Article

New ESG Fund naming rules- EU and the UK

Rory McEwan • December 19, 2024

In May 2024, the European Securities and Markets Authority (ESMA) released its Final Report for 'Guidelines on funds' names using ESG or sustainability-related terms'. According to a study in October 2023[1], ESMA asserts that the share of investment funds with ESG words in their name has increased from 3% to 14% between 2013 and 2023 and separately, Bloomberg Intelligence has predicted global ESG assets to hit $40 trillion by 2030[2]. The concern is that asset managers are incentivised to use these generic, green-sounding terms to appeal to the growing appetite that investors have to invest sustainably.

The name of a fund is important, as it is the initial communication to an investor and is often named for the investments the funds may contain, whether that be in property, infrastructure, credit or indeed, sustainability. As the report claims, investors are expected to check the fund's documentation and "look beyond the name itself", however the name of a fund does play a significant role in marketing and therefore decision making on the investor side.

The new naming rules intends to avoid confusion as to what constitutes an ESG fund and attempts to avoid allegations of greenwashing.

ESMA is not the only regulator concerned with transparency of sustainable investment products; in November of 2023, the FCA published the Sustainability Disclosure Requirements and Investment Policy Statement[3], which was clear in its intention to tackle greenwashing. Part of the FCA's policy involves four voluntary labels for investment products in order to provide clarity for investors; "Sustainability Focus", "Sustainability Improvers", "Sustainability Impact" and "Sustainability Mixed Goals". Each label has different defined goals though all of them require at least 70% of assets to be invested in accordance with the sustainability objective of the label. (Differing from ESMA's 80% threshold and the SEC's name rule, which also has an 80% threshold). The FCA requirements apply to all UK domiciled funds and the anti-greenwashing rule came into effect May

2024.

The above rules are some of the latest in what seems like an ever-changing regulatory landscape associated with ESG. Regulators are evidently focussing their efforts to best provide clarity for investors. Since the introduction of the Sustainability Finance Disclosure Regulation (SFDR) by the European Commission in November 2019, greenwashing has been high on the regulatory agenda globally.

It's worth noting that a large amount of funds are domiciled outside of the jurisdiction of ESMA, the FCA and the SEC. Territories such as the Cayman Islands, Guernsey, Jersey and Luxembourg have their own regulatory bodies who may take a different view on ESG. Nathaële Rebondy, European Head of Sustainability at Schroders, makes the point that client demand may differ between international markets, commenting "If a significant change to investment strategy is needed in order to keep a specific label in one individual market, then that might not be the right outcome for fundholders in other parts of the world"[4]. Additionally, earlier this year the German funds association asserted that the increasing regulation of sustainable funds is putting a disproportionate burden on smaller fund managers[5]. It remains to be seen whether these naming rules (or a similar version) will be adopted in other territories.

There are other concerns on potential issues prompted by these new rules, for example, Barclays analysts have estimated that asset managers could face the need to offload around $30bn in stocks and bonds if they want to hold onto their names under the new ESMA rules.[6] This will give asset managers a difficult choice and could increase the risk of 'green hushing'; where entities under-report sustainability credentials to avoid investor scrutiny, or 'green bleaching'; where asset managers play down their sustainability credentials to avoid additional regulatory requirements.

The regulatory requirements of ESG or sustainable funds is undoubtedly growing, however with the mass availability of ESG assets globally, there is a clear appetite for the products and therefore opportunity. Our clients need to have adequate governance structures in place to ensure data integrity, transparency and confidence in how their investment products are marketed, even down to the name.

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[1] https://www.esma.europa.eu/press-news/esma-news/esma-finds-increase-use-esg-related-language-eu-fund-industry

[2] https://www.bloomberg.com/company/press/global-esg-assets-predicted-to-hit-40-trillion-by-2030-despite-challenging-environment-forecasts-bloomberg-intelligence/

[3] https://www.fca.org.uk/publications/policy-statements/ps23-16-sustainability-disclosure-requirements-investment-labels

[4] https://www.schroders.com/en/channel-islands/intermediary/insights/what-does-the-latest-

european-sustainability-regulation-mean-for-investors-/

[5] https://www.funds-europe.com/esg-regulation-unfairly-burdening-smaller-firms-bvi/

[6] https://www.businesstimes.com.sg/esg/barclays-sees-us30-billion-selloff-risk-amid-new-eu-esg-fund-rule