Client Alert

Investment Funds and Asset Management

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Final Countdown: ESMA Guidelines on Funds' Names Using ESG or Sustainability-Related Terms

Over the past few years, there has been a sharp increase in funds using environmental, social, governance ("**ESG**"), sustainability, impact or sustainable development goals ("**SDG**") references in fund names. With this has come heighted scrutiny of potential greenwashing risk. In May 2024, the European Securities and Markets Authority ("**ESMA**") published its final report "*Guidelines on funds' names using ESG or sustainability-related terms*" ("**ESG Fund Names Guidelines**") to address potential greenwashing risk.

SCOPE AND IMPLEMENTATION

The ESG Fund Names Guidelines apply to Undertakings for Collective Investment in Transferable Securities ("**UCITS**") Management Companies and Alternative Investment Fund Managers ("**AIFMs**") (together "**Fund Managers**") in relation to UCITS and Alternative Investment Funds ("**AIFs**") that they manage (collectively described as "**funds**" in this update). It regulates the naming of such funds to prevent greenwashing and to ensure that investors are well-informed of the ESG and/or sustainability strategies of such funds.

Although not explicitly stated, we expect that many local regulators will adopt the ESG Fund Names Guidelines towards both EU based AIFMs and non-EU based AIFMs that market funds in their jurisdiction. This is also supported by the fact that the ESG Fund Names Guidelines apply in relation to the requirements for marketing communications under Article 4 of the Regulation (EU) 2019/1156 of the European Parliament and of the Council of 20 June 2019 on facilitating cross-border distribution of collective investment undertakings and amending Regulations (EU) No 345/2013, (EU) No 346/2013 and (EU) No 1286/2014 ("**EU Cross-Border Distribution of Funds Regulation**" or "**CBDFR**") and many EU local regulators adopted the requirements of the CBDFR to non-EU AIFMs under the local national private placement regimes.

Due to the non-binding nature of the ESG Fund Names Guidelines, all EU local regulators had to declare by 21 October 2024 if they intended to comply with the ESG Fund Names Guidelines. The local regulators can choose to comply with the ESG Fund Names Guidelines or explain that they do comply with the ESG Fund Names Guidelines entirely or in part. Although the deadline for such statements has already passed, many national regulators have not yet published their views. Others have confirmed their intention to comply but called for additional clarifications or shared their own interpretation of certain concepts covered in the ESG Fund Names Guidelines.

The ESG Fund Names Guidelines will apply from **21 November 2024** for new funds and from **21 May 2025** for existing funds. In addition to considering the requirements of the ESG Fund Names Guidelines, Fund Managers must also consider any views and guidance that have already or will be issued by the relevant local regulators, since expectations can vary from country to country.

This briefing provides an overview of the ESG Fund Names Guidelines and highlights the key concepts set out in them.

KEY REQUIREMENTS

The ESG Fund Names Guidelines set out a **non-exhaustive list** of key terms (and related terms) which can be used in the name of a fund only to the extent the fund meets certain threshold requirements prescribed by the ESG Fund Names Guidelines.

"**Key Terms**" include the use of the words: 'transition', 'impact', 'ESG' (or separately – 'social', 'environmental', 'governance'), 'sustainability' and/or any related terms. The Key Terms are also categorised as transition terms, impact terms and sustainability terms.

There are three main categories of naming rules to follow, some of which are different depending on the categorisation of the Key Terms:

(i) a single quantitative threshold of 80% of investments that should meet environmental and/or social characteristics or sustainable investment objectives;

(ii) an application of prescribed investment exclusions to the fund; and

(iii) for some terms, additional qualitative requirements.

Threshold Requirements

All funds using any of the Key Terms in their names should devote at least **80% of their investments** to meet environmental and/or social characteristics and/or sustainable investment objectives in accordance with the binding elements of their investment strategy.

Exclusion Requirements

Another layer of requirements is that such funds should apply either the Climate Transition Benchmark ("**CTB**") Exclusion or the Paris-aligned Benchmark ("**PAB**") Exclusion depending on the category of the Key Terms used by the fund to all of their investments.

Term	*Exclusion*
"Transition"; "Social"; and "Governance" and/or related terms	CTB Exclusion – means no investments in controversial weapons, tobacco, or anything in contravention of the UNGC Principles or OECD Guidelines for Multinational Enterprises (the "**CTB criteria**").
"Environmental"; "Impact"; and "Sustainability" and/or related terms	PAB Exclusion –includes both CTB Exclusion (the above restrictions) and various percentage restrictions on investments in refining oil, hard coal, gaseous fuel, etc. (the "**PAB criteria**").

Additional Qualitative Requirements

For fund names with terms including "sustainability", "transition", "impact" and/or related terms, they must also comply with certain additional qualitative criteria.

Term	*Additional qualitative criteria*
"Sustainable" and/or related terms	Funds must commit to invest *meaningfully* into sustainable investments. Note: "Meaningful" is not defined or attributable to a percentage threshold.
"Transition" and/or related terms	Funds must ensure that 80% of the investments committed are on a *clear and measurable path* to social or environmental transition.
"Impact" and/or related terms	Funds must ensure that 80% of the investments committed are made with the objective of *generating positive and measurable social or environmental impact* alongside a financial return.

Cumulative Requirements

Generally, a fund name that contains one or more of the Key Terms must comply with the abovementioned requirements cumulatively. It should be noted, however, that where "environmental"-related terms and "transition"-related terms are used together, both the Threshold and Additional Qualitative Requirements should be applied but only the less restrictive CTB criteria are applicable. The reason behind this is that a "transition" fund may invest in fossil fuel businesses in transition toward a greener business.

NEXT STEPS

All EU Fund Managers should review the names of all of their existing funds against the requirements of the ESG Fund Names Guidelines and any applicable guidance form the local regulators. They should also carefully consider fund names proposed for any funds to be launched in the near future to ensure that sustainability and ESG features of investment processes and strategies meet the expectations set out in the ESG Fund Names Guidelines and any applicable guidance form the local regulators.

For existing fund names, very careful consideration will need to be given to existing disclosures and reporting (for example under the Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector ("**SFDR**") and exposure to "transitioning" assets. Fund Managers will need to ensure that a fund name is and remains consistent with the sustainability features and outcomes communicated as part of these disclosures and will also need to carefully consider exposure to companies in breach of the Exclusion Requirements (e.g. PAB criteria). Following this assessment, Fund Managers will need to decide whether to align fund names with the ESG Fund Names Guidelines, amend the names or potentially divest (to the extent that is possible) from certain assets that do not meet the relevant criteria. Many EU regulators (e.g. Ireland and Luxembourg) have announced an expedited application procedure for funds that would like to adjust their names due to the ESG Fund Names Guidelines' requirements.

Non-EU AIFMs of funds that are marketed under the local national private placement regimes or are to be registered or otherwise approved for marketing in the EU will also need to understand whether the relevant EU member state intends to apply the ESG Fund Names Guidelines to non-EU AIFMs. If so, the relevant non-EU AIFM will also need to assess the use of the sustainability-related terms in their funds' names. For funds marketed in several jurisdictions, the situation may be more complex still – with national regulators taking different approaches to fund names within the EU.

Consideration of the ESG Fund Names Guidelines is likely to be an important area of focus for funds in the next few months given the range of sustainability features and investment offerings and the need for more granular data and information. Whilst sustainability-related regulation offers some guidance, even funds disclosing under Article 8 SFDR have different sustainability features and offer a very wide range of sustainability outcomes. Further issues arise in the context of investment strategies that intend to invest in "transitioning" assets where investments may breach the PAB or the CTB criteria.

It is worth noting that the ESG Fund Names Guidelines are not intended to be a labelling requirement for ESG funds nor are they intended to impose additional disclosure requirements. It is therefore necessary to consider the ESG Fund Names Guidelines in the context of ESG information and data already being produced and analysed by a fund in order to comply with sustainability-related regulations and standards, as this is likely to provide the most efficient way to comply with the ESG Fund Names Guidelines.

Please contact Sukhvir Basran and Costa Burkov for further information on the ESG Fund Names Guidance.
