CONSULTATION RESPONSE

BAFIN DRAFT GUIDELINES ON REQUIREMENTS FOR SUSTAINABLE FUNDS

6 September 2021

This consultation response represents the view of the PRI Association and not necessarily the views of its individual members.

INTRODUCTION

The Principles for Responsible Investment (PRI) is the world's leading initiative on responsible investment. The PRI is now a not-for-profit company with over 4,000 signatories (pension funds, insurers, investment managers and service providers) to the PRI's six principles with approximately US $120 trillion in assets under management.

The PRI supports its international network of signatories in implementing the Principles. As long-term investors acting in the best interests of their beneficiaries and clients, our signatories work to understand the contribution that environmental, social and governance (ESG) factors make to investment performance, the role that investment plays in broader financial markets and the impact that those investments have on the environment and society as a whole.

The PRI works to achieve this sustainable global financial system by encouraging adoption of the Principles and collaboration on their implementation; by fostering good governance, integrity and accountability; and by addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation.

The PRI welcomes the opportunity to respond to the BaFin consultation on Draft Guidelines on Requirements for Sustainable Funds.

ABOUT THIS CONSULTATION

BaFin, the German financial regulator, has published a set of draft guidelines which aim to protect investors from greenwashing by setting minimum requirements for funds which are designated or marketed as "sustainable". Such financial products must either maintain a minimum investment quota in sustainable assets, pursue a sustainable investment strategy, or track sustainable index.

For more information, contact :

Elise Attal

Head of EU Policy

Elise.attal@unpri.org

Alina Neculae

Senior Policy Analyst, EU

Alina.neculae@unpri.org

KEY RECOMMENDATIONS

The PRI welcomes the ambition of these new guidelines to mitigate the risk of greenwashing for sustainable finance products through better accountability and transparency. We agree that it is not enough for financial products marketed as sustainable to only "consider" sustainability criteria, instead sustainability factors should be prioritised in the investment decision process. Furthermore, we welcome the aim of the guidelines to supplement and promote existing EU initiatives.

The PRI makes the following recommendations:

- **Increase market harmonisation and coherence through enhanced collaboration at member state and EU-level.** While the PRI supports national efforts to set minimum standards for sustainable funds, there is a risk that these may cause market fragmentation and confusion for investors distributing funds across the EU. Market fragmentation may lead to financial products relocating to EU jurisdictions with less stringent ESG product standards. Therefore, we encourage further collaboration between national and EU regulators to create common minimum requirements for sustainable funds in order to mitigate the risk of greenwashing, as announced in the renewed sustainable finance strategy published in July 2021[1]. The development of EU-level minimum requirements for sustainable products should be a priority for the EU sustainable finance policy agenda.
- **Clarify the relationship between the guidelines and ongoing EU legislation.** The PRI recognises the intention of the guidelines to supplement ongoing EU initiatives such as SFDR and the Taxonomy which focus on disclosure requirements. However, although the SFDR only sets transparency obligations regarding, amongst others, sustainability risks and impacts, Articles 8 and 9 are being used by many financial market participants to categorise their funds according to their sustainability characteristics[2]. Therefore, we recommend BaFin provide further clarification on how, if at all, the requirements in the guidelines relate to Articles 8 and 9 of SFDR[3].
- **Recognise the positive sustainability impact of investor stewardship.** Stewardship is a crucial tool for sustainable investment and must be covered in the guidelines. We recommend BaFin do this in two ways. Firstly, the exclusion principles should have some form of caveat for funds which have an explicit stewardship objective – these funds play a vital role by incentivising and enabling companies to transition away from environmentally and socially-harmful activities. Secondly, we encourage BaFin to consider the recommendations from our recent PRI position paper on accelerating ambition on stewardship in the EU, in particular, our recommendations around the proposed Articles 8.1(b) and 8.2 of the draft regulatory technical standards of the SFDR and how the guidelines could align with this.
- **Clarify the definition of sustainable investments.** We welcome the approach BaFin has taken to align its definition of sustainable investments with the SFDR Art 2(17) definition. However, without the remaining SFDR framework of principal adverse impacts (PAIs) and final RTS, the

---

[1] Strategy for financing the transition to a sustainable economy | European Commission (europa.eu)

[2] See Morningstar study SFDR: Four Months After Its Introduction - Article 8 and 9 Funds in Review from 27 July 2021

[3] The French AMF clarified in January 2021 how its own guidelines relate to the SFDR obligations: https://www.amf-france.org/en/news-publications/news/implementation-sfdr-regulation-asset-management-companies-march-10-2021

guidelines leave a lot of room for interpretation. There needs to be clarity on how an investor would assess whether 75% of their assets meet the SFDR Art 2(17) definition, whether this links to PAIs or indeed the EU Taxonomy. The definition of sustainable investment should be clarified at EU level.

- **Strengthen the ESG safeguards.** Whereas we appreciate that EU Taxonomy Art 9 and SFDR Art 2 (17) are presented as the main safeguards throughout the document, the BaFin guidelines should specifically reference the "Do No Significant Harm" thresholds and "Minimum Safeguards" (i.e. UNGPs and ILO core standards) of the EU Taxonomy. Moreover, considering these guidelines are for "sustainable funds", the exclusionary safeguards should go beyond environmentally harmful activities and include social and governance issues.
- **Improve the "sustainable investment strategy" definition.** BaFin should make more detailed recommendations with regards to what constitutes a "sustainable investment strategy", beyond the "best in class" example. The current draft guidelines suggest that following a "best in class" sustainable strategy can qualify an asset as sustainable. This is much more lenient than the 75% threshold aligned with SFDR definition of sustainable investment. "Best in class" strategies favour investments in companies with relatively strong ESG performance, yet such an approach does not guarantee a substantial contribution to meeting sustainability goals such as the Sustainable Development Goals and Paris Agreement. Therefore, we recommend a more stringent and comprehensive definition of a "sustainable strategy", referencing the EU Taxonomy and stewardship activities.

The PRI has experience of public policy on sustainable finance policies and responsible investment across multiple markets and stands ready to further support the work of BaFin to develop requirements for sustainable funds. Any question or comments can be sent to policy@unpri.org.