Antonio Celeste, Head of Sustainability, Index Product Management, STOXX (left) and Saumya Mehrotra, Associate Vice President, Index Product Management, STOXX (right)

ESMA Fund Naming Rules: STOXX Sees Large Impact on Issuers

The European Securities and Markets Authority (ESMA) new guidelines for the use of ESG and Sustainability terms on fund names have entered into force on November 21, 2024, for new funds and will be applicable as of May 21, 2025, for existing products.

To better understand what impact the ESMA guidelines will have on the ETF market, we caught up with Antonio Celeste, Head of Sustainability, Index Product Management, STOXX and Saumya Mehrotra, Associate Vice President, Index Product Management, STOXX.

Antonio, can you explain what the ESMA fund naming guidelines are?

Antonio: The ESMA naming rules were designed to mitigate greenwashing and address the use of specific terms like 'ESG,' 'Sustainable,' or 'Impact' in fund names. Funds using these terms must meet certain sustainable-investing requirements defined by ESMA. The goal is to ensure that funds with these labels actually align with environmental and social objectives, offering investors more transparency.

Specifically, the guidelines apply to terms such as 'Sustainable', 'Environmental', 'Social', 'Governance', 'Transition', and 'Impact'. Any fund using these terms must meet an 80% threshold of investments aligned with environmental or social characteristics or sustainable objectives. The guidelines also require the application of exclusions based on the Paris-aligned Benchmark (PAB) and the Climate Transition Benchmark (CTB), particularly excluding fossil fuel-related investments.

Saumya, what do the guidelines mean for the suite of ETFs and indices available in the market?

Saumya: The new rules offer clearer guidelines and increased investor protection. However, they also add complexity to fund design, requiring funds to meet these new rules while adhering to the original investment philosophy. One significant change is that funds with 'ESG' or 'SRI' in their names must incorporate PAB exclusions, which essentially means excluding investments in oil and gas stocks. ISS ESG identified 2,047 funds with sustainability-related terms in their names, and 80% of them hold at least one company breaching PAB exclusions, mainly due to fossil fuel involvement (ISS, "ESMA Fund Naming Guidelines: A Path towards Greener Portfolios," August 27, 2024.)

This will likely drive demand for new indices with stricter ESG criteria, such as higher sustainability thresholds or clear exclusions for high-carbon industries. While indices themselves are not required to comply, their use in ETFs means they will still be indirectly affected.

How exactly will indices be impacted?

Saumya: Issuers will likely pursue two approaches. If a product requires minor ad-

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FIGURE 1: ESMA NAMING GUIDELINES AND REQUIREMENTS

The scope of the ESMA guidelines encompasses the following ESG or sustainability-related terms:

	Sustainable	Environmental, ESG,SRI	Social	Governance	Transition	Impact
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	✔	✔	✔	✔	✔	✔
Apply the Paris-aligned Benchmark (PAB) exclusions	✔	✔				✔
Apply the Climate Transition Benchmark (CTB) exclusions			✔	✔	✔	
Invest meaningfully in sustainable investments defined in Article 2(17) SFDR	✔					
Ensure that investments used to meet other thresholds 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					✔	✔

Source: STOXX, ESMA, from STOXX, "What's in a sustainability fund name? In Europe, increasing rigor." Transition-related terms include 'transition,' 'improving,' 'progress/ion,' 'evolution' and others.

justments, the methodology will likely be modified to align with the ESMA guidelines, as the impact on the original investment philosophy will be moderate. But if a product significantly differs from the guidelines, issuers have to choose either changing the product's name or methodology. Adjusting the name can trigger long bureaucratic processes, while changing the methodology could impact the fund's risk/return profile.

For ETFs needing methodology changes, we'll work closely with clients to find the best solutions. STOXX has launched two market consultations to gather input on whether our ESG & Sustainability STOXX and DAX indices should be modified to align with ESMA's guidelines. Some index methodologies have already been updated to better meet these standards.

How do STOXX's sustainability indices, overall, stand in relation to the ESMA guidelines?

Antonio: Many of our popular ESG indices already align with ESMA's guidelines, including the STOXX Europe 600 SRI, which underlies ETFs and futures, as well as our PAB and CTBs, and Biodiversity indices. The EURO STOXX 50 ESG will align with the guidelines by the March 2025 rebalance.

A key takeaway from the ESMA guidelines is the exclusion of oil and gas stocks. What does that mean for the sustainability investing landscape?

Saumya: The guidelines may encourage stricter exclusion policies in some funds, while others may advocate for engagement-based strategies, which encourage companies to transition toward cleaner energy. As funds exclude oil and gas stocks, capital flows may increasingly shift toward renewable energy, clean technology, and low-carbon sectors.

Aside from those exclusions, are there any other contentious points in the guidelines?

Saumya: There are a few areas that leave room for interpretation. For example, the requirement for an 80% threshold for investments aligned with environmental or social characteristics has not been clearly outlined. These guidelines will require enhanced ESG data management and compliance reporting, which could disproportionately affect boutique or niche ESG fund managers, who may struggle to meet the new data and reporting standards.

Could SFDR Article 8 funds be in breach of ESMA's guidelines?

Saumya: SFDR Article 8 funds are designed to promote environmental or social characteristics, but they often fall short of ESMA's 80% alignment threshold and the exclusion of high-carbon industries like oil and gas. Although ESMA is not changing SFDR, its guidelines may prompt Article 8 funds to re-evaluate their sustainability claims. Some Article 8 funds may even be reclassified to non-ESG categories if they cannot meet the 80% alignment requirement or justify the use of ESG-related terms.

How do you see asset managers and issuers reacting to comply with the ESMA guidelines?

Antonio: Investors will need to navigate these new requirements while also facing other EU and national-level rules, which may sometimes conflict with ESMA's directive. For now, the sustainable finance environment in Europe remains fragmented, which limits the growth of a unified sustainable finance hub. We expect to see many funds changing their names or methodologies in the coming months, which will require considerable effort from issuers.

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