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Disclosure: Various Asset Managers Downgrade ESG Fund Classifications

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Disclosure

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A number of large asset managers have announced their intention to downgrade ESG funds totaling tens of billions of dollars from Article 9–the highest sustainability classification under the Sustainable Finance Disclosure Regulation (SFDR)—to the broader, and less restrictive, Article 8. The asset managers include Amundi, BlackRock, DWS, HSBC AM, Axa, Invesco, NN Investment Partners, Pimco, Neuberger Berman, Robeco and Deka. These announcements follow draft guidelines **published** on November 18 by the European Securities and Markets Authority (ESMA) as part of a consultation on funds' names using ESG or sustainability-related terms. The ESMA consultation closes on February 20, 2023. The main elements of ESMA's consultation paper are (i) a quantitative threshold (80%) for the use of ESG related words; and (ii) an additional threshold (50%) for the use of "sustainable" or any sustainability-related term only, as part of the 80% threshold.

As defined in the SFDR, Article 8 funds are those that promote Environmental or Social characteristics but do not have them as the overarching objective. Article 9 funds are those that have specific sustainable goals as their objective.

In announcing the downgrades, several asset managers identified the lack of guidance regarding how to apply existing regulatory announcements in distinguishing Article 8 from Article 9 funds as the reason for the change. Clémence Humeau, head of sustainability coordination and governance at Axa, stated that "we would have liked a clearer definition of what is a sustainable fund … because now there are as many definitions as there are asset managers." Elodie Laugel, head of responsible investing at Amundi, which indicated that its decision affects $46 billion in assets, stated that "the regulation is not bringing enough clarity in terms of definition … which creates strong discrepancies in the market while leaving plenty of grey areas," and that it was their "responsibility … to protect clients [so] with such uncertainty and evolving regulation, [Amundi has] decided to take a very cautious approach."

Taking the Temperature: While on the one hand these announcements represent a reaction to specific potential regulatory guidance, they also reflect a broader significant concern over accusations of greenwashing. Just last week, the U.S. Securities and Exchange Commission announced a $4 million settlement with the asset management arm of a leading financial institution over alleged failures, between 2017-2018, to have written policies and procedures regarding the ESG research used to select and monitor investments and, thereafter, to have inconsistent application of the policies until February 2020. Two funds and a separately managed investment strategy were at issue. The SEC fine is over twice the amount imposed on another financial institution earlier this year for allegedly misrepresenting that all investments in certain mutual funds had undergone an ESG quality review. And in a different context, greenwashing concerns may have been at least the partial cause for several large banks to consider withdrawing from the Glasgow Financial Alliance for Net Zero (GFANZ) amid questions regarding their ability to satisfy increasingly stringent decarbonization commitments and the potential to be subject to litigation or enforcement actions as a result. That led to GFANZ amending its membership rules by dropping its connection to the UN-supported Race to Zero campaign. The combination of all of this creates a dynamic where regulatory efforts to promote accurate disclosure around the sustainability profile of investments arguably has the potentially negative consequence of promoting "greenhushing" and hindering industry climate initiatives. We expect this tension to resolve over time as regulatory guidance clarifies and market consensus builds. In the meantime, however, financial firms need to continue to be cautious about use of sustainability labels for investment products and to have a documented basis and methodology for supporting any such descriptions.