

ASSET MANAGEMENT  
& INVESTMENT FUNDS

## ESMA finalises Guidelines on funds' names using ESG or sustainability-related terms

On 14 May 2024, the European Securities and Markets Authority (ESMA) published its [Final Report](#) containing Guidelines on funds' names using ESG or sustainability-related terms ([Guidelines](#)).

The objective of the Guidelines is to ensure that investors are protected against unsubstantiated or exaggerated sustainability claims in fund names, and to provide asset managers with clear and measurable criteria to assess their ability to use ESG or sustainability-related terms in fund names.

6 MIN READ



The Guidelines apply to UCITS management companies, including any UCITS which has not designated a UCITS management company, Alternative Investment Fund Managers, including internally managed AIFs, EuVECA, EuSEF, ELTIF and MMF managers (**Fund Managers**). They are relevant to all fund documentation and marketing communications addressed to investors or potential investors of UCITS or AIFs. Fund Managers are expected to make every effort to comply with the Guidelines.



## Background

ESMA is concerned that increasing investor demand for investment funds that incorporate environmental, social and governance (**ESG**) factors could incentivise asset managers to include terminology in their funds' names designed to attract investor assets. ESMA is seeking to address the risk of "greenwashing" that may arise from misleading sustainability disclosures.

Against this background, in November 2022, ESMA launched a public consultation on Guidelines on funds' names using ESG or sustainability-related terms [view here](#). This followed ESMA's principles-based guidance for funds' names with ESG and sustainability-related terms included in its supervisory briefing on sustainability risks and disclosures in the area of investment management [view here](#).

After receiving significant feedback to the consultation, ESMA saw merit in making some modifications to its original proposals. The modifications are reflected in the final Guidelines, summarised below.

The Guidelines apply in relation to Fund Managers obligations to act honestly and fairly in conducting their business as well as the obligation that all information included in marketing communications is fair, clear and not misleading. They are published under a mandate for ESMA to develop guidelines specifying the circumstances where the name of an AIF or UCITS is unclear, unfair or misleading arising from the recent review of the AIFMD and UCITS Directive, whose amending Directive (Directive (EU) 2024/927) entered into force on 15 April 2024.



### Final Report Guidelines – summary

#### **Funds using transition, social and governance-related terms should:**

- apply an 80% threshold linked to the proportion of investments used to meet the environmental or social characteristics or sustainable investment objectives in accordance with the binding elements of the investment strategy, which are to be disclosed in their pre-contractual disclosures
- apply the Climate Transition Benchmark (CTB) exclusions<sup>1</sup>

#### **Funds using environmental or impact-related terms should:**

- apply an 80% threshold linked to the proportion of investments used to meet the environmental or social characteristics or sustainable investment objectives in accordance with the binding elements of the investment strategy, which are to be disclosed in their pre-contractual disclosures
- apply the Paris-Aligned Benchmark (PAB) exclusions<sup>2</sup>

#### **Funds using sustainability-related terms should:**

- apply an 80% threshold linked to the proportion of investments used to meet the environmental or social characteristics or sustainable investment objectives in accordance with the binding elements of the investment strategy, which are to be disclosed in their pre-contractual disclosures
- apply the PAB exclusions
- invest meaningfully in sustainable investments as defined in Article 2(17) SFDR

Where transitional, social or governance terms are combined with environmental or impact-related terms, the provisions should apply cumulatively, except for those terms combined with any transition-related terms, where the CTB exclusions should apply.

### Funds designating an index

Funds designating an index as a reference benchmark should only use the terms in scope of the Guidelines in their name if the Guideline's expectations are fulfilled by the fund. This may result in a mismatch between the names of passive funds and their reference index.

### Impact and transition terms

Funds using “transition” or “impact”-related terms in their names should also ensure that investments used to meet the 80% threshold are on a clear and measurable path to social or environmental transition or are made with the objective to generate a positive and measurable social or environmental impact alongside a financial return.

<sup>1</sup> CTB exclusions are listed in Article 12(1)(a)-(c) of Commission Delegated Regulation (EU) 2020/1818

<sup>2</sup> PAB exclusions are listed in Article 12(1)(a) to (g) of Commission Delegated Regulation (EU) 2020/1818

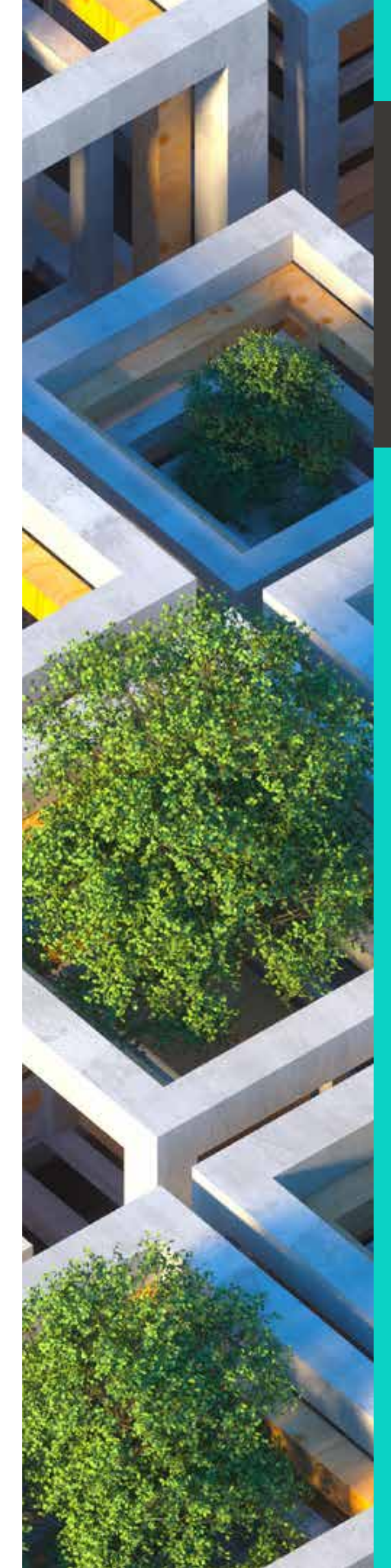




While not a definitive list, the Guidelines include explanations of key terms:

KEY TERMS	
<b>Transition</b>	“Transition”-related terms encompass any terms derived from the base word “transition” e.g. “transitioning”, “transitional” etc and those terms deriving from “improve”, “progress”, “evolution”, “transformation”, “net-zero” etc.
<b>Environmental</b>	“Environmental”-related terms means any words giving the investor any impression of the promotion of environmental characteristics e.g. “green”, “environmental”, “climate”, etc and may include “ESG” and “SRI” abbreviations.
<b>Social</b>	“Social”-related terms mean any words giving the investor any impression of the promotion of social characteristics e.g. “social”, “equality” etc.
<b>Governance</b>	“Governance”-related terms mean any words giving the investor any impression of a focus on governance e.g. “governance”, “controversies”, etc.
<b>Impact</b>	“Impact”-related terms mean any terms derived from the base word “impact” e.g. “impacting”, “impactful” etc.
<b>Sustainability</b>	“Sustainability”-related terms means any terms only derived from the base word “sustainable” e.g. “sustainably”, “sustainability” etc.

Notwithstanding this further detail on ESG and sustainability-related terms, the classification of some funds based on their names remains uncertain and care needs to be taken to ensure that classifying funds using terms such as “responsible” in their name does not result in the imposition of investment restrictions inconsistent with their investment philosophy.





### Key changes reflected in final Guidelines

- Removal of the 50% minimum (within the 80% of investments used to meet environmental and/or social characteristics) of sustainable investments for a fund named “sustainable” or any term derived from “sustainable”, replaced with a commitment to invest meaningfully in sustainable investments. This is consistent with ESMA’s existing guidance which provides that the term “sustainable” or “sustainability” should be used only by (1) funds disclosing under Article 9 SFDR, (2) funds disclosing under Article 8 SFDR which in part invest in economic activities that contribute to environmental or social objectives and (3) funds with taxonomy aligned sustainable investments. We expect that what constitutes “meaningful” investment in sustainable investments will vary depending on factors including the methodology for identifying and quantifying sustainable investments employed by Fund Managers.

- Acknowledging that the fossil fuel exclusions of PAB could unnecessarily penalise some funds using terms in their name that are not environmental or that focus on transition strategies, ESMA has instead provided for the minimum safeguards exclusion criteria of the CTB to apply for terms that are transition, social and governance related.
- A new category of transition-related terms designed not to penalise investment in companies deriving part of their revenues from fossil fuels, thus promoting strategies aimed to foster a path to transition towards a greener economy.
- ESMA has separated the terms related to social (S) and governance (G) from environmental (E) terms, including “S” and “G” terms in the same group as transition terms.
- New provision for “impact” and “transition” terms aimed to create an additional qualifying link between the strategy of the fund and its name, ensuring a measurable dimension to the strategy itself.

### Supervisory expectations

The Central Bank of Ireland will be responsible for ensuring that Fund Managers under its supervision comply with the Guidelines throughout the life of the fund. ESMA notes that investors could verify this information through the SFDR periodic disclosures.

The Guidelines clarify that a non-deliberate temporary deviation from the threshold and the exclusions, should be treated as a passive breach and corrected in the best interest of the investors. The following examples of situations warranting further investigation and supervisory dialogue are provided:

- discrepancies in the level of the quantitative threshold which are not passive breaches
- a fund that does not demonstrate a sufficiently high level of investments to use transition, ESG, impact or sustainability-related terms in its name
- where the competent authority considers that using transition, ESG, impact or sustainability-related terms in the fund name would result in investors receiving unfair or unclear information or in a failure of the manager to act honestly or fairly thus misleading investors.





### Next steps

The **application date** of the Guidelines will be **three months** from the date they are published on ESMA's website in all EU languages. Fund Managers of any **new funds created after the application date should apply the Guidelines immediately** from the application date. Unless any extension is agreed with the Central Bank, Fund Managers of funds existing before the application date should apply the Guidelines after **six months** from the application date.

Fund Managers should assess what compliance steps they may need to take to adapt to the Guidelines. This may include potential updates to funds' disclosures and the potential repositioning of portfolios for funds that currently would fall within the Guidelines but do not meet the thresholds and other criteria, or potentially the renaming of funds to remove ESG/ sustainability terms or clarify the use of an in-scope term.

For more information on this please contact any member of our [Asset Management & Investment Funds team](#).





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## Resources



[ESMA Final Report - Guidelines on funds' names using ESG or sustainability-related terms](#)

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[ESMA Consultation Paper on funds' names using ESG or sustainability related terms](#)

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[ESMA Supervisory Briefing on Sustainability Risks and Disclosures in the area of Investment Management](#)

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