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| 18 November 2022 |

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| Reply form for the Consultation Paper on Guidelines for the use of ESG or sustainability-related terms in funds’ names |
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| Date: 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 type <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 | UBS |
| Activity | Investment Services |
| Are you representing an association? |  |
| Country/Region | International |

# Introduction

Please make your introductory comments below, if any:

<ESMA\_QUESTION\_FUNA\_0>

In addition to the specific consultation questions, we would like to stress the following point:

* Terminology: It is not clear what constitutes an ‘ESG-related term’ or a ‘sustainable-related’ term. We would welcome guidance from ESMA on the type of terms that it considers are caught, even if this is non-exhaustive. Clear guidance on how potentially ambiguous name terms should be construed would also be welcome. For example, we would welcome guidance setting out that it will not be presumed that terms used to refer to technical features of a fund are ESG or sustainable-related terms. An example is the use of ‘evergreen’ to denote an open-ended fund structure. ESMA should confirm that potential ambiguities will be assessed not at face value but in the context of the fund’s actual investment objectives and strategy.
* International Alignment: Given similar proposals in other jurisdictions such as the UK, which will soon consider application to incoming funds from other jurisdictions, UBS is keen to see as much international alignment as possible to maximise international capital flows directed at financing the transition. One way to achieve this could be by adopting a category aimed at sustainability improvers (see our answer to Q11).

<ESMA\_QUESTION\_FUNA\_0>

1. : Do you agree with the need to introduce quantitative thresholds to assess funds’ names?

<ESMA\_QUESTION\_FUNA\_1>

UBS **supports** **minimum standards** for funds that – prominently though their names - hold themselves out as ESG or sustainable funds. Over time, this will bolster the industry’s reputation for **robust** ESG/sustainable funds, increasing investors’ trust and facilitate the EU meeting its sustainability goals.

However, when designing such thresholds - indeed the EU sustainable finance regime generally - the guiding principle should be that the approach chosen should be *in line with investors’ expectations*. It should also be simple and transparent to understand and not add additional complexity to the EU’s (already complex) sustainable finance regime.

Investors’ expectations from fund names stem from common-sense, namely that a majority of the fund’s investments will reflect the name. Existing EU Member State standards are testament to this. For example, in Germany, the BaFin requires an equity or bond fund to be invested as to 50% or more in equities or bonds respectively. However, at the moment, applying such an expected approach to sustainable funds may be challenging due to a lack of data from companies as to how sustainable they are.

Even more fundamentally, the Guidelines cannot meet an objective standard because there is no EU definition of what constitutes a ‘sustainable investment’ or an ‘environmental or social characteristic’. Instead, firms calibrate their own individual approaches. Imposing quantitative requirements by reference to flexible definitions is only an illusion of minimum standards. Accordingly, we are supportive of introducing clear definitions into the EU sustainability regime, especially as to what constitutes a ‘sustainable investment’.

In this context, **we believe there is merit in ESMA delaying these Guidelines until**: i) more companies have started reporting ESG and SI data under CSRD; and 2) clear definitions, especially as to what constitutes a ‘sustainable investment’, have been adopted under the EU sustainability regime. **At this point, a simple easily understood minimum standard in line with investors’ expectations can be introduced.**

If ESMA decides, nonetheless, to adopt these Guidelines without delay, we set out how in the meantime the thresholds might be calibrated given current data availability and lack of definitions but stress the approach falls short of meeting investors’ expectations or being simple to understand.

<ESMA\_QUESTION\_FUNA\_1>

1. : 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>

A universal 80% threshold for the E/S characteristics **is too high**. To take into account different asset classes’ ESG data availability a goal of: i) **70%** is appropriate for **passive, active equity, multi-asset, real estate and private market funds**; and ii) **50%** is appropriate for **fixed income (FI) funds**.

<ESMA\_QUESTION\_FUNA\_2>

1. : 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>

The proposed 50% SI threshold is **extremely difficult to attain** – a very low number of investments currently meet the definition. To illustrate this, only approximately 22% of the constituents of the MSCI’s ACWI Climate Paris-Aligned Benchmark are sustainable investments under SFDR according to the methodology that MSCI has adopted to ascertain this.

In terms of global compatibility, other jurisdictions’ regimes such as the proposed *SEC ESG Names Rule* and the *UK FCA’s Sustainable Disclosure Regime (SDR)* thresholds operate by reference to characteristics similar to the EU’s E/S characteristics and *not* sustainable investments.

**ESMA should consider adopting only the E/S threshold for both ESG and sustainable name terms** (not least because, in practice, few investors will make a distinction between these terms). We would also like ESMA to confirm that the terms ‘environmental or social characteristics’ and ‘sustainable investments’ have the same meaning as under SFDR.

<ESMA\_QUESTION\_FUNA\_3>

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

<ESMA\_QUESTION\_FUNA\_4>

Sustainability is **not static**. ESG data (especially with the forthcoming adoption of CSRD in the EU) and **companies’ sustainability** will increase over time and, as such, we would propose adopting thresholds which increase over time. We would prefer that ESMA only adopts the E/S threshold but, if ESMA decides to adopt the sustainable investments threshold as well, then the same principle of increasing the threshold over time should apply. As such, we would propose:

|  |  |  |  |
| --- | --- | --- | --- |
| **Phase** | **E/S %** | | **Sustainable %** |
| Active Equity, Passive, Multi-Assets & Real Estate and Private Markets | Fixed Income |
| 1 – Now | 60 | 40 | 20 |
| 2 – 2026 | 65 | 45 | 27 |
| 3 – 2028 | 70 | 50 | 35 |

Adopting such an approach would allow funds to gradually increase their standards in line with market developments and reduce sudden and significant changes to fund ranges which will not be beneficial to investors. Another point to consider is that many companies are currently in the beginning phase of transitioning. Accordingly, slowly increasing these targets over time will fit in with this transition. Please see Q11 where we detail the need for a category for transitioning investments.

<ESMA\_QUESTION\_FUNA\_4>

1. : 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>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_FUNA\_5>

1. : 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>

Applying Paris-aligned benchmark (PAB) exclusions to all funds that have ESG or sustainability name terms is **too stringent**. It will reduce the investible universe to the detriment of funds being able to meet the E/S and sustainable investments thresholds as well as to financial returns.

Instead, we would suggest adopting the EU **Climate** **Transition Benchmark** exclusions set out in Article 12(1), points (a) (controversial weapons), (b) (tobacco) and (c) (UN OECD Guidelines) of the EU Benchmark Delegated Regulation. In particular, this should apply for: i) funds using **ESG terms** in their names; and ii) funds using the terms **impact or transition** in their names. By definition, impact or transition funds will – intentionally - include investments that, currently, will not meet the PAB fossil fuel exclusions or may not meet the ‘do no significant harm requirements’ of the Taxonomy Regulation’s environmental objectives.

<ESMA\_QUESTION\_FUNA\_6>

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

<ESMA\_QUESTION\_FUNA\_7>

Currently, there is very little guidance in the EU sustainability regime (or, indeed, other SI regulations/industry standards) as to how derivatives should be considered. We see merit in ESMA introducing guidance as to how derivativesshould be taken into account but for the purposes of the EU sustainability regime overall and not solely for these Guidelines. Whatever is adopted should be applied in the same way under SFDR and the broader EU sustainability regime for a consistent approach.

In addition, we believe it would be more appropriate for ESMA to survey existing market practice and industry guidance[[1]](#footnote-2) and consult widely on a properly considered approach rather than asking for piecemeal suggestions from individual firms for a narrow purpose under this consultation.

<ESMA\_QUESTION\_FUNA\_7>

1. 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>

See para. 8 above.

<ESMA\_QUESTION\_FUNA\_1>

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

<ESMA\_QUESTION\_FUNA\_2>

See para. 8 above.

<ESMA\_QUESTION\_FUNA\_2>

1. : 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>

Asset managers do not design indices or chose their names. This responsibility lies with the index provider. Accordingly, responsibility should lie with the index provider to ensure that the Guidelines requirements are met when constructing its indices. This requires enhancing the regulatory requirements that index providers are subject to so that they are the same as asset managers in this regard. Specifically, index providers should be required to construct indices that have ESG or sustainable terms in their names so that they meet the quantitative thresholds under the Guidelines. This should be by reference to the index provider’s own methodology for E/S characteristics and sustainable investments so that there is a standardised approach to any one index in the market.

In particular, requiring asset managers to impose the Guidelines on existing **index tracking products** would be *very difficult* indeed.Firstly, all firms have different definitions of E/S characteristics and sustainable investments, so there would be no consistent approach to the same index. Secondly, all index providers do not currently provide data on, and their methodology to calculate, the percentage of investments meeting E/S characteristics or the percentage of sustainable investments.

<ESMA\_QUESTION\_FUNA\_8>

1. : 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>

Further guidance on this topic is desirable but please see para. 8 above as to how ESMA should approach the use of derivatives under the EU sustainability regime in a more holistic fashion.

<ESMA\_QUESTION\_FUNA\_9>

1. : Do you agree of having specific provisions for “impact” or impact-related names in these Guidelines?

<ESMA\_QUESTION\_FUNA\_10>

We support specific provisions for funds using “impact” or impact-related names in the context of the proposed Guidelines. The following approach would work:.

* E/S Threshold: This is the only appropriate threshold. Imposing the SI threshold may be contrary to what impact funds seek to achieve. **Only the E/S threshold should be applied**.
* Industry Standards: In addition, we would recommend compliance with relevant industry standards, and believe there should be further discussions to reach consensus on widely agreed definitions.

We note that impact funds should be able to demonstrate ‘additionality’ through **different channels**, including through stewardship and engagement.

<ESMA\_QUESTION\_FUNA\_10>

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

<ESMA\_QUESTION\_FUNA\_11>

The EU sustainable finance regime lacks a clearly defined category for **sustainability improvers**. Addressing this would be very beneficial given the very significant transformative sustainability improvements such investments can deliver. It would also better align the EU regime with the UK FCA’s proposed SDR ‘Improvers’ label. We propose the following:

* E/S Threshold: **Only the E/S threshold should apply**. It defeats the object to apply a sustainable investments threshold to transition funds.
* Demonstrating Improvements: A key aspect to transition funds is the role that stewardship and engagement play to increase investee companies’ commitments to environmental and social outcomes. Such strategies take time to come to fruition. ESMA should acknowledge this and, accordingly, the **minimum time period** for **demonstrating improvements** of transition funds should be **3 years** (and longer at the discretion of the investment manager).

It is important to distinguish a transition fund from an impact fund hence why we recommend additional requirements for impact funds as set out in para. 5 above.

<ESMA\_QUESTION\_FUNA\_11>

1. : 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>

The Guidelines will primarily benefit funds, especially those marketed to retail investors. In terms of other products:

* Segregated Accounts: There would be less benefit to segregated accounts provided to professional or high-net worth investors because they tend to be negotiated bi-laterally so the investor specifies (and understands) the level of sustainability. In addition, portfolio management services provided to retail clients on the basis of segregated mandates are often composed of assets in funds that are already in scope of the ESMA Guidelines. **In our view, this is sufficient for the time being**. Should ESMA consider applying similar guidelines for segregated mandates, then we recommend using the same phase-in approach proposed for the funds in scope of this consultation (cf. Q4).
* Insurance Products: To achieve high standards across the financial services industry and a ‘level playing field’, theGuidelines should also be applied to **insurance investment products**, especially those that are distributed to retail investors.

<ESMA\_QUESTION\_FUNA\_12>

1. : 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>

We understand that the draft Guidelines would become applicable from three months after their publication on ESMA’s website (potentially Q3/Q4 2023) with a six month transition period for existing funds, meaning that the rules would be applicable to existing funds by mid-2024.

Firms will have to undertake an extensive process comparing their existing products against ESMA’s Guidelines, determining whether and how to change the fund’s name and/or investment process and then go through necessary fund governance processes to effect any changes. Given this, we are concerned that the proposed timeline would not be sufficient to address the above considerations. **A 12-month transition period for existing funds is more achievable.**

<ESMA\_QUESTION\_FUNA\_13>

1. : 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. It would be wholly inappropriate to apply the Guidelines to funds which have already finished their subscription period because the name is no longer being used as a marketing tool. If the Guidelines were applied to such funds, this would potentially require realigning the fund’s investments to the detriment of existing investors; or changing the fund’s name which would be unwarranted. Furthermore, closed ended funds tend to be marketed to professional investors so the potential for harm or misunderstanding due to the fund’s name is significantly reduced.

<ESMA\_QUESTION\_FUNA\_14>

1. : What is the anticipated impact from the introduction of the proposed Guidelines?

<ESMA\_QUESTION\_FUNA\_15>

We anticipate:

* Increased Differentiation: Between investment managers’ **ESG/sustainable funds** (which include such terms in their names and are marketed as such) and their more ‘**traditional’ funds** which may employ ESG integration or less pervasive E/S characteristics.
* Numbers: It is likely that the number of ESG/sustainable funds may reduce.
* Transition Funds: If ESMA adopt appropriate guidelines to address transition funds, this may promote the transition fund category which will be beneficial.
* Impact Funds**:** Specific provisions and expectations for impact-labelled funds would foster investors’ understanding of which how such impact funds work and what they seek to achieve.

<ESMA\_QUESTION\_FUNA\_15>

1. : 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>

The EU sustainable finance regime is subject to constant flux. It has, and continues to be, very expensive and resource intensive to implement. These Guidelines will be no different and will require firms to re-examine their entire product range, reposition it where appropriate, make changes to investment and related systems and processes and update documentation. It will require **significant firm-wide cost and resources over a 12-month period**. Accordingly, it is incumbent on ESMA to ensure that it calibrates the regime in such a way that significant benefits accrue from the cost outlay. This will require recalibrating the thresholds so that standards are raised but a viable ESG/sustainable fund product range is still achievable.

<ESMA\_QUESTION\_FUNA\_16>

1. We note that MSCI’s *Methodology on Derivatives* is expected in March 2023. [↑](#footnote-ref-2)