BEUC The European Consumer Organisation

The Consumer Voice in Europe

Better Names for ESG and Sustainable Investment Funds

BEUC's views of ESMA's proposal for name-related requirements for investment funds

Contact: **financialservices@beuc.eu**

BUREAU EUROPÉEN DES UNIONS DE CONSOMMATEURS AISBL | DER EUROPÄISCHE VERBRAUCHERVERBAND
Rue d'Arlon 80, B-1040 Brussels • Tel. +32 (0)2 743 15 90 • www.twitter.com/beuc • www.beuc.eu
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Why it matters to consumers

Consumers who want to buy investment funds that do not harm the planet or people are often misled about the sustainability content of the funds on offer. The European Securities and Markets Authority (ESMA) has now proposed minimum sustainability requirements for funds that contain words like 'green', 'sustainable', 'ESG' etc. in their names because the name is often the first feature of a fund that potential retail investors notice and because names can, and often do, contain misleading promises. Narrowing the gap between an investment fund's sustainability promise and the reality of its contents is a welcome improvement, but it will not solve the underlying problems in the sustainable investment industry that create the conditions for greenwashing.

Summary

We agree with the need for measures to fight greenwashing in retail investment products and welcome the chance to comment on ESMA's proposals.

- Well-designed and properly enforced supervisory guidelines are a welcome stopgap measure, especially if several such measures are combined. However, they are no substitute for a reform of the regulatory framework for sustainable investment products, especially the Sustainability-Related Financial Disclosures Regulation, which should be turned into or supplemented by a proper product standard.
- We support minimum content thresholds for sustainable funds, but not the distinction between funds that carry words like 'sustainable' in their names and others that 'merely' use ESG-related terms. The same rules should apply to all sustainable/ESG/Green investment funds.
- We support the use of exclusion lists, but we suggest using a more far-reaching one than the one that ESMA proposes.
- So-called impact funds should be subject to rules that take their specificities into account. Fund managers should at least have to explain how they intend to achieve and measure impact.
- There should also be special rules for so-called transition funds. They should have to describe how they intend to improve the sustainability performance of investee companies and how they keep track of improvements (or the lack thereof).

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ESMA’s naming-related proposals are a welcome stopgap measure, but no substitute for a robust legal framework

BEUC shares the concerns about greenwashing in retail investment products and welcomes ESMA's efforts to use supervisory tools to curb it.[1] Names communicate information about a fund to retail investors and misleading fund names are a consumer protection issue that requires action in the form of supervisory requirements for funds that use terms like 'sustainable', 'ESG', 'green' etc. in their names. However, it is important to acknowledge the limitations of this approach, which should be a stopgap measure until we have a robust legal framework for sustainable investment products. Names are not the only means through which funds are (over-)sold as sustainable. This can, for instance, also happen when a fund that is self-classified as sustainable is shown in search results to retail investors who use online search and comparison portals. More importantly, however, profound regulatory intervention, especially a root-and-branch review of the Sustainability-Related Financial Disclosures Regulation (SFDR), is ultimately needed to create a robust legal framework for sustainable investment products. The recommendations made by BEUC and other civil society organisations in 2021 remain relevant in that regard.[2]

In the longer run, retail investors will be best served by labelling, classification and/or grading schemes for investment products that are based on standardised definitions and criteria. The UK Financial Conduct Authority, for example, is currently exploring the option of defining categories and labels for different types of sustainable investment products.[3]

No artificial distinction between ‘sustainable’ and ‘ESG’ funds: all funds should apply the same minimum requirements

ESMA suggests introducing quantitative minimum requirements for funds with sustainable-sounding names, although not all such names are to be subject to the same requirements. Funds that use ESG- or ESG-related terms in their names, such as 'climate change solutions fund' or 'biodiversity equity fund�much, would only have to ensure that at least 80% of fund investments are used to meet the environmental or social investment objective, whereas funds that use the word 'sustainable' or other sustainability-related terms, e.g. 'sustainable water equities fund‛ or 'sustainable society fund', would also have to ensure that 50% of the fund's investments are sustainable as defined Article 2(17) in the SFDR.

We agree with this approach, but not with the distinction between funds that use the term 'sustainability' or related terms, and those that use ESG-related terms. This distinction appears based on the assumption that the term 'sustainability' contains a stronger, more ambitious promise than 'mere' ESG words and should therefore be held to a higher standard. From a retail investor perspective, there is no reason to assume that naming differences like these influence how people perceive the sustainability promise of an investment product. Another problem with the special rule for ‘sustainable’ names is that it can be avoided too easily by substituting that term with an ESG-term. One could, for example, rename the ‘Sustainable Society Fund’ to ‘Fair and Inclusive Society Fund’, and thus retain all the marketing benefits of a ‘positive’ name, while avoiding the more stringent requirements for ‘sustainable’ funds. We suggest to eliminate the distinction and

[1] https://www.esma.europa.eu/press-news/consultations/consultation-guidelines-funds%E2%80%99-names-using-esg-or-sustainability-related. BEUC’s contribution to this consultation can be found here.[2] https://www.beuc.eu/sites/default/files/publications/beuc-x-2022-027_joint_recommendations_for_min_criteria_for_sustainable_investments_and_products_with_esg.pdf

[2] https://www.beuc.eu/sites/default/files/publications/beuc-x-2022-027_joint_recommendations_for_min_criteria_for_sustainable_investments_and_products_with_esg.pdf

[3] https://www.fca.org.uk/news/press-releases/fca-proposes-new-rules-tackle-greenwashing

apply the same rules to all sustainable/ESG/Green investment funds, regardless of which ESG- or sustainability-related term they use.

The 50% minimum share of sustainable investments should increase over time to reflect the fact that the universe of sustainable investment is likely to grow over the coming years, which will make it easier to create investment products that are nearly fully sustainable.

ESMA further proposes that all ESG or sustainable funds use exclusion lists to make sure that they are not invested in companies that harm people or planet. We agree with the proposal in principle, but call on ESMA to make it stricter and also suggest a different exclusion list than that proposed by ESMA, one that is more comprehensive and elaborated and more in line with what consumers would expect from a sustainable investment product.

Special rules for impact and transition funds are needed

Additional tailored rules should apply to funds that promise 'impact' or 'transition'. Impact funds promise to promote sustainable businesses, whereas transition funds claim that they help currently unsustainable businesses become more sustainable (or less unsustainable). These two types of real-world effects of an investment strategy are hard to achieve and even harder to measure, therefore the risk of over-promising is very high. BEUC members have indeed highlighted that impact promises in particular are frequently questionable or unsubstantiated.[4] In the absence of legal rules that define what counts as impact/transition and how they can be measured, ESMA should set out supervisory requirements that reflect the specificity of these fund types and require fund managers, at least, to demonstrate plausibly how they intend to achieve the desired effects and describe how they track and measure the effects and report past performance.

Transition funds should normally use a strategy of active pressure on company managements, also known as investor stewardship, to make investee companies more sustainable (or less unsustainable), and they should have to describe this strategy. This must include goals for measuring improvement and divestment triggers for when stewardship is unsuccessful. The exclusion lists that should apply to other types of sustainable funds cannot apply to transition funds because their goal is exactly to make bad companies or sectors better.

Moderate improvements expected, but regulatory framework needed

If these naming-related requirements are well-designed and properly enforced we expect moderate positive effects on the investment fund market, such as a clearer differentiation between sustainable and traditional return-only funds, especially if flanked by supervisory action in other areas, such as the distribution of funds through online portals. That would make it easier for retail investors, even those who do *not* wish to invest sustainably, to find the right product for them. It would also contribute to the fight against greenwashing because the minimum requirements and exclusions would narrow the gap between promise and reality in sustainable investment funds.

[4] The regional German consumer organisation Verbraucherzentale Baden-Württemberg has collected and officially complained about several cases of greenwashed investment funds, including examples of impact funds. See here and here.

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