Recommendations on Sustainability-Related Practices, Policies, Procedures and Disclosure in Asset Management. International Bulletin, June 2022.

IOSCO published its Report on the *Recommendations on Sustainability-Related Practices, Policies, Procedures and Disclosure in Asset Management* (Report), on 2 November 2021. This report follows and builds upon the IOSCO´s Consultation Report (Consultation Report), from June 2021, under the same title as the Report.
The Report aims to improve (a) sustainability-related practices, policies, procedures, and disclosures in the asset management industry by presenting both results from fact-finding exercises used to explore asset management practices and (b) disclosure requirements in IOSCO´s member jurisdictions, as well as through five recommendations for securities regulators and policymakers for asset managers.

The recommendations will help asset managers, regulators and/or policy makers address the main issues concerning sustainability-related risks and opportunities, enabling them to integrate sustainability-related considerations into their decision-making processes while allowing investors to make informed decisions without the risk of “greenwashing.”

The Report recognizes that there is a clear need to address challenges related to sustainability-related practices. Consequently, the IOSCO recommendations are designed to provide a list of potential areas for consideration as regulators and policymakers consider developing sustainability-related rules and regulations, consistent with their mandates and domestic regulatory frameworks. The recommendations outlined in the Report cover regulatory and supervisory expectations for asset managers, related disclosure both at the firm and product levels, supervision and enforcement, terminology, and financial and investor education.

Challenges associated with the lack of reliability and comparability of data at the corporate issuer level and the Environmental, Social, and Governance (ESG) data and ratings provided by third-party providers to enable the asset management industry to properly evaluate sustainability-related risks and opportunities are also recognized in the Report.

Synergies with other IOSCO Sustainable Task Force workstreams including, sustainability related disclosures for issuers and ESG ratings and ESG data providers, have been taken into account in the Report, as asset managers are users of this information.

In April 2020, IOSCO established a Board-level Sustainable Finance Taskforce (STF). The STF carried out work in three areas:

• corporate issuers’ sustainability-related disclosures

• asset managers’ disclosures and investor protection issues

• the role of Environmental, Social and Governance (ESG) data and ratings providers.

The Report is a result of the STF´s workstream for the second objective.

Data used for the Report

The Report considered the forty-five (45) comments received from individuals, regulators and securities industry organizations in response to the Consultation Report and are reflected in the recommendations.

Approximately half of the responding jurisdictions do not have sustainability-specific rules and instead currently use existing non-sustainability-specific rules to address sustainability-related risks and opportunities at the asset manager level and sustainability-related products.

Even in jurisdictions with sustainability-specific requirements, most securities regulators currently rely on existing supervisory and enforcement tools to address sustainability-related misconduct, such as providing false and misleading information relating to an asset manager's or product's commitment to sustainability.

Based on responses, the IOSCO found that sustainability-related requirements for the practices and disclosures of asset managers primarily pertained to (a) investment strategy, (b) risk management, (c) metrics and targets, and (d) governance, which are similar and consistent with the Task Force on Climate-Related Financial Disclosures Recommendations (TCFD) Framework. IOSCO observed that while there may be similarities in the types of disclosure covered by such requirements across jurisdictions, there is variation in implementation and scope.

A summary of the feedback, as well as a list of the individuals and organizations who responded, is included as an Annex to the Report. In addition, many jurisdictions provided examples of their approaches to sustainability, supervisory and enforcement tools, as well as some examples of greenwashing, which are also included in the Report.

Greenwashing Defined

A large portion of the Report is attributed to greenwashing. Greenwashing in the Report is defined as referring "to the practice of misrepresenting sustainability-related practices or the sustainability-related features of investment products." In the "race to promote their green credentials," some asset managers may misleadingly label products as sustainable without meaningful changes in the underlying investment strategies or shareholder practices. Such practices may vary in scope and severity, from the inappropriate use of specific sustainability-related terms used in an offering document, to misrepresentations about an entity's sustainability-related commitments, to deceptive marketing practices that deliberately misrepresent a product's sustainable impact.

Regulatory Approaches to Sustainability-Related Practices and Firm-Level Disclosures by Asset Managers

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

Regulatory Approaches to Disclosures for Investment Products

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

At the product level, greenwashing may include:

• Lack of alignment between the product's sustainability-related name and its investment objectives and/or strategies;

• Marketing that does not accurately reflect the product's investment objectives and/or strategies;

• Failure of product to follow its sustainability-related investment objectives and/or strategies;

• Misleading claims about the product's sustainability-related performance and results. This is the most prevalent type of greenwashing; and

• Lack of disclosure

Challenges

Challenges associated with the growth of the market for sustainability-related products that contribute to greenwashing and other investor protection concerns are discussed in the Report and are evidence for a greater need for consistent, comparable, and decision-useful information to reduce the risk of greenwashing. These challenges include areas such as data gaps at the corporate level, issues arising from the proliferation of data and ESG ratings providers, lack of consistency in terminology as well as labelling and classification, different interpretations of materiality, gaps in skills and expertise, and evolving regulatory approaches.

Recommendations

As a global baseline and as a result of its findings in preparation of the Report, the IOSCO recommendations have been provided as good practices that should be implemented for asset managers, while securities regulators and/or policymakers, as applicable, should consider setting regulatory and supervisory expectations for asset managers:

Recommendation 1 addresses the need for setting clear regulatory and supervisory expectations for asset managers in respect of the: (a) development and implementation of practices, policies and procedures related to material sustainability-related risks and opportunities; and (b) related disclosure. Specifically, the practices, policies, and procedures relating to material sustainability-related risks and opportunities and the disclosure should cover the following areas, as detailed by the TCFD:

• Governance: The asset manager's governance around material sustainability-related risks and opportunities.

• Investment strategy: How material sustainability-related risks and opportunities are factored into the asset manager's investment strategies and investment process, including, where relevant, the data and methodologies used.

• Risk management: How the asset manager identifies, assesses, and manages material sustainability-related risks.

• Metrics and targets: The metrics and targets used to assess and manage relevant material sustainability-related risks and opportunities where such information is material.

Recommendation 2 addresses the need for securities regulators and/or policy makers, to 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: sustainability-related products; and material sustainability-related risks for all products. Specifically, practices for disclosure at the product-level should cover the following areas:

• Names: Sustainability-related product names should accurately reflect the nature and extent of the product's sustainability focus.

• Label and classification: Promotion of the consistent and correct use of sustainability-related labels and/or classification systems.

• Investment objectives disclosure: Disclosure should include the nature and extent of a product's sustainability-related investment objectives, including which components of sustainability the product is focused on and whether sustainability is a primary focus of the product.

• Investment strategies disclosure: Disclosure should include the investment universe, investment selection process (including the types of ESG strategies used, as well as the use of indices and ESG scores or ratings, the extent of such use, and their methodologies, where applicable), sustainability criteria used, and the extent of the portfolio's focus on sustainability.

• Proxy voting and shareholder engagement disclosure.

• Risk disclosure: Disclosure of all material risks associated with investing in the specific sustainability-related product and enables investors to better understand the potential risks associated with the product. This type of risk disclosure could include any unique risks that arise from a product's focus on sustainability, such as concentration in certain types of investments and reliance on third-party providers for sustainability-related ratings. Disclosure of material sustainability-related risks by all types of products, including products that are not sustainability-related, assists investors with making informed investment decisions about how material sustainability-related issues can impact their investments. This type of risk disclosure could include any material risks that arise from sustainability-related issues.

• Marketing materials and website disclosure: disclosures that are fair, balanced and consistent with their regulatory filings.

• Periodic sustainability-related reporting.

Recommendation 3 addresses supervision and enforcement. Securities regulators and/or policymakers, should have supervisory tools to monitor and assess whether asset managers and sustainability-related products are in compliance with regulatory requirements and enforcement tools to address any breaches of such requirements. Supervisory and enforcement tools can help prevent greenwashing at both the asset manager and product levels and promote investor confidence in asset managers that take sustainability-related risks and opportunities into consideration as well as sustainability-related products.

Recommendation 4 addresses terminology. Securities regulators and/or policymakers, should consider encouraging industry participants to develop common sustainable finance related terms and definitions, including relating to ESG approaches, to ensure consistency throughout the global management industry. Without a set of consistent global terminology, the potential for investor confusion around sustainability-related products increases and may contribute to greenwashing. Terminology covers broader concepts beyond product types, such as ESG approaches (e.g., ESG integration, negative screening, best-in-class) and definitions of commonly used sustainability-related terms such as "green."

Recommendation 5 addresses financial and investor education. Securities regulators and/or policymakers should consider promoting financial and investor education initiatives relating to sustainability or enhance existing sustainability related initiatives.

Next Steps

On March 9, 2022, the Board of IOSCO approved a workplan for 2022 based on this Report, as well as the Report for Environmental, Social and Governance (ESG) Ratings and Data Products Providers completed in 2021, whereby the STF will commence workplans with the objective of mitigating greenwashing, increasing transparency and creating trustworthy information regarding the impact of sustainability on investors.

For more information:

Recommendations on Sustainability Related Practices, Policies, Procedures and Disclosure in Asset Management. Final Report.

https://www.iosco.org/library/pubdocs/pdf/IOSCOPD688.pdf