

20 February 2023

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Submitted online : <https://www.esma.europa.eu/press-news/consultations/consultation-guidelines-funds%E2%80%99-names-using-esg-or-sustainability-related>

RE: Consultation on Guidelines on funds' names using ESG or sustainability-related terms

BlackRock is pleased to have the opportunity to respond to the European Securities and Markets Authority's (ESMA) Consultation Paper on Guidelines for the use of ESG- or sustainability-related terms in funds' names.

As an asset manager, BlackRock is a fiduciary that invests and manages capital on behalf of retail and institutional investors across public and private asset classes. The money we manage is not our own – it belongs to our clients, the asset owners, who choose their own investment strategies and products from our broad product offerings.

BlackRock's investment approach is rooted in our fiduciary duty: we start with our client's objectives, we seek the best risk-adjusted returns, and we underpin our work with research, data, and analytics. We apply that same approach to sustainability and the way we assess sustainability-related drivers of risk and returns. Many of our clients are asking for products that have sustainability-focused objectives, in order to mitigate risk, capture opportunity, or align to other goals. We offer choices in investment products, portfolio construction, and stewardship (Voting Choice) to help them to meet their goals.

Executive summary

We are supportive of efforts to bring more clarity to the sustainable investment landscape, and we believe that clarity in fund naming can be an important enhancement to the existing Sustainable Finance Disclosure Regulation (SFDR). With that in mind, we are generally supportive of ESMA's objective to instruct investment funds to use clear terminology in how they present themselves to investors.

That said, it is equally essential that fund managers can accurately represent a fund with a name and description based on its primary investment focus. This means that rules (and especially thresholds) need to be designed and calibrated in a way that an investment product can be designed to meet the full breadth of legitimate investor objectives and be able to clearly and factually represent the strategy or product features in their fund name, including where ESG or sustainability considerations are a key part.

In our view, guidance in this area should also reduce uncertainty and help provide greater comparability between products. To do that most effectively, ESMA may wish to consider guidance that could help distinguish at a high-level between different types of ESG- or sustainability-related investment strategies or products. Clearer segmentation of products would aid investor decision-making and product comparability, and could help avoid some of the difficulties in calibrating quantitative requirements for the wide range of ESG and sustainable investment products. We outline this concept further in our response.

We recognise ESMA's focus on a minimum proportion of investments should substantiate the fund's ESG- or sustainability-related claim or objective. As this is a strategy-level commitment, it avoids the problems that might be associated with an asset-by-asset test for many index and ESG-related strategies (for example). As such, subject to technical clarifications about how instruments used for liquidity and risk management are treated in this calculation, we believe that it can work for most funds. We would however encourage ESMA to consider challenges in applying the proposed thresholds to fixed income, multi-asset funds, or those active in private markets.

We see more difficulty in designing a single set of minimum exclusion criteria. Investors express their sustainability needs and preferences in a variety of different ways, not all of which involve avoiding certain companies or sectors. Where those preferences do involve avoiding certain types of exposures, investors do not always seek to avoid the same ones, making a uniform set of minimum exclusion criteria across all products with an ESG- or sustainability-related term in their name problematic.

That said, it is clear that exclusions can and do play an important part in many products that deliver an ESG- or sustainability-related strategy or objective to investors. As such, we would be supportive of an additional requirement for products that use exclusions to achieve part or all of their ESG- or sustainability-related investment objectives to clearly explain how those exclusion policies work and contribute to the objective of the fund.

Given the definition of "sustainable investments" under the SFDR remains subject to outstanding Q&A from the European Supervisory Authorities (ESAs), we believe it is too early to gauge the possible implications of ESMA's proposed minimum allocation to sustainable investments.

We also believe ESMA should provide more clarity around the different terminology and high-level categories of ESG- and sustainability-related terms. Further clarity would be beneficial to investors and enhance certainty on which requirements would apply.

Finally, given the significant changes to product prospectuses and disclosure documentation in the past recent years under the SFDR and Taxonomy Regulation within a relatively short period of time, we believe it is important for ESMA's proposed changes to be appropriately phased within existing product update cycles.

We welcome the opportunity to comment on the issues raised by this consultation paper and will continue to contribute to ESMA's thinking on this and other topics.

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

In our experience, there is no one single way that investors approach sustainable investing. There are a variety of motivations for which investors seek out investment products or solutions with ESG- or sustainability-related strategies or objectives. For example:

- they may be seeking to avoid any number of a myriad of ESG- or sustainability-related risks;
- equally, they may be seeking exposure to the potential investment opportunities brought about by various ESG-or sustainability-related economic trends or developments;
- they may be seeking to align their investment portfolio with their own environmental or social objectives or;
- seeking to create positive, real-world sustainability impact through their investments.

Each of these motivations could lead an investor to a different investment product that meets that specific need or combination of needs. Accordingly, there is a range of investment products on the market today that seek to offer investors solutions to fulfil these aims. This wide variety of legitimate investment approaches means that it can be difficult to craft a 'one-size-fits-all' framework that can meaningfully substantiate the range of different ESG- or sustainability-related claims each product is making.

We are supportive of efforts to bring more clarity to the sustainable investment landscape, and we believe that clarity in fund naming can be an important enhancement to the existing Sustainable Finance Disclosure Regulation (SFDR). With that in mind, we are generally supportive of ESMA's objective to instruct investment funds to use clear terminology in how they present themselves to investors. Investment funds should not be marketed as ESG or sustainable or any related term, if they do not substantiate such a claim. We also agree that fund names play a crucial role in an investor's (and more specifically a retail investor's) understanding of the product's features, and therefore that appropriate naming Guidelines can add value from an investor protection perspective.

That said, it is equally essential that fund managers can accurately represent a fund with a name and description based on its primary investment focus. It is very likely that not all funds with an ESG- or sustainability-related name will meet ESMA's proposed thresholds and minimum safeguards in their current form (and indeed, this may be ESMA's intent), yet it is still important that these funds' names can accurately reflect the nature of the product's strategy or objective to avoid misleading investors.

Any rules (and especially thresholds) need to be designed and calibrated in a way that an investment product can be designed to meet a legitimate investor objective and be able to clearly and factually represent the strategy or product features in their fund name, including where ESG or sustainability considerations are a key part of it.

Finally, we believe ESMA should provide more clarity around the different terminology and high-level categories of ESG- and sustainability-related terms. Further clarity would be beneficial to investors and enhance certainty on which requirements would apply.

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.

To introduce thresholds that tie the assets in the portfolio to the substantiation of the fund's description of its objective or strategy in its name, the mechanics and construction of the requirement need to be reasonable and provide the market with sufficient scope (in terms of interpretation and practical implementation) for any such criteria to be applied in a manner that does not impede portfolio construction and ability to deliver investor product demands.

We believe ESMA's approach (tied to the SFDR pre-contractual disclosure asset allocation template) would allow the proposed quantitative threshold to apply at the level of the whole investment strategy, which we welcome. This means that investment strategies that seek to deliver certain types of ESG outcomes for investors (for example, a fund which seeks to overweight issuers with higher ESG metrics and underweight other issuers with lower ESG metrics, relative to a parent benchmark or investment universe, with the objective of achieving a more favourable ESG profile at an aggregate fund level as compared to the benchmark or investment universe) should generally be able to meaningfully apply the rule.

In calibrating the threshold, it is important to note that many portfolio managers often utilise exposures including cash (non-Money Market Fund UCITS funds, for example, are generally permitted to hold up to 20% of their portfolio in cash), derivatives and other assets in order to meet their objectives and manage risk for their clients. If the minimum thresholds are not appropriately calibrated, it could limit a portfolio manager's ability to navigate different and changing market environments.

While ESMA's proposed calibration (80%) may be relatively straightforward for public equity investment strategies to meet, we can envisage challenges for some types of multi-asset and fixed-income funds (who may have allocations to assets like sovereign debt, which may be difficult to count for the proposed minimum proportion due to lack of consensus in assessing sovereign issuers from an ESG perspective), private asset focused funds (where cash positioning at various stages of the fundraising/ deployment can vary significantly), or more complex structures like fund of funds or multi-manager funds. These strategies and fund structures often have credible ESG-related features or objectives, and it is important that final Guidelines can be readily applied to them.

Accordingly, we believe final Guidelines should take into account the need for funds to implement investment approaches to meet liquidity risk management and efficient portfolio management needs. In addition, this guidance should also take into account investments in other funds and funds' ability to take on leverage. This might be done by excluding assets used for liquidity and risk management from the threshold, or equally, by considering whether an 80% threshold is appropriate for all fund structures, asset classes, or geographical areas of investment focus.

We would also welcome clarification on how the thresholds should be assessed over time, including clear differentiation between inadvertent (for example due to overall market value fluctuations) and active breaches (a deliberate investment decision that results in a breach of the threshold).

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.

We believe that this proposal merits further reflection and consideration.

Firstly, we believe that ESMA should provide more clarity on what other “sustainability-related” naming terms might be considered to fall under any potential threshold (this is true generally of ESMA’s pro-posed Guidelines). This could potentially capture a very wide range of investment funds, making a wide variety of different sustainability-related claims, making a uniform threshold difficult to calibrate. That said, we are of the opinion that in the context of these Guidelines sustainable-related terms should only include words derived from the word “sustainable”.

Secondly, we recognise that there are currently a range of approaches on the market as to how to interpret the definition of “sustainable investments” under the SFDR. We are also aware that the European Supervisory Agencies (ESAs) have asked the European Commission for further clarification on the definition of sustainable investments, and that this, at the time of our response, remains unanswered. There-fore, given the potential for the definition of “sustainable investments” to change meaningfully in the future, we believe it is premature to set out any minimum threshold.

Finally, many investment funds make an explicit commitment to have a certain % of their portfolios invested in “sustainable investments” – leaving aside the lack of uniformity over that definition today (which could potentially persist into the application of any proposed rule in this regard) – this means that a range of different funds are directly comparable when it comes to allocation to “sustainable investments”, somewhat obviating the need for regulators to set a floor with regard to this metric.

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

N/A

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.

As we outline in our response to question 1, investors have a variety of ESG- or sustainability-related preferences and objectives. Naturally, few investment products are intended to cater to all of them simultaneously.

We believe that regulatory frameworks in this space (of which, naming requirements are one piece) should recognise that it is important for investors to have choice and a way to meet financial and ESG or sustainable investment objectives, wherever they are on their sustainable journey. In addition to the fund name an accurate description of an investment process is imperative to help investors in allocating capital.

While quantitative thresholds, if well-designed and -calibrated can further underpin this, there is of course a risk that they may not provide suitable flexibility for certain types of fund structures, or may not capture a particular product’s actual ESG- or sustainability-related claim or objective.

In general, we believe investors would benefit from a framework that allows them to segment various common ways in which sustainable investment products and strategies tend to be organised. For example, BlackRock organises our sustainable investment product offering around the following categories:

1. products/ strategies whose objective is to exclude or screen out particular sectors or issuers based on ESG- or sustainability-related considerations;
2. products/ strategies which seek to deliver portfolio level ESG outcomes, by delivering improved ESG metrics, relative to a parent benchmark or investment universe;
3. products/ strategies that seek to provide targeted investments in line with a particular ESG- or sustainability-related theme, or;
4. products/ strategies which seek to deliver positive measurable impact in line with an ESG- or sustainability-related objective

We believe this framework helps investors better understand which products meet their specific needs and objectives. A naming rule can be additive to such a framework and could aid in both investor decision-making and product comparability. Without clearer segmentation of products and strategies, strict quantitative thresholds can actually make it more difficult to compare products if their fundamental objectives are different from one another.

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.

Investors express their sustainability needs and preferences in a variety of different ways, not all of which involve avoiding certain companies or sectors. Where those preferences do involve avoiding certain types of exposures, investors do not always seek to avoid the same ones, making a uniform set of minimum exclusion criteria across all products with an ESG- or sustainability-related term in their name problematic.

The Paris Aligned Benchmark's (PAB) minimum safeguard criteria were established with the specific goals and objectives of the PAB framework and the need for the underlying exposures to achieve specific outcomes in respect of the Paris Agreement, they do not necessarily reflect all investors' sustainability-related preferences and objectives. Applying these criteria to a broader set of funds would result in a substantial amount of the investable universe being screened out. This will likely constrain strategies and restrict the ability of investors to find pooled investment solutions suited to their specific sustainable investment objectives.

That said, it is clear that exclusions can and do play an important part in many products that deliver an ESG- or sustainability-related strategy or objective to investors. As such, we would be supportive of an additional requirement that, where products use exclusions to achieve part or all of their ESG- or sustainability-related investment objectives, they should clearly explain how those exclusion policies work and contribute to the objective of the fund.

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

N/A

- 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?**

N/A

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

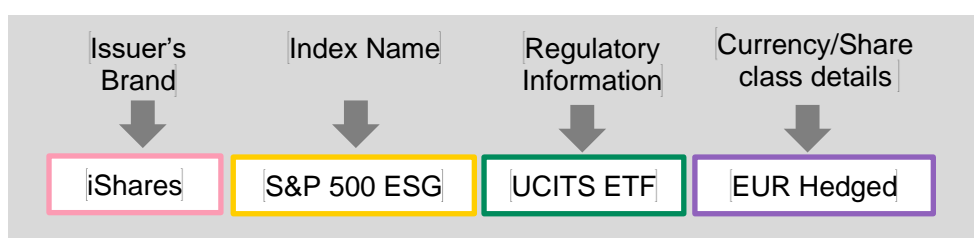
N/A

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.

We agree that the same rules should in principle also apply to index tracking products; however, this underlines the imperative of well-crafted rules that can be applied to a range of different ESG- or sustain-ability-related investment products and strategies.

As such, it's useful to note the specificities of index products that need to be taken into consideration when assessing compliance with these requirements. In particular, exchange-traded funds (ETF) names follow accepted conventions, driven by existing ESMA Guidelines and market practice, that are designed to help investors to compare ETFs and to understand their features.

The basic structure of ETF names is intended to tell investors the product's most important features and are typically structured as follows:



Critically, the second component of the fund name is the name of the benchmark index that the ETF tracks. Indices (and their names) are owned by third party index providers which calculate and provide independent verification of the indices, the use of which is then licensed to the ETF provider. It is, there-fore, not within the ETF provider's power to change the name of the index that its ETF tracks.

This limits the ability of an ETF to remove specific ESG- or sustainability-related words from its fund name were it to potentially fall short of some of ESMA's proposed criteria.

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

N/A

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

We do see merit in looking at "impact" or impact-related fund names differently from others in scope of these proposed Guidelines. Impact investing is a unique investment approach where very specific out-comes are required. Impact funds commit to generate intentional positive, measurable, and additional sustainability outcomes. Impact funds must also establish the managers' contribution to the achievement of impact.

Because of these unique characteristics, impact funds may not fit neatly into Guidelines where asset-level allocation or blanket exclusion requirements are the basis of how a manager substantiates a particular fund name.

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

While there has been growing interest in the market in “transition”-related investments, it is by nature a forward-looking concept and to date there are no market or regulatory standards for “transition funds”. Investment interest in the transition to a low-carbon economy can take a variety of angles: from strategies that seek to capture investment opportunities from anticipated technological changes to specific investments that can potentially help accelerate the energy transition in certain sectors or areas. Given this context, we would argue against introducing specific provisions that might have the unintended effect of limiting the diversity of approaches to transition investing that are developing.

As with our comments elsewhere in this response, we believe that a well-designed naming rule should be able to accommodate the range of developing transition-related products and strategies. Fund managers should be encouraged to use accurate and appropriate terminology in the “transition” products they develop and should be able to detail how the assets substantiate the overall portfolio outcome of the product. However, at this point in time, it is difficult to envision how a minimum allocation to sustainable investments or minimum safeguard requirements (in line with our answer to question 6) would apply.

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?

N/A

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.

N/A

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.

N/A

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

N/A

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.

N/A