
DDV Sustainable Finance Code of Conduct

**PRODUCT AND TRANSPARENCY STANDARD FOR STRUCTURED
PRODUCTS WITH SUSTAINABILITY CHARACTERISTICS**

As at: July 2022



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PREAMBLE

- The Sustainable Finance Code of Conduct of the German Derivatives Association (Deutscher Derivate Verband, DDV) introduces the product group of structured products with sustainability characteristics and positively distinguishes it from other structured products in accordance with the DDV product classification.¹ In addition, it contains essential transparency provisions for this product group.
- Pages 5 to 7 summarise the key statements of the Sustainable Finance Code of Conduct. This summary is also available in a separate brochure, which in turn references this Code of Conduct.
- The Sustainable Finance Code of Conduct has been formulated on the basis of current and expected future legal requirements and may be subject to further amendments based on these as well as changing national and international market conditions.
- The Sustainable Finance Code of Conduct is based on the current version of the “Supplement to the target market to include information on sustainability-related objectives and sustainability factors” (**ESG Associations Target Market Concept**) of the German Banking Industry Committee (Deutsche Kreditwirtschaft, DK), the German Federal Association for Investment and Asset Management (Bundesverband Investment und Asset Management, BVI), and the DDV.

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¹ See https://www.derivateverband.de/MediaLibrary/Document/Derivate-Liga_A3_2020_EN.pdf

ENTRY INTO FORCE AND COMPLIANCE

- The Sustainable Finance Code of Conduct enters into force on the date of application of the amendments to MiFID II to take into account sustainability factors and preferences with regard to product governance requirements.
- The members of the DDV commit themselves to complying with this Sustainable Finance Code of Conduct when publically offering structured products to retail clients in Germany. Members of the DDV may publically state that they apply the provisions of the Sustainable Finance Code of Conduct to their structured products with sustainability characteristics.
- Compliance with the Sustainable Finance Code of Conduct is to be regularly reviewed by the Sustainable Finance Code of Conduct Advisory Board.
- In the event of a breach of the Sustainable Finance Code of Conduct by a member of the DDV, the Board of Directors of the DDV shall take the decision as to appropriate measures, which could result in exclusion from the DDV.

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DDV SUSTAINABLE FINANCE CODE OF CONDUCT – SUMMARY

1. In offering structured products with sustainability characteristics, the members of the German Derivatives Association (Deutscher Derivate Verband, DDV) contribute to the protection of natural resources and universal human rights. This applies, in particular, to the achievement of the objectives of the sustainable finance agenda of the European Union, which they support and promote with these structured products.
2. The members of the DDV undertake to label a structured product as a “structured product with sustainability characteristics” only if it meets comprehensible sustainability standards.
3. The members of the DDV shall only label structured products with sustainability characteristics as such if they themselves or the group to which they belong have achieved the status of a sustainable company with at least one recognised rating agency and take into account the UN Global Compact and the UN Principles for Responsible Banking² or, alternatively, principles equivalent to the UN Principles for Responsible Banking.

² If the UN Principles for Responsible Banking are not relevant for an issuer and/or a specific financial instrument (e.g., because the issuer does not conduct traditional banking business), the UN Principles for Responsible Investment may be considered as an alternative.

DDV SUSTAINABLE FINANCE CODE OF CONDUCT – SUMMARY

4. The members of the DDV shall label a structured product as a structured product with sustainability characteristics only when the product has a sustainability-related target market in accordance with the ESG Associations Target Market Concept.³
5. When issuing structured products with sustainability characteristics, the members of the DDV shall focus on investment products as defined in the DDV product classification.⁴ Members shall not use sustainability-related labelling for leverage products. Investment products that benefit from a downward movement of the underlying asset are also to be excluded from such labelling.
6. The members of the DDV shall not apply any sustainability-related labelling for structured products if these products have companies as an underlying or reference issuers that exceed certain thresholds in their turnover from the production and/or distribution of military equipment or coal, or from tobacco production. Companies that produce or distribute controversial weapons are also to be excluded.

³ See https://www.derivateverband.de/EN/MediaLibrary/Document/Zielmarkt-konzept/22%200325%20ESG_Verb%C3%A4nde-konzept-ENG_final.pdf

⁴ See https://www.derivateverband.de/MediaLibrary/Document/Derivate-Liga_A3_2020_EN.pdf

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7. The members of the DDV shall not label structured products as structured products with sustainability characteristics if the products have agricultural commodities (soft commodities) as an underlying. Investors need to have the assurance that structured products with sustainability characteristics do not encourage speculation with important foodstuffs.
8. The members of the DDV shall not label structured products as structured products with sustainability characteristics if the products have companies as an underlying or reference issuers that commit serious violations of the UN Global Compact (without prospects of improvement), or of democracy or human rights. In particular, the ban on child labour may not be violated, and no massive damage may be done to the environment or natural resources.
9. The members of the DDV undertake to publish all relevant information on the structured products with sustainability characteristics issued by them in an easily accessible manner on a website so that investors can inform themselves about the sustainability-related labelling of the products.
10. This Sustainable Finance Code of Conduct shall be regularly reviewed and adapted to the applicable legal frameworks.

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DDV SUSTAINABLE FINANCE CODE OF CONDUCT – DETAILED DESCRIPTION

The detailed DDV Sustainable Finance Code of Conduct for the public offering of structured products with sustainability characteristics to private investors is organised according to the following topics:

-  Principal types of structured products with sustainability characteristics
-  The underlying
-  The issuer
-  Exclusion of certain product groups
-  Transparency
-  Sustainable Asset Pool



PRINCIPAL TYPES OF STRUCTURED PRODUCTS WITH SUSTAINABILITY CHARACTERISTICS



In principle, structured products with sustainability characteristics are aimed at investors with sustainability preferences⁵.

1. What is a “structured product with sustainability characteristics”?



Technically, a structured product with sustainability characteristics is a structured product whose target market falls into one of three categories of the ESG Associations Target Market Concept for products that may be aimed at clients (investors) with sustainability-related objectives pursuant to the first subparagraph of Article 9(9) of the MiFID II Delegated Directive.



This definition is explained in more detail below.



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⁵ In accordance with the first subparagraph of Article 9(9) of the MiFID II Delegated Directive.



PRINCIPAL TYPES OF STRUCTURED PRODUCTS WITH SUSTAINABILITY CHARACTERISTICS



2. Which products for investors with sustainability-related objectives does the ESG Associations Target Market Concept provide for?

Products for investors with sustainability-related objectives are aimed at investors who pursue one or more of the following sustainability preferences in their investments:



a) Products with an environmental impact⁷:

The first of the product categories mentioned above (No. 1) is aimed at investors seeking an impact-related investment within the meaning of the European Taxonomy Regulation.⁸



For such investors, it is important that their investment in securities finances, in whole or in part, economic activities that meet the strict requirements of the Taxonomy Regulation. The Taxonomy Regulation provides a classification system for environmentally sustainable economic activities to help achieve the goals of the 2015 Paris Agreement on Climate Change. The Paris Agreement aims to limit global warming to well below 2 °C and to strengthen the adaptation of business enterprises to climate change. Accordingly, investors want to make a contribution with their investments so that the transition to a sustainable economic system succeeds and Europe becomes climate-neutral by 2050.



⁶ Within the meaning of points (a) to (c) of Article 2(7) of Delegated Regulation (EU) 2017/565 as amended by Delegated Regulation (EU) 2021/1253.

⁷ See point (a) of Article 2(7) of Delegated Regulation (EU) 2017/565 as amended by Delegated Regulation (EU) 2021/1253. It is expected that with effect from 1 January 2023, four additional environmental objectives (sustainable use and protection of water and marine resources; transition to a circular economy; pollution prevention and control; protection and restoration of biodiversity and ecosystems) and the aspect of social sustainability will be added to the classification system of the Taxonomy Regulation.

⁸ Regulation (EU) 2020/852.



PRINCIPAL TYPES OF STRUCTURED PRODUCTS WITH SUSTAINABILITY CHARACTERISTICS



b) Products with a sustainability impact⁹:

The second of the above-mentioned product categories (No. 1) is aimed at investors seeking an impact-related investment within the meaning of the European Sustainable Finance Disclosure Regulation (**SFDR**)¹⁰.



The SFDR sustainability preference is characterised by its focus on other environmental objectives in addition to climate protection, such as waste recycling/reduction, maintaining biological diversity through wildlife and environmental conservation, more careful usage of natural resources, the protection of water and land, as well as social concerns, such as tackling inequality and discrimination, and respecting human rights.



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⁹ See point (b) of Article 2(7) of Delegated Regulation (EU) 2017/565 as amended by Delegated Regulation (EU) 2021/1253.

¹⁰ Regulation (EU) 2019/2088.



PRINCIPAL TYPES OF STRUCTURED PRODUCTS WITH SUSTAINABILITY CHARACTERISTICS



c) Products that consider principle adverse impacts (PAIs) on environmental and social factors¹¹:

The third of the product categories mentioned above (No. 1) is aimed at investors who want to take account of principal adverse impacts (**PAIs**).



These investors are not primarily concerned with promoting a particular environmental or social cause through their investment. However, it is important to them that their investment does as little harm as possible in relation to one or more of the following PAI factors:



- greenhouse gas emissions;
- biodiversity;
- water;
- waste;
- social themes/employee matters.



¹¹ See point (c) of Article 2(7) of Delegated Regulation (EU) 2017/565 as amended by Delegated Regulation (EU) 2021/1253.



PRINCIPAL TYPES OF STRUCTURED PRODUCTS WITH SUSTAINABILITY CHARACTERISTICS



3. How can structured products contribute to achieving sustainability-related objectives?

Structured products can meet the described sustainability-related investment objectives through the following mechanisms, among others:



a) Sustainability impact of the issuer's general business activities

The investor's sustainability-related objective can be achieved by using the proceeds of the issuance to finance the issuer's general business activities. Structured products are bearer bonds – with the issuance of a structured product, the issuer¹² generates issuance proceeds that it can use on the assets side of its balance sheet for its own business activities (e.g., granting loans, acquiring securities for its non-trading book, or concluding hedging transactions).



In consequence, issuers can contribute to one of the sustainability-related objectives mentioned above through its general business activities (for the relationship of the underlying to sustainability, see “The Underlying” below).



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¹² For the purposes of this document, the issuer here also means the product manufacturer within the meaning of the PRIIPs Regulation or the group to which the issuer belongs.



PRINCIPAL TYPES OF STRUCTURED PRODUCTS WITH SUSTAINABILITY CHARACTERISTICS



b) Sustainability impact of the use of proceeds

aa) Green Bond

The issuer can also issue a structured product as a green bond in accordance with a current market standard for green bonds (e.g., the ICMA Green Bond Principles) or the future EU-regulated standard for green bonds (the EU Green Bond Standard). The proceeds from the issuance must then be allocated according to the applicable standard in such a way that specific sustainability criteria are met. In this way, the issuance of the security contributes to one or more of the above-mentioned sustainability-related objectives.



bb) Segregation of a Sustainable Asset Pool

According to another recently developed approach, the issuer can also ensure that it holds assets that have an impact on the environment or sustainability, or take environmental and social factors (PAIs) into account, with a value greater than the sum of the issuance volume over the term of the respective structured product. These assets are virtually segregated from the issuer's other balance sheet assets from an accounting perspective, and their holding is regularly reviewed (a **Sustainable Asset Pool**). In this way, the investor's investment is linked to the financing of an economic activity that has an impact on the environment or sustainability, or takes environmental and social factors (PAIs) into account.



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PRINCIPAL TYPES OF STRUCTURED PRODUCTS WITH SUSTAINABILITY CHARACTERISTICS



4. What other requirements need to be met according to ESG Associations Target Market Concept?

According to the ESG Associations Target Market Concept, a structured product has to fulfil additional requirements in order to be included in one of the product categories mentioned above (No. 1):



- The issuer must take into account the **UN Global Compact** and have achieved the status of a sustainable company with at least one rating agency (see “The Issuer” below).
- Furthermore, the issuer must pursue a dedicated ESG strategy when selecting the **underlying**. In addition, only companies that have not committed any serious violations of the UN Global Compact or of democracy or human rights may be used as the underlying. For products that consider environmental or social factors (PAIs), selected PAIs are to be taken into account by means of minimum exclusions when selecting the underlying.
- Finally, the issuer must comply with a recognised industry standard (see below “DDV Standard for Structured Products with Sustainability Characteristics”).



THE UNDERLYING

The payment profile of a structured product is commonly linked to the performance of an underlying asset.



a) Selection of ESG-compatible underlyings¹³

When selecting the underlying for their structured products with sustainability characteristics, the members of the DDV undertake **to define one (or more) dedicated strategy or strategies** prior to the issuance, which must then be **disclosed** to the investor. Such strategy or strategies shall then be **applied** to the issuance of individual structured products. This is usually performed automatically. This also applies **in the case** of structured products that are linked to the performance of only a **single underlying asset**.



Certain underlyings are excluded with respect to the issuance of structured products with sustainability characteristics (see “Minimum exclusion criteria” on page 18).



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¹³ These provisions do not apply to structured products that do not have an underlying asset or that refer exclusively to one or more interest rates or interest rates indices.



THE UNDERLYING

b) Minimum exclusion criteria¹⁴

The ethical and moral values that investors want to see taken into account when investing in securities can vary greatly from person to person. In terms of a minimum standard, the members of the DDV undertake not to offer structured products with sustainability characteristics with the following companies as underlyings or reference issuers:



Companies that generate turnover from the following sources:

- Weapons > 10 %¹⁵ (prohibited weapons > 0 %)¹⁶
- Tobacco production > 5 %
- Coal > 30 %¹⁵



¹⁴ Relevant for individual underlyings as well as underlyings in a portfolio/basket (equities/bonds).

¹⁵ Turnover from production or distribution.

¹⁶ Weapons prohibited under the Convention on the Prohibition of the Use, Stockpiling, Production and Transfer of Anti-Personnel Mines and on their Destruction (Ottawa Treaty) or the Convention on Cluster Munitions (Oslo Treaty), or biological or chemical weapons as defined under the respective UN conventions (UN BWC and UN CWC).



THE UNDERLYING



- Serious violations of the following principles of the UN Global Compact (without prospects of improvement):
 - Protection of international human rights
 - No complicity in human rights abuses
 - Upholding the freedom of association and the recognition of the right to collective bargaining
 - Elimination of forced labour
 - Abolition of child labour
 - Elimination of discrimination when hiring and employing
 - Precautionary approach in dealing with environmental problems
 - Promote greater environmental awareness/responsibility
 - Development and propagation of environmentally friendly technologies
 - Combat all forms of corruption



Government bodies:

- Insufficient scoring according to the Freedom House Index¹⁷

Agricultural commodities:

- Agricultural commodities (soft commodities) are excluded as underlyings.

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¹⁷ <https://freedomhouse.org/report/freedom-world/2018/scores>



THE ISSUER



The members of the DDV undertake to issue structured products as structured products with sustainability characteristics only if they take into account the UN Global Compact and the UN Principles for Responsible Banking, or alternatively, principles equivalent¹⁸ to the UN Principles for Responsible Banking.¹⁹



In addition, structured products with sustainability characteristics shall be issued only by issuers that have received the status of a sustainable company from at least one rating agency.



¹⁸ If the UN Principles for Responsible Banking are not relevant for an issuer and/or a specific financial instrument (e.g., because the issuer does not conduct traditional banking business), the UN Principles for Responsible Investment may be considered as an alternative. Evidence that these frameworks have been taken into account can be provided by signing the corresponding document. Alternatively, the DDV Sustainable Finance Code of Conduct Advisory Board can decide on what constitutes appropriate consideration of the respective principles. The same applies to the recognition of equivalent principles.

¹⁹ Information on the UN Principles for Responsible Banking is available at <https://www.unepfi.org/banking/bankingprinciples/>, information on the UN Principles for Responsible Investment is available at <https://www.unpri.org/>, and information on the UN Global Compact is available at <https://www.unglobalcompact.org/>



EXCLUSION OF CERTAIN PRODUCT GROUPS

When issuing structured products with sustainability characteristics, the members of the DDV shall focus on investment products as defined in the DDV product classification.²⁰



As such, leverage products are not to be actively labelled as structured products with sustainability characteristics.



However, this does not imply any statement with regard to the use of leverage products as hedging instruments. Structured products play an important role in hedging risks. In securities portfolios that are fundamentally designed for sustainability (including those, for example, that are put together within the framework of asset management) these instruments should be permitted to be used, as there is also a need for hedging when investing in sustainable securities.



In addition, investment products that benefit from the falling price of the underlying asset are excluded from being labelled as structured products with sustainability characteristics or as sustainable securities in order not to encourage speculative investment behaviour to the detriment of sustainability objectives in any case of doubt.



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²⁰ See https://www.derivateverband.de/MediaLibrary/Document/Derivate-Liga_A3_2020_EN.pdf



TRANSPARENCY

The **members of the DDV undertake to publish all relevant information** in an easily accessible product policy on a website. The relevant information shall include, in particular:



a) The **selection mechanism (selection strategy)** of the **underlying asset** (if applicable), as well as information on any (minimum) **exclusions** at the level of the underlying asset.



b) Information on the **method and data source** used to select the underlying asset. For structured products with sustainability characteristics that are based on a **Sustainable Asset Pool**, additional information on the **criteria for the use of proceeds** (in terms of the requirements for the projects/companies to be funded) within the scope of the issuer's business activities is also to be included.



c) A reference on the homepage of the issuer/product manufacturer/group where relevant information can be found, in particular with regard to their consideration of the UN Global Compact and the UN Principles for Responsible Banking or equivalent principles considered as an alternative to the UN Principles for Responsible Banking, if applicable.²¹



d) For structured products with sustainability characteristics, **information on the rating agency** and the rating qualification (rating, score, etc.) achieved by the issuer. In addition, for structured products with sustainability characteristics, a statement is also to be made regarding how the issuer has been **classified as a sustainable issuer** on this basis.



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²¹ If the UN Principles for Responsible Banking are not relevant for an issuer and/or a specific financial instrument (e.g., because the issuer does not conduct traditional banking business), the UN Principles for Responsible Investment may be considered as an alternative. Evidence that these frameworks have been taken into account can be provided by signing the corresponding document. Alternatively, the DDV Sustainable Finance Code of Conduct Advisory Board can decide on what constitutes appropriate consideration of the respective principles. The same applies to the recognition of equivalent principles.



SUSTAINABLE ASSET POOL

If the structured product with sustainability characteristics is based on a Sustainable Asset Pool concept, the members of the DDV undertake to comply with the following criteria:



a) Suitable assets for the Sustainable Asset Pool



- Suitable assets for the Sustainable Asset Pool include, in particular, loans as well as securities held in the non-trading book (equities and bonds, such as green bonds).



- For each asset held in the Sustainable Asset Pool, the issuer calculates an **SFDR ratio** and/or, as soon as the required data is available, the taxonomy ratio. For the taxonomy ratio, either the KPIs reported by the investee companies in accordance with Article 8 of the Taxonomy Regulation or – to the extent permitted by supervisory law – data and/or taxonomy ratios supplied by external data providers can be used. These may relate to the investee company or specific assets. To determine the SFDR ratio, the issuer may use internal and/or publicly available data relating to the respective investee company as well as data and/or SFDR ratios provided by external data providers relating to the respective investee company. The individual SFDR or taxonomy ratios are then used to determine an SFDR or taxonomy ratio for the entire Sustainable Asset Pool as a whole.



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SUSTAINABLE ASSET POOL



b) Use of proceeds

- If a structured product is allocated to a Sustainable Asset Pool, the SFDR or taxonomy ratio of the structured product corresponds to that of the respective Sustainable Asset Pool. If several Sustainable Asset Pools have been set up, the allocation will be made to the Sustainable Asset Pool with an SFDR or taxonomy ratio corresponding to that specified for the structured product by the issuer.
- It is to be ensured that the nominal volume of a Sustainable Asset Pool is consistently greater than the sum of the gross issuance proceeds from the structured products allocated to the respective Sustainable Asset Pool from the value date of the issuances until their maturity.
- The formation of Sustainable Asset Pools is carried out by means of an accounting system set up specifically for this purpose. This accounting system should be subject to external or internal auditing as an instrument of sub-ledger accounting (see d) below). This ensures that there is no inadmissible dual use of the same asset for a Sustainable Asset Pool and a green bond of the issuer or for several Sustainable Asset Pools.



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SUSTAINABLE ASSET POOL

c) Underlying

If the product has an underlying asset that is relevant for the pay-out profile, the selection of the underlying asset is to indicate a sustainability strategy in accordance with the ESG Associations Target Market Concept.



d) Auditing

- The Sustainable Asset Pool is to be audited on a regular basis to ensure that:
 - i) the specified SFDR or taxonomy ratio is met; and
 - ii) the nominal volume of the Sustainable Asset Pool is consistently greater than the total gross issuance proceeds from the structured products allocated to the Sustainable Asset Pool during the audit period.
- The audit may be carried out internally (e.g., via internal audit) or externally by external auditors.
- The result of the audit shall be published on a designated website.



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