Frankfurt,
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BVI[1]'s position on Consultation Paper on Guidelines for the use of ESG or sustainability-related terms in funds' names

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

In general, we agree with ESMA that there is a need for a reliable EU-level guidance on the use of ESG and related terms in fund names. The current operating environment for funds that commit to certain ESG features is extremely complex, involves significant uncertainties and is subject to fragmentation due to the local requirements applied by national authorities or public/private ESG labels. However, in order to **effectively improve the situation for fund managers** and **provide orientation for investors**, the following prerequisites must be fulfilled:

- **Regulatory coherence and stability**: The approach proposed by ESMA to define ESG-related naming rules solely for UCITS and AIFs based on the relevant fund frameworks is rather surprising. The EU Commission has announced in its revised sustainable finance strategy that it will consider introducing minimum standards for ESG strategies especially for Article 8 products under SFDR that would certainly overlap with the ESMA Guidelines and might introduce yet another set of different requirements while serving the same purpose. There is a risk that fund managers might be subjected to the ESMA Guidelines and undergo major implementing efforts only to be submitted to further regulatory changes under SFDR in the near term. Indeed, there are clear indications that the Commission intends to launch an open consultation on SFDR review in 2023 that shall i.a. discuss the option of establishing a voluntary ESG labelling regime for all SFDR products alongside the transparency standards currently in place.

- We would thus expect that before taking a final decision in terms of the envisaged Guidelines, ESMA would liaise with the EU Commission in order to **ensure that the adoption of the ESMA Guidelines will not pre-empt fundamental policy decisions that shall be discussed as part of the general SFDR review. In case the public consultation on SFDR should be immediately pending, we urge ESMA to defer adoption of the Guidelines and instead to contribute the insights and ideas developed so far into the regulatory review process in order to avoid disorder in the EU fund market.**

- **Cross-sectoral consistency:** In general terms, it is of utmost importance to ensure that the ESMA Guidelines are **fully aligned with the underlying concepts of EU horizontal frameworks for sustainable finance** and in particular, do not introduce new approaches or amend the understanding of provisions that apply to all SFDR products. In this regard, we see some important deficiencies in the current drafts as outlined in our response to Q4. In addition, in order to avoid distortions of competition to the detriment of the fund industry, it is essential that the planned supervisory Guidelines on fund names **do not apply on a silo basis to UCITS and AIFs**, but are

[1] BVI represents the interests of the German fund industry at national and international level. The association promotes sensible regulation of the fund business as well as fair competition vis-à-vis policy makers and regulators. Asset managers act as trustees in the sole interest of the investor and are subject to strict regulation. Funds match funding investors and the capital demands of companies and governments, thus fulfilling an important macro-economic function. BVI's 114 members manage assets of some EUR 4 trillion for retail investors, insurance companies, pension and retirement schemes, banks, churches and foundations. With a share of 28%, Germany represents the largest fund market in the EU. BVI's ID number in the EU Transparency Register is 96816064173-47. For more information, please visit www.bvi.de/en.

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appropriately **extended to all financial products under SFDR that are marketed to retail investors** and thus subject to direct competition at the point of sale (cf. our comments to Q12 below). In view of the sequencing of reforms as anticipated above, this should be another argument in favour of deterring the sectorial ESMA Guidelines and focusing on the broader SFDR review.

- **Effective harmonisation at EU level**: Currently, there is a patchwork of regulatory/supervisory requirements and market standards that are relevant for funds marketed as ESG or sustainable. In Germany, BaFin has developed a supervisory practice for authorising ESG and alike retail funds launched in Germany; the French supervisor AMF applies a specific set of rules to any fund marketed to French investors. In some markets, like in Belgium, supervisors/distributors expect ESG funds to comply with the local sustainability label (Febelfin label), in other markets like in Germany there is a market standard for funds offered to investors with sustainability preferences. Outside the EU, the UK FCA and US SEC are currently in the process of finalising their own rules relating to fund names using ESG or sustainable terminology that will also impact globally operating fund managers. An obvious advantage of **a common EU framework** would be that it **could end the fragmentation, at least as regards the internal market, and yield the potential of sustainable finance** especially in the retail fund market. However, in order to achieve this objective, ESMA should strive for an **effective harmonisation** and articulate a clear expectation to the NCAs as addressees that the **final Guidelines** will be **applied in the national supervisory practice without any modifications or additions**.

- **Proportionality of application**: In view of the declared objective to enhance investor protection and prevent greenwashing, it is **disproportionate to extend the proposed Guidelines to all categories of investment funds**. Investor protection and greenwashing issues are relevant solely in relation to products that are offered for sale to retail investors; they should not pertain to AIFs that are launched solely for professional investors in accordance with their individual preferences and needs. Hence, the **scope of application** of the ESMA Guidelines should be **limited to** (1) **UCITS** and (2) **AIFs that are admitted to distribution to retail investors** in at least one Member State in accordance with Article 43 AIFMD.

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.

The proposed 80% threshold is too high to be applied for all fund types and in all circumstances. It should be noted that according to the ESMA proposal, the 80% threshold pertains to the minimum commitment in terms of the proportion of overall fund assets compliant with environmental or social (E/S) characteristics that shall be observed at all times in line with the specific fund terms. The following considerations should be taken into account when determining the appropriateness of a threshold:

- There must be **sufficient flexibility for the fund management to react in volatile/declining markets** by expanding the liquidity ratio in the fund portfolio. Limiting the share of instruments held for liquidity management and hedging purposes strictly to 20% would be counterproductive from the risk management perspective. Application of E/S criteria to instruments used for building up liquidity in the fund or to hedge the relevant risks does not present a suitable alternative. Cash and money market instruments used as liquidity buffers generally do not have any particular E/S characteristics. Index futures and other derivatives typically used for hedging are still very difficult to assess in E/S terms given the lack of established market standards. In many cases, such derivatives will not be accounted as meeting the criteria of the ESG strategy; ESG derivatives that are currently available in the market might be more appropriate from the ESG perspective, but they are so far inferior in terms of liquidity and pricing. The **ability of ESG-named funds** to **access liquid assets in difficult market circumstances** in order to uphold redemption possibilities of investors **must not be compromised**.

- **Some fund types are required by law to provide for a minimum liquidity buffer** in order to be able to meet redemption requests from investors. This applies for instance to German open-ended real estate funds that must in any event provide for 5% of liquidity in their portfolio, but in line with liquidity management rules, might be required to expand the liquidity share to up to 49% depending on market conditions. Also, given that ELTIFs are meant to invest in long-term and rather illiquid assets and that the revised ELTIF Regulation in the new Article 18 mandates ESMA to provide RTS relating to liquidity management tools, it will be a challenging task for ESMA to calibrate the liquidity requirements for redemption purposes on the one hand with the proposed threshold on the other hand, provided that ESMA intends to avoid that it becomes practically impossible to use ESG-related terminology for these ELTIFs. Given the ESG-agnostic nature of liquidity as mentioned above, such funds that wish to pursue ESG strategies and reflect this circumstance in their name might find themselves in a situation where the minimum commitment provided in terms of E/S characteristics would prevent them from meeting their liquidity management obligations which simply cannot be considered acceptable.

Therefore, **the threshold for the minimum commitment to environmental or social characteristics must be lowered in order to become practicable for all fund types**, especially all retail AIFs available in the EU. The need for practicality in terms of day-to-day fund management on the one hand and for credibility with regard to investors' expectations associated with the fund name on the other should be carefully balanced. In this regard, we would like to refer ESMA to supervisory practices in Member States that have been in place for many years in order to guide the use of other terms in the fund names that might be relevant for investment decisions, such as "equity", "bond", "money market" etc.. In order to comply with the principle of clear, fair and not misleading communication, it has been generally considered sufficient to ensure that the main focus of the investment strategy is aligned with features implied by the fund name which effectively means a minimum threshold of 51%.[2] It is obviously inconsistent that a principle which has been considered sufficient for years for ensuring sufficient investor protection when it comes to fair, clear and not misleading communications shall not apply with regard to ESG-related information.

Lastly, we would like to point out that there is a **conceptual inconsistency** in the current draft. Art. 8 SFDR is designed as a mandatory transparency provision that does not impose any qualitative requirements on the environmental or social characteristics of a product. Such E/S characteristics can be based, among others, on binding exclusion criteria for asset allocation. Consequently, a **commitment to apply minimum safeguards in line with the ESMA proposal in the Guidelines would already be sufficient as environmental or social characteristics** under Art. 8 SFDR that could be defined as relevant in the ESG templates. The proposed Guidelines do not clarify, however, whether such commitment would per se be considered adequate to justify the use of ESG related terms in the fund name or whether ESMA assumes the application of additional elements for meeting the 80% threshold. In view of the clear link to the minimum commitments in the pre-contractual ESG annexes envisaged by ESMA, such additional requirements should not be relevant. Generally, however, this

[2] The German "Guideline on fund categories" (Fondskategorien-Richtlinie) is based on this underlying principle, cf. § 2 (1).

inconsistency underscores the challenges with introducing minimum safeguards for all portfolio assets that we explain in detail in our replies to Q4 and Q6.

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.

We do not agree with introducing a specific threshold for the proportion of sustainable investments in the portfolio. Given the profound unclarities about the criteria for sustainable investments and the correct approach to calculating their share at the portfolio level, discussion about minimum quantitative requirements for sustainable investments should be postponed and linked to the broader SFDR review to be initiated soon.

First of all, we doubt whether a formal distinction between ESG-related and sustainability terms makes sense from the investors’ perspective. In everyday language ESG and sustainable are being used quite synonymously and the term “sustainable” is certainly not being associated with the regulatory concept of sustainable investments. “Sustainable” is also part of SDG-related investment strategies. SDG-focused investment funds should be able to refer to their investment objective in the fund name, even if the underlying investments do not meet the formal criteria of Article 2(17) SFDR (e.g. because of the DNSH requirements).

Specific requirements for sustainability-linked funds cannot be reasonably discussed, given that the questions on numerous aspects of sustainable investments submitted by the ESAs to the Commission in September 2022 still remain unanswered. Presuming that the pending responses will fundamentally reshape the understanding of sustainable investments and hopefully harmonise the calculation approach, we are currently **not in the position to assess in a reliable manner which proportion of sustainable investments could be reasonably expected in Article 8 funds**. Nonetheless, in order to prepare the ground for future analyses, we would like to point out the following:

- Attainment of an environmental or social objective is conceptually not the main investment purpose of Article 8 funds. Therefore, a **commitment to a certain share of sustainable investments can be only a by-product of the main investment strategy**, i.e. selection of assets based on certain defined environmental or social characteristics.

- Diverging approaches to determining and calculating sustainable investments are currently present in the market. **The less strict the approach, the higher the level of sustainable investments to which a product might be able to commit**. This is in our view a concerning situation and clarifications by the EU Commission would be most welcomed. While not being able to anticipate the final outcome of such clarifications, we would like to emphasise that **should the Commission opt for the pro-rata approach** and request calculations of sustainable investments based e.g. on the proportion of revenues derived from sustainable business activities, the **50% threshold would be far too high for most investment strategies that are suitable for retail investors**, certainly including broadly diversified equity funds.

- A **real-life example** provided by one of our members refers to an Article 8 fund that applies an ESG strategy based on a combination of positive screening criteria (best-in-class approach complemented by a transformation approach, each referring to an internally determined scoring system) and negative screening (exclusions). According to the internal calculations by our member based on currently available information, the **share of sustainable investments** in such a fund (which could be considered representative for equity based ESG strategies) **calculated pro rata to the share of sustainable revenues** from investee companies amounts to **27%**. Tentative feedback indicates that this is round about the maximum feasible scale of sustainable investments that can be achieved in Article 8 funds without compromising their financial investment objectives, especially in terms of proper risk diversification. Recent market research by Morningstar shows that only a very small share of Article 8 funds (approximately 4%) is currently committing to 50% or more of sustainable investments.[3] Our assumption is though that these funds do not follow the revenue-weighted approach for establishing the possible level of commitment.

- The envisaged 50% threshold would thus mean that the actual investment objective of Art.-8-products, namely generating financial returns while taking into account environmental and/or social factors, would be put into question. The focus of potential "sustainable" investment strategies would be on mostly European companies that already act very sustainably or offer sustainable products or services. As a result, there is a risk of high concentration in terms of regionality and sectors. The health care sector for example would be absolutely overweight, because the contribution to the SDGs is usually very high. Multi-asset funds that invest globally would then have to focus on European equities, which would impair the diversification opportunities and create a conflict between financial investment objectives and commitments in sustainability terms.

- Our example illustrates **another major challenge with sustainable investments which is the current status of the economy**. Most investee companies still have many activities that cannot be counted as sustainable or are still in the early stage of transformation and therefore do not pass the "do not significant harm" test. The scarce availability of sustainable investments is obviously the main limiting factor for risk diversified open-ended funds that provide for daily redemption opportunities in terms of their minimum commitment to investors. The actual state of the transitioning progress should be taken into account when defining specific quantitative requirements for sustainable investments. In particular, a level of sustainable activities that might become realistic in 5 to 10 years' time must not be anticipated in the current environment.

We understand that it is ESMA's intention as expressed in the open hearing to take into account the upcoming clarifications by the EU Commission before finalising the Guidelines. In view of the market challenges mentioned above, **we urge ESMA to seek further feedback from the industry** in this regard, either by organising **dedicated stakeholder workshops** or by conducting **another targeted public consultation**, in order to be fully able to assess how the Commission's answers will impact the ability of Article 8 (and 9) funds make binding commitments to certain levels of sustainable investments in their legal documents. In case the intelligence on the upcoming SFDR review will be confirmed, it would be preferable to discuss such implications in the course of this initiative for all SFDR products.

Q4: Do you think that there are alternative ways to construct the threshold mechanism? If yes, please explain your alternative proposal.

In principle, we fully **support the direct link between the thresholds envisaged for the ESMA Guidelines and the commitments in terms of portfolio composition** provided in the ESG annexes under SFDR. It is of utmost importance to ensure that the ESMA Guidelines are fully aligned with the underlying SFDR concepts and in particular, do not introduce new approaches or amend the

[3] Cf. SFDR Article 8 and Article 9 funds: Q4 2022 in Review, Morningstar Manager Research from 26 January 2023, exhibit 30 on page 32.

understanding of provisions that apply to all SFDR products. In this regard, we have **two important reservations** in terms of the current ESMA draft:

- **Understanding of the concept of minimum proportion:** In the open hearing ESMA expressed the view that the minimum commitments in terms of proportions of fund portfolio dedicated to E/S characteristics or sustainable investments that are relevant for the proposed thresholds should be maintained "at all times" during the lifetime of a product. We strongly disagree with this opinion. According to the editing instruction in the SFDR annexes, minimum proportion of the investments used to meet E/S characteristics shall be specified "in accordance with the binding elements of the investment strategy" which means that **details of the commitment depend upon the individual product terms**. So, while agreeing with ESMA that the minimum proportion as specified in the binding commitment shall be maintained in the portfolio "at all times", we deem it **fully legitimate to make the commitment itself conditional upon certain events**. Such events can be, for instance, expiry of a defined start-up phase after the fund launch or non-exercise of a termination right by any of the shareholder after which a fund needs to enter into liquidation phase. These conditions are particularly **relevant to funds investing in private equity, real assets and other less liquid markets** where building up a fund portfolio and divesting each take significant time. In any event, **interpretation of what constitutes a valid commitment** to a minimum proportion of E/S characteristics or sustainable investments is **purely an SFDR issue** that should **not be pre-empted by any specifications made by ESMA** solely in the context of UCITS and AIFs. We are convinced that this approach does not compromise the comparability objective as long as the conditions of the relevant minimum commitment are made fully transparent to investors alongside other details of E/S characteristics that can also significantly vary across products disclosing under Art. 8 SFDR.

- **Minimum safeguards versus environmental/social characteristics:** As explained above, the relationship between minimum safeguards presumed by ESMA to apply to all portfolio assets and the 80% commitment in terms of E/S characteristics is entirely unclear. The SFDR does not impose any material requirements for environmental or social characteristics that can be promoted as binding elements of the investment strategy. It is fully clear that **exclusion criteria**, if based on certain environmental or social considerations, **qualify as relevant E/S characteristics** and are generally **sufficient for a product to disclose under Article 8 SFDR**[4]. This means, however, that a **binding commitment in terms of minimum exclusions**, if applied at minimum to 80% of investments, **would already meet the relevant threshold for environmental or social characteristics** and qualify a fund for using ESG-related words in the fund name. From the consultation paper, it is unclear whether this result matches ESMA's expectations. **On the other hand, inconsistencies of the ESMA Guidelines with SFDR should be avoided by any means**. In our view, this confusion provides additional arguments against introducing mandatory minimum exclusions in the current regulatory environment, further to the point outlined in our reply to Q6 below.

[4] Cf. recital 16 to the SFDR DR 2022/1288.

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.

We have so far no alternative suggestions in this regard. As outlined above, we believe that E/S characteristics should follow the same approach as any other fund naming convention in order to be fair, clear and not misleading.

In addition, we would like once again to emphasise that **practicability of the naming criteria must be considered and tested** not only for straightforward equity and bond funds, but also for any other type of UCITS and AIFs that can follow ESG-related investment strategies. This pertains for instance to **multi-asset funds** that offer broad diversification opportunities across different asset classes, but also to **vehicles investing in real estate and infrastructure**. Tapping private capital for financing of green infrastructure and other projects contributing to the sustainable transformation of the economy is crucial for attaining the objectives of the EU Green Deal and investment funds, such as the newly reformed ELTIF, are supposed to play a pivotal role in steering capital flows also from retail investors.

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.

We do not agree with the proposed introduction of standardised minimum safeguards for any fund using ESG-related terms in its name and certainly do not support such introduction by means of an undifferentiated reference to the PAB framework.

In our reply to Q4 we already pointed out the **conceptual inconsistency with SFDR** that would arise if standardised exclusion criteria were treated differently from other environmental or social characteristics. In addition, we would like to refer ESMA to the following arguments:

- Funds disclosing under Article 8 already **apply a wide range of exclusion criteria** depending on the focus of their investment strategies, preferences of investors and local market standards. E.g. a fund that is launched and distributed in Germany has to comply with the set of exclusions requested as part of the BaFin supervisory practice and in addition, needs to adhere to the minimum exclusions specified in the German definition of the ESG target market that represents a common market standard for implementation of MiFID II requirements in Germany[5]. If such fund is also being distributed in other EU markets, e.g. in Belgium or France, additional exclusions under the Febelfin label that is commonly requested by Belgian distributors[6], or under the French SRI label[7], would apply. In case the fund commits to considering certain PAIs as part of its investment strategy or strives for a specific minimum level of sustainable investments, further exclusions based on PAI indicators would be expected in order to reduce adverse impacts in the portfolio or comply with the DNSH principle. Such **cumulation of exclusions** already leads to a **significant reduction of the available investment universe** and thus **constrains diversification opportunities**. Even if supervisory approaches by NCAs were replaced by the ESMA Guidelines in future, other exclusion criteria, especially those prompted by regulation or labels, will remain relevant.

[5] Cf. slide 3 of the German ESG target market definition.
[6] For excluded activities and practices, cf. section 2.2.5 of the Febelfin quality standard.
[7] The French SRI label is endorsed by the French authorities, cf. Label ISR - Pour des placements durables et responsables (lelabelisr.fr).

- Application of exclusions entails **many challenges outside direct investments in shares and bonds**. For indirect investments in companies, especially via target funds or derivatives, full commitment to exclusion criteria involving quantitative thresholds cannot be ensured due to the lack of up-to-date information concerning portfolio composition of target funds, index rebalancing rules that allow for adaptations of the index composition only at certain dates etc. A "look through" approach that has been indicated by ESMA during the open hearing certainly does not work for these asset classes. Hence, **application of minimum exclusions would discriminate against funds-of-funds and multi asset funds** that are valued as widely diversified investments also by investors with sustainability preferences. Comparable difficulties pertain to investments outside the EU where companies and other issuers are subject neither to ESG-related reporting requirements nor to a comparable level of local market pressure for disclosing ESG-relevant information. Since these data gap will not be closed in the foreseeable future, minimum exclusions would likely reduce diversification opportunities for globally investing funds.

- The **PAB exclusions** proposed by ESMA refer specifically to climate change issues and are thus **not appropriate as market standard for all ESG strategies**, especially those with a focus on other environmental or social characteristics. This applies in particular to the **exclusion criteria for coal and fossil fuels in Article 12(1)(d) to (g)** of DR 2020/1818. It is not commensurate to require funds that invest e.g. in sustainable infrastructure or in companies addressing social problems or providing sustainable solution for the food industry to comply with exclusions designed specifically for combating climate change.

- In the same vein, the **DNSH criteria defined under EU Taxonomy** that are referred to in Article 12(2) of DR 2020/1818 presume a high level of environmental ambition that may be justified for assessing investments as Taxonomy-aligned, but **must not be anticipated as a minimum standard for all ESG funds**. Moreover, the actual wording of Article 12(2) is very confusing, since it seems to **extend the DNSH Taxonomy criteria** that are designed for application at the level of economic activities **to the entire company performing such activities**. As a result, funds that commit to a certain level of Taxonomy-aligned investments as part of their sustainable investment pledge would need to perform a **threefold DNSH test** (1) for the relevant economic activity under the Taxonomy technical criteria, (2) for the issuer with reference to the PAI indicators under Art. 2(17) SFDR and then again (3) for the issuer based on the DNSH criteria of the Taxonomy while taking into account other economic activities that are not deemed Taxonomy-aligned. Given that even the **current situation with two conflicting DNSH texts** under EU Taxonomy and SFDR respectively is **very challenging in practice** and **far from satisfactory from the regulatory consistency point of view**, **introduction of yet another layer of DNSH test should be avoided in any event**.

- The **PAB exclusions** may **impede investment strategies that aim at supporting sustainable transition**. In view of the huge challenges the EU economy is facing in transitioning to more sustainable business models, it should be clear that **"best in transition" investment strategies** that identify leaders in credible transition and support their efforts by provision of capital and engagement activities are **fully legitimate and urgently needed components of the ESG investment universe**. **Exclusion requirements** are generally **prohibitive for such strategies**, since they require fund managers to divest from certain companies/sectors instead of incentivising the use of engagement tools for facilitating the much-needed transition. The exclusions stipulated for PAB would **inhibit transition strategies especially in the energy sector** where many large utility providers have already started to implement transitioning plans, but still derive a significant part of their revenues from GHG intense forms of energy generation. The implications for funds tracking climate transition benchmarks (CTBs) would be even less reasonable: such funds, mostly ETFs, would be prevented from using the phrase “climate transition” in their names because it is ESG-related, even though the principle of fair, clear and not misleading communication would require a reference to the name of the replicated CTB. Moreover, since the EU regulators decided not to extend the full set of the PAB exclusions to CTBs in order to enable investments in transitioning companies, the same must apply to any funds replicating a CTB.

In view of these arguments, we reject the idea of introducing mandatory minimum exclusions for funds with ESG-related naming elements. In order to uphold consistency with the SFDR framework that does not limit ESG investment approaches and treats exclusion criteria as valid E/S characteristics, ESMA could rather **consider proposing certain exclusions as good practice standards** without prescribing their use in any event. **Ideally, the list of such good practice exclusions would be reduced to common sense criteria that are considered relevant for any ESG investment**. In relation to the proposed PAB standard, this would apply to the **exclusion criteria for controversial weapons, tobacco and violation of fundamental social principles** in Art. 12(1)(a), (b) and (c) of DR 2020/1818.

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

In our view, the **ESMA Guidelines should abstain from any specific provisions for calculating thresholds in relation to derivatives or any other assets**. This is because **calculation of the minimum commitments** that are relevant in terms of the thresholds takes place under SFDR and should be **exclusively governed by SFDR rules** that apply likewise to funds and other relevant financial products.

There is currently no regulatory or market standard as to how derivatives shall be taken into account for commitments to E/S characteristics or sustainable investments. The EU Platform on Sustainable Finance was also unable to reach a consensus on the role of derivative investments under the EU Taxonomy and recommends further research on this issue.[8] For the time being, the ESG templates for pre-contractual disclosures include a dedicated sub-section on “how does the use of derivatives attain the environmental or social characteristics/the sustainable investment objective” for Article 8 or 9 products respectively. Here, the fund manufacturer is supposed to explain whether and under which conditions a fund can invest in derivatives as part of its ESG investment strategy. This transparency-based solution should be considered sufficient in the context of the ESMA Guidelines. In any case, clarifications of the calculation approach, if deemed necessary, should be sought in the broader context of SFDR in order to ensure equal treatment of all Article 8 and 9 products.

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?

We do not support any particular treatment of derivatives for the purpose of the ESMA Guidelines. Nonetheless, we would like to point out that the proposed differentiation between the notional value and the market value of derivatives is rather pointless in this regard. According to the current state-of-the-art, fund companies tend to refer to the economic exposure created by derivative investments involving

[8] Cf. EU Platform Recommendations on Data and Usability of the EU Taxonomy from October 2022, section 3.1.3.

delta consideration for calculating commitments to minimum proportions in relation to all portfolio assets.

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

As explained above, any clarifications of the calculation approach, if deemed necessary, should be sought under the SFDR framework in order to ensure equal treatment of all Article 8 and 9 products.

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.

From the context of this question, we assume that ESMA has index-replicating funds in mind, not all funds that assign an index as a reference benchmark e.g. for performance measurement. This being said, we agree in general that index-replicating funds should follow the same rules as actively managed funds with regard to criteria for using ESG-related naming terms. Such funds commit to environmental or social characteristics under Article 8 SFDR based on the factors for selection of the underlying index' components. However, as indicated in our response to Q6 above, exclusion-based criteria are very difficult to be taken into account given that the rebalancing rules of most indexes allow for adaptations of the index composition only at certain intervals, generally quarterly. Violations of potential exclusions that may become evident in the intermediate period generally cannot be reflected in the fund composition before the next rebalancing date without incurring tracking error. This should be weighted as another argument against introducing mandatory exclusions for all ESG funds.

In the context of index-tracking funds, however, the question arises how to deal with situations where the replicated ESG index using ESG-related terminology in its name will not meet all criteria of the envisaged ESMA Guidelines. Given the lack of regulatory standards for ESG benchmarks, it might be difficult for fund managers to negotiate respective adaptations of the index methodology, especially with large benchmark administrators operating globally. Nonetheless, an outcome whereby the name of a fund is required to be different than the name of the reference benchmark it tracks would arguably create less transparency for the end investor and achieve the opposite result to what the Guidelines intend.

Q9: Would you make a distinction between physical and synthetic replication, for example in relation to the collateral held, of an index?

Index funds following a synthetic replication approach basically use derivatives in order to invest in an index or its underlying components. The question of whether and if, under which conditions, investments via derivatives can be considered as promoting E/S characteristics or even as sustainable investments is of general importance for SFDR products and should not be answered in isolation for investment funds (cf. our answer to Q7 above).

As regards the proposed ESMA Guidelines, we thus think that **the same rules should apply in a product-neutral way to all index-replicating funds**. As regards synthetic replication, there is currently no clear market view as to whether the binding E/S characteristics as committed in the ESG annex shall be relevant only in terms of the index exposure created by the swap or in some way also pertain to the fund portfolio holdings. Given that the assets held in the fund portfolio work as collateral from the economic perspective and in general must not be aligned with the investment strategy pursued by the fund for generating financial returns (e.g. a fund tracking the performance of an equity index by way of a total return swap may have a fund portfolio invested in sovereign bonds), there might be good reasons to apply the same logic to any commitments in ESG terms.

As regards investments in derivatives, there is definitely room for further analyses on how and under which circumstances they can make a meaningful contribution to E/S characteristics or even sustainable investment commitments of SFDR products and whether targeted amendments are needed to enhance respective understanding of investors. We would anticipate such discussions in the course of the upcoming SFDR review.

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

It is not entirely clear whether is it ESMA’s intention that funds using the word “impact” in their names shall comply with both quantitative thresholds – as proposed, 80% for E/S characteristics and 50% for sustainable investments – in any case or depending on their relevant naming features (e.g. a fund being marketed as “ESG impact” would need to comply only with the threshold to be determined for E/S characteristics). The illustrative example 5 in Annex IV of the consultation paper indicates that the latter understanding should be correct. We support this interpretation that would allow for better differentiation of impact approaches. Funds pursuing impact-related strategies often have difficulties to meet the DNSH criteria for sustainable investments, either because they invest in transitioning companies that still have a significant proportion of non-sustainable activities (e.g. with high carbon intensity or other polluting emissions) or due to data gaps that are difficult to overcome for instance in relation to micro-finance loans. It would **help impact investing to evolve** if the use of the word “impact” were **not automatically tied to a high committed share of sustainable investments** in the fund portfolio. The distinction between ESG-related and sustainable impact funds should be thus better clarified in the final Guidelines.

Besides, we agree with ESMA’s suggestion that funds referring to “impact” in their name must strive for generating positive and measurable, social or environmental impact alongside a financial return.

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

Investment funds focused on facilitating sustainable transition e.g. by following “best-in-transition” investment approaches and actively engaging with their investee companies should be considered an **integral part of the ESG investment universe**. Transition-focused investment strategies **are key for achieving the core objective of the EU Green Deal** which is a sustainable transformation of the entire EU economy as a precondition for achieving carbon neutrality by 2050.

This being said, transition strategies are currently not subject to any particular treatment in regulatory terms. In most cases, transition-related funds will disclose under Article 8 like any other fund that selects investments in line with binding E/S characteristics. They will often also commit to consideration of certain PAI indicators that they strive to reduce in the course of the transition process. Beyond these elements, however, there is no market standard or other established understanding of transition funds, nor a common understanding of criteria for assessing commitments and progress in sustainable transition. Given the relatively nascent stage of development of this market segment and the lack of any regulatory reference point, we **do not deem it appropriate to discuss specific provisions for**

transition-related investment strategies in the context of the ESMA Guidelines. A distinction between transition-focused and other ESG investment strategies should be rather considered a **fundamental policy decision** that should be broadly debated in the course of the **upcoming review of the SFDR framework**.

On the other hand, the ESMA Guidelines should ensure that they **do not inhibit transition-related ESG approaches e.g. by introducing too strict mandatory exclusion criteria by reference to PAB requirements** that would prevent funds investing in transitioning companies from using ESG-related terms in their names. This pertains obviously to funds replicating CTBs, but also to any other active or passive fund with transition-focused investment strategy. Such outcome would be clearly counterproductive to the EU efforts for facilitating sustainable transformation of the EU economy.

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?

In essence, the initiative at hand aims at clarifying naming rules for funds disclosing under Article 8 SFDR. Since the scope of application and the proposed threshold criteria **refer directly to SFDR concepts**, we indeed believe that it would have been **more appropriate to roll it out as a joint ESG guidance under the SFDR framework** rather than developing sector-specific rules applicable solely to UCITS and AIFs.

Should ESMA be determined to proceed with the Level 3 guidelines as proposed, it is **crucial that equivalent rules be introduced also for other financial products under SFDR** that compete with ESG-related UCITS and AIFs at the point of sale. A **silo approach** under the ESMA Guidelines otherwise **risks distorting competition** and **creating inconsistencies with the cross-sectoral regulatory concept of SFDR**. In this regard, see also our reply to Q1.

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.

A **transitional period of 6 months is in our view too short** to align all existing funds with ESG-related terms in the fund names with the new ESMA Guidelines. As outlined in the cost-benefit analysis, more than 4,000 funds with several thousands of share classes would be affected. All these funds would need either to align binding ESG commitments in their investment strategy with the new criteria to be yet agreed by ESMA or to change the name of the fund. Depending on the relevant fund structure, either solution might require shareholders' agreement or prior information of shareholders via a durable medium as well as authorisation by the competent NCA and potentially approvals by other regulators due to distribution inside (for AIFs) or outside the EU. In case of index funds, a particular challenge could arise if the underlying index uses ESG-related terms in its name, but is not in conformity with the final ESMA Guidelines. Negotiations with the index provider for adapting the index composition, subsequent implementation of the amended index methodology in addition to the implementation steps at the fund level would take rather years than months.

On balance, we are thus **in favour of a grandfathering solution for all funds that hold a valid licence encompassing the use of ESG-related terms** in their names. The ESMA Guidelines, when adopted, should come into **application for newly launched funds in the first place** and should become **relevant for existing ESG funds only in case of changes to the E/S characteristics or the**

investment strategy that would require a renewal of fund authorisation by the competent NCA. Such a phasing-in solution for existing funds would allow for an orderly introduction of the new requirements and provide management companies with sufficient time for reviewing their existing product ranges. It would also correspond with the approach currently applied by BaFin in its supervisory practice. Despite the grandfathering granted by BaFin for existing funds, since summer 2021 already more than 170 funds launched in Germany have adapted to the BaFin criteria for ESG funds. For the purpose of the ESMA Guidelines, such grandfathering could be made **conditional upon funds disclosing under Article 8 or 9 SFDR**, given that the use of ESG-related terms as part of the fund name automatically triggers transparency obligations under Article 8 SFDR.

Should the grandfathering solution be not acceptable to ESMA, we request a longer transition period for existing funds holding a valid licence of at least 12 months.

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.

We see **no rationale for extending the proposed ESMA Guidelines to closed-ended funds**, or indeed **to any fund the subscription period of which has already expired**. Given the declared objective of the ESMA initiative which is to tackle greenwashing risk, it should be clear that the application of the Guidelines should be targeted at situations where potential investors could be misguided by the fund name when taking investment decisions. Such situations can arise only if the fund remains open for subscriptions or is actively offered for trading on a regulated market/MTF (in case of exchange-traded funds).

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

On a positive note, we agree with ESMA that EU-wide harmonisation of supervisory approaches to authorisation of funds with ESG-related names would increase confidence and legal certainty for both investors and fund managers. However, in order to realise such benefits, there needs to be **a true commitment among the NCAs to align their supervisory practices** to the ESMA approach without any modifications or gold-plating.

As regards the anticipated costs and efforts, these depend to a large extent on the transitioning/grandfathering solution for existing funds. The **proposed transition period of merely six months would tie up considerable resources** on the part of both fund managers and NCAs and might still **not be feasible in all circumstances**. Therefore, as outlined in our reply to Q13, we are in favour of a grandfathering solution that would allow existing funds to adapt to the ESMA Guidelines on the occasion of a planned change to E/S characteristics or the investment strategy. At the very least, the transition period for existing funds should be prolonged to at least 12 months.

Furthermore, the impact of the proposed Guidelines depends on the understanding of ESG-related terms that would trigger their application. The illustrative examples provided in Annex IV of the consultation paper indicate a rather wide understanding of ESG-relationship without providing for a clear delineation. Therefore, while ESMA explained in the open hearing that it is reluctant to provide for a list of relevant terms in order to avoid circumvention, we believe that **at least an indicative, non-exhaustive list would be helpful to provide orientation** for the market. In any case, terms that are not clearly ESG-related, but rather acquire such connotation from associated words, should not be per se included in such a list (for instance, the terms “water” or “energy” as such do not have an ESG-associated meaning, but “clean water/energy” indicates ESG-relevance). Otherwise, non-ESG thematic funds might be unduly restricted in the use of naming terms depicting the focus of their investment strategy.

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.

N/A