

**MEMO# 33690**

July 16, 2021

# Summary of IOSCO's Consultation on Proposed Sustainability-Related Practices and Disclosures in Asset Management

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TO: ICI Global Members SUBJECTS: ESG

International/Global RE: Summary of IOSCO's Consultation on Proposed Sustainability-Related Practices and Disclosures in Asset Management

On 30 June 2021, the Board of the International Organization of Securities Commissions (IOSCO) released for public consultation<sup>[1]</sup> the Recommendations on Sustainability-Related Practices, Policies, Procedures and Disclosure in Asset Management ("Consultation Report"). The consultation is open for public comments until 15 August 2021.

This Consultation Report focuses on asset managers and investor protection issues and aims to improve sustainability-related practices, policies, procedures, and disclosures in the asset management industry, including addressing the risk of greenwashing through improving transparency, comparability, and consistency in sustainability-related disclosure. Based on the factfinding exercises conducted by the Workstream 2 of IOSCO's Sustainable Finance Taskforce (SFT),<sup>[2]</sup> the Consultation Report outlines the types of greenwashing at the asset manager and product levels, describes the different regulatory approaches taken by securities regulators to address sustainability-related risks and opportunities, and provides an overview of the financial and investor education initiatives conducted by regulators. The Consultation Report further sets out and seeks feedback on recommendations for securities regulators and policymakers to address the challenges in sustainability-related practices and disclosure in the asset management industry.

The memorandum summarizes the five recommendations set out in the Consultation Report, and includes the full list of consultation questions at the end.

## **1. Background: Challenges in Sustainability-related Practices and Disclosures in the Asset Management Industry**

In the Consultation Report, IOSCO notes that the absence of agreed-upon definitions for terms used to describe sustainability-related products (e.g. "impact fund," "sustainable fund," and "social fund") could make it difficult for investors to understand such products or effectively compare such products. On the other hand, the co-existence of multiple labeling and classification schemes may lead to inconsistencies and differences across industries, asset classes, and regions, and in turn, lead to market fragmentation and regulatory arbitrage. These challenges could lead to an increase in instances of greenwashing.

IOSCO further highlights a clear need to address the challenges associated with the lack of reliability and comparability of data at the corporate level and in the ESG data and rating provided by third-party providers. IOSCO recently published the Report on Sustainability-related Issuer Disclosures<sup>[3]</sup> elaborating the priority areas for improvements in corporates' sustainability disclosures and IOSCO's vision for how these priorities could be delivered by the IFRS Foundation's International Sustainability Standards Board (ISSB). Additionally, IOSCO plans to publish a separate report in July 2021 that examines the inadequate level of disclosures by ESG data and rating providers around their methodology and provide recommendations in this area.

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

## **2. IOSCO's Recommendations to Securities Regulators and/or Policy Makers**

To address these challenges, IOSCO proposes the following recommendations for regulatory authorities to consider, in line with the various domestic regulatory frameworks.

### **A. Recommendation 1: Asset Manager Practices, Policies, Procedures, and Disclosure**

Securities regulators and/or policymakers, as applicable, should consider setting regulatory and supervisory expectations for asset managers in respect of the (a) development and implementation of practices, policies, and procedures relating to sustainability-related risks and opportunities; and (b) related disclosures.

This could ensure that asset managers take sustainability-related risks and opportunities into consideration and integrate them into their decision-making process, and accurately reflect this in their communication with their investors. IOSCO proposes that the sustainability-related practices, policies, procedures, and disclosures should cover the following four areas - governance, investment strategy, risk management, and metrics and targets, which are identified based on the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD).

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

IOSCO specifically seeks input on the scope of this recommendation - whether it should cover all asset managers or be limited to only those asset managers that take sustainability-related risks and opportunities into consideration in their investment process.

## **B. Recommendation 2: Product Disclosure**

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

This recommendation is focused on disclosure expectations and intends to prevent greenwashing at the product level by promoting consistency, comparability, and reliability in disclosures on the sustainability-related aspects of products. IOSCO proposes this recommendation to cover all products that consider sustainability in their investment decision-making or that market themselves as sustainable products, as well as the disclosure of material sustainability-related risks by all products regardless of investment strategy.

Regulatory authorities should set out disclosure expectations for sustainability-related products that wish to be offered to the public. The requirements or guidance relating to product-level disclosure should cover the following areas:

- Parameters around the naming of sustainability-related products
- Parameters around the use of sustainability-related labels and/or classification systems by sustainability-related products (e.g. the use of ESG or Sustainable and Responsible Investment (SRI) labels as well as third party certifications)
- Disclosure in product offering documents about sustainability-related products' investment objectives
- Disclosure about sustainability-related products' investment strategies in product offering documents (including, in particular, their sustainability-related investment strategies)
- Disclosure, where relevant: (a) about sustainability-related products' use of proxy voting and shareholder engagement, and (b) of past proxy voting and shareholding engagement records
- Disclosure of: (a) material risks by sustainability-related products, and (b) material sustainability-related risks by all products
- Content requirements for marketing materials and communications of sustainability-related products such that disclosures are fair, balanced, and consistent with their regulatory filing
- Encouraging asset managers to assess, measure, and monitor: (a) the sustainability-related product's compliance with its investment objectives and/or characteristics; (b) the sustainability impact of its portfolio to the extent applicable to the portfolio's stated design; and (c) its sustainability-related performance
- Periodic reporting relating to whether a sustainability-related product is meeting its sustainability-related investment objectives or characteristics, including the products' sustainability-related performance and holdings, during the applicable time period

While IOSCO acknowledges that sustainability-related metrics are under development at the current stage, it proposes that where an asset manager has identified or developed its own metrics or specifically referenced metrics as part of a sustainability-related product's investment objectives or characteristics, securities regulators and/or policymakers could consider whether periodic sustainability-related reporting should include such metrics and the methodologies behind the metrics.

IOSCO requests comments on whether different disclosure requirements should be set out for products with sustainability-related investment objectives as compared to products that promote sustainability-related characteristics. And if so, IOSCO welcomes comments on the relevant thresholds or other criteria in determining whether a product has sustainability-related investment objectives as compared to sustainability-related characteristics, and how should the disclosure requirements vary for these products.

### **C. Recommendation 3: Supervision and Enforcement**

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

IOSCO notes that supervisory and enforcement tools could help prevent greenwashing at both the asset manager and product levels and promote investor confidence in asset managers that take sustainability-related risks and opportunities into consideration as well as sustainability-related products.

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

### **D. Recommendation 4: Terminology**

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

As noted in the above section, the current lack of consistency around the use of sustainability-related terminology in the asset management industry increases the potential for investor confusion around sustainability-related products, thus contributing to greenwashing. IOSCO envisages securities regulators and/or policymakers could play a role in promoting industry coalescence around a set of consistent sustainability-related terms. IOSCO further notes that the issue of terminology is distinct from the issue of labeling and classification, as terminology covers broader concepts beyond product types, such as ESG approaches (e.g., ESG integration, negative screening, and best-in-class).

IOSCO seeks inputs on sets of standardized sustainability-related terms being developed by international organizations that should be considered by securities regulators and/or policymakers.

### **E. Recommendation 5: Financial and Investor Education**

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

IOSCO notes that financial and investor education can play a significant role in protecting investors from greenwashing, and complement the regulatory developments discussed in Recommendations 1, 2 and 4, by fostering a greater understanding of the benefits and risk profiles of sustainability-related products relative to other products.

Financial and investor education initiatives may include promoting sustainability-related risk awareness and improving investor comprehension about, and enhancing the transparency of sustainability-related products, which would improve comparability and informed decision-making as well as prevent greenwashing. These initiatives may also address the professional and licensing obligations of financial advisors to ensure that financial advisors have the necessary knowledge and skills to provide advice on sustainable finance. These initiatives could include tools, methodologies, guidelines, and orientations that focus on retail investors as well as the larger public.

## Complete List of Consultation Questions

1. Will the recommendations outlined below sufficiently improve sustainability-related practices, policies, procedures, and disclosure in the asset management industry and address the issue of greenwashing? Are there other areas of sustainability-related practices, policies, procedures and disclosure in the asset management industry not mentioned in this consultation report that should be addressed as separate recommendations?
2. The key areas identified are based on the key pillars of the TCFD Framework. Do you agree with this approach?
3. Should the scope of this recommendation cover all asset managers or be limited to only those asset managers that take sustainability-related risks and opportunities into consideration in their investment process?
4. Should securities regulators and/or policymakers, as applicable, consider setting out different disclosure requirements for products with sustainability-related investment objectives as compared to products that promote sustainability-related characteristics? If so, for which of the different areas of disclosure listed above should the requirements vary, and how should they vary? In addition, if so, should securities regulators and/or policymakers, as applicable, consider specifying thresholds or other criteria for determining whether a product has sustainability-related investment objectives as compared to sustainability-related characteristics, and what should those thresholds or criteria be?
5. Should naming parameters permit the product name to reference sustainability only if the investment objectives refer to sustainability?
6. Should a product need to have an ESG, SRI, or similar label in order to be marketed as a sustainability-related product?
7. Do you agree with the specified areas of investment strategies disclosure?
8. Should the disclosures address how past proxy voting and shareholder engagement records align with the investment objectives or characteristics of a sustainability-related product?
9. Should securities regulators and/or policymakers, as applicable, also address the format and presentation of marketing materials and website disclosure for sustainability-related products?
10. Should securities regulators and/or policymakers, as applicable, encourage the use of specific metrics or key performance indicators to assess, measure, and monitor the sustainability-related product's compliance with its investment objectives and/or characteristics? Should these metrics be subject to self-selection, or should there be a standardized approach?
11. Should periodic reporting include both quantitative and qualitative information about whether a sustainability-related product is meeting its sustainability-related

investment objectives and/or characteristics?

12. Do you agree that securities regulators and/or policymakers, as applicable, should encourage industry participants to coalesce around a set of consistent sustainability-related terms?
13. Are there any sets of standardized sustainability-related terms being developed by international organizations that should be considered by securities regulators and/or policymakers, as applicable?
14. Do you agree that securities regulators and/or policymakers, as applicable, should promote financial and investor education initiatives relating to sustainability, or, where applicable, enhance existing sustainability-related financial and investor education initiatives?
15. Are there any specific sustainability-related financial and investor education initiatives not mentioned in this consultation report that could be considered by securities regulators and/or policymakers, as applicable?

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#### endnotes

[1] See CR01/21 Consultation Report on Recommendations on Sustainability-Related Practices, Policies, Procedures and Disclosure in Asset Management, available at <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD679.pdf>

[2] The workstream conducted (i) a survey of STF members about regulatory and supervisory approaches relating to sustainability-related practices and disclosures at both the asset manager and product level, (ii) a repository on greenwashing and mis-selling cases in STF member jurisdictions and the tools or measures used to address the greenwashing or mis-selling, and (iii) a survey of members of STF and the IOSCO Committee on Retail Investors (IOSCO Committee 8) on current and planned financial and investor education initiatives in sustainability-related issues and IOSCO's potential contributions in this field.

[3] See FR04/21 Report on Sustainability-related Issuer Disclosures, available at <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD678.pdf>

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