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GREAT FUND INSIGHTS

ESMA Guidelines on funds' names: *Tell me your fund name, I'll tell you your fund strategy*

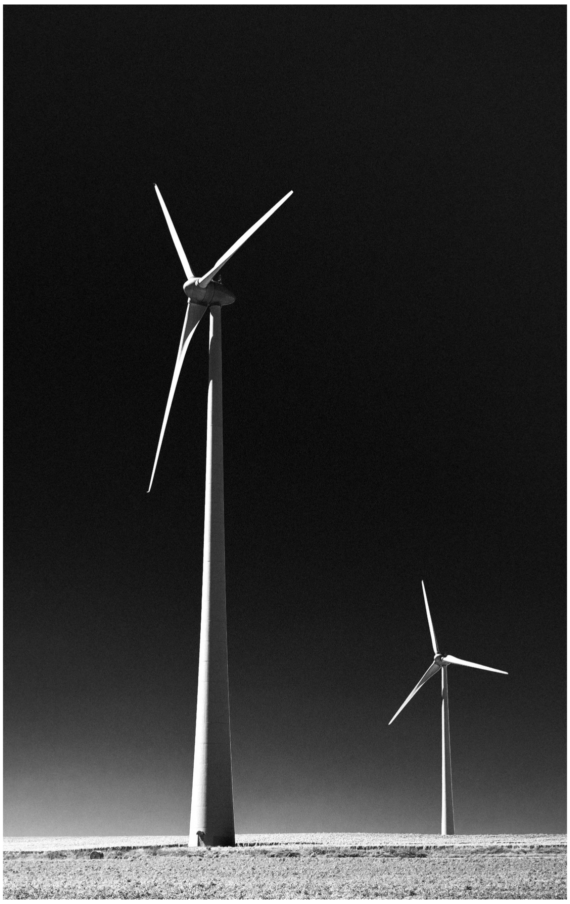
JULY 2024

On 14 May 2024, ESMA published its final guidelines on funds' names using ESG or sustainability-related terms (the Guidelines).

As a result, the use of certain environmental, social and governance (**ESG**) or sustainability-related terms will trigger minimum requirements based on (i) quantitative thresholds (80%), (ii) exclusion criteria (PAB and CTB exclusions) and (iii) additional qualitative criteria for some ESG or sustainability-related terms.

The Guidelines aim at preventing greenwashing and ensuring that investors are not misled by fund names that suggest a focus on ESG investments or sustainability objectives until the next review of SFDR[1]. Greenwashing has been a growing concern, and the Guidelines are presented as a step towards mitigating this risk.

The Guidelines are not intended to be a labelling regime for ESG or sustainable funds, nor to impose additional disclosure obligations on fund managers. However, they may have significant implications for fund managers that use ESG or sustainability-related terms in their fund names, as they may need to review and revise their fund names and/or investment strategies to ensure compliance with the Guidelines. The Guidelines could also have significant compliance costs for funds impacted.



[1] Regulation (EU) 2019/2088 of 27 November 2019 on sustainability-related disclosures in the financial services sector, as amended

1. Scope

1.1 FUND NAMES: ONLY FUNDS AND ONLY NAMES BUT FOR ALL INVESTORS

The Guidelines are the result of a consultation process that began in November 2022 and concluded in February 2023. Their release was postponed by ESMA in December 2023 due to the implementation of the AIFMD II and UCITS directive review. These directives specifically tasked ESMA to develop guidelines on the circumstances where the name of an AIF or UCITS is unclear, unfair or misleading. Feedback to the consultation suggested extending the guidance to other SFDR financial products and possibly MiFID[2] financial instruments as well as green bonds, notes and derivatives. Despite this, ESMA's mandate remains defined by the AIFMD II and UCITS Directive review, although the possibility of broadening the scope of the Guidelines will be considered.

The Guidelines' scope is narrower than the French AMF[3]'s recommendations or the UK FCA[4] rules on naming and marketing rules[5] in respect of the use of ESG terms that trigger their application. However, they have a broader reach in terms of addressees, as they apply to funds that are open to all types of investors as opposed to the French and UK rules, which are limited to funds offered to retail investors.

The Securities and Market Stakeholder Group (**SMSG**) has advised ESMA to expand the Guidelines to ultimately cover prospectus, KID[6], ESG statements and other documents, in addition to names, as they potentially could include misleading wording[7]. ESMA may take this advice on board, but for the time being the Guidelines are limited to funds' names only.

1.2 UCITS, AIFs, AND THEIR MANAGERS

The Guidelines are designed to apply to the following entities:

- UCITS Management Companies; and
- AIFMs, whether registered under the *de minimis* regime or fully authorized,

in relation to UCITS and AIFs (including MMFs)[8] they manage that use certain terms in their names, such as "transition," "impact," "environmental," "social," "governance," or "sustainable" (among others) which may carry particular expectations regarding the investment strategies and objectives of the fund.

The Guidelines also apply to self-managed UCITS and internally-managed AIFs (including ELTIFs,[9] EuSEFs,[10] and EuVECAs[11]).

2 Directive 2014/65/EU of 15 May 2014 on markets in financial instruments, as amended
3 *Autorité des Marchés Financiers*
4 *Financial Conduct Authority*
5 Policy Statement PS 23/16 – Sustainability Disclosure Requirements (SDR) and investment labels, Chapter 7 – page 45
6 Key Information Document
7 ESMA Final Report on the Guidelines on funds' names using ESG or sustainability-related terms, Annex II, 2. Q1 – pages 33-34
8 Money Market Funds
9 European Long-Term Investment Funds
10 European Social Entrepreneurship Funds
11 European Venture Capital Funds

1.3 NON-EU AIFs

It is worth noting that the Guidelines apply to UCITS and AIFs as defined in their respective sectorial directive. Since the AIFMD defines both EU AIFs and non-EU AIFs[12], the use of the more broader term AIF could be an indication that all non-EU AIFs should be in scope. Furthermore, the Guidelines are based on the general principle that AIFMs shall act honestly, with due skill, care and diligence and fairly in conducting their activities (Article 12(1) of AIFMD), which applies to EU authorized AIFMs managing non-EU AIFs marketed in the EU, indicating that non-EU AIFs managed by this type of AIFMs should be covered. However, non-EU AIFs marketed in the EU according to national private placement regimes fall under the competence of the relevant competent authority who should thus determine the applicability of the Guidelines to these AIFs.

1.4 NON-EU AIFMs MARKETING AIFs IN THE EU

The Guidelines do not explicitly define the scope with respect to non-EU AIFMs marketing AIFs in the EU, but we believe they are intended to be included. This interpretation is based on the application to non-EU AIFMs marketing AIFs in the EU of Article 12(1) of the AIFMD on which the Guidelines are based and with the Guidelines' objective to prevent greenwashing in the EU.

1.5 CLOSED-ENDED FUNDS

Closed-ended funds which have terminated their subscription period are in scope of the Guidelines.[13] ESMA refused to limit the scope to open-ended funds only or to open-ended funds and listed closed-ended funds, as suggested by some respondents to the consultation. Indeed, ESMA has deemed it "meaningful" to align the names of closed-ended funds with their underlying investments, asserting that excluding unlisted closed-ended funds would be "inconsistent" with the guidelines on marketing communications, which do not provide for such an exclusion.[14] However, funds that have ceased to market are not impacted by the guidelines on marketing communications, since they no longer use marketing documents. Most funds closed to marketing are also closed to redemptions and are addressed to professional investors. This regulatory change could impose potentially significant[15] costs for these funds and ultimately for their investors, that may be seen as unnecessary from an investor protection perspective.

2. Key requirements

The Guidelines have categorized certain key terms and a non-exhaustive list of related terms which trigger minimum requirements, based on quantitative thresholds, exclusion criteria, and additional qualitative criteria.

12 Article 4(1)(a) of AIFMD
13 ESMA Final Report on the Guidelines on funds' names using ESG or sustainability-related terms, Annex I, Q14, pages 24-25
14 See ESMA answer to Q14 of the feedback statement
15 ESMA report mentions that "*The majority of respondents note that there would be significant compliance costs in terms of prospectus updates, staffing, post-contractual information, internal coordination, training for financial advisors, possible modification of suitability tests with respect to the integration of suitability preferences.*"

2.1 SIX CATEGORIES OF TERMS TRIGGERING THE REQUIREMENTS

The Guidelines do not intend to create labels but only to prevent greenwashing. ESMA provides a non-exhaustive list of related terms which can be derived from the key term or simply associated to the key term.

FUND NAME INCLUDING ESG OR SUSTAINABILITY-RELATED TERMS	
Key categories of terms	**Examples of related terms**
Transition-related terms	Any terms deriving from "transition" such as transitioning, transitional Any terms deriving from "improve", "progress," "evolution," "transformations," "net-zero"
Environmental-related terms	Any word that gives investors the impression of promoting environmental characteristics, such as "green", "environmental," "climate," "ESG" and "SRI"
Social-related terms	Any word that gives investors the impression of promoting social characteristics, such as "social," "quality"
Governance-related terms	Any word that gives investors the impression of a focus on governance, such as "governance," "controversies"
Impact-related terms	Any word deriving from "impact," such as "impacting," "impactful"
Sustainability-related terms	Any word deriving from "sustainable," such as "sustainably," "sustainability"

2.2 SINGLE QUANTITATIVE THRESHOLD OF 80% FOR ALL CATEGORIES

All funds using ESG- or sustainability-related terms should meet an 80% minimum threshold in the proportion of investments used to meet environmental and/or social characteristics or sustainable investment objectives in accordance with the binding elements of the product investment strategy, as disclosed in the SFDR-RTS pre-contractual templates.

ESMA chose to introduce a single quantitative threshold for all key terms. To determine whether the threshold includes derivatives or other asset classes, investors must review the pre-contractual disclosures on the proportion of investments committed to meet the environmental and/or social characteristics or sustainable investment objectives and verify whether the fund manager includes them in its calculation.

2.3 CTB EXCLUSIONS FOR SOCIAL, GOVERNANCE, OR TRANSITION-RELATED TERMS AND PAB EXCLUSIONS FOR ENVIRONMENTAL, IMPACT-, AND SUSTAINABILITY-RELATED TERMS

Depending on the term used in their name, funds must either apply Climate Transition Benchmark (**CTB**) exclusions (i.e., they should not invest in companies involved in controversial weapons, tobacco cultivation, and production or violating UNGC or OECD guidelines) or the Paris-aligned Benchmark (**PAB**) exclusions (i.e., they should not invest in CTB exclusions nor in companies that derive a certain percentage of revenues from activities related to hard coal, lignite, refining of oil fuels, gaseous fuels, or from generating electricity releasing more than a certain percentage of CO^2 for each KwH of electricity generated).

ESMA specified in the feedback responses that exclusions apply regardless of the type of financial instruments invested in and issued by those companies (e.g., debt or equity).

ESMA further noted that the PAB exclusions were "particularly impactful" as they include certain revenue-based fossil fuel companies as well as many companies in the energy sector. In light of the feedback received, ESMA decided to introduce a new category of funds using transition-related terms in their names and apply only CTB exclusions to them so that they can still invest in fossil-fuel companies while promoting transition towards a greener economy. The same reasoning was applied to funds with social- or governance-related terms in their names that could be too restricted in their investment universe if they apply PAB exclusions.

<table>
<tr><th colspan="3">FUND NAME INCLUDING ESG OR SUSTAINABILITY-RELATED TERMS</th></tr>
<tr><th>Key categories of terms</th><th>Applicable exclusions</th><th>Details of companies excluded</th></tr>
<tr><td>Transition-related terms</td><td rowspan="3">CTB exclusions</td><td rowspan="3">Companies:
involved in any activities related to controversial weapons
involved in the cultivation and production of tobacco
that benchmark administrators find in violation of the UNGC principles or the OECD guidelines for Multinational Enterprises</td></tr>
<tr><td>Social-related terms</td></tr>
<tr><td>Governance-related terms</td></tr>
<tr><td>Environmental-related terms</td><td rowspan="3">PAB exclusions</td><td rowspan="3">CTB exclusions +
Companies that derive:
>1% of their revenues from the exploration, mining, extraction, distribution, or refining of hard coal and lignite
>10% of their revenues from the exploration, extraction, distribution, or refining of oil fuels
>50% of their revenues from electricity generation with a GHG intensity of more than 100g CO_2 e/kWh or from the exploration, extraction, manufacturing, or distribution of gaseous fuels.</td></tr>
<tr><td>Impact-related terms</td></tr>
<tr><td>Sustainability-related terms</td></tr>
</table>

2.4 ADDITIONAL QUALITATIVE REQUIREMENTS FOR TRANSITION-, IMPACT-, AND SUSTAINABILITY-RELATED TERMS

For funds using transition, impact-, and sustainability-related terms in their names, ESMA has also put forward a qualitative criterion, which will apply in addition to the quantitative threshold and exclusion lists.

FUND USING THE FOLLOWING TERMS IN THEIR NAMES	ADDITIONAL CRITERIA
Sustainability-related terms	Funds must commit to invest meaningfully in sustainable investments within the meaning of SFDR
Transition-related terms	Funds must ensure that the investments accounted for in the 80% threshold are on a **clear and measurable path to social or environmental transition**
Impact-related terms	Funds must ensure that the investments accounted for in the 80% threshold are **made with the objective of generating positive and measurable social or environmental impact alongside a financial return**

ESMA does not provide a specific percentage or definition for what constitutes a "meaningful" investment. It was initially proposed in the consultation paper that funds with sustainability-related terms in their names should have sustainable investments higher than 50%. This threshold was later dropped due to stakeholder feedback. The main reason was the lack of clarity of the concept of sustainable investment and lack of standardized issuer data.

2.5 CUMULATIVE REQUIREMENTS WHEN COMBINING TERMS

A fund name that combines environmental-, social-, or governance-related terms must apply the requirements in a cumulative manner. However, if environmental-related terms are combined with transition-related terms, the quantitative and qualitative criteria apply cumulatively but only the CTB exclusions are applicable instead of the more restrictive PAB exclusions. The application of CTB exclusions enables transition funds to use environmental-related terms and still invest in fossil fuel companies transitioning towards a greener activity.

2.6 FUNDS USING INDICES IN THEIR NAMES

Funds that designate an index as a reference benchmark should only use ESG or sustainability-related terms in their names if they fulfill the relevant requirements of the Guidelines, regardless of the name or characteristics of the index.

2.7 SUMMARY OF THE REQUIREMENTS

	Fund name	Requirements		
	Examples of related terms	**Quantitative threshold**	**Additional qualitative requirement**	**Exclusion list applicable**
Social-related terms	Any word that gives investors the impression of promoting social characteristics, such as "**social**," "**quality**"	80%	/	CTB exclusions
Governance-related terms	Any word that gives investors the impression of a focus on governance, such as "**governance**," "**controversies**"	80%	/	CTB exclusions
Transition-related terms	Any terms deriving from "**transition**" such as "**transitioning**", "**transitional**" Any terms deriving from "**improve**", "**progress**", "**evolution**", "**transformations**", "**net-zero**"	80%	Investments accounted for in the 80% threshold should be on a **clear and measurable path to social or environmental transition**	CTB exclusions
Environmental-related terms	Any word that gives investors the impression of promoting environmental characteristics, such as "**green**", "**environmental**", "**climate**", "**ESG**" and "**SRI**"[16]	80%	/	PAB exclusions
Impact-related terms	Any word deriving from "**impact**, such as "**impacting**," "**impactful**"	80%	Investments accounted for in the 80% threshold should be made with the objective to generate positive and measurable **social or environmental impact alongside a financial return**	PAB exclusions
Sustainability-related terms	Any word deriving from "**sustainable**," such as "**sustainably**," "**sustainability**"	80%	The fund must commit to invest "**meaningfully**" in sustainable investments as defined under SFDR	PAB exclusions

[16] SRI means Socially Responsible Investments. Despite the reference to social in the acronym SRI, the term is broadly used by investment funds for pursuing an ESG strategy in general, which may explain why it is categorized in the environmental-related terms category.

3. Supervisory expectations

ESMA expects competent authorities to comply with the Guidelines, and to ensure that fund managers do so as well "throughout the life of the fund." ESMA suggests that competent authorities should use the periodic disclosures under SFDR as a starting point for their supervision and enforcement of the Guidelines, and that they should consider certain inputs warranting further investigation and a supervisory dialog with fund managers, such as discrepancies in the level of the quantitative threshold, insufficient level of investments to use ESG or sustainability-related terms, or fund names that are unfair, unclear, or misleading.

Finally, ESMA indicates that a temporary deviation from the threshold and exclusions should be treated as a passive breach and corrected in the best interest of the investors, unless this results from the fund manager's action. Luxembourg funds must have regard to the national requirements in case of breach and their qualification under the new CSSF Circular 24/856 on investor protection in case of NAV calculation errors, non-compliance with investment rules, and other types of errors at UCI level.

4. Entry into effect

The competent authorities of Member States are expected to communicate their compliance intentions within two months after the publication of the Guidelines' translations on the ESMA's website. Several competent authorities have already addressed or attempted to address the risk of greenwashing and are likely to welcome a harmonization at EU level.

In Germany for instance, the BaFin[17] suspended the adoption of its own guidelines on sustainable funds, awaiting for regulatory stability, thereby suggesting that the German regulator will likely align with the Guidelines.

The French regulator, the AMF, issued its own recommendations[18] in 2020 and may need to reconcile these with the Guidelines. These recommendations however only apply to funds marketed towards retail investors in France, and foreign funds may rely on Position 7, allowing them not to comply with the recommendations, provided adequate disclosure is included in the marketing documents. ESMA has specified that national provisions may be stricter than the Guidelines as long as they do not prevent funds' passporting or the freedom to provide services or of establishment.[19]

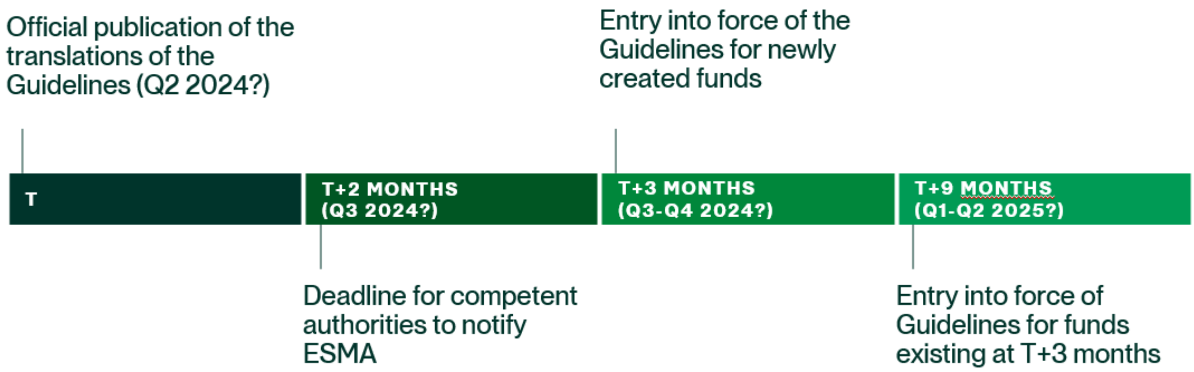
In Luxembourg, the CSSF[20] has proactively informed entities about the Guidelines and has been raising awareness regarding their scope and timeline, signaling probable future adherence.

In Belgium, the FSMA[21] already performs a systematic review of ESG-related claims in the legal documentation and marketing materials of funds. For that purpose, the FSMA has developed an automatic

17 *Bundesanstalt für Finanzdienstleistungsaufsicht*
18 AMF Position/Recommendation Doc-2020-03 Information to be provided by Collective Investment Schemes incorporating non-financial approaches
19 ESMA response to Q1 of the feedback statement
20 *Commission de Surveillance du Secteur Financier*
21 Financial Services and Markets Authority

tool to identify potential greenwashing (portfolio screening against exclusions lists),[22] which complements the regular controls it performs on the legal and marketing documents. There may be appetite for other competent authorities to deploy a similar tool in their supervisory practice. The Guidelines seem to support the FSMA's anti-greenwashing oversight and the FSMA may thus welcome the Guidelines.

The timeline for the implementation of the Guidelines is contingent upon the publication of the translations in all EU official languages. The effective date of the Guidelines is three months after their publication, and we estimate the effective date in Q3 or Q4 2024. For existing funds, there is a transition of six months from the effective date, which would place the deadline for compliance by existing funds to Q1 or Q2 2025.



22 Final Report of IOSCO on supervisory practices to address greenwashing (FR12/23 — December 2023), page 40

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