European Securities and Markets Authority

Reply form for the Consultation Paper on Guidelines for the use of ESG or sustainability-related terms in funds' names

18 November 2022

Date: 18 November 2022

Responding to this paper

The European Securities and Markets Authority (ESMA) invites responses to the specific questions listed in the Consultation Paper on Guidelines for the use of ESG or sustainability-related terms in funds' names published on the ESMA website.

Instructions

Please note that, in order to facilitate the analysis of the large number of responses expected, you are requested to use this file to send your response to ESMA so as to allow us to process it properly. Therefore, ESMA will only be able to consider responses which follow the instructions described below:

- use this form and send your responses in Word format (pdf documents will not be considered);
- do not remove the tags of type <ESMA_QUESTION_FUNA_0> - i.e. the response to one question has to be framed by the 2 tags corresponding to the question; and
- if you do not have a response to a question, do not delete it and leave the text "TYPE YOUR TEXT HERE" between the tags.

Responses are most helpful:

- if they respond to the question stated;
- indicate the specific question to which the comment relates;
- contain a clear rationale; and
- describe any alternatives ESMA should consider.

Naming protocol

In order to facilitate the handling of stakeholders' responses please save your document using the following format:

ESMA_CP_FUNA_NAMEOFCOMPANY_REPLYFORM.

e.g. if the respondent were ABCD, the name of the reply form would be:

ESMA_CP_FUNA_ABCD_REPLYFORM

Deadline

Responses must reach us by 20 February 2022.

All contributions should be submitted online at www.esma.europa.eu under the heading 'Your input - Consultations'.

Publication of responses

All contributions received will be published following the end of the consultation period, unless otherwise requested. **Please clearly indicate by ticking the appropriate checkbox in the website submission form if you do not wish your contribution to be publicly disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure.** Note also that a confidential response may be requested from us in accordance with ESMA's rules on access to documents. We may consult you if we receive such a request. Any decision we make is reviewable by ESMA's Board of Appeal and the European Ombudsman.

Data protection

Information on data protection can be found at www.esma.europa.eu under the headings 'Legal notice' and 'Data protection'.

General information about respondent

Name of the company / organisation	ShareAction
Activity	Audit/Legal/Individual
Are you representing an association?	☐
Country/Region	Belgium

Introduction

Please make your introductory comments below, if any:

<ESMA_QUESTION_FUNA_0>

ShareAction is a research and campaigning organisation pushing the global investment system to take responsibility for its impacts on people and planet, and to use its power to create a green, fair, and healthy society.

We want a future where all finance powers social progress. For 15 years ShareAction has driven responsibility into the heart of mainstream investment through research, campaigning, policy advocacy and public mobilisation. Using our tools and expertise, we influence major investors and the companies they invest in to improve labour standards, tackle the climate crisis and address inequality and public health issues.

ShareAction welcomes ESMA's proposal to introduce quantitative thresholds for ESG and sustainability related fund names. Quantitative thresholds on their own will not guarantee that funds names are an accurate reflection of their investment strategy and holdings, and further action is needed to curb greenwashing in sustainability disclosures. The recommendations made by ShareAction and other civil society organisations in 2022 remain relevant in that regard (https://shareaction.org/policies/joint-ngos-and-consumer-recommendations-for-minimum-criteria-for-sustainable-investments-and-products-with-esg-characteristics). However, thresholds in principle are a welcome step to guide fund managers, supervisors and other stakeholders in identifying and preventing greenwashing.

We have provided several suggestions, on how to clarify the guidance and make it more meaningful in its application. Our main recommendations are:

- Increase the threshold of the minimum proportion of investments for the use of any ESG-, transition-, or impact-related words in the name of a fund to 90%.
- Minimum safeguards should apply to 100% of investments, not only to the part that does not meet the ESG-, transition-,sustainability- or impact-characteristics or objectives of the fund.
- Funds with "sustainability" or any other sustainability-related term in their name should be required to hold at least 90% of assets that can be considered sustainable according to Art. 2(17) SFDR. The proportion of non-sustainable investments should be required to comply with the Do No Significant Harm principle and the Minimum (social) Safeguards of the Taxonomy Regulation (Art. 3(b) and 3(c)).
- ShareAction proposes that any fund name that is ESG-, sustainability-, transition- or impact related is accompanied by a logic model that explains clearly and distinctly to what extent and in what way the fund in question deserves to bear such name.

<ESMA_QUESTION_FUNA_0>

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

<ESMA_QUESTION_FUNA_1>
Greenwashing occurs as part of sustainability disclosures. The EU Sustainable Finance Disclosure Regulation (SFDR), aimed at combatting greenwashing, was clearly constructed as a disclosure regime, but in its implementation and interpretation turned into a de facto labelling regime, hereby creating conditions for continued misrepresentation of sustainability claims. The often used references to "light green" and "dark green" can easily be misinterpreted, as under the SFDR rules funds, are able to brand themselves green despite having - for instance - exposure to fossil fuels, or not actually trying to advance sustainability. The mislabelling and misclassification practices predate the SFDR implementation, but have also manifested themselves as part of SFDR disclosures. There is no requirement for Article 8 and Article 9 products to reveal the intended impact, which opens the door for greenwashing. We therefore call for the development of minimum criteria for Article 8 and Article 9 products.
The proposal to introduce these criteria is also supported by French supervisor Autorité des Marchés Financiers in this 2023 statement: https://www.amf-france.org/en/news-publications/news-releases/amf-news-releases/sustainable-finance-disclosure-regulation-amf-proposes-targeted-review-include-minimum-environmental

Read our recommendations for minimum criteria here: https://shareaction.org/policies/joint-ngos-and-consumer-recommendations-for-minimum-criteria-for-sustainable-investments-and-products-with-esg-characteristics

In the meantime, ShareAction welcomes ESMA's proposal to introduce quantitative thresholds for fund names. While quantitative thresholds on their own will not guarantee that funds names are an accurate reflection of their investment strategy and holdings, they will function as a useful guide.

<ESMA_QUESTION_FUNA_1>

Q2 : Do you agree with the proposed threshold of 80% of the minimum proportion of investments for the use of any ESG-, or impact-related words in the name of a fund? If not, please explain why and provide an alternative proposal.

<ESMA_QUESTION_FUNA_2>
No, ShareAction does not agree with the threshold figure of 80%. For a fund product that claims dedication to certain characteristics or causes, the suggested figure appears to be too low. A nutritional value-focussed consumer intending to buy bio muesli would not be content with 80% of the muesli having been grown through bio-focussed activities. A possible exception is water as an ingredient of many products, bio or not. In that way, 10% of funds claiming ESG or impact should be permitted to be invested in assets providing liquidity, or for duration or currency hedging. ShareAction believes that 90% is a threshold figure that would satisfy the requirement for clear labelling while allowing for practical asset management concerns.

ShareAction strongly agrees with the need for safeguards, but we think that these should not only apply to the investment not used to meet the environmental or social characteristics or objectives of the fund, but to all investments.

Moreover, ShareAction believes that the criteria of Commission Delegated Regulation (EU) 2020/1818 Article 12(1)-(2) are not strong enough and would have to be tightened to lend credibility to safeguards.

In particular, Article 12(1.d) would have to be lowered below 1% for revenues from coal related activities; 12(1.e) would have to be lowered significantly below 10% for revenues from oil related activities; and 12(1.g) would have to be lowered very significantly below 50% for revenues from gas and electricity related activities.

Lastly, ShareAction feels that the distinction between funds with ESG-related words and funds with sustainability-related words in their names is artificial, especially if this proposal is not meant to be read as part of the application of SFDR. The lower requirements for ESG-related versus sustainability-related fund names may not be justified as, without clear definitions, consumers and retail clients will not be able to differentiate the level of ambition expressed by the funds' names in each category.

<ESMA_QUESTION_FUNA_2>

Q3 : Do you agree to include an additional threshold of at least 50% of minimum proportion of sustainable investments for the use of the word "sustainable" or any other sustainability-related term in the name of the fund? If not, please explain why and provide an alternative proposal.

<ESMA_QUESTION_FUNA_3>
No, ShareAction strongly disagrees with the 50% minimum threshold for sustainable investments in funds with sustainability-related names. To justify the word "sustainable" or any other sustainability-related term, a fund must hold significantly more sustainable investments than only half of the portfolio. ShareAction believes that the threshold for funds with ESG-related words in their names (80% as per the proposal, or 90% as per ShareAction's suggestion) should be mirrored for funds with "sustainability" or any other sustainability-related term in their name.

The minimum proportion of sustainable investments for funds with sustainability-related terms in their names (50% in the ESMA proposal, 90% according to ShareAction's suggestions) should be required to comply with to Art. 2(17) SFDR.

As a safeguard, the maximum proportion of non-sustainable investments (50% in the ESMA proposal, 10% according to ShareAction's suggestions) should be required to comply with Do No Significant Harm principle and the Minimum (social) Safeguards of the Taxonomy Regulation (Art. 3(b) and 3(c)).

<ESMA_QUESTION_FUNA_3>

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

<ESMA_QUESTION_FUNA_4>
ShareAction's suggestions on how to improve the set thresholds can be found in our answers to questions 1-3. While ShareAction is supportive of the introduction of thresholds, this measure alone will not be sufficient. Without providing a clear definition of "ESG"- and "transition"-related words in fund names, and without clarifying whether "sustainability"-related is indeed supposed to be identical with the definition of Art. 2(17) SFDR, the opportunity for intentional and unintentional greenwashing is still abundant. We therefore urge ESMA to provide those definitions, as well as a clarification to how these terms are supposed to relate to SFDR.
<ESMA_QUESTION_FUNA_4>

Q5 : Do you think that there are other ways than the proposed thresholds to achieve the supervisory aim of ensuring that ESG or sustainability-related names of funds are aligned with their investment characteristics and objectives? If yes, please explain your alternative proposal. If yes, please explain your alternative proposal.

<ESMA_QUESTION_FUNA_5>
ShareAction proposes that any fund name that is ESG-, sustainability-, transition- or impact related is accompanied by a logic model that explains clearly and distinctly to what extent and in what way the fund in question deserves to bear such name. Through logic models, investment activity can be broken down and analysed. Where the future is concerned, assumptions can be checked for plausibility. Logic models, often called 'theories of change', have long been used by charities and NGOs to explain the impact they expect to have, but cannot strictly promise or evidence.

Using a Logic Model
INPUT --> ACTIVITY --> OUTPUT --> OUTCOME --> IMPACT
A logic model provides two kinds of components: Elements that are within the control of the investor and can (in principle) be evidenced; and elements that lie in the future or rely on complex causal chains. The former - input, activity and output - can be evidenced by regulators; the latter, outcome and impact - cannot be evidenced easily or at all. Therefore, determining what is and what isn't greenwashing becomes challenging without being able to look at assumptions. ShareAction recommend that for every financial product with ESG-, sustainability-, transition- or impact ambition, a Theory of Change (ToC) in form of a logic model is created. With this ToC, retail investors and regulators can form a view on the plausibility of sustainability claims.
By comparing the model steps Input, Activity and Output with available evidence and probing the assumptions for Outcome and Impact, it will be possible for the consumer to form a view on the strategy of a particular fund.

Examples of Greenwashing at each of the model steps
Input: Creating misleading impressions on what resources are available
Fund provider claims to employ sustainability experts when no-one at the firm has had any relevant training/knowledge

Activity: Misleading impressions on investment process
Fund provider claims to be doing research into environmental impacts of all portfolio holdings, when in fact this is only done for 30% of holdings

Output: Creating misleading impressions on how the portfolio looks
Fund provider claims that fund hasa significantly better ESG score than the benchmark, when in fact the difference is insignificant

Outcome: Creating misleading impressions about what the portfolio's design will achieve
Fund provider claims that engagement with investee companies will result in change to those companies' GHG emissions, but is unable to quantify what changes are expected and in which time-frame

Impact: Creating misleading impressions about the outcome's effect on planet and people
Fund provider claims that exclusion of fossil fuel companies will result in less carbon being put into the atmosphere, when in fact the link is not direct and requires assumptions on the effect of not buying particular securities

In addition, fund providers with transition-, sustainability- and impact-related terms in their funds' names should be required to provide sustainability context by explaining how the quantum of change expected from the funds' investments relates to the aggregate change that environment and society are requiring ("thresholds").

<ESMA_QUESTION_FUNA_5>

Q6 : Do you agree with the need for minimum safeguards for investment funds with an ESG- or sustainability-related term in their name? Should such safeguards be based on the exclusion criteria such as Commission Delegated Regulation (EU) 2020/1818 Article 12(1)-(2)? If not, explain why and provide an alternative proposal.

<ESMA_QUESTION_FUNA_6>
Yes, ShareAction strongly agrees with the need for minimum safeguards. However, we think that minimum safeguards should apply to 100% of investments, not only to the part that does not meet the ESG-, transition-,sustainability- or impact-characteristics or objectives of the fund.

As a minimum safeguard for funds with sustainability-related names, the maximum proportion of non-sustainable investments (50% in the ESMA proposal, 10% according to ShareAction's suggestions) should be required to comply with DNSH and Minimum (social) Safeguards of the Taxonomy Regulation (Art. 3(b) and 3(c)).

As a minimum safeguard for all funds in question, ShareAction believes that the criteria of Commission Delegated Regulation (EU) 2020/1818 Article 12(1)-(2) are not strong enough and would have to be tightened to lend credibility to safeguards. In particular, Article 12(1.d) would have to be lowered below 1% for revenues from coal related activities; 12(1.e) would have to be lowered significantly below 10% for revenues from oil related activities; and 12(1.g) would have to be lowered very significantly below 50% for revenues from gas and electricity related activities.

Finally, ShareAction believes that the definition of "deriving revenues" from particular activities should be made explicit to include the provision of finance through lending to or holding financial assets of companies directly engaged with such activities.
<ESMA_QUESTION_FUNA_6>

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

<ESMA_QUESTION_FUNA_7>
Yes, ShareAction believes that derivatives should be subject to specific threshold provisions.
However, ShareAction proposes that any fund name that is ESG-, sustainability-, transition- or impact related is accompanied by a logic model that explains clearly and distinctly to what extent and in what way the derivatives used are supporting a fund's name.

ShareAction believes that for the matter of thresholds, netting should not be permitted in cases where it is not about hedging non-ESG/sustainability related dimensions like currency or duration.
<ESMA_QUESTION_FUNA_7>

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

<ESMA_QUESTION_FUNA_1>
ShareAction suggests the use of notional value for the purpose of calculating minimum proportions. This would be in line with the SEC's proposal on "Investment Company Names" from 25 May 2022, in particular section "Considerations Regarding Derivatives in Assessing Names Rule Compliance". ShareAction agrees that the use of nominal value is in general more representative of the underlying exposure, and

that using market value could be used to minimise exposure to assets outside of the permissible proportion.
<ESMA_QUESTION_FUNA_1>

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

<ESMA_QUESTION_FUNA_2>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_FUNA_2>

Q8 : Do you agree that funds designating an index as a reference benchmark should also consider the same requirements for funds' names as any other fund? If not, explain why and provide an alternative proposal.

<ESMA_QUESTION_FUNA_8>
Yes, ShareAction believes that funds using an index as a reference benchmark should be treated as any other fund. ShareAction believes that the designation of an index is a contractual matter between client and fund provider, but has no significance whatsoever beyond guiding the choice of portfolio holdings. It is the portfolio's financial or impact material aspects in the sense of double materiality that fund names need to cover, not contractual matters between client and fund provider.
<ESMA_QUESTION_FUNA_8>

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

<ESMA_QUESTION_FUNA_9>
ShareAction believes that for synthetically replicated funds, any fund name that is ESG-, sustainability-, transition- or impact related is accompanied by a logic model that explains clearly and distinctly to what extent and in what way the derivatives used are supporting a fund's name.

<ESMA_QUESTION_FUNA_9>

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

<ESMA_QUESTION_FUNA_10>
ShareAction believes that funds using impact or impact-related words in their names should be obligated to provide an impact theory in the form of a logic model in their pre-contractual material clearly describing the effect that a fund provider expects to have. Such model should clearly describe the steps 1. Input, 2. Activity, 3. Output, 4. Outcome, 5. Impact.

In addition, fund providers of impact-related terms in their funds' names should be required to provide sustainability context by explaining how the quantum of change expected from the funds' investments relates to the aggregate change that environment and society are requiring ("thresholds").

<ESMA_QUESTION_FUNA_10>

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

<ESMA_QUESTION_FUNA_11>
ShareAction believes that for funds that use the word “transition” in its name, the same minimum requirements as “ESG”-named funds should apply. Additionally, ShareAction believes that funds using “transition” or transition-related words in their names should be obligated to provide a transition theory in the form of a logic model in their pre-contractual material clearly describing the effect that a fund provider expects to have. Such model should clearly describe the steps 1. Input, 2. Activity, 3. Output, 4. Outcome, 5. Impact.

In addition, fund providers of transition-related terms in their funds should be required to provide sustainability context by explaining how the quantum of change expected from the funds’ investments relates to the aggregate change that environment and society are requiring (“thresholds”).
<ESMA_QUESTION_FUNA_11>

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

<ESMA_QUESTION_FUNA_12>
Yes, ShareAction believes that similar guidance for other financial products would be very useful.
<ESMA_QUESTION_FUNA_12>

Q13 : Do you agree with having a transitional period of 6 months from the date of the application of the Guidelines for existing funds? If not, please explain why and provide an alternative proposal.

<ESMA_QUESTION_FUNA_13>
<ESMA_QUESTION_FUNA_13>

Q14 : Should the naming-related provisions be extended to closed-ended funds which have terminated their subscription period before the application date of the Guidelines? If not, please explain your answer.

<ESMA_QUESTION_FUNA_14>
Yes, ShareAction believes that the naming-related provisions should be extended to closed-ended funds which have terminated their subscription period before the application date of the Guidelines. The significance of fund names is not limited to the period before fund purchase. Rather, in order to be able to consider sustainability or impact characteristics of one’s fund portfolio, it is necessary for these funds to be named appropriately and accurately.
<ESMA_QUESTION_FUNA_14>

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

<ESMA_QUESTION_FUNA_15>
ShareAction believes that there are multiple impacts from the introduction of the proposed Guidelines, especially if our recommendations under questions 1-3 are taken on board:

1. Better ability of fund clients to make fund investing choices
2. Preservation of market integrity and fair pricing
3. Better regulatory insight into investment dynamics regarding sustainability risks

<ESMA_QUESTION_FUNA_15>

Q16 : What additional costs and benefits would compliance with the proposed Guidelines bring to the stakeholder(s) you represent? Please provide quantitative figures, where available.

<ESMA_QUESTION_FUNA_16>
Representing civil society, ShareAction's stakeholders are citizens, individual and as a group. For them, the introduction of naming guidelines for funds with ESG-, sustainability-, transition- or impact will mean a significant reduction in the time spent comparing and analysing potential fund investments.
<ESMA_QUESTION_FUNA_16>

Q17