IIGCC
The Institutional Investors Group on Climate Change

IIGCC response to ESMA consultation on guidelines for the use of ESG or sustainability-related terms in funds' names

About us

The Institutional Investors Group on Climate Change (IIGCC) is the leading European membership body enabling the European investment community in driving significant and real progress by 2030 towards a net zero and resilient future. IIGCC's 375+ members, representing over €50 trillion assets under management, can catalyse real world change through their capital allocation decisions, stewardship and engagement with companies and the wider market, as well as through their policy advocacy.

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IIGCC response

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

IIGCC believes that quantitative thresholds would help to underpin the integrity of funds' sustainability credentials and mitigate greenwashing. However, without further clarity around sustainability-related terms and definitions, there is a risk that the proposed thresholds could create further confusion in the market and exacerbate existing greenwashing risks. For example, the market is still awaiting clarifications from the Commission in response to the ESAs Q&As as to what constitutes a 'sustainable' investment per Article 2(17) of the Sustainable Finance Disclosure Regulation (SFDR). IIGCC is particularly concerned that a narrow definition of sustainable investments could limit investors' capacity to invest in transitioning assets with credible plans to align with net zero, which would have a detrimental impact on real world emissions reductions. In addition, references to 'environmental and social characteristics' also lack precision, encompassing a spectrum from baseline integration of ESG into risk management through to net zero alignment and impact investment strategies.

IIGCC therefore emphasises the need for ESMA to engage with the Commission, the ESAs and wider stakeholders to ensure these key terms and concepts are clearly defined and applied consistently across sustainable finance regulation and initiatives *before* introducing quantitative thresholds. While we note that the proposed guidelines are not intended to interfere with SFDR, it will also be vital to ensure that ESMA's proposals are consistent with the Commission's forthcoming work to establish minimum sustainability criteria for Article 8 products. Qualitative guidance should be provided to help the market navigate the use of these terms and any proposed quantitative thresholds e.g., whether the threshold should be reached from the launch of the fund, or whether the threshold can be set as a target.

A range of national guidelines have been issued or consulted on that set out minimum quantitative thresholds under SFDR (including in France and Germany). We would therefore welcome clarity from ESMA as to whether the guidelines proposed in this consultation will, over time, supersede national guidance, to create a more level playing field across the EU.

Quantitative thresholds are likely more appropriate for funds which seek to respond to client demand for funds which largely exclude laggard companies and/or which focus on companies that already have high taxonomy alignment.

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.

Per our response to Q1, while IIGCC welcomes initiatives aimed at underpinning the integrity of funds' sustainability credential and mitigating greenwashing, we are cautious at this stage about expressing support for specific thresholds in the absence of further clarity on the definitions and terminology around sustainable investments and environmental and social characteristics.

To support greater alignment with the EU's wider regulatory framework for sustainable finance, we would also welcome an explicit reference to the EU Taxonomy, for example by mandating a minimum percentage of taxonomy alignment in the portfolio. The Taxonomy provides the foundation for the EU's sustainable finance strategy, and underpins disclosures to be made under SFDR and the Corporate Sustainable Reporting Directive (CSRD), so referencing it in the guidelines will be essential.

In line with SFDR, IIGCC recommends that the use of environmental and social characteristics should be binding on the fund's investment decisions, consistent with previous ESMA guidance.

More broadly, ESMA should seek to ensure that proposed thresholds are consistent with those being introduced elsewhere, including the amendments to the SEC's amendments to the 'Names Rule' and the FCA's proposed sustainable investment labelling regime. This will help to encourage interoperability in the interest of investors with global investment horizons.
For public equities, academic research[1] finds that there is greater evidence for real world impact from the use of investor influence (engagement) that from portfolio tilting and/or exclusion/divestment decisions. An impact fund name should look to draw on the Global Impact Investing Network (GIIN) guidance[2]. It may be more appropriate to set criteria for the level of engagement activity – we thus encourage ESMA to monitor the PRI's Stewardship resourcing technical working group[3].

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.

Per responses above, it will first be important to define more clearly what is meant by 'sustainable' in this context. Research by Morningstar has shown that only 27% of Article 8 funds with the term 'sustainable' in their name would be compliant with ESMA's proposals. Given that Article 9 funds will need to be comprised almost entirely of 'sustainable' investments, setting a 50% threshold for Article 8 funds without these clarifications could exacerbate some of the existing challenges identified in the market. For example, we could see further fund downgrades if even fewer funds will

[1] https://www.csp.uzh.ch/en/research/Academic-Research/Investor-Impact.html
[22] https://thegiin.org/listed-equities-working-group/
[3] https://collaborate.unpri.org/group/12676/about

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be considered to hold 'sustainable investments' under the provisions, and potentially looser interpretations of Article 2(17) under SFDR.

However, IIGCC cautions against too narrow a definition of 'sustainable' which would then feed into minimum thresholds. For example, a decision to exclude transitioning investments with credible pathways to align with net zero from the definition of a sustainable investment would be hugely detrimental. Investors seeking to deliver real world impact and emissions reductions, such as through the use of the Net Zero Investment Framework (NZIF), which is used by over 120 investors globally (c $20 trillion in AUM), would consider assets with credible plans to align with net zero as sustainable, or 'aligned'. For example, NZIF assesses the alignment potential of listed equity and corporate fixed income assets against the following criteria:

- 1. Ambition: A long term 2050 goal consistent with achieving global net zero;
- 2. Targets: Short- and medium-term emissions reduction target (Scope 1, 2 and material scope 3);
- 3. Emissions performance: Current emissions intensity performance (Scope 1, 2 and material Scope 3) relative to targets;
- 4. Disclosure: Disclosure of Scope 1, 2 and material Scope 3 emissions;
- 5. Decarbonisation Strategy: A quantified plan setting out the measures that will be deployed to deliver GHG targets, proportions of revenues that are green, and where relevant, increases in green revenues;
- 6. Capital Allocation Alignment: A clear demonstration that the capital expenditures of the company are consistent with achieve net zero emissions by 2050;
- 7. Climate Policy Engagement: The company has a Paris-Agreement-aligned climate lobbying position and demonstrates alignment of its direct and indirect lobbying activities;
- 8. Climate Governance: Clear oversight of net zero transition planning and executive remuneration linked to delivering targets and transition;
- 9. Just Transition: The company considers the impacts from transitioning to a lower carbon business model on its workers and communities;
- 10. Climate risk and accounts: The company provides disclosures on risks associated with the transition through TCFD Reporting and incorporates such risks into its financial accounts.

IIGCC published a Q&A exploring NZIF's interaction with the SFDR last year, which identifies assets identified as 'achieving net zero' or 'aligned to a net zero pathway' per the NZIF alignment maturity spectrum as 'sustainable' for the purposes of SFDR. These are defined as:

- Achieving net zero: companies that have current emissions intensity performance at, or close to, net zero emissions with an investment plan or business model expected to continue to achieve that goal over time
- Aligned to a net zero pathway: meeting criteria 1-6 (or 2, 3 and 4 for lower impact companies); adequate performance over time in relation to criterion 3, in line with targets set.

In our view, it is vital that investors are able to classify assets achieving net zero or aligned to a net zero pathway as 'sustainable', both under SFDR and any proposed clarifications of terminology and definitions under ESMA's guidelines.

It will also be important to ensure that investors can continue to hold assets that may not be aligned to a net zero pathway, but are aligning towards this pathway over time, subject to investor stewardship and engagement. While the proposed 50% threshold should not prevent investors from holding these assets/companies, we urge ESMA to consider these issues in the context of the proposed guidelines.

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

See our responses above.

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 or objectives? If yes, please explain your alternative proposal.

As noted above, clarifying underlying concepts and definitions relating to sustainable investment and environmental and social characteristics will be the most impactful way of ensuring ESG or sustainability-related names of funds are aligned with their investment characteristics or objectives. This being said, IIGCC emphasises the importance of ensuring these definitions are not too narrowly defined.

Per previous responses, we also stress the importance of ensuring that the proposals are coherent with the EU's wider regulatory framework for sustainable finance, including SFDR, the Taxonomy and corporate disclosures under CSRD. In this regard, the EU Platform on Sustainable Finance's recent data and usability report should inform ESMA's approach. The report recommends that principal adverse impacts (PAIs) could serve as a tool for setting minimum criteria for Article 8 products, with very low maximum tolerance thresholds for 'always principle adverse' indicators (e.g. mandatory indicators). Other PAIs could also be used to assess progress sustainability credentials over time.

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 agree that minimum safeguards are important. Consistent with the principles of SFDR, these safeguards should ensure funds pursuing sustainable investments avoid doing significant harm to a wider range of environmental objectives, and that these investments adhere to good standards of governance. IIGCC notes that any proposed exclusion criteria should be proportionate to the spectrum of claims, investment objectives and strategies made in fund names and documentation. It would also be helpful to clarify whether these minimum criteria are intended to apply only to listed equities, or a wider range of asset classes.

While there is some justification for applying Paris-aligned Benchmark (PAB) criteria to funds pursuing sustainable investment strategies, IIGCC maintains that investors should allocate capital to assets whose emissions are declining over time and to climate solutions. We believe this could best be achieved by maintaining investment in assets, where there is an opportunity to maximise real world impacts by driving reductions in companies that need to transition through successful stewardship and engagement, rather than by excluding issuers from a benchmark to achieve emissions reduction targets. We are therefore cautious about the use of PAB exclusion criteria which could undermine investments in transitioning assets which use stewardship and engagement to bring investments in line with minimum safeguards within a set timeframe. We encourage ESMA to reflect on this important transition dynamic in the context of these proposals and instead place more emphasis on the product's stewardship strategy, investor actions taken, and investee company progress (to be reported on under SFDR). This approach would also be more consistent with the FCA's proposed 'Sustainable Improver' label under the Sustainability Disclosure Requirements (SDR).

In line with responses above, more clarity on the nature of these safeguards and how they should be applied would be welcome. Under the SFDR Do No Significant Harm test, via the Principle Adverse Impact Indicators, there is no guidance regarding what constitutes 'good enough' or 'material harm'. Beyond this, a list of 'always harmful activities', which are unable to improve their environmental performance and/or transition to net zero, could provide a basis for minimum standards for Article 8 and 9 products, and ESMA should engage with the Commission and Platform on Sustainable Finance on this issue. Investee companies carrying out activities which are unable to transition/improve in performance could be subject to exclusions or prioritised for stewardship and engagement to decommission these assets/wind up activities. This would help to address the risk of stranded assets within portfolios, and should be supported by improved and more widely available data from companies under the draft European Sustainability Reporting Standards (ESRS) and the upcoming review of the Taxonomy Disclosures Delegated Act (Article 8).

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

More detail is needed on how the provisions would apply to derivatives.

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

IIGCC encourages ESMA to provide more detail on how these proposals would apply to products tracking an index (including PABs and Climate Transition Benchmarks).

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

No IIGCC response.

Q10. Do you agree with having specific provisions for "impact" or impact-related names in these Guidelines? If not, please explain why.

IIGCC does not think it is appropriate at this stage to have specific thresholds for impact funds. Market understandings of the definition of 'impact' and the channels for achieving it are continuing to evolve, and we encourage ESMA to consider the FCA's labelling proposals in this context. Over time, high threshold could be considered for impact funds, in line with the need to invest in companies and activities that have a demonstrable positive climate/environmental impact.

It will also be important to fully capture the nuances between investor actions to generate impact (e.g. stewardship) and the contribution of the investee company. In the context of the net zero transition, while investors can provide an 'enabling' role by decarbonising their portfolios and scaling investment in climate solutions, the real-world impact (i.e. the decarbonisation of the real economy) is driven by the investees themselves. Where enterprise contributions are negative, investors need to engage their holdings to encourage progress on their transition journeys. Conversely, where investees are generating positive impacts, investors should reorient capital allocations towards them. IIGCC suggests that ESMA draws these nuances out more clearly in the proposals. ESMA should draw upon the work of the GIIN's guidance on impact in listed equities[4].

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

IIGCC believes that funds focussing on transitioning activities should either include a material and pre-defined proportion of investee companies in high-impact sectors[5] with credible transition plans to net zero when using the specific provisions for "transition" or translation-related names. This will help to underpin the integrity of funds' sustainability credentials, mitigate greenwashing and have a positive impact on real world emissions reductions. Investment strategies for transition-focused funds should focus heavily on investor stewardship and engagement. See our responses to Q3 and Q6 for more detail. ESMA should ensure that transition-related provisions are science-based, credible and consistent with both the wider EU regulatory framework for sustainable finance (e.g. Taxonomy, SFDR, CSRD) as well as the recommendations of the Task Force for Climate-related Financial Disclosures and the FCA's proposed 'Sustainability Improvers' category under SDR. IIGCC believes that new disclosures requirements stemming from CSRD and ISSB climate-related standards on climate transition plans will further facilitate the assessment of transition plans, and we welcome and support efforts to continue to align methodologies in the industry, with as much consistency or inter-operability at global level.

As noted in our response to Q3, IIGCC is particularly concerned that a narrow definition of sustainable investments could have a detrimental impact on investments in transitioning assets with credible net zero alignment pathways. When considering specific provisions to assess funds focusing transition-related approaches, we urge ESMA to consider the actions, recommendations and criteria established under NZIF and incorporate them into the proposals. NZIF is the most widely used alignment framework globally, and sets out steps for an effective investor transition plan to align portfolios with net zero and achieve real world impact by encouraging investees to decarbonise (including via stewardship) and to increase investment in climate solutions. IIGCC would be happy to discuss NZIF in more detail with ESMA if helpful.

Q12. The proposals in this consultation paper relate 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?

No IIGCC response.

[4] https://thegiin.org/listed-equities-working-group/

[5] High-impact sectors are set out in the NZIF Implementation Guide, Appendix B (pages 25-27).

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.

We believe a 12-month transitional period would provide the necessary time for investors to adapt fund names, strategies and portfolios in accordance with the proposals.

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.

Given that closed-ended funds will not be subscribed following the subscription period, we do not see the need to apply the proposed guidelines to these funds.

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

See IIGCC's responses above – without clarity on definitions and terminology, the introduction of quantitative thresholds could exacerbate existing confusion and greenwashing risks in the market.

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.

No IIGCC response.