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ESG

ESMA Guidelines on funds´ names using ESG or sustainability -related terms

ESMA has published its final report on the "Guidelines on funds´ names using ESG or sustainability -related terms", which establish the criteria that funds must follow when including ESG or sustainability-related terms in their names.

Legal flash

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- ESMA has established new Guidelines applicable to funds that include sustainability-related terms or ESG terms in their names.
- Funds that use ESG or sustainable terms in their name must use at least 80% of its investments to meet sustainable investment objectives and exclude controversial sectors.
- New funds must comply by 21 November 2024 and existing funds have until 21 May 2025 to change their name if necessary.

On May 14, 2024, the European Securities and Markets Authority ("**ESMA**") released its final report on the "Guidelines on fund´s names using ESG or sustainability-related terms" (the "**Guidelines**"). These Guidelines establish the criteria that funds must follow when including ESG or sustainability-related terms in their names. The criteria vary depending on the specific term used and the sustainable investment characteristics or objectives that the fund aims to promote.

Objective of the Guidelines

The main purpose of these Guidelines is to prevent fund names from being unfair, ambiguous, or misleading. Fund names are the first point of contact with investors and therefore constitute a highly relevant marketing tool. The Guidelines are another measure by the European Union to promote sustainable finance, focusing on increasing transparency, preventing greenwashing, and creating labels that allow investors to easily and confidently invest in sustainable activities.

Scope of application

The Guidelines will be mandatory for Undertakings for Collective Investment in Transferable Securities (UCITS), Alternative Investment Funds (AIFs), including European Venture Capital Funds (EuVECA), European Social Entrepreneurship Funds (EuSEF), European Long-Term Investment Funds (ELTIF), and Money Market Funds (MMF), as well as for the managers of such financial instruments.

Key provisions of the Guidelines

According to the Guidelines, funds that incorporate terms related to transition, social, governance, environmental, impact-related terms, or sustainability-related termsin their names must ensure that at least 80% of their investments are used to meet environmental or social characteristic or sustainable investment objectives, in line with the essential elements of their investment strategy. In addition, these funds must exclude investments in companies engaged in controversial sectors such as arms manufacturing, the tobacco industry, those that violate the United Nations Global Compact or OECD Guidelines, or that generate significant revenue from fossil fuel exploitation. In particular, funds that refer to sustainability in their name must commit to significant investment in economic activities that support an environmental objective, as defined in Article 2(17) of the Sustainable Finance Disclosure Regulation (SFDR).

The Guidelines also specify that funds that designate an index as a reference benchmark should only include the above-mentioned terms if they meet the requirements described in the Guidelines.

It should be noted, that the Guidelines give national supervisory authorities a superviosry role in ensuring compliance with the Guidelines throughout the life of the funds. Consequently, funds must comply with the Guidelines at all times and not only at the time of their authorization or registration.

In this regard, the Guidelines clarify that 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. On the other hand, the Guidelines do not address the consequences of a continuous deviation from the percentage and exclusions in investment. In any case, we understand that this will be considered an active infringement and will require fund managers to modify the names of the funds in question so that the Guidelines do not apply. The name change has then to be registered, in the case of Spanish funds, with the National Securities Market Commission (the "**CNMV**").

Entry into force and transition for existing funds

The Guidelines entered into force when published in in all official languages of the EU, including Spanish, on 21 August 2024. Two months after this publication, the CNMV had to communicate to ESMA whether it complies, does not comply but intends to comply, or does not comply and does not intend to comply with the Guidelines. The CNMV, in Spain, adopted the Guidelines that therefore apply to funds in Spain. The Guidelines entered into force on 21 November 2024. From then on, any new fund registered with the CNMV must comply with the Guidelines.

Existing funds will have six months from the entry into force of the Guidelines (i.e. until 21 May 2025) to comply with these. Managers must assess whether the Guidelines are applicable to the funds under their management and, if so, analyze how they should modify their investment policies to comply with the Guidelines. If they choose not to apply the Guidelines, they must modify the name of the funds and register the name change with the CNMV.

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