Sustainable finance regulation

Pressures and challenges

Freshfields Bruckhaus Deringer

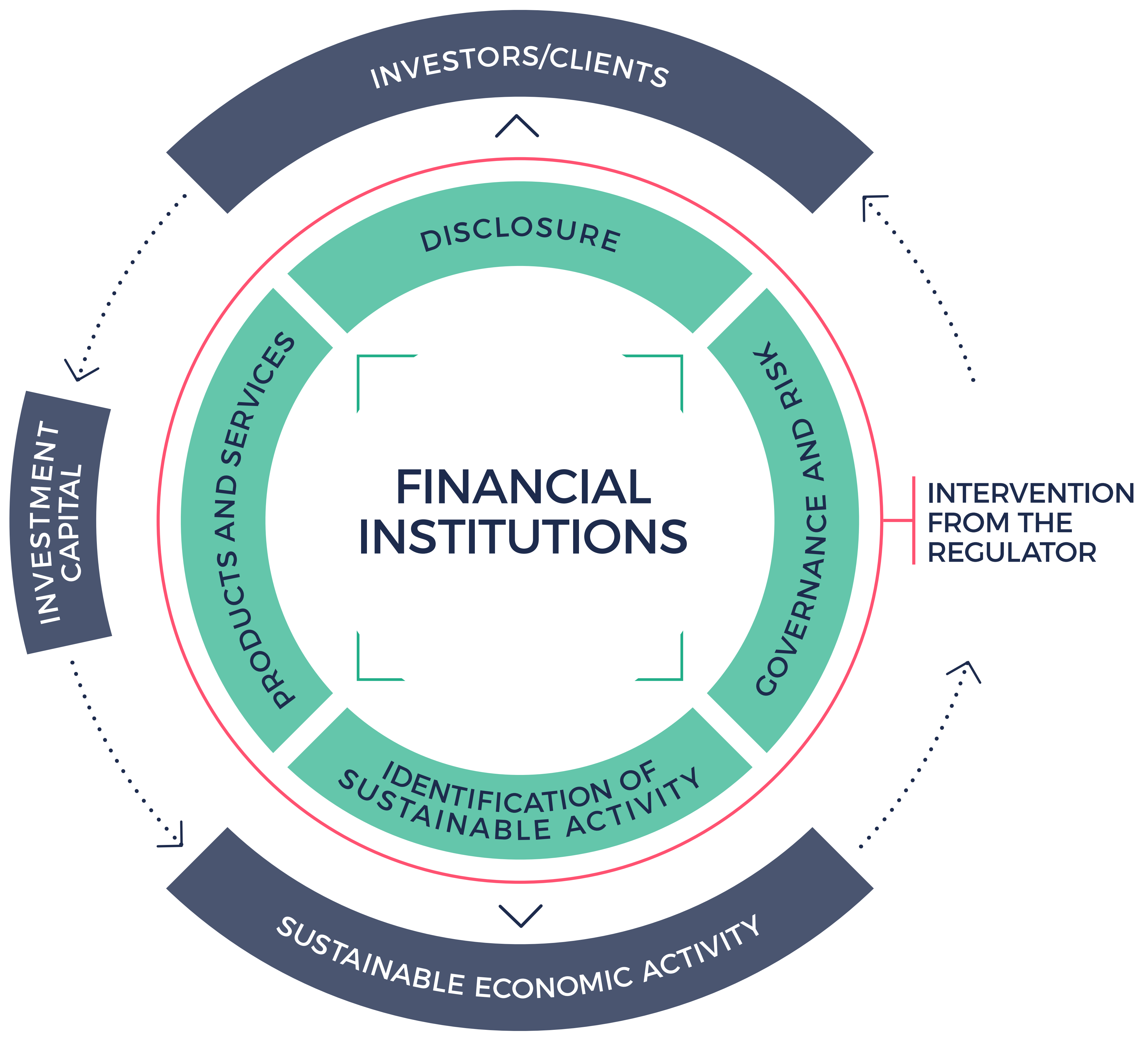
Regulating finance for a sustainable economy

Regulators are intervening in the four areas set out below

Motivated by the looming climate crisis, growing concern for inequalities, and the effects of the pandemic, regulators around the world are taking ambitious action on various 'sustainability' issues.

Their aims are to improve the sustainability of financial sector businesses and to guide capital towards sustainable economic activity. The regulatory interventions pose significant legal and compliance challenges. The risks warrant board-level attention.

This document introduces the key regulation and challenges. Although there are many private sustainability initiatives, the focus is intervention by regulatory authorities.



IDENTIFICATION OF SUSTAINABLE ACTIVITY

Financial firms need to be able to identify the sustainable activities to which capital can be allocated. Regulatory interventions seek to help financial institutions and their customers assess the sustainability of business activities. The interventions are intended to work from the ground up, starting by assessing which activities can be considered sustainable and then labelling them appropriately.

GOVERNANCE AND RISK

Regulators are requiring sustainability considerations to be integrated into the governance and risk management practices of financial institutions. The aim is to improve the understanding and management of sustainability issues and to allocate responsibility at board level.

PRODUCTS AND SERVICES

Regulators are encouraging financial institutions to make their investment products and services more sustainable and to make sustainable options more widely available to investors. Regulators will expect financial advice, investment portfolios, banking and pensions and other financial services to incorporate sustainability in a variety of ways.

DISCLOSURE

Information on the sustainability of products, services and financial institutions themselves will need to be publicly disclosed. Regulators hope to empower investors to assess their investments and make investment decisions based on sustainability performance.

Regulating finance for a sustainable economy

⚠ Key challenges

Data

- Lack of data impedes firms' ability to assess sustainability. Data are especially lacking for smaller and non-EU assets. Inadequate data hinder compliance with requirements ranging from disclosure to governance and risk management. For example, banks and insurers will struggle to satisfy the Bank of England's expectations around climate change stress tests without underlying data.
- Using unreliable or incomplete data creates liability risks. As sustainability data feature more heavily in investor decision-making, investors may find it is more worthwhile to challenge firms and even litigate where they consider they have been misled by unreliable sustainability data.
- Implementing sound arrangements for relying on third-party data providers.
- Even where data are available, processing sustainability data has its own challenges. For example, it is not always clear what standards to impose when determining what is sustainable or unsustainable. Should a green bond issued by an oil and gas company to finance a new renewable energy arm be considered a sustainable investment? Is the gender or racial balance of the company's board relevant to its classification as a sustainable investment? The processing and disclosure of sustainability data can lead to sensitive questions if not managed well.

Disclosure

- Implementing systems to gather and process information and prepare public disclosures that meet onerous regulatory requirements.
- Determining the form and content of disclosures relating to complex and sensitive issues, such as firms' impacts on the climate, supply chain human rights abuses and staff diversity.
- Determining how to handle sustainability data that may present an unfairly negative or misleading picture and managing the legal and reputational risks of doing so.
- Explaining failure to comply fully with disclosure requirements, eg due to lack of data.
- Complying with multiple disclosure frameworks, both regulatory and private. Firms will be subject to regulatory disclosure requirements but will often come under pressure to adhere to private or industry initiatives at the same time. It is also becoming increasingly likely that international regulatory norms and standards may diverge from each other. For example, while there are some common elements between the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD), and the EU Sustainable Financial Disclosure Regulation (SFDR), there are some differences in the calculation methodologies. The UK FCA is currently consulting on proposals to introduce new, climate-related disclosure rules and guidance which could require firms to report according to the formulas under both the TCFD and SFDR models.

Regulating finance for a sustainable economy

⚠ Key challenges

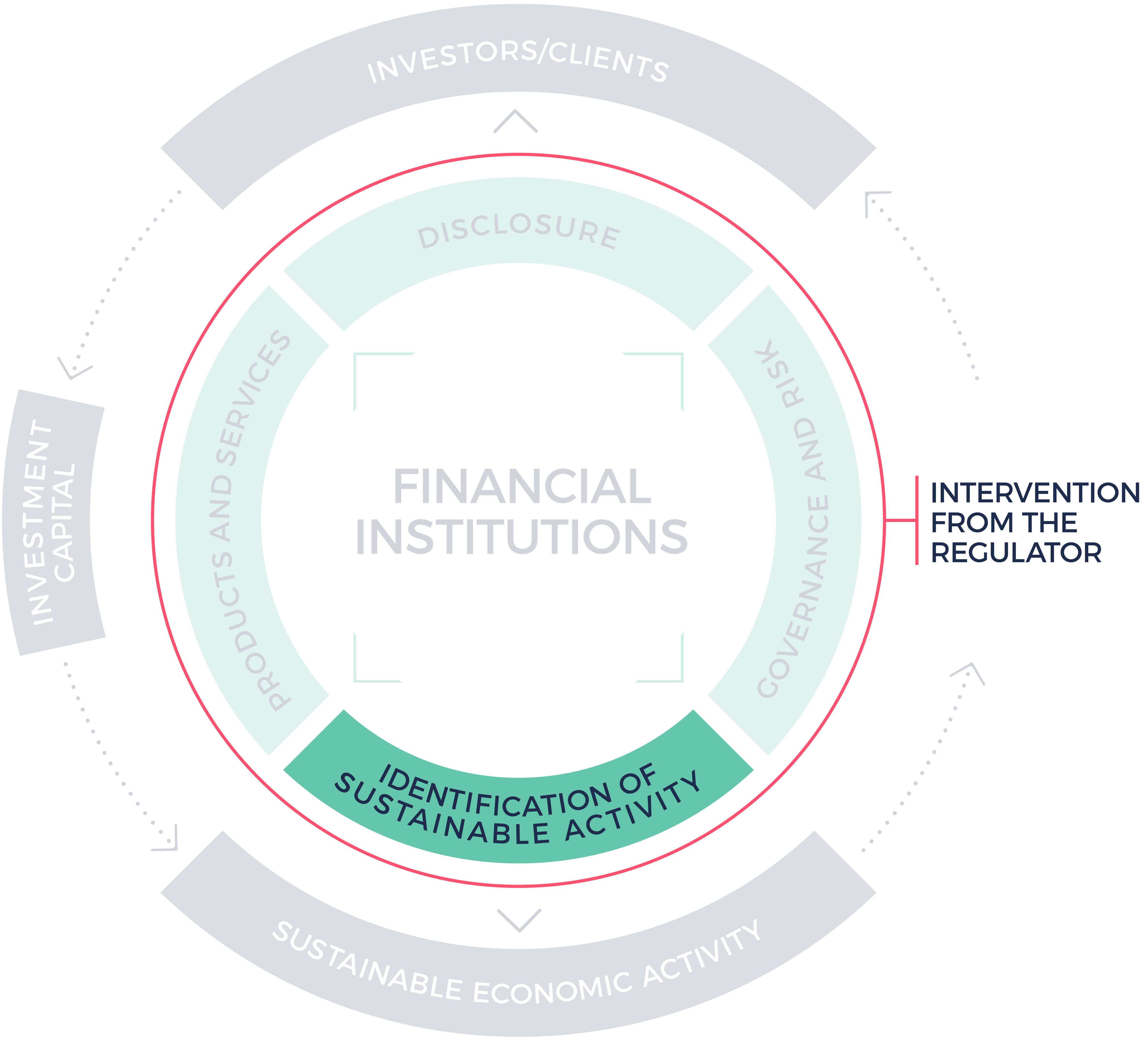
Governance and accountability

- Allocating board-level responsibility for overseeing the firm's approach to sustainability. Firms may want to consider introducing an ESG committee, a chief ESG officer, sub-committees etc.
- Balancing any trade-offs between sustainability concerns and financial return (where the two do not necessarily align). This applies to both financial institutions and companies in which they invest, particularly in the context of stewardship of companies. For example, some business may be profitable in the short term but ultimately harmful from a sustainability perspective; or cost-cutting may be necessary, but laying off workers or closing business lines may harm employees and damage stakeholder relations. Ensuring that fund managers give due consideration to balancing their duties to generate financial return for investors and their inherent interests in long-term sustainability may at times involve challenging trade-offs, particularly where stakeholders take differing views on the appropriate approach to seeking short- vs long-term returns.
- Understanding in what circumstances, how and to what extent the business should seek to remedy an adverse sustainability impact that it has caused.
- Taking care around public statements on sensitive sustainability issues. Unfounded claims to sustainability can do more harm than good. It will not always be possible to satisfy all stakeholders (or commentators) all the time, and regulators are increasingly focused on 'greenwashing'.
- Developing or acquiring the expertise to tackle complex and varied sustainability issues.
- Introducing processes for understanding clients' sustainability preferences and incorporating them into products and services. Broad concepts such as sustainability can be challenging to discuss and act on effectively. Clear, consistent and effective communication with clients will reduce liabilities further down the line.
- Implementing effective policies and procedures. Firms will need to manage potential sustainability issues throughout their operations, ranging from internal decision-making, such as managing carbon emissions, to external risks such as human rights violations by distant suppliers in long and complex supply chains.

Identification of sustainable activity

Enabling financial institutions to identify sustainable activity

Allocating capital to sustainable economic activity requires firms and investors to be able to identify sustainable activities. Sustainability is a broad concept and can be difficult to quantify. Many private firms and NGOs use differing metrics. Regulators are seeking to simplify the identification process. By developing or endorsing reliable classification systems, regulators hope to minimise confusion and reduce the risk of greenwashing. As a result, inefficiencies arising from inconsistent metrics should decrease while trust in sustainable investments should increase.



Identification of sustainable activity

⚠ Key challenges

- Getting to grips with and using the EU's sustainability taxonomy, which is extremely detailed and prescriptive.
- Determining the reliability of data and sourcing reliable data. Using reasonable and appropriate assumptions where data are lacking.
- Managing the legal risk of misleading statements based on unreliable or incomplete data.
- Monitoring and reassessing judgments as more or better data become available.
- Managing divergence between jurisdictions and regulations in respect of sustainability classification requirements.

Identification of sustainable activity

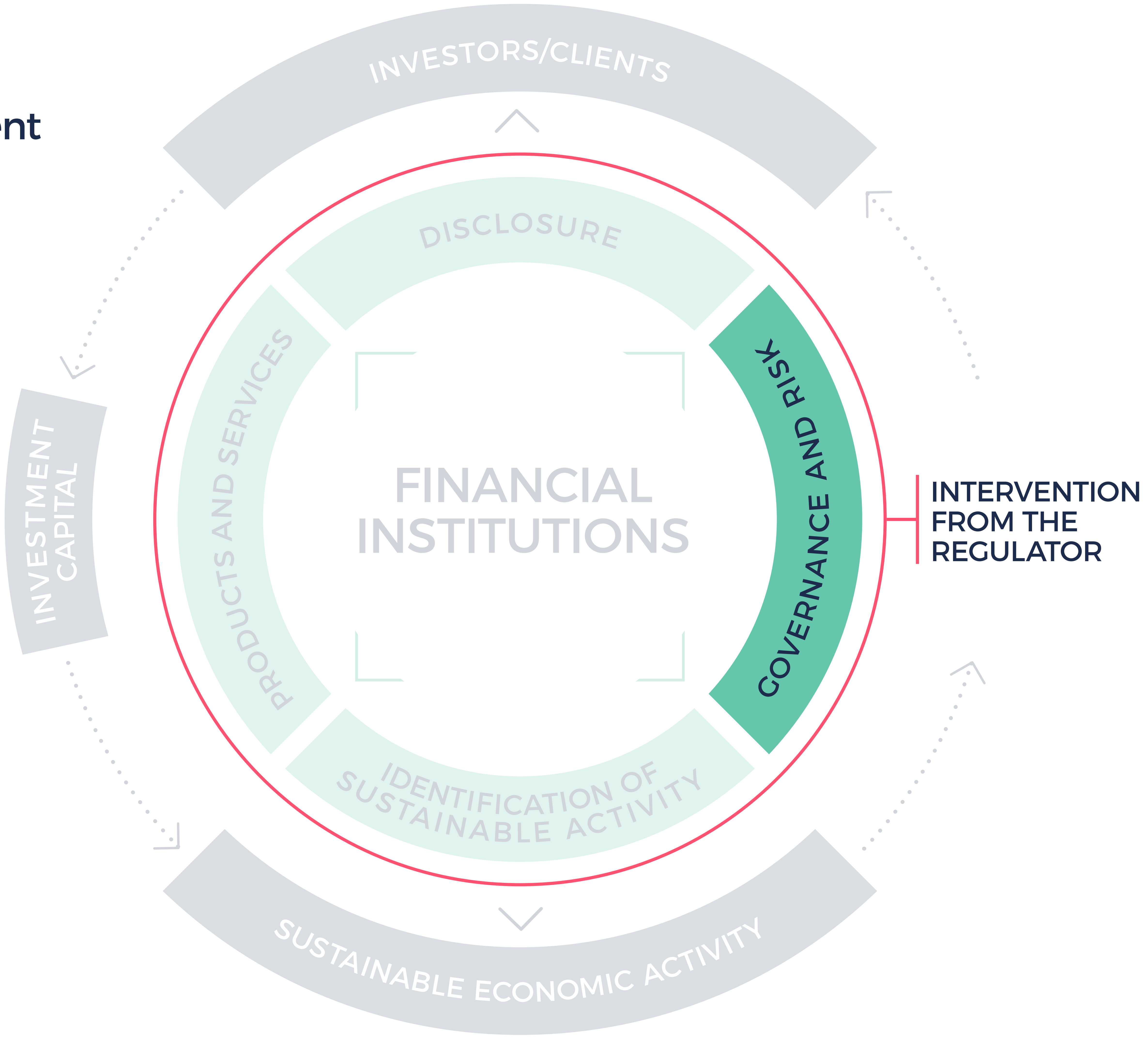
Examples of regulatory intervention

JURISDICTION	REGULATORY ACTION	IN-SCOPE FINANCIAL INSTITUTIONS	SUMMARY
European Union	EU Taxonomy Regulation	Financial market participants, as defined in the SFDR and non-financial business subject to the Non-Financial Reporting Directive (see disclosure section below)	The EU Taxonomy is a classification system using detailed quantitative criteria to assess the environmental sustainability of economic activities. Financial product disclosures, corporate annual reports and even new sustainability legislation introduced in EU member states must refer to the Taxonomy. The Taxonomy is intended to provide a tool with which to assess the sustainability of economic activities and financial products. The EU intends to expand the scope of the Taxonomy to cover social issues as well as the current focus of environmental sustainability. See Freshfields blog post. Under the EU's Corporate Sustainability Reporting Directive (proposed in April 2021) listed companies and large non-financial corporates would also be required to assess and disclose the alignment of their activities with the Taxonomy.
European Union	EU Green Bond Standard	Issuers of bonds or other capital market debt instruments	The EU Green Bond Standard (GBS) currently being developed [by the European Commission] is a voluntary standard open to issuers of bonds or other capital market debt instruments. Alignment with the standard signals to investors that the financing is used for environmentally sustainable business activity and would need to be verified by an EU accredited external verifier. Requirements for compliance will include: (i) allocation reporting and impact reporting; and (ii) disclosure requirements for corporates under the non-financial reporting directive (NFRD) on the way they operate and manage social and environmental challenges.
European Union	EU ecolabel for retail financial products	Issuers and distributors of financial products aimed at retail investors, such as UCITS investment funds	The European Commission will introduce a product labelling scheme to certify retail financial investment products that meet certain environmental criteria. The 'Ecolabel' will define minimum environmental performance of the product group and will be based on the requirements of the EU Ecolabel Regulation 66/2010. Adoption of the Ecolabel framework is expected by the end of 2021.
Hong Kong	HK Green Finance Certification Scheme	Issuers of 'green' bonds	Under the Green Finance Certification Scheme, the Hong Kong Quality Assurance Agency (HKQAA) is issuing two types of Certificates for products ranging from green bonds and green loans to green funds in order to raise awareness of green initiatives: Green Finance Pre-issuance Stage Certificate and Green Finance Post-issuance Stage Certificate. At the pre-issuance stage, assessment will focus on the requirements related to establishing and documenting: (i) objective; (ii) mechanism (including strategies, methodology, criteria); (iii) process; and (iv) competence. Post-issuance certification will require an implementation record of the above.
United Kingdom	UK Government proposals for a UK green taxonomy	Yet to be published	The UK Government has committed to implement a UK taxonomy, taking the scientific metrics in the EU taxonomy as its basis. Divergence in the regulatory requirements or substance of the taxonomy may give rise to significant compliance challenges for financial institutions operating across the UK and EU.

Governance and risk

Integrating sustainability into governance and risk management

Regulators are requiring financial institutions to ensure their internal operations, systems and practices are sustainable. This includes decision-making, strategy, risk management, remuneration, and supply chain diligence. Responsibility will sit with the board. Firms will need to implement policies and procedures to manage sustainability risks, such as how climate change affects asset values and how social issues affect reputations. Firms will also be expected to align remuneration with sustainability risk management. Regulators expect that by managing their sustainability risks and integrating sustainability policies across businesses, firms will reduce their exposure to unsustainable assets and reallocate capital to more sustainable activity.



Governance and risk

⚠ Key challenges

- Directors and decision-makers will need to balance stakeholder expectations on sustainability issues and financial return. The two will not necessarily always align, given that stakeholders may take differing views on short- vs long-term approaches to financial return. This applies to both financial institutions and the companies in which they invest, particularly in the context of stewardship of companies.
- Lack of data is a significant barrier to firms' ability to assess sustainability. For example, banks and insurers will struggle to satisfy the Bank of England's expectations around climate change stress tests without underlying data. Gathering and processing data, building expertise, and staying on top of industry and policy developments require significant resources, but firms will benefit from implementing processes sooner rather than later.
- Allocating board-level responsibility for managing the firm's approach to sustainability. Firms may want to consider introducing an ESG committee, a chief ESG officer, sub-committees etc. As sustainability becomes increasingly important to firms' internal operations and external relations, managing and aligning the various sustainability demands will likely require significant senior management attention.
- Developing or acquiring the expertise and skill sets needed to tackle complex and varied sustainability issues. Sustainability issues are wide-ranging (and growing), from environmental impacts to employee treatment and the behaviour of distant suppliers in the supply chain. If investing in government bonds, the relevant considerations could expand to cover the environmental policies or human rights records of those governments. Understanding these issues and how they affect a firm's business is not a simple task.
- Implementing effective policies and procedures. Firms will need to manage potential sustainability issues throughout their operations, ranging from internal decision-making such as the firm's approach to managing carbon emissions, allocating capital and making investments, to external risks such as human rights violations by suppliers in long and complex supply chains. Monitoring these issues and ensuring appropriate standards is a significant internal procedural and policy challenge.
- Making 'sustainable' decisions that satisfy potentially incompatible stakeholder views on the meaning of sustainability. For example, as regulators indicate expectations around diversity and inclusion at senior management levels, managers will need to determine how to balance competing conceptions of diversity across gender, ethnicity, and social backgrounds.

Governance and risk

Examples of regulatory intervention

JURISDICTION	REGULATORY ACTION	IN-SCOPE FINANCIAL INSTITUTIONS	SUMMARY
European Union	Delegated Directives on integrating sustainability into the operation of investment firms, AIFS and UCITS	Investment firms, alternative investment fund managers and UCITS managers among others	Under the Commission's proposals, firms would need to demonstrate that sustainability risks are considered in investment due diligence, risk management, remuneration, and governance processes. Regulators expect in-scope firms to improve their management of sustainability risks, such as financial risks from climate change, including by improving internal policies and hiring or training staff to ensure sufficient internal expertise.
Germany	BaFin Guidance Notice on dealing with sustainability risks	Banks, insurers and investment firms	BaFin expects financial institutions to establish adequate risk management processes for sustainability risks. BaFin's understanding of sustainability risks is broad and covers any environmental, social or governance (ESG) events or conditions, which, if they occur, have or may potentially have significant negative impacts on the assets, financial and earnings situation, or reputation of an entity. BaFin does not qualify sustainability risks as a new risk category but rather as an expression of the types of risk already covered by existing risk management frameworks such as credit risk, market risk, liquidity risk or operational risk. The main focus of the guidance is on integrating sustainability risks, or rather the specific focus on sustainability aspects, into such risk management frameworks. In this respect, BaFin sets out detailed good practice principles on how to evaluate, manage, monitor and report sustainability risks, including the quality of the underlying data. While relevant principles and procedures are of a non-binding nature, BaFin expects financial institutions, as a first step, to ensure that sustainability risks are considered and that such consideration is appropriately documented. See Freshfields blog post.
Hong Kong	HK SFC's Strategic Framework for Green Finance	Asset managers	The Hong Kong Securities and Futures Commission's flagship sustainable finance framework sets out plans to develop 'green finance' in Hong Kong, including disclosure and reporting. Under this work plan, the regulator has consulted the industry on significant changes to the Fund Manager Code of Conduct. The proposed changes include new requirements for the board and management of fund managers to oversee the incorporation of climate-related considerations into the investment and risk management processes, as well as to assess the firm's progress against its stated objectives for addressing climate-related issues.
Hong Kong	Hong Kong Monetary Authority 'greenness baseline' supervisory expectations for sustainable banking	Banks	In a bid to support Hong Kong's green finance development, the Monetary Authority is developing a common framework to assess the "Greenness Baseline" of individual banks. Relevant information on which the framework will be based relates to an Authorised Institution's stage of development in preparing for climate-related risks and environmental risks in six areas, namely: (i) governance; (ii) corporate planning and tools; (iii) risk management process; (iv) business policies, products and services; (v) performance and resources; and (vi) disclosure and communication. Once this framework is implemented, the Monetary Authority will monitor banks' progress.

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Governance and risk

Examples of regulatory intervention (continued)

JURISDICTION	REGULATORY ACTION	IN-SCOPE FINANCIAL INSTITUTIONS	SUMMARY
International regulatory bodies	Guidance from international regulatory bodies on managing climate risk	Banks, insurers and investment firms	The European Central Bank (ECB) published a non-binding guide on climate and environmental risks for banks, applicable to institutions directly supervised by the ECB. The guide is aimed at senior managers and sets out the ECB's views on sound, effective and comprehensive management and disclosure of climate and environmental risks. The European Banking Authority (EBA) has published a discussion paper on the management and supervision of ESG risks, applicable to credit institutions and investment firms. It has recommended that ESG issues should form part of the supervisory review carried out by supervisors under the EU's Capital Requirements Directive and Investment Firm Directive. Supervisors should assess firms' incorporation of ESG risks in strategies, governance and institutional controls, including risk appetite. In addition, the EBA has published a report on the main climate risks to the financial system. The Financial Stability Board (FSB) has published a report on the potential implications of climate change for financial stability, which considers the financial system as a whole. It identified financial regulatory trends, including: assessment of firms' management of climate and environmental risks; considering risks in monitoring of financial stability and quantification of risks through stress tests; and supporting the mitigation of climate risks through macroprudential policies. See Freshfields blog post.
Netherlands	Position paper of the Dutch Authority for the Financial Markets (AFM) about sustainability	Various financial institutions	In this position paper, the AFM outlines that it expects financial institutions to consider sustainability in their business operations, risk management and investment decisions.
Singapore	Monetary Authority of Singapore (MAS) guidelines on environmental risks and transition to an environmentally sustainable economy	Banks, insurers and asset managers	Financial instructions have an 18-month transition period to assess and meet the MAS guidelines, which were issued on 8 December 2020. The guidelines focus on three key areas: governance and strategy through effective oversight of environmental risks by boards and senior management; risk management by establishing policies and processes to monitor and manage such risks; and disclosure of approach to managing risks with reference to international reporting frameworks such as the TFCD. The MAS has indicated that the guidelines may be implemented in a way that is commensurate with the size and nature of the relevant financial institution's activities, as well as their risk profile.

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Governance and risk

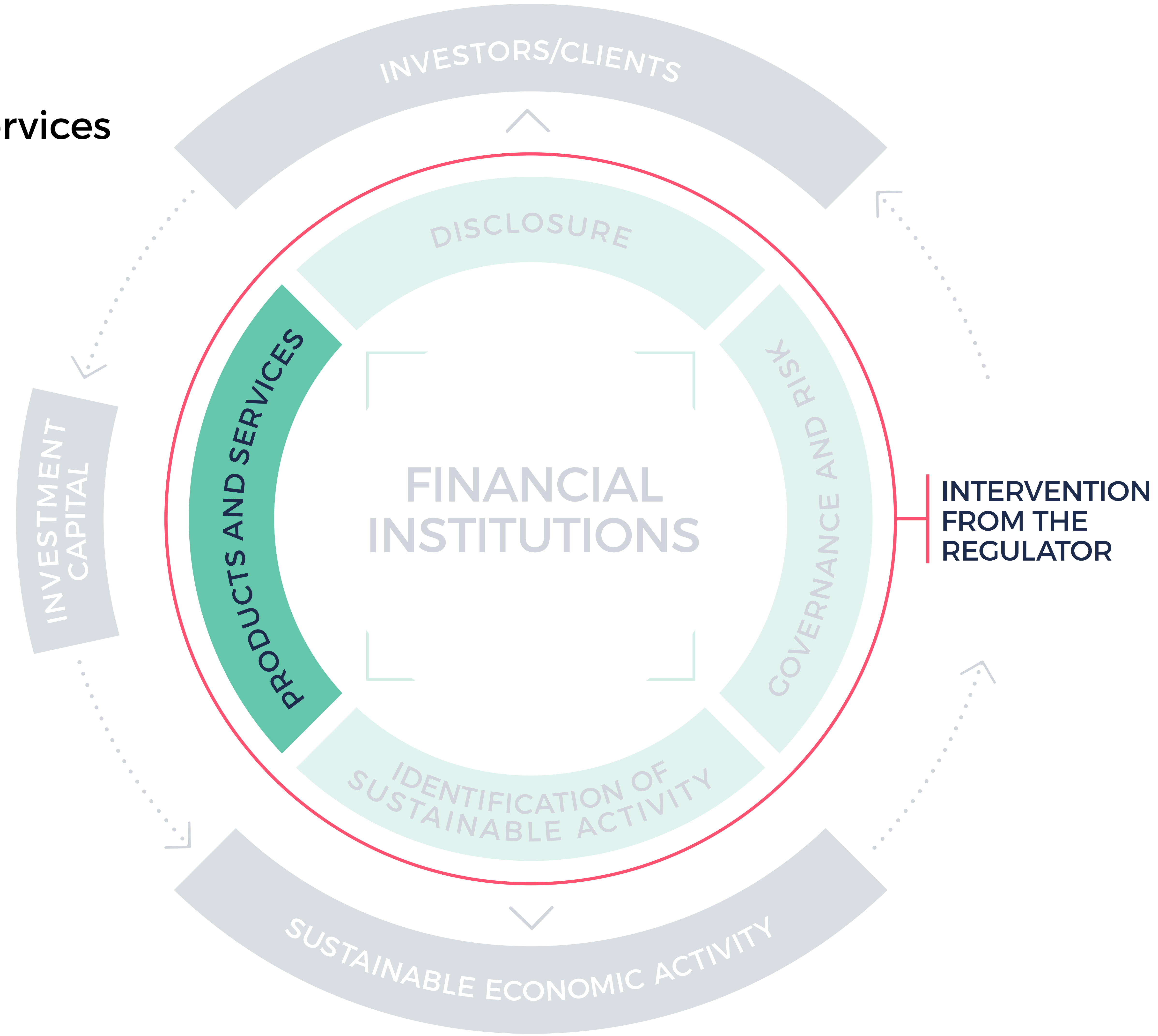
Examples of regulatory intervention (continued)

JURISDICTION	REGULATORY ACTION	IN-SCOPE FINANCIAL INSTITUTIONS	SUMMARY
United Kingdom	PRA Supervisory Statement SS3/19 on enhancing banks' and insurers' approaches to managing the financial risks from climate change	Banks and insurers	The PRA expects the highest level of executive management to allocate responsibility for identifying and managing financial risks from climate change under the Senior Management Functions regime. Where appropriate, the PRA will expect to see evidence of how the financial institution monitors and manages the financial risks from climate change in line with its risk appetite statement. The risk appetite statement should include the risk exposure limits and thresholds for the risks that the financial institution is willing to bear.
United Kingdom	Bank of England climate scenario stress testing of banks and insurers	Banks and insurers	The Bank of England is running 'Climate Exploratory Scenario' financial stress tests in 2021. Large banks and insurers will participate to test the resilience of the largest banks, insurers and the financial system. Firms will be tested against three distinct scenarios: (i) early policy action on climate change; (ii) late policy action; and (iii) no additional policy action. Firms' resilience to the scenarios will be tested in two parts: (a) quantifying the change in the value of their assets and (for insurers) liabilities at different points in each scenario. This would size the financial risks to participants' 30 June 2020 balance sheet; and (b) assessing how firms would change their business models in response to each scenario. This will include management actions, firm expectations and an outline of other risks. The Bank of England also expects banks and insurers to conduct stress testing and scenario modelling as part of their own internal risk management. The Bank has stated that these firms should seek to understand the potential effects of worst-case scenarios. See Freshfields blog posts here and here.
United Kingdom	Why diversity and inclusion are regulatory issues, speech by Nikhil Rathi, CEO of the FCA, 17 March 2021	Banks, insurers and investment firms	The FCA has commented on the financial risks and consumer protection risks of failure to promote gender and racial diversity and inclusion at financial services firms. The FCA stated that it will be exploring whether it should make diversity requirements part of the premium listing rules and whether the diversity of management teams should be part of approval considerations in senior manager applications.

Products and services

Increasing the sustainability of investment products and services

Regulators are requiring firms to integrate sustainability into various aspects of financial products and services. Firms will be required to consider the financial risks from sustainability issues, to assess the sustainability preferences of their clients, and to implement policies for engaging with portfolio companies on sustainability issues. Rules on the composition of financial indices will provide for reliable benchmarks for assessing the performance of sustainable products. Regulators expect that as sustainability features more widely in the design and provision of financial services, investors will increasingly make more sustainable investment choices.



Products and services

⚠ Key challenges

- As sustainability is integrated into due diligence and investment decisions, decision-makers may need to choose between, for example, what may be the most climate-friendly investment decision and the decision that may provide the most financial return over the time frame in which they are seeking to generate a return. If a fund manager's research points to soaring demand for fossil fuels in the post-COVID-19 recovery, should they sacrifice the potential financial gains from investing in the sector? How should decision-makers balance potential short-term financial gains with their investors' or the firm's sustainability goals? Poor or inconsistent decision-making can have both commercial and legal consequences (see also governance section above).
- Introducing processes for understanding clients' sustainability preferences and incorporating them into products and services. Broad concepts such as sustainability can be challenging to discuss and act on effectively.
- To what extent should product terms incorporate binding sustainability requirements? How and to what extent can existing product terms be changed in order to incorporate such sustainability requirements?
- Adapting and amending financial products to incorporate the requisite consideration of sustainability issues. This can include making amendments to investment management agreements with delegated managers, as well as introducing internal systems and tools.
- Gathering reliable and useful data to incorporate sustainability into decision-making and monitor compliance with the firm's or clients' preferences or expectations.
- Clearly disclosing how and when sustainability will be a feature in decision-making and, for example, whether it may be prioritised over financial return in any circumstances.
- Implementing sound policies for sustainable stewardship of investee companies.

Products and services

Examples of regulatory intervention

JURISDICTION	REGULATORY ACTION	IN-SCOPE FINANCIAL INSTITUTIONS	SUMMARY
European Union	EU Sustainable Finance Disclosure Regulation (SFDR) 2019/2088	Financial advisers and financial market participants (see further disclosure section below)	Firms marketing their products as sustainable will need to disclose information on the sustainability of products claiming to have sustainability characteristics or objectives. Additionally, financial institutions will be required to disclose the non-financial sustainability 'impacts' of their investments. Having made their investment decisions, financial institutions will need to have policies for engaging with investee companies on the adverse sustainability impacts that have been identified. These requirements are expected to encourage firms to consider whether they can or should integrate sustainability into their financial products so as to enable more favourable disclosures, and to ensure their products remain competitive with rival products offering sustainability features.
European Union	Delegated Directives on integrating sustainability into the operation of investment firms, AIFS and UCITS	Investment firms, AIFs and UCITS	Investment firms, managers of alternative investment funds and managers of UCITS would need to consider sustainability risks in due diligence and investment decisions and implement policies to manage those risks. Firms will be required to increase their analysis of sustainability risk data to enable portfolio selection and investment advice to reflect assessments of sustainability risks.
European Union	Delegated Directive on integrating sustainability into product manufacture and distribution	Product manufacturers and distributors (such as asset managers and insurers)	Firms would be required to identify and state the client sustainability preferences with which the product would be compatible. They would need to consider, during manufacture of the product and regular review, whether the products' sustainability characteristics are suitable for those preferences. Distribution of financial product that firms offer or recommend, and the distribution strategy, must also be compatible with identified target market's sustainability preferences.
European Union	Delegated Directive on integrating sustainability into suitability assessments for investment advice and portfolio management	Firms providing investment advice and portfolio management	Under the current MiFID II framework, firms providing investment advice and portfolio management are required to obtain the necessary information about the client's knowledge and experience in the investment field, their ability to bear losses, and objectives including the client's risk tolerance to enable the firm to provide suitable services. This necessary information would be expanded to include sustainability preferences, including sustainable investment objectives.
European Union	Low Carbon Benchmarks Regulation (EU) 2019/2089	Benchmark providers and administrators	Benchmark administrators and manufacturers that provide climate-related investment benchmarks and indices are subject to certain disclosure requirements and minimum specifications to ensure the reliability of climate benchmarks for end-users.

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Products and services

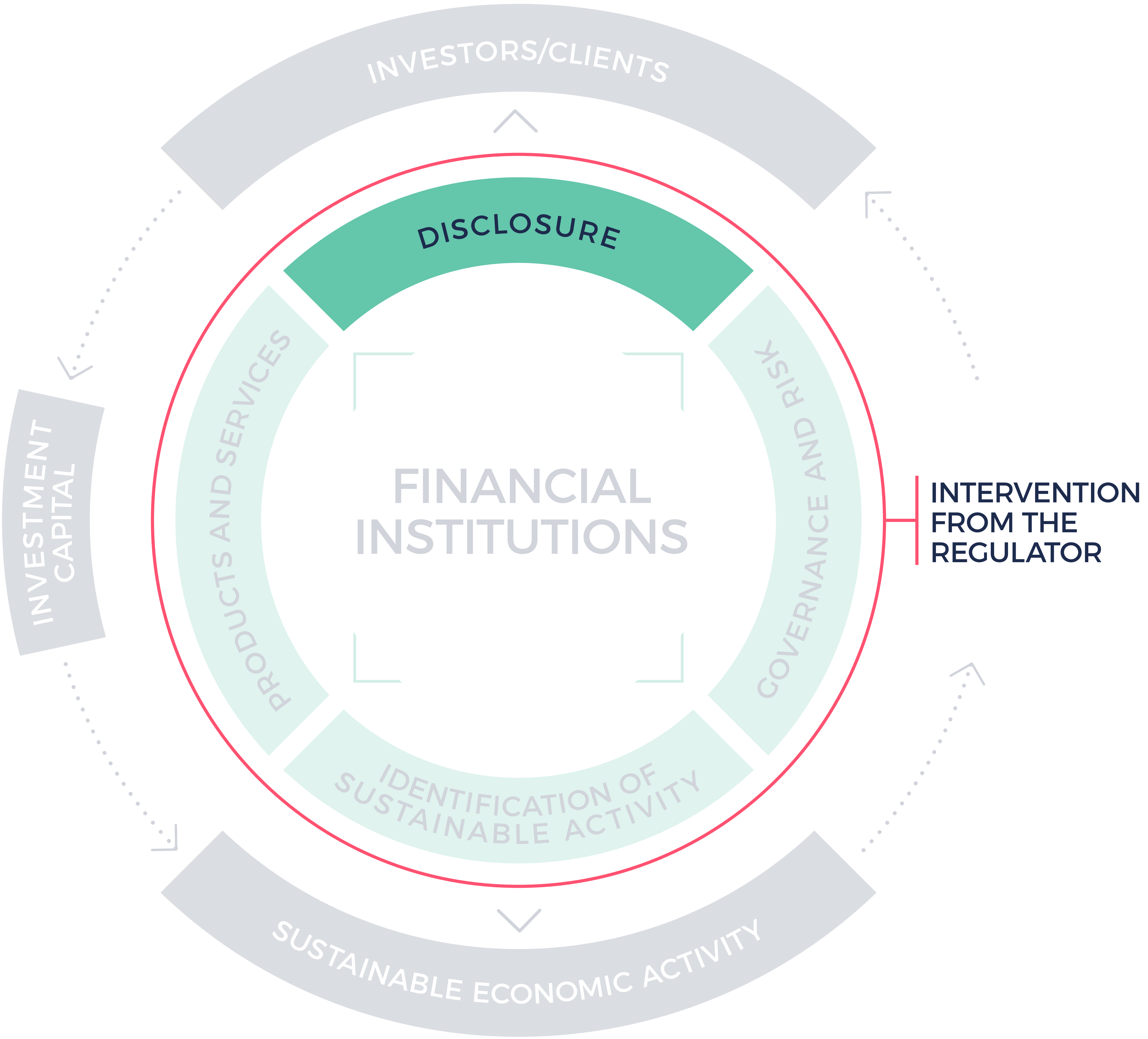
Examples of regulatory intervention (continued)

JURISDICTION	REGULATORY ACTION	IN-SCOPE FINANCIAL INSTITUTIONS	SUMMARY
United Kingdom	Pension Schemes Act 2021	Pension providers	The Act enables the government to pass regulations requiring pension scheme trustees to consider and report on climate change risks in relation to their investment strategy. See Freshfields blog posts here and here.
United Kingdom	FCA guidance on consideration of 'non-financial matters' in investments	Insurers and pension providers	FCA guidance (SYSC 3.2.23G for insurers and SYSC 4.1.15G for personal pension schemes) sets out expectations on how and when an insurer and pension provider may take into account 'non-financial matters'.
United Kingdom and European Union	Shareholder engagement requirements: FRC's UK Stewardship Code (2020); EU Shareholder Rights Directive; and FCA shareholder engagement requirements (Policy Statement and Handbook)	Banks, insurers and asset managers	The UK Stewardship Code promotes sustainability engagement with investee companies and reporting of sustainability issues. In the UK, COBS 2.2.3R of the FCA Handbook requires investment firms to disclose their commitment to the Stewardship Code. The Code itself imposes comply or explain reporting expectations, whereby financial institutions should include information on their Stewardship activities in their Stewardship Report or an explanation of why it hasn't been included. Article 3g of the EU Shareholder Rights Directive requires an engagement policy with institutional investors and asset management 'that describes how they integrate shareholder engagement in their investment strategy [and] monitor investee companies on relevant matters including… social and environmental impact and corporate governance'. Implementing the EU Shareholder Rights Directive, COBS 2.2B.6R and SYSC 3.4.5R of the FCA Handbook set out the requirements for the engagement policy of investment firms and insurers, including the monitoring of social and environmental impact and corporate governance.

Disclosure

Increasing disclosure of sustainability information

Financial institutions will be required to disclose information on the sustainability of their products and business practices. Disclosures will be required in respect of the sustainability characteristics of financial products, sustainability risk policies, the link between remuneration and sustainability risks, and the non-financial 'impacts' of investments, among other issues. The intention is that the disclosures give investors the information needed to make sustainable choices. Scrutiny of disclosures should encourage financial institutions to address their own sustainability shortcomings.



Disclosure

⚠ Key challenges

- Determining which of the many disclosure requirements are applicable, and which entities and business services are in scope.
- Implementing systems to gather and process information and prepare public disclosures that meet regulatory requirements.
- Determining the form and content of disclosures relating to complex and sensitive issues, such as firms' impacts on the climate, supply chain human rights abuses and staff diversity.
- Determining whether to set public commitments, determining how ambitious to be, and understanding the consequences of failing to meet those commitments.
- Determining how to handle sustainability data that may present an unfairly negative or misleading picture and managing the legal and reputational risks of doing so.
- Determining the extent to which the preparation of disclosures, in particular data gathering and processing, can be outsourced to third parties.
- Assessing whether sustainability information gathered under disclosure requirements qualifies as price-sensitive information to be disclosed under the market abuse regime.
- Managing different disclosure requirements across jurisdictions.
- Complying with multiple disclosure frameworks, both regulatory and private. Firms will be subject to regulatory disclosure requirements but will often come under pressure to adhere to private or industry initiatives at the same time.

Disclosure

Examples of regulatory intervention

JURISDICTION	REGULATORY ACTION	IN-SCOPE FINANCIAL INSTITUTIONS	SUMMARY
European Union	EU Sustainable Finance Disclosure Regulation (SFDR) 2019/2088	Financial advisers and financial market participants. Financial market participants are essentially portfolio or fund managers and include: firms providing portfolio management services; AIF managers; UCITS managers; and pension product providers	The SFDR will require disclosure of the sustainability risks and impacts of financial products, policies for addressing those risks and impacts, the link between remuneration and sustainability risks, and the non-financial 'impacts' of investments. The disclosures will be required in product prospectuses, periodic reports, and websites. Firms will have to gather and process detailed sustainability data. The result should be less greenwashing and more sustainable investment decisions by underlying investors and consumers. The disclosures will also affect internal operations as firms will be required to disclose, for example, how sustainability risks are managed and the link between remuneration and sustainability risk management.
European Union	EU Non-Financial Reporting Directive (NFRD) and guidelines on reporting climate-related information EU proposal for Corporate Sustainability Reporting Directive (CSRD), expanding the NFRD	Banks, insurers and listed companies (known as 'public interest companies') that have more than 500 employees and meet the definition of a 'large' company CSRD would expand the scope to all 'large' companies, not only banks, insurers and listed companies, and all listed companies except listed micro-companies	The NRFD requires large entities to publish a non-financial statement in their annual report. The non-financial statement must describe action, progress, and issues relating to environmental, social and employee matters, human rights, anti-corruption and bribery. The directive is implemented in the UK through requirements under the Companies Act 2006. The EU guidelines on climate-related disclosure integrate recommendations by the TCFD and provide guidance to companies in line with the Non-Financial Reporting Directive. The EU's Taxonomy Regulation requires firms caught by the non-financial reporting requirements to disclose the alignment of their activities with the EU Taxonomy (see Article 8 of the Taxonomy Regulation and ESMA report). The Corporate Sustainability Reporting Directive (CSRD) is the Commission's proposal to extend the NFRD reporting to a wider set of firms (draft CSRD here). It would apply to all large companies, not only public interest companies, and all listed companies except listed micro-companies. The requirement to disclose alignment with the taxonomy would then apply to this wider set of firms. The EU intends that once CSDR is implemented the resulting disclosures will amount to 'one-stop-shop' for corporate disclosure. See CSRD Q&A.
European Union	ESMA guidelines on requirements for credit ratings agencies to disclose consideration of ESG risks in credit ratings		The guidelines aim to ensure a sufficient level of transparency around the credit rating methodologies to enable users to understand how ESG risks are considered and to facilitate the user due diligence.

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Disclosure

Examples of regulatory intervention (continued)

JURISDICTION	REGULATORY ACTION	IN-SCOPE FINANCIAL INSTITUTIONS	SUMMARY
France	AMF Position-recommendation 2020-03 pertaining to communications by collective investment schemes that take into account non-financial characteristics in investment decisions	French management companies of most retail French funds and entities marketing in France such retail French funds or foreign passported UCITS to retail investors	On 11 March 2020, the French regulator *Autorité des marchés financiers* released Position-recommendation 2020-03 pertaining to communications by collective investment schemes that take into account non-financial characteristics in investment decisions (AMF Position-recommendation 2020-03). AMF Position-recommendation 2020-03, applies to most retail French funds, as well as EEA passported UCITS for marketing to French retail investors. In summary, in-scope French funds taking into account non-financial characteristics (eg environmental, ethical, low carbon, governance or green criteria) in investment decisions without a 'significantly engaging methodology' cannot focus on such criteria in their legal or marketing documentation. Those funds must present their use of non-financial criteria in a manner that is proportionate to the objective and effective impact of taking into consideration such criteria. Anything more than concise information (as defined in AMF Position-recommendation 2020-03) in the legal or marketing documentation will cause the relevant fund to be considered to be making non-financial criteria a central element/key aspect of its communication triggering the full application of the French rules under AMF Position-recommendation 2020-03.
Hong Kong	Cross-agency steering group on sustainable finance by seven Hong Kong regulators and government agencies	Financial institutions including banks, asset managers, insurance companies and pension trustees	Hong Kong's Green and Sustainable Finance Cross-Agency Steering Group is in the process of implementing a strategic plan, which includes among other action points: (i) rolling out mandatory climate-related disclosures in accordance with the TCFD Recommendations no later than 2025; (ii) adoption of the "Common Ground Taxonomy" under development by the International Platform on Sustainable Finance; and (iii) international alignment on sustainability reporting standards.
Netherlands	Guidance on Greenwashing from the Netherlands Consumer and Markets Authority	Indirectly relevant to firms offering financial products claiming sustainability characteristics	The Netherlands Consumer and Markets Authority (ACM) published Guidelines on Sustainability Claims. To protect consumers, the Guidelines offer companies and consumers practical guidance on what types of claims could be misleading or incorrect, and how to avoid 'greenwashing'. The Guidelines provide useful insight into the regulator's thinking regarding misleading sustainability claims and greenwashing. It remains to be seen whether the Guidelines will inform regulatory enforcement or be considered by courts when dealing with these issues. See Freshfields blog.

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Disclosure

Examples of regulatory intervention (continued)

JURISDICTION	REGULATORY ACTION	IN-SCOPE FINANCIAL INSTITUTIONS	SUMMARY
Spain	Law 11/2018, of 28 December, which amends the Commercial Code (*Código de Comercio*), the Companies Act (*Ley de Sociedades de Capital*) and Law 22/2015, on Auditing of Accounts, with regard to non-financial information and diversity	Public interest entities and companies considered large companies in the regulation's criteria	This regulation applies to public interest entities, as well as to certain companies considered as large companies under the regulation's criteria. The relevant entities will have to disclose information relating to environmental and social issues, as well as information on personnel, respect for human rights, equality and the fight against corruption and bribery.
Spain	Law 7/2021 on climate change and energy transition	Credit institutions, insurance and reinsurance companies, companies that formulate consolidated accounts and certain companies considered either public interest entities or large companies pursuant to the criteria referred to in law 11/2018	The relevant entities shall produce an annual report assessing the financial impact on the company of the risks associated with the exposure to climate change of their activity, including the risks of the transition to a sustainable economy and the measures adopted to address those risks.

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Disclosure

Examples of regulatory intervention (continued)

JURISDICTION	REGULATORY ACTION	IN-SCOPE FINANCIAL INSTITUTIONS	SUMMARY
United Kingdom	Mandatory TCFD disclosures in the UK FCA policy statement disclosures for UK premium listed companies and FCA listing rule 9. See also UK Government TCFD proposal	Listed firms and large non-listed firms including financial firms	Under the UK listing rules, for accounting periods beginning from 1 January 2021, premium listed companies must make disclosures consistent with the TCFD recommendations on a comply-or-explain basis. The UK Government has published a proposal to mandate TCFD disclosures for public companies, large private companies and LLPs by 2022. The Government has expressed plans to require TCFD-aligned disclosures across the economy by 2025.
United Kingdom	PRA Supervisory Statement on approaches to financial risks from climate change	Banks and insurers	The Supervisory Statement sets out the PRA's expectations concerning the strategic approach toward climate change risks, including expectations to disclose the financial risks from climate change in line with TCFD recommendations.
United Kingdom	FCA requirements on pension investments and Independent Governance Committees (Policy Statement and Handbook)	All UK firms operating personal pension schemes	The FCA requires all firms that operate workplace personal pension schemes to establish Independent Governance Committees to oversee the scheme. IGCs are required to report on the pension provider's ESG policies in order to provide an independent assessment of the management of 'ESG financial considerations'.
United Kingdom	CMA draft guidance on misleading sustainability claims	All businesses who make environmental claims	To mitigate the risk of greenwashing, the UK's Competition and Markets Authority (CMA) published in May 2021 draft guidance setting out how businesses can ensure they are complying with existing consumer protection obligations when making statements about the environmental benefits of their products, services, brands and businesses. See Freshfields blog post.
United States	SEC Guidance Regarding Disclosure Related to Climate Change	Public companies	In 2010, the U.S. Securities and Exchange Commission released interpretive guidance for U.S. reporting companies regarding existing disclosure requirements as they apply to climate change matters. Areas for potential disclosure include the impact of legislation and regulation, the impact of international accords, indirect consequences of regulation and business trends and physical impacts of climate change.