

# **Recommendations on Sustainability-Related Practices, Policies, Procedures and Disclosure in Asset Management**

## **Consultation Report**



**OICU-IOSCO**

**The Board  
OF THE  
INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS**

**CR01/21**

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This paper is for public consultation purposes only. It has not been approved for any other purpose by the IOSCO Board or any of its members.

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## Foreword

The Board of the International Organization of Securities Commissions (IOSCO) invites market participants and interested parties to submit comments on this report.

### How to Submit Comments

Comments may be submitted by one of the three following methods **on or before 15 August 2021**. To help us process and review your comments more efficiently, please use only one method.

**Important:** All comments will be made available publicly unless anonymity is specifically requested. Comments will be converted to PDF format and posted on the IOSCO website. Personal identifying information will not be edited from submissions.

#### 1. Email

- Send comments to [consultation-01-2021@iosco.org](mailto:consultation-01-2021@iosco.org)
- The subject line of your message must indicate ‘*Sustainability-related Disclosures for Asset Managers, Greenwashing and other Investor Protection concerns.*’
- If you attach a document, indicate the software used (e.g., WordPerfect, Microsoft WORD, ASCII text, etc) to create the attachment.
- Do not submit attachments as HTML, PDF, GIFG, TIFF, PIF, ZIP or EXE files.

#### 2. Facsimile Transmission

Send by facsimile transmission using the following fax number: + 34 (91) 555 93 68.

#### 3. Paper

Send 3 copies of your paper comment letter to:

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Your comment letter should indicate prominently that it is a ‘*Public Comment on Recommendations on Sustainability-Related Practices, Policies, Procedures and Disclosure in Asset Management*’.

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## Executive Summary

In recent years, there has been a growing recognition of the significant economic and financial impacts of climate change and environmental, social and governance (ESG) risks. The growth of ESG investing and sustainability-related products has led to several challenges, including concerns regarding consistency, comparability, and the risk of greenwashing. In addition, stakeholders have called on financial market regulators to act decisively in global efforts to achieve the climate change commitments under the Paris Agreement. In response, regulators and policymakers worldwide have been examining issues relating to sustainable finance, including climate change risks, in their regulatory and supervisory roles in order to address these challenges, including how asset managers take sustainability-related risks and opportunities into consideration.

Internationally, industry participants, investors, regulators, and policy makers have stepped up their efforts to address sustainability-related risks, opportunities and impacts, and to help mobilise capital to support the transition to a more sustainable future.

Since 2018, IOSCO has increased its focus on the implications of these developments for securities regulators. Further to the publication of its report titled *Sustainable Finance and the Role of Securities Regulators and IOSCO* in April 2020, IOSCO established a Board-level Task Force (STF) to carry out work in three areas:

- Workstream 1 - sustainability-related issuer disclosures;
- Workstream 2 - sustainability-related practices, policies, procedures, and disclosures for asset managers; and
- Workstream 3 - ESG ratings and ESG data providers.

This Consultation Report (the Report) focuses on asset managers and investor protection issues and aims to improve sustainability-related practices, policies, procedures and disclosures in the asset management industry. This includes encouraging asset managers to take sustainability-related risks and opportunities into account in their investment decision-making and risk management processes and addressing the risk of greenwashing through improving transparency, comparability and consistency in sustainability-related disclosure.

The Report discusses the types, and provides examples, of greenwashing at the asset manager and product levels, describes the different regulatory approaches currently taken by STF members to address sustainability-related practices by asset managers as well as disclosures at both the firm and product levels, and provides an overview of the current landscape of sustainability-related financial and investor education. The report also discusses challenges in this area and sets out recommendations for securities regulators and policymakers. The synergies with the two other STF workstreams are also explored in this report.

The findings indicate that in jurisdictions with sustainability-related requirements relating to practices and disclosures by asset managers at the entity level, the requirements can be broadly categorised into the following areas: governance, investment strategy, risk management, and metrics and targets, with governance requirements being the most common among jurisdictions.

Furthermore, where there are sustainability-related disclosure requirements at the product level, there are some commonalities in the areas of disclosure covered by the requirements, but there are differences in implementation and scope across jurisdictions.

Approximately half of the responding jurisdictions do not have sustainability-specific rules and instead currently use existing non-sustainability-specific rules to address sustainability-related risks and opportunities at the asset manager level and sustainability-related products. The main reasons cited for this regulatory approach include that (i) sustainability-related products comprise only a small portion of the local market, and (ii) the existing rules adequately address sustainability-related risks and opportunities at the asset manager level and sustainability-related products.

However, the findings also indicate that the majority of member jurisdictions currently rely on existing supervisory and enforcement tools to address sustainability-related misconduct, even in jurisdictions with sustainability-specific requirements.

The majority of member jurisdictions believe that financial and investor education can play a role in sustainable finance, including in building awareness among investors so that they can better identify greenwashing, misleading advertising and misinformation, and in supporting the mainstreaming of sustainable finance.

The most common financial and investor education initiatives were those dedicated to addressing sustainability-related instruments and products, and the main platform for the dissemination of content for financial and investor education is the internet. The primary audience for financial and investor education initiatives is retail investors, but there is also interest in including all market participants and society at large.

The Report contains six chapters, starting with an introduction in **Chapter 1**. **Chapter 2** discusses regulatory approaches relating to asset manager-level practices and related disclosures, while **Chapter 3** addresses regulatory approaches relating to product-level disclosures. **Chapter 4** examines the role of financial and investor education in sustainable finance and provides an overview of the initiatives conducted by regulators. **Chapter 5** addresses existing challenges, including data gaps at the corporate level, issues arising from the proliferation of data and ESG ratings providers, lack of consistency in terminology as well as labelling and classification, different understandings of materiality, gaps in skills and expertise, and evolving regulatory approaches.

Finally, **Chapter 6** sets out five recommendations as below. These recommendations are designed to provide a list of potential areas for regulatory consideration, in line with domestic regulatory frameworks.

Recommendation 1: Asset Manager Practices, Policies, Procedures and Disclosure. Securities regulators and/or policymakers, as applicable, should consider setting regulatory and supervisory expectations for asset managers in respect of the: (a) development and implementation of practices, policies and procedures relating to sustainability-related risks and opportunities; and (b) related disclosure.

Recommendation 2: Product Disclosure. Securities regulators and/or policymakers, as applicable, should consider clarifying and/or expanding on existing regulatory requirements or guidance or, if necessary, creating new regulatory requirements or guidance, to improve

product-level disclosure in order to help investors better understand: (a) sustainability-related products; and (b) material sustainability-related risks for all products.

Recommendation 3: Supervision and Enforcement. Securities regulators and/or policymakers, as applicable, should have supervisory tools to ensure that asset managers and sustainability-related products are in compliance with regulatory requirements and enforcement tools to address any breaches of such requirements.

Recommendation 4: Terminology. Securities regulators and/or policymakers, as applicable, should consider encouraging industry participants to develop common sustainable finance-related terms and definitions to ensure consistency throughout the global asset management industry.

Recommendation 5: Financial and Investor Education. Securities regulators and/or policymakers, as applicable, should consider promoting financial and investor education initiatives relating to sustainability, or, where applicable, enhance existing sustainability-related financial and investor education initiatives.

# Chapter 1: Introduction

## A. Background

In April 2020, IOSCO published its report titled *Sustainable Finance and the Role of Securities Regulators and IOSCO* with the objective of helping market participants address issues related to sustainability and climate change.<sup>1</sup> The report revealed that: (i) there are multiple and diverse sustainability frameworks and standards (ii) there is a lack of common definitions of sustainable activities, and (iii) there are investor protection challenges that have emerged, including greenwashing.

In addition, the report indicated that many issuers and asset managers operating cross border may be subject to different regulatory regimes or participate in multiple regional or international third-party initiatives. The wide variety of regulatory regimes and third-party initiatives, often with inconsistent objectives and requirements, may prevent stakeholders from fully understanding the risks and opportunities that sustainable business activities entail and lead to market fragmentation.

The report also referred to the work of the Network of Central Banks and Supervisors for Greening the Financial System (NGFS) on guidelines for climate and environmental related risk management for bank and insurer supervisors and noted that this could be further considered in the context of regulators of asset managers.

To address these challenges, IOSCO established a Board-level Task Force on Sustainable Finance (STF), with the aim of: (i) improving sustainability-related disclosures made by issuers and asset managers; (ii) collaborating with other international organisations to avoid duplicative efforts and enhance coordination of relevant regulatory and supervisory approaches; and (iii) conducting case studies and analyses of transparency, investor protection and other relevant issues within sustainable finance.

To achieve these objectives, the STF is carrying out work in three areas:

- Workstream 1 - sustainability-related disclosures for issuers;
- Workstream 2 - sustainability-related practices, policies, procedures and disclosures for asset managers; and
- Workstream 3 - ESG ratings and ESG data providers.

This Report is the outcome of Workstream 2.<sup>2</sup> As part of its review, the workstream conducted some fact-finding exercises, which included:

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<sup>1</sup> FR04/2020 *Sustainable Finance and the Role of Securities Regulators and IOSCO* – Final Report, Report of the Board of IOSCO, 14 April 2020, available at <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD652.pdf>.

<sup>2</sup> The members of Workstream 2 are ASIC Australia, FSMA Belgium, CVM Brazil, AMF France, SFC Hong Kong, OSC Ontario (Canada), CMVM Portugal, Finansinspektionen Sweden, FMSA Switzerland, FCA United Kingdom and the SEC United States.

- i) a survey of STF members about regulatory and supervisory approaches relating to sustainability-related practices and disclosures at both the asset manager and product levels, as well as regulatory and supervisory oversight in this area;<sup>3</sup>
- ii) a repository on greenwashing and mis-selling cases in STF member jurisdictions and the tools or measures used to address the greenwashing or mis-selling, in addition to any lessons learned from such cases; and
- iii) a survey of members of STF and the IOSCO Committee on Retail Investors (IOSCO Committee 8 (C8)) on current and planned financial and investor education initiatives in sustainability-related issues, barriers encountered, the role of financial and investor education in sustainable finance and IOSCO's potential contributions in this field.<sup>4</sup>

Building on an analysis of the responses received, the Report discusses the types, and provides examples, of greenwashing at the asset manager and product levels, describes the different regulatory approaches taken by STF members to sustainability-related practices by asset managers as well as disclosures at both the firm and product levels and provides an overview of the current landscape of sustainability-related financial and investor education. The Report also discusses challenges in this area and sets out recommendations to improve sustainability-related practices, policies, procedures and disclosure in the asset management industry.

A glossary of terms that are commonly used throughout the Report is included in **Annex 1**.

#### *Synergies with the other STF workstreams*

Asset managers feature prominently across all three IOSCO STF workstreams due to their central role in the eco-system of sustainability-related information:

- i) Asset managers as users of sustainability-related information;
- ii) Asset managers as licensed financial institutions and fiduciaries of assets entrusted to them by clients, for which regulatory and client-oriented reporting is required; and
- iii) Asset managers as public companies that prepare corporate-level disclosures for shareholders and wider stakeholders.

Asset managers need to procure and process ESG data that is relevant, comparable and decision useful as part of the investment management process in order to evaluate and monitor companies' ESG risks, progress and performance. Consequently, any firm-level and product-level disclosures made by asset managers relating to sustainability are dependent on the quality, reliability and accuracy of ESG data from disclosures by corporate issuers and third-party data providers.

IOSCO, through Workstream 1, has engaged with the International Financial Reporting Standards (IFRS) Foundation as the IFRS Foundation has worked towards the establishment of an International Sustainability Standards Board (ISSB).

IOSCO considers that the IFRS Foundation potentially could deliver a global baseline for investor-oriented sustainability-related disclosure standards focussed on enterprise value

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<sup>3</sup> 19 out of a total of 22 regulators responded to this survey.

<sup>4</sup> Twenty-two regulators responded to this survey.

creation which jurisdictions could consider incorporating or building upon as part of their mandatory reporting requirements as appropriate and consistent with their domestic legal frameworks. This could promote international consistency and comparability in sustainability-related information and also form the basis for the development of an audit and assurance framework.

IOSCO recognises that individual jurisdictions have different domestic arrangements for adopting applying, or otherwise availing of international standards. It will be important for individual jurisdictions to consider how the common global baseline of standards might be adopted, applied, or otherwise utilised within the context of these arrangements and wider legal and regulatory frameworks in a way that promotes consistent and comparable sustainability disclosures across jurisdictions.

IOSCO has strongly encouraged the ISSB to leverage the content of existing sustainability-related reporting principles, frameworks, and guidance, including the Task Force on Climate-related Financial Disclosures Framework (the TCFD Framework), as it develops investor-oriented standards focused on enterprise value, beginning with climate change.

IOSCO has encouraged a ‘building blocks’ approach to establishing a global comprehensive corporate reporting system. This could provide a consistent and comparable global baseline of sustainability-related information that is investor-focused and material to enterprise value creation, while also providing flexibility for interoperability on reporting requirements that capture wider sustainability impacts.

These important elements of an ISSB under the IFRS Foundation are covered in the Workstream 1 report.<sup>5</sup>

Given the dependency of firm-level and product-level disclosures made by asset managers relating to sustainability on disclosures from corporate issuers, the efforts of Workstream 1 to improve and progress the harmonisation of corporate sustainability reporting will directly impact disclosures by asset managers.

Workstream 3 is focused on the role of ESG data and rating providers given the growing role of ESG ratings and metrics in risk management, investment strategies and the development of new market indices. We note that the focus of Workstream 3 is essential to the work of Workstream 2, given asset managers’ use of ESG ratings and data.<sup>6</sup>

It is important to note that asset management firms that are also public companies produce firm-level disclosure for two distinct sets of audiences, namely: (i) shareholders and other stakeholders, and (ii) prospective and existing investor clients. While the latter is covered by this report, the former is covered by the Workstream 1 report.

## **B. Global Developments and Emerging Concerns Regarding Greenwashing**

### *i. Market Developments*

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<sup>5</sup> The STF Workstream 1 report can be accessed at [FR04/2021 Report on Sustainability-related Issuer Disclosures \(iosco.org\)](https://www.iosco.org/FR04/2021_Report_on_Sustainability-related_Issuer_Disclosures)

<sup>6</sup> The STF Workstream 3 report is in progress and will be available at [www.iosco.org](https://www.iosco.org) once finalised.

According to Bloomberg Intelligence, global ESG assets are on track to exceed USD 53 trillion by 2025, which would represent more than a third of the USD 140.5 trillion in projected total assets under management.<sup>7</sup> The growth of, and momentum behind, sustainability-related products is propelling a paradigm shift in the asset management industry worldwide whereby asset managers are now capitalising on sustainability-related opportunities and developing new sustainability-related products targeting both retail and institutional investors at an unprecedented pace.

In addition, the COVID-19 pandemic has accelerated investor demand for sustainable investments. Investments in sustainable products achieved a record high during the fourth quarter of 2020. According to Morningstar, global inflows into sustainable funds increased by 88 percent in the fourth quarter of 2020 to USD 152.3 billion.<sup>8</sup> Europe accounted for the largest share of these inflows, with approximately 80 percent, followed by the United States at 13.4 percent, up slightly from 12 percent in the third quarter of 2020. The remaining inflows amounted to USD 11.1 billion for Canada, Australia and New Zealand, Japan, and Asia, up from USD 9 billion in the second quarter of 2020.<sup>9</sup> In the first quarter of 2021, the global sustainable universe attracted USD 185.3 billion in net inflows, with Europe making up 79.2 percent of the inflows, followed by the United States at 11.6 percent.<sup>10</sup>

Sustainability-related financial products, including green bonds, social and sustainable-linked bonds, green mortgage-backed securities, green loans, and sustainability-linked loans, have also proliferated the market. Data from Morningstar revealed that product development in the fourth quarter of 2020 hit an all-time high, with 196 new offerings, including 37 in countries outside of Europe and the United States, resulting in the total number of sustainable funds, both active and passive, globally increasing to 4,153 by the end of December 2020. Asset managers have also focused on transitioning their conventional products into sustainable products, with at least 250 such funds in Europe. The Morningstar report noted that equity has remained the asset class of choice for ESG-oriented investors, who poured USD 82 billion into such funds in the last quarter of 2020, which doubled that of the previous quarter for Europe.<sup>11</sup> For the first quarter of 2021, equity funds took the majority of inflows in Europe with USD 89.8 billion, followed by fixed-income offerings with USD 33.7 billion.<sup>12</sup>

## *ii. Regulatory Developments*

In recent years, there has been a growing recognition of the significant economic and financial impacts of climate change and environmental, social and governance risks. The growth of ESG investing and sustainability-related products has led to several challenges, including concerns regarding consistency, comparability, and the risk of greenwashing. In addition, stakeholders

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<sup>7</sup> <https://www.bloomberg.com/professional/blog/esg-assets-may-hit-53-trillion-by-2025-a-third-of-global-aum/#:~:text=As%20of%20September%2C%20the%20U.S.,%25%20of%20smart%2Dbeta%20flows.&text=The%20%242.2%20trillion%20ESG%20debt,of%20the%20past%20five%20years.>

<sup>8</sup> [https://www.morningstar.com/content/dam/marketing/shared/pdfs/Research/Global ESG Q4 2020 Flows.pdf](https://www.morningstar.com/content/dam/marketing/shared/pdfs/Research/Global_ESG_Q4_2020_Flows.pdf)

<sup>9</sup> Same as footnote 8

<sup>10</sup> [global-esg-q1-2021-flow-report.pdf \(morningstar.com\)](https://www.morningstar.com/content/dam/marketing/shared/pdfs/Research/Global_ESG_Q1_2021_Flow_Report.pdf)

<sup>11</sup> Same as footnote 8

<sup>12</sup> Same as footnote 8

have called on financial market regulators to act decisively in global efforts to achieve the climate change commitments under the Paris Agreement. In response, regulators and policymakers worldwide have been examining issues relating to sustainable finance, including climate change risks, in their regulatory and supervisory roles in order to address these challenges in line with the domestic regulatory remit.

Voluntary standards and frameworks have also developed to assist asset managers in considering how to incorporate sustainability-related risks and opportunities into their investment processes and sustainability-related products. There are a number of existing and proposed sustainability-related standards and frameworks, such as the TCFD Framework, Principles of Responsible Investment (PRI) and the Chartered Financial Analyst (CFA) Institute ESG Disclosure Standards for Investment Products,<sup>13</sup> which are targeted towards many market participants, including asset managers.

The TCFD Framework, which was released in June 2017, is one of the most widely endorsed frameworks by both the financial industry and other stakeholders, including governments, regulators, stock exchanges, banks, insurers and investors. To date, there are over 1,900 TCFD supporters across 78 countries around the world. In addition to recommendations focusing on corporate disclosures, the TCFD's reporting framework also has specific recommendations for asset managers, including guidance in the areas of strategy and risk management. The TCFD launched a consultation with the aim of better understanding the evolution of forward-looking climate-related metrics used and disclosed by asset owners, asset managers, banks, and insurance companies, which ended in January 2021.<sup>14</sup> A working group has been launched to consider the benefits and challenges of disclosure of implied temperature rise and other forward-looking climate-related metrics. A summary of the consultation feedback was published in March 2021.<sup>15</sup>

Another private sector initiative with widespread voluntary adoption by institutional investors is the reporting framework for PRI signatories. Elements of the TCFD Framework were first incorporated into the 2018 PRI Investor Reporting Framework and a majority of these were upgraded to the core sections of the 2021 Investor Reporting Framework. Questions classified as "core" are subject to mandatory reporting, the responses to which will be published. "Core" responses will then be assessed to arrive at an overall Assessment Report for PRI signatories.

Other international organisations of supervisors and regulators have similarly emphasised the need to promote globally consistent, comparable and reliable disclosures and have referenced the TCFD Framework as a baseline in varying ways. These include the NGFS,<sup>16</sup> Financial Stability Board (FSB),<sup>17</sup> and International Association of Insurance Supervisors (IAIS).<sup>18</sup>

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<sup>13</sup> The CFA published an exposure draft in May 2021. The exposure draft can be accessed at <https://www.cfainstitute.org/-/media/documents/support/ethics/exposure-draft-cfa-institute-esg-disclosure-standards-for-investment-products.ashx>

<sup>14</sup> Task Force on Climate-related Financial Disclosures, *Forward-Looking Financial Sector Metrics*, Consultation Report, available at: <https://assets.bbhub.io/company/sites/60/2021/03/2020-TCFD-Forward-Looking-Financial-Metrics-Consultation.pdf>

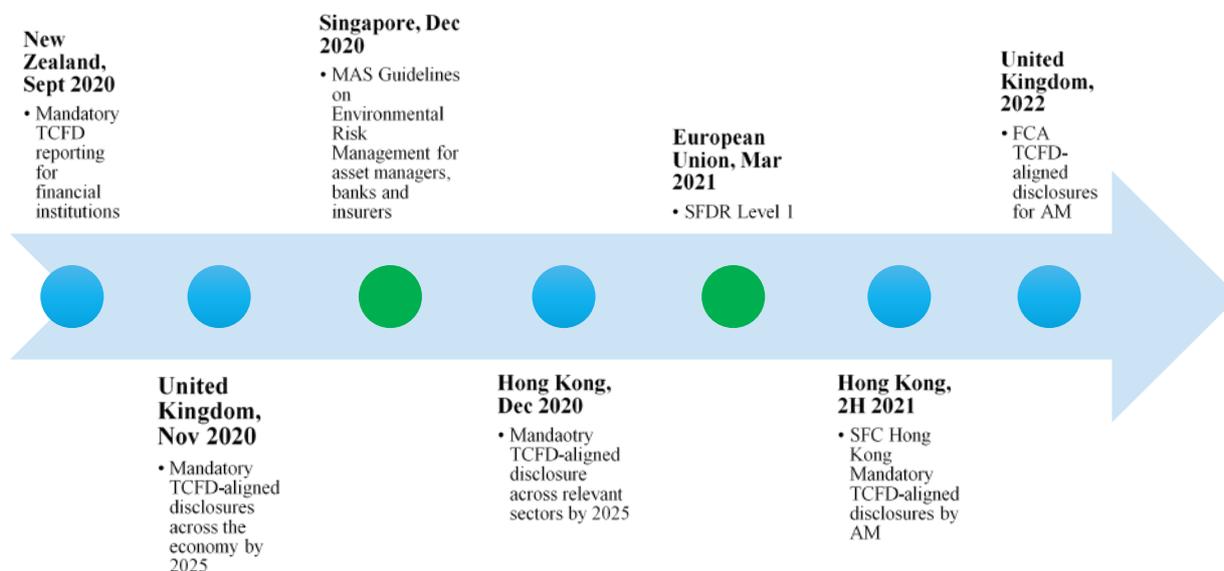
<sup>15</sup> TCFD publications, *Summary of the Forward-Looking Financial Metrics Consultation* (Mar 2021)

<sup>16</sup> Guide for Supervisors.

<sup>17</sup> Dec 2020 PR

<sup>18</sup> Issues Paper on the Implementation of the TCFD Recommendations para 42

Given the accelerated pace of developments and the interest in promoting convergence for disclosures, several recent announcements from governments and regulators on asset manager disclosures have made reference to the TCFD Framework. The following is a timeline of announcements and upcoming changes by various governments and regulators that refer to the TCFD Framework.



*Note:* Green circles represent policies that are currently in force.

### iii. Greenwashing

For the purposes of this Report, the term “greenwashing” refers to the practice by asset managers of misrepresenting their own sustainability-related practices or the sustainability-related features of their investment products. We note that such practices may vary in scope and severity, from the inappropriate use of specific sustainability-related terms used in an offering document, to misrepresentations about an entity’s sustainability-related commitments, to deceptive marketing practices that deliberately misrepresent a product’s sustainable impact.

While investments in sustainability-related products have been steadily growing, the shock caused by the COVID-19 pandemic and its disruptions to the economy have brought into sharper focus questions relating to sustainability and, with them, attention on sustainability-related products as “investors look for sustainable business models that can withstand market shocks.”<sup>19</sup>

As asset managers seek to match growing demand in sustainability-related products by expanding their sustainability-related product offerings through creating new products or rebranding existing ones, this is leading to the “temptation for certain market players to take advantage of consumers’ favourable view of green products – by using environmental arguments as a mere marketing tool, without designing or modifying production processes in

<sup>19</sup> Siobhan Riding, “ESG Funds Attract Record Inflows During Crisis” Financial Times (August 10, 2020), online: <https://www.ft.com/content/27025f35-283f-4956-b6a0-0adbfd4c7a0e>.

a way that would enable the creation of products and services with a real impact.”<sup>20</sup> In the “race to promote their green credentials,” some asset managers may therefore misleadingly label products as sustainable without meaningful changes in the underlying investment strategies or shareholder practices.<sup>21</sup>

Various types of greenwashing at both the asset manager and product levels are discussed in Chapters 2 and 3. Some of the challenges associated with the growth of the market for sustainability-related products that contribute to greenwashing and other investor protection concerns are discussed in Chapter 4.

Sustainability-related practices at the asset manager level are not always well-developed. In addition, sustainability-related disclosures at both the asset manager and product levels are not always consistent, comparable, or entirely transparent. All of this, combined with a lack of commonly agreed-upon terminologies and investor education on sustainable products, has led to the risk of greenwashing and investor confusion. This can result in investors purchasing products that do not meet their expectations from a sustainability perspective which, over time, may lead to an undermining of investor confidence in this segment of the market, necessitating IOSCO’s work in this area.

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<sup>20</sup> 2° Investing Initiative, *EU Retail Funds’ Environmental Impact Claims Do Not Comply with Regulatory Guidance* (March 2020), online: <https://2degrees-investing.org/resource/marketing-claims/>.

<sup>21</sup> ShareAction, *Point of No Returns* (March 2020), online: <https://shareaction.org/research-resources/point-of-no-returns/>.

## **Chapter 2: Regulatory Approaches to Sustainability-Related Practices and Firm-Level Disclosures by Asset Managers**

The demand for sustainable investing is developing at varying paces across different jurisdictions. The impact of climate-related risks, and other sustainability-related risks, is manifesting in different ways and with varying intensities across jurisdictions. In addition, disruptions due to the global COVID-19 pandemic have highlighted the fact that sustainability-related risks are a source of operational and financial risks.

To address these developments, a common starting point for regulators has been to increase awareness of the financial consequences associated with non-financial, sustainability-related issues, including climate-related risks and opportunities. The most common reasons for regulatory actions in this area, as indicated by STF members, are as follows:

- There is an increased recognition that climate change is a source of financial risk and a potential source of instability to the financial system.<sup>22</sup> However, there is evidence in some jurisdictions that risk management practices within the asset management industry relating to the systematic evaluation of the financial impact of climate-related risks may currently be limited.<sup>23</sup> The combination of these two factors may encourage financial regulators to take further steps to address these issues.
- There has been a rapid growth in the number and amount of assets under management of sustainability-related investment products, and with that growth, increased risks of greenwashing.

The current regulatory approaches to sustainability-related practices and firm-level disclosures taken by regulators are aimed at addressing these issues.

This chapter: (a) discusses and provides examples of different types of greenwashing at the asset manager level; (b) provides an overview of the different regulatory approaches by member jurisdictions to sustainability-related practices and disclosures at the asset manager level and explains how these approaches can promote greater transparency and accountability from asset managers, which can help prevent greenwashing; and (c) discusses and provides examples of supervisory and enforcement tools used by member jurisdictions in this area.

### **A. Types and examples of asset manager-level greenwashing**

The following is a non-exhaustive list of possible types of greenwashing that may occur at the asset manager level, with examples of each type.

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<sup>22</sup> FSB, [The implications of climate change for financial stability \(Nov 2020\) and NGFS, First Comprehensive Report \(Apr 2019\)](#)

<sup>23</sup> SFC Hong Kong, [Survey on Integrating Environmental, Social and Governance Factors and Climate Risks, in Asset Management \(Dec 2019\)](#)

*i. Marketing communications that do not accurately reflect the level and/or extent of the asset manager’s consideration of sustainability-related risks and opportunities in its processes*

This potential type of greenwashing may take the form of overstating or providing unclear messaging about the level or extent of the asset manager’s commitment, including whether it is committed to sustainability as an organisation (e.g., ensuring gender diversity at the executive level, establishing risk governance structures to assess sustainability-related risks to its business strategies) or as an asset manager (e.g., applying ESG strategies to its products), or both.

**Examples:**

An asset manager that does not take into account ESG criteria in its funds’ investment processes discusses on its website and in its marketing materials its sustainability-related initiatives (such as, for example, its participation in the TCFD) and views on sustainability, without making clear that its funds do not engage in ESG investment strategies or take climate-related risks into account.

An asset manager describes its sustainability-related commitments (e.g., implementation of exclusion policies, development of green funds) without clarifying the scope of these commitments, the potential limitations and their actual impact on the asset manager’s overall business and strategy.

*ii. Failure of asset manager to meet its public sustainability-related commitments*

Another possible type of greenwashing involves asset managers failing to meet their public sustainability-related commitments. An asset manager may use public sustainability-related commitments for positive media coverage or public relations purposes but fail to meet those commitments or demonstrate its progress towards meeting those commitments.

A ranking and analysis of 75 of the world’s largest asset managers’ approaches to responsible investment in March 2020 found that while all 75 of the asset managers were signatories to the PRI, 51 percent of the managers showed little evidence of appropriately integrating responsible investment across their assets, indicating that some PRI signatories merely use the initiative as a “tick box exercise.”<sup>24</sup> The same report also found that of the asset managers that expressed support for the TCFD framework but that had not yet published a report in accordance with the framework, only 38 percent of them indicated that they were planning to do so in the next reporting year, suggesting that public endorsement of the TCFD framework may not necessarily be an indication of real action by asset managers.

A separate study of active managers which are PRI signatories found that only a small number of funds improved their fund-level ESG scores, while many others use the PRI status to

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<sup>24</sup> ShareAction, *Point of No Returns: A ranking of 75 of the world’s largest asset managers’ approaches to responsible investment*, March 2020 <https://shareaction.org/wp-content/uploads/2020/03/Point-of-no>Returns.pdf>

successfully attract capital without making notable changes in their investment holdings that impact fund-level ESG scores.<sup>25</sup>

A third study of active managers which are rated PRI A+ found that while asset managers disclose that they support the TCFD and integrate climate change into investment processes, they often do not disclose their policies on fossil fuels or commit to robust decarbonization strategies such as setting Science-Based Targets or otherwise aligning their portfolios with the Paris Agreement.<sup>26</sup>

**Example:**

An asset manager makes public commitments to sustainability-related disclosure frameworks for positive media coverage but does not comply with those frameworks on an ongoing basis.

**B. Regulatory approaches to sustainability-related practices and disclosure at the asset manager level**

This subsection provides an overview of the scope and content of the different regulatory approaches by member jurisdictions to sustainability-related practices and disclosure at the asset manager level and explains how these approaches can promote greater transparency and accountability from asset managers, which may help prevent greenwashing.

*i. Degree of compulsion*

A range of sustainability-specific regulatory approaches were observed in the responses to our survey of member jurisdictions. Some of the regulatory frameworks for firm-level sustainability-related practices and disclosure are based on existing non-sustainability-specific rules while others have adopted new sustainability-specific legislation or guidance.

Across the survey categories of governance, investment management and risk management, half of the respondents, including those in both emerging and developed markets, indicated that there were no sustainability-specific rules in place in their respective jurisdictions.

The main reason cited by these jurisdictions for why they do not have sustainability-specific rules at the asset manager firm level is because their existing regulatory regimes already include expectations at the asset manager level that are applicable to sustainability-related practices and disclosures. Some respondents also indicated that the current absence of sustainability-specific rules can be explained by a lack of global standards and definitions in this area, nascent sustainable investing markets and regulators being cognizant of not overburdening an industry under development.

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<sup>25</sup> SSRN, Kim, Yoon (2020), [Analyzing Active Managers' Commitment to ESG: Evidence from United Nations Principles for Responsible Investment](#)

<sup>26</sup> Lee, K. and Gauthier, M. [2021], 2021 Review of Responsible Investment Practices, WWF.

To supplement the approach of using existing non-sustainability-specific rules, some of the qualitative measures that have been utilised by such jurisdictions include public messaging and engagement with asset managers on strengthening their investment and risk management processes to consider climate-related risks and opportunities.

**Regional trends - Findings from the IOSCO Asia Pacific Regional Committee’s Sustainable Finance Working Group (APRC SFWG)**

The APRC SFWG undertook a survey of member jurisdictions on their regulatory approaches to sustainable finance. The APRC SFWG survey found that a number of jurisdictions, including Hong Kong, Japan, and Singapore, who are members of the IOSCO STF, expect asset managers to consider sustainable finance matters in their identification, assessment and management of risks. Examples from these jurisdictions will be discussed in this chapter.

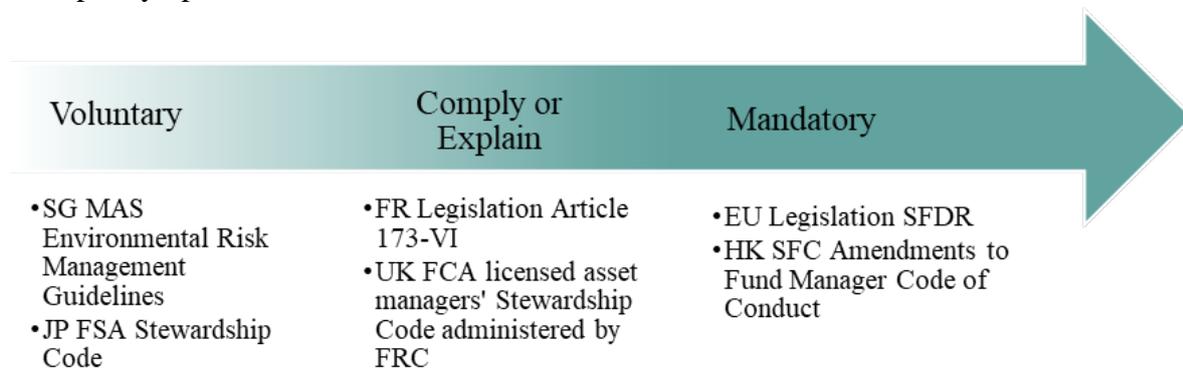
Indonesia’s Otoritas Jasa Keuangan (OJK) requires asset managers to prepare and submit a Sustainable Finance Action plan which covers, as a minimum: (i) the development of products and/or services, (ii) internal capacity building of financial services institutions (FSIs), or (iii) the adjustment of the organisation, risk management, governance, and/or standard operating procedures of FSIs which embrace sustainable finance principles.

There are different levels of compulsion in the approaches taken by jurisdictions where sustainability-specific rules have been put in place. Within STF membership we observed a range of regulatory approaches, from voluntary to comply or explain to mandatory.

The findings indicate that where securities regulators have put in place sustainability-specific requirements for asset managers, the majority of these regulatory approaches have been implemented on a comply-or-explain, or mandatory basis.

For jurisdictions relying on existing rules, some regulators have developed voluntary guidelines or rely on stewardship codes to communicate supervisory expectations concerning sustainability-related issues in asset management.

The following diagram illustrates the range of approaches available to regulators contemplating their policy options:



a. Voluntary Approach:

For jurisdictions relying on existing rules, some regulators have developed voluntary guidelines or rely on stewardship codes to communicate supervisory expectations concerning sustainability-related issues in asset management.

The Monetary Authority of Singapore (MAS) issued guidelines in December 2020 on environmental risk management for in-scope asset managers. MAS' guidelines set out principles or "best practice standards" that govern the conduct of specified institutions or persons.<sup>27</sup>

In Japan, the Principles for Responsible Institutional Investors, also known as Japan's Stewardship Code, were updated in 2020 to include considerations of sustainability<sup>28</sup> that are consistent with institutional investors' investment management strategies. Commitment to the Japan Stewardship Code is voluntary, and the code itself is neither law nor legally binding. However, signatories are expected to provide transparency of their adherence to the code on a comply-or-explain basis.

b. Comply or Explain Approach:

In France, requirements relating to sustainability-related disclosures are laid down in legislation. Of particular relevance to asset managers is Article 173-VI of the Energy Transition Law, which is aimed at increasing disclosure of climate-related and other ESG risks by financial institutions, as well as aligning institutional investor portfolios with both French and international climate strategy. Article 173-VI is implemented through a comply-or-explain approach. The French framework has been updated owing to the recently adopted Law on Energy and Climate, which specifies further transparency requirements imposed on asset managers. This update will complement the European Union Sustainable Finance Disclosure Regulation (EU SFDR)<sup>29</sup> requirements, adding a new focus on biodiversity-related issues.

The Financial Conduct Authority United Kingdom (the FCA UK), through its Conduct of Business Sourcebook (COBS), requires licensed firms to disclose their commitment to the Financial Reporting Council's Stewardship Code on a comply-or-explain basis.<sup>30</sup> In-scope investment management firms, as signatories to the Stewardship Code, are expected to take into account material ESG factors, including climate change, when fulfilling their stewardship responsibilities. Firms are required to meet application requirements set out by the Financial Reporting Council (FRC) before they are accepted as signatories to the Stewardship Code. Applicants are required to submit a stewardship report that explains how they have applied all

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<sup>27</sup> MAS, Guidelines, *Supervisory Approach and Regulatory Instruments* (December 2020)

<sup>28</sup> Sustainability defined as medium to long-term sustainability including ESG factors and the 17 UN Sustainable Development Goals, *Principles for Responsible Institutional Investors* (Mar 2020)

<sup>29</sup> <https://eur-lex.europa.eu/eli/reg/2019/2088/oj>

<sup>30</sup> COBS 2.2.3: Disclosure of commitment to the Financial Reporting Council's Stewardship Code

twelve principles and responded to the reporting expectations for the reporting period. Signatory reporting against the UK Stewardship Code is on an “apply-and-explain” basis.<sup>31</sup>

c. **Mandatory Approach:**

Several member jurisdictions have mandatory requirements in place through legislation or regulatory guidance.

The SFDR is an example of the mandatory approach applied through legislative action. At of the time of publication of this report, only the principle-based Level 1 disclosures are in force. The regulatory technical standards (RTS) that make up the Level 2 disclosures are expected to come into force in January 2022. Under the SFDR, all financial market participants, including asset managers, must disclose their policies on the integration of sustainability risks<sup>32</sup> in their investment decision-making process.

The Securities and Futures Commission of Hong Kong (SFC Hong Kong) launched a consultation which closed in January 2021. The SFC Hong Kong proposes to amend the Fund Manager Code of Conduct (FMCC) to require fund managers to take climate-related risks into consideration in their investment and risk management processes as well as to make appropriate disclosures. Disclosure requirements are mandatory for in-scope fund managers, and an exceptions disclosure is expected where climate-risks are irrelevant to any funds. Consultation conclusions and finalised requirements are expected to be published in the latter part of 2021.

*ii. Principle of Proportionality*

When developing supervisory expectations and new regulations, certain financial regulators have considered the principle of proportionality to phase in certain rule changes or to reduce the cost of compliance for smaller, less resourced firms. The proportionality approach may take into account workforce size (e.g., number of staff)<sup>33</sup>, financial footprint (e.g., assets under management<sup>34</sup>), risk profile and the interconnectedness of the firm.

When implemented, proportionality has generally involved: (i) a phased transition period, where smaller firms are granted an extended period for transition; and (ii) for larger firms, supervisory expectations of a more robust approach towards sustainability-related risks,

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<sup>31</sup> Part 1: Expectations of Reporting, The UK Stewardship Code, Review of Early Reporting (Sep 2020)

<sup>32</sup> ‘Sustainability risk’ means an environmental, social or governance event or condition that, if it occurs, could cause an actual or a potential material negative impact on the value of the investment, EU SFDR Article 2 (22)

<sup>33</sup> In the EU, under the SFDR, firms exceeding 500 employees must provide investors with disclosure of the principal adverse impacts of their investment decisions and advice on sustainability factors relating to: (i) the climate and the environment, and (ii) social and employee matters, respect for human rights, anti-corruption and anti-bribery matters. Firms with fewer than 500 employees may choose to comply or explain.

<sup>34</sup> The SFC Hong Kong, in the consultation paper titled *The management and disclosure of climate-related risks by fund managers*, proposed that large fund managers with AUM equal to or exceeding a certain threshold be subject to a reasonable transition period to comply with the baseline requirements and enhanced standards, respectively.

accompanied by more detailed disclosures. However, it is worth noting that in the context of climate-related risks, a smaller financial institution may not necessarily be less exposed to these risks. Depending on the business model and investments held, smaller firms may be concentrated in a specific asset class, sector or geographical region that could be adversely impacted by climate-related risks.

### *iii. Scope of Sustainability*

Approximately half of the respondents reported that they have put policies in place to address climate and environmental issues in addition to other sustainability-related issues. While there are differences in the scope of sustainability, many respondents reported that they utilise a climate-first approach with an emphasis on the financial impact of climate change. Some respondents indicated that their approach goes further to include dimensions of environmental and societal impact.

Examples range from a climate-first approach by the SFC Hong Kong to MAS's Guidelines, which extend the scope of reporting beyond climate and environment to also include biodiversity, pollution and land use. Another example is the EU SFDR, under which sustainability factors encompass environmental, social and employee matters, respect for human rights, anti-corruption and anti-bribery matters.

### *iv. Content of Requirements*

The content of regulatory and supervisory expectations and requirements relating to sustainability-related practices and disclosure at the asset manager level generally cover four major areas: (a) governance; (b) investment strategy; (c) risk management; and (d) metrics and tools, aligning with the TCFD framework for asset managers' disclosure.

This subsection discusses the content of members' current regulatory and supervisory expectations and requirements. It also describes plans among members to add to, or change, such expectations and requirements, as multiple jurisdictions are in the process of examining best practices, monitoring international developments in reporting standards and considering the need for sustainability-specific rules.

#### *a. Governance*

The results from our survey indicate that governance requirements are the most common among responding member jurisdictions that have sustainability-specific requirements at the asset manager level.

Governance structures help identify and assess sustainability-related opportunities and risks consistently throughout the organisation. Boards and senior management play critical roles in determining an asset manager's strategies, business plans and product offerings. These include identifying sustainability-related risks and opportunities over the short and long term, evaluating the actual and potential impact of these risks and opportunities on the asset manager's strategies, business plans and products, and providing oversight of the organisation's progress towards sustainability-related goals.

Governance disclosures enable clients of the asset manager to evaluate whether the asset manager's commitment to sustainability receives appropriate board and management attention, and whether sustainability-related practices are embedded into the organisation's governance structure and management processes, which can help prevent greenwashing at the asset manager level.

As discussed in Chapter 1, where an asset manager is a public company, it has two distinct audiences for its non-financial disclosures:<sup>35</sup> (i) shareholders and wider stakeholders; and (ii) asset manager's clients. Governance disclosures can address the informational needs of both audiences, and asset managers may benefit from cost efficiencies by reporting on the same indicators for both audiences.

Climate-related disclosure requirements for listed companies have seen rapid developments in recent years. This is discussed extensively in the report by the STF's Workstream 1. To the extent that the asset manager is also a listed company, the asset manager is subject to corporate governance disclosure requirements under regulatory requirements and/or listing rules.

In addition to general corporate governance disclosure requirements for asset managers that are public companies, the majority of jurisdictions also have in place legislation, regulatory guidelines, codes or other forms of rules relating to the governance and related disclosures of firms licensed to conduct investment management activities. These existing rules generally aim to ensure that asset managers operate in the best interest of their clients, effectively manage any conflicts of interest, and have the policies and procedures in place to identify, assess, and disclose risks, financial or otherwise, that the asset manager and the assets that it manages are exposed to.

For example, in the United States, the Investment Company Act of 1940 requires a fund's board to adopt written policies and procedures as part of its compliance program. To the extent that a fund has established policies and procedures relating to sustainability-related disclosures and governance, a fund's board is tasked with reviewing and approving such policies and procedures. Rule 38a-1 also requires that the adequacy of a fund's policies and procedures be reviewed annually and that the fund designate a Chief Compliance Officer who is responsible for administering the fund's policies and procedures.

In jurisdictions with sustainability-specific rules, there are a variety of regulatory approaches. For example, in December 2019, the Federal Financial Supervisory Authority of Germany (BaFin) issued guidance<sup>36</sup> regarding sustainability risks for financial institutions, including asset managers. The guidance sets out expectations for the management board of institutions to develop an understanding of, and allocate responsibilities for managing, material sustainability risks, including physical and transition risks, and their potential impact on the entity's business.

In December 2020, MAS issued guidelines to set out sound environmental risk management practices that asset managers may adopt. These include expectations for boards and senior

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<sup>35</sup> Cross reference discussion in Introduction

<sup>36</sup> BaFin, Sustainability risks: *BaFin publishes Guidance Notice* (Dec 2019)

management to maintain effective oversight of the asset managers' environmental risk management and disclosure, as well as the integration of environmental risk into the asset manager's investment risk management framework.

In the UK, the governance expectations in relation to stewardship are outlined predominantly in the UK Stewardship Code (2020). While the UK Stewardship Code is overseen by the FRC, the FCA UK expects their licensed asset managers to disclose the nature of their commitment to the Stewardship Code, or where it does not commit to the Code, its alternative investment strategy.

#### *Plans to add or change requirements*

The Securities Commission Malaysia (SC Malaysia) will be enhancing its regulatory framework on corporate governance for capital market intermediaries, including asset managers. The enhancement will include corporate governance guidelines for capital market intermediaries that may include requirements to consider material sustainability risks and opportunities in the intermediaries' strategic plan.

The FCA UK, as a member of the UK joint regulator and government TCFD Taskforce, published a consultation paper in June 2021 proposing mandatory entity- and product-level TCFD-aligned disclosure rules for asset managers, life insurers and FCA UK-regulated pension providers<sup>37</sup>. The FCA is aiming to finalise the rules by the end of 2021, with the new obligations coming into force on a phased basis from 1 January 2022, beginning with the largest firms.

In October 2020, the SFC Hong Kong launched a consultation to amend the FMCC to require fund managers to take climate-related risks into consideration in their investment and risk management processes as well as to make appropriate disclosures to meet investors' growing demand for climate risk information and to combat greenwashing. The proposed requirements cover four areas: governance investment management, risk management, and disclosure. Proposed climate governance requirements are baseline requirements applicable to all in-scope asset managers, which would involve mandatory disclosure. Consultation conclusions and final requirements are expected to be published in the latter half of 2021.

#### b. Investment Strategy

Sustainability-related requirements relating to investment strategy practices and disclosure address how material sustainability-related risks and opportunities are factored into the asset manager's investment strategies and investment process, including, where relevant, the data and methodologies used.

Practices in this area are key to ensuring sound management of client assets in accordance with sustainability-related commitments at both the asset manager and product levels.

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<sup>37</sup> Gov.uk, page 26, [Interim Report of the UK's Joint Government Regulator TCFD Taskforce](#) (Nov 2020)

Sustainability-related disclosures relating to investment strategy provide clients with transparency of how sustainability-related risks and opportunities are managed in their investments and allow clients to evaluate whether these practices support the sustainability-related claims and commitments made by the asset manager. In addition, such disclosures also provide regulators with the necessary information to assess if asset managers have implemented the practices and policies that are described in their public commitments and investor communications in order to determine the accuracy of these claims.

As such, both practices and disclosures in this area can help prevent greenwashing at the asset manager and product levels.

A number of member jurisdictions apply existing non-sustainability-specific rules in this area to asset managers that claim to practise sustainability investing.

Other jurisdictions have sustainability-specific rules in this area. For example, the SFDR requires that asset managers consider and document the relevance of sustainability risks when conducting due diligence on investments. Asset managers are required to include disclosures on their websites relating to policies that address the integration of sustainability risks into the asset manager's investment decision making process or advice. Where sustainability-related risks are not deemed relevant, an explanation must be provided. The SFDR also sets out principles of disclosures on sustainability considerations in investment decisions.<sup>38</sup>

Another example is the MAS' Guidelines on Environmental Risk Management, which were issued in December 2020, and which lay out expectations for asset managers to embed relevant environmental risk considerations in their research and portfolio construction processes if they have assessed them to be material.

#### *Plans to add or change requirements*

In its October 2020 consultation paper on the changes to the FMCC described above, the SFC Hong Kong set out its expectation that fund managers adopt processes to identify the relevance and materiality of climate-related risks and consider how such risks will affect their strategies and factor into their investment management processes if they become material over time. The consultation paper proposes that fund managers consider adopting the methodologies suggested by international reporting frameworks in assessing the materiality of climate-related risks. Internal records would be required to demonstrate that the asset manager assessed the materiality of these risks, and to support the disclosures of these practices.

As noted earlier, the FCA UK published its consultation on entity- and product-level TCFD-aligned disclosure rules for asset managers, life insurers, and FCA-regulated pension providers in June 2021.

#### c. Risk Management

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<sup>38</sup> Refer to Articles 3 and 4 of the SFDR.

Risk management, including processes for identifying, assessing, monitoring, and managing material investment and operational risks, is a core area of responsibility for asset managers. As sustainability-related issues have become more important, there has been a recognition that there is a need for increased oversight of processes for the assessment and management of sustainability-related risks, including in particular, climate risks. Sustainability-related risks can manifest themselves through financial risks, such as credit, market and liquidity risks. There may also be reputation and business risks for asset managers who do not meet the sustainability-focused expectations of investors. As such, sustainability-related risk management practices should not necessarily be viewed as standalone practices and may need to be integrated into existing risk infrastructure and processes in order to be effective. Such practices may include scenario analysis and stress testing.

Disclosures in this area provide investors with transparency into how asset managers are addressing sustainability in their risk management processes and can also provide regulators with the necessary information to ensure that an asset manager's risk management practices support their sustainability-related claims and disclosures, which may help prevent greenwashing at the asset manager level.

The majority of jurisdictions have general requirements relating to risk management that are not specific to sustainability and that apply to all asset managers. For example, in Ontario and Québec (Canada), there are requirements relating to a system of controls and supervision to manage risks at the asset manager level.

Similarly, licensed asset managers in Australia have an ongoing obligation to maintain adequate risk management systems under the Corporations Act.<sup>39</sup> The Australian Securities and Investments Commission (ASIC) has published guidance<sup>40</sup> on how to meet this obligation, which suggests that Responsible Entities can provide “additional transparency to investors about its arrangements by publicly disclosing a summary of the key aspects of its risk management systems—for example, on its website or in its annual report”.

In the United States, registered investment advisers must adopt compliance policies and procedures as required by rule 206(4)-7 under the Investment Advisers Act of 1940. In designing these policies and procedures, an investment adviser must first identify conflicts and other compliance factors creating risk exposure for the firm and its clients in light of the firm's particular operations, and then design policies and procedures that address those risks. To the extent that an investment adviser has established a process to measure and monitor sustainability risks as part of these policies and procedures, the Chief Compliance Officer is required to administer that policy and conduct an annual review of the adequacy and effectiveness of such policy.

Some jurisdictions have sustainability-specific requirements relating to risk management. These have generally been issued in the form of guidance, codes of conduct or stewardship codes. We note that requirements regarding risk disclosures are also imposed at the product level, which are discussed in greater detail in Chapter 3.

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<sup>39</sup> Australian Government, [Section 912A Corporations Act](#)

<sup>40</sup> ASIC, [Regulatory Guide 259: Risk management systems of responsible entities \(RG 259\)](#)

As discussed above, BaFin’s Guidance Notice on sustainability risks published in December 2019 contains descriptions of good practices at BaFin supervised entities, including asset management companies. These requirements include the integration of sustainability-related risks into risk identification, management and control processes, as well as the assessment of existing internal stress testing or scenario analysis tools to adequately reflect sustainability-related risks.

BaFin’s Guidance Notice states that stress tests may include specific sensitivity and scenario analyses to examine the entity’s ability to withstand adverse events or scenarios caused by physical and transition risks and should also take account of scenarios reflecting plausible future developments and make greater use of long-term scenario analyses. The outcomes of stress tests and scenario analyses may be interpreted on a quantitative basis, and depending on the background of the supervised entity, on a qualitative basis. The outcomes of these methods may thus serve as the starting point for descriptive and narrative elements.

In the Guidelines issued by MAS in December 2020, MAS recognised that stewardship is one of the key levers for asset managers to manage environmental risk. Asset managers are encouraged to incorporate environmental risk considerations into their stewardship frameworks, as sound stewardship practices can help shape the corporate behaviour of the companies that they invest in through direct or collective engagement, or proxy voting. Asset managers are expected to maintain proper documentation to support their engagement efforts and report on their stewardship initiatives.

#### *Plans to add or change requirements*

In a consultation that closed in January 2021, the SFC Hong Kong proposed to insert additional requirements and guidance in the SFC Hong Kong FMCC for fund managers to incorporate climate-related risks into their existing risk management framework, and to ensure that climate-related risks are treated in the same manner as other risks. The SFC Hong Kong requires fund managers to establish and maintain effective systems, policies, and procedures to: (i) identify relevant climate-related risks; (ii) assess the potential impact of the identified risks on each investment strategy and fund; and (iii) monitor and manage those risks on an ongoing basis. The SFC Hong Kong also proposed requiring large fund managers to assess the relevance and utility of scenario analysis in evaluating the resilience of investment strategies to climate-related risks under different climate pathways. Large fund managers are expected to implement scenario analysis within a reasonable timeframe if the assessment result is deemed to be relevant and useful. Large fund managers are also required to disclose their engagement policies.

As discussed above, the FCA UK published its consultation on entity- and product-level TCFD-aligned disclosure rules for asset managers, life insurers, and FCA-regulated pension providers in June 2021.

#### d. Metrics and Targets

Metrics and targets can be broadly categorised as point-in-time measurements or ‘backward-looking’ metrics and estimated or ‘forward-looking’ metrics or targets.

Disclosure of metrics and targets, and the methodologies underpinning them, can provide investors with the necessary information to understand how asset managers measure and monitor sustainability-related risks and opportunities. Further, it can inform investors about the sustainability-related impact financed by, or as a result of, their investment holdings, as well as provide information about how well asset managers are meeting their sustainability-related objectives.

Of particular relevance in this developing space of metrics and targets, are several industry initiatives, including the TCFD consultation on forward-looking financial sector metrics, which concluded in March 2021.<sup>41</sup> The TCFD's public consultation is particularly relevant as reference has been made to the TCFD Framework by an increasing number of securities regulators, as discussed in Chapter 1 of this report, as well as by other financial regulators under the NGFS,<sup>42</sup> and the Financial Stability Board<sup>43</sup> (the FSB). The TCFD plans to release broader, additional draft guidance on metrics and targets, as well as portfolio alignment tools, for further market review in June 2021.

The growing momentum of net-zero commitments within the investment management industry has, in particular, highlighted the need to clarify methodologies behind target-setting by financial institutions and net-zero strategies for investment portfolios. The Science Based Targets Initiative and the Net-Zero Investment Framework may shed some light in this emerging area.

The SFC Hong Kong, in the aforementioned consultation paper on the management and disclosure of climate-related risks by fund managers, proposed that fund managers: (i) disclose, at a minimum, the weighted average carbon intensity of Scope 1 and Scope 2 GHG emissions associated with the funds' underlying investments at a fund level, where data is available or can be reasonably estimated; and (ii) indicate the calculation methodology, underlying assumptions and limitations, and the proportion of investments which are assessed or covered. The SFC Hong Kong will publish the conclusions from its consultation, as well as the final requirements resulting from the changes to the FMCC in the latter half of 2021.

#### *Plans to add or change requirements*

In February 2021, the European Banking Authority, European Insurance and Occupational Pensions Authority and European Securities and Markets Authority (the European Supervisory Authorities or ESAs) published their final report that includes the draft RTS on the content, methodologies, and presentation of disclosures in accordance with the SFDR.<sup>44</sup> The draft RTS include a mandatory reporting template to be used for the mandatory statement on principal

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<sup>41</sup> TCFD, [Summary of Forward-Looking Financial Metrics Consultation.pdf](#) (Mar 2021)

<sup>42</sup> NGFS, Recommendation n°5, Achieving robust and internationally consistent climate and environment-related disclosure: The NGFS emphasises the importance of a robust and internationally consistent climate and environmental disclosure framework. NGFS members collectively pledge their support for the recommendations of the TCFD, First Comprehensive Report (Apr 2019)

<sup>43</sup> FSB, [FSB encourages the IFRS Foundation and authorities to use TCFD's recommendations as the basis for climate-related financial risk disclosures](#) (Dec 2020)

<sup>44</sup> ESMA, [Final Report on draft Regulatory Standards](#) (Feb 2021)

adverse impacts of investment decisions on sustainability factors. The disclosures are focused on a set of indicators for adverse impacts related to the climate and environment, as well as social and employee matters, respect for human rights, anti-corruption and anti-bribery matters. These indicators are divided into a core set of universal mandatory indicators that lead to principal adverse impacts of investment decisions on sustainability factors, irrespective of the result of the assessment by the financial market participant, and additional opt-in indicators for environmental and social factors, to be used to identify, assess, and prioritise additional principal adverse impacts. This requirement would enable investors and prospective investors to understand and compare the approaches to sustainable investment taken by different financial market participants so that they can make more informed investment decisions. The ESAs endeavour to apply the RTS on 01 January 2022.

As discussed above, the FCA UK published its consultation on entity- and product-level TCFD-aligned disclosure rules for asset managers, life insurers, and FCA-regulated pension providers in June 2021. In addition, the SFC Hong Kong will also publish the conclusions from its consultation and the final requirements of the changes to the FMCC in the latter half of 2021.

In addition to regulatory developments, the TCFD also published its summary of its consultation<sup>45</sup> on forward-looking financial sector metrics and will consider these findings for its planned 2021 work on metrics and targets. The TCFD will release broader, additional draft guidance for further market review and consideration later this year.

#### **v. *Supervisory and Enforcement tools***

Securities regulators are empowered by securities laws and regulation to discipline offenders in order to combat misconduct, including in the area of sustainability, such as providing false and misleading information relating to an asset manager's or product's commitment to sustainability.

The responses to our survey indicate that the majority of member jurisdictions rely on existing supervisory and enforcement tools to address sustainability-related misconduct, even in jurisdictions with sustainability-specific requirements.

For example, in Hong Kong, the Securities and Futures Ordinance (SFO) is the main piece of legislation that sets out the powers, roles and responsibilities of the SFC Hong Kong. Under the SFO, the SFC Hong Kong may publish codes or guidelines to provide guidance on various matters, and the FMCC is one such code. A failure to comply with the FMCC or other codes may be taken into account in considering whether the fund manager is a fit and proper person to remain licensed. As such, a failure to comply could result in a person losing their licence to carry out a regulated activity in Hong Kong and be subject to disciplinary action.

In Singapore, MAS-administered fund laws and regulations apply to all funds, including sustainability-related funds, and MAS is empowered to take action in an event of contravention,

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<sup>45</sup> TCFD, [Summary of the Forward-Looking Financial Metrics Consultation \(Mar 2021\)](#)

such as making false and misleading sustainability-focused disclosures in an offering document.

The ASIC in Australia has general supervisory tools that can be applied to address compliance with, and breaches of, regulatory requirements by asset managers in the area of sustainability or by sustainability-related products. Responsible entities (REs) and superannuation trustees are required to maintain an Australian Financial Services (AFS) licence. The licence imposes restrictions including requirements to comply with the financial services laws under the Corporations Act. ASIC also has wide powers to enforce compliance with the provisions in the Corporations Act and ASIC Act that apply to collective investment schemes, including sustainability-related products. These include, but are not limited to, the cancellation, variation or suspension of AFS licences of REs and superannuation trustees, and the taking of enforcement action, civil and criminal, including the use of bans on directors of REs, fines and imprisonment.

Regulators have also started to review asset managers' processes and practices against their disclosures, claims and other public commitments relating to sustainability.

For example, Commissione Nazionale per le Società e la Borsa (CONSOB) of Italy have carried out thematic reviews on asset management firms to assess compliance with business conduct and disclosure requirements. In its thematic reviews, the CONSOB utilizes a risk-based assessment framework which consists of an annual rating system and a semi-annual indicator to identify potential violations. Meanwhile, SC Malaysia has conducted a questionnaire-based review to understand asset managers' current practices in incorporating sustainability-related considerations within their business and processes, particularly in investment management.

In the United States, the Securities and Exchange Commission (US SEC) has announced that it will take an all-agency approach to address the increasing demand for climate and other ESG-related information.<sup>46</sup> The priorities laid out by the Division of Examinations for 2021 will include an enhanced focus on climate and ESG,<sup>47</sup> including by examining ESG fund proxy voting policies and practices to ensure alignment with investors' best interests and expectations, as well as examining firms' business continuity plans in light of intensifying physical and other relevant risks associated with climate change. In addition, a Climate and ESG Task Force has been set up in the SEC's Division of Enforcement,<sup>48</sup> which will proactively detect ESG-related misconduct, with an initial focus on identifying any material gaps or misstatements in issuers' disclosure of climate risks under existing rules and analysing disclosure and compliance issues relating to investment advisers' and funds' ESG strategies.

Across the EU, regulators are also contemplating the supervision and enforcement policies that are required as the EU SFDR becomes effective. For example, the Danish Financial Supervisory Authority (DFSA) has set up a new team dedicated to sustainability issues<sup>49</sup>. The

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<sup>46</sup> SEC, [SEC Response to Climate and ESG Risks and Opportunities](#)

<sup>47</sup> SEC, [SEC Division of Examinations Announces 2021 Examination Priorities](#)

<sup>48</sup> SEC, [SEC Announces Enforcement Task Force Focused on Climate and ESG Issues](#)

<sup>49</sup> Nordsip, [Supervisory Authorities' Early Approaches to SFDR](#)

new Sustainable Finance Unit at the DFSA is exploring the use of existing supervisory tools in relation to the SFDR. This includes thematic inspections, taking a risk-based approach to supervision, and enforcement responses such as public notices for companies that are in contravention of the rules.

Leveraging existing disclosure requirements for asset managers, the French L'Autorité des marchés financiers (AMF France) has reviewed the level and quality of disclosures, and any progress made since 2017. Several reports have been issued, together with guidelines and recommendations. Other supervisory work has focused on a review of existing risk management practices at the asset manager level and their consistency with disclosures.

The ESAs have issued a joint supervisory statement<sup>50</sup> on the application of the EU SFDR, and market participants are expected to comply with the disclosure obligations set out in the implementation timeline. National competent authorities<sup>51</sup> are also expected to prepare for the orderly and effective supervision of the compliance of financial market participants and financial advisors under the EU SFDR.

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<sup>50</sup> ESMA, [Joint ESAs Supervisory Statement - SFDR](#)

<sup>51</sup> Definition of national competent authorities: <https://www.esma.europa.eu/rules-databases-library/eu-acts-and-national-competent-authorities>

## Chapter 3: Regulatory Approaches to Disclosures for Investment Products

This chapter: (a) discusses and provides examples of different types of greenwashing at the product level; and (b) provides an overview of the different regulatory approaches to product-level disclosure by member jurisdictions for sustainability-related products and explains how the approaches can help prevent greenwashing.

### A. Types and Examples of Product-Level Greenwashing

The following is a non-exhaustive list of possible types of greenwashing that may occur at the product level, with examples of each type.

#### *i. Lack of alignment between the product's sustainability-related name and its investment objectives and/or strategies*

The first possible type of greenwashing at the product level involves a lack of alignment between the product's name and its investment objectives and/or strategies. This could take the form of the product's name suggesting that it is primarily focused on sustainability, but: (i) the product's investment objectives do not refer to sustainability; (ii) the product only uses ESG strategies in a limited way and is not primarily focused on sustainability; or (iii) the asset manager has discretion over whether the product takes sustainability into account.

- a. Product's name refers to sustainability but its investment objectives do not

Given the importance of a product's name in communicating its focus and objectives, the practice of a product referring to sustainability in its name despite not referring to sustainability in its investment objectives may mislead investors into purchasing products that appear to be focused on sustainability, but which are not.

#### **Examples:**

A product includes "ESG factors" in its name, but its investment objectives only state that it seeks to provide capital appreciation by investing primarily in global equity securities.

A product has the word "sustainable" in its name, but its investment objectives only reference financial performance.

- b. Product's name refers to sustainability but its use of ESG strategies is limited

A product that references sustainability in its name, but that is not primarily focused on sustainability and only uses ESG strategies in a limited way, could be misleading to investors who may expect a stronger sustainability focus from the product based on its name.

**Example:**

A product has “ESG” in its name, but only uses a limited negative screening strategy to exclude investments in controversial weapons and does not materially consider ESG factors in the rest of its investment strategies.

- c. Product’s name refers to sustainability but the asset manager has discretion over whether the product takes sustainability into account

Similar to the above scenario, a product that references sustainability in its name but provides the asset manager with discretion over whether the product takes sustainability into account could be misleading to investors who may expect that the product is fully committed to sustainability based on its name.

**Example:**

A product has the word “sustainable” in its name, but its disclosure states that the asset manager *may* take ESG factors into account in the product’s investment strategies and there is no actual commitment to do so.

*ii. Marketing that does not accurately reflect the product’s investment objectives and/or strategies*

Another possible type of greenwashing at the product level involves the product being marketed in a way that does not accurately reflect its investment objectives and/or strategies. Some common variations of this practice include: (i) suggesting that a product is a sustainability-related product when it is not; (ii) suggesting that a product is focused all three components of ESG when it only focuses on one component; and (iii) misrepresenting the extent and nature of the product’s use of ESG strategies.

- a. Product is marketed as a sustainability-related product but it is not

One variation of this type of greenwashing involves the product’s marketing materials suggesting that the product is focused on sustainability, but its investment objectives and/or strategies, as disclosed in the product’s disclosure documents, do not refer to sustainability. This may lead to investors purchasing products that appear, based on their representations, to be focused on sustainability, but which are not.

**Examples:**

A product is marketed as an ESG product, but while the manager of the product has access to ESG ratings and data, it does not take them into consideration in its investment process, and only uses investment strategies that are similar to those used by non-ESG products.

A product is marketed as a responsible investing product by being listed as a responsible investing product with an industry association, but the product’s investment objectives, as disclosed in the product’s disclosure documents, do not reference responsible investing.

This practice can also occur when the product is not necessarily being marketed explicitly as a sustainability-related product, but the product’s marketing materials highlight sustainability-related performance in a way that could lead an investor to believe that it is a sustainability-related product. This may lead investors who wish to invest in sustainability-related products to mistakenly purchase products that happen to perform well on certain sustainability metrics at a certain point in time, but which are not intended to be sustainability-related. Such products may later perform poorly on sustainability metrics as they are not intended to be sustainability-related.

**Example:**

A product’s website shows the product’s ESG ratings, identifying them to be on the high-end of an ESG performance scale and thus implying that the product has an ESG focus, but the product’s name, investment objectives and strategies do not reference sustainability or ESG at all, and the product is not managed by an asset manager that applies sustainability considerations across all of its products.

- b. Product is marketed as focusing on all three ESG components but is only focused on one

This variation involves products that are marketed as being focused on all three components of ESG, but which are in fact only focused on one of the components. This may confuse investors who want to invest in products that address all three ESG components into mistakenly investing in a product that only focuses on one of the three components. This may also lead investors to invest in a product that focuses on a different ESG factor than what they intended.

**Example:**

A product is marketed as being focused on all three components of ESG, but the disclosure documents indicate that the product is only focused on water quality, without any focus on, or supporting information about, social or governance issues.

- c. Extent and nature of product’s use of ESG strategies are different than advertised

This variation involves marketing sustainability-related products by emphasizing their use of certain ESG strategies in a way that is not reflective of how those strategies are actually used. This includes scenarios in which: (i) there is a maximum limit to the product’s use of those strategies; (ii) the product does not actually use the advertised investment strategies and/or uses different types of investment strategies altogether; and (iii) material aspects of the investment strategies are not prominently disclosed in the marketing materials. This may lead investors to invest in products based on an incorrect understanding of how the product will achieve its sustainability-related investment objectives.

**Examples:**

A product is marketed as an impact investment product, but does not actually engage in impact investing and only employs a basic level of negative screening.

A product is marketed on its website as an investment option for investors to manage climate change risk and transition to a low carbon economy using a proprietary decarbonization investment strategy. The product's website states that the proprietary strategy would result in the product holding no companies with significant involvement in coal-related activities (i.e., zero holdings in coal). However, this statement is qualified by a footnote which provides the product with broad exceptions to its claim of zero holdings in coal, such as allowing for the product to invest in companies that only derive a small portion of their power generation from renewable sources, with the remaining majority from thermal coal or other coal power.

A product's marketing materials indicate that the product uses corporate engagement, proxy voting and shareholder proposals to achieve its socially responsible investment objectives, but the product's prospectus does not disclose these approaches in its investment strategies disclosure, and the summary of the product's proxy voting policy disclosed in the product's disclosure documents does not explain how proxy voting is used to meet its socially responsible investment objectives.

*iii. Failure of product to follow its sustainability-related investment objectives and/or strategies*

A third possible type of greenwashing at the product level involves a product with stated sustainability-related investment objectives and strategies failing to follow those objectives and strategies in practice. This may lead to investors investing in products with stated sustainability-related investment objectives and strategies that appear to meet their sustainability-related aims, but which do not in practice do so.

It is worth noting that the failure could be intentional or be the result of poor asset management, including poor compliance practices. The former scenario is perhaps the most classic type of product-level greenwashing, in which a product intentionally does not do what it has stated to its investors that it will do. The latter scenario, while lacking the same intent to greenwash, can have the same consequence as the deliberate form of this type of greenwashing.

**Example:**

A product claims to use a negative screening investment strategy to screen out all companies that are involved in the oil and gas industry, but the product's portfolio in fact holds securities of companies in the oil and gas industry.

*iv. Misleading claims about the product's sustainability-related performance and results*

Another possible type of greenwashing at the product level involves the making of misleading claims about the sustainability-related performance of a product, which may lead investors to

purchase products under a false impression about the product’s sustainability-related performance. Examples of these types of misleading claims include: (i) claims about sustainability-related results (such as portfolio temperature or impact); (ii) claims about the existence of a direct causal link between a product’s investment strategy and specific sustainability-related portfolio results; and (iii) manipulating elements of disclosure to present an asset manager or product in a positive light.

This type of greenwashing is perhaps one of the most prevalent types of greenwashing. A June 2019 report revealed that, based on an analysis of the key information documents and marketing materials of 100 green thematic products in the EU, 85 percent of the products made impact claims in their marketing, and only 2 claims were deemed not to be misleading<sup>52</sup>. According to the report, the most common claim was to suggest that positive environmental impacts result from the product’s investment strategy.

**Example:**

A product claims that investments in the product will achieve greater carbon dioxide emission reductions than from recycling, going vegan or not driving a car, despite a lack of evidence disclosed to substantiate the claim, as well as a lack of explanation of how such impact is being calculated or measured (including any assumptions used in making those calculations).

A product claims that every euro invested in it will directly lead to the delivery of a certain number of health appliances for poor communities, without providing evidence for this claim.

*v. Lack of disclosure*

A lack of disclosure about the sustainability-related aspects of a product can lead to greenwashing. This includes a lack of disclosure about the product’s: (i) investment strategies, including the use of indices and ESG scores or ratings as part of the product’s investment strategies; (ii) use of proxy voting and shareholder engagement; and (iii) sustainability-related performance and results. This practice may lead to investors making investment decisions based on a lack of information about the sustainability-related aspects of the product that are material to the investor’s decision to invest.

It is worth noting that not all cases of a lack of disclosure are examples of greenwashing. However, greenwashing, or the potential of greenwashing, occurs when there is a lack of disclosure that leads to investor confusion or misunderstanding about the sustainability-related aspects of a product.

*a. Lack of disclosure about product’s investment strategies*

A lack of disclosure about a product’s investment strategies, including its use of indices (for index-tracking products or other products that reference one or more indices) and ESG scores

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<sup>52</sup> 2° Investing Initiative, *Impact Washing Gets a Free Ride: An Analysis of the Draft EU Ecolabel Criteria for Financial Products*, June 2019, pg. 26. <https://2degrees-investing.org/wp-content/uploads/2019/06/2019-Paper-Impact-washing.pdf>

or ratings (both “in-house” and third-party scores and ratings), may lead to investors purchasing products under a false impression about how the product will meet its investment objectives, including the investment universe from which the product will select its investments, and how the product will make those selections, including the evaluation criteria used to assess the sustainability performance of portfolio companies.

In particular, a lack of disclosure about a product’s investment strategies can lead to investor confusion or misunderstandings about what the product is permitted to invest in. For example, some investors may consider investments in certain countries, industries, sectors or issuers to be inappropriate investments for sustainability-related products. However, a product that is marketed as a sustainability-related product may be permitted to invest in such countries, industries, sectors or issuers, and may have a good reason to do so, such as, for example, if the product aims to use shareholder engagement to improve a specific issuer’s sustainability practices. This can be made clear to investors through investment objectives and strategies disclosure that states that the product may invest in countries, industries, sectors or issuers that may not appear to be sustainable-friendly (including identifying those countries, industries, sectors or issuers) and explains the rationale for such investments. However, where such disclosure does not exist, or is unclear, this may lead to investors purchasing products under a false impression about the types of investments that the product may make.

In addition, a lack of disclosure about a product’s investment strategies may include a lack of disclosure about the limitations in the data or methodologies used by the product. This may include a lack of disclosure about the level of uncertainty associated with the data used by the product and the use of assumptions and approximations in producing sustainability-related data, such as in the calculation of carbon emissions, and in particular, the consideration of “Scope 3” emissions.

**Examples:**

A product claims “Paris alignment” in its investment strategies but does not articulate what “Paris alignment” means and how it will be achieved by the product.

A product’s disclosure documents do not explain the product’s negative screening process, other than to state that investments with material ESG issues and poor risk/return characteristics will be excluded as investments.

A product states that it may exclude companies involved in severe ESG-related controversies but does not explain or describe what would constitute a severe ESG-related controversy.

A product discloses that it uses a quantitative multi-factor model, but the investment strategies disclosure in the product’s prospectus does not describe or explain the ESG factors used in the model.

A product refers to a specific combination of indices, which are briefly described in the product’s prospectus, but there is no description of the ESG factors used by the indices.

An index-tracking product references climate change in its name and specifies in its key investor information document that it invests in companies that contribute to climate transition, but the

disclosure provides limited information about how the selected index meets the objective of investing in companies that contribute to climate transition.

A product's disclosure does not explain what the third-party ESG ratings used by the product in determining its investment universe represent, how they should be interpreted in the context of the product's investment objectives and strategies, and the source of the ratings.

A product has significant weighting in certain "sin stock" sectors, despite the product's marketing materials emphasizing that the product's investment strategy takes ESG factors into account and the investment strategies disclosure does not explain that the product may invest in certain "sin stock" sectors.

A product has "sustainability" in its name but invests in controversial sectors such as mining and oil, and the investment strategies disclosure does not provide any clarity as to whether this could happen, and why.

b. Lack of disclosure about product's use of proxy voting and shareholder engagement

A lack of disclosure about a product's use of proxy voting and shareholder engagement, including its proxy voting and shareholder engagement policies, may lead to investors purchasing products under a false understanding about the nature and extent of the product's use of proxy voting and shareholder engagement as tools to achieve its sustainability-related investment objective. Without sufficient disclosure, investors may have expectations about what the asset manager aims to achieve through its use of proxy voting and shareholder engagement that cannot or will not be met.

Some have raised concerns about the prevalence of insufficient disclosure about proxy voting in certain jurisdictions. The aforementioned June 2020 report found that only 55 percent of the 75 asset managers reviewed disclosed a record of proxy votes cast in annual general meetings of investee companies,<sup>53</sup> and only 17 percent of the asset managers published rationales for their voting decisions. The report highlighted this statistic to be concerning considering that "proxy voting is often the only measurable evidence that asset owners, clients and other stakeholders have of asset managers' commitment to active stewardship and responsible investment more generally".<sup>54</sup>

There have also been some concerns raised about insufficient disclosure about shareholder engagement activities. The same report found that most of the reviewed asset managers reported on their sustainability-related shareholder engagement at an aggregate level, but rarely

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<sup>53</sup> ShareAction, *Point of No Returns: A ranking of 75 of the world's largest asset managers' approaches to responsible investment*, March 2020, pg. 33. <https://shareaction.org/wp-content/uploads/2020/03/Point-of-no>Returns.pdf>

<sup>54</sup> ShareAction, *Point of No Returns: A ranking of 75 of the world's largest asset managers' approaches to responsible investment*, March 2020, pg. 34. <https://shareaction.org/wp-content/uploads/2020/03/Point-of-no>Returns.pdf>

provided details about their engagements and outcomes.<sup>55</sup> Specifically, the report found that 36 percent of the asset managers disclosed no information about their sustainability-related shareholder engagement activities publicly, while 8 percent only communicated this information to clients. Meanwhile, 39 percent of asset managers provided limited disclosure about their engagement activities, usually in the form of a handful of short examples of engagement or a detailed split of the number of engagements by topic. Only 17 percent of the asset managers included a representative sample of detailed case studies of sustainability-related shareholder engagement in their reports. Finally, only 52 percent of the asset managers reported on the number of engagements or targeted companies, and only a few provided information on the nature of the engagements.

In addition, although there is some progress on this front, not all PRI A+ rated asset managers set time-bound objectives for engagement or disclose engagement progress and outcomes.<sup>56</sup>

**Example:**

A product does not disclose its full proxy voting record, and only provides highlights or commentary about specific votes that it has made as a shareholder of certain companies.

c. Lack of disclosure about product’s sustainability-related performance and results

A lack of disclosure about a product’s sustainability-related performance and results may include: (i) failing to provide any type of periodic reporting about the product’s sustainability-related performance and results; (ii) providing only limited reporting that does not give a full picture of the product’s sustainability-related performance and results; and (iii) failing to provide an explanation for awards or certifications obtained by the product in relation to its sustainability-related performance, which may be interpreted by investors to be an indicator of positive performance by the product.

This practice may lead to investors investing in products that they believe will achieve, or are achieving, specific sustainability-related goals that are important to the investor, without having any way of verifying whether the product is succeeding in meeting those goals, or in some cases, while being misled about the product’s sustainability-related performance and results.

**Examples:**

A product states that its targets for investment are companies with specific “green” characteristics but does not include key performance indicators for these characteristics in its periodic performance reporting.

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<sup>55</sup> ShareAction, *Point of No Returns: A ranking of 75 of the world’s largest asset managers’ approaches to responsible investment*, March 2020, pg. 35. <https://shareaction.org/wp-content/uploads/2020/03/Point-of-no>Returns.pdf>

<sup>56</sup> Stampe, J. et al, [2020], *RESPOND – Resilient and Sustainable Portfolios*, WWF and Lee, K. and Gauthier, M. [2021], “2021 Review of Responsible Investment Practices”, WWF

A product identifies real-world sustainability aims that are aligned with several of the United Nations Sustainable Development Goals, but does not provide quantifiable evidence of how, and how well, the product is meeting those aims, and only provides limited or anecdotal evidence of actions taken to meet those aims.

A product discloses that it has been certified as “ethical”, but there is no description of the basis for the certification.

## **B. Regulatory Approaches to Investment Product Disclosure**

This subsection provides an overview of the scope and content of the different regulatory approaches by member jurisdictions to sustainability-related product-level disclosure on a range of topics and explains how those requirements can help prevent greenwashing.

### *i. Scope of Requirements*

In general, a significant number of jurisdictions have mandatory general requirements relating to product disclosure that are applicable to all types of products, rather than only sustainability-related products.

The main reasons why some jurisdictions have general disclosure requirements that apply to all types of products rather than requirements that are specific to sustainability-related products are that: (i) the general requirements adequately address sustainability-related products; and (ii) in some jurisdictions, sustainability-related products comprise only a small fraction of all products and a sustainability-specific regulatory regime is not needed.

However, many jurisdictions have requirements that apply only to sustainability-related products. While there are a few exceptions, such requirements tend to be mandatory.

For example, in Hong Kong, the requirements under the Circular to Management Companies of SFC-Authorised Unit Trusts and Mutual Funds for Green or ESG Funds<sup>57</sup> (the SFC Hong Kong Circular) are applicable to SFC Hong Kong -authorised funds that incorporate one or more globally recognised green or ESG criteria or principles (such as the United Nations Global Compact Principles and the United Nations Sustainable Development Goals, or, on a case-by-case basis, other green or ESG criteria or principles recognised globally or nationally) as their key investment focus and which reflect such in their name and investment objective or strategy (Green or ESG Funds). There are similar requirements in Malaysia in the Guidelines on Sustainable and Responsible Investment Funds<sup>58</sup> (the SRI Funds Guidelines), which apply to funds that incorporate one or more sustainability considerations, and seeks to be qualified as SRI Funds under the SRI Funds Guidelines.

In some of the jurisdictions that have requirements that are specific to sustainability-related products, the requirements vary depending on the level of the product’s focus on sustainability.

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<sup>57</sup> <https://apps.sfc.hk/edistributionWeb/gateway/EN/circular/doc?refNo=19EC18>

<sup>58</sup> <https://www.sc.com.my/api/documentms/download.ashx?id=9a455914-71db-4982-a34b-9a8fc7df79b5>

For example, in EU member jurisdictions, under the SFDR,<sup>59</sup> different disclosure requirements apply to products that promote, among other characteristics, environmental or social characteristics, or a combination of those characteristics, provided that the investee companies follow good governance practices (**Article 8 Products**), as compared to products that have sustainable investment as their objective (**Article 9 Products**).

Another example is France, which introduced minimum standards for products using non-financial considerations in their marketing in 2020.<sup>60</sup> Different requirements apply depending on whether the product's non-financial investment management approach (i.e., its use of ESG investment strategies) is significantly engaging, non-significantly engaging or does not satisfy either of those thresholds. Only products whose approaches are significantly engaging (**Key Communication Products**) may make non-financial characteristics a key aspect of their communications (including in their names). Products which take non-financial criteria into consideration in their management without adopting a significantly engaging approach may only communicate in a limited way on the consideration of non-financial criteria (**Limited Communication Products**). The determination of what is "significantly engaging" involves meeting certain criteria. Products that do not meet the minimum standards to qualify as Key Communication Products or Limited Communication Products may only present information on their non-financial characteristics in their prospectus in a proportionate manner.

## *ii. Content of Requirements*

This subsection discusses the content of the different regulatory requirements relating to product-level disclosure by member jurisdictions and explains how those requirements can help prevent greenwashing. It also describes plans among member jurisdictions to add to, or change, such requirements.

In general, a number of jurisdictions are considering imposing sustainability-specific requirements or providing sustainability-specific guidance relating to product-level disclosure. Some of those jurisdictions are undertaking studies and reviews in order to determine whether there is a need for such requirements or guidance, while others are exploring international standards, best practices and experiences of other jurisdictions in this area. Specific plans to add to, or change, existing requirements relating to specific areas of product disclosure are discussed below.

### *a. Product Authorisation*

Product authorisation generally involves a process whereby a new product that wishes to sell securities to the public files an application and/or offering document that is required to meet certain minimum disclosure requirements, which is then subject to some form of regulatory review or approval.

Product authorisation systems can help prevent greenwashing by imposing minimum disclosure requirements, as discussed below in the subsections addressing different areas of

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<sup>59</sup> <https://eur-lex.europa.eu/eli/reg/2019/2088/oj>

<sup>60</sup> AMF Position DOC-2020-03. <https://www.amf-france.org/en/regulation/policy/doc-2020-03>

product disclosure.

Many jurisdictions have general product authorisation requirements that apply to all products, including sustainability-related products. In some of those jurisdictions, products that wish to sell securities to the public are required to file a prospectus or other offering document that meets specific disclosure requirements. For example, in the United States, funds are required to file a prospectus that discloses material information, such as investment objectives and strategies, fees, risks, performance, and governance. Other jurisdictions require products to file an application with the regulator that meets certain disclosure requirements.

Several jurisdictions have product authorisation requirements that are specific to sustainability-related products. Some of those jurisdictions require sustainability-related products to make an application and meet certain sustainability-related disclosure requirements before they are authorised as sustainability-related products. For example, in Hong Kong, the SFC Hong Kong Circular sets out an authorisation process for new and existing SFC Hong Kong -authorised funds that wish to be authorised as Green or ESG Funds that involves providing confirmation of compliance with the SFC Hong Kong Circular and meeting certain disclosure standards. Similarly, in Malaysia, there are specific authorisation requirements relating to both new and existing funds that wish to qualify as SRI Funds, involving both an application to the Securities Commission that includes providing a checklist of compliance with the SRI Funds Guidelines, as well as meeting certain disclosure requirements.

Other jurisdictions only require sustainability-related products to meet certain sustainability-specific disclosure requirements in an offering document such as a prospectus. In some of these jurisdictions, there are thresholds to determine the level of the product's sustainability focus that then determine the level of disclosure required. For example, in jurisdictions in the EU, there are different sustainability-related disclosure requirements in pre-contractual disclosures depending on whether the product is an Article 8 Product or Article 9 Product.

#### *Plans to add or change requirements*

In the United Kingdom, the FCA has been communicating with industry on a set of draft guiding principles relating to the design, delivery and disclosure of ESG investment products.<sup>61</sup> The aim of the draft guiding principles is to help firms interpret existing rules, including the requirement that disclosures are 'fair, clear and not misleading.'

#### b. Naming

Naming requirements set parameters around the words or message conveyed in a product's name. Requirements may include, for example, ensuring consistency between a product's name and its investment objectives in order to ensure that the name of the product is not misleading.

Requirements relating to naming for sustainability-related products can help prevent greenwashing by ensuring that products that identify themselves as sustainability-related

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<sup>61</sup> <https://www.fca.org.uk/news/speeches/building-trust-sustainable-investments>

through their names are accurately reflecting their focus on sustainability.

Several jurisdictions have general naming requirements that are not specific to sustainability-related products. In some jurisdictions, such as Ontario and Québec (Canada), the general requirements are focused on ensuring consistency between the product's name and its investment objectives and strategies. In the United States, all names of funds are subject to the "Names Rule," which generally requires that if a fund's name suggests a particular type of investment, industry, or geographic focus, the fund must invest at least 80 percent of its assets in the type of investment, industry, country, or geographic region suggested by its name.<sup>62</sup> Funds are also prohibited from adopting as part of their names "any word or words that the Commission finds are materially deceptive or misleading." Sustainability-focussed funds, in addition to other funds, are subject to these requirements and prohibitions.

In other jurisdictions, general naming requirements also encompass other concerns. For example, in China, a fund's name must indicate its type and investment characteristics and cannot contain anything that damages the national interest or public interest, defrauds or misleads investors, or otherwise infringes upon the lawful rights and interests of others.

Many jurisdictions have specific naming requirements for sustainability-related products. For example, in Hong Kong, the SFC Hong Kong Circular specifies that, with respect to the name of the fund, a Green or ESG Fund should invest primarily in investments that reflect the particular ESG or green investment focus for which the Green or ESG Fund represents (which is reflected in its name). In the case of Green or ESG Funds adopting screening or thematic strategies, the requirement that the Green or ESG Fund "invest primarily" means that the Green or ESG Fund is expected to invest at least 70 percent of its total net asset value in securities or other investments reflecting the stated green or ESG-related investment focus. In addition, in France, only Key Communication Products may refer to non-financial characteristics in their names.

#### *Plans to add or change requirements*

The CMVM Portugal has indicated that it is considering imposing a requirement within the authorisation and registration regime for funds whereby, in order to be allowed to use sustainability references in the fund's name, the fund must invest most of its portfolio according to ESG methodologies, disclose the asset selection approach, and commit to objective criteria that allow for the monitoring of the fund.

#### c. Labelling and Classification

Labelling and classification requirements set parameters around how a product is labelled or categorised beyond the product's name. Labelling includes, for example, the use of ESG or SRI labels as well as third-party certifications. Classification includes the use of ESG product types for product categorisation schemes.

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<sup>62</sup> Rule 35d-1 under the *Investment Company Act* Antifraud provisions of the federal securities laws, section 35(d) of the *Investment Company Act* and rule 35d-1 under the *Investment Company Act*.

Requirements relating to labelling and classification for sustainability-related products can help prevent greenwashing by ensuring that products that identify themselves as sustainability-related in their disclosure documents or marketing materials through their use of sustainability-related labels or product types are accurately reflecting their focus on sustainability.

A few jurisdictions have labelling and classification requirements that are specific to sustainability-related products.

In the EU, there are classification requirements for environmentally sustainable products under the EU's Taxonomy Regulation (the **Taxonomy Regulation**).<sup>63</sup> The Taxonomy Regulation sets out specific criteria for determining whether an economic activity, including a financial product, qualifies as environmentally sustainable and requires that the EU and its member jurisdictions apply the criteria to determining whether an economic activity qualifies as environmentally sustainable for the purposes of public measures, standards and labels. It is expected that additional requirements relating to the definition of activities as environmentally sustainable will be implemented under the Regulatory Technical Standards (the RTS), which have not yet been implemented.

In addition, AMF France recommends that Key Communication Products adhere to a charter, code or label regarding the criteria relating to the fulfillment of environmental, social, and governance quality objectives. With respect to products that use the SRI indication and market themselves as such, the AMF France also recommends that the product obtain the SRI label. This recommendation was developed specifically to address potential confusion relating to the use of the public SRI label established in France in 2015.

#### *Plans to add or change requirements*

The SFC Hong Kong is in the process of further refining the minimum requirements for funds to be considered an "ESG Fund."

#### d. Investment Objectives Disclosure in Product Offering Documents

Requirements relating to investment objectives disclosure in product offering documents or pre-contractual disclosure are generally aimed at requiring, and specifying the nature of, disclosure about a product's investment objectives.

In combination with requirements relating to product naming, labelling, classification and marketing materials, requirements about investment objectives disclosure can help prevent greenwashing by providing transparency about the nature and extent of a product's sustainability-related investment objectives, including which components of ESG the product is focused on and whether sustainability is a primary focus of the product.

Many jurisdictions have general requirements relating to investment objectives disclosure that are not specific to sustainability-related products and that apply to a wider range of products. For example, in Ontario and Québec (Canada), all funds are required to disclose, in their

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<sup>63</sup> <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex:32020R0852>

prospectus, the fundamental investment objectives of the fund, including information that describes the fundamental nature or features of the fund that distinguish it from other funds. In the United States, all registered funds are required to provide disclosure in their prospectuses about their investment objective.

The jurisdictions that have investment objectives disclosure requirements specific to sustainability-related products generally require that the product offering or pre-contractual disclosure documents disclose the product's sustainability-related investment objectives. For example, in Hong Kong, the offering documents of Green or ESG Funds are required to disclose a description of the key investment focus and targeted objective of the Green or ESG Fund, and where applicable, how the key investment focus is considered green or ESG-related. In France, the AMF France recommends that Key Communication Products disclose in their regulatory documents an investment objective describing the non-financial aspect of their management.

The FCA UK has issued non-Handbook guidance in Policy Statement PS19/4<sup>64</sup> stating that funds that set out non-financial objectives or that state that they are aiming to achieve a non-financial return should set them out in their prospectuses or key information document in a way that is fair, clear and not misleading and be clear about how they will measure whether those objectives are being met. In EU member jurisdictions, there are also specific investment objectives disclosure requirements where an Article 9 Product's sustainability-related investment objective is specific to environmental factors or if an Article 9 Product has reduction in carbon emissions as its objective.

#### e. Investment Strategies Disclosure in Product Offering Documents

Requirements relating to investment strategies disclosure in product offering documents or pre-contractual disclosure are generally aimed at requiring, and specifying the nature of, disclosure about investment strategies, including sustainability-related investment strategies. These requirements may address disclosure about the investment universe, investment selection process (including the types of ESG strategies used, as well as the use of indices and ESG scores or ratings, the extent of such use, and their methodologies, where applicable), sustainability criteria used, and extent of the ESG strategies used. The requirements may also address disclosure of the product's use of proxy voting and shareholder engagement as part of the product's investment strategies, as discussed later in this chapter.

Requirements about investment strategies disclosure can help prevent greenwashing by providing clarity to investors about how the product will achieve its sustainability-related objectives, including the nature and extent of the ESG strategies employed by the product (including proxy voting and shareholder engagement), the investment universe from which the product will select its investments, and which countries, industries, sectors or issuers that the product may invest in. This would include providing clarity to investors about which indices and ESG scores or ratings are being used by the product, the extent to which they are used, and

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<sup>64</sup> <https://www.fca.org.uk/publications/policy-statements/ps19-4-asset-management-market-study-feedback-cp18-9-final-rules-guidance>

the methodologies underlying those indices and ESG scores or ratings.<sup>65</sup> These types of disclosure requirements may help prevent investors from purchasing products under a false impression about the ways in which the product will meet its sustainability-related objectives and the types of investments that the product may make.

Many jurisdictions have general requirements relating to investment strategies disclosure that are not specific to sustainability-related products and that apply to a wider range of products. For example, in China, thematic funds, including sustainability-related and green funds, must specify and clarify their investment strategy in fund contracts, and must follow them in operating the fund. In the United States, all registered funds are required to provide disclosure about their investment strategies, including the particular type or types of securities in which the fund principally invests or will invest.

Some jurisdictions also have general disclosure requirements relating to the use of indices as part of a product's investment strategies. For example, in Belgium, products are required to explain the way in which an index is used by the product. Another example is Morocco, where the prospectus of each fund is required to disclose the index used by the fund as a benchmark.

Most of the jurisdictions that have investment strategies disclosure requirements specific to sustainability-related products generally require, at minimum, an explanation of how the product's sustainability-related investment objectives are being met. In addition, in the EU, Article 8 Products, which do not have sustainability-related investment objectives but which promote environmental and/or social characteristics, are also required to provide an explanation of how those characteristics are met.

Beyond these minimum requirements, there are also specific disclosure requirements relating to different aspects of sustainability-related products' investment strategies across different jurisdictions.

### *1. Investment universe*

Some jurisdictions require disclosure relating to the investment universe from which the product selects its investments. For example, in France, both Key Communication Products and Limited Communication Products must present the investment universe on which non-financial analysis is performed.

### *2. Investment selection process*

A number of jurisdictions require disclosure about the investment selection process adopted by the product, including the types of ESG strategies used. For example, the AMF France recommends that Key Communication Products disclose: (i) the types of approaches implemented; (ii) indications regarding the selection and management methods used; (iii) the significance of the various strategies and an indication of whether the approach can lead to the selection of certain sectors; and (iv) a summary of the process of consideration of non-financial

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<sup>65</sup> These areas are captured by the STF Workstream 3 report which is in progress; the report will be available at [www.iosco.org](http://www.iosco.org) once finalised.

characteristics and its sequencing relative to the financial strategy. In Hong Kong, Green or ESG Funds are required to disclose the investment selection process and criteria adopted by the Green or ESG Fund, such as the assessment criteria of the underlying investments (including, for example, any ESG ratings or third-party certificates or labels, and the carbon footprint and environmental impact associated with portfolio companies).

Some jurisdictions require specific disclosure relating to the use of a negative screening strategy. In Hong Kong, Green or ESG Funds are required to provide a description of whether an exclusion policy is adopted by the Green or ESG Fund, and the types of exclusions used. In Sweden, the fund rules must be clear on whether the fund supports or excludes certain companies from its investment universe.

### *3. Sustainability criteria or considerations*

A number of jurisdictions require disclosure of the sustainability criteria or considerations used by the product. For example, in Malaysia, an SRI Fund must disclose, as part of its investment strategies, the sustainability considerations that it has adopted, such as the United Nations Global Compact Principles, one or more of the United Nations Sustainable Development Goals (UN SDGs), or any other environment, social or governance factors. Similarly, in Hong Kong, Green or ESG Funds must disclose the relevant green or ESG criteria or principles considered.

Another example is Australia, where a product issuer that takes environmental, social, or ethical considerations or labour standards into account must outline those labour standards or environmental, social or ethical considerations. In EU member jurisdictions, Article 8 Products are required to disclose the environmental and/or social characteristics to which the investment underlying the product relate. In addition, the AMF France recommends that green bond, social bond or sustainability bond funds disclose an explanation of the criteria to be complied with for the selection of green bonds or social bonds. The AMF France also recommends that Key Communication Products disclose, in the prospectus, a list of the main non-financial criteria adopted, and in the key investor information document, examples of some of the most important non-financial criteria analysed.

In Sweden, the requirement goes beyond disclosure of the criteria and specifies that funds with ESG or green in their names must use objectively determinable selection criteria.

### *4. Extent of portfolio's focus on sustainability*

A number of jurisdictions require disclosure relating to the extent to which the product's portfolio relates to sustainability. For example, in Australia, products are required to disclose the extent to which labour standards, or environmental, social or ethical considerations are taken into account in the selection, retention or realization of investments. In Hong Kong, Green or ESG Funds must disclose the expected exposure to the securities or other investments that reflect the stated green or ESG investment focus. In France, both Key Communication Products and Limited Communication Products are required to disclose the minimum measurable objectives adopted by the product and the portfolio's minimum rate of non-financial analysis.

In EU member jurisdictions, both Article 8 Products and Article 9 Products are required to provide a description of how and to what extent the investments underlying the financial product are in economic activities that qualify as environmentally sustainable under the Taxonomy Regulation. In addition, Article 8 Products are required to include in their pre-contractual disclosure a statement that the “do no significant harm” principle applies only to those investments underlying the product that take into account the EU criteria for environmentally sustainable economic activities and that the remaining underlying investments do not take into account those EU criteria.

#### 5. *Use of indices*

Certain jurisdictions also have specific requirements relating to disclosure about the use of indices as part of the product’s investment strategies. For example, in Hong Kong, where a Green or ESG Fund has a reference ESG benchmark, it must disclose the benchmark being tracked and the characteristics and general composition of the benchmark.

In EU member jurisdictions, Article 8 Products and Article 9 Products are required to disclose, if the product has designated an index as a reference benchmark: (i) in the case of Article 9 products, information on how the designated index is aligned with the product’s objective and in the case of Article 8 Products, information on whether and how this index is consistent with the environmental and/or social characteristics promoted by the product; (ii) in the case of Article 9 Products, an explanation as to why and how the designated index aligned with that objective differs from a broad market index; and (iii) an indication of where the methodology used for the calculation of the index is to be found.

#### *Plans to add or change requirements*

The SFC Hong Kong is already in the midst of developing guidelines and recommendations relating to disclosure about the use of indices.

In addition, by the end of 2021, the EU will add to its disclosure framework for Article 8 Products and Article 9 Products by requiring *ex-ante* disclosure about the extent to which the product intends to align, and has been aligned, with the Taxonomy Regulation.

#### f. Proxy Voting and Shareholder Engagement Disclosure

Requirements relating to disclosure about a product’s use of proxy voting and shareholder engagement are generally aimed at requiring, and specifying the nature of, disclosure about such use. These requirements may cover disclosure about the product’s proxy voting and shareholder engagement policies, including where to access those policies, along with disclosure about the product’s past proxy voting and shareholder engagement records.

Requirements relating to disclosure about proxy voting and shareholder engagement can help prevent greenwashing in two ways. Firstly, such disclosure requirements for presale product offering documents and marketing materials can provide clarity to investors and prevent them from being misled about the nature and extent of a product’s use, or lack thereof, of proxy voting and shareholder engagement as tools to achieve the product’s sustainability-related

investment objectives. Secondly, such disclosure requirements in the context of periodic reporting promote accountability, so that investors will be aware if a product's proxy voting and shareholder engagement records are inconsistent with, or fail to meet, the product's stated sustainability-related aims.

The majority of jurisdictions have general disclosure requirements relating to proxy voting and shareholder engagement that apply to all products. Such requirements include, for example, requiring that the product have shareholder engagement and proxy voting policies, disclose such policies in accordance with specific disclosure requirements, and disclose on an annual basis its shareholder engagement and proxy voting records.

For example, in Brazil, according to self-regulation, the fund's prospectus, by-laws or form must: (i) include a statement that the manager follows a voting policy; (ii) identify the website where the policy may be found; and (iii) provide a description of the purpose of the voting policy. In Japan, asset managers are required to disclose the results of their stewardship activities, including dialogue with companies.

Some jurisdictions have requirements relating to disclosure about proxy voting and shareholder engagement that are specific to sustainability-related products. For example, Hong Kong requires that the offering documents of Green or ESG Funds, where applicable, disclose as part of their description of the Green or ESG Fund's investment strategies, the Green or ESG Fund's engagement with issuer companies. In addition, the AMF France recommends that products whose regulatory and marketing documents mention the existence of an engagement policy specify the procedures for accessing the documents that provide details about shareholder engagement, specifically voting and dialogue reports.

In some jurisdictions, sustainability-specific proxy voting and corporate engagement disclosure requirements are imposed at the asset manager level rather than at the product level, such as in EU member jurisdictions, including France, which in addition to EU rules also has its own recommendations relating to the disclosure of shareholder engagement policies at the portfolio management company level.

#### *Plans to add or change requirements*

MAS has proposed guidelines which will set out expectations for asset managers to exercise sound stewardship to help shape positive corporate behaviour and manage environmental risk associated with investee companies through engagement, proxy voting and sector collaboration.

In addition, the United States has announced that it is exploring options to improve disclosure of funds' proxy voting records.,

#### g. Risk Disclosure

Requirements in this area address the disclosure of risks for sustainability-related products as well as sustainability-related risks for all types of products.

Requirements relating to risk disclosure by sustainability-related products address the disclosure of all material risks for sustainability-related products, including any unique risks that arise from a product's focus on sustainability, such as concentration in certain types of investments and reliance on third-party providers for sustainability-related ratings.

Requirements relating to the disclosure of sustainability-related risks for all types of products, including products that not sustainability-related, address the question of how sustainability-related issues impact those products. This type of risk disclosure could include any risks that arise from sustainability-related issues, such as climate change risk and bribery and corruption risks.

Requirements relating to the disclosure of all material risks for sustainability-related products can help prevent greenwashing by enabling investors to better understand the potential risks associated with the product and the impact of those risks on a product's performance, including sustainability-related performance. For example, for an index-tracking product that invests in companies that contribute to climate transition, disclosure about the risks involved with tracking the selected index (including how it may impact the ability of the fund to meet its objective) can provide investors with a clear understanding of whether, and how, the product will meet its investment objectives. These types of requirements may help prevent investors from purchasing products without understanding whether the product will face challenges in meeting its sustainability-related objectives.

In addition, requirements relating to the disclosure of sustainability risks for both products that are sustainability-related and those that are not can help reduce information asymmetries and assist investors with making informed investment decisions about how sustainability-related issues can impact their investments.

Several jurisdictions have general requirements pertaining to risk disclosure which are not specific to sustainability-related funds or sustainability-related risks. For example, the FCA UK has requirements to ensure that a firm takes reasonable steps to ensure that a private customer understands the nature of the risks inherent in certain transactions, as well as requirements relating to pre-sale notifications and prospectus disclosure about risks. In the United States, all registered funds are required to provide disclosures about their investment risks, including a summary of the principal risks in their prospectuses.

Many jurisdictions have risk disclosure requirements that are specific to sustainability, including specific risk disclosure by sustainability-related products and sustainability-related risk disclosure by all products.

#### *1. Specific risk disclosure by sustainability-related products*

Requirements relating to risk disclosure for sustainability-related funds focus specifically on unique risks arising from the product being sustainability-related, such as climate risk, transition risk, and concentration risk. For example, in Hong Kong, the offering documents of ESG or Green Funds must include a description of the risks associated with the ESG or Green Fund's investment theme, such as a lack of a standardized taxonomy, subjective judgment in investment selection, reliance on third party providers for environmental scoring, certification

and labelling, style drift, and concentration in investments with an environmental or ESG focus.

## *2. Sustainability-related risk disclosure by all products*

Disclosure requirements which address the integration of sustainability-related risks generally involve a discussion and explanation of how sustainability-related risks are integrated into the overall investment approach of a product, including investment decisions. For example, in the EU, the SFDR sets out requirements with respect to disclosure about the integration of sustainability risks. The pre-contractual disclosures of products must include descriptions of the: (i) manner in which sustainability risks are integrated into investment decisions; and (ii) results of the assessment of the likely impacts of sustainability risks on the returns of the product. When sustainability risks are deemed not to be relevant, the pre-contractual disclosure must explain why.

### *Plans to add or change requirements*

The FCA UK in published its consultation on entity- and product-level TCFD-aligned risk disclosures for asset managers.

In addition, the SFC Hong Kong is proposing to require large fund managers to disclose the weighted average carbon intensity (WACI) of the fund's portfolio to provide more decision-useful, climate-related risk metrics to investors and align with the TCFD's metrics disclosure recommendations. Subject to data availability, large fund managers are expected to make reasonable efforts to disclose Scope 1 and Scope 2 GHG emissions data of a fund's portfolio together with its calculation methodology, assumptions and limitations.

### *h. Marketing Materials and Website Disclosure*

Requirements in this area address disclosure in product marketing materials and websites, including, for example, the content and format of marketing materials and websites.

Fair, balanced and consistent marketing materials and communications, including websites, for sustainability-related products can help prevent greenwashing by ensuring that product marketing is not inaccurate nor misleading.

Most jurisdictions do not have requirements that relate specifically to the marketing materials and websites of sustainability-related products. However, such jurisdictions have general mandatory requirements relating to the marketing materials and websites of all types of products.

For example, in Malaysia, there are guidelines relating to advertising and promotional activity by capital markets products and related services. In Morocco, all marketing materials related to mutual funds are subject to Moroccan Capital Markets Authority's approbation before they are released. In Singapore, fund advertisements and publications are prohibited from being false or misleading and are required to present a fair and balanced view of the units of the fund. In the United States, an investment adviser's advertisements (including websites) are prohibited from including untrue statements of material facts, or false or misleading

statements<sup>66</sup> and an investment fund is also subject to a number of rules and regulations governing its marketing activities, including anti-fraud provisions and prohibitions against material misstatements or omissions.

Some jurisdictions have specific mandatory requirements pertaining to the marketing materials and websites of sustainability-related products.

### *1. Marketing materials*

Some jurisdictions set out requirements for the content of marketing communications relative to the sustainability-related product's regulatory documents. For example, in EU member countries, marketing communications are prohibited from contradicting information set out under any of the other disclosure requirements of the EU SFDR. In France, in addition to the requirements under the EU SFDR, non-financial characteristics cannot be included in the marketing materials of a product if they are not included in its regulatory documents.

Several jurisdictions have specific requirements pertaining to the content of marketing materials for sustainability-related products. For example, the AMF France recommends that the marketing materials of Key Communication Products: (i) compare the product's non-financial factors to indicators; (ii) communicate information about the contribution of non-financial aspects to the financial performance of the product; and (iii) state a quantified non-financial objective in a promotional document. The AMF France also recommends that if a product uses the SRI indication and markets itself as such, it should obtain the SRI label. Further, it is also recommended that any warnings about the potential limits of the product's non-financial strategies be presented in a manner that is as visible as the product's advantageous factors.

In Sweden, if a sustainable product's marketing claims that the fund's investments are chosen on the basis of negative selection criteria, the product must make clear to investors that up to five per cent of the turnover in the company in which they are investing may relate to undesirable operations.

A few jurisdictions have certain requirements that financial products must meet in order to market themselves as sustainable, such as the EU member jurisdictions (including France, which also has its own requirements), as previously discussed. In addition, in Sweden, the Ethical Fund Marketing Committee issued an advisory statement that sets out the qualifications for marketing funds as sustainable.

### *2. Websites*

Some jurisdictions have requirements relating to website disclosure for sustainability-related products. For example, in the EU, Article 8 Funds and Article 9 Funds are required to publish and maintain certain sustainability-related disclosures on their websites, including: (i) a description of the product's environmental or social characteristics or sustainable investment objective; and (ii) information on the methodologies used to assess, measure and monitor the

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<sup>66</sup> Rule 206(4)-1 and section 206 (the general anti-fraud provision) of the Advisers Act.

environmental or social characteristics or the impact of the sustainable investments selected for the product, including its data sources, screening criteria for the underlying assets, and the relevant sustainability indicators used to measure the environmental or social characteristics or the overall sustainable impact of the product.

In addition, the AMF France recommends that non-financial reporting be easily accessible from web pages dedicated to SRI, ESG or socially responsible thematic funds and updated at least annually.

#### *Plans to add or change requirements*

In the EU, the RTS, when finalised and implemented, are expected to specify the content, methodologies, and presentation of information in relation to sustainability indicators and the promotion of environmental or social characteristics and sustainable investment objectives on websites and in periodic reports.

In addition, the CMVM Portugal has indicated that it will publish guidelines and recommendations which will provide that only an investment fund that invests most of its portfolio in accordance with ESG methodologies may promote and market (either via its website or other means) its sustainability-related features.

#### i. Monitoring of Compliance and Sustainability-Related Performance

Requirements in this area address the monitoring of, either by the asset manager or a regulatory or supervisory body, a product's: (i) compliance with its investment objectives; and (ii) its performance. These would include, for example, requirements for asset managers to monitor and evaluate their products' portfolios in order to ensure that the product is meeting its investment objectives (including meeting its performance goals) and requirements for a regulatory body to monitor products' compliance with their investment objectives. These types of requirements are different from requirements relating to periodic sustainability-related reporting, which are discussed below.

As discussed above, a product's failure to meet its stated sustainability-related investment objectives and strategies could be a type of greenwashing. Requirements to monitor a product's compliance and sustainability-related performance could help prevent greenwashing by ensuring that a product is meeting its sustainability-related investment objectives, including meeting any sustainability-related performance targets.

Most jurisdictions do not have specific requirements relating to the monitoring of compliance and sustainability-related performance of sustainability-related products but have general monitoring or compliance requirements that apply to all products. For example, in the United States, there are requirements relating to a registered fund's board's adoption of written policies and procedures and the appointment of a Chief Compliance Officer, as well as requirements relating to annual reviews of the adequacy of those policies and procedures.

Very few jurisdictions have monitoring requirements that are specific to ensuring compliance with a product's investment objectives. One such example is Hong Kong, where the manager

of a Green or ESG Fund is expected to regularly monitor and evaluate the Green or ESG Fund's underlying investments to ensure that the Green or ESG Fund meets its stated investment objective and requirements.

However, member jurisdictions do not generally have requirements relating to the monitoring of performance, including sustainability-performance, whether applicable to all products or sustainability-related products in particular.

j. Periodic Sustainability-Related Reporting

Requirements in this area address sustainability-related periodic reporting, such as requiring products with sustainability-related objectives to report on an ongoing basis the extent to which those objectives are being met.

Periodic reporting requirements can help prevent greenwashing by reducing information asymmetries. A product with stated sustainability-related investment objectives may fail to follow those objectives in practice. Periodic reporting relating to whether the product is meeting its objectives could help enable investors to monitor a product's performance and therefore evaluate its ability to meet its sustainability-related objectives on an ongoing basis.

A number of jurisdictions have general performance-related periodic reporting requirements that apply to all products. For example, in the United States, all open-end registered funds must disclose certain performance-related information in their registration statements on an ongoing basis.

A few jurisdictions require all products to provide periodic reporting of a product's past performance relative to its benchmark, if applicable. For example, in Singapore, investment schemes are required to disclose in their periodic reporting, where applicable, a comparison of the investment scheme's past performance with that of the benchmark index for the investment scheme or an index which reflects the investment focus of the investment scheme.

Several other jurisdictions have specific periodic reporting requirements for sustainability-related products.

1. *Sustainability-related performance reporting*

In EU member countries, both Article 8 Products and Article 9 Products are required to provide information regarding their sustainability-related performance in periodic reports. The periodic reports of Article 8 Products are required to disclose the extent to which environmental or social characteristics are met. In contrast, the periodic reports of Article 9 Products are required to disclose: (i) the overall sustainability-related impact of the product by means of relevant sustainability indicators; or (ii) where an index has been designated as a reference benchmark, a comparison between the overall sustainability-related impact of the product with the impacts of the designated index and of a broad market index through sustainability indicators.

In addition, the EU's Shareholders Rights Directive II<sup>67</sup> (SRD II) requires asset managers to develop and disclose on their website, on an annual basis, an engagement policy that describes how they integrate shareholder engagement into their investment strategy. The RTS, when they are finalised and implemented, are also expected to require participants in financial markets to compare their product performance year to year to measure the achievement of sustainability-related targets.

Some EU member jurisdictions also have their own additional requirements for sustainability-related periodic reporting. For example, in France, SRI and GreenFin labels impose specific annual reporting requirements relating to sustainability-related performance. The Swedish Investment Funds Act also requires fund management companies to provide an annual report or a separate report providing a follow-up on the sustainability work that has been carried out.

In Malaysia, the SRI Funds Guidelines require the annual and interim reports of SRI Funds, where applicable, to include a review on sustainability aspects of the SRI Fund's portfolio. The SRI Funds Guidelines also recommend that a review on sustainability aspects of the SRI Fund's portfolio, including a commentary on action, outcomes and performance metrics (where available) on sustainability topics material to the fund's portfolio, be made available to investors periodically.

## *2. Other types of periodic reporting for sustainability-related products*

Several jurisdictions, including EU member jurisdictions, Malaysia and the United Kingdom, require periodic reporting relating to the product's sustainability-related objectives, considerations or characteristics.

Some of those jurisdictions also impose additional disclosure elements as part of those reporting requirements. For example, in Malaysia, a qualified SRI Fund's annual report and interim reports, where applicable, must include a statement that the fund has complied with the SRI Fund Guidelines in addition to descriptions of sustainability considerations that have been adopted in the socially responsible investing strategies employed. In the United Kingdom, the FCA issued non-Handbook guidance in Policy Statement PS19/4 stating that funds that set out non-financial objectives should provide ongoing information to investors about the fund's non-financial objectives and be clear about how the asset manager will measure whether those objectives are being met.

### *Plans to add or change requirements*

The SFC Hong Kong is considering, at least annually, requiring sustainability-related products to provide a description of how the product has attained its sustainability-related focus during the assessment period, a description of the basis of the assessment (including any estimations and limitations), and where the product has provided previous periodic assessments, a comparison between the current and at least the previous assessment period.

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<sup>67</sup> <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32017L0828>

The CMVM Portugal has indicated that it will publish guidelines and recommendations to incentivize products to voluntarily disclose, in their annual reports, whether their investment policies continue to align with their long-term objectives, as set out in products' legal documents or as per reference to benchmarks.

In addition, by the end of 2021, the EU will add to its disclosure framework for Article 8 Products and Article 9 Products by requiring *ex-post* reporting on the extent to which the product has been aligned with the Taxonomy Regulation.

## Chapter 4: Financial and Investor Education

Investor and financial education play an important role in preventing greenwashing and protecting investors by contributing to the alignment of concepts and disclosures and increasing risk-awareness among investors in respect of sustainability-related products.

This chapter uses the responses received from STF and IOSCO C8 member jurisdictions to the financial and investor education survey described in Chapter 1 to provide an overview of the current landscape of financial and investor education in sustainable finance.

### A. The role of investor education in sustainable finance

#### i. Context

Financial education is the “process by which financial consumers/investors improve their understanding of financial products, concepts and risks and, through information, instruction and/or objective advice, develop the skills and confidence to become more aware of financial risks and opportunities, to make informed choices, to know where to go for help, and to take other effective actions to improve their financial well-being.”<sup>68</sup> According to the OECD, informed and financially literate individuals are better equipped to deal with the growing complexity of the financial market, which may improve not only their own well-being, but also market efficiency, as well as contributing to financial inclusion and protecting against fraudulent practices.<sup>69</sup> Given their aggregated view of the financial market, financial regulators are well-positioned to identify the need for and provide, financial and, more specifically, investor education.<sup>70</sup>

Financial and investor education is an essential tool to support sustainable finance, as well as to protect investors against greenwashing and sustainability-related risks, as indicated by the survey responses.

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<sup>68</sup> OECD (2005), *Improving Financial Literacy: Analysis of Issues and Policies*, OECD Publishing, Paris. Available at: <https://doi.org/10.1787/9789264012578-en>. [https://www.oecd-ilibrary.org/finance-and-investment/improving-financial-literacy\\_9789264012578-en](https://www.oecd-ilibrary.org/finance-and-investment/improving-financial-literacy_9789264012578-en) (Accessed 26 February, 2021).

<sup>69</sup> Please refer to OECD (2017), *OECD/INFE Policy Framework for Investor Education*, available at: <http://www.oecd.org/daf/fin/financial-education/OECD-INFE-policy-framework-investor-edu.pdf> (Accessed 26 February, 2021) and to OECD (2013), *Advancing National Strategies for Financial Education*, available at: [https://www.oecd.org/finance/financial-education/G20\\_OECD\\_NSFinancialEducation.pdf](https://www.oecd.org/finance/financial-education/G20_OECD_NSFinancialEducation.pdf) (Accessed 26 February, 2021).

<sup>70</sup> Key Issue 6 of Principle 3 of the IOSCO Methodology acknowledges that regulators “should play an active role in the education of investors and other market participants”: IOSCO (2013), *Methodology for Assessing Implementation of the IOSCO Objectives and Principles of Securities Regulation*, available at: <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD359.pdf> (accessed 26 February, 2021). In addition, please refer to IOSCO (2014), *Strategic Framework for Investor Education and Financial Literacy*, available at: <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD462.pdf> (Accessed 26 February 2021). It is worth mentioning, particularly, the work conducted by C8 members in this field. IOSCO holds a specific hub for investor education [https://www.iosco.org/investor\\_protection/?subsection=investor\\_education\\_gateway](https://www.iosco.org/investor_protection/?subsection=investor_education_gateway).

## *ii. Survey responses*

All respondents to the survey agreed that financial and investor education can play a role in sustainable finance. The respondents identified different ways in which financial and investor education can support sustainable finance, including:

- building awareness and informing investors so that they can better identify greenwashing, misleading advertising and marketing, and misinformation
- supporting investors who want to consider social and environmental impacts in their investments
- improving understanding of sustainability-related disclosures
- supporting the mainstreaming of sustainable finance
- increasing demand for sustainable investment products
- empowering beneficiaries of impact investment projects (e.g. microfinance).

In addition to the above, one jurisdiction highlighted that financial and investor education can help increase awareness of the sustainability-related risks encompassed in the financial market and promote sustainable investment according to the UN SDGs. Another jurisdiction highlighted the importance of providing capacity-building for listed companies and institutional investors in order to improve sustainability efficiency and market disclosure.

These findings reveal the strong links between investor education and the other topics covered in this report. In particular, the effectiveness of regulation of sustainability-related disclosure by asset managers and sustainability-related products may be enhanced through financial and investor education initiatives in order to prevent greenwashing. This can be further reinforced as investors become empowered to demand that asset managers adopt best practices and provide transparency on sustainable finance instruments and products.

## *iii. Execution*

### *a. Current financial and investor education initiatives*

More than half of the jurisdictions have implemented at least one financial and investor education initiative relating to sustainable finance, including sustainability-related risks. Some of the jurisdictions that have not yet implemented these types of initiatives explained that the absence of such programs is due to the complexity of the subject and the lack of maturity in certain sustainable topics. However, the majority of the jurisdictions that have not yet started such initiatives indicated that they are willing to undertake sustainability-related financial education activities in the future.

Of the jurisdictions that have already implemented sustainability-focused investor and financial education programs, the most common financial and investor education initiatives were those dedicated to sustainability-related instruments and products. Of these instruments and products, the most common types covered were green, social and sustainable bonds. These initiatives included publications about thematic bonds and guidance on how to read product documentation and identify ESG characteristics. The second most common types of products

covered were ESG-labelled funds, and the initiatives were focused on recommending that investors pay attention to the methodology and corresponding ESG criteria applied by the asset manager to a sustainability-related product.

Social risks, primarily relating to gender equality, in addition to other human rights topics such as labour rights and diversity, and sustainability and climate-related transparency, primarily relating to companies' non-financial disclosure about sustainability and climate-related issues, were the second-most common areas of focus for financial and investor education initiatives.

More than a third of the jurisdictions have also implemented initiatives relating to climate, environmental and greenwashing risks. Of the initiatives focused on climate and environmental risks, the focus was on financial and operational impacts stemming from climate change, waste management, a circular economy and pollution control. Initiatives focused on greenwashing risks included: educational content for retail investors to clarify the need to assess various documents connected to sustainable financial products; orienting investors to check sustainability-related disclosures instead of only relying on a product's "green" label; events and consultations to draw attention to greenwashing risks; and a platform to provide information on green bonds, including information about the use of proceeds. Some regulators focused on the importance of assessing the sustainability reports, policies and governance practices of target companies or other vehicles for investment.

Many jurisdictions also implemented initiatives relating to sustainability-focused asset managers, standard setters and ESG credit rating agencies. These initiatives were primarily focused on enhancing the awareness of various market participants, including financial institutions, stock exchanges, investors and market associations, about sustainability-focused asset managers, standard setters and ESG credit rating agencies. The initiatives also focused on standard setters such as the TCFD, the UN SDGs, and reporting frameworks such as the Sustainability Accounting Standards Board (SASB), the Global Reporting Initiative (GRI) and the International Integrated Reporting Council (IIRC).

About a third of the jurisdictions that have implemented initiatives have focused on impact investment and sustainable taxonomies and certifications. The impact investment-related initiatives considered the features of such instruments, how to measure and evaluate their impact, as well as how to understand the context of their potential socio-environmental benefits. Some of these jurisdictions also referred to guidelines for green bonds and highlighted environmental certifications and the adoption of international standards, such as those from the International Capital Market Association (ICMA) and the Climate Bonds Initiative (CBI).

Other initiatives included publications and partnerships dedicated to sustainable finance, awareness of the UN SDGs, and responsible investment. The initiatives also focused on strengthening the financial inclusion of vulnerable groups, children, youth, and minorities, thereby building a more inclusive and resilient market for sustainable finance.

As discussed, there have been a variety of sustainability-related subjects included in regulators' financial and investor education initiatives so far. Although some issues have been more developed or prioritised than others, the general efforts of jurisdictions to incorporate sustainability-related risks and sustainable finance in their investor education agendas are

notable. Further advancements in this area may follow the evolution of sustainability-related issues within the market, given that there are still many evolving and non-standardized concepts that have yet to be harmonised.

#### b. Future financial and investor education initiatives

Approximately three quarters of the jurisdictions reported a willingness to conduct sustainability-focused financial and investor education initiatives in the future, including starting new initiatives or continuing ongoing ones in 2021. The areas of focus identified were the same as those referenced in the section above, namely: sustainable finance instruments and products; climate change-related risks; environmental risks; sustainable taxonomy and certifications; social risks; greenwashing risks; sustainability and climate-related transparency; sustainability-focused asset managers, standard setters, ESG credit rating agencies; and impact investment.

The main topics highlighted for each subject were similar to those of initiatives that have already been implemented, such as gender equality, thematic bonds, and ESG-labelled funds, as discussed above.

Only a quarter of the respondents stated they do not currently intend to undertake any sustainability-focused financial and investor education initiatives. These jurisdictions identified the need to first study the best approach for the advancement of such issues within their jurisdictions.

#### c. Types of initiatives and modes of delivery

All the jurisdictions that have either already implemented, or are planning to implement, sustainability-focused financial and investor education initiatives agreed that websites should be the main source of information. Examples include online courses, guidance, and publications, among other types of programs. Social media and videos were also popular modes of delivery for conveying financial education in the area of sustainability, and the platforms used encompass Instagram Live, Facebook Live, TV spots, YouTube, Twitter, and LinkedIn.

Approximately half of the jurisdictions considered courses, including those provided via the internet (e.g., e-learning, massive open online courses, lectures), as important tools to reach their target audience in sustainable finance. A significant number of the jurisdictions also identified in-person events and the incorporation of financial education into school curricula to be relevant channels of distribution. The World Investor Week, promoted annually by IOSCO, was also identified as an important event.

Some jurisdictions also highlighted the use of news media campaigns, pre-trade financial risk assessment or investor surveys, hard-copy brochures, podcasts, blogs, infographics, EdTech and apps.

In conclusion, there is widespread agreement among member jurisdictions that the internet is the main platform for the dissemination of content for financial and investor education. The COVID-19 pandemic has also demonstrated the importance of reaching the wider public

through the internet, reducing plans for in-person courses or events. The internet's flexibility and adaptability make it a useful tool for jurisdictions aiming to expand financial and investor education in sustainable finance to a broader audience.

d. Target audience and partnerships and collaborations

All of the jurisdictions that have implemented, or that intend to implement, financial and investor education initiatives on sustainability identified retail investors as their target audience. Two-thirds of the jurisdictions also identified the public at large, including children and youths in school. More than half of the jurisdictions also identified a variety of market participants as the target audience, including issuers, market associations and asset managers. Institutional investors were also identified by one-third of the jurisdictions.

Most jurisdictions that have implemented, or that intend to implement, financial and investor education initiatives have partnerships and collaborations with associations, schools and government agencies. Such collaborations can engage a wider or more specific audience that regulators alone may not be able to reach.

These findings highlight regulators' continuous efforts towards providing education to retail investors but reveal that there is also interest in a more holistic approach that includes all market participants and society at large.

e. Providers of sustainability-focused financial and investor education

The types of organisations that are currently engaging in sustainability-focused financial and investor education initiatives across the jurisdictions are, from the most to least common:

- institutes of higher learning (e.g. graduate and executive education), including graduate, extension and masters courses focusing on ESG and sustainable finance, and business schools
- institutional and/or retail investor organisations, including capital market associations
- fund management associations for continuous professional training, including sustainable finance programs targeting investing professionals
- community-based financial literacy programs for retail investors, including public and private associations providing financial literacy education and general advice on sustainable finance
- licensing organisations for the advising and selling of investment products in relation to sustainability, including sustainability competency requirements
- organisations providing board certification, including investor councils, the CFA Institute and corporate governance institutes.

Other types of organisations include responsible investment associations for investors and investment professionals, audit companies, consumer advice centers and associations, non-governmental organisations, stock exchanges, bankers' associations, green academies, and public banks.

These findings indicate that a wide and diverse range of organisations participate in providing sustainability-focused financial and investor education and as such, regulators may wish to engage with other types of organisations that are already conducting such initiatives.

*iv. Challenges ahead*

Most jurisdictions identified a number of challenges in implementing sustainability-focused financial and investor education initiatives:

- Limited financial resources, infrastructure and skilled human resources to conduct financial and investor education initiatives, including: a lack of internal capacity-building; a lack of infrastructure for virtual platforms and educational channels; the risk of misleading or providing outdated information due to the quick and continuous evolution of sustainable finance; difficulties in comprehension of greenwashing issues; and the costs and different levels of preparedness of disclosure by companies and products;
- Lack of standardisation and clear guidance on disclosure, taxonomies, and regulatory approaches to sustainable finance; and
- Insufficient understanding of guidelines, data, and methodologies to apply in initiatives, including: difficulties in understanding investors' motivations; the lack of comparable qualitative and quantitative data; the need to cooperate with different market actors; difficulties in enhancing retail investors' confidence in sustainable finance and comprehension of potential returns; difficulties in outreach to adults for financial education; the absence of obligatory content in school curricula; low digital literacy; the need to develop methods to reach younger investors; and the need to develop educational and informational material to clarify investment products.

## Chapter 5: Challenges

Interest in sustainability has soared among the investor community in recent years, bringing with it the development of sustainability-related products and the sales and marketing of such products to investors. However, there are a number of challenges associated with the proliferation of sustainability-related products, such as data gaps at the corporate level, issues arising from the proliferation of data and ESG ratings providers, lack of consistency in terminology as well as labelling and classification, different interpretations of materiality, gaps in skills and expertise, and evolving regulatory approaches. This chapter explores these challenges.

### A. Data gaps at the corporate level

As of 2017, the percentage of the largest 100 companies in 49 countries (4,900 companies) that published sustainability reports was 75 percent as compared to only 12% in 1993.<sup>71</sup> However, as highlighted in TCFD's 2020 status report,<sup>72</sup> while the number of companies and the volume of disclosure have increased, companies' disclosures of the financial impact of climate change on their business, strategies and financial planning remain low.

Consistent, comparable, and reliable information on sustainability-related risks and opportunities from companies is therefore more important than ever for all types of investors interested in sustainability. This includes asset managers wishing to expand their product range to include sustainability-related products or strengthening their internal capabilities to appropriately assess and manage sustainability-related risks.

Corporate-level ESG data is important for asset managers for a number of reasons. Firstly, asset managers need to have access to information that is consistent, comparable, and reliable in order to identify the types of companies that will allow them to meet the investment objectives of their sustainability-related products. Further, information is required to assess such companies on an ongoing basis so that the asset manager is able to determine the continued suitability of such companies as underlying investments. Finally, reliable information at the corporate level is essential for asset managers whose investment strategies require them to influence the corporate behaviour of companies through proxy voting or shareholder engagement.<sup>73</sup>

However, there are a number of challenges relating to corporate-level sustainability-related data. Firstly, sustainability-related disclosures can be both quantitative and qualitative, and both have their own unique challenges. Quantitative disclosures may be limited and are often

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<sup>71</sup> <https://assets.kpmg/content/dam/kpmg/be/pdf/2017/kpmg-survey-of-corporate-responsibility-reporting-2017.pdf>

<sup>72</sup> TCFD, [TCFD 2020 Status Report](#)

<sup>73</sup> Appel, Ian and Gormley, Todd A. and Keim, Donald B., Passive Investors, Not Passive Owners (February 6, 2016). Journal of Financial Economics (JFE), Forthcoming, Available at SSRN: <https://ssrn.com/abstract=2475150> or <http://dx.doi.org/10.2139/ssrn.2475150>

not based on consistent methodology, even for the same metric, over time. Qualitative disclosures raise issues of consistency, reliability, and comparability.<sup>74</sup>

In addition, there is the issue of a lack of a single framework in this area. Several frameworks relating to the assessment and disclosure of sustainability-related matters at the corporate level already exist. These frameworks can support both companies' disclosures and asset managers' investment processes by setting out structure, definitions, metrics and methodologies for corporate-level disclosure. However, the market has not converged on a single framework and as such, these frameworks are inconsistently applied throughout various jurisdictions and typically only on a voluntary basis.

Incomplete and inconsistent sustainability-related disclosures at the corporate level may have implications at the product level for product design, delivery, and disclosure, as well as ongoing performance reporting, which could lead to investor harm. As part of the STF's Workstream 1, two pieces of fact-finding work were conducted to understand what sustainability-related information users of corporate-level information seek to inform their investment decisions, and the gaps and shortcomings associated with access to this information.<sup>75</sup> Asset managers, as users of corporate-level disclosures, indicated that the lack of complete, consistent, and reliable disclosures at the corporate level has an impact on the quality of the information that they use to manage their products' portfolios and, as a consequence, may compromise the type and quality of information that they are able to provide to their investors.

Without the requisite data at the corporate level, asset management firms may be unable to assess the effectiveness of their sustainability-related investment strategies. They may also be unable to demonstrate to investors that their products are investing in accordance with their stated objectives. These issues could increase the risk that investors buy unsuitable products and in certain circumstances, may lead to involuntary greenwashing, whereby the starting point in the information chain is not of reliable, comparable or consistent quality.

As such, globally consistent, comparable and reliable disclosures at the corporate level are important for asset managers and their products, and IOSCO sees an urgent need to improve the consistency, comparability of sustainability reporting to support investors' evolving informational needs and the ability of markets to price sustainability-related risks and opportunities and support capital allocation.

Over the year since the STF was established, IOSCO notes that global momentum has been building in both public and private sector initiatives on sustainability-related disclosures. For example, as noted above, the IFRS Foundation is seeking to establish an ISSB to develop a common set of global sustainability standards to help meet investor needs and to set a sound global baseline for jurisdictions to consider when setting or implementing their sustainability-related disclosure requirements.

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<sup>74</sup> The STF Workstream 1 report can be accessed at [FR04/2021 Report on Sustainability-related Issuer Disclosures \(iosco.org\)](#)

<sup>75</sup> The STF Workstream 1 report can be accessed at [FR04/2021 Report on Sustainability-related Issuer Disclosures \(iosco.org\)](#)

In a separate report published in June 2021,<sup>76</sup> IOSCO elaborated its vision and expectation for an ISSB. The report encourages continued progress towards globally consistent sustainability-related disclosures at the corporate level across jurisdictions, covering a breadth of sustainability-related topics and leveraging existing principles, frameworks, and guidance. The report also promotes a greater emphasis on industry-specific, quantitative metrics in corporate sustainability-related disclosures and the standardisation of qualitative information.

## **B. Proliferation of data and ESG rating providers**

The current lack of a consistent framework for corporate-level sustainability-related disclosures has left a gap in which third party data and rating providers have stepped in to provide information to investors, including asset managers. One challenge associated with this proliferation of data and ESG rating providers and asset managers' reliance on them is the lack of reliability and consistency in ESG data and ratings.<sup>77</sup> While this may be in part due to a lack of transparency<sup>78</sup> about the methodologies behind such data and ratings, this issue may also arise because the providers themselves rely on information from corporate issuers.<sup>79</sup> With the growing use of ESG data and ratings from data providers, there may be systemic over-reliance from asset managers on opaque ESG data and ratings from third-party providers.<sup>80</sup>

IOSCO is aware of the inadequate level of disclosures by data and rating providers around their methodologies, as well as the reliance on such providers to fill in the gaps in corporate-level disclosures. The IOSCO STF's Workstream 3 has examined these issues and its report<sup>81</sup> provides recommendations in this area.

## **C. Lack of consistency in terminology**

Another notable challenge is the lack of consistent terminology and definitions relating to sustainability in the asset management industry. For example, at the product level, many terms are currently used to describe sustainability-related products, such as "impact fund", "sustainable fund", "social fund," "low carbon funds" and "Paris-aligned funds." There may also be confusion over terms used to describe ESG strategies such as "ESG integration" and "negative screening." However, there are currently no agreed-upon definitions for these terms, making it difficult for investors to understand such products or effectively compare such products. This issue is compounded as products are marketed and distributed across

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<sup>76</sup> The STF Workstream 1 report can be accessed at [FR04/2021 Report on Sustainability-related Issuer Disclosures \(iosco.org\)](#)

<sup>77</sup> Boffo, R., and R. Patalano (2020), *ESG Investing: Practices, Progress and Challenges*, OECD Paris, [www.oecd.org/finance/ESG-Investing-Practices-Progress-and-Challenges.pdf](http://www.oecd.org/finance/ESG-Investing-Practices-Progress-and-Challenges.pdf)

<sup>78</sup> AFM, [French and Dutch financial market authorities call for a European regulation of ESG data, ratings, and related services](#) (Dec 2020)

<sup>79</sup> <https://www.blackrock.com/corporate/literature/whitepaper/viewpoint-towards-a-common-language-for-sustainable-investing-january-2020.pdf>

<sup>80</sup> BaFin *Guidance Notice on Dealing with Sustainability Risks* (January 15 2020), online: [https://www.bafin.de/SharedDocs/Downloads/EN/Merkblatt/dl\\_mb\\_Nachhaltigkeitsrisiken\\_en.html?sessionid=DBA8E9C5618DF7101A5A7C38DA5AC6AF.2\\_cid393?nn=9866146](https://www.bafin.de/SharedDocs/Downloads/EN/Merkblatt/dl_mb_Nachhaltigkeitsrisiken_en.html?sessionid=DBA8E9C5618DF7101A5A7C38DA5AC6AF.2_cid393?nn=9866146).

<sup>81</sup> The STF Workstream 3 report is in progress and will be available at [www.iosco.org](http://www.iosco.org) once finalised.

jurisdictions, where different understanding of terminologies can cause further investor-related concerns for regulators.

As discussed in Chapter 3, a lack of clarity about the nature of a product's investment objectives and strategies may lead to greenwashing.

Another concept that faces inconsistency in terminology and definitions is “temperature alignment.” Owing to the demand for sustainability-related products, some asset managers provide information about the measurement of a portfolio's implied temperature or alignment with a 1.5 or 2° scenario. However, the concept of “alignment with temperature trajectory” still remains unclear from the investor and investment portfolio perspectives. Furthermore, the underlying analytical frameworks and methodologies across different types of temperature alignment assessment approaches suffer from a lack of transparency and at times, consistency. This creates an obstacle to the credibility, comparison, and usefulness of the results.<sup>82</sup>

The issue of a lack of consistency in terminology is addressed in Recommendation 4 in Chapter 6.

#### **D. Lack of consistency in labelling and classification**

Related but separate to the issue of a lack of consistency in terminology is a lack of consistency in labelling and classification systems. For example, while labelling and classification systems have been developed in certain jurisdictions to catalogue and define ESG activities, they differ across jurisdictions both in terms of scope and the degree of compulsion.

There are two main categories of labels: labels focusing more broadly on ESG and those focusing specifically on environmental sustainability, often referred to as “green. Some labels are developed by financial market participants, some by professional associations, and the rest by specialised environmental labelling organisations. All labels aim to guarantee a particular level of quality regarding sustainable asset management. In terms of assets under management and attractiveness for European-based fund managers, two labels in particular that have been focused on these issues since 2019 are the French SRI label and the Belgian Towards Sustainability label.<sup>83</sup>

In addition, in the current interconnected financial market, the co-existence of multiple labelling and classification schemes may lead to inconsistencies and differences across industries, asset classes and regions. This issue may lead to market fragmentation and regulatory arbitrage, which in turn could lead to an increase in instances of greenwashing.

This issue is addressed in Recommendation 2 in Chapter 6.

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<sup>82</sup> <https://www.louisbachelier.org/wp-content/uploads/2020/07/rapport-0207-mis-a-jours.pdf>

<sup>83</sup> [https://www.novethic.com/fileadmin/user\\_upload/tx\\_ausynovethicetudes/pdf\\_complets/Novethic\\_Overview-European-Sustainable-Finance-Labels\\_June\\_2020.pdf](https://www.novethic.com/fileadmin/user_upload/tx_ausynovethicetudes/pdf_complets/Novethic_Overview-European-Sustainable-Finance-Labels_June_2020.pdf)

## **E. Different interpretations of materiality**

IOSCO, through its STF Workstream 1, has looked into issues of materiality in the context of sustainability-related information, as set out in its recently published report.<sup>84</sup> The report states that distinction is often drawn between financial materiality and environmental/social materiality. Traditionally, these different lenses have been associated with the differing information needs of investors (financial materiality) vis-à-vis other stakeholders, such as customers, employees, suppliers and civil society (environmental and social materiality). Reporting on *both* dimensions is often referred to as applying a double materiality lens.

The current work of the Alliance of Sustainability Reporting Organisations (the Alliance) has recently demonstrated that materiality is in fact a dynamic concept. Sustainability-related topics may become more material over time in response to changes in companies' operating environments and investor expectations. The distinction between investors and other stakeholders' information needs to continue to evolve. In December 2020, the Alliance developed and published a prototype climate-related financial disclosure standard (the Prototype) which incorporates the dynamic nature of materiality. The Prototype demonstrates that drawing a hard line between 'enterprise value' and 'impact' is not helpful for defining information that will help investors determine enterprise value.

A company's material external sustainability impacts will often also impact its future development, performance, position and, as a result, potentially enterprise value. This point is likely more apparent at least over a sufficiently long investment horizon.

Across all sectors and industries, companies depend to varying degrees on natural, social and human capital to create and preserve enterprise value. These assets are not always captured on company balance sheets but can be critical for value generation. Companies' dependencies on these assets, and how they protect and contribute to the stewardship of these assets, can therefore inherently influence investors' decisions. For example, where companies depend on ecosystem goods and services that flow from natural capital assets – such as air and water filtration, food and water production, and climate regulation – investors would benefit from disclosures on the management of these dependencies to make informed decisions.

## **F. Gaps in skills and expertise**

The skills and expertise required to effectively integrate sustainability-related risks and opportunities are another significant challenge faced by asset managers. Specialised skills and expertise are important components in the integration of sustainability-related metrics in the investment decision-making process and risk management procedures and may help prevent greenwashing.

While professional education and training relating to sustainability are only starting to take shape, asset management firms may want to consider whether to re-assess their approach to

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<sup>84</sup> The STF Workstream 1 report can be accessed at [FR04/2021 Report on Sustainability-related Issuer Disclosures \(iosco.org\)](https://www.iosco.org/FR04/2021_Report_on_Sustainability-related_Issuer_Disclosures).

evaluating such skills and expertise in their staff as well as third-party service providers. The development of common standards and definitions can provide more structure and consistency that can allow senior management and the boards of these firms to successfully integrate sustainability into the philosophy of their firms where they seek to do so and in the development programs of individual staff who will participate in the development and ongoing management of sustainability-related products.

This issue is addressed in Recommendation 5 in Chapter 6.

### **G. Evolving regulatory approaches**

A majority of the market participants consulted as part of IOSCO's report on *Sustainable Finance and the Role of Securities Regulators and IOSCO* suggested that counteracting greenwashing and mis-selling was an important issue for consideration by regulators. Some advocated for a stronger role by securities regulators in identifying and facilitating the development of sustainable investments.<sup>85</sup>

However, the 2019 survey of securities regulators done as part of the work leading to that report indicated that jurisdictions have taken different regulatory approaches to sustainability-related products. Only 45 percent of regulators surveyed indicated that they had carried out supervisory functions relating to the risks associated with the greenwashing of financial products. Sixty-four percent of these regulators indicated they had no specific rules directed at greenwashing, relying on existing rules of misrepresentation and wrongful disclosure for listed and unlisted products to supervise and, where appropriate, bring enforcement actions against firms.<sup>86</sup>

Divergence in regulatory approaches across different jurisdictions may exacerbate the aforementioned challenges relating to gaps and inconsistency in data and a lack of consistent terminology. This divergence also contributes to a lack of comparability for sustainability-related products and difficulties in decision-making and monitoring for investors, facilitating greenwashing and leading to other risks to market integrity and investor protection.

However, there are some commonalities across the regulatory approaches of different jurisdictions, as discussed in Chapters 2 and 3. Chapter 6 aims to address this issue by setting out recommendations that securities regulators and/or policymakers, as applicable, should consider in order to improve sustainability-related practices, policies, procedures and disclosure in the asset management industry.

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<sup>85</sup> FR04/2020, online: <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD652.pdf>.

<sup>86</sup> Ibid, page 8.

## Chapter 6: Recommendations

This chapter sets out recommendations that securities regulators and/or policymakers, as applicable, should consider, where in line with the domestic regulatory frameworks, in order to improve sustainability-related practices, policies, procedures and disclosure in the asset management industry, along with consultation questions relating to the recommendations.

*Question 1: Will the recommendations outlined below sufficiently improve sustainability-related practices, policies, procedures and disclosure in the asset management industry and address the issue of greenwashing? Are there other areas of sustainability-related practices, policies, procedures and disclosure in the asset management industry not mentioned in this consultation report that should be addressed as separate recommendations?*

**Recommendation 1: Asset Manager Practices, Policies, Procedures and Disclosure.** Securities regulators and/or policymakers, as applicable, should consider setting regulatory and supervisory expectations for asset managers in respect of the: (a) development and implementation of practices, policies and procedures relating to sustainability-related risks and opportunities; and (b) related disclosure.

Sustainability-related practices, policies and procedures help ensure that asset managers take sustainability-related risks and opportunities into consideration and integrate them into their decision-making process. The disclosure of such practices, policies and procedures is intended to promote consistency, comparability, and reliability in disclosure, which, as discussed in Chapter 2, will help prevent greenwashing at the asset manager level.

Asset managers could consider referencing the TCFD Framework in their disclosures of climate-related risks and opportunities. Asset managers could also consider adopting a phased-in approach to expanding such disclosures beyond climate-related risks and opportunities to other sustainability-related risks and opportunities by referencing the TCFD Framework.

Specifically, the practices, policies and procedures relating to sustainability-related risks and opportunities and the disclosure thereof could cover the following areas:

- i. Governance: The asset manager's governance around sustainability-related risks and opportunities
- ii. Investment strategy: How sustainability-related risks and opportunities are factored into the asset manager's investment strategies and investment process, including, where relevant, the data and methodologies used
- iii. Risk management: How the asset manager identifies, assesses, and manages sustainability-related risks
- iv. Metrics and targets: The metrics and targets used to assess and manage relevant sustainability-related risks and opportunities where such information is material.

These expectations would apply to asset managers in their capacity as fiduciaries of client assets, rather than in their capacity as public companies with shareholders. We note that asset managers may provide climate-related financial disclosures in their capacity as public

companies to shareholders and as asset managers to clients. As such, some elements of disclosure may overlap.<sup>87</sup>

Securities regulators and/or policymakers could also consider requiring that any firm-level commitments to other international or regional sustainability-related initiatives be disclosed, and that any relevant signatory reports be made publicly available.

*Question 2: The key areas identified are based on the key pillars of the TCFD Framework. Do you agree with this approach?*

*Question 3: Should the scope of this recommendation cover all asset managers or be limited to only those asset managers that take sustainability-related risks and opportunities into consideration in their investment process?*

**Recommendation 2: Product Disclosure. Securities regulators and/or policymakers, as applicable, should consider clarifying and/or expanding on existing regulatory requirements or guidance or, if necessary, creating new regulatory requirements or guidance, to improve product-level disclosure in order to help investors better understand: (a) sustainability-related products; and (b) material sustainability-related risks for all products.**

Regulatory requirements or guidance relating to product-level disclosure for sustainability-related products are intended to promote consistency, comparability, and reliability in disclosure, which, as discussed in Chapter 3, will help prevent greenwashing at the product level.

This recommendation is intended to cover all products that consider sustainability in their investment decision-making or that market themselves as sustainable products. The one exception is the disclosure of material sustainability-related risks by all products.

The requirements or guidance relating to product-level disclosure could cover the following areas, which have been discussed in detail in Chapter 3:

- i. **Product authorisation:** A product authorisation system (whether disclosure-based, application-based or a combination of both) that sets out disclosure expectations for sustainability-related products that wish to be offered to the public.

The expectation is not that securities regulators and/or policymakers, as applicable, set up a separate product authorisation system for sustainability-related products in particular; a product authorisation system that applies to all types of products would satisfy this recommendation so long as it sets out disclosure expectations for sustainability-related products that wish to be offered to the public.

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<sup>87</sup> The STF Workstream 1 report can be accessed at [FR04/2021 Report on Sustainability-related Issuer Disclosures \(iosco.org\)](https://www.iosco.org/FR04/2021-Report-on-Sustainability-related-Issuer-Disclosures).

ii. Naming: Parameters around the naming of sustainability-related products to help ensure that the name of the product accurately reflects the nature and extent of the product's sustainability focus, including promoting consistency with the product's name and its investment objectives, characteristics and/or strategies.

iii. Labelling and classification: Parameters around the use of sustainability-related labels and/or classification systems by sustainability-related products to help promote the consistent and correct use of labels and classification systems.

Labelling and classification refer to how a product is labelled or categorised beyond the product's name. Labelling includes, for example, the use of ESG or SRI labels as well as third-party certifications. Classification includes the use of ESG product types for product categorisation schemes.

iv. Investment objectives disclosure: Disclosure in product offering documents about sustainability-related products' investment objectives (including the fundamental nature or features of the products).

Investment objectives disclosure provides transparency about the nature and extent of a product's sustainability-related investment objectives, including which components of sustainability the product is focused on and whether sustainability is a primary focus of the product.

v. Investment strategies disclosure: Disclosure about sustainability-related products' investment strategies in product offering documents (including, in particular, their sustainability-related investment strategies), which could include disclosure about the investment universe, investment selection process (including the types of ESG strategies used, as well as the use of indices and ESG scores or ratings, the extent of such use, and their methodologies, where applicable), sustainability criteria used, and extent of the portfolio's focus on sustainability.

vi. Proxy voting and shareholder engagement disclosure: Disclosure, where relevant: (a) about sustainability-related products' use of proxy voting and shareholder engagement, which could include disclosure about proxy voting and shareholder engagement policies (including where to access those policies); and (b) of past proxy voting and shareholder engagement records (which could include disclosure about how the past proxy voting and shareholder engagements records align with and help advance the sustainability-related investment objectives or characteristics of the sustainability-related product).

In some jurisdictions, proxy voting and shareholder engagement disclosure requirements could be imposed at the asset manager level rather than at the product level.

vii. Risk disclosure: Disclosure of: (a) material risks by sustainability-related products, including any unique risks that arise from a product's focus on sustainability; and (b) material sustainability-related risks by all products.

Risk disclosure by sustainability-related products addresses the disclosure of all material risks associated with investing in the specific sustainability-related product and enables investors to better understand the potential risks associated with the product. This type of risk disclosure could include any unique risks that arise from a product's focus on sustainability, such as concentration in certain types of investments and reliance on third-party providers for sustainability-related ratings.

Disclosure of sustainability-related risks by all types of products, including products that not sustainability-related, assists investors with making informed investment decisions about how sustainability-related issues can impact their investments. This type of risk disclosure could include any risks that arise from sustainability-related issues.

- viii. Marketing materials and website disclosure: Content requirements for marketing materials and communications, including websites, of sustainability-related products to promote disclosures that are fair, balanced and consistent with their regulatory filings.

This recommendation is focused on the content of marketing materials and website disclosure rather than the format in order to focus on promoting transparency and consistency in the content of marketing materials and website disclosure.

The concept of marketing materials and communications of sustainability-related products being consistent with their regulatory documents is intended to ensure that marketing materials and communications are not inaccurate or misleading as compared to a product's regulatory documents.

- ix. Monitoring of compliance and sustainability-related performance: Encouraging asset managers to assess, measure and monitor: (a) the sustainability-related product's compliance with its investment objectives and/or characteristics; (b) the sustainability impact of its portfolio to the extent applicable to the portfolio's stated design; and (c) its sustainability-related performance.

The sustainability impact of a product's portfolio refers to the effect of the product's portfolio holdings on environmental, social and/or governance issues.

- x. Periodic sustainability-related reporting: Periodic reporting relating to whether a sustainability-related product is meeting its sustainability-related investment objectives or characteristics, including the product's sustainability-related performance and holdings, during the applicable time period.

This recommendation is focused on sustainability-related performance reporting in order to enable investors to monitor a product's performance and therefore evaluate the product's ability to meet its sustainability-related objectives or characteristics on an ongoing basis.

We acknowledge that sustainability-related metrics are under development and that securities regulators and/or policymakers, as applicable, may not choose to consider the disclosure of specific sustainability-related metrics at this time. However, where an asset manager has identified or developed its own metrics or specifically referenced metrics as part of a sustainability-related product's investment objectives or characteristics, securities regulators and/or policymakers, as applicable, could consider whether periodic sustainability-related reporting should include such metrics and the methodologies behind the metrics.

*Question 4: Should securities regulators and/or policymakers, as applicable, consider setting out different disclosure requirements for products with sustainability-related investment objectives as compared to products that promote sustainability-related characteristics? If so, for which of the different areas of disclosure listed above should the requirements vary, and how should they vary? In addition, if so, should securities regulators and/or policymakers, as applicable, consider specifying thresholds or other criteria for determining whether a product has sustainability-related investment objectives as compared to sustainability-related characteristics, and what should those thresholds or criteria be?*

*Question 5: Should naming parameters permit the product name to reference sustainability only if the investment objectives refer to sustainability?*

*Question 6: Should a product need to have an ESG, SRI or similar label in order to be marketed as a sustainability-related product?*

*Question 7: Do you agree with the specified areas of investment strategies disclosure?*

*Question 8: Should the disclosures address how past proxy voting and shareholder engagement records align with the investment objectives or characteristics of a sustainability-related product?*

*Question 9: Should securities regulators and/or policymakers, as applicable, also address the format and presentation of marketing materials and website disclosure for sustainability-related products?*

*Question 10: Should securities regulators and/or policymakers, as applicable, encourage the use of specific metrics or key performance indicators to assess, measure and monitor the sustainability-related product's compliance with its investment objectives and/or characteristics? Should these metrics be subject to self-selection, or should there be a standardised approach?*

*Question 11: Should periodic reporting include both quantitative and qualitative information about whether a sustainability-related product is meeting its sustainability-related investment objectives and/or characteristics?*

**Recommendation 3: Supervision and Enforcement. Securities regulators and/or policymakers, as applicable, should have supervisory tools to ensure that asset managers and sustainability-related products are in compliance with regulatory requirements and enforcement tools to address any breaches of such requirements.**

As discussed in Chapter 2, supervisory and enforcement tools can help prevent greenwashing at both the asset manager and product levels and promote investor confidence in asset managers that take sustainability-related risks and opportunities into consideration as well as sustainability-related products.

As a starting point, securities regulators and/or policymakers, as applicable, should examine the use of existing rules and tools for supervision and enforcement. This could include supervisory dialogue with asset managers.

**Recommendation 4: Terminology. Securities regulators and/or policymakers, as applicable, should consider encouraging industry participants to develop common sustainable finance-related terms and definitions to ensure consistency throughout the global asset management industry.**

As discussed in Chapter 5, there is currently a lack of consistency around the use of sustainability-related terminology in the asset management industry, which increases the potential for investor confusion around sustainability-related products, contributing to greenwashing.

Securities regulators and/or policymakers, as applicable, can play a role in promoting industry coalescence around a set of consistent sustainability-related terms. We note that the issue of terminology is distinct from the issue of labelling and classification, as terminology covers broader concepts beyond product types, such as ESG approaches (e.g., ESG integration, negative screening, best-in-class) and definitions of commonly used sustainability-related terms such as “green”.

*Question 12: Do you agree that securities regulators and/or policymakers, as applicable, should encourage industry participants to coalesce around a set of consistent sustainability-related terms?*

*Question 13: Are there any sets of standardized sustainability-related terms being developed by international organisations that should be considered by securities regulators and/or policymakers, as applicable?*

**Recommendation 5: Financial and Investor Education. Securities regulators and/or policymakers, as applicable, should consider promoting financial and investor education initiatives relating to sustainability, or, where applicable, enhance existing sustainability-related financial and investor education initiatives.**

Financial and investor education can play a significant role in protecting investors from greenwashing, promoting awareness of sustainability-related risks, and encouraging the continued growth of sustainability-related asset management products. In addition, financial

and investor education initiatives can complement the regulatory developments discussed in Recommendations 1, 2 and 4, including by fostering a greater understanding of the benefits and risk profiles of sustainability-related products relative to other products.

Securities regulators and/or policymakers, as applicable, are well-positioned to promote financial and investor education initiatives relating to sustainability due to their vast knowledge and their key role in capital markets.

Financial and investor education initiatives may include promoting sustainability-related risk awareness and improving investor comprehension about, and enhancing transparency of sustainability-related products, which would improve comparability and informed decision-making as well as prevent greenwashing. In emerging markets, such initiatives may also promote the importance of sustainable finance and expand the market for sustainability-related products.

Financial education initiatives may also address the professional and licensing obligations of financial advisors to ensure that financial advisors have the necessary knowledge and skills to provide advice on sustainable finance.

Financial and investor education initiatives could include tools, methodologies, guidelines and orientations that focus on retail investors as well as the larger public. These initiatives should seek to overcome barriers to access, mainly using the internet and, where applicable, could include partnerships with other institutions.

*Question 14: Do you agree that securities regulators and/or policymakers, as applicable, should promote financial and investor education initiatives relating to sustainability, or, where applicable, enhance existing sustainability-related financial and investor education initiatives?*

*Question 15: Are there any specific sustainability-related financial and investor education initiatives not mentioned in this consultation report that could be considered by securities regulators and/or policymakers, as applicable?*

## Annex 1: Glossary

Alliance of Sustainability Reporting Organisations	A group made of the leading standard setters (Carbon Disclosure Project, Climate Disclosure Standards Board, IIRC, GRI and SASB) that is also known as the “group of five”
ESG or Sustainability	Environmental (including climate-related), social and governance
Enterprise Value	Defined in the Prototype climate-related financial disclosure standard published by the Alliance of Sustainability Reporting Organisations in December 2020 as” [...] market capitalisation (shareholder value) plus the market value of net debt. It is determined by capital market participants, based on their estimation, spanning the short-, medium, and long-term, of the present value of expected cash flows. Essential inputs in determining enterprise value include corporate reporting in financial statements and in sustainability-related financial disclosures”
GRI	Global Reporting Initiative
Green Funds	Funds which have environmental-related investment objectives or characteristics
Greenwashing	The practice by asset managers of misrepresenting their own sustainability-related practices or the sustainability-related features of their investment products
IFRS Foundation	International Financial Reporting Standards Foundation
IIRC	International Integrated Reporting Council
ISSB	International Sustainability Standards Board
Net zero emissions	The balance between the amount of greenhouse gas produced and the amount removed from the atmosphere
NGFS	Network for Greening the Financial System
Prototype	The prototype climate-related financial disclosure standard developed by the Alliance of Sustainability Reporting Organisations
RTS	Regulatory Technical Standards under the SFDR
UN SDGs	United Nations Sustainable Development Goals
Science-Based Targets	A set of goals developed by a business to provide it with a clearly defined pathway to reduce greenhouse gas emissions in line with the scale of reductions required to meet the goals of the Paris Agreement, which are to limit global warming to well below 2°C above pre-industrial levels and pursue efforts to limit warming to 1.5°C
Sustainability-related products	Investment products, including funds, which have sustainability-related investment objectives or characteristics
SFDR	Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector, commonly referred to as the Sustainable Finance Disclosure Regulation
TCFD	Task Force on Climate-related Financial Disclosures
PRI	Principles for Responsible Investment