

Application date approaching for ESMA's guidelines on funds' names

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The European Securities and Markets Authority's (ESMA) guidelines on funds' names using environmental, social and governance (ESG) or sustainability-related terms will come into effect on 21 November 2024.

Any new funds created on or after this date should comply with the final guidelines (the **Guidelines**) immediately, while funds existing before the application date will benefit from a transitional period of six months, until 21 May 2025.

ESMA, the EU's financial markets regulator and supervisor, has published the translations [1] of the Guidelines in all official EU languages.

In this briefing, we explain the purpose of these Guidelines, the categories of terms outlined by them, and what actions fund managers need to take next.

Background

Following the consultation launched on 18 November 2022 [2] and the public statement of 14 December 2023 [3], ESMA has published its final report containing the Guidelines on funds' names using ESG or sustainability-related terms [4] on 14 May 2024.

This links to its more general mandate under the second Alternative Investment Fund Managers Directive (AIFMD II) [5], under which ESMA is expected to develop guidelines on circumstances in which the name of a fund is unfair, unclear or misleading.

Purpose and scope of application

The objective of the Guidelines is to (i) protect investors against unsubstantiated or exaggerated sustainability claims in fund names, and (ii) provide asset managers with clear and measurable criteria to assess their ability to use ESG or sustainability-related terms in fund names.

Entities in scope of the Guidelines are:

- management companies of undertakings for collective investment in transferrable securities (UCITS)
- any UCITS which has not designated a management company
- alternative investment fund managers (AIFMs)
- internally managed alternative investment funds (AIFs)

(Collectively, the investment fund managers (IFMs)).

In a separate communication [6], the Luxembourg Financial Sector Supervisory Authority (CSSF) has drawn the attention of market participants to the fact that these Guidelines apply to the above entities, irrespective of whether they are disclosing under Articles 6, 8 or 9 of Sustainable Finance Disclosure Regulation (SFDR)[7]. As such, each entity is expected to carry out a self-assessment to determine whether the Guidelines apply to products they manage and ensure the fund names are compliant with the Guidelines.

| Main takeaways

The Guidelines differentiate several categories of key terms:

- transition-related (for example, transition and any derived terms, as well as terms containing and deriving from improve, progress, evolution, transformation, net zero)
- environment-related (words giving the investor any impression of the promotion of environmental characteristics, such as green, environmental, climate, or including ESG and socially responsible investing (SRI) abbreviations)
- social-related (words giving the investor any impression of the promotion of social characteristics, such as social, equality)
- governance-related (giving any impression of governance focus, such as governance, controversies)
- impact-related (such as impact and any derived terms)
- sustainability-related (such as sustainable, sustainability)

For any such key term to be used, the fund needs to meet an 80% threshold linked to the proportion of investments used to meet the environmental or social characteristic or sustainable investment objectives in accordance with the binding elements of the investment strategy (as

disclosed in Annexes II and III of the SFDR Regulatory Technical Standards (RTS) [8].

Besides this general rule, the key terms can be further grouped based on additional conditions that should be met in order to use a particular term in the fund's name:

- sustainability, environmental and impact-related terms can be used if the fund applies exclusions according to the rules applicable to Paris-aligned benchmarks [9]
- transition, social and governance-related terms can be used if the fund applies exclusions according to the rules applicable to EU Climate Transition Benchmarks [10]
- funds using transition or impact-related terms in their names should also ensure that investments used to meet the threshold are on a clear and measurable path to transition or are made with the objective to generate a positive and measurable impact alongside a financial return
- funds using sustainability-related terms should commit to invest meaningfully in sustainable investments (as defined in Article 2(17) SFDR)

In terms of supervisory expectations, ESMA noted that a temporary deviation from the threshold and the exclusions should be treated as a passive breach (provided that the deviation is not due to a deliberate choice by the IFM). Further investigation by regulators and supervisory dialogue should be considered in relation to the following items: mismatches on quantitative thresholds which are not passive breaches, level of investments too low to justify the name, and the use of terms that would result in investors receiving unfair or unclear information or to be misled by these terms.

Next steps

IFMs of funds existing on 21 November 2024, whose names contain ESG-related terms, will need to make sure this matter is addressed in board meetings of individual funds and carry out an assessment of their portfolio composition and its alignment with the Guidelines. The deadline for compliance is by 21 May 2025.

New funds created on or after 21 November 2024 will need to ensure immediate compliance with the Guidelines.

It is important to note that this topic has been highlighted as one of the CSSF's supervisory priorities in the area of sustainable finance. In its communiqué of 22 March 2024 [11], the CSSF announced the intent to undertake supervisory actions to ensure that portfolio holdings reflect, inter alia, the name and the characteristic displayed in fund investor documentation.

[1] Guidelines on funds' names using ESG or sustainability-related terms, ESMA34-1592494965-657

[2] Consultation Paper On Guidelines on funds' names using ESG or sustainability-related terms; ESMA34-472-373

[3] Public Statement: Update on the guidelines on funds' names using ESG or sustainability-related terms; ESMA34-1592494965-554

[4] Final Report on the Guidelines on funds' names using ESG or sustainability-related terms; ESMA34-472-440

[5] Directive (EU) 2024/927 of the European Parliament and of the Council of 13 March 2024 amending Directives 2011/61/EU and 2009/65/EC as regards delegation arrangements, liquidity risk management, supervisory reporting, the provision of depositary and custody services and loan origination by alternative investment funds.

[6] CSSF Communiqué of 15 May 2024, ESMA publishes its Final Report on Guidelines on funds' names using ESG or sustainability-related terms

[7] 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, as amended

[8] Commission Delegated Regulation (EU) 2022/1288 of 6 April 2022 supplementing Regulation (EU) 2019/2088

[9] Article 12(1)(a) to (g) of Commission Delegated Regulation (EU) 2020/1818

[10] Article 12(1)(a) to (c) of Commission Delegated Regulation (EU) 2020/1818

[11] CSSF Communiqué of 22 March 2024, The CSSF's supervisory priorities in the area of sustainable finance

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