Regulation of ESG

A global overview of regulations impacting the investment chain

November 2023 (2nd Edition)

HSBC | Opening up a world of opportunity

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Executive Summary

International leaders have set ambitious goals to achieve a sustainable future in alignment with the UN's Sustainable Development Goals (SDGs). However, an increased sense of urgency is now required to translate these commitments into meaningful and timely action. Policymakers have leaned upon financial services regulators to help drive change across the entire investment chain. The result is that environmental, social, and governance (ESG) regulation is moving at a much greater pace to mobilise an industry-wide transformation.

This white paper examines the current priorities of regulators around the world as they continue to facilitate stronger ESG principles and practices within the financial services sector.

Introduction

Since the Paris Agreement brought nations together to commit to limiting global warming to 1.5 degrees Celsius, motivating a raft of pledges to reach net-zero carbon emissions by 2050, the world has seen a continued drive towards sustainability. The end of 2023 will see the first-ever Paris Agreement global stocktake, established under Article 14 of the agreement. Scheduled to take place every 5 years, the stocktake began at COP26 in Glasgow and will conclude during COP28 this year. This global accounting of the world's progress towards its sustainable commitments has been described by the UN as a critical moment for climate action.

Despite renewed efforts to increase the pace of change, the UN's Climate Change Report, published in October 2022, highlighted that the global community is significantly off-track from reaching its 1.5 degrees goal and is currently heading for 2.5 degrees warming by the end of the century.[1] However, according to the UN's Intergovernmental Panel on Climate Change (IPCC) in its latest Synthesis Report, the UN believes that limiting warming to 1.5 degrees is still achievable, with the implementation of "feasible, effective and low-cost mitigation and adaptation options to scale up across sectors and countries", whilst underscoring the urgency of taking more ambitious action.[2]

If the world is to honour the objectives of the Paris Agreement, globally we need to take a more holistic view of ESG that emphasises social and governance practices alongside the more obvious environmental sustainability objective. This can be achieved by following the framework established by the United Nations' 17 Sustainable Development Goals.

The UN's SDGs have been widely adopted by governments, institutions and businesses worldwide and represent a shared point of reference for measuring alignment with global efforts to prevent extreme climate change and to build a sustainable world where all can flourish. In Europe, a Eurostat report revealed that the EU has made significant progress towards three of its SDGs – ensuring decent work and economic growth (SDG 8), reducing poverty (SDG 1), and improving gender equality (SDG 5) – over the last five years, and has made moderate progress towards the remaining goals. However, more progress is expected on three additional goals: climate action (SDG 13), life on land (SDG 15), and global partnerships (SDG 17). The report also praises the establishment of "ambitious and unparalleled climate targets for 2030."[3]

1 UN Climate Press Release, October 2022: https://unfccc.int/news/climate-plans-remain-insufficient-more-ambitious-action-needed-now
2 AR6 Synthesis Report, March 2023: https://www.ipcc.ch/report/sixth-assessment-report-cycle
3 Eurostat report, May 2023: https://ec.europa.eu/commission/presscorner/detail/en/ip_23_2887

Mobilising private finance to close the green investment gap

The gap between intent and actuality in achieving a sustainable transition highlights the urgent need to accelerate efforts across geographies and sectors. Although global climate finance flows – both public and private, as well as domestic and international – have been growing in volume, reaching USD $632 billion per year in 2019-2020, a major increase of 590% is required to align with the goals outlined in the Paris Agreement.[4] The impact of climate change on biodiversity has also come into greater focus in recent years, with an additional USD $275-400 billion needed every year to protect the natural environment.[5] With a growing understanding that public financing on its own will not be sufficient to mobilise the USD $3-6 trillion of annual investment needed to transition to net zero and build climate-resilient economies[6], the financial services sector continues to play a very critical role in the mobilisation of private financing towards sustainable businesses and technologies.

> Regulators have an important role to play in facilitating this greater flow of sustainable finance by establishing a regulatory environment that supports a high degree of transparency and data quality.

This is needed to help investors make informed investment decisions that support the development of sustainable businesses and technologies.

4 UN Environment Programme speech, October 2022: https://www.unep.org/news-and-stories/speech/investment-and-trade-meet-paris-climate-goals
5 Report of the Independent High-Level Expert Group on Climate Finance, London School of Economics, November 2022: https://www.lse.ac.uk/granthaminstitute/wp-content/uploads/2022/11/IHLEG-Finance-for-Climate-Action.pdf
6 UN Environment Programme speech, October 2022: https://www.unep.org/news-and-stories/speech/investment-and-trade-meet-paris-climate-goals

Empowering informed ESG investment decisions

Across the globe, ESG has undoubtedly become a key focus of regulatory oversight, with regulators committed to developing the measures needed to achieve global sustainability targets. Recognising the urgent need to facilitate greater flows of capital towards sustainable investments, concerted measures have been implemented, at varying stages globally, across the investment chain to provide investors with increased availability of ESG-related information. With access to comprehensive, comparable, and reliable data, investors are empowered to make more informed investment decisions.

A significant portion of these regulatory measures requires laying the foundation for the proper disclosure of sustainability information amid heightened concerns about greenwashing. Regulators are stepping up efforts to crack down on misrepresentative claims about 'climate friendly' and 'sustainable' products that fail to stand up to scrutiny, with enforcement action being taken by regulators against those who make misleading claims. Financial regulators in the US, EU and UK are already addressing these concerns, with other regions set to follow.

Because enhanced ESG disclosures go hand-in-hand with a need for more comprehensive and reliable data, there has been a proliferation of ESG data products and an increase in ESG ratings providers. We are beginning to see a shift from the self-regulatory model that formerly dominated this growing sector of the financial market, to one where the introduction of regulatory requirements is becoming more commonplace. This is in keeping with recommendations made in a 2021 International Organization of Securities Commissions (IOSCO) report that raised concerns over a lack of transparency of the methodologies used in the provision of ESG ratings and data products.[7] The report also highlighted a lack of information and written policies defining and communicating ratings processes, and raised concerns relating to the management of conflicts of interest that can happen when ratings providers and associated entities work with each other.

ESG Data and Ratings Providers

For asset owners to understand which projects to invest in for the greatest positive climate impact, they need access to consistent and timely information that is both accurate and comparable and can inform their decision making. To aid this process, companies can be given ratings and rankings that more accurately reflect their ESG status. Companies are assigned a quantitative score and a risk category. While greater consistency and transparency is required on behalf of ESG data and ratings organisations, these providers are playing an increasingly important role in plugging the so-called "data gaps" in the ESG information provided by companies.

7 IOSCO report, November 2021: https://iosco.org/library/pubdocs/pdf/IOSCOPD690.pdf

Momentum of ESG standard setters and frameworks

> COP26 demonstrated a common desire to facilitate a meaningful convergence of regulatory approaches to, and timelines for, implementing policy for the establishment of ESG reporting.

Since that time, there have been determined efforts to facilitate greater harmonisation of standards and frameworks. We are currently witnessing a global re-alignment of ESG disclosure standards to ensure they remain complementary to each other, with different standards each having different purposes for different audiences.

ESG Standards and Frameworks

For firms to navigate the accelerated and often divergent regulatory environment, it can be helpful to highlight what is meant by concepts such as standards and frameworks, and how they differ in both approach and purpose.

What are ESG reporting standards?
ESG reporting standards are the agreed requirements and reporting criteria entities should abide by and may include specific metrics to be met. Corporate reporting standards tend to share the qualities of public interest focus, independence, due process, and public consultation. They are typically voluntary in nature, and many have emerged in response to increased demand for ESG compliance by market participants. For standards to be effective they need to be translated into regulation worldwide, with relevant enforcement measures, monitoring, and governance measures in place.

What are ESG disclosure frameworks?
ESG disclosure frameworks provide a set of principles offering guidance on how to consider and report on a certain sustainability topic. They offer reporting entities flexibility to define their reporting approach within the structure of the framework. They also aid adoption of specific topics, such as ESG, in the absence of a well-defined set of standards. Between 2013 and 2016, the number of reporting frameworks that focus on sustainability in a broad sense doubled to nearly 400.[8]

Global Reporting Initiative Standards
The Global Reporting Initiative (GRI) is an international organisation that sets sector-specific disclosure standards, including the asset management sector, providing companies with a common language to disclose their impact on the environment. The GRI standards are

8 Social Impact Investment Taskforce report, April 2023: https://www.gov.uk/government/publications/green-finance-strategy/mobilising-green-investment-2023-green-finance-strategy#fn:35

the only global standards with an exclusive focus on impact reporting and are aimed at a multi-stakeholder audience. The standards aim to give investors and other stakeholders greater confidence in the sustainability credentials of businesses. The GRI is expected to finalise a Biodiversity Topic Standard in Q1 2024.[9]

International Sustainability Standards Board Standards

The International Sustainability Standards Board (ISSB) is charged with overseeing standards for the disclosure of sustainability-related financial information that are being drafted by the International Financial Reporting Standards (IFRS) Foundation. These standards are based on the principle of "financial materiality" and are intended for an investor audience.

In June 2023, the ISSB published its first global sustainability-related financial reporting standards: IFRS S1 and S2, which serve as a baseline for global ESG disclosures.

IFRS S1 General Requirements for Disclosure of Sustainability-Related Financial Information

IFRS S1 provides requirements for the disclosure of sustainability-related financial information regarding an entity's sustainability-related risks and opportunities.[10]

IFRS S2 Climate-related Disclosures

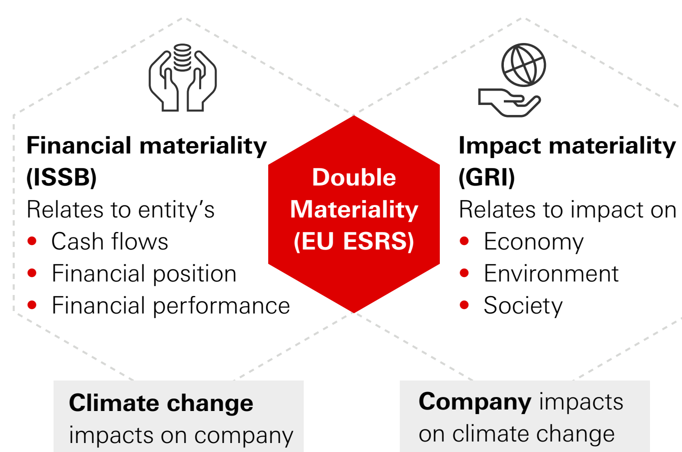
IFRS S2 outlines requirements for entities to disclose information about any climate-related risks and opportunities that can help users of general-purpose financial reports make informed decisions when deciding to allocate resources to a specific business.

Both these standards are effective for reporting periods beginning on or after 1 January 2024 and reporting could begin in 2025, initially on a voluntary basis. As always, their effectiveness will be measured by the extent to which these standards are adopted, and to which stakeholders can come into alignment on their core principles. The ISSB has committed to expanding its scope to include biodiversity, human capital, human rights, and integration in reporting.

Market regulators now have to decide whether to adopt the ISSB standards and how to best align them with their requirements. The UK, Singapore and Australia are among the markets that have declared their intention to adopt them so far; with Hong Kong requiring all issuers on the Hong Kong Stock Exchange (HKEX) to make ISSB-aligned disclosures from 2024.[11] Observers can expect to see different jurisdictions adopting ISSB standards with differing levels of localisation and implementation. As such, it may take some time for a common language for disclosures to emerge.

European Sustainability Reporting Standards

In July 2023, the European Commission adopted the European Sustainability Reporting Standards (ESRS) for use by all companies subject to the EU's Corporate Sustainability Reporting Directive (CSRD).[12] The ESRS was developed by the European Financial Reporting Advisory Group (EFRAG) in discussion with the ISSB and the GRI to ensure interoperability between the EU and global standards. The European standards are aimed at a multi-stakeholder audience and are based on the principle of "double materiality" that considers both the climate-related impacts on a company as well as that company's impact on the climate and other ESG factors. The full range of environmental, social, and governance issues, including climate change, biodiversity and human rights, are covered in the standards, which will be phased in over time for different companies starting in January 2024.



Source: HSBC Global Research

9 Letter from GRI Chair, July, 2023: https://www.globalreporting.org/news/news-center/keeping-up-the-standard-setting-momentum

10 IFRS S1 general requirements, June 2023: https://www.ifrs.org/issued-standards/ifrs-sustainability-standards-navigator/ifrs-s1-general-requirements

11 'HKEX to require climate reporting from all issuers from 2024', Fintech Global, April, 2023: https://fintech.global/2023/04/18/hkex-to-requite-climate-reporting-from-all-issuers-from-2024

12 'The Commission adopts the European Sustainability Reporting Standards', European Commission, July 2023: https://finance.ec.europa.eu/news/commission-adopts-european-sustainability-reporting-standards-2023-07-31_en

The Climate-related Financial Disclosures Framework

The Task Force on Climate-related Financial Disclosures (TCFD) is a specialist taskforce that was created by The Financial Stability Board (FSB) in 2017, providing a framework featuring 11 recommended climate-risk disclosures. It is intended for use by organisations, asset owners and asset managers, and the issuer community in a bid to improve the quality of climate-risk information available. Its 2022 status report found that, while companies have made encouraging progress on disclosing climate-related information, urgent work is still required to improve transparency; with a greater focus needed on the global context of climate change.[13]

However, the report also found that all regions have improved levels of disclosures over the preceding three years. Europe is leading the way with an average 60% disclosure across all 11 categories, significantly greater than the next highest disclosure levels in Asia-Pacific (34%). Disclosure levels in North America grew by 12% to 29% in the 2020-2021 period.

Taskforce on Nature-related Financial Disclosures Framework

The Taskforce on Nature-related Financial Disclosures (TNFD) has been set up to create a management and disclosure framework that sets a global baseline for the way organisations report and act on evolving nature-related risks and opportunities and initiate a shift away from nature-negative to nature-positive capital allocation decisions. The taskforce consists of 40 financial institutions and businesses with assets under management (AUM) exceeding $20 trillion.[15]

The TNFD framework is intended to be used by businesses and financial institutions of different sizes, across sectors and jurisdictions, in a manner that can inform the global baseline on nature-related reporting. The final risk management and disclosure framework was released in September 2023. Over 100 pilots were conducted by the TNFD, with 10 National Consultation Groups (NCG) across the world, to facilitate market engagement, capacity building and adoption.[16]

Focus on biodiversity

The UN has been holding conferences on biodiversity since 1994,[14] running parallel to the UN's Conference of Parties (COP) summits. Significantly, COP15 saw the announcement of the Kunming-Montreal Global Biodiversity Framework, a historic voluntary commitment dedicated to the conservation of 30% of the world's land and 30% of its oceans by 2030 and hailed as the "30x30 ambition." At present, only 17% of land and 10% of marine areas are protected. The commitment calls for all large companies to monitor, assess and disclose their risks, dependencies and impact on biodiversity with full transparency, including disclosures relating to their operations, value chains and portfolios.

13 TCFD Status Report, October, 2022: https://assets.bbhub.io/company/sites/60/2022/10/2022-TCFD-Status-Report.pdf
14 'What is the UN Biodiversity Conference?', London School of Economics, October 2022: https://www.lse.ac.uk/granthaminstitute/explainers/what-is-the-un-biodiversity-conference
15 About the Taskforce on Nature-related Financial Disclosures: https://tnfd.global/about
16 Ibid.

The regulatory imperative: driving ESG through the investment chain

As standard setters continue to expand the scope of their global ESG standards across different industries and sectors, national financial services regulators continue to adopt and adapt aspects of these frameworks within their own regulatory regimes. Of particular relevance are the ways in which regulation can support sustainable investing and how investment chains should be regulated. As such, ESG regulation includes targeted requirements for asset owners, asset managers, and issuers to ensure that all stakeholders in the investment chain support ESG outcomes.

With a proliferation of ESG frameworks and regulations impacting the investment chain, firms now need to navigate a far more complex regulatory landscape. If they are to successfully channel the required financial flows to sustainable investments, it is essential that they have access to disclosures along the entire investment chain that can effectively support investment decisions.

Asset owners to play an enhanced governance role

Positioned at the start of the investment chain as the providers of capital, asset owners play an influential role in driving ESG change across the investment community. The fiduciary duties of asset owners require them to seriously consider ESG factors as part of their investment process, and to actively engage with asset managers and issuers on these issues. Regulatory initiatives aim to encourage asset owners to properly integrate ESG considerations into their investment beliefs, policies, and mandates, and to communicate their commitments publicly.

> By clearly committing to take climate impact into account in their investment strategies, asset owners create incentives for asset managers to focus on ESG, and trigger resulting sustainable investment practices through the investment chain.

Regulators expect asset owners to underpin their ESG investment beliefs with effective governance processes, ensuring that their sustainability commitments are embodied throughout the organisation and its operations. Asset owners need to be able to demonstrate how sustainability factors are taken into account in internal systems, policies, and in the performance of staff in accountable roles. These governance requirements extend to the manager selection process and require on-going monitoring of asset manager performance to understand how ESG has been integrated into the investment decision-making process. As such, these increased obligations upon asset owners will drive their managers to regularly disclose how ESG factors have been accounted for. By setting out these ESG reporting expectations, asset owners will be better equipped with the information needed to assess the performance of asset managers against their own ESG investment beliefs.

Asset managers must embed ESG principles into operations

Playing the central role in the investment chain, asset managers are responding to the bottom-up push from investors to create products with an ESG focus. Rising investor demand has created new commercial opportunities for managers to take advantage of. In turn, managers have focused greater attention on producing ESG investment products for their asset owner clients.

From the other direction, regulators are placing top-down pressure on asset managers to ensure that they consider and manage material sustainability-related risks in their investment and risk management processes, and within their product manufacturing operating model. As such, managers are increasingly obligated by the regulations of the jurisdictions in which they operate to disclose how these risks are considered and to explain the metrics used for each product or investment strategy. These specified regulatory measures require asset managers to fully embed ESG considerations in almost all aspects of their operations, including strategic financial planning, governance, risk management and reporting frameworks.

The overarching regulatory intention is to ensure that asset managers promoting ESG remain transparent and accountable in the product manufacturing process, with sustainability disclosures being the key procedural tool to achieve this. Over time, the disclosures made by asset managers will provide investors with further insights on how their investment portfolios measure up against sustainability objectives and aid investor understanding of how sustainability risks and opportunities are managed within each of their portfolios. The growing range of regulations currently in development underscores the pressing need for a greater integration of ESG principles into the investment process as well as a stronger post-trade control environment that is better able to manage greenwashing risks.

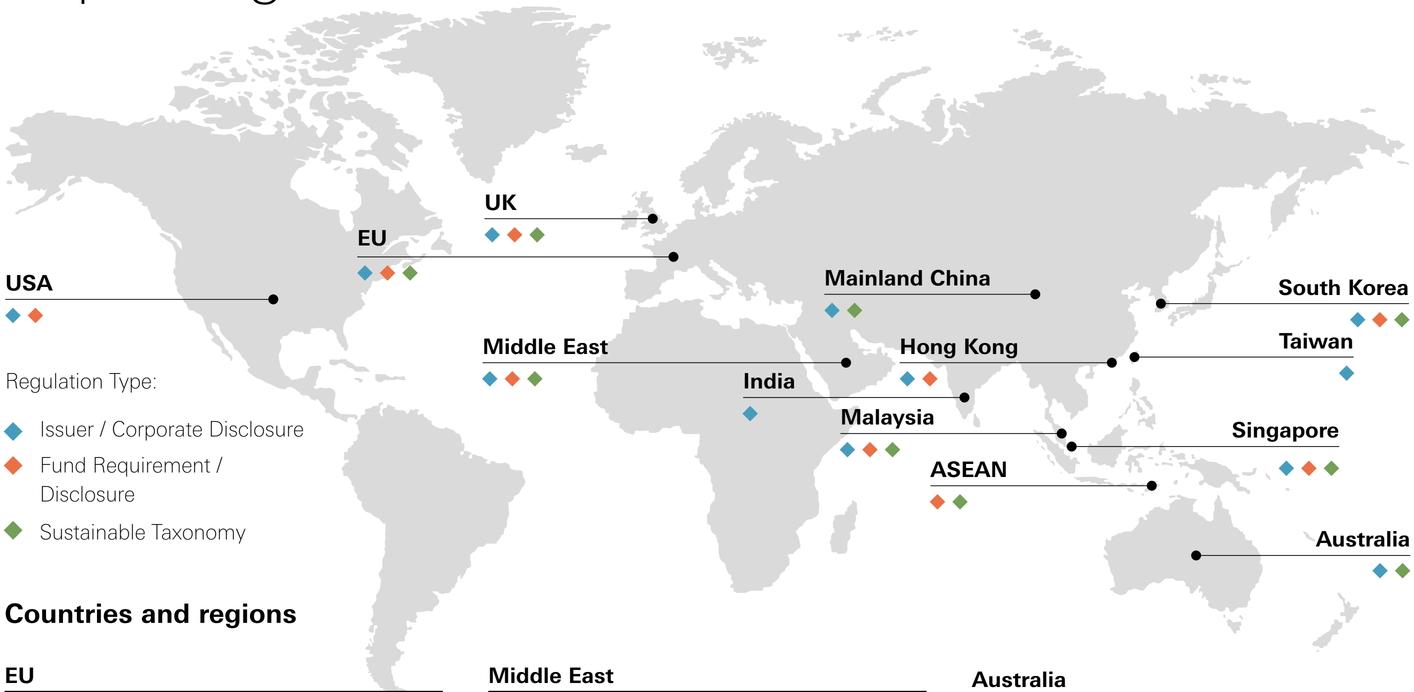
Issuers face increased ESG obligations

In addition to the mounting public scrutiny that has obliged issuers to disclose the impact of ESG risks on their performance, issuers are now facing more mandatory disclosure and due diligence requirements, as well as efforts to improve the quality of corporate ESG disclosures. This has resulted in many countries introducing more rigorous sustainability reporting obligations, with more countries set to follow. This marks an important departure from the voluntary disclosure requirements that have been commonplace up to now, as regulators seek to expand the scope of reporting requirements to include a wider range of issuers and extend the breadth of the ESG data being made available. To achieve this, regulators are aligning, where possible, to the recommendations and frameworks of the global standard setting organisations. These measures should, over time, alleviate the challenges currently faced by asset owners and asset managers in obtaining the reliable issuer data needed to fulfil their own corporate and product reporting obligations.

Stock exchanges are also introducing improved listings rules requiring issuers to disclose ESG information in a bid to provide investors with enhanced sustainability data. Despite the considerable increase in obligations, the challenge of complying with a far more complex disclosure environment may be offset by the phased introduction of stricter reporting and assurance requirements. This could ease pressures for issuers who have yet to make ESG disclosures, especially for smaller companies in the financial community. However, a sea change in the regulatory landscape is well underway and companies need to view their ESG reporting duties with the same rigour with which they handle their financial reporting obligations. Issuers need to ensure the consistency of ESG data across publications as well as use accurate and effective tools to collect, scrub, and analyse the data they are reporting. To ensure the consistency and reliability of ESG information, regulators have signalled their intentions to require assurance on sustainability information from an accredited independent auditor, ensuring that the sustainability information complies with the certification standards.

What, then, are the key global developments currently needing attention?

Overview of ESG regulatory developments impacting the investment chain



Countries and regions

EU
- Corporate Sustainability Reporting Directive (CSRD)
- Corporate Sustainability Due Diligence Direction (CS3D) – proposed
- ESMA Guidelines on Funds' Names Using ESG or Sustainability-Related Terms – proposed
- Sustainable Finance Disclosure Regulation (SFDR)
- EU Taxonomy for Sustainable Activities

UK
- TCFD-Aligned Climate-Related Disclosure Requirements for Listed Companies
- FCA PS21/23: Enhancing Climate-Related Disclosures by Standard Listed Companies
- FCA PS21/24: Enhancing Climate-Related Disclosures by Asset Managers, Life Insurers and FCA-Regulated Pension Providers
- FCA Sustainability Disclosure Requirements – proposed
- UK Green Taxonomy – proposed

USA
- SEC Climate-Related Disclosures – proposed
- New York Stock Exchange ESG Guidance
- SEC Amendments to the Investment Company Act "Names Rule"
- SEC Amendments to ESG Rules and Disclosures for Investment Advisers and Investment Companies – proposed

Middle East
- Abu Dhabi Exchange ESG Disclosure Guidance
- Saudi Exchange ESG Disclosure Guidelines
- Bahrain Bourse ESG Reporting Guide
- Abu Dhabi Financial Services Regulatory Authority (FSRA) – ESG fund rules
- UAE Sustainable Finance Taxonomy – proposed

ASEAN
- ASEAN Sustainable and Responsible Fund Standards
- ASEAN Taxonomy for Sustainable Finance – proposed

Mainland China
- Measures for Corporate Disclosures of Environmental Information
- China Green Bond Endorsed Project Catalogue (2021 edition)
- EU-China Common Ground Taxonomy – proposed

Hong Kong
- HKEX Consultation Paper on Enhancement of Climate Disclosure under its ESG Framework – proposed
- HKEX Environmental, Social and Governance Reporting Guide
- SFC Circular to management companies of SFC-authorised unit trusts and mutual funds - ESG funds

Taiwan
- TWSE Corporate ESG Information Disclosure
- FSC Listed Company Sustainability Action Plan

Australia
- ESG Reporting Guide 2015
- Australia Sustainable Finance Taxonomy – proposed

Singapore
- SGX Phased TCFD-aligned climate reporting
- MAS Disclosure and Reporting Guidelines for Retail ESG Funds
- GFIT Taxonomy – proposed

India
- SEBI Revised Disclosure Requirements for Issuance and Listing of Green Debt Securities
- SEBI Business responsibility and sustainability reporting by listed entities
- SEBI Consultation Paper on ESG Disclosures, Ratings and Investing – proposed

South Korea
- FSC ESG Corporate Disclosure Rules
- FSC ESG Fund Disclosure Standard – proposed
- The Korean Green Taxonomy (K-Taxonomy)

Malaysia
- Bursa Malaysia Sustainability Framework
- Securities Commission Guidelines on Sustainable & Responsible Investment (SRI) Funds
- Climate Change and Principle-based Taxonomy (CCPT)
- Principle-Based Sustainability and Responsible Investment Taxonomy

Note: Not exhaustive list of the most material ESG regulatory changes, as of August 2023. Dates are tentative.

Key global ESG regulatory developments in focus

Europe (EU)

For some time now the EU has established its position as a world-leader in driving ESG regulation forward. As it seeks to foster greener business practices and implement net-zero targets, it has amplified the pressure on the financial sector by implementing greater regulation around disclosures and ESG reporting.

EU regulators increase ESG momentum
In June 2023, the European Commission put forward a new sustainable finance package outlining measures to enhance and expand the EU sustainable finance framework.[17] The new package aims to provide continued support to companies and the financial sector in the transition to a climate-neutral and sustainable economy by 2050; address challenges in complying with new disclosure and reporting requirements; and further facilitate the private funding of transition projects and technologies.

As part of this package, the Commission approved, in principle, a new set of EU Taxonomy criteria for economic activities making a substantial contribution to one or more of the non-climate environmental objectives. The EU Taxonomy, which was implemented in parallel to the EU's Sustainable Finance Disclosure Regulation (SFDR), sets out a common definition for environmental sustainability. It outlines six environmental objectives: climate change mitigation; climate change adaptation; sustainable use and protection of water and marine resources; transition to a circular economy; pollution prevention and control; and protection and restoration of biodiversity and ecosystems. The Taxonomy requires large EU-listed companies, including asset managers and insurers, to disclose KPIs in alignment with its classifications. It also enhances SFDR product-level disclosures, requiring asset managers and sustainable funds to disclose how their assets and investment products meet its criteria, and to what extent; they also need to disclose the proportion of investments that are aligned with the Taxonomy. The inclusion of more economic activities, covering all six environmental objectives, will serve to expand the scope of the Taxonomy to additional economic sectors and companies, helping to further scale up sustainable investments in the EU.[18]

17 European Commission press release, June 2023: https://ec.europa.eu/commission/presscorner/detail/en/ip_23_3192
18 European Commission sustainable finance package overview, June 2023: https://finance.ec.europa.eu/publications/sustainable-finance-package-2023_en

SFDR 2.0

The Sustainable Finance Disclosure Regulation (SFDR) came into effect in 2021 and is intended to increase transparency in sustainable investment markets by outlining a broad range of ESG metrics.[19] It was the first major effort to regulate transparency on ESG disclosures in the asset management industry and aims to strengthen investor protection and combat greenwashing. At the entity level, ESG considerations must be reflected in a firm's investment strategies and policies and be publicly available on its website. Based on the principle of double materiality, it requires asset managers to disclose how, and to what extent, sustainability factors are integrated into their decision-making processes, as well as the impact of ESG risks on financial returns. Additionally, large asset owners and asset managers (defined as having over 500 employees) must disclose whether the principal adverse impacts (PAI) of investment decisions on sustainability are taken into consideration, with smaller firms permitted the option to disclose on a comply or explain basis. At the product level, investment funds require a classification to indicate the fund's alignment with sustainability objectives; associated marketing and other documentation must be updated accordingly.

In January 2023, SFDR Level 2 regulatory technical standards (RTS) came into effect, requiring EU fund providers, as well as non-EU entities that market to EU investors, to supply detailed sustainability-related disclosures and complete mandatory reporting templates.[20] In April 2023, the European Supervisory Authorities (ESAs) – the EBA, EIOPA and ESMA – initiated a consultation proposing to expand the scope of regulatory technical standards in areas such as PAI disclosures, the SFDR "do no significant harm" (DNSH) test and material amendments to the mandatory product-level disclosure templates for Article 8/9 products.[21] The European Commission is also consulting on potential improvements to the SFDR framework, with a final report expected in Q2 2024.[22] There is no confirmed timeline for when the new rules, which the industry has termed as "SFDR 2.0," will come into effect.

Enhancing issuer disclosures

The EU has taken a major step forward in the standardisation of sustainability reporting with the adoption of the European Sustainability Reporting Standards (ESRS) in July 2023.

> The standards will provide information for investors to understand the sustainability impact of the companies in which they invest.

Covering the full range of environmental, social, and governance issues, including climate change, biodiversity and human rights, the standards must be used by all companies subject to the Corporate Sustainability Reporting Directive (CSRD).[23] The CSRD introduces more detailed non-financial reporting requirements and applies to large EU companies as well as those listed on an EU-regulated market. Reporting begins in 2025 for the financial year 2024. It aims to provide more and better quality, comparable ESG information that is of the same standard as financial reporting.

19 'Questions and answers (Q&A) on the SFDR Delegated Regulation,' European Banking Authority, November 2022: https://www.esma.europa.eu/sites/default/files/library/jc_2022_62_jc_sfdr_qas.pdf
20 'Final Report on draft Regulatory Technical Standards,' European Securities and Markets Authority, February 2021: https://www.esma.europa.eu/sites/default/files/library/jc_2021_03_joint_esas_final_report_on_rts_under_sfdr.pdf
21 Joint Consultation Paper Review of SFDR Delegated Regulation regarding PAI and financial product disclosures: https://www.esma.europa.eu/sites/default/files/2023-04/JC_2023_09_Joint_consultation_paper_on_review_of_SFDR_Delegated_Regulation.pdf
22 https://finance.ec.europa.eu/sustainable-finance/disclosures/sustainability-related-disclosure-financial-services-sector_en
23 EU Corporate sustainability reporting information page: https://finance.ec.europa.eu/capital-markets-union-and-financial-markets/company-reporting-and-auditing/company-reporting/corporate-sustainability-reporting_en#legislation

Recognising the importance of transparency in the global value chains of companies, the European Commission has proposed the Corporate Sustainability Due Diligence Directive (CS3D) to introduce extensive due diligence rules relating to adverse human rights impacts, including child labour and worker exploitation, as well as the environmental impacts of a business and its subsidiaries across the entire value chain.[24] Once the amended CS3D is adopted, likely in 2024, EU member states will have two years to implement the directive in local legislation.

Measures to address greenwashing

As part of its new sustainable finance package released in June 2023, the EU is also considering a legislative proposal to make ESG ratings more reliable and comparable.[25] If adopted, the proposal will require ESG ratings providers to be supervised by the European Securities and Markets Authority (ESMA) to ensure their services are both high quality and reliable, and to prevent conflicts of interest. Ratings providers will be required to base their ratings activities on rigorous, systematic, and transparent methodologies that are objective and are subject to validation. Both providers and users of ESG ratings, and all those companies subject to them, will need to pay especial attention to this new balance of voluntary codes and regulatory requirements in 2023 and beyond.

In a bid to eliminate misleading or deceptive fund names, in November 2022 ESMA began consulting on guidelines for the use of ESG or sustainability-related terms in fund names.[26] If implemented, these guidelines would help protect investors from unsubstantiated or exaggerated sustainability claims by introducing criteria for the accurate assessment of the ESG-alignment of investment funds, including certain thresholds for sustainable investments to be met before ESG-related terms can be used in product names. The guidelines would take effect three months after their publication and include a transitional period of six months for funds launched prior to the application date.

Following their Call for Evidence on greenwashing in November 2022, the ESAs published their first Progress Report to help market participants better understand, mitigate, and prevent greenwashing risks.[27] The report established a common definition for greenwashing, namely: "a practice where sustainability-related statements, declarations, actions, or communications do not clearly and fairly reflect the underlying sustainability profile of an entity, a financial product, or financial services. This practice may be misleading to consumers, investors, or other market participants." The ESAs will publish final greenwashing reports in May 2024 and will consider final recommendations, including possible changes to the EU regulatory framework.

24 Text of the EU Council on Corporate Sustainability Due Diligence and amending Directive: https://www.europarl.europa.eu/doceo/document/TA-9-2023-0209_EN.html
25 European Commission press release, June 2023: https://ec.europa.eu/commission/presscorner/detail/en/ip_23_3192
26 ESMA press release, November 2022: https://www.esma.europa.eu/press-news/esma-news/esma-launches-consultation-guidelines-use-esg-or-sustainability-related-terms
27 ESMA press release, June 2023: https://www.esma.europa.eu/press-news/esma-news/esas-put-forward-common-understanding-greenwashing-and-warn-risks

United Kingdom

The UK's green finance ambitions

Determined to honour its COP26 commitment to become the world's first net-zero aligned financial centre and aid the transition to a nature-positive, resilient economy, the UK has taken further steps to progress its ambitions.

> In March 2023, the UK published its 2023 Green Finance Strategy renewing its intention to retain its global leadership position in the sustainable finance sector.[28]

The Strategy sets out how the UK will combine national leadership with the expertise of the UK financial sector via an ambitious regulatory framework. In doing so, it aims to accelerate the transition to a green global financial system; facilitating a proliferation of green finance flows worldwide, in both emerging and developing markets.

Having established advanced climate and nature targets, private finance will be crucial for the UK to deliver on its net-zero ambitions; an additional GBP £50-60 billion capital investment will be needed each year through the late 2020s and into the 2030s.[29] Domestic nature-related goals could also require investment in the range of GBP £44-97 billion over the next decade.[30]

To achieve this, the UK is determined to deploy strong governmental oversight on the financial sector and to bring financial firms' operations into alignment with both domestic and global net-zero objectives, including its nationally determined contribution under the Paris Agreement, and domestic carbon budgets.[31] Critical to this agenda is ensuring financial institutions have robust transition plans at a firm-wide level and set out how they will decarbonise in line with net-zero targets.

Mandatory Transition plan reporting

In recognition of the central importance of companies making measurable and actionable transition plans, the UK government is committed to making disclosure of these plans mandatory, with the FCA having implemented updated rules for asset managers and owners and listed companies based on a comply or explain basis. To achieve this, it has established the Transition Plan Taskforce (TPT) to help set the gold standard for private sector transition plans.[32]

28 'Mobilising Green Investment: 2023 Green Finance Strategy', HM Government, March 2023: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1149690/mobilising-green-investment-2023-green-finance-strategy.pdf

29 'Net Zero Strategy: Build Back Greener', HM Government, October 2021,(pp.327-328): https://www.gov.uk/government/publications/net-zero-strategy

30 'Finance Gap for UK Nature Report', Green Finance Institute, October 2021: https://www.greenfinanceinstitute.co.uk/news-and-insights/finance-gap-for-uk-nature-report

31 'Fact Sheet: Net Zero-aligned Financial Centre,' HM Treasury, November 2021: https://www.gov.uk/government/publications/fact-sheet-net-zero-aligned-financial-centre/fact-sheet-net-zero-aligned-financial-centre

32 'Setting a gold standard for climate transition plans,' Transition Plan Taskforce, April 2022: https://transitiontaskforce.net

More disclosures to come

Encouraging greater transparency is an essential tool for ensuring that accurate sustainability data flows through sustainable finance markets in the UK and beyond. As such, the UK is aiming to improve the quantity and quality of sustainability-related information and data available to the market. This will allow asset owners to better understand which projects will have the greatest impact on the climate while facilitating lending and borrowing that takes climate risks fully into account.

> More, better-quality information should feed into more accurate product pricing and give companies and their stakeholders visibility of their path to net zero.

The UK's disclosure framework seeks to align certain requirements with the recommendations made by the global TCFD taskforce. Indeed, it was the first G20 country to require economy-wide disclosures in alignment with the TCFD as per its Greening Finance roadmap. TCFD-aligned disclosures will be phased in across the investment chain, with the UK committed to broadening the scope of its disclosure requirements beyond its current focus on climate reporting. The UK's Financial Conduct Authority (FCA) already has TCFD-aligned disclosure rules in place for premium listed companies as well as issuers of standard listed shares.[33] It is committed to rolling out these requirements across the entire economy by 2025, with a significant portion of requirements already in place by 2023. Already, asset managers and some FCA-regulated asset owners must make mandatory, TCFD-aligned disclosures at the entity level. These entities are required to disclose how climate-related risks and opportunities are taken into account in managing or administering investments on behalf of clients and consumers. Additionally, a baseline set of consistent, comparable disclosures must be made at the product/portfolio level, including a core set of metrics.

The UK was also the first government to fund and support the creation of the TNFD framework, published in September 2023, conscious of the financial risks associated with biodiversity loss. The TNFD is seen as an essential tool for achieving Target 15 of the Global Biodiversity Framework, which requires businesses, especially large transnational companies and financial institutions, to monitor and disclose their "risks, dependencies and impacts on biodiversity."[34] In keeping with this goal, the UK welcomes closer integration with the ISSB, sharing its ambitions to create a global baseline for sustainability reporting.

33 'PS21/23: Enhancing climate-related disclosures by standard listed companies,' Financial Conduct Authority, December 2021: https://www.fca.org.uk/publications/policy-statements/ps-21-23-enhancing-climate-related-disclosures-standard-listed-companies

34 Kunming-Montreal Global Biodiversity Framework: Target 15, Convention on Biological Diversity: https://www.cbd.int/gbf/targets/15

UK Sustainability Disclosure Requirements (SDR)

The SDR is a streamlined disclosure framework created by the FCA that is an essential component of the UK's green finance strategy. The framework brings together new and existing sustainability reporting requirements that will enable market participants to identify viable investment opportunities and prevent the harms of greenwashing by holding sustainability claims to a higher, agreed-upon standard. It builds upon the work done by the TCFD; expanding its scope beyond climate to incorporate broader sustainability topics, with an aim to help the UK's asset management sector foster trust in sustainable investment products among consumers.[35]

The proposals also include a new labelling regime that would require producers of investment products to disclose product sustainability information, including sustainability impact, risks, and opportunities. Similar to the approach taken by the EU, the SDR will place restrictions on the use of the sustainability terms that UK asset managers can use in investment product names and marketing materials.[36] This is in line with a new anti-greenwashing rule requiring sustainability claims to be clear and fair, and not make misleading claims. The FCA plans to publish the final policy statement during the second half of 2023.

Strengthening ESG data

To facilitate greater transparency and reliability of ESG data, the UK government has echoed moves in the EU by developing a new UK Taxonomy that will facilitate the ready supply of reliable sustainability data that financial markets can use to support the financing of sustainable investment. The FCA believes this could help demonstrate the credibility of specific sustainability-linked assets. The Taxonomy will help fight greenwashing and improve the integrity of markets.

It will begin with an initial trial as a voluntary disclosure protocol, with the ultimate aim to phase in mandatory requirements.

As part of the Edinburgh reforms, and in recognition of the increasing importance of investor access to reliable ESG ratings, the UK Government and Treasury are consulting on the development of regulation setting standards ESG ratings providers must follow, with the view of bringing these providers under FCA oversight.[37] The FCA has also convened an industry-led ESG Data and Ratings Working Group to develop a voluntary Code of Conduct for ESG data and ratings providers to be consistent with other jurisdictions.[38] The Code is expected to be finalised by the end of 2023.

35 'FCA updates on its Sustainability Disclosure Requirements (SDR) and investment labels consultation,' Financial Conduct Authority, March 2023: https://www.fca.org.uk/news/news-stories/fca-updates-sustainability-disclosure-requirements-and-investment-labels-consultation

36 'CP22/20: Sustainability Disclosure Requirements (SDR) and investment labels,' Financial Conduct Authority, October 2022: https://www.fca.org.uk/publications/consultation-papers/cp22-20-sustainability-disclosure-requirements-sdr-investment-labels

37 'Future regulatory regime for Environmental, Social, and Governance (ESG) ratings providers,' HM Government, March 2023: https://www.gov.uk/government/consultations/future-regulatory-regime-for-environmental-social-and-governance-esg-ratings-providers

38 'We welcome the consultation on a new Code of Conduct for Environmental, Social and Governance data and ratings providers,' Financial Conduct Authority, July 2023: https://www.fca.org.uk/news/news-stories/we-welcome-consultation-new-code-conduct-environmental-social-and-governance-data-and-ratings

Asia Pacific

ESG momentum builds in Asia Pacific
As ESG investment picks up pace in Asia, global investors are putting increased pressure on APAC capital markets to publish standardised ESG disclosures that can help meaningfully guide investment. Momentum is also coming from a desire to catch up with developments in Europe and elsewhere. A growing range of financial hubs across the region have been introducing comprehensive guidelines and rules governing financial market participants across the investment chain.

Hong Kong

Hong Kong aims to be one of the first global markets to bring its corporate disclosure frameworks in line with ISSB standards. The Hong Kong Stock Exchange (HKEX) has proposed all listed issuers make climate-related disclosures in their annual ESG reports and introduce additional climate-related disclosures based on ISSB Climate Standards.[39] The proposed amendments to the Listing Rules are expected to come into effect on 1 January 2024 on an interim basis, with full compliance with the rules required from 2026. Hong Kong's proposed changes would enhance the quality of, and provide greater transparency over, the climate risks and opportunities presented by corporations. These developments have the potential to accelerate the convergence of ISSB-aligned ESG disclosure standards throughout Asia.

Mandatory ESG requirements for fund managers

In August 2021, the Hong Kong Securities and Futures Commission (SFC) issued the Consultation Conclusions on the Management and Disclosure of Climate-related Risks by Fund Managers with amendments to the Fund Manager Code of Conduct (FMCC).[40] The new regulations require managers of collective investment schemes (CISs) to take climate-related risks into consideration in their risk management processes and to make appropriate disclosures.

The baseline requirements applicable to all CIS managers cover governance, investment management, risk management, and disclosure. Managers with more than HK $8bn in fund assets for any 3 months in the previous reporting year must also comply with enhanced standards:

- **Scenario Analysis:** Assess the relevance and utility of scenario analysis in measuring the resilience of investment strategies against climate-related risks. If relevant, develop plan to implement scenario within a reasonable period of time.

- **Carbon Emissions Disclosures:** Calculate and report the portfolio carbon footprint of Scope 1 and Scope 2 greenhouse gas (GHG) emissions associated with underlying investments. Scope 3 GHG emissions to be included if data is available.

39 HKEX consultation paper, April 2023: https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/April-2023-Climate-related-Disclosures/Consultation-Paper/cp202304.pdf
40 Securities and Future Commission consultation paper, August 2021: https://apps.sfc.hk/edistributionWeb/api/consultation/conclusion?lang=EN&refNo=20CP5

Singapore

In Singapore, the SGX has introduced a phased approach to mandatory climate reporting based on the recommendations of the TCFD.

> Currently, climate reporting is mandatory for issuers in the financial industry, agriculture, food and forest products industry, and energy industry.

For other issuers, climate reporting is on a comply or explain basis. Additional sectors will come into scope of the mandatory reporting in 2024.[41]

For asset managers, the Monetary Authority of Singapore (MAS), has set expectations on the disclosure and reporting guidelines applicable to ESG funds.[42] The MAS highlighted that fund managers are responsible for assessing whether their fund is an ESG fund that would fall within the scope of the Circular, if it uses or includes ESG factors as its key investment focus and strategy, and represents itself as an ESG-focused fund. The rule took effect on 1 January 2023.

Singapore's Green Finance Industry Taskforce (GFIT) has been consulting on the introduction of its own Green Taxonomy that would introduce detailed thresholds and classification criteria for green and transition related activities across five sectors.[43] The final taxonomy is expected to be published before the end of 2023. The Monetary Authority of Singapore (MAS) is also considering a Code of Conduct[44] for ESG ratings and data product providers in a bid to introduce industry-wide standards for the disclosure of methodologies, data sources, governance and the managing of conflicts of interest.

South Korea

In South Korea, guidance is available for voluntary ESG disclosures by issuers, with these set to become mandatory for larger corporations by 2025, and for all issuers listed on the Korea Composite Stock Price Index (KOSPI) by 2030.[45] South Korea's Financial Services Commission (FSC) has also pledged resources to help support ESG disclosures by domestic companies in alignment with international standards.

In April 2023, a taskforce was created by the financial regulator to develop ESG fund disclosure standards, to help South Korean ESG investments align with global standards, prevent greenwashing, and enhance responsible management.[46] The framework will cover ESG investment targets, manager capabilities and performance.

The Korean Green Taxonomy (K-Taxonomy) has also been fully in place since 2023. K-Taxonomy refers to the classification of green economic activities contributing to six environmental goals: greenhouse gas reduction; adaptation to climate change; sustainable water conservation; recycling; pollution prevention and management; and biodiversity, which broadly resemble the EU Taxonomy's six objectives.[47]

41 'Sustainability Reporting,' SGX Group, April 2023: https://www.sgx.com/sustainable-finance/sustainability-reporting

42 'CFC 02/2022 Disclosure and Reporting Guidelines for Retail ESG Funds,' Monetary Authority of Singapore, July 2022: https://www.mas.gov.sg/regulation/circulars/cfc-02-2022---disclosure-and-reporting-guidelines-for-retail-esg-funds

43 'Green Finance Industry Taskforce (GFIT),' Monetary Authority of Singapore, November 2019: https://www.mas.gov.sg/development/sustainable-finance/green-finance-industry-taskforce

44 'MAS Proposes Code of Conduct for Providers of ESG Ratings and ESG Data Products,' Monetary Authority of Singapore, June 2023: https://www.mas.gov.sg/news/media-releases/2023/mas-proposes-code-of-conduct-for-providers-of-esg-ratings-and-esg-data-products

45 Financial Services Commission press release, January 2021: https://www.fsc.go.kr/eng/pr010101/75177

46 'ESG Fund Disclosure Standard Establishment TF Launched,' (Korean-language only press release), 2023: https://www.fss.or.kr/fss/bbs/B0000188/view.do?nttId=126803&menuNo=200218&cl1Cd=&sdate=&edate=&searchCnd=1&searchWrd=&pageIndex=2

47 Republic of Korea Ministry of Environment press release, December 2022: https://eng.me.go.kr/eng/

Mainland China

In Mainland China, policymakers and regulators have demonstrated initial commitments to bring ESG disclosures up to the level of international markets by establishing clearer definitions and disclosure requirements for corporates and financial market participants. Green development will be a major focus of the central government, as laid out in the 20th Party Congress Report[48], and central regulators, including the China Securities Regulatory Commission and the State Administration for Market Regulation, have committed to developing a set of environmental disclosure standards for listed companies before the end of 2025.[49] Last year, a subsidiary of the State Council encouraged state-owned enterprises to issue ESG reports by 2023 in its Work Plan for Improving Quality of Listed Central SOEs[50], and the first Chinese laws and regulation-based guidance for enterprise ESG disclosure[51] were released by the China Enterprise Reform and Development Society (CERDS), a State Council-backed think tank.

Taiwan

In November 2021, Taiwan's Federal Supervisory Commission (FSC) issued a new notice requiring listed issuers to enhance the quality of existing Corporate Social Responsibility (CSR) reporting, which includes disclosing information on key environmental and social issues such as quantitative information on greenhouse gas emissions, water consumption and waste.[52] The FSC also laid out Taiwan's first set of formal criteria and disclosure requirements for onshore funds using ESG labels.[53] These new rules, which became effective in July 2021, require fund houses to provide and disclose their own ESG investment principles; as well as explain why they choose certain companies to include in their ESG fund products over others, and what international principles they are following when making these decisions. The FSC will also deliver guidance on ESG investments by launching a sustainability rating and classification system.

Australia

Australia currently does not have specific ESG reporting requirements in place for listed issuers, offering only guidance to companies on the disclosure of material ESG risks and opportunities at its own discretion.[54] However, the government is currently seeking to introduce standardised requirements for climate-related disclosures in line with international standards in a bid to help Australian firms compete in global markets. The Australian Treasury recently concluded its consultation on a new climate-related financial risks disclosure regime that could take effect in 2024.[55] A sustainable finance taxonomy is also in the early stages of development.[56]

48 Report to the 20th National Congress of the Communist Party of China, October 2022: https://www.fmprc.gov.cn/eng/zxxx_662805/202210/t20221025_10791908.html
49 As stated in China's 14th Five Year Development Plan for Finance Standardisation: https://cset.georgetown.edu/wp-content/uploads/t0284_14th_Five_Year_Plan_EN.pdf
50 'Work plan for improving the quality of listed companies controlled by central enterprises,' State-owned Assets Supervision and Administration Commission (SASAC), May 2022 (Mandarin language only): (SASAC) http://www.sasac.gov.cn/n2588030/n2588944/c24789613/content.html
51 'China moves to standardize fragmented ESG reporting landscape,' Thomson Reuters, October 2022: https://www.thomsonreuters.com/en-us/posts/news-and-media/china-esg-reporting
52 Korean Ministry of Environment press release, December 2022: https://eng.me.go.kr/eng/
53 Financial Supervisory Commission Republic of China (Taiwan) press release, December 2022: https://www.fsc.gov.tw/en/home.jsp?id=54&parentpath=0,2&mcustomize=multimessage_view.jsp&dataserno=202212230003&dtable=News
54 'ESG Reporting Guide for Australian Companies', Financial Services Council, 2015: https://www.asx.com.au/documents/asx-compliance/acsi-fsc-esg-reporting-guide-final-2015.pdf
55 'Climate-related financial disclosure: Second consultation,' Australian Government Treasury, June 2023: https://treasury.gov.au/consultation/c2023-402245
56 Australian Sustainable Finance Institute, Taxonomy Project website: https://www.asfi.org.au/taxonomy

India

During the period 2021-2022, India had voluntary disclosure requirements in place for its top 1,000 listed issuers by market capitalisation; with companies expected to disclose all ESG risks and a fully costed strategy to mitigate or adapt to these risks, subject to specified performance criteria. These requirements became mandatory in the 2023 financial year. In January 2023 India introduced a principles-based framework for rating the ESG alignment of companies.[57] The Securities and Exchange Board of India (SEBI) has also proposed a framework for ESG disclosures by mutual fund schemes, designed to ensure the accurate labelling of products in a bid to combat greenwashing.[58]

Malaysia

Malaysia's Securities Commission (SC) issued a Principles-Based Sustainable and Responsible Investment Taxonomy for the Malaysian Capital Market in 2022, setting out universal guiding principles for identifying ESG-aligned economic activities.[59] The SC also issued revisions to its Guidelines on Sustainable and Responsible Investment (SRI) Funds in 2021, with additional requirements that any new or existing funds must meet to qualify as an SRI or ASEAN Sustainable and Responsible Fund.[60] In a bid to bring the country's climate and sustainability agenda into alignment with international standards, Malaysia established an advisory committee responsible for the implementation of ISSB standards in the country, and issued a 2022 note offering guidance to help mutual funds manage ESG risks.[61]

Regional cooperation to establish common APAC standards

Across Asia, pressure is mounting for asset owners and managers to issue ESG disclosures; demonstrate how their investment decisions take ESG impact into account; and effectively measure, monitor and manage green products to avoid greenwashing. Despite the lack of consistent frameworks across Asia, cooperation between jurisdictions is on the rise, with work underway to establish common disclosure standards. ASEAN members are collaborating to establish an ASEAN Taxonomy for Sustainable Finance that would serve as a common language for communication and coordination between jurisdictions for classifying ESG-aligned economic activities and financial instruments.[62] The ASEAN Capital Markets Forum (ACMF) has also developed the ASEAN Sustainable and Responsible Fund Standards (SRFS) which aims to provide the minimum disclosure and reporting requirements that can be consistently applied to CIS that seek to qualify under the Standards.[63] As these efforts develop further, Asian firms, as well as global firms with businesses in Asia, will be interested to see the extent to which ESG regulations converge with global standards.

57 'India regulator opts for principles-backed approach on ESG ratings,' Reuters, January 2023: https://www.reuters.com/business/sustainable-business/india-regulator-opts-principles-backed-approach-esg-ratings-sources-2023-01-20/

58 'Sebi's proposed ESG disclosure to address risk of "green washing",' Economic Times of India, October 2021: https://economictimes.indiatimes.com/mf/mf-news/sebis-proposed-esg-disclosure-to-address-risk-of-green-washing-experts/articleshow/87361687.cms

59 'Climate Change and Principle-based Taxonomy', Central Bank of Malaysia, April 2021: https://www.bnm.gov.my/-/climate-change-principle-based-taxonomy

60 'Securities Commission Malaysia Publishes Revised Guidelines on Sustainable and Responsible Investment Funds,' Mayer Brown, March 2023: https://www.mayerbrown.com/en/perspectives-events/blogs/2023/03/securities-commission-malaysia-publishes-revised-guidelines-on-sustainable-and-responsible-investment-funds

61 'Guidance note on managing environmental, social and governance risks for fund management companies,' Securities Commission Malaysia, January 2022: https://www.sc.com.my/api/documentms/download.ashx?id=09879b86-6948-4c0c-8d29-559764a09964

62 ASEAN Taxonomy for Sustainable Finance, Association of Southeast Asian Nations: https://asean.org/book/asean-taxonomy-for-sustainable-finance/

63 ASEAN Capital Markets Forum: theacmf.org

United States

Driving the sustainability agenda forwards
Under the Biden administration there has been a concerted push to forge a more sustainability-focused agenda. Targets are already in place to achieve a 100% clean energy economy and net-zero emissions by 2050.[64] What's more, the introduction of the Inflation Reduction Act (IRA) – the largest piece of climate legislation in US history – represents a turning point in policy. The IRA brought in new provisions, tax breaks and other incentives to encourage companies to build a green economy by investing in climate-positive solutions including renewables, energy storage, clean hydrogen, carbon capture, and electric vehicles (EVs).

With policymakers placing renewed attention on ESG considerations, and investors demanding greater quality and consistency in sustainability information, regulators have been given the motivation needed to establish enhanced ESG regulatory frameworks. The Securities and Exchange Commission (SEC) has signalled its intent to move from principles-based guidelines to mandatory regimes, and is considering requirements such as standardised disclosures, emissions reporting, and more stringent criteria for the labelling of ESG funds.[65] This has set the US on a course to narrowing the regulatory gap for ESG disclosures compared to other jurisdictions such as the EU.

There is a growing need for US corporations to align closely with the ESG disclosure and reporting frameworks and principles established in the EU in order for their European partners and subsidiaries to comply with their own regional reporting requirements. Even companies who do not fall under the scope of US reporting requirements will need to consider the requirements of companies within their value chain who may be impacted by regulation and will need to provide information about ESG impacts to help their European partners with their reporting obligations.

Strengthening sustainability disclosures
As investors seek greater information on the sustainability impact of companies, policymakers put forward a number of proposals to simplify and standardise ESG and climate risk disclosures in 2021.

> In March 2022 the SEC published proposals that would require listed companies, both foreign and domestic, to make climate disclosures in alignment with the TCFD framework starting from 2024.[66]

If implemented, it would be the broadest federally-mandated ESG disclosure rule in US history.

64 White House press release, April 2021: https://www.whitehouse.gov/briefing-room/statements-releases/2021/04/22/fact-sheet-president-biden-sets-2030-greenhouse-gas-pollution-reduction-target-aimed-at-creating-good-paying-union-jobs-and-securing-u-s-leadership-on-clean-energy-technologies/
65 U.S Securities and Exchange Commission speech, July 2021: https://www.sec.gov/news/speech/gensler-pri-2021-07-28
66 Enhancement and Standardization of Climate-Related Disclosures fact sheet, U.S. Securities and Exchange Commission: https://www.sec.gov/files/33-11042-fact-sheet.pdf

The proposals aim to increase the quality, consistency, and comparability of a company's climate risks and raise the transparency of GHG emissions targets in a bid to foster greater accountability. The changes would help investors identify both the risks and the opportunities of their investments while also clarifying and simplifying the disclosure process. There is widespread shareholder support for enhanced disclosure requirements. However, political debate over the proposals is on-going and the precise timing of any legislation remains unclear.

The SEC is also considering additional disclosure requirements relating to human capital and the ESG credentials of sustainable investment funds, as well as increased requirements for the labelling of ESG funds.[67] Beyond these disclosure proposals the SEC has established a dedicated ESG taskforce with a focus on examining greenwashing and other ESG-related misconduct.[68] Financial regulators are also enhancing their levels of supervisory engagement and enforcement strategies.

Middle East

ESG regulations across the Middle East are at a comparatively early stage in development, however as the focus turns to COP28 taking place in the UAE in late 2023, further development of the region's ESG regulatory frameworks are likely to progress. Many countries have made commitments to a net zero transition, including the UAE, Saudi Arabia, and Bahrain, with governments paying increased attention to ESG risks and demonstrating greater willingness to come into alignment with the growing global focus on sustainability.

In the UAE, the Abu Dhabi Securities Exchange (ADX) has guidance in place for listed companies to voluntarily disclose ESG indicators.[69] More broadly, under the sustainable finance framework issued by the UAE Sustainable Finance Working Group (SFWG), proposals are being considered to align corporate ESG disclosures with the global standards issued by the ISSB.[70] The SFWG is also seeking to enhance climate-related corporate governance and risk management standards in the UAE's financial services entities, and to develop a UAE Sustainable Finance Taxonomy in order to support the transition to a net zero economy.[71] For asset managers in Abu Dhabi, the Financial Services Regulatory Authority (FSRA) has set specific requirements for domestic ESG labelled funds, requiring funds to be assessed based on accepted green taxonomies or global standards.[72]

Elsewhere in the region, stock exchanges have encouraged listed companies to disclose ESG metrics and indicators. The Bahrain Bourse has set guidelines for voluntary ESG reporting to help inform investor decision making[73], and similarly, companies listed on the Saudi Exchange can opt to disclose ESG factors in accordance with common reporting guidelines.[74] The Boursa Kuwait, as a member of the United Nations-led Sustainable Stock Exchanges (SSE) initiative, has developed a comprehensive guide for listed companies to report on recommended sustainability metrics, setting out disclosure best practices to assist companies in their reporting.[75]

67 'SEC Proposes to Enhance Disclosures by Certain Investment Advisers and Investment Companies About ESG Investment Practices,' U.S Securities and Exchange Commission press release, 2022: https://www.sec.gov/news/press-release/2022-92

68 'SEC Announces Enforcement Task Force Focused on Climate and ESG Issues,' U.S Securities and Exchange Commission press release, 2022: https://www.sec.gov/news/press-release/2021-42

69 https://adxservices.adx.ae/WebServices/DataServices/contentDownload.aspx?doc=1704806

70 20221109-sfwg-progress-report-final.pdf (adgm.com)

71 20221109-sfwg-progress-report-final.pdf (adgm.com)

72 ADGM1547_9602_VER08040723.pdf (thomsonreuters.com)

73 ESG Template (bahrainbourse.com)

74 ESG_Disclosure_Guidelines_EN.pdf (saudiexchange.sa)

75 ESG Reporting Guide (boursakuwait.com.kw)

Conclusion

The world is stepping up its intentions to build a sustainable, high-value global economy that benefits all and keeps global temperatures below the agreed 1.5 degrees Celsius target. The result is a greater push for global regulatory and best practice standards that can overcome regional variations and move steadily in the direction of mandatory disclosures and reporting.

The momentum to integrate ESG principles into all aspects of business operations and supply chains is being driven by the twin forces of greater regulatory scrutiny and pressure on markets from investors and other stakeholders seeking actionable information on which to base their sustainable investment decisions. The hope is that a more standardised, coherent regulatory regime will help bring global supply chains into closer ESG alignment and facilitate the significant flow of private finance needed to build the green economies of tomorrow.

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