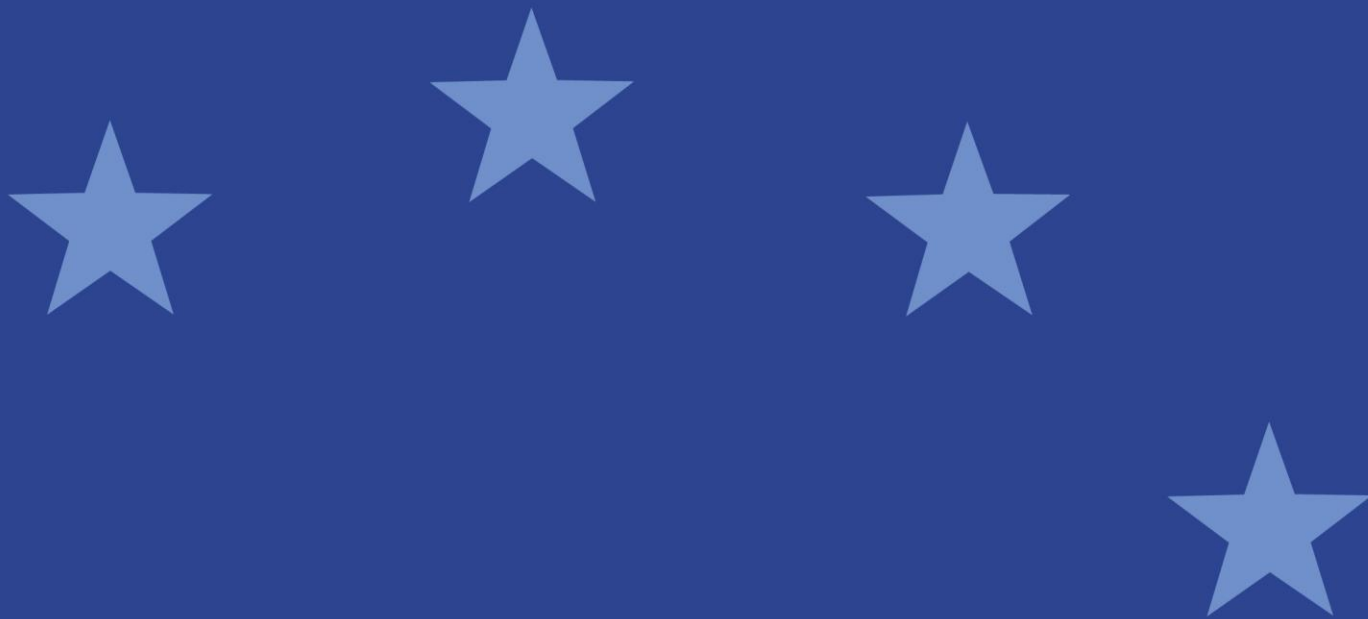




European Securities and  
Markets Authority

## **Reply form for the Consultation Paper on Guidelines for the use of ESG or sustainability-related terms in funds' names**



## Responding to this paper

The European Securities and Markets Authority (ESMA) invites responses to the specific questions listed in the Consultation Paper on Guidelines for the use of ESG or sustainability-related terms in funds' names published on the ESMA website.

### **Instructions**

Please note that, in order to facilitate the analysis of the large number of responses expected, you are requested to use this file to send your response to ESMA so as to allow us to process it properly. Therefore, ESMA will only be able to consider responses which follow the instructions described below:

- use this form and send your responses in Word format (pdf documents will not be considered);
- do not remove the tags of `<ESMA_QUESTION_FUNA_0>` - i.e. the response to one question has to be framed by the 2 tags corresponding to the question; and
- if you do not have a response to a question, do not delete it and leave the text "TYPE YOUR TEXT HERE" between the tags.

Responses are most helpful:

- if they respond to the question stated;
- indicate the specific question to which the comment relates;
- contain a clear rationale; and
- describe any alternatives ESMA should consider.

### **Naming protocol**

In order to facilitate the handling of stakeholders' responses please save your document using the following format:

`ESMA_CP_FUNA_NAMEOFCOMPANY_REPLYFORM.`

e.g. if the respondent were ABCD, the name of the reply form would be:

`ESMA_CP_FUNA_ABCD_REPLYFORM`

### **Deadline**

Responses must reach us by 20 February 2022.

All contributions should be submitted online at [www.esma.europa.eu](http://www.esma.europa.eu) under the heading 'Your input - Consultations'.

### **Publication of responses**



All contributions received will be published following the end of the consultation period, unless otherwise requested. **Please clearly indicate by ticking the appropriate checkbox in the website submission form if you do not wish your contribution to be publicly disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure.** Note also that a confidential response may be requested from us in accordance with ESMA's rules on access to documents. We may consult you if we receive such a request. Any decision we make is reviewable by ESMA's Board of Appeal and the European Ombudsman.

### ***Data protection***

Information on data protection can be found at [www.esma.europa.eu](http://www.esma.europa.eu) under the headings 'Legal notice' and 'Data protection'.

## General information about respondent

Name of the company / organisation	The Investment Association
Activity	Investment Services
Are you representing an association?	<input checked="" type="checkbox"/>
Country/Region	UK

## Introduction

*Please make your introductory comments below, if any:*

<ESMA\_QUESTION\_FUNA\_0>

### About the IA

The IA champions the UK-based investment management industry, supporting British and global savers, investors and businesses. Our 250 members manage £10 trillion of assets and the investment management industry supports 122,000 jobs. IA members operate from offices across the EU and are active in every single Member state. In 2021/2022, IA members had invested more than £720bn into European equity, and we remain committed to supporting Europe's transition to a greener and more sustainable future. Our mission is to make investment better. Better for clients, so they achieve their financial goals. Better for companies, so they get the capital they need to grow. And better for the economy, so everyone prospers. Our purpose is to ensure investment managers are in the best possible position to:

- Build people's resilience to financial adversity
- Help people achieve their financial aspirations
- Enable people to maintain a decent standard of living as they grow older
- Contribute to economic growth through the efficient allocation of capital.

The money our members manage is in a wide variety of investment vehicles including authorised investment funds, pension funds and stocks and shares ISAs.

The IA is registered on the EU Transparency Register, registration number 5437826103-53.

### Executive summary

The IA welcomes the opportunity to respond to ESMA's Consultation Paper on Guidelines on funds' names using ESG or sustainability-related terms.

Investment managers are committed to bringing clarity, transparency and consistency to the way industry describes and delivers sustainable and responsible investment products to clients. It is this commitment to clients and client outcomes that has dominated investment managers' thinking and work on all aspects of implementing SFDR over the last few years as well as requirements in other jurisdictions and obligations at national level. We recognise that product names are a critical first step in communicating

with clients some of the product's features and it is in that spirit that we provide the answers to the questions posed in the consultation paper.

The key points we would like to make are:

1. In principle, we find the use of quantitative thresholds appropriate when there is a common criteria for how to determine the thresholds. However, this is not the case for funds disclosing under SFDR Article 8 and 9 funds, where each fund has the ability to define the criteria for the threshold. We therefore do not think that quantitative thresholds proposed by ESMA will promote comparability between funds.
2. Given we do not support the setting of quantitative thresholds for sustainable investments in advance of agreed eligibility criteria for sustainable investments, at this time we do not support the proposed threshold of 80% linked solely to the fund's name.
3. We have concerns around the additional threshold of 'at least 50% of minimum proportion of sustainable investments for the use of the word 'sustainable' or any other sustainability-related term. It is unclear why is there a need to differentiate between the use of the term 'sustainable' as opposed to other 'ESG-related' terms, and under which of the headings such terms would fall.
4. While we understand the logic behind creating minimum exclusions, we believe the minimum safeguards should apply consistently with those prescribed in SFDR, rather than introducing further complexity.
5. Members have expressed concerns about the length of the transitional period: six months is not enough time to implement the name changes or adapt portfolios to abide with the proposed guidelines and we are therefore suggesting a transition period of at least 12 months.

<ESMA\_QUESTION\_FUNA\_0>

## **Q1 : Do you agree with the need to introduce quantitative thresholds to assess funds' names?**

<ESMA\_QUESTION\_FUNA\_1>

As we outline above, investment managers are committed to bringing clarity, transparency and consistency to the way industry describes and delivers sustainable and responsible investment products to clients.

In principle, we find the use of quantitative thresholds appropriate when there is a common criteria for how to determine the thresholds, for example when creating a fund labelling system. However, this is not the case for funds disclosing under SFDR Article 8 and 9 funds, where each fund has the ability to define the criteria for the threshold. We therefore do not think that the thresholds proposed by ESMA will promote comparability between funds.

Moreover, it is our view that setting thresholds linked to fund names is not an appropriate way to tackle a diversified universe of investment funds and strategies. We question the premise of setting quantitative thresholds linked to funds' names without consideration for the strategy and policy of the fund or in the absence of, for example, further definition of key terms such as "ESG", "sustainability" and "impact". We are concerned that this could lead to further inconsistency in how ESG legislation is applied across the market and may lead to confusion for both institutional and retail investors.

We understand and support the key aim of ESMA's proposals to address greenwashing risks and enhance comparability, but it is our view that at this stage there needs to be a pragmatic implementation of the rules. As such, it is our preference for the guidelines to mirror ESMA's supervisory guidance on sustainability risks and disclosures in the area of investment management which states that ESG-related terms should only be used when supported in a material way by evidence of sustainability characteristics, themes or objectives that are reflected fairly and consistently in the fund's investment objectives and policy and its strategy as described in the regulatory fund documentation.

To enhance investors' understanding and demonstrate how the ESG claims a fund is making using specific terms in its name are substantiated, we suggest that any fund using ESG terms in its name should demonstrate in a clear way the investment process together with the ESG binding elements that substantiate these claims in its name.

Furthermore, we acknowledge ESMA's comments at the 23 January Open Hearing regarding its hesitation to publish a definitive list of terms that would be considered ESG or a sustainability-related term for fear of regulatory arbitrage. However, we suggest that some level of guidance from ESMA is needed around key terms that ESMA deem are "sustainability-related". This would provide investment managers with more clarity to accurately implement ESMA's requirements. For example, the term "responsible" is widely used in fund names that are pursuing strategies that go beyond ESG integration but it is unclear whether that would be deemed to be an ESG-related term as per the draft guidelines. The term "solutions" could arguably be both ESG and impact related. Whilst some members don't consider the term "SDG" to be impact-related, others disagree.

Some members, although not all, believe that the publication of a non-exhaustive list would help avoid fragmentation between how National Competent Authorities will be implementing the proposed guidelines, including the threshold.

If ESMA proceeds with having an additional threshold for funds using sustainability-related terms in their names, it will be more important that a list is published as it is currently unclear in which categories terms such as "SDG", "Paris-aligned" and "net-zero" would fit and as a result it is unclear whether a fund using one of these terms in its name will need to meet both thresholds or just the 80%.

Below we explore some further concerns we have with the concept of quantitative thresholds:

### ***Equity focus and difficulties for multi-asset funds***

ESMA's draft guidelines create significant focus on equity due to the requirement to meet specific thresholds. Multi-asset funds and/or fixed income funds are likely to contain assets including government bonds, and in particular, cash. The use of any threshold will effectively place a cap on these assets, e.g. if meeting the 80% threshold, there is, in effect, a 20% cap on cash. In a situation where the market is falling and the 80% is becoming a smaller proportion of NAV and cash is stable, members will be forced to maintain the 80% even if it is not financially in the investors' best interests.

### **Regulatory coherence across SFDR and MiFID**

There is significant concern that ESMA's proposed approach would create a disconnect with the MiFID II sustainability preferences regime by discriminating against other allowable approaches, such as qualitative and/or quantitative consideration of Principal Adverse Impacts (PAIs). Ultimately, any naming guidelines should clearly match the features and thresholds within the fund range, and at the moment, the only clear guidance on what can be marketed as 'sustainable' in the EU is set out in MiFID II Delegated Acts. This applies across the use of all names, for example ESG and sustainable names, and any enhancements on these thresholds should be first embedded in minimum thresholds for Article 8 and 9 funds under SFDR or European labels, in consultation with industry, before being reflected in ESMA's proposed naming guidelines.

The IA has long been a strong proponent of global regulatory coherence and harmonisation of sustainable finance rules due to the global nature of the investment management industry. Uncoordinated approaches will make implementation of these guidelines challenging for investment managers and will create significant investor confusion. We would encourage ESMA to look closely at how these proposals sit amongst existing threshold requirements at national level and emerging threshold requirements in other non-EU jurisdictions.

Alternatively, one suggested solution is that funds with sustainability-related terms in funds' names should have the option of meeting one or a combination of the MiFID sustainability preferences criteria. For example, this could take the form of the following:

1. Consideration of one of more PAIs, qualitative through the use of exclusions, controversies or engagements, as per ESMA's guidelines or quantitatively.
2. A minimum commitment to sustainable investments. If ESMA's preference is to set a numerical threshold we believe that this should not be set well above what current market standard is (as per Morningstar analysis) and would need to be reviewed in light of any changes from the European Commission.
3. A minimum commitment to the EU Taxonomy, with level to be reviewed on an on-going basis as the sustainable investment market evolves and matures with similar threshold measures to above point two.

### **Transitioning assets**

Finally, setting specific thresholds doesn't take in to account funds with assets that are improving on a forward-looking basis, i.e. it is suggested that the wording currently under point 15a is changed to 'a fund with ESG-related words in its name should have a minimum proportion of at least X% of investments to meet the E/S characteristics or demonstrate sound prospects for improvement in these areas as determined by the investment manager'.

<ESMA\_QUESTION\_FUNA\_1>

**Q2 : Do you agree with the proposed threshold of 80% of the minimum proportion of investments for the use of any ESG-, or impact-related words in the name of a fund? If not, please explain why and provide an alternative proposal.**

<ESMA\_QUESTION\_FUNA\_2>

We fully support the need to ensure that funds with ESG-related names invest primarily in assets that meet the product's ESG characteristics, therefore preventing greenwashing and, as stated above, we support the setting of thresholds linked to a product's ESG and/or sustainable characteristics where there is a clear sustainable criteria. Given that is not the case here, we do not support the setting of quantitative

thresholds for sustainable investments in advance of agreed eligibility criteria for sustainable investments and therefore do not support the proposed threshold of 80%.

It should be noted that in our recent response to the UK Financial Conduct Authority's consultation on creating a Sustainable Disclosure Requirements and investment labels, for its proposed Sustainable Focus label, we support that at least 70% of a 'sustainable focus' product's assets must meet a credible standard of environmental and/or social sustainability, or align with a specified environmental and/or social sustainability theme. In the FCA's case, the threshold of 70% is based on assets that meet a sustainability criteria which is not the case with the proposed ESMA threshold.

Based on our views in question 1, we make the following additional points.

We request clarification on what underlying evidence ESMA has used to justify an 80% threshold. As mentioned in our answer to question 1, this threshold could be particularly challenging to achieve for a range of asset classes, in particular multi-asset products. Furthermore, for **synthetically-replicated passive funds** it should be made clear that the focus is on the exposure of the fund, rather than purely investments.

Should ESMA continue with the proposed approach of setting thresholds, some IA members suggest that the 80% threshold should be calculated on the non-cash assets of the portfolio and there needs to be a clear distinction between how this calculation is applied to funds that set KPIs at an asset level versus funds that set KPIs at a portfolio level. Those members believe that a fund setting KPIs at an asset level (for example this could be a fund that requires assets to be below a given carbon intensity or above a certain ESG score) should ensure that 80% of their non-cash assets meet this requirement. However, for funds setting KPIs at the portfolio level (for example a fund that targets carbon intensity to be below the benchmark, or that the ESG score is above a benchmark), 100% of the non-cash assets should be considered as meeting the threshold (and therefore meeting the 80% threshold test) as long as the fund itself is meeting these overall portfolio targets.

Lastly, members have previously faced challenges under SFDR with regards to **closed-ended funds primarily invested in private markets**, as the rules require the disclosure of a minimum proportion of investments to be met at all times based on NAV. However, these funds will typically perform an initial fund raising and therefore contain a significant amount of cash before deploying their capital. Again, should ESMA continue with the route of thresholds, we would recommend that the 80% either be calculated on the basis of the total investments (excluding assets for liquidity purposes (e.g. cash and cash equivalents), hedging or efficient portfolio management) or be applied pragmatically for such funds in the scaling-up phase until they are fully invested.

<ESMA\_QUESTION\_FUNA\_2>

**Q3 : Do you agree to include an additional threshold of at least 50% of minimum proportion of sustainable investments for the use of the word "sustainable" or any other sustainability-related term in the name of the fund? If not, please explain why and provide an alternative proposal.**

<ESMA\_QUESTION\_FUNA\_3>

It is unclear why there is a need to differentiate between the use of the term 'sustainable' as opposed to other 'ESG-related' terms, and under which of the headings such terms would fall. For example, one member has funds with 'SDG-Engagement' in their name that do not commit to a certain percentage of sustainable investments. As mentioned above, as 'SDG' is not explicitly mentioned as a term in ESMA's draft guidelines, it is unclear whether ESMA thinks it's a sustainability-related term or an ESG-related term. Whilst it is assumed that as a standalone word 'SDG' would be considered sustainability-related, the meaning of this changes when the term is combined with 'engagement'. Clarity is required as to which threshold this term – and others – would sit under.



As also stated above, we fully agree with the need to ensure that funds with ESG and sustainability related terms in fund names invest primarily in assets that meet the product's ESG or sustainable characteristics. However, it is not clear why ESMA feels it is necessary to set different thresholds depending on what sustainability-related term is being used in the fund name. Members have expressed a number of concerns around the additional threshold of 'at least 50% of minimum proportion of sustainable investments for the use of the word "sustainable" or any other sustainability-related term'.

There are a number of current challenges with the term 'sustainable investments' which are:

- variance in definitions of 'Sustainable Investments' across managers and others, ranging from managers making discretionary assessments based on views of investment teams, assessing based on revenue linked to Sustainable Development Goals (SDGs) or linking to SBTIs;
- even across managers using the same definition of 'Sustainable Investments', the variance in data available to assess whether investments are 'Sustainable Investments' creates different outcomes for what could be defined as a 'Sustainable Investment'; and
- the definition of 'Sustainable Investments' could still be subject to regulatory change depending on how the European Commission responds to the ESA's request for a standardised definition of the term 'Sustainable Investments'.

ESMA should also be aware that adopting quantitative and prescriptive views on which funds can be named 'sustainable' may impact sustainable fund ranges in the EU market in such a way that investors wishing to invest sustainably may not be able to invest in certain asset classes or geographies with a risk of undue focus on large cap developed issuers which are aligned with the Sustainable Development Goals. We see the potential for this to restrict Europe's ability to direct financing to help meet Net Zero targets and deliver real world sustainable outcomes.

For example, under SFDR, the approaches appear to vary significantly. Setting a quantitative threshold for a term with an unclear definition could create a significant amount of confusion for end investors. It could also be particularly challenging for passive products which rely on benchmark providers which will be out of scope of these guidelines. A restrictive interpretation of sustainable investments will have the following unintended consequences:

- a) Pushing sustainable funds into a narrow universe of assets that may miss evolving opportunities and challenges;
- b) Limited consumer choice as all funds become default thematic funds; and
- c) Outsourcing of due diligence expected of financial market participants to third-party data providers whose data at best may be backward looking and at worst is very poor quality.

A separate threshold for the use of the word 'sustainable' or any other term derived from 'sustainable' will be very problematic for funds that primarily invest in sovereign bonds given currently there is no appropriate methodology to assess the taxonomy-alignment of these assets. Whilst there are firms that have classified sovereign green, social and sustainable bonds as sustainable investments, the market for these labelled sovereign bonds, although growing, remains relatively modest in size. Imposing a strict threshold at this stage could undermine efforts to grow this market. This could also lead to unintended market risk consequences – if trends of greater flows into sustainable products continue there could be a preference for corporate over sovereign holdings by asset allocators.

Rather than imposing a threshold, we believe that it will be more proportionate to require that funds that use 'sustainable' or any other related term should reflect sustainability in their investment objectives. This is consistent with IOSCO's Good Sustainable Finance Practices regarding naming. If this is not sufficient, as per our response to Question 2, we believe there is merit for the guidelines to mirror ESMA's supervisory guidance on sustainability risks and disclosures in the area of investment management which states that in order to avoid confusion with investors, that the use of the term "sustainable" or "sustainability" should be used only by (1) funds disclosing under Article 9 SFDR, (2) funds disclosing under Article 8 SFDR which in part invest in economic activities that contribute to environmental or social objectives and (3) funds disclosing under Article 5 TR. This approach is consistent with two of the elements of MiFID II

sustainability preferences which do not prescribe a minimum threshold in relation to commitment to sustainable investments, including taxonomy alignment.

<ESMA\_QUESTION\_FUNA\_3>

**Q4 : Do you think that there are alternative ways to construct the threshold mechanism? If yes, please explain your alternative proposal.**

<ESMA\_QUESTION\_FUNA\_4>

Focusing on minimum thresholds for meeting binding environmental or social characteristics as outlined in the pre-contractual disclosures (for Article 8 and 9) for all sustainable terms allows for a wider variety of approaches, e.g. ESG tilts provided they are clearly articulated. However, ESMA's remit with these proposed guidelines is not to make rules about the interpretation of SFDR - it is introducing guidelines under the "honestly and fairly" rules in UCITS and AIFMD and the "clear, fair and not misleading" rule in the cross-border distribution of funds regulation. Therefore, any clarification on definition of Article 8 SFDR funds should be made under the Commission review of SFDR.

<ESMA\_QUESTION\_FUNA\_4>

**Q5 : Do you think that there are other ways than the proposed thresholds to achieve the supervisory aim of ensuring that ESG or sustainability-related names of funds are aligned with their investment characteristics and objectives? If yes, please explain your alternative proposal. If yes, please explain your alternative proposal.**

<ESMA\_QUESTION\_FUNA\_5>

Instead of introducing quantitative thresholds to assess fund names, ESMA should focus on ensuring that consumers understand there are a range of products that can sit underneath the umbrella of sustainability and that the name of a product aligns with its investment objective or strategy. This would support IOSCO's Recommendations on Sustainability-Related Practices, Policies, Procedures and Disclosure in Asset Management (Final Report) which note greenwashing may occur at the product level due to a lack of alignment between product's name and its investment objective or strategy.

Ultimately, the focus needs to be on influencing the European Commission to clarify areas of SFDR which are not clear today – any attempt at defining 'sustainable investment' or if minimum thresholds are necessary should be embedded in the level 1 regulations rather than naming guidelines.

<ESMA\_QUESTION\_FUNA\_5>

**Q6 : Do you agree with the need for minimum safeguards for investment funds with an ESG- or sustainability-related term in their name? Should such safeguards be based on the exclusion criteria such as Commission Delegated Regulation (EU) 2020/1818 Article 12(1)-(2)? If not, explain why and provide an alternative proposal.**

<ESMA\_QUESTION\_FUNA\_6>

While we understand the logic behind creating minimum exclusions, we believe the minimum safeguards should apply consistently with those prescribed in SFDR, rather than introduce further complexity. Therefore, we would propose that financial market participants should define minimum standards for their own funds as appropriate and disclose what they are in pre-contractual disclosures for Article 8 funds. For Article 9 funds, we would propose that the minimum thresholds should be aligned with the Do No Significant Harm assessments determined by asset managers.

The proposed guidelines would preclude investment in a number of 'transition' stocks and would not encourage or recognise the impact of stewardship. It is also not clear what the minimum requirements for non-equity/ corporate debt would be. Clarification is needed on whether the proposal is a list of company exclusions or 'any companies that are found or estimated by them or by external data providers to significantly harm one or more of the environmental objectives referred to in Article 9 of Regulation (EU) 2020/852 of the European Parliament' which is less precisely defined (beyond the UNGC violations).

### ***Restrictiveness of Paris-Aligned Benchmark exclusions***

There are also significant concerns regarding the consultation paper's suggestion to use Paris-Aligned Benchmark (PAB) exclusions as a minimum safeguard across funds using both ESG and sustainability related terms. The minimum exclusions under the PAB were designed for very ambitious climate products and therefore are not suitable for the broad universe of ESG/sustainable investment products, including socially focused funds, that will be subject to the ESMA guidelines.

Furthermore, the PAB is very restrictive and will also not allow for funds focused on engagement/stewardship to invest in transitioning companies while using any terms that reflect the aim of the fund. It is also extremely challenging to comply with the PAB when it comes to emerging market funds.

One suggestion is to align the minimum safeguards with the set of minimum exclusions proposed for Climate Transition Benchmarks, namely tobacco, controversial weapons and UN Global Compact violators, plus the addition of coal, which would align with the current market standard.

We also note that even the Climate Transition Benchmark exclusions are predicated on the investments being in investee companies. However, ESG/sustainable investment products can invest in a range of asset classes, including sovereigns, real estate, derivatives, etc. We therefore ask that ESMA clarify whether the exclusions only apply in the case of equity/corporate bond funds or whether a different set of exclusions should be applied for other asset classes. If, however, ESMA intends to expand the safeguards to other asset classes (e.g. sovereigns), we have included below our preference.

Another suggestion is to include exclusions matching other existing sustainable requirements in the European market including the United Nations Global Compact, the OECD Guidelines for Multinational Enterprises, the UN Guiding Principles for Business and Human Rights, Responsible Business Conduct and International Labour Organization (ILO) Conventions).

For sovereigns, our preference is for the minimum safeguards to be based on governments that:

- a) are subject to UN sanctions;
- b) are included in OECD blacklist; and/or
- c) have not ratified the Paris Climate Agreement.

### ***Focus on asset class as opposed to sustainability profile***

Secondly, as outlined above, there is concern that some of the current proposed guidelines reflect the asset class more than the sustainability profile of the fund and will benefit equity growth-oriented funds over, for example, fixed income funds given the different investible universes of these two asset classes. The specific examples provided by one member include:

- Companies that derive 10% or more of their revenues from the exploration, extraction, distribution or refining of oil fuels. The transportation industry, for example, is involved in the distribution of oil fuels, but one can argue that a company committed to reducing the emissions from transport, e.g. sustainable shipping is fundamental to reaching global emission targets as the sector accounts for approximately one third of global emissions (2021, EIA). Furthermore, the above criteria would exclude investments in energy companies that have a credible decarbonisation strategy.
- Companies that derive 50% or more of their revenues from the exploration, extraction, manufacturing or distribution of gaseous fuels.
- Companies that derive 50% or more of their revenues from electricity generation with a GHG intensity of more than 100 g CO<sub>2</sub> e/kWh. 100 g CO<sub>2</sub> Wh is a low threshold that many electric utility companies could fail depending on seasonal factors e.g. during a period of low wind speeds % of revenues generated from more emitting sources would increase. This could create volatile forced selling in the market depending on unpredictable weather factors.

### ***Subjective criteria***

There is also concern surrounding the inclusion of subjective criteria in the list, which could possibly affect the following:

- Companies that benchmark administrators find in violation of the United Nations Global Compact (UNGC) principles or the Organisation for Economic Co-operation and Development (OECD) Guidelines for Multinational Enterprises. As different external providers have different views on which companies are violators, hard exclusions would potentially be based on subjective and or outdated information.
- Companies that are found or estimated by internal assessments or by external data providers to significantly harm one or more of the environmental objectives of the EU Taxonomy. Four of the six environmental objectives of the EU Taxonomy remain undefined and therefore demonstrating harm is potentially also subjective and at risk of greenwashing.

### **Significant harm**

Separately, we note that the PAB requires the exclusion of “any companies that are found or estimated by them or by external data providers to significantly harm one or more of the environmental objectives referred to in Article 9 of Regulation (EU) 2020/852” – environmental DNSH. The environmental DNSH concept is very vague and therefore could give rise to confusion and opportunities for regulatory arbitrage and as such, our preference is for these requirements to be disapplied in the final guidelines.

### **Application to all investments or investments that do not meet the environmental and/or social characteristics or sustainable investment objective**

Our preference is that the minimum safeguards should only be applied to investments used to meet environmental and/or social characteristics or sustainable investment objective and not to assets used for liquidity (e.g. cash and cash equivalents), hedging or efficient portfolio management purposes.

If ESMA does decide to implement minimum safeguards – **these should not be applied** to the entire asset allocation but attempt to carve out assets held for liquidity and hedging purposes where there is often no interpretational data that would allow an asset to be assessed against minimum standards.

<ESMA\_QUESTION\_FUNA\_6>

### **Q7 : Do you think that, for the purpose of these Guidelines, derivatives should be subject to specific provisions for calculating thresholds?**

<ESMA\_QUESTION\_FUNA\_7>

We believe it would be most helpful for ESMA to remain open-minded in its approach to derivatives and be non-prescriptive. Derivatives are highly complex and how they are used within a fund depends on the fund strategy and asset class. There remains significant work to do in this area, across a variety of pieces of sustainability regulation in Europe including SFDR and the Taxonomy, and we point to IIGCC’s work<sup>1</sup> to incorporate derivatives into its Net Zero Investment Framework as a useful publication when ESMA is considering its approach to derivatives.

<ESMA\_QUESTION\_FUNA\_7>

### **a) Would you suggest the use of the notional value or the market value for the purpose of the calculation of the minimum proportion of investment?**

<ESMA\_QUESTION\_FUNA\_1>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_FUNA\_1>

### **b) Are there any other measures you would recommend for derivatives for the calculation of the minimum proportion of investments?**

<ESMA\_QUESTION\_FUNA\_2>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_FUNA\_2>

**Q8 : Do you agree that funds designating an index as a reference benchmark should also consider the same requirements for funds' names as any other fund? If not, explain why and provide an alternative proposal.**

<ESMA\_QUESTION\_FUNA\_8>

There are potential challenges when applying these requirements to index tracking strategies, including Exchange Traded Funds (ETFs).

As the market convention for naming ETFs and other index tracking strategies is to include the name of the benchmark in the fund name, as ESMA's guidelines will not apply to benchmark providers, ETF providers may be in a problematic situation whereby a benchmark provider includes ESG-related terms in the name but the fund provider isn't allowed to reference this.

It is suggested that it would be disproportionate to require fund managers to police the benchmark market for ESG fund terms and therefore fund managers should be able to continue to use the benchmark name, including any ESG-related term that it might contain, in fund names in order to maintain clarity in the market.

Further clarification from the Commission on the treatment of the asset allocation question in Annex II for index tracking products would also be beneficial to address this question.

One member has suggested that given the ESG benchmark requirements differ significantly from SFDR and the Taxonomy, the requirements should be reviewed in order that they are better aligned. As part of this review, consideration should be given as to whether to introduce minimum requirements for ESG benchmarks that would align with the minimum requirements proposed by ESMA for funds. For this to be feasible, we recognise that there would need to be consistency between active and index funds. ESMA's guidelines therefore need to be extended to reference benchmarks so managers can be satisfied the underlying benchmark meets ESMA's guidelines. Until this happens, it will be challenging for index products.

<ESMA\_QUESTION\_FUNA\_8>

**Q9 : Would you make a distinction between physical and synthetic replication, for example in relation to the collateral held, of an index?**

<ESMA\_QUESTION\_FUNA\_9>

We would caution against drawing a strong distinction between physical and synthetic replication, since in practice many physically replicated funds will undertake securities lending and therefore questions regarding any collateral held will be common to both approaches.

One member has noted their approach is to apply minimum safeguards to the collateral basket held to ensure that it does not undermine the ESG objective of the fund. This principle could serve as a basis for any fund that undertakes significant securities lending or synthetic replication. For funds undertaking securities lending, it would also be important to ensure that securities can be recalled for the purposes of proxy voting, where engagement and stewardship are considered part of the ESG investment strategy.

<ESMA\_QUESTION\_FUNA\_9>

**Q10 : Do you agree of having specific provisions for "impact" or impact-related names in these Guidelines?**

<ESMA\_QUESTION\_FUNA\_10>

We would in principle support specific provisions for the inclusion of "impact" related terms in fund names, provided that they are aligned with the principles of the Global Impact Investing Network (GIIN), which provides the leading global definition of impact investing. Specifically, that the product invests with the objective of delivering positive and measurable environmental or social impact alongside a financial return.

However, we would advise against setting quantitative thresholds regarding sustainable investments or Taxonomy-alignment for impact products given the nature of many impact investments and the lack of reliable data.

Finally, we would like to request clarity on paragraph 20 of the draft guidelines requiring that ‘the use of the word “impact” or “impact investing” or any other impact-related term should be used only by funds meeting the quantitative thresholds set out in paragraphs 16 and 17’. We note that paragraph 17 contains the 50% sustainable investment threshold. The example of the impact fund provided (Global Impact Fund), however, is a fund with 0% sustainable investments. We would like to request clarification on this point.

<ESMA\_QUESTION\_FUNA\_10>

**Q11 : Should there be specific provisions for “transition” or transition-related names in these Guidelines? If yes, what should they be?**

<ESMA\_QUESTION\_FUNA\_11>

In principle, we would support a framework that is agnostic as to the investment strategy approach and can be equally applied to climate, environmental, social and other approaches as opposed to creating additional layers of regulation that will add, rather than reduce, the confusion in the market and for investors. In addition, we would highlight that there are myriad approaches to transition and defining a clear and unambiguous standard could be challenging.

However, as we note above, the proposals above regarding minimum safeguards could, in particular, be challenging for transition strategies. One of our suggestions is the use, instead, of minimum exclusions based on the Climate Transition Benchmark requirements.

Furthermore, it remains unclear where transition strategies sit within SFDR and whether transition strategies can be included under Article 9 and can be considered as sustainable investments. Should the European Commission define sustainable investments narrowly and therefore such strategies no longer be considered to fall under Article 9, it could be helpful to introduce provisions regarding transition to ensure that such strategies remain visible to investors.

Lastly, clarity is needed on whether the minimum safeguard proposal is a list of company exclusions or also ‘any companies that are found or estimated by them or by external data providers to significantly harm one or more of the environmental objectives referred to in Article 9 of Regulation (EU) 2020/852 of the European Parliament’ which is less precisely defined (beyond the UNGC violations).

Additionally, at the moment as far as we understand the proposed guidelines, there wouldn’t be any restriction on using the term ‘transition’ in the name so we see little benefit of extending the naming rules to cover these funds unless there is a significantly reduced threshold.

<ESMA\_QUESTION\_FUNA\_11>

**Q12 : The proposals in this consultation paper relates to investment funds’ names in light of specific sectoral concerns. However, considering the SFDR disclosures apply also to other sectors, do you think that these proposals may have implications for other sectors and, if so, would you see merit in having similar guidance for other financial products?**

<ESMA\_QUESTION\_FUNA\_12>

Yes, we consider it important that other investment products, including unit-linked and structured products and potentially also pension products, should be subject to similar requirements to ensure a level playing field and that consumers are not confused by differing requirements.

<ESMA\_QUESTION\_FUNA\_12>



**Q13 : Do you agree with having a transitional period of 6 months from the date of the application of the Guidelines for existing funds? If not, please explain why and provide an alternative proposal.**

<ESMA\_QUESTION\_FUNA\_13>

Members have expressed concerns about the length of the transitional period: six months is not enough time to implement the name changes or adapt portfolios to abide with the proposed guidelines and we are therefore suggesting a transition period of at least 12 months. Some concerns in particular include:

- Members anticipate changes to a significant number of their products given the level of the thresholds, and, given the number of clients with whom members would need to engage to discuss the changes, six months is incredibly limited.
- In some EU Member States changing the name of funds may involve a lengthy and complex re-filing of regulatory documentation with the NCAs. In the event of index-based strategies, it will depend on whether index providers adjust the naming of their indices to the new ESMA Guidelines.
- It is also suggested that (an extended) transitional period for existing products is also applied to new products, therefore lengthening the application period for new products. A three-month application period (as per paragraph 6) is too short for products that may already be fairly advanced in their development and we are therefore concerned that such a short period could therefore have an adverse effect on new product development and innovation.

<ESMA\_QUESTION\_FUNA\_13>

**Q14 : Should the naming-related provisions be extended to closed-ended funds which have terminated their subscription period before the application date of the Guidelines? If not, please explain your answer.**

<ESMA\_QUESTION\_FUNA\_14>

No, we believe that closed-ended funds that have terminated their subscription period should not be subject to these new requirements. Since the legal basis is to ensure that communications are “fair, clear and not misleading”, any closed fund that has terminated subscriptions would no longer be undertaking any marketing and therefore applying these rules would be tantamount to retrospective application.

<ESMA\_QUESTION\_FUNA\_14>

**Q15 : What is the anticipated impact from the introduction of the proposed Guidelines?**

<ESMA\_QUESTION\_FUNA\_15>

Whilst we believe it is important that a fund's name is accurate and not misleading, the name of a fund is not the sole determinant of whether an investor will select a fund for investment. As such, ESMA should ensure that the guidelines reflect a proportionate approach in tackling the harms it is trying to avoid. If calibrated appropriately as per our response to the relevant questions included in this consultation, we believe the guidelines will help enhance investor protection by minimising the risk of greenwashing given that a type of greenwashing that may occur at the product level is the lack of alignment between the product's sustainability-related name and its investment objectives and/or strategies.

Whilst the guidelines may help minimise the risk of greenwashing, the introduction of guidelines may also lead to unintentional consequences including adding to investor confusion and concentration risk/market risk.

<ESMA\_QUESTION\_FUNA\_15>

**Q16 : What additional costs and benefits would compliance with the proposed Guidelines bring to the stakeholder(s) you represent? Please provide quantitative figures, where available.**

<ESMA\_QUESTION\_FUNA\_16>

We broadly agree with the cost-benefit analysis in Annex 5 of the consultation. However, we do not agree that it captures all the potential costs that will be incurred by fund managers when implementing the proposed guidelines. For example, funds that currently would fall within the scope of the proposed guidelines but do not meet the thresholds would experience additional costs (e.g. transaction costs) in re-positioning their portfolio particularly when other funds are also doing the same. For funds that would choose to re-name, in addition to costs associated with amending pre-contractual and periodic disclosure documents and relevant marketing materials, costs will also be incurred in relation to translating these documents, convening boards (if timing of the change in name does not align with the normal board meeting cycle) and communicating with shareholders including any required meetings. We also question why there are no estimated cost figures included in the analysis.

<ESMA\_QUESTION\_FUNA\_16>

**Q17**