



ESG: WHAT TO EXPECT FROM FINANCIAL REGULATORS IN 2023 – DISCLOSURES, DATA AND 'GREENWASHING' IN THE SPOTLIGHT

ESG disclosures, data product and ratings providers and 'greenwashing' will be in the regulatory spotlight in 2023, as financial regulators seek to implement measures aimed at improving the sustainability information made available to investors and to ensure that claims of being 'green', 'climate-friendly' and 'sustainable' stand up to scrutiny.

DISCLOSURES

Channelling private capital towards sustainable investments, seen as integral to the success of 'sustainable finance' strategies, relies on 'decision-useful' disclosures along the investment chain. Consequently, in recent years there have been efforts to improve the quality of non-financial, 'ESG' or 'sustainability' disclosures produced by corporates, with many countries around the world, including the US, the EU and the UK, introducing more rigorous corporate sustainability reporting obligations, with more in the pipeline. In parallel with this, improving the quality of disclosures to investors has been high on the regulatory agenda – a trend that will continue in 2023. The EU led the way with the Sustainable Finance Disclosure Regulation (SFDR) and the Taxonomy Regulation, which require disclosure of the sustainability characteristics of investment products, to assist end investors in making more informed investment decisions. Now similar rules are proposed elsewhere, including in the UK and the US. In May 2022, the US Securities and Exchange Commission issued [proposals](#) for ESG disclosure rules and updates to the Names Rules. Meanwhile, the UK financial services regulator, the FCA, has recently consulted on a proposed regime for sustainable disclosure requirements and investment labels, known as the [SDR](#), with a policy statement expected in June 2023 and the majority of rules to apply from June 2024. For firms, particularly asset managers with global businesses, 2023 is likely to be a year when the convergence of reporting standards and the interoperability between various disclosure regimes will be high on the agenda, as will the need to clarify key concepts underpinning the EU disclosure regime, with Q&A expected to be published by the Commission early in 2023.

Implementing SFDR has raised numerous practical issues that are likely to feature in the Commission's forthcoming evaluation. The Commission is expected to issue a consultation paper in 2023 and we expect the lack of clarity around SFDR disclosure to feature prominently in this assessment. In some senses, the difficulties encountered in implementing SFDR appear to have been reflected in the UK proposals, with certain elements of the EU

regime – for example, 'Do No Significant Harm' – excluded as they are considered too restrictive. Alignment with the EU Taxonomy is similarly not required under SDR, as the UK is opting instead for the development of a UK Green Taxonomy, although the legislation relating to this has been delayed, pending a review by the UK Government of its approach. Further information on this is expected to be included in the updated UK Green Finance Strategy, to be published in early 2023.

Delays to the UK Green Taxonomy, as well as plans to expand the regime over time in line with sustainability reporting standards of the International Sustainability Standards Board (ISSB) which are still in development, have led some in the financial industry to urge caution in requiring SDR disclosures before the UK Green Taxonomy and ISSB standards are fully in place. This is due to concerns about compounding the problem of 'data gaps', which has been an issue in the implementation of SFDR and Taxonomy reporting, where non-availability of Taxonomy-related information has been a major challenge. Until the Corporate Sustainability Reporting Directive is implemented, which will be in phases from 2024 to 2028, the industry will, at least to some extent, remain reliant on proxy data from third-party providers, hence the interest of financial regulators in this segment of the market.

ESG DATA PRODUCT AND RATINGS PROVIDERS

Disclosure requires data. Consequently, there has been a proliferation in recent years of ESG data products and ESG ratings providers. Although there have been some attempts at self-regulation through voluntary codes of conduct, such as in Japan, this growing sector of the financial market is largely unregulated. This will begin to change in 2023, as regulators in several jurisdictions are considering introducing regulatory requirements, as recommended by IOSCO in its 2021 report, to address concerns about the transparency of methodologies, governance of ratings processes and management of conflicts of interest. For example, as part of the so-called 'Edinburgh Reforms' of financial services, the UK Government has said that it will consult on bringing ESG data product and ratings providers within the regulatory perimeter in Q1 2023, building upon its October 2021 Roadmap to Sustainable Investing. The EU is similarly considering measures intended to strengthen the reliability and comparability of ESG ratings, with a legislative proposal in this area expected in June 2023.

For those affected by ESG data and ratings, whether as providers or users, as well as the companies that are the subject of them, the interaction of new regulatory requirements with voluntary codes and the international consistency of requirements are likely to be high on the agenda in 2023.

'GREENWASHING'

In 2023 we will continue to see further regulatory scrutiny of 'greenwashing' in the financial sector, both in terms of enforcement action and in a re-calibration of regulation intended to tackle concerns that firms may be making exaggerated, misleading or unsubstantiated claims about the sustainability credentials of their financial products.

Financial services regulators in many countries, including the [US](#), EU and UK, are already addressing greenwashing concerns. The UK SDR regime for example, proposes sustainable investment labels, disclosure requirements and restrictions on the use of sustainability-related terms in product naming and marketing materials from UK asset managers, in addition to containing an 'anti-greenwashing rule', under which sustainability-related claims must be fair, clear and not misleading. The US SEC proposals of May 2022 cover similar ground, with requirements for sustainable investment funds, categorising products to determine disclosures and proposing changes to product naming

rules, aimed at enabling investors to make better-informed decisions about these products. More broadly, the European Supervisory Authorities have recently issued a Call for Evidence, seeking input on potential greenwashing practices in the whole EU financial sector, including banking, insurance and financial markets. A progress report is expected by the end of May 2023 and a final report by the end of May 2024. Alongside this, we also see in the EU a push to prevent misleading or deceptive fund names. The EU financial services regulator ESMA is consulting on guidelines on funds' names using ESG or sustainability-related terms and expects to issue guidelines by Q2/Q3 2023. In parallel, financial regulators are stepping up supervisory engagement and enhancing their enforcement strategies around ESG. This is likely to result in increased enforcement activity in many countries, including in the UK and in the US, where the SEC's Climate and ESG Taskforce has been active.

So data, disclosure and 'greenwashing' are very much on the regulatory agenda in 2023. They are interconnected and highly dynamic. The challenge for regulators and the financial sector is a globally coherent regime that addresses these issues while facilitating provision of 'decision-useful' information to investors. Expect efforts to achieve this objective in 2023 and beyond.

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