COMMENT

Comment

of the German Insurance Association (GDV)
ID-number 6437280268-55

on the ESMA Consultation on Guidelines on funds' names using ESG or sustainability related terms (Consultation Paper ESMA34-472-373)

Gesamtverband der Deutschen Versicherungswirtschaft e. V.
German Insurance Association
Wilhelmstraße 43 / 43 G, 10117 Berlin
Postfach 08 02 64, D-10002 Berlin
Phone: +49 30 2020-5000 · Fax: +49 30 2020-6000

Rue du Champ de Mars 23, B-1050 Brüssel
Phone: +32 2 28247-30 · Fax: +49 30 2020-6140
ID-number 6437280268-55
www.gdv.de

Contact
investments
European office

E-Mail
kapitalanlagen@gdv.de
bruessel@gdv.de

Introduction

As one of the largest institutional fund investors in Germany, the insurance industry has not only invested more than one third of its EUR 1.9 trillion in AIFs but has also invested more than EUR 100 billion in mutual funds for its customers, mostly in the context of unit-linked insurances. Considering that the interest of retail investors in sustainable funds increases, it is important that fund names are not misleading in order not to make false promises about the sustainability characteristics of the fund. We therefore support efforts to ensure consistency between fund names and the investment objectives embodied in the investment strategy or investment goals and to avoid greenwashing. However, the following should be considered:

There is already a large number of legislative acts in the area of sustainable finance that aim to provide transparency on sustainability-related claims of financial products and their providers. The Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector (“SFDR”) and the Regulation (EU) 2020/852 on establishing a framework to facilitate sustainable investment ("Taxonomy Regulation") not only aim to create a consistent understanding and level playing field across the EU for the offering of sustainable investment products but also to avoid greenwashing. Thereby, we consider it important that the ESMA-guidelines do not conflict with the requirements of these regulations. We welcome the fact that the proposed guidelines explicitly state that no interference with these regulations is intended.

However, we would also like to stress that there are other well established and effective rules in place today, which specifically protect customers from unclear and misleading claims (including on sustainability-related characteristics). The Unfair Commercial Practices Directive (2005/29/EC – “UCPD”) and the Unfair Terms Directive (93/13/EC) e. g. pursue this aim. Their abstract rules form the basis of an extensive jurisprudence und supervisory practice. In this way, they provide civil courts and supervisory authorities with robust means to deal with greenwashing when it arises. This is illustrated by the extensive Guidance by the EU Commission on the interpretation and application of the UCPD (2021/C 526/01), which includes comprehensive instructions on the subject of sustainability. At the same time, the UCPD is flexible enough to deal with each individual claim in accordance with its specific nature.

We would, furthermore, point out that the Legislator is currently working on a legislative proposal, which would specify the requirements of the UCPD for sustainability-related claims in more detail (COM (2022) 143 final). We also understand that yet more legislation with the same objective may be forthcoming.

We believe that it would be important for ESMA to consider these rules (existing and planned) and the question how they would interact with the envisaged guidelines.

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

We consider clarity and thus legal certainty about the characteristics of a product with ESG or sustainability in its name to be very important for both product providers and investors. In our opinion, however, it is crucial that the following sequence is followed: First, the EU Commission must clarify the calculation method of "sustainable investments" according to Art. 2 Nr. 17 SFDR as outlined in question 1 of the ESA queries of 9. September 2022 relating to the interpretation of SFDR. Only when this prerequisite is fulfilled, the introduction of quantitative minimum thresholds for the naming of funds is useful.

We also strongly advocate a common EU approach instead of a multitude of different national approaches to achieve this goal. Furthermore, for EU harmonization and true comparability of products it is of utmost importance to have a common understanding of the naming convention, i. e. a clear differentiation which names/words (e. g. green, climate, etc.) relate to the ESG-terms and which ones to the sustainability-terms (if both terms are set to persist separately in the final guidelines). Leaving this decision to national supervisory authorities might again lead to inconsistencies.

We have doubts that the considered introduction of two different thresholds with different requirements is suitable to achieve the intended goal. Different requirements depending on the name of the fund rather lead to increased complexity and are not likely to make it easier for the client to identify to what extent the product is suitable to meet their own sustainability preferences. The differentiation provided for in the guidelines and the different requirements associated with it are not likely to be apparent to consumers or could at least lead to confusion among customers who may not understand the differences between the various criteria for such funds resulting from the name of the fund. We consider it problematic that it is left to the national competition authorities to assess the respective classification depending on the terms used. Different interpretations are conceivable here, which in turn would be recognisable neither for customers nor for other financial market participants. In the area of sustainable finance, where convergence is to be established, different standards and practices could thereby become established in the various member states. This could lead to difficulties in cross-border market access and in the comparability of products. However, uniform handling must be ensured in order to guarantee a fair and equal market in all member states.

As long as the precondition (clarification on the calculation method of “sustainable investments” according to Art. 2 Nr. 17 SFDR (see above for details) for eventually introducing quantitative minimum thresholds is not met, a principles-based approach should be used as guidance for using sustainable or ESG related wording in fund names.

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.

No. As stated above, clarification on the calculation method for “sustainable investments” needs to be provided (as outlined by question 1 of the ESA queries of 9. September 2022 relating to the interpretation of SFDR), before determining any quantitative minimum thresholds. In general, we consider that this guideline should follow the same principles as other regulation addressing fund names. In order to comply with the principle of clear, fair and non-misleading communication, it has been considered sufficient to ensure that the main focus of the investment strategy is aligned with features implied by the fund name (min. 51% investments with E/S characteristics). We would also recommend that this guideline in any case allows for a higher proportion such as 25% that can be allocated to cash and derivatives, as this is needed for liquidity and general risk management purposes. If such overall threshold is applied, we would suggest that cash and derivatives held for risk management purposes are excluded.

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.

No. As mentioned above, it is crucial that the EU Commission clarifies the calculation method for "sustainable investments" as per Art. 2 Nr. 17 SFDR (as outlined by question 1 of the ESA queries of 9. September 2022 relating to the interpretation of SFDR) before setting any threshold. This is very important in order to achieve true comparability between products. We therefore recommend that the timing and outcome of this clarification be considered before finalising the fund naming guidelines.

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

If two different criteria with different thresholds are being considered, both criteria should be equivalent, i.e., implemented as alternative criteria. Thus, meeting either criterion should be sufficient to use any type of ESG or sustainability-related fund name (either minimum proportion of investments used to meet the promoted environmental or social characteristics or minimum proportion of investments used to attain a sustainable investment).

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.

We believe that the existing legislation on unfair commercial practices (including the amendments on the prevention of greenwashing which are currently discussed by the Co-legislator) should be taken into account when considering introducing yet further regulation by way of guidelines (please see our respective introductory comments).

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.

No, we don't agree with the proposal to include minimum safeguards. In the case of mandatory application of minimum safeguards to overall fund investments based on exclusion criteria such as Commission Delegated Regulation (EU) 2020/1818 Article 12(1)-(2), efforts to finance the transformation of the economy would be hampered. According to Article 12 (1) (d) Administrators would have to exclude inter alia already companies that derive 1 % or more of their revenues from exploration, mining, extraction, distribution or refining of hard coal and lignite.

Fund managers would be deprived of the opportunity for such funds to engage in active dialogue in the context of ESG engagement, to raise awareness of the consequences of climate change and address ESG issues, and to influence the management of target companies in order to promote a sustainable orientation of corporate strategies and thus support the green transformation of the economy.

Furthermore, the proposed exclusions, based on the exclusions for Paris-aligned Benchmarks (PAB), relate primarily to climate and are therefore not suitable for a holistic ESG approach. Moreover, the investment strategies of SFDR Art. 8/9 products already cover exclusions. Additional mandatory layers of exclusions thus further reduce the investment universe/diversification opportunities.

Also, the reference to the DNSH criteria of the Taxonomy Regulation in Art. 12 (2) of the PBA does not take into account the difference between activity level for taxonomy-alignment and company level. The DNSH Taxonomy criteria are designed for application at the level of economic activities and not for application to the entire company performing such activities and as minimum standard for ESG funds. 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 Nr. 17 SFDR and again (3) for the issuer based on the DNSH criteria of the Taxonomy. Given that even the current situation with two conflicting DNSH tests 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.

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

We see no reason why derivatives should be carved out or be subject to specific provisions for calculating thresholds. When they are intended for investment purposes of investments in respective "green" assets, they should be taken into account.

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?

/

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

/

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.

/

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

/

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

/

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

Building on the 17 Sustainable Development Goals of the United Nations and the Paris Climate Change Agreement of 2015, a comprehensive sustainability framework has been created in the European Union since 2018 with the aim of

transforming the economy towards a sustainable and CO2-neutral economy. On the way to a more sustainable resource-efficient economy, the financial sector, as a key institutional investor group, has a significant role to play.

Mandatory consideration of minimum safeguards based on exclusion criteria such as Commission Delegated Regulation (EU) 2020/1818 Article 12(1)-(2) would largely prevent transformation efforts, as described in response 6. Therefore, first and foremost, product requirements for sustainable investments should take these transformation efforts into account and admit them. With clear, fair, and transparent disclosure of these aspects to the customer, further consideration in the funds' name is then not necessary.

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?

As already clearly stated in the question, the proposals in this paper relate to the names of investment funds, resulting from specific sectoral concerns. The guidelines envisaged by ESMA have therefore rightly been developed and intended exclusively for funds.

As mentioned above, effective regulation to counter greenwashing exists already today at EU level, with yet more legislation being forthcoming (see our comments on question 1).

Insurers support the EU Commission's current efforts to develop a comprehensive Sustainable Finance Framework (SF Framework). In the existing regulatory environment, they already take concrete actions such as implementing sustainable-related disclosures, standards and strategies in their portfolios with respective relevance for their products. Undeniable clear guidance on the application of the regulations of the EU SF Framework, e. g. Art. 8 and 9 of the SFDR as well as the Taxonomy is needed. Also, the calculation methods of "sustainable investments" according to Art. 2 Nr. 17 SFDR should be clarified and coherent with the rest of the EU SF Framework (as outlined by question 1 of the ESA queries of 9. September 2022 relating to the interpretation of SFDR).

In any case it has to be considered, that the financial products available on the market differ, in some cases considerably, in terms of their objectives, structure and functioning and are accordingly subject to different regulatory requirements. Insurance products for example differ significantly from investment funds. Insurers' investments must cover their long-term liabilities on the liability side and thus follow

an asset-liability matching approach, which requires the need to manage the asset and liability sides of the balance sheet when selecting assets. In this context, the principle of balancing in the collective and over time applies to insurance products. In Germany e. g. life insurers mostly maintain (only) a single “security assets” (so called Sicherungsvermögen), which is subject to all insurance products with security assets participation. The security assets must therefore not only cover one specific product, but regularly a large number of products. In contrast to this any requirements regarding funds only apply exclusively to one specific investment fund, but not simultaneously to other funds of the Fund Management Company, so that the portfolio of a fund must solely be considered exclusively separately and on its own.

For structural reasons alone, therefore, for insurance products with participation in the security assets (Sicherungsvermögen) different aspects must be taken into account when specifying certain investment requirements than for funds. In particular, the ESMA guidelines that contemplate certain thresholds for funds named as sustainable or ESG-funds could not be applied in the same way to pension products with participation in the security assets (Sicherungsvermögen).

If it should prove necessary in the future, EIOPA would have to consider corresponding guidelines and will then have to take into account the specific requirements and particularities of insurance products.

Despite all the differences between products, it is always equally important to ensure that communication is fair, clear and not misleading.

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 consider the inclusion of a grandfathering provision necessary to ensure legal certainty and to avoid unnecessary distortions. Investment funds that were already approved at the time of publication of the final guidelines should be excluded.

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.

/

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

Whether the guidelines achieve their goal of giving investors more security when investing in funds that have sustainability references in their fund name seems

questionable. As described, a key prerequisite for the guidelines is the clarification of the calculation approach for sustainable investments. Moreover, the intended differentiation between funds that have either ESG or sustainability-related fund names is likely to be difficult for consumers to understand. In addition, as explained, there is a risk that the categorisation of the funds will be handled differently by the respective NCAs.

Depending on the actual content of the final guideline, many funds may have to adapt. Either in terms of changing the name, which will lead to additional costs, or in terms of changing the assets held by the fund, which will entail transaction costs for the funds and reduce financial performance. Both would tie up significant resources for fund managers and national supervisory authorities. Second-round effects for insurance products with affected underlying funds must also be taken into account accordingly.

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.

/

Berlin, 20 February 2023