

ESG: Comparison of EU, UK and US regimes for fund names



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Introduction

In this latest financial services ESG briefing we compare the regimes that are being developed by EU, US and UK regulators as regards fund names. Investor demand for investment funds that incorporate environmental, social and governance factors have grown and will continue to grow in the future. The name of a fund is important as it is usually the first fund attribute that investors see and can have a significant impact on investment decisions. Financial services regulators are aware of this and have concerns regarding greenwashing.

In response in the EU, the European Securities and Markets Authority is consulting on draft guidelines on funds' names using ESG or sustainability-related terms. In the UK, the Financial Conduct Authority is consulting on sustainable investment labels and a general anti-greenwashing rule. In the US, amendments are being proposed to rule 35d-18 of the Investment Company Act of 1940 (also known as the "Names Rule") to expand its scope to apply to any fund name with terms that suggest, among others, investment decisions incorporating one or more ESG factors.

Are rules in force in your jurisdiction with respect to the use of Environmental, Social or Governance (ESG) or sustainability related terms in the names of funds?

EU: No, there are no such binding rules in force at the moment, whether it be in the Grand Duchy of Luxembourg or at the level of the European Union.

However, the European Securities and Markets Authority (**ESMA**) has published supervisory briefing on 31 May 2022 (the **Briefing**) containing principle-based guidance on fund names with ESG and sustainability-related terms. The Briefing had been issued in application of article 29(2) of Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 (i.e. the regulation establishing the ESMA – the **ESMA Regulation**): therefore (as detailed in such article and reminded in the Briefing) it is non-binding (and do not subject and European Supervisory Authority (**ESA**) to a comply or explain mechanism) and only serves to promote common supervisory approaches and practices.

UK: At present, there is no specific rule concerning the use of ESG or sustainability-related terms in the names of funds, but there is a broad panoply of laws, regulatory rules and guidance which impact on the use of ESG or sustainability related terms in the names of funds. The presently applicable laws are broadly concerned with consumer protection. For example, the Consumer Protection from Unfair Trading Regulations 2008 prohibit the use of unfair commercial practices, i.e., those which are contrary to professional diligence, and which materially distort, or are likely to materially distort, the economic behaviour of the average consumer. More specifically, Regulation 15(9) of the Open-Ended Investment Companies Regulations 2001 provides that the name of the company must not be undesirable or misleading.

Key existing regulatory requirements include Principle 7 of the FCA's Principles for Businesses which states that "A firm must pay due regard to the information needs of its clients and communicate information to them in a way which is clear, fair and not misleading" and which is further confirmed by specific rules relating to investment firms' conduct of business.

However, on 19 July 2021 the Financial Conduct Authority (**FCA**) issued a Dear CEO letter on authorized ESG and sustainable investment funds and noted that fund names are subject to restrictions and must not be misleading. Where a fund uses 'ESG', 'green', 'sustainable,' 'responsible,' 'ethical', 'impact', or related terms in its name, this could be misleading unless the fund pursues ESG/sustainability characteristics, themes or outcomes in a way that is substantive and material to the fund's objectives, investment policy and strategy.

US: On 25 May 2022, the US Securities and Exchange Commission (**SEC** or **Commission**) proposed new rules to enhance the regulatory framework for disclosures concerning investment funds and investment advisers' ESG investing strategies (the **Proposed Rules**). If adopted, the Proposed Rules would require SEC-registered advisers to include ESG factors and strategies for investors in fund prospectuses, annual summaries and brochures.

If the answer to question n°1 above is “no”, are such rules being developed in your jurisdiction?

EU: Yes, the ESMA has opened a discussion on this subject on 18 November 2022 via the publication of a [consultation paper](#) on guidelines for naming funds' using ESG or sustainability-related terms (the **Consultation Paper**), which closed on 23 February 2023. The ESMA is expecting to issue final guidelines on the subject (the **Guidelines**) by Q2/Q3 2023, which will be issued under article 16 of the ESMA Regulation: therefore, and contrary to the Briefing, these Guidelines will be subject to a comply or explain mechanism from the ESAs.

UK: Yes. On 25 October 2022, the FCA published Consultation Paper 22/20 Sustainability Disclosure Requirements and Investment Labels.

In the Consultation Paper, the FCA expresses that there are growing concerns that firms may be making exaggerated, misleading or unsubstantiated sustainability-related claims about their products; claims that do not stand to closer scrutiny (so-called 'greenwashing'). The FCA notes that such greenwashing may already be eroding trust in the market for sustainable investment products and that, as a result, it has a role to play in building 'guardrails' against greenwashing to protect consumers from potential harms.

Considering this, in the Consultation Paper the FCA proposes new rules to help consumers navigate what the regulator describes as an increasingly complex investment product landscape, protect consumers from greenwashing and rebuild trust. The proposals build on an earlier FCA Discussion Paper published last November.

The Consultation Paper proposes to introduce:

- Sustainable investment product labels that will give consumers the confidence to choose the right products for them. There will be three categories – sustainable focus, sustainable improvers and sustainable impact – underpinned by objective criteria. Firms will need to decide if they want to apply for a sustainable investment label to their products and assess whether the product meets the qualifying criteria.
- Restrictions on how certain sustainability-related terms – such as ‘ESG’, ‘green’ or ‘sustainable’ – can be used in product names and marketing for products which do not qualify for the sustainable investment labels. The FCA is also proposing a more general anti-greenwashing rule covering all regulated firms. In the FCA’s view, this will help avoid misleading marketing of products.
- Consumer-facing disclosures to help consumers understand the key sustainability-related features of an investment product – this includes disclosing investments that a consumer may not expect to be held in the product.
- More detailed disclosures, suitable for institutional investors or retail investors that want to know more.
- Requirements for distributors of products, such as investment platforms, to ensure that the labels and consumer-facing disclosures are accessible and clear to consumers.

As can be seen from the above the proposals impact how a fund is marketed rather than the fund name per se (except perhaps in relation to the restrictions on sustainability-related terms).

US: Rules are being developed under the jurisdiction of the SEC. Funds and advisers should consider adopting internal frameworks for the use of ESG factors to mitigate the risk of inconsistent use or messaging on this potentially key issue.

If the answer to question n°2 above is “yes”, when will such rules be in force?

EU: The Guidelines are expected to be published by Q2/Q3 2023 and are proposed (so far – based on the draft Guidelines contained in the Consultation Paper) to be applicable from 3 months after the publication of their translation on the ESMA website. Within 2 months of this publication, the ESAs will have to notify the ESMA whether they (i) comply, (ii) do not comply (and reasons why), but intend to comply, or (iii) do not comply and do not intend to comply with the guidelines (and reasons why).

Furthermore, a transitional period 6 months should apply for those funds already existing before the date of such publication.

UK: The FCA’s Consultation Paper closed to comments on 25 January 2023 and the FCA intends to publish final rules and a Policy Statement in Q3 2023.

It is expected that there will be a 12-month implementation period following the publication of the Policy Statement (save in respect of the new 'anti-greenwashing rule' to be introduced as part of these proposals, which will come into force immediately on publication of final rules).

Firms that are providing portfolio management arrangements will be exempt from the naming and marketing rules when 90% or more of the value of constituent products qualify for any investment label for 18 months after the publication of the Policy Statement.

The FCA proposes that its general anti-greenwashing rule reiterating requirements for all regulated firms that sustainability-related claims must be clear, fair and not misleading will come into effect immediately on publishing the Policy Statement.

Later this year or next the FCA will consult on applying the proposals in its Consultation Paper to overseas funds.

US: The SEC's Proposed Rules had a public comment period and are now pending finalization or further proposals. This is the SEC's second ESG-related rule proposal. On 21 March 2022, the SEC proposed ESG disclosure rules requiring domestic and foreign registrants (public companies) to provide climate-related disclosures in their registration statements and annual reports. Those proposed rules also had a public comment period and are now pending finalization or further proposals.

If the answer to question n°1 or question n°2 above is “yes”:

Are quantitative thresholds (e.g. proportion of ESG related investments and/or sustainable investments) applied, or contemplated to be applied, as a condition for funds to use of ESG and/or sustainability related terms in their names?

EU: Yes, such quantitative thresholds are contemplated to be applied under the Guidelines as a condition for funds to use of ESG and/or sustainability related terms in their names.

UK: As mentioned above the FCA is proposing three categories of sustainable investment label – sustainable focus, sustainable improvers and sustainable impact. Each of these labels must meet five overarching principles, a number of cross-cutting considerations and certain category specific key considerations.

For the sustainable focus label, to meet consumers' expectations, one of the proposed specific key considerations is that at least 70% of a 'sustainable focus' product's assets meet a credible standard of environmental and/or social sustainability or align with a specified environmental and/or social sustainability theme. The standard must be robust, independently assessed, evidence-based and transparent.

Portfolio management services can only use a sustainable investment label if 90% or more of the value of all constituent products in which they invest qualify for the same label.

US: Yes. Whether and how the SEC's Proposed Rules will impact a fund depends primarily on what newly defined ESG fund-type applies to the fund's investment decisions. To make this determination, funds would have to perform confidential internal reviews of how ESG metrics

have been incorporated in investment strategies and how the fund presents those ESG investment strategies in marketing materials.

Are different quantitative thresholds applied, or contemplated to be applied, depending on the type of terms (e.g., different threshold for ESG related terms and sustainability related terms) used by a fund in its name?

EU: Yes, such different quantitative thresholds are contemplated to be applied under the Guidelines depending on the type of terms (e.g., different threshold for ESG related terms and sustainability related terms) used by a fund in its name.

UK: For the other two labels quantitative thresholds are not contemplated.

Instead, the specific key consideration for the sustainability improvers label will be for products whose objective is to deliver measurable improvements in the sustainability profile of assets over time. These products seek to invest in assets that, while not currently environmentally or socially sustainable, are selected for their potential to become more environmentally and/or socially sustainable over time, including in response to the stewardship influence of the firm. A firm seeking to use this label must disclose clearly where the product will and will not invest and must describe the product's asset selection and stewardship if its stewardship is not achieving the intended improvements. The firm should describe how it assesses the potential for the sustainability profile of assets to improve over time. This must also be reflected in key performance indicators (KPIs), to enable the firm to be held to account for performance over time.

The key consideration for the sustainable impact label will be for products whose explicit objective is to achieve a positive, measurable contribution to sustainable outcomes. These are products that invest in assets that provide solutions to environmental or social problems, often in underserved markets or to address observed market failures. The manager of the product will be expected to apply industry-standard approaches to performance measurement, reporting against KPIs that capture the investor contribution to positive sustainability outcomes. This is to evidence environmental or social outcomes in line with the product's stated objective.

US: If an internal review indicates that a fund is likely to be considered an ESG-Focused Fund or ESG Impact Fund under the Proposed Rules, it may be necessary to devote greater resources to handle the accompanying increased disclosure requirements.

Integration Fund: A fund that considers one or more ESG factors along with other, non-ESG factors in investment decisions where those ESG factors are generally no more significant than other factors in the investment selection process.

ESG-Focused Fund: A fund that focuses on one or more ESG factors by using them as a significant or main consideration (1) in selecting investments or (2) in its engagement strategy with the companies in which it invests. The SEC will explicitly consider a fund's name and sales literature as possible indicators that the fund's investment decisions incorporate ESG factors as a significant or main consideration.

ESG Impact Fund: A subset of ESG-Focused Funds, a fund that seeks to achieve a specific ESG impact or impacts.

If the answer to question 4. a. above is “yes”, how are such thresholds applied, or contemplated to be apply (please describe the metric used for the application of such threshold, and if such threshold is presented as a minimum/maximum/average to be complied with)?

EU: (i) If a fund has any ESG, or impact-related words in its name, a minimum proportion of 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, which are disclosed in Annexes II and III of [Commission Delegated Regulation \(EU\) 2022/1288](#) (the **SFDR RTS**), which supplements [Regulation \(EU\) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector](#) (the **SFDR**), and (ii) If a fund has the word “sustainable” or any other term derived from the word “sustainable” it should allocate within the 80% referred to under (i) at least 50% of minimum proportion of sustainable investments as defined by Article 2(17) of SFDR, which is also disclosed in Annexes II and III of the SFDR RTS.

Furthermore, (i) 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 set out above according to the Guidelines, and additionally whose investments under the minimum proportions mentioned above are made with the intention to generate positive, measurable social or environmental impact alongside a financial return and (ii) funds designating an index as a reference benchmark could use ESG and sustainability related words in their name only if the guidance above are fulfilled.

UK: In terms of the sustainable focus label, at this stage the FCA is not being prescriptive as to how a firm will demonstrate that credible standard of sustainability. This may change in the future and may be linked to the UK Green taxonomy once developed.

US: The Proposed Rules define an “ESG-Focused Fund” as one which focuses on one or more ESG factors as a significant consideration in selecting investments or in its engagement strategy with the companies in which it invests. This is meant to be a type of quantitative threshold, but the line itself is a little subjective. Within the ESG-Focused Funds category, the Proposed Rules also designate certain funds as “ESG Impact Funds.” These are funds that seek to achieve a specific ESG impact or impacts.

Listed are some of the thresholds:

- Unlike Integration Funds, the Proposed Rules would require ESG Impact Funds to provide detailed disclosures through an “ESG Strategy Overview” table in their prospectuses.

- ESG-Focused Funds that are not Impact Funds will be required to provide only a high-level overview of how the fund incorporates ESG factors in their investment strategies in the proposed table.
- For ESG-Focused Funds that rely on proxy voting or engagement with issuers as a significant means of implementing an ESG strategy, the Proposed Rules will require additional disclosures about their proxy and engagement efforts.

There are certain exclusions, for example the Proposed Rules treat UITs (Unit Investment Trust) differently than investment management companies because of the unmanaged nature of UITs.

If the answer to question 4. a. above is “yes” or “no”, are any other safeguards applied (e.g. exclusion criteria), or contemplated to be applied, in your jurisdiction with respect to the use of ESG or sustainability terms in the names of fund?

EU: Yes, such minimum safeguards are recommended to be applied by the Guidelines.

UK: Yes, please see below.

US: On 20 September 2023, the SEC adopted amendments to rule 35d-1 under the Investment Company Act of 1940, the fund “Names Rule” which aim to broaden the scope of registered investment companies and business development companies that must comply with the current requirement to adopt a policy to invest at least 80 percent of their assets in accordance with the investment focus that the fund’s name suggests. This is independent of the Proposed Rules described in other questions.

If the answer to question 4. d. above is “yes”, what are such safeguards (please describe what they are and how they apply)?

EU: Minimum safeguards (including the exclusion criteria as defined in [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 - the **Benchmark Delegated Regulation**) are recommended under the Guidelines to be applied by the ESAs for all funds using an ESG or sustainability-related term in their name.

Therefore, except for the exclusion criteria provided by the Benchmark Delegated Regulation, other minimum safeguard will have to be defined by the ESAs. The exclusion criteria of the Benchmark Regulation are in particular:

- companies involved in any activities related to controversial weapons (controversial weapons shall mean controversial weapons as referred to in international treaties and conventions, United Nations principles and, where applicable, national legislation),

- companies involved in the cultivation and production of tobacco,
- 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,
- companies that derive 1 % or more of their revenues from exploration, mining, extraction, distribution or refining of hard coal and lignite,
- companies that derive 10 % or more of their revenues from the exploration, extraction, distribution or refining of oil fuels,
- companies that derive 50 % or more of their revenues from the exploration, extraction, manufacturing or distribution of gaseous fuels,
- companies that derive 50 % or more of their revenues from electricity generation with a GHG intensity of more than 100 g CO₂ e/kWh, and
- any companies that are found or estimated by them or by external data providers to significantly harm one or more of the environmental objective of Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment.

UK: As mentioned above each category of sustainable investment product label must meet five overarching principles, a number of cross-cutting considerations and certain category specific key considerations. The five overarching principles cover (1) sustainability objective (2) investment policy and strategy (3) key performance indicators (4) resources and governance (5) investor stewardship. There are also a number of cross cutting considerations associated with each of the principles covering what firms must do and what they must disclose. There are also category specific key considerations.

Where a fund seeks to use one of the labels and meets the relevant criteria it must notify the FCA that it will use the label within one month. The FCA will review the application and may challenge. However, the FCA will not approve the use of the label. This is simply a notification requirement.

Where an investment product does not qualify for a sustainable investment label, proposed restrictions around the naming and marketing of products to retail investors apply.

There are two elements to this. First, an anti-greenwashing rule will apply to all financial services firms (not just asset managers). All regulated firms will need to ensure that the naming and marketing of financial products and services in the UK is clear, fair and not misleading, and consistent with the sustainability profile of the product or service (i.e., proportionate and not exaggerated). Second, the FCA is proposing a prohibition of certain terms such as (but not limited to) 'ESG' (or 'environmental', 'social' or 'governance'), 'climate', 'impact', 'sustainable' or 'sustainability', 'responsible' 'green', 'SDG (sustainable development goals)', 'Paris-aligned' or 'net zero' in product names and in their marketing to retail clients. The proposed rules will apply to products that are made available to retail investors in the UK. Products offered to institutional investors are not in scope of these requirements as the FCA does not consider this to be proportionate at this stage.

Where products are offered to retail investors and have a sustainable investment label, distributors must display the label prominently on a relevant digital medium and provide access to the accompanying consumer-facing disclosures.

Where a distributor is marketing a non-UK product to UK retail investors and prohibited sustainability-related terms are included, the distributor must place a notice on that product, alerting retail investors that: “This product is based overseas and is not subject to FCA sustainable investment labelling and disclosure requirements.” The notice must be placed in a prominent place on the relevant digital medium (e.g., product webpage or page on a mobile application), and be accompanied by a hyperlink to the FCA webpage which will set out what the labelling and disclosure requirements are for retail investors that wish to know more.

US: There is an existing Names Rule that requires a registered investment company to invest in accordance with its 80% investment policy “under normal circumstances,” and for the 80% investment policy to apply at the time that a fund invests its assets. The new Names Rule requires a fund review the makeup of its portfolio assets’ applicable to its “80% basket” at least quarterly and has a timeframe – generally 90 days – for getting back into compliance if a registered fund departs from its 80% investment policy. Unlike the Proposed Rules described in other questions, this 80% requirement does not apply to private funds.

If the answer to question 4 a. or d. above is “yes”, are funds subject to reporting/disclosures in relation to the thresholds and/or other safeguards applies in your jurisdiction with respect the use of ESG or sustainability terms in the names of fund?

EU: Indirectly, yes, as such funds must already disclose/report to their investors in relation to the thresholds and other condition contemplated by the Guidelines in application of SFDR, the SFDR RTS, and other related text (pre-contractual disclosure and annual reporting in particular). Otherwise, no reporting is contemplated by and linked to the Guidelines (except the notification due by the ESAs to the ESMA on whether they comply or will comply by the Guidelines, as mentioned above).

UK: In its Consultation Paper the FCA is proposing both consumer facing disclosures and detailed product level disclosures.

Consumer-facing disclosures will provide a summary of the products’ key sustainability-related features so that consumers may better understand them. This will be a new, standalone document. It will also help consumers compare similar products or the same product over time and hold the provider to account for its sustainability claims. The FCA is proposing that the consumer facing disclosure will be provided alongside documents that present other key investor information (e.g., the Packaged Retail Investment and Insurance-based products (PRIIPs) Key Information Document (KID)). In its Consultation Paper the FCA is not, however, proposing to introduce any new rules that specifically require sustainability-related disclosures to be set out in the KID.

Detailed disclosures are intended to provide more granular information which may be useful to institutional investors and a broader range of stakeholders. To reduce the burden on firms the FCA is proposing that detailed product-level disclosures be made in two forms of existing documentation, depending on the information being disclosed: pre-contractual disclosures (fund prospectus, prior information document) and sustainability product report (building from the TCFD product report).

The FCA is also proposing sustainability entity reports which build on the TCFD framework, extending disclosure requirements under the four pillars – governance, strategy, risk management and metrics and targets – on climate-related financial disclosures to sustainability-related risks and opportunities. Only the following types of entities will need to produce these reports: (i) UK asset managers with £50 billion or more of assets under management from 24 months after the FCA's rules come into effect; and (ii) UK asset managers with between £5 billion and £50 billion assets under management, 36 months after the FCA's rules come into effect.

Unlike the EU SFDR the FCA is not proposing to require disclosure of principal adverse impacts at the entity level. Also, the FCA is not mandating a prescribed form of template for pre-contractual disclosures nor do the disclosures mirror the SFDR's 'Do No Significant Harm' approach.

Distributors will have responsibilities to ensure that retail investors can access consumer-facing disclosures.

The disclosure requirements in the FCA's Consultation Paper are a starting point. It intends to develop its rules and guidance over time. For example, it proposes to add more specificity to both product- and entity-level disclosure requirements as the International Sustainability Standards Board develops its sustainability disclosure standards.

There are various reporting requirements built into the proposed measures, and which relate to the sustainable investment label determined for the Fund. For example, for all sustainable investment labels, one of the five overarching principles is that a sustainable investment product must have an explicit environmental and/or social sustainability objective, i.e., the 'Sustainability Objective'. One of the key cross-cutting considerations for firms in meeting the Sustainability Objective is that they monitor the product's performance against the Sustainability Objective, and provide ongoing performance reporting to investors (i.e., clients and consumers) in relation to it.

US: For registered investment companies (not hedge funds or private equity funds) there is a new prospectus requirement to define or explain words used in a fund name if those words imply a certain strategy or focus, along with related internal recordkeeping requirements for compliance. Registered investment companies also have to list the criteria that the fund uses to select the investments that such defined terms describe. The Proposed Rules will "activate," so to speak, the extra requirements, described in other questions, that would apply broadly to all funds..

What is, or will be, the consequence for a fund having ESG or sustainability related terms in its name if it breaches the relevant thresholds and/or other safeguards during its life (please also indicate if a grace period is, or will be, applicable)?

EU: The Guidelines recommend that ESAs consider the above-mentioned rules throughout the life of the fund, and 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 investors. Each ESA will have to define what they consider a passive breach in light of the foregoing.

UK: As noted above, there will be a transitional period when the FCA finalizes its rules (save in respect of the general 'anti-greenwashing rule', as noted above).

The FCA states in its Consultation Paper that it will apply its usual supervisory and enforcement approaches and respond to compliance issues when they arise. It may take enforcement action if a firm has failed to meet a requirement to make the necessary disclosures; made misleading disclosures or misused a label; or breached the naming and marketing rules. In addition to firm-focused sanctions such as monetary fines and product-related interventions; the FCA may also take action in respect of Senior Managers at an investment firm responsible for the relevant breaches of regulatory rules.

US: A failure to comply with these rules (the adopted fund names rule or, if adopted, the proposed additional disclosure rules) could easily put a fund in the SEC's crosshairs if there is any significant investment strategy that was not properly disclosed even if it were not material to the investment strategy. Given the SEC's overall focus on ESG disclosures and recent enforcement activity and regardless of whether the Proposed Rules are adopted in their current form, fund advisors should begin to review their compliance programs regarding investor disclosures. They should also review their ESG practices and policies to make sure that they are consistent with their disclosures and representations.



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