

Final Report

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



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1 Executive Summary

Reasons for publication

In recent years, investor demand for investment funds that incorporate environmental, social and governance (ESG) factors has been growing sharply and it is expected to continue growing in the future. Competitive market pressures create incentives for asset managers to include terminology in their funds' names designed to attract investor assets. This increasing demand has led to concerns in ESMA. Misleading sustainability disclosures may give rise to risk of "greenwashing". This is particularly relevant if funds are named as green or socially sustainable, when sufficient sustainability standards commensurate with that name have not been met. Against this background, ESMA consulted in November 2022 on guidelines for investment funds using ESG or sustainability-related terms in their names (ESMA34-472-373¹).

The initiative followed a supervisory briefing on sustainability risks and disclosures in the area of investment management published on 31 May 2022 (ESMA34-45-1427)² which contained, among other things, some principles-based guidance for funds' names with ESG and sustainability-related terms.

The consultation paper consulted on provisions for the use of ESG- and sustainability-related terminology in funds' names. The key elements consisted of a threshold for the use of ESG-related terms linked to the investments used to meet environmental or social characteristics or sustainability objectives in SFDR (80%) or to the share of sustainable investments for sustainability-related terms (50%) combined with exclusion criteria from the Paris-aligned Benchmarks (PAB) rules.

ESMA received significant input from stakeholders to the consultation paper. While the original reasons for the consultation paper remain valid, in light of the feedback received ESMA adjusted the guidelines in several areas and prepared in this final report updated guidelines to address greenwashing risk stemming from ESG- or sustainability-related terms used in investment fund names.

In addition to the need to consider the helpful feedback, ESMA has also monitored developments in the negotiations on the legislative review of the Alternative Investment Funds Directive (AIFMD) which has provided a direct legal mandate to ESMA to develop these guidelines.

Contents

Section 2 explains the background to the proposed guidelines, an update on the mandates in the AIFMD and UCITS Directive review and the changes introduced in the guidelines following the feedback to the consultation paper. Annex I provides the Feedback Statement, Annex II includes the opinion of the Securities and Markets Stakeholders Group (SMSG).

Annex III sets out the cost-benefit analysis which details the expected impact of the Guidelines. The Guidelines are set out in Annex IV.

Next Steps

The Guidelines in Annex IV of this report will be translated into the official EU languages and published on the ESMA website. The publication of the translations will trigger a two-month period during which competent authorities must notify ESMA whether they comply or intend to comply with the Guidelines. The Guidelines will apply from three months after the publication of the translations, subject to some transitional provisions for managers of funds existing before the date of application.

¹ https://www.esma.europa.eu/sites/default/files/library/esma34-472-373_guidelines_on_funds_names.pdf

² [Supervisory briefing on sustainability risks and disclosures](#)

2 Overview

2.1 Background

1. The need to enhance investor protection is particularly evident when funds use terms which suggest an investment focus in companies that meet certain sustainability standards. This type of terminology is particularly powerful in fund names, as funds can attract significant interest and stand out to investors by using sustainability or ESG-related terms in their names.
2. The name of a fund is an instrument to communicate information about the fund to investors and is also an important marketing tool for the fund. The name of a fund is usually the first attribute investors see and, while investors are expected to look beyond the name itself and check in detail the fund's documentation, the name can have a significant impact on their investment decisions.
3. Investors are allocating an increasing proportion of their investments in sustainability strategies in order to use their capital to help sustainable purposes. Investors may reasonably expect funds with these names to invest in companies with policies, practices, or characteristics that are consistent with sustainability standards. Competitive market pressures create incentives for asset managers to include terminology in their funds' names designed to attract investor assets, leading in certain instances to greenwashing, for example by making false claims about sustainability practices.

2.2 Public consultation

4. On 18 November 2022 ESMA launched a public Consultation on Guidelines on funds' names using ESG or sustainability-related terms (ESMA34-472-373), proposing to develop guidelines on the basis of existing provisions in the AIFMD, UCITS Directive and the EU regulation on facilitating cross-border distribution of collective investment undertakings. The consultation closed on 20 February 2023.

2.3 The AIFMD and UCITS Directive review

5. Article 14(1)(a) of Directive 2009/65/EC (UCITS Directive) provides that Member States must ensure that a management company "acts honestly and fairly in conducting its business activities in the best interests of the UCITS it manages and the integrity of the market". Equally, Article 12(1)(a) of the Directive 2011/61/EU (AIFMD) provides that Member States must ensure that, at all times, AIFMs "act honestly, with due skill, care and diligence and fairly in conducting their activities".

6. Furthermore, Article 4(1) of the Regulation (EU) 2019/1156 on facilitating cross-border distribution of collective investment undertakings (“Regulation (EU) 2019/1156”) provides that AIFMs, EuVECA managers, EuSEF managers and UCITS management companies shall ensure that all marketing communications addressed to investors are identifiable as such and describe inter alia that all information included in marketing communications is “fair, clear and not misleading”.
7. These guidelines are published under new mandates stemming from the recently reviewed AIFMD and UCITS Directive, whose amending Directive (Directive (EU) 2024/927) was published in the Official Journal on 26 March 2024³ and entered into force on 15 April 2024. The new mandates in Article 23(7) of the AIFMD and Article 69(6) of the UCITS Directive request ESMA to develop guidelines specifying the circumstances where the name of an AIF or UCITS is unclear, unfair, or misleading. In a nod to potential future developments in EU legislation, the mandates note that new sectoral rules setting standards for fund names or marketing of funds will take precedence over guidelines.⁴
8. Although the new mandates in AIFMD and the UCITS Directive are in articles connected to the disclosure to investors, the obligation “not to mislead” with the name stems from broader obligations about behaving honestly and fairly, referred to above in paragraphs 5 and 6.
9. The mandates referred to above relate to funds’ names in general, not only sustainability-related ones. ESMA will in due course consider other situations than sustainability-related ones, but that work will require a separate consideration and consultation. However, for the sustainability-related circumstances covered in this Final Report it would be disproportionate to conduct another public consultation, given that the consultation conducted on 18 November 2022 covered the appropriate areas for recommendations in relation to sustainability-related fund names.
10. Finally, it should be noted that these guidelines have been designed in light of the current legislative framework. ESMA will review the guidelines, if necessary, in case of any update of the relevant legislation, in line with the provisions of the mandates under the AIFMD and UCITS Directive.

³ https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=OJ:L_202400927

⁴ The mandates state: “In order to ensure a uniform application of the rules applicable to name of the AIF/UCITS, ESMA shall develop guidelines to specify the circumstances where the name of an AIF/UCITS is unfair, unclear, or misleading. Those guidelines shall take into account relevant sectoral legislation. Sectoral legislation setting standards for fund names or marketing of funds takes precedence over those guidelines.”

2.4 Amendments to the guidelines following feedback to the consultation paper

11. Following the feedback received from stakeholders ESMA saw merit in making some modifications to the guidelines presented in the consultation paper. These are described below and are reflected in the revised text of the guidelines. More detailed feedback on how the comments made by respondents in response to the consultation were addressed is included in the Feedback Statement in Annex I.

12. In order to describe the changes compared to the consultation paper, it is necessary to first to summarise the provisions in the draft guidelines that were consulted on:

A. ESG-related terms:

If a fund has any ESG-related words in its name, a minimum proportion of at least 80% of its investments should be used to meet the environmental or social characteristics or sustainable investment objectives in accordance with the binding elements of the investment strategy, as disclosed in Annexes II and III of SFDR Delegated Regulation.

B. Sustainability-related terms:

If a fund has the word “sustainable” or any other term derived from the word “sustainable” in its name, it should allocate, within the 80% of investments to “meet the characteristics/objectives”, at least 50% of minimum proportion of sustainable investments as defined by Article 2(17) of Regulation (EU) 2019/2088 (SFDR) as disclosed in Annexes II and III of SFDR Delegated Regulation.

C. Impact-related terms

The use of the word “impact” or “impact investing” or any other impact-related term should be used only by funds meeting the quantitative thresholds and the minimum safeguards, and additionally whose investments under the minimum proportions are made with the intention to generate positive, measurable social or environmental impact alongside a financial return.

D. Minimum safeguards

Minimum safeguards including exclusion criteria for Paris-aligned Benchmarks (PAB), as defined in the Benchmark Regulation Delegated Regulation (CDR (EU) 2020/1818)

Article 12(1)⁵-(2), were recommended for all investment funds using an ESG- or sustainability-related term in their name.

13. The modifications to the guidelines following the feedback received from stakeholders are described below:

Removal of the 50% threshold for sustainable investments

14. ESMA has decided to remove the 50% threshold for sustainable investments. This measure has been criticised by stakeholders because the definition of Article 2(17) SFDR is considered too open to discretion by fund managers to function effectively as a specific threshold. Indeed, the European Commission confirmed in Q&A II.1 of the joint Q&As on SFDR that *“the notion of sustainable investment can [...] also be measured at the level of a company and not only at the level of a specific activity”*⁶. ESMA has, however, decided to introduce instead a commitment to invest meaningfully in sustainable investments for the use of any sustainability-related words in funds’ names, which is already contained in paragraph 30 of the supervisory briefing ESMA34-45-1427⁷.

15. The commitment referred to in paragraph 15 is disclosed in the SFDR templates. As stated in joint SFDR Q&A VII.8⁸, the commitment should be met by financial products at all times.

16. The 80% threshold related to the investments used to meet environmental and/or social characteristics or sustainable investment objectives has been retained and has been applied to all terms in the guidelines.

Adjustments of minimum safeguards

⁵ Exclusions for EU Paris-aligned Benchmarks are contained in Article 12(1)(a)-(g) of Commission Delegated Regulation (EU) 2020/1818) include:

(a) companies involved in any activities related to controversial weapons;

(b) companies involved in the cultivation and production of tobacco;

(c) companies that benchmark administrators find in violation of the United Nations Global Compact (UNGC) principles or the Organisation for Economic Cooperation and Development (OECD) Guidelines for Multinational Enterprises;

(d) companies that derive 1 % or more of their revenues from exploration, mining, extraction, distribution or refining of hard coal and lignite;

(e) companies that derive 10 % or more of their revenues from the exploration, extraction, distribution or refining of oil fuels;

(f) companies that derive 50 % or more of their revenues from the exploration, extraction, manufacturing or distribution of gaseous fuels;

(g) companies that derive 50 % or more of their revenues from electricity generation with a GHG intensity of more than 100 g CO₂ e/kWh.

⁶ Joint SFDR Q&A II.1, page 6 https://www.esma.europa.eu/sites/default/files/2023-05/JC_2023_18_-_Consolidated_JC_SFDR_QAs.pdf

⁷ 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 disclosing under Article 5 TR;

⁸ Joint SFDR Q&A VII.8, page 47: https://www.esma.europa.eu/sites/default/files/2023-05/JC_2023_18_-_Consolidated_JC_SFDR_QAs.pdf

17. Consultation respondents criticised the "one size fits all" approach by ESMA by requiring PAB exclusions for all ESG and sustainability-related terms in fund names. Respondents highlighted that since PAB exclusions include certain revenue-based fossil fuel companies, some transition focused strategies could not use appropriate terms in their names.
18. ESMA has recognised that the fossil fuel exclusions in PAB could unnecessarily penalise some funds using terms in their name that are not environmental or that focus on transition strategies. Therefore, the exclusion criteria of the Climate Transition Benchmark (CTB) are instead provided for terms that are transition-, social- and governance-related. CTB exclusions⁹ refer to (a) companies involved in any activities related to controversial weapons, (b) companies involved in the cultivation and production of tobacco, and (c) companies that benchmark administrators find in violation of the United Nations Global Compact (UNGC) principles or the Organisation for Economic Cooperation and Development (OECD) Guidelines for Multinational Enterprises.

Category for transition-related terms

19. To further reflect the feedback related to transition terms, ESMA introduced a new category for transition-related terms. The provisions for transition-related terms in fund names require, in addition to the 80% threshold, the application of CTB exclusions only. The introduction of this category of terms is 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.
20. The transition-related terms include words such as "improving", "progress/ion", "evolution", "transformation", and any related words. This would help catch a wide set of terms that give the impression of a positive evolution towards the goals described in the objectives.

Separation of "E" from "S" and "G" terms and combination of terms

21. ESMA has separated the terms related to social (S) and governance (G) from environmental (E) terms. The social and governance terms are included in the same group as the transition terms, allowing funds with those terms in their name to apply the CTB exclusions only. Environmental terms should still only be used by funds applying the PAB exclusions. The commonly used "ESG" and "SRI" abbreviations would still be considered environmental terms.

⁹ CTB exclusions are listed in points (a)-(c) of footnote 4 (Article 12(1)(a)-(c) of Commission Delegated Regulation (EU) 2020/1818).

22. The rationale behind this proposal is that funds with social or governance terms in their names promoting social characteristics or objectives (or focusing on governance) could be too restricted in their investment universe by fossil fuel exclusions. PAB exclusions continue to be merited for environmental terms, as it is reasonable for investors to expect funds with environmentally related terms in their names to not significantly invest in fossil fuels.
23. 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 would always give an impression of sustainability irrespective of any other terms used in the name.

Impact and transition terms: measurability

24. ESMA also foresaw a further provision for funds using “impact”- or “transition”-related terms in their names. When using any “impact”-related word fund managers should ensure that the investments under the minimum proportion of investments are made with the intention to generate positive, measurable social or environmental impact alongside a financial return. When using any “transition”-related word fund managers should demonstrate that the investments are on a clear and measurable path to social or environmental transition.
25. The aim of this provision is to create an additional qualifying link between the strategy of the fund and its name, ensuring a measurable dimension to the strategy itself. There was already a recommendation in paragraph 30 of the supervisory briefing that “impact” terms should only be used by funds “whose investments are made with the intention to generate positive, measurable social and environmental impact alongside a financial return”.

Transitional period

26. A transitional period of 6 months is foreseen for existing funds, consistent with the proposal made in the consultation paper. Considering that the guidelines will start applying 3 months after the publication of the translations, this will give managers of existing funds a minimum of 9 months’ time in total to comply following the forthcoming publication of the translations.

3 Annex I: Feedback Statement

INTRODUCTION

ESMA received 125 responses to the consultation paper, 27 of which were confidential. The responses were mainly from asset management industry associations, NGOs, consumers' representatives and asset managers. The answers received are available on ESMA's website unless respondents requested confidentiality. ESMA also received the advice of Securities and Markets Stakeholder Group (SMSG), which is published in Annex II.

In general, respondents agreed with ESMA on the need of tackling greenwashing risk stemming from the misleading use of ESG terminology in funds' names but had split views on the content of the proposal.

The detailed content of the responses and ESMA feedback is outlined in this Feedback Statement.

PROPORTION OF INVESTMENTS FOR FUNDS' NAMES USING ESG OR SUSTAINABILITY-RELATED TERMS

Q1: Do you agree with the need to introduce quantitative thresholds to assess funds' names?

While mostly all respondents, including the SMSG, agreed with the need of tackling greenwashing risk stemming from the misleading use of ESG terminology in funds' names, the introduction of quantitative thresholds to assess funds' names was met with mixed reactions. The SMSG expressed scepticism about setting quantitative thresholds due to the lack of standardised issuer data from the yet-to-be-implemented CSRD and ESAP, emphasising the need for clear, common, and measurable factors to avoid misleading investors. A clear no was expressed by 53 respondents, claiming the quantitative thresholds are not necessary, that there is a lack of clarity in the definitions, that such guidelines would disrupt and add confusion to an already complex regulatory framework and that therefore it would be better to wait and see how the future intervention of the European Commission in terms of reviewing existing legislation could address this issue.

A slight majority of respondents agreed on having quantitative thresholds although they also remarked that there is a need for (1) a better definition of the ESG terminology, and (2) a clarification of the calculation methodology with regards to cash, liquidity investments and derivatives.

ESMA response:

ESMA notes the responses received from stakeholders but continues to believe that guidance based on at least a single quantitative threshold is a helpful provision to link the substance of a fund with the name it carries, despite the shortcomings highlighted by some stakeholders in their responses. Furthermore, a quantitative threshold is easy to understand and to apply.

To address concerns raised by some stakeholders about the role of potential guidelines in this area where the legislative framework may be addressing this in the future, ESMA stresses that reform of e.g., SFDR may take many years to complete, while greenwashing risks in funds need to be addressed in the present. ESMA acknowledges that some national competent authorities have introduced measures already in their jurisdictions and that any national provisions relating to fund names can be stricter than the provisions in these guidelines. However, any such national provisions must be compatible with Union law, including passporting of funds, the exercise of the freedom to provide services and the freedom of establishment.

Q2: Do you agree with the proposed threshold of 80% of the minimum proportion of investments for the use of any ESG-, or impact-related words in the name of a fund? If not, please explain why and provide an alternative proposal.

Those respondents who were against the introduction of thresholds repeated their opposition when answering a question on the level of the threshold at 80%. In addition to these respondents, some others, while agreeing on the previous question on thresholds, criticised the 80% level as either (1) not sufficiently ambitious, claiming that it should be even higher or (2) that it is too high to be met in the current situation.

Among those respondents against the thresholds, some argued that if the thresholds were to be kept in the final version of the guidelines, then cash, liquid assets and hedging derivatives should be excluded from the calculation methodology. With regards to the level of the threshold, respondents expressed a preference for levels ranging from 35% to 75%.

Some other respondents, while against quantitative thresholds, proposed to proceed with a more detailed definition of the assets *“used to meet the E/S characteristics”*. Another stakeholder pointed out that if minimum safeguards are applied, then the use of thresholds would be redundant.

The SMSG further proposed several non-exhaustive criteria to be used in order to have the right to use ESG terms in the name, ranging from the assessment of thematic investments and engagements strategies to rating improvement and selection approaches and KPI improvements.

ESMA response:

ESMA takes note of the positions of the stakeholders. ESMA believes that 80% is a percentage that would ensure that a sufficient part of assets is invested in line with the name of the fund to meet basic expectations of investors presented with a specific fund name. This also takes into account existing supervisory approaches on funds' names, including outside the EU (e.g., the US SEC fund naming rule). The proposal of the SMSG on alternative criteria for the use of ESG-related terms in funds' names has been duly analysed but has not been retained as it would imply the establishment of a set of complex rules which would also restrict the capacity of fund managers in the application of their chosen strategy.

Q3: Do you agree to include an additional threshold of at least 50% of minimum proportion of sustainable investments for the use of the word “sustainable” or any other sustainability-related term in the name of the fund? If not, please explain why and provide an alternative proposal.

Most of the respondents were against the proposal to introduce an additional threshold at 50% for sustainability-related words. The main reason stemmed from the lack of clarity of the sustainable investment definition in SFDR. In addition, respondents cited the difficulty for end-investors to differentiate between ESG-related words and sustainability-related words, thus adding confusion in the use of said terminology. A few of these respondents were against this threshold because it was too low, and the use of sustainability-related words should be reserved only for those funds disclosing under Article 9 SFDR. The SMSG further pointed out that such a threshold, according to market studies, may not be attainable by funds disclosing under Article 8 SFDR.

Those who agreed with the introduction of this additional threshold recognised the positive effect this measure could have, while noting similar reservations in terms of definitions and calculation as they had in Question 2.

ESMA response:

ESMA takes note of the responses sent by stakeholders and their criticism to a threshold for sustainable investments linked to the definition of Article 2(17) SFDR, which is perceived as too open to discretion by fund managers, making comparison between funds' sustainable investment levels difficult. For this reason, ESMA has decided to drop the 50% threshold. Nonetheless, in order to avoid misleading investors, to use sustainability-related terms in funds names, funds should still invest meaningfully in sustainable investments.

Q4: Do you think that there are alternative ways to construct the threshold mechanism? If yes, please explain your alternative proposal.

When asked about alternative proposals, almost half of the respondents, including the SMSG, provided many suggestions illustrating a wide variety of alternative options, including:

- Reviewing SFDR;
- Using a principles-based approach;
- Only applying qualitative thresholds with lower quantitative ones;
- Measuring the proportion of sustainable investments compared to a benchmark;
- Applying thresholds but without minimum safeguards;
- Differentiating between ESG-strategies;
- Measuring sustainability under the Taxonomy and using lower thresholds;
- Requiring disclosure on the intention to hold companies not aligned to the name;
- Using a phase-in approach;
- Aligning sustainability to the MiFID/IDD sustainability preferences;
- Comply or explain mechanism for FMPs;
- Introducing a minimum threshold for social investments;
- 50% of NAV (excluding cash and derivatives without ESG exposure), the rest screened by applying minimum safeguards;
- Distinguish between transition investments and investments in companies that have already transitioned; and
- Express thresholds as KPIs.

Some respondents did not think that there were alternative options. Some said that they prefer to wait for a legislative intervention at Level 1, others agreed to the threshold mechanism but with the caveats mentioned in the answers to the questions above.

ESMA response:

ESMA has taken note of the various alternative ways proposed by stakeholders to construct the threshold mechanism. ESMA is of the opinion that the system proposed is at the same time easy to understand and to apply. The main reason for this approach is to have a methodology which is to a large extent independent from any other existing legislation. The mechanism uses the disclosures prescribed by SFDR as a way to assess the suitability of a fund's name by using a source of data which is disclosed for transparency purposes. This is also why ESMA has not linked any requirements specifically to the disclosure articles in SFDR (i.e., Article 8 and 9 SFDR).

The combination of the exclusion criteria and the 80% threshold is, in ESMA's opinion, an appropriate way to have both screening criteria that eliminate investments in companies which

are not in line with the name of the fund and at the same time set a robust majority of assets invested in accordance with the name and thus the strategy of the fund.

Q5: Do you think that there are other ways than the proposed thresholds to achieve the supervisory aim of ensuring that ESG or sustainability-related names of funds are aligned with their investment characteristics or objectives? If yes, please explain your alternative proposal.

A clear majority of respondents responded that there are other ways than the thresholds to address the greenwashing risks highlighted by ESMA in the consultation paper. A small number of respondents said that the proposed thresholds were the best way to address the greenwashing risk identified.

Among those who proposed other ways, a common response was for ESMA and its NCAs to enforce and supervise the content of the ESMA supervisory briefing on ESG disclosures instead. Others suggested that the SFDR rules are sufficient and should instead be enforced better.

Most commonly, respondents suggested that the SFDR Level 1 should be reviewed and amended to deliver legislative solutions to the greenwashing risks identified, especially the risk that Article 8 SFDR disclosure is used as a proxy label. However, those stakeholders who emphasised the need to make Level 1 changes typically did not offer any solutions in the interim while waiting for such a review to take place. The typical problem identified with the Level 1 framework was the lack of clarity in certain key concepts, especially the definition of “sustainable investment” in Article 2(17) SFDR.

One group of respondents suggested that instead of thresholds ESMA request a measurable KPI to be identified by affected investment funds, including binding ESG objectives.

Others suggested that ESMA promote investment fund labels, perhaps similar to what the FCA has proposed in the UK, focusing on fund strategies.

A small group of respondents said that thresholds were not the way to address the issues identified, but they did not offer any alternative.

A few respondents suggested the thresholds should be connected to more specific criteria than those suggested in the consultation paper, including by linking the thresholds to the definition of “sustainability preferences” in the MiFID II and IDD Delegated Regulations.

Some consumer representatives suggested a focus on the Unfair Commercial Practices Directive (UCPD) instead of thresholds, noting that the current review of that Directive included a discussion on combating greenwashing.

The SMSG pointed out the importance to make sure to convey the investment flows towards transition as highlighted in the European Commission's sustainable finance agenda.

ESMA response:

ESMA takes note of the feedback received by stakeholders. The proposal to intervene at Level 1 represents the most popular one, but ESMA notes that Level 1 changes are beyond ESMA's remit, while promoting convergence in the application of the existing provisions to effectively combat the immediate risk of greenwashing is part of the ESMA objectives. ESMA supports labels but these would require legislative changes and they will require a long time to be implemented and will not help tackling the issue at stake in an urgent manner. The issue of fostering transition has been considered and ESMA has restructured the proposal to facilitate investments in companies transitioning to a greener economy.

Q6: Do you agree with the need for minimum safeguards for investment funds with an ESG- or sustainability-related term in their name? Should such safeguards be based on the exclusion criteria such as Commission Delegated Regulation (EU) 2020/1818 Article 12(1)-(2)? If not, explain why and provide an alternative proposal.

A slight majority of respondents, primarily asset management companies or their trade associations as well as the SMSG, disagreed with ESMA's proposal in this respect, saying that there should not be minimum safeguards for investment funds, especially based on the exclusion criteria in Commission Delegated Regulation (EU) 2020/1818 Article 12(1)-(2).

However, a significant number of respondents, albeit slightly fewer than the previous category, consisting of NGOs, investor representatives and index providers, agreed with the question that there should be minimum safeguards based on the aforementioned exclusion criteria.

The criticisms from industry respondents generally focused on the climate focused nature of the exclusion criteria in Commission Delegated Regulation (EU) 2020/1818, which they say do not fit some ESG or sustainability strategies they claim. Furthermore, some respondents questioned the legal competence of ESMA to impose such restrictions in guidelines.

More generally, most industry respondents noted that the proposed exclusion criteria go further than Article 8 of SFDR, which only requires "good governance" of investee companies. Those respondents urged ESMA to focus on enforcement of the SFDR rules for Article 8 and the DNSH provisions for sustainable investments.

Many industry respondents noted that if ESMA insists on exclusion criteria, only those in Article 12(1)(a)-(c) should be used: i.e., companies involved in controversial weapons, tobacco or found in violation of UN Global Compact Principles or the OECD Guidelines for Multinational Enterprises. Some non-industry respondents also recommended excluding any companies that start new fossil fuel projects.

Some suggested that while exclusion criteria could be beneficial for investor protection, ESMA should wait until the Commission has conducted its comprehensive assessment of SFDR.

One non-industry respondent suggested ESMA require that funds using the relevant terms in their names should undertake engagement with investee companies instead of relying on exclusions.

Finally, some industry respondents suggested ESMA should instead rely on the SFDR disclosures to show how funds meet their sustainability characteristics or objectives.

ESMA response:

The exclusion criteria under the Climate Transition Benchmark (CTB) and the Paris-Aligned Benchmark (PAB) are a further important element of the proposed guidelines. It should be noted that the PAB exclusions are particularly impactful considering that they would rule out investments in undertakings deriving significant revenues from fossil fuels.

ESMA confirms that the exclusions would apply in an equivalent way to Article 12(1) of Commission Delegated Regulation (EU) 2020/1818, i.e., to “companies”, regardless of how investment in those companies are made or which financial instrument those companies may issue. In other words, there would be no distinction between what kind of financial instrument an investment is made in, the company would still be excluded.

ESMA believes that this is the most meaningful approach in order to tackle the greenwashing risk arising from the improper use of funds’ names at the current juncture of development of the legislation on sustainability disclosures.

ESMA takes note of some of the concerns expressed by stakeholders and in light of the feedback received, has decided to change its approach by separating the terms referring to “transition” and proposing some adjustments to make sure that the proper exclusions are applied only to those funds for which they are relevant.

Q7: Do you think that, for the purpose of these Guidelines, derivatives should be subject to specific provisions for calculating the thresholds?

a) Would you suggest the use of the notional value or the market value for the purpose of the calculation of the minimum proportion of investment?

b) Are there any other measures you would recommend for derivatives for the calculation of the minimum proportion of investments for naming purposes?

Several respondents highlighted the current lack of standards in terms of how derivatives are taken into account for commitment to environmental or social characteristics or sustainable

investments and call for a consistent approach. The SMSG expressed the need of having a calculation consistency between areas of regulation.

Some stakeholders stated that if the derivative is meant to help attain the ESG investment objective, then it should be taken into account as it is in other investment ratios. Conversely, the derivative should be disregarded if its use is not meant to attain the ESG objective (i.e., for example if it is used for instance as tactical derivative and/or temporarily for market (beta) hedging/exposure purposes, or for FX or duration purposes, to manage subscriptions, etc...). Another stakeholder believed that derivatives should be included in the threshold calculations and that financial market participants should be free to choose whether to use the notional or market value for this purpose, provided that investors are informed. Another stakeholder stated that derivatives should be subject to specific provisions for calculating the thresholds. In particular, there should be differentiations based on the use of the derivative (i.e., for hedging and EPM techniques vs investment purpose). Also, certain type of derivatives should not be assessed from an ESG-perspective (i.e., FXs or Interest Rate Swaps, hence they should be excluded).

However, the majority of stakeholders did not see the need for specific provisions for calculating minimum sustainable thresholds for derivatives for the purpose of these guidelines. Some stakeholders supported the approach that the calculation of the minimum commitments that are relevant in terms of the thresholds should be governed by SFDR rules. In particular, if Article 8 and Article 9 SFDR requirements include derivatives in calculation of sustainable proportions of overall investments, there is no need to introduce a new calculation method for naming purposes.

Some stakeholders believed more time is needed to form a consensus amongst the industry on the calculation of thresholds for derivatives to avoid market participants and underlying investors are exposed to a variety of different methodologies and that until then flexibility is needed.

Several stakeholders believed that it is important to differentiate between the different uses and types of derivatives and that in any case the calculation methods should be considered consistently with the existing guidance on calculating leverage of UCITS and AIMFD.

ESMA response:

ESMA takes note of the feedback received from stakeholders. Due to the continuing concerns about the interaction between the proposed measures and those in SFDR, ESMA believes that more exceptions or additional requirements should be avoided. It is important to remember that the guidelines are intended as an investor protection measure related only to the names of investment fund in order to stop the more egregious forms of greenwashing. The guidelines are not intended to provide a sustainability product labelling framework for investment funds.

For this reason, ESMA has decided not to include any indication about provisions related to derivatives and the calculation methodologies for sustainable investments or investments used to meet environmental or social characteristics. In other words, the 80% threshold would simply be derived from the disclosures of the commitment to the proportion of investments to meet the environmental or social characteristics (under Article 8 SFDR) or the sustainable investment objectives (under Article 9 SFDR)¹⁰. As a consequence, the calculations for derivatives, or any other asset classes, would follow the decisions made by the fund manager under the SFDR disclosures.

ADDITIONAL RECOMMENDATIONS RELATED TO FUND NAMES

Q8: Do you agree that funds designating an index as a reference benchmark should also consider the same requirements for funds names like any other fund? If not, explain why and provide an alternative proposal.

Several respondents noted that the proposed guidelines refer to SFDR precontractual disclosures, but index providers are not in the SFDR scope but covered by the BMR regulation. They argued that the same rules should apply as soon as index providers are in the scope of SFDR. In addition, index and structured funds have special characteristics and should be granted a temporary exemption. Another respondent supported the consistency between active and index funds, but until the guidelines are extended to cover benchmark providers, it would be challenging for passive funds to meet the guidelines.

The majority of respondents, including both industry and consumer associations were of the view that funds designating an index as a reference benchmark should consider the same requirements for funds naming as any other funds. This raised the issue of indices' names as retail investors assume that index providers follow a harmonised set of rules when in reality there are multiple challenges linked to a lack of common definition, comparability and transparency issues.

Several trade association respondents did not believe that funds designating an index as a benchmark should adhere to the same requirements as non-index funds and recommend ESMA to consider an exemption of at least two years for ETF/index-tracking funds from the application of its final guidelines.

Considering the same quantitative thresholds for funds might create problems of index tracking strategies which are reliant upon third parties to provide data relating to ESG characteristics of their portfolio. One respondent stated that the EU Benchmark regulation sets out the rules for ESG benchmarks and any addition would create requirements for benchmark

¹⁰ These disclosures would be available under the narrative description in the section "What is the asset allocation planned for this financial product" in the pre-contractual templates contained in Annexes II and III of the SFDR Delegated Regulation.

administrators to change their methodologies and lead to regulatory divergences. A few company respondents believed that ESG benchmark requirements needs to be reviewed in order to align them with SFDR/Taxonomy but for the time being it would be disproportionate to require fund managers to police the benchmark market for ESG fund terms. Another individual respondent questioned the applicability to funds designating an index as a reference benchmark in view of the additional challenges that index-based investment funds face.

Finally, some respondents pointed out that there are contractual obligations on the asset manager to use the index name, because the use of indices by funds is managed according to license agreements signed by the asset manager with the index providers.

ESMA response:

While taking note of the opinions expressed by respondents, ESMA believes that the mere reference to an index is not enough to ensure that the fund name is in line with the characteristics or objectives of the fund itself, precisely for the reasons illustrated by some stakeholders on the lack of common definitions and the subsequent comparability and transparency issues. That is why ESMA retains the provision that also funds referring to a particular index should follow the recommendations stated by the guidelines.

ESMA acknowledges that there may be commercial considerations for fund managers to consider in relation to their license agreements with index providers but believe that investor protection considerations should prevail over commercial agreements.

Q9: Would you make a distinction between physical and synthetic replication, for example in relation to the collateral held, of an index?

The majority of respondents both from industry and consumers, including SMSG, replied that no distinction is needed because when a Total Return Swap is used by a fund to replicate an index or a reference benchmark using derivative instruments, it benefits from the same exposure effects than if it directly replicated the index. As regards synthetic replication, there was no clear market view as to whether the binding E/S characteristics as committed in the ESG annex should be relevant only in terms of the index exposure created by the swap or in some way also pertain to the fund portfolio holdings.

ESMA response:

ESMA takes note of the feedback received which supports the view that any fund should be subject to the same provisions in terms of naming, without making any particular distinction between synthetic and physical replication.

Q10: Do you agree with having specific provisions for “impact” or impact-related names in these Guidelines? If not, please explain why.

The majority of respondents, including SMSG, agreed with the proposal of having specific provision for “impact” or impact-related names in the Guidelines. However, opinions were divided on the definition of a threshold. In this context, some respondents were in favour of a threshold, two respondents were in the opinion that impact fund should comply with the highest criteria in the market and not be ‘lighter’ than sustainable funds, suggesting a threshold of 70% or 80%, while others indicated that a uniform quantitative criterion should apply for all funds.

On the other hand, several respondents, who agreed with specific provisions for “impact”, were not in favour of having a quantitative threshold and rather suggested referring to the following three pillars: intentionality, additionality, and measurability.

Some participants also asked ESMA to clarify whether funds that use the word ‘impact’ or ‘impact investing’ or any other impact-related term are subject to both thresholds (80% and 50%) or just the 80% threshold.

However, a slightly lower number of respondents disagreed with the proposal of having such provision. Broadly, respondents were concerned about the lack of legal definition and clear guidance on the measurability of an impact, with some suggesting establishing the concept already envisaged in ESMA’s Supervisory Briefing that indicate “impact investments”. However, other respondents were of the opinion that this topic is sufficiently covered by the GIIN principles and should in any case be addressed within the review of the SFDR.

Overall, respondents saw the need for a clear definition of “impact investment”.

Some other respondents stressed the link of the provision for “impact” with the UK FCA work.

ESMA response:

ESMA believes that it is necessary to single out impact terms in fund names, as those terms represent a particular strategy for investors presented with the name, where the emphasis is not only on a financial performance but rather on the impact these funds may achieve on their objective. Therefore, ESMA believes that, in addition to the proposed requirements, funds using an impact-related word in their name should also demonstrate a positive, measurable impact. This provision was already included in the supervisory briefing on sustainability risks and disclosures in the area of investment management published in May 2022.

Q11: Should there be specific provisions for “transition” or transition-related names in these Guidelines? If yes, what should they be?

Different views were expressed by respondents regarding the inclusion of a specific provision for transition-related names in the guidelines.

Numerous respondents were of the view that a clear identification of transition / transition-related names should be incorporated given the very significant transformative sustainability improvements such investments can deliver towards the EU's climate neutrality and environmental objectives. Moreover, some respondents indicated that the usage of "transition" or transition-related names should be limited to investment products classified as "impact-generating", which are characterised by their "high" ambition level to actively support the transition toward a more sustainable world through targeted investor action or robust transition plan.

Four respondents noted the equivalence between "transition funds" and the UK Financial Conduct Authority concept of "sustainability improvers" and requested ESMA to better align the EU regime with the UK FCA's proposed SDR 'Improvers' label.

In contrast, many respondents argued against introducing specific provisions or creating additional layers of regulation that might have the unintended effect of limiting the diversity of approaches to transition investing and could pose significant challenges for "transition" strategies.

While eight respondents mentioned that, in their views, the "transition-related" names are already covered by "ESG-related" names rules, for eight other stakeholders it remained unclear whether the "transition-related" names were captured under the EU SFDR and whether transition strategies can be included under Article 9 SFDR and can be considered sustainable investments, stressing the need for a clear definition of "transition" and its inclusion in the SFDR framework. A few respondents indicated in this regard that a clear definition from the European Commission of what "transition" entails and a clear indication of how transition can be taken into consideration would be desirable. Two other respondents were of the opinion that the transition should be part of the sustainability investment (SI) definition and calibration.

Some respondents believed that the definition of a specific provision for "transition" may result in complicating unclear legal and conceptual situation unless the European Commission provides a narrower definition of sustainable investments. More specifically, one respondent considered that at least for funds using an ESG benchmark as underlying, such provision should not apply.

Five other respondents believed that additional minimum safeguards would have a very negative impact on funds that invest in transitioning companies as the suggested ones could pose significantly challenges for "transition" strategies.

Suggestions

Five respondents expressed a preference for establishing a framework for the use of transition-related names rather than a quantitative threshold, given the intrinsic qualitative nature and measurement of engagement success. If such a framework was introduced, there should be a

link between the name and the product with the aim of delivering measurable improvements in the sustainability profile of assets over time, providing evidence that proportionate engagement efforts have been made.

In contrast, some respondents suggested an alternative approach to construct the threshold mechanism combining qualitative thresholds in addition to quantitative ones. The suggested qualitative criteria mainly refer to proving that the fund investments are contributing towards a low-carbon transition and should have a robust and ambitious transition plan. While suggestions for the quantitative threshold focused on measuring through the increase of the percentage of funds' investments that show environmental or social characteristics by the end of the strategy's timeframe and monitor that those actions are consistent with the transition plan in the medium and long-term using interim metrics to track this progress.

ESMA response:

ESMA takes note of the feedback received and recognises the importance that funds with transition terms in their names should comply with requirements that would not hamper their strategies. Therefore, ESMA has proposed to create an additional category for funds using the word "transition" or any other words suggesting a commitment to transition in their name. Those funds will be required to apply both the 80% threshold and the CTB exclusions. These exclusions, which seems pertinent to this type of fund, would also permit investments in companies deriving part of their revenues from fossil fuel investments, thus allowing a path to transition that otherwise may not be possible when applying the PAB exclusions. In order to ensure that transition strategies are not unduly impacted, ESMA notes 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.

ESMA believes that this adjustment will not penalise strategies aiming at the transition to a greener economy.

Q12: The proposals in this consultation paper relate to investment funds' names in light of specific sectoral concerns. However, considering the SFDR disclosures apply also to other sectors, do you think that these proposals may have implications for other sectors and, if so, would you see merit in having similar guidance for other financial products?

A significant majority of respondents to the question, including the SMSG, agreed with the question that there is merit in having similar guidance for other financial products. Such responses frequently cited the need to have a level playing field between different sectors.

Those respondents consisted of investment fund industry representatives, consumer representatives and NGOs.

A small minority of respondents disagreed with the suggestion to extend similar guidance to other financial products. Those respondents were primarily representatives of the insurance and banking industries.

Some respondents noted that they either did not know or did not choose to comment about whether the guidance should be extended.

Some of those respondents who agreed with the question argued that not only should the guidance be extended to other SFDR financial products, but also financial instruments referred to in MiFID and other instruments such as green bonds, notes and derivatives. Others suggested that only retail financial product should be targeted. One suggested while funds should be a priority, extension to other sectors could be assessed after a certain period, e.g., one year.

Of the respondents who did not know, some noted that ESMA should assess the impact carefully before extending the guidance, without choosing to come down on one side of the argument or the other.

ESMA response:

ESMA takes note of the various comments received from stakeholders. At the time of the consultation, ESMA focused on the investment fund sector as the one with the higher risk of greenwashing and therefore acted as promptly as possible to issue requirements for these products. With the mandates received within the AIFMD and UCITS Directive ESMA received a precise indication on the scope of the guidelines. Nevertheless ESMA, together with the other European Supervisory Authorities (ESAs), will reflect on the need to widen the scope of these guidelines to other financial products.

APPLICATION AND TRANSITIONAL PERIOD

Q13: Do you agree with having a transitional period of 6 months from the date of the application of the Guidelines for existing funds? If not, please explain why and provide an alternative proposal.

A slight majority of the respondents disagreed with the proposal of having a transitional period of 6 months. Only one considered the transition period should be reduced to 3 months. The rest of respondents indicated that 6 months period might be insufficient due to the complex nature of the reshaping that may need to occur for the impacted funds, involving several processes (e.g., analysis and design, internal approval processes, information to unitholders, together with the need to manage possible reputational risks, refiling of the umbrella funds and

the adaptation of the ESG index for funds using ESG benchmarks). The alternative proposal received showed a clear split between:

- 12 months (38 respondents);
- 12 to 18 months (five respondents);
- 18 months (four respondents); or
- A longer transitional period without any specific proposed timelines (three respondents).

Some respondents highlighted specific issues, such as particularities for closed-ended real estate funds with illiquid assets.

In addition, some respondents asked ESMA to clarify whether the six-month application period envisaged in the guidelines is additional to the three-month period established for the effective application of the rule.

Nonetheless, a significant number of respondents agreed with the proposed six-month transitional period. Among these respondents, some indicated that while they agreed with the proposed period, they would prefer a transition period of between six and twelve months.

Finally, there was also some respondents who expressed a preference for a grandfathering provision for already approved and existing funds.

ESMA response:

ESMA takes note of the different views among stakeholders on the length of the transitional period to be granted to investment funds to comply with the requirements laid out in the guidelines. ESMA is conscious of the effort in terms of time that existing investment funds may have to go through in order to adapt to the guidelines. Nevertheless, ESMA believes that the current provision is already very generous as the guidelines will start applying 3 months after the publication of the translations and with a further 6-month transitional period for existing funds it will give managers of existing funds a minimum of 9 months' time to comply, without taking into account the time necessary for the translations.

Q14: Should the naming-related provisions be extended to closed-ended funds which have terminated their subscription period before the application date of the Guidelines? If not, please explain your answer.

A majority of respondents were of the opinion that the naming-related provisions should not be extended to closed-ended funds.

They explained that closed-ended funds are no longer open for distribution and therefore there is no need for them to adhere to the naming-related provisions as they are not actively being marketed or sold to investors. Furthermore, they saw little rationale in applying the provisions, as it would be seen as a retroactive change, which they considered to be inappropriate.

The main comments received were as follows:

- Some respondents were in favour of introducing a grandfathering provision;
- One respondent was of the view that the provision should apply only for new closed-ended funds;
- Another respondent highlighted that closed ended funds tend to be marketed to professional investors so the potential for harm or misunderstanding due to the fund's name is significantly reduced;
- In addition, some respondents proposed a disclosure statement in marketing materials advising investors that the fund is not subject to the Guidelines.

A minority of respondents were of the opinion that the naming-related provisions should apply to all investment funds, including listed closed-ended funds, for the sake of consistency. Some of these respondents explained that since closed-ended funds continue to be traded even if the initial offer is over, the naming-related issue still matter. One respondent stressed that closed-end funds do not always have a fixed maturity date and can remain open indefinitely. The SMSG further noticed that such rules should not be applied to open-ended funds whose subscriptions have been terminated.

ESMA response:

ESMA, taking note of the feedback received, believes that the proposed requirements should apply without distinction to either open- and closed-ended funds. ESMA is of the view that it would be meaningful to ensure that the name of the fund matches with the underlying investments even for investors in a closed-ended fund (including existing investors). Furthermore, excluding unlisted closed-ended funds from the scope of these guidelines would create an inconsistency with the Guidelines on marketing communications under the Regulation on cross-border distribution of funds where such an exclusion does not exist.

Q15: What is the anticipated impact from the introduction of the proposed Guidelines?

The majority of respondents, in particular from consumer associations were of the opinion that the new guidelines will provide clarity to the market and standardisation, comparability across funds, with the caveat that the success of the guidelines will depend on whether all NCAs adopt them.

The SMSG wished to highlight that if the Guidelines are adopted as such, there could be a significant impact by shifting further money towards negative screening approaches only. Some respondents said that the introduction of the proposed guidelines, if not appropriately calibrated, would instead increase the risk of greenwashing (given the thresholds are based on concept not clearly defined), increase the risk of “green bleaching”, if the constraints are too stringent and inadequate and inapplicability to retail ETF/index since benchmark administrators are not covered by SFDR and the guidelines. However, according to some respondents it was important to provide at least an indicative list of words to provide orientation to the market. Failing that, the consequence would be that funds might be unduly restricted in the use of naming terms depicting the focus of their investment strategy.

In addition, several respondents mentioned the significant cost of compliance and product reclassification, the risk of creating further confusion for European investors on which products deliver sustainable outcomes given interoperability issues (i.e., the ecolabel), and the fact that end-investors would pay the consequences from diverging rules. A few respondents also highlighted the impact of the proposed guidelines in the context of similar regulatory developments in other jurisdictions such as the US and the UK. Respondents from trade associations noted that the rules could inhibit investment in real estate transition efforts, questioned the legal validity and raised the concern of concentration risks due to the timing of ramping up investment or divestment by a fund to meet the relevant quantitative thresholds imposed by the guidelines. A few respondents raised the risk of diverging interpretation for the classification of terms between ‘ESG’ and ‘Sustainable’ category, asking for a modified approach for transition funds.

ESMA response:

ESMA takes note of the feedback received and acknowledges the considerable effort required to minimise the greenwashing risk stemming from unclear or misleading funds’ names. Nevertheless, ESMA believes that these measures will increase the trust end-investors have in the funds they invest in.

Q16: What additional costs and benefits would compliance with the proposed Guidelines bring to the stakeholder(s) you represent? Please provide quantitative figures, where available.

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 sustainability preferences. Several respondents believed that the 30% increase in costs would be passed through to end clients. One respondent estimated costs between €20,000 and €30,000 per fund while another one suggested between €60,000 and €100,000.

Respondents from a consumer association argued that well-designed and well-enforced naming-related requirements, especially if flanked by supervisory action in other areas of the investment fund value chain, would lead to a clearer and more visible differentiation in the investment product markets. Another respondent recommended that the cost-benefit analysis of the proposed guidelines consider the added compliance costs associated with navigating and implementing potentially conflicting or inconsistent requirements across jurisdictions. A few respondents noted that ESMA did not provide a thorough analysis of costs, for example for funds that currently would fall within the scope of the proposed guidelines but do not meet the thresholds would experience additional costs (e.g., transaction costs) in re-positioning their portfolio particularly when other funds were also doing the same.

ESMA response:

ESMA takes note of the feedback received. Apart from few respondents, stakeholders have not precisely quantified the cost of compliance with the requirements. ESMA further points out that the cost of compliance could be compensated by the transparency towards end-investors, who will appreciate clarity and possibly reward those funds whose name is clear and not misleading.

4 Annex II: Advice of the Securities and Markets Stakeholder Group

SMSG advice to ESMA on ESMA's consultation on Guidelines on funds' names using ESG or sustainability-related terms ("naming" consultation)

1. Executive Summary

Link to greenwashing consultation

In the wake of the ESAs' consultation on greenwashing, ESMA consults on future Guidelines on funds' names using ESG or sustainability related terms. The SMSG finds that the two consultations are closely related while timelines as well as scope are different. The greenwashing consultation involves all three ESAs working on a 2-year timeline, while the "naming" consultation applies to funds only and have a timeline of less than one year. There is also a difference in mandate, the ESAs having received a formal mandate from the EC on the greenwashing theme while the funds' naming consultation is not based on such a formal mandate. That said the SMSG finds that many of the topics looked at in the greenwashing discussion fit very well also in the funds' naming discussion.

Naming approach

The SMSG considers that it is good that ESMA initiates a discussion about the name of products, as names are - especially for the retail market - a powerful marketing tool. Regrettably, too often the name may even be the only reference looked at, or the only information taken in by some investors. In any case, the SMSG is of the opinion that the name of a fund should not be misleading. There is also room to be clearer in the name – as part of a wider discussion on potentially misleading statements - subject to the consideration that in practice very little information can normally be conveyed by a name. In addition, legitimately, as for any other product, names need not use vocabulary directly connected to the fund's strategy or assets. The name is not necessarily connected to an asset management type of vocabulary.

Quantitative threshold

The SMSG is not convinced by the proposed quantitative threshold approach. Definitions of concepts as well as underlying data are not yet finalised. It may be confusing for investors to add a second threshold, i.e., the Sustainable Investment threshold. This quantitative proposal may thus miss its goal at this stage of development of the sustainable finance framework. Thus, the SMSG considers that a two-step approach (qualitative first and quantitative at a second stage) may be a more appropriate approach.

Threshold breaches

The SMSG agrees with ESMA that temporary passive breaches should be corrected in the best interest of the unitholders. To avoid the need to define “technical” authorised breaches, the threshold calculation should not be done on the AUM/NAV of the fund, but on the exposure value of the investment portfolio (i.e., without ancillary liquid assets and EPMs) in a consistent way with the other fund ratios on, for instance, diversification or eligibility.

Exclusions

ESMA proposes to require the Paris aligned benchmark (PAB) exclusions to all investments of ESG-named funds. The SMSG does not agree with ESMA on this point. First, all ESG funds do not follow a PAB objective. Second, excluding the energy sector (without discriminating among companies) amounts to an exclusion of transition financing, which is an important objective of the sustainable finance agenda, as this is where the most important efforts are needed to achieve real carbon reduction impact.

Indices

The SMSG also raises the question of the probable divergence between fund names, in the remit of ESMA’s proposed guidelines, and index names. Indices are very often an investment objective reference for funds or a tracking reference (examples: “ESG World Leaders index” or “For Good World index”).

Link to existing strategies and transition investing

The SMSG regrets that the consultation paper does not assess existing strategies, nor link the proposal to existing rule-based efforts included in some national regimes or labels.

There is a need of clarification regarding ESG investment strategies and processes. Current ESG strategies implemented by asset managers go much further and are more diverse than negative screening. The SMSG sees a role for ESMA in establishing a list of key ESG investment approaches/strategies with their corresponding characteristics.

The SMSG in its response presents (not exhaustively) existing criteria that can be used to have the right to use an ESG term in the name: thematic investing on an ESG theme, engagement strategies, relative rating improvement approach, relative selection approach, and KPI improvement. Strategies that constrain the portfolio’s investments on an ex-ante basis on sustainability aspects/factors should be recognised. Indeed, it should be evidenced that sustainability aspects/factors have been of decisive importance in the selection of assets for a significant part of the portfolio’s investments.

The SMSG is reluctant to establish thresholds at a stage where we do not have more clarity on whether the definitions include or do not include the transition. If “naming” compliant Art. 8 and 9 funds would no longer be allowed to invest in any transition investments in their portfolio, the SMSG wonders which will ultimately be the impact on the environment of the European sustainable finance agenda implementation?

SMSG members consider that, implicitly, the proposed approach relies too much on a static view of “green” or ESG funds. There is a risk that a portfolio that invests in a sector that needs to transition on a high impact scale (energy sector for instance) may not be compliant, whereas a portfolio invested in more neutral sectors would be compliant while having possibly considerably much less impact on the green deal objectives. The important financing needs for the ecological transition should be factored in in the ESMA’s final Guidelines.

2. Questions of the consultation

Q1. Do you agree with the need to introduce quantitative thresholds to assess funds’ names?

The SMSG agrees with ESMA that names can be misleading at times and that the issue is relevant but has the following remarks and positions.

Definitions

The SMSG is not convinced by the proposed quantitative threshold approach for several reasons. One important impediment to this approach is the lack of clarity of the underlying rules: we lack, for example, common “ESG” and “sustainable investment” definitions and calibrations. The sustainable investment definition is not yet calibrated, and if for instance asset managers have different assessments on the transition, they may get to different outcomes for similar portfolios. “Retail” investors” will also likely be confused about the distinction, as proposed by ESMA, between “ESG- related words” and “sustainability related terms”.

Data

The SMSG is not convinced that we are currently at a stage where we are able to set quantitative thresholds. We still lack standardised issuer data, as the CSRD and the ESAP are not yet implemented. Quantitative thresholds require clear, common, and measurable underlying factors to be effective. If such factors are not in place, there is a risk that investors may be misled.

Negative screening vs more positive and impactful ESG strategies / transition

Quantitative thresholds seem to implicitly rely solely on - and therefore validate only – negative screening (exclusion) sustainable investment strategies. The SMSG in its reply to the ESA’s

greenwashing consultation noted that this is merely one of the many sustainable investment strategies used by asset managers. Moreover, it is the least effective approach compared to others such as the engagement, impact, thematic, and best in class strategies.

The SMSG understands that from a supervision point of view a quantitative threshold approach might seem a more simple, white-and-black solution than more elaborated alternative solutions. It would indeed be an easier to check solution. However, even if the proposal has some merits, in practice, the need of clarification of the underlying rules is a major issue.

In addition, SMSG members think that, implicitly, the proposal seems to rely too much on a static view of “green” or ESG funds. If the taxonomy alignment proportion is used to classify funds for instance, there is a risk that a portfolio that invests in a sector that needs to transition on a high impact scale (such as the energy sector) may not be compliant, whereas a portfolio invested in more neutral sectors would be compliant while having possibly considerably less impact on the green deal objectives. As the taxonomy has not been designed to be an investment approach, it has not addressed the financing needs for the ecological transition, which are huge and impactful. Transition probably needs to be considered in a forward-looking way, in the sense that for transition it is important to look at the change (and the rate of change) in a factor or a set of factors towards the objective/target and not only at the ‘greenness’ level at one point in time, which is a snapshot of the current level of ‘greenness’ as opposed to the change. The level of ‘greenness’ can be used to distinguish, with the appropriate definitions and data, between e.g. – ‘green’ vs. ‘brown’ investments.

There is a need of clarification regarding ESG investment strategies and processes. Current ESG strategies implemented by asset managers are much more diverse than “merely” negative screening. ESMA could make a list of key ESG investment approaches/strategies with their corresponding characteristics. Such clarifications are necessary as they can also help advisors to avoid a mismatch of expectations between what funds promise, and what investors expect them to do.

More generally, a quantitative threshold approach would seem to exclude most of the very needed transition investments and increase further the weight of e.g., the Big Tech companies¹: it is not because some listed companies may display highly taxonomy-compliance that buying even more shares of those companies will contribute to the European green deal aiming at channelling massive private investment towards the transition to a climate-neutral economy. The SMSG is concerned that there could even be that investors are being misled if this quantitative threshold approach would be pursued.

Lastly, greenwashing being in essence misleading information related to ESG/sustainability matters, any quantified threshold approach applied to fund names would have to comply with existing EU investor rules on clear, fair and not misleading information, in particular art 44 of the delegated regulation (EU) 2017/565².

Also for these reasons the SMSG is reluctant to establish thresholds before knowing with more clarity if the definitions include or do not include the transition. If “naming” compliant Art. 8 and 9 funds would no longer include transition investments in their portfolio, the SMSG questions what will be ultimately the impact on the environment of the European sustainable finance agenda implementation?

Regarding the proposed thresholds approach, the SMSG would also like to understand how this approach will match the ESMA/EC work (not yet finalised) on the Art. 8 and 9 minimum investment criteria - is the threshold meant to replace these criteria?

Articulation with existing regimes and strategies

The SMSG would also like to raise the question of the articulation with existing regimes. With a convergence objective in mind, the consultation does not explore current national regimes. The SMSG acknowledges the urgent need for ESMA to give guidance to NCAs that do not yet have a “naming” regime, or a regime based on minimum investment criteria for ESG funds. However, some NCAs, including France or Germany, have already or are about to establish national rules. France has imposed “naming” thresholds linked to the intensity of the ESG criteria used in the investment strategy. The SMSG considers that all market participants would benefit from gaining additional knowledge as to the NCAs’ agreement and engagement on this initiative, as well as on the freedom for each NCA to maintain or introduce their own preferred/appropriate criteria.

On a more general stance, the SMSG would like ESMA to assess what the impact would be for the fund ecosystem if it were to go from a more general ESG-rating selection approach or from an engagement strategy or label-based approach to a new type of approach based on a unique and different type of threshold. The SMSG is concerned that a new approach means that also fund producers will have to do again things that already exist, knowing that the real game changers around the availability of data and the finalisation of the taxonomy (including the social one) are still to come. In any case, it should be acknowledged that for the moment fund manufacturers have to work with what is there.

There are also practical questions regarding how ESMA defines what is an “E” or a “S” characteristic. How is this calculation to be done in practice? Will there be a need to classify each instrument and relate it to “E” or “S” or could the whole ESG portfolio’s objective be considered (like a minimal ESG rating/assessment or a relative approach to do better than the benchmark on a KPI or rating)?

Threshold breaches

The SMSG agrees with ESMA that “a temporary deviation from the thresholds, if the said deviation is not due to a deliberate choice of the asset manager, should be treated as a passive breach and corrected in the best interest of the unitholders.” Indeed, if ESMA proceeds with

the proposal, it should be clearly stated that a portfolio value is not static and that passive breaches are to be corrected with a timing that considers the best interest of investors. In addition, ramp-up strategies (like private equity), formula funds, target date funds and other fund particularities should be accounted for in the threshold's application date. Funds closed for subscriptions or funds that are not marketed any more at the application date of the Guidelines should not be in the scope.

To avoid the need to define "technical" authorised breaches, the threshold calculation should not be done on the AUM/NAV of the fund, but on the exposure value of the investment portfolio (i.e., without ancillary liquid assets and EPMs) in a consistent way with the other fund ratios relating to, for instance, diversification or eligibility.

ESG terms

The SMSG considers that a list of ESG terms would bring more clarity to all actors through the value chain and proposes that such a list be included in the guidelines. To reduce NCA divergence a non-exhaustive list should as a minimum be shared at the ESMA level with all NCAs.

"What's in a name?"

ESMA's consultation covers only questions on names. However, names are part of a larger set of documents that express a fund's characteristics, including on ESG. Some local regulations are wider, like the French AMF doctrine that refers also to other kinds of information (Prospectus, KID, marketing documents). There is a risk that as ESMA focuses on names only, non-compliant funds continue to be sold as ESG funds despite a name change. ESMA is right in targeting the name, but should ultimately also look at the prospectus, the KID ESG statements etc. The SMSG generally supports that ESMA focuses on fund names as the name is too often the only thing some retail investors might be looking at but cautions that potential misleading wording can go beyond naming as the SMSG expressed in the advice on greenwashing. The goal would be to obtain in the end consistency between different investor material (and products) marketed to retail investors.

The way forward

The SMSG agrees with ESMA that the issue is relevant and that non-misleading fund name information is important to investors. It is important to manage investors' expectations and be strict with regards to fund naming. Appropriate guidelines should be in place to support an investment suitable to the needs and preferences of that investor. This said, there are at present too many moving parts. There is first a need to learn more about the current situation, and to gain such knowledge we should mandate a review of the current names as presently used. As noted above a study should be carried out to see how ESG factors are incorporated and which the different ESG strategies are. On this basis a set of rules/options could be

presented, building as much as possible on existing national regimes. The SMSG is of the opinion that it would not be advisable to “rush” with a one-size-fits-all threshold.

Taking due account of both the need for action and the current regulation-under-construction situation, the SMSG would advise ESMA to follow a two-step approach: first, define more qualitative guidelines in the period between now and full completion of the CSRD, ESRS³ and ESAP⁴, while also clarifying definitions of concepts used under SFDR, and, second, carry out a revision of these guidelines with introduction of quantitative thresholds once data are available and the regulatory framework is completed.

In brief, the question arises whether thresholds solve the issue with fund names. The SMSG is of the opinion that there are still too many uncertainties to make thresholds an efficient measure as of today.

Q2. Do you agree with the proposed threshold of 80% of the minimum proportion of investments for the use of any ESG-, or impact-related words in the name of a fund? If not, please explain why and provide an alternative proposal.

The SMSG reminds that it is important to link the proposal to existing efforts in the field. The unique threshold proposed is difficult to assess as long as the underlying concepts are not clarified. More clarity on definitions and calibration on methodologies are needed if we want any threshold option to work.

The group would also like to comment on the calculation basis. To avoid the need to define “technical” authorised breaches, the threshold calculation should not be done on the AUM/NAV of the fund. Indeed, any fund holds ancillary liquid assets (cash, deposits on sight, money market funds) for daily operations. There is no reason to compare a fund with more cash to another having less. The same logic applies to funds using EPMs (efficient portfolio techniques) to manage portfolio risks and operations (ex: FX hedging or broad index derivatives that are temporarily used to manage subscriptions). The calculation should be done on the exposure value of the investment portfolio (i.e., without ancillary liquid assets and EPMs) in a consistent way with the other fund ratios like diversification or eligibility.

If this is not possible within ESMA’s current remit, then, until the exposure calculation is possible, the thresholds must take into account the investable universe after removing about 20% ancillary liquid assets – the rule in France and Luxembourg for instance, and about a similar proportion for EPMs.

Also, it would be advisable to assess how names are used, namely what ex ante rules are applied by fund managers to evidence the reality of the ESG management/engagement, so that to be able to come up with alternative proposals. For instance, the SMSG sees several existing criteria that can be used to have the right to use an ESG term in the name (not exhaustive):

- Thematic investing on an ESG theme: the fund aims to select investments that are participating or positively contributing to an ESG theme.
- Engagement strategies: the asset manager takes a position on ESG issues and demands that the targeted companies improve their practices over time (these requirements are formulated via a structured approach including direct dialogue with the company, voting and long-term monitoring). These strategies take time to implement and include escalation actions depending on each situation. Regarding the stewardship and voting policy for transition investing more particularly, the asset managers' policy encompasses voting at AGMs of the portfolio companies that need to transition, including on the ESG/sustainability related resolutions and in particular those aimed at accelerating the company's transition. The reason/strategy and results of these actions are disclosed in the annual report.
- Relative rating improvement approach: the fund aims at improving the average non-financial rating of the fund relative to the benchmark/investment universe (narrowly defined).
- Relative selection approach: the fund aims selecting the best issuers of the benchmark/investment universe (narrowly defined) based on their non-financial rating and/or excluding issuers on the basis of non-financial characteristics.
- KPI improvement: improving a/several KPI(s) on the portfolio over time or compared to the one(s) of the benchmark/investment universe.
- Other.

These funds have to make explicit in the prospectus their ex-ante (constraining) ESG securities selection strategy to be able to use an ESG name. Merely performing ESG integration is not sufficient: providing ESG ratings or analysis to investment managers without constraining the portfolio investments on an ex-ante basis on the sustainability aspects/factors is not significant enough as a commitment. To link with ESMA's proposal, the resulting investment portfolio that has been selected through the ESG filter (e.g., criteria/KPI/engagement) should cover a significant part of the portfolio. Indeed, it should be evidenced that the sustainability aspects/factors have been of decisive importance in the selection of assets for a significant part of the portfolio's investments.

Q3. Do you agree to include an additional threshold of at least 50% of minimum proportion of sustainable investments for the use of the word “sustainable” or any other sustainability-related term in the name of the fund? If not, please explain why and provide an alternative proposal.

It is difficult to set a quantitative threshold on sustainable investments (SI) as of SFDR while definitions are not yet clarified and ESMA has not yet received the clarifications requested last year from the European Commission. For instance, one of the most impacting features is the fact that not all methodologies consider the whole company as a sustainable investment. Indeed, the % of SI is based on different methodologies, each asset manager having its own methodological points and calibrations. In addition, these are currently changing, calibrations are reviewed, as this is a new exercise for asset managers and works as an iterative process.

The SMSG thinks that accuracy is relevant to all questions linked to the calculation of thresholds, even more if this is not only a transparency issue but also an ex-ante management rule to implement and follow/check. A better approach may be to distinguish between “ESG” which can refer to all ESG characteristics and a more specific criteria that can be referred to as “sustainable”. This could be an additional threshold (level to be defined), a relative threshold (between the fund and its benchmark using the same SI methodology of the asset manager) or something else based on different criteria. “ESG” refers to sustainability-related topics and sub-topics as per the ESG categorisation of topics under CSRD and ESRS, while „sustainable” can be more seen as a characteristic of a product, service, or company, by describing its current state. With this perspective in mind, a fund manager can have an ESG-oriented strategy, or objectives, while a fund can be more or less sustainable. This is at meta-level, as it is difficult to assess to what extent a single company can be sustainable.

It is useful to mention also that the use of the word "sustainable" is very widespread today. Regarding retail investment for instance, several types of products may use the same word, not only funds. For instance, notes sold to retail may use it or banking accounts. Regarding distribution, MiFID uses also "sustainable preferences" as vocable without linking it to the SFDR SI concept. There is no alignment of definition between the different pieces of regulation. This piecemeal approach leads to confusion of concepts. In the end, what it matters is that retail investors be protected. With this context in mind, the SMSG thus advises ESMA to weigh if the proposed partial linkage between the SFDR SI concept and proportion to the use of the "sustainable" word for European funds brings clarity or confusion to end users.

Market studies would show that 50% may not be attainable as less than 20% of current Art 8 funds would target more than 50% investment in sustainable investments. In practice, the application of a 50% threshold would potentially require a change in name for more than 80% of Art 8 funds that use sustainability-related terms in their name. Is the market wrong or is the rule too strict?

Two ratios might be complex for investors.

From an individual investor point of view, first a 80% and then another 50% threshold as set out in ESMA’s proposal is very difficult to apprehend for individual investors. The SMSG considers that it to be important to have in mind the need to make life easier for investors. The

effect of the guideline may be that investors and advisors may be lost on the way, as the rules become too complex.

Art 8 and 9 need clarification

The SMSG understands that ESMA is proposing rules for naming funds on top of the SFDR classification. In practice, the two sets of rules are interrelated. We do however not see that ESMA has a mandate to work directly on establish minimum criteria for Art 8 and 9 funds. It follows that there is some additional confusion in the market.

The SMSG agrees with ESMA that the current unclear situation on definitions and fund classifications (and downgrades/upgrades) are not sustainable and need action. However, setting rules on naming of funds is not starting from a white page. On the contrary, the proposal arrives in a market that already applies a given set of rules and already invests in research and data to implement ESG strategies that are already invested by retail and/or institutional clients. Individual potential abuse situations should be dealt with. Regarding setting rules for the entire fund market, the SMSG believes there is a need to take the necessary time to be more effective in the rule setting and achieving to prevent “greenwashing”. If the necessary time is not taken to robustly define the framework and the underlying concepts, there is risk that we will make very little progress on greenwashing (50%/80%/X% “of what”?) The group is concerned that negative screening and similar approaches are envisaged in the proposal, at the same time as independent research shows these are the least effective approaches.

The SMSG is conscient that ESMA cannot change level 1. It is however possible to work at level 2 and level 3, by giving more guidance to asset managers and encourage the agenda transition. The SMSG believes that the agenda of supervisors should not only encompass investor protection, but also the effectiveness of sustainable finance, as an element of support of the financing of a sustainable economy.

Art 9 and 8 funds are already considered by investors as a classification, even if this is not the primary intention of the legislator (it was aimed as a transparency regime). In addition, if investors think that investing in Art 9 funds is more of a guarantee than investing in Art 8, they will continue the trend already observed and invest more in Art 9. If Art 9 funds are almost a “null” category, it may lead to a bubble in the few assets deemed eligible. This is why the SMSG is of the opinion that it is needed to clarify criteria for Art 9. When asset managers do not think they are on solid ground, they change classification, with puzzled investors as a result. For instance, in Q4 2022, about 40% of Art 9 funds changed classification for Art 8. In addition, if almost all funds are categorised as Art 8, even those that merely apply some company-wide sectoral or legal exclusions, the Art 8 classification greenwashing risks increases mechanically and may disappoint investors that would like to discriminate between different ESG intensities in their ex-ante management rules.

Q4. Do you think that there are alternative ways to construct the threshold mechanism? If yes, please explain your alternative proposal.

Yes, even if ESMA introduces this proposal based on thresholds, this represents only one option. The SMSG thinks there are alternative ways that are worth exploring.

Regarding the effects of any naming option, the SMSG thinks it would be useful to distinguish between transition investments and investments in companies that have already transitioned. For instance, companies transitioning from an oil and gas only model to a mixed model with renewables and with a phase out should be considered as eligible investments. Several metrics like turnover, CapEx, OpEx, net zero paths/plans, enabling activities are elements can be used to define transition investments.

In any case, thresholds may also be expressed as a KPI (not only as a proportion), or in terms of issuer number, or be implemented in relative terms (for instance, comparing a KPI in the fund with the benchmark/investment universe).

Q5. Do you think that there are other ways than the proposed thresholds to achieve the supervisory aim of ensuring that ESG or sustainability-related names of funds are aligned with their investment characteristics and objectives? If yes, please explain your alternative proposal.

Yes. Please refer to previous responses.

The SMSG would first ask ESMA to clarify and specify the minimal criteria needed for the eligibility of other investment approaches than negative screening. The SMSG thinks it is important to make sure that Art 8 and 9 funds, and especially Art 9 funds, help to convey investment flows towards the transition, as per the European Commission's sustainable finance agenda. If investments do not flow into the transition, the objective of sustainable finance to support the economy, all sectors included, to transition will not be achieved. For instance, if "transition" is in the name of a fund, it should be expected that the investments of the fund have a clear transition plan. In addition, there are currently initiatives that permit to assess the transition plans.

Q6. Do you agree with the need for minimum safeguards for investment funds with an ESG- or sustainability-related term in their name? Should such safeguards be based on the exclusion criteria such as Commission Delegated Regulation (EU) 2020/1818 Article 12(1)-(2)? If not, explain why and provide an alternative proposal.

The SMSG completely disagrees with ESMA's proposal in this respect. Even if it may seem simple to pick these criteria, they are not relevant for the naming guidelines. The SMSG is of the opinion that it is excessive to ask all ESG funds to apply the Paris agreement exclusion to

all their investments. These exclusions are crafted in the specific objective of a climate index that looks to be aligned to the 2015 Paris Climate Agreement objectives.

Aligning all ESG funds to these exclusions will exclude the energy sector, one of the sectors in urgent need of transition from fossil fuels towards low carbon energy. For instance, the transition from gas to wind energy takes time and companies will currently have blended activities. Excluding all of them without distinguishing between companies that do not make progress and companies that engage seriously on the reduction of GHG emissions goes against the objective of encouraging the renewable energy sector. Transitioning companies should have credible transition plans, for instance with verified science-based targets to be eligible as sustainable investments.

The SMSG deems this exclusion proposal as non-coherent with the European Commission's objectives in this matter. The SMSG proposes instead clarifying the criteria for other investment strategies than negative screening. Also, it is useful to factor in how Art 8 and 9 ESG funds would help the investment in the transition. ESMA should come up with concrete proposals on investment strategies definitions (e.g., thematic, engagement, impact, best in class/universe/effort, solidarity funds, green bond funds/sustainability linked bond funds) and think of how this proposal can align with existing regimes.

Q7. Do you think that, for the purpose of these Guidelines, derivatives should be subject to specific provisions for calculating thresholds?

a) Would you suggest the use of the notional value or the market value for the purpose of the calculation of the minimum proportion of investment?

Regarding derivatives, the SMSG believes that there should be as much calculation consistency as possible between the areas of regulation (similarity of derivative treatment between financial and non-financial ratios).

The SMSG considers that derivatives should be considered in a consistent manner with the financial ratios. Currently, diversification ratios, concentration ratios, eligibility ratios are calculated and checked by the depositary at their exposure value. It means taking into account the delta equivalent exposure of the underlying asset of the derivative, as per CESR's guidelines on Risk Measurement and the Calculation of Global Exposure and Counterparty Risk for UCITS (CESR/10-788).

b) Are there any other measures you would recommend for derivatives for the calculation of the minimum proportion of investments?

The rule should be clear: derivatives that contribute to the ESG objective should be taken into account while efficient portfolio management techniques (EPMs) should be disregarded.

Q8. Do you agree that funds designating an index as a reference benchmark should also consider the same requirements for funds' names as any other fund? If not, explain why and provide an alternative proposal.

Consistency is desired in principle with indices, but it is not in ESMA's remit. The same difficulty applies for global indices. The SMSG acknowledges that ESMA is right in noticing the problem, however asking index providers to follow ESMA's rules is difficult to achieve in practice. The result may simply be that custom indices proliferate even more than today, that costs go up and that other products (like derivatives) can still reference the parent/main index versions. Questions may also arise in terms of unlevel playing field for EU domiciled funds in a global index market and even at some point of effects on the markets' efficiency.

Q9. Would you make a distinction between physical and synthetic replication, for example in relation to the collateral held, of an index?

There should be consistency with the financial treatment where the two investment replication techniques have the same effects. The SMSG does not see a distinction to make.

In this context it should be noted that a fund portfolio that is swapped against a fund's exposure is not a "collateral", it is the propriety of the fund. Collateral is what is received by the fund: all assets received in the context of OTC financial derivative transactions and other efficient portfolio management (EPM) techniques to cover the fund's counterparty risk.

Q10. Do you agree of having specific provisions for "impact" or impact-related names in these Guidelines?

The SMSG considers that the rule "say what you do and do what you say" applies also to "impact". Before introducing thresholds, the term "impact" should be defined, for instance by the 3 pillars widely recognised today: intention, additionality, measure. This step is needed as we lack a regulatory European-wide definition. An impact strategy goes beyond meeting some ESG criteria by making ex ante efforts to reinforce the ESG dynamic that is pursued by a fund.

Q11. Should there be specific provisions for "transition" or transition-related names in these Guidelines? If yes, what should they be?

The SMSG has above and do also here emphasise that the transition is where the most financing needs are which should be taken into account in Art 8 as well as Art 9 products. Rather than having a specific provision, strategies that invest in companies that engage in transition with solid plans should be authorised to use ESG wordings in their name. The SMSG reminds that companies' plans will ultimately need to be certified and that information on transition plans under the CSRD framework will not be available before 2025. Each company in scope will then disclose its own plan, and the credibility and the quality of the plan is yet to be assessed in order for the information to be used by investment managers and other

investors. Indeed, there should be clear and precise conditions in the transition plan and “engagement washing”⁵ should be avoided. SRD2 engagement reports should show how actors are actively engaged with issuers. If a company has a transition plan (that should also contain KPIs), then the asset manager needs to have a strategy to accompany the company (dialogue) that can go up to proposing or supporting resolutions at AGMs.

Q12. The proposals in this consultation paper relate to investment funds’ names in light of specific sectoral concerns. However, considering the SFDR disclosures apply also to other sectors, do you think that these proposals may have implications for other sectors and, if so, would you see merit in having similar guidance for other financial products?

The SMSG considers that a sectoral level playing field is needed. As noted above, unless the ESAs agree on a coherent common approach, an unlevel playing field will exist between products. Key performance indicators may be different between sectors, but the same overarching rule should be applied by all ESAs.

Q13. Do you agree with having a transitional period of 6 months from the date of the application of the Guidelines for existing funds? If not, please explain why and provide an alternative proposal.

Mindful of the investor protection agenda, the SMSG considers that there is a need for an appropriate transitional period for existing funds. The length of such period depends on the final Guidelines that will be decided, and the efforts required to be made by market participants, their ecosystems, and regulators. Considering the different phases of managing such an implementation project (also keeping in mind that the European Commission might come out with an SI definition which could require additional implementation time), a transitional period of 6 months may be insufficient. In this case, it could be useful assessing if 12 months may be acceptable.

Q14. Should the naming-related provisions be extended to closed-ended funds which have terminated their subscription period before the application date of the Guidelines? If not, please explain your answer.

In case the question relates to listed closed-ended funds, they should be in the scope. If the question relates to open ended funds that are closed to subscriptions, whatever the subscription/distribution channel, or are not marketed any more, they should not be in the scope. Open ended funds whose subscriptions have been terminated will no longer market the product, so applying these rules would not be proportionate.

Q15. What is the anticipated impact from the introduction of the proposed Guidelines?

The SMSG considers that if the Guidelines are adopted as such, there may be a serious impact by shifting further money towards the negative screening approaches only. The SMSG reiterates the need to ensure that positive screening strategies (e.g. transition, engagement, best in class, thematic, impact) are eligible and be included in the naming scope. The market estimates of the effect of the proposed Guidelines show that very few funds would be compliant with the 50% threshold or with the exclusions. On existing EU ESG funds, instead of targeting (as an example) about 80% in and 20% out, there seems that the effect would be the opposite case (less than 20% in).

This advice will be published on the Securities and Markets Stakeholder Group section of ESMA's website.

Adopted on 20 February 2023

[signed]

[signed]

[signed]

Veerle Colaert

Adina Gurau Audibert

Urban Funered

Chair

Rapporteur

Rapporteur

Securities and Markets
Stakeholder Group

5 Annex III: Cost-benefit analysis

Technical options

Article 14(1)(a) of the UCITS Directive and Article 12(1)(a) of AIFMD provide that management companies and alternative investment fund managers act honestly and fairly in conducting their activities while the Regulation 2019/1156, together with Directive (EU) 2019/1160 aims at abolishing the barriers stemming from divergent regulatory and supervisory approaches concerning the cross-border distribution of funds. In this context, the Guidelines aim at setting common standards for fund managers when promoting UCITS and AIFs using a transition-, impact-, ESG- or sustainability-related term in their name, including when these funds are set up as EuSEFs, EuVECAs, ELTIFs and MMFs, in order to facilitate marketing of funds throughout EU Member States.

In this context, the proposed option was identified and analysed by ESMA to address the policy objectives of these Guidelines.

Policy Objective	<p>Under Article 14(1)(a) of the UCITS Directive and Article 12(1)(a) of AIFMD management companies and fund managers shall act honestly and fairly in conducting their activities while under Article 4(1) of Regulation 2019/1156 they shall ensure that all marketing communications addressed to investors are identifiable as such and describe inter alia that all information included in marketing communications is fair, clear and not misleading.</p> <p>In this context, the Guidelines aim at setting common standards on the fair, clear and not misleading character of funds' name.</p>	
Baseline scenario	The baseline scenario should be understood for this CBA as the lack of guidance relating to the name of the fund using ESG or sustainability-related terminology.	
Technical proposal	To ensure that the information included in fund names are fair, clear and not misleading and that fund managers act honestly, the Guidelines include certain criteria for ESG or sustainable funds names for the assessment by NCAs.	
	Qualitative description	Quantitative description
<i>Benefits</i>	ESMA considers that the adoption of common standards on the use of transition-, ESG-, impact-, or	N/A

	<p>sustainability-related terms in funds' names throughout Member States reduces the risk of misleading information to investors.</p> <p>Furthermore, this guidance could have a beneficial effect in terms of standardising practices in naming funds, as consistent requirements will be applicable in all EU Member States, thus reducing the compliance costs over time.</p>	
<i>Costs to regulator</i>	<p>The Guidelines on funds' names using transition-, ESG or sustainability-related terms may, by the introduction of quantitative thresholds, imply additional supervisory actions from NCAs to verify whether funds' names are misleading.</p> <p>However, this is not expected to add significant costs to NCAs, as this additional assessment will be part of the approval process for new funds and the verification of fund documents or marketing communications that can be made pursuant to the powers conferred to NCAs by AIFMD, the UCITS Directive and Regulation 2019/1156. Hence, the supervision costs incurred for NCAs should not be seen as an obstacle for the implementation of the Guidelines.</p>	N/A
<i>Compliance costs</i>	<p>No additional costs are expected in terms of IT systems, training or additional staff both within</p>	

<ul style="list-style-type: none"> • IT • Training • Staff 	<p>financial market participants and competent authorities to comply with the proposed Guidelines on funds' names using transition-, ESG or sustainability-related terms.</p>	
<p>Other costs</p>	<p>It is anticipated that fund managers would incur additional cost to comply with these new requirements set out in the Guidelines. In particular, fund managers may have to change the name of the fund or change its strategy with the consequence of amending either the pre-contractual and periodic disclosure documents and the relevant marketing material or the portfolio composition. However, it is expected that the costs of compliance with the Guidelines may be incurred only on a one-off basis after the application of these Guidelines and only for existing funds.</p>	<p>Out of 67,496 investment funds domiciled in the EU, including 29,839 UCITS funds and</p>

		<p>37,657 AIFs, ¹¹ ESMA staff have identified 6,490 funds with ESG-related terms in their name (9.6% of the total). These include 1,702 AIFs (4.5% of AIFs) and 4,788 UCITS funds (16% of UCITS). Funds' names have been screened for ESG words and phrases that include both derivations of the word 'sustain', such as sustainability, sustainable, etc., as well as other ESG-related words relating to environmental or social topics—governance-related words are relatively infrequent.</p> <p>Among these 4,788 UCITS funds containing at least one ESG-related word, the relative shares as per SFDR disclosure type are the following:</p> <p>Article 6 SFDR: 6% (287 funds)</p> <p>Article 8 SFDR: 76,3% (3,654 funds)</p> <p>Article 9 SFDR: 17,7% (847 funds)</p> <p>It is reasonable to expect that those 287 funds disclosing under Article 6 SFDR could be particularly impacted by the guidance on funds' names, since they should not promote environmental or social characteristics nor have a sustainable objective (or, if they</p>
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¹¹ UCITS data from Morningstar as of end-October 2023. AIF data from AIFMD as of Q4 2022.

		<p>do, then they should instead disclose under either SFDR Article 8 or Article 9). Any of the 3,654 and 847 funds disclosing under Article 8 and 9 SFDR, respectively, would be impacted if the minimum proportion of their assets is not in line with the proposed threshold(s).</p> <p>ESMA received from few respondents an estimate of the cost of compliance. These estimates differ as some respondents referred to a range between €20,000 and €30,000 per fund while others suggested between €60,000 and €100,000.</p>
<i>Innovation-related aspects</i>	No innovation related impacts are expected from this option.	
<i>ESG-related aspects</i>	Due to the nature of this proposal, all issues discussed in this CBA	

	are of relevance to ESG-related aspects.	
<i>Proportionality-related aspects</i>	The costs highlighted above may impact smaller firms to a greater extent.	N/A

Conclusions

Considering what has been illustrated above, ESMA believes that the overall supervisory and compliance costs associated with the implementation of these guidelines are justified by the objectives described above and will be largely compensated by the benefits for investors in terms of reduction of the greenwashing risk, enabling them to rely to a greater extent on fund names using ESG- or sustainability-related terms being fair, clear and not misleading.

In particular, it is expected that the guidelines will enhance the clarity of the information addressed to investors and potential investors in relation to investments in ESG or sustainable funds and will encourage such investments. It is also likely that the guidelines will increase certainty for fund managers in the area of ESG or sustainability-related financial products as particular terms could be used in product names with greater confidence.

6 Annex IV: Guidelines on funds' names using ESG or sustainability-related terms

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6.1 Scope

Who?

1. These 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 and ELTIF and MMFs managers as well as competent authorities.

What?

2. These Guidelines apply in relation to Article 14(1)(a) of Directive 2009/65/EC, Article 12(1)(a) of Directive 2011/61/EU and Article 4(1) of Regulation (EU) 2019/1156. In particular, they apply in relation to the obligation 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.
3. These obligations are relevant to all fund documentation and marketing communications addressed to investors or potential investors for UCITS and AIFs, including when they are set up as EuVECAs, EuSEFs, ELTIFs and MMF.

When?

4. These guidelines apply three months after the date of the publication of the guidelines on ESMA's website in all EU official languages.
5. Managers of any new funds created after the date of application of the guidelines, should apply these guidelines immediately in respect of those funds.
6. Managers of funds existing before the date of application of these guidelines should apply these guidelines in respect of those funds after six months from the application date of the Guidelines.

6.2 Legislative references, abbreviations and definitions

6.2.1 Legislative references

AIFMD	Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010 ¹²
CDR (EU) 2020/1818	Commission Delegated Regulation (EU) 2020/1818 of 17 July 2020 supplementing Regulation (EU) 2016/1011 of the European Parliament and of the Council as regards minimum standards for EU Climate Transition Benchmarks and EU Paris-aligned Benchmarks ¹³
CDR (EU) 2022/1288	Commission Delegated Regulation (EU) 2022/1288 of 6 April 2022 supplementing Regulation (EU) 2019/2088 of the European Parliament and of the Council with regard to regulatory technical standards specifying the details of the content and presentation of the information in relation to the principle of 'do no significant harm', specifying the content, methodologies and presentation of information in relation to sustainability indicators and adverse sustainability impacts, and the content and presentation of the information in relation to the promotion of environmental or social characteristics and sustainable investment objectives in pre-contractual documents, on websites and in periodic reports ¹⁴
ESMA Regulation	Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC ¹⁵
KIID Regulation	Commission Regulation (EU) No 583/2010 of 1 July 2010 implementing Directive 2009/65/EC of the European

¹² OJ L 174, 1.7.2011, p.1.

¹³ OJ L 406, 3.12.2020, p. 17.5

¹⁴ OJ L 196, 25.7.2022, p. 1.

¹⁵ OJ L 331, 15.12.2010, p. 84.

Parliament and of the Council as regards key investor information and conditions to be met when providing key investor information or the prospectus in a durable medium other than paper or by means of a website¹⁶

Regulation (EU) No 345/2013

Regulation (EU) No 345/2013 of the European Parliament and of the Council of 17 April 2013 on European venture capital funds¹⁷

Regulation (EU) No 346/2013

Regulation (EU) No 346/2013 of the European Parliament and of the Council of 17 April 2013 on European social entrepreneurship funds¹⁸

Regulation (EU) 2019/2088

Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector¹⁹

UCITS Directive

Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS)²⁰

6.2.2 Abbreviations

AIFM	Alternative Investment Fund Manager
CDR	Commission Delegated Regulation
CTB	EU Climate Transition Benchmark
ELTIF	European Long Term Investment Funds

¹⁶ OJ L 176, 10.7.2010, p. 1.

¹⁷ OJ L 115, 25.4.2013, p. 1.

¹⁸ OJ L 115, 25.4.2013, p. 18.

¹⁹ OJ L 317, 9.12.2019, p. 1.

²⁰ OJ L 302, 17.11.2009, p. 32.

ESMA	European Securities and Markets Authority
EuSEF	European Social Entrepreneurship Fund
EuVECA	European Venture Capital Fund
MMF	Money Market Fund
PAB	EU Paris-aligned Benchmark
SFDR	Sustainable Finance Disclosure Regulation (Regulation (EU) 2019/2088)
UCITS	Undertaking for Collective Investment in Transferable Securities

6.2.3 Definitions

Benchmark	a market index against which to assess the performance of a fund;
Fund	a collective investment undertaking (as defined in Article 1(2)(a-b) of the UCITS Directive and Article 4(1)(a) of the AIFM Directive);
Fund Managers	<p>a) a management company (as defined in Article 2(1)(b) of the UCITS Directive);</p> <p>b) an investment company that has not designated a management company authorised pursuant to the UCITS Directive;</p> <p>c) an AIFM (as defined in Article 4(1)(b) of the AIFMD) of an AIFs; and</p> <p>d) an internally managed AIF in accordance with Article 5(1)(b) of the AIFMD.</p>

6.3 Purpose

7. These guidelines are based on Article 23(7) of the AIFMD, Article 69(6) of the UCITS Directive and Article 16(1) of the ESMA Regulation. The purpose of these guidelines is to specify the circumstances where the fund names using ESG or sustainability related terms are unfair, unclear or misleading.
8. The name of a fund is a means of communicating information about the fund to investors and is also an important marketing tool for the fund. A fund's name is often the first piece of fund information investors see and, while investors should go beyond the name itself and look closely at a fund's underlying disclosures, a fund's name can have a significant impact on their investment decisions.

6.4 Compliance and reporting obligations

6.4.1 Status of the guidelines

9. In accordance with Article 16(3) of the ESMA Regulation, competent authorities and financial market participants must make every effort to comply with these guidelines.
10. Competent authorities to which these guidelines apply should comply by incorporating them into their national legal and/or supervisory frameworks as appropriate, including where particular guidelines are directed primarily at financial market participants. In this case, competent authorities should ensure through their supervision that financial market participants comply with the guidelines.

6.4.2 Reporting requirements

11. Within two months of the date of publication of the guidelines on ESMA's website in all EU official languages, competent authorities to which these guidelines apply must notify ESMA whether they (i) comply, (ii) do not comply, but intend to comply, or (iii) do not comply and do not intend to comply with the guidelines.
12. In case of non-compliance, competent authorities must also notify ESMA within two months of the date of publication of the guidelines on ESMA's website in all EU official languages of their reasons for not complying with the guidelines.
13. A template for notifications is available on ESMA's website. Once the template has been filled in, it shall be transmitted to ESMA.
14. Financial market participants are not required to report whether they comply with these guidelines.

6.5 Guidelines on funds' names using ESG or sustainability-related terms in UCITS and AIF names

6.5.1 Explanations of key terms under these Guidelines

15. The following explanations are relevant for the key terms mentioned in the below sections of these Guidelines.

- "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.
- "Environmental"-related terms mean any words giving the investor any impression of the promotion of environmental characteristics, e.g., "green", "environmental", "climate", etc. These terms may also include "ESG²¹" and "SRI²²" abbreviations.
- "Social"-related terms mean any words giving the investor any impression of the promotion of social characteristics, e.g., "social", "equality", etc.
- "Governance"-related terms mean any words giving the investor any impression of a focus on governance, e.g., "governance", "controversies", etc.
- "Impact"-related terms mean any terms derived from the base word "impact", e.g., "impacting", "impactful", etc.
- "Sustainability"-related terms mean any terms only derived from the base word "sustainable", e.g., "sustainably", "sustainability", etc.

6.5.2 Recommendations to fund managers on the use of terms in funds' names

16. Funds using transition-, social- and governance-related terms should:

- meet an 80% threshold linked to the proportion of investments used to meet environmental or social characteristic or sustainable investment objectives in accordance with the binding elements of the investment strategy, which are to be disclosed in Annexes II and III of CDR (EU) 2022/1288; and
- exclude investments in companies referred to in Article 12(1)(a) to (c) of CDR (EU) 2020/1818.

²¹ "ESG" means Environmental, Social, Governance

²² "SRI" means Socially Responsible Investments

17. Funds using environmental- or impact-related terms should:
- meet an 80% threshold linked to the proportion of investments used to meet environmental or social characteristic or sustainable investment objectives in accordance with the binding elements of the investment strategy, which are to be disclosed in Annexes II and III of CDR (EU) 2022/1288; and
 - exclude investments in companies referred to in Article 12(1)(a) to (g) of CDR (EU) 2020/1818.
18. Funds using sustainability-related terms should:
- meet an 80% threshold linked to the proportion of investments used to meet environmental or social characteristic or sustainable investment objectives in accordance with the binding elements of the investment strategy, which are to be disclosed in Annexes II and III of CDR (EU) 2022/1288;
 - exclude investments in companies referred to in Article 12(1)(a) to (g) of CDR (EU) 2020/1818; and
 - commit to invest meaningfully in sustainable investments referred to in Article 2(17) of the SFDR.
19. Where a Fund name combines terms from more than one of paragraphs 16 and 17, the provisions of those paragraphs should apply cumulatively, except for those terms combined with any transition-related terms, where only paragraphs 16 and 21 should apply.

Further recommendations for specific type of funds

20. Funds designating an index as a reference benchmark should only use the terms as referred to in paragraphs 16 to 18 in their name if the guidance under those paragraphs are fulfilled by the Fund.
21. Funds using “transition-” or “impact”-related terms in their names should also ensure that investments used to meet the threshold referred to in paragraphs 16 and 17 respectively 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.

Supervisory expectations

22. Competent authorities should consider paragraphs 16 to 21 throughout the life of the Fund. Investors could verify this information through the periodic disclosures provided in accordance with the CDR (EU) 2022/1288. A temporary deviation from the threshold and the exclusions, should be treated as a passive breach and corrected in the best interest of the investors, provided that the deviation is not due to a deliberate choice by the Fund Manager.
23. Subject to the relevant circumstances, competent authorities should consider that inputs warranting further investigation and a supervisory dialogue with the Fund Manager include the following:
- Discrepancies in the level of the quantitative threshold which are not passive breaches;
 - A Fund that does not demonstrate sufficiently high level of investments to use transition-, ESG-, impact- or sustainability-related terms in its name; or
 - 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.