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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

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| --- | --- |
| Name of the company / organisation | Invest Europe |
| Activity | Investment Services |
| Are you representing an association? |  |
| Country/Region | Belgium |

# Introduction

Please make your introductory comments below, if any:

<ESMA\_QUESTION\_FUNA\_0>

Dear ESMA,

We write in response to the consultation paper published by ESMA on the proposed introduction of [Guidelines on funds’ names using ESG or sustainability-related terms](https://www.esma.europa.eu/sites/default/files/library/esma34-472-373_guidelines_on_funds_names.pdf) (the Consultation Paper).

Invest Europe represents the European private equity, venture capital and infrastructure investment industry, a sector which has been significantly impacted by the introduction of sustainable finance legislation (and in particular the EU Sustainable Finance Disclosure Regulation (SFDR) and EU Taxonomy Regulation (TR)).

We set out our thoughts on ESMA’s proposals below. Whilst we have answered many of ESMA’s questions, we wish to set out our perspective in narrative format first. We would be delighted to meet with you to discuss any of the points raised in our response.

Executive summary

* We welcome ESMA’s efforts in promoting transparency and tackling the risk of greenwashing and support the work done to promote supervisory convergence in the assessment by NCAs of the use of ESG or sustainability-related terms in funds’ names.
* We believe that the introduction of these guidelines amounts to rulemaking which is not within the powers of ESMA. It is clear that Article 16(1) of the ESMA Regulation (Regulation (EU) 1095/2010) empowers ESMA to issue interpretive guidance with the view to establishing consistent, efficient and effective supervisory practices. However, it does not grant ESMA the power to create what are effectively substantive rules relating to portfolio composition, which overlap (or sometimes conflict) directly with other laws like the SFDR.
* We understand that the European Commission has announced its intention to review the implementation of the SFDR by the end of its current mandate (Q2 2024) with a particular focus on the SFDR’s use as a de facto labelling tool by the market. We urge ESMA to wait for the outcome of the European Commission’s review (or at least for the publication of the European Commission’s proposals) to ensure that ESMA’s proposals are consistent with any proposed revisions to the SFDR to ensure that market participants do not have to contend with multiple potentially divergent and overlapping regimes.
* However, should ESMA nonetheless introduce the proposed guidelines we believe that the guidelines should:
  + 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 understand, based on comments made by ESMA officials at the Open Hearing on 23 January, that ESMA is particularly concerned about greenwashing risks in a retail context and so limiting the scope of the guidelines to funds which are open to such investors is both appropriate and proportionate;
  + include an express grandfathering provision exempting closed-ended funds which have had their first close, or as a less optimal solution those which are fully closed, by the application of the guidelines from the scope of the guidelines. ESMA officials appeared to indicate, in the Q&A section of the Open Hearing held on 23 January, that ESMA would be supportive of an exemption for closed-ended funds which are fully closed prior to the application of the guidelines;
  + introduce a predictable timetable for the application of the proposed transitional provisions to closed-ended funds and open-ended funds made available to EU retail investors which remain open to subscription by such investors as at the date the guidelines apply. We suggest that the relevant date should be fixed well in advance, for example, 30 June 2024, in order to give market participants time to prepare for the legal and regulatory steps necessary to conform to the guidelines.

Whilst our suggested amendments to the guidelines do not allay our substantial concerns about ESMA’s power to introduce the guidelines in the first instance, the above amendments would, in our view, go some way to mitigating otherwise acute concerns about the legality of the guidelines, in the context of doubts about ESMA’s powers to make de facto rules concerning portfolio composition.

* We propose some changes to the guidelines to make them work appropriately for blind pool funds and to clarify certain statements made in the guidelines.
* We believe that the minimum safeguards should be dropped entirely from the proposed guidelines. Again, we reiterate that the introduction of such minimum safeguards amounts to rulemaking which is not within the powers of ESMA and goes beyond the legal requirements of the level one SFDR text. Should ESMA nonetheless seek to introduce minimum safeguards, such safeguards should not be overly burdensome. As currently drafted, the proposed exclusions make little sense outside of the EU Climate Benchmarks.
* The suggested fund names rules will have unintended consequences by not leaving room for contextualization. In addition, we are not certain that they accurately address the greenwashing concerns that ESMA is seeking to resolve through the introduction of these guidelines as further discussed below, in the context of retail investors specifically when the investor base of private equity and venture capital (PE/VC) funds mainly consists of institutional investors.

Support for enhanced clarity

Our members support the prioritised efforts made by ESMA to promote transparency and tackle the risk of greenwashing as identified in the ESMA Strategy and Sustainable Finance Roadmap. In particular, we support the principles-based guidance in ESMA’s Supervisory Briefing of 31 May 2022. We also support ESMA’s policy intent to enhance supervisory convergence and harmonise the approaches taken currently in certain Member States under national rules.

We are acutely focussed on the climate emergency and the urgent need to address many other pressing environmental and social concerns, and we are supportive of urgent initiatives to channel capital towards sustainable investments. We are aware that there is increasing investor demand for products which either (a) “promote” E/S characteristics or (b) have a “sustainable investment objective” (as those terms are defined in the SFDR) on the one hand and the need to guard against the risk of “greenwashing” by products on the other. Against this background, we understand the importance and need for ESMA to act but it is important that any rules which are introduced (e.g., on fund names) provide predictability, certainty and are drafted in a manner which dovetails with the existing SFDR and EU Taxonomy Regulation (“TR”) requirements. In that context, we strongly welcome Commissioner McGuinness’s recent announcement of a review of the SFDR, with a focus on certainty and usability. We note that the SFDR was not designed to act as a labelling regime but instead as a disclosure regime. This has been confirmed many times by the European Commission and ESMA. While there may be a need to create labels for retail funds in the future, we see a risk that the proposed guidelines could lead to the creation of a labelling regime “via the backdoor”.

Private equity and venture capital firms have dedicated significant time, resources and investment to understand and operationalise the existing SFDR and TR rules. Significant ongoing uncertainty remains about key aspects of those Regulations including for example the definition of “sustainable investment” (as defined in Article 2(17) SFDR), or the meaning of a “promoted environmental or social characteristic”. Should ESMA intend to introduce the guidelines irrespective of the European Commission’s review of the level one text of SFDR – this was mentioned during the Open Hearing on 23 January - we urge ESMA to be mindful of the evolving regulatory landscape and the fact that financial market participants are already grappling with significant uncertainty in relation to the application of the SFDR and TR when developing guidelines on the use of ESG-related terms in funds’ names.

Concerns about ESMA’s powers to make the guidelines as proposed

Linked to the above point, and whilst noting that Invest Europe is fully supportive of ESMA’s stated policy objective to ensure that fund names are fair, clear and not misleading, we have to question ESMA’s powers to introduce the guidelines with the content as proposed.

In our view, the proposed requirements go beyond the power granted by Article 16(1) of the ESMA Regulation (Regulation (EU) 1095/2010) to issue guidelines and recommendations with the view to establishing consistent, efficient and effective supervisory practices. Accepting that certain Member States have domestic regulation concerning fund names, we believe that consistency in this context must be a matter of consistency of the implementation of Union laws. It is clear that Article 16(1) empowers ESMA to issue interpretive guidance but not to create what are in practice substantive rules relating to portfolio composition, which overlap (or sometimes conflict) directly with laws in relation to which the Parliament and the Council have recently legislated, and in relation to which the European Commission intends shortly to commence a review. This point is illustrated most clearly by the requirement that 50% [of the 80%] of investments made by a fund which has the word “sustainable” in its name must invest in “sustainable investments” as defined in SFDR Article 2(17). The proposed changes are substantial and do change the nature of SFDR by introducing minimum thresholds which is not the initial idea and ambition of SFDR. The introduction of any such substantial change should go through the same ordinary legislative process as the other parts of the regulation.

However, this question of vires is most problematic in relation to the proposed introduction of “minimum safeguards”, and the absence of proper transitional relief. The combination of *de facto ultra vires* rulemaking and retroactive effect is most concerning from the perspective of the rule of law. Please refer to our drafting suggestions below.

Finally, ESMA states in its consultation that investors “may reasonably expect funds with [green] names to invest in companies with policies, practices, or characteristics that are consistent with ESG standards” (page 6). ESMA’s proposal assumes that its own guidelines are consistent with the ESG standards expected by investors. However, ESMA has designed these proposals in advance of considering evidence submitted by investors in response to the ESAs Call for Evidence on Greenwashing; work which should reveal what ESG standards investors expect green funds to meet. Neither has ESMA undertaken work to understand the market impact of its proposals. ESMA may be seeking to address concerns that investors do not share while risking the growth of the market for green funds in Europe. We note the [Securities and Markets Stakeholders Group’s Advice to ESMA on the ESAs’ Call for Evidence on Greenwashing](https://www.esma.europa.eu/sites/default/files/2023-01/esma22-106-4384_smsg_advice_on_greenwashing.pdf) dated 18 January 2023 “stresses the importance of establishing a framework with intelligible rules and guidelines from the start, in the absence of which it is difficult to come up with usable products” (paragraph 35, page 9). We encourage ESMA to await the outcome of the ESAs work on greenwashing before feeding that work into the Commission’s review of SFDR so that the appropriate time can be taken to develop a coherent set of intelligible rules under SFDR II.

Grandfathering and the Transitional Period

We note that ESMA proposes to introduce a transition period of six months for funds launched prior to the date of application of the proposed guidelines. Based on ESMA’s stated intention, we understand that ESMA plans to publish finalised guidelines in Q3 2023 (and the proposed guidelines would become applicable three months after the date of publication). Under the proposed transitional provision as drafted, funds launched prior to this date which use ESG-related or “sustainability-related” terms in their names are given two options, either to: (a) bring their investments in line with the quantitative thresholds set out in the proposed guidelines; or (b) change their name so that the fund in question no longer has an ESG-related or “sustainability-related” term in its name. Mandating that funds that closed prior to 10 March 2021 (i.e., before the SFDR came into force) be re-named to comply with the guidelines may mean that fund managers could unintentionally, and without the operational systems in place, be viewed as operating an Article 8 fund. Names of such funds may not always be able to describe what the fund actually invests in. Changes to the investment strategy required under (a) above will very likely involve investor consent and consequently impose a significant burden on managers and give rise to uncertainty.

We urge ESMA to reconsider the scope of the proposed transitional rule and to introduce an appropriate grandfathering provision for closed-ended funds which are fully closed with respect to EU retail investors (and therefore no longer promoted) prior to the application of the proposed guidelines.

The application of the proposed guidelines to closed-ended products which have concluded their fundraising period and finalised their pre-contractual disclosures (and therefore investment strategy) would be counterintuitive and contrary to the principle of non-retroactivity. If a fund is closed for the admission of a new investor, the rationale of the protection of the investor in its decision to invest in the financial product does not subsist anymore and therefore the applicability of the rules would have no justification. Helpfully, during the Open Hearing on 23 January, ESMA appeared (in the Q&A section) to acknowledge that funds that are fully closed prior to the application of the guidelines would be out of scope. We would appreciate explicit confirmation of that in any finalised guidelines.

In the absence of grandfathering, as drafted, the logical corollary of the proposed guidelines is that fully closed funds which use ESG-related or “sustainability-related” terms in their name and do not meet the requirements of the proposed guidelines would either have to change their investment strategy (which is the basis upon which investors will have invested in such funds and may not be possible and, if it is possible, may require investor consent and “material change” filings with competent authorities pursuant to AIFMD or other filings), or otherwise change their names (which would be confusing, expensive and may require investor consent (which the fund manager may not be able to obtain)). There would be no policy benefit to requiring this for fully closed funds since those products would no longer be promoted.

Completely similar concerns apply to closed-ended funds which have had their first close but haven’t fully concluded the fundraise process, with the same detrimental outcome to the fund and its investors as described above. Therefore, we urge ESMA to introduce a grandfathering provision exempting closed-ended funds which have had their first close by the application of the guidelines from the scope of the guidelines. The application of the proposed guidelines to funds who are in the process of fundraising (e.g., a fund between second and final close) would raise significant complications (e.g., amending documents, material change filings, etc.). This would be disruptive to the fundraising process (which is usually only a 12 to 18-month period), and so any such delay could be material and greatly impact fundraising.

As drafted, the limited transitional provisions would impose a significant and potentially unworkable burden on managers. This is, of course, separate to the conceptual question of how closed-ended private funds would even be able to re-constitute their portfolios to be compliant with the proposed guidelines within a six-month period without opening themselves to allegations of mis-selling by investors who previously subscribed to the fund on the basis of its stated investment policy. Our members’ funds generally comprise illiquid investments and a sale at short notice will likely be impossible or seriously prejudicial to investors’ interests.

For closed-ended private funds which have not had a first close yet and remain open to new EU retail investors as at the date which the proposed guidelines are effective, we believe that the transitional period is too short. We suggest that the date of application should be fixed well in advance, for example, 30 June 2024. So, instead of proposing a transitional period which ends a set number of months after the date of publication of the final guidelines (where this date itself may change), in the interests of predictability and certainty we suggest that closed-ended funds which remain open to new EU retail investors as at the date of application of the guidelines but are fully closed to new EU investors before 30 June 2024 should also benefit from grandfathering relief.

In respect of open-ended funds, our view is that the proposed transitional period of six months is too short and we would encourage ESMA to consider a longer transitional period of 18 months.

In the light of the above, we have suggested amendments to the transitional (paragraph 7 in the proposed guidelines, Annex III to the Consultation Paper) as set out in strikethrough, bold and italics below:

7. A transitional period of ~~6~~ ***18*** months should apply for those ***open-ended*** funds already existing before the date of the publication of the guidelines on ESMA’s website in all EU official languages. ***For the avoidance of doubt, closed-ended funds which have had their first close for or are fully closed to new EU retail investors before the date of application of the guidelines will not be required to comply with the requirements of these guidelines. Closed-ended funds which are open to new EU retail investors as at the date of application of the guidelines but are fully closed to new EU investors before 30 June 2024 should also benefit from grandfathering relief.***

Application of the proposed guidelines to blind pool funds

Typically, our members raise blind pool funds. A blind pool is a fund with a stated investment policy, but which deploys capital opportunistically over time (typically in illiquid assets), during a multi-year investment phase. Such funds will typically not have made any investments at the time their pre-contractual disclosures are finalised.

This gives rise to several challenges in the application of the guidelines.

First, it appears that the 80% and 50% thresholds are intended to be applied by reference to the value of investments made by the fund from time to time. This will be difficult to predict, and to satisfy, during the multi-year investment (or ramp up) phase, and will be affected unpredictably by periodic valuations of investments. For example, the first investment made by a fund may be inconsistent with the environmental or social characteristics promoted, or (where relevant) the sustainable investment objectives in accordance with the binding elements of the investment strategy, even though all subsequent investments (exceeding 80% measured at the point of full deployment) may be aligned. Second, similarly, the threshold will be difficult to satisfy during the multi-year divestment phase at the end of the life of the fund. Third, we believe that the measurement period to calculate the thresholds for funds which have a ramp-up and wind-down period should be at the end of the investment period (rather than measurement on an ongoing basis). Where a fund does not meet the minimum requirements, we would encourage ESMA to consider a cure period during which the fund may make amendments to the existing portfolio (e.g., dispose of assets that do not meet the environmental or social characteristics).

In the light of the above, we have suggested amendments to the quantitative thresholds (paragraphs 16 and 17 in the proposed guidelines, Annex III to the Consultation Paper) as set out in strikethrough, bold and italics below:

16. 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 ***(or, where relevant, undeployed commitments should remain available)*** to meet the environmental or social characteristics or sustainable investment objectives in accordance with the binding elements of the investment strategy, which are disclosed in Annexes II and III of Commission Delegated Regulation (EU) 2022/1288. ***The 80% threshold should be calculated without reference to cash or short-term investments held for liquidity purposes, or any positions held for hedging purposes.***

17. 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 to “meet the environmental or social characteristics or sustainable investment objectives” under paragraph 16 above~~ at least ~~50%~~***30%*** of ***its investments or the commitments (whichever is practicable)*** ***to*** ~~minimum proportion of~~ sustainable investments as defined by Article 2(17) of SFDR, which is also disclosed in Annexes II and III of Commission Delegated Regulation (EU) 2022/1288.

***NEW - 17a. Where an investment fund has a ramp-up and wind-down period, the proportions referred to in paragraphs 16 and 17 should be measured at the end of that investment period. Where an investment fund holds illiquid assets, the relevant thresholds should be calculated by reference to acquisition cost of such assets.***

Third, managers of such funds will find it difficult if not impossible to predict confidently their compliance with the quantitative thresholds proposed in paragraphs 16 and 17 of the draft proposed guidelines (Annex III to the Consultation Paper) as they will not be able to predict confidently the potential portfolio composition of the fund in order to measure and establish compliance with the proposed quantitative thresholds at the pre-contractual stage. Counterintuitively therefore, for such funds the introduction of quantitative thresholds may disincentivise managers from validly seeking to pursue strategies which “promote” E/S characteristics (or otherwise have a sustainable investment objective) and use an ESG or “sustainability” related term in their name, in order to attract capital to be deployed towards pressing environmental or social need. For this reason, we propose that the thresholds should be lowered somewhat, to say 60%, and 30%, respectively.

Scope limitation

During the Open Hearing on 23 January, ESMA emphasised at various points that the driving force behind the proposed guidelines is a concern about greenwashing in the context of retail investors specifically. Accordingly, the proposed guidelines should be limited in scope to funds which are marketed to retail investors in need of ESMA’s protection. Professional investors (as that term is defined for the purposes of AIFMD, by reference to MiFID), which constitute the main investor base of PE/VC funds, do not generally make investment decisions solely based on the name of a fund, relying instead on more detailed disclosures of a fund’s investment and sustainability strategy (e.g., the mandatory SFDR disclosures). Such investors typically possess the requisite knowledge and sophistication to judge a fund’s investment strategy without relying solely on the fund name.

Many of the newly introduced restrictions on the use of sustainability-related fund names in other jurisdictions are therefore limited to retail investors (for example, in the UK, Japan or Singapore, same as the current AMF doctrine in France and the withdrawn proposal for a retail fund guideline in Germany). In our view, if ESMA’s proposed introduction of additional, more rigid requirements for funds using sustainability-related terms in their names (which go beyond the rules of SFDR) applies to funds which are open to professional investors, this could inadvertently act as an impediment to channelling much needed private capital from such investors to support the sustainable economic and social transition. The proposed introduction of the guidelines could result in firms setting up and marketing funds to professional investors becoming even more cautious when using sustainability-related terms and promoting sustainability-related strategies, as evidenced by the current phenomenon of “greenhushing” or “greenbleaching”. We fear that this may not only limit the appetite to create new fund products to address the most pressing environmental and social concerns but also contribute to the general backlash towards sustainable investing and in so doing slow down the greening of the financial system. We therefore urge ESMA to exclude funds which solely target non-retail investors from the scope of these guidelines.

Ambiguity in scope

As drafted, the proposed guidelines apply to funds which use in their names any terms which are “ESG related”, “impact-related” or “any other term derived from the word sustainable”. Regrettably, the proposed guidelines do not provide a list (exhaustive or otherwise) of terms that ESMA considers to fall within each of these categories.

The examples provided in Annex IV to the Consultation Paper are helpful but limited in their utility as they are largely uncontroversial and self-evident (e.g., Annex IV lists funds with names using terms such as “climate change”, “sustainable water”, “sustainable society”, “biodiversity” and “global impact” as in scope of the proposed guidelines). Annex IV to the Consultation Paper also raises a number of questions: e.g., is “water” on a standalone basis an “ESG related” term or is it only an “ESG related” term when used in conjunction with “sustainable”? Would terms which describe the investment focus of a fund such as “forestry” be caught by the proposed guidelines?

Amongst our members, some manage funds which invest in energy infrastructure (which may include upstream oil and gas or even coal), and which do so merely in order to maximise risk-adjusted returns for investors by incorporating sustainability risk considerations (as all funds must do pursuant to Article 6 SFDR and AIFMD) without any intention to promote environmental or social characteristics within the meaning of Article 8 SFDR. It would be helpful to get clear regulatory confirmation that references to the term “energy” do not mean it will be in scope because this is a sector and not an ESG-related initiative.

We urge ESMA to publish further guidance on the terms which it considers to be “ESG related” or “impact related” or otherwise “derived from the word sustainable”. Ideally, this would take the form of a “safe-harbour” list of words which, on their own, are not considered to be ESG-related, and a list of words which are. This would assist our members greatly and provide a greater degree of certainty and clarity. For the “safe-harbour” list, it will be important to exclude specific ESG-related terms which coincidentally constitute the name of the fund manager. For instance, if a fund manager has the word “green” in its name, that should not mean that 80% of its funds’ investments should be “green”.

In this regard, we note that the UK Financial Conduct Authority (FCA) recently published a non-exhaustive list of terms which would be proscribed under its proposed sustainability disclosure and investment labelling requirements (see e.g. proposed rule ESG 3.3.2R(2) in [CP 22-20](https://www.fca.org.uk/publication/consultation/cp22-20.pdf)). We understand that respondents to that consultation are likely to call on the FCA for similar guidance. We understand from comments made by ESMA officials at the Open Hearing, that ESMA may be reluctant to disclose a “safe-harbour” list of terms for fear that such a list could be circumvented but we believe that the need for clarity, predictability and certainty outweighs the risk of deliberate circumvention.

Finally, we note that – amongst our members – certain fund managers have names which may be construed as being “ESG related”, “impact related” or otherwise “derived” from the word sustainable. We would urge ESMA to clarify that such names should not come within the scope of the rules.

Minimum Recommended Safeguards

One area of particular concern for our members are ESMA’s proposals for the introduction of “minimum safeguards” as set out in paragraph 18 of the proposed guidelines. ESMA defines the proposed “minimum safeguards” with reference to the exclusion criteria set out in Articles 12(1)-(2) of the EU Benchmark Delegated Regulation (EU 2020/1818). These exclusions would apply to all the investments made by funds, including those which are not used to meet the environmental or social characteristics or objectives of the fund.

The minimum safeguards actually go beyond the minimum safeguards articulated in the SFDR. It is not clear why there should be an additional requirement for Article 8 funds in respect of minimum safeguards purely on the basis that they have used an ESG-related term in the title of the fund. We strongly believe that this element of ESMA’s proposals should be dropped entirely.

In essence, the introduction of these “minimum safeguards” amounts to the introduction of an additional layer of rules applicable to a particular category of funds (i.e., those which use “ESG related”, “impact related” or terms “derived” from sustainability in their names). Neither the TR nor the SFDR level one or level two texts contemplate the introduction of such “minimum safeguards” for funds which either “promote” E/S characteristics (Article 8 SFDR products) or which have a “sustainable investment” objective (Article 9 SFDR products). Under the SFDR RTS this is a mere disclosure requirement for Article 8 funds in that the question is asked what minimum safeguards are applied to the “other” investments (i.e., those not contributing to the attainment of the E/S characteristics promoted by the fund). Therefore, we strongly urge ESMA to reconsider the introduction of such “minimum safeguards” and to delete this aspect of the guidelines.

Should ESMA believe that such minimum safeguards are required to ensure comparability and to avoid the perceived threat of “greenwashing”, then our preference would be for any such “minimum” standards to be introduced via a change to SFDR itself, pursuant to the ongoing review by the European Commission.

Furthermore, we would like to highlight a number of specific concerns on the use of the EU Benchmark Delegated Regulation as the basis of ESMA’s proposed “minimum safeguards”.

* Firstly, it is important to note that the EU Benchmark Delegated Regulation’s exclusion criteria are designed for a particular and limited purpose, which is to ensure, for the purposes of an EU Climate Benchmark, that the listed companies included in such a benchmark do not cause significant harm. The EU Climate Benchmarks have been designed to be used by a specific category of sustainable products, for example in the context of funds with a reduction in carbon emissions as their sustainable investment objective (Article 9(3) SFDR). Introducing them as minimum safeguards for an Article 8 SFDR fund merely due to the fact that such a fund uses a sustainability-related term in its name effectively applies Article 9 SFDR requirements to all assets (see also below) of an Article 8 SFDR fund.
* Secondly, the proposed minimum safeguards are unduly burdensome and do not adequately cater for the diversity of investment strategies pursued by fund managers. This is because, for example, for certain investment strategies (e.g., credit or minority equity investments), our members may not have the data required to ensure that underlying investments meet the – exclusions contained in the proposed - list of minimum safeguards. Additionally, for Article 8 “light” funds, fund managers are not required to conduct the Do No Significant Harm (DNSH) test, and ESMA has included this as a minimum safeguard. Lack of data to complete the test will also be an issue.
* Further, we believe that the proposed “minimum safeguards” arguably run counter to the EU’s broader objective of supporting the transition to a net zero economy. Investments in companies operating in sectors excluded by Articles 12(1)-(2) of the EU Benchmark Delegated Regulation (e.g., the exclusions in Articles 12(1)(d)-(g)) 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 and so in our view excluding such companies from the investible universe of funds within the scope of the proposed guidelines runs counter to channelling investments towards economic activities which support the transition to a net zero economy.
* Moreover, the exclusion criteria have been designed in the context of a single sustainable investment objective, i.e., carbon emissions reduction and arguably do not make sense when applied broadly to any sustainability-related strategy, as set out below:
  + While excluding companies found in violation of the UN Global Compact or dealing with controversial weapons may be applied across all types of investment strategies, the strict exclusion of fossil fuel production and fossil fuel-based energy production only makes sense for funds pursuing a climate-related strategy. However, not all Article 8 or 9 SFDR funds focus on climate or, more broadly, the environment. Social objectives or characteristics are often forgotten in the public discussion focusing on “green” funds but are equally important to ensure a just transition. Where no other means are available, fossil fuel-based energy production may still be required to ensure the provision of energy to less privileged countries and communities. Even if social considerations were to be left aside, the exclusions would hinder funds from investing in investments to support the transition of the energy sector towards less carbon-emitting forms of energy production. In addition, even for climate-focused Article 9 SFDR funds no such rigid thresholds apply under the SFDR itself. Instead, the ESAs have recommended to use self-defined thresholds adapted to the investment strategy to take into account principal adverse impacts of investment decisions on sustainability factors (PAI) in the context of the SFDR “do no significant harm” (DNSH) principle. Finally, we note that the AMF proposes in its recent SFDR position paper[[1]](#footnote-2), which prefigures the Commission’s review of SFDR, that Article 8 SFDR funds still be allowed to invest in fossil fuel sector activities, albeit subject to certain conditions.
  + When it comes to the exclusion of tobacco, it is important to note that neither the SFDR nor TR contain any exclusions or criteria related to tobacco cultivation and production (notably this is not covered by the PAI indicators in Table 1 which should be taken into account for “sustainable investments”).
  + We note that ESMA refers also to Article 12(2) of the EU Benchmark Delegated Regulation. This provision requires that benchmark administrators exclude companies found or estimated to significantly harm one or more of the TR environmental objectives. Applying this to all types of funds using sustainability-related terms in the fund name would introduce a mandatory TR DNSH screening “via the backdoor” not only for Article 9 SFDR funds (which, as confirmed several times by the European Commission, are not limited to investing in Taxonomy-aligned investments) but also for all assets held in Article 8 SFDR funds. The use of the EU Benchmark Delegated Regulation makes even less sense when looking at the strict methodological requirements applicable to benchmark administrators when using estimates to make this determination (see Article 13(2) EU Benchmark Delegated Regulation).

Finally, if the proposed “minimum safeguards” are introduced, we urge ESMA to think carefully about the naming of such safeguards, as the TR already refers to a concept of “minimum safeguards” (as defined by Article 18(1) of the TR). Noting that “greenwashing” may obviously be caused in some cases by a deliberate intention to mislead investors, we believe that in many cases the lack of legal certainty surrounding the TR and SFDR caused by unclear and often overlapping regulatory standards, rules and guidance is unhelpful and contributes to the risk of “greenwashing” as market participants must make judgement calls on unclear concepts in the absence of guidance. With this context in mind the introduction of multiple separate and legally distinct concepts of “minimum safeguards” is unhelpful at best and would likely contribute to the ongoing uncertainty.

Ambiguity of threshold measurement

Since the proposed new requirements have been developed independently from a review of SFDR, they will perpetuate legal uncertainty. For example, the 80% threshold is proposed to be applied to “the environmental or social characteristics **or** *[our emphasis]* the sustainable investment objectives in accordance with the binding elements of the investment strategy, which are disclosed in Annexes II and III of Commission Delegated Regulation (EU) 2022/1288”. An Article 8 product may promote environmental or social characteristics other than a thematic investment strategy (such as an engagement approach (see ESMA Supervisory Briefing paragraph 36)). How should an Article 8 product which promotes engagement measure its conformity to the guidelines?

For example, members may have funds with “SDG-Engagement” in the name that do not commit to make a % of sustainable investments given the nature of the fund itself. Given SDG is not explicitly mentioned as a term in the consultation paper, it is unclear whether ESMA thinks it’s a sustainability-related term, or an ESG-related term. We presume as a standalone word SDG would be considered sustainability-related given the “s”, but what about when combined with “engagement”? Then the meaning of the term changes completely. This is important because if “SDG engagement” is considered a sustainability-related term, then those members would be in breach of the 50%-80% rule. This is just an example of why we believe the proposed rule will have unintended consequences by not leaving room for contextualization. It would be helpful to get clarity on this point.

Furthermore, based on comments made by ESMA officials at the Open Hearing on 23 January 2023, we understand that ESMA’s intention is that the thresholds ought to apply to all investments made by a fund. In practice, this means that the thresholds would apply, *inter alia*, to cash or money market instruments held by a fund for liquidity or hedging purposes. This runs directly counter to the SFDR level two disclosure templates which distinguish between a fund’s core investments which are aligned with a product’s promoted environmental and/or social characteristics and a residual category of “other” investments which often encompasses cash held by a fund for hedging or liquidity purposes.

<ESMA\_QUESTION\_FUNA\_0>

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

<ESMA\_QUESTION\_FUNA\_1>

Whilst we welcome ESMA’s efforts to provide more clarity and promote supervisory convergence, including through guidelines, we do not believe that ESMA has the power under the ESA Regulation to introduce quantitative thresholds in this way. However, should ESMA nonetheless introduce guidelines, we would ask ESMA to introduce more elaborate grandfathering and transitional relief. We urge ESMA to clarify that closed-ended funds which have had their first close for or are fully closed to EU retail investors prior to the application of the deadline are out of scope. Applying the guidelines to closed-ended funds that have already been signed up to is a retrospective move, which would raise significant complications. For closed-ended and open-ended funds open to EU retail investors we urge ESMA to introduce a predictable timetable. Please refer to our narrative response above for further detail.

<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>

Please refer to our narrative response. In light of concerns about the application of the guidelines to blind pool funds and the need to ensure that assets are available to be deployed into cash or hedging to protect investors at various points in the economic cycle, we propose a somewhat lower threshold of, say, 60%. In light of concerns about the application of the guidelines to closed-ended funds, we recommend that the guidelines be adapted such that, in the case of closed-ended funds, the thresholds are applied by reference to investments or “commitments” (as practicable). We have proposed drafting amendments.

<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>

Please refer to our narrative response and to our answer to Q2. We propose a somewhat lower threshold of, say 30%.

<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>

Alternative ways to construct the threshold mechanism must surely include a comply or explain mechanism. If a fund manager is unable to mould their characteristics to achieve 80% of the investments within their investment strategy, then they should be able to explain why not and the relevant NCA will review when provided with the fund documents under AIFMD.

The fund manager should have a choice in measuring the threshold depending on the fund strategy and asset class and explain in the disclosures the measurement mechanism. In other words, it should be permissible to choose between investments and commitments.

<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>

In light of serious concerns about ESMA’s powers to make what amount in substance to mandatory rules about portfolio composition, we believe that there should be much more extensive grandfathering and transitional relief, especially (but not exclusively) in respect of closed-ended funds. Please refer to our narrative response above.

<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>

No. We are very concerned about, and in fact disagree with, the proposal to use Paris Aligned Benchmark (PAB) exclusions as a minimum safeguard across funds using both ESG and sustainability-related terms. We have serious concerns about ESMA’s powers to make such guidelines and we suggest that this aspect of the proposals should be removed.

Again, we note the [Securities and Markets Stakeholders Group’s Advice to ESMA on the ESAs’ Call for Evidence on Greenwashing](https://www.esma.europa.eu/sites/default/files/2023-01/esma22-106-4384_smsg_advice_on_greenwashing.pdf) dated 18 January 2023. The SMSG observes that the interpretation of what is an Article 9 product has “toughened” to such an extent that “some asset managers are leaving “art 9” territory for “art 8” territory” with the result that Article 9 funds have turned from a ““niche” category to almost a “no” or “null” category” (paragraph 35, page 9). The minimum standards proposed in ESMA’s draft guidelines adopt the criteria applicable to a Paris-aligned benchmark, which is a tougher standard than that applied to *sustainable* investments. We do not consider that ESMA has sufficiently explained the policy rationale for this. A fund that does not make any claims to be ‘sustainable’ or make ‘sustainable investments’, but uses, for example, ‘responsible’ in its name would, under the draft guidelines, be allowed to *only* make Paris-aligned investments. In contrast, an Article 9 fund that does not use a sustainability-related name, but only makes sustainable investments, would not need to apply the Paris-aligned exclusion criteria to any of its investments. To adopt the SMSG’s language, ESMA risks turning the market for funds with a sustainability-linked name into “almost a “no” or “null” category”. If ESG funds are unable to easily distinguish themselves from other funds in the market, then ESMA’s proposals may jeopardise the growth of the ESG fund market.

If ESMA are of the view that such “minimum safeguards” should nonetheless be introduced, we draw your attention to a number of observations.

It is not clear to us why the minimum safeguards have been crafted by reference to the EU Benchmarks Delegated Regulation. This instrument is tailored to the public markets and has been criticised for its lack of clarity. Moreover, it was designed in the context of products pursuing a limited, climate-related objective (carbon emissions reduction) and which meet the highest sustainability standards. As such, in our view it does not make sense to apply the exclusions in the EU Benchmarks Delegated Regulation to products pursuing broader strategies (see also the more detailed comments in the introduction).

ESMA asks stakeholders if they can propose an alternative to the PAB; however, we believe the DNSH principle is already there to apply minimum safeguards to “sustainable investments”.

The current *disclosure requirement* under the SFDR RTS for Article 8 funds as to whether minimum thresholds are applied to “other” investments is sufficient for the purpose of investor protection. Keeping in mind that such a fund would have to use a minimum of 80% of its investments to meet its environmental or social characteristics under the proposed guidelines there will in many cases not be many “other” investments left to which the proposed exclusions could apply since they cannot be applied to cash and other liquidity.

<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>

We believe that derivatives should be included in the threshold calculations and that financial market participants should be free to choose whether to use the notional or market value for this purpose, provided they are clear to investors which has been chosen and they use the same approach consistently over time.

<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>

Please refer to our answer to Q7.

<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>

No.

<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>

We have no view on this.

<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>

We have no view on this.

<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>

Within the boundaries of the statements made in the introduction, we do not object to the consultation proposals including rules on the use of the word “impact” or “impact investing”. However, if the ESAs are going to specify rules on the use of the term “impact”, then they should articulate clearly what they consider impact to mean, which is a matter of considerable uncertainty. It may for example make sense to refer to the definition of “impact investing” published by the Global Impact Investing Network (GIIN) which is a widely accepted standard. Moreover, it should be clarified that such impact can be created in funds which either meet the requirements of paragraph 16 or of paragraph 17. Contrary to widespread belief impact investments following the GIIN definition which are being managed according to generally accepted impact principles (such as the Operating Principles for Impact Management (OPIM) or the SDG Impact Principles) do not always qualify as sustainable investments under SFDR. They often fail to pass the SFDR DNSH test, for example because of the large set of mandatory PAI indicators designed for listed companies for which there is not enough data and because of the need to preclude investments in activities which are made sustainable through the investment (and where often the most impact can be generated). Permitting impact only in the context of sustainable investments would cut off financing for many transition-based strategies meeting the strictest impact standards but which are “only” Article 8 SFDR funds under the SFDR terminology.

Finally, it would be helpful to be clearer about what are other “impact-related terms” and their exact status under the SFDR, i.e., are they associated with Article 8, “sustainable investment” under Article 2(17) of the SFDR or Article 9 investments, or all of these concepts. For example, “transition” should not be regarded as an impact-related term (see below).

<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>

No. Within the SFDR framework room should be left to develop all kinds of transition-related strategies without further limiting the use of this term. Already the transition aspect has been rather neglected in the SFDR framework and in our view further restrictions introduced via the guidelines would create even more impediments to financing the economic and social transition.

<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>

We believe that the fact that these proposals relate only to funds, which are only one type of financial product under SFDR illustrates our wider concern about ESMA’s powers to make what amount to substantive rules on portfolio composition. We think that these issues should be addressed holistically through the European Commission’s forthcoming review of the SFDR framework, in combination with less prescriptive principles-based guidelines on the use of terms consistent with the “clear, fair and not misleading” rule.

<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 believe that this transitional period is too short. We propose grandfathering relief exempting any closed-ended funds which have had their first close or are fully closed to EU retail investors prior to the application of the proposed guidelines. In addition, for those closed-ended funds which remain open to new EU retail investors as at the date of application of the guidelines, we suggest a specific and predictable date (e.g., 30 June 2024), as opposed to a number of months after the date of publication of the final guidelines. We also propose a 18-month transitional period for open-ended funds.

In addition, we would like to reiterate our strong request to ESMA to reconsider the introduction of “minimum safeguards” and to delete this aspect of the guidelines.

<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. Moreover, the end date for the transitional provision for closed-ended funds should be longer, and should be on a predictable date, such as 30 June 2024, around which financial market participants can plan effectively.

<ESMA\_QUESTION\_FUNA\_14>

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

<ESMA\_QUESTION\_FUNA\_15>

The guidelines will have very substantial adverse impacts on many funds in the market in a manner which is unpredictable, unjustified and of questionable legal validity. In the longer term, we are sympathetic to the policy intention of having clear rules about the ESG-related features of fund names. However, the ambiguity as to what constitutes an ESG-related term will bring long-term legal uncertainty and unpredictable costs. We urge ESMA to publish further guidance on the terms which it considers to be “ESG related” or “impact related” or otherwise “derived from the word sustainable”. Ideally, this would take the form of a “safe-harbour” list of words which, on their own, are not considered to be ESG-related, and a list of words which are.

<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>

We do not have quantitative data to provide.

<ESMA\_QUESTION\_FUNA\_16>

1. *Proposal for minimum environmental standards for financial products belonging to the Art. 8 and Art. 9 categories of SFDR*, Autorité Des Marchés Financiers. [↑](#footnote-ref-2)