Despite DOL Proposed Rule, ESG Investing Faces Barriers

By **William Pollak** (December 14, 2021)


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On Oct. 14, the U.S. Department of Labor published a proposed rule titled Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights.[1] It permits retirement plan fiduciaries to consider climate change and other environmental, social and governance factors when selecting investments and exercising shareholder proxies.

The DOL's action has been hailed by social and environment activists as a momentous development but, as discussed further below, the potential impact may be reduced by retirement plan fiduciaries' cautiousness in the face of the recent flood of Employee Retirement Income Security Act litigation.[2]

The 2020 DOL Regulation

The DOL's proposed rule is a stark departure from several controversial DOL regulations issued in 2020, at the end of the Trump administration. In June 2020, the DOL published a proposed regulation that required plan fiduciaries to select investments "based solely on financial considerations relevant to the risk-adjusted economic value."[3]

The preamble to the proposed rule expressed skepticism of the value of ESG factors and specifically explained that the

> proposed regulation is designed in part to make clear that ERISA plan fiduciaries may not invest in ESG vehicles when they understand an underlying investment strategy of the vehicle is to subordinate return or increase risk for the purpose of non-pecuniary objectives.[4]

While the final 2020 regulation, Financial Factors in Selecting Plan Investments, omitted any explicit discussion of ESG factors, it retained the requirement that investment decisions must be based solely on pecuniary factors.

It defined such factors as those "expected to have a material effect on the risk and/or return of an investment based on appropriate investment horizons consistent with the plan's investment objectives and the funding policy."[5]

The rule permitted the consideration of nonpecuniary factors only as a tiebreaker if the two investments were otherwise indistinguishable — when the fiduciary is "unable to distinguish [among investment alternatives] on the basis of pecuniary factors alone" — and required extensive documentation around such decisions.[6]

In addition, the final regulation included a prohibition against using funds that consider nonpecuniary factors as a retirement plan's qualified default investment alternative, or QDIA.[7]

Thus, as the DOL later acknowledged: "Many stakeholders have indicated that the [2020] rules have been interpreted as putting a thumb on the scale against the consideration of ESG factors, even when those factors are financially material."[8]

Shortly thereafter, the DOL issued a second rule confirming that fiduciaries making proxy voting decisions "must act solely in accordance with the economic interest of the plan and its participants" and may not push nonpecuniary benefits or goals unrelated to the financial interests of plan participants.[9]

In the preamble to the final rule, the DOL again emphasized that "use of plan assets by fiduciaries to further policy-related or political issues, including ESG issues, through proxy resolutions" would be inappropriate even if it did not decrease the value of the plan's investment.[10]

Commentators generally interpreted this rule as suggesting additional scrutiny of proxy voting that took ESG factors into consideration.

The 2020 regulations were in effect for only a few months before the newly elected Biden administration announced, in March 2021, that it was reexamining the 2020 ESG regulations and would not enforce them.[11]

2021 Proposed Rule Removes Barriers to Considering ESG Factors

Following an executive order from the Biden administration,[12] on Oct. 14 the DOL announced a proposed rule[13] that reversed course from the Trump administration and made it easier for retirement plans to add investment options based on ESG factors.

The proposed rule contains five key changes:[14]

1. It explicitly recognizes that ESG factors are appropriate investment considerations and evaluating the projected return of a portfolio "may often require an evaluation of the economic effects of ... ESG factors on the particular investment or investment course of action."[15]

2. It replaces the pecuniary factors standard of the 2020 rule with a new test that requires a fiduciary's decision to "be based on risk and return factors that the fiduciary prudently determines are material to investment value."[16] The proposed rule also describes three categories of ESG factors, which may be material to the risk-return analysis.[17]

3. It revises the tiebreaker test to indicate that nonpecuniary factors can be considered where investment courses of action equally serve the plan's financial interests, which has generally been interpreted as broader in scope than the 2020 regulation's requirement that the two investments be indistinguishable. In addition, the proposed rule eliminates many of the more onerous documentation requirements.

4. It removes the prohibition on QDIAs that use nonfinancial factors.[18]

5. It rescinded the new language added in the 2020 revisions that suggested a heightened scrutiny of ESG-related proxy votes.[19]

While the new regulation was touted by many commentators as a sea change, the DOL carefully drafted the proposed regulation to retain the traditional framework and reframed ESG factors as pecuniary considerations.[20]

Indeed, the DOL suggested that fiduciaries should analyze ESG factors through the lens of the effect that they can have on financial performance. In fact, the proposal's preamble points out that in many cases, ESG factors are material, and oftentimes fiduciaries should consider such factors when assessing investment risks and returns.[21]

In support of this position, the DOL cited "research and investment practices suggesting that climate change and other ESG factors are material economic considerations."[22] Although the topic is hotly debated, there is support for the view that ESG factors can affect both risks and returns and, thus, should be a valid metric that fiduciaries can consider.

For example, Institutional Shareholder Services Inc. studied U.S. companies with a market capitalization above $250 million between 2013 and 2019, and concluded in a 2019 report that "high ESG performance is generally positively related to valuation and profitability and negatively correlated with volatility."[23]

And, as BlackRock Inc. Chief Executive Officer Larry Fink highlighted in his 2021 letter to clients:

> Over the course of 2020, we have seen how purposeful companies with better environmental, social, and governance (ESG) profiles have outperformed their peers. ... This outperformance was even more pronounced during the first quarter downturn, another instance of sustainable funds' resilience that we have seen in prior downturns.[24]

Potential Impacts of the Proposed DOL Rule

The proposed DOL rule has been praised by environmental and social justice activists who believe that the changes will encourage a significant flow of 401(k) assets into ESG funds.[25]

There are reasons to believe that they may be right — while ESG funds have significantly increased in popularity over the last decade,[26] retirement plans have generally remained on the sidelines and, according to one study, only a small fraction of retirement plans have ESG options.[27]

The DOL's proposed rule may encourage more plan sponsors to start offering ESG investments.

For example, shortly after the DOL issued the proposed regulation, Morningstar Inc. announced that it intended to offer the Morningstar ESG Pooled Employer Plan,[28] which it touted as the first pooled employer plan for the industry that would be intentionally designed to limit exposure to ESG risks, dependent on final guidance from the DOL.[29]

Moreover, according to a recent report from Cerulli Associates, investment advisers expect to add an ESG investment option to the plan menu for nearly one-quarter of their defined contribution plan clients.[30]

Given the approximately $7 trillion in 401(k) plan assets,[31] there could be a meaningful impact from the DOL's proposed regulation if even a small percentage of plan sponsors begin including an ESG option in plan lineups, shifting the QDIA to an ESG fund, or voting their proxies in accord with ESG principles.

Impediments to Wider Adoption of ESG Investing

Several factors, however, may limit a shift to ESG investments by 401(k) plan fiduciaries.

First, some fiduciaries may be reluctant to make a significant change to their plan's investment lineup or QDIA given the DOL's flip-flop over the last year and the uncertainty surrounding the permanence of the current rules if a new administration is elected in 2024.

Second, in the face of extensive litigation against defined contribution plans, fiduciaries may tread carefully.

ESG funds are typically actively managed funds with higher expense ratios than passive index funds,[32] and, as a result, fiduciaries could face increased litigation risk if they retain a more expensive ESG fund that underperforms either market indices or other alternative funds.[33]

Third, certain ERISA fiduciaries may hesitate to adopt ESG investment options if they have concerns about their ability to accurately assess whether an investment is truly environmentally and socially responsible and whether ESG factors are likely to, in fact, be material to the investment's performance.

Indeed, there is an ongoing public debate surrounding the appropriate criteria for ESG investments. For example, there have been numerous reports of so-called greenwashing, whereby funds are labeled as green but, in fact, have exposure to fossil fuel companies.[34]

It can be equally difficult to measure societal impact and corporate governance consistently across industries. For example, some ESG funds have come under fire for holding large investments in tech companies given some of the recent regulatory scrutiny directed at the tech industry.[35]

And while there are a number of highly reputable third-party ESG rating services, such as Morningstar's ESG Risk Ratings,[36] most ESG risk ratings blend multiple criteria into one ESG score.

As Morningstar contributor Karen Wallace noted, this approach can make it difficult to assess companies like Tesla Inc., for example, which Morningstar gives a high rating for environmental factors, but a low social rating due to its safety risks from automated driving capabilities and a low governance rating due to its recent controversies.[37]

Indeed, while the vast majority of purported ESG funds receive high sustainability ratings from Morningstar, approximately 21 ESG funds received Morningstar's lowest ratings, suggesting that they have well-above average ESG risks.[38]

A 2019 study out of the MIT Sloan School of Management analyzed data from six prominent ratings agencies and noted that "ESG ratings from different providers disagree substantially" with correlations that range from 0.38 to 0.71.[39]

Thus, plan fiduciaries may fear that they could face litigation risk if they offer a fund in their 401(k) plan lineup that purports to be an ESG fund, but is later challenged as failing to fully satisfy that criteria.

In apparent recognition of the difficulty of obtaining consistent and high-quality information regarding ESG risks, the U.S. Securities and Exchange Commission has recently expressed an intent to increase ESG-related disclosure requirements.[40]

For example, earlier this year, the SEC's chair directed staff to evaluate the agency's "disclosure rules with an eye toward facilitating the disclosure of consistent, comparable, and reliable information on climate change."[41]

However, in a June speech at the National Investor Relations Institute's virtual conference, SEC Commissioner Elad Roisman questioned whether climate change risk is susceptible to a static set of disclosures:

> In the area of climate-related disclosures in particular, we have continuing development in scientists' projections of what physical risks we can expect climate change to present to companies and their assets on various time horizons.[42]

If the SEC continues on its current path,[43] there is optimism that increased ESG-related disclosures will make it easier for investors to more accurately assess a company's ESG risk.

It is possible, however, that enhanced disclosure requirements could also have unintended consequences.

Recent years have seen an upswing in litigation alleging that companies have exaggerated their environmentalism and enhanced ESG disclosures may result in a corresponding uptick in securities litigation.

Thus, enhanced disclosures may not save ERISA plan fiduciaries. They could find themselves subject to breach of prudence claims if they offer an ESG fund that either fails to live up to its own marketing, or invests in companies subject to litigation related to their own ESG disclosures.

In short, there is reason to believe that the new DOL regulations will accelerate the already sizable shift of assets into ESG funds, which could have many beneficial impacts.

The DOL's regulation does not, however, lessen the litigation risk faced by fiduciaries who may, accordingly, act cautiously in anticipation of future developments — such as enhanced ESG disclosure requirements, new DOL or SEC rules, or lengthier track records of ESG success — before making a change.

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[1] Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights, 86 Fed. Reg. 57272 (Oct. 14, 2021), available at https://www.federalregister.gov/documents/2021/10/14/2021-22263/prudence-and-loyalty-in-selecting-plan-investments-and-exercising-shareholder-rights.

[2] Employee Retirement Income Security Act of 1974 ("ERISA"), 29 U.S.C. 18 § 1001 et seq.

[3] 85 Fed. Reg. 39113, 39113 (June 30, 2020); https://www.govinfo.gov/content/pkg/FR-

2020-06-30/pdf/2020-13705.pdf.

[4] 85 Fed. Reg. at 39115–16 (ESG investing "has engendered important and substantial questions and inconsistencies, with numerous observers identifying a lack of precision and rigor in the ESG investment marketplace."). The proposed rule also followed an Executive Order that directed the Department to "complete a review of existing [Department] guidance on the fiduciary responsibilities for proxy voting to determine whether any such guidance should be rescinded, replaced, or modified to ensure consistency with current law and policies that promote long-term growth and maximize return on ERISA plan assets." Executive Order on Promoting Energy Infrastructure and Economic Growth (April 10, 2019), available at https://www.federalregister.gov/documents/2019/04/15/2019-07656/promoting-energy-infrastructure-and-economic-growth.

[5] Financial Factors in Selecting Plan Investments, 85 Fed. Reg. 72846, 72868 (Nov. 13, 2020), available at https://www.govinfo.gov/content/pkg/FR-2020-11-13/pdf/2020-24515.pdf.

[6] 85 Fed. Reg. at 72862. The DOL, however, "caution[ed] fiduciaries against too hastily concluding that ESG themed funds may be selected based on pecuniary factors or are not distinguishable based on pecuniary factors, thereby triggering the tie-breaking provision of paragraph (c)(2) of the final rule." 85 Fed. Reg. at 72859. Moreover, to rely on this exception, the fiduciary was required to provide extensive documentation about how the chosen non-pecuniary factors are consistent with the interests of the plan participants.

[7] 85 Fed. Reg. at 72865.

[8] 86 Fed. Reg. at 57276; see also id. at 57284 (the 2020 regulation had "a chilling effect on appropriate integration of climate change and other ESG factors in investment decisions ... including in circumstances that the current regulation may in fact allow.") This perception of the 2020 rules appears to have been influenced, in part, by the preamble of the proposed rule and by the DOL's public statements surrounding the 2020 regulations. For example, DOL Secretary Eugene Scalia, in an opinion article in The Wall Street Journal, characterized the regulation as "remind[ing] plan providers that it is unlawful to sacrifice returns, or accept additional risk, through investments intended to promote a social or political end." Eugene Scalia, Retirees' Security Trumps Other Social Goals, THE Wall Street Journal (June 23, 2020).

[9] Fiduciary Duties Regarding Proxy Voting and Shareholder Rights, 85 Fed. Reg. 81658, 81666 (Dec. 16, 2020), available at https://www.federalregister.gov/documents/2020/12/16/2020-27465/fiduciary-duties-regarding-proxy-voting-and-shareholder-rights.

[10] 85 Fed. Reg. 81665.

[11] See U.S. Department of Labor Statement Regarding Enforcement of its Final Rules on ESG Investments and Proxy Voting by Employee Benefit Plans, U.S. Department of Labor (March 10, 2021), available at https://www.dol.gov/sites/dolgov/files/ebsa/laws-and-regulations/laws/erisa/statement-on-enforcement-of-final-rules-on-esg-investments-and-proxy-voting.pdf.

[12] Executive Order 14030 (May 20, 2021) available at https://www.federalregister.gov/documents/2021/05/25/2021-11168/climate-related-financial-risk (directing the Secretary of Labor to "identify agency actions that can be taken

under ERISA ... to protect the life savings and pensions of United States workers and families from the threats of climate-related financial risk").

[13] https://www.federalregister.gov/documents/2021/10/14/2021-22263/prudence-and-loyalty-in-selecting-plan-investments-and-exercising-shareholder-rights.

[14] These five changes are discussed in more detail in prior articles by this publication, including Elizabeth Goldberg, Julie Stapel, and Lance Dial, DOL Proposal Signals Relaxed Rules for ESG Investing, Law360, available at https://www.law360.com/articles/1433645.

[15] 86 Fed. Reg. at 57276.

[16] Id. at 57278.

[17] The proposed rule describes the following three categories as examples of ESG factors that may be material to a fiduciary's risk-return analysis:

- "Climate-change related factors, such as a company's exposure to the physical risks of climate change" (including the "significant economic consequences on businesses as more extreme weather damages physical assets, disrupts productivity and supply chains, and force adjustments to operations"). 86 FR at 57276–77. The proposed rule also posits that "[c]limate change is particularly pertinent to the projected returns of pension plan portfolios that, because of the nature of their obligations to their participants and beneficiaries, typically have long-term investment horizons." Id.

- "Governance factors, such as those involving board composition, executive compensation, and transparency and accountability in corporate decision-making, as well as a corporation's avoidance of criminal liability and compliance with labor, employment, environmental, tax, and other applicable laws and regulations." Id.

- "Workforce practices, including a company's progress on workforce diversity, inclusion, and other drivers of employee hiring, promotion, and retention; its investment in training to develop its workforce's skill; equal employment opportunity; and labor relations." Id.

[18] Id. at 57279–80.

[19] Acting Assistant Secretary for the DOL's Employee Benefits Security Administration, Ali Khawar, explained that "[t]he bias that the previous administration's rules created was to really favor not voting and not taking action. ... These are assets that are owned by the 401k participants and beneficiaries, and the obligation that fiduciaries have in other contexts don't stop when you're talking about proxy voting."

[20] The U.S. Supreme Court has suggested that fiduciaries should consider financial rather than non-pecuniary benefits. Fifth Third Bancorp v. Dudenhoeffer, 573 U.S. 409 (2014); see also 29 CFR § 2550.404a-1 (the DOL's "investment duties" regulation sets forth a

similar framework).

[21] Acting Assistant Secretary for the DOL's Employee Benefits Security Administration Ali Khawar noted that "[w]hat we are doing with our proposal today is confirming our belief that ESG factors and proxy voting, depending on the context, can be justified as financially material." He explained that "[a] principal idea underlying the proposal is that climate change and other ESG factors can be financially material and, when they are, considering them will inevitably lead to better long-term risk-adjusted returns, protecting the retirement savings of America's workers."

[22] 86 FR at 57276 n.26 (citing Comment #567 at https://www.dol.gov/sites/dolgov/files/EBSA/laws-and-regulations/rules-and-regulations/public-comments/1210-AB95/00567.pdf; Comment #709 at https://www.dol.gov/sites/dolgov/files/EBSA/laws-and-regulations/rules-and-regulations/public-comments/1210-AB95/00709.pdf.).

[23] Dr. G. Kevin Spellman, CFA, David O. Nicholas, ESG Matters, Institutional Shareholder Services (2019) available at https://www.issgovernance.com/file/publications/ISS_EVA_ESG_Matters.pdf. Other reports have reached similar conclusions. See MSCI, Guido Giese, Zoltan Nagy, Linda-Eling Lee, Deconstructing ESG Ratings Performance: Risk and Return for E, S and G by Time Horizon, Sector and Weighting at 9 (June 2020), https://www.msci.com/esg/deconstructing-esg-performance; see also Sustainable Reality: Analyzing Risk and Returns of Sustainable Funds, Morgan Stanley Institute for Sustainable Investing (2019) https://www.morganstanley.com/pub/content/dam/msdotcom/ideas/sustainable-investing-offers-financial-performance-lowered-risk/Sustainable_Reality_Analyzing_Risk_and_Returns_of_Sustainable_Funds.pdf; Jon Hale, Sustainable Equity Funds Outperform Traditional Peers in 2020, Morningstar.com, (2020), available at https://www.morningstar.com/articles/1017056/sustainable-equity-funds-outperform-traditional-peers-in-2020.

[24] See Larry Fink's 2021 Letter to CEOs, available at https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter (noting that 94% of the sustainable indexes outperformed their parent benchmarks during COVID-19 crisis Q1 2020) (citing https://www.blackrock.com/corporate/about-us/sustainability-resilience-research).

[25] See, e.g., Brian Anderson, New ESG Guidance from DOL Seeks to Reverse Chilling Effect of Trump-Era Rules, 401K Specialist (Oct. 13, 2021) (quoting a number of "politicians and industry stakeholders'" reactions to the new DOL guidance) available at https://401kspecialistmag.com/new-esg-guidance-from-dol-seeks-to-reverse-chilling-effect-of-trump-era-rules/; Brian Croce, DOL ESG Investing Rule Could Be Here to Stay, Pensions & Investments (Nov. 1, 2021) available at https://www.pionline.com/washington/new-dol-proposal-esg-investing-could-be-here-stay-experts-say.

[26] Although reports of the exact amount of assets invested in ESG-oriented investments vary, it appears as if assets have grown from $2 trillion to over $18 trillion over the last decade, and nearly $40 billion streamed into ESG funds in the first two quarters of 2021, a new record. See Alyssa Stankiewicz, U.S. Sustainable Fund Assets Reach a New Milestone in 2021's Second Quarter, Morningstar (July 26, 2021) available at https://www.morningstar.com/articles/1048918/us-sustainable-fund-assets-reach-a-new-milestone-in-2021s-second-quarter; see also U.S. Sustainable Investment Foundation,

Adding Sustainable Funds to Defined Contribution Plans, at 5, available at https://www.ussif.org/files/Publications/Plan%20Sponsor%20Guide%202021%20FINAL.pdf.

[27] See, e.g., Report on U.S. Sustainable and Impact Investing Trends 2020, U.S. Forum for Sustainable and Responsible Investment at 61 (2020) (noting that fewer than one-fifth of 401(k) plans had assets in "socially conscious" investment strategies).

[28] https://www.morningstar.com/products/esg-pep.

[29] See Morningstar Press Release, Morningstar Investment Management and Pai Announce First ESG Pooled Employer Plan (October 14, 2021), available at https://newsroom.morningstar.com/newsroom/news-archive/press-release-details/2021/Morningstar-Investment-Management-and-PAi-Announce-First-ESG-Pooled-Employer-Plan/.

[30] Cerulli Associates, U.S. Defined Contribution Distribution 2021: Uncovering Investment-Only Distribution Opportunities, available at https://www.cerulli.com/reports/us-defined-contribution-distribution-2021.

[31] See, e.g., Investment Company Institute ("ICI"), Frequently Asked Questions about 401(k) Plan Research (Oct. 11, 2021) ("As of June 30, 2021, 401(k) plans held an estimated $7.3 trillion in assets and represented nearly one-fifth of the $37.2 trillion U.S. retirement market."), available at ici.org.

[32] For example, Parnassus Core Equity Investor (PRBLX) has an expense ratio of 0.84%; Shelton Green Alpha Fund (NEXTX) has an expense ratio of 1.28%; 1919 Socially Responsive Balanced Fund (SSIAX) has an expense ratio of 1.16%. See e.g., Rob Berger and Benjamin Curry, The Best ESG Funds of 2021, Forbes Advisor (Nov. 1, 2021), available at https://www.forbes.com/advisor/investing/best-esg-funds/.

[33] Ironically, the proposed regulation could also create potential liability for plan fiduciaries if they fail to sufficiently consider ESG factors in their decision-making.

[34] Karen Wallace, What is Greenwashing (And What You Can Do About it), Morningstar (Apr. 15, 2021) available at: https://www.morningstar.com/articles/1033521/what-is-greenwashing-and-what-you-can-do-about-it; Emily Stewart, The Thorny Truth about Socially Responsible Investing, Vox (Oct. 10, 2021), available at https://www.vox.com/the-goods/22714761/esg-investing-divestment-fossil-fuels-climate-401k; Beau River, The Increasing Dangers of Corporate Greenwashing in the Era of Sustainability, Forbes (Apr. 29, 2021), available at https://www.forbes.com/sites/beauriver/2021/04/29/the-increasing-dangers-of-corporate-greenwashing-in-the-era-of-sustainability/?sh=15595c4a4a32.

[35] Alicia Adamczyk, Your ESG Fund Might Be Invested in Facebook and it Highlights a Major Issue with Sustainable Investing, CNBC Make It (Oct. 27, 2021) available at https://www.cnbc.com/2021/10/26/your-esg-fund-might-be-invested-in-facebook.html.

[36] https://www.sustainalytics.com/esg-ratings.

[37] What is Greenwashing, available at: https://www.morningstar.com/articles/1033521/what-is-greenwashing-and-what-you-can-do-about-it.

[38] Margaret Giles, Not All Sustainable Funds Are Equally Sustainable, Morningstar (Apr. 14, 2021) ("U.S. sustainable funds as a whole deliver on their sustainability claims, but there are still funds whose performance in sustainability falls short.").

[39] See Florian Berg, Aggregate Confusion: The Divergence of ESG Ratings, MIT Sloan School of Management (May 17, 2020), available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3438533; citing A. K. Chatterji, R. Durand, D. I. Levine, and S. Touboul, Do ratings of firms converge? Implications for managers, investors and strategy researchers, Strategic Management Journal, 37(8):1597–1614 (2016).

[40] Chair Gary Gensler, "Testimony Before the Subcommittee on Financial Services and General Government, U.S. House Appropriations Committee" (May 26, 2021), https://www.sec.gov/news/testimony/gensler-2021-05-26.

[41] Acting Chair Allison Herren Lee, Public Input Welcomed on Climate Change Disclosures, (Mar. 15, 2021) available at https://www.sec.gov/news/public-statement/lee-climate-change-disclosures; see also Potential Recommendations of ESG Subcommittee (Dec. 1, 2020) available at https://www.sec.gov/files/potential-recommendations-of-the-esg-subcommittee-12012020.pdf (issuing a preliminary recommendation that the Commission requires the adoption of standards by which corporate issuers disclose material ESG risks.).

[42] Commissioner Elad Roisman, Can the SEC Make ESG Rules that are Sustainable, (June 22, 2021), available at https://www.sec.gov/news/speech/can-the-sec-make-esg-rules-that-are-sustainable.

[43] The European Union has already finalized a number of new rules requiring additional ESG disclosures. For example, the Sustainable Finance Disclosure Regulation came into effect on March 10, 2021, and imposes a number of new ESG disclosure and reporting requirements on financial services participants. The EU Taxonomy Regulation (comes into effect next month) and aims to create a standardized classification system for environmentally sustainable activities. Because many investment firms and issuers are active in both European and U.S. markets, the European regulations may also improve ESG disclosures in the U.S.