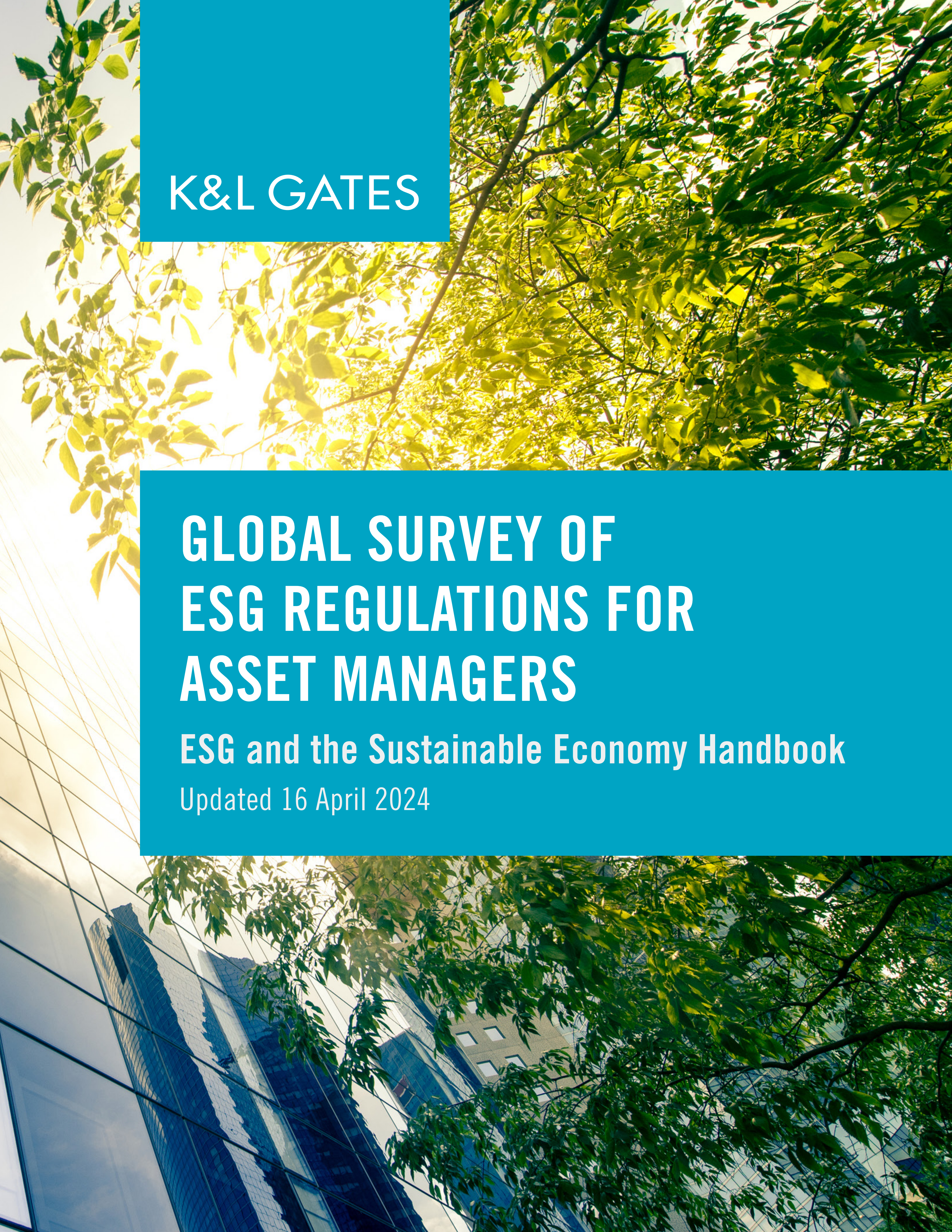

K&L GATES

GLOBAL SURVEY OF ESG REGULATIONS FOR ASSET MANAGERS

ESG and the Sustainable Economy Handbook

Updated 16 April 2024

CONTENTS

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 are 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.

WHAT IS NEW?

The global landscape of ESG regulation continues to evolve quickly. Below are some of the key changes that occurred since the last publication of this survey on 5 February 2024:

United States: While the Securities and Exchange Commission (SEC) has not yet adopted final ESG rules for funds and advisers (which were expected in 2023), it did approve climate risk-related reporting rules applicable to public operating companies and other issuers. These rules were promptly challenged and are currently under judicial review.

Japan: The Financial Services Agency of Japan (FSA) adopted guidelines setting forth certain concepts and factors to be considered in pursuing impact investments.

Singapore: Starting in 2025, listed companies in Singapore will be required to make certain greenhouse gas (GHG) emissions disclosures.

Australia: Draft legislation for mandatory climate-related financial disclosures was introduced into Parliament and has now been referred to the Senate Economics Legislation Committee for inquiry and final report by 30 April 2024.

European Union: EU institutions agreed to introduce a regulatory framework for ESG rating agencies that is intended to enhance their transparency and integrity. In addition, the Luxembourg financial regulator, Commission de Surveillance du Secteur Financier (CSSF), published its supervisory priorities in the area of sustainable finance, which outlines four focus areas (credit institutions, asset managers, investment firms, and issuers), and indicates which aspects of those areas will be prioritized.

United Kingdom: The UK Financial Conduct Authority (FCA)'s new Sustainability Disclosure Rules will start to come into force on 31 May 2024.

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?

At the federal level, no formal ESG-specific rule is currently in place for funds and advisers (i.e., fund managers), but in March 2024, the SEC finalized its climate risk-related reporting rules applicable to public operating companies and other issuers of securities in the United States. While these rules do not apply to funds (except for business development companies), they have implications for advisers and funds that may be able to use the information required by the rules in their investment processes, disclosures, and reporting.

In addition to SEC reporting requirements, the state of California has passed legislation that would require companies "doing business" in California to make certain disclosures of their emissions and climate-related risks. Other states have adopted—or are considering adopting—various laws or regulations that seek to regulate how and whether ESG factors may be considered by those conducting business in such states. In general, these laws and regulations require advisers to consider only "pecuniary" factors, and advisers that consider ESG factors in investing may be subject to sanction. Other states have adopted legislation that would prohibit the state government from doing business with or investing with firms that avoid investment in certain industries for ESG purposes.

While there are no laws or regulations specifically relating to ESG disclosures for funds or advisers as of the date of this survey, the existing federal 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 in place procedures ensuring 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 27 May 2022, **SEC Takes First Step Toward Standardized ESG Disclosures for Funds and Investment Advisers**, 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 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.

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.

In addition, as noted below, the SEC finalized rule amendments that introduce new requirements for Registered Funds and business development companies with names suggesting an "investment focus." In doing so, the SEC specifically identified the consideration of ESG factors as an element suggesting an "investment focus."

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 seeks 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 are 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 September 2023, the SEC adopted rule amendments that introduced 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 at the federal level. 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 in their investment processes and engagement strategies. In some cases, funds would need to provide disclosure about their consideration of 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 relating to ESG considerations (available as an alert on the K&L Gates HUB website on 25 May 2023, **The ESG Debate Heats Up: State AGS Investigating Asset Manager Involvement In ESG Initiatives And Related Proxy Voting**).

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 climate risk-related reporting rules described above will require US public operating companies and other issuers to include certain disclosures regarding the financially material climate risks associated with their businesses and operations, including by requiring Scope 1 and Scope 2 emissions information. As noted, these rules have already been subject to challenge.

In addition, various US states, such as California (as described above), 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.

What is on the horizon?

As noted above, the 2022 Proposal is currently under consideration by the SEC, and the challenges relating to the climate risk reporting rules seem to just be beginning. In addition, since the California reporting legislation has been challenged in court, it remains to be seen how and whether this legislation will be implemented, and whether other states—which continue to consider ESG-related legislation—will do so as actively as they did last year.

ASIA

HONG KONG

By 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. Undertakings for 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 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 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 GHG 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, adopted the ISSB standards on a fully converged basis. Unlike IFRS accounting standards, the ISSB standards are not 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 (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 in 2023 (conclusions currently pending) to enhance the ESG reporting in line with ISSB standards beginning 1 January 2025. 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 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 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.
- 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.

In November 2021, the International Organization of Securities Commissions 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. A working group comprised of Hong Kong and international representatives from the ESG ratings and data products industry was established to develop a voluntary code of conduct for ESG ratings and data providers.

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 Comprehensive Guidelines for Supervision of Financial Instruments Business Operators (Supervisory Guidelines) issued by the FSA require asset managers to make certain disclosures and implement certain organizational or operational and due diligence measures (ESG Guidelines) regarding 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 publication).
- *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 companywide 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 Resources*: 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 subadviser or submanager), 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," which are attached to the Code 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, upon public consultation on 29 March 2024, the FSA adopted the "Basic Guidelines on Impact Investment (Impact Finance)," setting forth certain concepts and factors to be considered in pursuing "impact investments" (Impact Investment Guidelines). The Impact Investment Guidelines highlight four specific elements of impact investments: (a) intention; (b) contribution; (c) identification, measurement, and management; and (d) accelerating market transformations. They also provide guidance regarding these concepts. For example, with respect to intention, they describe how intended social and environmental impacts can be or should be clarified. The stated purposes of the Investment Guidelines include setting forth shared understandings and expectations for concepts relating to impact investments among asset managers, investors, and other stakeholders, and encouraging further discussions among them. While the Impact Investment Guidelines do not create any legal or regulatory obligations per se, asset managers may want to consider these elements when providing services to Japanese investors in the area of impact investments.

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 Japan 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 (versus 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?

Recently, the FSA announced that it will convene a group of certain stakeholders—including asset managers, brokers, and retail investors—to discuss issues relating to sustainability investment products. In the announcement, the FSA also indicated that it plans to issue a report based on the group's meetings in mid-2024. The ultimate purpose appears to be to promote investments by retail investors in sustainable investments.

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 anticompetitive effects, such conduct may be found problematic from an anticompetition perspective.

SINGAPORE

By Ed Bennett and Ke Jia Lim,
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The Singapore section of this publication is issued by K&L Gates Straits Law LLC, a Singapore law firm with full Singapore law and representation capacity, and to whom any Singapore law queries should be addressed. K&L Gates Straits Law is the Singapore office of K&L Gates LLP.

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, a 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 SFDR. 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 on 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.

On 3 December 2023, MAS launched the Singapore-Asia Taxonomy for Sustainable Finance (the Taxonomy). The Taxonomy sets out detailed thresholds and criteria for defining green and transition activities that contribute to climate change mitigation across eight focus sectors: energy, industrial, carbon capture and sequestration, agriculture and forestry, construction and real estate, waste and circular economy, information and communications technology, and transportation.

This initiative is designed to mitigate the risk of greenwashing and ensure that financed activities are on a credible path to net-zero emissions.

Transition activities are defined through two approaches:

- A "traffic light" system that defines green, transition, and ineligible activities across the eight focus sectors. In this context, "transition" refers to activities that do not meet the green thresholds now but are on a pathway to net-zero—or contributing to net-zero outcomes.
- A "measures-based approach" that seeks to encourage capital investments into decarbonization measures or processes that will help reduce the emissions intensity of activities and enable the activities to meet the green criteria over time.

MAS plans to collaborate with industry stakeholders and government agencies to explore the Taxonomy's use in developing taxonomy-aligned financial instruments, accelerating the flow of capital into green and transition activities, and encouraging companies to disclose transition plans and use the Taxonomy to support these disclosures.

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 clearly defines 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, including 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 (e.g., 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.

Climate Reporting

From financial year (FY) 2025, listed companies in Singapore will be required to make ISSB-aligned climate-related disclosures of GHG emissions if any three of the following categories of GHG emissions are applicable:

- *Scope 1 GHG emissions*: Direct emissions from owned or controlled resources of the entity.
- *Scope 2 GHG emissions*: Indirect emissions from the generation of purchased energy by the entity.
- *Scope 3 GHG emissions*: Any indirect emissions that occur in the value chain of the entity, including upstream and downstream emissions.

Entities listed on the Singapore Exchange will have to report on Scope 1 and Scope 2 GHG emissions from FY 2025. From FY 2026, they will be required to report on the much broader Scope 3 GHG emissions where applicable.

From FY 2027, large nonlisted companies with at least S$1 billion in revenue and total assets of at least S$500 million will also be required to report on Scope 1 and Scope 2 GHG emissions. The reporting requirements for these companies in relation to Scope 3 GHG emissions will be reviewed in the coming years and in any event will not come into force before FY 2029.

The new reporting requirements will apply to listed business trusts, investment funds (excluding exchange-traded funds), and real estate investment trusts. It remains to be seen if this climate-related disclosure requirement will extend to private investment funds in the future.

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 an approach to regulate this nascent and rapidly changing industry.

Following public consultation from June to August 2023, in December 2023, MAS published a Code of Conduct for Providers of ESG Rating and Data Products (CoC) and an accompanying compliance checklist for providers (Checklist). The CoC covers best practices on governance, management of conflicts of interest, and transparency of methodologies and data sources, including disclosure on how forward-looking elements are taken into account in data products. This disclosure is intended to allow users to better consider transition risks and opportunities when determining capital allocation. MAS is encouraging providers to disclose their adoption of the CoC and publish their completed Checklist within 12 months from publication of the CoC. In addition, providers must apply the CoC on a "comply or explain" basis. MAS has also encouraged market participants that use ESG ratings and data products to engage with providers that adopt the CoC.

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. The full platform is scheduled to take effect in early 2024 and will be progressively rolled out.

MAS is intending to introduce a set of Guidelines on Transition Planning to provide guidance for asset managers to facilitate their transition planning processes as they build climate resilience and enable robust climate mitigation and adaptation measures.

In the proposed guidelines, asset managers are urged to consider, among other things:

- Adopting a multiyear view for the continued sustainability of their portfolios in a "forward-looking manner." For instance, asset managers should set decarbonization targets that are supportive of the global transition to a carbon-minimized economy as part of their strategic decision-making process.
- Engaging with issuers regarding the need to adopt mitigation strategies where climate risks appear to be of material concern. In this regard, asset managers are encouraged to implement structured processes to identify and prioritize issuers for engagement, especially those which are more vulnerable to transition.
- Having a clear and actionable strategy and approach to guide the implementation of their transition plans.
- Proactively communicating their transition planning process by publishing sustainability reports.
- Establishing mechanism(s) through which the asset managers' existing approaches to respond to climate-related risks are regularly refined due to the evolving nature of climate risk management practices.

AUSTRALIA

AUSTRALIA

By Jim Bulling and Lisa Lautier

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

Funds and asset managers are prohibited from making statements that are false or misleading, and from engaging in dishonest, misleading, or deceptive conduct when offering or promoting sustainability-related products. These prohibitions are set out under the Corporations Act 2001 (Cth) (Corporations Act) and the Australian Securities and Investments Commission Act (ASIC Act).

In addition, funds and asset managers must comply with certain disclosure obligations and guidelines when preparing a product disclosure statement for sustainability-related products that are offered to retail investors. These obligations and guidelines are set out under the Corporations Act and ASIC Regulatory Guide 65 (RG 65). They require disclosure of the extent to which labor standards or environmental, social, or ethical considerations are taken into account in selecting, retaining, or realizing an investment.

To assist funds and asset managers in complying with their obligations, the Australian Securities & Investments Commission (ASIC), issued **Information Sheet 271** (INFO 271). The information sheet defines "greenwashing" and sets out nine questions to consider when offering or promoting sustainability-related products. There is an expectation that funds and asset managers will consider this information sheet when offering or promoting sustainability-related products. ASIC has increased enforcement action in relation to these obligations.

Finally, as discussed below, Australia recently introduced draft legislation for mandatory climate-related financial disclosure requirements, which is expected to commence from 1 January 2025. While the draft legislation does not contain any express requirements in relation to product labeling or categories, it will require certain funds and asset managers to prepare a "sustainability report" in addition to annual financial statements.

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

On 2 November 2023, an Australian ministerial department (Treasury) released a Consultation Paper on Australia's Sustainable Finance Strategy. One of the key priorities is to improve sustainability labeling for investment products. The Consultation Paper outlined a proposal to establish a labeling regime that provides information to consumers and investors on the sustainability characteristics of financial products labeled as "green," "sustainable," "ESG," or similar. The proposed regime will require "clear minimum standards" for what qualifies as a prescribed sustainability label.

We expect to hear more from Treasury on this proposal late in 2024.

In the meantime, the Financial Services Council (FSC), the leading body that sets standards and develops policy for its members, has issued guidance on product labeling. This guidance is set out in:

- **FSC Guidance Note No. 44 Climate Risk Disclosure in Investment Management** (Guidance Note 44) dated 3 August 2022.
- FSC Information Sheet: Labeling Responsible Investment Products dated 24 February 2024.

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 latest FSC Information Sheet outlines overarching principles in relation to the use of responsible or suitability-related terms in investment product labeling. It also provides guidance on commonly used labels such as "ESG," "Responsible," "Sustainable," "Sustainable Development Goals," "Earth/Nature," "Impact," "Ethical," "Stewardship," "Active Ownership," "Low carbon," "Net zero," and labels with religious meanings. The information sheet sets out an expectation of what that label represents and provides good practice examples of funds that use those labels.

FSC guidance is, strictly speaking, only relevant for FSC members, but it is influential in establishing industry standards and expectations.

In addition to industry guidance, funds and asset managers should also be aware of ASIC's expectations. Interestingly, one of the four key themes of ASIC's regulatory interventions set out in **ASIC Report 763** 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.

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

As noted above, Australia's disclosure requirements for funds and asset managers are set out in legislation, ASIC regulatory guidance, and industry guidance.

Australia's reporting requirements with respect to climate-related financial disclosures, on the other hand, are being progressively phased in over the next three to four years.

On 27 March 2024, Treasury introduced into Parliament, the Treasury Laws Amendment (Financial Market Infrastructure and other measures) Bill (the Bill), which implements the climate-related financial disclosures regime.

The Bill requires entities to report climate-related information under a "sustainability report" to be lodged with ASIC each financial year. The proposed regime builds on the existing financial reporting framework for entities that lodge financial reports under the Corporations Act.

Climate-related information that is reported will need to comply with **reporting standards** issued by the Australian Accounting Standards Board (AASB). These standards, currently in draft, largely align with the International Sustainability Standards Board (ISSB) standards with some modifications.

Under the Bill, reporting obligations will be phased in over the next three to four years. Funds and asset managers will fall within one of three groups if they meet two of the three asset, revenue, and employee size thresholds:

- *Group 1*: 1 January 2025: Entities that have consolidated revenue of at least AU$500 million, consolidated assets of AU$1 billion, and 500 or more employees.

- *Group 2*: 1 July 2026: Entities that have a consolidated revenue of at least AU$200 million, consolidated assets of AU$500 million, and 250 or more employees. Importantly, Group 2 Entities also include fund managers at the registered entity level and superannuation funds if the value of assets at the end of the financial year of the entity and the entities it controls is AU$5 billion.
- *Group 3*: 1 July 2027: Entities that have at least AU$50 million of consolidated revenue, AU$25 million of consolidated gross assets, and 100 or more employees.

Details required to be incorporated in the "sustainability reports" include:

- Material climate risks and opportunities (noting certain smaller entities that do not face material climate risks and opportunities may state as such).
- Any metrics and targets of the entity for the financial year related to climate that are required to be disclosed pursuant to the Draft Reporting Standards, including metrics and targets relating to Scope 1, 2, and 3 GHG emissions, with reporting of Scope 3 emissions to follow after a 12-month grace period.[2]

Auditing standards for compliance with the draft legislation have not yet been released but are due to be made by the Auditing and Assurance Standards Board. The auditing standards are expected to be similar to the existing assurance requirements in the Corporations Act for financial reports and will require entities to obtain assurance reports from financial auditors. However, the audit review will be limited initially to climate statements relating to Scope 1 or Scope 2 GHG emissions.

In addition, the draft legislation contains some limited immunities which provide that, with respect to Scope 3 emissions and scenario analysis, no legal action can be made against a person in relation to statements made in sustainability reports lodged during the transitional period. However, this limited immunity does not apply to criminal proceedings or where ASIC brings a civil claim and, with respect to that claim, there is a fault element or ASIC seeks an injunction or declaration as remedy.

Where entities make incorrect statements in their sustainability disclosure reports during this transitional period, ASIC may direct the entity to confirm, explain, and rectify such errors. Where ASIC gives a direction, it must hold a hearing with the entity and provide reasonable opportunity for the entity to make submissions.

The Bill has now been referred to the Senate Economics Legislation Committee for inquiry and final report by 30 April 2024.

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 climate-related information from their asset managers (both local and offshore) in order to ensure that they can comply with their disclosure obligations.

The Bill and the draft AASB Reporting Standards do not specifically consider the proposed application of mandatory climate-related reporting regimes to foreign companies operating in Australia.

In that regard, the proposed mandatory regime applies to entities that meet the required size thresholds for Group 1 and Group 2 Entities, or where they can be properly classified as a 2M Entity. In addition, the regime is proposed to apply to each entity that is—or is required to be—a registered corporation under the National Greenhouse and Energy Reporting Act 2007 (Cth) (NGERA). According to the NGERA, corporations are required to be registered if they:

- Emit more than 50 kilotons of GHG or produce 200 terajoules of energy for a financial year;
- Are a constitutional corporation (meaning a foreign corporation, and trading or financial corporation formed within the limits of the Commonwealth); and
- Do not have a holding company incorporated in Australia.

Interestingly, this could include a foreign-incorporated entity that operates directly in Australia without an Australian-incorporated subsidiary.

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.

Investors may also be subject to Australia's climate-related reporting regime, as discussed above, if they can be classified as a Group 1 Entity, Group 2 Entity, or 2M Entity.

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

As part of ASIC's Sustainable Finance enforcement priority, ASIC continues to focus on greenwashing, issuing another infringement notice in relation to alleged ESG misconduct on 26 February 2024. This brings the number of infringement notices to 17.

Action taken by ASIC to date includes action in relation to:

- Scope and application of sustainability-related investment screens being overstated or inconsistently applied.
- Vague and insufficiently explained terms when describing investment approach.
- Inaccurate representations of an investment screen in an index methodology.

- Projects or products being described as "carbon neutral," "clean," or "green" with no reasonable basis for these claims.
- Net-zero statements and targets not having a reasonable basis or were factually incorrect.

On 28 March 2024, the Federal Court ruled on ASIC's first greenwashing civil penalty action against a product issuer. The Federal Court found the product issuer contravened the ASIC Act by making false or misleading representations about certain ESG exclusionary screens applied to investments in respect of a quoted index fund (the Fund).

The representations were made to the public in a range of communications, including an interview on YouTube, a presentation at a fund manager event, a media release, and statements published on the product issuer's website. Investments held by the fund were based on the Bloomberg Barclays MSCI Global Aggregate SRI Exclusions Float Adjusted Index (Index). The product issuer had claimed the Index excluded only companies with significant business activities in a range of industries, including those involving fossil fuels, but has admitted that a significant proportion of securities in the Index and the Fund were from issuers that were not researched or screened against applicable ESG criteria.

The case highlights the importance of disclosure and the importance of clarifying how any ESG screening is applied across a fund portfolio.

The matter has been listed for further hearing on 1 August 2024, at which time the Court will consider the appropriate penalty to impose for the conduct.

ASIC has another two greenwashing-related civil penalty actions before the Federal Court.

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. In addition to the introduction of mandatory climate-related reporting as discussed above, other items include:

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

EUROPE

EUROPEAN UNION

By Philipp Riedl (Germany), Michelle Lloyd (Ireland), Áine Ní 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 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 ESG factors, risks, and impacts are integrated into their processes and products at both the financial market participant level and the applicable product level. The SFDR is a key aspect of the European Union's wider sustainable finance policy, designed to attract private investment to support the transition to a sustainable economy. It does this by requiring financial market participants to be transparent to investors with respect to sustainability risks and how they may affect returns and, also, with respect to the adverse impacts that investments have on the environment and society. This approach is known as "double materiality."

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, an activity is considered environmentally sustainable if the activity:

- Contributes substantially 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 (TSCs).

The six environmental objectives comprise two climate-related objectives and four nonclimate-related environmental objectives. The TSCs for the two climate-related objectives have applied since January 2022, and the TSCs for the remaining four have applied only since January 2024. The TSCs set out the criteria for determining if activities cause significant harm to other environmental objectives. The economic activities covered include those within the sectors of manufacturing, supply and disposal, construction (e.g., real estate), and information and communication.

The EU Taxonomy Regulation interacts with other legal acts, and significantly with 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 UCITS management companies, alternative investment fund managers (AIFMs), and firms subject to Markets in Financial Instruments Directive (MiFID II) (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 II 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 (PAIs) on sustainability factors. MiFID II firms must also take into account sustainability risks when providing investment advice.

Corporate Sustainability Reporting Directive

The Corporate Sustainability Reporting Directive (CSRD) is a reporting directive that requires certain companies to report on a double-materiality basis similar to the SFDR, as well as provide other information. The mandatory requirements are being applied on a roll-out basis starting in 2024:

- 1 January 2024 for certain in-scope public interest entities with more than 500 employees.
- 1 January 2025 for other larger companies and public interest entities with more than 250 employees.
- 1 January 2026 for listed small and medium enterprises, with an "opt out" possible until 2028.

The CSRD does not yet apply to funds or the majority of fund managers. However, the CSRD will interact significantly with the SFDR, as the data and reporting produced pursuant to the CSRD will be used by financial market participants in the preparation of their product-level disclosures under the SFDR, and the availability of these reports and additional data will enhance the quality of disclosures to investors under the SFDR.

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 market 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 a 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., 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 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. However, proposals under consideration at the European Commission may result in a new criteria-based labeling system described more fully below. For financial products promoting environmental or social characteristics and 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 sustainability-related terms (e.g., the word "sustainable" or any other term derived from it) in the fund's name will require the fund manager to use at least 80% of a fund's investments to attain environmental or social characteristics; to apply the Paris-aligned benchmark exclusions; and to invest meaningfully in sustainable investments defined in Article 2(17) SFDR, reflecting the expectation investors may have based on the fund's name. It is also expected to introduce naming rules for transition-related terms in fund names. Funds using such terms in their names should have at least 80% of their investments aligned with the exclusion criteria of the EU Climate Transition Benchmark. However, funds promoting exclusively social characteristics should not be restricted in their investments by fossil fuel exemptions.

In addition, funds using "transition" or "impact" related terms in their names should also ensure that investments under the 80% minimum noted above are made with the intention to generate positive, measurable social or environmental impact alongside a financial return, or are on a clear and measurable path to social or environmental transition.

It is expected that the guidelines will not be published prior to the publication of the Alternative Investment Fund Managers Directive and UCITS Directive revised texts (in April 2024).

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 under the SFDR 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 is itself 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. How the sustainability disclosure requirements will apply to funds-of-funds is still lacking comprehensive guidance. 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 amended in the near future. In December 2023, the three European supervisory authorities responsible for asset managers and other investment firms, banks, and insurance companies published the Final Report on the review of the regulatory technical standards. The Final Report proposes 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. In general, the disclosure applies a more coherent and simplistic concept (e.g., dropping the asset allocation disclosure) following consumer tests in various EU member states. Adoption is planned in the course of 2024, which may lead to application as of January 2025.

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, human rights, anti-corruption, and anti-bribery matters.
- Enabling financial market participants to systematically consider positive and negative sustainability impacts of their investment decisions.

With respect to the first bullet point above, the European Commission closed two consultations on 15 December 2023. Both consultations covered the current requirements of the SFDR and the interactions with other sustainable finance legislation. The targeted consultation also looked at potential changes to the disclosure requirements for financial market participants and, significantly, the introduction of a potential categorization system for funds.

If implemented, the SFDR could move from being a purely disclosure regime to a disclosure and labeling regime. The European Commission acknowledged that Articles 8 and 9 of the SFDR are already being used as de facto product labels. The consultation raised questions regarding the benefits of having a product categorization system based on precise criteria for sustainability goals and performance at EU level. In this regard, the Commission is looking at two broad options.

The first approach would see categorization based in a different way than in accordance with the existing concepts used in Articles 8 and 9 of SFDR, such as strategy (e.g., the promise of and contribution to certain sustainability objectives, a transition focus based on criteria unrelated to environmental and social characteristics, or the concept of "do no significant harm"). Such an approach might result in the existing concepts falling away entirely. If such an approach were adopted, it could be interoperable with the United Kingdom's SDR regime (as defined below). The second approach would seek to build on and develop the distinctions between Articles 8 and 9 and the existing concepts embedded therein, enhanced by additional criteria that more clearly define the products falling within the scope of each article.

Although the consultations have now closed, there are no immediate plans to implement changes based on its proposals, although we expect that the topic will be addressed by the next European Commission following the elections in 2024.

In addition, the European Union's institutions agreed to introduce a regulatory framework for ESG rating agencies that is intended to enhance their transparency and integrity. In-scope ESG ratings will

provide an opinion on a company's or a financial instrument's sustainability profile by assessing its exposure to sustainability risk and its impact on society and the environment. Under the ESG Rating Regulation, EU providers of ESG ratings will require a license from, and be supervised by, ESMA. The regulation imposes certain operational requirements, such as rules relating to the methodology for ratings and certain disclosure requirements. It provides for the possibility of issuing separate E, S, and G ratings. If only a single rating is issued, the weighting of the E, S, and G factors will need to be stated. Non-EU rating providers wishing to operate in the European Union will need to have their ESG ratings endorsed by an authorized EU ESG rating provider. An EU Commission equivalence decision in relation to their country of origin may also give third-country providers access to the European Union. Until the EU Commission has adopted such decision, small rating providers (annual turnover below €12 million) outside the European Union may alternatively seek recognition by ESMA if they apply the ESG Rating Regulation's requirements (other than licensing). The ESG Rating Regulation is expected to apply in the second half of 2025.

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 to date has been 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 in 2022 of certain of these submissions as part of its "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.

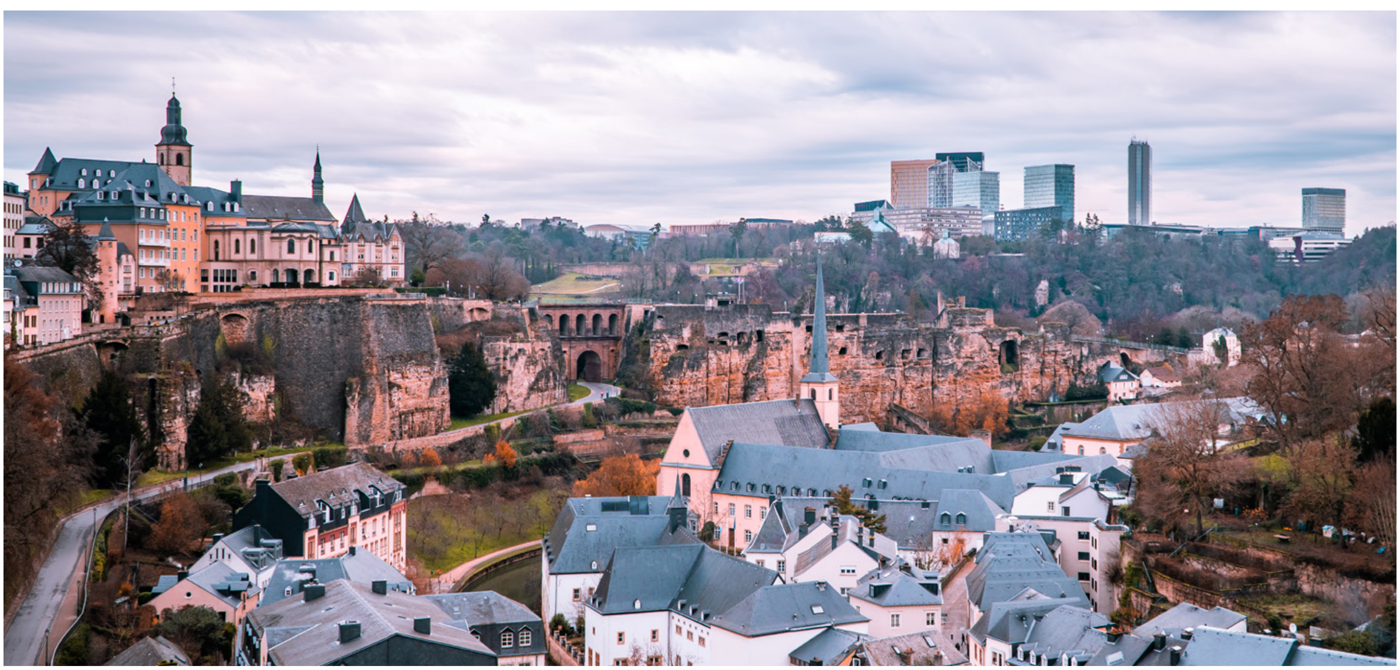
In the first quarter of 2023, the Central Bank reviewed the portfolios underlying funds of varying ESG-related commitments, in particular to ascertain whether the underlying portfolios of funds in fact reflected the level of ESG focus suggested by their precontractual disclosures. Although its findings have not yet been published, the Central Bank has indicated in a workshop in November 2023 that it is presently taking a view on certain points that diverge slightly from a strict reading of the SFDR. For instance, the Central Bank has confirmed that it will raise questions about the appropriateness of having a product subject to Article 8 of SFDR when it cannot commit to having a percentage of its portfolio aligned with environmental and social characteristics. This would seem to introduce a threshold requirement for Article 8 funds. The Central Bank has not issued formal guidance on this yet, however, and emphasized that their findings did not necessarily represent their final position and may be subject to change.

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, CSSF, has, since the SFDR started to be enforced, attempted to (a) create a level and transparent playing field for all financial market participants (FMPs) conducting business in Luxembourg, and (b) facilitate FMPs' compliance with SFDR requirements, which at least some FMPs may find demanding. In seeking to achieve these goals, the CSSF (a) 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 (b) requires investment fund managers, among others, to complete an annual SFDR questionnaire in accordance with the financial year-end of the financial products that will be used to determine the level of compliance of the FMPs with SFDR and ESG standards.

Furthermore, on 22 March 2024, the **CSSF's supervisory priorities in the area of sustainable finance** was published. In this paper, CSSF outlines four focus areas (namely, credit institutions, asset managers, investment firms, and issuers) and indicates which aspects of those areas will be prioritized in terms of supervision (i.e., sustainability disclosures, risk management, etc.). A significant revelation in this Communiqué is that the Luxembourg regulator confirms its intention to ensure compliance and, most importantly, consistency across the fund documentation and marketing material in the context of financial products. This confirms legal practitioners' expectations that the Luxembourg regulator would at some point attempt to effectively intervene and perform checks on FMPs' disclosures in order to ensure a level playing field; thus, effective transparency toward investors.



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 Financial Conduct Authority (FCA), the regulator of funds and asset managers, has stated that it sees tackling greenwashing as a core regulatory priority and has made new rules in this area, discussed below, that will start to come into force on 31 May 2024. However, before 31 May 2024, UK requirements impacting asset managers that wish to make ESG-related claims to UK persons are set forth in various existing rules and guiding principles regarding marketing and retail investor protection, many of which are generally applicable rather than being specifically targeted at the asset management industry. 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, that are selling to consumers, i.e., natural persons. This includes the rules found in the UK Competition and Markets Authority (CMA)'s guidance on making environmental claims on goods and services published on 20 September 2021. This is sometimes called its "**Green Claims Code**." The CMA also shares certain consumer protection functions with the UK Advertising Standards Authority (ASA), which administers the requirements for advertising in the UK Code of Non-Broadcast Advertising and Direct and Promotional Marketing and the UK Code of Broadcast Advertising (the CAP and BCAP Codes). The ASA has issued guidance designed to help firms interpret the CAP and BCAP rules regarding environment-related advertising issues.

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 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 GHG 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 firms (a) must conduct business with integrity; (b) must communicate information to their clients in a manner that is clear, fair, and not misleading; and (c) must ensure that a communication or a financial promotion is fair, clear, and not misleading. The Principles also include a "Consumer Duty" requiring firms to act to deliver good outcomes for consumers, including supporting consumer understanding by

communicating information to them in a way that is clear, fair, 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, dated 14 January 2022 (**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?

The FCA finalized new Sustainability Disclosure Rules (SDR) in a November 2023 Policy Statement on "Sustainability Disclosure Requirements (SDR) and investment labels" (PS23/16) (Policy Statement). The new regime 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. These rules are not yet in force and, until that time, there are no rules specific to asset managers and investment funds on labeling and categorization.

Under SDR, the FCA is introducing an optional labeling regime for FCA-authorized firms to use in relation to UK funds. It will take effect on 31 July 2024. All products using a label must have a sustainability objective to improve or pursue positive environmental or social outcomes as part of their investment objectives. Firms must identify and disclose whether pursuing the positive sustainability outcomes may result in material negative outcomes.

The available labels are:

- *Sustainable Focus*: The sustainability objective must be consistent with an aim to invest in environmentally or socially sustainable assets determined using a robust evidence-based standard that is an absolute measure of sustainability.
- *Sustainable Improvers*: The sustainability objective must be consistent with an aim to invest in assets that have the potential to improve environmental or social sustainability over time—determined by their potential to meet a robust, evidence-based standard that is an absolute measure of environmental or social sustainability.
- *Sustainable Impact*: The sustainability objective must be consistent with an aim to achieve a predefined positive measurable impact in relation to an environmental or social outcome, measured using a robust method. These products must align with a clearly specified theory of change.
- *Sustainability Mixed Goals*: Products with a sustainability objective to invest in accordance with two or more of the sustainability objectives of the other three labels. Firms must identify (and disclose) the proportion of assets invested in accordance with any combination of the other labels.

Subject to limited exceptions, at least 70% of a labeled product's assets must be invested in accordance with its sustainability objective. However, in the case of the Sustainability Mixed Goals label, products must invest at least 70% of their assets in accordance with a combination of the sustainability objectives from two or more other labels.

In addition, a new "anti-greenwashing" rule will apply to all FCA-regulated firms starting 31 May 2024. The FCA considers it to be consistent with the "Consumer Duty" referred to above, but it is of broader scope, as it is not limited to consumer-related business. The anti-greenwashing rule will establish a new direct link between sustainability claims and the existing general rules and principles in the FCA Handbook requiring clear, fair, and not misleading communications. The "anti-greenwashing" rule will apply to all FCA or PRA authorization firms communicating with UK prospects in relation to any product or service. Accordingly, the anti-greenwashing rule will apply indirectly to the claims of non-UK products managed by non-UK firms that rely on authorized UK distributors. In addition, starting 2 December 2024, UK distributors to UK retail clients of overseas funds that (a) have been recognized for UK retail distribution (including recognized exchange-traded funds), and (b) include certain sustainability-related terms, will be required to prepare and display a notice that "This product is based overseas and is not subject to UK sustainable investment labeling and disclosure requirements."

The above requirements, other than where a UK distributor is used, the anti-greenwashing rule, and the overseas product notice rule will not apply to non-UK funds, even where they are sold to UK investors. The FCA has disclosed its intention to work with the UK government to consider options as to how non-UK funds should be regulated in this regard. The FCA has also stated its intention to expand the scope of SDR to portfolio managers and pension products.

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 requires 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.

The Policy Statement has provided detail on future product- and entity-level disclosures for in-scope asset managers as part of the SDR. These will include simplified consumer-facing disclosures that, through the use of plain language, will help consumers understand the key sustainability-related features of a product. In addition, certain mandatory detailed disclosures will 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 is imposing new naming and marketing requirements on FCA-regulated firms that provide in-scope products to retail investors and use sustainability-related words in product names or marketing. In-scope products that are not labeled products will, from 2 December 2024, not be able to use the terms "sustainable," "sustainability," or "impact," or any variation of those terms, in their names. Other sustainability-related words (e.g., "responsible" or "green") may only be used in the nonlabeled product's name if the product has sustainability characteristics that the product's name accurately reflects. The new rules also prohibit "Sustainability Focus," "Sustainability Improvers," and "Sustainability Mixed Goals" labeled products from using the term "impact" in product names. A nonlabeled product will, starting 2 December 2024, only be able to use a sustainability-related term in its name or marketing material if it: (a) abides by the "anti-greenwashing" rule referred to above; (b) publishes the same disclosures required in relation to a labeled product; and (c) ensures all of the product's marketing material contains a prominent statement to clarify that the product does not have a label and the reasons why.

As part of the SDR, where in-scope products are offered to retail investors and have a sustainable investment label, FCA authorized 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. In relation to nonlabeled products that use sustainability-related terms in their names or marketing, those distributors will be required to provide retail investors with access to the applicable 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?

Not generally. The existing rules, other than those referred to in the first paragraph of the answer to the first question in this UK section, do not apply to offshore funds being marketed in the United Kingdom. As discussed above, the future anti-greenwashing and overseas product notice rules will apply indirectly in relation to offshore funds being marketed in the United Kingdom where a UK distributor is used. Otherwise, the proposed rules under SDR will not apply to offshore funds being marketed into the United Kingdom. The FCA intends to undertake a separate consultation on how SDR may be applied in respect of offshore funds in due course.

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 Policy Statement 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 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.

The ESG landscape is also evolving and evolving quickly. The pace of change alone will create new challenges for asset managers in relation to their existing products as well as their global products, especially for products that have a global distribution.

That said, there are some common themes that suggest some practical approaches asset managers can take to address these differing and evolving 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-sfdrfast- 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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