REPORT

# ESG INVESTING: A GLOBAL REGULATORY REVIEW AND OUTLOOK

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### **ESG INVESTING: A GLOBAL REGULATORY REVIEW AND OUTLOOK**

As environmental, social, and governance (ESG) considerations become increasingly central to investment strategies worldwide, the regulatory landscapes governing ESG investing are evolving rapidly across different regions. Throughout 2024, Morgan Lewis has been diving into the intricate regulatory frameworks shaping ESG investments in key global markets, including the United States, the European Union, the United Kingdom, the Asia-Pacific region, the Middle East, and Africa. Each region presents unique challenges and opportunities, reflecting local economic, environmental, and political contexts, while also contributing to broader global trends in sustainable finance.

This report provides an overview of these regional ESG regulatory frameworks and highlights the commonalities and emerging trends that characterize each of these diverse markets.

Across all regions, there are certain recurring themes, including the following:

- There continues to be market interest in ESG investing—and in some regions that
  interest is growing. As the same time, certain jurisdictions and especially the United
  States continue to see active checks on ESG investing in the form of the anti-ESG
  movement that posits that ESG is an impermissible investment consideration and
  greenwashing attacks that are challenging ESG representations as overblown. While the
  United States has been the primary flashpoint of these ESG challenges, there is evidence
  similar regulatory and/or litigation challenges are popping up in non-US jurisdictions.
- There has been an increasing emphasis on transparency and disclosure, driven by a growing regulatory focus on combating greenwashing and ensuring that ESG claims are credible and substantiated. In order to address greenwashing and similar concerns, many regulatory bodies worldwide are implementing stricter guidelines and penalties to enhance investor confidence and maintain market integrity.
- In part due to the above two factors, the regulatory approaches can vary from one region to another, with the United States grappling with a fragmented state-by-state approach and the European Union and United Kingdom leading with comprehensive disclosure mandates. This is creating compliance challenges for investors and fund sponsors alike as these regulatory approaches can be contradictory.
- The rise of sustainable finance instruments, such as green bonds, underscores the financial sector's pivotal role in driving ESG-related investments.

As discussed in this report, the evolving regulatory landscapes not only shape the present but will significantly influence the future of sustainable investing, offering both challenges and opportunities for investors and companies alike.

#### **The United States**

The regulatory environment for ESG investing in the United States is characterized by a multifaceted approach, primarily governed by three key players: the US Securities and Exchange Commission (SEC), the US Department of Labor (DOL), and state legislatures. The SEC's focus has increasingly turned towards the accuracy and transparency of ESG-related disclosures. This heightened scrutiny stems from concerns that asset managers may overstate their ESG credentials, leading to potential misalignments between marketing claims and actual investment practices. Recent enforcement actions by the SEC have resulted in significant penalties for firms found to have made materially misleading statements about their ESG practices, signaling the seriousness with which the SEC views these issues. Asset managers are thus encouraged to ensure that their ESG claims are not only accurate but also consistently applied across all forms of communication.

The DOL, which oversees the Employee Retirement Income Security Act (ERISA), has also played a pivotal role in shaping the landscape of ESG investing in retirement plans. The DOL's stance on ESG has shifted dramatically depending on the political administration, reflecting broader national debates about the role of ESG in fiduciary decision-making. Under the Biden administration, the DOL reversed previous guidance that had limited the consideration of ESG factors, allowing them to be included in risk/return analyses. However, this position remains contested, with ongoing litigation and legislative efforts aimed at restricting or expanding the role of ESG in retirement plans.

At the state level, the regulatory landscape is equally complex, with a patchwork of laws either promoting or disincentivizing ESG investments, creating a challenging environment for asset managers operating across multiple state jurisdictions (as well as across international jurisdictions, since many US state anti-ESG rules are in conflict with other regimes—namely the European Union). The state level regulation of ESG investing has primarily imposed rules around the investment of state level assets, namely state retirement plans. The states have imposed a variety of pro and anti-ESG rules, including the following:

- On the "pro ESG" side, ESG rules that promote or require (1) the consideration of ESG factors in making investments and/or (2) the pursuit of ESG-related goals; and rules that prohibit investment in certain industries or sectors (e.g., firearms) based on ESG considerations
- On the "anti-ESG side" ESG rules that require all investments to be made for maximizing investment return and restrict or prohibit (1) the consideration of ESG factors in making investments (unless such consideration is based on financial factors); and/or (2) the pursuit of ESG-related goals, rules that prohibit states from "discriminating" against individuals or other companies based on ESG scores or other value-based scores, and rules that prohibit boycotting of certain industries, namely the energy industry
- ESG disclosure rules that require that certain entities to disclose whether and how they are considering ESG type factors rather than promote or restrict the consideration of certain ESG factors

The pace of the enactment of these state-level ESG rules has slowed somewhat in recent months—and at least two of the rules have been enjoined by federal courts. Nonetheless, the United States continues to seek to regulate the investment of ESG assets.

Learn more: ESG Investing: The US Regulatory Perspective

#### The European Union and United Kingdom

The European Union and United Kingdom have emerged as global leaders in the regulation of ESG investing, particularly in their efforts to combat greenwashing and enhance the transparency of ESG-related disclosures. The EU Sustainable Finance Disclosure Regulation (SFDR), introduced in 2021, is a cornerstone of this regulatory framework, requiring fund managers and financial advisors to disclose how they integrate sustainability risks and the principal adverse impacts of their investments. The SFDR classifies funds into three categories—Articles 6, 8, and 9—with varying levels of disclosure obligations depending on the extent to which ESG considerations are integrated into investment strategies. This classification system is designed to improve comparability and transparency for investors, thereby reducing the risk of greenwashing.

Fund managers also need to be aware of the EU Corporate Sustainability Reporting Directive (CSRD), which will require large private EU companies to include sustainability information in their annual reporting, beginning in 2025, in accordance with the detailed European Sustainability Reporting Standards developed by the European Financial Reporting Advisory Group. The CSRD requires "assurance" of the information and a "double materiality" assessment, requiring companies to report on sustainability matters if a topic is material either from a financial and/or impact perspective.

The United Kingdom is following a similar path with its Financial Conduct Authority (FCA) implementing an anti-greenwashing rule set to take effect in May 2024. This rule will require all FCA-regulated firms to ensure that any sustainability claims made about financial products or services are accurate, clear, and substantiated. Additionally, the United Kingdom's upcoming Sustainability Disclosure Requirements (SDR) and Investment Labels will introduce a phased approach to regulating sustainability disclosures, initially focusing on managers of private and retail funds. The United Kingdom's regulatory approach mirrors the European Union's in its emphasis on protecting investors and maintaining market integrity, particularly in the context of the growing demand for sustainable investment products.

Learn more: Understanding EU and UK Climate Disclosure and Anti-Greenwashing Regimes

#### **Asia-Pacific**

ESG investing is rapidly gaining momentum across the Asia-Pacific region, with key markets such as Mainland China, Hong Kong, Japan, and Singapore each developing their own regulatory frameworks. However, the approach to ESG regulation in this region is far from uniform, reflecting the diverse economic and political landscapes.

In China, ESG regulation is closely tied to the country's broader goals of economic transition and sustainable development. The introduction of sustainability reporting guidelines by China's main stock exchanges marks a significant step towards enhancing transparency and encouraging ESG investments, particularly in traditionally high-emitting sectors, such as steel and agriculture. China's green finance initiatives, including the expansion of its carbon market and green loan programs, further highlight its commitment to integrating ESG considerations into its financial system.

Hong Kong, on the other hand, has positioned itself as a global leader in green finance, leveraging its status as a major financial hub to attract sustainable investments. The city's regulatory efforts have concentrated on enhancing ESG disclosures for companies listed on the Hong Kong Stock Exchange (HKEX) and encouraging fund managers to integrate climate-related risks into their investment strategies, as well as the adoption of International Sustainability Standards Board standards.

In Japan, the focus has been on aligning domestic regulations with international standards, particularly following the adoption of the Japan Stewardship Code and Corporate Governance Code in 2014 and 2015, respectively. In an effort to achieve carbon neutrality by 2050, the Japanese government published in 2021 the "Green Growth Strategy," identifying 14 sectors that are expected to grow in the coming decades. To date, 20 projects have been formed and over 2 trillion yen have been allocated in support of this endeavor.

Meanwhile, Singapore has taken a proactive approach by implementing a robust regulatory framework aimed at standardizing ESG disclosures, promoting responsible ESG practices, and fostering sustainable financial markets. A significant step in this direction was the establishment of the Green Finance Industry Task Force (GFIT) by the Monetary Authority of Singapore, which aims to position Singapore as a leading green finance hub in the Asia-Pacific region. Since its creation, the GFIT has developed the Singapore-Asia Taxonomy for Sustainable Finance and introduced stricter ESG disclosure requirements to enhance transparency and prevent greenwashing. Additionally, Singapore is advancing environmental risk management and scaling green financing solutions through initiatives like the Singapore Sustainable Finance Association and Project Greenprint.

Learn more: ESG Investments: The Asia-Pacific Regulatory Perspective

#### **The Middle East**

The Middle East is undergoing a significant transformation in its approach to ESG investing, driven by a combination of global pressures and local economic diversification strategies. Saudi Arabia, Oman, and

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the United Arab Emirates are at the forefront of this shift, each developing regulatory frameworks that support the growth of sustainable investments.

In Saudi Arabia, ESG considerations are being integrated into the country's Vision 2030 plan, which aims to reduce the nation's dependency on oil and promote economic diversification. The country has set ambitious renewable energy targets, with significant investments being channeled into solar and wind energy projects. The Saudi Public Investment Fund (PIF) plays a central role in this transition, spearheading initiatives such as the NEOM mega-city project, which aims to be powered entirely by renewable energy.

Oman and the UAE are also making strides in adopting ESG principles. Oman's Vision 2040 emphasizes sustainable growth and environmental stewardship, with a particular focus on expanding renewable energy capacity. The country has also introduced a sustainable finance framework, encouraging the issuance of green bonds and other ESG-aligned financial instruments.

In the UAE, the government's commitment to sustainability is reflected in its designation of 2024 as the "Year of Sustainability" and its ambitious Net-Zero 2050 Strategy. The UAE has established the Sustainable Finance Working Group to harmonize ESG regulations across the country and promote the development of green finance products.

These efforts are positioning the Middle East as an emerging hub for ESG investments, particularly in the context of the region's ongoing economic transformation.

Learn more: ESG Investments: The Middle Eastern and African Regulatory Perspective Part 1

#### Africa

Africa is increasingly becoming a focal point for ESG investing, driven by a combination of rapid economic growth, vulnerability to climate change, and evolving regulatory frameworks. The continent's abundant natural resources and significant environmental challenges make it a prime candidate for sustainable investment initiatives. However, the ESG landscape in Africa is still in its early stages, with a lack of standardized policies and limited access to green finance posing significant challenges.

Despite these hurdles, there are promising developments across the continent. For instance, Gabon's "Green Gabon" initiative aims to harness the country's vast forest resources for sustainable development, with a particular focus on wood certification to prevent deforestation. Gabon has also successfully issued green and blue bonds, demonstrating the growing potential for ESG-aligned financial products in Africa.

Other African countries are also making strides in ESG regulation and investment. Benin, for example, was the first Sub-Saharan African country to launch green bonds, while Cote d'Ivoire and Tunisia have implemented mandatory CSR reporting for large companies. However, the continent faces significant challenges in fully integrating ESG standards, particularly due to the prevalence of informal economies and the immediate need to address poverty and infrastructure deficits. Nonetheless, Africa presents substantial opportunities for ESG investments, particularly in areas such as renewable energy, sustainable agriculture, and water management.

As the continent continues to develop, the adoption of ESG principles is expected to play a crucial role in driving sustainable economic growth and addressing pressing social and environmental issues.

Learn more: ESG Investments: The Middle Eastern and African Regulatory Perspective Part 2

#### **Global Trends and Regulatory Commonalities**

As ESG investing gains momentum globally, certain trends and commonalities emerge across these diverse regional regulatory landscapes. From an increased focus on transparency and disclosure to proactive measures against greenwashing, there is a clear global shift towards more stringent oversight

of ESG claims and practices. While each region's approach is influenced by its unique economic and political environment, common goals—such as ensuring accurate ESG reporting, promoting sustainable finance, and navigating the challenges and opportunities inherent in these initiatives—are evident. This convergence highlights a shared commitment to embedding ESG principles into the fabric of financial markets worldwide, driving a more sustainable future. These common threads among regions in their approach to ESG regulation, despite varying local contexts, are detailed below.

**Regulatory Evolution**: Across all regions, there is a clear trend of increasing regulation around ESG investing, primarily focusing on transparency, disclosure, and preventing greenwashing. Whether through national policies or region-specific guidelines, governments are moving toward more stringent oversight of ESG claims and practices.

**Focus on Disclosure**: Another major theme is the emphasis on transparency and accurate reporting. In all regions, regulators are mandating or encouraging companies and fund managers to disclose how they integrate ESG factors into their operations and investment decisions. This is particularly evident in the EU, UK, and Asia-Pacific regions.

**Greenwashing Prevention**: Preventing greenwashing is a common goal across regulatory regimes. The EU, UK, and other regions are implementing rules to ensure that ESG-related claims are not misleading. This is coupled with increasing penalties for companies that fail to substantiate their ESG claims.

**Regional Specificity**: While there are global trends, each region's approach to ESG regulation is shaped by local economic, environmental, and political contexts. For example, the US faces a polarized regulatory environment, the EU is leading with stringent disclosure mandates, and the Middle East is aligning ESG investments with broader economic diversification goals.

**Sustainable Finance and Green Bonds**: The growth of green bonds and other sustainable finance instruments is highlighted in several regions, such as the Middle East and Asia-Pacific. These financial tools are becoming key drivers for funding ESG-related projects.

**Challenges and Opportunities**: Despite progress, challenges remain, particularly in Africa and the Middle East, where standardized ESG policies are still developing. However, these regions also offer significant opportunities for growth in ESG investments, driven by unique environmental and social needs.

#### Looking Ahead

As ESG investing continues to gain prominence globally, the regulatory landscape will undoubtedly evolve too. The trends observed across different regions suggest that governments and regulatory bodies will intensify their efforts to standardize ESG practices, mitigate the risks of greenwashing, and ensure ESG investments are both impactful and credible.

In the coming years, we can expect to see further harmonization of ESG standards, particularly as regions like Asia-Pacific and the Middle East align their frameworks more closely with those in the EU and UK. This could foster greater consistency in ESG reporting, making it easier for investors to compare and assess the sustainability credentials of different companies and funds on a global scale. Furthermore, the rise of technology-driven solutions will likely play a crucial role in overcoming data challenges, enabling more accurate and comprehensive ESG reporting.

However, challenges remain, particularly in regions where ESG frameworks are still developing. Addressing these gaps will be critical to unlocking the full potential of ESG investing and ensuring that all markets can contribute to the global sustainability agenda. As stakeholders across the financial industry navigate these changes, staying informed and emphasizing adaptability will be key to seizing the opportunities that lie ahead. The evolution of ESG regulation represents not just a challenge, but a

transformative opportunity to reshape the future of finance in a way that aligns with the broader goals of environmental stewardship, social equity, and long-term economic resilience.

### CONTACTS

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