



## Consultation Paper

# Framework for the Introduction of ESG Schemes as a New Mutual Funds Category



## 1. Background

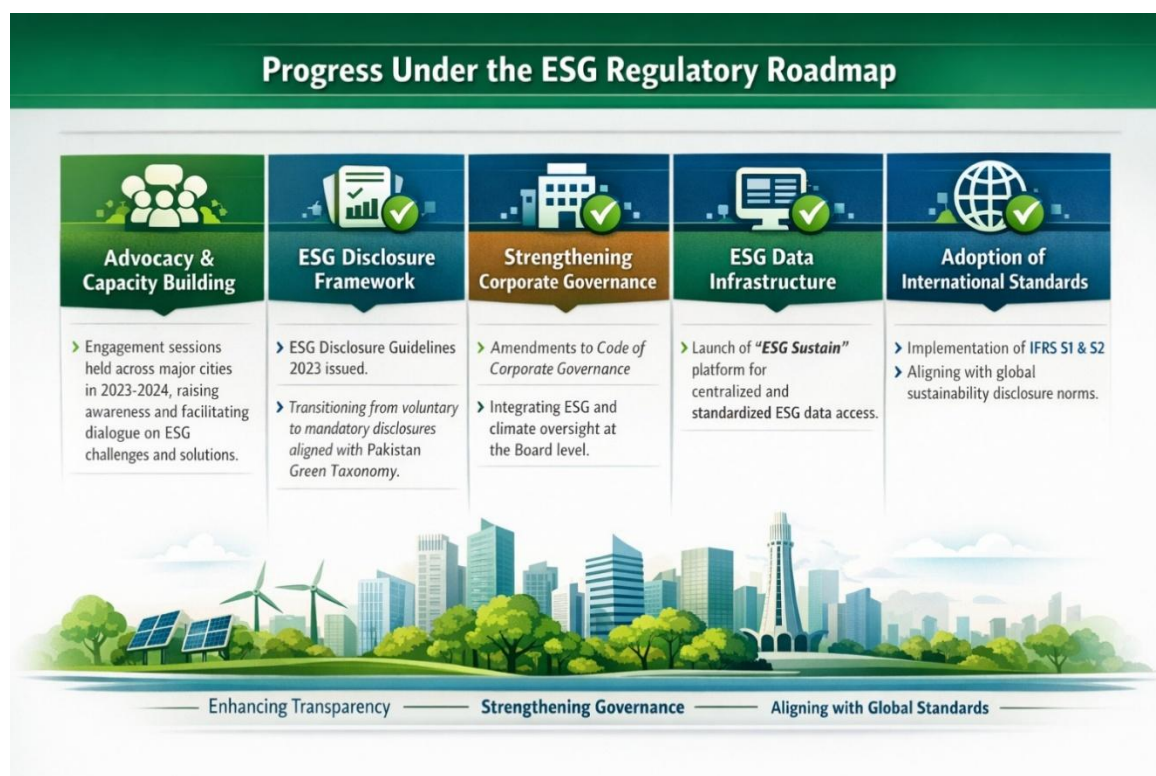
Environmental, Social and Governance (ESG) considerations have, over the past decade, transitioned from a niche investment philosophy to a core component of mainstream financial decision-making. Globally, regulators, institutional investors, and asset managers are increasingly recognizing that ESG factors are not merely ethical considerations, but financially material drivers of long-term risk, return, and resilience.

In Pakistan, the Securities and Exchange Commission of Pakistan (SECP) has adopted a forward-looking approach to align the domestic financial ecosystem with these global developments. The issuance of the ESG Regulatory Roadmap in 2022 marked a foundational step in this direction, setting out a phased and pragmatic pathway for the development of an ESG ecosystem tailored to local market conditions.

The roadmap identified key pillars necessary for building a robust ESG framework, including:

- Awareness and capacity building across stakeholders;
- Development of ESG disclosure standards and reporting practices;
- Establishment of data infrastructure and digital platforms;
- Introduction of ESG-linked financial products; and
- Mechanisms for monitoring, evaluation, and impact assessment.

Since then, SECP, in coordination with other stakeholders, has made meaningful progress across these areas.



## 2. Rationale for ESG Mutual Funds

While the regulatory and institutional foundations for ESG integration have been progressively established, a key missing link remains the availability of structured investment products that translate ESG principles into actionable investment opportunities. In this context, the introduction of ESG mutual funds constitutes a key milestone under the SECP's ESG Regulatory Roadmap, aimed at facilitating the development of sustainable finance products within the capital market.

Globally, ESG mutual funds have emerged as an important conduit for channelling capital towards sustainable and responsible activities. These products serve multiple functions:

- a) They enable retail and institutional investors to participate in sustainability-oriented investments;
- b) They facilitate capital allocation towards companies demonstrating stronger ESG performance;
- c) They provide market-based incentives for improved corporate behaviour; and
- d) They contribute to the broader objective of sustainable and inclusive economic development.

In the absence of a formal regulatory framework, however, there is a risk of inconsistent practices, lack of standardization, and potential misrepresentation of ESG claims. The introduction of a structured ESG Scheme category is therefore aimed at:

- i. Establishing minimum standards and safeguards for ESG investing;
- ii. Ensuring credibility and consistency across ESG-labelled products;
- iii. Protecting investors from misleading or unsubstantiated claims; and
- iv. Supporting the orderly development of Pakistan's sustainable finance market

## 3. Key Considerations in Designing the Framework

In developing the proposed framework, the Commission has sought to balance flexibility with accountability. On one hand, ESG investing is inherently diverse, with multiple approaches (screening, integration, impact investing) and evolving methodologies. Overly prescriptive regulation may stifle innovation and limit product development.

On the other hand, the absence of clear standards may give rise to greenwashing, inconsistent disclosures, and erosion of investor confidence. Accordingly, the proposed approach seeks to:

- Provide principle-based guidance rather than rigid rules;
- Define minimum thresholds and eligibility criteria;
- Ensure transparency through enhanced disclosures; and
- Introduce governance and assurance mechanisms to strengthen credibility.

## 4. Proposed Regulatory Framework for ESG Schemes

The proposed regulatory framework for ESG Schemes in Pakistan is as follows:

## **4.1 Categorization**

Instead of creating an entirely new standalone product category, ESG Schemes are envisaged as an overlay within existing CIS categories. This approach allows asset managers to integrate ESG considerations across different asset classes (equity, income, balanced, etc.) while maintaining familiarity for investors.

## **4.2 Investment Restrictions**

A key element of the framework is the establishment of baseline exclusions for activities that are widely considered inconsistent with ESG principles.

These exclusions are intended to:

- Avoid exposure to sectors associated with significant environmental or social harm;
- Align investment practices with evolving global norms; and
- Provide a clear minimum standard for ESG-labelled products.

## **4.3 ESG Investment Strategies**

Recognizing the diversity of ESG investing approaches, the framework allows flexibility for Asset Management Companies to adopt one or more strategies.

### **i. Negative Screening**

Exclusion of companies, sectors, or activities that are inconsistent with ESG principles or give rise to material ESG risks or controversies. This approach aims to avoid exposure to harmful or non-compliant investments.

### **ii. Positive Screening (Best-in-Class Selection)**

Selection of companies demonstrating superior ESG performance relative to sector peers. This approach promotes investment in entities with strong environmental, social, and governance practices.

### **iii. ESG Integration**

Systematic incorporation of material ESG factors into traditional financial analysis and investment decision-making. ESG risks and opportunities are evaluated alongside financial metrics to enhance long-term risk-adjusted returns.

### **iv. Impact Investing**

Investment with the intention to generate positive, measurable environmental and/or social outcomes alongside financial returns. Schemes adopting this approach shall disclose impact objectives, key performance indicators, and methodologies for monitoring and reporting outcomes.

#### 4.4 Naming of Schemes (Addressing Greenwashing Risks)

The naming of ESG Schemes is a critical aspect of investor communication and carries significant implications for market integrity. In global markets, concerns around greenwashing, where sustainability claims are exaggerated or not substantiated, have prompted regulators to introduce stricter naming and labelling standards.

In this context, the use of terms such as “green”, “sustainable”, “ESG”, or “impact” should not be merely promotional, but must be grounded in the scheme’s actual investment strategy, asset allocation, and disclosures.

Misalignment between a scheme’s name and its underlying investments may mislead investors regarding the nature and objectives of the product, thereby undermining trust in ESG-labelled instruments. Accordingly, schemes using such terminology are expected to demonstrate:

- Meaningful allocation to ESG-aligned investments;
- Consistency between stated strategy and actual portfolio composition; and
- Transparent disclosures enabling verification of ESG claims.

This approach seeks to strike a balance between encouraging innovation and preventing misuse of ESG terminology.

#### 4.5 Minimum ESG-Aligned Investments

A minimum allocation threshold is essential to ensure that ESG Schemes are substantively aligned with their stated investment objectives, rather than merely adopting ESG labels without meaningful portfolio alignment. International experience indicates that the absence of such thresholds increases the risk of greenwashing and undermines investor confidence.

In this regard, a minimum threshold of seventy percent (70%) of net assets being invested in ESG-aligned securities or instruments is being considered. This threshold is intended to strike a balance between ensuring meaningful ESG exposure while allowing sufficient flexibility for liquidity management and portfolio construction.

##### a) Equity-Oriented ESG Schemes

For equity-oriented schemes, ESG alignment may be established through:

- Investment in listed equity securities of companies included in the PSX Sustainability Index, once operational; or
- Till the absence of such an index, through an internally developed ESG assessment methodology by the Asset Management Company.

However, such methodology is expected to be robust, transparent, and consistently applied, and shall:

- Incorporate compliance with the SECP ESG Disclosure Guidelines;
- Consider sector-specific material ESG factors;
- Apply minimum ESG scoring or threshold criteria;
- Evaluate environmental, social, and governance pillars; and
- Take into account ESG controversies, where relevant.

To ensure governance and accountability, this methodology shall be:

- Approved by the Board of Directors of the Asset Management Company; and
- Clearly disclosed in the offering document.

Furthermore, for equity-oriented ESG Schemes, compliance with the 70% minimum investment requirement shall be determined based on the quarterly average of net assets calculated on a daily basis, in order to ensure consistency and prevent short-term window dressing.

#### **b) Debt-Oriented ESG Schemes**

Eligible instruments may include green, social, gender, sustainability, and sustainability-linked bonds or sukuk.

These may include:

- Government-issued green securities;
- Instruments aligned with the Pakistan Green Taxonomy; and
- Instruments aligned with the Green Bond and Gender Bond Guidelines.

This approach is intended to promote the development of Pakistan's sustainable debt market while ensuring alignment with established regulatory frameworks and taxonomies.

#### **4.6 Investment of Remaining Assets**

The remaining portion of the portfolio may be allocated to cash and near-cash instruments for liquidity and risk management purposes.

Such investments may include:

- Cash held in bank accounts (excluding Term Deposit Receipts); and
- Treasury Bills with a maturity not exceeding 90 days.

This flexibility is intended to enable efficient portfolio management without diluting the overall ESG character of the scheme.

### **5. Disclosure and Reporting Requirements**

#### **5.1 Offering Documents**

It is proposed that ESG Schemes shall disclose the following in their offering documents:

- **ESG Investment Strategy**

A clear description of the ESG approach adopted by the scheme (e.g., screening, integration, or impact investing), including how ESG factors are incorporated into investment decisions and portfolio construction.

- **Screening Methodology**

Details of the screening process applied, including any exclusion criteria, ESG scoring models, use of internal or external data, and treatment of ESG controversies or non-compliant issuers.

- **ESG-Aligned Allocation Criteria**

The criteria and thresholds used to determine ESG-aligned investments, including minimum allocation requirements, eligible instruments, and any benchmarks or indices used for alignment.

- **ESG-Related Risks**

Disclosure of key risks associated with ESG investing, including data limitations, methodology risks, potential concentration risks, and the risk that ESG objectives may not be fully achieved.

## 5.2 Annual Reports

ESG Schemes shall disclose the following in their annual reports:

- **ESG Portfolio Profile and Implementation**

A description of the ESG characteristics of the portfolio, including how the stated ESG investment strategy has been applied in practice and the extent of alignment with ESG objectives.

- **Engagement and Voting Activities**

Details of engagement with investee companies on ESG matters, including voting behavior, key issues raised, and outcomes of such engagements, where applicable.

- **Changes in Portfolio Composition**

Material changes in the ESG-aligned portfolio during the reporting period, including additions or exclusions arising from ESG considerations or controversies.

- **Board Confirmation of ESG Compliance**

A statement from the Board of Directors of the Asset Management Company confirming that the scheme has been managed in accordance with its stated ESG investment strategy and requirements.

- **Independent Reasonable Assurance on ESG Alignment**

A statement confirming that independent reasonable assurance has been obtained on an annual basis regarding the scheme's compliance with its ESG strategy and objectives.

The Board of Directors shall ensure that the assurance provider possesses the requisite expertise, independence, and competence to undertake such assurance.

### **5.3 Stewardship Policy**

Asset Management Companies managing ESG Schemes shall be required to formulate, maintain, and publicly disclose a stewardship (or engagement) policy. Such policy shall clearly articulate the AMC's approach towards ongoing monitoring of investee companies, engagement with investee companies on material ESG matters, exercise of voting rights in a manner consistent with ESG objectives, and the identification and management of material ESG risks, including controversies. This framework is intended to promote active ownership, enhance accountability, and ensure that ESG considerations are effectively integrated throughout the investment lifecycle.

### **6. Use of ESG Ratings**

ESG ratings issued by licensed credit rating agencies or internationally recognized providers may be utilized as supplementary inputs within the investment decision-making process. However, reliance on such ratings shall not absolve the Asset Management Company of its obligation to undertake independent analysis, due diligence, and fiduciary oversight. The ultimate responsibility for ensuring ESG alignment and integrity of the investment strategy shall remain with the AMC.

### **7. Conclusion**

The introduction of ESG Schemes as a recognized category within the regulatory framework represents a significant step towards advancing sustainable finance in Pakistan. The proposed framework seeks to strike an appropriate balance between enabling innovation and ensuring robust safeguards against misrepresentation and greenwashing, thereby fostering investor confidence and market integrity. By establishing minimum standards, enhancing disclosure and governance requirements, and providing flexibility in implementation, the Commission aims to facilitate the orderly development of ESG investment products tailored to local market conditions while remaining aligned with evolving international practices. The Commission encourages all stakeholders to provide their valuable feedback on the proposals set out in this consultation paper to support the development of a transparent, credible, and well-functioning ESG ecosystem in Pakistan.

## 8. Invitation for Public Comments

### **Format for sharing feedback:**

Any feedback may be sent by April 21, 2026 via email to [fmd.feedback@secp.gov.pk](mailto:fmd.feedback@secp.gov.pk) or by post at the following address

Head of Department,  
Fund Management Department,  
Specialized Companies Division,  
5th Floor, NICL Building, SECP Head Office,  
Jinnah Avenue, Blue Area, Islamabad.

<b>Name of person submitting feedback</b>		
<b>Name of organization</b>		
<b>Sr. No.</b>	<b>Comment</b>	<b>Rationale</b>

If you wish to keep all or any part of your submissions and your identity confidential, please indicate the same. In all other cases, your provided comments will be made public, except for your contact information

### ***Disclaimer:***

*Securities & Exchange Commission of Pakistan (SECP) is fully empowered, at its discretion, to accept or not accept a recommendation in accordance with its mandate and policy objectives. SECP reserves the right not to publish any submission received where SECP considers it not in the public interest to do so, such as where the submission appears to be libellous or offensive.*