SUSTAINABLE FUNDS: DO THEY LIVE UP TO THEIR NAME?

European regulators puzzled by ESG naming

March 2023
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I. Marketing pays off

Greenwashing has been high on the priority list for regulators in Europe and France for several years. The European Securities and Markets Authority (ESMA), the European Insurance and Occupational Pensions Authority (EIOPA), and the French financial markets authority (AMF) and banking and insurance supervisor (ACPR) are all seeking to tackle the problem. And on the consumer side, the European Consumer Organisation (BEUC) has also voiced concerns. In its February 2023 position paper it warns that greenwashing is especially rife in the investment fund industry, due in part to fund naming strategies. “Regulatory shortcomings, insufficient standardisation, the use of relatively new and vague terms and the unavailability of reliable data facilitate greenwashing …”, according to the BEUC.

Despite the growing corpus of regulations governing so-called sustainable financial products, how funds are named has so far fallen through the cracks. The much-discussed Sustainable Finance Disclosure Regulation (SFDR) standardises the level of transparency required by all financial market participants and for each product category created by the regulation. Marketing strategies however are outside its scope.

SFDR Explainer

SFDR stands for the Sustainable Finance Disclosure Regulation. The main provisions (Level 1) took effect on 10 March 2021. The regulation sets out to improve and standardise transparency in the market for sustainable financial products in Europe. SFDR establishes a framework for explicitly incorporating “sustainability” in investments. It gives investors information on the likely impact of sustainability risks on returns and the social and environmental “adverse impacts” arising from funds’ investment choices. SFDR imposes disclosure requirements for both the financial product and the entities marketing these products. Entities must classify their products according to three categories linked to articles in the Regulation. Article 6 is the default classification common to all products based on the principle of “comply or explain”. Financial products with environmental and/or social characteristics are classed as Article 8. Funds that have a sustainable investment objective are classed as Article 9. The issue of misleading investors arises from the potential use of the regulation as a marketing tool, in a context of strong demand for so-called sustainable products.

A false equivalence between classification under SFDR and external quality assurance has created a windfall effect, reflected in investor appetite: funds flowed first to Article 8 funds, which reaped the benefits until early 2022 when the war in Ukraine triggered significant outflows from all funds. Although lower in absolute value, positive net inflows to Article 9 funds have been steady since the category was launched on the market.

In its Report on Trends, Risks and Vulnerabilities, 2023 ESMA analyses the graph opposite noting that “these trends highlight the greater resilience of products with higher perceived sustainability credentials, confirming the view that sustainability-oriented investors are less sensitive to short-term returns”.

Net inflows by product category (€bn, cumulatively), EU funds.

Sources: Morningstar, ESMA.
ESMA again: “competitive market pressures” in the “sustainable” funds market “create incentives for asset managers to include terminology in their funds’ names designed to attract investor assets”, a trend corroborated by a February 2023 paper by Morningstar (in French). Morningstar’s analysts identified 988 funds domiciled in Europe that had rebranded by adding a term related to sustainability to their name since 2018, when the EU Action Plan on Sustainable Finance Action Plan was introduced. Morningstar also notes that we hit peak rebranding in 2021 as SFDR Level I obligations took effect. Staying with Morningstar’s paper, “the sustainability profile of rebadged funds improved during the renaming stage”, with such funds reducing their exposure to fossil fuels or raising their ESG ratings. However, the majority failed to meet the requirements for “sustainable funds” according to Morningstar’s classification and “their efforts to strengthen their ESG credentials seem to fade with time”. In conclusion, the paper’s authors opine that “many of these funds had dropped off investors’ radar before rebranding”, and that adding sustainability-related terminology “attracted renewed attention – if only for a few months”.

A fund’s sustainability credentials cannot be deduced from its name, yet, fund inflow data compiled from Morningstar Direct for all 217 self-classified Article 9 funds in March 2022 show higher inflows to funds using ESG or sustainability-related terms in their name (169 funds) compared with neutrally badged funds (38 funds). Inflows recorded for this panel illustrates how the use of “terms in their name which suggest an investment focus in companies that meet certain ESG standards” is a “particularly powerful” marketing tool, according to ESMA.

**Should we be wary of funds that rebrand?**

Of particular note in this panel is the absence of distinction in downgrades between funds that opted for a naming strategy – a marketing strategy that involves choosing a name that includes a reference to sustainability – and funds with neutral names. Of the initial panel of 217 funds, as many sustainability-named funds (50%) were reclassified out of Article 9 as funds with neutral names (49%).

ESMA also points out that investor appetite for “sustainable” financial products has remained steady, despite the wave of downgrades of Article 9 funds late in 2022 – a phenomenon covered extensively in the financial press. Witness a panel of 217 Article 9 funds managed in France dissected by Novethic: 47% were downgraded from SFDR Article 9 in the period March 2022 to March 2023.
A closer look at some of the financial products recently renamed by asset managers sheds more light on the ultimate marketing rationale behind the move, revealing three potential reasons for rebadging.

### Adding clarification or nuance regarding the fund’s investment theme

<table>
<thead>
<tr>
<th>SFDR Art.</th>
<th>Former name</th>
<th>New name</th>
<th>Justification</th>
<th>Current marketing hook</th>
</tr>
</thead>
<tbody>
<tr>
<td>9</td>
<td>Active</td>
<td>Social Leaders</td>
<td>Improve perception of the fund’s objectives, with no impact on fund profile or investment process.</td>
<td>Selection of companies that incorporate social and societal challenges in their growth strategies.</td>
</tr>
<tr>
<td>8</td>
<td>Credit Income</td>
<td>SDG Credit Income</td>
<td>Name change to more closely reflect a commitment to the UN SDGs.</td>
<td>Actively managed fund investing in companies that contribute to realising the UN SDGs.</td>
</tr>
<tr>
<td>8</td>
<td>Or Bleu</td>
<td>Planète</td>
<td>Move from investments in companies operating in the water sector to a focus on companies whose business is related to the environment.</td>
<td>Make environmental impact and saving the planet the focus of investments.</td>
</tr>
</tbody>
</table>

### Adding a term related to sustainability, without a material change to investment strategy

<table>
<thead>
<tr>
<th>SFDR Art.</th>
<th>Former name</th>
<th>New name</th>
<th>Justification</th>
<th>Current marketing hook</th>
</tr>
</thead>
<tbody>
<tr>
<td>8</td>
<td>Global Fund</td>
<td>Sustainable global Fund</td>
<td>N/A</td>
<td>Invest in companies that both generate attractive long-term value and have embraced a sustainable development approach.</td>
</tr>
<tr>
<td>8</td>
<td>Europe Actions</td>
<td>Europe Valeurs Responsables</td>
<td>The rebranding does not change the risk/return profile and the other fund characteristics remain unchanged.</td>
<td>N/A</td>
</tr>
<tr>
<td>8</td>
<td>Bonds</td>
<td>ESG Bonds</td>
<td>Investment strategy adjusted to limit investment in non-ESG rated securities to no more than 10% of the sub-fund.</td>
<td>Sustainability factors are included in the sub-fund’s investment process.</td>
</tr>
</tbody>
</table>

### Using a standard name to signal that the fund belongs to an SFDR category

Some asset managers base their name directly on the SFDR classification. For example, they might add “ESG” to the name of each “Article 8” fund.

<table>
<thead>
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<th>New name</th>
<th>Justification</th>
<th>Current marketing hook</th>
</tr>
</thead>
<tbody>
<tr>
<td>8</td>
<td>Global Corporates Bond</td>
<td>Global ESG Corporates Bond</td>
<td>Naming convention where the name of each Article 8 sub-fund must include “ESG”.</td>
<td>This product does not promote ESG and does not have a sustainable investment objective.</td>
</tr>
</tbody>
</table>

This type of strategy seems to run counter to what the European legislature intended when it issued SFDR. “Article 8” classification is intended to foster transparency in the market by ensuring a broad range of funds apply the same level of transparency according to characteristics ranging from “the perception that investments take sustainability into account” to direct claims. The aim was certainly not to give funds a marketing tool allowing them to add references likened to characteristics that could make them eligible for self-classification under SFDR. In the case above, the prospectus even states that the fund does not promote an “ESG approach” – despite the ESG in its name.

This example calls to mind the Call for evidence issued by the European Supervisory Authorities (ESAs) in November 2022, which seeks input to shed light on greenwashing practices across “various segments of the sustainable investment value chain and of the financial product lifecycle”. Respondents are invited to submit contributions on topics including inconsistencies in disclosures and communications, and misleading and/or suggestive use of ESG-related terminology, which the ESAs term “naming-related greenwashing.”
II. Investors at risk of losing their bearings

The lack of clear guidelines forms the background to ESMA’s November 2022 Consultation Paper on a set of rules on fund names. With comments invited up to 20 February 2023, the Consultation aims to tackle greenwashing and ensure that ESG- and sustainability-related terminology in fund names is supported by evidence of their management processes. ESMA is proposing minimum quantitative thresholds built exclusively around the concepts introduced by SFDR (see text box: What do “characteristics” and “sustainable investment” mean?). These proposals are in addition to other initiatives aimed at regulating how funds or life insurance products are sold and marketed according to more objective characteristics than their name. The aim is to prevent asset managers from exaggerating sustainability claims, reduce the risk of greenwashing and help consumers to make informed choices. Yet, the sheer number of key concepts savers need to grasp for an informed overall understanding, especially if they are based on poorly-defined underlying notions, can in itself fuel misunderstanding.

This graphic clearly illustrates how the combined effect of different labels, based on more or less rigorous eligibility criteria, and regulations with different definitions of sustainability that have yet to be harmonised is adding to complexity in the sustainable funds market. In the AMF’s opinion, the definition of sustainable investment under SFDR is “vague” and “should be clarified to become tangible”. It published a position paper in February 2023 proposing a set of minimum environmental standards for financial products classified under Articles 8 and 9 of SFDR, according to the sustainability definitions in the Taxonomy Regulation.

What is more, the AMF is of the opinion that SFDR “created a gap between the reasonable expectations expressed by investors and the reality of the practices” and “fuelled greenwashing”. The ESAs concur, acknowledging in their Call for Evidence that greenwashing may occur even in the specific disclosures required by the EU sustainable finance regulatory framework.

Source: Novethic

Key concepts for informed understanding

- SRI
- Greenfin
- Art. 8/9 To date
- Art. 8/9 AMF 2023 Proposal
- Article 6
- % of sustainable investments according to Art. 2(17)
- Taking account of PAIs
- % alignment with the Taxonomy

Legible ▲ Not very legible

Sale and marketing guidelines

- Pacto law
- AMF Position 2020
- ESMA guidelines
- ACPR Recommendation
- MiFID

Guidelines for end investors

- Labels
  Minimum criteria relating to the investment process and, by label, compliance with a green share
- SFDR
  Regulation to standardise transparency requirements
- EETs
  Standardised template for exchange of information under SFDR and the UE Taxonomy

This graphic clearly illustrates how the combined effect of different labels, based on more or less rigorous eligibility criteria, and regulations with different definitions of sustainability that have yet to be harmonised is adding to complexity in the sustainable funds market. In the AMF’s opinion, the definition of sustainable investment under SFDR is “vague” and “should be clarified to become tangible”. It published a position paper in February 2023 proposing a set of minimum environmental standards for financial products classified under Articles 8 and 9 of SFDR, according to the sustainability definitions in the Taxonomy Regulation.

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III. Is SFDR fit for purpose?

Vague “sustainable investments”

Article 2.17 defines sustainable investment as an economic activity that contributes to an environmental (E) or social (S) objective, provided that these investments do not significantly harm any other E/S dimensions and that principles of good governance are followed. As funds complete the EET templates, it becomes easier to identify how those that have committed to a certain percentage of sustainable investments in their portfolio see their environmental (energy, renewable energy, raw materials, water and land, waste, GHG emissions, biodiversity, circular economy, etc.) or social (inequality, social cohesion, social inclusion, labour relations, investment in human capital, economically or socially disadvantaged communities, etc.) contributions.

However, here again, an analysis of the EET data cross-referenced with fund names shows only a weak correlation between the contributions suggested by the names of thematic funds and the detailed disclosures in the templates. In fact, at this stage, the share of funds disclosing at least one social or environmental contribution through their investment strategies according to Article 2.17 of SFDR is lower for funds with a generic name than for funds whose names include a reference to an environmental, social or carbon theme.

1. CONTRIBUTION

[...] investment in an economic activity that contributes to an environmental objective, as measured for example, by key resource efficiency indicators [...] on the production of waste, and greenhouse gas emissions, or on its impact on biodiversity and circular economy, or an economic activity that contributes to a social objective [...] provided that these investments do not significantly harm any of those objectives.

FINDING

- Of the 95 funds with a thematic marketing strategy (E,S or carbon) in their name:
  - 12 funds (13%) with an investment strategy that states at least one contribution to an environmental objective, under Article 2(17) of SFDR;
  - 4 funds (4%) with an investment strategy that states at least one contribution to a social objective, under Article 2(17) of SFDR.

- Of the 37 funds whose name does not double as a marketing tool:
  - 16 funds (43%) with an investment strategy that states at least one contribution to an environmental objective, under Article 2(17) of SFDR;
  - 5 funds (14%) with an investment strategy that states at least one contribution to a social objective, under Article 2(17) of SFDR.

2. DNSH

[...] provided that these investments do not significantly harm any of those objectives.

FINDING

Terms like "fossil free" or "ex-fossil fuels" inserted in the names of some funds is one way of flagging the exclusions, which echo the DNSH principle.

3. GOOD GOVERNANCE

[...] and that the investee companies follow good governance practices, in particular with respect to sound management structures, employees relations, remuneration of staff and tax compliance.

FINDING

The use of "leaders" in combination with other concepts frequently refers to good governance principles.

Source: Novethic
EET template: under-exploited opportunity for clarification

In this section of the template, funds with names using environmental- or social-sustainability terms can opt to make commitments on minimum quantified thresholds for the theme or on alignment with the environmental objectives of the EU Taxonomy. In practice many currently confine themselves to a minimum share of sustainable investments, without breaking down the information according to environmental or social objectives.

To illustrate the range of investment strategies and approaches implemented to complete this part of the pre-contractual disclosures annex for Article 8 and 9 products, Novethic delved into several samples of funds with identical names.

« Climate Action »

The analysis of the four funds presented below shows three types of pre-contractual commitment for the same marketing hook.

<table>
<thead>
<tr>
<th></th>
<th>Article 8</th>
<th>Article 9</th>
<th>Minimum investments aligned with E/S characteristics</th>
<th>Min sustainable investments acc. to Art. 2(17)</th>
<th>Label(s)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Climate Action A</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>10% environmental objective ✔ minimum Taxonomy ❌</td>
<td>SRI</td>
</tr>
<tr>
<td>Climate Action B</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>80% environmental objective ❌ minimum Taxonomy ❌</td>
<td>Towards Sustainability</td>
</tr>
<tr>
<td>Climate Action C</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>75% environmental objective ✔ minimum Taxonomy ✔</td>
<td>SRI, Towards Sustainability</td>
</tr>
<tr>
<td>Climate Action D</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>90% environmental objective ✔ minimum Taxonomy ✔</td>
<td>Greenfin, LuxFLAG ESG</td>
</tr>
</tbody>
</table>

In this example, the decision whether or not to break down the fund’s minimum Sustainable investment allocation to highlight investments contributing to an environmental objective differentiates best-in-class funds from those that are purely thematic. Note that the Greenfin-labelled fund is the only fund with an environmental objective for all its sustainable investments (under the meaning of SFDR). In contrast, the prospectus for the Climate Action C fund states that 75% of investments are sustainable. Of these, 25% have an environmental objective while the objective of the remaining 50% is not specified.
“Water” or “Aqua”:

The analysis of the five funds referencing water in their name yields even more contrasting data. Of this basket of funds, three are self-classified as “Article 9” funds and two as “Article 8”. They all state a minimum share of sustainable investments, but without necessarily allocating a specific percentage within that share to either an environmental objective or to alignment with the Taxonomy. Even more surprising, one of the funds allocates the majority of its sustainable investments to a social objective (20%, as opposed to just 10% to an environmental objective). It states that this is based on a reading of the draft European Social Taxonomy, although it does not mention a similar study of the draft Environmental Taxonomy when it comes to its water objective.

Ultimately, aside from the disclosures required under SFDR, the minimum percentage of income generated by water-related segments required for a company to be included in that investment universe varies from 15% to 40%, when it is detailed. One fund also uses a “relevance score” for companies in terms of the water theme.

WATER-THEMED FUNDS: A CLOSER LOOK

- % minimum investments aligned with E/S characteristics [50% – 90%]

- % minimum sustainable investments under the meaning of Article 2.17 of SFDR [10% – 85%]

- % minimum sustainable investments under the meaning of Article 2.17 of SFDR that meet E/S criteria [10% – 51%] > (E) [0% – 20%] > (S)

- % minimum Taxonomy-aligned investments [0% – 5%]

- % minimum income generated from water for a company to be included [15%–40%]

Scant use of the Taxonomy

To date, minimum percentages of alignment with the Taxonomy disclosed by market participants have rarely exceeded 5%, with the exception of a handful of green bond funds. The first disclosures from non-financial companies that include data on their alignment are only now being published, which explains this low alignment percentage. Until further notice, the Belgian Financial Services and Markets Authority (FSMA, equivalent to the French AMF) recommends that Article 8 & 9 funds under Belgian law should not tick the box in the pre-contractual annex committing them to a minimum percentage of Taxonomy-alignment.
How to Interpret “Sustainable Investment”

Many market participants have warned in recent months that the definition of sustainable investment under SFDR (as per Article 2.17) is very difficult to grasp. The majority of responses to ESMA’s Consultation Paper on funds’ names mention this definition as the main obstacle to the implementation of the proposed guidelines. Article 2.17 was among the topics of a recent list of additional SFDR queries requiring the interpretation of Union law, sent by the ESAs to the European Commission. In this document, the three authorities suggested 5 ways to interpret this definition at economic activity level:

- **a)** the economic activity being carried out by the investee company in itself contributes to an environmental or social objective;
- **b)** the economic activity potentially contributes to an environmental or social objective simply because it is carried on in a sustainable manner by the investee company;
- **c)** the economic activity contributes to the general environmental objective of climate change mitigation when covered by a granular sector-specific transition plan, for example based on the ACT methodology;
- **d)** the economic activity is conducted by a company who has made commitments towards, or adopted a strategy aiming at, reducing its environmental or social harm;
- **e)** no economic activity is singled out, but the company as a whole complies with DNSH principles.

In this list, only definitions a, b, and c allow for a granular assessment of environmental or social contributions, while the remaining two rely on concepts only assessable more generally at entity level. The EU Commission has simply replied that “SFDR does not set out minimum requirements that qualify concepts such as contribution, do no significant harm, or good governance.”

How to Interpret “Characteristics”

As clarified in July 2021 by the European Commission, “environmental or social characteristics” within the context of Article 8 products should be understood as “market practises, tools and strategies and a combination thereof such as screening, exclusion strategies, best-in-class/universe, thematic investing, certain redistribution of profits or fees”. This means that simple sector exclusions or more elaborate rules guiding a product’s investment process fall under the same definition. The intention is to require the same transparency from all Article 8 funds, regardless of their level of ambition, but this approach leaves two options to consider the characteristics promoted by the investment product:

- **“Relative” characteristics**, stemming from the extra-financial elements of the investment strategy, which are potentially little ambitious and allow for a high and easy to reach precontractual share of investments aligned with the promoted characteristics
- **“Absolute” characteristics**, corresponding to attributes of the investee companies, irrespective of other elements of the investment strategy.

The fact that the SFDR framework does not ensure the adequacy between the name of a fund and the characteristics that this name suggests therefore opens the way to ESG- or greenwashing.
The lack of clear rules in the Regulation opens the door for asset managers to continue to use fund names as part of their marketing strategies to steer investors towards certain financial products. In some cases, prospectuses have even been amended to point out that a fund that uses the term “sustainable” in the name at minimum meets the criteria for an “Article 8” fund, or that “Article 9” funds are recognisable by the use of “impact” – an ill-suited term. Whether or not the strategy is organised by fund range, the plethora of ESG- or sustainability-related terms in their names makes the promise of sustainability anything but clear for the end investor. The word cloud below gives a good illustration of the potential for confusion. It is drawn from the names of a panel of 1,150 European funds at 30 September that carry one of the nine sustainable finance labels tracked by Novethic and listed by Morningstar.

Within this panel, generic “extra-financial” terms (such as SRI, ESG, responsible and ethical) are the most widely used – by a total of 360 funds. They cover a wide array of characteristics (ESG integration and screen, exclusion strategies and positive best-in-class screening) – but with no guarantee that they will be properly understood by end investors. Coming a close second is the adjective “sustainable” in five languages, and related concepts (SDGs, transition and engagement) used in a total of 272 funds, 259 of which make direct use of “sustainable”. As is evident from the responses to the ESMA consultation, some asset management firms suggest using the word “sustainable” to mark out Article 9 funds that mainly comprise sustainable investments as defined in Article 2.17 of SFDR. But other asset managers already use the word as a naming convention for Article 8 funds.

These first two groups of terms primarily evoke entity-level characteristics which are applied indifferently to a range of sustainability issues. This stands in contrast to the 109 funds that refer to an environmental theme and the 42 that specify a social theme, or the 30 funds that reference carbon emissions. Looking at “E” semantics, the adjective “green” (38 funds) is slightly ahead of “climate” (35 funds), notably owing to green bond funds. Next most common stamps are “environment” and “water”. Terms stressing the “S” are spread between specific labels for solidarity funds and thematic funds: employment, inclusion, health and gender balance. A dozen or so funds directly include “social” in the name. Lastly, of the carbon-themed funds (low carbon, “net zero” trajectory, Paris-Aligned-Benchmark or Climate Transition Benchmark, or funds that “offset” their emissions), the older term “low carbon” has fallen behind “net zero” and “Paris-aligned”.

All in all, 85 funds in this sample use two or three terms in their naming conventions. They sometimes combine macro-trends with a sustainability-related term (future SRI, smart ESG, sustainable growth, sustainable food trends, silver age SRI) or linked concepts (eco-social, sustainable climate, sustainable environment, low-carbon SRI, renewable sustainable). Besides redundant combinations (such as responsible SRI, PAB net-zero climate, etc.) some word associations have the potential to suggest very precise concepts (these include climate action, sustainable healthcare, food for biodiversity, save earth) and this is where trust could be eroded if the portfolios cannot substantiate the ESG branding. Energy-themed funds that brand themselves “sustainable”, “smart” or “new” can also spawn a degree of confusion.
Novethic found 17 funds marketed with “impact” in the name. This is the only category where a combination of the term with all the other categories mentioned above was found (for example: responsible impact, carbon impact, gender equality impact). One feeder fund goes as far as adding “impact” to its name even though the master fund makes no mention at all of “impact”. A number of academic papers have shown that the semantics are problematic here, since funds tend to be “impact-aligned” rather than “impact-generating”. The prudent approach of one British asset manager in referring to “impact-aligned” is therefore to be welcomed.
V. How to clear away the fog of words

In a sign of the total confusion gripping the sustainable funds market since SFDR came into force, several Greenfin-badged funds have been among the wave of those back-pedalling from Article 9 classification to the less stringent Article 8 category. Yet, other Greenfin funds use the portfolio allocation thresholds intended by the label to define indicators to measure attainment of their sustainable investment objective as Article 9 funds. In a bid to bring some clarity, in October 2022, the UK Financial Conduct Authority (FCA) issued its proposals for a regulatory framework distinguishing between three categories of funds, all with minimum criteria. The proposed Sustainability Disclosure Requirements (essentially the UK equivalent of SFDR), could see a regime based around three categories or labels: “sustainable focus”, “sustainable improvers”, and “sustainable impact”. Firms that want to label their products must meet the qualifying criteria to be able to use ESG- or sustainability-related terms in their name or marketing materials. “Impact” is reserved for the third category of fund.

Faced with the “reality of practices”, the French financial markets authority (AMF) now recommends minimum requirements to be met by financial products for them to be classed as Article 9 or Article 8 under SFDR. The name of the product then becomes of secondary importance. In 2020, the AMF adopted an overall position intended to ensure that communication surrounding extra-financial strategies remained proportionate to the objective and effective impact of the consideration of these non-financial criteria by the fund’s management. However, the AMF seems determined to steer clear of definitions of sustainability that are open to diverging interpretations. Out go qualitative thresholds and percentages calculated at the discretion of asset managers. And in come the EU Taxonomy framework and, when the Regulation allows, an unambiguous and clear-cut definition of transition. And to tackle the problematic use of the term “impact”, rather than regulating fund names, think tank 2° Investing Initiative (2DII) published its proposal for an Impact Potential Assessment Framework (IPAF) for financial products on 14 March 2023. Its methodology is to calculate an “impact potential” score, taking all the fund’s characteristics into account as well as current academic research on impact mechanisms.

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FCA PACKAGE PROPOSAL (OCTOBER 2022)

The first category – sustainable focus – would encompass products who could demonstrate that 70% of their assets meet a credible standard of environmental and/or social sustainability, or align with a specified environmental and/or social sustainability theme (for example circular economy). Products badged sustainable improvers would have to adopt an objective of delivering measurable improvements in the sustainability profile of assets (for people and/or planet) over time. Lastly, sustainable impact products would be those with an explicit objective to achieve a positive, measurable contribution to real world sustainability outcomes (environmental and/or social) through financial as well as other types of investor additionality.
Annex 1: Comparison of four “Climate Action” funds

<table>
<thead>
<tr>
<th>SFDR category</th>
<th>Climate Action A</th>
<th>Climate Action B</th>
<th>Climate Action C</th>
<th>Climate Action D</th>
</tr>
</thead>
<tbody>
<tr>
<td>SFDR objective or characteristics</td>
<td>Art. 8</td>
<td>Art. 9</td>
<td>Art. 9</td>
<td>Art. 9</td>
</tr>
<tr>
<td>Label(s)</td>
<td>SRI</td>
<td>Towards Sustainability</td>
<td>SRI/Towards Sustainability</td>
<td>Greenfin / LuxFLAG ESG</td>
</tr>
<tr>
<td>ESG score higher than the MSCI ACWI index score.</td>
<td>Maximise total return by investing in the equity securities of companies globally that are expected to enable, and/or benefit from, the transition to a lower GHG economy and to net zero carbon emissions.</td>
<td>Leverage the performance of the global equity market by investing in companies that are taking tangible and direct action to address the challenges and risks of climate change and whose growth and profitability are primarily driven by providing solutions.</td>
<td>Generate a positive environmental impact through investments in shares issued by companies that operate in green eco-activities and develop solutions and businesses that actively contribute to the environmental transition towards reaching the Paris agreement.</td>
<td></td>
</tr>
<tr>
<td>Taxonomy objectives the fund intends to contribute to</td>
<td>None</td>
<td>None</td>
<td>1-2, and 3-6 “in the longer term”</td>
<td>1-6</td>
</tr>
<tr>
<td>Indicators used to measure attainment of the sustainability objective, or compliance with the characteristics promoted</td>
<td>ESG rating of the fund</td>
<td>• Fund’s holdings in Sustainable Investments,</td>
<td>• “Temperature alignment” portfolio (&lt;2.5°)</td>
<td>• Green products and revenues</td>
</tr>
<tr>
<td>% minimum investments aligned with I/S characteristics</td>
<td>90%</td>
<td>• Fund’s ESG rating</td>
<td>• Higher exposure to critical sectors (as defined by EU PAB rules) than the Benchmark</td>
<td>• ESG rating</td>
</tr>
<tr>
<td>% minimum sustainable investments under the broad meaning of Article 2.17</td>
<td>10%</td>
<td>% minimum investments aligned with E/S characteristics</td>
<td>75%</td>
<td>90%</td>
</tr>
<tr>
<td>% minimum sustainable investments under Article 2.17 – thematic</td>
<td>10% (E)</td>
<td>% minimum investments aligned with E/S characteristics</td>
<td>25% (E)</td>
<td>90% (E)</td>
</tr>
<tr>
<td>% minimum Taxonomy-aligned investments</td>
<td>0%</td>
<td>% minimum investments aligned with E/S characteristics</td>
<td>5%</td>
<td>5%</td>
</tr>
<tr>
<td>Method of assessing contributions (Art. 2.17)</td>
<td>Companies that meet two criteria: • follow good environmental and social practices; and • avoid manufacturing products or providing services that harm the environment and society.</td>
<td>• a minimum proportion of the issuer’s business activity contributes to an Environmental and/or Social Objective, or • the issuer’s business practices contribute to an Environmental and/or Social Objective</td>
<td>Non-specified (“exclusive ESG analysis”)</td>
<td>Two types of companies are selected: • strong green intensity: more than 50% of revenues are generated by activities contributing directly or indirectly to eco-activities. • moderate green intensity: between 10% and 50% of revenues from activities contributing directly or indirectly to eco-activities.</td>
</tr>
<tr>
<td>Climate exclusions</td>
<td>Coal</td>
<td>Coal and consumables Oil and gas exploration and production “integrated” oil and gas companies</td>
<td>Coal</td>
<td>Coal + compliance with Greenfin exclusions</td>
</tr>
<tr>
<td>Summary of the investment strategy</td>
<td>Best-in-class</td>
<td>Best-in-class</td>
<td>Thematic</td>
<td>Best-in-class</td>
</tr>
<tr>
<td>Top 10 investments</td>
<td>• Microsoft Corp</td>
<td>• Deere</td>
<td>• Microsoft Corp</td>
<td>• IBM</td>
</tr>
<tr>
<td></td>
<td>• Apple Inc</td>
<td>• Nextara Energy</td>
<td>• Waste Connections</td>
<td>• General Mills</td>
</tr>
<tr>
<td></td>
<td>• Abbvie Inc</td>
<td>• AG Growth International</td>
<td>• Air Products &amp; Chemicals</td>
<td>• Quanta Services</td>
</tr>
<tr>
<td></td>
<td>• S&amp;P Global</td>
<td>• Enel</td>
<td>• Mastec</td>
<td>• Jacobs Solutions</td>
</tr>
<tr>
<td></td>
<td>• Principal Finl</td>
<td>• Nutriens Ltd</td>
<td>• Schneider Electric</td>
<td>• Microsoft Corp</td>
</tr>
<tr>
<td></td>
<td>• TJA Companies</td>
<td>• EDP Renovaenergy</td>
<td>• Agiva PLC</td>
<td>• Koninklijke DSM</td>
</tr>
<tr>
<td></td>
<td>• Home Depot</td>
<td>• FMC Corp</td>
<td>• Tritobre</td>
<td>• RJR</td>
</tr>
<tr>
<td></td>
<td>• Mastercard</td>
<td>• Bioglobe</td>
<td>• Air Liquide</td>
<td>• General Mills</td>
</tr>
<tr>
<td></td>
<td>• Metlife</td>
<td>• Ecolab</td>
<td>• Ball Corp</td>
<td>• Quanta Services</td>
</tr>
<tr>
<td></td>
<td>• Merk And Co</td>
<td>• Synrise AG</td>
<td>• Koninklijke DSM</td>
<td>• Jacobs Solutions</td>
</tr>
</tbody>
</table>

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Sustainable funds: **do they live up to their name?**

Study conducted by Nicolas Redon et Myriam Menif under the supervision of Anne-Catherine Husson-Traore.

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