Morgan Lewis | White Paper

# THE REGULATORY OVERLAY

## ON ESG INVESTING

www.morganlewis.com

September 2020

**Morgan Lewis**

September 9, 2020

Dear clients, friends, and colleagues:

On behalf of my fellow co-authors, thank you for the opportunity to share an international perspective on the regulatory landscape governing environmental, social, and governance (ESG) investment.

ESG is an incredibly fast-growing and evolving area that presents challenging considerations for global asset managers. Our global investment funds team has prepared this White Paper as a regulatory framework to navigate such considerations across the United States (authors Miranda Lindl O'Connell and Julie Stapel), the United Kingdom and the European Union (author William Yonge), and Asia (authors Joel Seow and Helen Fok).

Over the last decade, the consideration of ESG factors in making investment decisions has grown in importance. As stated by the European Securities and Markets Authority (ESMA) in its *Strategy on Sustainable Finance*, "The financial markets are at a point of change as it can be observed that investor preferences are shifting towards an interest in financial products that incorporate environmental, social and governance factors, which have increased rapidly over the last few years. Moreover, sustainability factors are increasingly affecting the risks, returns and value of investments."[1]

Promoters of ESG in the marketplace often point to the growing number of institutional investors and asset managers that have become signatories to the United Nations Principles for Responsible Investment (UNPRI) as an indicator of the increasing consideration of ESG in investing.[2] Indeed, recent publications from various industry sectors point to ESG going mainstream. Hundreds of commercial ESG indices provide ESG ratings of individual companies, and an S&P 500 ESG index is in preparation.[3] Even index funds are increasingly focusing their marketing on ESG factors.[4] The outbreak of the coronavirus (COVID-19) appears to have accelerated this trend.[5]

We hope this White Paper will serve as a guide as you navigate this complex and developing landscape.

Sincerely,

Miranda Lindl O'Connell
Partner, Investment Management

[1] ESMA, Strategy on Sustainable Finance (Feb. 6, 2020).

[2] *See* *Principles for Responsible Inv*., Signatory Directory Updated 7/5/2020 (2020). As of July 2020, there are 2,833 signatories. Most signatories (1,539) are European; the second-largest group is from North America (718) and a significant number are based in China, Japan, Singapore and other Asian countries (202).

[3] Max M. Schanzenbach & Robert H. Sitkoff, Reconciling Fiduciary Duty and Social Conscience: The Law and Economics of ESG Investing by a Trustee, 72 Stan. L. Rev. 381, 387 (2020).

[4] *See, e.g.*, *ESG Investing: Where Your Money Can Reflect What Matters to You*, Vanguard (July 6, 2020); Sustainable Investing: A "Why Not" Moment, BlackRock Inv. Inst. (May 9, 2018).

[5] *See* Georg Kell, *Covid-19 Is Accelerating ESG Investing and Corporate Sustainability Practices*, Forbes (May 19, 2020).

# THE REGULATORY OVERLAY ON ESG INVESTING

This White Paper highlights the legal and regulatory considerations in the United States, the United Kingdom, the European Union, Hong Kong, and Singapore that asset managers and their institutional investor clients should reconcile in marketing and adapting portfolios to ESG considerations.

In the United States, the increasing number of fund sponsors and other asset managers marketing themselves as ESG-oriented advisers is attracting heightened scrutiny from regulators notwithstanding the lack of formal regulatory guidance.[6] Although the US Securities Exchange Commission has not yet taken the step of issuing formal guidance to asset managers on ESG, there have been indications that it is forthcoming. In this paper, we examine these indications and other guidance given to date that asset managers should consider in effectuating ESG policies.

Further, the US Department of Labor, the agency charged with the interpretation and enforcement of ERISA, the statute applicable to private-sector employee benefit plans, has also been active in the ESG space. ERISA includes stringent fiduciary requirements that some have construed as consistent with the ESG factors, but, as discussed in more detail below, the Department of Labor has recently proposed a regulation that may put additional pressure on ERISA fiduciaries considering ESG factors.

In Europe, the European Union has taken decisive top-down action to support the transition to a low-carbon, more resource-efficient and sustainable economy embodied by its Sustainable Action Plan 2018, the objective being to position the European Union in the vanguard of global endeavors to construct a financial system that supports sustainable growth.

The United Kingdom, no longer a member of the European Union, is forging its own top-down path with its "Green Finance Strategy – Transforming Finance for a Greener Future 2019," but has nonetheless pledged that it will "match the ambition" of the EU's Sustainable Action Plan. The UK's strategy aims to (i) align private-sector financial flows with clean, environmentally sustainable and resilient growth, supported by government action, and (ii) strengthen the competitiveness of the UK financial sector.

In Hong Kong, while many ESG regulatory initiatives are still at the development stage, there has been an increasing regulatory focus on this topic, as reflected by the ESG-related regulatory frameworks and approaches, enhanced disclosure requirements to listed companies, and other policies published by different regulators.

In Singapore, ESG is not heavily regulated in the Singapore financial and capital markets sectors but is governed by a mixture of self-regulating and voluntary practices. Recent developments toward sustainable financing and ESG-linked investment products have been led and encouraged through initiatives by the Monetary Authority of Singapore.

# WHAT IS ESG?

Taking ESG factors into account in investing is not a new phenomenon. In the past, application of ESG typically took the form of excluding certain industrial sectors or certain countries from investment mandates. For example, restrictions against investing in gambling, armaments, alcohol, and tobacco were first introduced by faith-based charities and have now expanded into popular use.[7] Further, disinvestment from South Africa in the 1970s and investment boycotts against Iran and Northern Ireland in the 1980s

[6] *See* Warren Rojas, *Legal Battles Likely over Trump's ESG Crackdown, Advisers Say*, Bloomberg Law (June 24, 2020), (discussing recent Labor Department guidance on plans justifying ESG investments); Dieter Holger, *As Funds Jump on the "Sustainable" Bandwagon, Regulators Raise Concerns*, Wall St. J. (Apr. 5, 2020) (discussing increased marketing of fund sponsors as ESG advisers); Juliet Chung & Dave Michaels, *ESG Funds Draw SEC Scrutiny*, Wall St. J. (Dec. 16, 2019), (discussing recent examination letters sent to ESG fund managers).

[7] *See* Invesco, *Responsible Investing and Active Ownership* (May 17, 2017).

became popular approaches.[8] While this continues in some form, the approach has largely shifted to incorporating ESG criteria in investment decisions.

"ESG" is an umbrella term for a range of environmental, social, and governance factors against which investors can assess the behavior of the entities they are considering for investment. ESG is the term often preferred by the investment world when using these types of factors to assess corporate behavior, evaluate the future financial performance of companies (particularly in the long term), and manage risk. ESG criteria are factors that investors use to screen, identify, and evaluate potential investments with:

- environmental criteria related to, for example, how a company performs in its use of renewable investment strategies and global energy demands that promote clean and sustainable energy;
- social criteria related to how a company manages relationships, such as with its suppliers and within the communities where it operates; and
- governance criteria related to, for example, a company's leadership, executive pay, internal controls, and shareholder rights.

Different terms, often used interchangeably, are used to express the various approaches. In addition to ESG, there is responsible investing, sustainable investing, and impact investing. Responsible investing[9] and sustainable investing[10] appear to be used synonymously with ESG, with sustainable investing being the nomenclature of choice being used by the larger asset managers.

While ESG investing is investing based on ESG criteria, measurement, and accountability, impact investing is investing to generate a positive, measurable social or environmental impact. Depending on investors' strategic goals, impact investments target a range of returns (from below market to market) and provide capital worldwide to help in areas such as sustainable agriculture, renewable energy, conservation, microfinance, and affordable and accessible basic services like housing, healthcare, and education. Impact investing generally indicates a priority of the achievement of the sought-after impact over or regardless of the investment returns. Responsible and sustainable investing tends to incorporate ESG factors with equal or less importance than the priority of a return on investment.[11]

ESG policies cover a wide variety of factors, and each of the environmental, social, and governance goals typically covered individually could warrant its own paper on approach to implementation, monitoring, reporting, and enforcement techniques. Popular ESG frameworks are the Global Reporting Institute, the Task Force on Climate Related Financial Disclosures, the Sustainability Accounting Standards Board, and the United Nations Sustainable Development Goals.[12]

In forming ESG policies, asset managers and investors rely on legal and investment expertise in areas such as private equity, venture capital, exchange-traded funds, structured and leveraged finance, investment fund formation and management, corporate and securities regulation, fiduciary considerations, and for-profit and not-for-profit tax advice to meet their unique investment considerations and goals.[13] For example, implementing an ESG policy for a private foundation or family office will be quite different than implementing a policy for a public pension plan. Further, a mom-and-pop shop engaging in customized advising agreements will take a different approach than a large asset manager with billions of dollars of assets under management that takes a more uniform and top-down approach to investment parameters.

---

[8] *See id.*; Vikram S. Ghandi, Caitlin Reimers Brumme & Sarah Mehta, *The Rise Fund: TPG Bets Big on Impact*, HBS No. 9-318-041, Harv. Bus. Sch. Publ'g (2019).

[9] *See* Principles for Responsible Inv., *What Is Responsible Investment?*; Cambridge Inst. for Sustainability Leadership, *What Is Responsible Investment?*.

[10] *See* The Forum for Sustainable and Responsible Inv., *Sustainable Investing Basics*.

[11] *See* Dietrich Knauth, *How Fund Managers Can Identify and Mitigate Risks From the SEC's Increased Focus on ESG Investing (Part Two of Two)*, Priv. Equity L. Rep. (Jan. 28, 2020).

[12] *See* BSR, *ESG in Private Equity: How to Write a Responsible Investment Policy* (Mar. 2019), Cambridge Assocs., *Considerations for ESG Policy Development* (June 2017).

[13] *See* Principles for Responsible Inv., *Writing a Responsible Investment Policy* (Aug. 13, 2012); Pac. Cmty. Ventures, *The Impact Due Diligence Guide* (July 3, 2019).

Notwithstanding the differences among the players in the ESG investing space, this paper is seeking to set forth the different legal and regulatory regimes to which asset managers looking to incorporate ESG factors into their investment processes may be subject.

# ESG LEGAL AND REGULATORY OVERSIGHT IN THE UNITED STATES

In the United States, asset managers and trustees of pensions, charities, and personal trusts invest tens of trillions of dollars of other people's money subject to the obligations imposed by law and regulation. In this part of the paper, we consider the overlay of the US Investment Advisers Act of 1940, as amended (the Advisers Act), and the US Employee Retirement Income Security Act of 1974, as amended (ERISA), on ESG practice and trends. Of particular focus in the United States is the interplay of the fiduciary duty applicable to asset managers and plan administrators and ESG considerations.

## I. ESG Legal and Regulatory Securities Law Framework in the United States

There is growing concern in the United States that the lack of standardization on ESG may affect whether investors are able to make informed investment decisions when trying to select ESG financial products. As a result, some industry participants have asked whether the US Securities and Exchange Commission (SEC), similar to its European counterparts, should propose rulemaking requiring standardized ESG disclosure. For example, SEC Commissioners Allison Herren Lee and Hester Peirce recently criticized the SEC for not making any attempt to address investor need for standardized disclosure on climate risk.[14] Recent updates to Regulation S-K (the disclosure rules relating to registrants' description of their business, legal proceedings, and risk factors) drew sharp criticism from dissenting SEC Commissioners Caroline Crenshaw and Ms. Herren Lee for the absence of any requirement of ESG disclosures with particular focus on climate change risk and human capital.[15] In this part of the paper, we provide the regulatory backdrop of the SEC that asset managers should be aware of in incorporating ESG factors.

*SEC*

The SEC is the regulatory authority tasked with monitoring and enforcing compliance of asset managers as investment advisers under the Advisers Act. An "investment adviser" is defined as "any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities."[16] Persons falling within the definition of "investment adviser" are generally required to register with the SEC unless exempted from the registration requirement.[17] Asset managers typically fall within the definition of "investment adviser" under the Advisers Act and register with the SEC unless they qualify for an exemption to registration.[18]

Section 206(1) and 206(2) of the Advisers Act provides that it is unlawful for an investment adviser, through interstate commerce, "to employ any device, scheme, or artifice to defraud any client or prospective client," and to "engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client." The US Supreme Court has interpreted these provisions as imposing fiduciary duties of care and loyalty on principal transactions by investment advisers, whether registered or unregistered.[19]

---

[14] *See* Comments by Allison Herren Lee, SEC Comm'r, *"Modernizing" Regulation S-K: Ignoring the Elephant in the Room* (Jan. 30, 2020); Comments by Hester M. Peirce, SEC Comm'r (May 21, 2020).

[15] *See* Comments by Allison Herren Lee and Caroline Crenshaw, SEC Comm'rs (Aug. 26, 2020).

[16] 15 U.S.C. § 80b-2(a)(11).

[17] Nora M. Jordan, et al., Advising Private Funds: A Comprehensive Guide to Representing Hedge Funds, Private Equity Funds and Their Advisers § 6:14 (2019-2020 ed.); 15 U.S.C. § 80b-3(a).

[18] 15 U.S.C. § 80b-2(a)(11); *see also* Joshua C. Dawson & Paul J. Foley, Square Pegs Don't Fit in Round Holes: The Impact of the Dodd-Frank Act's Elimination of the Private Fund Exemption on Private Equity Fund Advisers, 9 Liberty U. L. Rev. 445, 449 (2015).

[19] *SEC v. Cap. Gains Research Bureau, Inc.* (*Capital Gains*), 375 U.S. 180, 192–93 (1963).

In a 2019 interpretive release, the SEC summarized its position on the fiduciary duties of investment advisers as follows:

> This fiduciary duty requires an adviser to adopt the principal's goals, objectives, or ends. This means the adviser must, at all times, serve the best interest of its client and not subordinate its client's interest to its own. In other words, the investment adviser cannot place its own interests ahead of the interests of its client. This combination of care and loyalty obligations has been characterized as requiring the investment adviser to act in the best interest of its client at all times. In our view, an investment adviser's obligation to act in the best interest of its client is an overarching principle that encompasses both the duty of care and the duty of loyalty. . . . [I]n our view, the duty of care requires an investment adviser to provide investment advice in the best interest of its client, based on the client's objectives. Under its duty of loyalty, an investment adviser must eliminate or make full and fair disclosure of all conflicts of interest which might incline an investment adviser—consciously or unconsciously—to render advice which is not disinterested such that a client can provide informed consent to the conflict. We believe this is another part of an investment adviser's obligation to act in the best interest of its client.[20]

US common law interpreting the fiduciary duties of investment advisers is well developed. Under US common law principles of agency, an asset manager, as agent, owes fiduciary duties to its client, as principal.[21] It is generally agreed that the duties of care and loyalty are among the basic fiduciary duties advisers are generally held to owe their clients.[22] Some authorities also refer to a duty to act in good faith and a duty of disclosure.[23]

With respect to the duty of care, advisers are required to exercise due care (prudence and reasonableness) when acting on behalf of clients, employ reasonable care to avoid misleading clients,[24] have a reasonable basis for investment advice,[25] and seek the best execution of a client's trades (i.e., seek the best net price and terms reasonably available under the circumstances).[26] With respect to a duty of loyalty, advisers are

---

[20] Commission Interpretation Regarding Standard of Conduct for Investment Advisers, 84 Fed. Reg. 134, 33,671 (July 12, 2019) [hereinafter, "Commission Interpretation"].

[21] Agency is the fiduciary relationship that arises when one person (a "principal") manifests assent to another person (an "agent") that the agent shall act on the principal's behalf and subject to the principal's control, and the agent manifests assent or otherwise consents to so act. Restatement (Third) of Agency § 1.01 (2006).

[22] *Capital Gains*, 375 U.S. at 193–97 (1963) (finding that the duties of an investment adviser to its clients include to provide impartial investment advice, to act in good faith, and to fully disclose all material facts and employ reasonable care to avoid misleading clients); Bruce Karpati, Chief, SEC Enforcement Div.'s Asset Mgmt. Unit, Speech on Private Equity Enforcement Concerns (Jan. 23, 2013), at 6–7.

[23] *See Capital Gains*, 375 U.S. at 194.

[24] *Id.*

[25] *SEC Fiduciary Standard*, InvestmentAdviser.org.

[26] Advisers have long been held to have a duty to seek best execution of client trades, and this duty is most commonly referred to as "fiduciary" in nature. *See Newton v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, 135 F.3d 266, 270–71 (3d Cir. 1998) ("The duty of best execution, which predates the federal securities laws, has its roots in the common law agency obligations of undivided loyalty and reasonable care that an agent owes to his principal."). *See also* Commission Guidance Regarding Client Commission Practices Under Section 28(e) of the Securities Exchange Act of 1934, Release No. 34-54165, 86 SEC Docket 1235 (July 18, 2006) ("Fiduciary principles require money managers to seek the best execution for client trades[.]"); In the Matter of Fleet Investment Advisors, Release No. IA-821, 70 SEC Docket 1217 (Sept. 9, 1999) ("In addition, an investment adviser's fiduciary duty includes the requirement to seek the best execution of client securities transactions where the adviser is in a position to direct brokerage transactions[.]"). Lastly, see Rule 206(3)-2(c) under the Advisers Act, which refers to the adviser's duty to act in the best interests of its clients, including the duty "with respect to best price and execution" for client transactions.

required to act in the best interests of their clients,[27] place the interests of clients above their own,[28] obtain clients' informed consent to any conflicts of interest after full and frank disclosure,[29] obtain appropriate informed consent regarding any conflict of interest that may cause the adviser to render advice that is not disinterested,[30] and avoid any self-dealing without appropriate consent.[31]

Intertwined in the fiduciary duties imposed under the Advisers Act and US common law is the obligation to make full and frank disclosures of all material aspects of the advisory relationship.[32] Registered investment advisers chiefly accomplish this though Part 2 of Form ADV, which all registered investment advisers are required to file (or make available) and update at least annually with the SEC.[33] As the fiduciary obligations are imposed under law, such disclosures strictly required under this form are not necessarily sufficient to satisfy an investment adviser's fiduciary obligations, and additional disclosures may be necessary.[34]

With respect to ESG, the SEC has acknowledged that asset managers are required to comply with ESG reporting obligations, integrate related policies and procedures, and take ESG factors into account as part of their compliance with statutorily imposed fiduciary duties. The disclosure of ESG information is required if it would be viewed as significantly altering the total mix of information available for investors. Pursuant to a recent recommendation of the SEC Investor Advisory Committee, the best way for investment advisers to fulfill these obligations is for issuers to report the material ESG data necessary to conduct analysis and make investment decisions.[35] The variation of data and approaches to investment decisions with respect to ESG itself and the "E," "S," and "G" separately is the basis of the aforementioned recommendation for the SEC to issue formal guidance on the same.

*ESG and an Adviser's Fiduciary Duties*

An open question in the ESG space and another basis for the aforementioned push for regulatory guidance is whether consideration of ESG factors in making investment decisions support or detract from the ability of asset managers to fulfill their fiduciary duties to their clients. Consider, for example, if an investment decision is made based on the financial viability of the proposed investment to generate a positive return but is also successfully screened according to ESG factors. Is the fiduciary in a better position to meet its fiduciary duties if an investment decision contemplates both financial and ESG factors instead of just the financial implications? Does the addition of ESG to financial factors make the investment superior because it is a better indication of a risk-adjusted return?[36] The SEC has not yet taken a position on whether ESG should be considered in the investment process, but SEC guidance strongly suggests that if an asset manager markets itself as investing according to an ESG framework, then examinations of ESG disclosure

---

[27] *See* Amendments to Form ADV, Release No. IA-3060, 98 SEC Docket 3502 (Aug. 12, 2010) ("Under the Advisers Act, an adviser is a fiduciary whose duty is to serve the best interests of its clients[.]") [hereinafter, "Release 3060"]. *See also* Commission Guidance Regarding the Duties and Responsibilities of Investment Company Boards of Directors with Respect to Investment Adviser Portfolio Trading Practices, Release Nos. 2763, 28345, 58264, 34-58264, IA-2763, IC-28345, 93 SEC Docket 2469, n.64 (July 30, 2008) ("Under sections 206(1) and (2), in particular, an adviser must discharge its duties in the best interest of its clients[.]").

[28] The Commission recently characterized this as an adviser's obligation "not to subrogate clients' interests to its own." Release 3060 at 3. *See also* Press Release, Inv. Adviser Ass'n et al., *Without Fiduciary Protections, It's Buyer Beware for Investors* (June 15, 2010).

[29] Release 3060 at 3. While in some contexts disclosure (and consent) has been recognized to "cure" conflicts, the disclosure must be full and frank: "If dual interests are to be served, the disclosure to be effective must lay bare the truth, without ambiguity or reservation, in all its stark significance." *See* Kathryn B. McGrath, Dir., SEC Div. of Inv. Mgmt., Address at the 1987 Mutual Funds and Investment Management Conference: Will the Investment Company and Investment Advisory Industry Win an Academy Award? (citing Austin W. Scott, *The Fiduciary Principle*, 37 Cal. L. Rev. 539, 544 (1949)).

[30] In the Matter of Dawson-Samberg Capital Management, Inc., Now Known as Dawson-Giammalva Capital Management, Inc., and Judith A. Mack, Respondents, Release No. 1889, 72 SEC Docket 2473 (Aug. 3, 2000) (citing *Capital Gains*, 375 U.S. at 191–92).

[31] *See* Release 3060 at 36.

[32] *See Capital Gains*, 375 U.S. at 194 ("Courts have imposed on a fiduciary an affirmative duty of . . . full and fair disclosure of all material facts.").

[33] Jordan et al., *supra* note 16, § 9.82.

[34] *See* Advisers Act Release No. 3060, n.7 (July 28, 2010).

[35] SEC, *Recommendation of the SEC Investor Advisory Committee Relating to ESG Disclosure* (May 21, 2020).

[36] *See* Schanzenbach & Sitkoff, *supra* note 3 (presenting the difference between "collateral benefits ESG" and "risk-return ESG investing"); Knauth, *supra* note 11 (discussing the management of different ESG strategies); *Sustainable Investing, supra* note 4.

and investment processes will form part of any audit of the manager. In the following sections, we consider the SEC guidance given to date on ESG, first on a more general basis and then with respect to the interpretation of the fiduciary duties.

### (i) General SEC Guidance on ESG

The SEC's guidance to date on ESG investing and the fiduciary duty has been underwhelming. Certain recent developments, including a May 14, 2020 recommendation on uniform ESG disclosure from the Investor-as-Owner Subcommittee of the SEC Investor Advisory Committee, indicate that the SEC staff is contemplating concrete action.[37] The subcommittee recommended that the SEC should update its reporting requirements for issuers to include ESG factors as well as its reporting requirements for issuers to include certain ESG factors, including "decision-useful" ESG factors, starting with outreach efforts to investors, issuers, and other market participants that would help SEC staff evaluate options for updating SEC reporting requirements.[38]

Further, the SEC has taken an interest in related areas, such as Rule 35d-1 (the Names Rule) under the US Investment Company Act and to what extent investors rely on terms such as "ESG" and "sustainable" as an indication of the types of assets in which a fund invests. As perhaps an acknowledgment of the rising popularity of ESG funds, the SEC has stepped in with the Request for Comment regarding whether the Names Rule should apply to funds that include terms such as "ESG" and "sustainable" in their names.[39] The Names Rule was adopted by the SEC in 2001, as an investor-protection measure, designed to help ensure that investors were not misled or deceived by a fund's name. Specifically, the Names Rule prohibits any fund from adopting as part of its name "any word or words that the Commission finds are materially deceptive or misleading."[40] A number of comment letters have been submitted containing recommendations from investors, industry groups, and advisory firms, indicating the level of interest in the topic.[41]

In spite of the uncertainty, investment advisers are expected to manage ESG investments in compliance with the Advisers Act and regulations thereunder. In the SEC's Office of Compliance Inspections and Examinations (OCIE) 2020 Examination Priorities Report, OCIE indicates as a priority "a particular interest in the accuracy and adequacy of disclosures provided by [registered investment advisers] offering clients new types of emerging investment strategies, such as strategies focused on sustainable and responsible investing, which incorporate [ESG] criteria."[42]

While the SEC has not placed ESG on its near-term agenda and has not proposed a direct rule on ESG with respect to private funds, given the growth in the sector and demand for clarity by managers and investors alike, we expect to see a principles-based approach setting forth certain criteria and disclosure requirements, particularly if the administration changes. We expect there to be lobbying for standardization across jurisdictions to address possible conflicts with the EU, the United Kingdom, and other jurisdictions that have already taken a position on such standards.

### (ii) SEC Guidance on Specific Duties

Next we turn to examples of certain input the SEC has given during exams of advisers and specific responses on the relevant fiduciary duties of asset managers.

*Exams*

First, with respect to exams, the OCIE recently conducted exams of investment advisers that manage investment funds that take ESG-related factors into consideration when making investment choices for

---

[37] SEC, Inv. Advisory Comm., Investor-as-Owner Subcomm., Recommendation from the Investor-as-Owner Subcommittee of the SEC Investor Advisory Committee Relating to ESG Disclosure (May 14, 2020).

[38] *Id.* at 1.

[39] *See* Request for Comments on Fund Names, 85 Fed. Reg. 45, 13,224 (Mar. 6, 2020).

[40] *See id.*; 17 C.F.R. § 270.35d-1.

[41] SEC, Comments on Request for Comments on Fund Names (last accessed July 8, 2020).

[42] Office of Compliance Inspections and Examinations, SEC, *2020 Examination Priorities 15* (2020).

clients. The SEC's focus on ESG issues started in 2019 and has been a feature of the ESG-focused document request lists received by asset managers. Among other items, the request lists include a focus on:

- what managers are disclosing and marketing to investors versus actual practices;
- what internal ESG policies and procedures managers have adopted, and whether they are following them; and
- whether managers are claiming compliance with ESG industry standards, and, if so, whether they are complying with those standards.43

On the exams that we are aware of, the SEC staff is focusing on a broad array of topics such as (i) whether the adviser adheres to the UNPRI; (ii) what ESG investments have been made and sold, and why; (iii) whether the adviser has its own or uses a third party's ESG scoring system, and how the scoring system works; (iv) proxy voting information concerning ESG matters; and (v) information about service providers engaged by the adviser that assist in ESG-related diligence. These and other ESG-related exam questions are the SEC's way of ensuring that asset managers are managing their client funds in accordance with their stated strategies.

*The Duty of Care*

Next, with respect to the duty of care, as referenced above, this duty encompasses, among other things, the duty to provide advice that is in the best interest of the client and the duty to provide advice and monitoring over the course of the relationship.[44] In the context of ESG investing, the duty to provide advice in the best interest of the client is likely the most challenging obligation given disparate ESG disclosure and reporting criteria.[45] To provide advice in the best interest of a client, an investment adviser must (i) have a reasonable understanding of the client's guidelines and objectives and (ii) have a reasonable belief that the investments it recommends are in the best interest of the client based on those objectives.[46]

Regarding the first point, commentators and SEC Commissioner Hester Peirce have voiced skepticism over the lack of a common understanding of ESG strategies, which makes it difficult to adequately understand specific client objectives.[47] But in the context of investment advisory agreements, the investment adviser can typically look to the agreement for detailed and negotiated guidelines.[48] Sustainability guidelines and objectives must be clearly defined in the agreement, even more so than in an advisory agreement that doesn't include ESG factors, to avoid the ambiguities surrounding nebulous "sustainability" terms that do not have any generally accepted meanings.

Turning to the second requirement, for an investment adviser to have a reasonable belief that recommended investments are in the best interest of the client, the adviser must undertake a "reasonable investigation into the investment sufficient not to base its advice on materially inaccurate or incomplete information."[49] While considerations generally include costs (including fees and compensation), investment characteristics, risks, potential benefits, and market and economic conditions, among others, ESG considerations may consist of various nontraditional factors such as values investing, negative screening, and thematic investing, and can even be the basis of how the adviser earns its compensation or profits share.[50]

---

[43] *See* Hena Lees, Best Practices for Exempt Reporting Advisers to Build and Implement Compliance Programs to Support a Transition to RIA Status (Part One of Two), Priv. Equity L. Rep. (July 21, 2020).

[44] Commission Interpretation at 33,672.

[45] *See id.* at 33,670, n.9.

[46] *See id.* at 33,672.

[47] *See* Chung & Michaels, *supra* note 6.

[48] Commission Interpretation at 33,673.

[49] *Id.*

[50] *Id.* at 33,674.

The difficulty in developing a "reasonable belief" comes with the unsettled nature of reporting and disclosure guidelines when it comes to ESG investing. There are no settled criteria for advisers to utilize when assessing ESG investments.[51] SEC Chairman John Clayton recently discussed his views on the difficulty of adequately gauging such investments if relying on third-party "rating" tools that provide numerical scores or grades.[52] Thus, investment advisers providing advice on ESG strategies should be careful to rely on any third-party rating tools and should instead develop their own criteria and rigorously investigate potential investments to ensure that the investments satisfy their clients' investment objectives.

Related to the obligation to understand a client's objectives are the reporting obligations under Item 8 of Part 2A of Form ADV. Under this item, an investment adviser must disclose its methods of analysis, its investment strategies, and any specific risk of loss that clients should be willing to bear. Investment advisers with ESG strategies should disclose the specific objectives of the strategy employed and the tools and methodology used to assess appropriate investment opportunities. As it pertains to risks, advisers should specifically identify how their methodologies may result in loss of capital that the client should be prepared to bear.

*The Duty of Loyalty*

The duty of loyalty is the adviser's duty to not place its own interests ahead of its clients'.[53] Critical in meeting this obligation is the duty to make a full and fair disclosure of all material facts relating to the advisory relationship.[54] Regardless of the sophistication of the client, disclosure must be clear and detailed enough for the client to make an informed decision on whether to accept or reject a conflict of interest.[55]

Has the asset manager disclosed sufficiently (i) the risks related to ESG investing, (ii) how ESG factors are integrated into the investment decisionmaking process, and (iii) how the fiduciary is evaluating whether the factors are met and measured over time?[56] Further, conflicts may arise when the adviser uses third-party services (for example "rating tools" of ESG investments) to determine the sufficiency of an investment. If the adviser receives any incentive, the conflict must be fully disclosed and made available to the client.

With respect to US common law, case law regarding whether an adviser breaches its fiduciary duties existing under statute in incorporating ESG factors in its investment decision is undeveloped to date. However, case law is clear that consistent with the SEC guidance on the same, an asset manager breaches its fiduciary duties by making investments contrary to the investment policy of the client, so if that policy requires that ESG be incorporated into the investment process, the manager must do so.[57]

## II. ESG Legal and Regulatory ERISA Framework in the United States

In the United States, employee benefit plans sponsored by private-sector employers represent a significant portion of the assets of institutional investors, estimated at approximately $18.7 trillion as of the first quarter of 2020.[58] The assets of these employee benefit plans are subject to ERISA,[59] which is a federal

[51] *See* Comments by J. Clayton, SEC Chairman (May 27, 2020).

[52] *Id.*; Sustainable Investing, *ESG Funds Draw SEC Scrutiny*.

[53] Commission Interpretation at 33,675.

[54] *Id.* at 33,676.

[55] *Id.* at 33,677.

[56] Knauth, *supra* note 11.

[57] Trs. of Nev. Resort Ass'n - Int'l All. of Theatrical Stage Emps. & Moving Picture Mach. Operators of U.S. & Canada Local 720 Pension Tr. v. Grasswood Partners, Inc., No. 2:11-CV-00044-MMD, 2013 WL 1249617 (D. Nev. Mar. 27, 2013); Sergeants Benevolent Ass'n Annuity Fund v. Renck, 19 A.D.3d 107, 796 N.Y.S.2d 77 (2005); Tussey v. ABB, Inc., No. 2:06-CV-04305-NKL, 2012 WL 1113291 (W.D. Mo. Mar. 31, 2012), amended in part, No. 06-4305-CV-C-NKL, 2012 WL 2368471 (W.D. Mo. June 21, 2012), and aff'd in part, vacated in part, rev'd in part, 746 F.3d 327 (8th Cir. 2014); Goldenberg v. Indel, Inc., 741 F. Supp. 2d 618 (D.N.J. 2010); Landgraff v. Columbia/HCA Healthcare Corp., No. 3-98-0090, 2000 WL 33726564 (M.D. Tenn. May 24, 2000), aff'd, 30 F. App'x 366 (6th Cir. 2002); Cal. Ironworkers Field Pension Tr. v. Loomis Sayles & Co., 259 F.3d 1036 (9th Cir. 2001).

[58] *Retirement Assets Total $28.7 Trillion in First Quarter 2020*, Inv. Co. Inst. (June 17, 2020).

[59] 29 U.S.C. §§ 1001–1461 (2019).

statute that governs private-sector employee benefit plans. ERISA plans pose additional considerations regarding ESG factors as compared to other types of institutional investors based on ERISA's strict fiduciary rules.

The US Department of Labor (DOL) is the primary regulator of the investment activity of ERISA plans. The DOL has the authority to both interpret ERISA and enforce its provisions, as discussed in more detail below.

For purposes of this discussion, we will focus on ERISA-governed retirement plans, which fall into two major categories—defined benefit plans and defined contribution plans. We will provide a brief summary to compare and contrast the two different types of plans because DOL guidance treats them differently to some extent when it comes to the use of ESG factors.

Defined benefit plans promise participants a specified benefit at a designated time. The employer that sponsors the plan (also referred to as the "plan sponsor") bears the investment risk in a defined benefit plan because the plan sponsor is obligated to pay the promised benefits at the designated time regardless of how the plan's assets perform.

Defined contribution plans, in contrast, do not promise any specified benefit but rather provide for employee and/or employer contributions to the plan and a plan participant then receives the balance reflected in his or her plan account at the time the distribution is taken. Thus, the participant (and not the plan sponsor) bears the investment risk. Also, defined contribution plans are overwhelmingly "participant directed," meaning that a participant selects from a menu of investment options made available by the plan sponsor.

Another feature of defined contribution plans that arises in the analysis of ESG considerations is the "qualified default investment alternative," or "QDIA."[60] The QDIA is the investment option in the plan lineup that is used when a participant has not given an affirmative investment option election, for whatever reason. As more and more plan sponsors adopt automatic enrollment features, the assets in QDIAs have continued to grow as participants often do not respond to prompts to direct the investment of their 401(k) contributions.

**ERISA Fiduciaries and Their Duties**

ERISA imposes stringent duties on any person or entity that is a "fiduciary" within the meaning of Section 3(21) of ERISA.[61] Any person or entity that exercises any discretionary authority or discretionary control respecting management of a plan or the disposition of its assets is a fiduciary of the plan within the meaning of ERISA.[62] Most ERISA plans have a number of different fiduciaries. Some fiduciaries may be internal to the employer that sponsors the plan, such as a chief investment officer, a treasurer, investment office staff, or a committee formed by the employer to manage the plan. Other fiduciaries may be third parties retained by the internal plan fiduciaries at the employer, such as investment consultants and investment managers.

Section 404(a) of ERISA imposes four specific duties on fiduciaries:[63]

- A duty to act for the exclusive purpose of providing benefits to participants and their beneficiaries and defraying reasonable expenses of administering the plan;
- A duty to act with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims;
- A duty to diversify the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so; and
- A duty to act in accordance with the documents and instruments governing the plan (insofar as such documents and instruments are consistent with ERISA).

[60] 29 U.S.C. § 1104(c)(5); 29 C.F.R. § 2550.4040c-5 (2019).

[61] 29 U.S.C. § 1102(21) (2019).

[62] *Id.* § 1102(21)(A)(i).

[63] *Id.* § 1104(a).

In addition to the four specific fiduciary duties in Section 404(a) of ERISA, Section 403(c) of ERISA addresses ERISA's requirement that plan assets generally be held in trust and also provides that the assets must be held for the exclusive purpose of providing benefits and defraying reasonable expenses.[64] This is referred to as ERISA's "exclusive benefit rule."

The first of the duties listed above, sometimes referred to as the "duty of loyalty," has raised questions for ERISA fiduciaries considering use of ESG factors in investment decisionmaking. The issue, specifically, has been whether consideration of ESG factors represents acting for a purpose *other than* providing benefits to participants and their beneficiaries or defraying reasonable expenses, in violation of the duty of loyalty. The second of the duties listed above, the duty of prudence, has raised questions with respect to whether investments that take into account ESG factors are prudent investments for an ERISA plan.

There are long-standing regulations interpreting the duty of prudence as applied to plan investment decisionmaking.[65] These regulations require that:

- the fiduciary making an investment or engaging in an investment course of action give appropriate consideration to those facts and circumstances that, given the scope of the fiduciary's investment duties, the fiduciary knows or should know are relevant; and
- the fiduciary acts accordingly.

This includes giving appropriate consideration to the role that the investment or investment course of action plays (in terms of such factors as diversification, liquidity, and risk/return characteristics) with respect to that portion of the plan's investment portfolio within the scope of the fiduciary's responsibility. Currently, this regulation does not specifically address ESG factors. As discussed below, however, a recent DOL proposal would change that.

ERISA imposes serious penalties on fiduciaries who are found to have breached their fiduciary duties. Participants and beneficiaries can bring claims of breach of fiduciary duty to restore to the plan the losses caused by the breach. The DOL can also bring actions for breach of fiduciary duty, both requiring losses to be restored and imposing, in its discretion, an additional monetary penalty for fiduciary breaches. The DOL has enforcement authority as well. The DOL can examine both a plan's internal and third-party fiduciaries and has broad authority to demand documents and records. We have seen recent DOL investigations ask specifically about ESG considerations in plan investing.

**The History of DOL Interpretation and Guidance on Consideration of ETIs/ESG Factors in Plan Investing and Exercising Shareholder Rights**

The DOL has issued guidance on this question in various forms for nearly 30 years. In many respects, that guidance has resembled a ping-pong match as US presidential administrations have come and gone, each seeking to leave its own imprint on the question. An overview of this history helps set the stage for the current circumstances.

*Episode 1—1994*

In 1994, the DOL issued Interpretive Bulletin (IB) 94-1[66] to address what the DOL called "economically targeted investments," or "ETIs." IB 94-1 defined ETIs to mean "investments selected for the economic benefits they create apart from their investment return to the employee benefit plan investor."[67] This points up the challenge that definitions have played in DOL guidance, as investment professionals may not view this definition of "ETI" to mean the same thing as ESG, especially with respect to whether such considerations are intrinsically part of the economic considerations of an investment or whether they are indeed "in addition," as this definition of ETI seems to assume.

[64] *Id.* at § 1103(c).

[65] 29 C.F.R. §§ 2550.404a-1 et seq.

[66] Interpretive Bulletin Relating to the Fiduciary Standard Under ERISA in Considering Economically Targeted Investments, 29 C.F.R. § 2509.94-1 (1994).

[67] *Id.* This definition illustrates one of the challenges in understanding the DOL's guidance because this definition of "ETIs" may not accord with what many in the industry view as "ESG."

The DOL's conclusion in IB 94-1 was that ETIs would be subject to the same standards from the regulation governing the prudence requirements in plan investing as would any other investment. Thus, if an ETI can meet those requirements, then a fiduciary electing to invest in an ETI will not violate the duty of loyalty, the duty of prudence, or the exclusive benefit rule.[68]

*Episode 2—2008*

In 2008, IB 2008-01 superseded IB 94-1.[69] IB 2008-01 retreated from the DOL's prior position that ETIs that can meet the applicable fiduciary requirements are permissible investments. Rather, IB 2008-01 stated that "ERISA's plain text does not permit fiduciaries to make investment decisions on the basis of any factor other than the economic interest of the plan."[70] There was no discussion in IB 2008-01 that the economic benefits created by an ETI may be, in fact, part of "the economic interest of the plan" (a concept that does not arise until the next episode). Rather, ETIs and the "economic interests" of the plans were viewed as two distinct concepts.

IB 2008-01 also introduced the notion of an ETI as a "tiebreaker." The DOL seemed to acknowledge that in the case of two identical investments, a fiduciary could choose the ETI based on its collateral economic benefits by way of "breaking the tie" without violating its fiduciary duties. IB 2008-01 sounded a note of caution, however, by stating that the DOL believes that ERISA fiduciaries will rarely be able to establish that two investments were identical. This is a theme that will arise again.

*Episode 3—2015 and 2016*

In 2015, the Obama DOL withdrew IB 2008-01 and replaced it with IB 2015-01.[71] Notably, IB 2015-01 is also where ESG is distinguished from ETI, along with an acknowledgement that the "terms do not have a uniform meaning and the terminology is evolving." IB 2015-01 also makes the connection between the economic interest of the plan and ESG factors, stating, "Environmental, social, and governance issues may have a direct relationship to the economic value of the plan's investment. In these instances, such issues are not merely collateral considerations or tie-breakers, but rather are proper components of the fiduciary's primary analysis of the economic merits of competing investment choices."[72] The DOL further noted that fiduciaries need not treat investments that take ESG factors into account as "inherently suspect or in need of special scrutiny."[73]

IB 2015-01 also addresses ESG factors in the context of a defined contribution plan investment lineup and states that ERISA's fiduciary duty and the exclusive benefit rule do not preclude consideration of collateral benefits in a fiduciary's decision to designate a "'socially-responsible'" [74] fund in an investment lineup.

**The Current State of Play**

The Trump administration has been active on the issue of ESG considerations in plan investing.

*Field Assistance Bulletin 2018-01*

First, in April 2018 the DOL issued Field Assistance Bulletin 2018-01.[75] This Field Assistance Bulletin, or FAB, purported not to repeal or replace either IB 2015-01 or IB 2016-01. Nor did the FAB directly reject the proposition that ESG factors are properly economic considerations. It did, however, warn that fiduciaries

---

68 *Id.* ("The fiduciary standards applicable to ETIs are no different than the standards applicable to plan investments generally. Therefore, if the above requirements are met, the selection of an ETI, or the engaging in an investment course of action intended to result in the selection of ETIs, will not violate section 404(a)(1)(A) and (B) and the exclusive purpose requirements of section 403.").

69 Supplemental Guidance Relating to Fiduciary Responsibility in Considering Economically Targeted Investments, 29 C.F.R § 2509.08-1 (2008).

70 *Id.*

71 Interpretive Bulletin Relating to the Fiduciary Standard Under ERISA in Considering Economically Targeted Investments, 80 C.F.R. § 65135 (2015).

72 *Id.* at 65,136.

73 *Id.*

74 *Id.* at 65,137.

75 U.S. Dep't of Labor, Field Assistant Bulletin No. 2018-01 (2018).

"must not too readily treat ESG factors as economically relevant to the particular investment choices at issue when making a decision."[76] Further, even if a fiduciary were to treat ESG factors as economically relevant, "the weight given to those factors should also be appropriate to the relative level of risk and return involved compared to other relevant economic factors."[77]

The FAB also addressed the use of ESG factors in defined contribution plan lineups. It confirmed that an ESG-themed fund may be an investment choice among many if it is "a prudently selected, well managed and properly diversified ESG-themed investment alternative"[78] that can be added without requiring participants to forgo other non-ESG-themed investment options.

However, the FAB sounds a note of caution about using an ESG-themed investment option in the investment option that is the "qualified default investment alternative," or "QDIA." The FAB notes that the QDIA is different than simply offering an additional investment option in the lineup because the participant being invested in the QDIA may not have elected to do so and thus "the decision to favor the fiduciary's own policy preferences in selecting an ESG-themed investment option for a 401(k)-type plan . . . would raise questions about the fiduciary's compliance with ERISA's duty of loyalty.[79] This very reasoning, however, proceeds from the assumption that ESG factors are an expression of "the fiduciary's own policy preferences," rather than integral to the economic analysis.

*Proposed Regulation on "Financial Factors in Selecting Plan Investments"*

Most recently, on June 30, 2020 the DOL published a proposed regulation in the *Federal Register* that would amend the regulation discussed above regarding the duty of prudence as applied to the investment duties of an ERISA fiduciary.[80] Many aspects of the original regulations were left intact. Here is a summary of those points that were changed.

First, the description of the duty-of-loyalty and duty-of-prudence requirements now include a specific requirement that the fiduciary "[h]as not subordinated the interests of the participants and beneficiaries in their retirement income or financial benefits under the plan to unrelated objectives, or sacrificed investment return or taken on additional investment risk to promote goals unrelated to those financial interests of the plan's participants and beneficiaries or the purposes of the plan."[81]

Second, a new section has been added to the regulation titled "Consideration of Pecuniary vs. Non-Pecuniary Factors."[82] A "pecuniary factor" is defined as "a factor that has a material effect on the risk and/or return of an investment based on appropriate investment horizons consistent with the plan's investment objectives and the funding policy established pursuant to section 402(a)(1) of ERISA."[83] The proposed regulation provides that a fiduciary's evaluation of an investment must be focused only on pecuniary factors and that ESG considerations are pecuniary factors "only if they present economic risks or opportunities that qualified investment professionals would treat as material economic considerations under generally accepted investment theories."[84]

The new proposed regulation also rekindles the notion of ESG factors as a "tie breaker" for "economically indistinguishable investments."[85] The use of an ESG tie breaker would require the fiduciary to document specifically why two investments were determined to be indistinguishable and why the indistinguishable

---

76 *Id.*

77 *Id.*

78 *Id.*

79 *Id.*

80 Financial Factors in Selecting Plan Investments, 85 Fed. Reg. 39,113–28 (proposed June 30, 2020) (to be codified at 29 C.F.R. pt. 2550).

81 *Id.* at 39,127.

82 *Id.*

83 *Id.* at 39,128.

84 *Id.* at 39,127.

85 *Id.*

investment options were chosen in the first place. In the preamble to the proposed rule (the materials written by the DOL explaining and introducing the rule), the DOL appears to be skeptical that two investments ever really could be indistinguishable, making it somewhat puzzling why this provision was included at all.[86]

Finally, the regulation addresses the use of ESG factors in the investment lineup of participant-directed defined contribution plans. It echoes the FAB in concluding that an ESG-oriented investment option may be included in the lineup if it is "prudently selected, well managed, and properly diversified" and provided that the fiduciary uses "only objective risk-return criteria" in selecting and monitoring *all* investment alternatives, including any "environmental, social, corporate governance, or similarly oriented investment alternatives."[87]

The proposed regulation flatly prohibits any "environmental, social, corporate governance, or similarly oriented investment mandate alternative" from being added as a QDIA or as a component of a QDIA.[88] In the preamble, the DOL states its view that investments with ESG features—even if selected by fiduciaries purely on the basis of objective risk-return criteria—are inappropriate in a QDIA where participant contributions and balances may be invested without a participant's affirmative decision.[89] This prohibition further reflects the DOL's apparent skepticism about the validity of ESG factors as economic factors because, if ESG factors were indeed economic factors, why should participants in the QDIA be deprived of investments taking into account those particular economic factors?

*What's Next?*

The DOL has set an ambitious timetable for the comments and finalization of this regulation. The DOL provided only a 30-day comment period. Comments were due on July 30, 2020, and more than 1,000 comments were received from a variety of industry participants. Many of the comments from organizations representing ERISA plan sponsors expressed concern that the new regulations could be overly rigid and create a fiduciary standard for the consideration of ESG factors that is different from that applicable to other investment decisionmaking.

These comments must then be considered and, if requested, hearings may be scheduled. Once the final rule is published in the *Federal Register*, the regulation will become effective 60 days thereafter. Thus, depending on the length of the period to review comments, it is feasible that the regulation could be finalized prior to inauguration day (possibly even before Election Day, although that seems less likely).

If adopted as proposed, the new regulations may justifiably cause ERISA fiduciaries to pause in their consideration of ESG factors. They can expect that any decisions involving ESG factors will be subject to heightened scrutiny and likely be viewed as requiring heightened or additional documentation. We understand that the DOL is already conducting examinations of both plan sponsors and those providing investment management and advice to plans regarding the use of ESG considerations. Once the DOL examiners have the force of a full-fledged regulation behind them, we might expect these inquiries to sharpen and become more widespread.

Of course, as the history of guidance outlined above demonstrates, things change with the presidential administrations on this issue. The proposed regulation, however, if finalized, has a key difference from the prior IBs in that it is a "notice and comment rulemaking" within the meaning of the Administrative Procedures Act. Generally, the regulation cannot be removed without a notice and comment rulemaking to remove it.[90] Note, however, if a new regulation has been published in the *Federal Register* fewer than 60

---

86 *Id.* at 39,117.

87 *Id.* at 39,127.

88 *Id.*

89 *Id.* at 39,118–19.

90 We note that the Congressional Review Act provides an avenue by which a new president could repeal regulations of the prior president that had been published in the *Federal Register* fewer than 60 days before the inauguration. 5 U.S.C. §§ 801–08. That

days before the change in administration, the new president can rescind such regulation without a notice and comment process. IBs, in contrast, can be removed more readily.

# ESG LEGAL AND REGULATORY OVERSIGHT IN THE EUROPEAN UNION AND UNITED KINGDOM

## I. The European Union

*Setting the Scene*

In 2015, landmark international agreements were established with the adoption of the UN 2030 Agenda for Sustainable Development[91] and the Paris Agreement.[92] The European Union (EU) is one of the parties that adopted the Paris Agreement on climate change and the UN 2030 Agenda for Sustainable Development in 2015. The Paris Agreement, in particular, includes the commitment to align financial flows with a pathway toward low-carbon and climate-resilient development. Climate change is a cross-cutting issue that has an impact on all market participants, from issuers to financial services firms to consumers. The EU supports the transition to a low-carbon, more resource-efficient and sustainable economy; it is looking to build a financial system that supports sustainable growth. The EU's wider package of regulatory change follows global efforts to tackle climate change and achieve a sustainable economy, acknowledging the role that the private sector must play if governments from around the world are to meet their ambitious sustainability targets under the Paris Agreement and the UN 2030 Agenda.[93]

Before we turn to, and in order to develop a proper understanding of, the raft of sustainable finance-related legislation being produced by the EU, we must first address the EU's wider political plan. The EU saw as a threshold task the need to define the concept of "sustainable finance" and did so as follows: the process of taking due account of environmental and social considerations when making investment decisions, leading to increased investment in longer-term and sustainable activities. More specifically, environmental considerations refer to climate change mitigation and adaptation, as well as the environment more broadly and the related risks (e.g., natural disasters). Social considerations may refer to issues of inequality, inclusiveness, labor relations, and investment in human capital and communities. The governance of public and private institutions, including management structures, employee relations, and executive remuneration, plays a fundamental role in ensuring the inclusion of social and environmental considerations in the decisionmaking process. All three components—environmental, social, and governance—are integral parts of sustainable economic development and finance. In the EU's policy context, sustainable finance is understood as finance to support economic growth while reducing pressures on the environment and taking into account social and governance aspects. Sustainable finance also encompasses transparency on risks related to ESG factors that may impact the financial system, and the mitigation of such risks through the appropriate governance of financial and corporate actors.[94]

The EU is examining how to integrate sustainability considerations into its financial policy framework in order to mobilize finance for sustainable growth. The European Commission established a High Level Experts Group (HLEG) in December 2016 to help develop an overarching EU roadmap on sustainable finance. HLEG published its final report in January 2018,[95] concluding that ESG had to be considered as part of the drive toward sustainable finance and recommending the following:

---

procedure has been used relatively infrequently, but the Trump administration used it to roll back 14 Obama-era regulations. Juliet Eilperin & Darla Cameron, *How Trump Is Rolling Back Obama's Legacy*, Washington Post (Mar. 24, 2017).

[91] United Nations, *Transforming Our World: the 2030 Agenda for Sustainable Development* (Oct. 21, 2015).

[92] United Nations, *The Paris Agreement* (Dec. 12, 2015).

[93] United Nations, *supra* note 89.

[94] Eur. Comm'n, *What Is Sustainable Finance?*.

[95] Eur. Comm'n – High-Level Expert Grp. on Sustainable Fin., *Financing a Sustainable European Economy* (2018).

- Establishing a classification system (or taxonomy), starting with climate mitigation, to establish market clarity on what is "sustainable";
- Clarifying investor duties and bringing greater focus on ESG factors when making investment decisions;
- Improving disclosure by financial institutions and companies to make sustainable opportunities and risks transparent;
- Developing official EU sustainability standards for some financial assets, starting with green bonds; and
- Integrating sustainability in financial institutions' governance as well as in financial supervision.

Those recommendations formed the basis of the European Commission's action plan on sustainable finance, which it adopted in March 2018.[96] The 2018 Action Plan on Financing Sustainable Growth states that sustainability and the transition to a low-carbon, more resource-efficient and circular economy are key in ensuring the long-term competitiveness of the EU economy. It adds that the financial system has a key role to play in that transition by reorienting private capital to more sustainable investments, thereby fostering more transparency and long termism in the economy. The action plan set out a strategy to connect finance with sustainability, and included the following:

- Establishing a clear and detailed EU classification system (or taxonomy) for sustainable activities;
- Establishing EU labels for green financial products; this will help investors to easily identify products that comply with green or low-carbon criteria;
- Introducing measures to clarify asset managers' and institutional investors' duties regarding sustainability;
- Strengthening the transparency of companies on their ESG policies; and
- Introducing a "green supporting factor" in the EU prudential rules for banks and insurance companies; this means incorporating climate risks into a bank's risk management policies and supporting financial institutions that contribute to fund sustainable projects.

**A Summary of the Sustainable Finance-Related Legislation**

In May 2018, the European Commission adopted a package of measures implementing several key actions announced in its action plan on sustainable finance. The package included proposals for the following three grounding regulations on:

- The establishment of a framework to facilitate sustainable investment. This regulation, which has become known as the "Taxonomy Regulation,"[97] establishes the conditions and the framework to gradually create a unified classification system or taxonomy on what can be considered an environmentally sustainable economic activity. This is part of the EU's efforts to achieve clarity on what is considered to be a "green" or "sustainable" investment.
- Disclosures relating to sustainable investments and sustainability risks. This regulation, sometimes labeled "the Sustainable Disclosure Regulation,"[98] will introduce disclosure obligations on how institutional investors and asset managers integrate ESG factors into their risk-management processes. Delegated acts will further specify requirements on integrating ESG factors into investment decisions, which is part of institutional investors' and asset managers' duties towards investors and beneficiaries.

---

[96] Eur. Comm'n, Action Plan: Financing Sustainable Growth (Mar. 8, 2018).

[97] 2020 O.J. (L 2020/852), the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088

[98] 2019 O.J. (L 2019/2088), sustainability-related disclosures in the financial services sector (EU).

- Amending the Benchmarks Regulation. The proposed amending regulation, known as the "Low Carbon Benchmark Regulation,"[99] creates a new category of benchmarks comprising low-carbon and positive carbon impact benchmarks, which will provide investors with better information on the carbon footprints of their investments requiring benchmark administrators that pursue or take into account ESG objectives to provide an explanation of how the key elements of the methodology reflect the ESG factors and to explain in their published "benchmark statement" how ESG factors are reflected and setting out the key requirements governing the methodology for the two new benchmarks.

**Taxonomy Regulation**

The Taxonomy Regulation entered into force on July 12, 2020; however, that is not the date on which the provisions apply in practice. Articles 4, 5, 6, 7, 8(1), 8(2), and 8(3) apply from January 1, 2022 when they relate to environmental objectives classified as climate change mitigation and climate change adaptation. The same articles apply from January 1, 2023 when they relate to the other environmental objectives contained in the Taxonomy Regulation.

The Taxonomy Regulation sets out six environmental objectives and allows economic activity to be labeled as environmentally sustainable if it contributes to at least one of the objectives without significantly harming any of the others.

These environmental objectives are:

- climate change mitigation;
- climate change adaptation;
- sustainable use and protection of water and marine resources;
- transition to a circular economy, including waste prevention and increasing the uptake of secondary raw materials;
- pollution prevention and control; and
- protection and restoration of biodiversity and ecosystems.

The Taxonomy Regulation also supplements the disclosure requirements prescribed in the Sustainable Disclosure Regulation.

The taxonomy should prove very helpful for investment funds wishing to develop sustainable products or pursue ESG-related strategies.

**Sustainable Disclosure Regulation**

The Sustainable Disclosure Regulation entered into force on December 29, 2019, but most of the provisions will apply beginning March 10, 2021. However, certain provisions listed in Article 20(3) relating to technical standards have applied since December 29, 2019, and others listed in the same article relating to periodic reporting will apply beginning January 1, 2022.

The Sustainable Disclosure Regulation lays down harmonized rules on transparency for financial market participants and financial advisers with regard to the integration of sustainability risks, the consideration of adverse sustainability impacts, and the provision of sustainability-related information with respect to certain financial products. Financial products falling within the scope of the regulation (including undertakings for the collective investment in transferable securities (UCITs), alternative investment funds (AIFs), and segregated accounts) marketed in the EU that promote, among other things, environmental or social characteristics or have sustainable investment as their objective will have to comply with more granular requirements than other types of financial products. The main objective behind this being to mitigate "greenwashing" and ensure that the "green" or "ESG" labeling is not just a marketing exercise but is actually reflected in investment decisionmaking. The Sustainable Disclosure Regulation also seeks to avoid divergent

[99] 2019 O.J. (L 2019/2089), amending Regulation (EU) 2016/1011 with regard to EU climate transition benchmarks, EU Paris-aligned benchmarks, and sustainability-related disclosures for benchmarks (EU).

measures across EU Member States and to ensure that end-investors are offered standard and comparable information in order to make an informed decision.

As noted above, the Sustainable Disclosure Regulation applies to a wide range of "financial market participants" and "financial advisers," and will introduce requirements at the firm level and at the level of "financial products" as defined in Article 2 thereof. As regards financial market participants, it applies to all managers of AIFs (AIFMs) and UCITS management companies, as well as investment firms providing portfolio management services. The Sustainable Disclosure Regulation also applies to "financial advisers," which include persons (including AIFMs, UCITS management companies, and investment firms) providing investment advice. As regards AIFMs, no distinction is made between smaller subthreshold AIFMs or fully authorized AIFMs. Investment managers employing more than 500 employees will, however, be subject to more granular disclosure requirements.

Non-EU investment managers who are classified as AIFMs may fall within scope. It is expected that non-EU AIFMs managing EU AIFs or actively marketing their products via national private placement regimes in the European Economic Area (EEA) may be required to comply with the Regulation. For example, a US investment adviser managing an Irish AIF or marketing a Cayman AIF or a Singapore-based investment manager managing a Singapore AIF into the EEA may be required by the EU local competent authority to comply with specific requirements of the regulation. It remains to be clarified how information related to the AIFM itself, rather than to the particular financial product that is being managed or distributed, will have to be implemented.

**Low Carbon Benchmark Regulation**

The regulation on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds ((EU) 2016/1011) (the Benchmarks Regulation[100]) has applied since January 2018. The regulation aims to restore investor and consumer confidence in (i) the accuracy, robustness, and integrity of indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds, and (ii) the benchmark-setting process itself. The European Commission proposed reforms to the Benchmarks Regulation, as it identified a lack of appropriate and objective low-carbon indices that could be used as a reference index. It also considered that there is a high risk of greenwashing: that is, where all low-carbon indices are promoted as equally environmentally relevant despite having different characteristics.

The Low Carbon Benchmark Regulation, which entered into force on December 10, 2019, amends the Benchmarks Regulation by introducing two new categories of benchmarks:

- An EU climate transition benchmark, which is a benchmark where the underlying assets are selected, weighted, or excluded in a way that the resulting benchmark portfolio is on a decarbonization trajectory.
- An EU Paris-aligned benchmark, which is a benchmark where the underlying assets are selected, weighted, or excluded in a way that the resulting benchmark portfolio's carbon emissions are aligned with the objectives of the Paris Agreement.

The European Commission is empowered to adopt delegated acts to specify the minimum standards for each of these benchmarks.

The Low Carbon Benchmark Regulation specifically:

- Sets out key requirements for the methodology for EU climate transition and EU Paris-aligned benchmarks. It lists the elements that administrators have to disclose and the procedure to follow to amend their methodology;
- Requires administrators for each benchmark or family of benchmarks that pursue or take into account ESG objectives to explain in the benchmark statement how ESG factors are reflected; and

[100] 2016 O.J. (L 2016/1011), indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No. 596/2014 (EU).

- Requires administrators of benchmarks or family of benchmarks that pursue or take into account ESG objectives to provide an explanation of how the key elements of the methodology reflect the ESG factors.

The European Commission published for consultation draft texts of three delegated acts supplementing the Benchmarks Regulation on April 8, 2020. The texts relate to:

- Minimum standards for EU climate transition benchmarks and EU Paris-aligned benchmarks. This regulation[101] sets out the minimum standards that EU climate transition and EU Paris-aligned benchmarks should meet in order to be labeled as such, and lays down the transparency requirements on the methodology for both benchmarks.
- The explanation in the benchmark statement of how ESG factors are reflected in each benchmark provided and published. This regulation[102] sets out the explanation that should be included in the benchmark statement about how ESG factors are reflected in each benchmark or, where applicable, family of benchmarks provided and published.
- The minimum content of the explanation on how ESG factors are reflected in the benchmark methodology. This regulation[103] lays down the minimum content of the explanation of how the key elements of the benchmark methodology reflect ESG factors for each benchmark, with the exception of interest rate and foreign exchange benchmarks, as well as the standard format to be used.

In July 2018, the European Commission sought advice from the European Securities and Markets Authority (ESMA) on potential legislation under EU directives governing fund managers and investment firms with regard to sustainability.[104] ESMA published its advice on April 30, 2019 in the form of two separate reports, one on integrating sustainability risks and factors in the UCITS Directive and AIFMD[105] and the other on integrating sustainability risks and factors in the Markets in Financial Instruments Directive (MiFID) framework.[106] The European Commission intends to clarify how asset managers, insurance companies, and investment or insurance advisers should integrate sustainability risks and, where relevant, other sustainability factors in the areas of organizational requirements, operating conditions, risk management, and target market assessment. It will do it either by amending existing delegated acts under the UCITS Directive 2009/65/EC, the AIFM Directive 2011/61/EU (AIFMD), the MiFID II Directive 2014/65/EU, the Solvency II Directive 2009/138/EC, and the IDD Directive 2016/97, or by adopting new delegated acts under the same directives.

To that end, on June 8, 2020 the European Commission published consultative draft texts of the delegated acts to integrate sustainability risks and factors into the AIFMD and the UCITS legislative frameworks. The proposals will require AIFMs and UCITS management companies to:

- take sustainability risks into account when complying with organizational requirements, and environmental, social, and governance considerations should be integrated into organizational requirements;
- have expertise for the effective integration of sustainability risks, and senior management's responsibility includes the integration of sustainability risks;

101 Eur. Comm'n, Sustainable Finance – Minimum Standards for Climate Benchmarks (2020).

102 Eur. Comm'n, Sustainable Finance – Environmental, Social and Governance Criteria (Benchmarks) (2020).

103 Eur. Comm'n, Financial Benchmarking – Building in Environmental, Social and Governance Criteria (2020).

104 Eur. Comm'n, Formal Request to EIOPA and ESMA for Technical Advices on Potential Amendments to, or Introduction of, Delegated Acts Under Directive 2009/65/EC, Directive 2009/138/EC, Directive 2011/61/EU, Directive 2014/65/EU and Directive 2016/97/EU with Regard to the Integration of Sustainability Risks and Sustainability Factors (2018).

105 ESMA, ESMA's Technical Advice to the European Commission on Integrating Sustainability Risks and Factors in the UCITS Directive and AIFMD (Apr. 30, 2019).

106 ESMA, ESMA's Technical Advice to the European Commission on Integrating Sustainability Risks and Factors in MiFID II (Apr. 30, 2019).

- include sustainability risks in the identification of any conflicts of interest;
- consider the principal adverse impacts of investment decisions on sustainability factors;
- integrate sustainability risks into the investment due diligence process; and
- include procedures relating to sustainability risks in their risk-management policies.

On the same date, it published consultative draft texts of four further delegated acts covering:

- The MiFID II product governance obligations: MiFID II investment firms manufacturing and distributing financial instruments should consider sustainability factors in (i) the product approval process of each financial instrument, and (ii) in the other product governance and oversight arrangements for each financial instrument that is intended to be distributed to clients seeking financial instruments with a sustainability-related profile. A general statement that a financial instrument has a sustainability-related profile will not be sufficient.[107]
- Organizational requirements and operating conditions for MiFID II investment firms: investment firms providing financial advice and portfolio management will need to carry out a mandatory assessment of sustainability preferences of clients. Investment firms should take these sustainability preferences into account in the selection process of financial products and will also be required to prepare client reports that explain how the recommendation meets a client's investment objectives, risk profile, capacity for loss bearing, and sustainability preferences. The amendments also require investment firms to take into account sustainability risks when complying with the organizational requirements and to integrate sustainability risk into risk-management policies.[108]
- The integration of sustainability risks in the governance of Solvency II insurance and reinsurance undertakings, specifying requirements on governance, conflicts of interest, and risk management for insurance and reinsurance undertakings and requiring insurers to reflect sustainability risks in their risk-management processes, by requiring remuneration policies to be consistent with the integration of sustainability risks, and by requiring that sustainability risks are taken into account in the implementation of the prudent-person principle.[109]
- The product oversight and governance requirements for insurance undertakings and insurance distributors and into the rules on conduct of business and investment advice for insurance-based investment products, integrating sustainability factors in suitability assessments, and integrating sustainability risks into the product oversight and governance requirements and the rules on conflicts of interest.[110]

**Draft Delegated Regulations Under MiFID and Insurance Distribution Directive**

The European Commission published a draft regulation under MiFID on January 4, 2019 on how portfolio managers and financial advisers should take sustainability issues into account when assessing suitability.[111] Under MiFID, investment firms must act in the best interests of their clients. Investment firms providing investment advice or portfolio management are required to provide suitable personal recommendations to their clients or make suitable investment decisions on behalf of their clients. Suitability has to be assessed against clients' knowledge and experience, financial situation, and investment objectives. However, ESG issues are not normally considered under the current suitability regime.

---

[107] Eur. Comm'n, Sustainable Finance – Obligation on Investment Funds to Advise Clients on Social and Environmental Aspects (2020).

[108] *Id.*

[109] Eur. Comm'n, Sustainable Finance – Obligation for (Re)insurance Companies to Advise Clients on Social and Environmental Aspects (2020).

[110] Eur. Comm'n, Sustainable Finance – Obligation for Insurance Firms and Brokers to Advise Clients on Social and Environmental Aspects (2020).

[111] Document Ares (2018) 2681500.

The draft regulation would require firms to identify their clients' ESG preferences so that their advice and investment decisionmaking reflect the clients' financial objectives and ESG preferences. In addition, firms will be asked to ensure that ESG considerations are properly reflected in their policies and procedures required under MiFID in order that they understand the nature, features, costs, and risks of financial instruments selected for their clients. The draft regulation seeks to make concrete the concept of ESG with some helpful definitions, including one for "ESG preferences," which is defined as "a client's choice whether and which environmentally sustainable investments, social investments or good governance investments should be integrated into their investment strategy." In short, the draft regulation clarifies that MiFID firms providing financial advice and portfolio management should:

- carry out a mandatory assessment of their clients' ESG preferences in a questionnaire sent to them;
- take their clients' ESG preferences into account in selecting financial products; and
- for retail clients only, prepare a report to the client that explains how the recommendation to the client meets its investment objectives, risk profile, capacity for loss bearing, and ESG preferences.

The draft regulation helpfully states that there will not be a requirement for existing sustainability assessments to be revisited and contemplates a 12-month transitional period following its commencement.

Notably, ESMA published its "Guidelines on certain aspects of the MiFID II suitability requirements" in 2018[112] taking the opportunity to recommend as good practice that firms should currently consider ESG factors when gathering information on a client's investment objectives, paving the way for investment firms to volunteer to include ESG preferences in their suitability assessments ahead of becoming obliged to do so.

The European Commission also published on January 4, 2019 a draft regulation under the Insurance Distribution Directive as regards the integration of ESG considerations and preferences into investment advice for insurance-based investment products[113] that contains provisions:

- clarifying that insurance intermediaries and insurance undertakings are obliged to conduct, as part of the suitability assessment, an assessment of sustainable preferences of their customers, both in the selection process and in the questionnaire to collect customers' information; and
- requiring insurance intermediaries and insurance undertakings to include information on the ESG preferences in the sustainability statement explaining how the recommendation meets the customer's objectives, risk profile, capacity for loss, and ESG preferences.

**Recent Renewed EU Political Impetus**

The EU continues to invest considerable political capital in its sustainable finance drive and, since its flurry of legislative activity (covered above), has continued to produce initiatives. In December 2019 the European Commission published its "European Green Deal,"[114] emphasizing that the private sector will be key to financing the green transition. In the European Green Deal, the Commission outlines its plans to strengthen the foundations for sustainable investment, make it easier for investors and companies to identify sustainable investments, and manage climate and environmental risks and integrate them into the financial system. A main headline commitment within the European Green Deal is the introduction of legislation to introduce a statutory target for the EU to be carbon neutral by 2050. In addition, it commits to presenting a renewed sustainable finance strategy in the latter part of 2020.

ESMA is prepared to assist the European Commission with the fulfilment of the European Green Deal, in particular by providing advice on integration and consistency within the existing financial regulation. ESMA has already begun the analysis of current financial regulation to identify areas where the risk of

---

[112] ESMA, *ESMA Publishes Final Guidelines on MiFID II Suitability Requirements* (May 28, 2018).

[113] Eur. Comm'n, amending Delegated Regulation (EU) 2017/2359 with regard to environmental, social, and governance preferences in the distribution of insurance-based investment products (2019).

[114] European Commission, *A European Green Deal Striving to Be the First Climate-Neutral Continent* (2019).

greenwashing might arise. In February 2020, ESMA published its strategy for sustainable finance.[115] Its key priorities include:

- completing the regulatory framework relating to transparency obligations arising under the Sustainable Disclosure Regulation.
- including a chapter on risks related to sustainable finance in its reports on trends, risks, and vulnerabilities.
- conducting more analysis of financial risk from climate change, including possible climate-related stress testing.
- fostering supervisory convergence of EU law in the ESG area. ESMA will focus on mitigating the risk of greenwashing, preventing misselling and misrepresentation, and improving transparency and reliability in reporting nonfinancial information.
- participating in the EU platform on sustainable finance under the Taxonomy Regulation. The platform will develop and maintain the EU taxonomy and monitor capital flows to sustainable finance.

Steven Maijoor, the chair of ESMA, delivered a speech in February 2020 about sustainable finance,[116] in which he made recommendations in two areas:

- Regarding ESG disclosures, he highlighted the importance of high-quality information on the impacts that ESG factors have on financial markets participants and companies and vice versa. He stated that ESMA (alongside the other two European Supervisory Authorities) is working on the codification of requirements for the marketing of products claiming to have ESG characteristics and accounting for the adverse impacts of their investments.
- Regarding greenwashing, he called for the creation of an EU standard on green bonds to avoid misselling. He also called for the regulation and supervision of ESG rating agencies, criticizing the lack of public scrutiny of ESG ratings and the lack of clarity on the methodologies underpinning their scoring mechanisms and diversity.

The European Commission published a consultation document on a "Renewed Sustainable Finance Strategy" on April 8, 2020,[117] believing that the current context requires a more comprehensive and ambitious strategy. The renewed strategy will build on the 10 actions put forward in the European Commission's initial 2018 Action Plan on Financing Sustainable Growth, which laid down the foundations for channeling private capital toward sustainable investments. Building on the achievements of the 2018 Action Plan on Financing Sustainable Growth, the Renewed Sustainable Finance Strategy will predominantly focus on three areas:

- Strengthening the foundations for sustainable investment by creating an enabling framework, with appropriate tools and structures. Many financial and nonfinancial companies still focus excessively on short-term financial performance instead of their long-term development and sustainability-related challenges and opportunities.
- Increased opportunities to have a positive impact on sustainability for citizens, financial institutions, and corporations. This second pillar aims at maximizing the impact of the frameworks and tools in the European Commission's arsenal in order to "finance green."
- Climate and environmental risks will need to be fully managed and integrated into financial institutions and the financial system as a whole, while ensuring social risks are duly taken into account where relevant. Reducing the exposure to climate and environmental risks will further contribute to "greening finance."

[115] ESMA, Strategy on Sustainable Finance (Feb. 6, 2020).

[116] ESMA, Sustainable Financial Markets: Translating Changing Risks and Investor Preferences into Regulatory Action (Feb. 12, 2020).

[117] Eur. Comm'n, Consultation Document – Consultation on the Renewed Sustainable Finance Strategy (Apr. 8, 2020).

**Impact of Brexit on the UK's Take-Up of Above EU Legislation**

The UK government's Green Finance Strategy (GFS)[118] says that the UK would "match the ambition" of the EU's 2018 Sustainable Finance Action Plan.

Under the terms of the European Union (Withdrawal) Act 2018, only EU legislation that comes into force before or during the transition period following the withdrawal of the UK from the EU on January 31, 2020 will become retained EU law. This transition period will end on December 31, 2020.

The UK government has decided to onshore into UK law the Benchmarks Regulation as amended by the Low Carbon Benchmark Regulation.

Under the administration led by former Prime Minister Theresa May, HM Treasury set out the then UK government's position on the Sustainable Disclosure Regulation in a memorandum dated July 3, 2018,[119] making clear that the government:

- is supportive of the aim of having a clearer taxonomy across the Green Finance Industry and is broadly welcoming of the 2018 Action Plan on Sustainable Finance. The UK was influential in the HLEG on Sustainable Finance, with a third of its members drawn from UK institutions. The aims outlined in the European Commission's 2018 Action Plan are aligned with the UK's interests in developing green finance, an area in which the UK has significant expertise and thus stands to benefit from any increased export potential in this market.
- is supportive of the aim to enhance the transparency of ESG considerations for the benefit of investors. Existing financial services regulation already contains significant disclosure requirements for firms offering financial products and investment advice, which the UK government support, but are not opposed to the introduction of specific ones for sustainability considerations if it helps investors to make more informed decisions. There could, however, be significant costs to firms associated with updating their disclosures.
- queries whether there is a need to prescribe further disclosure requirements through legislation rather than guidance.

It is now clear that the UK does intend to include the Sustainable Disclosure Regulation itself (but not the range of elaborating technical standards to be promulgated by the European Supervisory Authorities thereunder at a later date) within UK law following the end of the Brexit transition period. An amended draft version of the Financial Services (Miscellaneous Amendments) (EU Exit) Regulations 2020 was published on May 6, 2020 by the administration led by Prime Minister Boris Johnson. Part 3 amends the Sustainable Disclosure Regulation; specifically, Articles 4(6) and (7), 8(3), 9(5), 10(2), 11(4), and 13(2) of the regulation are omitted. These articles all relate to technical standards required to be produced by the European Supervisory Authorities and have been omitted because they will not function effectively at the end of the transition period.

The disclosure requirements set out in Articles 4-8 of the Taxonomy Regulation will only apply with respect to the two environmental objectives after December 31, 2021 and for the remaining environmental objectives after December 31, 2022. Therefore, in the UK these requirements will not form part of retained EU law. However, given that the Taxonomy Regulation entered into force in July 2020, the remainder of the regulation itself (i.e., except Articles 4-8) will become retained EU law. This effectively means that the UK will retain the framework for the taxonomy, including the high-level environmental objectives.

As regards the three draft delegated acts published on April 8, 2020 and the six draft delegated acts published on June 8, 2020, it seems reasonably clear that the UK will not onshore as EU retained law any of those EU delegated acts that have not entered into force by December 31, 2020.

---

118 HM Treasury, Dep't for Bus., Energy & Indus. Strategy*, Green Finance Strategy Transforming Finance for a Greener Future* (July 2, 2019).

119 UK Government memorandum dated 3 July 2018 on the proposal for the Sustainable Disclosure Regulation.

## II. United Kingdom: Green Finance Strategy

The impact of climate change on financial services markets, and the potential for financial services markets to help combat climate change, is well known. There are a number of global, EU, and UK initiatives on this issue: for example, the Financial Stability Board's (FSB's) Task Force on Climate-related Financial Disclosures (TCFD), the European Commission's Sustainable Finance Action Plan (which we address in detail above), and the UK government's GFS and the response of the UK regulators to it. The latter two build off the TCFD to a significant extent, so let us begin by reviewing the TCFD.

### TCFD

There is increasing international recognition of the need to integrate climate and environmental factors into mainstream financial decisionmaking. One of the most influential initiatives to emerge is the FSB's[120] private-sector TCFD, supported by Mark Carney, former governor of the Bank of England, and chaired by Michael Bloomberg.[121] An increasingly large proportion of the private sector is now beginning to implement the TCFD recommendations, and in September 2017, the UK became one of the first countries to formally endorse them.

The TCFD seeks to develop recommendations for voluntary climate-related financial disclosures that are consistent, comparable, reliable, clear, and efficient, and provide decision-useful information to lenders, insurers, and investors. The TCFD's 31 members were chosen by the FSB to include both users and preparers of disclosures from across the G20's constituency covering a broad range of economic sectors and financial markets.

The TCFD reported on the challenges of measuring and disclosing information on risks related to climate change. The Task Force conducted a climate-related financial disclosure review.[122] This found that few companies disclose the financial impact of climate change on the company or the resilience of their strategies under different climate-related scenarios. The Task Force also noted the risks to the value of longer-term investments if current valuations do not adequately factor in climate-related risks because of insufficient information. Another recent study[123] has found there is a lack of sufficiently detailed, consistent, asset-level data on climate-related value creation or erosion, which among other issues makes it difficult for financial institutions to identify assets likely to become stranded.

The TCFD's recommendations were published in June 2017[124] to help businesses disclose risks and opportunities arising from climate change. The aim is to help investors understand which companies are most at risk, which ones are best prepared, and which are taking action. There is already significant support for the TCFD's framework among both issuers and investors. The TCFD's final report sets out four

---

[120] The FSB was established in April 2009 as the successor to the Financial Stability Forum (FSF). At the Pittsburgh G20 Summit in September 2009, the heads of state and government of the G20 endorsed the FSB's original Charter of September 25, 2009 that set out the FSB's objectives and mandate, and organizational structure. The FSB has assumed a key role in promoting the reform of international financial regulation and supervision. The FSB's predecessor institution, the FSF, was founded in 1999 by the G7 Finance Ministers and Central Bank Governors following recommendations by Hans Tietmeyer, president of the Deutsche Bundesbank. G7 ministers and governors had commissioned Dr. Tietmeyer to recommend new structures for enhancing cooperation among the various national and international supervisory bodies and international financial institutions so as to promote stability in the international financial system. He called for the creation of an FSF. G7 ministers and governors endorsed the creation of the FSF at a meeting in Bonn in February 1999. Membership of the FSF brought together:

- national authorities responsible for financial stability in significant international financial centers, namely treasuries, central banks, and supervisory agencies;
- sector-specific international groupings of regulators and supervisors engaged in developing standards and codes of good practice;
- international financial institutions charged with surveillance of domestic and international financial systems and monitoring and fostering implementation of standard; and
- committees of central bank experts concerned with market infrastructure and functioning.

[121] TCFD.

[122] TCFD, *Task Force on Climate-related Financial Disclosures: Status Report* (Sept. 25, 2018).

[123] EY, *Climate Change - the Investment Perspective* (2016).

[124] TCFD, *Recommendations of the Task Force on Climate-related Financial Disclosures* (June 2017).

overarching recommendations. Underneath these sit 11 recommended disclosures that provide more granular detail on the information to be disclosed under each of the recommendations. This framework is intended to provide the market with decision-useful, forward-looking information in four thematic areas: governance, strategy, risk management, and metrics and targets. The four recommendations and the 11 supporting recommended disclosures are shown in the table below.

Figure 4

**Recommendations and Supporting Recommended Disclosures**

| Governance | Strategy | Risk Management | Metrics and Targets |
|---|---|---|---|
| Disclose the organization's governance around climate-related risks and opportunities. | Disclose the actual and potential impacts of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning where such information is material. | Disclose how the organization identifies, assesses, and manages climate-related risks. | Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material. |
| **Recommended Disclosures** | **Recommended Disclosures** | **Recommended Disclosures** | **Recommended Disclosures** |
| a) Describe the board's oversight of climate-related risks and opportunities. | a) Describe the climate-related risks and opportunities the organization has identified over the short, medium, and long term. | a) Describe the organization's processes for identifying and assessing climate-related risks. | a) Disclose the metrics used by the organization to assess climate-related risks and opportunities in line with its strategy and risk management process. |
| b) Describe management's role in assessing and managing climate-related risks and opportunities. | b) Describe the impact of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning. | b) Describe the organization's processes for managing climate-related risks. | b) Disclose Scope 1, Scope 2, and, if appropriate, Scope 3 greenhouse gas (GHG) emissions, and the related risks. |
| | c) Describe the resilience of the organization's strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario. | c) Describe how processes for identifying, assessing, and managing climate-related risks are integrated into the organization's overall risk management. | c) Describe the targets used by the organization to manage climate-related risks and opportunities and performance against targets. |

Source: Final Report, Recommendations of the Taskforce on Climate-related Financial Disclosures, June 2017

The TCFD's final report also includes guidance for all sectors on each of the recommended disclosures. The purpose of the guidance is to assist preparers by "providing context and suggestions for implementing the recommended disclosures." It does this by setting out key matters that the disclosing party should consider when developing its disclosures. The final report was published alongside two additional documents, which will also be relevant to preparers in developing their disclosures. These are:

- Supplementary sector-specific guidance to implement the recommendations in a report titled "Implementing the Recommendations of the Task Force on Climate-related Financial Disclosures";[125] this guidance covers banks, insurance companies, asset owners, asset managers, and nonfinancial companies operating in a range of sectors (including energy, transportation, materials and buildings, agriculture, food, and forest products).
- A Technical Supplement, titled "The Use of Scenario Analysis in Disclosure of Climate-related Risks and Opportunities."[126]

The TCFD encourages organizations to include their climate-related disclosures in their mainstream financial filings. This recognizes that climate-related issues are likely to be material for most organizations. If disclosures are included in mainstream reports, such as the annual financial report, they will be subject to the systems, controls, and governance frameworks that apply more widely for these reports. This approach should also raise awareness and understanding among investors and other users. The TCFD also provides general guidance on the approach to disclosures by way of a set of Fundamental Principles for Effective Disclosure at Appendix 3 of the Final Report, which include guidance that disclosures should contain relevant information; be specific and complete; be clear, balanced, and understandable; be consistent over time; be comparable among organizations within a sector, industry, or portfolio; be reliable, verifiable, and objective; and be provided on a timely basis.

[125] TCFD, *Implementing the Recommendations of the Task Force on Climate-related Financial Disclosures* (June 2017).

[126] TCFD, *The Use of Scenario Analysis in Disclosure of Climate-Related Risks and Opportunities* (June 2017).

**UK's Green Finance Strategy**

On September 18, 2017, the UK government launched a Green Finance Taskforce to speed up the growth of green finance (including private-sector investment in green technologies, infrastructure, and startups) and the transition to a low-carbon economy. In November 2017, the UK government invited the Green Finance Taskforce to present a report and policy recommendations on how the government could best achieve the public and private investment the UK needs to meet its carbon budget and related environmental goals; consider a range of interventions, from making infrastructure investment more sustainable to scaling up green mortgages; and maximize the UK's share of the global green finance market. The government also announced that it had officially endorsed the FSB's TCFD's June 2017 final report and recommendations for the effective disclosure of climate-related financial risks discussed above. The recommendations can be used by companies to provide information to investors, lenders, and insurance underwriters about the financial risks companies face from climate change.

Claire Perry, Minister of State for Climate Change and Industry, commented: "The transition to a low carbon economy is a multi-billion-pound investment opportunity and a key part of this government's Industrial Strategy. Developing standards to promote responsible investment in sustainable projects and establishing the Green Finance Taskforce will help ensure businesses across the UK take full advantage of it."[127]

In March 2018, the Green Finance Taskforce published its report, "Accelerating Green Finance,"[128] which contains wide-ranging recommendations, including:

- measures to strengthen the market for green mortgage products, including recommendations on energy efficiency in buildings;
- clarification of ESG aspects of the fiduciary duty and Statement of Investment Principles for pension fund trustees;
- issuing a sovereign green bond; and
- strengthening nonfinancial narrative reporting on climate change matters, through clearer guidance and implementing the TCFD disclosures.

The report defines green finance as "investment in environmental technology, infrastructure and services" and includes recommendations to:

- establish a new Green Finance Institute (GFI) brand (including a Green Fintech Hub) to strengthen green finance initiative capacity;
- improve climate risk management through advanced data and analytics and a Centre for Climate Analytics;
- strengthen implementation of the recommendations of the TCFD, including a government review of disclosure in 2020 and clarification of government and financial regulator guidelines;
- boost investment into innovative clean technologies, including a dedicated public-private green venture capital fund;
- publish a national capital-raising plan that aligns UK infrastructure planning with the delivery of the Clean Growth Strategy[129] and the 25-year plan[130]. The 25-year plan sets out the UK government's goals for improving the environment, within a generation, to leave it in a better state than it was found in;
- issue a sovereign green bond as part of the plan to raise national capital;

---

[127] HM Treasury, Dep't for Bus., Energy & Indus. Strategy, *UK Government Launches Plan to Accelerate Growth of Green Finance* (Sept. 18, 2017).

[128] Green Finance Taskforce, *Accelerating Green Finance* (Mar. 2018).

[129] HM Treasury, Dep' for Bus., Energy & Indus. Strategy, *The Clean Growth Strategy: Leading the Way to a Low Carbon Future* (Oct. 2017).

[130] HM Treasury, Dep' for Envir., Food & Rural Affairs, *A Green Future: Our 25 Year Plan to Improve the Environment* (Jan. 2018).

- set up local green finance initiatives (for example, clean growth regeneration funds) and a local development finance fund; and
- integrate resilience into the green finance agenda.

The report makes the following recommendations on energy efficiency in buildings and the market for green lending products:

- extend 2035 targets for energy performance certificates from residential properties to commercial properties by the end of 2018;
- introduce a requirement for operational energy ratings starting in 2020;
- introduce green building passports for residential and commercial properties by 2020;
- pilot fiscal measures and mortgage products to boost demand for energy-efficient retrofits from 2019;
- provide short-term incentives to "pump prime" the markets for green consumer loans and green mortgages; and
- promote integrating green factors into lenders' decisions on mortgages.

The report also recommends clarification of investor roles and responsibilities, particularly on ESG issues, including that:

- regulators should ensure that fiduciary duty guidance explains the importance of ESG;
- the government should require the statement of investment principles to include statements on the extent to which ESG issues are considered, and the government should clarify that trustees need to understand their beneficiaries' preferences;
- the government should clarify that investment consultants should have expertise on ESG issues and that investment advisers should ask clients about their sustainability preferences; and
- the Financial Conduct Authority (FCA) should require that contract-based schemes have similar requirements.

The UK government has made a legally binding commitment to achieving net-zero greenhouse gas emissions by 2050.[131] To meet this challenge and in response to the Green Finance Taskforce's March 2018 report, the government published its GFS in July 2019,[132] emphasizing the vital role that financial services play in financing the "greening" of the economy.

A summary of the GFS report follows. According to the report, actions being taken by the UK government to ensure that climate and environmental factors are recognized and acted upon as a matter of strategic and financial imperative include:

- setting out its expectation for all listed companies and large-asset owners to disclose in line with the TCFD recommendations by 2022;
- establishing a joint taskforce with UK regulators, chaired by government, which will examine the most effective way to approach disclosure, including exploring the appropriateness of mandatory reporting;
- supporting quality disclosures through data and guidance, such as those being prepared for occupational pension schemes by a new government and regulator-sponsored working group;
- clarifying responsibilities for the Prudential Regulation Authority (PRA), FCA, and Financial Policy Committee to have with regard to the Paris Agreement when carrying out their duties,

[131] HM Treasury, Dep't for Bus., Energy & Indus. Strategy, *UK Becomes First Major Economy to Pass Net Zero Emissions Law* (June 27, 2019).

[132] HM Treasury, *supra* note 116.

and including climate-related financial issues in the government's allocation letter to the Pensions Regulator;

- working with industry and the British Standards Institution to develop a set of Sustainable Finance Standards, and chairing a new International Organization for Standardization Technical Committee on Sustainable Finance;
- working with the FCA and the Bank of England, including through the Fair and Effective Markets Review, to consider steps that can be taken to understand the potential or actual barriers to the growth and effectiveness of green finance markets; and
- working with international partners to catalyze market-led action on enhancing nature-related financial disclosures.

The UK government will also use its influence to strive toward the greening of the global financial system. This will include:

- playing an active role as a founding member of the Coalition of Finance Ministers for Climate Action;
- co-leading, alongside Egypt, an adaptation and resilience strand at the UN Climate Action Summit;
- partnering with the private sector to drive the phase out of unabated coal power and develop sustainable supply chains;
- exploring initiatives to accelerate the alignment of financial flows to the Paris Agreement's objectives; and
- aligning the UK's Official Development Assistance with the Paris Agreement.

As part of its strategy for mobilizing green investment, actions the UK government will take include:

- announcing a package of measures to mobilize green finance for home energy efficiency;
- using the forthcoming Environment Bill to place the 25 Year Environment Plan on a statutory footing;
- determining the steps necessary for landlords and businesses to understand and potentially disclose operational energy use;
- strengthening engagement with local actors to accelerate green finance across the country;
- working with the GFI to address market barriers to greater and more rapid deployment of green capital into priority sectors; and
- examining, through the National Infrastructure Commission, the resilience of the UK's infrastructure to consider what action the government should take to ensure it is resilient to future changes, such as climate change.

To ensure the UK continues to capture the commercial opportunities arising from the "greening of finance" and the "financing of green," the actions the UK government will take include:

- launching the GFI to strengthen public- and private-sector collaboration and cement the UK's position as a global hub for green finance;
- enhancing climate-related and environmental data and analytics and promoting dialogue with regulators and industry to support innovation;
- promoting the adoption and mainstreaming of green finance products and services, including through the launch of a Green Home Finance Fund making £5 million of funding available to the private sector to pilot products such as green mortgages; and

- engaging with professional bodies to drive green finance competencies—notably through the launch of a Green Finance Education Charter—upskilling the UK's diplomatic networks and building capacity on green finance across the public sector.

The government is also mobilizing green investments internationally, working with governments such as those of China, Brazil, and Mexico to develop green finance markets through the UK Partnering for Accelerated Climate Transitions program and the Prosperity Fund.

In particular, the government set an expectation that all listed issuers and large-asset owners would be disclosing in accordance with the TCFD recommendations by 2022.

On July 2, 2019, the FCA published a Joint Declaration with the PRA, the Pensions Regulator, and the Financial Reporting Council welcoming the publication of the government's GFS and setting out our shared understanding of the financial risks and opportunities of climate change.[133]

**FCA Leadership and Response to GFS and TCFD**

In October 2018, the FCA published its Discussion Paper (18/8) on Climate Change and Green Finance.[134] This sought views on potential FCA action on climate change and green finance, in line with its strategic objective of ensuring that relevant financial markets function well. In particular, the Discussion Paper set out:

- how the different impacts of climate change could impact the FCA's long- and short-term objectives;
- some of the opportunities and risks the transition to a low-carbon economy presents in the UK's financial services markets; and
- the specific action the FCA will take in the near term to ensure that markets function well and deliver good outcomes for consumers.

Green finance is defined by the G20's Sustainable Finance Study Group as the "financing of investments that provide environmental benefits in the broader context of environmentally sustainable development."[135]

Globally, demand for green financial services has significantly increased as part of the transition toward a low-carbon economy but, in the short term, the FCA has identified the following four areas that it believes require greater regulatory focus:

- First, given the long-term nature of pension investments, where the potential impact of climate change–related risks is much more likely given the periods for which products are held, the FCA proposes to address the recommendations of the Law Commission's report on Pension Funds and Social Investment.[136]
- Second, the FCA is taking steps to boost innovation in specialist green products and ensure that these markets work well and deliver good outcomes for all consumers.
- Third, for disclosures by issuers of securities admitted to trading on a regulated market, the FCA intends to explore whether greater encouragement is needed to ensure that issuers give investors appropriate information, and whether issuers require further clarity over what is expected of them.
- Finally, the FCA is seeking views on introducing a new requirement for financial services firms to report publicly to their customers and operations on how they manage climate risks.

---

[133] FCA, *Joint Statement on Climate Change* (July 2019).

[134] FCA (DP 18/8), *Climate Change and Green Finance* (Oct. 2018).

[135] G20 Green Fin. Study Grp., *G20 Green Finance Synthesis Report* (Sept. 5, 2016).

[136] Law Comm'n, *Pension Funds and Social Investment* (June 2017).

In October 2019 and further to its earlier Discussion Paper, the FCA published its Feedback Statement, "Climate Change and Green Finance: summary of responses and next steps,"[137] presenting its evolving approach following the Discussion Paper. The Feedback Statement sets out: why climate change is an important issue for the FCA, the financial services sector, and the users of financial services; provides a summary of feedback to its Discussion Paper and responses; and describes its actions to date and next steps.

To meet its strategic and operational objectives in respect of climate change and green finance, the FCA announced that it will focus on three outcomes:

- issuers are to provide markets with readily available, reliable, and consistent information on their exposure to material climate change risks and opportunities;
- regulated financial services firms are to integrate consideration of material climate change risks and opportunities into their business, risk, and investment decisions; and
- consumers are to have access to green finance products and services that meet their needs and preferences and receive appropriate information and advice to support their investment decisions.

Clearly, achieving this will involve close collaboration by the FCA with government, other regulators, and industry, particularly as work on common global metrics and standards on sustainability is still developing.

More generally, the FCA notes there are currently no universally agreed common, minimum standards and guiding principles for measuring the performance and impact of green finance products. Minimum standards can be helpful for enhancing investor confidence and trust and enabling markets to develop. For example, minimum standards may help ensure investors understand what they are buying and prevent misleading greenwashing of financial products and services. Greenwashing is marketing that portrays an organization's products, activities, or policies as producing positive environmental outcomes when that is not the case. Adequate disclosure of climate change risks can have an impact on the value of long-term investment decisions. As noted above, there are particular risks in the pensions sector, due to the long-time horizons of the investments, that make climate change a material factor in the financial performance of pension funds and the UK insurance sector. If these investments are used to provide for people's retirement, they could be heavily affected if they do not take into account the impacts of climate change.

As part of exercising stewardship of investee companies, the FCA observes that asset managers and other financial services providers will necessarily have to consider the impact on valuation of underlying investments. Firms may also take the effect of climate change into account as part of broader considerations of sustainability. The FCA wants to ensure that its regulatory approach creates an environment where financial services firms can adequately manage the market risks from moving to a low-carbon economy, but are also able to exploit opportunities to benefit consumers.

In its earlier Discussion Paper, the FCA invited views on how to enhance the consistency, comparability and decision usefulness of climate-related financial disclosures, with specific reference to the TCFD's recommendations. In its Feedback Statement, the FCA reveals that many stakeholders asked the FCA to clarify existing issuer disclosure requirements and potentially strengthen them via rules, in a proportionate manner. Respondents to the Discussion Paper shared the following views with the FCA that the FCA noted in the Feedback Statement:

- Existing disclosure obligations for issuers already require climate-related disclosure.
- Industry would support promoting greater consistency in the approach to materiality, and to disclosures more generally. Stakeholders see a case for the FCA to clarify existing issuer disclosure obligations and potentially strengthen them via rules, in a proportionate manner.
- The TCFD's 11 recommended disclosures were already widely regarded as providing a useful framework to enhance and structure climate-related financial disclosures; guidance would need to be developed over time to ensure an appropriate degree of consistency and comparability.

[137] FCA (FS 19/6), *Climate Change and Green Finance: Summary of Responses and Next Steps (Feedback to DP18/8)* (Oct. 2019).

- There were mixed views on the appropriate compliance basis, with the majority of respondents favoring a "comply or explain" approach, at least initially. They noted that capabilities are still emerging in this area and acknowledged that directors' liability attaches to disclosures made by public companies.

In March 2020 and further to its Feedback Statement, the FCA published its Consultation Paper, "Proposals to enhance climate-related disclosures by listed issuers and clarification of existing disclosure obligations."[138] The FCA proposes to introduce a new rule for commercial companies with a UK premium listing, requiring them to state whether they comply with the recommendations of the TCFD and to explain any noncompliance. The proposed new rule promoting adoption of the TCFD's recommendations will directly affect commercial companies with a UK premium listing. The FCA considers its proposed new rule to be a first step toward adoption of the TCFD's recommendations more widely within its Handbook, both as they apply to listed companies and as they apply to financial services companies. The FCA proposes that the new rule take effect for accounting periods beginning on or after January 1, 2021. This will mean that the first reports that have to be issued in compliance with the proposed rule would be published in 2022.

The FCA is also consulting on guidance with regard to existing obligations set out in EU legislation and in the FCA Handbook that may already require issuers to disclose information on climate-related and wider ESG matters under certain circumstances. The guidance on which the FCA is also consulting impacts a wider scope of issuers, not just those in the premium segment, including:

- listed issuers;
- issuers with securities admitted to trading on regulated markets; and
- other entities in the scope of requirements under the Market Abuse Regulation[139] and the Prospectus Regulation.[140]

The new rule and guidance will reference specific versions of the TCFD's publications; i.e., the documents published by the TCFD in June 2017. The FCA remarks that its proposals are consistent with the direction of travel in the UK government's GFS.

Several asset management firms, and insurance companies with asset management businesses, have a UK premium listing and therefore fall within the scope of the proposed new rule. The TCFD's report, "Implementing the Recommendations of the Task Force on Climate related Financial Disclosures," also published in June 2017, acknowledges that where an asset manager is a public company, it has two distinct groups of users for its climate-related financial disclosures:

- the asset manager's shareholders, who will be interested in risks and opportunities at enterprise level; and
- the asset manager's clients, who want information on the asset manager's products and investment strategies.

The TCFD emphasizes the information needs of asset management clients. More specifically, the TCFD suggests that asset managers should consider materiality through the lens of investment performance for clients. As part of this, the TCFD recommends reporting to clients on the "carbon footprint" of their portfolios, further suggesting that these disclosures be made irrespective of a materiality assessment. The TCFD also recommends that asset managers provide climate-related financial information to their clients using existing reporting channels, where relevant. The FCA states it is still considering how best to enhance climate-related disclosures by regulated firms, coordinating with the cross-regulator taskforce on TCFD implementation, and taking into account relevant EU disclosure initiatives. In the meantime, the FCA expects in-scope asset managers and insurance companies with asset management businesses to prepare enterprise-level disclosures in their capacity as issuers, rather than in their capacity as regulated firms. That

---

138 FCA (CP 20/3), *Proposals to Enhance Climate-Related Disclosures by Listed Issuers and Clarification of Existing Disclosure Obligations* (Mar. 2020).

139 596/2014/EU.

140 2017/1129/EU.

is, the FCA expects them to assess materiality and report climate-related financial information in a manner consistent with premium-listed commercial companies operating in other industries. The FCA will separately clarify its approach to enhancing climate-related disclosures by asset managers as FCA-regulated firms. However, the FCA sees considerable benefit to clients from receiving targeted climate-related information on asset managers' products and strategies, and it therefore encourages these firms to voluntarily make disclosures in line with the TCFD's framework for asset managers.

Accordingly, the FCA proposes to take an approach that will foster best practice but will not force issuers into making disclosures they cannot confidently support or discourage them from making best efforts. Therefore, the FCA proposes to introduce the new rule on a "comply or explain" basis, at least initially. A comply-or-explain approach will allow in-scope issuers to either make TCFD-aligned climate-related disclosures or explain publicly why they have not done so. In particular, this will mean that in-scope issuers will have to include a statement of compliance in their annual financial report, setting out whether they have made disclosures consistent with some or all of the TCFD's four recommendations and the 11 supporting recommended disclosures.

Finally, the FCA notes that it is considering how best to enhance climate-related disclosures by regulated firms, including asset managers and life insurers. In doing so, it is coordinating with government and other regulators and also taking into account interactions with relevant EU disclosure initiatives.

## UK Stewardship Code 2020

The Financial Reporting Council's (FRC's)[141] 2020 version of the UK Stewardship Code[142] applicable from January 1, 2020 describes good practice for institutional investors when engaging with investee companies. The UK Stewardship Code 2020 (the Code) defines "stewardship" as "the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society."

The Code sets high stewardship standards for asset owners and asset managers, and for service providers that support them. The Code comprises a set of "apply and explain" principles for asset managers and asset owners and a separate set of principles for service providers. Both sets of principles are set out in the table below. The Code does not prescribe a single approach to effective stewardship. Instead, it allows organizations to meet the expectations in a manner that is aligned with their own business models and strategies.

| PRINCIPLES FOR ASSET OWNERS AND ASSET MANAGERS |
|---|
| Purpose and governance |
| 1. Purpose, strategy and culture |
| 2. Governance, resources and incentives |
| 3. Conflicts of interest |
| 4. Promoting well-functioning markets |
| 5. Review and assurance |
| Investment approach |
| 6. Client and beneficiary needs |
| 7. Stewardship, investment and ESG integration |
| 8. Monitoring managers and service providers |
| Engagement |
| 9. Engagement |
| 10. Collaboration |
| 11. Escalation |
| Exercising rights and responsibilities |
| 12. Exercising rights and responsibilities |

[141] The FRC's mission is to promote transparency and integrity in business. The FRC sets the UK Corporate Governance and Stewardship Codes and UK standards for accounting and actuarial work, monitors and takes action to promote the quality of corporate reporting, and operates independent enforcement arrangements for accountants and actuaries. As the Competent Authority for audit in the United Kingdom, the FRC sets auditing and ethical standards and monitors and enforces audit quality.

[142] FRC, *The UK Stewardship Code 2020*.

| PRINCIPLES FOR SERVICE PROVIDERS | |
|---|---|
| 1. | Purpose, strategy and culture |
| 2. | Governance, resources and incentives |
| 3. | Conflicts of interest |
| 4. | Promoting well-functioning markets |
| 5. | Supporting client's stewardship |
| 6. | Review and assurance |

Stewardship activities include:

- analysis before investment;
- monitoring assets and service providers;
- engaging issuers and holding them to account on material issues;
- working with others to influence issuers and manage market-level risks; and
- publicly reporting on the outcomes of these activities.[143]

All UK FCA-authorized asset managers must produce a statement of commitment to the Code or explain why it is not appropriate for their business model. The FCA's Conduct of Business sourcebook 2.2.3R requires a firm (other than a venture capital firm) that is managing investments for a professional client that is not a natural person to disclose clearly on its website, or if it does not have a website then in another accessible form, either:

- the nature of its commitment to the Code; or
- where it does not commit to the Code, its alternative investment strategy.

The investment market has changed significantly since the publication of the first UK Stewardship Code in 2012. There has been significant growth in investment in assets other than listed equity, such as fixed-income bonds, real estate, and infrastructure. These investments have different terms, investment periods, rights, and responsibilities, and signatories will need to consider how to exercise stewardship effectively in these circumstances.

Environmental factors (particularly climate change) and social factors, in addition to governance, have become material issues for investors to consider when making investment decisions and undertaking stewardship. The Code also recognizes that asset owners and asset managers play an important role as guardians of market integrity and in working to minimize systemic risks as well as being stewards of the investments in their portfolios.

The 2020 Code has a greater focus on ESG (including climate change) matters than the previous version. The key changes on ESG aspects include:

- The new definition of "stewardship," which clarifies that the purpose is to create value for clients and beneficiaries (rather than to create value for beneficiaries, the economy, and society). The definition of stewardship refers specifically to the "sustainable benefits for the economy, the environment and society." Signatories are expected to take ESG matters, including climate change, into account and to ensure their investment decisions are aligned with their clients' needs.
- For service providers, Principle 5 provides: "Signatories support clients' integration of stewardship and investment, taking into account, material environmental, social and governance issues, and communicating what activities they have undertaken."
- The principles for asset managers and asset owners include that:

  (i) signatories systematically integrate stewardship and investment, including material ESG issues, and climate change, to fulfill their responsibilities (Principle 7); and

[143] *See* FRC, *Feedback Statement – Consulting on a Revised UK Stewardship Code*, ¶ 2.4 (Oct. 2019).

(ii) signatories' purposes, investment beliefs, strategies, and culture enable stewardship that creates long-term value for clients and beneficiaries, leading to sustainable benefits for the economy, the environment, and society (Principle 1).

- In relation to Principle 7 for asset managers and asset owners, the reporting outcomes provide that signatories should disclose the issues they have prioritized for assessing investments before holding, monitoring through holding and exiting. This should include the ESG issues of importance to them.
- In relation to their activities, signatories should explain either:

(i) how integration of stewardship and investment has differed for funds, asset classes, and geographies and how they have ensured that:

  - tenders have included a requirement to integrate stewardship and investment, including material ESG issues; and
  - the design and award of mandates include requirements to integrate stewardship and investment to align with the investment time horizons of clients and beneficiaries; or

(ii) the processes they have used to:

  - integrate stewardship and investment, including material ESG issues, to align with the investment time horizons of clients and/or beneficiaries; and
  - ensure that service providers have received clear and actionable criteria to support integration of stewardship and investment, including material ESG issues.

For the outcomes, signatories should explain how information gathered through stewardship has informed acquisition, monitoring, and exit decisions, either directly or on their behalf, and with reference to how they have best served clients and/or beneficiaries.

Asset managers, asset owners, and the companies that they invest in should consider that there is increasing momentum for companies to report on climate-related risks and opportunities in their annual reports in line with the TCFD recommendations.

**Climate Financial Risk Forum**

On June 29, 2020 the Climate Financial Risk Forum (the CFRF) published a guide written by industry for industry to help firms approach and address climate-related financial risks.[144] The guide provides practical recommendations to firms of all sizes on disclosure of climate-related financial risks, effective risk management, scenario analysis, and opportunities for innovation in the interest of consumers.

The CFRF was jointly established in March 2019 by the FCA and the PRA, reflecting the importance of climate change to their respective strategic objectives. Its aim is to build capacity and share best practice across financial regulators and industry to advance the sector's responses to the financial risks from climate change. Membership is drawn from a wide range of industry participants to ensure the perspectives of a broad range of firms are represented.

The objective of the guide is to help firms understand the risks that arise from climate change and to provide support on how to integrate these risks into their strategy and decisionmaking processes. Each chapter within the guide provides practical tools, experience, knowledge, and case studies that firms can use as they develop their strategies, processes, and approaches. The key areas are:

- risk management: by appropriately embedding climate-related financial risk into their governance and risk management processes, firms can make informed business decisions and improve their resilience;

[144] FCA, *Climate Financial Risk Forum* (June 29, 2020).

- scenario analysis: by appropriately modeling and considering a range of possible scenarios, a firm can better understand and manage future risks today, while capturing opportunities to support the transition to a net-zero carbon economy;
- disclosures: by making effective climate-related financial disclosures, a firm can improve transparency, thereby helping the market appropriately assess the true future value of assets; and
- innovation: by developing novel products, services, policies, and approaches, a firm can adapt its business to respond to the potential impacts of climate change, benefit consumers, and deliver the change required to meet climate goals.

Addressing climate-related financial risk is an ongoing process, and this guide could assist firms in doing this. The guide complements wider work from both regulators in this space. This includes the FCA's proposals to improve issuers' climate risk disclosures through applying the recommendations of the TCFD.

Sheldon Mills, the FCA co-chair of the CFRF and Interim Executive Director of Strategy and Competition, commented on the day of publication: "Climate change represents an unprecedented challenge to the planet, and the financial services industry has a significant role to play if we are to meet the UK's target of net zero by 2050. The CFRF is a positive example of collaboration between regulators and industry to find common ways to overcome barriers to meeting this challenge. The Guide will be a helpful tool for firms in seeking to address the risks and potential opportunities presented by the transition to net zero. We will continue to work through the forum to build upon this progress."

# ESG LEGAL AND REGULATORY OVERSIGHT IN HONG KONG AND SINGAPORE

## I. Hong Kong

ESG is not defined under Hong Kong laws, rules, regulations, regulatory guidelines, or circulars. However, in line with global trends , ESG is gaining traction, and the following section aims to provide an overview of the ESG-related initiatives promoted by the key regulators of the financial services sector, the Hong Kong Securities and Futures Commission (the SFC) and the Hong Kong Monetary Authority (the HKMA), since September 2018.

### ESG Regulatory Framework in Hong Kong

*The Hong Kong Securities and Futures Commission*

The SFC has been active in publishing ESG frameworks for policies, guidance, and disclosures and engaging the market of asset managers on ESG through surveys. It has been particularly focused on environmental guidance, both publishing a framework and releasing findings of a survey on ESG factors.

The Strategic Framework for Green Finance was published in September 2018.[145] Among the key action items were:

(i) enhancing disclosure by listed companies of environmental information (in particular climate-related disclosure);

(ii) conducting a survey of asset managers and asset owners on their sustainable investment practices and engaging with the industry to formulate appropriate policies and guidance;

(iii) facilitating the development of a wider range of green-related investments;

(iv) supporting investor awareness in green finance; and

(v) participating in international initiatives.

[145] SFC, *Strategic Framework for Green Finance* (Sept. 21, 2018)

In December 2019, the SFC released findings of its survey on Integrating ESG Factors and Climate Risks in Asset Management.[146] Included in the findings is an indication by the SFC of its plan to develop standards and provide practical guidance on the management of climate change risks in asset management, and establish an industry group to exchange views among the SFC and experts on environmental and climate risks and on sustainable finance.

In April 2019, the SFC published the "Circular to Management Companies of SFC Authorized Unit Trusts and Mutual Funds – Green or ESG Funds."[147] One of the main purposes of this circular is to enhance comparability of disclosures between similar types of SFC-authorized green or ESG funds and their transparency and visibility in order to facilitate investors to make informed investment decisions in this evolving investment area. Moreover, this circular sets out the SFC's expectation on how the existing Code on Unit Trust and Mutual Funds and disclosure guidelines for SFC-authorized funds apply to green or ESG funds, and provides guidance to those funds.

Lastly, the SFC has published a list of SFC-authorized green and ESG funds that will be updated from time to time.[148]

*The Hong Kong Monetary Authority*

The HKMA also is particularly focused on the environmental prong of ESG. In May 2019, the HKMA introduced three sets of measures to support and promote Hong Kong's green finance development.[149]

One of the measures is a three-phase approach to promote green and sustainable banking. Phase I includes, among other things, developing a common framework to assess the "Greenness Baseline" of individual authorized institutions (AIs). In May 2020, the HKMA launched its "greenness" self-assessment framework,[150] which consists of six key elements: (i) governance, (ii) corporate planning and tools, (iii) risk management process, (iv) business policies, products and services, (v) performance and resources, and (vi) disclosure and communication. The HKMA highlighted that the assessment is not a pass-or-fail test, and that one objective of the framework, among others, is to assist AIs in reviewing readiness and preparedness in addressing climate and environmental risks. Around 50 AIs will initially be expected to complete the assessment within 12 weeks.

Regarding Phase II of the three-phase approach, the main focus is the development of supervisory expectations and requirements for green and sustainable banking. As a precursor to an upcoming formal consultation of supervisory requirements, the HKMA published a white paper in June 2020151 that sets out its initial thinking about its supervisory approach to addressing climate-related issues—including nine guiding principles covering the areas of governance, strategy, risk management, and disclosure.

Another two measures include (i) adopting a principle that priority can be given to green and ESG investments if the long-term return is comparable to other investments on a risk-adjusted basis, and (ii) establishing the Centre for Green Finance under the HKMA Infrastructure Financing Facilitation Office, which will serve as a platform for technical support and experience-sharing for green development of the Hong Kong banking and finance industry.

*The Hong Kong Exchanges and Clearing Limited and the Stock Exchange of Hong Kong*

We would be remiss in failing to highlight the ESG-related enhanced disclosures applicable to companies listed on the Stock Exchange of Hong Kong (SEHK). The SEHK, a wholly owned subsidiary of the Hong

---

[146] SFC, *Survey on Integrating Environmental, Social and Governance Factors and Climate Risks, in Asset Management* (Dec. 16, 2019)

[147] SFC, *Circular to Management Companies of SFC-Authorized Unit Trusts and Mutual Funds – Green or ESG Funds* (Apr. 11, 2019).

[148] SFC, *List of Green and ESG Funds* (Feb. 24, 2020).

[149] HKMA, *HKMA Introduces Key Measures on Sustainable Banking and Green Finance* (May 7, 2019).

[150] HKMA, *Common Assessment Framework on Green and Sustainable Banking* (May 13, 2020).

[151] HKMA, *White Paper on Green and Sustainable Banking* (June 30, 2020), published by the HKMA, dated 30 June 2020.

Kong Exchanges and Clearing Limited (HKEx), introduced the ESG Guide in 2013.[152] In 2016, the SEHK upgraded the ESG Guide's reporting obligation to "comply or explain," and this significantly moved the dial for Hong Kong reporting of ESG by companies listed on the SEHK.[153] With an aim to further enhance the quality of disclosure, the SEHK released in December 2019 the conclusions to its consultation on the review of the SEHK and related Listing Rules.[154] The changes include the requirement to shorten the deadline of ESG reports to five months after financial year end, the introduction of a mandatory disclosure requirement, including (i) a board statement of the board's consideration of ESG issues; (ii) application of the relevant reporting principles (materiality,[155] quantitative,[156] balance[157] and consistency[158]); and (iii) a narrative explaining the reporting boundaries of the ESG report and describing the process used to identify which entities or operations are included in the ESG report. The ESG report also includes comply-or-explain provisions on environmental and social factors.

Further, in June 2020 the HKEx announced plans to launch the HKEx Sustainable and Green Exchange (STAGE), which is a new information platform that will act as a central hub for data and information on sustainable and green finance investments in the region.[159] During its initial phase (until the end of 2020), STAGE will be a repository of information on sustainability, green and social bonds, and ESG-related exchange-traded products listed on HKEx. Over time, HKEx will consider expanding its coverage to introduce more asset classes and product types.[160]

*Other Regulatory ESG Activity*

In support of the promotion of green finance and green bonds, the Hong Kong Green Finance Association published a green bond guide, which, among other things, sets out a set of green bond principles that issuers may follow.[161] It also issued an environmental impact assessment guidance, which provides guidance to the bond issuers or parties involved in the bond issuance on how to conduct impact assessment in the context of green bonds.[162]

Further, the Hong Kong Quality Assurance Agency (HKQAA) has implemented Green Finance Certification Schemes, which provide third-party conformity assessments on different green financial products, such as green debt instruments and green funds. In May 2020, the HKQAA further launched a new extension, Green Finance Certification Scheme – ESG Fund, for ESG funds.[163]

**ESG Trends in Hong Kong**

ESG factors are increasingly being considered by regulators, issuers, and asset managers. For the green bond market in Hong Kong, as part of the HK$100 billion green bond scheme, in May 2019 the Hong Kong government issued its inaugural green bond with an issuance size of US$1 billion, attracting more than

---

[152] HKEx, *Consultation Paper on Review of the Environmental, Social and Governance Reporting Guide and Related Listing Rules* (May 2019).

[153] *Id*.

[154] HKEx, *Consultation Conclusions on Review of the Environmental, Social and Governance Reporting Guide and Related Listing Rules* (Dec. 2019).

[155] Materiality: The threshold at which ESG issues determined by the board are sufficiently important to investors and other stakeholders that they should be reported. *See id*.

[156] Quantitative: Key performance indicators (KPIs) in respect of historical data need to be measurable. The issuer should set targets (which may be actual numerical figures or directional, forward-looking statements) to reduce a particular impact. In this way, the effectiveness of ESG policies and management systems can be evaluated and validated. *See id*.

[157] Balance: The ESG report should provide an unbiased picture of the issuer's performance. The report should avoid selections, omissions, or presentation formats that may inappropriately influence a decision or judgment by the report reader. *See id*.

[158] Consistency: The issuer should use consistent methodologies to allow for meaningful comparisons of ESG data over time. *See id*.

[159] HKEx, *HKEx to Launch New Sustainable and Green Exchange* (June 18, 2020).

[160] *Id*.

[161] Hong Kong Green Fin. Ass'n, *Our Guide to Green Bonds* (Sept. 2019).

[162] Hong Kong Green Fin. Ass'n, *Green Bond Environmental Impact Assessment* (Sept. 2019).

[163] For details of different Green Finance Certificate Schemes.

US$4 billion in orders from investors.[164] Furthermore, there was an increase in diversification of issuer types and project categories funded by green bonds in 2019 when compared with 2018, while the largest proceed allocation of green bonds by volume was the buildings category, followed by the waste category and the industry, transport, water, and land-use category.[165] As for investment strategies of issuers, the SFC received a noticeable increase during 2018 in the number of new fund applications and applications for a change of investment strategy to adopt an ESG investment theme.[166]

In addition, some other clues may indicate the potential affect of ESG on companies' fundraising—the application for an initial public offering (IPO) of Megvii Technology Limited (Megvii) is an example. Megvii, a Chinese artificial intelligence company, submitted an application for an IPO on the main board of the SEHK in August 2019.[167] In October 2019, it was blacklisted by the US government for its alleged involvement in human rights violations with respect to Beijing's repression of Muslim minorities.[168] Megvii let its application to the SEHK lapse in February 2020 and did not resubmit the application as an extension before the deadline of May 2020.[169] Despite the lack of official explanation from Megvii about the lapse of its IPO application, some observers maintain that this was, to a certain extent, related to investors' general reluctance to invest in companies that have an undesirable public image in terms of social issues.

On May 5, 2020, the HKMA and the SFC initiated the establishment of the Green and Sustainable Finance Cross-Agency Steering Group (the Steering Group).170 Other members of the Steering Group are the Environment Bureau, the Financial Services and the Treasury Bureau, the HKEx, the Insurance Authority, and the Mandatory Provident Fund Schemes Authority.

The Steering Group aims to coordinate the management of climate and environmental risks to the financial sector, accelerate the growth of green and sustainable finance in Hong Kong, and support the Hong Kong government's climate strategies through:

(i) examining policy and regulatory issues in green and sustainable finance, particularly those that may have a cross-sectoral impact;

(ii) facilitating policy direction and coordination to ensure Hong Kong has a cohesive and comprehensive green and sustainable finance strategy;

(iii) addressing technical cross-sectoral issues by, for example, forming technical working groups and consulting with different experts and stakeholders;

(iv) tracking international and regional trends, issues, and developments in green and sustainable finance, and considering how Hong Kong should better position itself and provide leadership in the region and globally; and

(v) identifying areas where Hong Kong can promote its strengths and thought leadership on green and sustainable finance regionally and globally.

## II. Singapore

Another active ESG jurisdiction is Singapore. This section sets forth the ESG practices in Singapore with particular focus on regulatory guidance in Singapore and the general approach to ESG in Singapore. As further set forth below, ESG is not heavily regulated in the Singapore financial and capital markets sectors. Instead, it is governed by a mixture of self-regulating and voluntary practices. On ESG trends in Singapore, recent developments weigh toward sustainable financing and ESG-linked investment products as led and encouraged through initiatives by the Monetary Authority of Singapore (MAS).

---

164 *See* Thomson Reuters (J. Fioretti), *Hong Kong Raises $1 Billion in Oversubscribed First Green Bond* (May 21, 2019).

165 Climate Bonds Initiative, *Hong Kong Green Bond Market Briefing 2019* (May 2020).

166 Chartered Secretaries, *Green Finance: An SFC View* (Mar. 11, 2019).

167 *See* *US-Blacklisted Chinese AI Firm Megvii Cleared for US$500 Million Hong Kong IPO*, S. China Morning Post (Jan. 6, 2020).

168 *Id.*

169 S&P Glob. Mkt. Intel., *Megvii Lets Hong Kong IPO Application Lapse Again* (May 25, 2020).

170 HKMA, *Joint Statement on the Establishment of the Green and Sustainable Finance Cross-Agency Steering Group* (May 5, 2020).

**ESG Regulatory Framework in Singapore**

At a regulatory level, the different levels governing ESG practices in Singapore may be broadly categorized as ESG regulations, self-regulation, and voluntary practices.

*ESG Regulations*

The first level involves ESG regulations containing the force of law where noncompliance may result in organizations attracting criminal sanction and penalties. For example, in the real estate industry, developers constructing new buildings or carrying out major retrofitting for existing buildings[171] are required to meet the minimum environment sustainability standards under the Building Control (Environmental Sustainability) Regulations[172] and the Code for Environmental Sustainability of Buildings.[173] Although there are certain examples of this level of regulation, self-regulation is the more common approach in Singapore.

*Self-Regulation*

Self-regulation refers to a regulatory authority or trade association that issues self-regulating guidelines for its organizations to abide by. This self-regulating approach is prominent within the financial and capital markets industry in Singapore. Although these guidelines do not contain the force of law, noncompliance at this level may result in adverse consequences to organizations in terms of negative publicity, in turn making these organizations a less attractive investment proposition to public investors. Here are some examples of self-regulatory authorities and trade associations in Singapore:

(i) The Singapore Exchange (SGX) introduced sustainability reporting in June 2016,[174] mandating listed companies to report on material ESG factors on the "comply or explain" regime under its listing rules. The comply-or-explain regime requires listed companies to publicly report on material factors and explain any noncompliance or deviation from best practices. Listed companies are also required to report on their corporate governance practices in compliance with the Code of Corporate Governance[175] under the same regime.

(ii) In the banking industry, the Association of Banks in Singapore (ABS) issued the ABS Guidelines on Responsible Financing[176] to ensure that its members integrate responsible financing practices in their business models. One key consideration in the guidelines is that ESG and ABS members are advised to develop policies and internal controls to implement responsible financing.

(iii) In line with the guidelines above, the MAS has further announced that in 2020 it will be issuing its consultation paper on MAS's Environmental Risk Management Guidelines in the area of sustainable finance to enhance the financial system's resilience to environmental risk.[177]

*Voluntary Practice*

The last form of regulation involves a voluntary set of ESG guidelines issued by trade associations for members. These guidelines are nonbinding and set out ESG standards and objectives that members should strive for in their operations. An example is in the adoption of the Singapore Stewardship Principles (SSP) for Responsible Investors by the Investment Management Association of Singapore[178] and Singapore

---

[171] Bldg. & Const. Auth., *Regulatory Requirements for New Buildings and Existing Buildings Undergoing Major Additions and Alterations (A&A)*.

[172] Minister for Nat'l Dev. (No. S 199), *Building Control (Environmental Sustainability) Regulations 2008* (Apr. 3, 2008).

[173] Bldg. & Constr. Auth., *Code for Environmental Sustainability of Buildings* (Oct. 2012).

[174] SGX, *Sustainability Reporting*.

[175] MAS, Code of Corporate Governance (2007).

[176] ABS, ABS Guidelines on Responsible Financing (June 1, 2018).

[177] Jacqueline Loh, Deputy Managing Dir., MAS, Keynote Speech at Asian Venture Philanthropy Network Virtual Conference 2020: Keeping Green and Impact in Focus (June 8, 2020).

[178] Inv. Mgmt. Ass'n. of Sing., *Singapore Stewardship Principles (SSP)*.

Venture Capital & Private Equity Association.[179] An underlying objective of the SSP is to ensure that its members participate in investor stewardship in growing sustainable businesses to provide benefits for all stakeholders while contributing to the community.

Similarly, in the meetings, incentive travel, conventions and exhibitions industry, the Singapore Tourism Board has issued a set of sustainability guidelines[180] to encourage industry players to adopt ESG practices to meet international environmentally sustainable meeting standards.

**ESG Trends in Singapore**

The focus and trend of ESG practices in Singapore weigh toward sustainable financing and ESG-linked investment products. This is led and encouraged by MAS, which has developed an action plan[181] to turn Singapore into a leading center for green finance in Asia and the world.

In 2017, MAS introduced the sustainable bond grant scheme[182] to encourage the issuance of green, social, and sustainable bonds for companies to channel capital toward sustainable practices. To expand the use of the scheme, MAS in February 2019 lowered the minimum initial issuance size from S$200 million to S$20 million.[183] However, in order for bond issuers to qualify for the scheme, issuers must demonstrate that their practices are aligned with internationally recognized ESG principles or standards.

MAS has also set up a US$2 billion green investment program[184] to invest in public market investment strategies with a strong green focus. The program will direct funds to asset managers supporting green initiatives and projects within Singapore and the region. MAS will select asset managers who are experienced in green investment capabilities or who are able to demonstrate environmental capabilities in their investment process.

In the private sector, green financing is prominent, with clear business model shifts by lenders in Singapore. This shift is apparent with major lenders in Singapore such as DBS, OCBC, and UOB ceasing financing for new coal power plants[185] and being actively involved in providing financing for the development of new environment-friendly buildings. Some examples in 2020 alone include green financing obtained by CapitaLand,[186] GuocoLand,[187] and Frasers Property[188] for their respective developments.

As a result of the regulations governing the real estate development sector and focus on green financing in Singapore, real estate listed companies are achieving market-leading ESG scores[189] for their business practices. Internationally, three Singapore companies—City Developments Limited, CapitaLand Limited, and Singtel Telecommunications Limited—are ranked among the world's 100 most sustainable corporations.[190]

All three companies above take reference and align their internal ESG objectives to the United Nations Sustainable Development Goals. Moreover, when reporting ESG activities, all three companies adopt the Global Reporting Initiative (GRI) standards. However, each company may differ on the type of framework or standards it uses to report or gauge its ESG activities. For example, CapitaLand and Singtel prepare their

---

[179] Sing. Venture Cap. & Priv. Equity Ass'n., *Singapore Stewardship Principles for Responsible Investors* (Aug. 2016).

[180] Sing. Tourism Bd., *Sustainability Guidelines for the Singapore MICE Industry* (Nov. 2013)

[181] *See* MAS, *Sustainable Finance* (Nov. 2019).

[182] *See* MAS, *Sustainable Bond Grant Scheme* (Mar. 2017).

[183] *See* MAS, *Reply to Parliamentary Question on Green Bond Grant Scheme* (Question No. 1640) (Mar. 5, 2020).

[184] *See* MAS, *New US$2 billion Investments Programme to Support Growth of Green Finance in Singapore* (Nov. 11, 2019).

[185] *See* Ong Ye Kung, Minister for Educ., Sing., & Bd. Member, MAS, Keynote Speech at SFF x SWITCH 2019: Green Finance for a Sustainable World (Nov. 11, 2019).

[186] A. Williams, *CapitaLand Snags $500m Sustainability-Linked Loan from UOB*, Strait Times (May 28, 2020).

[187] *GuocoLand Bags $730m Green Loan for Bugis Project*, Strait Times (May 20, 2020).

[188] V. Kor, *Frasers Property Secures Singapore's First Green Loan for Fernvale Lane EC*, EdgeProp (June 8, 2020).

[189] U. Devi, *Room for Improvement in Overall Sustainability Reporting by Singapore-Listed Companies: SGX RegCo-CGIO Joint Review*, The Edge (Dec. 4, 2019).

[190] A. Williams, *CDL, CapitaLand, Singtel Among World's 100 Most Sustainable Companies*, Strait Times (Jan. 21, 2020)

sustainability reports on the GRI Core option, whereas CDL reports on the GRI Comprehensive option. CapitaLand and CDL have also voluntarily chosen to apply the Guidance on Social Responsibility Framework ISO 26000:2010[191] in assessing their ESG compliance to international standards.

# CONCLUSION: STAY TUNED

As ESG continues to gain traction with investors, asset managers are confronted with varying levels of regulation that they must balance with the wide array of ESG demands being made by investors. What may work for a manager on ESG in Singapore may not be sufficient for the top-down approach being taken in the EU. One thing seems certain: such laws, rules, regulations, and guidance on ESG will continue to evolve as the evolution of the investors in making ESG demands, the asset managers in responding to them, and the authorities that regulate them in developing the ESG boundaries and framework continues.

## Contacts

If you have any questions or would like more information on the issues discussed in this White Paper, please contact any of the following Morgan Lewis lawyers:


**MIRANDA LINDL O'CONNELL**
miranda.lindl-oconnell@
morganlewis.com
+1.415.422.1118

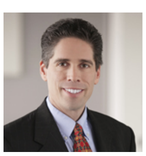
**JULIE K. STAPEL**
julie.stapel@
morganlewis.com
+1.312.324.1113

**WILLIAM YONGE**
william.yonge@
morganlewis.com
+44.20.3201.5646

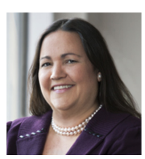
**JOEL SEOW**
joel.seow@
morganlewis.com
+65.6389.3005

**CHRISTOPHER J. DLUTOWSKI**
christopher.dlutowski@
morganlewis.com
+1.212.309.6046

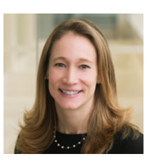
**LINDSAY B. JACKSON**
lindsay.jackson@
morganlewis.com
+1.202.739.5120



**DANIEL R. KLEINMAN**
daniel.kleinman@
morganlewis.com
+1.202.739.5143



**MARLA J. KREINDLER**
marla.kreindler@
morganlewis.com
+1.312.324.1114



**AMY C. MCDONALD**
amy.mcdonald@
morganlewis.com
+1.617.341.7810


---

191 Int'l Org. for Standardization, *Guidance on Social Responsibility* (ISO 26000:2010).

**Abu Dhabi**

| | | |
|---|---|---|
| William L. Nash III | +971.2.697.8810 | william.nash@morganlewis.com |
| Alishia K. Sullivan | +971.2.697.8820 | alishia.sullivan@morganlewis.com |

**Boston**

| | | |
|---|---|---|
| Marion Giliberti Barish | +1.617.951.8801 | marion.barish@morganlewis.com |
| Lea Anne Copenhefer | +1.617.951.8515 | leaanne.copenhefer@morganlewis.com |
| Richard A. Goldman | +1.617.951.8851 | rich.goldman@morganlewis.com |
| Barry N. Hurwitz | +1.617.951.8267 | barry.hurwitz@morganlewis.com |
| Roger P. Joseph | +1.617.951.8247 | roger.joseph@morganlewis.com |
| Jeremy B. Kantrowitz | +1.617.951.8458 | jeremy.kantrowitz@morganlews.com |
| Gerald J. Kehoe | +1.617.341.7840 | gerald.kehoe@morganlewis.com |
| Daniel A. Losk | +1.617.341.7783 | daniel.losk@morganlewis.com |
| Amy C. McDonald | +1.617.341.7810 | amy.mcdonald@morganlewis.com |
| Paul B. Raymond | +1.617.951.8567 | paul.raymond@morganlewis.com |
| Toby R. Serkin | +1.617.951.8760 | toby.serkin@morganlewis.com |
| Stephen C. Tirrell | +1.617.951.8833 | stephen.tirrell@morganlewis.com |

**Chicago**

| | | |
|---|---|---|
| Marla J. Kreindler | +1.312.324.1114 | marla.kreindler@morganlewis.com |
| Julie K. Stapel | +1.312.324.1113 | julie.stapel@morganlewis.com |

**Dallas**

| | | |
|---|---|---|
| Carrie J. Rief | +1.214.466.4159 | carrie.rief@morganlewis.com |

**Dubai**

| | | |
|---|---|---|
| Ayman A. Khaleq | +971.4.312.1880 | ayman.khaleq@morganlewis.com |

**Hong Kong**

| | | |
|---|---|---|
| Alice Huang | +852.3551.8618 | alice.huang@morganlewis.com |

**London**

| | | |
|---|---|---|
| Simon Currie | +44.20.3201.5644 | simon.currie@morganlewis.com |
| Gawain Hughes | +44.20.3201.5640 | gawain.hughes@morganlewis.com |
| Robert C. Mailer | +44.20.3201.5339 | robert.mailer@morganlewis.com |
| Oliver M. Rochman | +44.20.3201.5340 | oliver.rochman@morganlewis.com |
| Louis H. Singer | +44.20.3201.5593 | louis.singer@morganlewis.com |
| William Yonge | +44.20.3201.5646 | william.yonge@morganlewis.com |

**Miami**

| | | |
|---|---|---|
| Ethan W. Johnson | +1.305.415.3394 | ethan.johnson@morganlewis.com |

**New York**

| | | |
|---|---|---|
| Craig A. Bitman | +1.212.309.7190 | craig.bitman@morganlewis.com |
| Christopher J. Dlutowski | +1.212.309.6046 | christopher.dlutowski@morganlewis.com |
| Christine M. Lombardo | +1.212.309.6629 | christine.lombardo@morganlewis.com |
| Jedd H. Wider | +1.212.309.6605 | jedd.wider@morganlewis.com |
| Joseph D. Zargari | +1.212.309.7020 | joseph.zargari@morganlewis.com |

**Orange County**

| | | |
|---|---|---|
| Laurie A. Dee | +1.714.830.0679 | laurie.dee@morganlewis.com |
| Jarrod A. Huffman | +1.714.830.0633 | jarrod.huffman@morganlewis.com |

**Philadelphia**

| | | |
|---|---|---|
| Sean Graber | +1.215.963.5598 | sean.graber@morganlewis.com |
| Timothy W. Levin | +1.215.963.5037 | timothy.levin@morganlewis.com |
| John J. O'Brien | +1.215.963.4969 | john.obrien@morganlewis.com |

**San Francisco**

| | | |
|---|---|---|
| Miranda Lindl O'Connell | +1.415.442.1118 | miranda.lindl-oconnell@morganlewis.com |
| Peter M. Phleger | +1.415.442.1096 | peter.phleger@morganlewis.com |

**Singapore**

| | | |
|---|---|---|
| Edward Bennett | +65.6389.3026 | edward.bennett@morganlewis.com |
| Joel Seow | +65.6389.3005 | joel.seow@morganlewis.com |

**Tokyo**

| | | |
|---|---|---|
| Tomoko Fuminaga | +81.3.4578.2503 | tomoko.fuminaga@morganlewis.com |
| Tadao Horibe | +81.3.4578.2506 | tadao.horibe@morganlewis.com |
| Carol Tsuchida | +81.3.4578.2611 | carol.tsuchida@morganlewis.com |
| Christopher P. Wells | +81.3.4578.2533 | chris.wells@morganlewis.com |

**Washington, DC**

| | | |
|---|---|---|
| Gregg S. Buksbaum | +1.202.739.5080 | gregg.buksbaum@morganlewis.com |
| Laura E. Flores | +1.202.373.6101 | laura.flores@morganlewis.com |
| Thomas S. Harman | +1.202.373.6725 | thomas.harman@morganlewis.com |
| Lindsay B. Jackson | +1.202.739.5120 | lindsay.jackson@morganlewis.com |
| Daniel R. Kleinman | +1.202.739.5143 | daniel.kleinman@morganlewis.com |
| W. John McGuire | +1.202.373.6799 | john.mcguire@morganlewis.com |
| Christopher D. Menconi | +1.202.373.6173 | christopher.menconi@morganlewis.com |
| Courtney C. Nowell | +1.202.739.5223 | courtney.nowell@morganlewis.com |
| Michael B. Richman | +1.202.739.5036 | michael.richman@morganlewis.com |
| Steven W. Stone | +1.202.739.5453 | steve.stone@morganlewis.com |


## About Us

Morgan Lewis is recognized for exceptional client service, legal innovation, and commitment to its communities. Our global depth reaches across North America, Asia, Europe, and the Middle East with the collaboration of more than 2,200 lawyers and specialists who provide elite legal services across industry sectors for multinational corporations to startups around the world. For more information about us, please visit www.morganlewis.com.