Are you using ESG terminology for your funds' names? New rules come into effect in November

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- **New guidelines to protect investors from greenwashing**
- **The three categories of fund names are under scrutiny**
- **The deadlines for new and existing funds to comply**

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*The European Securities and Markets Authority has released its much-anticipated final guidelines on the use of environmental, social, and governance, or sustainability-related terms in fund names. New funds will have to comply from November, and existing funds have six months to do so. **Angel Ramon Martinez Bastida** and **Abdelhak Kembouche** explain what private fund managers should do to be compliant with the new rules.*

As investor interest in funds that incorporate environmental, social and governance (ESG) factors grows and is expected to continue to do so, the naming of these funds has become crucial. This is because it is often the first piece of information investors have about a fund, significantly influencing their investment decisions. Financial services regulators are aware of this and are concerned about the risks of greenwashing.

In our 'SFDR: what you need to know for 2023' article we explored the European Securities and Markets Authority's (ESMA) drafting of guidelines around the naming of funds using ESG or sustainability-related names to avoid confusion and prevent deceptive fund naming to protect investors. These guidelines come into force next month

The guidelines introduce quantitative thresholds (e.g., proportion of ESG-related investments and/or sustainable investments) that funds must meet to use ESG and/or sustainability-related terms in their names. The Commission de Surveillance du Secteur Financier (CSSF) notification of the ESMA rule noted that market participants, regardless of whether they are disclosing under Article 6, 8 or 9 of the Sustainable Finance Disclosures Regulation (SFDR), must carry out a self-assessment of the applicability of the guidelines to the products they manage and to ensure compliance of fund names with these guidelines.

Application to private markets

The guidelines apply to private markets and EU AIFMs and alternative investment funds (AIFs) are in scope. There was some discussion about the inclusion of closed-ended AIFs in the scope, and ESMA finally decided that these too are in scope.

The guidelines do not explicitly clarify if they apply to non-EU AIFMs and non-EU AIFs. While non-EU AIFs managed by EU AIFMs are likely in scope if marketed in the EU, the situation is less clear for non-EU AIFMs marketing AIFs in the EU under Article 42 of the AIFMD.

The three categories

The guidelines categorise funds into three groups based on the terms used in their names:

1. Funds using transition, social, and governance-related terms (Category 1).
2. Funds using ESG-related terms (Category 2).
3. Funds using sustainability-related terms (Category 3).

Funds in Category 1 using “transition” terms and funds in Category 2 using “impact” terms must ensure their investments are on a clear and measurable path to social or environmental transition or aim to generate a positive and measurable social or environmental impact alongside a financial return.

If a fund combines terms from Category 1 and Category 2 in its name, the requirements of both categories apply cumulatively, except for terms combined with transition-related terms, where only the requirements under Category 1 and 2 apply.

The guidelines recommend that national competent authorities (NCAs) consider these rules throughout the life of a fund, with investors able to verify this information through periodic disclosures provided in accordance with SFDR Level 2. Temporary derivations from the applicable thresholds or conditions, if not due to a deliberate choice of the asset manager, can be considered a passive breach and corrected in the best interests of investors.

Date of application

The guidelines apply from 21 November 2024. Managers of new funds are expected to comply with the guidelines from the date of application, while managers of existing funds should comply by 21 May 2025.

Next steps

AIFMs should assess whether they fall within the scope of the guidelines. For those in scope, the next task is to identify funds containing ESG or sustainability-related terms in their names. This analysis includes names not explicitly provided as examples in the guidelines but that give investors the impression of having environmental, transition, social, and/or governance meanings.

Having identified these funds, managers need to either change the fund name to fall outside the guidelines (which may require investor consent) or review the fund's investment strategy and legal documentation (including SFDR disclosures) to ensure compliance.

If you want to discuss the impact of these new guidelines on your existing or new fund, please contact Angel Ramon or Abdelhak.