January 2026

Practice Insights

To Combat Greenwashing, ESMA Raises the Bar for ESG Integration and Exclusions

By Ruth Knox, Matthew Ivor-Jones and Joanna Broadwith

The European Securities and Markets Authority (ESMA) published its second thematic note on sustainability-related claims (Second ESMA Note) on 14 January. The Second ESMA Note focuses on how firms describe ESG strategies in non-regulatory communication, and in particular, ESG integration and ESG exclusions, two of the most common but often "less ambitious" sustainable investment approaches.

The Second ESMA Note follows relatively soon after the publication of ESMA's first thematic note in July 2025. The first thematic note on sustainability-related claims outlined four key principles that should underpin sustainability-related claims while also setting out practical do's and don'ts and examples of good and bad practice in relation to ESG credentials, industry initiatives, labels and awards, and comparisons to peers. The Second ESMA Note follows a similar structure.

Four Guiding Principles

ESMA reiterates that all sustainability claims must be "clear, fair, and not misleading". To achieve this, firms must adhere to four core principles with such claims, which must be:

1. Accurate: Claims must be accurate, consistent, precise, avoid omission and cherry-picking, and should ensure that the ESG terminology and non-textual imagery or sounds are consistent with the sustainability profile of the entity or product.

2. Accessible: Information must be easy to access and understand (avoiding overly complex jargon), though it should not be "over-simplistic".

3. Substantiated: Claims must be backed by clear and credible reasoning, facts and processes, and substantiation should be based on methodologies that are fair, proportionate and meaningful.

4. Up to date: Sustainability claims should be based on information that is up to date with any material change to be disclosed in a timely manner.

Guidance Areas: ESG Integration and Exclusions

The Second ESMA Note contends that ESG integration and ESG exclusions are widely used in the market in communications with investors, especially retail investors, and can be (and have been) misleading.

ESMA sets out its understanding of both ESG integration and ESG exclusion strategies, as summarized below:

- ESG integration: Binding or nonbinding strategy aimed at improving risk-adjusted returns by factoring in material ESG factors, risks and opportunities into the investment process or decision-making process, which may be based on financial (or single) materiality or on an assessment of sustainability impact in the real economy (double materiality).

- ESG exclusions: Strategy commonly aimed at avoiding or minimising exposures that are prone to risks and/or at aligning the portfolio with specific values or norms, sometimes implemented via a consistent application of filters to a universe of securities, issuers, investments, sectors, regions, business practices and/or other financial instruments to rule them out.

Observations and Areas of Divergence

ESMA observes that ESG integration and ESG exclusions are generally viewed as less ambitious strategies and are used inconsistently across the market, often implying very different levels of ambition. As a result, these terms require clear and precise explanation to avoid misleading investors, particularly if "ESG integration" is used as an umbrella label for other ESG approaches. ESMA highlights that divergent market practices may undermine the usefulness of such claims. Key points of variation include:

- ESG integration: Key variables include whether or not integration is binding on the product's ESG approach, whether ESG changes trigger a need for action, how ESG factors influence portfolio construction and valuation/financial analysis, and the actual impact on portfolio composition.

- ESG exclusions: Divergences arise from absolute or relative threshold ambition, whether a materiality assessment underpins ESG criteria on which the exclusion rules are based and the actual reduction of the investable universe/impact on portfolio composition.

ESMA includes examples of good and poor practice in the Second ESMA Note, which illustrate ESMA's expectations that all communications on ESG integration and exclusions must be clear, fair and accurate to avoid greenwashing.

ESG Integration

In the Second ESMA Note, ESMA provides do's and don'ts for firms on ESG integration. These include the following:

Do's	Don'ts
Clearly define "ESG integration" in plain language to accurately describe how ESG factors are considered and try to use illustrative examples.	Don't use "ESG integration" as an umbrella term to describe a variety of ESG strategies such as exclusions, best in class, etc.
Be clear about: (1) whether ESG integration is binding or non-binding; (2) whether ESG factors trigger portfolio decisions; (3) the extent to which ESG factors are used in the financial analysis of holdings; and (4) ESG's impact on portfolio composition.	Don't make entity-level claims without clarifying whether it includes only products applying ESG integration and/or other products doing other ESG strategies.
Clarify at which level ESG integration is done (e.g., at the level of security selection, security weighing, asset allocation).	For products that have an ESG benchmark, do not claim integration if neither product nor benchmark implements it.

Do's	Don'ts
Be transparent about any differences in the level of ambition with which ESG integration is done for various asset classes, sectors, etc., and at each step of the process.	Don't use ESG integration as the basis for emphasising the superior sustainability profile of a product, unless this is supported by other factors.
Be clear about whether the strategy adopts a single or a double materiality approach.	

ESG Exclusions

In the Second ESMA Note, ESMA provides do's and don'ts for firms on ESG exclusions. These include the following:

Do's	Don'ts
Clearly describe the process, the ESG criteria and thresholds used to implement ESG exclusions.	Don't claim to adopt an ESG exclusions strategy if the exclusion rules are not based on defined criteria and applied consistently.
Clarify whether ESG exclusions are defined in absolute terms or based on thresholds that apply to all the criteria or some of them.	Do not claim superior sustainability unless thresholds are ambitious and effects are demonstrable.
Be transparent about whether the ESG exclusions strategy relies on a materiality assessment, and if so, whether this is single or double materiality.	
Be clear about the level of impact of the exclusions on the investable universe and/or on the final portfolio composition.	
Clarify if the exclusions are defined following a firmwide policy and/or whether they are tailor-made to the product's investment universe.	

Implications — Why Should Firms Care?

The Second ESMA Note illustrates that the European regulatory institutions are increasingly scrutinising sustainability-related claims and frameworks. It is part of a broader trend of growing regulatory intolerance of greenwashing and firms should take the direction of policy travel in Europe seriously when they review and update their ESG integration and exclusion frameworks.

Firms should:

- Review existing anti-greenwashing guidance and/or internal marketing policies against ESMA guidance, focusing in particular on how ESG integration and/or exclusion commitments are described. If this initial review identifies gaps, firms should then undertake a targeted assessment of relevant EU-facing, non-regulatory materials (such as websites, sustainability reports, pitch decks, marketing communications and factsheets) against the Second ESMA Note, rather than conducting a wholesale marketing audit, unless material deficiencies are identified.

- Review the firm's training programme to make sure it has appropriate training, systems, processes and controls in place to ensure all sustainability-related claims are robust, based on frameworks that are measurable and defensible and align with regulatory disclosures, including under the EU Sustainable Finance Disclosure Regulation (SFDR).

- Compare ESG integration or ESG exclusion policies or commitments against the ESMA "good practice" examples.

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If you have any questions concerning these developing issues, please do not hesitate to contact the following Paul Hastings London lawyers below:

Ruth Knox
+44-20-3321-1085
ruthknox@paulhastings.com

Matthew Ivor-Jones
+44-20-3023-5250
matthewivor-jones@paulhastings.com

Joanna Broadwith
+44-20-3986-1236
joannabroadwith@paulhastings.com