



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



18 November 2022

## 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 European Federation of Investors and Financial Services Users (BETTER FINANCE)
Activity	Other Financial service providers
Are you representing an association?	<input type="checkbox"/>
Country/Region	Europe

## Introduction

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

<ESMA\_QUESTION\_FUNA\_0>

ESMA's Guidelines on funds' names using ESG or sustainability related terms in their names propose the use of quantitative thresholds whereby "if an investment fund has any ESG-, or impact-related words in its name, a minimum proportion of 80% of its investments should be used to meet the environmental or social characteristics or sustainable investment objectives..." and "if an investment fund has the word "sustainable" or any other term derived from the word "sustainable" it should allocate within the 80% of investments at least 50% of minimum proportion of sustainable investments".

BETTER FINANCE would like to point out that there is an urgent need for:

- further clarity on definitions to enhance retail investor understanding and differentiation of ESG/sustainability and other terms;
- harmonisation of terms and definitions across legislation;
- expanding minimum safeguards beyond exclusion and integration of engagement approach;
- adopt specific provisions for transition and encourage the use of strong engagement and active share ownership to accelerate energy transition plans for example;
- adopt specific provisions for impact with sufficient proof of the impact presented in a clear and measurable way; and
- clarifications over the proposed "temporary deviation" regarding approximate period.

<ESMA\_QUESTION\_FUNA\_0>



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

<ESMA\_QUESTION\_FUNA\_1>

ESMA's Guidelines on funds' names using ESG or sustainability related terms in their names propose the use of quantitative thresholds whereby "if an investment fund has any ESG-, or impact-related words in its name, a minimum proportion of 80% of its investments should be used to meet the environmental or social characteristics or sustainable investment objectives..." and "if an investment fund has the word "sustainable" or any other term derived from the word "sustainable" it should allocate within the 80% of investments at least 50% of minimum proportion of sustainable investments" as defined in the Sustainable Finance Disclosure Regulation (SFDR). BETTER FINANCE is of the view that a **fund's name is often the first and even too many times the only piece of information retail investors see** and that can have a **significant impact on their investment decisions**, hence we agree with ESMA that **names can be misleading** if those funds do not invest in what their names would suggest. However, the current conditions as set out by the **quantitative thresholds may be somewhat confusing** for retail investors as the distinction between ESG-related words and sustainability related terms is not yet easy to differentiate. A **quantitative approach could indeed be helpful for supervisors**, but this needs to be accompanied with a **clear and easy to understand distinction** between the proposed two thresholds and their definitions (which needs to be addressed through a legislative review of the Sustainable Finance Disclosure Regulation overall). Studies already show that **investors are increasingly more cautious** on investment advice for sustainable products and lose some trust (1) <https://www.dsw-info.de/presse/pressemitteilungen-2022/anlageberatung-zu-nachhaltigen-produkteninvestoren-zurueckhaltend-wenig-klarheit-in-den-vorgaben/>. Also a prerequisite to any quantitative approach is to **take into account not only the least effective sustainable fund investment strategy** (exclusion or negative screening) **but also the most effective ones: engagement and transition investing**, as documented for example in ESMA SMSG's response to the ESAs consultation on greenwashing (2) [https://www.esma.europa.eu/sites/default/files/2023-01/esma22-106-4384\\_smsg\\_advice\\_on\\_greenwashing.pdf](https://www.esma.europa.eu/sites/default/files/2023-01/esma22-106-4384_smsg_advice_on_greenwashing.pdf) para. 26

<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>

While in theory a **quantitative threshold of 80% is acceptable metric for the exclusion investment approach only**, it assumes that retail investors have a **common understanding of the ESG/impact related words** in the name of a fund. Given that **"ESG" refers to sustainability-related topics overall**, retail investors may struggle to **differentiate ESG and separate sustainability terms** for the secondary threshold of 50%. Despite the purpose of the SFDR, to improve transparency in the market for sustainable investment products and to prevent greenwashing practices, we are witnessing the regulation's use as a labelling exercise due to the fact that funds and asset managers have plenty of leeway to interpret ESG credentials in various ways and switch back and forth between Article 6, 8 and 9 of the SFDR. If a product is labelled as Article 8 or 9, retail investors reasonably expect the product to have a certain level of ESG credentials, and the **lack of clarity from the regulatory environment creates an additional barrier for retail investors** and must be addressed through a legislative review. On the one hand, the market does not have a uniform interpretation of definitions (ESG/sustainability etc.), which **risks being to the detriment of retail investor understanding of the financial products they are investing in**. On the other there is **little support for retail investors to enable them to properly distinguish** between the difference of ESG derived terms and those of sustainability. Further **clarity on definitions and methodologies** are necessary to enhance the use of the proposed thresholds.

<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>

Same as above – the proposed **quantifiable metric could indeed be applicable** in cases where sustainability related terms are **commonly understood and harmonised across legislation**. And again, it seems for now **adapted only to exclusion investment approaches, not to transition and engagement ones**. A retail investor may **not be able to understand what the exact difference is** between ESG/impact related terms and those of sustainability related terms, since ESG includes sustainability linked words in any case. BETTER FINANCE would like to point out that ESMA's recommendation to only consider minimum safeguards consisting of the **exclusion criteria, may be ineffective**, given other approaches such as the **engagement**, and the use of transition financing which is an **important objective of the sustainable finance agenda** and where efforts are needed for a net change of carbon emissions for example.

<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>

ESMA should consider **extending the minimum safeguards beyond exclusion and integrate engagement** as well as **distinguish between transition investments and pure taxonomy-compliant ones in the funds' names**. Ultimately, retail investors would need **clear and concise guidelines** to enhance their understanding of the proposed rules and how to utilise them in order to make a better-informed decision regarding their investments. If a fund has an ESG/sustainability/transition related term in its name and does not allocate certain amount within these topics/ does not disclose in pre-contractual templates, then this would **indeed lead to greenwashing (therefore publicly disclosed transition plans are of crucial importance)**. However, if such rules become too complex for an average retail investor to understand it may have a **detrimental impact instead**. Additionally, it should be noted that funds' names can ultimately be changed/adapted in a way that could avoid falling in the scope of the guidelines, which would defeat the purpose of the thresholds. BETTER FINANCE **agrees that thresholds are necessary to avoid greenwashing**, but would like to point out that further clarity is needed to support retail investor understanding and differentiation between the 80 and 50% allocation thresholds.

<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>

Yes, as mentioned in previous answers BETTER FINANCE is of the view that **minimum safeguards criteria should be extended** to include other investment approaches such as **engagement** and not solely negative screening (exclusion). A 2021 independent study confirmed that the investment approach focused on exclusion – encompassing **negative selection or disengagement – as the least effective**, while the **most effective** fund investment strategy derives from **engagement** (3) <https://better-finance.eu/publication/better-finance-position-on-the-classification-of-investment-funds-regarding-sustainability/>. Funds must establish a measurable exercise/tool to assess this, which will enhance clarity and impact for retail investors and address reputational risk for funds. If we for instance consider the alternative, whereby European institutional investors disengage and increase their sell-off at bargain prices of fossil fuel related stocks to non-European investors who may or may not have the aim of reorienting cash flows of companies towards a green transition, it becomes clear that this poses a much greater risk for the environment in the long run. Therefore, if investments do not flow into the transition, the **objective of sustain-**



**able finance to support the economy**, all sectors included, to transition will not be achieved. For instance, if “**transition**” is in the name of a fund, it should be expected that the **investments of the fund have a clear publicly disclosed transition plan**.

<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>

BETTER FINANCE is of the view that there are **significant limitations to taxonomy and exclusion-based approaches** to responsible investing and invites the supervisory authority to **consider engagement and other more effective investment strategies than exclusion** and the effect this may have on the number of eligible (sustainable) funds. In particular, aligning all ESG funds to these **exclusions will exclude the energy sector**, which is one of the sectors in need of transition. Investments for the purpose of transition can positively impact the environment, **provided companies are engaged ones**, i.e. that they are accompanied with active share ownership and engagement aiming in particular at increasing the focus of the corporate investment plans and business model of a fossil fuel company for example towards a low carbon pathway and accelerate energy transition plans. **Strong engagement** for example **could benefit retail investors and companies alike**, and by extension the overall objectives of the sustainable finance agenda. Transitioning companies should have **credible transition plans**, for instance with verified science-based targets to be eligible as sustainable investments. The **taxonomy was not designed as a methodology for effective ESG investing strategies**, as it only describes the ASG compliant economic activities, i.e. the end-goal of the ESG transition required. Especially for listed equity investments (the major part of ESG retail fund investing, the “**exclusion**” **investing strategy may eventually prove not only not effective but detrimental by diverting precious funding resources to activities / companies that – even if highly taxonomy- compliant – will do little or nothing to improve ESG factors**. The current ESG indices - mostly based on the exclusion approach – increase further the weightings of already very highly valued tech companies in the software and communications areas in particular , **with no evidence of positive impact on ESG factors**. BETTER FINANCE believes that for these reasons the **exclusion approach is the most prone to greenwashing risks**.

<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>

As derivatives are a complex type of financial security referring to a type of financial contract whose value is dependent on an underlying asset for example, whereby their use either mitigates risk or assumes risk with the expectation of commensurate reward, **derivatives should be subject to specific provisions** for calculating thresholds in regard to the proposed Guidelines. In order to **properly inform non-professional individual (“retail”) investors**, since the use of derivatives can generate a significant difference between the stated **investment objectives of an investment fund and the actual constituents of its portfolio**. For example a synthetic ESG equity index fund using total return swaps can be in principle largely invested in - for example – non “green” Japanese bonds.

<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>

Market value and notional value each represent different sums that are important for investors to understand. MiFID rules on clear information warrants that it has to be understood by the majority of the targets.





However, **retail investors will have no understanding of what is the “notional value” of an investment, especially a publicly listed one.**

<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>

Not applicable to retail investors.

<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>

**ESG index funds should indeed follow the same requirements as funds claiming to use an “active” approach.** This raises the issue in turn of ESG indices’ names. For example, are the “FTSE4Good” indices really helping index funds or any active funds benchmarked on such indices to do any good? While this will **ensure complete consistency for retail investors**, funds designating an index as a reference benchmark (whether passive/index or active ones) assumes that index **providers follow a harmonised set of rules**, especially when in reality there are multiple **challenges linked to a lack of a common definition, comparability, together with transparency issues**. For example, ratings from MSCI and Sustainalytics serve as input to both benchmark indices and fund ESG ratings. Without a **proper regulatory framework in the space of ESG ratings and indices**, certain index providers may simply create custom indices, raise costs and make it difficult to follow proposed rules.

<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>

Yes, please see above response to Q7.

<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>

**Yes** - With the rapid development of sustainably denominated financial products, it is becoming increasingly important to assess the **impact** they have on making the real economy more sustainable. Currently there is **no specific regulatory guidance governing the content of environmental impact claims** in the finance sector, **despite some existing definitions (in general)** like the one of ‘Finance for Tomorrow: “impact finance is an investment or funding strategy that aims to accelerate the just and sustainable transformation of the real economy by providing proof of its positive effects.” (4) Finance for Tomorrow impact definition, available at: <https://financefortomorrow.com/en/impactfinance/#:~:text=Impact%20Finance%20is%20an%20investment,evidence%20of%20its%20beneficial%20effects> The **proof/evidence of the impact** should be **clear and measurable**. It should also be noted that the same **rule should apply for impact related fund names as it does to ESG/sustainability/transition etc.** The three pillars more widely recognised today in relation to impact are inclusive of intention, additionality and measure.

<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>

**Yes** - as mentioned in previous responses to this consultation, BETTER FINANCE is of the view that **transition/transition related names should be integrated in the guidelines** given the important role of transition finance in achieving a net positive change (for example with GHG reduction). Therefore, investments in fossil fuel companies can positively impact the environment, provided they are **engaged ones**, i.e. that they are accompanied with active share ownership aiming in particular at increasing the focus of the corporate investment plans and business model of the fossil fuel company towards a low carbon pathway and accelerate **energy transition plans**.

<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>

**Same overarching rules should be applied** by all ESAs and **harmonisation of guidelines** with existing legislation is **necessary to ensure retail investors** (regardless of the type of ESG product/service they invest in) **can compare and easily understand** how products differentiate.

<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>

A **transitional period is indeed necessary**, however the **exact length should also take into account** Annex III: Draft Guidelines on funds' names using ESG or sustainability-related terms, Point 21, which stipulates a provision for a **"temporary deviation"** whereby funds are given additional timeframe to comply with the threshold. BETTER FINANCE would also like to point out that **there is no set/approximate** time period for a said "temporary deviation" which may in fact be detrimental for retail investors and their associated investment decisions if left unaddressed.

<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>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_FUNA\_14>

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

<ESMA\_QUESTION\_FUNA\_15>

If **revised accordingly**, the Guidelines will have a **positive impact in relation to preventing greenwashing and decreasing barriers to responsible investment**, reduce unfair competition and increase capital flows deriving from sustainable/ESG etc. products and services. The **Guidelines can also boost** retail investor **trust and confidence** in financial markets **if executed in a harmonised and easy to understand approach**. However, **under the current Guidelines**, especially in **reference to using negative screening approaches only**, as well as the unclear "temporary deviation" period, the **impact may be the opposite**.

<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>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_FUNA\_16>

**Q17**