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Submitted via online survey

20 February 2023

Dear Sir or Madam,

**AIMA comments on ESMA Consultation Paper On Guidelines on funds' names using ESG or Sustainability-related terms**

The Alternative Investment Management Association (AIMA)<sup>1</sup> welcomes the opportunity to respond to the European Securities and Markets Authority (ESMA) consultation paper On Guidelines on funds' names using ESG or Sustainability-related terms<sup>2</sup> (the Consultation Paper).

While we acknowledge the importance of work to develop and refine the EU's regulatory framework covering sustainable finance, our view is that work on the proposed Guidelines is premature and should be paused. We believe that any measures relating to funds' names using ESG or sustainability-related terms should instead be considered as part of the envisaged review of the Sustainable Finance Disclosure Regulation (SFDR). This would likely lead to a more coherent and cohesive sustainable investment regime than working on funds' names as a parallel project, particularly given there is still a lack of clarity over certain concepts within SFDR (i.e. definition of sustainable investments), with guidance and secondary legislation still expected.

We also note the lack of a solid legal basis for introducing Guidelines that feature such prescriptive

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<sup>1</sup> The Alternative Investment Management Association (AIMA) is the global representative of the alternative investment industry, with around 2,100 corporate members in over 60 countries. AIMA's fund manager members collectively manage more than US\$2.5 trillion in hedge fund and private credit assets. AIMA draws upon the expertise and diversity of its membership to provide leadership in industry initiatives such as advocacy, policy and regulatory engagement, educational programmes and sound practice guides. AIMA works to raise media and public awareness of the value of the industry. AIMA set up the Alternative Credit Council (ACC) to help firms focused in the private credit and direct lending space. The ACC currently represents over 250 members that manage US\$600 billion of private credit assets globally. AIMA is committed to developing skills and education standards and is a co-founder of the Chartered Alternative Investment Analyst designation (CAIA) – the first and only specialised educational standard for alternative investment specialists. AIMA is governed by its Council (Board of Directors). For further information, please visit AIMA's website, [www.aima.org](https://www.aima.org).

<sup>2</sup> [https://www.esma.europa.eu/sites/default/files/library/esma34-472-373\\_guidelines\\_on\\_funds\\_names.pdf](https://www.esma.europa.eu/sites/default/files/library/esma34-472-373_guidelines_on_funds_names.pdf)

elements, such as minimum safeguards, which go beyond the requirements of the SFDR and the SFDR RTS. The Guidelines would effectively amount to the creation of another layer of rules outside of the normal co-decision process which would create a distinct category of funds (i.e. those funds in scope of the proposed Guidelines).

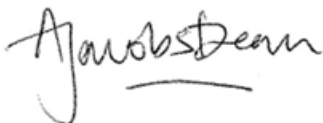
If ESMA does go ahead with implementing the Guidelines at this time, we would ask for further clarity over the calculation of the minimum proportion of investments, and the definition of ESG-related and sustainability-related terms, in order to reduce complexity.

Additionally, we would ask that closed-ended funds which have terminated their subscription period before the application date of the Guidelines are exempt, given that those funds will already have set out a fixed investment strategy and investors will have invested in them on that basis.

A significant amount of work will need to be undertaken by firms to either change the fund name or change the investment strategy if either is not compatible with the Guidelines, particularly where investor or regulatory consent needs to be sought. We would therefore ask that firms are given a longer transitional period (12 months) to comply with the Guidelines.

These points are discussed in further detail below in the attached Annex. We would be happy to elaborate further on any of the points raised in this letter. For further information, please contact Kate Boulden, Associate Director, Governance and Innovation, by email at [kboulden@aima.org](mailto:kboulden@aima.org).

Yours sincerely,



Adam Jacobs-Dean  
Managing Director, Global Head of Markets, Governance and Innovation  
AIMA

## Annex: Consultation Paper questions

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

We do not believe it is necessary to introduce quantitative thresholds to assess funds' names at this time. ESMA is likely to achieve a more coherent sustainable finance regime by delaying work on implementing Guidelines on fund naming until broader reviews are completed, namely the assessment of the implementation of the Sustainable Finance Disclosure Regulation (SFDR) (as indicated by Mairead McGuinness, European Commissioner for Financial Services, Financial Stability and Capital Markets Union in a speech<sup>3</sup> in December 2022) and other anti-greenwashing projects (such as the recent ESAs' call for evidence<sup>4</sup>). Any Guidelines or rules for fund naming should be fully integrated into this work, and as such, these Guidelines may pre-empt findings. Instead, a deliberate product naming review could be considered as part of these ongoing projects.

It may also be beneficial to give more time before introducing Guidelines on funds' names given that there is still a lack of clarity over certain concepts within SFDR, in particular around the definition of sustainable investments, with guidance and secondary legislation still expected.

Furthermore, the Guidelines would (if implemented) create uneven and divergent regulatory expectations for different financial products which are subject to SFDR. This is because the Guidelines are limited in their application to funds subject to the EU AIFMD and EU UCITS regimes. The Guidelines would not apply to other financial products (under Article 2(12) of SFDR), including IBIPs, pension products, pension schemes or PEPPs. This creates an unfair and non-level playing field for AIFMs and UCITS Management Companies, which would then be subject to stricter rules on the naming of their financial products than is the case for other financial market participants that are in-scope of SFDR. This also reinforces the assertion that a product naming review should form part of a broader review of SFDR, and should be applicable to all products in scope.

More broadly, we would question whether it is necessary to have specific rules or regulatory requirements in respect of the use of funds' names using ESG or sustainability-related terms, given that numerous rules already exist that address mis-selling. However, if ESMA does go ahead with implementing the Guidelines on funds' names, we believe that further consideration is needed of the proposed minimum proportion of investments, minimum safeguards and scope of funds captured. We would also ask that the Guidelines only apply to those funds which are open to subscription by EU retail investors (as that term is defined for the purposes of AIFMD, by reference to MiFID). We believe limiting the scope to the Guidelines to funds which are open to these investors would be appropriate and proportionate.

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<sup>3</sup> [https://ec.europa.eu/commission/presscorner/detail/en/SPEECH\\_22\\_7520](https://ec.europa.eu/commission/presscorner/detail/en/SPEECH_22_7520)

<sup>4</sup> [https://www.eiopa.europa.eu/sites/default/files/joint-committee/esas\\_call\\_for\\_evidence\\_on\\_greenwashing.pdf](https://www.eiopa.europa.eu/sites/default/files/joint-committee/esas_call_for_evidence_on_greenwashing.pdf)

**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 is proposing that ‘if a fund has any ESG-related words in its name, a minimum proportion of at least 80% of its investments should be used to meet the environmental or social characteristics or sustainable investment objectives in accordance with the binding elements of the investment strategy, as disclosed in Annexes II and III of SFDR Delegated Regulation.’

***Comments on the specific percentage threshold:***

We do not believe that defining a minimum proportion of investments is appropriate. It is worth noting that SFDR does not itself set a minimum proportion of investments that must promote E/S characteristics before a product can be considered to be subject to the requirements of Article 8. Therefore the 80% figure proposed in the Guidelines is in our view an unnecessarily high standard to be met, particularly given that investment managers would more typically think of their overall exposure to E or S risks (factoring in leverage, short positions and derivatives exposures), rather than taking a narrow perspective based on a percentage of investments in the portfolio.

***Comments on the calculation methodology for the percentage threshold:***

If a quantitative threshold were to be introduced, additional clarity is needed on a number of points:

- It is unclear how the minimum proportion of investments percentage should be calculated, for example, whether it should be based on the Net Asset Value (NAV) figure, and if cash and short positions should be included in calculations. We believe it should be up to firms to decide how this minimum proportion is calculated, as long as the firm clearly discloses its approach, and would ask ESMA to confirm that this is the case.
- Closed-ended funds and funds with a fixed life span (e.g., a 10-year life span for a fund) face particular difficulties with making percentage commitments. This may include those funds making illiquid investments, including private equity funds, infrastructure funds and real estate funds. This difficulty occurs for various reasons, including:
  - the necessity of a ramp-up and ramp-down period for investments (which may mean that there are significant periods of time across the life of the fund where the percentage commitment cannot be met),
  - the illiquidity of underlying investments making portfolio adjustment difficult,
  - capital which has been committed by investors but not yet drawn down, and
  - the fund owning infrequently valued or difficult to value assets.

We suggest that, for such funds, ESMA may wish to allow flexibility for the firm to determine how to define the “80% of what”, and afford the firm flexibility for the variables noted in this bullet point. For instance, we would argue that, for funds investing in illiquid assets, any threshold should be set by reference to cost of investments made, rather than to their value from time to time.

- Where a fund temporarily breaches the threshold, due to circumstances such as the market valuation of assets moving adversely against the threshold, we believe the

Guidelines should allow the manager a reasonable period of time (commensurate with the liquidity of the portfolio of assets) to correct this situation. If changes were to become more permanent, we would ask that firms are given six months to make changes to the name of the fund in order to comply with the Guidelines.

***Comments on the concept of “ESG-related words”:***

Clarity is also needed over the definition of ESG-related terms and which terms could be captured by the Guidelines. For example, it is unclear whether terms related to ‘energy’ or ‘forestry’ would be included as they could be construed as having sustainability links, even where the fund was not aiming to invest aligned with E or S characteristics. Additionally, it could be made clearer whether terms such as ‘Responsible investment’ would be considered an ESG-related term.

A more detailed list of what is considered an ESG-related terms is needed. We therefore recommend that ESMA includes in the Guidelines a non-exhaustive list of indicative or example ESG-related terminology which would trigger the application of the Guidelines. Such a list would alleviate the uncertainty inherent within open-ended concepts such as a term which is “derived from the word sustainable” and greatly assist market participants by providing both predictability and clarity as to which terms are in scope of the Guidelines. By way of comparison, ESMA cites the UK FCA’s proposed naming rule for sustainability products.<sup>5</sup> We note that the draft FCA Rules propose to include both (i) an express list examples of sustainability-related terminology to which the FCA’s naming rule would apply, and (ii) a statement that the naming rule also applies to: “*any other term which implies that a sustainability product has sustainability characteristics*”.<sup>6</sup>

If ESMA is concerned that publishing a list of example names could be seen as a definitive list which is then open to attempted circumvention, ESMA could include further guidance to confirm that the list is non-exhaustive, and that other terms not included in the list could still trigger the Guidelines.

***Comments on investments used to meet environmental or social characteristics:***

Paragraph 16 of the Guidelines proposes that the 80% rule would apply to the minimum proportion of investments which must be “*used to meet*” the environmental or social characteristics of the financial product.

This has raised a particular question in the fund management industry as to the effect of certain investment strategies, including (a) binding investment exclusions, and (b) negative screens, on determining whether the remaining investable universe is used to meet the E/S characteristics of the financial product. In particular, whether the remaining investable universe, after the application of exclusions or of negative screens, is automatically deemed to be used to meet the E/S characteristics of the product, or, whether a further process is required, to determine that an investment has some positive alignment with the promoted E/S characteristics.

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<sup>5</sup> Paragraph 9 of the Consultation Paper.

<sup>6</sup> UK Financial Conduct Authority Consultation Paper CP22/20, “Sustainability Disclosure Requirements (SDR) and investment labels”, Appendix 1, draft handbook rule ESG 3.3.2R (2) and (3), respectively.

A simple worked example may assist this analysis. For example, Firm A, Firm B, and Firm C each manage a different European Listed Equities Fund, which discloses under Article 8 SFDR, and each fund promotes the environmental characteristic of climate change mitigation (and the term “climate change” is in the name of each of their funds). Each Firm takes a different approach to their binding investment criteria in pursuit of climate change mitigation:

- **Firm A imposes sectoral exclusions only:** Firm A does not invest in certain key sectors which directly harm climate change, including coal and oil, both extraction and refinement. After the application of those exclusions, there are no other specific constraints on the European Listed Issuers in which the fund may invest.
- **Firm B imposes negative screening:** Firm B assesses European Listed Issuers according to the harm that they do to climate change goals, and excludes the bottom 20% of European Listed Issuers in every sector according to this harm.
- **Firm C imposes positive screening:** Firm C assesses European Listed Issuers according to the positive effect they have on climate change mitigation, and its fund can invest only in the top 50% of European Listed Issuers in each sector according to this positive scoring.

It may be helpful if ESMA could comment whether the binding investment strategies imposed by each of Firm A, Firm B and Firm C would result in the remaining investable universe being **automatically** deemed to be “used to meet” the specified environmental goal. And if the remaining investable universe is not automatically aligned, whether a further positive assessment process is therefore necessary.

**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 is further proposing that ‘if a fund has the word “sustainable” or any other term derived from the word “sustainable” in its name, it should allocate within the 80% of investments to “meet the characteristics/objectives” under sub-paragraph a) above at least 50% of minimum proportion of sustainable investments as defined by Article 2(17) 17 of Regulation (EU) 2019/2088 (SFDR) as disclosed in Annexes II and III of SFDR Delegated Regulation.’

We see a strong need for additional guidance about how the minimum proportion of investments should be calculated and further clarity over the terms captured in ‘sustainability-related term’, given that how a firm should calculate its holdings in ‘sustainable investments’ is still unclear, with industry awaiting further guidance from the Commission on the ESAs’ latest “Queries related to interpretation of SFDR”. Given this, it seems premature for ESMA to set this quantitative threshold or consult on the correct threshold. The threshold might be very challenging if managers can only treat that proportion of a company's activities that are sustainable as part of its holdings in ‘sustainable investments’.

In addition, we would ask that ESMA clarify whether the 50% is i) 50% of the 80% of the minimum proportion of investments for the use of any ESG-, or impact-related words or ii) 50% of the fund

value. The ESMA team during the Public Hearing held on 23 January 2023 indicated that the 50% threshold applies to all investments (i.e., option (ii)). We would be grateful for explicit confirmation of this in the Guidelines.

**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 is also seeking views about potential safeguards that might be necessary for remaining investments of the funds, i.e., investments not used to meet the environmental or social characteristics or objectives of the fund. ESMA has proposed the exclusion criteria applicable to Paris-aligned Benchmarks in the Benchmark Regulation Delegated Regulation (Commission Delegated Regulation (EU) 2020/1818) Article 12(1)-(2) to support the name of the fund in the fund documentation and the marketing communications to be fair, clear and not misleading and that fund managers act honestly.

***Preferable not to impose minimum safeguards in this manner:***

We do not believe that the introduction of "minimum safeguards" are necessary given that this is not a requirement for funds under the Level 1 or Level 2 of SFDR. Therefore, in AIMA's view, the introduction of any proposed "minimum safeguards" which go beyond the requirements of the SFDR effectively amount to the creation of another layer of rules which would create a distinct category of funds (i.e. those funds in scope of the proposed Guidelines). If ESMA is of the view that such "minimum safeguards" are required, then AIMA's strong preference would be for any such measures to be introduced via a change to the SFDR itself, pursuant to the planned review of the SFDR. We believe a more proportionate approach would be the reporting of 'unexpected investments' (i.e. those that may not be typically associated with the E/S characteristics or sustainability objective). It is also important to note that credit investors may not have the data required to ensure the investment meets the list of minimum safeguards.

***If ESMA proceeds with using exclusions from the BMR Delegated Regulation:***

We do not believe that the exclusion criteria set out in Articles 12(1)-(2) of the Benchmark Delegated Regulation are the appropriate starting point. There are two significant concerns in the industry.

Firstly, the application of article 12(1) would effectively prohibit many **climate transition** strategies from disclosing under Article 8 SFDR (as it would not be permissible to invest in, for example, a fossil fuel company with the goal of assisting its transition to greater investment in renewable energy). The minimum safeguards arguably run counter to the EU's broader objective of supporting the transition to a net zero economy (e.g. Article 12(1)(d) excludes companies deriving more than 1% of their revenues from the certain coal related activities and Article 12(1)(f) contains a similar exclusion for companies deriving more than 50% of their revenues from certain natural gas related activities). Investments in companies operating in sectors excluded by Articles 12(1)-(2) of the EU BMR Delegated Regulation are arguably necessary to ensure energy security and affordability during the decarbonization process. Engagement with investee companies in these

sectors is one way to reduce emissions and/or improve the sustainability profile of investee companies in sectors vital to the transition, therefore excluding such companies from the investible universe of funds within the scope of the proposed guidelines could be considered counterintuitive.

Secondly, the use of the Article 12(2) reference to the exclusion of issuers which significantly harm one of the six Taxonomy objectives is a significant overreach from the Taxonomy to Article 8 of SFDR. There is no “do no significant harm” (DNSH) test in SFDR for Article 8 products (unless they commit to making sustainable investments), and so it is an inappropriate extension of the DNSH test to apply it to all investments of an Article 8 product with ESG terminology in its name. It is similarly not clear why investments made in pursuit of social objectives, or of environmental objectives not falling within the Taxonomy, should be subject to the DNSH test for all investments. Additionally, the proposed minimum safeguards are disproportionately focused on GHG emissions, though funds with ESG terms in their names will not necessarily pursue environmental aims. For example, a fund with the term “socially responsible” in its name would need to exclude companies for environmental reasons, despite not advertising itself as environmentally sustainable.

If ESMA wishes to use elements of Article 12 as minimum safeguards, we suggest that it may be more appropriate to limit this only to Article 12(1)(a), (b) and (c), but not otherwise.

**Q7. Do you think that, for the purpose of these Guidelines, derivatives should be subject to specific provisions for calculating thresholds? 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? b) Are there any other measures you would recommend for derivatives for the calculation of the minimum proportion of investments?**

The Consultation Paper acknowledges that the disclosures of the minimum proportion of investments used to meet the environmental or social characteristics or sustainable investment objectives in Annexes II and III of the SFDR Delegated Regulation do not contain any specific instruction for how derivatives should be treated and seeks views on whether derivatives should have a specific calculation method for the purpose of calculating the naming thresholds indicated in the Guidelines.

We do believe that derivatives should be considered when calculating the minimum thresholds; however, a common approach for the treatment of derivatives in the EU’s Sustainable Finance Framework has yet to be agreed. Indeed, the first Platform on Sustainable Finance did not reach a consensus<sup>7</sup> on the future treatment of derivatives and called on the European Commission to undertake further research via its successor. Additionally, there is no industry-wide consensus around how to calculate the minimum proportion of investment with regard to derivatives. Industry organisations, such as ISDA, have been working towards reaching a consensus on the methodology to classify derivatives as ESG/sustainable/taxonomy-aligned and to include them into related ratios. Therefore, until a consistent approach to treating derivatives is agreed on, we

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<sup>7</sup> Platform on Sustainable Finance, Platform Recommendations on Data and Usability, October 2022: [https://finance.ec.europa.eu/system/files/2022-10/221011-sustainable-finance-platform-finance-report-usability\\_en\\_1.pdf](https://finance.ec.europa.eu/system/files/2022-10/221011-sustainable-finance-platform-finance-report-usability_en_1.pdf)



believe firms should be given the flexibility to use the measure which they believe is most appropriate as long as the method chosen is clearly stated and explained.

In addition to the notional value and market value, another measure which should also be considered for derivatives for the calculation of the minimum proportion of investments is the “delta”. Banks that provide a derivative compute the equivalent market exposure of each derivative on a daily basis; this metric is called “delta” and represents the amount by which a derivative value would increase or decrease if the underlying financial instrument value increases or decreases by one percent. The use of the delta position reflects the real economic exposure gained through derivatives and could be a suitable indicator for the purpose of the calculation of the minimum proportion of investment for derivatives transactions.

**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 has suggested that funds designating an index as a reference benchmark could use ESG- and sustainability- related words in their name only if the relevant thresholds proposed are met by the fund.

However, we do not believe that funds designating an index as a reference benchmark should have the same requirements for funds’ names as any other fund, as there are particular challenges for managers invested in or emulating index tracker funds. Managers will largely be reliant on the information and assessments from these providers, with little ability to challenge what is included in the index. Different index providers will make different assessments of the same company; what is considered a ‘green’ or ‘sustainable’ company by one provider may not be considered as such by another. Managers are unable to change the portfolio composition to meet Guidelines on funds’ names should the index use ESG-related terms.

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

We do not believe there should be specific provisions for “transition” or transition-related names. There are challenges for transition funds meeting quantitative minimum thresholds, as by their nature, the thresholds and minimum proportions will likely change over time. As noted above, the current proposals for minimum safeguards would prohibit many transition strategies from using sustainability-related terms in their names.

**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.**

We believe that more time is needed for funds to comply with the Guidelines. The work needed to either change the investment strategy or change the fund name can be considerable and is not a simple task, particularly where funds need to gain approval from investors and/or Regulators to make changes (e.g. “material change” filing pursuant to AIFMD). Therefore, a transitional period of 12 months would be beneficial.

Predictability for firms would also be helpful. We would therefore ask ESMA to set a specific date where the Guidelines would come into force, for example 30 June 2024. As currently drafted, the transitional period applies 6 months after the application of the Guidelines on ESMA's website, which is itself an undefined date (as the Guidelines apply 3 months after official translations are published on ESMA's website and there is no concrete timeframe for the translation process).

**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.**

No. We do not believe that the naming-related provisions should be extended to closed-ended funds which have had a first close before the application date of the Guidelines, as the investors in such products will already have agreed to a fixed investment strategy and amendments to that strategy would need to be agreed with investors. =

It would be difficult for closed-ended funds to comply, especially for private funds, given that assets values vary and investments are often highly illiquid. Investments within closed-ended funds also change over time, depending on whether they are in the ramp up or selling period. Therefore, the minimum proportion of investments meeting the criteria will vary over the different stages of the funds life-cycle.

We therefore suggest that such funds should be expressly excluded from the Guidelines.