EUROSIF RESPONSE TO THE ESMA CONSULTATION ON GUIDELINES FOR THE USE OF ESG OR SUSTAINABILITY-RELATED TERMS IN FUNDS' NAMES

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Key points

Eurosif supports the idea of introducing minimum sustainability criteria for the different product categories to guarantee that sustainability-related claims and commitments are in line with the reasonable expectations investors can have. However, this should happen alongside a review of the SFRD framework aiming for:

- a clearer delineation between product categories so that FMPs can classify their investment products appropriately and in a manner that clearly conveys the characteristics of the product;
- clarity of rules including key concepts and definitions;
- better reflecting specificities of impact/transition investments;
- improving the Do No Significant Harm provisions and reflecting on whether a consideration of the Principle Adverse Impact indicators is appropriate to that end;
- addressing any other issues identified during the first years of the implementation.

We recommend properly considering whether to keep SFRD as a disclosure framework and complement it with product labels with different levels of ambition or whether to turn SFDR into a fully-fledged standard by setting the minimum performance criteria for each of the product categories.

In the meantime, we suggest providing as much clarity as possible with regards to the existing SFDR provisions (including on what can be considered as ESG characteristics) in the long-awaited Q&As from the European Commission.

Question 1

Do you agree with the need to introduce quantitative thresholds to assess funds' names?

As stated Eurosif shares ESMA's concern that sustainability disclosures may give rise to "greenwashing" risks if funds are named as green or socially sustainable, despite not meeting sufficient sustainability standards that would justify the use of that name.

As explained in the report of June 2022, Eurosif supports the idea of introducing minimum sustainability criteria for the different product categories to guarantee that sustainability-related claims and commitments are in line with the reasonable expectations investors can have. However, this should happen together with adjusting the SFRD framework to provide sufficient clarity on the different concepts and clearly delineating different SFDR product categories.

While we appreciate that the guidelines could temporarily fill certain gaps in the SFRD and broader sustainable finance framework and improve supervisory convergence, it can be questioned whether setting the minimum criteria without providing sufficient clarity on the key concepts and definitions in SFRD (e.g., a definition of ESG characteristics) is an appropriate way forward. There is a risk that introducing the proposed quantitative thresholds to assess funds' names at this stage could even further increase the confusion.

Instead, we suggest:

- To review SFRD level 1 aiming for 1) a clearer delineation between product categories so that FMPs can classify their investment products appropriately and in a manner that clearly conveys the characteristics of the product; 2) ensure all the definitions and key concepts are clear, 3) reflect on how to better cater for the specificities of impact/transition investments for instance by considering a new product category; 4) reflect on the Do No Significant Harm provisions and whether the Principle Adverse Impact indicators' consideration is best suited to that end; 5) address any other issues identified during the first years of the implementation; and finally 6) whether to keep SFRD as a disclosure framework and complement it with product labels with different levels of ambition or whether to turn SFDR into a fully-fledged standard by setting the minimum performance criteria for each of the product categories.

- In the meantime, we suggest providing as much clarity as possible with regards to the existing SFDR provisions (including on what can be considered as ESG characteristics) in the long-awaited Q&As from the European Commission.

Question 2

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.

As stated above, before implementing any quantitative threshold for the use of certain terms in the names of financial products, it is necessary to provide clarity on SFRD-related terms and concepts, in particular, what is meant by ESG characteristics which currently are not defined. Moreover, impact or transition-related investments are currently not addressed or reflected in SFRD which should be addressed during the review of level 1 text.

If ESMA were to proceed with the guidelines on the thresholds, the 80% threshold appears to be reasonable, considering common sense as well as the data presented in the cost-benefit analysis (CBA). However, once again, we first need more clarity on what is meant by ESG characteristics and which products can reasonably qualify. Sharing the approach used by ESMA during the CBA would be helpful to that end.

At the same time, we would like to flag feedback received that in some markets a threshold of 80% is perceived as too high for Alternative Investment Funds (AIFs). This could be addressed by defining different quantitative thresholds for different asset classes.

Also, we suggest clarifying whether investments for hedging and liquidity purposes would be considered within the 80% threshold. While it is reasonable for such investments not to constitute a high proportion of the fund, we are talking about products with ESG characteristics, not sustainable investments. Cash and derivative transactions are important for the fund's ability to adapt to volatile market situations and manage the risks in the best possible way.

Question 3

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.

Before implementing any quantitative threshold for the use of certain terms in the names of financial products, we need clarity on SFRD-related terms, including the definition of sustainable investments (please consult Eurosif's report of June 2022 for further explanations). As explained in our response to question 1, there is a need for a proper review of level 1 text of SFDR during which setting the minimum criteria should be addressed.

We would also like to point out that there has been quite a lot of confusion regarding the 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. Our reading of the proposed guidelines is that it is minimum 50% of investments meeting the requirements of Art. 2 para 17 of SFDR out of 80% of investments meeting the ESG characteristics, however, that should be clarified.

Moreover, our understanding is that all of the proposed thresholds apply only to products disclosing under Art. 8 of SFRD, meaning products with ESG characteristics. If that is the case, again it should be clarified in the text of the guidelines, if ESMA goes ahead with its proposals.

While we understand that the aim is to put the bar higher for products marketed as Art. 8 products, questions arise why products disclosing under Art. 8 of SFRD, meaning so-called products with ESG characteristics, would be allowed to use a "sustainability"-derived term in their names. Using the logic of rules in the SFDR, it would seem that the "sustainability"-derived terms should be reserved only for products disclosing under Art. 9 of SFRD, meaning products in line with the definition of Art. 2 para 17.

Question 4

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

Please see our responses to previous questions, in particular question 1.

Question 5

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.

Please see our responses to previous questions, in particular question 1.

Question 6

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.

Overall, we agree there may be a need for minimum safeguards for investment funds with an ESG- or sustainability-related term in their name. However, in line with the responses to previous questions, this requires further reflection as part of the review of SFDR and the overall alignment of the sustainable finance framework.

There could be merits of aligning the minimum safeguards with the exclusions for the Paris-aligned benchmarks, however, questions arise about how this relates to the Do No Significant Harm (DNSH) criteria under SFRD, in particular Art. 2 para 17, DNSH and the minimum safeguards under the EU Taxonomy. Also, as Art. 8 products are referred to as a "light green" category, and hence of a lower ambition than sustainable investments, it may not be appropriate to apply a set of uniform exclusions.

While we would in principle support the idea of exclusions for Art. 9 products, meaning sustainable investments also referred to as "dark green" products, for Art. 8 products, also referred to as a "light green" category, and hence of a lower ambition than sustainable investments, it may not be appropriate to apply a set of uniform exclusions.

Commenting on some specific exclusions for the Paris-aligned benchmarks, there is a threshold of companies that derive 1 % or more of their revenues from exploration, mining, extraction, distribution or refining of hard coal and lignite. However, we understand that 1% may be too low and if used at all, should be increased to 5% (which we understand is the usual threshold of green product labels) as otherwise investments in e.g., pharma companies could be excluded.

Then, in light of the criteria in the EU Taxonomy, the exclusions of companies that derive 50 % or more of their revenues from electricity generation with a GHG intensity of more than 100 g CO2 e/kWh and companies that derive 50 % or more of their revenues from the exploration, extraction, manufacturing or distribution of gaseous fuels, in the current context could be considered as not sufficiently ambitious.

Finally, as mentioned before, the current framework is not appropriate for impact and transition investments, whereby the criteria should rather be more linked to the stewardship or engagement of investors with the investee companies.

Question 7

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

Treatment of derivatives in the context of sustainable investments has always been a very sensitive subject which is not easy to tackle. Derivatives which are used for the purpose of hedging the risk of sustainable investments or those with ESG characteristics, or are enabling sustainable investments which otherwise would not be available, could be considered as sustainable investments or investments with ESG characteristics. However, further consideration should be given to how to strike the right balance and ensure that rules are not circumvented by simply changing a legal wrapper of the derivative trade. It may be useful to set up a dedicated working group to discuss and consider this subject in more detail.

At the same time, it is important to recognise the value of derivatives investments for risk management purposes.

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?

In line with the proposals of the Platform on Sustainable Finance, we believe that this subject requires further technical work.

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

In line with the proposals of the Platform on Sustainable Finance, we believe that this subject requires further technical work.

Question 8

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.

This requires further reflection in view of the forthcoming review of SFRD. It may be useful to consider setting minimum criteria for different product categories and asset classes.

Question 9

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

Yes, it would be sensible to make a distinction between physical and synthetic replication in the case of index funds. Again, this requires further reflection in view of the forthcoming review of SFRD. It may be useful to consider setting minimum criteria for different product categories and asset classes.

Question 10

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

Impact and transition investments are crucial for advancing the transition towards a sustainable economy. Unfortunately, their specificities are currently not properly reflected in SFDR. Overall it is very important to adjust the framework to better consider impact- and transition-focused investments and this should be properly considered during the SFRD review.

The provisions proposed in the draft guidelines seem to put "impact" investments in the same category as products with ESG characteristics which does not do justice to such investments. Meanwhile, the definition in Art. 2 para 17 is also not appropriate for impact funds. For further Eurosif proposals regarding impact and transition funds, please see the report of June 2022 as well as the White Paper from July 2022.

Question 11

Should there be specific provisions for "transition" or transition-related names in these Guidelines? If yes, what should they be?

See response to Q 10.

Question 12

The proposals in this consultation paper relate 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?

There should be a consistent approach to different financial product categories, while recognizing the specificities of different asset classes.

Question 13

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.

If ESMA were to proceed with the proposed guidelines, yes, we would find appropriate to provide for a transitional period, however, we believe it should be extended to 12 months allowing market participants sufficient time to adjust.

Question 14

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.

No response

Question 15

What is the anticipated impact from the introduction of the proposed Guidelines?

See response to question 1.

Question 16

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

Asset managers and other industry practitioners have made important efforts in the past years to implement the current sustainable finance framework. They are aware of the essential role that financial markets play in the green transition and in climate action. However, investors note that investing sustainably is still more costly than traditional investment, which is in a way ironic and may be counterproductive. While we agree with the need for appropriate minimum criteria for sustainable investments, we believe that this would be better addressed by a fully-fledged level 1 review of SFDR, possibly combined with other legislative measures. We fear that the proposed guidelines would, at this stage, increase the complexity of the framework with limited benefits.