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

European Securities and Markets Authority

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 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 under the headings 'Legal notice' and 'Data protection'.

General information about respondent

Name of the company / organisation	Schroders Investment Management (Europe) SA
Activity	Investment Services
Are you representing an association?	☐
Country/Region	Luxembourg

Introduction

Please make your introductory comments below, if any:

<ESMA_QUESTION_FUNA_0>

Given the sharp increase in ESG and sustainability related funds in recent years, Schroders supports ESMA's objective to address potential greenwashing risks by supporting a system which promotes clarity and transparency of fund names. We want to point out that fund names, such as any other promoted feature of an investment product, are already subject to the "fair, clear and not misleading" principle. We agree that products disclosing under Article 6 SFDR should not have ESG or sustainability related terms in their name, while Article 8 products need to ensure that their name is consistent with the sustainability features of their investment process and promoted outcomes. Article 9 products that have a sustainable objective should be able to use any ESG or sustainability related terms in their name, as they are deemed to only invest in sustainable assets.

End investors' appetite for sustainability features can be very different, and the spectrum of investment offering intends to meet these various expected outcomes. Sustainability is more of a continuum than a black and white positioning. We believe that there is a place for investment strategies that support the transition of the economy to more sustainable outcomes, both on the environmental and social aspects, alongside strategies that invest in "best in class" or advanced contributors to sustainable objectives.
As an asset manager providing services cross-border, we see that national regulators have already applied different regimes within the EU, notably regarding fund names. As an example, in France the AMF position 2020-03 explicitly requires products that refer to non-financial criteria in their name to meet the requirements of the "significantly engaging approach"[1].

This fragmentation means that retail clients within the EU are faced with multiple approaches to what is considered to be sustainable or ESG. We believe that harmonisation is needed to ensure that end investors benefit from the same framework across the EU and indeed globally. And also that global asset managers such as us can, to the extent possible, converge with other local and regional regulatory requirements, such as in the UK, Singapore, Australia and elsewhere without the proposed new ESMA requirements limiting or impeding the cross-border distribution of EU funds or the competitiveness of the EU Fund industry.

We agree that SFDR is far from providing clarity to investors, leaving room for improvement. However, we question whether the proposed guidelines can substantially correct the current situation when the basis for calculation of the 50% minimum threshold, namely the definition of sustainable investments (Art. 2(17) SFDR), remains vague and hence every product provider is required to come up with their own interpretation. We are anticipating further Q&As which are expected to provide clarity on the definition of a 'sustainable investment' and this may shift further the "calculation base" for the proposed threshold. Therefore, funds may need to re-assess their names (or portfolios). This is not conducive to promoting trust in the ESG European fund industry.

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[1] These requirements include a non-financial analysis of more than 90% of the portfolio and i) a rating upgrade vs. universe after eliminating 20%+ of the worst securities in the universe or ii) a reduction of the investment universe of at least 20% or iii) another significant approach such as adherence to the Greenfin label criteria. One important point is that the rating upgrade or selectivity has to be calculated to the exclusion of public or quasi public bonds, liquid assets held accessorily and solidarity assets.

Our preferred option would be to allow the market to stabilise and digest recent and upcoming changes regarding the interpretation of SFDR, in particular clarity on the meaning of a 'sustainable investment' before any additional measures such as on fund names are considered. In our view, this wouldn't leave a regulatory gap as the current marketing rules cover the risk of fund name greenwashing. We encourage consequent enforcement of the "fair, clear and not misleading" principle.

If ESMA decides to move ahead, we consider the following issues need to be addressed in the final guidelines:

- It must be clear that **national labels and doctrines are overruled by ESMA's guidelines**, otherwise we continue the risk of having parallel systems with different outcomes, while sustainable funds' investment universes might become too small to properly meet clients' risk and return expectations due to cumulative requirements.

- The same rules must **apply to all financial products** with sustainable features sold to retail clients (i.e. guidelines must apply beyond UCITS and AIFs), otherwise we risk an unlevel playing field in addressing greenwashing.

- The guidelines need to **focus on funds qualifying under Art. 8 SFDR**. We would argue that "impact funds" should only sit under Art. 9 SFDR, and Art. 6 SFDR are not ESG or sustainability related funds and hence should not have ESG related terms in their fund name at all.

- We need to leave room for funds with an investment strategy focusing on **transition**, which per definition includes assets which are not yet "sustainable" but nevertheless are making progress towards more sustainable outcomes.

- The guidelines need to allow Art. 8 funds with **ESG/sustainability strategies based on PAI and taxonomy alignment** to use 'sustainable' or sustainability related terms in their fund names. Otherwise a client can voice sustainability preferences according to MiFID and then be offered a fund which is not permitted to use "sustainable" or sustainability related terms in the fund name. This would certainly confuse consumers.

- Both regulators and industry need **more time to implement** the final guidelines. Based on the required process, we would strongly advocate for an implementation period of 12 months.

<ESMA_QUESTION_FUNA_0>

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

<ESMA_QUESTION_FUNA_1>
The need to introduce quantitative thresholds depends on what objective regulators would like to achieve. Our understanding is that the main drivers for the proposed approach is (i) investor protection, and (ii) harmonisation across the EU.

While in principle we believe it makes sense to refer to quantitative thresholds for the second purpose, achieving the desired harmonisation effect will depend heavily on how sustainable investments are defined and whether existing national regimes will be overruled by ESMA's guidelines. At the moment, Art. 2(17) allows for flexibility in implementation. While there are downsides to a lack of granular prescription when defining sustainable investments, the advantage is that flexibility supports innovation as the breadth of what can reasonably be defined as a sustainable investment evolves to meet consumers changing needs and facilitate a net zero transition. Similar to the discussions around ESG ratings, we don't see differences in approaches as problematic per se, as long as there is transparency around the approach and methodology applied. So while we support some room for interpretation, in our view applying a quantitative threshold when there are different interpretations as to what is a sustainable investment may limit harmonisation across the market.

As far as the first objective (investor protection) is concerned, achieving the aim will depend on the consumer's understanding of the basis for calculating the thresholds. This is not an easy task given its rather technical and sophisticated nature (due to definitions, etc).

We believe that a comprehensive approach is necessary for ESG/sustainability related products hence assessment shouldn't stop once a quantitative threshold is met. This should, of course, also ensure that the fund name is in line with the investment strategy. Fund managers should be able to explain how ESG factors are considered in the investment process, even where they are not named "sustainable" including to describe integration of sustainability characteristics.

Given the various interpretations and definitions of sustainable investments and investments used to meet environmental or social characteristics, any quantitative threshold is, ultimately, arbitrary and there is a risk investor confidence could be undermined.
<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>
As described above we have some concerns around introducing quantitative thresholds. However, if such an approach is pursued, we believe that the required proportion must be significant/the majority.

In this context it is important to be flexible towards different asset classes such as multi-asset funds and geographies where data availability is limited, e.g. small caps, sovereigns, and emerging markets. Otherwise funds that have high allocation to these (not in the least for risk diversification purposes) may struggle to meet the threshold. Cash exposures are also important for any strategy investing partially or fully in private markets, due to the ramp up period necessary to fully invest the portfolio. Without such flexibility, the guidelines would effectively work for equity products only, thus significantly limiting the sustainable investment universe.

We believe that the proposed thresholds should not apply to impact funds (which, naturally, turn to "impact-related words" in their fund name): our view is that such funds fall under Art. 9 SFDR and hence the 100% SI investment threshold applies already.

Last but not least, the scope of what could be categorised as "ESG related words" is subjective and can be related to cultural perceptions. We also note that many fund consumers view the terms "ESG" and

“sustainable” almost interchangeably. This could lead to different interpretations between asset managers as well as end investors creating confusion and undermining investor confidence. The guidelines provide some examples linking one word with another to make it ESG related, when the word on its own would not necessarily be (e.g. water). We believe this should be drawn out in the guidelines. As an example, the word "transition" can be either used by a product supporting the transition of investee companies to a more sustainable business model (based on engagement and voting) or by a product investing in companies that directly contribute to the transition to net zero. In this example, the first product would disclose under Article 8 while the second would be in Article 9. Otherwise the objective of the guidelines, to ensure harmonisation across the EU, will be difficult to achieve.
<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>
We have some concerns whether the desired effect will be achieved by the proposed thresholds, as highlighted under Q1 and Q2, particularly as further clarity is expected on the definition of a sustainable investment (SI).

Referring solely to SI for Art. 8 funds would ignore the fact that MiFID allows three alternative venues for “sustainability preferences”: SI, PAI and taxonomy alignment. Using SI as the only valid benchmark for ”sustainable” or sustainability related terms in a fund name would mean that investors who articulate sustainability preferences based on PAI or taxonomy alignment (though the latter will probably also qualify as SI, so the issue is mainly around PAI) could be offered a fund based on a PAI strategy only with potentially no reference to "sustainable” or sustainability, since it won’t comply with the guidelines’ 50% SI threshold. We believe that such an outcome is confusing to investors and won’t foster trust in the sustainable investment market.

Additionally, we don’t believe it makes sense to differentiate between “ESG or impact related words” on the one hand and “sustainable” and “sustainability related terms” on the other hand: most retail investors don’t differentiate between these. Based on our experience, most people actually might presume that “ESG related words” represent at least as high a bar as the former. In our view, the challenge is in regards to the subjective nature of such terms. The key to avoid misleading fund names is that the product name is adequate to the product’s stated investment process and strategy.

The proposed approach is also problematic as far as funds investing in the transition of the economy/companies are concerned: per the definition, such assets cannot (yet) qualify as “sustainable investments”. Yet it is clear that, to achieve one of the most important objectives of the sustainable investment agenda, namely to meet the Paris Agreement targets, investment in companies and economies which are not yet green but demonstrate progress towards a more sustainable business model is key. Preventing such funds from using "sustainable” or sustainability related terms would put them at a significant disadvantage vis à vis other funds and prevent them from being clear as to their objective.
<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>
An alternative would be to focus on the overall portfolio outcomes rather than individual holdings.
In this context, we see benefits in the approach recently taken by the FCA in CP22/20 as regards the “sustainable focus” and “improver” categories. Taking a similar approach would recognise the role that stewardship and transition investment have for the sustainability agenda. In comparison, the proposed ap-

proach based on a proportion of SI would exclude such strategies from using "sustainable" or sustainability related terms and hence mean a significant disadvantage for them, potentially also preventing them from describing themselves clearly.
<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>
See our response to Q4.

As outlined in our general remarks, we take the view that the current marketing rules cover the risk of fund name greenwashing sufficiently and we would encourage thorough enforcement of the "fair, clear and not misleading" principle.
<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>
We note that the referenced criteria focus on climate measures specifically, which is not an ideal outcome for non-climate strategies. Defining similar criteria in other areas is much more challenging and is likely to prove limiting in terms of managers' abilities to continue to innovate in developing the thoughtful strategies that both clients value and which will be most important in driving change.

It's also difficult to understand why it is appropriate to just rely on the concept of "significant harm" as applicable to Paris aligned benchmarks. Also, applying such exclusion criteria to all Article 8 funds fails to consider their investment approach (such as supporting the transition).

Instead, we strongly believe that emphasis should be put on governance, ensuring firms have a robust approach when naming a product as sustainable. In this context, the qualifying criteria proposed by the FCA in CP22/20 (SDR) could be helpful.

In any case, we strongly believe that such minimum safeguards would effectively goldplate/change SFDR and should therefore remain a decision of the co-legislators.
<ESMA_QUESTION_FUNA_6>

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

<ESMA_QUESTION_FUNA_7>
We would like to refer to ISDA's response and share the view that it is too early to make an informed and definite decision on the treatment of derivatives.
<ESMA_QUESTION_FUNA_7>

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

<ESMA_QUESTION_FUNA_1>

We would like to refer to ISDA's response and share the view that it is too early to make an informed and definite decision on the treatment of derivatives.
<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>
We would like to refer to ISDA's response and share the view that it is too early to make an informed and definite decision on the treatment of derivatives.
<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>
At a first glance, index funds should also fall under the scope of the guidelines to ensure a level playing field. However, we acknowledge that if the underlying benchmark already fulfils the criteria of the guidelines (i.e. matches the thresholds) it doesn't make sense to duplicate the assessment at fund level. Naturally, investors would expect that if a fund is replicating an ESG benchmark, it would be an ESG fund.

More importantly though, there are legal impediments for an index fund to have a different name than the underlying benchmark. This needs to be resolved before any decision regarding the guidelines are taken. We encourage ESMA to look into this issue closely.
<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>
No.
<ESMA_QUESTION_FUNA_9>

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

<ESMA_QUESTION_FUNA_10>
We believe that products having "impact" in their name must have a sustainable investment objective and therefore should be in the Article 9 category. Impact investing needs to adhere to the principle of investing into companies and organizations with the intent to contribute to measurable positive social or environmental impact alongside financial returns, using agreed frameworks such as the Operating Principles for Impact Management.

The logical consequence is that for these funds the Art. 9 threshold of 100% SI applies and the proposed guidelines thresholds are superfluous for such funds.
<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. First of all, it needs to be stressed that the word "transition" can be either used by a product supporting the transition of investee companies to a more sustainable business model (based on engagement

and voting) or by a product investing in companies that directly contribute to the transition of the global economy – for example to net zero.

Per definition, assets of the first category cannot (yet) qualify as “sustainable investments”. Yet it is clear that, to achieve one of the most important objectives of the sustainable investment agenda, investment in companies and economies which are not yet running a sustainable business approach is key. It should be noted that the word “transition” has climate connotations. However, we strongly believe that the intention should be to capture a broader economy wide shift to a more sustainable footing – including for example on social and governance issues. In this context, the concept of an “improver” category akin to the one outlined in the FCA’s CP 22/20 could be useful. One important metric for transition assets is to have clear transition targets against which progress is monitored and clear consequences if they fall short of those targets.

Excluding such funds from using sustainable or sustainability related terms would put them at a significant disadvantage vis à vis other funds.
<ESMA_QUESTION_FUNA_11>

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

<ESMA_QUESTION_FUNA_12>
Yes, we strongly believe that a level playing field between UCITS and AIFs on the one hand and other financial products sold to retail investors, such as unit-linked or pension funds products, must be achieved. We understand that one of the objectives of the guidelines is investor protection. Similar criteria must apply across financial products in order that consumers can expect similar standards whatever product they buy. We suggest the ESAs should be working towards a common regulatory understanding on marketing rules.
<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>
While we definitely agree that there must be a transitional period, we believe that 6 months is too short, and strongly urge ESMA to implement at least a 12 month transitional period. We would refer to EFAMA’s response which explains very well the different steps and usual timelines for approving a fund name. We include the following steps usually undertaken for a fund name change, alongside the anticipated timeframes:

- Product committee paper and approval: **1 month**
- Fund Board committee paper and approval: 1 month, frequency of meeting is every quarter, so this can take up to **4 months**
- Prospectus and shareholder notice drafting: **1 month**
- Regulatory submission through to regulatory approval: **2 months**
- Shareholder notice typesetting, translation and distributor requirements: **1 month**
- Shareholder notice: **1 month**

Prior to the above steps, we would need to understand and educate internally on the guidelines, and then review the in-scope products against these guidelines in conjunction with the relevant departments including Legal, Compliance, Product, Investments, Client Group. This work is expected to take at least **1 month.**

The total estimated timeframe to perform all the above steps is at least **12 months.**

In the case of the guidelines, we would like to stress that it would require a screening of all funds currently falling under Art. 8 (and 9) SFDR. Only then the process outlined by ESMA would start, namely to decide whether to change the name of the fund or its portfolio (with subsequent procedural steps).

Even in "normal" circumstances, such an implementation process is challenging and time consuming. However, we would like to stress that all firms implementing the guidelines will have to face substantial additional implementation tasks: We expect the upcoming Q&As by the European Commission, in particular the clarification of a sustainable investment to have a significant impact on existing Art. 8 and 9 products. It will require time to work through them. In parallel, we will be asked to review SFDR pre-contractual disclosure templates and to include the latest taxonomy additions. It goes without saying that the NCAs will be faced with the same challenge. It is hard to imagine how 6 months can suffice for such a major task.
<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>
We understand that investor protection concerns are one of the main drivers for ESMA to propose the guidelines. In our view closed-ended funds without any new subscriptions do not pose a risk as they are no longer available for subscription. We therefore believe that the guidelines shouldn't apply in those cases.
<ESMA_QUESTION_FUNA_14>

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

<ESMA_QUESTION_FUNA_15>
As described in Q13, the anticipated impact would be an in-depth review of the proposed guidelines across our Article 8 and potentially also Article 9 funds. And then assessing the next steps which may involve a confirmation that the current parameters are sufficient, or amendments to fund names and/or the sustainable investment process. The appropriate governance steps would need to be followed, including presentation to our product committee, the relevant fund boards, the regulator, and potentially also the shareholders. All SFDR material would need to be updated, including pre-contractual, website disclosures and any other marketing material.
<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>
It is difficult to estimate the costs for the proposed guidelines. Implementation would involve a number of business resources over a period of several months, so we would consider the guidelines to create significant costs.
<ESMA_QUESTION_FUNA_16>

Q17