A series of briefings that take a "bite-size" look at international trends in different jurisdictions, drawing on Baker McKenzie's expert financial services practitioners.

Bite-size Briefings: Environmental, Social and Governance (ESG) regulation

A series of briefings that take a bite-size look at international trends in different jurisdictions, drawing on Baker McKenzie's expert financial services practitioners with local market knowledge.

This edition takes a bite-size look at the latest environment, social and governance (ESG) developments in Brazil, the European Union, Belgium, Hong Kong SAR, Japan, Singapore, Thailand, and the United Kingdom. Since we looked at ESG in our **July 2021** edition, significant progress has been made internationally on creating a regulatory framework. As was the case then, there are still widely different rates of progress, but international standards are now firmly entrenched and many jurisdictions besides the EU have either enacted compulsory rules on reporting and disclosure or are in the process of doing so. We are now seeing actual implementation and firms dealing with the complexities, such as over how green to label funds. Other areas coming to the fore include a focus on the quality of ESG data from corporates on which financial institutions rely to make their disclosures. That said, leaders in the financial sector are without doubt most concerned about the risk of litigation and enforcement action arising out of allegations of green washing. Terms such as "green hushing" and "green bleaching" have emerged where businesses choose to remain silent about or downplay their firms' or products' ESG attributes. The US, where regulation is enforcement-led, is out in front but other jurisdictions are starting to see cases being brought. While ESG potentially brings financial institutions opportunities to grow their business, the risks require careful governance and management.

Brazil

In Brazil, no federal or state law expressly requires the disclosure and reporting of ESG matters. So far, disclosures are voluntary for the private sector.

The National Emissions Registry System (SIRENE) publishes the results of emissions in Brazil of all greenhouse gases not controlled by the Montreal Protocol for the following sectors: waste, agriculture, land use, land use change and forestry, energy and industrial processes, and use of other products. One significant challenge is how to make SIRENE compatible with the recently created SINARE (the National Greenhouse Gas Emissions Reduction System established in May 2022 through Federal Decree No. 11.075/2022). SINARE was created to be a single digital center for recording emissions, removals, reductions, offsets of greenhouse gases and transactions, transfers, and the retirement of certified emission reduction credits.

Despite the absence of federal or state law, there are rules issued recently by the Brazilian Central Bank (BACEN) that apply to financial institutions and by the Brazilian Securities Commission (CVM) that apply to publicly held companies. In summary, these rules require businesses to report environmental, social and climate risks.

Currently, the Federal Senate is scrutinizing proposed legislation (bill of law No. 4,363/2021), which would create an ESG national seal or stamp to be granted to companies that invest in ESG transactions and projects. The aim is to promote sustainable practices among financial institutions.

Because there is no legislation on the subject, there is no provision that imposes penalties for noncompliance with the disclosure and reporting of ESG matters. However, companies often find themselves pressured by the market and consumers to adopt ESG practices. Thus, there is reputational risk in noncompliance or greenwashing practices. Additionally, there is also an obligation regarding the veracity of the information provided by companies to state agencies, especially the CVM and the BACEN. For this reason, any false or incomplete information can be questioned.

Most companies (especially large companies) are implementing initiatives related to ESG matters by establishing easy-to-access information channels and by publishing digital reports on their websites. These businesses are making commitments over, for example, reducing GHG emissions; the consumption of renewable electricity; reducing water consumption; making investments in health, education and income generation; and promoting diversity (especially in leadership positions), etc.

Finally, São Paulo's investment promotion and competitiveness agency, the "InvestSP" public initiative, is of interest to the financial sector. ESG is currently on InvestSP's agenda, as it aims to promote best investment practices such as the creation of an ESG implementation and monitoring plan.

European Union

The EU has been instrumental in reshaping the sustainable investing landscape through the introduction of new legislation, including the Sustainable Finance Disclosure Regulation (SFDR) and the EU Taxonomy Regulation. Additionally, key parts of the existing regulatory framework have been amended, such as MiFID II and the Alternative Investment Fund Managers' Directive. Suitability disclosures have been in place since 1 January 2023 following the finalization of the SFDR regulatory technical standards (SFDR RTS). Firms within scope of the SFDR with products that promote environmental or social characteristics, or that have sustainable investments as their objective, are now required to make detailed sustainability disclosures on standardized templates. Many firms making these disclosures will also need to demonstrate how their investments align with the Taxonomy Regulation. Until now, it has been difficult for some market participants to accurately judge the appropriate sustainability categorization for their products, so these disclosures are expected to trigger further adjustments within the regulated sector as participants gain access to granular data from across the market. It is also increasingly clear that EU authorities expect market participants to proactively source data for their disclosures, and that such data must be accurate - failure to collect adequate data is likely to have a significant impact on firms' sustainability disclosures.

Regulatory change at the EU level will continue apace in 2023 - certain gas and nuclear power activities have been brought within scope of the Taxonomy Regulation; the European Securities and Markets Authority (ESMA) is considering how sustainability language should be used in financial product names; and firms falling within scope of the Corporate Sustainability Reporting Directive (CSRD) will be required to collect and disclose far greater quantities of data than previously expected, to markedly improve data availability. However, firms prioritizing social investment strategies will need to wait for news on progress toward the EU's Social Taxonomy, which stalled somewhat in the second half of 2022.

Belgium-EU

In January 2023, the Belgian Financial Services and Markets Authorities (FSMA) - one of Belgium's main financial supervisory authorities - published a Q&A on the entry into force of the RTS addressed to managers of (alternative) undertakings for collective investment and public undertakings for collective investment under Belgian law. The Q&A aims to support fund managers on the practical implementation of the SFDR RTS. In particular, they aim to provide clarification on the applicable rules arising from the RTS for UCITS management companies, self-managed UCITS and the managers of public and non-public alternative investment funds, as well as the FSMA's expectations in this regard. The clarifications and expectations of FSMA in its Q&A are formulated subject to any further future clarifications by the Commission or the European Supervisory Authorities (EBA, ESMA and EIOPA). However, the Q&A already takes into account and summarizes the key elements of existing Q&As published by the Commission (**Q&A 1** and **Q&A 2**) and the **European Supervisory Authorities**, as well as of ESMA's **Supervisory briefing** of May 2022 on sustainability risks and disclosures in the area of investment management. The FSMA's key message is that a fund's offering documentation (such as a prospectus) must always contain the required sustainability information so that the investor understands the fund's level of ambition with regard to sustainability and provides for a sufficient level of information to make an informed investment decision. This information must be further detailed in the annexes of the prospectus, using the mandatory templates under the SFDR RTS. The FSMA's Q&A gives valuable insights on its interpretation of the SFDR RTS and should be taken into close consideration by Belgian fund managers. Of note, the FSMA considers the fight against greenwashing as one of its key supervisory priorities.

United Kingdom

The UK is also moving forward with its own ESG package comprising product and firm-level disclosures, new requirements on product distributors, the use of sustainable investment labels, as well as rules on naming and marketing in-scope products. As part of these measures, the Financial Conduct Authority (FCA) is also proposing to introduce a general anti-greenwashing rule to clarify that sustainability-related claims must be clear, fair and not misleading. The UK is also developing its own version of the EU's Taxonomy Regulation, although progress on this has stalled somewhat since the government announced in December 2022 that it is "reviewing its approach to taxonomy development", and it is not yet clear to what extent the UK Taxonomy will diverge from the EU's.

These measures are being implemented alongside the FCA's regime for climate-related financial disclosures (applicable to certain life insurers and FCA-regulated pension providers (termed together as "asset owners") as well as certain asset managers). The deadline for certain large asset managers and asset owners to publish their first set of disclosures is 30 June 2023. Other asset managers and asset owners within scope of the regime will need to ensure that they have begun to collect data from 1 January 2023, with a view to making disclosures by 30 June 2024.

Late 2022 also saw the FCA announce the formation of a new ESG data and ratings group, which will work to develop a Code of Conduct for ESG data and ratings providers. While the UK government is considering whether to bring ESG data and ratings providers within scope of the FCA's supervisory perimeter, the Code may function as an interim, voluntary measure providing a "soft" introduction to operating in a more regulated, transparent environment prior to the implementation of any new legislative regime.

On the banking side, the Prudential Regulation Authority (PRA) will continue to work with banks and insurers on assessing climate-related financial risks. The PRA's recent Dear CEO letter published in October 2022 highlighted that while "governance of climate risks has advanced in most firms… levels of embedding may vary and the assessment of supervisors is that further progress is needed by all firms".

The sector has seen a marked increase in regulatory enforcement over the past year, and this is expected to continue into 2023. While the focus to date has been on greenwashing, the market is also voicing concerns around green bleaching (where market participants invest into sustainable activities but refrain from categorizing their products correctly, so to avoid the disclosure obligations), although it remains to be seen how regulators tackle this particular challenge.

Hong Kong

In May 2020, the Green and Sustainable Finance Cross-Agency Steering Group (CASG) was co-initiated by the Hong Kong Monetary Authority (HKMA) and the Securities and Futures Commission (SFC). Other members of the CASG include the Environment and Ecology Bureau, the Financial Services and Treasury Bureau, Hong Kong Exchanges and Clearing Limited, the Insurance Authority and the Mandatory Provident Fund Schemes Authority. CASG aims to coordinate the management of climate and environmental risks in the financial sector, accelerate the growth of green and sustainable finance in Hong Kong and support the government's climate strategies. To date, the focus of the Hong Kong regulators has largely been directed at climate risk. In December 2022, the CASG **announced** that it had entered a collaboration agreement with a non-profit organization, CDP (formerly the Carbon Disclosure Project), to jointly enhance climate data availability and sustainability reporting in Hong Kong. CASG and CDP will work together to:

- **Enhance climate and environmental disclosure**, improve data availability and accessibility in Hong Kong.
- **Support capacity building and upskilling**, to assist local companies in disclosing high-quality climate and other environmental-related data in line with existing and upcoming global standards and best practice.
- **Facilitate data flow**, to provide financial institutions with better data resources to assess climate and environmental risks, and to support the real sector in the transition toward carbon neutrality.

As for the regulation of securities, the Fund Manager Code of Conduct issued by the SFC has been amended to include requirements on climate-related risks. The SFC also issued a **Circular** on Management and Disclosure of Climate-related Risks by Fund Managers and a set of **Frequently Asked Questions** (FAQs) to provide further guidance on such requirements. The new requirements apply to discretionary fund managers that manage collective investment schemes (CIS). The changes cover four major aspects: (i) governance, (ii) investment management, (iii) risk management and (iv) disclosure. The SFC has adopted a two-tiered approach. All in-scope fund managers are required to comply with the baseline requirements, while large fund managers (with CIS under management, which is equal to or exceeds HKD 8 billion in value for any three months in the previous reporting year known as "Large Fund Managers"), are required to comply with certain enhanced standards. The changes are to be implemented in phases, which began in August 2022. Large Fund Managers must comply with the baseline requirements from August 2022 and the enhanced requirements from

November 2022. All other in-scope fund managers must comply with the baseline requirements from November 2022.

On 2 August 2022, the SFC released a **circular** publishing its **Agenda for Green and Sustainable Finance** setting out its view of the way forward. The SFC will continue to focus on the following:

- Enhancing corporate disclosures.
- Monitoring the implementation of and enhancing existing measures relating to environmental, social and governance (ESG) funds and expectations for fund managers.
- Identifying an appropriate regulatory framework for any proposed carbon markets.

On the banking regulatory front, the Hong Kong Monetary Authority (HKMA) **announced** the new Supervisory Policy Manual (SPM) Module GS-1 on climate risk management (SPM GS-1) on 30 December 2021. SPM GS-1 is intended to provide high-level guidance to authorized institutions (AIs) to build climate risk resilience by incorporating climate considerations into governance, strategy, risk management and disclosure. AIs had 12 months (i.e., until the end of December 2022) to prepare for implementation. The new disclosures that were to begin in 2023 under the new SPM GS-1 need to be aligned with the TCFD recommendations. In June 2022, the HKMA also published an **update** of its further two-year plan to address the integration of climate risk into the banking supervisory process so that AIs could proceed and adjust their climate strategies as necessary.

Japan

The Japanese government declared in 2020 that the country must become carbon neutral by 2050, and ESG-related initiatives are accelerating. Japanese administrative authorities such as the Japanese Financial Services Agency (JFSA) have issued several guidelines to help a broad range of financial institutions and market participants align their activities with international ESG standards. In March 2020, the Japanese Stewardship Code was amended to encourage institutional investors to include sustainability and sustainable growth in their investment policies and to take into account non-financial factors in their investment management strategies. In June 2021, the Japanese Corporate Governance Code was amended to include ESG-related recommendations.

Most recently, in December 2023, the JFSA published the finalized Code of Conduct for ESG Evaluation and Data Providers, which addresses issues pointed out by the Technical Committee, including transparency and fairness of evaluation, as the demand for ESG ratings and data provision is expected to increase. The Code of Conduct provides principles (i.e., (i) Securing Quality, (ii) Human Resources Development, (iii) Ensuring Independence and Managing Conflicts of Interest, (iv) Ensuring Transparency, (v) Confidentiality, (vi) Communication with Companies) and guidelines with the aim of ensuring that ESG ratings and data can be relied on by investors. Japan is one of the first countries to issue guidelines for ESG ratings and data providers.

Further, in June 2022, the JFSA's disclosure working group discussed disclosure guidelines for sustainability and governance-related factors and published a report that suggested including mandatory disclosure of sustainability information and corporate governance information in statutory annual securities reports and securities registration statements. In January 2023, after public consultation, the JFSA amended the disclosure regulations under the Financial Instruments Exchange Act to require that listed companies in Japan disclose sustainability information. According to the JFSA's guidance, sustainability information includes not only environmental and social but also employees, human rights, anti-corruption, governance, cybersecurity and data security-related information. While the amended disclosure regulations do not set out detailed disclosure standards, companies are expected to disclose their efforts and initiatives with respect to sustainability to the fullest extent possible. The amended disclosure regulations apply to annual securities reports and securities registration statements for the financial year ending on or after 31 March 2023.

The working group was also discussing best practice for corporate disclosure and published a report in December 2022 concluding that third-party assurance with respect to sustainability disclosures should be required and suggested that assurance providers should not be limited to accounting and audit firms.

Finally, the JFSA is also focused on tackling greenwashing and has proposed amendments to the "Comprehensive Supervisory Guidelines for Financial Instruments Business Operators, etc." in order to define specific items to be verified when disclosing information on publicly offered investment trusts and organizational resources and due diligence of asset managers regarding ESG.

Singapore

In the past few years, the Monetary Authority of Singapore (MAS), as Singapore's central bank and integrated financial regulator, has begun to position itself as a global champion of sustainable development and the green finance ecosystem and use its international financial hub status to leverage and support Asia's low-carbon transition. Documented in the **Green Finance Action Plan** that was announced in 2019, MAS addresses the challenge through a two-pronged push-pull approach:

1. **Strengthening financial sector resilience to environmental risks**: Exercising MAS' supervisory oversight, the **Guidelines** on Environmental Risk Management for Banks, Asset Managers and Insurers ("**ERM Guidelines**") were published in December 2020 (and came into effect in June 2022). They guide local financial institutions to begin considering, managing and mitigating climate risks, including through the use of climate scenario analysis. In May 2022, to accelerate adoption and improve industry standards, supplemental information papers were published reflecting market progress and emphasizing good practices and room for improvement.

   Besides integrating environmental risks into existing risk management frameworks, MAS also addresses sectoral resilience through complementary enhancement of ESG data through industry ESG data generation and disclosures:

   i. The ERM Guidelines require the clear and meaningful disclosure of environmental risk in accordance with well-regarded international frameworks. Initial support leaned toward the Task Force on Climate-Related Disclosures' recommendations, but the latest public statements indicate a shift in the upcoming International Sustainability Standards Board standards.

   ii. Alongside this, MAS published **Circular** No. CFC 02/2022 on Disclosure and Reporting Guidelines for Retail ESG Funds in July 2022 (which came into effect on 1 January 2023). It imposed stricter guidelines for retail ESG funds to better standardize labeling and disclosures.

   iii. The ERM Guidelines and Circular No. CFC 02/2022 parallel the Singapore Exchange's imposition of mandatory climate reporting for, among others, issuers in the financial industry from 1 January 2023 onwards (up from a "comply or explain" basis).

2. **Promoting market development and innovation**: MAS has concurrently deployed a series of incentives and infrastructural support to promote its sustainability agenda:

   i. MAS has provided a series of subsidies, grants and investments to pay the costs of green finance products, such as (A) the **Green and Sustainability-Linked Loan Grant Scheme** in January 2021 (which subsidizes the initial setup of sustainability frameworks, obtaining of independent sustainability assessments and ongoing monitoring costs), (B) the USD 2 billion Green Investments Programme in November 2019, (C) the **Insurance Linked Securities Grant Scheme** in January 2021 and (D) the earmarked SGD 50 million Green Fintech Grant of the **Financial Sector Technology and Innovation Scheme**, which remains valid until March 2023.

   ii. Numerous private-public partnerships have arisen, such as (A) Project Greenprint, which supports infrastructure development for ESG data flows with multiple ESG-focused initiatives, including the ESG Data and Certification Registry, (B) the ESG Impact Hub, which fosters ESG industry collaboration, (C) the setup of local ESG expertise centers to facilitate Asia-focused research and training, such as the Singapore Green Finance Centre, Sustainable Finance Institute Asia and the Sustainable and Green Finance Institute, and (D) the Singapore Fintech Festival and Global Fintech Innovation Challenge, which foster industry salience, facilitate discussions and drive innovation.

   iii. MAS also convened the Green Finance Industry Taskforce (GFIT) in January 2021 to help overcome taxonomic issues and promote the development of ESG data generation. Besides industry consultations, GFIT has since published the **Handbook** on Implementing Environmental Risk Management for Asset Managers, Banks and Insurers.

Finally, these developments should be viewed against the backdrop of the broader Singapore Green Plan 2030, which charts ambitious and concrete targets over the next decade to strengthen Singapore's commitments under the Paris Agreement and the UN's 2030 Sustainable Development Agenda.

Thailand

Thailand's vision of being a high value-added, sustainable and green economy is set out in the draft 13th National Economic and Social Development Plan, which defines a transformative development pathway for the country for the next five years. To achieve this goal, Thai regulators - in particular, the Office of the Securities and Exchange Commission (SEC) and the Bank of Thailand (BOT) - are active in transforming Thailand's regulatory landscape to enhance the importance of ESG in the Thai financial market.

For its part, the SEC has published regulations and guidelines on the disclosure requirements of (i) ESG-related bonds (e.g., sustainability-linked bonds and green bonds), and (ii) the sustainable and responsible investing fund, the SRI Fund, to provide sufficient information to investors and prevent greenwashing. Additionally, to attract market participants to issue or set up these types of products, the SEC currently exempts from official fees, the issuance of ESG-related bonds or establishment of SRI funds.

Furthermore, the SEC has published guidelines on the management and disclosure of climate-related risks for asset management companies (AMC). These constitute voluntary manual for AMCs to assess climate-related risk when managing funds.

From the BOT side, the central bank is committed to sustainability-related actions in support of the 2021 Glasgow Declaration of the Network of Central Banks and Supervisors for Greening the Financial System (NGFS). The BOT is planning to launch guidelines for financial institutions on good practices for sustainable banking and is also collaborating with other stakeholders to create a central database for ESG disclosures.

In addition to the above, Thailand has set a target to reduce greenhouse gas emissions by 20% to 25% by 2030 and is in the process of preparing an action plan to achieve this goal. Both the BOT and the SEC are part of the Thailand Taxonomy working group ("Working Group"). The Working Group is preparing Thai taxonomy for environmentally sustainable activities ("Thailand Taxonomy") to create a standardized classification for businesses when assessing the environmental impact of their activities on a voluntary basis. The Thailand Taxonomy will be one of the options for referencing access to financial services and products that will support a business's transition to environmental sustainability.

The Thailand Taxonomy uses environmental science-based principles that categorize environmental characteristics of activities into three levels (i.e., a traffic-light system) as follows:

- Green: activities that mitigate climate change with net greenhouse gas emissions close to or equal to zero
- Amber: activities that currently do not have net greenhouse gas emissions close to or equal to zero and are in the process of reducing greenhouse gas emissions
- Red: activities that cannot be assessed as being environmentally friendly toward reduction of greenhouse gas emissions and do not qualify as Green or Amber-level activity

Phase 1 of the Thailand Taxonomy project will focus on the classification of economic activities in the energy and transportation sectors. In phase 2, the Working Group will continue the project in relation to other key sectors such as agriculture.

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