From: European Investors-VEB
To: ESMA
Re: European Investors' Consultation Reply to ESMA Guidelines on funds' names using ESG or sustainability-related terms
Date: 17 February 2023

Introduction

This brief introductory remark with preamble is followed by European Investors' replies to the specific questions in their numbered order.

European Investors-VEB

For almost 100 years European Investors (EI) aims to strengthen the representation of investors in Europe by the following activities:

- engaging with listed companies at their shareholders' general meetings, and in one-on-one meetings with their directors, representing long-term investors, based on our proprietary analyses which encompass qualitative criteria;
- representing investors in legislative and regulatory discussions within Europe on areas which directly impact their legal position and their investments; and
- initiating legal proceedings to mend corporate governance deficiencies or to have compensation awarded to investors who have incurred losses on their investments due to fraud, deceit or mismanagement from the part of companies listed in Europe, banks, auditors and (former) directors.

Preamble

Although investors and financial consumers are aware of the unhealthy incentives, and emphasis on the self-interest of financial companies, it can be said – and we experience this time and time again – that confidence in the credibility of information provided by financial institutions is high. This confidence is partly due to the existence and actions of supervisors and is comparable to the belief in labelling in the food and pharmaceutical industry.

Investors and financial consumers have a responsibility when it comes to research into investment propositions. This is separate from the fact that they will rely on fund names in an initial selection of potential investments.

The initial selection of investors will undoubtedly weigh in the final investment decisions since it concerns a fundamental choice made by most investors from a behavioural perspective. Once a proposition is 'out of scope' due to an initial option, it will no longer be included in the final choice, even if it would be an eminently suitable solution for the investor concerned

Understandably, investment proposition providers consider this when designing fund names. However, the good will suffer from the bad here. EI, therefore welcomes further regulation of fund names.

<u>Q1</u> EI agrees fundamentally. It seems evident that investor protection is, thereby, promoted. EI concurs: the concern that sustainability disclosures give rise to greenwashing is entirely justified, if only from anecdotal evidence. Taking it from the Consultation Paper itself, we would point to the fact that there is a considerable percentage (13 %) of funds the names of which contain at least one ESG-related word that discloses under Article 6 SFDR. For the sake of clarity: where a Fund discloses under Article 6 SFDR, there is no justification whatever for even the remotest whiff of sustainability (whether in the Fund name or otherwise). We would, by way of illustration, also point to the AFM in the Netherlands reporting in 2021 on the implementation of the SFDR. It noted that Funds would incorrectly have investors believe that they were exclusively aimed at sustainable investing (ie labelling as Article 9 SFDR). Moreover – and to the particular point of this consultation, a concern that fund names incorporating sustainability-related terms *by themselves* attract investors, without those investors making enquiries enabling them to take an informed view on the accuracy or truthfulness, is perfectly illustrated by the article co-authored by Stefan Zeisberger, *Do Investors Care About Impact?*[1] The study reveals that when investors compare several sustainable investments, their 'willingness to pay' is primary driven by an emotional, rather than a calculative, valuation of impact.

<u>Q2</u> Undoubtedly, whereas such threshold is arbitrary, EI agrees. Of course, as is also conceded in the Consultation Paper, all this may be seen in the context of the SFDR distinction between so-called Article 8 and Article 9 Funds. It may not be a coincidence that this Consultation comes at a moment where there are considerable uncertainties on properly distinguishing between Article 8- and Article 9-classification. Strikingly, a marked number of Funds have recently downgraded from Article 9- to Article 8-products. ESMA will appreciate that this may likely be a cause for frustration among investors having invested in such downgraded funds, having taking them – at the time of their purchase – to be Article 9 ones. It may be clear; had the investors known about the downgrading (however much the downgrading was equally unforeseen by the seller at the time of the transaction), it could well have led to a different decision.

Yet, this Consultation's proposals concern a distinct matter. Even where the more strict quantitative criteria ESMA proposes for funds using (a derivative of) the word sustainable apply, it may well regard Article 8 Funds. There is a likely risk however for an equivalence to be construed between the 'lower' threshold of 80 % for investments to be used to meet the fund's professed ESG-objectives and Article 8 Funds on one hand, and the 'stricter' standard of 50 % within the 80 % for sustainability-denominated Funds and Article 8 Funds on the other.

ESMA itself stresses in the Consultation Paper that the proposed Guidelines are not intended to interfere with the SFDR-requirements.

> [. . .] are not intended to interfere with the requirements of Regulation (EU 2019/2088 on sustainability related disclosures in de financial services sector (SFDR) or the requirements of the Regulation (EU) 202/852 on the establishment of a framework to facilitate sustainable investment ("the Taxonomy Regulation"). They apply in relation to the above-mentioned requirements in the UCITS Directive, AIFMD and Regulation 2019/1156.

[1] The Review of Financial Studies 13 September 2022. Available at: Do Investors Care about Impact? | The Review of Financial Studies | Oxford Academic (oup.com).

Q3 Agreed, but with reference to our reply to Q2 above.

Q4 It is not so much a matter of 'constructing' threshold mechanisms. Introducing quantitative criteria by themselves, bring about a threshold mechanism. But one could be concerned about the degree to which such threshold mechanisms will prove to be adequate, given that – as is the case with classifying Funds as SFDR Article 8 or 9 products – it will be to the FMPs themselves to classify.

Q5 Were the SFDR actually to 'bite', EI believes these Guidelines not to be necessary. It is inconceivable to EI that, were classifications as Article 8 or Article 9-products, capable of being relied on as being materially correct, those Funds could be depended on as properly denominated. To turn this argument around; the fact that it appears to be necessary to issue these Guidelines, is poor testimony to the SFDR. As indicated earlier under our reply to Q1, obviously there ought not to be a possibility for Funds which do not justifiably classify under Articles 8 or 9 SFDR – disclosing under Article 6 – to use ESG-related terms in their names.

Q6 Not only does EI agree with the need for minimum safeguards for the remaining investments of the Funds, but it deems this an essential complement thereof. The exclusion criteria formulated in Article 12(1)-(2) of Commission Delegated Regulation (EU) 2020/1818 are fit-for-purpose, and, hence, the reference thereto in the proposed paragraph 18 meet with our full support.

Q7 EI suggests the use of market value – the reason being that the notional value of (certain) derivatives may well be negligible.

Q8 EI agrees that where Funds designate an index as a reference benchmark, they should be subject to exactly the same regime as any other Fund. In essence, where such Funds suggest sustainability-related objectives through their names, there is a similar (potentially deceptive) attraction to investors.

Q9 On the contrary – precisely where there is synthetical replication – there is just cause for enhancing investor protection. Where synthetic replication applies, there is considerable counterparty risk. Thus, by no means a distinction should be made.

Q10 EI entirely agrees that where Funds profess to have *impact* with their investment policy, there should be a more stringent regime. EI argues, at this place, in favour of a holistic approach: the terminology and regulatory regimes should be synchronous throughout all European Union regulatory instruments and practice.

Q11 EI believes that there should not be a specific carve-out for 'transition'-related labels. Anything being advocated under the guise of transition, should be categorised under 'impact-related', and, hence, not be treated differently. This is as much in view of an approach which is based upon 'substance over form', as it is motivated by our wish not overly to complicate matters. Complexity in this area may well be a licence for deceit, or, at least, obfuscation.

Q12 Absolutely – with things changed that should be changed, a similar regime should apply to such financial products which are not covered.

Q13 EI agrees with the proposed six months transitional period. This seems not an unreasonably long period. In fact, EI knows from experience that Fund names are amended frequently and that this doesn't appear to be operationally difficult. Of course, EI is curious indeed to monitor the developments during the transitional period – especially the extent to which Funds will amend their names such that the sustainability-related element is struck off. Again, where this happens, this could be seen as a reason for investors feeling frustrated about their previous investments.

Q14 This is of course a matter which may likely cause issues if, upon the naming provisions having taken effect, these Funds would see themselves urged to amend their names. However, in the interest of transparency, and the cleansing effect going forward, EI is in favour of such extension. EI would add that it may prove very costly to investors which are committed to sustainability targets themselves, having to divest of investments which turn out no longer to fit in their portfolio. The more such investors approach certain deadlines toward (their own) sustainability targets, the more this may hurt.

Q15 EI favours the enhanced investor protection which is the expected result of these Guidelines. EI will monitor, with interest, whether, in if so, how, there may be cases where investors allege deceit where Funds retract sustainability-related names.

Q16 EI wishes to see enhanced investing into sustainability-related financial instruments by retail and institutional investors alike. More security – caused by the perceived increase of investor protection – is likely to see such investments increase.