ERIG INDEX

REGULATORY CLARITY CRITICAL TO STEER SUSTAINABLE TRANSITION

AUTHORS: **SHEELA VEERAPPAN**, SENIOR SUSTAINABILITY INVESTMENT SPECIALIST AT ABRDN &
VANESSA CHOI, ESG COMPLIANCE MANAGER, ASIA AT ABRDN

Regulators worldwide have stepped up scrutiny of sustainable investing in recent years by tightening legislation, reporting requirements and disclosure frameworks.

But in itself this has raised fears about over-regulation – that stricter requirements or having too many rules could be counterproductive and stifle efforts to create a cleaner, greener and sustainable future by deploying more capital into sustainable developments.

This was a hot topic at abrdn's second annual **Sustainability Summit**[1] in Singapore in May, when speakers debated the merits of regulation on environmental, social and governance (ESG) investing.

The debate for and against strict regulation

was designed to be theoretical to facilitate discussion on sustainable investing with real-life impact, not represent the personal or company views of speakers.

On one side of the debate, proponents of current regulation pointed out that money continues to pour into ESG-oriented investments despite this increase in scrutiny.

Globally, asset managers are forecast to see ESG-related assets under management surge 84% from US$18.4 trillion in 2021 to US$34 trillion by 2026.[2]

On the other side, sceptics argued the burdensome impacts of regulatory requirements have also grown exponentially – costing companies an increasing amount of time and money just to meet all the requirements.

Clearly the landscape for ESG-related investing has become much more complex than it was two decades ago when the term ESG was first coined. Investors must navigate a maze of regulations, disclosure requirements, standards and taxonomies in their decision-making process. Regulatory developments for sustainable investments include:

- Disclosure rules at both a product and company level;
- Guidelines on managing ESG risks at a company level;
- Standards such as TCFD (see below) that are specific in focus and largely voluntary;
- Taxonomies – classification systems that define activities/investments in distinct groups, can be tied to regulations and are mandatory to implement or seen as setting standards.

As a result, rules around integrating ESG factors into investment products and services and the transparent disclosure of relevant information have tightened significantly.

The lack of regulatory harmonisation across geographies – and between taxonomies – further complicate matters. Both developments create significant reporting burdens for global investors.

At abrdn, we believe that clear, fit-for-purpose regulation is the first step to ensuring clients are comfortable that the products and services they invest in are in line with the outcomes they expect.

Since regulations are evolving constantly, we regard them as minimum hurdles for sustainable investing. It's incumbent on asset managers to consult clients regularly to help them understand the impact of regulatory changes on their investments.

At the same time, we recognise the need for a balance to be struck: over-regulation can be counterproductive and place excessive reporting burdens on investors and companies.

We believe the industry as a whole has a decisive role to play in ensuring capital is being deployed into sustainable investments.

Learning from Europe

Certainly regulators in different markets have different priorities and objectives.

As a general rule, they set out to improve the resilience of sustainable investments via downside risk protection, avoidance of greenwashing and re-directing capital into sustainable activities.

Regulation provides frameworks that help to define what constitutes as sustainable. In theory, that makes it easier for investors to identify suitable companies – as well as externally managed funds or mandates – to infuse with capital.

In practice, the reality on the ground is complicated. Europe has taken the lead by rolling out comprehensive ESG regulations. It designed its Sustainable Finance Disclosure Regulation (SFDR) to improve transparency for sustainable products and avoid greenwashing.

But its rollout has been challenging, and in many ways SFDR can be viewed a proving ground for regulators to learn from, particularly in Asia-Pacific where regulations and standards are at various stages of being drafted across countries.

Generally, we have identified three lessons that regulators in Asia Pacific can learn from Europe:

- There's a lack of inter-operability between SFDR and rules/guidelines outside the European Union, notwithstanding a push for global standards on ESG data to drive cross-border coherence.
- There's a lack of common taxonomy for ESG and standardised definition of what constitutes sustainable investing. Taxonomies can bring more clarity to environmental and social issues.
- More progress is needed to motivate investors and companies to adopt transparent disclosure practices to clamp down on greenwashing (misrepresentation of the positive impact that a financial product, investment strategy or company has).

Importantly, the lack of coherent standards on ESG data disclosure tends to heighten greenwashing risks and reduce investor confidence in sustainable products as well as limiting the level of investor protection. Worse, it can lead to a misallocation of capital where investors plough money into areas with little or no real-world impact.

Asset managers have an important role to play here in steering capital and driving the transition towards a sustainable future.

At abrdn, we are working with policymakers and industry standard-setters to support the development and delivery of fit-for-purpose regulations that we are confident can advance sustainable investing while offering a level of investor protection.

Similarly, we seek to play a leading role in the markets where we operate by encouraging and working with companies to develop better disclosure practices as part of maintaining the highest disclosure standards to engender greater trust.

ERIG INDEX

- Sustainability Summit in Singapore
- PwC Asset and Wealth Management Revolution 2022 report

This document has been prepared by Evergreen Research Pty Ltd trading as ERIG Index ABN 17 647 506 590 (Authorised Representative 001289533 of Evergreen Fund Managers Pty Ltd ABN 75 602 703 202 AFSL 486275) and contains general advice only. The material is for the information purposes of non-retail clients only. It is not, and is not to be construed as, advice or a recommendation to acquire, hold or dispose of financial products or to use financial services.
August 2023