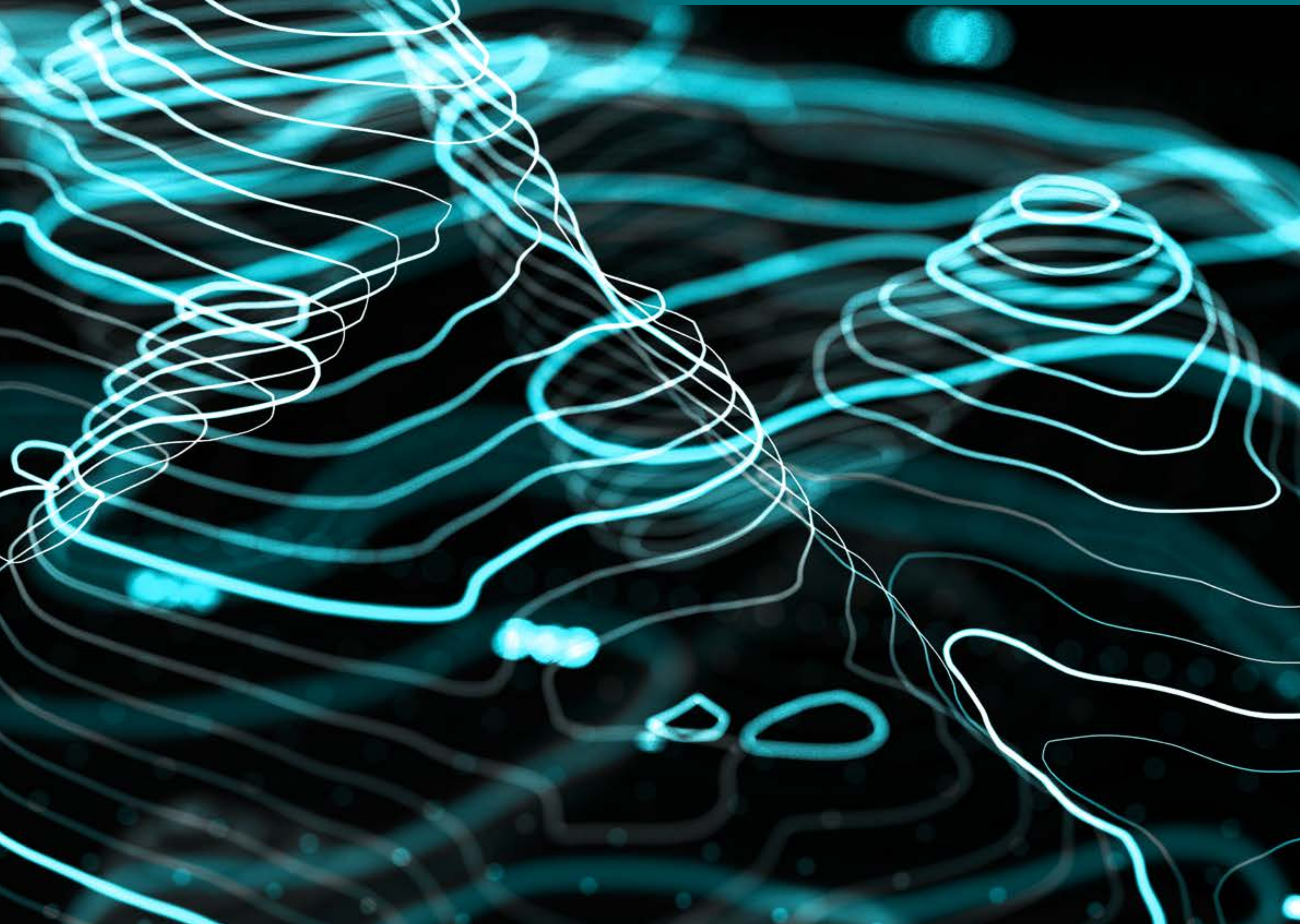
Sustainable investment – navigating the challenges for fund governance

October 2022

First Sentier MUFG
Sustainable Investment Institute



Contents

About the Institute

The First Sentier MUFG Sustainable Investment Institute (the Institute) provides research on topics that can advance sustainable investing. As investors, both First Sentier Investors and MUFG recognise our collective responsibility to society and that investment decisions should be made with consideration to our communities both now and in the future.

The Institute commissions research on Environmental, Societal and Governance (ESG) issues, looking in detail at a specific topic from different viewpoints. The Institute recognises that investors are now looking in far greater depth, and with far greater focus, at issues relating to sustainability and sustainable investing. These issues are often complex and require deep analysis to break down the contributing factors. If as investors we can better understand these factors, we will be better placed to consider our investment decisions and use our influence to drive positive change for the benefit of the environment and society.

The Institute is jointly supported by First Sentier Investors (FSI) and Mitsubishi UFJ Trust and Banking Corporation, a consolidated subsidiary of MUFG. Representatives of both organisations provide input to the activities of the Institute.

An Academic Advisory Board advises the Institute on sustainability and sustainable investment research initiatives. The Academic Advisory Board comprises prominent leaders from academia, industry and nongovernmental organisations in the fields of Responsible Investment, climate science and related ESG endeavours. The Board provides independent oversight to ensure that research output meets the highest standards of academic rigour.

Contact

institute@firstsentier.com
www.firstsentier-mufg-sustainability.com
www.mufg-firstsentier-sustainability.jp

Acknowledgements

The Institute would like to thank the authors of this publication, Fund Boards Council (FBC), and the many individuals who kindly gave of their time to be interviewed as part of this research.

About Fund Boards Council

FBC is an organisation exclusively focused on fund governance, promoting examples of excellence from the asset management industry where we find them, offering guidance, consultancy and training to firms who need our help.

We actively support fund boards in delivering greater value, improved transparency and better governance for their investors. FBC has extensive understanding of the intricacies and nuances of fund governance and its role within the wider governance structure of investment management firms.

Through internal expertise, industry advisers and key relationships with regulators, we have our finger on the pulse of the needs of fund boards and provide unique proprietary insight and support for fund boards and the senior executives who work closely with them. Our unique singular focus on fund governance means we can support our corporate members and clients with access to unparalleled insight, latest thinking and deep expertise to help them address the challenges their fund boards are grappling with.

https://fundboards.org/about/

About the Institute's sponsors

First Sentier Investors

About First Sentier Investors

First Sentier Investors (formerly First State Investments) is a global asset management group focused on providing high quality, long-term investment capabilities to clients. We bring together independent teams of active, specialist investors who share a common commitment to responsible investment and stewardship principles. These principles are integral to our overall business management and the culture of the firm.

All our investment teams – whether in-house or individually branded – operate with discrete investment autonomy, according to their investment philosophies.

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MUFG

About MUFG

MUFG Mitsubishi UFJ Financial Group, Inc. (MUFG) is one of the world's leading financial groups. Headquartered in Tokyo and with over 360 years of history, MUFG has a global network with approximately 2,400 locations in more than 50 countries. The Group has about 170,000 employees and offers services including commercial banking, trust banking, securities, credit cards, consumer finance, asset management, and leasing. The Group aims to "be the world's most trusted financial group" through close collaboration among our operating companies and flexibly respond to all of the financial needs of our customers, serving society, and fostering shared and sustainable growth for a better world. MUFG's shares trade on the Tokyo, Nagoya, and New York stock exchanges.

https://www.mufg.jp/english

About the Trust Bank

Mitsubishi UFJ Trust and Banking Corporation, as a core member of MUFG, provides its customers with a wide range of comprehensive financial solutions leveraging unique and highly professional functions as a leading trust bank. Such financial solutions include real estate, stock transfer agency, asset management and investor services, and inheritance related services, in addition to banking operations. We aim to realize our vision to be the trust bank that creates "a safe and affluent society" and "a bright future with our customers together". We support our customers and societies through their challenges with Trust, and thus we build on a new key concept: "Create a Better Tomorrow". First Sentier Investors was acquired by the Trust Bank in August 2019.

https://www.tr.mufg.jp/english

Executive summary

Investors choose to invest in pooled funds to access the expertise of investment professionals. Financial objectives, such as capital preservation and/or growth, remain key investment objectives, but other considerations, such as investments' sustainability characteristics are increasingly being considered.

Sustainable investment has evolved and grown significantly over recent decades and particularly in the past three to five years. Assets under management in sustainable investment funds have quadrupled in just 3 years, increasing from around US$0.7 trillion at the start of 2019 to almost US$3.0 trillion at the end of 2021[1]. New regulations and an increasing variety of approaches have accompanied this growth. The term 'sustainable investment fund' is used within the report to refer to any investment fund that may include some form of sustainability-related considerations within the investment decision.

As guardians of third party capital, investment managers are required to act in their investors' best interests, including striving to meet the stated objectives of the investments that they manage, whatever they may be. Legal, structural and organisational arrangements of investment funds vary globally – for example 'investment company' corporate structures which are more common in Western Europe and contract-based unit trust structures which are more common in Hong Kong, Japan and Australia. Nonetheless, ultimate accountability and oversight of a fund's activities typically rests with a fund governance body. Such governance body is, usually and for the purposes of this report, referred to as a 'fund board'.

Fund governance and oversight arrangements could vary across legal structures and jurisdictions, however there is a broad consistency in the core objectives of fund oversight overall (Appendix 2).

In the context of fund oversight, inclusion of sustainability considerations in investment decisions arguably does not fundamentally change the existing governance responsibilities of fund boards. However, the implementation of fund oversight could be impacted by the evolving backdrop for sustainable investment, including:

- **Variation in definitions of sustainability and greenwashing** – resulting in a risk of fund's objectives and strategy being misunderstood by investors and intermediaries and/or a risk that statements with respect to fund's sustainability features cannot be substantiated
- **Growth in sustainable investments** – increasing the oversight responsibilities for fund boards, as the number and variety of thematic funds grow
- **Increasing regulation** – increasing the regulatory compliance responsibilities for investment firms, with ultimate responsibility on boards to ensure compliance.

The goal of this report is to take account of the above context and help fund boards improve their oversight of sustainable investment funds. The research concentrates primarily on retail investment funds and six jurisdictions – the United Kingdom, Ireland, Luxembourg, Japan, Hong Kong and Australia.

Executive summary

The legal and regulatory frameworks applicable to investment products in the reviewed jurisdictions can be very detailed and prescriptive, as is the case for example for fund authorisation, disclosure requirements and corporate governance requirements (including board composition). Some of this prescription extends to how sustainable investment funds are managed, including fund naming, classification and disclosures (e.g. the Sustainable Finance Disclosure Regulation (SFDR) in the EU). However, these frameworks are generally silent when it comes to the requirements for effective oversight of sustainable investment funds, other than setting out general rules which apply across all types of investments.

For the purpose of the report, fund board responsibilities are considered within four areas of governance, commonly noted within fund governance guidance in the jurisdictions under review (Appendix 2):

- **Delivery of the fund's commitments to its investors**: ensure that funds have clearly articulated objectives, select appropriate investment managers to fulfil these objectives and effectively monitor whether these objectives are being met
- **Compliance with laws and regulations**: ensure that funds are developed and managed in line with relevant requirements, including those covering product design, product documentation, and mandatory reporting
- **Risk management**: ensure that key risks are identified, monitored and managed within agreed board risk appetite limitations and consider the effectiveness of internal controls
- **Board composition**: ensure that the board members have appropriate skills, knowledge and experience to discharge their duties

Interviews with 25 fund board directors and other fund board professionals were held to understand how they are approaching the oversight of sustainable investment funds (Appendix 1). These interviews highlighted a number of key challenges faced by fund boards, as well as suggestions on how to address them. Our research also identified examples of management information (MI) which can be used to facilitate oversight of sustainable investment funds.

Delivery of fund's commitments to its investors

Generally, any contractual fund features, including such that may be sustainability-related, should be appropriately incorporated into fund objectives, considered in the selection of investment managers and monitored effectively.

Challenges: It is currently unclear as to what role fund boards should play in terms of ensuring that this takes place, especially when it comes to overseeing fund documentation, how the investment manager implements sustainable investing and how monitoring takes place. Indeed, interviews conducted indicate that a minority of fund boards are involved in setting policies or guidance on how sustainability is incorporated in the investment process or receive information on sustainability-related features of such funds (Exhibits 1 and 2).

Most of the fund boards saw sustainability policy as being explicitly set by the fund's mandate and the fund's investment manager's general approach to sustainable investing i.e. from the 'bottom-up' (Exhibit 1). The general consensus view was that the executive teams responsible for managing funds are best placed to understand and implement sustainable investing policy. However, there was also acknowledgement that the fund board was ultimately responsible for this policy and the associated controls to oversee it.

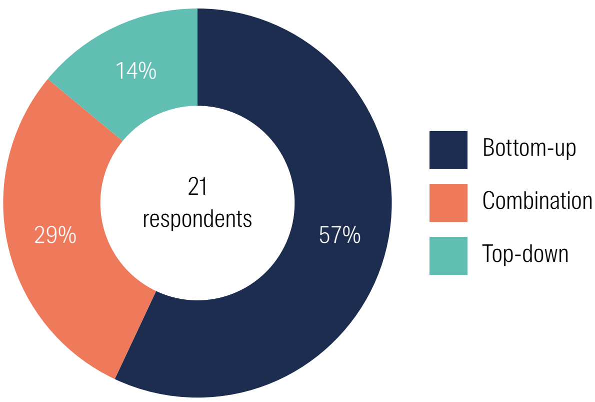
Still, almost two thirds of the fund boards described their involvement in monitoring fund's performance against sustainability objectives/characteristics as being low – with a strong reliance on executive functions, executive committees or board sub-committees to undertake this oversight (Exhibit 2).

With respect to other internal forums receiving MI on fund's sustainability features, investment committees were cited in almost two-thirds of the cases (with variation as to whether this investment committee was a sub-committee of the fund board or an executive forum). A much smaller proportion consider this type of MI at a Risk Committee (usually a sub-committee of the fund board), with a quarter of fund boards monitoring this elsewhere (usually various executive forums, including product governance committees).

Actions: Fund boards should satisfy themselves that:

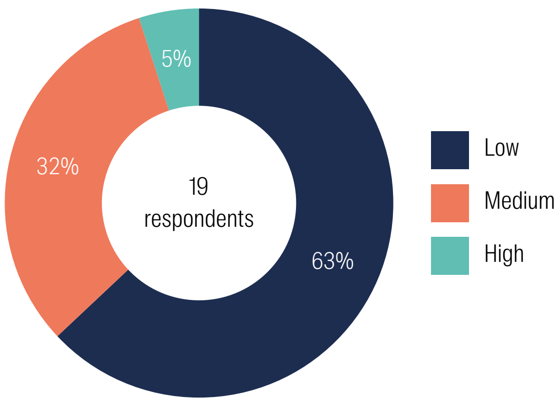
- clearly articulated sustainable investing policies are in place (including how fund objectives are set)
- they understand and have confidence in their manager's approach to assessing sustainability
- monitoring of fund performance explicitly considers sustainability features for funds that have such features

Exhibit 1: How would you describe the board's involvement in setting the fund's sustainability investment policy and/or objectives



Source: Fund Boards Council
Note: Refer to Appendix 1 for methodology notes on interview approach and data gathering

Exhibit 2: How would you describe your involvement in oversight of fund performance against sustainability objectives/characteristics



Source: Fund Boards Council
Note: Refer to Appendix 1 for methodology notes on interview approach and data gathering.

Executive summary

Compliance with laws and regulations

Detailed rules and guidance in relation to to sustainable investment fund naming, classification and product documentation are emerging. Some of the reviewed jurisdictions also require mandatory reporting on sustainability-related risks, even for funds and entities where sustainability is not part of the fund objectives (e.g. SFDR).

Challenges: Some fund boards are relatively remote from activities impacted by these rules and guidance, including requirements affecting product development, pre- and post-sale disclosures and mandatory reporting – including for example the requirements of the Taskforce on Climate-Related Financial Disclosures (TCFD).

Actions: Fund boards should satisfy themselves that:

- sustainability requirements are incorporated into product governance frameworks
- controls around fund documentation and mandatory reporting remain effective
- the product approval proposals (especially requests to 'repurpose' existing funds as sustainable investments) remains adequate
- they are aware of data used, its potential limitations and related data integrity controls.

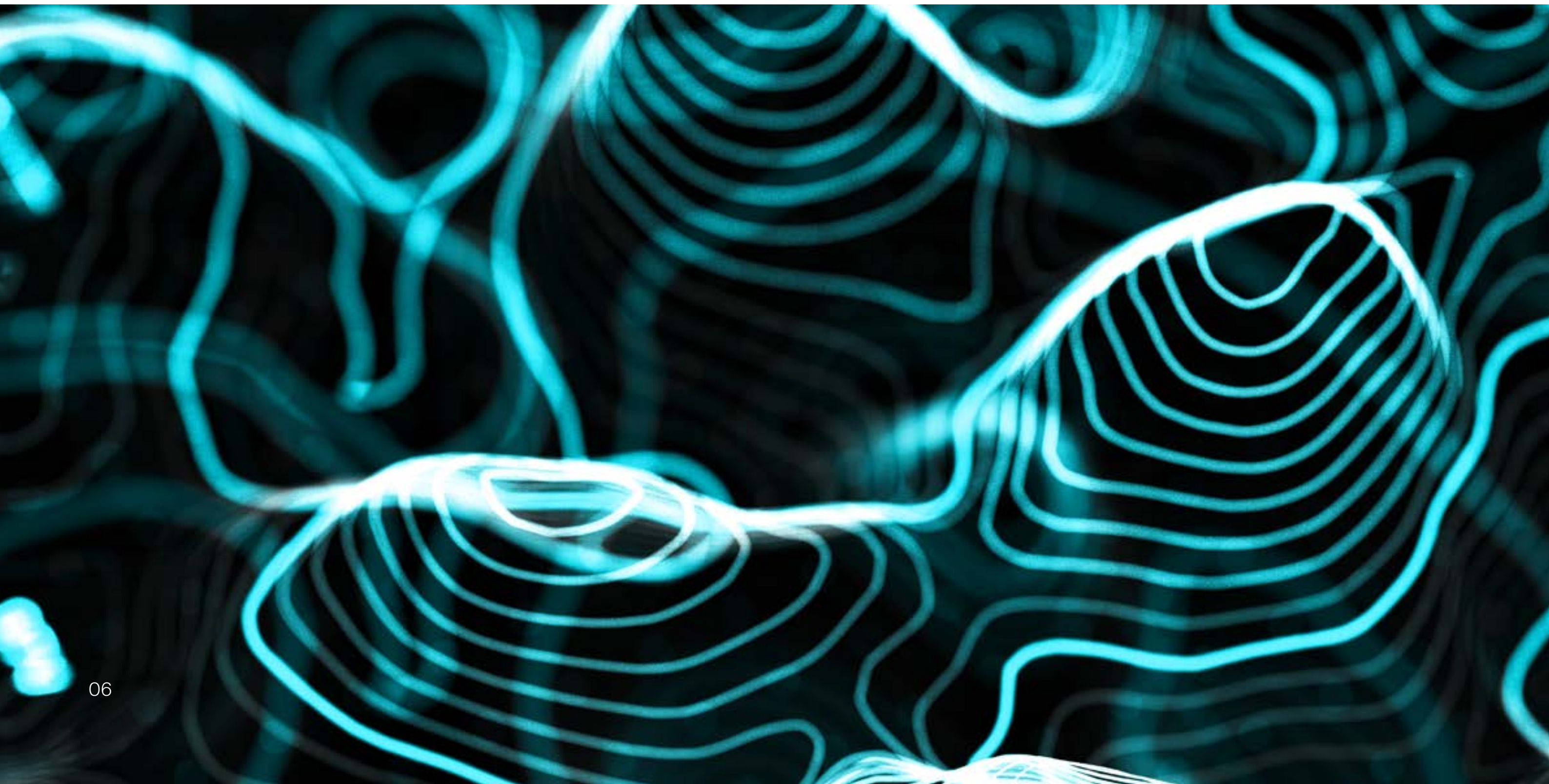
Risk management

Fund managers are increasingly required to consider and/or disclosure assessment of sustainability-related investment risks, including climate change risk, at an entity and product level. Growing scrutiny of how sustainability-related characteristics of investment products are communicated also draw greater attention to true to label requirements and the risks of those not being met (more generally referred to as greenwashing in the context of sustainability). Such risks also need to be integrated as part of investment due diligence and risk management policies and processes as well as within governance structures.

Challenges: Some fund boards may not have considered how sustainability risk is managed in portfolios or included in their risk management frameworks. Internal processes may not be fully adapted to reflect fast evolving regulatory requirements.

Actions: Fund board directors should satisfy themselves that:

- sustainability risk is appropriately incorporated into portfolio management and enterprise risk management frameworks and governance, where necessary and appropriate
- all relevant risk management functions can effectively address sustainability-related risks
- true to label controls can effectively address greenwashing risk.



Board composition and expertise

Fund board directors need to have knowledge, skills, and experience to fulfil responsibilities relating to sustainable investments. This includes a full understanding of the nature of these funds, related risks and relevant regulatory responsibilities.

Challenges: Some fund boards may not yet have developed an appropriate knowledge and understanding of key sustainable investing regulations, investment approaches, tools and metrics involved. For example, under a third of interviewees rated the knowledge of the boards that they serve on as 'high' – a level of knowledge generally observed by them in professionals more actively involved in product or investment processes, (Exhibit 3).

The interviewees felt that their fund boards were generally more knowledgeable about fund-related sustainable investment regulations (such as fund naming, labelling and disclosures) than entity-level disclosures (such as the TCFD). It was generally acknowledged that executive directors (EDs) had a higher level of knowledge than non-executive directors (NEDs), often with at least one ED being a subject-matter-expert (such as Head of Product, Head of Responsible Investment or someone with investment experience such as the Chief Investment Officer).

Actions: Fund boards should:

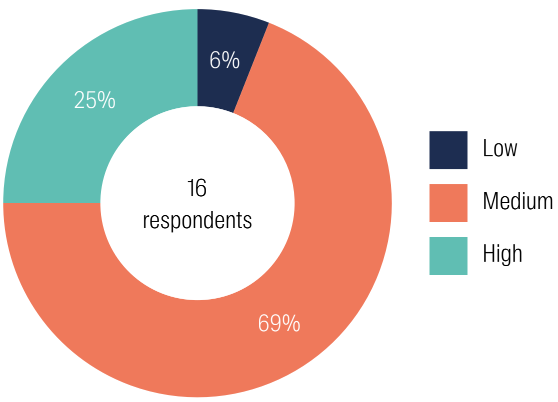
- undertake board assessments to identify gaps in sustainable investment knowledge, skills and experience
- address any gaps identified, as appropriate – this could include training, 'deep dive' board sessions, recruitment of a subject matter experts in the board.

Sustainable investment requirements are still developing in many jurisdictions. As those evolve, interviewees pointed out that clear and consistent governance guidance from regulators would be welcomed, especially in terms of the local requirements for fund labelling, disclosure and monitoring of sustainable investment funds.

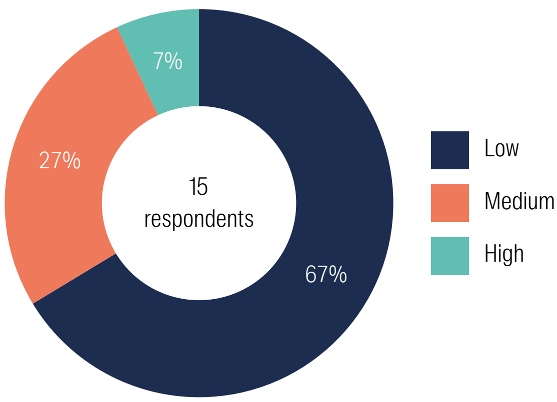
Apart from advancing local requirements, international harmonisation, where possible and practical, was also pointed out as beneficial. This includes standards such as the SFDR and the EU Taxonomy, as well as those being developed at international level, such as by the International Sustainability Standards Board (ISSB) and TCFD.

Exhibit 3: How would you rate the fund board's knowledge of sustainability-related regulation on a scale of high, medium or low

Fund-related regulations



Entity-level disclosures



Source: Fund Boards Council
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Introduction

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Methodology

Purpose of report

The goal of this report is to help fund boards improve their oversight of sustainable investment funds. It aims to:

- **Explore** how sustainability considerations fit within fund board responsibilities
- **Map** some of the challenges that fund boards face with respect to sustainability considerations
- **Suggest** practical actions which fund boards can take to navigate these challenges.

Scope

This report concentrates primarily on:

- **Retail-customer focused sustainable investment funds** – this includes funds which have specific sustainability-related investment objectives, as well as funds which may not have a sustainability objective, but incorporate some sustainability-related considerations into the underlying investment approach
- **Six jurisdictions** – the UK, Ireland, Luxembourg, Japan, Hong Kong and Australia.

Research methods

The research included two main research methods:

- **Desktop research** of regulatory and legal requirements
- **In-depth interviews** with fund board directors and other fund board professionals.

Limitations

The research has focused on how to improve the effectiveness of fund board oversight of sustainable investments. Many other related questions arise such as whether sustainable investing is effective to achieve a 'real world' outcome in general and whether sustainable investments may deliver superior risk/return outcomes. Answering such questions is not in scope of the research and are only mentioned in the context of examples of issues for individual fund boards to explore.

This report is primarily focused on the role of the fund board and while touching on the responsibilities of relevant executives and other related entities, the aim is not to provide a detailed guide on managing sustainable investments.

The research does not provide a full review of all regulations and laws that could be applicable to such a complex topic but rather aims to offer a practical guide to help fund boards navigate through the relevant challenges.

The report considers regulatory and legal requirements applicable across the six jurisdictions around the time of publication of this report. The rapid pace of change in sustainable investment related regulations and laws mean that some observations may not be completely aligned with all current requirements.

The suggestions made in the report are informed by the research approach and are aimed at being broadly applicable across jurisdictions. Full compliance with local regulations has not been verified as part of the report. It is recommended that fund boards and individual directors seek input from their compliance officers, legal counsel and other professional advisors where appropriate.

Defining sustainable investments and greenwashing

There has been much industry debate over the years about defining sustainability and sustainable investments in the context of financial products. The fact that sustainability continues to lack a common global definition and remain subjective, results in challenges for fund oversight, for example with respect to how fund boards ensure that fund's sustainability objectives/characteristics are well communicated and/or how attainment of those objectives is monitored.

Sustainable investing evolved from ethical or 'values-based' approaches which exclude certain companies or controversial activities from investment portfolios to a more broadly defined investment process which incorporates (or integrates) environmental, social and corporate governance (ESG) issues in the analysis, selection and retention of investments.

The term 'ESG' was coined by the UN Principles for Responsible Investment (PRI) initiative, convened in 2006. The notion of 'ESG integration' is fundamental to the PRI Principles for Responsible Investment where it is defined as: *"the explicit and systematic inclusion of ESG issues in investment analysis and investment decisions"*.

This definition allows for a wide range of approaches from a very light level of integration to the consideration of ESG issues in every single investment decision, and every shade in between. This is reflected in the wide variety of sustainable investment funds available today.

Two key initiatives agreed in 2015 influence the way ESG is defined and considered in practice:

- the 'Paris Agreement', an international treaty on climate change which aims to limit global warming, and
- the UN's '2030 Agenda for Sustainable Development', an internationally supported plan to ensure sustained and inclusive economic growth, social inclusion, and environmental protection.

The EU's Sustainable Finance Action Plan, which aims to promote sustainable investment, built on these initiatives and introduced the Sustainable Finance Disclosure Regulation which came into effect in March 2021. The SFDR defines sustainable investment[2] as:

> *'sustainable investment' means an investment in an economic activity that contributes to an environmental objective, as measured, for example, by key resource efficiency indicators on the use of energy, renewable energy, raw materials, water and land, on the production of waste, and greenhouse gas emissions, or on its impact on biodiversity and the circular economy;*
>
> *or an investment in an economic activity that contributes to a social objective, in particular an investment that contributes to tackling inequality or that fosters social cohesion, social integration and labour relations or an investment in human capital or economically or socially disadvantaged communities,*
>
> *provided that such investments do not significantly harm any of those objectives and that the investee companies follow good governance practices, in particular with respect to sound management structures, employee relations, remuneration of staff and tax compliance;*

In turn, sustainability at economic activity level has been defined via sustainability or green 'taxonomies'. An environmental taxonomy (such as the EU Taxonomy) is a classification system which provides definitions for which economic activities can be considered environmentally sustainable. The EU have developed the world's first taxonomy with other regions including the UK, some Asia Pacific countries and international organisations like the World Bank following suit.

However, taxonomies are also subject to being deemed ambiguous as the debate about the classification of nuclear power and natural gas as sustainable under the EU's system has shown.

As the subjectivity and variability around definitions of 'sustainability' and 'sustainable investment' remain, so does the risk of intentionally or unintentionally misrepresenting a fund's sustainability characteristics. Fund boards will need to be aware not only of the state of greenwashing-related regulations and regulatory sanctions imposed, but also of the drivers of greenwashing risk and how those are being mitigated.

The EU defines greenwashing through an environmental lens as: "the practice of gaining an unfair competitive advantage by marketing a financial product as environmentally friendly, when in fact basic environmental standards have not been met"[3]. In practice, greenwashing could also be unintentional, for example when communications are less clear and objective or when a claim is not necessarily incorrect, but cannot be substantiated with evidence.

The issue of greenwashing is of increasing concern to regulators globally, including being a priority area of focus in the roadmaps issued by the UK's Financial Conduct Authority (FCA) and the European Securities Markets Association (ESMA) in 2022. Regulators in other jurisdictions including in Hong Kong, Singapore, Australia, Switzerland, Germany, Japan and the US have also raised concerns. The number of related regulatory investigations is still relatively small, but precedents already exist – for example BNY Mellon investigation by the Securities and Exchange Commission (SEC) in the US and DWS investigation by the SEC and Federal Financial Supervisory Authority (BaFin) in Germany.

Growth in sustainable investment funds

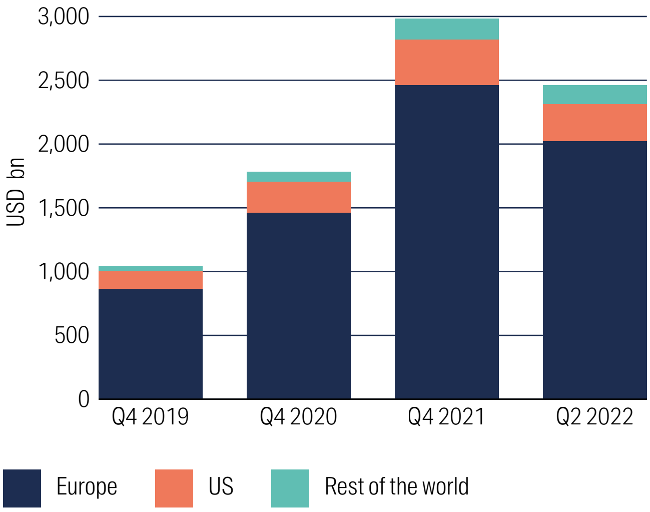
There has been a proliferation of new (or in many cases repurposed) products entering the market in recent years. The number of sustainable funds grew to 6,709 in June 2022 from 5,932 as at the end of 2021 with the majority of products and the current growth being in Europe (Exhibit 4 and 5).

Exhibit 4: Global sustainable funds, flows and assets under management as of Q2 2022

	Flows		Assets	
	USD bn	% Total	USD bn	% Total
Europe	30.7	94%	2,033	82%
United States	–1.6	–5%	296	12%
Asia ex-Japan	1.1	3%	61	2%
Australia/New Zealand	0.6	2%	26	1%
Japan	0.2	1%	25	1%
Canada	1.5	5%	24	1%
Total	32.6		2,465	

Source: Morningstar Direct, Manager Research. Data as of 30 June 2022.

Exhibit 5: Sustainable funds – evolution of assets under management



Source: Morningstar, data as of Q2 2022; Note: Estimated data using screen grabbing utility, Graph Grabber v2.0.2.

Note: Data classification utilizes Morningstar's definition of sustainability. This definition excludes funds that employ only limited exclusionary screens such as controversial weapons, tobacco, and thermal coal, as well as funds that formally integrate ESG considerations in a 'non-determinative' way for their investment selection.

It will be interesting to see how the demand for sustainable investment funds develops, as regulators step in to tighten sustainability definitions and impose more reporting requirements.

A new provision under the Markets in Financial Instruments Directive (MiFID) and Markets in Financial Instruments Regulation (together MiFID II) introduced in August 2022, arising as an action from the EU Sustainable Finance Action Plan, introduced provisions on integrating sustainability factors, risks and preferences into certain organisational requirements and operating conditions for MiFID investment firms, including in respect of suitability assessments.

The regulations require that, as a routine component of financial advice, investment advisers should ask about, and then respond to, investors' preferences regarding the sustainable impact of their investments.

Research has shown that when provided with information on the sustainability profile of similar investment products, the majority of consumers will choose the more positive sustainability products.

On one hand, regulations such as MiFID II could contribute to further interest in and demand for suitable/ESG products across the EU and beyond. On the other, it could dampen demand if sustainability preference assessments reveal that there is a gap between consumer expectations and product availability. Increasingly onerous disclosure and reporting requirement with respect to sustainability funds may also deter fund providers from developing such products.

Increasing regulation

For fund boards, a key challenge will be building up an appropriate understanding of all new regulations that are being brought into force and how to ensure compliance with them.

In addition to taxonomies which define ‘sustainability’ or ‘sustainable activities’, regulators have to a varying degree mandated:

- product or entity-level disclosures of certain information (for example, SFDR has different requirements depending on the nature of the fund, see box below)
- fund classifications according to their sustainability characteristics
- sustainability and/or climate-change risk related disclosures.

SFDR regulation requires sustainability risk disclosures for all funds (as set out in Article 6), with additional disclosures for the two types of funds described in Article 8 and 9[5]:

Article 8

“Where a financial product promotes, among other characteristics, environmental or social characteristics, or a combination of those characteristics, provided that the companies in which the investments are made follow good governance practices”

Article 9

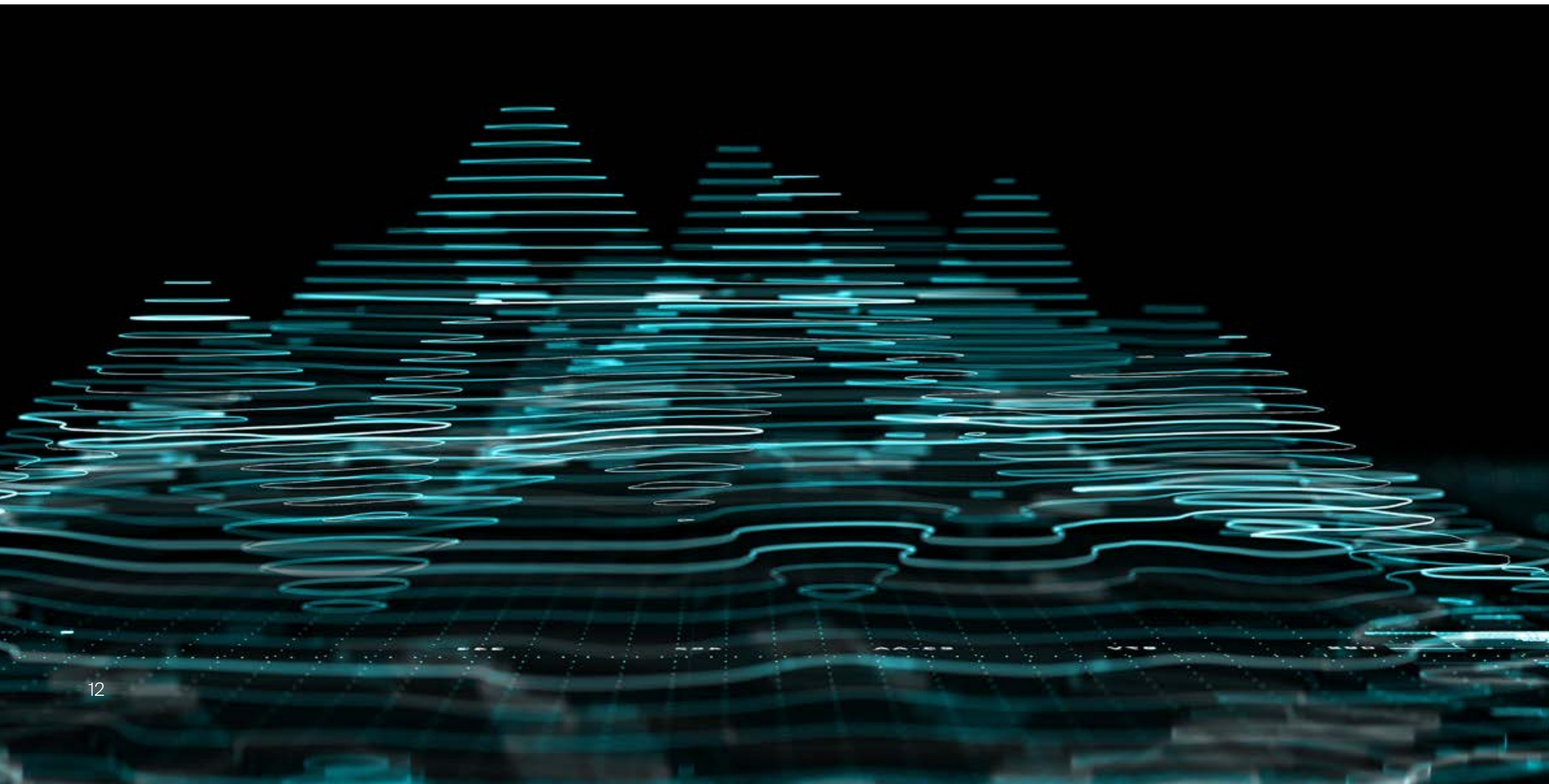
“Where a financial product has sustainable investment as its objective and an index has been designated as a reference benchmark”

Climate risk features as a common theme across many ESG and sustainability regulations and laws. This arises from the close link between sustainability and the policy goals of initiatives like the Paris Climate Agreement and the environmental elements of the Sustainable Development Goals (part of the 2030 Agenda for Sustainable Development).

There is increasing regulation governing the financial industry’s management of climate-related risks and opportunities. For example in 2021, Australia, the UK & Hong Kong finalised requirements and guidelines in relation to climate-related risk management and reporting (Appendix 2), with similar regulation expected across other key jurisdictions.

The common baseline for these standards is the TCFD framework created by the Financial Stability Board. The TCFD was established to develop consistent climate-related financial risk disclosures for use by companies, banks, and investors in providing information to stakeholders. Its framework is structured around four thematic areas of how organisations operate: Governance, Strategy, Risk Management and Metrics & Targets.

For example, the UK requirement for product level reporting will include an annual TCFD-aligned report which will be required to disclose various greenhouse gas emissions-related information, as well as various climate scenario analysis with implied temperature rise metrics and climate value-at-risk data[6].



Fund structures and oversight

Typical structure of an investment fund

Although legal structures and forms could vary by jurisdiction, typically an investment fund structure would include a fund vehicle, an authorised fund manager and a depository or trustee (Exhibit 6).

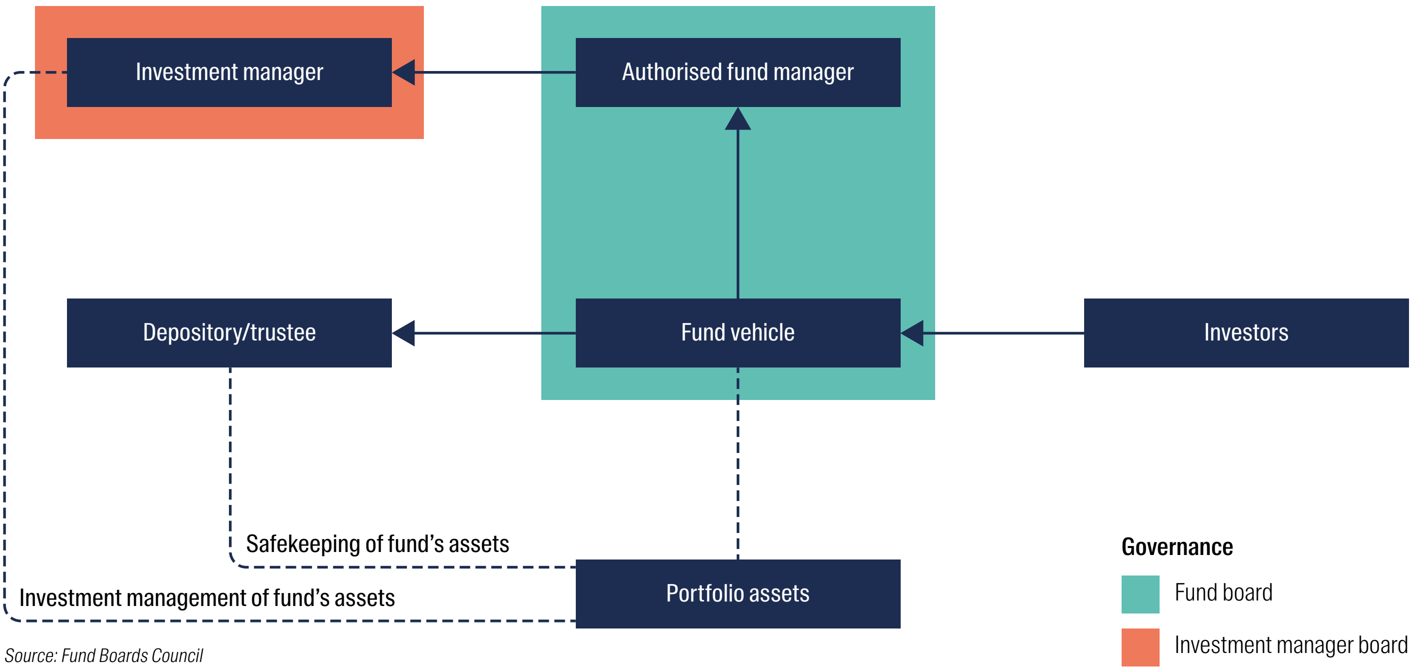
- A **fund vehicle** issues units or shares in the fund to investors (depending on the legal structure of the vehicle). Two of the most common vehicles are unit trusts, being the primary structure in use in Hong Kong, Australia and Japan for example, and investment companies, being often used in the European Union and the UK.
- An **authorised fund manager (AFM)** is ultimately responsible for running an investment fund, including ensuring that it is managed according to relevant regulations. The AFM is typically a corporate entity which needs to be authorised by the relevant regulator. A fund's AFM is typically a distinct legal entity, but is often owned by or is part of the investment manager (IM) appointed to manage the fund's portfolio.
- A **depositary or trustee** is required to be independent from the AFM. It plays an investor protection role and is responsible for the safekeeping of a fund's assets (often appointing a custodian for this purpose). It is also responsible for overseeing the AFM's activities to ensure that they are performed in accordance with regulation and in investors' best interests.

Investment companies – Collective investment funds structured as investment companies with variable capital are more commonly used in Western Europe, including Ireland, Luxembourg and the UK. Such structures are known as an Irish collective asset management vehicle (ICAV) in Ireland, a société d'investissement à capital variable (SICAV) in Luxembourg and an open-ended investment company (OEIC) in the UK. Although regional nuances would exist, investment companies are corporate entities, typically governed by instruments of incorporation and a board of directors. Investors own shares in the investment company and the company is able to issue and redeem shares continually according to investor demand.

Unit trusts – Collective investment funds in Australia, Japan and Hong Kong are primarily structured as unit trusts – a contractual arrangement under a trust deed as opposed to an incorporated entity structure. Established vehicles in Western Europe are also structured as unit trusts, while incorporated entity structures are more common for newer funds.

Fund governance and oversight arrangements could vary across legal structures and jurisdictions, however there is a broad consistency in the core objectives of fund oversight overall (Appendix 2).

Exhibit 6 – Generic structure of an investment fund



Source: Fund Boards Council

Fund structures and oversight

Governance of an investment fund

Given the similarities in the core objectives of fund oversight across the reviewed jurisdictions, the term ‘fund board’ is used to refer to the governance body that is ultimately responsible for the oversight of funds activities and that investors’ best interest is observed.

In general an AFM is ultimately responsible for running an investment fund. An AFM is also commonly called a management company or ‘ManCo’ in European funds and in the UK is often referred to as an authorised corporate director (ACD). In Australia the AFM is referred to as the ‘Responsible Entity’. Sometimes the investment manager also plays the legal role of the AFM, as is the case in some Japanese and Hong Kong fund structures.

Some jurisdictions also operate the concept of a fund vehicle board with a group of directors who are separate to the board of the AFM (for example in Luxembourg and Ireland). It is common for the fund vehicle board to delegate many of their responsibilities to the fund vehicle’s AFM. In the context of this report, ‘fund board’ is used to refer to the board of both types of entities[7].

The governance and broader management responsibilities of an AFM can vary by jurisdiction, legal structure, size of AFM, etc. Exhibit 7 illustrates the general scope of AFM governance and management, using the ‘three lines of defence’ model.

In practice, many AFMs delegate elements of these first, second and third-line responsibilities to other entities, either within the same group or third-party service providers. Investment management activities are the most commonly delegated activity. While the fund board can delegate activities and responsibilities, accountability remains with the fund board, including the duty to act in the best interests of investors.

Exhibit 7: Typical governance structure of an Authorised Fund Manager

Layer	Typical roles	Responsibilities and typical activities
Fund board	Chair, Chief Executive Officer, Chief Financial Officer, Chief Risk Officer, Non-Executive Directors etc.	Establish objectives for the organisation and a strategy to achieve them
		Ensure that necessary resources are in place to meet these objectives and measure performance against them
		Establish a framework of prudent and effective controls which allow risk to be assessed and managed
		Meet any regulatory responsibilities specifically assigned to the board
First line	Portfolio managers, Product managers, Fund operations, Finance, Marketing, Distribution etc.	Provide the fund management services to investors including:
		Selecting investments
		Producing literature and mandatory disclosures
		Marketing, promotion and sales
		Developing new funds
		Fund administration
		Finance and accounting
		First line risk management (including design and implementation of controls as well as identifying risk owners).
Second line	Compliance, Risk management	Provide expertise and support on regulatory and risk-management matters
		Monitor compliance with applicable laws and regulations
		Assist risk owners to define target risk exposure
		Provide risk reporting
Third line	Internal audit	Provide assurance on the effectiveness of governance, risk management and internal controls, including first and second line controls

Source: Fund Boards Council

The fund board challenge: developing robust sustainability oversight

The legal and regulatory frameworks applicable to investment products can be very detailed and prescriptive, as is the case for fund authorisation, disclosure requirements and corporate governance requirements (including board composition). Some of this prescription extends to how sustainable investment funds are managed, including fund naming, classification and disclosures (e.g. EU SFDR requirements). However, these frameworks are generally silent when it comes to the requirements for effective oversight of sustainable investment funds, other than setting out general rules which apply across all types of investments.

For the purpose of the report, four common themes have been identified (Appendix 2):

- **Delivery of the fund's commitments to its investors**: ensure that funds have clearly articulated objectives, select appropriate investment managers to fulfil these objectives and effectively monitor whether these objectives are being met.
- **Compliance with laws and regulations**: ensure that funds are developed and managed in line with relevant requirements, including those covering product design, product documentation, and mandatory reporting.
- **Risk management**: ensure that key risks are identified, monitored and managed within agreed board risk appetite limitations and consider the effectiveness of internal controls.
- **Board composition**: ensure that the board members have appropriate skills, knowledge and experience to discharge their duties.

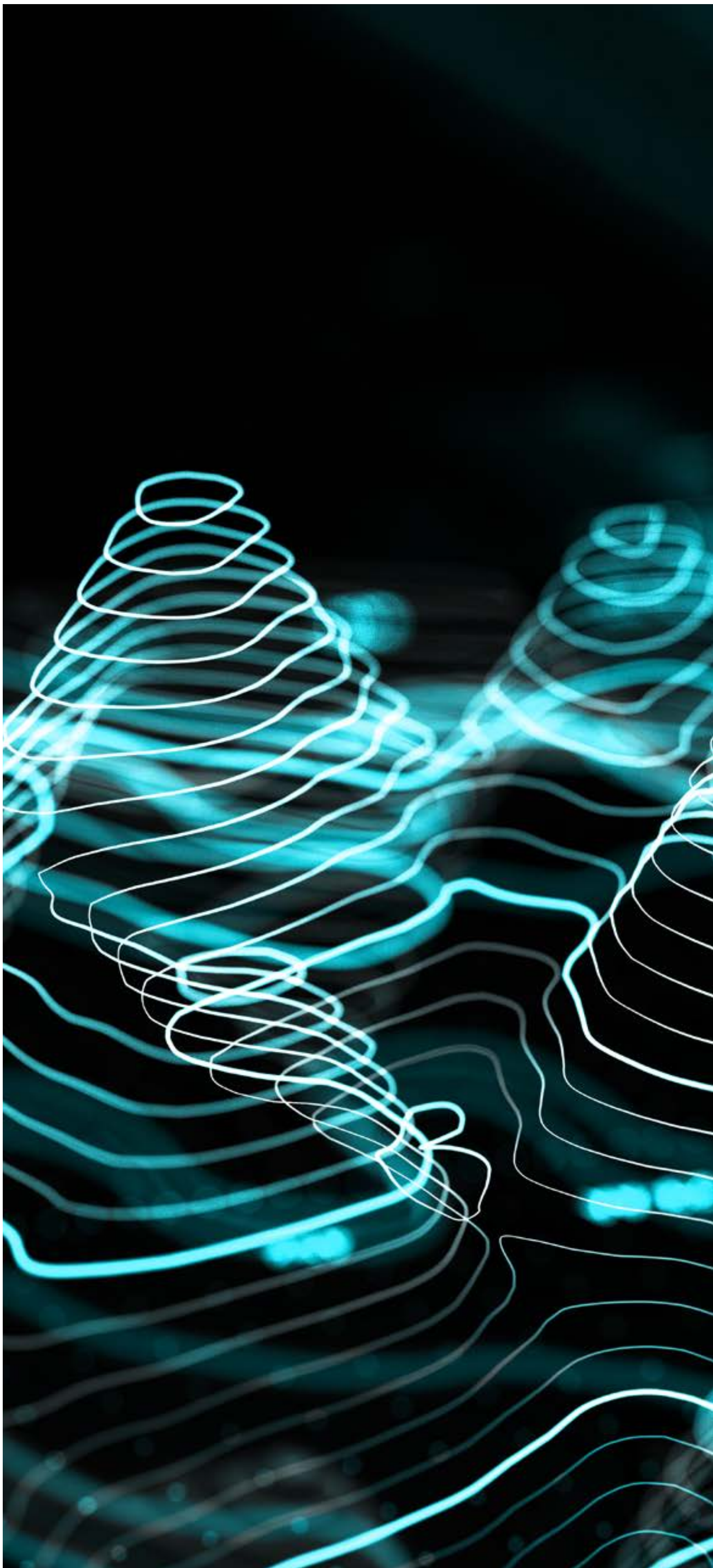
Interviews with 25 fund board directors and other fund board professionals were held to understand how they are approaching the oversight of sustainable investment funds (Appendix 1). These interviews highlighted a number of key challenges faced by fund boards, as well as suggestions on how to address them. Our research also identified examples of management information which can be used to facilitate oversight of sustainable investment funds.

It is worth noting that some fund boards may see this type of MI as much more detailed than would typically be considered at board level for other types of funds. The appropriate level of detail for MI will be a decision based on each AFM's operating model and the board's risk appetite.

Many interviewees commented that it could be appropriate for the fund board to get to a lower level of detail on sustainable funds for a period until such time as they have confidence in the effectiveness of the controls and their own knowledge of this area.

Delivery of fund's commitments to its investors

The fund board is ultimately responsible for ensuring that a fund has a clearly articulated objective and an investment strategy to achieve this. The fund board is also responsible for selecting appropriate investment managers to implement the strategy and ensuring effective monitoring of whether the objective is being met.



Sustainability considerations

Where funds have general or specific sustainability features, these features should be:

- appropriately incorporated into the fund's stated objectives
- considered in selection of investment managers
- monitored effectively.

Challenges

It is currently unclear as to what role fund boards should play in determining:

1. How sustainability features are incorporated into fund objectives (e.g. impact of sustainability on investment policy)
2. How the investment manager implements sustainability considerations in order to meet the fund's stated objectives (e.g. data and assessment tools used)
3. Fund's performance oversight – how performance against stated sustainability features is monitored.

The fund board challenge: developing robust sustainability oversight

Delivery of fund's commitments to its investors

1. How sustainability features are incorporated into fund objectives

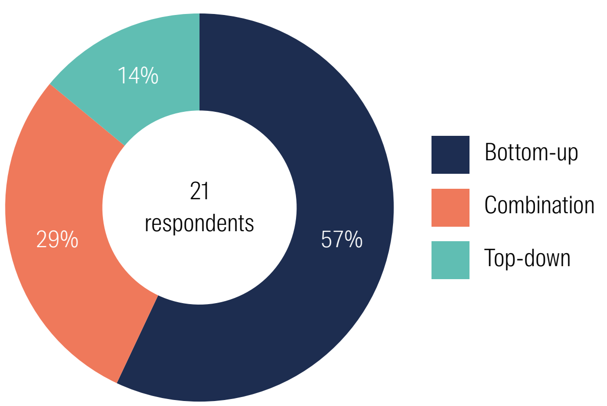
The way in which sustainability is incorporated into fund objectives is arguably a key policy decision for authorised fund managers.

This includes deciding whether a fund might have general or specific sustainability targets as well as whether these follow a 'group company' sustainability policy or a 'fund-specific' approach. It also involves taking a view on what sustainability means, including what framework to use to assess individual investments and support investment decisions.

The interviews conducted suggested a wide range of practice when it comes to the degree to which fund boards are involved in driving how sustainability considerations are incorporated into investment decisions and fund objectives.

Most of the fund boards saw sustainability policy as being explicitly set by the fund's mandate and the fund's investment manager's general approach to sustainable investing (i.e. from the 'bottom-up'). A minority of fund boards set a 'top-down' sustainable investing policy which they expect funds and fund managers to follow, while just under a third of boards consider policy to be set in a 'combined' way (e.g. where the board engages with proposals from the investment manager and signs these off).

Exhibit 8: How would you describe the boards' involvement in setting the funds' sustainability investment policy and/or objectives



Source: Fund Boards Council
Note: Refer to Appendix 1 for methodology notes on interview approach and data gathering

The fund boards which set policy at board level were typically independent fund management companies (operating funds for a range of delegate investment managers), or organisations operating a 'manager of manager' fund proposition (where funds utilise one or more third-party investment managers).

The general consensus view was that the executive teams responsible for managing funds are best placed to understand and implement sustainable investing policy. However, there was also acknowledgement that the fund board was ultimately responsible for this policy and the associated controls to oversee it.

> *"The role of the fund board director is very different to a corporate board director – less about progressing an ESG agenda for a company and more about making sure that a fund does what it says on the tin in terms of ESG promises".*
>
> – Irish fund board director

Fund board focus

Fund boards should satisfy themselves that there is a clearly articulated policy for how the funds' sustainability features are set. This should include details on whether policy is based on a general corporate view or if it is set on a fund-by-fund basis.

Examples of relevant MI

Documentation from the investment manager which clearly sets out:

- their interpretation of sustainable investing and how this is incorporated in investment decisions
- a set of criteria by which funds are categorised depending on the degree to which sustainable investing features in the fund's objectives and investment strategy
- how the investment manager's internal categorisation maps onto relevant regulatory requirements (e.g. disclosure requirements under Article 8 and 9 of SFDR).

Delivery of fund's commitments to its investors

2. How the investment manager implements sustainability considerations in order to meet a fund's objectives (including data and assessment tools)

There is considerable variability in how different investment managers implement sustainability considerations in their investment and decision-making processes, even for funds with apparently similar objectives. This includes variability in the nature and output from assessments and tools which consider sustainability (for example, tools which produce ESG 'ratings').

In light of variability in assessments and approaches, the interviews explored the degree to which fund boards were aware of and engaged with how their funds' investment manager undertakes assessments of sustainability. For example, an oil and gas energy company could be categorised as:

- '**green**' (high environmental sustainability): appropriate for inclusion in a sustainable fund because of its commitment and investment to the clean energy transition, or
- '**brown**' (low environmental sustainability): inappropriate for inclusion in a sustainable fund because of its current and historical greenhouse gas emissions.

Interviewees acknowledged the variability in approaches and all felt that the selection of individual investments was wholly the responsibility of relevant executive teams. There was, however, some debate about whether it was appropriate for fund board directors to question a portfolio manager on why a particular investment was included in a portfolio. Most interviewees felt this was appropriate, especially from the perspective of the board satisfying themselves that the portfolio manager can describe a clear process and robust case for including the security, rather than questioning the choice of the individual company.

All the fund boards which were 'internal' to investment management groups were broadly aware of the fact that their investment manager had a proprietary assessment approach with respect to sustainability factors. Most of the investment managers had central assessment approaches, including a global model which is used across all funds across jurisdictions. None of these fund boards felt they had any control over this assessment approach and only a small minority of them considered the fund board to even have been consulted on the approach. One interviewee did note that they were aware of some of the controls around the group model and details of a group internal audit review had been shared with the fund board.

None of the fund boards which operated as an independent management company had their own assessment approach, although they would typically undertake technical due diligence on delegate managers investment processes in general (which could include their sustainable investing approach).

"Why should our fund board sign off the ESG-assessment model? We don't sign off the yield curve model for fixed income valuation or the discounted cashflow model for equity valuation...

...but I guess I can see the case for thinking about some degree of board involvement in oversight of these models given the materiality of ESG investing to our business and how new these models are (relative to the more established ones)."

– Hong Kong fund board director

"Our role as a fund board is to make sure the funds do what it says on the tin. That means that we should be ensuring that appropriate fund strategies, policies and procedures are in place, but we should not be looking at how individual stocks are selected."

– Irish fund board director

The fund board challenge: developing robust sustainability oversight

Delivery of fund's commitments to its investors

"It is not the board's role to undertake detailed policy-setting and oversight of the minutiae. The board should ensure that the business has the right governance, the right people, the right process and the right oversight arrangement – not the detail, that is for the ExCo to undertake. They should ensure that appropriate controls have been set up to undertake oversight at each stage of the product life cycle from design to implementation to monitoring and reporting."

– UK independent authorised fund manager board director

The interviews also covered the potential reputational risks to the fund board if their investment manager's approach resulted in the inclusions of investments which would be rejected by other credible assessment methodologies. Interviewees recognised this risk and some acknowledged it as a potential gap in the controls in place in their organisations.

Some interviewees felt that clear disclosures of the assessment approach adopted by the firm (and controls to ensure it is followed) would mitigate this risk.

One interviewee noted a control in place at his fund's management company, whereby a second-line risk team independently reviews stocks in funds with an explicit sustainability objective using a third party assessment methodology. This team then challenges the portfolio manager if they find outliers using their independent assessment, and record whether they consider the manager's justification for including the stock is credible. MI on this control was then reported to the fund board's risk committee for oversight purposes.

Fund board focus

Evaluate the fund board's level of confidence in the way the investment manager implements sustainable investing, including any assessment tools and models employed.

Consider obtaining additional assurance on areas, such as:

- the effectiveness of first line controls over investment strategy implementation
- the use of second line risk management controls
- independent reviews of sustainability assessment models (e.g. from a third-party specialist consultancy).

Examples of relevant MI

Documentation from the investment manager which articulates their approach to implementing sustainable investing, including the nature and role of any assessment tools and models (to facilitate challenge of any vague or unclear statements).

The results of internal or external assurance work reviewing the way sustainable investing is implemented, which could include:

- validation of the nature and effectiveness of the assessment models
- results of quality assurance reviews by first line responsible investing teams (e.g. reviews undertaken of each investment team's approach and implementation)
- results of second line compliance monitoring or risk reviews and internal audit reviews
- results of external specialist third-party reviews.

The fund board challenge: developing robust sustainability oversight

Delivery of fund's commitments to its investors

3. Fund performance oversight – how delivery of fund objectives is monitored

Overall oversight of fund performance is generally recognised as a fund board responsibility across all reviewed jurisdictions (Appendix 2). A key question is the degree to which fund boards are (and should be) involved in the detailed oversight of a fund's performance against stated sustainable investment objectives/characteristics.

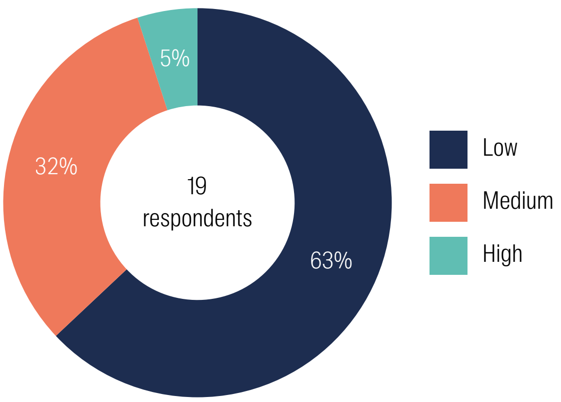
Almost two thirds of the fund boards described their involvement in monitoring fund's performance against sustainability objectives/characteristics as being low (with a strong reliance on executive functions, executive committees or board sub-committees to undertake this oversight).

Around a third of the fund boards considered themselves to have a medium level of involvement in oversight of fund sustainability performance, with this being discussed at board meetings, including receipt of relevant MI.

Only one fund board was highly involved in oversight (for example, scrutinising MI in detail as part of board discussions) and they were responsible for a number of Article 9 funds under SFDR (i.e. funds with an explicit sustainable investment objective).

Most of the interviewees noted that their fund board did not receive any MI on sustainable investment funds (i.e. management information specifically focused on monitoring performance against sustainability objectives of funds which have such features in their mandates).

Exhibit 9: How would you describe your involvement in oversight of fund performance against sustainability objectives/characteristics



Source: Fund Boards Council
Note: Refer to Appendix 1 for methodology notes on interview approach and data gathering.

A small minority noted that the board receives some MI in the performance section and/or risk section of board packs.

"We are starting to see one or two page ESG summaries for funds, but very little time is spent discussing this at board meetings. I assume this is being covered in more detail at executive level boards at the investment manager or management company. I do think that a lot of work needs to be done to demonstrate to the fund board that the investment manager and management company are monitoring and managing this. I will be asking questions at my fund board discussions, looking for evidence of how the investment process includes checking if individual investments meet ESG requirements."

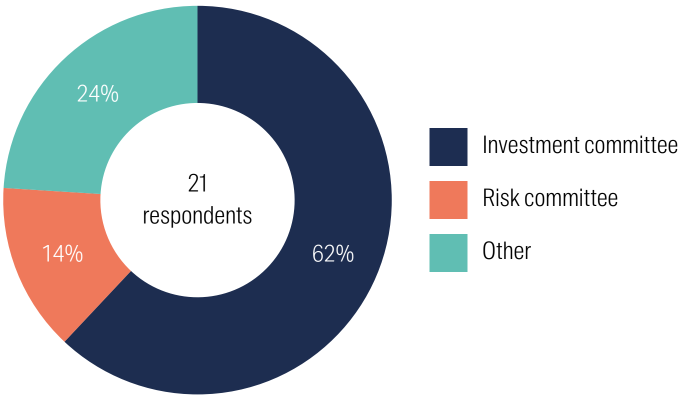
– Irish fund board director

"We are starting to ask more questions at our fund board on this. I think we should be taking a 'show me' rather than 'tell me' approach because of the high reputational risk of greenwashing. ESG oversight is less mature than other areas like oversight of liquidity risk. We went through a similar process on liquidity risk where a couple of years ago we wanted detailed MI (to 'show me') and now that things are more established, we are comfortable with MI which is at a level to just 'tell me' what is going on."

– UK fund board director

Delivery of fund's commitments to its investors

Exhibit 10: Which other internal forums receive MI and monitor funds' sustainability features



Source: Fund Boards Council
Note: Refer to Appendix 1 for methodology notes on interview approach and data gathering.

With respect to other internal forums receiving MI on fund's sustainability features, investment committees were cited in almost two-thirds of the cases (with variation as to whether this investment committee was a sub-committee of the fund board or an executive forum). A much smaller proportion consider this type of MI at a Risk Committee (usually a sub-committee of the fund board), with a quarter of fund boards monitoring this elsewhere (usually various executive forums, including product governance committees).

In general, interviewees considered that the product governance process plays a key role in setting agreeing an appropriate sustainable investment policy and how this translates into the fund's mandate.

They also felt that this product governance process should ensure that any sustainable investment funds being launched should have appropriate controls in place to ensure mandate compliance, including agreeing relevant sustainability Key Performance Indicators (KPIs) or Key Risk Indicators (KRIs).

Fund board focus

Fund boards should be satisfied that effective monitoring arrangements are in place to consider the sustainability-related features of funds. This includes obtaining assurance that:

- appropriate controls are in place to ensure compliance with any sustainable investment features in fund mandates
- relevant sustainability-related KPIs or KRIs are agreed

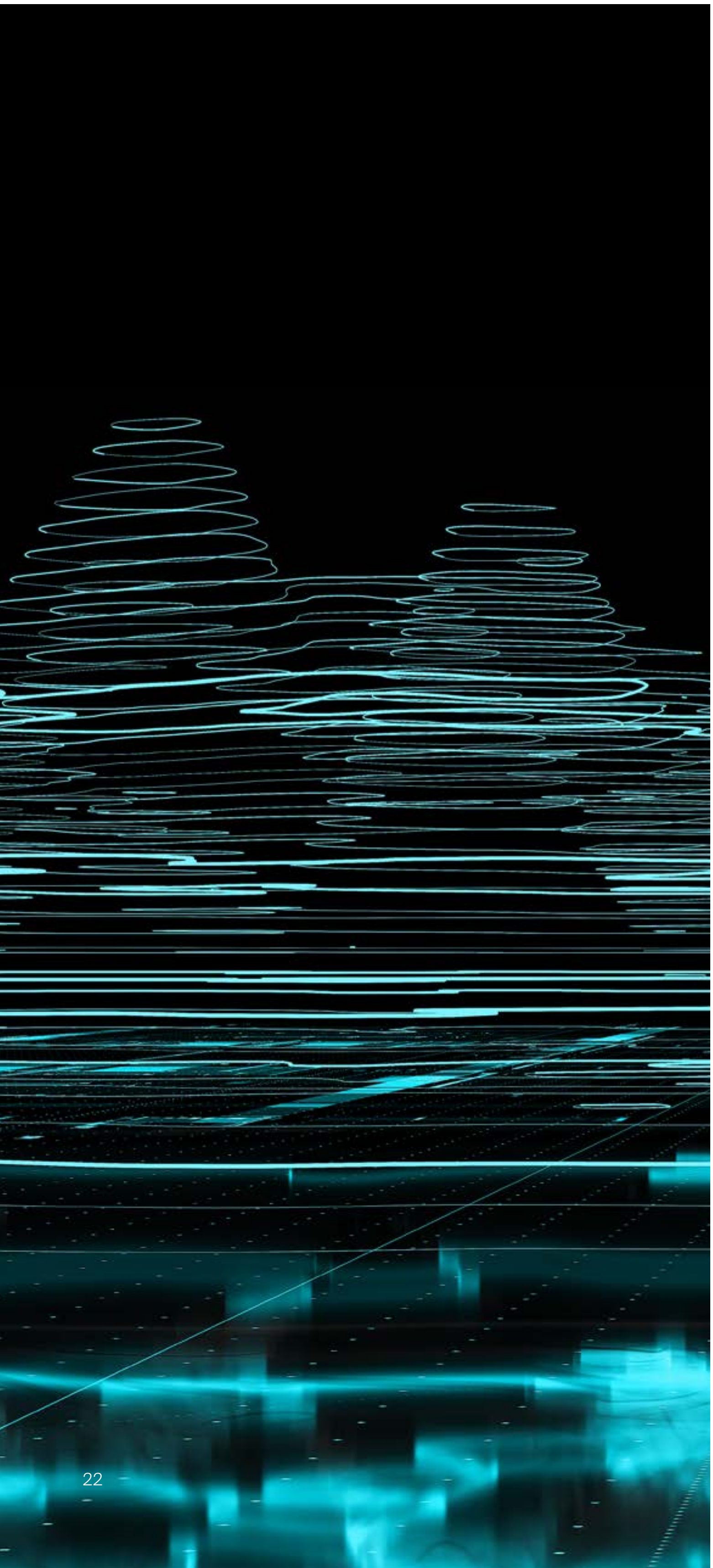
The risk of insufficient data being available to monitor outcomes should be addressed at the design stage by selecting KPIs and KRIs which can realistically be obtained with existing systems and data providers.

Monitoring activities should be related to the degree of sustainability features of funds, for example higher levels of attention and more detailed metrics for funds subject to the Article 8 and 9 disclosure requirements under SFDR.

Examples of relevant MI

- Governance maps setting out where responsibility lies for monitoring the performance and objectives of sustainable investment funds
- Terms of reference for relevant committees or executive forums, to include:
  - explicit delegation of responsibility to monitor measures of sustainable investment objectives/features
  - escalation and reporting routes up to the fund board
- Examples of relevant KPIs and KRIs that could be included in MI packs:
  - carbon emissions-related data for a climate change related fund
  - average ESG-rating for a fund's holdings vs. benchmark where the objective is to invest in companies with better than benchmark ESG-ratings)
- Documentation of pre and post-trade controls, as well as portfolio monitoring controls, incorporate sustainable investing portfolio constraints and requirements.

Compliance with laws and regulations



Generally the fund boards are ultimately responsible to ensure that funds are developed and managed in line with all relevant requirements (Appendix 2). Sustainability-related regulation is rarely included as an explicit compliance responsibility; however boards' responsibilities include compliance with all applicable laws and regulations.

Sustainability considerations

Regulators are increasingly applying rules and guidance to how sustainability considerations are to be addressed in fund naming, classification and product documentation (both documents issued to investors pre-contract and periodically post sale).

Some jurisdictions also require mandatory reporting on sustainability-related risks or factors, even for funds and entities where sustainability is not part of the investment objectives. Many financial regulators require additional reporting in line with the TCFD framework.

Challenges

Some fund boards are relatively remote from the following activities and will need to consider how to achieve an appropriate level of oversight of:

1. Product development activities, including fund naming and classifications/labels
2. Production and publication of product documentation (including pre-contractual and post-sale disclosures)
3. Other mandated disclosures, such as TCFD reporting – meeting both entity level and product level reporting requirements, including oversight of climate data.

Compliance with laws and regulations

1. Product development activities, including fund naming and classification

Regulators typically impose general requirements that a fund's sustainability focus should be reflected consistently in its design, delivery and disclosure.

Most of the reviewed jurisdictions require fund names to be clear and not misleading. The UK and Hong Kong offer more focused guidance, requiring the sustainability-related fund names to reflect the level of materiality of sustainability in the fund's objective (Appendix 2).

Similar requirements for being clear and not misleading apply also to descriptions of a fund's objective and investment strategy, and all documentation (including promotional materials) (e.g. the Consistency and Design principles outlined in the UK FCA's ESG Guiding Principles, as shown in Appendix 2).

Fund board focus

Fund boards should be satisfied that their product governance framework addresses all relevant sustainable investment fund requirements. This includes obtaining assurance that:

- relevant requirements are considered in sustainable investment fund approvals and existing fund reviews
- requests to 'repurpose' or 'reclassify' existing funds as sustainable investment funds are appropriate (e.g. raising challenges if no material changes are being introduced to the investment objective or process)
- appropriate checklists are incorporated into product approval templates to demonstrate that all relevant requirements have been addressed (including sign-off by compliance).

Examples of relevant MI

- Documentation of product governance frameworks, including examples of product development templates which explicitly address sustainable investment fund requirements (including checklists, where appropriate)
- Documentation of the fund classification process (including assurance controls and thresholds for each category).
- List of funds overseen by the board within each sustainability category, highlighting any changes in classification since previous board meeting
- Compliance monitoring review reports to provide assurance, that e.g. :
  - fund names align with the fund objective, strategy and sustainability characteristics
  - fund descriptions are 'true to label' and objective in marketing literature, factsheets etc.
- Results of investor and intermediary testing to validate understanding of fund names and classification

The fund board challenge: developing robust sustainability oversight

Compliance with laws and regulations

2. Production and publication of product documentation (including pre-contract and post-sale disclosures)

The regulatory requirements applicable to product documentation are typically very prescriptive.

Pre-contract fund disclosures requirements include elements such as:

- the nature of sustainable investment objectives and the investment strategy to achieve this objective (EU, UK, Hong Kong)
- the assessment methodology to be used to evaluate sustainability of investments (EU, Hong Kong)
- metrics to be used to assess the fund's sustainability performance through its life cycle (Hong Kong)
- the share of fund assets managed to the sustainability objective (EU, UK)
- reference benchmarks (EU, Hong Kong)
- how sustainability risks are considered in the investment strategy (EU, Hong Kong).

Post-sale fund disclosures requirements include elements such as:

- the extent to which the fund has attained its stated sustainability objective, based on pre-defined metrics (Hong Kong)
- a comparison of the fund's performance against the designated benchmark (EU, Hong Kong)
- specific sustainability metrics or indicators when relevant (at investment manager or fund level). Those could include:
  - SFDR Principal Adverse Impact indicators (PASIs)
  - Greenhouse gas (GHG) emissions, carbon intensity, etc.

See Appendix 2 for a list of sustainability-related pre- and post-sale disclosure requirements across the relevant jurisdictions.

Fund board focus

Fund boards should be satisfied that robust processes are in place to produce pre and post-sale disclosures and that these comply with all relevant requirements, including with respect to sustainability considerations.

Given variability in data completeness and quality, impact of data sources on prepared documentation and disclosures should also be understood.

Examples of MI

- Documentation of the process by which pre and post-sale disclosures are produced, including:
  - roles and responsibilities
  - relevant risk management and quality assurance controls (including checklists, where appropriate).
- Exception reports highlighting where any fund disclosure documentation has not been produced, reviewed or met the current requirements
- Documentation of sustainability data architecture, details of data integrity controls and impact of data sources or quality on mandatory disclosures
- Compliance monitoring includes a review of customer-facing reports to provide assurance on the disclosure production process, including data used in the process.

The fund board challenge: developing robust sustainability oversight

Compliance with laws and regulations

3. TCFD reporting – meeting both entity level and product level reporting requirements, including oversight of climate data

While the TCFD reporting framework was originally something which firms could adopt on a voluntary basis, financial regulators are increasingly requiring firms (including AFMs) to report following the TCFD framework.

For example, the UK's FCA's rules require asset managers to make mandatory disclosures consistent with the TCFD's recommendations on an annual basis at:

- **entity level** – an entity-level TCFD report setting out how they take climate-related risks and opportunities into account in managing or administering investments, and
- **product or portfolio level** – a baseline set of consistent, comparable disclosures in respect of their products and portfolios, including a core set of metrics.

Both levels of reporting require a significant depth of analysis and explanation including climate-related scenario analysis and quantitative metrics on greenhouse gas emissions.

Acknowledging that AFMs are often part of larger groups, the UK regulation does allow for some flexibility for firms to cross-refer to disclosures made by the group or an affiliate member of the group. However, the AFM would still be expected to have a clear rationale for relying on other entities and to have appropriate engagement by the fund board to meet their governance obligations.

Fund board focus

Be aware of:

- AFM's regulatory responsibilities to undertake TCFD reporting, both at entity and product (fund) level
- how the business ensures robust methodologies are applied to climate-related scenario analysis and data quality.

Examples of relevant MI

- Documentation of the process by which TCFD reporting is produced, including roles and responsibilities of key functions involved
- Documentation of how the business approaches climate-related scenario analysis and controls in place to validate models utilised
- Documentation of sustainability related data architecture and details of data integrity controls
- Compliance monitoring including a review of reports to provide assurance on the TCFD disclosure process, including data used in the process.

Risk management

The fund board is ultimately accountable for ensuring that the AFM has appropriate processes, systems and controls in place to identify, monitor and manage risks (Appendix 2). Risks would generally include investment and operational risks.

Sustainability considerations can impact risk-related responsibilities of fund boards in two main ways:

1. sustainability (or climate change more specifically) as an investment risk
2. 'greenwashing' risk.

Sustainability as an investment risk

Several of the reviewed jurisdictions require product and/or entity-level disclosures on how sustainability and/or climate change risks are incorporated into the investment process. Some of the examples include:

- amendments to Undertakings for Collective Investment in Transferable Securities (UCITS) regulations require sustainability to be considered in investment decisions where it could have material negative investment impact
- SFDR requires disclosure of how sustainability risks have been considered and incorporated in the investment process or why they are not considered material
- the Securities and Futures Commission of Hong Kong (SFC) requires disclosures on governance and oversight of climate risk.

In some jurisdictions (e.g. EU), those requirements do not apply only to funds which may have a defined sustainability mandate/objective, they apply to all funds, so fund boards should be looking to implement relevant assessments across all funds that they are responsible for. Sustainability considerations may also be incorporated into risk management frameworks.

Greenwashing risk

The issue of greenwashing is of increasing concern to regulators globally – for example it is a priority area in the roadmaps issued by the UK's FCA and ESMA in 2022.

Greenwashing is generally not a new risk for the investment management industry. It could be considered as a variant of mis-selling, which is already prohibited and can and does result in civil or criminal sanctions. Investment managers already need to be able to articulate clearly their investment proposition and provide evidence when challenged by boards or regulators.

Fund boards should be aware of greenwashing risks and satisfy themselves that appropriate and effective controls are in place to mitigate it.

"ESG risk is a big focus now, in a similar way to how liquidity risk was a big focus in the recent past.

As was the case with liquidity risk, I expect ESG risk metrics will be incorporated in the MI which we see.

For example, whereas the risk dashboard at the fund board in the past would have include things like a market stress test, liquidity stress test and credit stress test, there will now be an ESG section going forward."

– Luxembourg fund board director

Risk management

1. Incorporating sustainability risk considerations into risk management frameworks and governance

AFMs typically have in place risk management frameworks at two levels – **portfolio risk management and enterprise risk management** (ERM).

Portfolio risk management covers how risk is managed within and across individual investment funds, including as part of the investment process. Examples below demonstrate how sustainability risk management may be incorporated in portfolio risk management. It is also important to note that sustainability may play a greater or lesser role within individual investment strategies depending on the nature of the strategy, but the regulatory expectation is increasingly for sustainability risk to be considered across all funds.

- **The investment due diligence process**: for example, evaluation of sustainability-related risks as part of the investment research for a securities inclusion in (or removal from) a portfolio
- **Monitoring sustainability risk**: for example by considering a sustainability risk profile for a fund across a range of metrics, including relative to a benchmark (e.g. metrics associated with greenhouse gas emissions)
- **Stewardship**: the way in which engagement takes place with the firms in which the fund invests, including the approach taken to voting in light of sustainability risk considerations
- **Climate Scenario Analysis**: for example assessing 'Transition' and 'Physical' risks facing portfolios and how this could influence investment strategy
- **Distribution**: for example, considering sustainability preferences in the distribution chain for the fund, especially investor sustainability preferences

Enterprise risk management covers how risk is managed for the AFM as a corporate entity, including compliance with regulatory requirements. At an enterprise level, sustainability risk management may be incorporated in a number of ways including, but not limited to:

- **Risk taxonomy** – incorporate sustainability risk within the entity's taxonomy, i.e. the way it describes risks to facilitate risk identification and categorisation
- **Risk appetite** – establish key risk indicators (KRIs) relevant to sustainability and agreeing board risk appetite for these measures
- **Impact on other risk categories** – consider how to incorporate sustainability risk into other risk categories, including potential impact on credit risk, market risk, liquidity risk and operational risk (including data availability/data quality risk) and reputational risk
- **Corporate governance** – incorporate sustainability risk into existing management and board level governance forums (including risk and compliance committees and product governance committees), including considering appropriate dashboards and MI relating to sustainability risk at these forums.

Fund board focus

Fund board directors should be aware of their AFM's regulatory responsibilities to consider sustainability risk and should satisfy themselves that risks are appropriately incorporated into both portfolio management and ERM frameworks and governance.

Examples of relevant MI

Portfolio management

- Documentation of portfolio management approaches, including how sustainability risk is considered
- Portfolio level sustainability risk reporting, including evidence of monitoring risks (e.g. greenhouse gas emissions)
- Output from assessment of Transition and Physical risks facing portfolios (including climate scenario analysis)

ERM frameworks and governance

- Documentation of the AFM's risk taxonomy, key risk indicators (KRIs) and risk registers which incorporate sustainability risk
- Documentation of the AFM's governance framework and sustainability risk policies, signposting roles and responsibilities of forums and individuals to monitor and manage sustainability risks

Three lines of defence and sustainability risk

Research interviews highlighted a common theme in the way fund boards approached managing regulatory risks and sustainability risk in particular. There is strong reliance placed upon the 'three lines of defence' model, for example:

- **First line activities**: where portfolio managers, researchers and trading teams are responsible for investment selection and monitoring, including using pre- and post-trade compliance systems
- **Second line activities**: where compliance monitoring and risk review teams review the effectiveness of first line controls and whether policies and processes are aligned with regulatory requirements
- **Third line activities**: internal audit reviews of the control environment, as well as particular areas of attention, for example as set by the board audit committee

However, a number of key themes emerged from discussions about the efficacy of the three lines of defence to oversee funds' sustainability-related features:

- Oversight is likely to be most effective where sustainability-related features are clearly defined and translated into measurable restrictions. (Note: this may not be applicable to all types of features, e.g. stewardship activities).
- Controls and competencies are generally the most developed in the first line of defence with portfolio managers and responsible investment teams who are experts on sustainable investing. Second and third-line of defence teams may have relatively less experience in this area.
- Fund boards are currently making relatively limited use of second and third lines of defence to undertake assurance work on the effectiveness of sustainable investment fund controls. However, many of the research interviews highlighted that this was something they would consider adding to the 2023 compliance monitoring and/or audit plan.

Interviewees also commented on the fact that there are generally no prescribed regulatory requirements for the degree to which fund boards should oversee sustainable investment fund mandate compliance, so each entity will operate what they deem to be appropriate controls.

"Mandate compliance is overseen using the 'standard approach' with involvement of the three lines of defence as well as the ManCo and Depositary.

The ManCo does spot checks of things, but places reliance on the investment manager and does not have their own risk management and oversight teams or systems. The focus will be on monitoring against breaches at a fund level and ensuring that things are escalated to the board and regulator where necessary."

– Irish fund board director

Examples of the kind of controls which could be put in place within each of the three lines of defence include:

First line

- Sustainable investment features coded into pre and post trade compliance systems and first-line investment risk/compliance teams monitor MI to identify any issues on a daily basis
- Integration of sustainability across all funds is monitored periodically (at least annually) with validation taking place across each investment team's processes
- Stewardship activities are monitored, with qualitative MI produced to demonstrate the nature and outcome of engagement with investee companies
- Validation takes place of all sustainability statements in fund documentation and marketing materials (including online content) to ensure consistency with investment processes, including testing investor and intermediary understanding

Second line

- Second-line risk teams monitor agreed KPIs and KRIs in monthly reports, including comparing these to agreed risk appetite thresholds
- Second-line compliance monitoring team review relevant areas including: integration of sustainability into investment processes, alignment of processes with disclosures and general alignment with regulatory requirements

Third line

- Internal audit review of areas considered to be of high risk by the fund board, including potential areas of greenwashing (e.g. validating that key promises about sustainable investment features of funds can be supported by evidence)

Risk management

2. Greenwashing risk

The widely used term of 'greenwashing' is not universally defined, but is generally used to refer to situations where there may be a mismatch between the (often exaggerated) claims about the sustainability credentials of an investment product and the actual credentials of the product. Greenwashing could be intentional or unintentional and could arise in a variety of cases.

Sources of greenwashing risk:

- ambiguity in the narratives on the fund's sustainability credentials and/or the investment strategy
- overstating the ESG characteristics of a fund
- lack of consistency between the set investment strategy/ policy and product documentation/ marketing materials
- inability to substantiate or evidence statements in product documentation
- investment execution does not correspond to the fund's objective and strategy or inability to evidence consistency
- analytical tools and data limitations and/or inappropriate use of tools/data which results in inability to support the investment analysis with the intended sustainability consideration

AFMs require effective controls to ensure that funds are 'true to label' with respect to their 'promised' sustainability features. These controls are explored in more detail in earlier sections (for example on delivering a fund's commitment to its investors and the importance of utilising the three lines of defence model to mitigate risks).

Research interviews highlighted different opinions amongst fund board directors regarding responsibility for general sustainability commitments made by a fund's investment manager, rather than specific features included in a fund's objectives or strategy. For example, many investment managers are signed up to the UN PRI and/or the Net Zero Asset Managers Initiative, impacting the way they select investments across all clients (including funds).

Most interviewees agreed that the fund board should have some oversight of these more general commitments, but one interviewee felt that reputational risk arising from these commitments fell to the investment manager's board to manage, with the fund board only liable for specific sustainability features promised by individual funds.

"Post SFDR, the level of scrutiny was raised significantly and we created a board sub-committee called the Fund Approval Committee comprising fund board directors and ManCo board directors (mainly independents) to review the entire development process and fund design.

Whereas previously there has been a focus on things like liquidity, investment universe, leverage and benchmarks, now ESG was added prominently to the mix. The focus of the Fund Approval Committee is not just disclosure, but also obtaining assurance that the fund manager can support and achieve the promises in the disclosures."

– Luxembourg fund board director

The fund board challenge: developing robust sustainability oversight

Board composition

Most jurisdictions require fund board directors to have the necessary knowledge, skills, and experience to fulfil their responsibilities.

This includes having a full understanding of the nature of the regulated company's business, activities and related risks, as well as their individual and collective responsibilities. For example, the Irish Funds Corporate Governance Code specifies that the board should be of a sufficient size and expertise to adequately oversee the operations of the fund' (Appendix 2).

Sustainability considerations
In order to fulfil their responsibilities, fund board directors require sufficient knowledge and understanding of:

- sustainable investing regulations
- relevant investment approaches, including the different investment objectives to incorporate sustainability (ranging from values-based exclusions to investing for particular sustainability outcomes, such as impact investing)
- available data, metrics and assessment tools (e.g. ESG ratings, climate scenario modelling, etc), including their limitations.

Challenges
Fund boards may not have all necessary knowledge, skills, and experience to fulfil their responsibilities when it comes to sustainable investment funds.

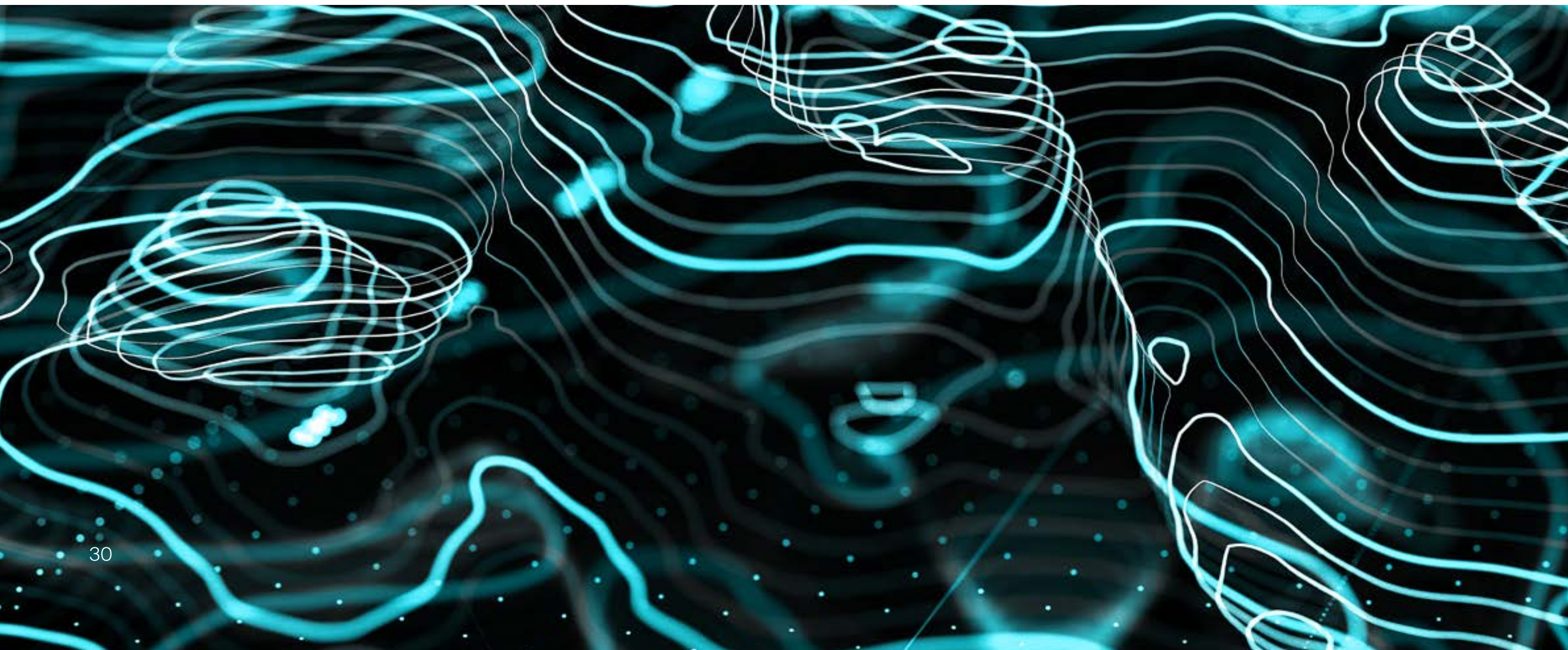
The interviews revealed a variable picture of the level of knowledge and competency of fund boards relating to sustainable investing.

It was generally acknowledged that executive directors (EDs) had a higher level of knowledge than non-executive directors (NEDs), often with at least one ED being a subject-matter-expert (such as Head of Product, Head of Responsible Investment or someone with investment experience such as the Chief Investment Officer).

It was acknowledged, however, than NEDs could bring very valuable sustainability-related skills and experience to the fund board table.

"The two independent NEDs on our board are very involved in ESG-related activities, with my other board appointment to a listed investment trust focused on clean energy and the other iNED being very involved in industry working groups on ESG-investing. This equips us as iNEDs to calibrate what management are telling us, enables us to be self-informed and provides us with access to deep-dive training"

UK fund board director



The fund board challenge: developing robust sustainability oversight

Board composition

The interviewees felt that their fund boards were generally more knowledgeable about fund-related sustainable investment regulations (such as fund naming, labelling and disclosures) than entity-level disclosures (such as the TCFD requirements).

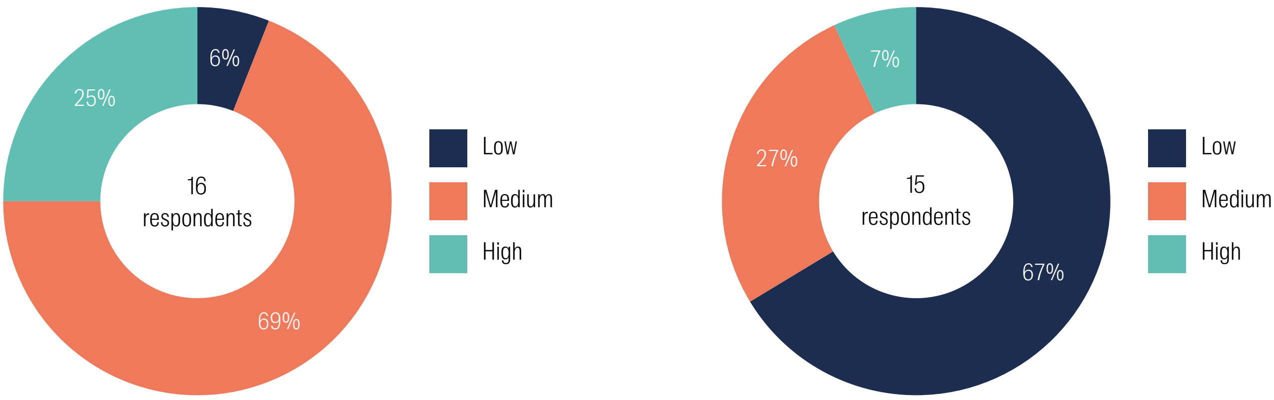
This was not surprising given the fact that sustainable investing regulations are already mandatory in many fund jurisdictions (especially the EU, Hong Kong and Australia – refer to Appendix 2) and have been for years in some cases. By contrast, entity-level disclosures have been voluntary for most organisations up until now and will only become mandatory for some organisations from 2022 or later. It is interesting to note that more than two-thirds of interviewees felt their fund board had a medium level of knowledge and experience of sustainability-related regulations. In many cases this was described as an average between Executive Directors, who would be rated high, and Non-Executive Directors who would be rated low.

Many considered entity-level disclosures to be the responsibility of the fund's investment manager and/or a group company. However, there appears to be growing awareness that the fund board will be held accountable for these entity-level disclosures and many interviewees noted that this was on the agenda for later in 2022 or early 2023, as well as training being planned.

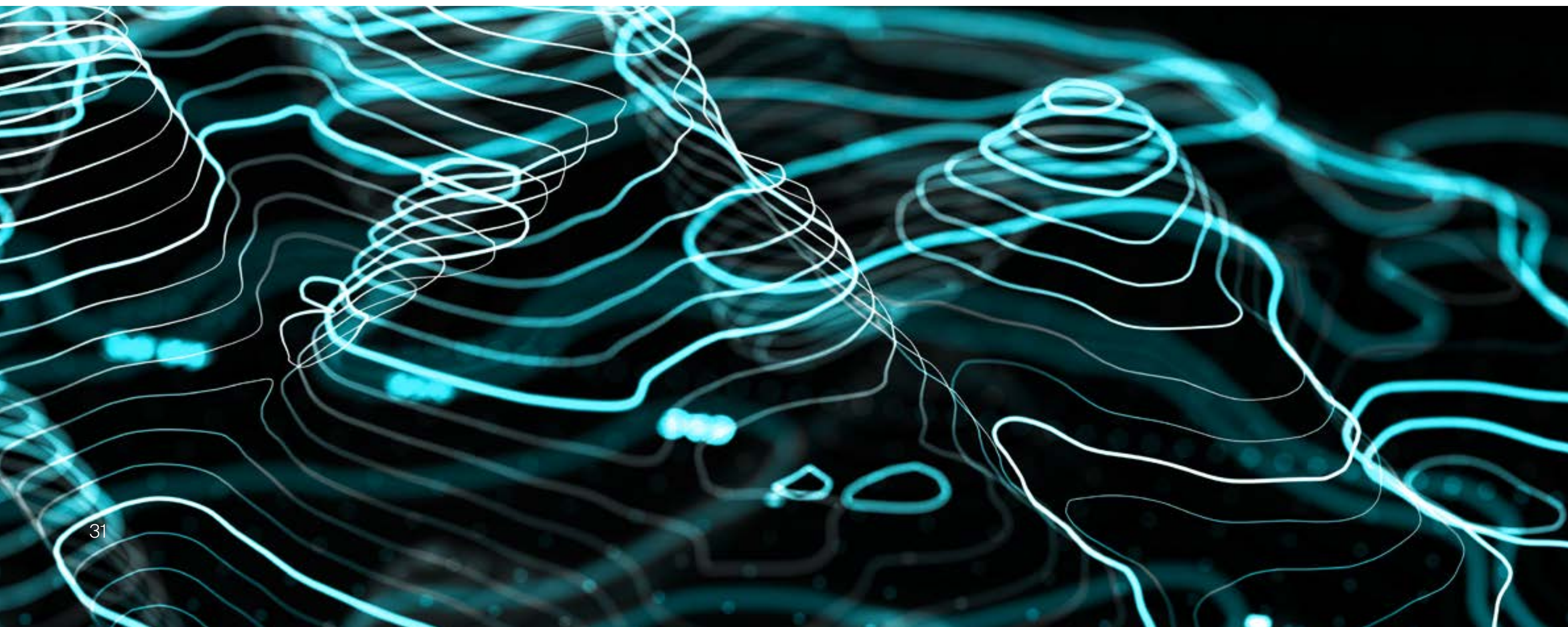
Exhibit 11: How would you rate the fund board's knowledge of sustainability-related regulation on a scale of high, medium or low

Fund-related regulations

Entity-level disclosures



Source: Fund Boards Council
Note: Refer to Appendix 1 for methodology notes on interview approach and data gathering.



The fund board challenge: developing robust sustainability oversight

Board composition

Fund board focus

Fund boards should:

- undertake board assessments to identify gaps, if any, in sustainable investment knowledge, skills and experience
- take appropriate action to address these gaps – for example:
  - regular and 'deep-dive' training for existing board members
  - recruitment of a subject-matter-expert board member (can be as an independent director, to provide a greater degree of independent challenge).

Examples of knowledge and understanding to develop

Relevant regulations

- General knowledge of the regulations on sustainable investing relevant to the domicile of the fund range (including fund labelling, disclosure and reporting requirements)

Sustainable investing

- Sustainable investing approaches: how investment managers typically implement sustainable investing across different asset classes
- Fund objectives and strategies: the nature of the various approaches and how they map to the degree of sustainability features included

Assessment tools and metrics

- Sustainable investment assessment tools and models: awareness of the nature and limitations of these tools and models
- Sustainability metrics: the nature and range of metrics, including data challenges and limitations in some asset classes
  - focus on climate metrics including for example greenhouse gas emissions metrics and portfolio temperature metrics
- Stewardship: an understanding of the different components of stewardship (e.g. engagement & voting), how they achieve outcomes and what best practise in engagement looks like
- Climate related risks: understanding of Transition and Physical climate risks and broad appreciation of how the key risks play out in each asset class
  - Includes a high level understanding of climate scenarios, the different types and how the output should be interpreted

The regulatory environment

Project research, including interviews and desktop, identified more commonalities than differences in fund board oversight of sustainable investment funds across the selected jurisdictions.

The main identified differences relate to the degree to which regulators in each region have articulated expectations of how sustainable investment funds should be overseen, as well as the way the regulators themselves supervise investment firms with sustainable investment funds in their product range. For example, preservation of trust in financial markets is a key priority for the Financial Conduct Authority in the UK.

"The financial sector can support not just the transition to net zero, but also towards a more sustainable future more broadly – but this requires consumers being able to trust firms to deliver on their ESG promises. Greenwashing presents a risk to confidence in the market and the much needed flow of capital to help secure net zero and help to secure all our futures"

– Mark Manning, Technical Specialist, Sustainable Finance and Stewardship, FCA
Fund Boards Council event, March 2022

As sustainable investment continues to develop and so does regulation, the project research identified two regulatory areas which would continue to evolve.

Better global alignment in regulation and practical implementation guidance

Sustainable investment requirements are still developing in many jurisdictions. Apart from advancing local requirements, international harmonisation, where possible and practical, was pointed out as beneficial. This includes standards such as the SFDR and the EU Taxonomy, as well as those being developed at international level, such as by the International Sustainability Standards Board (ISSB) and TCFD.

Clear and consistent guidance from regulators would also be welcomed, especially in terms of the local requirements for fund labelling, disclosure and monitoring of sustainable investment funds.

Supervision and enforcement

To date, most regulatory activity has been focused on disclosure requirements. The research interviews highlighted appetite from fund board directors for effective supervision (including enforcement, where appropriate) once clear implementation guidance is available.

Examples of good and poor practices would also be welcomed by fund board directors.

Appendices

Appendix 1: Interview methodology notes

Interview approach and questions

A total of 25 individuals across 21 organisations were interviewed. Interviewees were fund board directors or otherwise involved in the work of fund boards (e.g. executives or consultants involved in fund board governance).

Interviewees were sent an agenda in advance of meetings with a set of questions. The following example illustrates these questions in the context of an Irish fund board director. Please note that slight variations were applied to tailor questions to fund board directors in other jurisdictions.

Example questions

Q1. Does your fund board have its own policy setting out expectations for if and how funds should incorporate Environmental, Social and Governance (ESG) considerations in how investments are selected, or does it 'approve' an ESG policy proposed by the investment manager for each fund?

Q2. How does your fund board go about overseeing whether individual funds are being managed according to their mandate in general, and in particular when that mandate has specific ESG features?

Note: we understand that detailed oversight may be delegated to executive committees including an investment committee, but we are still keen to understand how the board obtains comfort that this oversight is taking place effectively.

Q3. Where the fund's investment manager has a 'general' policy 'integrating' ESG across all funds (i.e. including those which may not have a specific ESG mandate), how does the fund board go about obtaining assurance that this policy is being followed (i.e. that ESG is indeed being integrated in a material way within each fund or investment process)?

Q4. Are any ESG measures being presented to the fund board as part of performance or other Management Information, or is this level of detail considered at an investment committee (and is this committee constituted as a sub-committee of the board)?

Q5. Has the fund board been consulted on the selection of an ESG measurement 'basis' – i.e. the principles behind any methodology selected to measure and incorporate ESG into mandates and/or to integrate it across funds? This includes any 'ESG-rating' models utilised as part of the investment process.

Note: we understand that the minutiae of the methodology's calculation and application will be undertaken by the executive – we are interested in what role the board has played, if any, in the selection of the methodology (given the wide range of possible approaches available today, both using internal ratings within a fund manager or using third-party rating providers like Sustainalytics, MSCI etc).

Q6. How would you rate the fund board's level of knowledge and expertise of (and any significant gaps for attention relating to:

- Fund-related ESG considerations, including the EU Sustainable Finance Disclosures Regulation requirements and Central Bank of Ireland's specific requirements?
- Entity-level climate-related disclosure requirements – i.e. Task Force on Climate-Related Financial Disclosures, including those which may apply to your fund's management company now and in the future, say as a result of the EU's EU Corporate Sustainability Reporting Directive (CSRD)?

Q7. Has the fund board had any training on fund-related ESG matters and/or climate-related disclosure requirements recently?

Interviews were typically held for 45–90 minutes, with detailed notes produced to record the discussions.

The interviews were qualitative in nature, but some responses to questions were coded to facilitate the production of charts to illustrate the range of responses. The coding was undertaken by FBC based on a judgement of interviewee responses.

Data presented through charts in the report could depict a varying number of responses, depending on whether enough detail was covered in the interview to facilitate coding a response to a particular question. The number of responses varied between 15 and 21.

The charts and other interview findings presented in the report are included to illustrate the nature of discussions with the sample of interviewees. They are not presented as being statistically significant, nor warrant that they are indicative of the full population of fund boards across the jurisdictions included in this work.

Appendices

Appendix 1: Interview methodology notes

Summary of interviewee details

We refer to authorised fund manager in a generic sense, as also used throughout the report. This includes whether an AFM is 'internal' (i.e. part of the same group as the investment manager for the funds) or 'independent' (i.e. providing 'hosted' services to a range of third-party different investment managers for individual funds which they 'host').

References to 'ManCo' are to a management company and to a 'fund entity' are as per the definitions used throughout the report. Where an interviewee held more than one role, we have mentioned the most relevant role to this research. We include multiple roles where more than one individual was included in the same interview.

Exhibit 12: List of interviewees

#	Role	Type of organisation	Location
1	**Non-Executive Chair of Board**	AFM (internal)	UK
2	**Non-Executive Chair of Board**	AFM (internal)	UK
3	**Non-Executive Chair of Board**	AFM (independent)	UK
4	**Executive Chair of Board** **Chief Executive (designate)** **Head of Product Governance**	AFM (internal)	UK
5	**Non-Executive Chair of Board**	AFM (internal)	UK
6	**Non-Executive Director** **Non-Executive Director** (Chair of Board Risk Committee)	AFM (internal)	UK
7	**Non-Executive Director**	Fund entity	Ireland
8	**Non-Executive Chair of Board**	Fund entity	Ireland
9	**Non-Executive Chair of Board**	Fund entity	Ireland
10	**Non-Executive Chair of Board and Non-Executive Director** (one individual)	ManCo (internal) Fund entities	Luxembourg
11	**Non-Executive Director**	Fund entity/ManCo	Luxembourg
12	**Executive Director (of group company)** (Head of Compliance)	ManCo (independent)	Luxembourg
13	**Investment Consultant** (Responsible investment consultant to fund entities)	AFM (Responsible Entity)	Australia
14	**Corporate Governance Lead** (Head of Legal and Company Secretariat)	AFM (Responsible Entity) and Investment Manager	Australia
15	**Executive Director** (Managed Fund Services)	AFM (independent Responsible Entity)	Australia
16	**Executive Director** (Chief Executive Officer)	Fund entity/investment manager	Hong Kong
17	**Head of Product** **Head of Product Development**	Fund entity/investment manager	Hong Kong
18	**Senior Investment Research Manager**	Fund entity/investment manager	Hong Kong
19	**Head of Investments**	Fund entity/investment manager	Japan
20	**Investment and governance team** (detailed written response to questions)	Fund entity/investment manager	Japan
21	**Executive Director (UK entity)** (Head of Compliance and Regulation)	Fund entity/investment manager	Japan (via UK office)

Appendix 2: Regulations overview

The regulatory synopsis hereto is included in order to provide context and examples of regulatory requirements. It should not be considered as a complete and/ or exclusive regulatory review within the selected jurisdictions.

Exhibit 13: Fund governance requirements across selected jurisdictions

Requirements	UCITS[9]	Ireland[10]	Luxemburg[11]	United Kingdom[12]	Hong Kong[13]	Japan[14]	Australia[15]
Composition, independence and expertise of fund oversight body		Sufficient size and expertise to adequately oversee the operations of the fund; The board should mostly be formed of non-executive directors and at least 1 independent director; The independent directors shall have a knowledge and understanding of the investment objectives, the regulation of collective investment schemes, policies and outsourcing arrangements; The board shall ensure that directors are aware of the relevant policies and procedures and have received adequate and sufficient training to enable them to discharge their duties.	The Board should have good professional standing and appropriate experience and use best efforts to ensure that it is collectively competent to fulfil its responsibilities; Consideration should be given to the inclusion in the Board of one or more members that are, in the opinion of the Board, independent.	At least one quarter of the members of AFM's governing body are independent natural persons; The AFM must take reasonable steps to ensure that independent members appointed to its governing body have sufficient expertise and experience.	The directors of the management company must be of good repute and in the opinion of the Commission possess the necessary experience for the performance of their duties. In determining the acceptability of the management company, the Commission may consider the qualifications and experience of persons employed by the management company and any appointed investment delegate.		Minimum of three directors, with at least two of those ordinarily residing in Australia.
Delivery of the fund's commitments to its investors	Senior management of UCITS management companies is responsible for: • responsibility for the general investment policy for each managed UCITS and oversight of the approval of investment strategies for each UCITS; • verification that the general investment policy is properly implemented; • periodical approval of the adequacy of the internal procedures for investment decisions;	The directors have certain common law duties including, inter alia, the duty to act with due skill, care and diligence, duty to act honestly in the best interests of the company; The board may delegate authority to subcommittees or third parties… but, where the Board does so, it shall have mechanisms in place for monitoring the exercise of delegated functions. The Board cannot abrogate its overall responsibility; The Board shall ensure that internal control procedures of service providers are being monitored to ensure that they are effective;	The board should ensure that high standards of corporate governance are applied at all times; the board should act fairly and independently in the best interests of the investors; The board should ensure that investors are properly informed, are fairly and equitably treated, and receive the benefits and services to which they are entitled; The board should act with due care and diligence in the performance of its duties; The board should ensure that shareholder rights are exercised in a considered way and in the best interests of the fund;	AFM senior personnel responsibilities include: Implementation of the general investment policy for each scheme it manages; Overseeing the approval of investment strategies; Ensuring and verifying on a periodic basis that the general investment policy, the investment strategies and the risk limit system of each scheme it manages are properly and effectively implemented and complied with; Approving and reviewing on a periodic basis the adequacy of the internal procedures for undertaking investment decisions for each scheme it manages;	General obligations of a management company include: Manage the scheme in accordance with the scheme's constitutive documents and in the best interests of the holders. It is also expected to fulfill the duties imposed on it by the general law; Take reasonable care to ensure that the trustee/custodian is properly qualified for the performance of its duties and functions and discharging its obligations in respect of custody of a scheme's property; At all times demonstrate that those representatives and agents appointed by it or engaged for the scheme possess sufficient know-how, expertise and experience in dealing with the underlying investments of the scheme; Ensure the scheme is designed fairly, and operated according to such product design on an ongoing basis, including, among others, managing the scheme in a cost-efficient manner taking into account the size of the scheme and the level of fees and expenses etc.	A Trustee has the following duties: • duty of care: a trustee must administer trust affairs in line with the purpose of the trust; a Trustee must administer Trust affairs with the due care of a prudent manager • duty of loyalty: a Trustee must administer Trust affairs and conduct any other acts faithfully on behalf of a Beneficiary • conflicts of interest: a Trustee is not allowed to carry out acts that create conflicts of interest • duty to appoint and supervise a third party when delegating administration of Trust affairs: when delegating the administration of Trust affairs to a third party, a Trustee must delegate said administration to a suitable person in light of the purpose of a Trust • duty of equity: in the case of a Trust with two or more Beneficiaries, a Trustee must perform duties of Trustee equitably on behalf of these Beneficiaries.[24]	An officer of a registered scheme must: Act honestly; Exercise the degree of care and diligence that a reasonable person would exercise if they were in the officer's position; Act in the best interests of the members and, if there is a conflict between the members' interests and the interests of the responsible entity, give priority to the members' interests;
Compliance with laws and regulations	Ensuring compliance;	The Directors shall ensure a CIS or ManCo is run in compliance with legislation, regulations, codes of practice, guidance notes, guidelines and any other rules or directives, which are of relevance; The Board is responsible for compliance with legislation and applicable regulatory requirements and for compliance with provisions of the prospectus and constitutional documents of the applicable CIS or ManCo;	The board should ensure compliance with all applicable laws and regulations and with the fund's constitutional documents;	Ensuring that the AFM has a permanent and effective compliance function;			Take all steps that a reasonable person would take, if they were in the officer's position, to ensure that the responsible entity complies with this Act, any conditions imposed on the responsible entity's Australian financial services licence, the scheme's constitution, and the scheme's compliance plan;
Risk management	Periodical approval of the risk management policy; Sustainability factors should be taken into account by management companies as part of their duties towards investors; management companies should assess not only all relevant financial risks on an ongoing basis, but also all relevant sustainability risks.	The board is responsible for the effective and prudent oversight…and is ultimately responsible for ensuring that risk and compliance is properly managed; The board is responsible for ensuring that all applicable risks can be identified, monitored and managed at all times; ensuring that there are appropriate processes and systems in place to monitor and manage risks.	The board should ensure that an effective risk management process and appropriate internal controls are in place.	Approving and reviewing on a periodic basis the risk management policy and arrangements, processes and techniques for implementing that policy;	Put in place proper risk management and control systems to effectively monitor and measure the risks of the positions of the scheme and their contribution to the overall risk profile of the scheme's portfolio;		
Other					Maintain or cause to be maintained the books and records of the scheme and prepare the scheme's financial reports. These reports must be prepared and made available to all registered holders and filed with the Commission.	Duty to separate property: a Trustee must separate property that comes under Trust property from property that comes under Trustee's own property and that which comes under Trust property of other Trusts. Duty to report on processing status of administration of Trust affairs: a settlor or a beneficiary may request a Trustee to report on the processing status of administration of Trust affairs as well as the status of property that comes under Trust property and the obligation covered by the Trust property. Duty to prepare, report on, and retain books: a Trustee must prepare books and other documents or electronic or magnetic records relating to the Trust property, in order to clarify the accounts on Trust affairs as well as the status of property that comes under Trust property and the obligation covered by the Trust property.	Not make use of information acquired through being an officer of the responsible entity; Not make improper use of their position as an officer to gain, directly or indirectly, an advantage for themselves or any other person or to cause detriment to the members of the scheme.

Appendix 2: Regulations overview

Exhibit 14: Sustainability-related fund requirements and classifications across selected jurisdictions

Requirements	UK	EU Sustainability Regime (SFDR/Taxonomy)	Hong Kong	Japan	Australia
Standardised sustainability definitions	Sustainable investment means an investment in an economic activity that contributes to an environmental objective, as measured, for example, by key resource efficiency indicators… or an investment in an economic activity that contributes to a social objective… or an investment in human capital or economically or socially disadvantaged communities, provided that such investments do not significantly harm any of those objectives, and that the investee companies follow good governance practices.[2] The EU taxonomy is a classification system, establishing a list of environmentally sustainable economic activities.[3]	Sustainable – products that pursue specific sustainability characteristics, themes or objectives alongside delivering a financial return.[16]	Funds which incorporate ESG factors as their key investment focus and reflect such in the investment objective and / or strategy.[18]		
Sustainability-related fund naming conventions		It is essential that funds marketed with a sustainability and ESG focus describe their investment strategies clearly and any assertions made about their goals are reasonable and substantiated; A fund's s focus on ESG/sustainability should be reflected consistently in its name, stated objectives, its documented investment policy and strategy, and its holdings; References to ESG/sustainability in a fund's name, financial promotions or fund documentation should fairly reflect the materiality of ESG/sustainability considerations to the objectives and/or investment policy and strategy of the fund.[17]	A product's name shall not be misleading; an ESG fund's primary investments and/or strategy should reflect the particular ESG focus which the fund name represents.[18]	When assigning names such as 'ESG', 'SDGs' and 'impact' to the funds it is necessary to explain and disclose more clearly how the products meet the characteristics implied by the names so that customers do not misunderstand the meaning of the names.[24]	General prohibitions of misleading and deceptive statements and conduct include: • false or misleading statements;[15] • dishonest conduct;[15] • misleading or deceptive conduct in relation to a financial product[15] • misleading or deceptive conduct;[19] • false or misleading representations[19]
Fund classifications based on sustainability characteristics of funds		SDR proposals outline the following sustainable fund categories: • products not promoted as sustainable; • responsible products (which may have some sustainable investments); • transitioning ((sustainable characteristics, themes or objectives; low allocation to UK taxonomy-aligned sustainable activities); • aligned (sustainable characteristics, themes or objectives; high allocation to UK taxonomy-aligned sustainable activities); impact (objective of delivering positive environmental or social impact).[16]			

Appendix 2: Regulations overview

Exhibit 15: Product-level sustainability disclosure requirements

Requirements	EU Sustainability Regime (SFDR/Taxonomy/UCITS Amendments)	United Kindom	Hong Kong	Japan	Australia
Pre-contract product disclosures	SFDR Art 6 (all funds): • the manner in which sustainability risks are integrated into investment decisions; • the results of the assessment of the likely impacts of sustainability risks on the returns of the financial product. • If the financial market participant deems sustainability risks not relevant, the disclosure should include a clear and concise explanation as to why.[20] SFDR Art 8 (funds promoting environmental/social characteristics): • description of the environmental or social characteristics promoted by the products; • sustainability indicators used to measure the attainment of these characteristics; • investment strategy and asset allocation approach; • if there is a designated index, whether and how this index is consistent with those characteristics, and where the index methodology can be located; • whether the fund assesses the adverse impacts of its investments on sustainability factors;[20] FDR Art 9 (funds with a sustainable investment objective): • description of the sustainable investment objective; • indicators used to measure attainment of that objective; • investment strategy and asset allocation approach; • if no designated reference benchmark, an explanation on how the objective is to be attained; • if an index has been designated, information on how the index is aligned with the objective; • consideration of the principal adverse impacts on sustainability factors;[20] In addition, if an Article 8/9 fund promotes environmental characteristics/contributes to an environmental objectives, the EU Taxonomy adds the following requirements: • environmental objectives/objectives to which the fund contributes (or environmental characteristics which the fund promotes); • how and to what extent the underlying investments qualify as environmentally sustainable for the purposes of the Taxonomy & the proportion of environmentally sustainable investments.[3]	TCFD product reports must include the following information: • carbon emissions (scope 1, 2,3 GHG emissions, total carbon emissions, total carbon footprint, weighted average carbon intensity); • where a TCFD product report relates to a TCFD product that has concentrated exposers or high exposures to carbon intensive sectors, the firm must describe those and disclose a qualitative summary of the likely impact of the 'orderly transition', 'disorderly transition' and 'hothouse world' scenarios on the underlying assets; • climate value-at-risk; • metrics that show the climate warming scenario with which a TCFD product is aligned.[24] References to ESG (or related terms) in a fund's financial promotions or fund documentation should fairly reflect the materiality of ESG/sustainability considerations to the objectives and/or investment policy and strategy of the fund.[17] The proposals for retail investor-focused disclosures include: • the investment product label, • the objective (including specific sustainability objectives), • investment strategy pursued to meet the objective (including sustainability objectives), • the proportion of assets allocated to sustainable investment (according to the UK Taxonomy), • stewardship approach, • sustainability metrics.[16]	An ESG fund should disclose the following in the offering documents: • the ESG focus of the fund (a description of the fund's ESG focus & a list of ESG criteria used to measure the attainment of the fund's ESG focus); • the ESG investment strategy (a description of the investment strategy adopted by the ESG fund & a summary of the process of consideration of ESG criteria); • asset allocation (the expected or minimum proportion of securities or other investments that are commensurate with the fund's ESG focus); • reference benchmark; An ESG fund should disclose the following additional information: • how the ESG focus is measured and monitored throughout the lifecycle of the ESG fund and the related control mechanisms; • methodologies adopted to measure ESG focus; • due diligence carried out in respect of the ESG-related attributes of the fund's assets; • engagement policies; • sources and processing of ESG data.[18]	If the fund's name includes "ESG" or "SDGs", disclosures on how the fund satisfies these designations using specific metrics.[21] The following is also recommended: • appropriate information provision and disclosure should be promoted in a consistent manner that conforms to the investment process • a firm should strive to enhance disclosure of its policies and initiatives by, for example, explaining its basic ESG approach ESG integration, engagement policies and specific examples in its sustainability report or responsible investment report • the characteristics and investment process of ESG funds should be adequately disclosed in the prospectus • where a firm invests in a company considering ESG factors based on the investment process described in the prospectus, efforts should be made to enhance disclosure, not only through investment reports and monthly reports, but also by using other documents so that the firm can explain in detail 'how the corporate value of investees is currently evaluated based on ESG factors' and 'what engagement and voting rights are exercised toward improving the corporate value of investments based on ESG factors, as well as future policies'.	A Product Disclosure Statement must include the following statements, and such of the following information as a person would reasonably require for the purpose of making a decision, as a retail client, whether to acquire the financial product (...) if the product has an investment component – the extent to which labour standards or environmental, social or ethical considerations are taken into account in the selection, retention or realisation of the investment.[15] A product issuer must disclose if labour standards or environmental, social or ethical considerations are taken into account in selecting, retaining and realising an investment; the extent to which these standards and considerations are taken into account in selecting an investment, including methodology and any weighting system used; a description of the retention and realisation policies.[22]
Periodic product disclosures	SFDR Article 8 (funds promoting environmental/social characteristics): • the extent to which the fund met the environmental or social characteristics; • the top investments of the fund; • the proportion of sustainability-related investments; • actions that have been taken to meet the environmental or social characteristics during the reference period.[20] SFDR Art 9 (funds with a sustainable investment objective): • the extent to which the sustainable investment objective of the fund was met; • the top investments of the fund; • the proportion of sustainability-related investments; • actions that were taken to attain the sustainable investment objective during the reference period.[20]	Pre-contractual and ongoing periodic disclosures on responsible or sustainable investment funds should be easily available to consumers and contain information that helps them make investment decisions.[17]	An ESG fund should conduct periodic assessment, at least annually, to assess how the fund has attained its ESG focus. The fund should disclose the following information about its periodic assessment: • how the fund has attained its ESG focus during the assessment period (including the proportion of underlying investments that are commensurate with the fund's ESG focus; • the proportion of the investment universe that was eliminated or selected as a result of the fund's ESG-related screening; • a comparison of the performance of the fund's ESG factors against the designated reference benchmark; • actions taken by the fund in attaining the fund's ESG focus; • any other necessary information).[18]		

Endnotes

1. *Morningstar (2022) Morningstar Global Sustainable Fund Flows: Q2 2022 in Review.*
2. *'Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector' (2019) Official Journal of the European Union, L 317.*
3. *'Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088' (2020) Official Journal of the European Union, L 198.*
4. *https://dcif.co.uk/giving-millennials-the-responsible-investments-they-want-2/*
5. *Please note that this summary is provided for illustrative purposes only. Please see relevant EU regulation for current requirements, such as REGULATION (EU) 2019/2088 Article 6, 8 and 9 as well as relevant regulatory technical standards (RTS) relating to this regulation.*
6. *Financial Conduct Authority (2021) Enhancing climate-related disclosures by asset managers, life insurers and FCA-regulated pension providers (PS21/24).*
7. *Please note that this simplification aims to allow for a discussion of the practical impacts of sustainable investment fund requirements across the various jurisdictions considered in this report. Please note that detailed consideration of how specific regulation and laws apply to AFMs vs. fund boards is out of scope of this report and fund board directors should seek legal and compliance advice if and where required.*
8. *Financial Conduct Authority (2021) Enhancing climate-related disclosures by asset managers, life insurers and FCA-regulated pension providers (PS21/24).*
9. *'Commission Delegated Directive (EU) 2021/1270 of 21 April 2021 amending Directive 2010/43/EU as regards the sustainability risks and sustainability factors to be taken into account for Undertakings for Collective Investment in Transferable Securities (UCITS)' (2021) Official Journal of the European Union, L 277.*
10. *The Irish Funds Industry Association (2011) Corporate Governance Code for Collective Investment Schemes and Management Companies.*
11. *Association of the Luxembourg Fund Industry (2022) ALFI Code of Conduct for Luxembourg Investment Funds.*
12. *Financial Conduct Authority, FCA COLL Collective Investment Schemes Sourcebook.*
13. *Securities & Futures Commission of Hong Kong (2019) SFC Handbook for Unit Trusts and Mutual Funds, Investment-Linked Assurance Schemes and Unlisted Structured Investment Products.*
14. *The Trust Act 2006 (Japan).*
15. *Corporations Act 2001 (Australia).*
16. *Financial Conduct Authority (2021) Sustainability Disclosure Requirements (SDR) and investment labels (DP21/4).*
17. *Financial Conduct Authority (2021) Authorised ESG & Sustainable Investment Funds: improving quality and clarity.*
18. *Securities & Futures Commission of Hong Kong (2021) Circular to management companies of SFC-authorized unit trusts and mutual funds - ESG funds.*
19. *Australian Securities and Investments Commission Act 2001.*
20. *'Commission Delegated Regulation (EU) 2022/1288 of 6 April 2022 supplementing Regulation (EU) 2019/2088 of the European Parliament and of the Council with regard to regulatory technical standards specifying the details of the content and presentation of the information in relation to the principle of 'do no significant harm', specifying the content, methodologies and presentation of information in relation to sustainability indicators and adverse sustainability impacts, and the content and presentation of the information in relation to the promotion of environmental or social characteristics and sustainable investment objectives in pre-contractual documents, on websites and in periodic reports' (2022) Official Journal of the European Union, L 196.*
21. *Financial Services Agency (2021) Report by the Expert Panel on Sustainable Finance: Building A Financial System that Supports a Sustainable Society.*
22. *Australian Securities & Investments Commission (2011) RG 65 Section 1013DA disclosure guidelines.*
23. *Financial Conduct Authority, FCA ESG Environmental, Social, and Governance Sourcebook.*
24. *Financial Services Agency (2022) Progress Report on Enhancing Asset Management Business 2022 (Summary).*