GLOBAL SURVEY OF ESG REGULATIONS FOR ASSET MANAGERS

ESG and the Sustainable Economy Handbook

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INTRODUCTION

Asset managers (i.e., investment advisers) offering funds in more than one country are accustomed to adapting to different regulatory requirements. However, the challenges presented by the global regulation of environmental, social, and governance (ESG) investing strategies is presenting a particularly arduous burden.

Not only do investor demands differ among countries, but the regulators and other controlling bodies have imposed, or proposed to impose, different requirements that will impact approaches to investing fund assets, disclosures, and marketing, even with respect to the same strategies. While the approaches and goals can vary across jurisdictions, one message is universal in all languages: regulators want asset managers to say what they do and do what they say. Some regimes seek to accomplish this with specific ESG labeling or other requirements, others are currently relying on existing rules prohibiting fraud and material misrepresentations.

To help asset managers keep up with the current regulatory landscape and get a comparative sense of various regions' current requirements regarding common issues, our lawyers—located in the Americas (the United States), Asia (Hong Kong, Japan, and Singapore), Australia, and Europe (European Union including Ireland and Luxembourg[1] and the United Kingdom)—have provided an overview of their regional regulation by responding to the same eight questions regarding the existing ESG-related rules and other ESG developments impacting the investment management industry. We summarize, among other things, each country's or region's position on ESG-related labeling and categories, investment requirements, disclosure and reporting requirements, and restrictions for offshore products, as well as other ESG-related initiatives that could impact asset managers doing business in that country or region. Taken together, this publication provides a high-level view of the overall global ESG regulatory landscape, allowing managers to think strategically about how their firms can navigate this changing environment and approach their business activities in the various regions in which they offer services.

While we expect that governments will continue to address ESG concerns by amending existing or imposing new rules at a rapid pace, the following summary responses are designed to provide asset managers—particularly those with an international business—with a helpful guide, based on practical experience, to basic requirements and trends impacting their services and products, as well as offer practical insight into how they can seek to straddle the various regulatory regimes.

AMERICAS

UNITED STATES

By Keri E. Riemer and Lance Dial

What rules, if any, are currently in place (i.e., have been adopted) for funds and asset managers?

No formal ESG-specific rule is currently in place for funds and advisers (i.e., fund managers), although the US Securities and Exchange Commission (SEC) announced its intention to adopt a final rule requiring certain disclosures and reporting in late 2023. However, existing laws and rules prohibiting materially misleading statements and previously issued guidance from the SEC staff do provide limits and standards for funds and advisers with respect to their use of ESG factors. In addition, SEC enforcement actions indicate that the SEC will take a very strict read of ESG-related disclosures and expect that asset managers have procedures in place to ensure that any ESG-related processes they describe in fund disclosures or marketing materials are consistently followed.

Proposed ESG-Specific Rules for Funds and Advisers

In May 2022, the SEC proposed a sweeping set of requirements for SEC-registered investment companies (e.g., mutual funds, exchange-traded funds, closed-end funds) (Registered Funds) and investment advisers that, if adopted, would establish a new ESG taxonomy for such entities and require them to disclose and report certain information regarding their use of ESG factors (the 2022 Proposal). (Aspects of the 2022 Proposal are summarized below and described in more detail in client alerts available on the K&L Gates HUB website dated 17 November 22, **The SEC's New Rule Demonstrates That It Believes Shareholder Reports, Like Clothes, Should Be Tailored To You,** and 21 June 2022, **Q&A On The Proposed ESG Reforms For Registered Funds: Addressing The Potential Challenges Imposed And Comment Opportunities**.) Although the views expressed in the proposing release relating to the 2022 Proposal are not themselves enforceable, they do reflect what the SEC expects of funds and advisers and what may eventually be required of them. Dozens of members of the industry provided comments (including criticism and suggesting alternatives) on the proposed reforms. The SEC is expected to adopt final reforms—which will integrate many of the concepts included in the 2022 Proposal—in the fall of 2023.

Existing Rules and Guidelines

As indicated above, funds and advisers are currently subject to laws and rules that prohibit them from making materially misleading statements or untrue statements of material fact, including statements about ESG. Accordingly, funds and advisers are currently required to provide accurate disclosures regarding their use of ESG-related factors in their investment strategies. In May 2021, the staff of the SEC issued a risk alert urging funds and advisers to, among other things, establish policies and procedures related to ESG investing, ensure that portfolio management practices were consistent with disclosures about ESG approaches, and implement adequate controls around the implementation and monitoring of negative screens (e.g., prohibitions on investing in tobacco). Nearly two years later, the SEC took enforcement action against the investment adviser of a Registered Fund after determining that the adviser made material misstatements and omissions concerning its consideration of ESG factors

when managing the fund's assets. Advisers are also subject to Rule 206(4)-1 (the Marketing Rule) under the Investment Advisers Act of 1940, as amended (the Advisers Act), which was designed to prevent false or misleading advertisements by advisers, including in connection with the private funds (e.g., hedge funds, private equity funds) they manage. Accordingly, even in the absence of a specific ESG rule, funds and advisers are still bound by existing requirements pertaining to material misstatements and omissions and accurate reporting.

What labels or categories, if any, are currently required or have been proposed for funds and asset managers?

The 2022 Proposal included a new disclosure taxonomy for Registered Funds and advisers:

Registered Funds

- *Integration Funds*: Funds that consider one or more ESG factors alongside other, non-ESG factors in their investment decision-making process, but where such ESG factors are not dispositive in the funds' investment decisions.
- *ESG-Focused Funds*: Funds that consider one or more ESG factors as significant or primary factors in selecting investments or in engagement with portfolio companies, including funds that apply inclusionary or exclusionary screens, focus on ESG-related engagement with issuers, or that track an ESG-focused index.
- *Impact Funds*: A subset of ESG-focused funds that seek to achieve one or more specific ESG impacts (e.g., advancing the availability of clean water, sustainable management of timberland).

Advisers

- *Integration Strategy*: One or more ESG factors alongside other, non-ESG factors is included in the adviser's investment advice, but such ESG factors are generally no more significant than other factors when the adviser advises clients with respect to investments.
- *ESG-Focused Strategy*: One or more ESG factors are a significant or main consideration in advising clients with respect to investments or in the adviser's engagement strategy with the companies in which its clients invest.
- *ESG Impact Strategy*: ESG-focused strategy that seeks to achieve one or more specific ESG impacts.

In addition, in September 2023, the SEC finalized rule amendments that introduce new requirements for funds with names suggesting an "investment focus" and specifically identified the consideration of ESG factors as an element suggesting an "investment focus." (Information about the newly adopted amendments is available on the K&L Gates HUB website as an alert on 26 September 2023, **What's In A Fund Name? SEC Approves Changes To The Fund Names Rule.**) As a result, a fund with a name suggesting an ESG-related investment program is required to disclose how it defines the relevant terms used in its name and adopt a policy to invest at least 80% of its assets in investments suggested by its name.

What disclosure and reporting requirements are currently required or have been proposed for funds and asset managers?

There are no ESG-specific disclosure or reporting requirements applicable to funds or advisers. That said, current regulations effectively require certain levels of disclosure about material facts, including the incorporation of ESG factors. Specifically, a Registered Fund that utilizes ESG factors in its investment strategies must disclose how such factors are used and any risks related to its ESG-related strategies in its registration statement and, if applicable, shareholder reports. Likewise, an adviser that employs one or more ESG strategies in formulating investment advice or managing assets

is required to disclose information regarding such strategies (and related risks if such strategies are "significant") in its Form ADV Part 2A (i.e., brochure), but there are no specific ESG-related requirements.

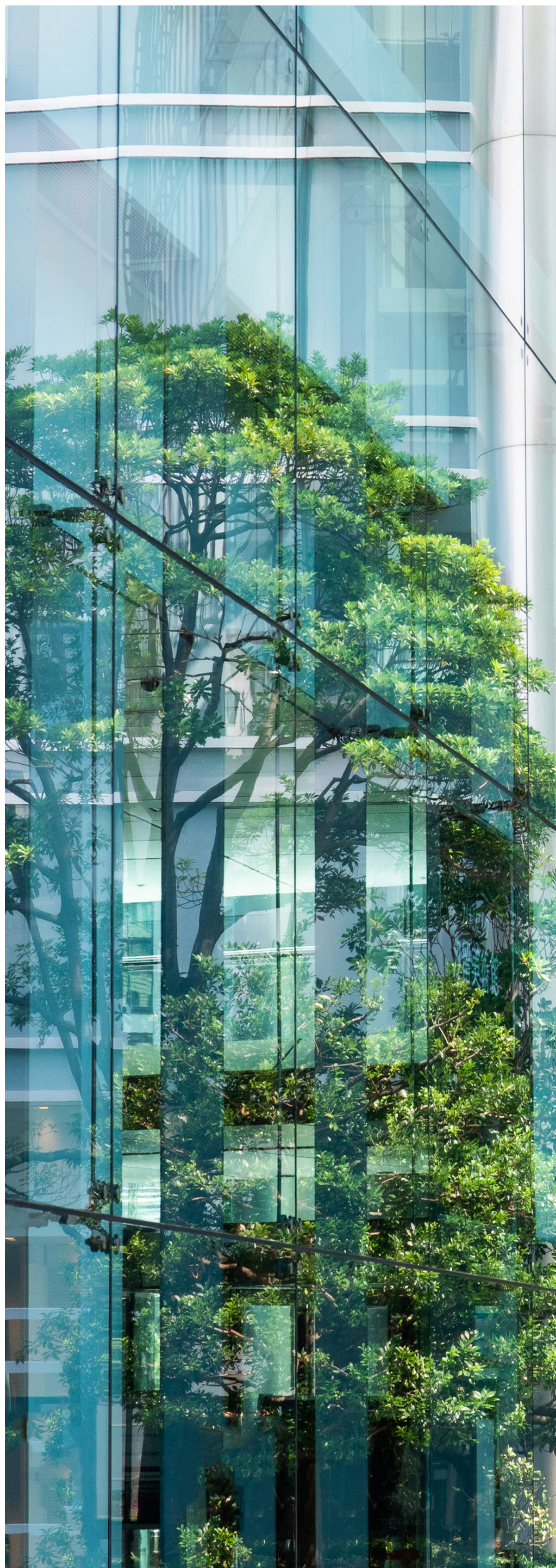
As noted above, the 2022 Proposal included specific ESG disclosure and reporting requirements for Registered Funds and advisers, but no disclosure or reporting requirements were proposed for private funds (e.g., hedge funds, private equity funds).

Registered Funds

- *Prospectus Disclosures*: Under the 2022 Proposal, integration, focused, and impact funds would be required to provide information about, among other things, their use of ESG factors into their investment processes and engagement strategies. In some cases, funds would need to provide disclosure about their consideration of greenhouse gas (GHG) emissions. A fund's specific disclosure obligations would depend on whether the fund is an integration, focused, or impact fund.
- *Annual Shareholder Report Disclosures*: If the 2022 Proposal is adopted without modification, Registered Funds would also be required to include various ESG-related disclosures in their shareholder reports, including, in some cases, certain GHG emissions metrics, including the fund's carbon footprint and "weighted average carbon intensity" using a specific formula.
- *Form N-CEN Reports*: Under the 2022 Proposal, Registered Funds would be required to provide ESG-related information in their Form N-CEN reports.

Advisers

The 2022 Proposal imposes additional Form ADV reporting and disclosure requirements, including new questions in Form ADV Part 1A addressing the use of ESG factors, ESG strategies, and whether advisers conduct other business activities as, or have related persons that are, ESG service



providers. For example, in its brochure, an adviser would be required to disclose, with respect to each significant investment strategy, the type of ESG strategy or strategies used (i.e., integration, ESG-focused, or impact), the ESG factor(s) used, how the adviser incorporates a particular ESG factor or a combination of factors into its management of the strategy, and any criteria or methodology used to evaluate, select, or exclude investments based on the consideration of ESG factors. Advisers would also need to disclose material relationships with certain related persons that are ESG service providers and information about proxy voting policies (available as an alert on the K&L Gates HUB website 25 May 2023, **The ESG Debate Heats Up: State AGS Investigating Asset Manager Involvement In ESG Initiatives And Related Proxy Voting**) relating to ESG considerations.

Are there any current or proposed requirements outside of disclosure and reporting (e.g., product-level investment requirements)?

The Marketing Rule (with respect to advisers) and anti-fraud rules currently apply to funds and advisers in connection with their ESG-related statements and investment activities. Existing rules under the Advisers Act and the Investment Company Act of 1940, as amended, relating to compliance programs impose certain obligations on advisers and Registered Funds, respectively, that could require funds or advisers to incorporate ESG elements into their compliance programs. Notably, the 2022 Proposal does not include a requirement that a Registered Fund or adviser invest a certain minimum percentage of assets in a type of issuer or strategy, though (as discussed above) a Registered

Fund with ESG terminology in its name will now be required to invest at least 80% of its assets consistent with its name.

Do the existing or proposed rules apply equally to offshore funds being marketed in the region, or do they apply solely to locally domiciled products?

Non-US funds may only be offered in the United States on a private placement basis and pursuant to certain securities law exemptions. While such offshore funds would not be subject to the new rules impacting Registered Funds, they would be subject to the prohibitions against misrepresentations described above.

Are any rules in place for investors (versus funds and fund managers)?

The SEC has not proposed or adopted specific rules for nonfund investors, such as natural persons. The Employee Retirement Income Security Act of 1974 has provisions that impact how ESG factors may be considered for retirement plans.

Are there other actions or initiatives that could impact funds and managers?

The various states in the United States have begun adopting their own legislation that impacts how ESG factors can be considered. While the legislation takes several forms and key details differ from state to state, the laws tend to share core common features. First, those adopted to date apply only to the disposition or management of state funds (e.g., who the state can hire, in which companies the state can invest, or what standards must be applied by fiduciaries who are investing state money, particularly the assets of state pension plans). Second, with respect to the management of state funds, the state laws generally limit the consideration of ESG factors to financial or "pecuniary" decision making. In other words, even in states that have adopted laws presumably restricting the consideration of ESG factors, there remains room for investment managers to make decisions on investments based on ESG factors so long as that consideration is grounded in the pursuit of financial returns. On the other hand, these state laws most likely prohibit states from investing in impact investment strategies.

California, in particular, recently passed legislation that would require companies (including asset managers) "doing business in California" with revenues over certain thresholds to report and disclose details about their scope 1, 2, and 3 GHG emissions and climate-related risks.

What is on the horizon?

As noted above, the 2022 Proposal is currently under consideration by the SEC, and we expect a final rule to be adopted in 2023. At the state level, individual state legislatures should be expected to continue to consider legislation impacting the ability to consider ESG factors, with some states moving to substantive regulatory provisions (e.g., requiring advisers to provide specific disclosures or obtain client consent with respect to the consideration of ESG factors). Accordingly, the regulatory environment in the United States with respect to ESG will likely become more complicated, at least in the near term.

ASIA

HONG KONG

By Carolyn Sng and Sook Young Yeu

What rules, if any, are currently in place (i.e., have been adopted) for funds and asset managers?

Currently, there are prescribed ESG rules for funds that have been authorized by the Hong Kong Securities and Futures Commission (SFC) to be marketed to retail investors in Hong Kong and that consider ESG or sustainability factors (including climate change) in their investment process (Hong Kong ESG Funds). As described in greater detail below, Hong Kong ESG Funds are subject to certain disclosure and reporting requirements, as currently set out in the SFC's "**Circular to management companies of SFC-authorized unit trusts and mutual funds – ESG funds**," which took effect 1 January 2022.

The SFC maintains on its website a database of Hong Kong ESG Funds. The database is categorized according to the investment theme (e.g., climate change, environmental, sustainability, food security, forestry, nutrition, social, sustainable energy, water) and investment strategy (e.g., best in class, positive screening, impact investing, thematic), in each case as disclosed in the applicable Hong Kong ESG Fund's offering document. Collective investment in transferable securities (UCITS) authorized by the SFC will be considered Hong Kong ESG Funds if they incorporate ESG factors as their key investment focus and reflect such in their investment objectives or strategies. This is irrespective of whether they are classified as falling under Article 8 or Article 9 of The European Union's Sustainable Finance Disclosure Regulation (SFDR).

Fund managers that are SFC-licensed intermediaries are subject to certain conduct rules. In particular, fund managers with investment discretion over collective investment schemes, including both SFC-authorized funds (i.e., funds authorized to be marketed to retail investors) and private funds (i.e., hedge funds), are required to take climate-related risks into consideration as part of their investment and risk management processes and to make appropriate disclosures. These requirements, which largely reflect recommendations and proposals of the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD), were imposed pursuant to the SFC's Consultation Conclusions on the Management and Disclosure of Climate-Related Risks by Fund Managers, which took effect 20 August 2022.

What labels or categories, if any, are currently required or have been proposed for funds and asset managers?

While no ESG investment labels or categories have been established for either SFC-authorized funds or private funds, there is a general requirement that licensed intermediaries must ensure that their product disclosures are not misleading. Accordingly, ESG-related names may only be used for products where such ESG-related considerations are applied in the investment process. In addition, there is a general requirement that a product's name must not be misleading, and references to ESG or related terms in an authorized fund's name or marketing materials should be accurate and proportionate. A fund that does not satisfy the definition of a "Hong Kong ESG Fund" (set forth above) would generally not be permitted to name or market itself as ESG related.

What disclosure and reporting requirements are currently required or have been proposed for funds and asset managers?

While there are currently no prescribed ESG-related disclosure or reporting requirements for non-SFC-authorized funds, as noted above, intermediaries are required to ensure that their product disclosures are not misleading.

Unlike in some other regions, where specific ESG-related disclosures are not yet required, Hong Kong ESG Funds are currently required to make various ESG-related disclosures in their respective offering documents. Such required disclosures include information about the ESG focus or investment theme of the fund, the criteria used to measure the attainment of such focus or investment theme, the investment strategy and methodologies adopted (including any exclusion policies), the expected or minimum asset allocation to the designated ESG focus, any applicable reference benchmarks or additional information references used by the fund, and any risks or limitations associated with the fund's ESG focus. In addition, the Hong Kong ESG Fund or its manager must disclose to investors on its website or via other means, and review and keep updated, certain additional information, including how the Hong Kong ESG focus is measured and monitored (and related internal and external control mechanisms), details regarding the due diligence carried out in respect of the fund's investments, a description of the fund's engagement policies (including proxy voting), and a description of the sources and processing of ESG data upon which the fund relies (including any assumptions made when data is not available).

In addition, a Hong Kong ESG Fund is required to conduct periodic assessments at least annually on how it has attained its ESG focus and then disclose to investors the results of such assessments by appropriate means (e.g., in annual reports).

In particular, the Hong Kong ESG Fund should disclose—such as in its annual report—the proportion of underlying investments that are commensurate with its ESG focus, the proportion of the investment universe that was eliminated or selected as a result of ESG-related screening, a comparison of the performance of the fund's ESG factors against any designated reference benchmarks, and information about actions (such as shareholder engagement or proxy voting activities) taken by the fund to attain its ESG focus.

UCITS that are authorized by the SFC are generally subject to a streamlined regulatory approach. A UCITS fund authorized as a Hong Kong ESG Fund that meets the disclosure and reporting requirements for Article 8 or Article 9 funds under the SFDR will be deemed to have generally complied with the Hong Kong disclosure and reporting requirements for Hong Kong ESG Funds.

As noted above, fund managers with investment discretion over collective investment schemes are required to take climate-related risks into consideration in their investment and risk management processes and to make appropriate disclosures. The applicable requirements depend on the relevance and materiality of climate-related risks to the investment strategies and funds managed. Required disclosures include baseline requirements applicable to all such fund managers, such as governance structure in relation to the management of climate-related risks and steps taken to incorporate risk management into the investment management process (including any key tools and metrics applied). Such disclosures must be made to investors via channels, such as websites, newsletters, or reports, and reviewed at least annually (and updated in the interim, where appropriate), and fund investors must be informed of any material changes as soon as practicable.

A large fund manager with HK$8 billion (US$1.02 billion) or more in fund assets for any three months in the preceding reporting period may also be subject to enhanced risk management and

disclosure standards, including a description of its engagement policy at the entity level regarding the management of material climate-related risks and disclosure of scope 1 and scope 2 greenhouse gas emissions associated with portfolio investments at the fund level, together with calculation methodology, underlying assumptions and limitations, and the proportion of investments that are assessed or covered.

With respect to reporting requirements, fund managers are subject to SFC reporting requirements as licensed intermediaries. However, there are currently no prescribed ESG-related SFC reporting requirements.

Are there any current or proposed requirements outside of disclosure and reporting (e.g., product-level investment requirements)?

There are currently no prescribed ESG-related requirements for non-SFC-authorized funds.

Fund managers of Hong Kong ESG Funds are required to regularly monitor and evaluate the underlying investments to ensure that the Hong Kong ESG Funds continue to meet their stated ESG focus and requirements. In addition, SFC-authorized funds and their fund managers are required to comply with all applicable codes and guidelines in relation to their authorization and licensing that are not specifically related to ESG.

There are general requirements for licensed intermediaries to know their client (including their investment objectives); to exercise due care, skill, and diligence in providing services to the client; and to act in the best interests of the client. If a client has indicated ESG- or climate-related investment preferences in its investment mandates, the intermediary is expected to take those into consideration. However, there is no current requirement that the intermediary determine a client's "sustainability preferences."

Do the existing or proposed rules apply equally to offshore funds being marketed in the region, or do they apply solely to locally domiciled products?

The requirements relating to SFC-authorized funds apply irrespective of domicile. As long as a fund, including an offshore fund, has been authorized by the SFC for marketing to retail investors in Hong Kong, it must comply with the applicable requirements.

Are any rules in place for investors (versus funds and fund managers)?

There are currently no prescribed ESG-related rules for investors. The SFC has issued a set of "Principles of Responsible Ownership," which provides principles and guidance to assist investors in determining how to best meet their ownership responsibilities. These principles are nonbinding and voluntary, but investors are encouraged to adopt them and to disclose to their stakeholders that they have done so in whole or in part, as well as explain any deviations or alternative measures adopted.

Are there other actions or initiatives that could impact funds and managers?

In June 2023, the International Sustainability Standards Board (ISSB) published its two inaugural International Financial Reporting Standards (IFRS) sustainability standards for reporting periods beginning on or after 1 January 2024, subject to endorsement by local jurisdictions and transitional relief. The Hong Kong Institute of Certified Public Accountants, the acts of which impact funds and managers, has indicated it proposes to adopt the ISSB standards on a fully converged basis. Unlike IFRS accounting standards, the ISSB standards, when adopted, will not be mandatory for Hong Kong-incorporated companies, unless

there are other applicable legislation or regulatory requirements mandating compliance (e.g., listing rules issued by The Stock Exchange of Hong Kong Limited, or HKEX). The HKEX listing rules currently provide for certain mandatory and certain "comply or explain" requirements in relation to ESG. The HKEX has recently concluded a consultation (conclusions currently pending) to enhance the ESG reporting in line with ISSB standards beginning 1 January 2024. The proposed changes will make all climate-related disclosures mandatory, and such disclosures will be brought largely in line with the ISSB standards. There will be a transitional period of two reporting years for certain disclosures, such as the financial impact of climate-related risks and opportunities and scope 3 emissions, to allow listed issuers more time to put in place internal procedures and measures to comply.

Other than for HKEX-listed companies, there are currently no proposals for the mandating of ISSB standards for other entities in Hong Kong, including funds and fund managers. However, it is open to any entity to adopt the ISSB standards on a voluntary basis. As the ISSB standards are implemented internationally, there may be increasing investor expectations for voluntary adoption by funds to promote transparency and comparability.

What is on the horizon?

The Cross-Agency Steering Group, comprised of various regulators and governmental bodies, was established by the Hong Kong government to accelerate the growth of green and sustainable finance and support the government's climate strategies. The group has identified the following as near-term priorities:

- Climate-related disclosures aligned with TCFD recommendations to be mandatory across relevant sectors no later than 2025. As discussed above, there are currently no proposals to mandate the ISSB standards for entities other than HKEX-listed issuers, but it is possible further initiatives will be proposed in the financial sector.
- To adopt the Common Ground Taxonomy in Hong Kong in the context of the financial sector and specifically in relation to Hong Kong ESG Funds.
- To promote a climate-focused scenario analysis to assess the impact on financial institutions under different climate pathways, such as the use of scenario analysis by large-asset managers.

In November 2021, the International Organization of Securities Commissions (IOSCO) issued its report on ESG ratings and data products providers, which provides various recommendations, including on the engagement of providers of such products by Hong Kong ESG Funds and fund managers. The SFC has been engaging with the financial sector, providing guidance and clarification based on the IOSCO framework. It is possible further published guidance or requirements may follow.

The SFC's initial ESG focus in relation to fund managers has been on climate-related risks, as metrics are generally more developed in this area currently and the SFC believes that this will help effective implementation. However, the SFC has also acknowledged the importance of ESG factors more generally and stated that it will remain abreast of international and market developments and consider an expansion of the regulatory coverage to other aspects of ESG over the longer term.

JAPAN

By Yuki Sako

What rules, if any, are currently in place (i.e., have been adopted) for funds and asset managers?

Disclosure and Organizational Resources Requirements for Publicly Offered ESG Investment Trusts

The Financial Services Agency of Japan (FSA) recently amended its Comprehensive Guidelines for Supervision of Financial Instruments Business Operators (Supervisory Guidelines) to require asset managers to make certain disclosures and implement certain organizational or operational and due diligence measures (ESG Guidelines) with regard to publicly offered ESG-focused investment trusts. The ESG Guidelines, which became effective 31 March 2023, include:

- *Definition of ESG Funds*: ESG Guidelines focus on "ESG Funds," which are defined as publicly offered investment trusts that (a) consider ESG as "a key factor" in the selection of investment assets, and (b) disclose that ESG is such a key factor in their respective prospectuses (Japan ESG Funds). Asset managers must determine whether their funds are "ESG Funds" (referred to as Japan ESG Funds in this paper).
- *Required Disclosure Regarding Investment Strategies*: Japan ESG Fund managers are required to provide ESG-related disclosures in the fund's prospectuses, including (a) detailed information about key ESG factors considered in selecting investment assets; (b) a description of how key ESG factors are considered in the investment process; (c) the risks and limitations of such consideration; (d) for Japan ESG Funds that seek to achieve a certain impact, detailed information about the impact and how it is measured; (e) any fund-specific policy or the manager's company-wide stewardship policy; and (f) if additional disclosure is provided on a website, references to such website.
- *Required Disclosure Regarding Portfolio Construction*: Japan ESG Fund managers are required to disclose in the fund's prospectus, with respect to any Japan ESG Fund, any designated target or standard ratios or indicators, whether on the basis of an amount of investments selected by key ESG factors or on the entire portfolio basis. If no target or standard ratios are designated, there should be an explanation as to why that is the case.
- *Required Disclosure Regarding Reference Index*: If a Japan ESG Fund seeks to track a specific ESG index, the Japan ESG Fund manager is required to disclose how ESG factors are considered by such ESG index and the manager's reasons for selecting such ESG index.
- *Required Periodic Disclosure*: Japan ESG Fund managers are required to provide, as applicable, the following periodic disclosures in the fund's investment reports or periodic disclosure documents: (a) if target or standard ratios of investments selected by key ESG factors are designated, actual investment ratios calculated using the amount of investments (market value) selected by such ESG factors against the total net assets; (b) if target or standard ESG valuation indicators used for selecting investments are designated for entire ESG portfolios, the status of achievement; (c) any ESG impact achieved; (d) actions taken in accordance with any related stewardship policy; and (e) if further information regarding these items is provided on a website or elsewhere, references to such website or places.
- *Required Due Diligence for Investment Management Outsourcing*: When management of a Japan ESG Fund is

outsourced to another manager, appropriate due diligence must be conducted with regard to such other manager, including its investment management practices and whether such manager provides all types of required disclosure and reporting listed above or an explanation as to why it does not provide such disclosure or reporting.

- *Organizational Recourses*: Japan ESG Fund managers must have adequate resources to both (a) provide investment management services in accordance with the funds' stated investment strategies, and (b) monitor such services, including by maintaining ESG-related data or information technology infrastructure or securing appropriate personnel. If management of a Japan ESG Fund is outsourced to another manager (i.e., a sub-adviser or sub-manager), the primary asset manager must have the internal resources necessary to conduct due diligence and ensure that the sub-manager's disclosures and reporting are accurate.
- *Due Diligence for ESG Rating and Data Providers*: Japan ESG Fund managers must conduct appropriate due diligence when using ESG ratings or data in their investment process.

The ESG Guidelines also apply to non-ESG publicly offered investment trusts (Non-Japan ESG Funds). Specifically, Non-Japan ESG Funds may not use ESG-related terms (e.g., ESG, sustainable development goals, green, decarbonization, impact, sustainable) in their names, and when ESG is only one factor to be considered along with other factors and has no greater significance, such Non-Japan ESG Funds' prospectuses and marketing materials should not include statements that would mislead customers to think that ESG is a key factor in selecting investment assets.

Code of Conduct for ESG Rating and Data Providers

In December 2022, the FSA issued the final "Code of Conduct for ESG Evaluation and Data Providers" (Code of Conduct). The Code of Conduct consists of six principles and guidelines for ESG rating and data providers to (a) ensure quality of ESG ratings and data; (b) provide more transparency and fairness; (c) address conflicts of interest issues; (d) ensure the retention of appropriate personnel, including providing appropriate training; (e) mitigate conflicts of interest and ensure independence, objectiveness, and neutrality; (f) provide for proper handling of nonpublic information; and (g) facilitate better communications with operating companies that receive ESG ratings and other entities. Although the Code of Conduct is not a formal regulation, the FSA calls for ESG rating and data providers to formally endorse the Code of Conduct. Accordingly, such entities are subjected to a "comply or explain" regime; providers must comply with, or provide an explanation as to why they are departing from, the Code of Conduct.

More directly relevant to asset managers, the Code of Conduct includes "recommendations to investors;" the recommendations are attached to the Conduct of Conduct as references but are not formally part of the Code of Conduct. For this purpose, the term "investors" includes entities and persons that invest proprietary or client funds, such as asset managers. The recommendations call for investors to:

- Carefully examine and understand the purpose, methodologies, and limitations of ESG evaluation and data they utilize for their investment decisions.
- To the extent there are issues in evaluation results, engage in dialogue with the applicable ESG evaluation and data providers or companies.
- Publicly clarify the basic approach of how they utilize ESG evaluation and data in their investment decisions.

While the FSA has stressed that the recommendations are voluntary and do not impose formal obligations, it also affirmed that each asset manager should consider implementing these principles as appropriate

in consideration of the nature of its business, confidentiality, and fiduciary obligations. Asset managers using ESG ratings and data should be mindful that the FSA views these measures as an important part of proper ESG rating and data usage.

What labels or categories, if any, are currently required or have been proposed for funds and asset managers?

No formal labels or categories have been established or proposed.

What disclosure and reporting requirements are currently required or have been proposed for funds and asset managers?

Other than the disclosure and reporting requirements under the ESG Guidelines discussed above, there are no ESG-specific disclosure or reporting requirements applicable to funds or asset managers. Note, however, that Japan requires publicly listed companies to provide certain ESG-related disclosures under the corporate disclosure regime.

Are there any current or proposed requirements outside of disclosure and reporting (e.g., product-level investment requirements)?

No. However, the FSA convenes several groups of academic and industry experts to discuss various ESG-related issues in the financial sector. Most recently, on 30 June 2023, an expert panel focused on impact investing issued a report setting forth some draft basic guidelines regarding impact investments and requested public comments until 10 October 2023.

Do the existing or proposed rules apply equally to offshore funds being marketed in the region, or do they apply solely to locally domiciled products?

The FSA has stated that the ESG Guidelines generally do not apply to foreign domiciled investment funds that are managed outside of Japan. While the Supervisory Guidelines primarily apply to asset managers registered in Japan or certain managers that are relying on exemptions that are subject to the FSA's supervision, non-Japanese managers whose asset management services to ESG Funds were delegated to them by Japanese managers may be indirectly impacted as a result of that outsourcing. Accordingly, such non-Japanese sub-managers may ultimately be required to satisfy some of the aforementioned disclosure and reporting requirements.

Are any rules in place for investors (vs funds and fund managers)?

As discussed above, the Code of Conduct for ESG rating and data providers includes recommendations (i.e., not formal rules) for investors, including fund managers. As noted, these include recommendations that certain disclosures be provided and actions be taken by investors with respect to their use of ESG ratings and data.

Are there other actions or initiatives that could impact funds and managers?

No.

What is on the horizon?

We expect that the FSA will continue to be actively engaged in reviewing various ESG-related policy and regulatory issues, as well as setting forth guidelines for ESG-related products.

In addition, Japanese government agencies other than the FSA have also been reviewing ESG-related issues and taking actions that could impact funds and asset managers. For example, on 31 March 2023, the Japan Fair Trade Commission adopted the "Guidelines Concerning the Activities of Enterprises, etc., Toward the Realization of a Green Society Under the Antimonopoly Act" to prevent anticompetitive or unfair conduct and to raise transparency and predictability of the application and enforcement of the Antimonopoly Act. While this is not specifically targeted for funds or asset managers, if managers' conduct, including manners of marketing or distribution focusing on ESG, result in anti-competitive effects, such conduct may be found problematic from an anti-competition perspective.

SINGAPORE

By Ed Bennett

What rules, if any, are currently in place (i.e., have been adopted) for funds and asset managers?

Given the growing international investor interest in ESG-related investment products, in late July 2022, the Monetary Authority of Singapore (MAS) released MAS Circular No. CFC 02/2022 (Circular), setting out ESG disclosure and reporting guidelines to mitigate the risk of greenwashing with respect to a retail ESG fund (called a "scheme" in the Circular).

MAS also used the Circular, which took effect 1 January 2023, to explain how the requirements under the existing Code on Collective Investment Schemes (CIS Code) and Securities and Futures (Offers of Investment) (Collective Investment Schemes) Regulations 2005 (SF(CIS)R) should apply to retail ESG funds.

The Circular pertains to retail "ESG funds" and the related capital markets services (CMS) licensees and approved trustees under Section 289 of the Securities and Futures Act 2001 (SFA) who sponsor and operate such ESG funds.

The Circular defines an "ESG fund" as an authorized or recognized scheme (i.e., fund) that: (a) uses or includes ESG factors as its key investment focus and strategy (i.e., ESG factors significantly influence the scheme's selection of investment assets), and (b) represents itself as an ESG-focused scheme. ESG funds may incorporate sustainable investing strategies with significant ESG influences, such as impact investing and ESG inclusionary investing. This could include broad strategies, such as the application of best-in-class positive screening and ESG tilts, and thematic strategies, such as strategies with a specific focus on ESG outcomes, such as low-carbon transition. Notably, a scheme would not be regarded as having an ESG investment focus if it only uses negative screening or merely incorporates or integrates ESG considerations into its investment process to seek financial returns.

In assessing the compliance of a fund with the Circular, MAS will consider its compliance with the relevant ESG rules in its home jurisdiction, if any. For example, an undertaking for collective investment in transferable securities (UCITS) scheme that is an ESG fund would be considered to have complied with the Circular's disclosure requirements if it complies with Article 8 or 9 of The European Union's Sustainable Finance Disclosure Regulation. However, compliance with the naming requirements under Section B of the Circular (as discussed in more detail below) is still required for any such UCITS fund.

What labels or categories, if any, are currently required or have been proposed for funds and asset managers?

Chapter 4.1 of the CIS Code provides that scheme names must be "appropriate, and not undesirable or misleading." Therefore, should an ESG fund wish

to use an ESG-related name, an ESG focus should be reflected in its investment portfolio or strategy in a substantial manner.

To assess whether a scheme is ESG focused, MAS will consider factors such as whether the scheme's capital is primarily invested in an ESG strategy (i.e., generally, at least two-thirds of the scheme's net asset value must be invested in accordance with an ESG-related investment strategy).

MAS also expects fund managers to explain in each scheme's offering documents how its investments are substantially ESG focused in cases where it is neither possible nor practicable to determine, at the individual asset level, the proportion of a scheme's net asset value that is invested in accordance with ESG investing strategies.

What disclosure and reporting requirements are currently required or have been proposed for funds and asset managers?

Prospectus Disclosure Requirements and Guidelines

The third schedule of the SF(CIS)R sets out the requirements for information to be disclosed in a scheme's prospectus. In addition, the Circular requires that the prospectus of an ESG fund lodged (i.e., filed) with MAS to clearly define ESG-related terms and disclose information relating to the fund's investment focus, investment strategy, reference benchmark, and the risks associated with investing

in the scheme. The Circular sets out some practical examples of the disclosure requirements:

- *Investment Focus*: The ESG focus of the scheme and the relevant ESG criteria, methodologies, or metrics used to measure whether the ESG focus is achieved.
- *Investment Strategy*: An explanation of how the sustainable investing strategy is used to achieve the scheme's ESG focus, the binding elements of the strategy in the investment process, and how the strategy is applied in the investment process on a continuous basis; the relevant ESG criteria, metrics, or principles considered in the investment selection process; and the minimum allocation into assets used to achieve the scheme's ESG focus.
- *Reference Benchmark*: Where the scheme references a benchmark or index to measure whether an ESG focus is achieved, an explanation of how the benchmark or index is consistent with or relevant to its investment focus; and where the scheme references a benchmark or index for financial performance measurement only, a statement to this effect.
- *Risk Factors*: Risks associated with the scheme's ESG focus and investment strategy, such as concentration in investments with a certain ESG focus and limitations of methodology and data.

Annual Report Disclosure Requirements and Guidelines

Annual reports of ESG funds must include the following information:

- Details of how, and the extent to which, the scheme's ESG focus was fulfilled during the financial period—this should include a comparison with the previous period (if any).
- The actual proportion of the scheme's investments that meet its ESG focus (if applicable).
- Actions taken to achieve the scheme's ESG focus, for example, through engaging with stakeholders.

Additional Information Disclosures

Fund managers should disclose, by appropriate means, additional information regarding an ESG fund, such as:

- How the ESG focus is measured and monitored, as well as the related internal or external control mechanisms that are in place to monitor compliance with the scheme's ESG focus on a continuous basis (including methodologies used to measure the attainment of the scheme's ESG focus, if any).
- Sources and usage of ESG data or any assumptions made where data is lacking.
- Due diligence carried out in respect of the ESG-related features of the scheme's investments.
- Any stakeholder engagement policies (including proxy voting) that can help influence corporate behavior of investee companies and contribute to the attainment of the scheme's ESG focus.

Are there any current or proposed requirements outside of disclosure and reporting (e.g., product-level investment requirements)?

No, requirements are currently limited to the enhanced disclosure and reporting obligations described above.

Do the existing or proposed rules apply equally to offshore funds being marketed in the region, or do they apply solely to locally domiciled products?

As noted above, MAS will consider an offshore fund's compliance with its local regulations, to the extent adequately demonstrated by the fund sponsor. MAS will also consider the compliance of a foreign "recognized" scheme with the relevant ESG rules in its home jurisdiction when assessing compliance with the Singapore requirements.

Are any rules in place for investors (versus funds and fund managers)?

There are currently no prescribed ESG-related rules or voluntary codes for investors.

Are there other actions or initiatives that could impact funds and managers?

With the release of the final report of the International Organization of Securities Commissions on "ESG Ratings and Data Products Providers" identifying key areas of concern and providing recommendations for good practices around governance, management of conflicts of interest, and transparency for ESG rating and data product providers, MAS, like other regulators, is developing a regulatory approach to regulate this nascent and rapidly changing industry.

In its consultation paper on "Proposed Code of Conduct for ESG Rating and Data Product Providers," MAS proposed taking a phased and proportionate regulatory approach, starting with a voluntary industry code of conduct (CoC). The CoC sets a baseline industry standard of transparency in methodologies and data sources, governance, and management of conflicts of interest. The CoC will be implemented on a voluntary "comply or explain" basis. Providers would be required to either comply with the best practices set out in the CoC or explain why they have not complied with specific best practices. In order for product users to identify compliant providers and facilitate interoperability for ESG rating and data product providers' global operations, MAS proposed that the providers also comply with a self-attestation checklist. Providers would then publish their checklists to enable industry players to assess and select the appropriate providers to engage.

For the long-term regulation of ESG rating providers, MAS proposed to apply the CMS licensing regime under the SFA to ESG rating providers. The proposed regulatory regime for the provision of ESG rating services will likely emulate the regulatory regime for the provision of credit rating services. As CMS licensees, the ESG rating providers will have to comply with the corresponding regulations, guidelines, and notices under the SFA, including a code of conduct that could be modeled on the CoC. MAS will have supervisory and enforcement powers over ESG rating service providers.

What is on the horizon?

The Singapore Green Plan 2030 (Green Plan) was unveiled in February 2021 to advance Singapore's sustainable development agenda and charts Singapore's green targets over the next decade. The Green Plan includes targets for Singapore to become a leading center for green finance in Asia and globally. Various requirements were identified for green finance to work effectively, such as implementing a consistent set of global disclosure and reporting standards; improving the quality, availability, and comparability of data; and developing taxonomies for green and transition activities.

MAS also launched Project Greenprint in December 2020, which aims to harness technology to support green finance in conjunction with the financial industry—establishing data platforms to mobilize capital for green projects, facilitating the acquisition and certification of climate-relevant data, and monitoring the financial industry's commitments to emissions reductions.

AUSTRALIA

By Jim Bulling

What rules, if any, are currently in place (i.e., have been adopted) for funds and asset managers?

At present, Australia does not yet have a "mandatory" ESG regulatory regime for funds and asset managers. That being said, there are existing statutory requirements relating to the promotion or offer of sustainability-related products, and there are proposals for mandatory climate-related financial disclosure requirements to commence from 1 July 2024.

Funds and asset managers are prohibited from engaging in misleading or deceptive conduct when offering or promoting sustainability-related products. In addition, funds and managers must comply with some bespoke existing disclosure obligations when offering a product disclosure statement for sustainability-related products. These obligations are contained within Section 1013D(1)(I) of the Corporations Act 2001 (Cth) (Corporations Act) and the Regulatory Guide 65 Section 1013DA disclosure guidelines. For example, the Corporations Act requires disclosure regarding the extent to which ESG factors are taken into account in the selection or retention of an investment. The Australian Securities Investment Commission (ASIC), which regulates financial services and markets in Australia, has recently increased enforcement of these obligations.

What labels or categories, if any, are currently required or have been proposed for funds and asset managers?

Currently, there are no specific laws in Australia related to ESG labeling or categories of products (other than the existing obligation to not engage in misleading or deceptive conduct noted above).

However, in August 2022, the Financial Services Council (FSC), the leading body that sets standards and develops policy for its member companies, released guidance on labeling as part of **FSC Guidance Note No. 44 Climate Risk Disclosure in Investment Management** (Guidance Note 44). Guidance Note 44 addresses the use of product labels such as "climate friendly," "net zero," "impact," and "best of sector," and it offers asset managers recommendations as to how they can approach disclosure to ensure it aligns with such labels. The FSC's ESG working group is also currently in the process of finalizing specific guidance for firms that use responsible investment or sustainability-related terms in their investment product labeling, and further guidance is expected to be issued by early October 2023. FSC guidance is, strictly speaking, only relevant for FSC members, but it becomes influential in establishing industry standards.

Additionally, in June 2022, ASIC released **Information Sheet 271** (INFO 271), which clarified the existing obligations against greenwashing and the regulator's expectations for funds and asset managers in this respect. Thereafter, ASIC released **Report 763**, which outlined the regulator's greenwashing interventions from July 2022 through March 2023. Interestingly, one of the four key themes of ASIC's regulatory interventions for this period was "fund labels." The report details the interventions undertaken in instances where financial products or managed funds were not "true to label," meaning that "the names of the products or funds included sustainability-related terms that were inconsistent with the funds' investments or the investment process described." Failure to act in

accordance with ASIC's labeling expectations has attracted enforcement actions, such as corrective disclosure outcomes and infringement notices.

Moreover, under the Australian government's "Sustainable Finance Agenda," there are plans to design and develop a sustainable finance taxonomy. In March 2023, the Australian Sustainable Finance Institute (ASFI) released the final version of its framing paper (Framing Paper), which did not directly address the issue of product labeling but did note that a future taxonomy may be used by ASIC to "establish principles-based guidance that would support intermediaries to label and rate investment products." However, ASIC has yet to give any indication of releasing guidance with respect to labeling.

What disclosure and reporting requirements are currently required or have been proposed for funds and asset managers?

In line with similar approaches globally, most notably the finalization of the International Sustainability Standards Board's (ISSB) disclosure standards, the government plans to introduce a mandatory climate-related reporting regime in Australia.

On 27 June 2023, the Australian Treasury (Treasury) released the **Climate-Related Financial Disclosure Consultation Paper**, which was the second of two consultation papers on the introduction of a mandatory climate disclosure framework in Australia. (A brief summary of the mandatory disclosures is available on the K&L Gates Global Investment Law Watch blog entry dated 30 June 2023, **Australia: Mandatory Climate Disclosures Framework Takes Shape With Release Of New Consultation Paper And ISSB Standards.**) The Treasury's proposed approach in this paper includes three phases of implementation, with reporting commencing from 1 July 2024 for certain large entities, including institutional investors and asset managers, with additional commencement dates in 2026 and 2027 for smaller entities.

The details required to be included in such mandatory reports are:

- Material climate risks and opportunities in their annual reports, using qualitative and eventually quantitative analysis.
- Climate resilience assessments against at least two possible future states, including the Paris Agreement's goal to limit temperature increases to 1.5°C above preindustrial levels and another state of the entity's choice (e.g., net zero emissions by 2050).
- Climate transition plans and targets (if any).
- Scope 1 and 2 greenhouse gas emissions, with scope 3 emissions to follow after a 12-month grace period.[2]

The Australian Accounting Standards Board is now in the process of developing specific Australian standards (that are to be aligned with the ISSB) for consultation later in 2023. The Australian government will also issue further guidance on scenario analysis, stress testing, and transition planning to assist entities in quantifying and disclosing their climate risks.

It is expected that the Australian standards will include specific requirements in relation to the reporting of financed emissions by institutional investors and asset managers.

Guidance Note 44 outlines the expectations for institutional investors and asset managers with respect to setting net zero targets, disclosing climate-friendly investment features, and climate change risk reporting. Similarly, ASIC's INFO 271 provides guidance to institutional investors and asset managers in relation to communications about their sustainability-related offerings and questions to consider in order to avoid greenwashing.

Are there any current or proposed requirements outside of disclosure and reporting (e.g., product-level investment requirements)?

The Australian Prudential Regulation Authority (APRA)—which regulates Australian banks, insurers, and superannuation funds—has outlined its expectations for such entities with respect to their consideration of ESG factors in their investment risk management framework and investment strategy in the draft Prudential Practice Guide, **Draft SPG 530 Investment Governance**. This supports APRA's revised Prudential Standard, **SPS 530 Investment Governance**, which commenced on 1 January 2023. Funds and asset managers are expected to consider ESG factors when forming, implementing, and monitoring their investment risk management framework and investment strategy. This report makes specific reference to the importance of stress testing and due diligence, with APRA expecting entities to consider scenarios that address climate risk, including both physical and transition risks. Once again, these are merely guiding principles and do not create enforceable requirements.

Do the existing or proposed rules apply equally to offshore funds being marketed in the region, or do they apply solely to locally domiciled products?

The disclosure obligations discussed above and the expectations of ASIC in relation to greenwashing will apply to all investment products offered to Australian investors, including those offered by offshore managers. In addition, Australian superannuation funds will be seeking assistance from their asset managers (both local and offshore) in order that they can comply with regulator expectations.

The Treasury's consultation papers do not specifically consider the proposed application of mandatory climate-related reporting regimes application to foreign companies in Australia. In that regard, the proposed mandatory regime applies to certain entities that are required to lodge financial reports under Chapter 2M of the Corporations Act. Accordingly, if a foreign company is required to report under Chapter 2M and meets the required size thresholds, it may be subject to the mandatory climate-related reporting regime.

In any event, where offshore managers are engaged by Australian superannuation funds, those managers will be asked to provide the information that is relevant to superannuation funds' own reporting obligations.

In addition, the regime is proposed to apply to each entity required to report under Chapter 2M of the Corporations Act that is a "controlling corporation" under the National Greenhouse and Energy Reporting Act 2007 (Cth). A controlling corporation is defined as a constitutional corporation that does not have an Australian-incorporated holding company. Interestingly, this can include a foreign-incorporated entity that operates directly in Australia without an Australian-incorporated subsidiary.

However, for now, the regime remains in the consultation stage with final submissions having been received. As such, we await to see if this issue is directly addressed in the future.

Are any rules in place for investors (versus funds and fund managers)?

APRA's Prudential Practice Guide, Draft SPG 530 Investment Governance, has outlined its expectation that Registerable Superannuation Entity (RSE) Licensees clearly articulate the extent to which ESG considerations inform their investment decision making. APRA expects entities to consider ESG factors at all stages of the investment process, including in formulating the investment strategy and determining an appropriate level of diversification, conducting due diligence, and monitoring investment performance. Therefore, as superannuation funds are "RSE Licensees," this will incidentally impact fund managers whose clients are typically superannuation funds; these considerations will be passed from

the superannuation fund through to the manager. However, these considerations are guidance only and are not requirements.

Are there other actions or initiatives that could impact funds and managers?

There has been a significant increase in ASIC enforcement actions against greenwashing in the last 12 months. Information about the ASIC's Report 763 is available on the K&L Gates Global Investment Law Watch blog in a post dated 16 May 2023 (**Australia: ASIC Releases Report On Recent Greenwashing Actions**). ASIC has provided an overview of the 35 greenwashing interventions that have taken place from July 2022 through March 2023. The regulatory interventions during this period consisted of 23 corrective disclosure outcomes, 11 infringement notice issues totaling more than AU$150,000 (with a further infringement notice issued shortly after the report was finalized), and one commencement of civil penalty proceedings.

ASIC's regulatory interventions can be broadly categorized into one of the following categories:

- Net zero statements and targets not having a reasonable basis or are factually incorrect.
- Unreasonable use of terms, such as "carbon neutral," "low carbon," "clean," or "green."
- Scope and application of sustainability-related investment screens being overstated or inconsistently applied.
- Inaccurate labeling and vague terms in sustainability-related funds.

Since the release of Report 763, ASIC has commenced civil penalty proceedings against two large asset managers for engaging in sustainability-related misleading conduct and misrepresentations. This is ASIC's third greenwashing enforcement action against asset managers this year.

Likewise, as part of the "Sustainable Finance Agenda," the government has outlined its intention to increase funding for ASIC in support of enforcement actions against greenwashing. In August 2023, ASIC released its **Corporate Plan for 2023–2027**, in which the regulator announced that greenwashing enforcement was key to support their "sustainable finance" strategic priority. We therefore expect ASIC's focus on greenwashing to increase, such that funds and asset managers will increasingly have to monitor their disclosures and manage their risk of greenwashing.

What is on the horizon?

There is significant change on the horizon for Australia's ESG regulatory landscape. In this respect, the government's "Sustainable Finance Agenda" has detailed what to expect for the next four years. This includes:

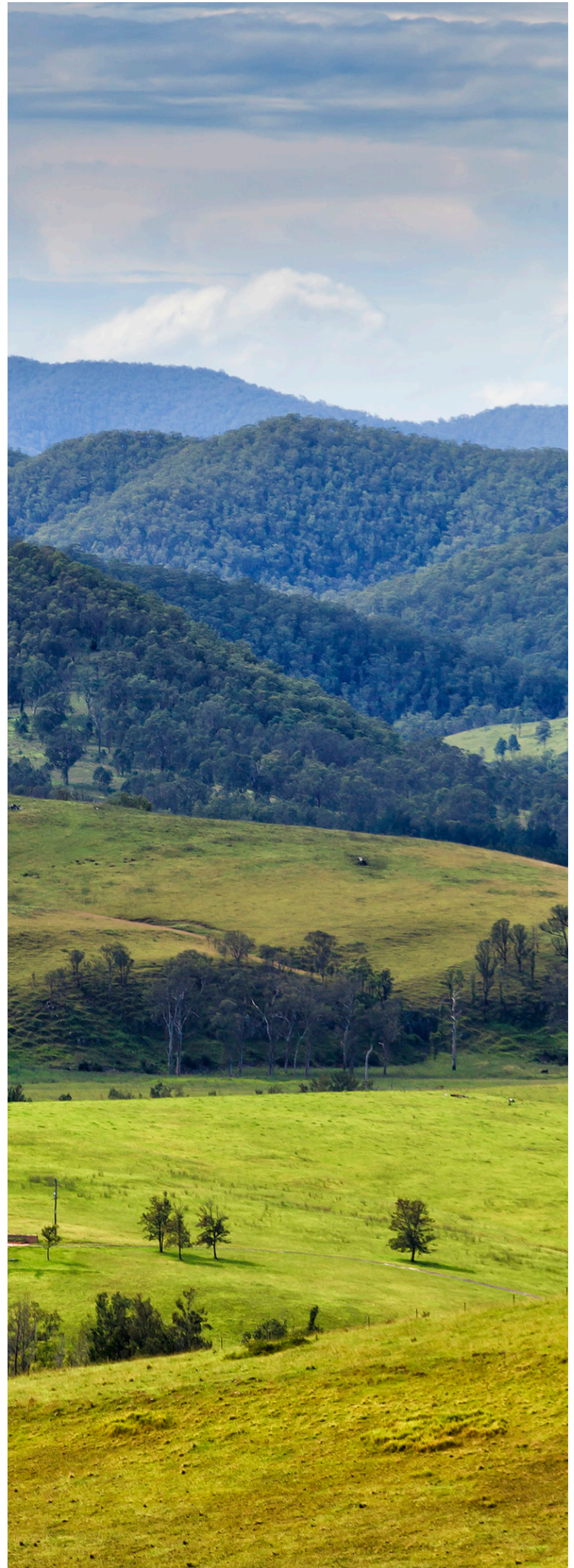
- Funding to ASIC to support enforcement action against greenwashing.
- The introduction of mandatory reporting and disclosure standards.
- Increasing support for the initial development of a sustainable finance taxonomy in Australia.
- The establishment of a sovereign green bonds program.

The ASIC chair has also stated the regulator's intention to address the phenomenon of "greenhushing" (i.e., intentionally not mentioning ESG goals or strategies) in two speeches in June 2023. He cautioned that silence by firms with respect to ESG was, in ASIC's view, another form of greenwashing. We expect to see enforcement actions taken by ASIC with respect to this.

In a media release in July 2023, ASIC's deputy chair highlighted the immediate imperative for companies to begin implementing appropriate processes, practices, and governance ahead of the future reporting requirements that will be aligned with the ISSB. Accordingly, fund and

asset managers must now begin considering the potential implications of the new ISSB standards in order to be well placed to transition to future climate-related disclosure standards in Australia.

As discussed above, the finalization of a sustainable finance taxonomy in Australia is also on the horizon. The ASFI Framing Paper previously noted recommends that the taxonomy cover key sustainability objectives, including climate mitigation and adaption, environmental management, resource resilience, and social objectives. In addition, it recommends that reporting on taxonomy alignment be mandatory where companies are seeking to make claims regarding the sustainability objectives of their activities or products. The initial development phase commenced on 1 July 2023 and will concern the development of screening criteria for at least three priority sectors and other associated technical work.



EUROPE

EUROPEAN UNION

By Philipp Riedl, Michelle Lloyd (Ireland), Aine Ni Riain (Ireland) and Adam Paschalidis (Luxembourg)

What rules, if any, are currently in place (i.e., have been adopted) for funds and asset managers?

Sustainable Finance Disclosure Regulation

The European Union's Sustainable Finance Disclosure Regulation (SFDR)[3] and its Delegated Regulation[4] require financial market participants (including fund managers and other asset managers) to make certain prospectus, website, and other disclosures regarding how sustainability is integrated at both the financial market participant level and the applicable product level. As discussed in greater detail below, the SFDR, which is primarily intended to prevent greenwashing and address concerns regarding unsystematic and inconsistent disclosures, requires in-scope firms to provide information about, among other things, sustainability risks and ESG strategies in the investment decision-making process and advisory processes.

EU Taxonomy Regulation

The EU Taxonomy Regulation[5] and its Delegated Regulations set out a classification system (the EU Taxonomy) that establishes economic activities that can be considered environmentally sustainable. Under the EU Taxonomy Regulation, an activity is considered environmentally sustainable if the activity:

- Contributes to one of six environmental objectives identified in the EU Taxonomy Regulation.
- Does not do any significant harm to any of the six environmental objectives.
- Avoids violation of minimum social impacts.
- Complies with the relevant technical screening criteria.

The EU Taxonomy Regulation is referenced by other legal acts, including the SFDR. A financial product (e.g., a fund or a managed account) is making environmentally sustainable investments if its investments are aligned with the EU Taxonomy Regulation.

Organizational Requirements

EU financial market players—including undertaking for collective investment in transferable securities (UCITS) management companies, alternative investment fund managers (AIFMs), and firms subject to Markets in Financial Instruments Directive II (MiFID) (e.g., investment firms, broker-dealers, and other entities that provide investment-related services)—are required to observe specific ESG-related measures relating to ESG risk management. For example, such firms must take into account risks related to sustainability with respect to reporting, risk controlling, and internal policies.

MiFID Code of Conduct

MiFID firms that provide investment advice are required to consider their clients' sustainability preferences when determining the clients' respective investment objectives and selecting suitable financial products. For example, such firms must consider the extent to which clients require that a minimum portion of their assets be invested in environmentally sustainable investments (EU Taxonomy-aligned) or other sustainable investments (as defined in the SFDR) and whether clients require that financial products consider principal adverse impacts on sustainability factors (PAI). MiFID firms must also take into account sustainability risks when providing investment advice.

What labels or categories, if any, are currently required or have been proposed for funds and asset managers?

While the European Union has not formally adopted ESG "labels" or "categories" for financial products, market participants, in practice, refer to financial

products according to the applicable SFDR disclosure obligations:

- "Article 6 product"—no ESG strategy.
- "Article 8 product"—ESG strategy.
- "Article 8+ product"—ESG strategy and a minimum proportion of EU Taxonomy-aligned investments or other sustainable investments (SFDR-aligned).
- "Article 9 product"—exclusively EU Taxonomy-aligned investments or other sustainable investments (SFDR-aligned).

The disclosure obligations are described in greater detail below.

What disclosure and reporting requirements are currently required or have been proposed for funds and asset managers?

The SFDR and EU Taxonomy Regulation provide for four basic disclosure and reporting obligations:

Sustainability Risks (SFDR Articles 3, 5, and 6)

Financial market participants are required to disclose if and how they integrate sustainability risks into their investment decisions in relation to a financial product, as well as the impact of sustainability risks (including transition risks) on the returns of the financial product and the remuneration of their employees. To the extent that sustainability risks are considered irrelevant, participants must explain why. These disclosure requirements apply to all financial markets participants and to all financial products. Disclosures must be made on an entity (i.e., firm, asset manager) level on the firm's website and on a product (i.e., fund, managed account) level in a precontractual document (e.g. prospectus, private placement memorandum).

PAIs (SFDR Articles 4 and 7)

All financial market participants are generally required to comply with the PAI disclosure requirements on an entity level and product level. Accordingly, firm websites and product documents must include disclosures regarding how principal adverse impacts on environment, social, and employee matters are considered when investment decisions are made. In addition, on an annual basis, firms and products must provide information about quantitative impacts (e.g., greenhouse gas—or GHG—emissions, energy consumption) of the firm's managed portfolio and the respective product. An exemption from this disclosure requirement may be available for smaller firms.

Sustainable Investments (SFDR Articles 9, 10, and 11)

All market participants are required to disclose on a product level the extent to which, and how, an applicable financial product has environmentally sustainable investments (EU Taxonomy-aligned) as its investment objective or explain that it has no such investments.

In addition, if a financial product invests 100% in EU Taxonomy-aligned investments or other sustainable investments (SFDR-aligned), additional information must be provided in firm and product documents (e.g., product prospectus, firm website).

Environmental or Social Characteristics (SFDR Articles 8, 10, and 11)

Likewise, if a financial product promotes environmental or social characteristics, information must be provided regarding such characteristics, the indicators used to measure the attainment of the promoted ESG strategy, and the binding elements of the ESG strategy. At the moment, the SFDR does not provide for specific requirements on the envisaged ESG strategy of the product. For financial products promoting environmental or social characteristics and, in addition, committing to make a minimum proportion of sustainable investments (Article 8+ financial products), information regarding allocation of sustainable investments is also required.

Are there any current or proposed requirements outside of disclosure and reporting (e.g., product-level investment requirements)?

It is expected that the European Securities and Markets Authority (ESMA) will soon be issuing guidelines for fund names containing ESG or sustainability-related terms. Such guidelines will apply to UCITS management companies, AIFMs, and other asset managers.

The proposed guidelines aim to reduce greenwashing risks by ensuring that funds' names are fair, clear, and not misleading and that they use ESG and sustainability-related terminology only when the funds have certain sustainability characteristics or objectives. Accordingly, it is expected that the guidelines will include quantitative thresholds for using ESG and sustainability-related terms in fund names.

Under the proposed guidelines, any fund that has ESG-related words in its name must have at least 80% of its investments meet the environmental or social characteristics or sustainable investment objectives in accordance with the binding elements of the SFDR disclosed investment strategy.

Using the word "sustainable" or any other term derived from it in the fund's name will require the fund manager to allocate within the 80% of ESG investments at least 50% to sustainable investments (SFDR-aligned).

Do the existing or proposed rules apply equally to offshore funds being marketed in the region, or do they apply solely to locally domiciled products?

The disclosure and reporting requirements described above also apply to non-EU asset managers and funds (i.e., an AIFM from a non-EU country that carries out its activities within the European Union based on national law exemptions, such as through a private placement). However, it is unclear whether a non-EU fund would be required to comply with the foregoing obligations if it sells shares (i.e., units) to EU investors based on an unprovoked reverse solicitation.

Are any rules in place for investors (versus funds and fund managers)?

There are no rules in place for retail investors. If an investor in a fund itself is a fund, the same disclosure rules apply to the investing fund. For example, a fund carrying out exclusively sustainable investments and disclosing under SFDR Article 9 may, if acting as fund investor, only invest in target funds holding exclusively sustainable investments. Insurance companies will have to consider sustainability criteria as part of their risk management and disclosure obligations.

Are there other actions or initiatives that could impact funds and managers?

The SFDR Delegated Regulation will be reviewed and amended in the near future. The three European supervisory authorities responsible for asset managers and other investment firms, banks, and insurance companies recently proposed significant changes to the existing requirements, including proposing new sustainability indicators in relation to PAIs and additional disclosure requirements regarding the "do no significant harm" principle. Mandatory disclosure regarding GHG emissions reduction targets was also proposed.

What is on the horizon?

In addition to the anticipated changes noted above, ESMA launched its so-called "Sustainable Finance Roadmap 2022–2024," which includes the following initiatives:

- Developing minimum sustainability criteria or a combination of criteria for financial products that disclose under SFDR Article 8.
- Clarifying the indicators for climate- and environment-related PAI.
- Introducing PAIs on social and employee matters, human rights matters, anti-corruption matters, and anti-bribery matters.
- Enabling financial market participants to systematically consider positive and negative sustainability impacts of their investment decisions.

In addition, the European Union is planning to introduce a regulatory framework for ESG rating agencies that is intended to enhance their transparency and integrity.

Considerations for Ireland and Luxembourg

Asset managers offering funds or other services in EU countries should bear in mind that some such individual countries may have additional considerations or guidelines. Two examples of that are Ireland and Luxembourg, which are popular European domiciles for cross-border fund distribution. Asset managers should identify any additional requirements imposed by the particular countries in which they provide advisory services.

Ireland

The position in Ireland is to apply the requirements of SFDR without any "gold-plating" (i.e., implementation that exceeds what is necessary to incorporate a directive). The Central Bank of Ireland (the Central Bank) is nonetheless very focused on its role as a key gatekeeper in this area, with Ireland being the second-largest, and fastest-growing, fund domicile in the European Union and the largest exchange-traded fund domicile in Europe. Of all Irish-domiciled funds, approximately 25% are Article 8, Article 8+, or Article 9 funds, and that portion of the overall Irish-domiciled fund universe is expected to grow.

To date, the majority of SFDR-related precontractual disclosures have been submitted and approved by the Central Bank without review, facilitated by "fast-track" filings accompanied by certifications of compliance. The Central Bank conducted a review last year of certain of these submissions as part of its 2022 "Gatekeeper Review" and published its findings and expectations. Generally, the expectations cited were consistent with those that had previously been issued by the ESMA and the European Commission, and the Central Bank has been conscious about not contributing to regulatory divergences at the European level. The Central Bank's Gatekeeper Review did, however, emphasize the importance of disclosing fund-specific sustainability risks.

In the first quarter of 2023, the Central Bank reviewed the portfolios underlying funds of varying ESG-related commitments, in particular to ascertain whether the underlying portfolios of funds in fact reflected the level of ESG focus suggested by their precontractual disclosures, although its findings have not yet been published.

ESMA announced in July 2023 that it, along with other European national competent authorities (including the Central Bank), is launching a Common Supervisory Action (CSA) on the integration of sustainability risks and on sustainability-related disclosures in the investment fund sector. The CSA is intended to assess adherence to rules and standards, gather information on greenwashing, and identify further supervisory and regulatory intervention cases. The review is expected to conclude in the third quarter of 2024, and the Central Bank has already issued questionnaires to certain asset managers as part of the information-gathering phase of the project. It is likely that the Central Bank will publish a report on its findings during the course of the review and a clarification on how its expectations could better be met in relation to Irish-domiciled funds and managers.

Luxembourg

In an effort to justify Luxembourg's reputation as an attractive place to organize and operate investment funds, particularly alternative investment products, while also maintaining quality control, the Luxembourg financial regulator, Commission de Surveillance du Secteur Financier (CSSF), has, since the SFDR started to be enforced, attempted to (i) create a level and transparent playing field for all financial market participants (FMPs) conducting business in Luxembourg, and (ii) facilitate FMPs' compliance with SFDR requirements, which at least some FMPs may find demanding. In seeking to achieve these goals, the CSSF (i) implemented an expedited process for FMPs to review, amend, and obtain CSSF authorization[6] for their funds' documents for purposes of complying with SFDR disclosure requirements, and (ii) requires investment fund managers, among others, to complete an SFDR questionnaire that will be used to determine the level of compliance of the FMPs with SFDR and ESG standards.

UNITED KINGDOM

By Michelle Moran and Philip Morgan

What rules, if any, are currently in place (i.e., have been adopted) for funds and asset managers?

The UK Financial Conduct Authority (FCA), the regulator of funds and asset managers, has stated that it sees tackling greenwashing as a core regulatory priority. Current UK requirements impacting asset managers that wish to make ESG-related claims to UK persons are set forth in various rules and guiding principles regarding marketing and retail investor protection. These include, for example, the rules on misleading advertisements under the Misrepresentation Act 1967 and Sections 89 and 90 of the Financial Services Act 2012, which in effect prohibit "greenwashing" and other forms of misrepresentation. Other rules and codes apply in relation to businesses, including asset managers, funds and fund distributors, and selling to retail investors, such as the rules found in the UK Competition and Markets Authority's "**Green Claims Code**."

In its 2021 "**Policy Statement on enhancing climate-related disclosures by asset managers, life insurers and FCA-regulated pension providers" (PS21/24)**, the FCA introduced rules and guidance concerning the approach taken by FCA-authorized firms to ESG matters, particularly with respect to disclosure of climate-related financial information. These ESG-related disclosure rules are contained in the ESG sourcebook, which is part of the FCA's Handbook of Rules and Guidance and are currently applicable to FCA-authorized firms with at least £5 billion of assets under management. Specifically, an in-scope firm must prepare and publish a Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD) "entity report" (i.e., a public report that outlines an asset manager's approach to climate-related matters when managing or administering investments on behalf of clients) and "public TCFD product reports" (i.e., reports containing disclosures regarding key metrics, such as greenhouse gas emissions, in relation to the funds and separate accounts managed by the asset manager) on an annual basis. FCA guidance also encourages UK asset managers to assess the extent that they have considered the United Kingdom's commitment to a net zero economy in developing and disclosing their transition plan as part of their entity report or otherwise explain why they have not done this.

FCA-authorized firms must also comply with the FCA's rules and guiding principles, including the overarching Principles for Business (Principles), which set out, as enforceable rules, high-level standards of market conduct. The Principles include, for example, requirements that (a) firms must conduct business with integrity; (b) firms must communicate information to their clients in a manner that is clear, fair, and not misleading; and (c) firms must ensure that a communication or a financial promotion is fair, clear, and not misleading.

Managers of FCA-authorized funds also need to consider the FCA's guiding principles on design, delivery, and disclosure of ESG and sustainable investment funds set forth in the FCA's "**Dear Chair" letter**, dated 19 July 2021 (Guiding Principles), which we referred to in an alert available on the K&L Gates HUB website (**ESG Regulatory Developments In The UK, Japan, And Hong Kong**). The Guiding Principles are statements of the FCA's expectations for UK FCA-authorized funds that make ESG-related claims; they do not apply to funds that merely integrate ESG considerations into their mainstream investment processes. Rather than introduce new requirements, the Guiding Principles are based on existing rules, and their primary aim is to prevent greenwashing in FCA-authorized funds' disclosures. While the Guiding Principles are relevant for the design of new products, they apply equally to existing ones and should be considered by firms in their next periodic review of a relevant product that makes ESG or sustainability claims.

What labels or categories, if any, are currently required or have been proposed for funds and asset managers?

There are currently no rules specific to asset managers and investment funds on labeling and categorization. However, the FCA proposed new Sustainability Disclosure Rules (SDR) in an October 2022 **Consultation Paper on "Sustainability Disclosure Requirements (SDR) and investment labels" (CP22/20)** (Consultation Paper). The proposals in the Consultation Paper are a starting point for a regime that the FCA has stated will (at least initially) apply to (broadly) FCA-authorized asset managers and will expand and evolve over time and introduce certain core elements: (a) sustainable investment labels, (b) qualifying criteria that firms must meet to use a label, (c) product- and entity-level disclosures, and (d) naming and marketing rules.

At a high level, the FCA has proposed a new "anti-greenwashing" rule, which is expected to apply to all FCA-regulated firms beginning in late 2024. Although this will not result in any substantive change to current law, it will establish a direct link between the existing general rules and principles in the FCA Handbook and sustainability claims. In addition, the FCA has proposed the following optional labeling regime for FCA-authorized firms, which is also expected to apply beginning in late 2024:

- *Sustainable Focus*: Products that have an objective to invest at least 70% of their assets in investments that meet a credible standard of environmental or social sustainability, or that align with a specified environmental or social sustainability theme.
- *Sustainable Improvers*: Products that have an objective to deliver measurable improvements in the sustainability profile of their assets over time, including through investor stewardship.
- *Sustainable Impact*: Products that have an objective to achieve a predefined, positive, and measurable environmental or social impact. These products are typically highly selective, emphasizing investment in assets that offer solutions to environmental or social problems and that align with a clearly specified theory of change.

While the above requirements would not apply to non-UK funds, even where sold to UK investors, the FCA has disclosed its intention to undertake a separate consultation on how these non-UK funds should be regulated.

What disclosure and reporting requirements are currently required or have been proposed for funds and asset managers?

As noted above, certain current disclosure requirements are set forth in the ESG sourcebook, which require annual disclosures by in-scope asset managers of

climate-related financial information consistent with the TCFD Recommendations and Recommended Disclosures at both an entity level (i.e., the TCFD entity report) and product level (i.e., the public TCFD product reports). We have also noted above the FCA's current Guiding Principles, which seek to provide guidance to in-scope asset managers on compliance with existing rules relevant to greenwashing.

In regard to proposed disclosure and reporting requirements, the Consultation Paper envisages product- and entity-level disclosures for in-scope asset managers as part of the SDR. These call for simplified consumer-facing disclosures that, through the use of plain language, will help consumers understand the key sustainability-related features of a product and certain detailed disclosures. The latter would include (a) disclosures in offering documents (e.g., fund prospectuses) regarding a product's sustainability-related features; (b) for products that have a sustainability label, ongoing sustainability-related performance information in sustainability product reports; and (c) sustainability entity reports covering how firms are managing sustainability-related risks and opportunities (whether a firm uses a sustainability label or not).

Are there any current or proposed requirements outside of disclosure and reporting (e.g., product-level investment requirements)?

As part of the SDR, the FCA has proposed to prohibit FCA-regulated firms that provide in-scope products to retail investors from using certain sustainability-related words in their product names and marketing unless the products qualify for a sustainability label (as discussed above). Such prohibited terms would include "ESG" (or "environmental," "social," or "governance"), "climate," "impact," "sustainable" or "sustainability," "responsible," "green," "sustainable development goals," "Paris-aligned," or "net zero." The FCA also proposed that "Sustainable Focus" or "Sustainable Improvers" products be prohibited from using the term "impact" in product names and marketing. This proposal would codify existing guidance in the Guiding Principles.

The FCA has also proposed, as part of the SDR, that where in-scope products are offered to retail investors and have a sustainable investment label, distributors must display prominently, and keep up to date, the correct label on a relevant digital medium (e.g., product webpage) and provide access to the accompanying retail investor-facing disclosures. For products that do not use a sustainable investment label, the distributor would nevertheless be required to provide retail investors with access to the retail investor-facing disclosure.

Do the existing or proposed rules apply equally to offshore funds being marketed in the region, or do they apply solely to locally domiciled products?

No, the existing and proposed rules do not apply equally to offshore funds being marketed in the United Kingdom. However, as previously noted, the FCA intends to undertake a separate consultation on how the proposals in the Consultation Paper may be applied with respect to offshore funds.

Are any rules in place for investors (versus funds and fund managers)?

There are specialist rules in place for, for example, pension schemes, which aim to create greater transparency and oversight within the pension sector. Trustees of certain pension funds are required to report and publish climate-related risks. The impact on funds and fund managers is that if their underlying investors include an affected pension scheme, the relevant pension scheme investor may insist on a fund or fund manager making pertinent disclosures to the pension scheme to allow the scheme to assess climate-related risks.

Also, the FCA intends to expand the scope of the SDR regime to certain FCA-regulated asset owners and other investment products (e.g., pensions).

Are there other actions or initiatives that could impact funds and managers?

Not at this time, but other actions are expected to be taken in the future, as discussed above and below.

What is on the horizon?

The FCA has indicated that the disclosure requirements set out in the Consultation Paper are only a starting point and that it intends to develop rules and guidance over time, such as by adding more specificity to both product- and entity-level disclosure requirements under the SDR as the International Sustainability Standards Board (ISSB) develops its sustainability disclosure standards.

In addition to developing proposals to expand the scope of investment products captured under the SDR, the FCA has expressed its intention to expand the regime in the following areas:

- *Overseas Products*: The FCA will continue to consider options for how to treat offshore products.
- *Financial Advisers*: The FCA is exploring rules for financial advisers regarding advisers' consideration of sustainability factors when providing investment advice and understanding investors' preferences regarding sustainability to ensure product suitability.
- *Listed Issuers*: The FCA intends to consult on adapting its TCFD-aligned disclosure rules for listed issuers to reference the ISSB's standards, once finalized and made available for use in the United Kingdom.
- *Disclosure of Transition Plans*: The FCA intends to build on its TCFD-aligned disclosure rules, which reference the TCFD's guidance on transition plans.
- *Taxonomy-Related Disclosure Requirements*: The FCA will consider how to update its product-level disclosure requirements to include relevant disclosures once the UK Green Taxonomy is developed.

CONCLUSION

As reflected above, the global ESG landscape is widely varied, with jurisdictions addressing ESG matters in their own ways with their own goals. This can cause challenges for asset managers who seek to deploy asset management services and investment funds at scale and consistently around the globe. It is not possible at this point to develop a single "highest common factor" approach applicable to all jurisdictions, as some are imposing labeling requirements, while others are focusing on disclosure, and only some regions have prescriptive process requirements with respect to risk identification and product integrity. As a result, the global ESG landscape will remain an area requiring significant compliance resources for the foreseeable future. Indeed, some asset managers may consider creating bespoke products to address the regulatory needs of individual jurisdictions rather than trying to comply with multiple regulatory regimes.

That said, there are some common themes that suggest some practical approaches asset managers can take to address these differing requirements. Specifically, clear and accurate disclosure to investors remains of paramount importance in all jurisdictions. As a result, asset managers operating in this fragmented global environment should take extra care to ensure that their ESG strategies are clearly described and that their portfolio managers are following any ESG processes that are communicated to investors. In addition, asset managers should ensure that their marketing materials do not overstate their ESG features. Not only could such overstatements create regulatory concerns in and of themselves, such statements may also create different regulatory obligations in some jurisdictions with respect to labeling, disclosures, or testing.

ENDNOTES

[1] Please note that individual countries within the European Union may impose additional ESG-related requirements or restrictions. While we touch on some particular considerations for Ireland and Luxembourg, asset managers should consider whether the particular EU countries that they perform services in have introduced rules or guidelines that exceed those that apply to all EU members.

[2] Scope 1 emissions are “direct” emissions, which a company causes by operating the things that it owns or controls. Such emissions can result from operating machinery to make products, driving vehicles, cooling buildings, or powering computers and other equipment. Scope 2 emissions are “indirect” emissions created by the production of the energy bought by a company, such as the fossil fuels generated by a company using purchased electricity. Scope 3 emissions are anticipated to be the most common form of emissions for asset managers, as they are “indirect” emissions from activities upstream or downstream in a company’s value chain (e.g., emissions from investments).

[3] 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.

[4] Commission Delegated Regulation (EU) 2022/1288 of 6 April 2022 supplementing Regulation (EU) 2019/2088 of the European Parliament and of the Council with regard to regulatory technical standards specifying the details of the content and presentation of the information in relation to the principle of do no significant harm, specifying the content, methodologies, and presentation of information in relation to sustainability indicators and adverse sustainability impacts, and the content and presentation of the information in relation to the promotion of environmental or social characteristics and sustainable investment objectives in precontractual documents, on websites, and in periodic reports.

[5] 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, and amending Regulation (EU) 2019/2088.

[6] Information about the process is available at **https://www.cssf.lu/en/2021/02/communication-on-the-sfdr-fast-track-procedure-and-the-deadline-of-10-march-2021/,** and (second round) **https://www.cssf.lu/en/2022/09/communication-to-the-investment-fund-industry-on-sfdr-rts-confirmation-letter/**.

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