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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 | Clarity AI |
| Activity | Sustainability tech provider |
| Are you representing an association? | ☐ |
| Country/Region | Spain |

# Introduction

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

<ESMA\_QUESTION\_FUNA\_0>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_FUNA\_0>

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

<ESMA\_QUESTION\_FUNA\_1>

* Yes, we agree. Two main reasons:
  + Research is clear that names are important to investors when they make their choices. It is therefore important that there are guardrails in place around the use of terms.
  + Investors have been using Article 8 and 9 as de facto labels. As such, it is important that they not only imply a level of sustainability but that they actually deliver some minimum standard.
* This is an important issue but is only one of the issues currently facing investors in EU. For instance:
  + Could the regime be broadened to encompass a wider variety of sustainability linked objectives (impact, improvement, transition), such as those seen in regimes in UK and US?
  + Can we ensure that findings are equally valid for private and public assets, for active and passive funds?
  + Can we incentivise shareholder activism in a way that materially impacts investee companies?
  + Should PAI reporting be mandatory at product level?

<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>

* We have no specific insight on this threshold level. We believe the market will be grateful for the certainty provided by a concrete figure. Nevertheless, some flexibility could be built in to ensure that threshold is not broken through fluctuations in the valuations of certain assets.
* This requirement also seems very difficult to police: how can you measure if investments are being used to meet the environmental or social characteristics or sustainable investment objectives in accordance with the binding elements of the investment strategy? It is also not clear which terms would be impacted by the 80% figure. To that end, we would suggest ESMA releases a set of terms that would be affected by this rule and guidance on how investments might be judged to have met the investment characteristics or objectives.
* In general, we see this threshold as the main mechanism for ensuring that the fund is making investment decisions in line with its overarching strategy. This is similar to the provision within Article 9 funds that they should make “only” sustainable investments except for assets used for hedging or cash purposes. The key difference is that no numeric figure is mentioned for Article 9. As such, we suggest aligning the requirements across the two categories (i.e. implementing an 80% minimum sustainable investment for Article 9).

<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>

* Firstly, the wording is not clear as drafted. We are aware of confusion around whether it referred to 50% of the whole fund or 50% of the 80% threshold (i.e. 40%). We understand from the ESMA hearing that it is the former.
* Secondly, we have undertaken some analysis of this using EET and our in house data and found that many Article 8 funds with sustainable in their names (or terms derived from “sustainable”) will struggle to make the 50% threshold.
* From our data, we found that roughly 850 Article 8 funds and 250 Article 9 funds have the word sustainable or a derived term in their name[[1]](#footnote-1).
* Drawing on EET data, we were able to examine what minimum proportion of sustainable investment affected funds were committing to. In total, nearly 500 Article 8 funds and 150 Article 9 funds report a minimum sustainable investment proportion (looking at field 20420).
* Of those, only 16% (less than 100 funds) planned a sustainable investment of more than 50%. In fact, over 20% of those funds planned 10% or less sustainable investment.
* Even amongst Article 9 funds, we find much higher SI on average, but still found 10% were not planning sustainable investment above 50%.
* We also checked this data against our in house data that goes beyond the EET disclosure to examine level of sustainable investment and found a broadly similar picture. From this analysis, we examined 715 Article 8 funds with “sustainable” terms in their names and found only 13% have an actual sustainable investment over 50%.
* These are preliminary results based on an ongoing analysis that will be published in full in the coming weeks (with new data). The results may develop but we believe the preliminary results are enlightening in terms of the adjustments that will be necessary from the industry.
* Given these significant adjustments, we would advocate for a longer transition period to ensure that the new measure is not overly disruptive to the market and end investors.
* If not, we fear there could be a wave of “downgrades” similar to those seen in Article 9 funds. It may also be the case that funds attempt to “game” the system by avoiding “sustainable” but instead using terms like “green” which do not have a minimum SI attached to them.

<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>

* The interaction between the 50% sustainable investment and 80% “aligned” assets may be confusing for some end investors. Perhaps a system where different strategies were recognised (impact, transition, sustainable) could make things more straightforward (with minimum SI for Article 9 funds).

<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>

* We believe there is still room for improvement within the SFDR beyond these proposals.
* To this end, we noted a recent publication by the French AMF which highlighted a few points worth considering:
  + possibly introducing minimum exclusions across the board for Article 8 and 9 funds
  + whether SFDR could make it easier for funds to incorporate transition assets into their strategy
  + whether to mandate PAI reporting at product level for all Article 8 and 9 funds
  + how to encourage greater shareholder activism to effect change in investee companies.
* Overall, we agree with the AMF overarching suggestion of initiating a concrete discussion on the topic.

<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>

* As noted above, we are in favour of minimum safeguards as a general concept. This helps ensure a minimum standard and can offer assurance to end investors in terms of the outcomes they can expect from their investments.
* One observation here is not to create an uneven playing field within Article 8 funds. Therefore, if there are minimum standards, it could be worth applying them across the board and not just to funds with certain terms in their names.
* We plan to test these thresholds to understand how the relevant universe of funds would be affected by them as part of our upcoming research mentioned above.
* A priori, we believe that these safeguards will necessitate a longer transition period, given some investments may not meet them. For instance, in a recent Whitepaper [https://clarity.ai/research-and-insights/sfdr-just-how-sustainable-are-article-9-funds/] we published, we found nearly 20% of the Article 9 funds have more than 10% of their investments in companies with violations of the UNGC principles or the OECD Guidelines for multinational enterprises. Further clarity on what exactly a violation means and how long it would apply for would apply for (including the impact of any corrective action) would also be useful.

<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>

* No strong view.

<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>

* No strong view – the market value may be more accurate but might be out of date for illiquid securities.

<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 strong view.

<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>

* Agree that for consistency this could be useful.

<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>

* No strong view.

<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 agree with treating impact with specific provision. However, we still believe that more could be done to reflect differing investment objectives of different end investors. As per UK’s SDR and proposals from US SEC, impact could be treated as a category in its own right, with its own KPIs and reporting requirements. To assist this, the EU could propose a definition for “impact” that could be used by market participants.

<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>

* We agree with treating transition with specific provision. However, we still believe that more could be done to reflect differing investment objectives of different end investors. As per UK’s SDR, transition could be treated as a category in its own right, with its own KPIs and reporting requirements.

<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>

* No strong view.

<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>

* As mentioned above, based on our evidence, we would push for a longer transitional period.

<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 strong view.

<ESMA\_QUESTION\_FUNA\_14>

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

<ESMA\_QUESTION\_FUNA\_15>

* Without a transition period we worry that funds may rename themselves to avoid the toughest parts of the regulations.
* It is also possible that the proposals could lead to a wave of “downgrades” from Article 8 to Article 6. This could cause damage to the EU’s green deal and efforts to green the economy.

<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>

* No strong view.

<ESMA\_QUESTION\_FUNA\_16>

1. Terms include: Sustainable, Sust, Sus, Sustainability, Sustnby, Sustain, Sstnb, Sustainab, Sustnb and Sstnbl [↑](#footnote-ref-1)