



**FINANCE
DENMARK**

Consultation Paper ESMA Guidelines on funds' names using ESG or sustainability-related terms

Introductory remarks

Finance Denmark thanks for the opportunity to express our view on the guidelines on funds' names using ESG or *sustainability*-related terms.

Finance Denmark welcomes a guideline enabling level playing field across the EU concerning the naming of funds.

Legal uncertainty

Finance Denmark would like to point out that in making these guidelines, it must be taken into account that there is a series of uncertainties as to how SFDR and its Delegated Regulation 2022/1288 are to be interpreted. Especially, the interpretation of what constitutes a sustainable investment in accordance with Article 2(17) of SFDR and how such a sustainable investment may be calculated is uncertain.

Due to this array of legal certainties, the ESAs submitted a series of questions to the Commission in the autumn of 2022 touching upon core elements of SFDR. The coming answers will potentially alter the interpretation of SFDR significantly.

Therefore, the interpretation of SFDR will evolve over time. In this light, and to ensure their useability, the guidelines and their requirements must accommodate this fact and the future answers given by the Commission.

Our proposals in this response aim at taking these factors into account and offer practical solutions to the legal uncertainties.

As a further introductory remark, we would like to note that, in our view, the proposed threshold of 80 % of the minimum proportion used to meet the environmental or social characteristics has an ambiguous impact as the definitions of "social characteristics" and "environmental characteristics" are unclear.

To avoid legal conflicts and legal uncertainties, it is our opinion that the guidelines must build upon the existing SFDR legislation. This applies to both level 1 and 2. In line with this, the guidelines should be strictly limited to regulating the naming of financial products. Thus, defining and clarifying terms and legal concepts that have impacts beyond the sphere of naming should be left out of these guidelines.

In general, we do support legal clarifications, but they must be done at the correct legislative level and not in guidelines, please see Q 11.

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

Finance Denmark supports the introduction of quantitative thresholds for funds using ESG- or sustainability-related terms in their names to avoid greenwashing. In our view, it is important that a fund bearing a name that suggests it has ESG-related characteristics actually has a substantial part of investments used to meet environmental or social characteristics.

However, it must be stressed that ESG-related terms and the term "sustainable" constitute very different degrees of legitimate expectations to the funds.

In our view, it is clear that the term "sustainability" sets a high standard for funds promoting environmental or social characteristics or environmental or social objectives.

Therefore, we agree that there should be set distinct requirements for the use of the term "sustainability" in contrast to the remaining ESG-related terms.

The scope of the guidelines

Finance Denmark would like to ask for further guidance on the scope of the term "ESG-related words".

Breach of the guidelines

Finance Denmark would like to ask for further guidance in the guidelines on what the required actions are in case of a breach of the thresholds.

Finance Denmark would like to stress that changing of a name of a fund is not something that can be done overnight as it requires the approval of the general assembly of the fund as well as corresponding amendments to the statutes of the fund in question. These amendments to the statutes of the fund must be approved by the National Competent Authority, please see Q16.

Finance Denmark suggests that if a breach has taken place, this should lead to a change of name of the relevant fund only after an appropriate period of time to make sure that temporary/passive breaches due to e.g. market turbulence can be handled in the best interest of investors.

This would ensure that funds will not be forced to disinvest due to temporary and short-term breaches to the detriment of the customers.

Lack of data

Data is the most important source of information on the investees and the financial instruments in which there may be invested. Data is needed to establish

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whether an investee or an investment in a financial instrument can be regarded as sustainable. However, the collection of data is still in its early stages, and there is often a lack of data.

In the light of this and in order to avoid greenwashing, Finance Denmark is of the opinion that the word "sustainable" and ESG-related terms in funds' names should only be used if the use of the relevant notion or term can be supported by evidence of the fund meeting the thresholds or other relevant requirements in the relevant fund documentation.

This, on the other hand, means that a fund whose sustainability cannot be supported by evidence solely due to a lack of data may not use the word "sustainability" in its name.

Similarly, if a fund in its name suggests promoting one or more certain environmental or social characteristics through the use of ESG-related terms, this or these characteristics must be supported by evidence. If these ESG-related terms cannot be supported by evidence, they may, in our view, not be used in the name of the fund.

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.

Finance Denmark suggests that a threshold of 75% of a fund's investments should be used to meet the environmental or social characteristics or sustainable investment objectives in accordance with the binding elements of the investment strategy when a fund uses an ESG-related term.

It is important for Finance Denmark that there is a connection between, on the one hand, the name of the fund and the characteristics that its name suggests, and, on the other hand, the actual underlying investments of the fund. The 75% threshold would ensure this connection.

A 75% threshold would ensure enough flexibility and room for manoeuvre in cases of e.g. extraordinary market situations in which the funds might have to increase the shares of cash and/or derivatives of the funds for a shorter period of time.

In addition, the wording "minimum proportion" should, in our view, be changed and replaced with the wording "planned asset allocation" in accordance with the second headline, page 3 of Annex II of the SFDR Delegated Regulation

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2022/1288. The notion “minimum proportion” is used in the text in the paragraph headlined “What is the asset allocation planned for this financial product”. Therefore, we believe that “planned asset allocation” being used in the headline would be a more correct terminology. This would, in our view, also ensure alignment of the regulation.

For comments regarding impact-related words, please see Q10.

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.

Finance Denmark agrees in principle with the additional threshold of at least 50% of sustainable investments for funds using the term “sustainable” in their name.

However, in our view, a series of important nuances must be added to the threshold to operationalize it and enable more sustainable investments as there are major legal uncertainties in the SFDR on the definition of a sustainable investment, and how such a sustainable investment may be calculated. These legal uncertainties are touched upon by the ESAs in their questions to the Commission, please see Q1-2.

In order for the guidelines to work in practice, they must take these legal uncertainties into account. This should be done in the ways suggested below which are aligned with the 50% threshold, please see Q4.

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

As described above, Finance Denmark supports the thresholds in principle. We would, however, suggest some very important changes to the 50% threshold due to the mentioned legal uncertainties and to operationalize the threshold.

Calculation of sustainable investments

The guidelines should consider that there are different methods of calculating sustainable investments.

The calculation of sustainable investments is mainly done through two different methods of calculation; either entity-based or activity based. Finance Denmark suggests that both methods are considered by the guidelines to further operationalize the guidelines.

When using the entity-based method of calculating a sustainable investment, an investment as a whole will be regarded as sustainable if a minimum level of the

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current or expected turnover or capex of the investee company stems from activities that contribute to environmental or social objectives, provided that the investee follows good governance, and that the investment does not do any significant harm to the environmental or social objectives mentioned in SFDR Article 2(17).

On the other hand, when using the activity-based method, a sustainable investment will solely be the part of the turnover of the investment that contributes to an environmental or social objective provided that the investee follows good governance, and that the investment does not do any significant harm to the environmental or social objectives mentioned in SFDR Article 2(17).

The required 50% minimum proportion of sustainable investments should consider and accommodate both methods. It is very important for the sustainable transition of the economy that both methods are accommodated for.

Therefore, Finance Denmark suggests that the guidelines outline that the 50% minimum proportion of sustainable investments is set in accordance with the entity-based method. However, the guidelines should additionally stress that if a fund applies the activity-based method, the requirement of the 50% minimum proportion of sustainable investments is met, provided the fund meets an equivalent level of sustainable investments. Further, it is our suggestion that it is the duty of the fund using the activity-based method to document that the required level of sustainable investments of the fund is met.

Finance Denmark is of the opinion that the two methods of calculations described above may be combined in one fund. A combination of these methods is needed, for example in relation to mixed investment funds containing a range of different financial instruments, such as different combinations of shares and bonds.

Finance Denmark, furthermore, suggests a relative approach, please see Q5.

However, Finance Denmark would like to point out that in practice, due to these guidelines, it will become even more difficult to offer sustainable funds to investors with a low risk tolerance and/or short time frame as these investors' needs do not fit with the risk/return of the majority of the sustainable funds that can be offered today.

Since data on sustainability in most cases is limited to shares, and it often does not exist for other financial instruments such as wide range of bonds, sustainable funds often have a high risk/return profile and cannot be offered to investors with different needs and preferences. The guidelines risk magnifying this issue.

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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 are aligned with their investment characteristics or objectives? If yes, please explain your alternative proposal.

The proposed thresholds should, in our view, not be the only way of ensuring a high and reliable standard of sustainability in funds to avoid greenwashing. Therefore, Finance Denmark suggests that a relative approach for investment products could be included in the guidelines as an alternative to the thresholds, too.

The aim of the relative approach is to accommodate the uncertainty tied to the fact that the current understanding and interpretation of a sustainable investment in accordance with Article 2(17) of SFDR is unclear and the fact that a sustainable investment is calculated in many different ways.

Finance Denmark, therefore, suggests that a fund holding significantly more sustainable investments than a broad, conventional market index also should be allowed to use the word "sustainable" in its name.

More specifically, the fund's share of sustainable investments must exceed the share of sustainable investments in a broad, conventional market index *with 50 % or more*. Then, the fund, in our view, should be allowed to use the term "sustainable" in its name.

When assessing whether the fund holds significantly more sustainable investments than a broad, conventional market index, either method of calculation of sustainable investments may be used.

Also, the relative approach makes sure that the requirements for naming a product "sustainable" will increase over time, as the economy step by step will become more sustainable and the share of sustainable investments in a broad, conventional market index increases 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.

Finance Denmark agrees with the need for minimum safeguards for investments in funds with the word "sustainability" in their name. However, we believe it would be disproportionate and too far-reaching to base the safeguards on the exclusion criteria in the benchmark regulation (2016/1011), including its delegated regulation (2020/1818), as suggested. One reason being that this would introduce a misalignment in the guidelines as they are based on the SFDR. The requirements

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of the two regulations are not aligned and should, therefore, in our opinion, be kept apart.

Finance Denmark finds it important to ensure legal alignment and not to complicate the process of putting together a sustainable fund. Minimum safeguards should, in our view, be defined by the manufacturer in accordance with SFDR. Additionally, the minimum safeguards should follow the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights.

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

- 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 for naming purposes?**

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SFDR and the Taxonomy Regulation have provisions on how to include derivatives in asset allocation calculations. These provisions should apply for the calculation of the thresholds for the purpose of these guidelines to ensure that asset allocation/minimum proportion is consistent across all minimum allocations. In line with this, market value should in general be used for calculating the minimum proportion of investments. Further guidance in this respect is needed in terms of defining market value for derivatives in order to ensure consistent treatment of derivatives in the minimum proportion calculations. Such guidance should take into account that applying traditional market value may not make sense for certain derivatives. This guidance should, however, not be included in these guidelines, but addressed in guidance papers to the interpretation and application of SFDR and the Taxonomy Regulation

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.

ESMA has, in our reading, made it clear in their Supervisory Briefing, cf. item 30-31 on page 9-10, that passively managed funds may, subject to agreement with the index provider, use the ESG-related terms that are a part of the relevant reference benchmarks of the fund, including the whole or parts of the benchmarks' name. This could be specific climate or ESG benchmarks, such as Climate Transition Benchmark (CTB) and Paris Aligned Benchmark (PAB).

Finance Denmark would like to point out the importance of aligning guidelines for naming all kinds of funds, including funds designating an index as a reference benchmark. If there are no guidelines or restrictions on the naming of the index, the consequence of the supervisory briefing will be a discrepancy between the



guidelines regarding the naming of funds designating an index as a reference benchmark and other kinds of funds.

This is a problem if a fund is using a reference benchmark with an ESG-related term or the term sustainable in its name, but this benchmark does not meet the requirements for the use of an ESG-related term or the term "sustainable" in relation to the requirements of a naming of fund.

Finance Denmark would much appreciate an alignment of guidelines for the naming of all kinds of funds.

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

Finance Denmark has no comments to this question.

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

Finance Denmark agrees with ESMA on the need to regulate the term "impact" in funds' names.

In our reading of ESMA's Supervisory Briefing, cf. item 30 on page 9-10, funds using the term "impact" in their name should be limited to SFDR Article 9 funds. Such a fund must have one or more concrete environmental or social objectives. These objectives should have a significant positive impact that can be measured quantitatively. This entails that the fund must be able to document how, through its investments, it has made a significant positive impact on the relevant environmental or social objectives.

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

Finance Denmark generally supports judicial clarifications, and we do support further guidance on the notion of "transition". However, legal clarifications must be made at the correct legislative level.

Therefore, Finance Denmark is not of the opinion that there should be any specific provision on the term "transition" in these guidelines, as the scope of these guidelines should be strictly limited to matters regarding the naming of funds in order to avoid legal conflicts. "Transition" is the core of a sustainable investment in our view and, therefore, should be dealt with in level 1 or 2 of SFDR.

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Further, this question touches upon some of the questions made by the ESAs to the Commission. These questions remain for now unanswered. However, once answered, they will have a significant impact on the implementation and the requirements of SFDR 2019/2088 and its Delegated Regulation 2020/852.

By introducing a provision on the term "transition", the guidelines may interfere with the requirements and with SFDR 2019/2088 and its Delegated Regulation 2020/852 as the provision in some extent would have to define the term "transition". That would be in conflict with paragraph 11 of the guidelines.

Therefore, Finance Denmark does not support any specific provision on the term "transition" in these guidelines.

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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?

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To ensure a level playing field across similar and competing products, Finance Denmark finds that the guidelines should apply to all products within the scope of Article 2(12), point b)-g) of SFDR as well as Article 2(12), point a) provided that the portfolios are being marketed as independent products to the investors. Leaving out these products would create an uneven playing field to the detriment of funds.

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.

Finance Denmark would like to point out that the change of a fund's name cannot be done overnight, and it is administrative burdensome to do so. For example, a change of name must be done at a general assembly.

The change of a fund name consists of a series of administrative steps in Denmark.

A change of a fund's name can only be done through an amendment to the articles of association of the fund. A change of the fund's articles of association requires the adoption of an amendment at the general assembly.

Therefore, a general assembly must be summoned, and an agenda must be drawn up and prepared with the necessary items beforehand. The summoning to the general assembly must be done with a certain prior notice regulated by the fund's articles of association.

Then, the general assembly must be held at which the amendment of the articles of association has to be adopted. Afterwards, the National Competent Authority must approve the adopted amendment to the articles of association. When the



National Competent Authority has approved the amendment, changes must be made accordingly in legal documents, including the prospectus, agreements with customers and third parties of the fund. Changes must also be in the marketing material and the management company's IT-systems. The changes of IT-systems must also be made by the fund's depositary.

The amendment of the fund's articles of association may also lead to adjustments of the portfolio.

All these steps are connected with administrative burdens and expenses. This is especially the case for extraordinary general assemblies as additional administrative processes must be set up.

Therefore, Finance Denmark would suggest a transitional period of 12 months. This would give the funds sufficient time to change their names in an orderly process without incurring extra costs in relation to an extraordinary general assembly. Additionally, this transitional period of 12 months would enable the funds to approve the changes of their names at their respective annual general assemblies, please see Q16.

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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.

Finance Denmark does not see a need to extend the naming-related provisions to closed-ended funds. In line with the European Commission Q&A on SFDR from July 2021, pre-contractual information on environmental or social characteristics or sustainable investment objectives, were not required for funds that were no longer made available to investors as of 10 March 2021. As the naming-related provisions addresses the pre-contractual stage, they should not cover closed-ended funds.

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

Finance Denmark would like to stress that it is important that the regulation on funds' names strikes the right balance between, on the one hand, the protection of investors' legitimate expectations in order to avoid greenwashing and, on the other hand, the support of the main objective of the SFDR to help foster the sustainable transition of the economy.

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.

As a general note, Finance Denmark would like to point out that changes of names of funds is burdensome, especially, if the changes of names must be



made acutely. The expenses of changing names of funds consist among others of costs in relation to the organization and holding of extraordinary general assemblies that are required to legally change the name of the relevant funds, please see Q13. Other costs consist of updating the marketing material as well as relevant legal documents. There are also costs pertaining to the adjustment of portfolios.

These expenses are significant. At the same time, they are difficult to quantify precisely.

In addition, a listed fund must pay a fee of DKK 3500, approx. EUR 467, for changing its name. Listing of retail funds is common in Denmark.

The guidelines would most likely affect large parts of the sector. If the transitional period is too short and the guidelines are applicable too early, this could lead to administrative bottlenecks at the National Competent Authorities as the change of names of funds and other amendments of the fund's statutes must be approved by the relevant National Competent Authority.

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