# Clients&FriendsMemo

## "Climate Risk Is Investment Risk":[1] The Asset Management Industry Confronts The Challenges and Opportunities Presented By Climate Change Transition

**February 2, 2022**

### Introduction

The asset management industry has been sounding the alarm for some time about the risks and opportunities posed by climate change. While private equity giant, Carlyle, is the most recent financial institution to hit the headlines for its pledge to reach net zero greenhouse gas emissions by 2050, it is not the first and certainly will not be the last.[2] As detailed in our previous article, Investors and Regulators Turning up the Heat on Climate-Change Disclosures: Attempting to Make Sense of the State of Play in the US, EU, and UK, asset managers have been signaling the importance of issuers disclosing environmental impacts for more than a decade—creating focus groups to study sustainability-related risks, pushing for guidance from regulators concerning climate-related disclosures, and publicly supporting shareholder efforts for increased transparency concerning climate-related risks. Our previous article also highlighted how the regulatory and public company responses to these calls for improved climate-related disclosures have been slow to arrive and inconsistent in substance—issuers are disclosing different amounts and types of information, and using different methodologies and metrics to measure, for example, greenhouse gas emissions, with little guidance from regulators. Because sustainability-related disclosures made at the fund level necessarily depend on issuer disclosure,[3] the lack of standardized and consistent disclosures has posed significant challenges for the asset management industry.

Confronted with these challenges, asset managers' calls for action have intensified in recent years. In June 2021, 457 investors representing over $41 trillion in assets under management ("AUM")

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1 BlackRock, Larry Fink's 2022 Letter To CEOs: The Power of Capitalism, https//www.blackrock.com/corporate/investor-relations/larry-fink-ceo-lettter.

2 Andrew Ross Sorkin, et al., *Exclusive: Carlyle to Announce 2050 Net-Zero Commitment*, NYT DEALBOOK (Feb. 1, 2022), https://www.nytimes.com/2022/02/01/business/dealbook/florida-texas-vaccine-mandates.html.

3 Jessica Ground and Clara Kang, *Comment on Climate Change Disclosures*, Harv. L. Sch. F. on Corp. Governance (Oct. 14, 2021), https://corpgov.law.harvard.edu/2021/10/14/comment-on-climate-change-disclosures/.

signed the 2021 Global Investor Statement to Governments on the Climate Crisis (the "Statement"), which urged governments to work with institutional investors to "raise ambition and accelerate action to tackle the climate crisis" by, among other things, "reduc[ing] global net carbon dioxide emissions by 45 percent from 2010 levels by 2030."[4] The signatories observed that "more investors than ever before [are] embedding net zero goals and strategies into their portfolio decisions, engaging companies to cut their emissions and calling on policymakers to deliver robust climate action[,]" and that investors are "urgently seeking to decrease their exposure to climate risk as a core fiduciary duty and benefit from the opportunities associated with the transition to a net-zero emissions economy." The Statement asked governments to take a number of actions to support a net-zero transition, including "implementing mandatory climate risk disclosure requirements aligned with the [Financial Stability Board's] Task Force on Climate-Related Financial Disclosures ("TCFD") recommendations, ensuring comprehensive disclosures that are consistent, comparable, and decision-useful."[5]

Likewise, the Glasgow Financial Alliance for Net Zero ("GFANZ"), launched in April 2021 by Mark Carney, UN Special Envoy for Climate Action and Finance and UK Prime Minister Boris Johnson's Finance Adviser for the recently concluded United Nations' climate conference known as COP26, seeks to provide a forum for leading financial institutions to accelerate the transition to a net-zero global economy. Its members currently include over 450 financial firms across 45 countries responsible for over $130 trillion in assets. Though private equity firms were the notorious holdouts on what is lauded as Wall Street's—and the greater financial industry's—most ambitious climate coalition yet, yesterday's announcement by Carlyle will likely spur additional private equity firms to sign on in the coming months.[6] In its October 2021 Call to Action, GFANZ laid out a scheme of policy requests to G20 governments, including "economy-wide net-zero targets aligned to 1.5C; reform of financial regulations to support the net zero transition; phase-out of fossil fuel subsidies; pricing carbon emissions; mandatory net zero transition plans and climate reporting for public and private enterprises by 2024; unlocking the trillions of climate finance required to support developing

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4 THE INVESTOR AGENDA, *2021 Global Investor Statement to Governments on the Climate Crisis*, https://www.iigcc.org/download/2021-global-investor-statement-to-governments-on-the-climate-crisis/?wpdmdl=4555&refresh=60c32944090db1623402820. The Investor Agenda was created by seven major investor groups—Asia Investor Group on Climate Change ("AIGCC"), CDP (formerly Carbon Disclosure Project), Ceres, Investor Group on Climate Change ("IGCC"), Institutional Investor Group on Climate Change ("IIGCC"), Principles for Responsible Investment ("PRI") and the United Nations Environment Programme Finance Initiative ("UNEP FI")—to collaborate on "a common leadership agenda on the climate crisis that is unifying, comprehensive, and focused on accelerating investor action for a net-zero emissions economy." THE INVESTOR AGENDA, *About Us*, https://theinvestoragenda.org/about-the-agenda/.

5 *Id.*

6 Alastair Marsh, *Blackstone, Apollo Among Holdouts Snubbing New Finance Club*, BLOOMBERG (Nov. 28, 2021), https://www.bloomberg.com/news/articles/2021-11-28/blackstone-among-key-holdouts-snubbing-new-club-in-big-finance?sref=JCixClyW; Andrew Ross Sorkin, et al., *Exclusive: Carlyle to Announce 2050 Net-Zero Commitment*, NYT DEALBOOK (Feb. 1, 2022), https://www.nytimes.com/2022/02/01/business/dealbook/florida-texas-vaccine-mandates.html.

economies meet the transition to net zero; working with farmers and businesses to stop illegal deforestation, provide viable alternatives and promote sustainable regenerative agricultural practices; support for a just transition."[7] Through its policy recommendations, the alliance aims to "restructure the global financial system and ensure that public and private capital flows are working hand in hand with public policy to accelerate the global transition to net zero, while ensuring a just transition for all."[8]

Meanwhile, asset managers are experiencing increasing regulatory oversight with respect to various policies, procedures and practices, including concerning (i) the consistent use of climate change terminology and messaging; (ii) whether a firm diligences, selects and monitors its investments in a manner consistent with its sustainability disclosures; and (iii) whether a firm's proxy voting processes are in line with its disclosures and marketing materials.[9] Increased regulatory scrutiny requires asset managers to carefully consider the disclosures of the companies in which they are invested and the disclosure they must, in turn, make to regulators and their clients.

This article addresses the key global industry initiatives, disclosure frameworks, reporting obligations, and potential pitfalls facing asset managers. It further highlights the push for greater transparency as the regulatory landscape concerning "sustainable investing,"—which we construe broadly to mean investing by "sustainable" or "green" funds, investment in "green" financial products, or investments in companies that have prioritized and report on sustainability in their business operations such that they are regarded as "sustainable" companies—continues to evolve.

First, we identify the challenges of clear and accurate reporting at the fund level. That reporting necessarily depends on the quality and consistency of the information and measurements processed by the fund and then disclosed to fund investors, but there is still not consensus among regulators or investors as to the best way to measure or methods for reporting such metrics. Relatedly, asset managers must also be wary of "greenwashing," when companies or the funds themselves claim to be environmentally friendly but are subject to challenge for not acting consistent with stated "environmentally friendly" initiatives.

Next, we attempt to make sense of the bevy of acronym-laden investor-led initiatives to address these problems. Though many of these organizations have overlapping agendas (yet distinct

7 GFANZ, *Act Now*, https://assets.bbhub.io/company/sites/63/2021/10/GFANZ-call-to-action.pdf. Countries aligned with the 2015 Paris Agreement committed to limit global average temperature rise to 1.5°C above pre-industrial levels. Kate Abnett, *Explainer: What's the difference between 1.5°C and 2°C of global warming?*, REUTERS (Nov. 9, 2021), https://www.reuters.com/business/cop/whats-difference-between-15c-2c-global-warming-2021-11-07/.

8 GFANZ, *Act Now*, https://www.gfanzero.com/press/call-to-action/.

9 Meaghan Kelly, Carolyn Houston, May Mansour, *New SEC Risk Alert Focuses on ESG-Related Disclosures and Policies*, Harv. L. Sch. F. on Corp. Governance (Apr. 26, 2021), https://corpgov.law.harvard.edu/2021/04/26/new-sec-risk-alert-focuses-on-esg-related-disclosures-and-policies/.

approaches and memberships), they are, in large part, driving the climate change agenda for the asset management industry. We also discuss some of the most influential disclosure frameworks promulgated for use by asset managers and other companies. A challenge confronting the financial and other industries is that there is no unified globally-adopted disclosure standard. While certain approaches (as discussed below) are gaining wider acceptance in certain jurisdictions, it still remains unclear which, if any, of the existing proposed regimes will be widely adopted by regulators and the asset management industry (or other industries) as a whole.

The article then discusses key regulatory guidance for the asset management industry. For example, the United States Securities and Exchange Commission ("SEC") recently has issued informal guidance concerning sustainability disclosures for asset managers, identifying best practices for fund disclosures and observations concerning disclosure deficiencies. The EU has gone farther—taking formal action to standardize and improve the ways in which asset managers' disclosures describe climate-related risks. The European Union's Sustainable Finance Disclosure Regulation ("SFDR") took effect last year. The goal of the SFDR is to improve transparency concerning sustainability risks by requiring various disclosures, specifically for asset management firms and financial services institutions, including banks, insurance companies, pension funds, investment firms and financial advisers that operate, sell products or manage funds in the EU. This legislation has implications for certain U.S. asset managers, as it applies to any firms that sell investment products in the EU, including Vanguard Group, BlackRock Inc., and State Street Corp.[10] Last year the United Kingdom also passed the Pension Schemes Act of 2021, which requires funds with assets under managements of more than five billion pounds to assess and disclose climate-related impacts and risks. Although the Pension Schemes Act does not reach U.S. managers, and the SFDR only applies to U.S. managers selling products in the EU, these initiatives are indicative of the action that governments around the world are taking to require enhanced climate-related risk action by industry.

Each of these subjects is discussed in detail below. Our takeaways include that:

- Disclosures must be sufficiently clear, precise, and tailored to an adviser's and its clients' specific sustainability investment guidelines, mandates and restrictions. As discussed herein, there are numerous third party frameworks that asset managers can follow to ensure compliance with current demands.
- Asset managers must take pains to accurately assess the environmental, social, and governance characteristics of their products and the issuers in which they invest.[11] Any

[10] Jean Eaglesham and Anna Hirtenstein, *ESG Disclosure Rules From Europe Challenge U.S. Fund Managers*, WSJ (Mar. 22, 2021), https://www.wsj.com/articles/esg-disclosure-rules-from-europe-challenge-u-s-fund-managers-11616405401.

[11] John Hale, *What is Greenwashing, and Answers to Your Other Questions*, MORNINGSTAR (Oct. 21, 2021) https://www.morningstar.com/articles/1062642/what-is-greenwashing-and-answers-to-your-other-questions.

sustainability-related claims should be supported by reliable data and metrics and associated investor communications should aim to clearly articulate a fund's sustainability objectives and portfolio characteristics.[12]

- Asset managers should consider the adoption (and related disclosure) of policies, procedures and practices concerning sustainability and the use of related terminology. This could include the due diligence they will undertake to evaluate the sustainability characteristics of their investments, the sustainability-specific factors relevant to investment decisions, and the processes they will employ for monitoring investments either given a firm's disclosed investing approaches or its objectives regarding the sustainability characteristics of its investments.[13]
- Certain institutional asset managers are playing a leading role in advancing climate change initiatives and agendas and exerting influence well beyond the asset management industry. BlackRock, Vanguard and State Street, to name just a few, regularly publish information regarding their climate stewardship activities, and the annual letter to CEOs from Laurence Fink, BlackRock's Chairman and CEO, much of which has been devoted to climate change in recent years, is virtually required reading for large swaths of business executives. For example, BlackRock publicly advocates that issuers disclose climate change information by adhering to the TCFD framework, and State Street has disclosed that it will be carbon neutral for Scope 1 and 2 emissions (*i.e.*, total direct and indirect greenhouse gas emissions from the company's operations) this year. All three signed on to the Net-Zero Asset Managers Initiative, whose goal is to convince the companies they invest in to achieve net-zero greenhouse gas emissions by 2050. According to Mr. Fink's most recent letter, "climate risk is investment risk," necessitating proactive industry action along these lines— "[w]e focus on sustainability not because we're environmentalists, but because we are capitalists and fiduciaries to our clients." If anything, we expect key players in the asset management industry to be as or even more vocal and proactive in the near and medium term. But with that high profile comes increased scrutiny, and asset managers need to exercise caution regarding the accuracy of their disclosures and their governance practices in this area.
- Relatedly, one aspect of the industry's proactive approach to climate change is the increasing willingness of asset managers to express views on issuers' sustainability activities. State Street, for example, states that it has engaged with over 600 companies in multiple industries since 2014 regarding climate change issues and it has expressed a willingness to vote against the reelection of directors if its communicated climate change concerns go unaddressed. State Street also claims that it votes on every shareholder climate change proposal for companies in its portfolios, including say-on-climate proposals (*i.e.*, where shareholders seek

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12 *Id.*

13 Amy Matsuo, *SEC Examinations Risk Alert: Compliance Issues in ESG investing*," Harv. L. Sch. F. on Corp. Governance (May 3, 2021) https://corpgov.law.harvard.edu/2021/05/03/sec-examinations-risk-alert-compliance-issues-in-esg-investing/.

periodic non-binding votes on a company's climate transition plan and progress) or proposals that would permit shareholders to vote on the company's climate plans. Likewise, BlackRock indicated that in the 2020–2021 proxy year, it voted against 255 directors and 319 companies based on climate-related concerns that could negatively impact shareholder value. It also voted for 64% of climate-related shareholder proposals in that same period. And, in the same vein at Vanguard, "where climate matters present material risks, the funds are likely to support shareholder proposals that seek reasonable and effective disclosure of greenhouse gas emissions or other climate-related metrics. The funds may also support proposals that ask companies to pursue climate risk mitigation targets, such as those aligned to the goals of the Paris Agreement."[14] The bottom line is that many asset managers will continue to be increasingly vocal and active in terms of engagement and voting and appear likely to hold accountable issuers that are perceived to be laggards in climate transition efforts.

- Perhaps the logical culmination of the industry's proactive stance could be instances of collaboration with, or at least support of, activist investors in certain situations. While climate-focused activism is increasingly a feature of the investment and governance landscape, so too may be the alignment of the goals and views of institutional asset managers and activist investors. The most notable example involves Engine No. 1's successful effort to install three directors on the board of Exxon Mobil based on criticism of the company's climate transition efforts and its related impact on long-term shareholder value. But that success depended on obtaining the support of the company's large institutional shareholders, including BlackRock, State Street and Vanguard. Engine No. 1 reportedly reminded these institutions that its campaign aligned with their own stated goals based, in part, on their membership in the Net Zero Asset Managers Initiative. Whether or the extent to which we see increasing instances of cooperation or support by institutional asset managers for activist campaigns remains to be seen, but we anticipate that the Engine No. 1 situation will not be the last time such an alliance occurs.

## II. Challenges in Fund Reporting on Sustainable Investments and the Greenwashing Problem

Investor demand, environmental concerns, and looming regulations have pushed asset managers to adopt disclosure frameworks and investing strategies that increasingly take into account climate change challenges. But disclosure, governance or compliance frameworks are only as useful as the quality of the information available to the fund and then disclosed to fund investors. Asset managers confront challenges in measuring the performance of a fund's sustainable investments, including due to the absence of accepted definitions of what constitutes a sustainable investment and difficulties obtaining reliable and thorough climate metrics and other climate-related disclosure at the issuer level. As a result, investors are left to question the reliability and thus the value of

[14] VANGUARD, *Vanguard Investment: Stewardship Insights Why climate change matters to long-term investors* (June 2020), https://corporate.vanguard.com/content/dam/corp/advocate/investment-stewardship/pdf/perspectives-and-commentary/ISWHYC_062020.pdf.

climate related performance data. Further, and in part in light of the foregoing, asset managers need to tread carefully in touting climate related performance or other information given regulators' focus on whether such claims are accurate or, instead, amount to "greenwashing, *i.e.*, when a company or fund markets itself as environmentally friendly but does not actually minimize or otherwise account for investments in companies creating adverse environmental impacts environmental impact."[15]

## A. Assessing the Performance of a Fund's "Sustainable" Investments Presents Various Challenges

It is well known that interest in ESG investments has significantly increased over the years—the number of ESG funds (sometimes referred to as socially responsible investing ("SRI") funds) has doubled in just the last three years.[16] According to the ISS Market Intelligence Asset Management Industry Market Sizing Report, ESG funds in 2020 reaped $60 billion in net flows, nearly triple the 2019 total.[17] ISS also found that high ESG performance is positively related to valuation and profitability, and high-ESG[18] companies are adept allocators of capital and outperform other stocks.[19] Another study also has cited evidence that ESG funds are "offering investors something different from traditional funds with respect to both portfolio composition and voting" but notably, investors have not had to "sacrifice economic performance" in opting for ESG funds.[20]

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15 Tim Quinson, *Regulators Intensify ESG Scrutiny as Greenwashing Explodes*, BLOOMBERG (Sept. 1, 2021), https://www.bloomberg.com/news/articles/2021-09-01/regulatory-scrutiny-of-esg-greenwashing-is-intensifying?srnd=green-finance; Adryan Corcione, *What is Greenwashing?*, BUSINESS NEWS DAILY (Dec. 21, 2021), https://www.businessnewsdaily.com/10946-greenwashing.html.

16 Robertson, *et al.*, *Do ESG Mutual Funds Deliver on Their Promises?*, Harv. L. Sch. F. on Corp. Governance (June 23, 2021), https://corpgov.law.harvard.edu/2021/06/23/do-esg-mutual-funds-deliver-on-their-promises/; Daniel Macciocchi, *Does Socially Responsible Investing Change Firm Behavior*, Harv. L. Sch. F. on Corp. Governance (July 29, 2021), https://corpgov.law.harvard.edu/2021/07/29/does-socially-responsible-investing-change-firm-behavior/#:~:text=Overall%2C%20our%20results%20suggest%20that,want%20to%20change%20corporate%20conduct.

17 Subodh Mishra, *et al.*, *ESG Matters II*, Harv. L. Sch. F. on Corp. Governance (June 2, 2021), https://corpgov.law.harvard.edu/2021/06/02/esg-matters-ii/ (citing Kevin Spellman, *et al.*, *ESG Matters (Part II)* (May 18, 2021), http://images.marketing.strategic-i.com/Web/AssetInternational/%7B9d55812d-18e1-4111-8c7a-e9848b8fee4d%7D_ISS_MI_2020_Asset_Management_Market_Sizing_Report_Preview.pdf).

18 "ISS ESG Corporate Rating data for ESG Performance (ranges from 0 to 100) includes over 800 indicators, with approximately 90% industry-specific. Weights for E, S, and G pillars are dependent on the industry. For each industry, five key issues, representing more than 50% of the overall rating, are identified." Dr. G. Kevin Spellman, *et al.*, *ESG Matters*, ISS EVA (2019), https://www.issgovernance.com/file/publications/ISS_EVA_ESG_Matters.pdf.

19 Dr. G. Kevin Spellman, *et al.*, *ESG Matters*, ISS EVA (2019), https://www.issgovernance.com/file/publications/ISS_EVA_ESG_Matters.pdf.

20 Quinn Curtis, *et al.*, *Do ESG Mutual Funds Deliver on Their Promises?*, Harv. L. Sch. F. on Corp. Governance (June 23, 2021), https://corpgov.law.harvard.edu/2021/06/23/do-esg-mutual-funds-deliver-on-their-promises/.

But others contend that the correlation between "ESG" and fund performance is overstated in large part due to informational and classification challenges.[21] Scientific Beta, a "smart beta" index provider associated with the Edhec Research Institute, a French academic think-tank, studied 24 ESG strategies that were found to "outperform" and concluded that although ESG leaders typically outperformed "ESG laggards" by nearly three percent per year, the results were driven by "quality metrics" such as high profitability and conservative investment rather than non-financial ESG factors. In other words, performance is based on "quality strategies mechanically constructed from accounting ratios."[22] The study also credited higher performance of ESG funds as being driven by ESG "momentum" and predicted that the performance of most ESG funds will, at some point, return to long-term market averages. "Between the countless ways of measuring and weighing ESG scores, the ad hoc nature of 'ESG integration' and the reality of ESG performance reflecting sectoral tilts and quality factors rather than environmental, social or governance drivers, the entire field of ESG investing is built on shaky foundations that crumble under closer scrutiny."[23] Scientific Beta's position is that investors focused on "changing the world" should invest capital in "better" companies and engage with those companies on how they can improve their practices.[24] And perhaps there is a need for such engagement—results from another study showed that SRI funds "do select companies with better environmental and social conduct" but "do not improve the environmental or social conduct of their portfolio firms."[25]

One problem is that "ESG means different things to different investors" and the market "is responding to those differences with an array of distinct products."[26] There are over 600 ESG rating providers that rely on different definitions and metrics and therefore can produce vastly different ratings for the same company.[27] For example, Tesla has received both a top ESG rating and a bottom rating from two different rating agencies.[28] Rating agencies also tend to have a sector skew that rewards companies in certain industries and penalizes others; for example, awarding higher scores to technology companies than oil companies. But that bias may not be

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21 Steve Johnson, *ESG outperformance narrative "is flawed", new research shows*, FT (May 4, 2021), https://www.ft.com/content/be140b1b-2249-4dd9-859c-3f8f12ce6036.

22 *Id.*

23 *Id.*

24 *Id.*

25 Daniel Macciocchi, *Does Socially Responsible Investing Change Firm Behavior*, Harv. L. Sch. F. on Corp. Governance (July 29, 2021), https://corpgov.law.harvard.edu/2021/07/29/does-socially-responsible-investing-change-firm-behavior/#:~:text=Overall%2C%20our%20results%20suggest%20that,want%20to%20change%20corporate%20conduct.

26 *Id.*

27 *Id.*

28 *Id.*

justified, or may ignore the interdependence of multiple sectors in a company's supply chain. One study showed that:

> [i]n 2019, amid rising pressure from its employees, [Amazon] finally revealed its carbon-dioxide emissions, which totaled about 44.4 million tons in 2018. Last June, the company reported that its emissions jumped by 15% over the prior year to about 51.1 million tons. That means Amazon's emissions are nearly as high as those of oil giant Chevron, which emitted 60 million tons of CO2 in 2019. Amazon's uptick in emissions should be not be surprising. As it handles more goods and services, the company has to use more energy in its data centers, warehouses, delivery trucks, and more than 80 cargo jets.[29]

Asset managers have attempted to deal with the lack of consistent, reliable and comparable issuer data by creating internal policies and frameworks to make their own assessments. BlackRock, for instance, has implemented a "heightened scrutiny model" to manage exposure in its portfolios by using its own set of risk management tools to increase due diligence on existing and future investments.[30] In 2007, the California State Teachers' Retirement System ("CalSTRS") created the Green Initiative Task Force that issues reports on CalSTRS's environmental-themed investments and its risk-management efforts.

In April 2021, the Basel Committee on Banking Supervision[31] published the "Climate-related financial risks –measurement methodologies" report, which underscored these challenges in five key findings:

> First, climate-related financial risks have unique features, necessitating granular and forward-looking measurement methodologies.

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[29] Dan Romito, *Introducing the Technergy ESG Reporting Strategy*, Harv. L. Sch. F. on Corp. Governance (June 20, 2021), https://corpgov.law.harvard.edu/2021/06/20/introducing-the-technergy-esg-reporting-strategy/.

[30] BLACKROCK, NET ZERO: A FIDUCIARY APPROACH (2022) https://www.blackrock.com/corporate/investor-relations/blackrock-client-letter.

[31] The Basel Committee on Banking Supervision ("BCBS") is the "primary global standard setter for prudential regulation of banks and provides a forum for regular cooperation on banking supervisory matters." BIS, About BIS – Overview, https://www.bis.org/bcbs/.

> Second, to date, measurement of climate-related financial risks by banks and supervisors has centered on mapping near-term transition risk drivers into counterparty and portfolio exposures.
>
> Third, banks and supervisors have predominantly focused on assessing credit risk, as they advance in applying methods to translate climate-related exposures into categories of financial risk.
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> Fourth, while banks and supervisors remain at an early stage of translating climate-related risks into robustly quantifiable financial risk, work continues to gather pace.
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> Fifth, key areas for future analytical exploration relate to measurement gaps in data and risk classification methods, as well as methodologies suitable for assessing long-term climate phenomena not always of a standard nature.[32]

The report also discusses how banks and supervisors can practically implement the use of the metrics it identifies.[33] In particular, it explains how banks can translate climate risks into quantifiable financial risks to enable them to manage their exposure to climate transition risk. For example, the report encourages banks to collect "new and unique types of data" such as data concerning physical and transition risk drivers (*e.g.*, climate information or information about current and projected hazard events), vulnerability to exposures (*e.g.*, counterparties' sensitivity to energy prices or carbon emissions in production and distribution), and translating climate-adjusted economic risk factors into financial risk (*e.g.*, adjusting current systems projecting cash flows, valuations, or prices to account for climate change risk).[34]

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32 Basel Committee, *Climate-related financial risks –measurement methodologies*, 1–2 (Apr. 2021), https://www.bis.org/bcbs/publ/d518.pdf.

33 Basel Committee, *Climate-related financial risks –measurement methodologies*" (Apr. 2021); *see also* Basel Committee, *Principles for the effective management and supervision of climate-related financial risks* (Nov. 2021) (https://www.bis.org/bcbs/publ/d530.pdf)

34 Basel Committee, *Climate-related financial risks –measurement methodologies*, 1–2 (Apr. 2021), https://www.bis.org/bcbs/publ/d518.pdf; Amy Gunia, *Thinking of Investing in a Green Fund? Many Don't Live Up to Their Promises, a New Report Claims*, TIME, Sept. 20, 2021, https://time.com/6095472/green-esg-investment-funds-greenwashing/.

### B. Greenwashing

One issue that investors and regulators have focused on is greenwashing.[35] Influence Map, a London-based climate change think tank, recently released a study showing that 723 equity funds managing more than $330 billion in total net assets used ESG claims and climate-related key words in their marketing.[36] But "[m]ore than 70% of the funds with broader ESG goals are also misaligned with global climate targets" outlined in the Paris Agreement, meaning that they do not further the goal of limiting emissions to keep global temperatures to less than 2°C above pre-industrial levels.[37] "The variability and imprecision of [current] industry ESG definitions and terms can create confusion among investors if investment advisers and funds have not clearly and consistently articulated how they define ESG and how they use ESG-related terms, especially when offering products or services to retail investors."[38] Greenwashing, inadvertent or not, carries with it a double-edged risk—asset managers that engage in such practices not only lose the confidence of investors but also attract potential regulatory enforcement.[39]

Unfortunately, even when asset managers adopt a model to evaluate sustainability-related performance and disclosures, without a single industry standard guiding the quality and quantity of disclosure or how to measure climate impacts, they face the risk of being accused of greenwashing. An asset manager that invests in a company that fails to properly disclose its ESG characteristics may be unknowingly misleading its clients regarding sustainability characteristics of their investments.[40] In fact, a London-based nonprofit found that "55% of funds marketed as low carbon, fossil-fuel free and green energy exaggerated their environmental claims, and more than 70% of funds promising ESG goals fell short of their targets."[41] A report by the Economist last year

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35 Tim Quinson, *Regulators Intensify ESG Scrutiny as Greenwashing Explodes*, BLOOMBERG (Sept. 1, 2021), https://www.bloomberg.com/news/articles/2021-09-01/regulatory-scrutiny-of-esg-greenwashing-is-intensifying?srnd=green-finance; https://www.businessnewsdaily.com/10946-greenwashing.html.

36 Amy Gunia, *Thinking of Investing in a Green Fund? Many Don't Live Up to Their Promises, a New Report Claims*, TIME (Sept. 20, 2021), https://time.com/6095472/green-esg-investment-funds-greenwashing/.

37 *Id.*

38 SEC, *Risk Alert: The Division of Examinations' Review of ESG Investing*, (Apr. 9, 2021) https://www.sec.gov/files/esg-risk-alert.pdf?utm_medium=email&utm_source=govdelivery.

39 Tim Quinson, *Regulators Intensify ESG Scrutiny as Greenwashing Explodes*, BLOOMBERG (Sept. 1, 2021), https://www.bloomberg.com/news/articles/2021-09-01/regulatory-scrutiny-of-esg-greenwashing-is-intensifying?srnd=green-finance.

40 BLACKROCK, *Towards a Common Language for Sustainable Investing* (Jan. 2020), available at https://www.blackrock.com/corporate/literature/whitepaper/viewpoint-towards-a-common-language-for-sustainable-investing-january-2020.pdf, at 7.

41 Tim Quinson, *Regulators Intensify ESG Scrutiny as Greenwashing Explodes*, BLOOMBERG (Sept. 1, 2021), https://www.bloomberg.com/news/articles/2021-09-01/regulatory-scrutiny-of-esg-greenwashing-is-intensifying?srnd=green-finance.

found that some of the largest ESG funds "are stuffed full of polluters and sin stocks."[42] Eight of the ten largest U.S. sustainable funds invest in oil-and-gas companies.[43] Indeed, BlackRock was criticized in recent years because one of its ESG funds invested in Exxon Mobil Corp. while allegations that it misled investors on how it accounted for climate-change regulations were pending.[44] Similarly, Vanguard Group's FTSE Social Index Fund, which excludes companies that cause environmental pollution or severe damage to ecosystems, faced similar criticism when it invested in Occidental Petroleum Corp. after it settled with Peruvian indigenous villages for an undisclosed sum to settle a lawsuit for contaminating the Amazon.[45]

In addition to all of these challenges, there are industry debates about whether investing in (or financing) fossil fuel and other companies that are significant greenhouse gas emitters furthers or hinders sustainability efforts. For example, with respect to fossil fuels, there has been commentary that banks should not withdraw all funding nor should asset managers divest from the fossil-fuel industry because of the need for that energy to construct green power sources, particularly in emerging markets.[46] Nor have regulators or investors meaningfully addressed the issue of conflicting ESG priorities—for instance, an investment in a company that promotes diversity but is a higher carbon emitter.[47] Asset managers will have to confront these and other issues in the near and medium term with, at least at present, little to no guidance from regulators.

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42 *Sustainable finance is rife with greenwash. Time for more disclosure*, THE ECONOMIST (May 22, 2021), https://www.economist.com/leaders/2021/05/22/sustainable-finance-is-rife-with-greenwash-time-for-more-disclosure.

43 Notably, many of these funds exclude gun makers, casino operators and tobacco companies, but have not reduced investment in fossil fuels in the same way. *See also* Hiroki Tabuchi, *Private Equity Funds, Sensing Profit in Tumult, Are Propping Up Oil*, N.Y.TIMES (Oct. 13, 2021), https://www.nytimes.com/2021/10/13/climate/private-equity-funds-oil-gas-fossil-fuels.html#:~:text=the%20main%20story-,Private%20Equity%20Funds%2C%20Sensing%20Profit%20in%20Tumult%2C%20Are%20Propping%20Up,lifelines%20to%20coal%20power%20plants.

44 The New York Attorney General argued at trial that, beginning in December 2013, ExxonMobil made several written and oral misrepresentations and omissions that misled investors in violation of New York state law. Decision After Trial, *New York v. Exxon Mobil Corporation*, Index. No. 452044/2018 (NY Sup. Ct. Dec. 10, 2019), https://int.nyt.com/data/documenthelper/6569-new-york-vs-exxonmobil/eb27e49cb4cdbb4add80/optimized/full.pdf#page=1; Akane Otani, *ESG Funds Enjoy Record Inflows, Still Back Big Oil and Gas*, WSJ (Nov. 11, 2019), https://www.wsj.com/articles/top-esg-funds-are-all-still-invested-in-oil-and-gas-companies-11573468200.

45 Akane Otani, *ESG Funds Enjoy Record Inflows, Still Back Big Oil and Gas*, WSJ (Nov. 11, 2019), https://www.wsj.com/articles/top-esg-funds-are-all-still-invested-in-oil-and-gas-companies-11573468200.

46 Francine Lacqua & Alastair Marsh, *StanChart Says It's 'Not Practical' to Halt Fossil Fuels*, BLOOMBERG (Oct. 13, 2021), https://www.bloomberg.com/news/articles/2021-10-13/stanchart-says-it-s-just-not-practical-to-halt-fossil-finance?sref=JCixClyW.

47 *Id.*

## III. Investor-Led Organizations, Reporting Frameworks, and Regulatory Guidance for Asset Managers

Given the current state of climate-related U.S. regulatory disclosure guidance, asset managers have been advocating for and relying on third party organizations, frameworks and principles (such as the TFCD recommendations advocated for in the 2021 Global Investor Statement)[48] to help address the various challenges facing asset managers in the era of climate change. These organizations and frameworks, many of which have been created by or with input from the institutional investor community, provide recommendations at both the asset manager and issuer levels. Sustainability reporting organizations also have consistently advocated for a global comprehensive reporting system, and have issued disclosure frameworks for issuers to consider when preparing their own disclosures.

### A. Investor-Led Climate Change Organizations

The chart below identifies key climate-related initiatives focused on the asset management industry, which are then discussed in more detail in the following the chart.

| Investor Network | Key Areas of Focus | Target Membership | Founders and Contributors | Established |
|---|---|---|---|---|
| **Principles of Responsible Investment** | Incorporating sustainability issues into investment practices | Institutional investors, including Barclays Asset Management Limited, BlackRock, Goldman Sachs Asset Management, and Janus Henderson Investors. | United Nations | 2006 |
| **Ceres Investor Network** | "Make the financial business case for sustainability to the largest, most influential investors, companies, policymakers and regulators." Ceres encourages "individual and collective actions that help stabilize the | Investors, companies and capital market influencers. Membership includes BlackRock, Engine No. 1, KKR & Co. L.P., Amazon, Apple, and State Street. | Joan Bavaria, then-president of Trillium Asset Management | 1989 |

[48] The TCFD framework also has been incorporated into the European Union reporting scheme. *See* Jason Halper, *et al.*, *Investors and Regulators Turning up the Heat on Climate-Change Disclosures*, Harv. L. Sch. F. On Corp. Governance (July 24, 2021), https://corpgov.law.harvard.edu/2021/10/04/investors-and-regulators-turning-up-the-heat-on-climate-change-disclosures/.

| Investor Network | Key Areas of Focus | Target Membership | Founders and Contributors | Established |
|---|---|---|---|---|
| | climate, protect water and natural resources, build a just and inclusive economy, and accelerate sustainable capital markets."<br>The Ceres Ambition 2030 initiative: decarbonize six of the highest-emitting sectors.[49] | | | |
| **Climate Action 100+[50]** | 1. Implement a strong governance framework on climate change;<br>2. Take action to reduce greenhouse gas emissions across the value chain; and<br>3. Provide enhanced corporate disclosure. | 1. 167 Focus Companies<br>2. Investor Signatories, including Credit Suisse Asset Management, J.P. Morgan Asset Management, and UBS Asset Management. | Investor Networks: Asia Investor Group on Climate Change (AIGCC); Ceres; Investor Group on Climate Change (IGCC); Institutional Investor Group on Climate Change (IIGCC); PRI | 2017 |
| **Investment Company Institute** | "[S]eeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, | Regulated funds, including those sponsored by BNP Paribas, Credit Suisse, and Morgan Stanley. | 68 mutual funds and 43 closed-end funds | 1940 |

49 Ceres, *Ceres Ambition 2030*, https://www.ceres.org/climate/ambition2030 (last visited Jan 31, 2022).

50 Climate Action 100+, *How We Work*, https://www.climateaction100.org/approach/how-we-work/ (last visited Jan. 31, 2022).

| Investor Network | Key Areas of Focus | Target Membership | Founders and Contributors | Established |
|---|---|---|---|---|
| | directors, and advisers." | | | |
| **World Economic Forum** | 1. Mastering the Fourth Industrial Revolution<br>2. Solving the problems of the Global Commons<br>3. Addressing global security issues | Leading global companies, including Boston Consulting Group (BCG), Fidelity International, and PricewaterhouseCoopers (PwC). | Professor Klaus Schwab | 1971 |
| **The Investor Agenda** | 1. Engaging companies to drive and demonstrate progress in line with a 1.5-degree Celsius future.[51]<br>2. Managing systemic climate risks in investor portfolios and enabling the transition by shifting capital to value-creating businesses set to succeed in a net-zero future.<br>3. Advocating for policies aligned with delivering a just transition to a net-zero economy by 2050 or sooner.<br>4. Enhancing investor disclosure to align with the TCFD's recommendations in order to help stakeholders track | Investors, including BBVA Asset Management, California Public Employees Retirement System (CalPERS), and State Street. | AIGCC, CDP (formerly Carbon Disclosure Project), Ceres, IGCC, IIGCC, PRI and the United Nations Environment Programme Finance Initiative (UNEP FI) | 2018 |

[51] Countries aligned with the 2015 Paris Agreement committed to limit global average temperature rise to 1.5°C above pre-industrial levels. Kate Abnett, *Explainer: What's the difference between 1.5°C and 2°C of global warming?*, REUTERS (Nov. 9, 2021), https://www.reuters.com/business/cop/whats-difference-between-15c-2c-global-warming-2021-11-07/ .

| Investor Network | Key Areas of Focus | Target Membership | Founders and Contributors | Established |
|---|---|---|---|---|
| | investor action in line with a 1.5-degree Celsius pathway. | | | |
| **The Paris Aligned Investment Initiative (PAII)** | 1. Driving net zero investing commitments—by asset managers through the Net Zero Asset Managers initiative (see below) and by asset owners through the PAII Net Zero Asset Owner Commitment.<br><br>2. Supporting investors to implement commitments, using the PAII's Net Zero Investment Framework.<br><br>3. Collaborating globally as the forum for AIGCC, Ceres, IGCC, IIGCC and the investment community to develop and support further practical approaches to enable Paris aligned investing. | 53 asset owners, including HSBC, National Trust, and Sierra Club Foundation. | The Institutional Investors Group on Climate Change (IIGCC) (Europe), Investor Network on Climate Risk (INCR) (North America), Investor Group on Climate Change (IGCC) (Australia & New Zealand) and Asia Investor Group on Climate Change (AIGCC) (Asia) | 2019 |
| **The Net Zero Asset Managers Initiative** | Supporting the goals of net zero greenhouse gas emissions by 2050 or sooner, in line with global efforts to limit warming to 1.5 degrees Celsius; and to supporting investing aligned with | Asset managers, including DWS, Invesco, and Vanguard. | AIGCC, CDP, Ceres, IGCC, IIGCC, and PRI | 2020 |

| Investor Network | Key Areas of Focus | Target Membership | Founders and Contributors | Established |
|---|---|---|---|---|
| | net zero emissions by 2050 or sooner. | | | |
| **Glasgow Financial Alliance for Net Zero (GFANZ)** | "[E]conomy-wide net-zero targets aligned to 1.5C; reform of financial regulations to support the net zero transition; phase-out of fossil fuel subsidies; pricing carbon emissions; mandatory net zero transition plans and climate reporting for public and private enterprises by 2024; unlocking the trillions of climate finance required to support developing economies meet the transition to net zero; working with farmers and businesses to stop illegal deforestation, provide viable alternatives and promote sustainable regenerative agricultural practices; support for a just transition."[52] | Its members currently include over 450 financial firms across 45 countries responsible for over $130 trillion in assets. | Mark Carney, UN Special Envoy for Climate Action and Finance and UK Prime Minister Johnson's Finance Adviser for COP26, and the COP26 Private Finance Hub in partnership with the UNFCCC Climate Action Champions, the Race to Zero campaign and the COP26 Presidency. | 2021 |

52 GFANZ, *Call to Action* (Oct. 11, 2021), https://assets.bbhub.io/company/sites/63/2021/10/GFANZ-call-to-action.pdf. Countries aligned with the 2015 Paris Agreement committed to limit global average temperature rise to 1.5°C above pre-industrial levels. Kate Abnet, *Explainer: What's the difference between 1.5°C and 2°C of global warming,* REUTERS (Nov. 9, 2021), https://www.reuters.com/business/cop/whats-difference-between-15c-2c-global-warming-2021-11-07/.

1. Principles of Responsible Investment

The Principles of Responsible Investment ("PRI") is a nonprofit organization created in 2006 and supported by the United Nations Environment Programme Finance Initiative (UNEP FI) and the UN Global Compact. It consists of a network of international investors committed to implementing the six "Principles for Responsible Investment"—principles that "reflect the view that environmental, social and governance (ESG) issues can affect the performance of investment portfolios and therefore must be given appropriate consideration by investors if they are to fulfill their fiduciary (or equivalent) duty."[53] Those principles include incorporating ESG issues into investment analysis and decision-making processes, incorporating ESG issues into ownership policies and practices, seeking appropriate disclosure on ESG issues by the entities in which they invest, promoting acceptance and implementation of the Principles within the investment industry, enhancing the PRI's effectiveness in implementing the Principles, and reporting on activities and progress towards implementing the Principles.[54]

The PRI provides "a voluntary framework by which all investors can incorporate ESG issues into their decision-making and ownership practices and so better align their objectives with those of society at large."[55] PRI signatories are required to report on their responsible investment activities on an annual basis by responding to "indicators" in the PRI reporting framework, a subset of which are aligned with the TCFD recommendations.[56] Since 2006, the number of PRI signatories has increased from 100 to over 4,200.[57]

2. Ceres Investor Network

Ceres is a nonprofit organization now consisting of over two hundred institutional investors managing over $47 trillion in assets. Ceres aims to "make the financial business case for sustainability" by:

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53 United Nations Global Compact, Integrate the Principles for Responsible Investment, https://www.unglobalcompact.org/take-action/action/responsible-investment.

54 *Id.*

55 *Id.*

56 PRI, *What are the Principles of Responsible Investment?* (July 26, 2021) https://www.unpri.org/pri/what-are-the-principles-for-responsible-investment; Task Forces on Climate-related Financial Disclosures, 2021 Status Report (Oct. 2021). PRI, Minimum Requirements (last accessed Jan. 31, 2022) https://d8g8t13e9vf2o.cloudfront.net/Uploads/q/t/s/PRI-Minimum-Requirements.pdf.

57 PRI, *About the PRI*, https://www.unpri.org/pri/about-the-pri (last visited Jan. 31, 2022).

- Coordinat[ing] deep stakeholder engagements and dialogue with Ceres network members and our global partners;[58]
- Deliver[ing] science-based research and innovative tools that inspire best practices;
- Co-lead[ing] global initiatives that drive collective action and economy-wide solutions;[59]
- Mobiliz[ing] advocacy campaigns to advance strong state, federal and global policy and regulatory actions;[60] and
- Leverag[ing] the power of the media and digital communications to promote bold sustainability leadership.[61]

Ceres has also published a 10-year action plan, the Ceres Roadmap 2030, to help guide investors and businesses towards greater sustainability.[62] On October 18, 2021, Ceres published the "Investor Guide to Corporate Greenhouse Gas Commitments" to help companies incorporate the reduction of greenhouse gas emissions into their overall corporate strategy. The Guide represented Ceres' response to the fact that 40% of the largest U.S. companies in the Fortune 500 lack any climate goals, and of the ones that have set goals, only one in four set science-based targets. The Ceres Guide provides fact sheets that investors can use to engage with issuers on their clean energy goals, greenhouse gas reduction goals, carbon credits, and transition plans.[63]

3. Climate Action 100+

Climate Action 100+ was officially launched in December 2017 at the One Planet Summit in Paris with 225 signatories focused on sustainability practices at 100 target companies. It currently counts as signatories 615 asset managers responsible for $60 trillion in assets, and aims to provide guidance on how the largest emitters of greenhouse gas can take action to address climate

58 Ceres partners include Climate Action 100+, The Investor Agenda, PAII, We Mean Business, and America Is All In. CERES, *Ceres' Nonprofit Partners*, https://www.ceres.org/about-us/ceres-nonprofit-partners (last visited Jan. 31, 2022).

59 One such initiative is Ceres Ambition 2030 that seeks to decarbonize the six highest-emitting sectors: banking, electric power, food, oil and gas, steel, and transportation. CERES, *Ceres Ambition 2030*, https://www.ceres.org/climate/ambition2030 (last visited Jan. 31, 2022).

60 Recently, in response to the federal government's call for comments on revisions to the federal procurement process, Ceres submitted recommendations that would help reduce greenhouse gas emissions and incentivize zero-carbon innovation. Ceres, Press Release, (Jan. 13, 2022) https://www.ceres.org/news-center/press-releases/ceres-calls-us-government-strengthen-federal-procurement-process.

61 CERES, *About US*, https://www.ceres.org/about-us (last visited Jan. 31, 2022).

62 CERES, *Ceres ROADMAP 2030* (Oct. 7, 2020) https://www.ceres.org/resources/reports/ceres-roadmap-2030?utm_source=website&utm_medium=button&utm_campaign=roadmap&utm_content=report&_ga=2.170424803.2132378231.1637503824-148619627.1637503824.

63 CERES, *Investor Guide to Corporate Greenhouse Gas Commitments* (Oct. 18, 2021), https://www.ceres.org/resources/reports/investor-guide-corporate-greenhouse-gas-commitments.

change. It works in collaboration with other investor networks, including Ceres, PRI and the PAII.[64] Signatories to the Climate Action 100+ have agreed to:

- [i]mplement a strong governance framework which clearly articulates the board's accountability and oversight of climate change risk;
- [t]ake action to reduce greenhouse gas emissions across the value chain, consistent with the Paris Agreement's goal of limiting global average temperature increase to below two degrees Celsius above pre-industrial levels, aiming for 1.5 degrees. Notably, this implies the need to move towards net-zero emissions by 2050 or sooner; and
- [p]rovide enhanced corporate disclosure in line with the final TCFD recommendations and sector-specific Global Investor Coalition on Climate Change ("GIC") Investor Expectations on Climate Change guidelines (when applicable),[65] to enable investors to assess the robustness of companies' business plans against a range of climate scenarios, including well below two degrees and improve investment decision-making.[66]

Climate Action 100+ also provides resources for non-signatories to support the goals of Climate Action 100+, including by flagging key shareholder proposals during the proxy season.[67]

4. Investment Company Institute

The Investment Company Institute ("ICI") is an association representing regulated funds globally (*e.g.*, mutual funds, exchange-traded funds ("ETFs"), and others). The ICI "seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers." ICI's members manage more than $31 trillion in the U.S., serve more than 100 million U.S. shareholders, and manage approximately $10 trillion in assets in other jurisdictions.[68]

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64 Climate Action 100+ (2022), https://www.climateaction100.org/about/.

65 The Global Investor Coalition on Climate Change (GIC)—now called the PAII—is a joint initiative of four regional climate change investor groups: The Institutional Investors Group on Climate Change (IIGCC) (Europe), Investor Network on Climate Risk (INCR) (North America), Investor Group on Climate Change (IGCC) (Australia & New Zealand) and Asia Investor Group on Climate Change (AIGCC) (Asia). IIGCC, *Initiatives & collaborations*, https://www.iigcc.org/our-work/initiatives-collaborations/ (last visited Jan. 31, 2022). The initiative provides investors with a collaborative platform to encourage public policies, investment practices, and corporate behavior that address long-term risks and opportunities associated with climate change. The Investor Expectations guidelines call on banking firms to set enhanced net zero targets for 2050 or sooner with interim targets to be included, scale up green finance and withdraw from projects that fail to meet Paris Agreement goals.

66 Climate Action 100+, *The Three Asks*, (2022) https://www.climateaction100.org/approach/the-three-asks/.

67 Climate Action 100+, *2021 Proxy Season*, (2022) https://www.climateaction100.org/approach/proxy-season/.

68 ICI, *About ICI*, https://www.ici.org/about-ici.

In July 2020, the ICI endorsed a white paper entitled "Funds' Use of ESG Integration and Sustainable Investing Strategies, an Introduction," authored by the ICI's ESG Working Group.[69] Ultimately, the white paper advocates for two main principles: (1) the integration of a consistent framework for categorizing and describing funds, and (2) the adoption of common terms to describe these funds in public communication. In articulating its first principle, the white paper first distinguishes between "ESG integration" and "sustainable investing."

> ESG integration and sustainable investing are both investment processes that coexist along a spectrum. One way to distinguish them is to recognize that funds integrate ESG factors into their traditional investment process as a way to seek financial returns. Funds that have a sustainable investment objective use ESG analysis as a significant part of the fund's investment thesis to meet investors' objectives while seeking financial returns.

The white paper recommends that fund managers publish on their websites how they integrate ESG considerations into the investment process, based on the view that it would "enhance a fund's financial performance by analyzing material ESG considerations along with other material risks such as credit risk and counterparty risk."[70] According to ICI, most fund managers engage in sustainable investing through three "nonexclusive investment approaches" and a fund's use of any or all of these approaches should be disclosed: ESG exclusionary investing (excluding sectors that do not meet certain sustainability criteria), ESG inclusionary investing (seeking sectors with positive sustainability outcomes), and impact investing (seeking to "generate positive, measurable, reportable social and environmental impact alongside a financial return").[71] Throughout the publication, the white paper advocates for its second principle: adoption of clear and consistent terms and investment techniques. In advocating for common terminology, the ICI seeks to inform interested investors of ESG investing and the various choices available. In addition to its white paper, the ICI also regularly issues comment letters on ESG policy issues.[72]

5. World Economic Forum

The World Economic Forum is an independent nonprofit established in 1971 that brings together political, business, culture, and other leaders to "demonstrate entrepreneurship in the global public

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69 ICI, News Release, *ICI Board Endorses Fund Industry ESG Roadmap* (July 23, 2020), https://www.ici.org/news-release/20_news_esgprimer; ICI, *Funds' Use of ESG Integration and Sustainable Investing Strategies: An Introduction* (July 2020), https://www.ici.org/system/files/attachments/20_ppr_esg_integration.pdf.

70 *Id.*

71 *Id.*

72 ICI, *ESG Resource Center*, https://www.ici.org/esg.

interest while upholding the highest standards of governance."[73] The World Economic Forum promotes the "stakeholder theory" that every organization is accountable to society.[74] In September 2020, it published a report entitled "Measuring Stakeholder Capitalism: Towards Common Metrics and Consistent Reporting of Sustainable Value Creation."[75] The report originated from the 2020 Annual Meeting in Davos, where 120 of the world's largest companies committed to developing a core set of common metrics and disclosures of non-financial factors for investors and stakeholders. The report recommends a framework that sorts disclosures into four pillars: Principles of Governance, Planet, People, and Prosperity. The pillars align with the United Nations Sustainability Development Goals and have as their aim the publication of metrics and disclosures that will "enable each company to provide the narrative and the numbers that its investors and stakeholders need to track [the] corporate journey towards sustainable value creation."[76] The recommended metrics—consisting of "21 core and 34 expanded metrics and disclosures"—are based on existing standards, like the TCFD, with the goal of "accelerating convergence among the leading private standard-setters and bringing greater comparability and consistency to the reporting of ESG disclosures."[77] The core metrics are "primarily quantitative," meaning that many firms are already reporting the information or can do so "with reasonable effort."[78] The 34 "expanded metrics," however, "represent a more advanced way" of reporting on sustainable value creation and include monetary terms capturing the impact of their operations on climate change.[79]

6. The Investor Agenda

The Investor Agenda was created by seven major investor groups—AIGCC, CDP (formerly Carbon Disclosure Project), Ceres, IGCC, IIGCC, PRI and UNEP FI—to "evaluate the best investor guidance on tackling the climate crisis and advocate collectively for public policy to accelerate the net-zero transition."[80] The Investor Agenda is a "unifying, comprehensive, and focused" agenda to

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73 World Economic Forum, *Our Mission*, https://www.weforum.org/about/world-economic-forum.

74 *Id.*

75 World Economic Forum, Reports, *Measuring Stakeholder Capitalism: Towards Common Metrics and Consistent Reporting of Sustainable Value Creation* (Sept. 22, 2020), https://www.weforum.org/reports/measuring-stakeholder-capitalism-towards-common-metrics-and-consistent-reporting-of-sustainable-value-creation.

76 World Economic Forum, *Measuring Stakeholder Capitalism Towards Common Metrics and Consistent Reporting of Sustainable Value Creation* 44 (Sept. 2020), https://www3.weforum.org/docs/WEF_IBC_Measuring_Stakeholder_Capitalism_Report_2020.pdf.

77 World Economic Forum, *Measuring Stakeholder Capitalism: Towards Common Metrics and Consistent Reporting of Sustainable Value Creation* 3 (Sept. 2020), https://www3.weforum.org/docs/WEF_IBC_Measuring_Stakeholder_Capitalism_Report_2020.pdf.

78 *Id.* at 6.

79 *Id.* at 14.

80 The Investor Agenda, *About Us*, https://theinvestoragenda.org/about-the-agenda/.

"accelerate investor action for a net-zero emissions economy."[81] The agenda is broken down into four key areas—corporate engagement, investment, policy advocacy, and investor disclosure—which serve as a "roadmap for a robust investor climate action plan."[82] It endorses four major initiatives:

1. The Net Zero Asset Managers initiative[83]
2. The United Nations-convened Net-Zero Asset Owner Alliance and the Target Setting Protocol[84]
3. The Science Based Targets initiative (SBTi) for financial institutions[85]
4. The Paris Aligned Investment Initiative and the Net Zero Investment Framework 1.0[86]

To further its agenda, the organization supports alignment with the TCFD recommendations and encourages investors to "set science-based portfolio emissions reduction targets that are consistent with achieving global net-zero emissions by 2050 or sooner, with credible intermediate targets."[87]

81 *Id.*

82 *Id.*

83 *See infra* 1.a.8.

84 The United Nations-convened Net-Zero Asset Owner Alliance is a group of over 30 of the largest asset owners committed to reducing carbon emissions in their portfolio to net zero by 2050. PRI, *About the Alliance*, https://www.unepfi.org/net-zero-alliance/.

85 SBTi is a partnership between CDP, the United Nations Global Compact, World Resources Institute (WRI) and the World Wide Fund for Nature (WWF) that created a framework to help companies reduce their greenhouse gas emissions. Science Based Targets, *About Us*, https://sciencebasedtargets.org/about-us. More recently, it launched a tool to help companies set science-based targets to cut emissions. Science Based Targets, *Set A Target*, https://sciencebasedtargets.org/step-by-step-process.

86 In its own words, "[t]he Net Zero Investment Framework 1.0 is designed to provide a basis on which a broad range of investors can make commitments to achieving net zero emissions and define strategies, measure alignment, and transition portfolios. . . . . The aim is to provide a framework that can be used by asset owners and asset managers, considering their different mandates and starting points. In that context, investors adopting the Framework are expected to use it on an 'implement or explain' basis, in the context of their fiduciary duties, and may, therefore, take account of specific contexts and strategies where some elements of the Framework may not be applicable." IGCC, *Net Zero Investment Framework 1.5C: Implementation Guide* 6 (Mar. 2021), https://www.iigcc.org/download/net-zero-investment-framework-implementation-guide/?wpdmdl=4425&refresh=61f04ade208541643137758.

87 The Investor Agenda, *Investment*, https://theinvestoragenda.org/focus-areas/set-a-net-zero-target/.

### 7. The Paris Aligned Investment Initiative

The PAII is a "collaborative investor-led global forum enabling investors to align their portfolios and activities to the goals of the Paris Agreement."[88] The initiative was established in May 2019 by the IIGCC, and focuses on three key areas:

- Driving net zero investing commitments—by asset managers through the Net Zero Asset Managers initiative and by asset owners through the PAII Net Zero Asset Owner Commitment.
- Supporting investors to implement commitments, using the PAII's Net Zero Investment Framework.
- Collaborating globally as the forum for AIGCC, Ceres, IGCC, IIGCC and the investment community to develop and support further practical approaches to enable Paris aligned investing.[89]

In August 2020, the initiative issued a Net Zero Investment Framework explaining how to implement a plan for investors to align their portfolios with the goals of the Paris Agreement.[90] Less than a year later, after a public consultation period and extensive stakeholder engagement, it published the Net Zero Investment Framework 1.0 that incorporates several amendments and clarifications to its original Framework.[91]

### 8. The Net Zero Asset Managers Initiative

The Net Zero Asset Managers Initiative is "an international group of asset managers committed to supporting the goals of net zero greenhouse gas emissions by 2050 or sooner, in line with global efforts to limit warming to 1.5 degrees Celsius; and to supporting investing aligned with net zero emissions by 2050 or sooner."[92] Asset managers aim to achieve these goals by, among other things, "setting targets for assets managed in line with net zero pathways, corporate engagement and stewardship, [and] policy advocacy."[93] Over 200 asset managers representing $57 trillion

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88 Paris Aligned Investment Initiative, *Home*, https://www.parisalignedinvestment.org/ (last visited Jan. 31, 2022).

89 *Id.*

90 IGCC, *Net Zero Investment Framework 1.5C: Implementation Guide* 3 (Mar. 2021), https://www.iigcc.org/download/net-zero-investment-framework-implementation-guide/?wpdmdl=4425&refresh=61f04ade208541643137758.

91 THE INSTITUTIONAL INVESTORS GROUP ON CLIMATE CHANGE, Net Zero Investment Framework Implementation Guide, (Mar. 2021); IGCC, *Net Zero Investment Framework 1.5C: Implementation Guide* (Mar. 2021), https://www.iigcc.org/download/net-zero-investment-framework-implementation-guide/?wpdmdl=4425&refresh=61f04ade208541643137758.

92 Net Zero Asset Managers Initiative, https://www.netzeroassetmanagers.org/ (last visited Jan 31, 2022).

93 Net Zero Asset Managers Initiative, *Q & A*, https://www.netzeroassetmanagers.org/q-and-a (last visited Jan. 31, 2022).

AUM have signed on to the initiative. The initiative is supported by Asia Investor Group on Climate Change, CDP (discussed below), Ceres, IIGCC, Investor Group on Climate Change, and PRI.

9. Glasgow Financial Alliance for Net Zero

As discussed above, GFANZ was launched in April 2021 by Mark Carney to encourage financial institutions to accelerate the transition to a net-zero global economy.[94]

## B. Institutional Investor Disclosure Frameworks

1. Task Force on Climate-Related Financial Disclosures (TCFD)

The TCFD was created by the Financial Stability Board (FSB) in 2015 and seeks to promote consistent and comparable climate-related disclosures across all firms.[95] The TCFD Recommendations, likely the most widely endorsed climate change reporting framework, set out a comprehensive framework that has been developed by, and is directly responsive to the needs of, users and preparers of financial filings across a range of financial and non-financial industries. The Recommendations focus on information intended to be actionable by investors, lenders, insurance underwriters and other consumers of such information. The TCFD recommends that companies across all industries disclose: (i) "the organization's governance around climate-related risks and opportunities"; (ii) "the actual and potential impacts of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning where such information is material"; (iii) "how the organization identifies, assesses, and manages climate-related risks"; and (iv) "the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material."[96] With respect to the fourth category, the TCFD specifically recommends that companies disclose the metrics used by the organization to assess climate-related risks and opportunities, publish information regarding greenhouse gas emissions and related risks, and describe the targets used by the organization to manage climate-related risks and opportunities. The TCFD also provides guidance for certain industries most affected by climate change.

The TCFD makes certain recommendations specifically directed to fund level disclosures.[97] For example, with respect to disclosures concerning investment opportunities and strategy, the TCFD recommends that asset managers describe "the climate-related risks and opportunities the

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94 *See supra Introduction* and Table 1.

95 TCFD, *About*, https://www.fsb-tcfd.org/about/ (last visited Jan. 31, 2022).

96 TCFD, *Proposed Guidance on Climate-related Metrics, Targets, and Transition Plans* (June 2021), https://assets.bbhub.io/company/sites/60/2021/05/2021-TCFD-Metrics_Targets_Guidance.pdf.

97 See *id.*

organization has identified over the short, medium, and long term" and "the impact of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning." With respect to climate-related *opportunities*, the TCFD recommends that asset managers disclose the proportion of assets or operating, investing, or financing activities that are materially exposed to transition risk, including a description of significant concentrations of exposure to carbon-related assets.[98] With respect to climate-related *impact*, the TCFD recommends that asset managers describe how climate-related risks and opportunities are factored into relevant products or investment strategies, and how a transition to a lower-carbon economy may affect those products or strategies.

The TCFD also makes recommendations concerning the metrics and targets that asset managers use to assess climate-related risks and opportunities and how, if at all, those metrics have changed over time. Asset managers should "measure and disclose the alignment of their portfolios consistent with" a climate scenario in which global temperatures rise 2°C or lower (*e.g.*, a Paris-aligned temperature pathway), and "incorporate forward-looking alignment metrics into their target-setting frameworks and management processes." The TCFD also calls for the disclosure of financed-emissions (greenhouse gas emissions associated with investments) if they can be reasonably estimated, and the use of the Partnership of Carbon Accounting Financials' ("PCAF") methodology and Weighted Average Carbon Intensity ("WACI"), as applicable.[99] The TCFD suggests the disclosure of any other metrics that would be useful for decision-making, and provides examples of such metrics.[100]

The so-called "Group of Five"—comprised of five major sustainability reporting organizations—the CDP (formerly the Carbon Disclosure Project),[101] the Climate Disclosure Standards Board

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98 The TCFD recognizes that the term carbon-related assets is not well-defined, and as a result urges financial institutions to adopt a consistent definition to facilitate comparability.

99 The PCAF is a collaboration of 170 financial institutions with assets under management of over $59 trillion, which has created the Global GHG Accounting and Reporting Standard for the Financial Industry. PCAF, *The Partnership for Carbon Accounting Financials (PCAF) launches Japan coalition* (Nov. 12, 2021), https://www.carbonaccountingfinancials.com/newsitem/the-partnership-for-carbon-accounting-financials-pcaf-launches-japan-coalition. The Standard provides financial institutions with a methodology for calculating and disclosing financed emissions (*i.e.*, emissions resulting from operations financed by loans and investments). TCFD, *Proposed Guidance on Climate-related Metrics, Targets, and Transition Plans* (June 2021), https://assets.bbhub.io/company/sites/60/2021/05/2021-TCFD-Metrics_Targets_Guidance.pdf. The WACI measures a fund's exposure to carbon intensive companies. Various fund companies already are disclosing WACI to their investors, including, for instance, iShares exchange traded funds managed by BlackRock. *Id.*

100 TCFD, *Proposed Guidance on Climate-related Metrics, Targets, and Transition Plans* (June 2021), https://assets.bbhub.io/company/sites/60/2021/05/2021-TCFD-Metrics_Targets_Guidance.pdf.

101 CDP is a global disclosure reporting system concerning environmental impacts, which aims to incentivize and guide companies on their efforts to reduce their greenhouse gas emissions, safeguard water resources and protect forests. FSB, *Report on Promoting Climate-Related Disclosures* (July 7, 2021), https://www.fsb.org/wp-content/uploads/P070721-4.pdf.

("CDSB"),[102] the Global Reporting Initiative ("GRI"),[103] the Value Reporting Foundation ("VRF"),[104] and Sustainability Accounting Standards Board ("SASB")[105]—have added their gloss on the TCFD Recommendations. In 2020, they jointly published a paper detailing standards for reporting on enterprise value that takes into account climate-related risks.[106] The paper offered a prototype for a global, climate-related financial disclosure standard. This prototype uses the four pillars of the TCFD as the basis for a wider set of sustainability-related financial risks and opportunities for asset managers to consider. Thus, while companies may need to report to any one of the organizations in the Group of Five, TCFD-compliant responses should readily translate to any of these frameworks.

Based on the Group of Five's endorsement of the TCFD Recommendations and the TCFD's October 18, 2021 announcement that TCFD-aligned disclosures increased by 99% in just the past year, coupled with the fact that numerous large institutional investors including BlackRock and State Street and proxy advisory firms such as ISS have endorsed adhering to the TCFD disclosure standards, the TCFD Recommendations are gaining momentum toward becoming the prevalent climate change disclosure framework.[107]

2. International Sustainability Standards Board

On November 3, 2021, during the COP26 UN Global summit, the IFRS Foundation announced the formation of the International Sustainability Standards Board ("ISSB"), to "develop—in the public interest—a comprehensive global baseline of high-quality sustainability disclosure standards to

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[102] The CDSB Framework sets out an approach to reporting environmental information in mainstream reports, with the objective of aligning with and completing financial reporting and encouraging the standardization of environmental information. FSB, *Report on Promoting Climate-Related Disclosures* (July 7, 2021), https://www.fsb.org/wp-content/uploads/P070721-4.pdf.

[103] Sarah Murray, *Measuring what matters: the scramble to set standards for sustainable business*, FT (May 13, 2021), https://www.ft.com/content/92915630-c110-4364-86ee-0f6f018cba90.

[104] The VRF sets forth an integrated process for reporting material information about an organization's ability to create value over time in a way that reflects the commercial, social and environmental context within which it operates. FSB, *Report on Promoting Climate-Related Disclosures* (July 7, 2021), https://www.fsb.org/wp-content/uploads/P070721-4.pdf.

[105] SASB's industry-specific standards identify the sustainability-related risks and opportunities most likely to affect a company's financial condition, operating performance or risk profile, which in turn impact a company's current and future market valuation. In 2018, SASB devised a set of sustainability accounting standards for corporate disclosures covering material issues for 77 industries. The standards, according to SASB, "identify the minimal set of financially material sustainability topics and their associated metrics for the typical company in an industry." *A Practical Guide to Sustainability Reporting Using GRI and SASB Standards* (2021), https://www.sasb.org/wp-content/uploads/2021/04/GRI-SASB-V4-040721.pdf.

[106] *Reporting on enterprise value* (Dec. 2020), https://29kjwb3armds2g3gi4lq2sx1-wpengine.netdna-ssl.com/wp-content/uploads/Reporting-on-enterprise-value_climate-prototype_Dec20.pdf.

[107] 2021 Status Report (Oct. 2021), https://assets.bbhub.io/company/sites/60/2021/07/2021-TCFD-Status_Report.pdf.

meet investors' information need."[108] The IFRS also announced a commitment on the part of certain members of the Group of Five to consolidate into the ISSB, namely, the CDSB (an initiative of the CDB) and the VRF (which houses the Integrated Reporting Framework and the SASB Standards). Finally, the IFRS also published prototype climate and general disclosure requirements developed by the IFRS's Technical Readiness Working Group ("TRWG"), a group formed by the IFRS Foundation Trustees to undertake preparatory work for the ISSB.[109] The Prototype Climate-related Disclosures Requirements recommend that asset managers disclose:

- the amount of assets under management by asset class that employ (1) integration of environmental, social, and governance issues, (2) sustainability themed investing, and (3) screening;
- a description of its approach to the incorporation of environmental, social, and governance (ESG) factors in investment and/or wealth management processes and strategies; and
- a description of proxy voting and investee engagement policies and procedures.[110]

The TRWG also published a Supplement: Technical Protocols for Disclosure Requirements, which provides industry-specific recommendations, including for asset managers.[111] The recommendations include accounting metrics, key definitions, and other information recommended for inclusion.

### C. Regulatory Guidance

Regulators around the world are in various stages of issuing climate change guidance or directives, including for compliance, governance and disclosure on the part of the asset management industry. We previously have discussed the state of play in the EU, UK and U.S. on disclosure focused

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108 The IFRS Foundation is a not-for-profit organization that aims to develop globally accepted accounting and sustainability disclosure standards—IFRS Standards—and to promote and facilitate adoption of the standards. Standards are developed by our two standard-setting boards, the International Accounting Standards Board (IASB) and the newly created ISSB. IFRS, News, *IFRS Foundation announces International Sustainability Standards Board, consolidation with CDSB and VRF, and publication of prototype disclosure requirements* (Nov. 3, 2021), https://www.ifrs.org/news-and-events/news/2021/11/ifrs-foundation-announces-issb-consolidation-with-cdsb-vrf-publication-of-prototypes/; IFRS, *IFRS Foundation Trustees announce strategic direction and further steps based on feedback to sustainability reporting consultation* (Mar. 8, 2021), https://www.ifrs.org/news-and-events/news/2021/03/trustees-announce-strategic-direction-based-on-feedback-to-sustainability-reporting-consultation/.

109 IFRS, *Technical Readiness Working Group*, https://www.ifrs.org/groups/technical-readiness-working-group/#resources.

110 IFRS, *Climate-related Disclosures Prototype* (Nov. 2021), https://www.ifrs.org/content/dam/ifrs/groups/trwg/trwg-climate-related-disclosures-prototype.pdf.

111 IFRS, *Supplement: Technical Protocols for Disclosure Requirements* (Nov. 2021), https://www.ifrs.org/content/dam/ifrs/groups/trwg/climate-related-disclosures-prototype-technical-protocols-supplement.pdf.

climate change regulatory developments.[112] Below we discuss certain U.S., EU and UK regulatory guidance directed specifically to asset managers.

1. SEC Examinations Risk Alert: Compliance Issues in ESG Investing

On April 9, 2021, the SEC's Division of Examination released a risk alert that it counseled asset managers to review in considering updates to their compliance and controls. The risk alert highlighted the "observations of deficiencies and internal control weaknesses from examinations of investment advisers and funds regarding ESG investing."[113] While conducting its review, the Division observed that investment advisors approach ESG investing in various ways. For instance, some firms consider ESG factors among a broader mix of economic trends and other metrics, while others focus specifically on the ESG practices of the companies in which they invest. Though the Division did not endorse one approach over another, it stated that the lack of standard definitions and terms across the industry makes it challenging for firms to disclose their approach and product offerings in a way that allows investors to compare products and make informed investment decisions. To guide asset managers before formal guidelines are promulgated, the Staff published a list of its observations of effective practices, which included:[114]

- The issuance of simple and clear disclosures that are tailored to the firm's approaches to ESG investing and explain how investments were evaluated under global ESG frameworks;
- The development of policies and procedures that address ESG investing, including research, due diligence, selection, and monitoring that will be completed;
- The retention of compliance personnel who are knowledgeable about the firm's ESG-related practices.

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[112] Jason Halper, *et al.*, *Investors and Regulators Turning up the Heat on Climate-Change Disclosures*, Harv. L. Sch. F. On Corp. Governance (July 24, 2021), https://corpgov.law.harvard.edu/2021/10/04/investors-and-regulators-turning-up-the-heat-on-climate-change-disclosures/.

[113] SEC, *Risk Alert: The Division of Examinations' Review of ESG Investing*, (Apr. 9, 2021), https://www.sec.gov/files/esg-risk-alert.pdf. The Division noted that the "Risk Alert uses the term 'ESG' in the broadest sense to encompass terms such as 'socially responsible investing,' 'sustainable,' 'green,' 'ethical,' 'impact,' or 'good governance' to the extent they describe environmental, social, and/or governance factors that may be considered when making an investment decision. These terms, however, are not defined in the Investment Advisers Act of 1940 ('Advisers Act'), the Investment Company Act of 1940 ('Investment Company Act'), or the rules adopted thereunder." *Id.*

[114] SEC, *Risk Alert: The Division of Examinations' Review of ESG Investing*, (Apr. 9, 2021), https://www.sec.gov/files/esg-risk-alert.pdf.

The risk alert warned that future examinations would focus on:[115]

- **Portfolio management**, including a review of firm "policies, procedures, and practices related to ESG and its use of ESG-related terminology; due diligence and other processes for selecting, investing in, and monitoring investments in view of the firm's disclosed ESG investing approaches; and whether proxy voting decision-making processes are consistent with ESG disclosures and marketing materials."
- **Performance advertising and marketing**, including a "review of the firm's regulatory filings; websites; reports to sponsors of global ESG frameworks, to the extent the firm has communicated to clients and potential clients a commitment to follow such frameworks; client presentations; and responses to due diligence questionnaires, requests for proposals, and client/investor-facing documents, including marketing material."
- **Compliance programs**, including a "review of the firm's written policies and procedures and their implementation, compliance oversight, and review of ESG investing practices and disclosures."

Finally, the risk alert identified areas where statements concerning ESG investing were potentially misleading, including concerning firms' adherence to global ESG frameworks. Examples of such deficiencies included:[116]

- Portfolio management practices were different than the firm's policies or other client or investor-facing documents;
- Firms did not have adequate controls in place to monitor, maintain, and/or update clients' ESG-related investing guidelines, mandates, and restrictions;
- Firms did not have adequate controls in place to ensure ESG-related disclosures and marketing are consistent with firm policies;
- Firms engaged in proxy voting that was inconsistent with their stated approaches;
- Firms published marketing materials with unsubstantiated ESG claims; and
- The firm's compliance programs did not adequately address relevant ESG issues.

2. The SEC's Asset Management Advisory Committee

In December 2020, the ESG subcommittee of the SEC's Asset Management Advisory Committee ("AMAC") published "potential recommendations" for ESG funds regarding ESG investment

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[115] *Id.*

[116] *Id.*

products.[117] The subcommittee noted that "[o]ur recommendation is limited in scope: significant disclosure requirements for material risks already exist and we do not see the need to change the disclosure laws to improve the quality and comparability of ESG for investors. What we do recommend is the adoption of standards for those disclosures; we propose that mandatory, rather than voluntary, standards be established, as the current, unguided approach has not resulted in consistent comparable, complete and meaningful disclosure."[118] The AMAC invited discussion on the "potential recommendations."

On March 21, 2021, SEC Commissioner Elad Roisman issued a statement concerning the ESG-related recommendations, posing questions concerning "figuring out exactly which ESG information is material":

- How have you gauged what investors are looking for when it comes to ESG products? People have invested now around $2 Trillion into funds labeled "ESG," "green," and the like. But, it is not clear to me that we understand these investors' objectives, which (as the subcommittee's preliminary recommendation states) may fall outside risk/return alone. How do you design and market products tailored to investors' interests?
- To the extent you are focusing on minimizing risk and achieving high returns, what E, S, and G information specifically do you believe you need from issuers, and why? How is this information related to valuing potential targets for investment and valuing portfolio companies on an ongoing basis?
- I would like to understand how asset managers are currently seeking out this information. I know some request companies provide SASB or TCFD disclosures, or they seek the information in a different manner. How do you choose which approach to take?
- How have European disclosure mandates, such as the Sustainable Finance Disclosure Regulation, factored into this decision-making?
- To the extent that you are looking to increase comparability of issuers' disclosure, why is this important in the case of ESG? In other contexts, we do not demand perfect comparability across all categories of material information.

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117 *See* Jason Halper, *et al.*, *Investors and Regulators Turning up the Heat on Climate-Change Disclosures*, Harv. L. Sch. F. On Corp. Governance (July 24, 2021), https://corpgov.law.harvard.edu/2021/10/04/investors-and-regulators-turning-up-the-heat-on-climate-change-disclosures/.

118 SEC, *Discussion Draft: Asset Management Advisory Committee Potential Recommendations of ESG Subcommittee* (Dec. 1, 2020), https://www.sec.gov/files/potential-recommendations-of-the-esg-subcommittee-12012020.pdf.

In July 2021, AMAC made formal recommendations for the SEC to adopt.[119] With respect to issuer disclosures, the AMAC recommended that the SEC should:

- require the adoption of standards by which corporate issuers disclose material ESG risks;
- utilize standard setters' frameworks to require disclosure of material ESG risks; and,
- require that material ESG risks be disclosed in a manner consistent with the presentation of other financial disclosures.

With respect to ESG investment product disclosures, the AMAC recommended that the SEC suggest (i) "best practices to enhance ESG investment product disclosure, including alignment with the taxonomy developed by the ICI ESG Working Group and clear description of each product's strategy and investment priorities, as well as description of non-financial objectives such as environmental impact or adherence to religious requirements"; and (ii) "best practices for investment products to describe each product's planned approach to share ownership activities in the Statement of Additional Information, and any notable recent ownership activities outside proxy voting, which is reported in Form N-PX, in shareholder reporting."

The SEC has not formally adopted any of the recommendations by the AMAC.

3. The Sustainable Finance Disclosure Regulation ("SFDR")

The EU's SFDR requires asset managers to provide a number of sustainability-related disclosures, even if the asset managers do not have an express ESG or sustainability focus. The SFDR requires institutional investors, asset managers and advisers to report how they integrate sustainability risks and adverse impacts at the entity (asset manager) level, and also to report how they classify and report their ESG products' sustainability risks and adverse impacts. If the financial product has a sustainability focus, meaning it promotes environmental or social characteristics, or has sustainable investment or reduction in carbon emissions as objectives, then additional disclosures are required.[120]

- The SFDR calls for two levels of disclosures:[121]

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119 SEC, *Discussion Draft: Asset Management Advisory Committee Recommendations for ESG* (July 7, 2021), https://www.sec.gov/files/amac-recommendations-esg-subcommittee-070721.pdf.

120 *See* Jason Halper, *et al.*, *Investors and Regulators Turning up the Heat on Climate-Change Disclosures*, Harv. L. Sch. F. On Corp. Governance (July 24, 2021), https://corpgov.law.harvard.edu/2021/10/04/investors-and-regulators-turning-up-the-heat-on-climate-change-disclosures/.

121 S&P GLOBAL MARKET INTELLIGENCE, *What is the Impact of the EU Sustainable Finance Disclosure Regulation (SFDR)?* (Apr. 1, 2021) https://www.spglobal.com/marketintelligence/en/news-insights/blog/what-is-the-impact-of-the-eu-sustainable-finance-disclosure-regulation-sfdr.

- Entity level disclosures must include:
    - how the entity integrates sustainability risks into its decision-making process or financial advice;
    - the policies concerning how an entity considers Principal Adverse Impacts ("PAIs"), which are negative or material effects on sustainability factors (e.g., carbon footprint);
    - how remuneration policies are consistent with the integration of sustainability risks; and
    - disclosures on sustainability risk integration (e.g., how sustainability risks may impact performance of financial products).
- Product level disclosures must include:
    - an explanation of how financial products account for PAIs, regardless of whether the product is intended to meet sustainability goals;
    - an explanation as to how products that promote "Environmental" or "Social" characteristics meet their goals; and
    - an explanation as to how products that have sustainable investment as an objective achieve that objective.

4. UK's Pension Schemes Act of 2021

The UK's Pension Schemes Act 2021 requires retirement funds with more than 5 billion pounds of assets to disclose the impact of their holdings on and their ability to manage climate-change.[122] Pensions will be required to publish an "absolute emissions metric, emission-intensity metric and climate change metric for the funds' assets, and scenario analysis for the resilience of its investment strategies."[123] The Act also requires large asset owners to issue disclosures consistent with the TCFD recommendations.[124]

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[122] Ronan Martin & Greg Ritchie, *Can Your Pension Resist Climate Change?*, U.K. Funds Tally Risks, BLOOMBERG LAW (Oct. 7, 2021), https://news.bloomberglaw.com/private-equity/can-your-pension-resist-climate-change-u-k-funds-tally-risks?utm_source=rss&utm_medium=PENW&utm_campaign=0000017c-59c0-d21c-af7e-79fd8e3c0004; *see also* Legislation.gov.uk, *Pension Schemes Act 2021*, https://www.legislation.gov.uk/ukpga/2021/1/contents.

[123] *Id.*

[124] UK Dept. for Work & Pensions, *Government response: Taking action on Climate risk: improving governance and reporting by occupational pension schemes* (July 21, 2021), https://www.gov.uk/government/consultations/taking-action-on-climate-risk-improving-governance-and-reporting-by-occupational-pension-schemes-response-and-consultation-on-regulations/outcome/government-response-taking-action-on-climate-risk-improving-governance-and-reporting-by-occupational-pension-schemes.

The requirements applied to large schemes (5 billion pounds or more in assets), master trusts and collective defined contribution schemes starting in October of 2021 and will apply to schemes with (1 billion pounds or more in assets) starting on October 1, 2022.

**IV. Conclusion**

The asset management industry is facing mounting pressure to strengthen disclosure of climate-related risks and opportunities and to support "sustainability" initiatives, all while continuing to maximize financial returns for its investors. As asset managers try to balance these potentially conflicting tasks—pursuing "sustainability" and making money—in an evolving regulatory landscape, asset managers should continue to monitor and rely upon the (albeit limited) guidance from regulators. Until regulators issue better and clearer guidance, however, asset managers should consider the recommendations published by the numerous investor-led organizations discussed herein, such as PRI, Ceres, or GFANZ, and follow the now well-recognized disclosure frameworks such as the TCFD recommendations, which have earned credibility within the asset management industry and with regulators over the last several months.

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