

MEMO# 34510

December 7, 2022

ESMA Proposes Guidelines on ESG and Sustainability-Related Fund Names

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TO: ICI Members

ICI Global Members

ESG Advisory Group

ESG Task Force

Global Regulated Funds Committee SUBJECTS: Disclosure

ESG

International/Global RE: ESMA Proposes Guidelines on ESG and Sustainability-Related Fund Names

On 18 November, the European Securities and Markets Authority (ESMA) published a consultation on proposed guidelines introducing quantitative criteria for funds with names using ESG- or sustainability-related terms.[\[1\]](#) ESMA has proposed these measures on funds' names to address the perceived risk of greenwashing in light of delays in development and applicability of the EU Taxonomy. Responses to the consultation are due by 20 February 2023, and ESMA plans to issue the final guidelines in Q2 or Q3 of 2023. ICI Global will be working with members to submit a response.

1. Snapshot: What's Included in ESMA's Proposed Guidelines

ESMA's proposed guidelines would introduce quantitative thresholds for funds using names with ESG- or sustainability-related terminology. If a fund uses such terms in its name, the investment manager would be required to report the proportion of the funds' investments (expressed as a percentage) that are used to meet its sustainability or ESG characteristics or objectives in pre-contractual and periodic disclosures. Unlike the FCA's recent proposal, this would not extend to marketing materials.

ESMA is specifically proposing that if a fund has any ESG-related terms in its name, at least 80% of its investments must be used to meet its ESG characteristics or objectives. Managers would need to disclose the exact percentage in the pre-contractual disclosures of those funds (in the templates provided for in Annexes II and III and SFDR) as well as in the periodic disclosures of those funds (Article 53(a), Article 61(a), Annex IV and V of SFDR). Additionally, if a fund has the word "sustainable" or any other term derived from the word "sustainable" in its name, at least half of the investments within this 80% (therefore 40%)

must be sustainable investments as defined by Article 2(17) of SFDR.

The proposed guidelines also note that funds referencing an index as a benchmark will only be able to use ESG- or sustainability-related terms in their names if they meet the quantitative criteria, even if the index they are referencing uses ESG or sustainability-related terminology. Furthermore, ESMA notes that funds using impact-related terms in their name should "make investments with the intention to generate positive and measurable social or environmental impact alongside a financial return," but does not lay out any additional quantitative thresholds for those funds to meet other than the thresholds applying to all funds using ESG or sustainability-related terms.

FUND NAME

80% Primary Threshold

50% Secondary Threshold

No ESG or Sustainability Terminology

Not applicable

Not applicable

ESG Terminology

Applicable - 80% of a funds' investments must be used to meet its ESG characteristics

Not applicable

Sustainable Terminology

Applicable - 80% of a funds' investments must be used to meet its ESG characteristics

Applicable - of this 80%, half must be sustainable investments as defined by Article 2(17) of SFDR

Impact Terminology

Applicable - 80% of a funds' investments must be used to meet its ESG characteristics

Possibly applicable - if the fund name uses sustainable terminology as well, then of this

80%, half must be sustainable investments as defined by Article 2(17) of SFDR

2. Relationship to Existing EU Sustainable Finance Measures

The proposed guidelines are interrelated to several pieces of EU sustainable finance regulation, including some that are still in development:

- Minimum Criteria for SFDR Article 8 Funds: For several months the European Commission has been considering the introduction of "minimum criteria" for funds making disclosures under Article 8 of SFDR. This is in response to the larger than expected uptake of Article 8 by market participants and concerns about potential greenwashing. ESMA's proposed guidelines setting out quantitative criteria for fund names will potentially come out before any minimum standards coming from the European Commission. The guidelines are clearly targeted at Article 8 funds, and ESMA even specifies that they will not affect the European Commission guidance from July 2021 that funds disclosing under Article 9 of SFDR "may invest in a wide range of underlying assets, provided these underlying assets qualify as 'sustainable investments.'"
- May 2022 ESMA Supervisory Briefing ([link](#)): ESMA published a supervisory briefing which outlined some principles for funds using ESG- or sustainability-related terms in their names. These proposed guidelines are meant to provide a more specific framework than that supervisory briefing.
- ESAs September 2022 Questions ([link](#)): The European Supervisory Authorities (ESAs) submitted a set of questions to the European Commission related to the application of SFDR. They specifically asked questions on how to define what constitutes a "sustainable investment" under Article 2(17) of SFDR. The answers to some of the questions around "sustainable investment" and the constituents of Paris-Aligned Benchmarks (PAB) and Climate Transition Benchmarks (CTB) may have a very significant impact on the application of the draft Guidelines that are being consulted.
- ESAs November 2022 Q&A ([link](#)): The ESAs published a set of questions and answers related to the application of SFDR. With respect to the principle of Do No Significant Harm (DNSH), the ESAs note that an approach simply looking at controversies is considered insufficient. They also note that there remain outstanding issues on how to interpret a "sustainable investment" under Article 2(17) of SFDR.
- ESAs November 2022 Call for Evidence on Greenwashing ([link](#)): The ESAs launched a call for evidence to gather information on how various stakeholders think about the risk of greenwashing, with the goal of developing a more granular understanding of what constitutes greenwashing. This may be interrelated to this proposal on funds names, as ESMA states a key objective of quantitative criteria for funds with ESG or sustainability related terminology is to combat greenwashing.

3. Comparison to Other Jurisdictions

UK SDR

The UK FCA is consulting on rules that would restrict the use of certain sustainability-related terms such as 'ESG' or 'green' in product names or marketing materials for funds which do not qualify for their three proposed sustainable investment labels.^[2] The Sustainable Focus label the FCA is proposing would require at least 70% of a funds' assets to meet a credible standard of environmental and/or social sustainability.

US SEC Names Rule

The US SEC is proposing an amendment to rule 35d-1 to expand its scope to apply to any

fund which uses terminology in its name that suggests investment decisions incorporate one or more ESG factors.[3]

4. Key Issues for ICI Members

- Sequencing: As highlighted above, ESMA's proposed threshold for funds' using sustainability-related terms in their names is dependent on how "sustainable investments" are defined under Article 2(17) of SFDR. As a result, it will be difficult to assess the impact of these measures for fund managers until there is more clarity on the definition of a sustainable investment when the Commission provides answers to the questions asked by the ESAs.
- Interoperability: ESMA's proposal comes as the UK FCA and US SEC are still in the process of finalizing their own rules relating to fund names using ESG- or sustainability-related terminology. Given none of these rules are finalized, it is difficult to assess exactly how they will interact. Furthermore, while the UK and US are following a market-driven approach to defining a sustainable investment, the EU's approach is more prescriptive.
- Definitions of Greenwashing: Under the current draft ESMA Guidelines, the 80% test would be linked to the binding environmental and/or social characteristics a fund promotes, particularly as disclosed in the pre-contractual templates[4] for funds making Article 8 disclosures. It is difficult to assess the impact of this as regulators are still working toward a common understanding of what constitutes greenwashing and how to prevent it.

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Notes

[1] <https://www.esma.europa.eu/press-news/consultations/consultation-guidelines-funds'-name-s-using-esg-or-sustainability-related>

[2] <https://www.fca.org.uk/publications/consultation-papers/cp22-20-sustainability-disclosure-requirements-sdr-investment-labels>

[3] <https://www.sec.gov/news/press-release/2022-91>

[4] <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32019R2088>