

Using ESG or Sustainability-related Terms in Funds' Names: ESMA's Guidelines

May 2024

Following an 18 month wait since the publication of the European Securities and Markets Authority's ("ESMA") consultation on funds' names using ESG or sustainability-related terms, we now have ESMA's **final report** containing the applicable guidelines ("**Guidelines**"). This has brought some clarity in terms of application dates and the general criteria to be applied, although there are a number of areas where further guidance or clarification at the EU or domestic level would assist in mitigating the implementation challenges.

The Guidelines do not provide an exhaustive list of terms that will bring a fund within scope. The conditions applied where certain terms are used in funds' names are set out in the table below.

Terms Used	Conditions Applicable
<p>Social-related</p> <p>Any words giving the investor any impression of the promotion of social characteristics.</p> <p>Examples: "social", "equality"</p> <p>Governance-related</p> <p>Examples: "governance", "controversies"</p>	<ul style="list-style-type: none"> ▪ 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 fund's investment strategy. ▪ Apply the exclusions applicable to Climate Transition Benchmarks ("CTBs").
<p>Transition-related</p> <p>Any terms derived from the base words "transition", "improve", "progress", "evolution", "transformation", "net-zero.</p> <p>Examples: "transitioning", "transitional" "improving", "progress/ion".</p>	<ul style="list-style-type: none"> ▪ 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 fund's investment strategy. ▪ Apply the exclusions applicable to CTBs. ▪ Investments should be on a clear and measurable path to social or environmental transition.

<p>Environmental-related</p> <p>Any words giving the investor any impression of the promotion of environmental characteristics.</p> <p>Examples: “green”, “environmental”, “climate”, “ESG”, “SRI”.</p>	<ul style="list-style-type: none"> ▪ 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 fund’s investment strategy. ▪ Apply the exclusions applicable to Paris-aligned Benchmarks (“PABs”).
<p>Impact-related</p> <p>Any terms derived from the base word “impact”.</p> <p>Examples: “impacting”, “impactful”.</p>	<ul style="list-style-type: none"> ▪ 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 fund’s investment strategy. ▪ Apply the exclusions applicable to PABs. ▪ Investments must generate a positive, measurable social or environmental impact alongside a financial return.
<p>Sustainability-related</p> <p>Any terms only derived from the base word “sustainable”.</p> <p>Examples: “sustainably”, “sustainability”.</p>	<ul style="list-style-type: none"> ▪ 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 fund’s investment strategy. ▪ Apply the exclusions applicable to PABs. ▪ Commit to invest meaningfully in sustainable investments as defined in Article 2(17) of the Sustainable Finance Disclosure Regulation (“SFDR”).

The Guidelines provide that, where terms are combined, the provisions should apply cumulatively. In order to ensure that transition strategies are not unduly impacted, ESMA has specified that, where environmental terms are used in combination with transition terms in the name of a fund, the CTB exclusions should apply. This would, however, not apply for “sustainable” terms, as “sustainable” terms should always give an impression of sustainability irrespective of any other terms used in the name.

Fund managers must now assess the impact of the Guidelines on their existing fund ranges. Where an existing portfolio using ESG or sustainability-related terms does not comply with the Guidelines, managers must consider whether to:

- change the name of the relevant fund; or
- change the investment policy / strategy to comply with the Guidelines.

In the version of the Guidelines consulted upon in November 2022, it had been proposed to require that a fund using the term “*sustainable*” or sustainability-related terms in its name would be required to meet a 50% threshold of sustainable investments. This threshold has been replaced in the final Guidelines with the requirement to “*invest meaningfully in sustainable investments*”, without further guidance as to what is meant by “*invest meaningfully*”. This formulation could give rise to different interpretations by national competent authorities, which would undermine supervisory convergence and cross-border distribution.

Next Steps

The Guidelines are being translated into the official languages of the EU and the translations will be published on ESMA’s website once complete. The Guidelines will apply three months after the date of that publication. Funds existing before the application date will be subject to a six month transitional period.

An important point to note in relation to timing is that it is expected that the European Commission will adopt changes to the SFDR Level 2 regulatory technical standards before the end of 2024 and that fund managers will have at least one year to comply with the revised Level 2 measures. A misalignment between the timing of the application of the Guidelines and the Level 2 measures would require managers to revise their pre-contractual disclosures by two separate deadlines within a very short timeframe. This may lead to confusion for end investors and to increased costs.

Industry is currently engaging with the Central Bank of Ireland in relation to industry’s implementation concerns and has requested that a fast-track process be put in place to process any changes to fund names or fund documentation necessitated by the application of the Guidelines, as has been put in place on previous occasions where the SFDR required updates to fund disclosures.

Please get in touch with your usual Asset Management and Investment Funds Department contact or any of the contacts listed in this publication should you require further information in relation to the material referred to in this briefing note.

Full details of the Asset Management and Investment Funds Department, together with further updates, articles and briefing notes written by members of the Asset Management and Investment Funds team, can be accessed at www.matheson.com.



Tara Doyle

Partner

T +353 1 232 2221

E tara.doyle@matheson.com



Dualta Counihan

Partner

T +353 1 232 2451

E dualta.counihan@matheson.com



Shay Lydon

Partner

T +353 1 232 2735

E shay.lydon@matheson.com



Philip Lovegrove

Partner

T +353 1 232 2538

E philip.lovegrove@matheson.com



Liam Collins

Partner

T +353 1 232 2195

E liam.collins@matheson.com



Michelle Ridge

Partner

T +353 1 232 2758

E michelle.ridge@matheson.com



Barry O'Connor

Partner

T +353 1 232 2488

E barry.oconnor@matheson.com



Donal O'Byrne

Partner

T +353 1 232 2057

E donal.o'byrne@matheson.com



Eunan Hession

Partner

T +353 1 232 2402

E eunan.hession@matheson.com



Orlaith Finan

Partner

T +353 1 232 2351

E orlaith.finan@matheson.com



Brónagh Maher

Professional Support Lawyer

T +353 1 232 3757

E bronagh.maher@matheson.com

This material is provided for general information purposes only and does not purport to cover every aspect of the themes and subject matter discussed, nor is it intended to provide, and does not constitute, legal or any other advice on any particular matter. The information in this document is provided subject to the Legal Terms and Liability Disclaimer contained on the Matheson website.

Copyright © Matheson