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ESG INVESTING TEAM

Building Momentum: 2024 Outlook for ESG Regulation

After a year of burgeoning regulatory development, we assess what may come next

Many governments across the world have recognized that their net-zero targets cannot be achieved without robust policy and regulatory frameworks. Some have also realized that sustainability is not only about climate, and are therefore paying increasing attention to the way companies behave on other material ESG issues, including their interactions with nature, stakeholders along the supply chain, and their own workers. In the meantime, the rapid increase in investor demand for ESG-related strategies and investment products has highlighted the need for new rules to ensure transparency around sustainability claims and protect investors from greenwashing.

The European Union has traditionally been at the forefront of these efforts, with its ground-breaking 2018 Sustainable Finance Action Plan setting the pace for other jurisdictions looking to reorient capital flows toward a more sustainable economy, manage financial risk stemming from climate change, and promote corporate transparency on sustainability issues and "long-termism". As policymakers in Asia, the U.S., Latin America and elsewhere consider their own frameworks, investors and companies alike grapple with this evolving and complex web of ESG-related regulatory requirements.

In this *Insights*, we take stock of what global policymakers developed in 2023 to deliver on their net-zero commitments and other sustainability-related goals and in response to the spike in investor demand. More importantly, we seek to provide some guidance on what we believe is in store for an equally crucial 2024.

Taking Stock of 2023

Fund disclosure requirements continue to challenge asset managers

2023 was a landmark year for ESG policy and regulation. Throughout the year, investors continued to navigate existing and upcoming required fund disclosure, labelling and naming frameworks.

In recognition that the Sustainable Finance Disclosure Regulation (SFDR) requires further improvements, last year the European Commission launched a review of the SFDR Level 1 framework to consider whether a labelling regime would be more appropriate than the current disclosure requirements. Any potential changes to the pillars of SFDR in the context of the Level 1 review will only materialize a few years after the 2024 European elections, considering EU legislation takes from 16 to 24 months on average to be adopted.[1] In the meantime, to the confusion of many market participants, the European Supervisory Authorities proposed shorter-term technical changes to the Level 2 rules of the framework, including on Principal Adverse Impact indicators, the Do No Significant Harm test, and other key areas.

On the other side of the English Channel, to close 2023 with a flourish, the U.K.'s Financial Conduct Authority released its much-awaited final Sustainable Disclosure Requirements (SDR) rule at the end of November. In contrast with SFDR, the new rule introduces a labeling regime from the outset, and addresses key comments raised by the industry on the draft version of the rule, including on the criteria for the "impact" label, the definition of sustainable investments, and others. For the foreseeable future, the application of SDR labels will, however, be limited to U.K.-domiciled funds, excluding a considerable number of overseas funds that make sustainability claims but are domiciled outside of the U.K. As a result, once the rule is fully implemented, U.K.-domiciled funds holding SDR labels will co-exist with overseas funds potentially claiming alignment with a different framework (e.g., SFDR Article 8 or 9).

ESG data is about to get better

It is no secret that a recurring concern of investors that consider ESG factors as part of their investment processes has been the lack of high-quality and actionable ESG data from companies. The growing importance of sustainability reporting standards for companies has therefore been a welcome development in the last year, with the International Sustainability Standards Board (ISSB) adopting its climate and general sustainability standards, and specific countries and regions starting to develop their own mandatory reporting requirements. Together with the adoption of the EU's Corporate Sustainability Reporting Directive and its accompanying European Sustainability Reporting Standards (ESRS), we believe these are positive steps toward improving the availability of ESG data.

Unfortunately, differences have already emerged between jurisdictions—both in terms of their selected approach to materiality (financial vs. double materiality[2]) and regarding the ESG topics that fall into scope of disclosure (climate only vs. a broader set of sustainability-related items). As a result, depending on their location, companies may need to adapt company reporting to accommodate jurisdictional-based requirements. The good news is that the more jurisdictions build on the ISSB's global baseline, the more companies and investors will have a common understanding of definitions and fundamental disclosures.

As other reporting standards emerge, including potential nature-related disclosure standards from the Taskforce on Nature-related Financial Disclosures, we hope that the ISSB continues to play a role in seeking to avoid international fragmentation and focusing on financial materiality.

As active investors, we believe engaging with investee companies on their sustainability reporting and supporting them in their journey to implement ISSB standards will be crucial in the coming years. Given that ISSB standards build on the pillars of the Task Force on Climate-related Financial Disclosures (TCFD) recommendations, there is an opportunity for companies to leverage their TCFD report to comply voluntarily with ISSB. The ISSB standards also refer to the Sustainability Accounting Standards Board (SASB) standards, and therefore companies already using SASB to identify financially material ESG topics could build on these disclosures to report on ISSB standards.

[1] European Parliament, Mid-term Activity Report 1 July 2019 – 31 December 2021 (9th parliamentary term).

[2] According to the ESRS, "double materiality" has two dimensions: impact materiality and financial materiality. Impact materiality refers to impacts on people or the environment; financial materiality refers to information that is material for primary users of general-purpose financial reports in making decisions relating to providing resources to the entity.

Regional progress: It's not just about the EU anymore

Given the impact of this ever-changing regulatory landscape, we recognize that investors and companies are paying close attention to developments on a global scale. To assess the progress of each region's sustainable finance frameworks, we have identified nine types of ESG regulatory initiatives, ranging from reporting and disclosures to labels, ratings and others. Progress is categorized as follows:

- Adopted: ESG legislative or regulatory requirements that are currently applicable in the region.
- In progress: ESG legislative or regulatory requirements currently under development, meaning a white paper, a roadmap, a public consultation, or a legislative/regulatory proposal has been published on the subject in the region.
- No requirements: Based on the nine types of possible ESG requirements that we have identified, this refers to areas where no regulatory or legislative action has been taken.

The following displays illustrate the diverging areas of focus and the speed at which global policymakers and regulators are building their regulatory frameworks.

Regional Progress of ESG Requirements: Americas

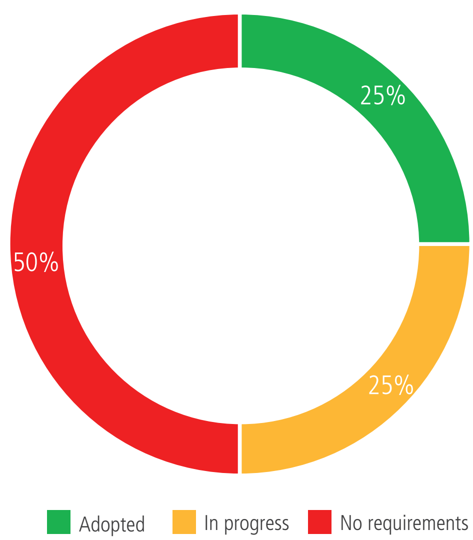
Jurisdiction	Corporate reporting	Fund disclo-sures	Taxonomy	Due diligence	Labeled bonds	ESG ratings	Sustain-ability risks/ preferences	Central bank climate policy	Bio diversity disclo-sures
U.S.	⌛	⌛	✗	✓	✗	✗	⌛	⌛	✗
Canada	⌛	✓	⌛	⌛	✗	✗	✗	⌛	✗
Colombia	✗	✓	✓	✗	✓	✗	✓	✓	✗
Brazil	✓	✗	✓	✗	✗	✗	✗	⌛	✗

Key ✓ Adopted (legislation published) ⌛ In progress ✗ No requirements

Tensions in the U.S. are increasing ahead of the 2024 presidential election, but other regions endorse ISSB standards.

- The politization of ESG in the U.S. has led to delays in the publication of ESG fund disclosure and climate-related disclosure rules by the Securities and Exchange Commission. The ESG backlash persists, and the elections in November 2024 will lead to increased commentary, pressures and the potential introduction of anti-ESG bills.
- However, in the meantime, the U.S. Inflation Reduction Act, which marked its first anniversary in August 2023, is driving investment in clean energy with a broad range of tax incentives. A total of 280 clean energy projects have been announced across 44 U.S. states in its first year, representing $282 billion of investment.[1]
- ESG policy and regulatory discussions seem to be gaining traction in Canada and Latin America, with the former now assessing the introduction of reporting standards based on the ISSB baseline. In Latin America, Brazil has been the first country to announce the adoption of International Sustainability Standards Board, which will become mandatory by 2026.

ESG REGULATION PROGRESS



[1] Goldman Sachs, as of October 31, 2023.

Regional Progress of ESG Requirements: Europe

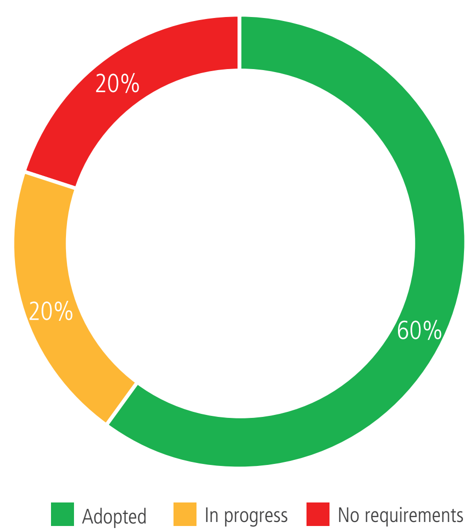
Jurisdiction	Corporate reporting	Fund disclo-sures	Taxonomy	Due diligence	Labeled bonds	ESG ratings	Sustain-ability risks/ preferences	Central bank climate policy	Bio diversity disclosures
EU	✓	✓	✓	⌛	✓	⌛	✓	✓	✓
France	✓	✓	✓	✓	✓	⌛	✓	✓	✓
Germany	✓	✓	✓	✓	✓	⌛	✓	✓	✓
Switzerland	✓	✓	✗	✗	✗	✗	✗	✗	✗
U.K.	✓	⌛	⌛	⌛	✗	⌛	⌛	✓	✗

Key ✓ Adopted (legislation published) ⌛ In progress ✗ No requirements

The EU is focusing on enhancing company reporting and has launched consultation of the SFDR, but progress in the U.K. has been slower than expected

- The EU continues to implement its Sustainable Finance Action Plan through:
  - The implementation of the Corporate Sustainability Reporting Directive
  - The adoption of rules for ESG ratings providers
  - The review of the Sustainable Finance Disclosure Regulation requirements
- Further, the Corporate Sustainability Due Diligence Directive, currently under negotiation, may require companies to demonstrate their actions to protect the environment and human rights. It is unclear whether asset managers will fall under the scope of the directive.
- Beyond financial services regulation, the EU continues to work on broader green finance initiatives under the Green Deal Industrial Plan, including the Net Zero Industry Act and the Critical Raw Materials Act.
- In the meantime, green policy continues to progress in the U.K., including proposals on sustainable disclosures, ESG ratings and the potential adoption of the ISSB reporting framework.

ESG REGULATION PROGRESS



Regional Progress of ESG Requirements: Asia-Pacific (APAC)

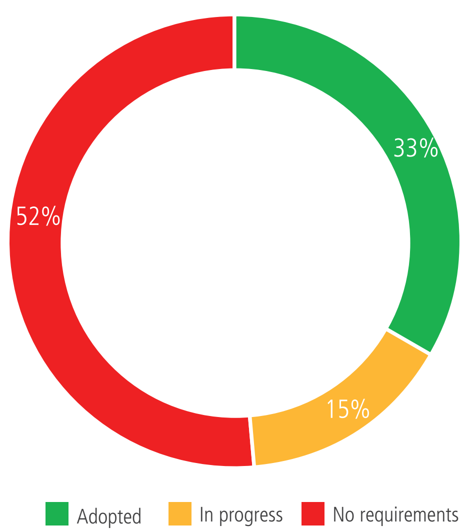
Jurisdiction	Corporate reporting	Fund disclo-sures	Taxonomy	Due diligence	Labeled bonds	ESG ratings	Sustain-ability risks/ preferences	Central bank climate policy	Bio diversity disclosures
ASEAN	✗	✗	✓	✗	✓	✗	✗	✗	✗
Australia	⌛	✓	⌛	✗	✗	✗	✗	✗	✗
China	⌛	⌛	✓	✗	✓	✗	✗	✗	✗
Hong Kong	✓	✓	⌛	✗	✗	⌛	✓	✗	✗
India	✓	✓	⌛	✗	✓	✓	✗	⌛	✗
Japan	✓	✓	✗	✓	✗	✓	✗	⌛	✗
Singapore	✓	✓	⌛	✗	✓	⌛	✓	✓	✗
Taiwan	✓	✓	⌛	✗	✗	✗	✓	✗	✗

Key | ✓ Adopted (legislation published) ⌛ In progress ✗ No requirements

APAC is moving quickly on sustainability-related reporting and Australia has announced potential fund labelling regime

- ESG reporting rules continue to evolve in Asia, with regulators striving to close the fund and corporate disclosure gap with Europe. To that end, a number of new proposals aim to raise the bar for sustainability-related reporting through the adoption of the ISSB standards (e.g., Hong Kong, Japan, Singapore and Australia).
- Asia is also moving fast on proposing regulation or codes of conduct to improve the transparency and good governance of ESG ratings, including in Hong Kong, India, Singapore and Japan.
- Finally, Australia published its much-awaited Sustainable Finance Strategy for stakeholder consultation, including a potential labelling regime for sustainable funds.

ESG REGULATION PROGRESS



What to Expect in 2024

Despite the progress made during 2023, we believe 2024 will see continued adoption of ESG-related regulation, including sustainable finance frameworks that will test the ability of asset managers, investors and companies to respond effectively to evolving and new requirements.

In particular, a number of currently unresolved issues should gain clarity in the new year, including:

- ESG disclosure and/or labeling by investment advisers and funds in the U.S., Australia and the EU
- Sustainability reporting requirements for operating companies in the U.S. and a few APAC jurisdictions
- A final EU rule for funds with ESG names
- Rules and standards across jurisdictions on ESG rating providers

In addition, a trend we see as positive and that is likely to continue is the increasing regulatory efforts to consider the role of sustainable finance in supporting transitioning companies in their journeys to net zero. This is reflected in the work that some jurisdictions are doing to provide frameworks for credible transition planning (e.g., the U.K. and Singapore), the development of sectoral pathways for companies (e.g., the EU), and the adoption of transition taxonomies (e.g., the Singapore-Asia Taxonomy).

As an active investor, we welcome this growing focus on providing forward-looking metrics and objectives which, in conjunction with investor engagement and stewardship, and believe it could lead to the achievement of real-world decarbonization and the ability of investors to better assess companies' net-zero alignment. While traditional measures such as carbon footprint and carbon intensity are useful in that they are comparable across companies and portfolios, we believe there are major pitfalls associated with relying heavily on them for net-zero alignment assessments. For this reason, we have created the Neuberger Berman Net-Zero Alignment Indicator, which, building on the Net-Zero Investment Framework of the Institutional Investors Group on Climate Change, considers quantitative forward-looking data as well as real-time qualitative inputs from specialist research analysts to assess companies' net-zero alignment statuses independently.

The table below contrasts how some jurisdictions are only at the beginning of their efforts to implement ESG-related regulation while others work to finalize frameworks and even begin the process of reviewing existing rules.

Progress in 2023 vs. Expectations for 2024

Topic	2023 Progress	2024 Expectations
Corporate reporting	**Global:** International Sustainability Standards Board (ISSB) making progress: >12 jurisdictions working on adopting standards. **Europe:** EU CSRD Corporate Sustainability Reporting Directive (CSRD) and European Sustainability Reporting Standards (ESRS) adopted. **U.S.:** California Climate Disclosure Bills adopted. **China:** Chinese State-owned Assets Supervision and Administration Commission of the State Council (SASAC) guideline on ESG disclosure for Central State-Owned Companies (SOEs) adopted.	**Global:** Companies to start reporting on ISSB on a voluntary basis in 2024. More countries to endorse and begin implementing the standards through legislation. **Europe:** CSRD companies required to report in 2025 to start preparing their reports in 2024. Companies to report in 2026 (i.e. NBAMIL may be captured) to begin materiality assessments. **U.S.:** SEC to publish its final Climate Disclosure rule. **China:** Chinese SOEs to begin reporting on certain indicators.
Fund disclosures	**Europe:** EU Commission published consultation on Level 1 SFDR changes to explore a potential labelling system. These Level 1 fundamental changes will not be effective before 2027. European Supervisory Authorities (ESAs) also published Level 2 changes on shorter term technical changes to SFDR. **U.K.:** Financial Conduct Authority (FCA) published its final Sustainability Disclosure Requirements (SDR) for funds. **U.S.:** Securities and Exchange Commission (SEC) adopted Names Rule but postponed the publication of its ESG Fund Disclosure rule.	**Europe:** EU Commission to continue stakeholder consultation on SFDR Level 1, but clarity on the nature of the future regime not expected until later. **Europe:** EU Commission to approve ESAs proposed Level 2 changes. **U.K.:** FCA SDR rules enter into force. **U.S.:** SEC to publish final ESG Fund Disclosure rule. **Global:** In addition to above, new fund disclosure rules or labels to be explored in: Australia, Japan, etc.
ESG ratings	**Europe:** EU and U.K. working on legislation to regulate ESG ratings providers. **Global:** Codes of Conduct for providers adopted in the U.K., Singapore, Hong Kong, India, etc.	**Europe:** EU and U.K. legislation on ESG ratings providers to be finalized. **Global:** Adoption of Codes of Conduct in other jurisdictions.
Due diligence	**Europe:** EU Corporate Sustainability Due Diligence Directive (CSDDD) being negotiated by EU policymakers. Agreement to exclude financial services industry.	**Europe:** EU countries to transpose CSDDD into national frameworks and companies to prepare for implementation.
Biodiversity disclosures	**Global:** Taskforce for Nature-related Financial Disclosures (TNFD) published its final reporting recommendations. **Global:** ISSB consulted on whether biodiversity should be its next standard.	**Global:** ISSB to confirm whether it will be adopting a biodiversity standard. **Global:** TNFD recommendations to inspire disclosure requirements in jurisdictions. **Global:** 153 signatories of the Biodiversity Pledge to report biodiversity targets.
Other: transition frameworks	**Europe:** European Commission published guidance on Transition Finance for companies and investors. **Singapore:** Singapore published consultation on guidance for managers. **Australia:** Treasury announces plans for legislative reform under the new Sustainable Finance Strategy.	**Europe:** EU to publish transition pathways per sector. **Singapore:** Singapore to publish guidance on transition planning for managers. **Australia:** Treasury to provide next steps on guidance/rules on transition planning for companies.

In this ever-changing landscape, Neuberger Berman continues to engage on emerging ESG regulations and standards to help our clients and the companies in which we invest navigate these complex frameworks.

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