

Proposed Enhancements to the ADGM’s Sustainable Finance Regulatory Framework

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On May 20, 2024, the Abu Dhabi Global Market’s (“ADGM”) Financial Services Regulatory Authority (“FSRA”) and Registration Authority (“RA”) jointly launched a discussion consultation on enhancing the sustainable finance (“SusFin”) regulatory framework of the ADGM (the “Framework”).

Stakeholders were encouraged to submit comments on [Discussion Paper No. 1 of 2024](#) (the “DP”). Cleary Gottlieb participated in the consultation process, which closed on July 19, 2024.

In the DP, the FSRA and the RA emphasized the need for the ongoing development of the Framework, as sustainable finance remains a strategic priority for the ADGM. Since adopting the Framework in 2023 following a similar public consultation, the ADGM has implemented comprehensive disclosure requirements for licensed entities to boost transparency and accountability. Among other things, the ADGM has expanded its market framework to include “environmental instruments” such as carbon offsets, and has established rules for green and climate transition funds, green and sustainability-linked bonds, and sukuks.

In a nutshell, the DP outlines:

- a) proposed guidance with respect to the FSRA’s expectations for ESG-labelled investment vehicles; and
- b) appropriate next steps for ADGM-licensed entities in the areas of: (i) integration of climate-related risks in their risk management frameworks and governance processes, and (ii) transition planning.

This alert memorandum summarizes the key discussion points set out in the DP. For any inquiries concerning the DP, Cleary Gottlieb’s submission, or our analysis of the regime’s potential future implications for firms, please contact one of the authors.

If you have any questions concerning this memorandum, please reach out to your regular firm contact or the following authors

ABU DHABI

Chris Macbeth
+971 2 412 1730
cmacbeth@cgsh.com

Mishura Otubu
+971 2 412 1813
motubu@cgsh.com

Daniela Weerasinghe
+971 2 412 1702
dweerasinghe@cgsh.com

Kay Hechaim
+971 2 412 1831
khechaim@cgsh.com



Background

2023, dubbed by the UAE presidency as the nation's "Year of Sustainability" and extended to 2024, marked a major milestone with a boom in sustainable finance activities. At COP28, hosted by the UAE in December 2023, the UAE banking sector committed AED 1 trillion (US\$ 270 billion) towards SusFin initiatives by 2030. Notably, 30% of green bonds in the Middle East have been issued in the UAE.¹ The Dubai International Financial Center ("DIFC") houses Nasdaq Dubai, the largest ESG sukuk market, accounting for 64% of the world's dollar-denominated sustainable sukuk.² In July 2024, the UAE's clean energy powerhouse, Masdar, raised US\$ 1 billion for renewable energy projects through green bonds, following a US\$ 750 million offering in 2023.

In November 2023, the UAE Sustainable Finance Working Group ("SFWG")³ launched the Principles for the Effective Management of Climate-related Financial Risks (the "SFWG Principles"), with the ADGM as one of its signatories. In June 2024, the SFWG introduced the Principles for Sustainability-Related Disclosures for Reporting Entities to help financial institutions align with international best practices.⁴

The ADGM continues to position itself as a leader in sustainable finance in the UAE and the Middle East with initiatives like the 2019 Sustainable Finance Agenda and pioneering regulations for carbon credits and offsets. The ADGM also launched the world's first regulated carbon credit trading exchange and clearing house, setting new standards for environmental financial instruments.

Efforts to Mitigate Greenwashing Risks

To mitigate the risk of greenwashing in connection with "green", "sustainable", or similarly labelled investment funds or portfolios, the Framework provides guidance on the following designations: (i) ADGM Green Funds

and ADGM Climate Transition Funds, (ii) ADGM Green Portfolios and ADGM Climate Transition Portfolios, (iii) ADGM Green Bonds and ADGM Sustainability-Linked Bonds, and (iv) ADGM Green Sukuks and ADGM Sustainability-Linked Sukuks. These designations, issued by the FSRA, do not guarantee compliance with applicable rules but highlight the recipient's claim to be invested in green or transitioning activities.

The DP emphasized that the initial implementation of the Framework focused on environmental considerations for labeling green and climate transition funds. To enhance the Framework further, the DP called for greater clarity on regulatory expectations for labeling investment products that pursue broader sustainability goals. This is crucial to boost investor confidence and properly mitigate greenwashing risks.

The ADGM sought feedback on its plan to adopt a step-by-step approach to developing a regulatory framework for ESG labels. The first step involves publishing voluntary guidance, followed by implementing binding rules once ESG practices become more established locally and globally.

The DP explained that "greenwashing" refers to any misrepresentation of sustainability-related practices or features of an investment product or service. This can occur in various aspects of an investment product's ESG profile, including its name, investment policy, strategy, impacts, targets, and performance metrics. Such practices can mislead and confuse investors, causing them to invest in assets misaligned with their objectives or ambitions, thereby undermining their confidence in ESG investment products.

The DP emphasized that ESG investment products should in plain and simple language:

¹ See the following [report](#), p 3.

² See the DIFC website [here](#).

³ The members of the SFWG include the UAE's Ministry of Finance, Ministry of Economy, Ministry of Climate Change and Environment, the Office of the UAE's Special Envoy for Climate Change, the Central Bank of the UAE, the

Securities and Commodities Authority, ADGM's FSRA, the DIFC's Dubai Financial Services Authority, and UAE exchanges (namely, Abu Dhabi Securities Exchange, Dubai Financial Market and Nasdaq Dubai).

⁴ See the following [press release](#).

- accurately describe their ESG goals or parameters; and
- clearly explain any ESG-related claims, ensuring they are not vague, exaggerated, incorrect, or misleading about their connection to positive ESG outcomes.

The DP asserted clear expectations that an ESG investment product's objectives and name should be aligned, stating that an ESG label should only be used if the product's main goals or ambitions focus on ESG matters. An ESG label is appropriate only if all three components "E", "S", and "G" are part of the investment objectives to avoid conflation of different sustainability factors and resulting investor confusion. For example, an ESG label should not be used where an investment product targets only environmental sustainability or social issues. One measure under consideration is a 75% threshold, requiring that at least 75% of an investment product's assets be invested in ESG objectives. If this threshold is not met, terms like "ESG" or "sustainable" should not be used in the product's name. In this sense, the use of broad terms such as "sustainable" and "socially responsible" should be accompanied with disclosures regarding how the investment objectives of the product relate to its name.

The DP proposed classifying ESG investment strategies into four distinct categories aligned with market practice:

1. **ESG Integration:** Investments based on the integration of ESG considerations into an asset's strategy, processes, or objectives.
2. **Screening:** Permitting or prohibiting certain investments based on defined criteria.
3. **Impact Investing:** Investments based on the level of impact the asset is expected to achieve.
4. **Thematic Investing:** Investments based on themes such as carbon emission reduction or nature preservation.

This classification aims to prevent "category error" and investor confusion (e.g., an investor investing in an ESG fund, based on a screening strategy, assuming that no investment in oil and gas will be made, while in reality the fund pursues an ESG integration strategy, aiming to incorporate ESG considerations into the practices of oil and gas companies). Each category

entails distinct considerations and processes. ESG investment products should clearly state the strategies that they are designed to pursue and provide sufficient related disclosures (e.g., screens, thresholds or factors considered qualitatively or quantitatively) to assess compliance with such strategies. Any permitted flexibility to invest a certain percentage of a product's portfolio in non-ESG compliant assets should also be disclosed.

The DP did not consider "stewardship" (investments made to influence a corporation's behavior and decisions through shareholder proposals or proxy voting) as a standalone strategy. Rather, it should be standard practice within each ESG investment strategy, with all ESG investment vehicles encouraged to disclose matters related to stewardship.

Investment products that pursue an identifiable ESG impact should disclose any resulting "additionality" (i.e., the ESG benefits achieved directly from the investment, that go beyond the positive outcome that would have occurred without implementing the strategy) and assess it using ESG indicators and/or metrics on a regular basis.

Additionally, the DP emphasized the use of a credible, publicly-available third-party taxonomy to ensure that selected assets align with the ESG values of the investment product. Otherwise, there is a risk that an investor's understanding of ESG might not align with that of the investment product. The taxonomy selected should help clearly identify the pursued ESG ambitions, with disclosures regarding its appropriateness. The DP questioned whether to require a third party attestation that an ESG investment product's assets comply with the chosen ESG taxonomy, given the associated costs, with the FSRA deeming it beneficial to provide assurances to investors that an investment product's objectives are clear, fair and not misleading.

The DP also highlighted the importance of ESG indices (which would exempt investment products from the need to align with an ESG taxonomy or obtain a third party attestation) in developing passive, lower-cost ESG investment products, which are particularly appealing to retail investors. These indices are expected to:

1. disclose the name and provider of the index;
2. provide a description of the methodology used for asset selection;
3. explain how the index supports the underlying ESG objectives of the investment product; and
4. clearly disclose all potential or actual conflicts of interest from the use of such indices.

Integration of Climate-Related Risks and Transition Planning into Business Strategies

The DP recognized the importance of encouraging and potentially requiring entities to account for and plan for climate-related risks. Incorporating these risks into entities' risk management frameworks and governance processes will encourage taking action to mitigate such risks, benefiting both the entities and society at large. The DP sought feedback on whether the SFWG Principles should be adopted as binding rules for financial firms licensed in ADGM, the appropriate scope of enforcement, and whether sector-specific considerations warrant different rules. It also explored the extension of SFWG Principles to non-financial firms.

Furthermore, the DP emphasized that encouraging entities to develop their own net zero transition plans can advance the UAE's Net Zero by 2050 Strategic Initiative. This approach complements the Framework's "comply or explain" ESG disclosure regime, which addresses backward-looking information, with transition plans providing forward-looking information. The DP also considered whether these transition plans should be published and disclosed publicly. It acknowledged that standards for transition plans are still not fully developed, particularly regarding their content.

Conclusion

The DP arrived less than a year after the Framework's implementation, showing the ADGM's ambition to continuously improve its sustainable finance framework, by evaluating its strengths and weaknesses and sparking discussions on potential enhancements. In summary, the ADGM is proactively considering

effective measures to prevent and mitigate greenwashing risks and may encourage or require entities to adopt and disclose transition plans. These steps will continue to position the ADGM as a global hub for sustainable finance and keep the UAE on track to meet the Net Zero by 2050 Strategic Initiative goals.

The FSRA is expecting to publish its final guidance on ESG-labelling by the end of the year.

In parallel, the DIFC's efforts to promote sustainable finance, including its Sustainable Finance Framework (announced in October 2023), underscore the UAE's commitment to leading the region in developing and achieving sustainability goals.

We continue to monitor the ADGM's initiatives, anticipating further groundbreaking developments in their sustainable finance journey.

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