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ALERT MEMORANDUM

An Innovative **Sustainable Finance** Regulatory Framework Takes Shape in the **Abu Dhabi Global Market (ADGM)**

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On November 10, 2022, the ADGM's Financial Services Regulatory Authority ("FSRA") and Registration Authority ("RA") jointly launched a public consultation on a proposed new sustainable finance regulatory framework for the ADGM.

Stakeholder submissions were encouraged in the form of comments to Consultation Paper no. 6 of 2022 (the "CP"). Cleary Gottlieb submitted comments during the consultation process, which closed on January 23, 2023.

In the CP, the FSRA and the RA framed sustainable finance as a strategic priority for Abu Dhabi – also in light of the United Arab Emirates' recently announced net zero strategy, and its role as host of the next UN Climate Change Conference of the Parties (COP28). The ADGM's final regulations on sustainable finance are now eagerly awaited, and it is hoped that (already in advance of COP28 – to be held in Dubai) the new regulatory framework will encourage a significant acceleration of funding needed for the technical solutions that will achieve the UAE's 2050 net zero goals and ultimately help solve the climate crisis.

The CP outlines the ADGM's plans with respect to:

(i) a voluntary opt-in regime with minimum eligibility requirements and for green-labelled financial instruments; and

(ii) a comply-or-explain ESG disclosure regime for large companies and large asset managers incorporated in the UAE.

In addition to publishing the final sustainable finance regulations, it is expected that the ADGM will run a separate consultation on the management of climate risk by local financial sector firms.

This alert summarizes the key provisions outlined by the CP. For any inquiries concerning the CP, Cleary Gottlieb's submission, or our analysis of the regime's potential future implications for firms, please contact one of the authors.

I. Background

The ADGM's early focus on sustainable finance was crystalised in the "Sustainable Finance Agenda" of January 2019. The first of the agenda's four action items concerned the future integration of ESG in the local regulatory framework.

Much has been done since then (including through the establishment of the UAE "Sustainable Finance Working Group", the development of the ADGM's own "Sustainable Finance Platform" (dedicated to reviewing ESG data published by companies in the region) and the growth of the annual, ADGM-hosted "Abu Dhabi Sustainable Finance Forum".[1] Finally, the ADGM was part of the group of UAE authorities that developed the region's "Guiding Principles on Sustainable Finance", in January 2020.[2]

In 2019, the UAE's two 'offshore' exchanges, the Abu Dhabi Securities Exchange and the Dubai Financial Market, became the first in the region to issue voluntary ESG reporting guidelines.[3] These guidelines took on additional significance in January 2021, when the UAE's Securities and Commodities Authority ("SCA") stated that issuers of locally-listed securities would be expected to issue periodic sustainability reports, pursuant to Article (76) of the local Governance Code.[4]

The reforms announced under the CP will for the first time extend similar rules beyond just listed companies (albeit initially on a voluntary basis).[5]

II. Sustainability-labelled funds and bonds

Sections A to D of the CP outline the key features of the ADGM's proposed opt-in regime for certain ESG-labelled financial instruments.[6]

(1) ADGM Green Funds ("GFs")

The ADGM proposes to create a voluntary opt-in framework for funds that choose to seek an "ADGM Green Fund Designation".

In order to receive an ADGM GF designation, funds shall only invest in either:

— assets aligned with an existing regulatory green taxonomy (such as the ASEAN or the EU taxonomy, or the upcoming UAE taxonomy), that the fund manager would have the option to choose freely; or

— assets that track, or are included in, the EU's Paris-Aligned Benchmark ("PAB"), which approximates a pathway to decarbonisation that is aligned with Paris Agreement goals.[7]

Once having obtained the GF designation, funds will be allowed significant time to align to this however. The requirement will in fact concern:

— only 50.1% or more of the Fund's assets within two years of the date on which the designation is granted; and

— 75% for the following three years.

Unlike funds reserved to qualified investors ("QIFs"), public funds wishing to use the GF designation will need to have a third party attest their assets' alignment

1 The Sustainable Finance Agenda is accessible here.
2 Abu Dhabi's "ESG Disclosure Guidance for Listed Companies" is accessible here; Dubai's "ESG Reporting Guide" is accessible here.
3 The Guiding Principles are accessible here.
4 See Article 51 of the "Governance Guide for Public Joint-Stock Companies", attached to SCA Board Chairman Decision no. 3 of 2020 and accessible here.
5 Once in place, the CP's sustainable finance framework will amend (among others) the ADGM Companies Regulations, the Financial Services and Markets Regulations, the ADGM Conduct of Business, Funds, and Markets Rulebooks and the FSRA Glossary.
6 The rules discussed in this Section II are complemented by the CP's Attachment 2 (*Sustainable Finance Supplementary Guidance*).
7 In practice, the EU PAB tracks companies that are on track to reduce their carbon emissions by 50% compared to companies in their parent index basket, and 7% year-on-year.

with the chosen taxonomy every year. Public funds will also need to apply to ADGM authorities and undergo a review before obtaining the designation (whereas QIFs would only be required to make a notification).

The ADGM will keep a public register of designated GFs. According to the CP, use of the ADGM's GF logo in marketing materials would require a separate and additional authorisation.

(2) ADGM Climate Transition Funds ("CTFs")

The CP proposes to create a second type of voluntary fund label, that will apply to vehicles that invest in assets that are on a pathway to carbon neutrality.

To qualify for a CTF designation, funds shall invest in:

- assets aligned with a "climate transition taxonomy" (meaning an independent, specialist and third party publication that identifies economic activities that have the potential to become sustainable over time);[8]
- companies with a public, "*credible*" net zero strategy;[9]
- green and sustainability-linked bonds and *sukuks*;[10]
- greening real estate assets and infrastructure;[11] and
- assets that track, or are included in, the EU's Climate Transition Benchmark.[12]

At least 75% of a CTF's portfolio will be expected to fall within one or more of the above categories from the date on which the CTF designation is granted.

As for GFs, only CTFs that are public funds will require third party attestation on their climate transition taxonomy-aligned assets. In light of their specific nature, CTFs would be made subject to internal review and a series of dedicated disclosure requirements in addition to those that apply to GFs.

(3) Discretionary managed portfolios

The CP notes that "green" and otherwise sustainability-labelled discretionary-managed portfolios are increasingly being offered to retail investors – particularly in the robo-advisory space.

The CP therefore envisages a framework for such retail products that would essentially mirror the requirements proposed with respect to GFs and CTFs (including as to the use of the relevant logo).

(4) Green and sustainability-linked bonds, and sukuks

Lastly, the CP proposes to introduce similarly voluntary "ADGM Green Bond" and "ADGM Sustainability-Linked Bond" designations for debt instruments and *sukuks* (*i.e.*, *Sharia*-compliant bonds). The first designation would apply to instruments issued in order to fund "green" projects, whilst the second would concern debt issued with the objective of financing improvements in a company's overall sustainability.

The designation would be available to financial instruments (including *sukuks*) that:

- are offered in the ADGM (regardless of the issuer's place of establishment);
- conform to ICMA's Green Bond or Sustainability-Linked Bond principles, or a framework equivalent to ICMA's; and

[8] Although the CP does not identify any such taxonomies at this time, it hints at the possibility to consider the ASEAN taxonomy's "amber" category for this purpose. At a first look, it would not seem that this category of assets would fit the proposed purpose. In our view, the ASEAN "Plus Standard" amber assets would be a more appropriate reference point.

[9] By way of guidance, the ADGM suggests that this should focus on entities whose net zero greenhouse gas emissions targets have been verified by the Science-Based Targets initiative (SBTi).

[10] The CP proposes that only bonds and *sukuks* issued under third party frameworks and subject to external review be eligible.

[11] Similarly, the CP proposes that the sustainability rating of the underlying assets be measured by a third party.

[12] Other equivalent "transition benchmarks" might also qualify once they arise.

— are assessed by a third party.

The framework may in the future be extended to include also “transition-like” bond instruments.

Instruments carrying either of the proposed designations would require an annual third-party review, to attest compliance with the applicable requirements.

III. ESG disclosures for large companies and asset managers

The CP goes on to propose a voluntary, “comply-or-explain” new ESG disclosure regime for large ADGM-headquartered companies. [13]

The regime (which may become mandatory in the future) would capture:

(i) companies with a turnover of US$ 68 million or greater; and

(ii) fund and asset managers with US$ 6 billion AUMs or greater.

The new rules would begin to apply in 2023, although newly-formed entities would be given three years to adapt from their date of incorporation before being caught. Entities not in scope would nevertheless be encouraged to opt-in. Foundations, LLPs and LPs, and “branches” of foreign companies would be altogether excluded from the scope of the rules. Listed companies would remain subject to their own applicable ESG disclosure guidance.

In-scope entities choosing to disclose on ESG would be left free to choose their international framework of reference (*e.g.*, the rules issued by the International Sustainability Standards Board, the Task Force on Climate Related Financial Disclosures, the Global Reporting Index or other rules – presumably also including other jurisdictions’ national regulatory regimes).

In principle, the regime that is proposed would not seem to trace a common minimum baseline, such that companies would be required to report just on climate (as opposed to all E-S-G angles), or only on ESG-related financial risks (and not also impacts). Reports would initially only require internal review, and no third party audit.

IV. Comparative insights

By implementing the regulations proposed in the CP, the ADGM joins the EU and a few other jurisdictions that are leaders in sustainable finance regulation. Although, for the time being, the proposed financial product labelling and disclosure regimes will apply on a voluntary basis, it is likely that companies will abide by the new rules in large numbers, bending to the rising ESG-related pressure of markets and supervisors alike.

Overall, the regulatory roadmap that the CP lays out follows in the footsteps of the EU. This includes the creation of a voluntary standard for “green bonds” – an attempt to counter greenwashing risks without discouraging local listings of sustainable finance’s longest-established (and most prolific) creation. Indeed, the CEO of Masdar (the UAE’s renewable energy champion) recently chose the ADGM as the venue to announce plans for their first green bond, to be launched in 2023.

Some differences deserve specific mention. Particular merit is seen in the proposed CTF fund label, capable of capturing transition finance capital. The ADGM is perhaps the first jurisdiction to really attempt to create this fund category (notably absent from the EU framework) – a move that will certainly be applauded by industry and governments alike. [14] The possibility for disclosing entities to choose their taxonomy, or their disclosure framework, of reference also appears to be a pragmatic move, amidst the plethora of diverse

[13] The rules discussed in this Section II are complemented by the CP’s Attachment 1 (*Environmental, Social and Governance Disclosure Guidance*).

[14] The UK Financial Conduct Authority may be the next to consider this, as was announced in relation to the upcoming “sustainability disclosure requirements” (under the labe of “sustainable improvers”).

ESG regimes that have been emerging across the globe.

The requirement for public funds to obtain a third-party verification of compliance also stands in contrast with the EU's (and prospectively, perhaps, also the US's) pure disclosure-based regimes.

Through its recent submission to this consultation, and its future participation in the consultations, conferences, roundtables and other initiatives of the ADGM and others in the region, Cleary Gottlieb looks to take an active part in the shaping of the region's sustainable finance framework.

The CP closed shortly after the conclusion of the 15th Abu Dhabi Sustainability Week and the 5th Abu Dhabi Sustainable Finance Forum (ADSFF), whose theme was "Charting the Path to COP28". During the ADSFF, various speakers acknowledged the urgent need for innovative financing solutions to help fund the transition to clean energy as part of the UAE's "Net Zero by 2050" initiative. It was suggested that the World Future Energy Summit, hosted by Abu Dhabi during the Abu Dhabi Sustainability Week of which the ADSFF also forms part, had shown that the technical solutions necessary to achieve that goal are already available. It was also asserted that the capital necessary to finance those solutions was also already available. In fact, in this context Abu Dhabi was repeatedly described as the "capital of capital".

By implementing ambitious, innovative sustainable finance regulations, the ADGM is laying strong foundations for a bridge between those technical solutions and those sources of capital. In doing so, it is hoped that the ADGM will become a strong hub for the transformative investment that is urgently required both to "finance green" and to "green finance".

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