability of an investment, i.e. of financial products or corporate bonds that are marketed as "*environmentally* sustainable".

To be called environmentally sustainable an economic activity should:

1. contribute substantially to one or more of the environmental objectives¹⁰⁷

¹⁰⁵ https://ec.europa.eu/info/publications/180524-proposal-sustainable-finance_en

¹⁰⁶ EC Proposal for a Regulation on the establishment of a framework to facilitate sustainable investment COM(2018)353 <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52018PC0353>

¹⁰⁷ Six objectives are listed: Climate change mitigation (avoiding or reducing greenhouse gas emissions or enhancing greenhouse gas removals); climate change adaptation (reducing the negative effects of the current and expected future climate or preventing an increase or shifting of negative effects of climate change);

2. not significantly harm any of the environmental objectives
3. be carried out in compliance with the minimum safeguards
4. comply with technical screening criteria¹⁰⁸

Criteria 1, 2 and 3 are specific to the environmental focus. The third criterium however states the more general expectation that:

"... economic activities should only qualify as environmentally sustainable where they are carried out observing the International Labour Organisation's ('ILO') declaration on Fundamental Rights and Principles at Work and the eight ILO core conventions. The ILO core conventions define human and labour rights that companies are due to respect. Several of these international standards are also enshrined in the Charter of Fundamental Rights of the European Union, in particular the prohibition of slavery and forced labour and the principle of non-discrimination. Those minimum safeguards are without prejudice to the application of more stringent requirements on environment, health and safety and social sustainability set out in Union law, where applicable."¹⁰⁹

The quality standard positions itself as an extended and more elaborated set of such 'minimum safeguards' for a sustainable investment, including not only social (ILO) but also environmental and governance elements.

As a minimum norm, the standard aims to be a general bottom-line and does not require a specific thematic focus. This does not mean that it does not contain any requirements on the environmental (e.g. on energy) or the social level (e.g. tobacco, weapons). These specific requirements however, are not seen as an optional thematic focus, but as essential to be considered as 'socially responsible' or 'sustainable' in general. So even an *environmentally* sustainable product should not finance tobacco or weapons; and a *socially* sustainable product should not finance coal.

European sustainability labels

The proposed regulation does not establish a label for socially responsible financial products. Instead, it provides the framework to set out the criteria that need to be taken into account when setting up such labels at national or EU level. Thus, the regulation does not prevent member states from keeping in place, or further developing, labelling schemes – as long as they comply with the criteria set out here for environmentally sustainable economic activities.¹¹⁰ In this way the EU initiatives do not preclude pro-activity and ambition on the national level.

The quality standard has the objective to provide a 'base sustainability standard' and label, and as such focusses mainly on the principle of doing 'no harm'. Beyond this minimal norm, thematic investments aimed at delivering a positive impact by substantially contributing to environmental,

sustainable use and protection of water and marine resources; transition to a circular economy, waste prevention and recycling; pollution prevention and control (air, water and soil); protection of healthy ecosystems (biodiversity, forests)

¹⁰⁸ Like potential contributions & long-term impact, minimum requirements to avoid significant harm, qualitative or quantitative thresholds, market liquidity and avoid distorting competition, facilitate the verification of compliance, etc. These will be developed by the EC Technical Expert Group on Sustainable Finance, established in June 2018.

¹⁰⁹ Recital 21 of the proposal

¹¹⁰ See the detailed explanation on article 1 in the explanatory memorandum to the proposal

social or governance objectives, can be developed. Thus, additional themed labels are expected to be added to the quality standard in the future, in line with the specific criteria and metrics set by the relevant EU taxonomies.

The quality standard intends to stay fully aligned with the future taxonomy, metrics and standards developed as part of the EC action plan on sustainable finance. Moreover, by means of the practical implementation of this quality standard, the Belgian financial sector wants to actively contribute to the debate and the development of an ambitious future EU standard for sustainable financial products.

2020 - 2022 ... (EU Process)

