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November 17, 2021

IOSCO Final Recommendations on Sustainability-Related Practices and Disclosures in Asset Management

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TO: ICI Members
ICI Global Members
ESG Task Force
EU ESG Disclosure Regulation Working Group SUBJECTS: ESG
International/Global RE: IOSCO Final Recommendations on Sustainability-Related Practices and Disclosures in Asset Management

On 2 November 2021, the Board of the International Organization of Securities Commissions (IOSCO) published a report[1] setting out five recommendations for securities regulators and policymakers in improving sustainability-related practices, policies, procedures and disclosures in the asset management industry. These recommendations are designed to provide a list of potential areas for regulatory consideration in line with domestic regulatory frameworks.

ICI Global submitted a response to IOSCO's consultation on the proposed recommendations in August 2021,[2] and we were pleased to see that the final recommendations address many of our comments. We remain concerned with some of the examples of greenwashing provided in the report, as well as some of the prescriptive product-level disclosures that IOSCO recommends. For example, IOSCO identifies the lack of alignment between the product's sustainability-related name and its investment objective as one of the examples of greenwashing. We had noted in our response that the sustainability-related aspects of a product are commonly disclosed in the investment strategy rather than investment objective.

The memorandum briefly summarizes the five recommendations in the Final Report.

1. Regulatory expectations for asset managers in relation to sustainability-related practices, policies and disclosures

IOSCO suggests securities regulators and/or policymakers set regulatory and supervisory expectations for asset managers in respect of the development and implementation of practices, policies and procedures relating to material sustainability-related risks and opportunities, and the related disclosure. This is to ensure that asset managers take material sustainability-related risks and opportunities into consideration and integrate them into the decision-making process, and promote consistency, comparability, and reliability in disclosure.

IOSCO focuses on material sustainability-related risks and opportunities, and states that this recommendation should cover all asset managers, regardless of whether they take sustainability-related risks and opportunities into consideration in their investment process. Yet, this does not intend to suggest that all asset managers should offer sustainability-related products. Asset managers that do not offer sustainability-related products may still consider material sustainability-related risks and opportunities as part of their role as fiduciaries of client assets.

Asset managers could consider referencing the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) in their disclosures of climate-related risks and opportunities and adopt a phased-in approach to expand the disclosures beyond climate considerations. IOSCO adds that regulators and policymakers may also consider adopting a phased-in approach to implementing their regulatory and supervisory expectations to recognize the cost of compliance, including for smaller, less-resourced asset managers, where applicable.

2. Regulatory requirements on product-level disclosure

To combat greenwashing at the product level, IOSCO encourages securities regulators and/or policymakers to clarify and/or expand on existing regulatory requirements or guidance or, if necessary, create new regulatory requirements or guidance, to improve product-level disclosure. Such disclosure requirements should apply to products that consider sustainability in their investment decision-making or that market themselves as sustainable products. All products, regardless of investment strategy, should also disclose material sustainability-related risks accordingly.

In our consultation response, we had expressed concerns about setting out disclosure requirements for products that might conflate the process of ESG integration with sustainability-related investment strategies. We were pleased to see that such approach is not adopted in the final recommendations.

IOSCO suggests a list of items that the requirements or guidance relating to product-level disclosure should cover.[3] Among other things, IOSCO suggests that regulators and policymakers could consider permitting a product to reference sustainability in its name only if the investment objective refers to sustainability. We had noted in our response that the ability to utilize a product name that references sustainability should not be restricted to only those products whose investment objectives refer to sustainability, given that it is common practice to elaborate on sustainability in the investment strategy rather than the investment objective section of a prospectus. Generally, products with sustainability-related objectives have an outcome that is sustainability-related (e.g., "impact" products).

We were pleased to see that IOSCO does not recommend the use of minimum standards set by regulators for sustainability-related products. IOSCO instead suggests 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, regulators and policymakers could consider whether the periodic sustainability-related reporting should include such metrics and the methodologies behind the metrics.

3. Supervisory and enforcement tools

IOSCO suggests that securities regulators and/or policymakers should have supervisory tools to monitor and assess whether asset managers and sustainability-related products comply with regulatory requirements, as well as enforcement tools to address any breaches of such requirements. Not only could this address greenwashing at both asset manager and product levels but also promote investor confidence in asset managers that take sustainability-related risks and opportunities into consideration as well as sustainability-related products.

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

4. Common sustainable finance terms and definitions

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. IOSCO suggests that securities regulators and/or policymakers encourage industry participants to develop common sustainable finance-related terms and definitions in order to promote industry coalescence around a set of consistent sustainability-related terms.

IOSCO clarifies 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, best-in-class). IOSCO highlights that there is a particular need for the development of common terms and definitions for ESG approaches.

5. Promote financial and investor education initiatives

IOSCO notes that financial and investor education can play a significant role in protecting investors from greenwashing, including by fostering a greater understanding of the benefits and risk profiles of sustainability-related products relative to other products. Securities regulators and/or policymakers should consider promoting financial and investor education initiatives relating to sustainability.

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.

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endnotes

[1] See FR08/21 Final Report on Recommendations on Sustainability-Related Practices, Policies, Procedures and Disclosure in Asset Management (November 2021), *available at* https://www.iosco.org/library/pubdocs/pdf/IOSCOPD688.pdf. ("Final Report")

[2] See ICI Memorandum No. 33728, 13 August 2021, *available at* https://www.ici.org/memo33728.

[3] See Final Report, supra note 1, p.66-69.