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Global Fund Management Regulatory Outlook 2023

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EXECUTIVE SUMMARY

The financial services industry is no stranger to frequent regulatory upheaval and scrutiny, however the past year has been particularly demanding on market participants, including but not limited to product providers, platforms, distributors, financial advisers and those providing data and technology infrastructure to meet the symphony of deadlines that defined 2022.

A common theme across major global markets were calls for further clarity on sustainability disclosure requirements. The European Commission published a number of Q&As in response to questions raised by the industry and even the European Supervisory Authorities (ESAs), and the United Kingdom issued its consultation paper on Sustainability Disclosure Requirements (SDR) and investment labels, indicating a strong position for greater transparency around sustainability.

The deadline for the EU's transition from UCITS KIIDs to PRIIPs KIDs and the new rules for existing PRIIPs coincided with the first submissions of pre-contractual reports required by the Sustainable Finance Disclosure Regulation (SFDR) Level II Regulatory Technical Standards (RTS) on 1 January 2023. PRIIPs KIDs have been contentious since their inception in 2018 and the revised RTS put significant pressure on product providers to meet the deadline at the turn of the year. Anticipation of amendments to the SFDR RTS is expected to cause further discomfort, if approved early this year, as changes to the templates, to include nuclear power and natural gas in the taxonomy, take effect just three days after publication of the update in the Official Journal of the EU.

Europe is also closely looking at the United Kingdom's new Consumer Duty, which aims to set higher and clearer standards of consumer protection. The Duty, according to the FCA, will lead to a major shift in financial services, impacting every link in the product provider/platform/adviser chain, from provider governance to adviser due diligence. Overall, the Consumer Duty is about the culture throughout firms, from product design to customer support and pretty much everything in between.

Meanwhile, Hong Kong, Singapore and Australia have benefited from standards set by Europe and the United Kingdom, to closely align and progress the formation of their sustainability frameworks and accompanying disclosure requirements. Progress may be slower but it is happening, with Hong Kong's enhanced disclosures for large fund managers coming into effect in November last year, and Singapore's disclosure and reporting guidelines for retail ESG funds coming into effect on 1 January 2023. The Australian fund industry is leading the sustainability charge there, with the Treasury a step (or two) behind, publishing its consultation paper on 'Climate-related financial disclosures' just in December 2022.

It seems clarity, transparency and sustainability will reign supreme as the dominating themes in fund regulation for the year ahead. Open discourse within the wider industry will be required to steer regulatory developments that make sense and deliver on Consumer Duty.

EUROPE

Sustainability disclosures

10 March 2021
European SFDR[1] Level 1 Requirements – ESG characteristics

Who does it impact?
- Financial Market Participants (fund groups, insurance companies providing Insurance-Based Investment Products (IBIPs) Discretionary Fund Managers (DFMs), pension providers)
- Financial Advisers

2 August 2022
MiFID & IDD delegated acts – Sustainability factors

Who does it impact?
- Fund groups
- Insurance companies
- Distributors
- Platforms
- Financial Advisers

31 October 2022
European Commission adopts ESAs'[2] proposal for new SFDR RTS[3] to include taxonomy-aligned nuclear energy and fossil gas disclosures

1 January 2023
SFDR Level 2 RTS – Pre-contractual reports in force

Who does it impact?
- Financial Market Participants
- Financial Advisers

February 2023
FinDatEx EET[4] Version 1.1.1 – Expected release pending the publication of the Official Journal of the European Union on a revised SFDR RTS

Who does it impact?
- Product Providers

30 April 2023
SFDR Level 2 RTS – Periodic reports

Who does it impact?
- Financial Market Participants

[1] European Sustainable Finance Disclosure Regulation

[2] European Supervisory Authorities, i.e. ESMA (European Securities and Markets Authority), EBA (European Banking Authority) and EIOPA (European Insurance and Occupational Pensions Authority)

[3] Regulatory Technical Standards

[4] European ESG Template

SFDR & EU Taxonomy

2022 was driven by one topic in particular: SFDR.

The European Sustainable Finance Disclosure Regulation (SFDR) has already been one of the most wide-ranging regulations in terms of its impact on the funds industry, and one of the most challenging to comply with. And further changes came into effect on 1 January 2023.

After much political debate, on 31 October 2022 the European Commission adopted the ESAs' proposal for the handling of gas and nuclear energy, which are both now considered taxonomy-aligned. Implementation is expected to take place in early 2023 and the corresponding processes are already under way, pending final scrutiny by the European Parliament and Council. If no objections are raised, the amendments to the SFDR RTS will enter into force, along with new disclosure templates, three days after their publication in the Official Journal of the European Union.

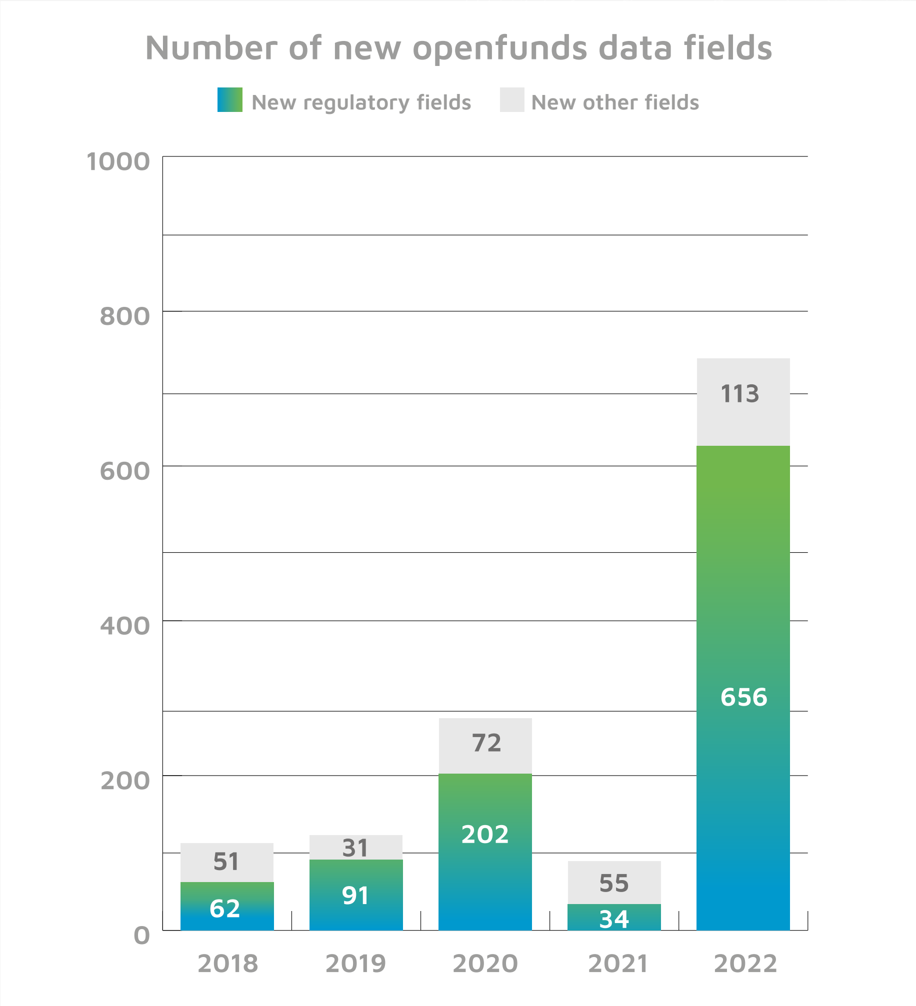
For fund managers, this raises an uncomfortable scenario. As the corresponding new RTS will effectively become the new rule just three days after the journal's publication, all pre-contractual reports will need to be newly prepared and submitted.

This further raises a concern on the subject of data – and more specifically around the availability of corresponding data and the ability of data providers to supply this data in order to help market participants comply with the new disclosure requirements. Therefore, the problematic sequential order of the EU regulation becomes clear once again.

> **Approval of the amendments to the SFDR RTS, expected in early 2023, will enter into force just 3 days after their publication in the Official Journal of the European Union. This raises an uncomfortable scenario for fund managers who will need to prepare and submit new pre-contractual reports.**

Fund data growth

An analysis of openfunds fields shows just how much of an impact regulatory change and the introduction of sustainability disclosures have had on data growth. Regulatory change is the biggest driver of data growth, with 68.7% of new fields created in the past five years being as a result of new regulations or a change in regulations. 2022 was a particularly memorable year, with SFDR regulation injecting 90.7% of the 656 new regulatory fields created (from the EET). PRIIPs[5] changes account for the remaining number of regulatory fields created in 2022 (from the EPT[6]), effective as of 1 January 2023, alongside SFDR.



However, this is not the only big issue. While various Q&As in recent months have led to a large number of clarifications on the one hand, they have also undoubtedly triggered the withdrawal of almost all Article 9 funds from the market. The defined minimum criteria for Article 9 funds have led to many providers relabelling them as Article 8 funds. Passive investments that have tracked various Paris Aligned or low-carbon indices can be found among these. This trend is currently leading to the near extinction of Article 9 funds, which was certainly not planned by the regulator. Therefore, further clarifications are expected in 2023 which could lead to a new wave of classifications that may invite more Article 9 funds back into the market.

[5] Packaged Retail and Insurance-based Investment Products
[6] European PRIIPs Template

MiFID II & IDD

In August 2022, both MiFID II and the Insurance Distribution Directive (IDD) introduced the requirement in the EU for distributors to ask their clients about their sustainability preferences as part of the suitability assessment.

But, as has often been the way, the implementation of this change has been strictly prescribed by the European regulators, both in terms of its place in the suitability assessment process and in how a distributor has to incorporate a client's preferences in the provision of advice and product recommendations.

The existing criteria for consideration in the suitability assessment (knowledge and experience, capacity for loss, etc.) continue to take precedence, and sustainability preferences should only be considered after those. And, whatever the client's response, the regulators only accept three criteria when it comes to matching preferences to investment products:

- The proportion invested in sustainable investments as defined in SFDR Article 2(17);
- The proportion invested in taxonomy-aligned assets; or
- Whether the product considers principal adverse impacts (PAIs).

Once a client has expressed sustainability preferences, only those products that meet them may be recommended. Any deviation from that is possible only if the client changes their preferences and this is documented by the adviser.

While the consideration of sustainability preferences has not been specifically mandated in the UK, the need to consider the obligations as part of the Consumer Duty means that any such preferences expressed by a client must be included in any product or fund recommendation.

PRIIPs disclosures

In Europe, the United Kingdom and other jurisdictions close to the EU

Rarely has a single regulation been so roundly condemned from every angle from the very beginning as much as the one for PRIIPs. Barely were PRIIPs KIDs out of their wrappers before both the EU and UK regulators were forced to acknowledge the need for significant changes to disclosures. However, they chose very different solutions to the most contentious issue: that of how to show meaningful return expectations.

The most contentious issue: How to show meaningful return expectations.

While the route chosen by the EU was to try to make the performance scenarios "less pro-cyclical" by extending the price history required and making the calculations more complex, the answer chosen by the UK was to get rid of them completely and replace them with narrative explanations around the drivers of future returns.

But the truth was finally accepted in the UK, as evidenced in HM Treasury's consultation paper in December 2022, which said bluntly that the "PRIIPs Regulation, which the UK inherited from the EU, is not fit for purpose". And, just to make sure the message was clear, the paper added that the;

"Regulation will be repealed by the Financial Services and Markets Bill and the government intends to commence this as a matter of priority".

PRIIPs KIDs will not disappear from the UK before a replacement retail disclosure regime is put in place.

The consultation is open until 3 March 2023, so the timetable for changes is not yet clear, but PRIIPs KIDs will not disappear from the UK before a replacement retail disclosure regime is put in place. While "it is the government's view that it would not be appropriate for different disclosure regimes to govern UCITS and PRIIPs in the long term", the aim is for a flexible approach that takes the complexity of the product into account without the need to shoehorn a range of disparate products into a single template.

While UCITS KIIDs continue to exist and PRIIPs KIDs are on death row in the UK, PRIIPs KIDs march on in the EU as the retail pre-sale disclosure document, at least until the outcome of the promised review of the whole regulation. The fixed three-page limit is now supplemented by two additional documents signposted from the KID (but not technically part of the KID) showing past performance and a monthly update of the performance scenarios.

Switzerland has also adopted the PRIIPs KID as an acceptable alternative to its own disclosure document, the Basisinformationsblatt, as long as foreign funds include (generally in an annex running to a fourth page) information on the paying agent, Swiss representative, country of domicile and where fund documents may be obtained.

Norway – a member of the European Free Trade Association (EFTA) and the European Economic Area (EEA), which normally follows EU rules very closely – has chosen yet another route. Finanstilsynet, the country's financial regulator, published its position in November 2022, based on a lack of approval of the PRIIPs Regulation by the Norwegian Parliament.

From 1 January 2023 "until further notice", Norwegian mutual funds marketed locally must publish UCITS KIIDs, while those marketed elsewhere need to publish whatever pre-sale document is mandated by the host state, i.e. EU PRIIPs KIDs in the EU or UCITS KIIDs in the UK. However, EU-domiciled funds will be able to use their PRIIPs KIDs (prepared in Norwegian) when marketed in Norway.

Unsurprisingly, Finanstilsynet also felt the need to warn distributors that there would be two different and incomparable types of key information document circulating for mutual funds in Norway.

Evolution of EPT

With both UK and EU PRIIPs KIDs changing, it was clear that the European PRIIPs Template (EPT) created in 2017 by FinDatEx, the pan-European industry body set up to facilitate data exchange, would no longer be valid, so Version 2.0 was created at the beginning of 2022 to cope with the new EU data fields.

Following the FCA's publication of final rules on PRIIPs KIDs in the UK (and clarification that an EU-domiciled fund sold in the UK would need a UK PRIIPs KID or a UCITS KIID, as appropriate), further changes to the EPT were needed.

While the biggest difference between EU and UK PRIIPs KIDs centres around the treatment of performance illustrations, other changes are fairly minor, so it was decided to merge the data fields into a single template branded Version 2.1, with a new section for UK-specific fields.

Funds linked to PRIIPs available only to retail investors in the EU may choose to complete either Version 2.0 or Version 2.1, while any funds with a UK connection need to complete Version 2.1, taking note of which fields need to be populated based on the geographical distribution profile.

UNITED KINGDOM

December 2021
FCA's PS21/24 on enhancing climate-related disclosures and ESG sourcebook published

Who does it impact?
• Product providers

October 2022
FCA's CP22/20 on Sustainability Disclosure Requirements (SDR) and investment labels published

Who does it impact?
• Product providers
• Distributors
• Platforms

January 2023
FCA's CP22/20 consultation period ends

Who does it impact?
• Product providers
• Distributors
• Platforms

June 2023
FCA expected to finalise rules and publish a policy statement (PS) on SDR – to encompass TCFD[7] disclosures already in place

Who does it impact?
• Product providers
• Distributors
• Platforms

June 2024
Labelling, naming and marketing, consumer-facing and pre-contractual disclosure requirements and rules for distributors (12 months from publication of the PS)

Who does it impact?
• Product Providers

December 2024
Discretionary fund managers subject to same labelling, naming and marketing regime based on underlying funds

Who does it impact?
• Discretionary fund managers

June 2025
First ongoing sustainability performance-related disclosures to be published (24 months from publication of the PS)

Who does it impact?
• Product Providers

[7] Task Force on Climate-Related Financial Disclosures

The road to net zero by 2050

FCA's Sustainability Disclosure Requirements Consultation Paper (CP22/20)

Following consultation with its industry-wide Disclosure and Labelling Advisory Group[8] (DLAG), the FCA's CP22/20 threw up a number of changes from the discussion paper from a year earlier, notably in the fund labelling and naming proposals. Most of these have been welcomed, but there may still be wrinkles to iron out before final rules are published.

Proposals in the consultation include three sustainability investment labels that serve different investor needs and are seen as being mutually exclusive without a hierarchy, i.e. with no different shades of "green":

Sustainability Investment Labels		
Sustainable focus	**Sustainable improvers**	**Sustainable impact**
Investing primarily in sustainable assets, or those aligned with a sustainability theme	Aiming to deliver improvements in the sustainability profile of their assets over time	Directing new capital to projects or activities that aim to deliver positive impact
Intentionality + Sustainability objective + Financial objective		

The key for all three labels is intentionality, with each one requiring a sustainability objective alongside a financial objective. While all are expected to use engagement and stewardship to drive improvements in the sustainability profile of underlying investments, this will be the primary focus of the "improvers" category.

Alongside the labels is a proposed naming and marketing regime that will ban funds which do not qualify for a label from using any term that might imply sustainability characteristics, either in their name or in any marketing; for example, only "impact"-labelled funds will be allowed to use that term.

The consultation closes on 25 January 2023, and the FCA expects to publish its policy statement by the end of June 2023. The sustainable fund labels, restrictions on using terms implying sustainability and first consumer-facing and pre-contractual disclosures will start a year later, with periodic disclosures a further year after that.

The FCA's motivation is clearly spelled out in the consultation paper: it wants greater transparency around sustainability in order to reduce the risk of greenwashing and help to rebuild consumers' trust in the financial services industry. Only as possible secondary outcomes do we see the goals of achieving a greater availability of sustainable investment products and increased funding for sustainable activities.

As with the discussion paper, the TCFD recommendations will be the baseline, supplemented by the International Sustainability Standards Board (ISSB) standards, once they are finalised.

The FCA wants greater transparency around sustainability in order to reduce the risk of greenwashing and help to rebuild consumers' trust in the financial services industry.

[8] https://www.fca.org.uk/publication/fca/dlag-terms-of-reference.pdf

Consumer Duty

1 July 2022
Consumer Duty in force (start of transition period)

27 July 2022
FCA's PS22/9 and FG22/5, with new rules and non-handbook guidance, published

Who does it impact?
- Product providers
- Platforms
- Distributors
- Financial advisers
- FCA-authorised service providers

31 October 2022
Boards/management of all firms to have implementation plans in place

Who does it impact?
- Boards/management of all firms

30 April 2023
Product and service providers to complete their reviews and share these with distributors/advisers so they can meet the July deadline

Who does it impact?
- Product providers
- Platforms
- Distributors
- Financial advisers
- FCA-authorised service providers

31 July 2023
End of transition period for open products (postponed from 30 April 2023)

Who does it impact?
- Product providers
- Platforms
- Distributors
- Financial advisers
- FCA-authorised service providers

31 July 2024
End of transition period for closed products

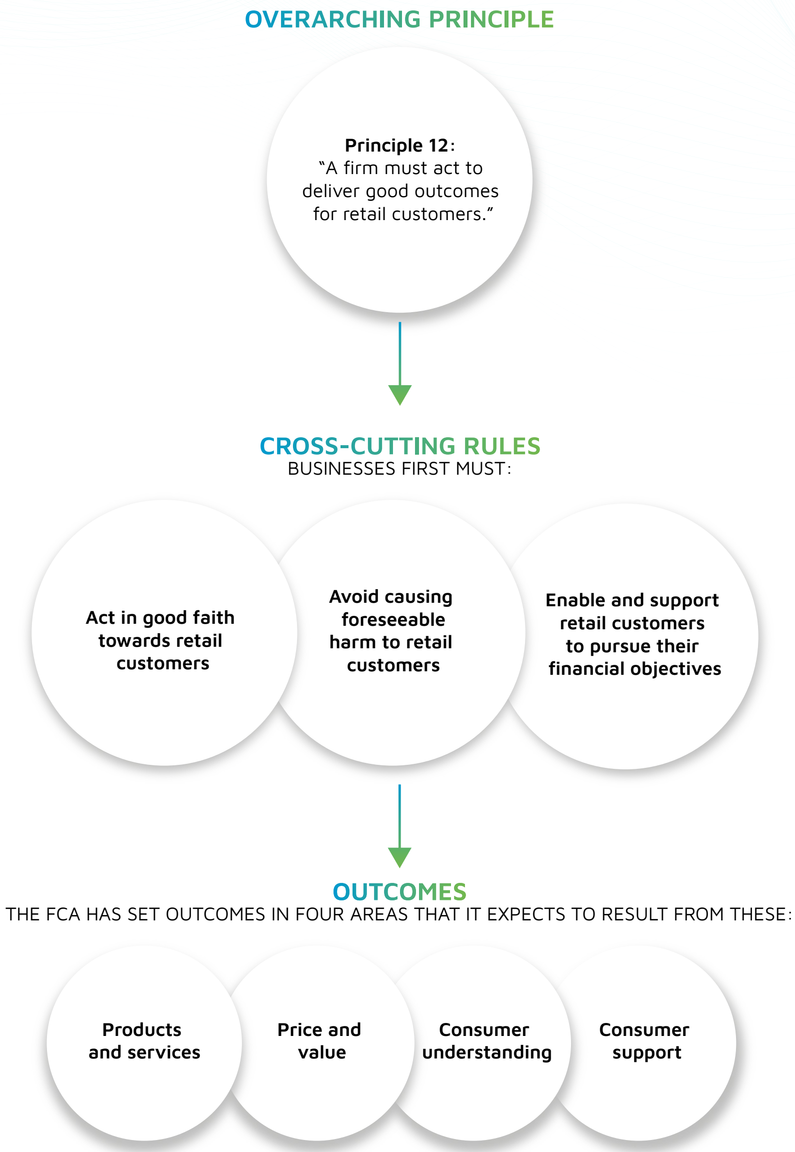
Who does it impact?
- Product providers

In July 2022 the FCA published its policy statement and non-handbook guidance on the introduction of the Consumer Duty.

The good news was that it accepted a delay to the start date, pushing it back to the end of July 2023. But the bad news was that every regulated firm in the UK would need all of the intervening year to get fully up to speed, particularly as there was to be much less time before firms were to have their implementation plans in place: by the end of October 2022, only three months after the publication of the final details.

The FCA later accepted that this was far too tight a timescale and instead required firms in the meantime to show they were making good progress towards having an implementation plan, with providers needing to be able to share their plans with advisers and distributors by the end of April 2023, giving everyone three months to meet the July deadline.

What do the final FCA rules entail?



FCA-regulated firms will need to consider the needs and circumstances of consumers above all. This means that providers will need to ensure they create products and services to meet the needs of a specified section of the market, and that advisers and distributors will need to ensure that those products don't get into the hands of those for whom they have not been designed.

Those products and services will also need to be available at a price that provides value to the end consumer. The FCA accepts that the cheapest may not always mean the best, but the cost of a product or service must be appropriate to the end consumer's risk–return profile.

There has been a lot of attention paid to the need to consider the needs of vulnerable clients in terms of ensuring that they get the support they need and understand what they are being told by their adviser or providers. This aspect has garnered such attention because it is clear that vulnerability does not refer only to disabilities or age: clients may also temporarily be vulnerable if they are going through a major life change, such as bereavement.

Further developments and clarifications will certainly be made around the Consumer Duty in 2023 as the implementation deadline approaches. But one thing is clear: businesses can no longer simply carry on as normal and hope that nothing will change.

HONG KONG

June 2021
SFC's 'Circular to Management Companies of SFC-authorised Unit Trusts and Mutual Funds – ESG Funds' published

Who does it impact?
All SFC-authorised funds which incorporate ESG factors as their key investment focus and reflect such in the investment objective and/or strategy
Effective date 1 January 2022

August 2021
SFC's 'Circular on Management and Disclosure of Climate-related Risks by Fund Managers' published

Who does it impact?
Baseline disclosures affect all fund management companies, Enhanced disclosures affect Large Fund Managers (with AUM of HK$8bn+). Final deadlines for compliance no later than November 2022 (or August 2022 for Large Fund Managers)

December 2021
Supervisory Policy Manual – Climate Risk Management (GS-1) expectation for banks to develop risk management frameworks in relation to climate risk and align climate disclosures with the TCFD by no later than 2025

Who does it impact?
Banks

January 2022
SFC's 'Circular to Management Companies of SFC-authorised Unit Trusts and Mutual Funds – ESG Funds' comes into effect

November 2022
SFC's 'Circular on Management and Disclosure of Climate-related Risks by Fund Managers' comes into effect

An emerging sustainability framework

Given Hong Kong's role as an integrated global capital hub for businesses in mainland China, emerging ESG regulations can have a widespread impact. While to date it is Hong Kong's listed companies and the broader financial sector that are feeling the greatest impact, we expect that other corporates will also be starting to experience the flow-on effects of upgraded regulatory requirements on ESG issues.

Since 2016, Hong Kong-listed companies have needed to report on ESG elements on a comply-or-explain basis. However, financial regulators are now also requiring banks and asset managers to address climate-related risks and disclosures.

In 2021, the Securities and Futures Commission (SFC) issued its 'Circular to Management Companies of SFC-authorised Unit Trusts and Mutual Funds – ESG Funds', which aims to enhance the disclosure standards of ESG funds. The circular also acted to enhance naming and disclosure requirements, as well as adding a requirement to carry out periodic assessment and reporting.

In addition, the SFC also released upgraded disclosure requirements for managers of collective investment schemes requiring them to take climate-related risks into consideration and make appropriate disclosures. The requirements have been broken down in three ways: using Baseline and Enhanced categories; at the entity and fund level; and between Large Fund Managers (with AUM over HK$8bn) and the rest. The SFC also set two transition periods across these categories, the last of which came into effect in November 2022 (Enhanced disclosures for Large Fund Managers, and Baseline disclosures for other groups). Disclosures should be reviewed at least annually and updated as necessary.

It is also worth noting that under the circular, UCITS funds will be considered "ESG funds" in Hong Kong if they incorporate ESG factors as their key investment focus and reflect such in their investment objective and/or strategy. UCITS ESG funds which meet European disclosure and reporting requirements for Article 8 or Article 9 funds under the SFDR will be deemed to have generally complied in substance with the disclosure requirements set out in the circular.

However, on 1 January 2023 the Level 2 requirements under the Regulatory Technical Standards (RTS) for SFDR came into effect, meaning that managers of UCITS products will need to comply with the SFDR Level 2 requirements. As UCITS are updating prospectuses, managers should ensure that relevant SFC requirements are met. Generally, non-material changes should not require prior approval from the SFC. However, managers would likely need to confirm that:

- RTS requirements do not trigger a material change to the fund;
- There is no material change or increase in the overall risk profile of the fund following the changes; and
- Changes don't trigger any material adverse impact on holders' rights or interests.

UCITS funds will be considered "ESG funds" in Hong Kong if they incorporate ESG factors as their key investment focus

Following the regulatory clarification around the SFDR in 2022 stating that funds with sustainable investment as an objective should only make sustainable investments, some SFC-authorised UCITS may no longer satisfy the requirements of SFDR Article 9 and the SFDR classification may need to change. Managers of these UCITS should consider any implications of re-classification and comply with relevant SFC requirements, including regulatory approval and investor notice requirements.

Regulators have also highlighted the need for comparable, reliable sustainability reporting to allow the market to direct capital to sustainable investments. As is the case with other global regulators, the progress of the ISSB standards (expected to be finalised very soon) is therefore a key focus.

Likewise, with the TCFD arguably becoming the default global framework for climate disclosure around the world, Hong Kong's Green and Sustainable Cross-Agency Steering Group (CASG) has announced that climate-related disclosures aligned with TCFD recommendations are to be mandatory across "relevant sectors" by 2025 (this is expected to capture listed entities, banks, insurance companies, asset managers and pension trustees).

China's recently implemented guidance for enterprise disclosure standards on ESG initiatives aims to establish a framework that officials say will be more suitable for assessing risk and performance indicators for investors steeped in the domestic market. The guidance draws on international developments in ESG priorities, but leans heavily towards priorities established by the Chinese government, such as the drive for common prosperity and social stability.

While to date Hong Kong looks to be adopting a business-as-usual response to the new regulation, the evolution of ESG rules in mainland China will bear watching. While there is a growing body of regulatory guidance for ESG reporting, developments appear to be heavily fragmented, with some guidelines remaining voluntary. Clearly, a more cohesive approach will be critical not only for China, but also for its financial counterparties.

SINGAPORE

2019
Green Finance Action Plan
Who does it impact?
Banking, insurance and asset management

January 2021
Proposed Green Taxonomy
Who does it impact?
Financial institutions

December 2021
Singapore Exchange (SGX) climate-related disclosures aligned with the TCFD framework. Publication of reports are on a phased basis commencing FY2022, ending FY2024 by sectors
Who does it impact?
Listed companies

May 2022
Green Taxonomy (second consultation)
Who does it impact?
Financial institutions

June 2022
Singapore Green Bond Framework
Who does it impact?
Bond issuers

July 2022
Circular No. CFC 02/2022 – 'Disclosure and Reporting Guidelines for Retail ESG Funds' published
Who does it impact?
Authorised or recognised schemes which use or include ESG factors as their key focus or strategy

January 2023
Circular No. CFC 02/2022 – 'Disclosure and Reporting Guidelines for Retail ESG Funds' comes into effect
Who does it impact?
Authorised or recognised schemes which use or include ESG factors as their key focus or strategy

The ESG circular takes effect

Since the release of Singapore's Green Finance Action Plan in 2019, the Monetary Authority of Singapore (MAS) has advanced its agenda on green financing with further requirements around climate-related disclosures.

This has been complemented by the Singapore Exchange (SGX) announcing in 2021 that it will introduce climate-related disclosures aligned with the TCFD framework. All issuers must provide climate reporting on a comply or explain basis in their sustainability reports from FY2022, with mandatory climate reporting becoming mandatory for issuers in the financial, agriculture, food and forest products, and energy industries from FY2023; and materials and buildings, and transportation industries from FY2024.

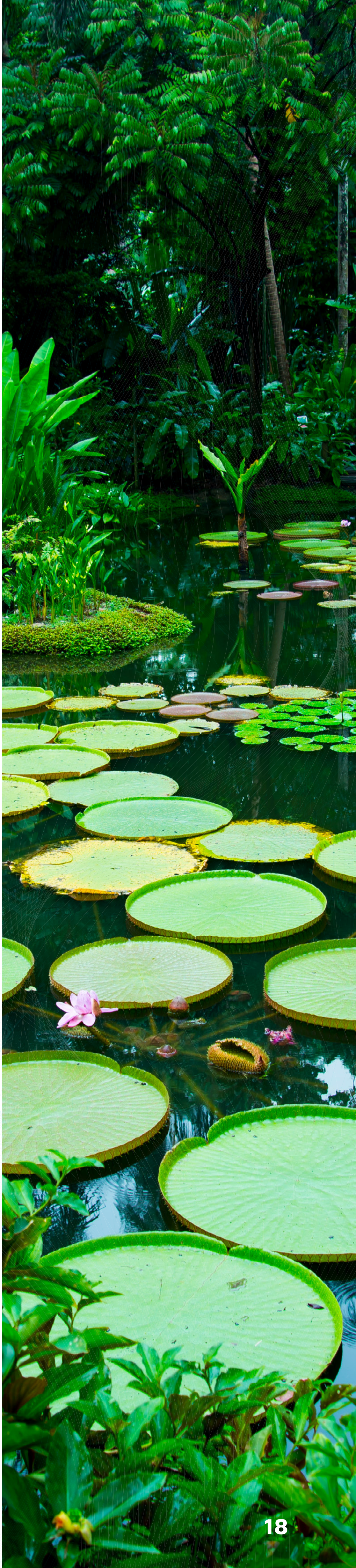
For fund managers, the release of Circular No. CFC 02/2022 – 'Disclosure and Reporting Guidelines for Retail ESG Funds' represents an important early step in market transparency. Effective from 1 January 2023, the circular requires retail ESG funds to provide details on their investment strategies, the criteria and metrics they use to select investments, and the risks and limitations associated with their strategies. In essence, funds that are sold under the ESG label will now have to provide relevant information to substantiate that label.

In order to mitigate the risk of greenwashing, MAS has defined an ESG fund as an authorised or recognised scheme that:

- Uses or includes ESG factors as its key investment focus and strategy (meaning that ESG factors significantly influence the scheme's selection of investment assets); and
- Represents itself as an ESG-focused scheme.

While recognising that ESG can be incorporated in a number of ways, MAS has stated that a scheme that only uses negative screening, or which merely incorporates or integrates ESG considerations into its investment process to seek financial returns, would not be regarded as having an ESG investment focus.

MAS has also provided guidance on exposure thresholds, noting it will consider factors including whether a scheme's net asset value is primarily (i.e. more than two-thirds) invested with an ESG focus. MAS also notes, however, that there may be cases where it is neither possible nor practicable for a manager to determine the proportion of a scheme's net asset value that has been invested with an ESG focus, and as such managers are expected to clearly explain how schemes' investments are substantially ESG-focused. This also ties back to the naming conventions for funds as delineated under the circular, which states that any trust including an ESG aspect in its name should reflect ESG as a focus in its investment portfolio and/or strategy in a substantial manner.



In addition to standard clauses regarding appropriate disclosure of the ESG nature of the investment focus, strategy and risks, the circular also requires managers to explain how any reference benchmark used to measure the attainment of an ESG focus is relevant to the focus of the fund. Also required are guidelines regarding annual reporting on ESG matters and disclosure regarding how ESG is measured and monitored for assumptions to be made.

Similar to Hong Kong, under the circular, UCITS funds will be deemed to have complied with the disclosure requirements under the circular if they are classified as falling under SFDR Article 8 or 9. However, given the launch of the Level 2 SFDR requirements, managers will need to be alert to ensure that changes do not conflict with the circular.

MAS has also publicly stated that it is putting in place programmes with other market participants so as to enhance sustainability disclosures. This initiative includes:

- Consultation on introducing mandatory disclosure requirements for financial institutions once the ISSB has established baseline standards.
- Mandatory climate-related financial disclosures by listed entities on a staged roll-out basis through to January 2024.
- Development of a sustainability reporting road map for all Singapore-incorporated companies.
- Development of a green taxonomy to help financial institutions classify activities as being environmentally sustainable, harmful or in transition.

At this point, the existing and pending disclosure frameworks in Singapore look to be fittingly focused on identifying key ESG metrics and mandating their disclosure in a manner that facilitates the formation of common standards.

AUSTRALIA

August 2019
ASIC's non-binding recommendation supporting the use of the TCFD when disclosing climate change-related risks and opportunities
Who does it impact?
Listed companies with material exposure to climate change

November 2021
APRA: CPG 229 'Climate Change Financial Risks'
Who does it impact?
Authorised deposit-taking institutions (ADIs), registrable superannuation entities (RSEs), RSE licensees, general insurers, life companies and private health insurers

June 2022
ASIC INFO 271: 'How to avoid greenwashing when offering or promoting sustainability-related products'
Who does it impact?
Responsible entities of managed funds, corporate directors of corporate collective investment vehicles and trustees of RSEs

August 2022
FSC Guidance Note No. 44 – 'Climate Risk Disclosure in Investment Management'
Who does it impact?
FSC investment management members

December 2022
Treasury consultation paper – 'Climate-related financial disclosure'
Who does it impact?
Listed entities, financial institutions (banks, insurers, superannuation funds)

Progress towards sustainability, but definitions currently lacking

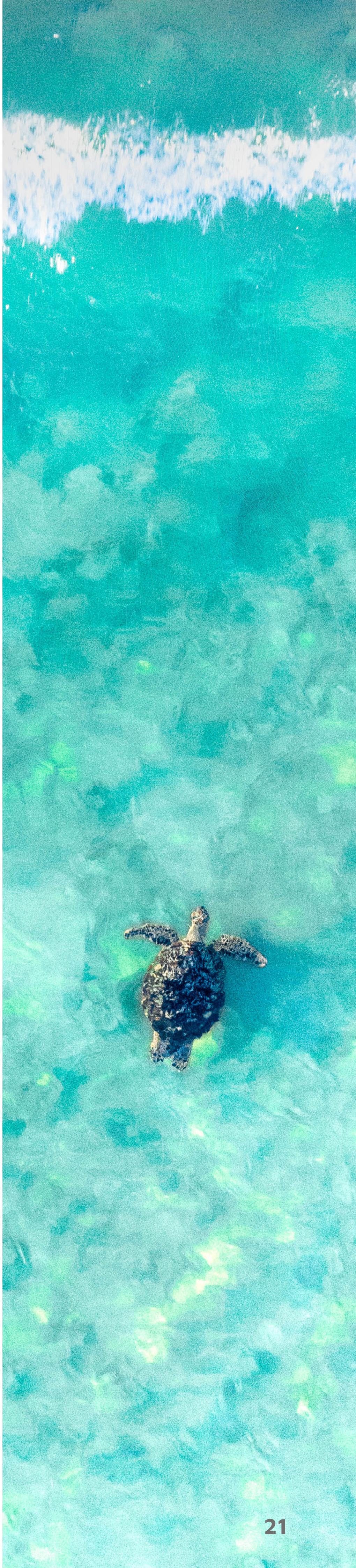
Unlike most developed economies, Australia currently lacks a clear legal framework on funds' disclosure requirements regarding what is classified as "green" or sustainable. This clearly makes it difficult to objectively assess to what extent funds either incorporate ESG principles or pursue sustainability objectives.

Australia's key financial services regulators, which collectively form the Council of Financial Regulators (CFR), have taken broad steps to ensure financial institutions and other corporations manage the financial risks associated with climate change. Chiefly, however, this has been through engagement with the international community to contribute to the development of best practice in addressing climate-related risks. Currently, CFR is focusing on the following broad themes:

- Measuring and understanding climate-related risks
- Setting supervisory expectations for management and disclosures of climate-related risks
- Further improving climate-related risk disclosures
- The impact of emerging international taxonomies and standards

CFR agencies are also actively engaged in international forums regarding the alignment of domestic and international actions. An area of particular interest is the proposed International Sustainability Standards Board (ISSB) standards, which aim to drive greater consistency in sustainability reporting. In addition, as jurisdictions including the EU, UK and New Zealand move towards mandating the disclosure of climate risks, consideration is being given to the possible impacts of these developments on Australian firms and whether and how Australia should respond to these international developments.

Regulators had in the past expressed the opinion that companies should consider providing further and more detailed voluntary disclosure under the recommendations developed by the global industry-based TCFD; however, they had traditionally stopped short of mandating this approach. Also, despite a lack of clear guidelines as to what "green" is defined as being, Australian Securities & Investments Commission (ASIC) will still act against funds if they breach the Corporations Act by engaging in conduct that is, or is likely to be, misleading and/or deceptive.



To date, there are three different sets of non-binding market guidance which have been issued:

- ASIC Information Sheet INFO 271: a principles-based guidance note which emphasises that to avoid misleading or deceptive greenwashing practices, product issuers should consider several key questions as to whether disclosures about sustainability-related products are providing:
    - Truth in promotion by using clear labels and defining sustainability-related terminology
    - Clarity in communication by providing clear explanations of how sustainability-related considerations are factored into investment strategies
- The Financial Services Council (FSC) Guidance Note No. 44: a principles-based guidance note seeking to provide a set of common baseline expectations for the investment management industry's approach to claiming net zero through the disclosure of climate-friendly investment features and climate change risk reporting.
- Australian Prudential Regulation Authority (APRA) – CPG 229 'Climate Change Financial Risks': a principles-based approach designed to outline prudent practices in relation to climate change financial risk management. The guidance seeks to reflect the established framework for considering and managing climate risks developed by the TCFD as well as good practice observed through APRA's own analysis.

Despite a lack of formal regulations, it is important to note that the industry has been willing to take the lead on driving sustainability initiatives. The Australian Sustainable Finance Institute (ASFI) was formalised in 2021 to coordinate, facilitate and drive the implementation of the industry-designed Australian Sustainable Finance Roadmap.

The Roadmap highlights a number of key proposals which can be categorised under four domains: embedding sustainability into leadership, integrating sustainability into practice, enabling resilience for all Australians, and building sustainable finance markets.

There are several key recommendations that outline the potential shape of activity relevant to the fund management industry, which can be summarised as follows:

- Recommendation 9 – An Australian sustainable finance taxonomy should be established (this is already under way).
- Recommendations 11 and 12 – Financial institutions and ASX-listed companies should report according to TCFD recommendations (subject to threshold rules) by 2023.
- Recommendation 19 – Financial institutions should work with financial system regulators to embed sustainability into regulatory standards.
- Recommendation 27 – Australia's financial system participants should support the development of sustainability labelling and disclosure for financial services products.
- Recommendation 28 – Financial advisers, superannuation funds, accountants and platforms should ensure they consider the sustainability preferences of consumers.

Significantly, all of these recommendations echo critical developments in the UK, EU, US and elsewhere. Even more significantly, on 12 December 2022 Australia's Treasury announced its commitment to an Australian Government Sustainable Finance Agenda and the launch of an industry consultation process on a proposed mandatory climate-related disclosure regime in the pursuit of comprehensive sustainability reporting in line with international trends and standards.

Several key elements have been raised in the consultation (which will conclude in February 2023). Firstly, as with other countries, a phased approach has been proposed, commencing with the suggestion that large listed and financial entities should issue their first climate disclosure reports in FY 2025. Secondly, the delivery of a reporting requirement that is internationally compatible, initially TCFD-aligned and able to reflect ISSB standards (when available) has also been suggested.

It is logical for Australia to align its disclosure requirements with those of major global markets, and for these standards to become mandatory. The challenge for the industry, however, will not only be to agree on meaningful compatible standards, but also to achieve the necessary transformation in measurement and reporting that meeting these standards will require.

While the exact picture of sustainability regulation remains unclear, a definite shape is forming. Participants in Australian financial services would do well to consider not only current developments but also the lessons learnt from offshore developments to guide future planning and resourcing.

DDO catching managers out

As noted in our 2022 regulatory outlook, Australia's Design and Distribution Obligations (DDO) came into effect on 5 October 2021. The DDO seeks to increase product providers' responsibility beyond disclosure so that there is less reliance on consumers' financial literacy and financial advice.

For every product in scope (i.e. any product requiring a Product Disclosure Statement, prospectus or disclosure to investors under the Corporations Act), its provider needs to produce a "clear and concise" Target Market Determination (TMD) document. This TMD sets out the type of consumers for whom the product may be appropriate and why, and how long they should consider holding the product. It also needs to describe any triggers that would prompt a review of the TMD and how often a scheduled review should take place.

In ASIC's Corporate Plan for 2022–26, DDO is listed as one of the regulator's four priorities. ASIC has stated it will actively pursue targeted, risk-based surveillances and take enforcement action, including issuing stop orders, and other regulatory action to address poor design and distribution of products.

In August 2022, ASIC Chair Joseph Longo noted that;

"we have now shifted our focus from facilitating implementation to active supervision and enforcement".

True to his word, by 31 December 2022 ASIC issued over 20 interim stop orders on "DDO-related" matters, halting distribution and potentially causing significant reputational damage.

ASIC initiated civil penalty actions in Australia's Federal Court against two firms in Dec 2022,

Key issues identified in these cases have included:

- An outright lack of TMDs
- Failure to appropriately identify the consumers they intended to target
- Features and risks of a product being judged not to have been suited to the TMD target market
- Breaches of the requirement to specify appropriate trigger points for review

In addition, ASIC initiated civil penalty actions in Australia's Federal Court against two firms in December 2022, highlighting the risks facing entities which breach DDO legislation.

ASIC has also urged superannuation trustees to review and, if necessary, improve the effectiveness of TMDs for their products after a sample review of trustee compliance found some poor practices. ASIC noted that some of the TMDs lacked specificity and raised questions about the underlying arrangements that trustees have in place to ensure their products reach the right consumers.

While the number of enforcement actions taken to date has been relatively low (in comparison with the market as a whole), ASIC has initially targeted those sub-segments of the market that it has long held to be problematic when it comes to retail understanding. However, an increase in enforcement across the wider market is also already starting to occur, with some equity funds also receiving stop orders in November 2022. We expect to see rapid evolution in definitions for target markets and monitoring processes going forward.

The FSC, the Australian industry trade body, had previously noted some inevitable teething problems with TMDs, and we expect to see guidance on them continue to be refined. In the meantime, product issuers need to ensure that the creation, monitoring and distribution of TMDs remains robust in the face of regulatory pressure.

LOOKING AHEAD

With the changes to PRIIPs KIDs in both the EU and UK out of the way at the end of 2022, focus will move onto the key issues of 2023 and beyond.

The top priority almost everywhere is now sustainability disclosures.

Just because the EU's SFDR Level 2 prescribed disclosure templates took effect on 1 January does not mean that everything about sustainability disclosures is now done in Europe. Apart from the challenges of collecting the data on underlying investee companies, which will continue for some time, there are still regulatory developments to come.

The disclosure templates will change again, as soon as the inclusion of natural gas and nuclear power has been signed off, probably before the end of the first quarter of this year. And the EU Taxonomy needs to be finalised, with all the details on how to assess economic activities in respect of the remaining four environmental objectives: protection of water and marine resources, pollution prevention and control, restoration of biodiversity and ecosystems, and the transition to a circular economy.

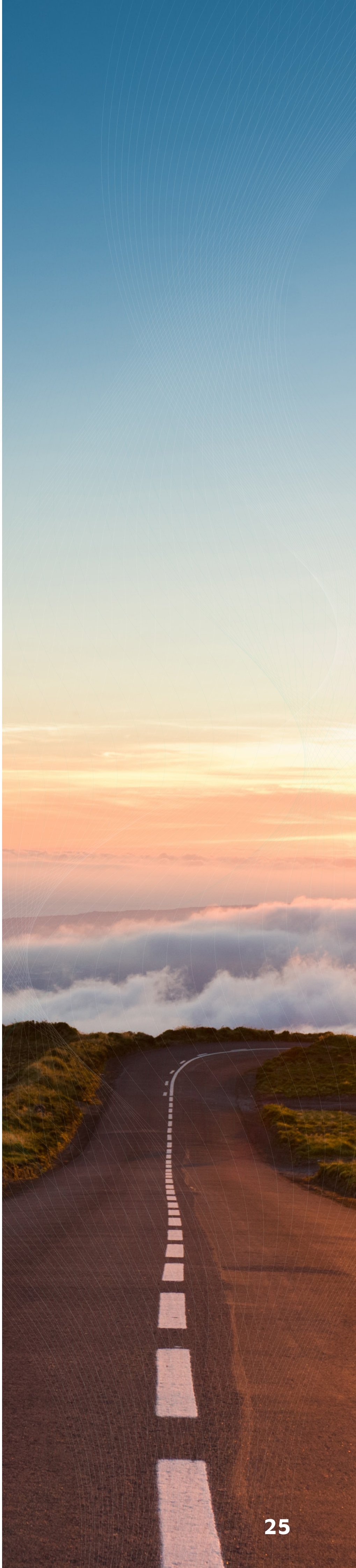
At least the EU has published its green taxonomy, so it won't be joining the many countries, including the UK and Australia, that are looking to publish theirs, possibly this year.

The UK is also developing its Sustainability Disclosure Regime and proposed sustainable fund labelling system. The plan is to publish a policy statement in June and to start the staggered implementation process then, starting with its general anti-greenwashing rule. Just a month later, at the end of July, the FCA's new Consumer Duty is due to take effect, with the aim of driving cultural change at firms all along the product chain, putting the consumer's interest at the heart of everything.

If you thought all things PRIIPs are now out of the way, the European Supervisory Authorities (ESAs) are due to report back to the European Commission by the end of April on their proposed changes to the regulation itself. Having tinkered around with the Level 2 details, this is the long-overdue review that the original regulation in 2014 said should happen by the end of 2018. Among other things, this review should be looking at the delivery mechanism of KIDs and whether the products in scope need to be changed.

Not to be left out, the UK is looking at a complete overhaul of not just PRIIPs KIDs but the entire retail disclosure framework. Both the Treasury and the FCA are consulting on this, but we are still at an early stage; with the exemption for UCITS KIIDs in place until possibly the end of 2026, there is time to get this right.

To find out how we can support your regulatory compliance and reporting, contact our team of specialists.



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