

Greenwashing – Proposed Clampdown on Fund Names

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Background

On 20 February 2023, the European Securities and Markets Authority's ("**ESMA**") [consultation paper](#) (ESMA34-472-373) "Guidelines on funds' names using ESG or sustainability-related terms" (the "**Consultation**") closed to comments.

The rationale behind the Consultation is to combat greenwashing, by ensuring that fund names reflect their underlying investments. In ESMA's own words, ESG and sustainability-related terms should be "supported in a material way by evidence of sustainability characteristics or objectives that are reflected fairly and consistently in the fund's investment objectives and policy".

The guidelines, if implemented as proposed, will be relevant for to both European Economic Area ("EEA") managers of alternative investment funds ("AIFs) and financial products and also to non-EEA AIF managers (e.g. US managers) carrying out marketing via the national private placement regimes ("NPPR"). The guidelines, as proposed, would not apply to non-EEA AIFs which solely rely on reverse solicitation for raising capital from EEA investors.

Investment thresholds

ESMA has proposed a minimum proportion of investments that will be required to support the ESG or sustainability-related terms in fund names:

- for funds with "ESG-related" or "impact-related" words in their name, at least 80% of investments should be used to meet the environmental or social characteristics, or sustainable investment objectives in accordance with the binding elements of the fund's investment strategy, as disclosed under the [Sustainable Finance](#)

[Disclosure Regulation](#) ((EU) 2019/2088) (“**SFDR**”); and

- for funds with “sustainable” or any other “sustainability-related term” in their name, within the 80% threshold above, at least 50% of the investments should qualify as “sustainable investments” under Article 2(17) SFDR.

ESMA also recommends "minimum safeguards" (i.e. excluding certain investments, such as controversial weapons) for all funds which have an ESG or sustainability-related term in their name, by reference to Articles 12(1) to 12(2) of the [Delegated Benchmark Regulation](#) (2020/1818).

The guidelines will therefore affect all fund categories and ESMA expects that funds disclosing under Article 6 of the SFDR will be particularly impacted by the guidance, since they should not promote environmental or social characteristics nor have a sustainable objective (or if they do, then they should instead disclose under either SFDR Article 8 or Article 9).

Restricted terms

Unfortunately, ESMA has not provided a comprehensive list of restricted terms. The list of terms in the Consultation include:

- “ESG-related” words;
- “Impact-related” words (**Note:** in addition to the thresholds above, for funds with such a name, investments must be made with the intention to generate positive, measurable social or environmental impact alongside a financial return); and
- “Sustainable” or any other “sustainability-related term”.

The Consultation also does not provide much detail as to what terms may be caught by these categories, save for a few examples:

- “Climate change”;
- “Water” (in combination with “sustainable”);
- “Society” (in combination with “sustainable”); and
- “Biodiversity”.

Regulatory overreach?

Given the ongoing general uncertainty surrounding the SFDR, the market is largely supportive of regulatory efforts to promote supervisory convergence in the assessment of ESG or sustainability-related terms in fund names by NCAs. However, market participants have raised concerns that the Consultation represents an overreach by ESMA. ESMA states in the Consultation that it issued the proposed guidelines under Article 16(1) of the [ESMA Regulation](#) (Regulation (EU) 1095/2010) (the “**ESMA Regulation**”). In effect, this provides ESMA a mechanism to issue guidance and recommendations, in order to facilitate the uniform application of EU law.

Should the rules in the Consultation be finalised, however, they would create substantive new legal obligations not contained in the SFDR or [Taxonomy Regulation](#) ((EU) 2020/852).

UK developments

The United Kingdom’s Financial Conduct Authority (“**FCA**”) is also considering its own fund name restrictions.

The FCA’s [consultation paper](#) (CP22/20) on “Sustainability Disclosure Requirements (“**SDR**”) and investment labels” (the “**UK Consultation**”), closed to comments on 25 January 2023 (please find our article [here](#)). In effect, the SDR is intended to operate as the UK’s own version of the SFDR.

The UK Consultation proposed three distinct sustainable investment product labels, with increasingly rigorous sustainability criteria:

- sustainable focus;
- sustainable improvers; and
- sustainable impact.

Investment managers who (i) make their product available to retail investors in the UK; and (ii) do not qualify for / use a sustainable investment product label, are prohibited from using the following terms in the naming or marketing of their products (non-exhaustive list):

- “ESG” (or “environmental”, “social” or “governance”);
- “climate”;

- “impact”;
- “sustainable” or “sustainability”;
- “responsible”;
- “green”;
- “SDG” (sustainable development goals);
- “Paris-aligned”; and
- “net zero”.

The restrictions only applying when dealing with retail investors will be key for many alternative investment fund managers – a carve-out not present in the ESMA Consultation.

The FCA is also proposing that “sustainable focus” and “sustainable improvers” products are prohibited from using the term “impact” in the naming and marketing of those products.

The FCA may extend the rules to non-UK managers marketing in the UK via the NPPR, but this has not been confirmed yet and is currently not expected to be included in the final rules.

Next steps

Following the closing date of the Consultation, ESMA will review the feedback and responses received and expects to issue the final Guidelines by Q2/Q3 2023.

Firms in-scope of the SFDR will be subject to the Guidelines should (1) review whether any funds have ESG-related terms in their names, (2) verify that the SFDR disclosures are aligned with the applicable quantitative threshold and (3) in case there is no alignment, be prepared to either amend the investment strategy or the name of the fund.

Currently the Consultation envisages a 6-month transition period for funds launched prior to the effective date of the proposed guidelines.

In the UK, the FCA has stated that it intends to publish its final rules by the end of Q2 of 2023.

Please contact the Proskauer team if you have any questions or would like to find out more.

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