CLEARY GOTTLIEB

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Climate and the Financial Sector

This weekly newsletter highlights climate-related regulatory, litigation and enforcement developments relevant to the financial sector.

General

28 February 2023 [UK] – **CMA Consults on Environmental Sustainability Agreement Guidelines**

The UK's Competition and Markets Authority (CMA) has published draft guidelines on the application of competition rules to agreements between competitors to tackle environmental sustainability objectives. The guidance aims to provide legal certainty, and to ensure competition law does not impede legitimate industry collaboration on environmental initiatives. The consultation on the Draft UK Guidelines is open until 11 April 2023. [link]

For a detailed analysis of the CMA's draft guidelines, please see our firm's alert memorandum, accessible here.

7 March 2023 [EU] – **EBA publishes its report on diversity practices**

The CRD IV Directive requires institutions to consider the diversity of the management body when recruiting new members. The European Banking Authority (EBA) published a report on diversity practices and the gender pay gap at the level of the management body. In its report, the EBA showed that more than a quarter of firms still do not comply with these CRD IV requirements. Banks and investment firms that fail to comply with diversity rules should be subject to sanctions by national supervisory authorities, the EBA said. The EBA will continue to monitor diversity in management bodies and publish benchmarking studies on diversity and the gender pay gap. [link]

7 March 2023 [EU] – **ECB publishes a working paper on climate and the economy**

The European Central Bank (ECB) shared its views on how the economy will be affected by climate change and on public policies designed to mitigate it. In particular, the ECB notes that climate change is likely to lead to financial market stress and rising public debt. However, two types of uncertainty will affect the impact on the economy: first, the climate consequences of greenhouse gas emissions are uncertain, and, secondly, the scope and speed of implementation of climate policies will also affect the economy. The ECB stresses that a coordinated response by fiscal authorities, central banks, regulators and supervisors is needed to ensure an effective and smooth transition to a net-zero economy. [link]

8 March 2023 [France] – **The French High Council of Auditors (*Haut Conseil du commissariat aux comptes*) will become an ESG oversight body**

The French High Council of Auditors prepares to assume responsibility for auditing non-financial information by the end of 2023. The High Council of Auditors will be proposed by the French government as the reference authority for the control and sanctioning of all non-financial auditors, according to the French Minister of Justice. This choice will be included in the law implementing the CSRD by the end of the year. The audit regulator would thus supervise all players in the sector (including those who are not statutory auditors) and ensure uniform application of the rules.[link]

8 March 2023 [France] – **AMF promotes shareholder dialogue on environmental and climate issues**

The *Autorité des marchés financiers* (AMF) communicated on climate issues as part of its shareholder dialogue on such issues and published the recommendations of its Commission on Climate and Sustainable Finance on climate resolutions. First, the AMF encourages listed companies to better communicate their climate strategy. Companies should ensure that the climate strategy is accompanied by specific targets and presented in detail at each annual general meeting. The AMF believes that climate information should be submitted to shareholders for approval under conditions to be determined by law. Second, the AMF's Climate and Sustainable Finance Commission makes its recommendations for climate resolutions at general meetings, namely:

- Approve the inclusion of resolutions proposed by shareholders on the agenda of the general meeting. They cannot be rejected by the board of directors on the basis of its strategic prerogatives;
- Strengthen the AMF's powers in the event of a refusal to include a resolution on the agenda;

- Pending regulatory and legislative clarification of the increase in the AMF's powers and role, facilitate the referral of cases to the commercial courts.
- Agree on the content of "Say on Climate" resolutions, which could include, among other things, disclosure of Scope 1, 2 and 3 greenhouse gas emissions, disclosure of investment and operational expenditures, and disclosure of the reference scenarios used to determine the climate targets to be achieved.

[link] - [link]

8 March 2023 [France] – **French government considers tax incentives for green investments**

The French government is considering tax incentives to promote climate-friendly industrial projects as part of the green industry law. Finance Minister Bruno Le Maire said financing measures could include tax credits and changes to asset depreciation rules. The new law is a response to the United States' $400 billion green industry attraction plan. [link]

9 March 2023 [EU] – **EU Commission calls for climate risk test**

The European Commission invites the European Supervisory Authorities (ESAs), the European Central Bank and the European Systemic Risk Board to conduct a climate risk test in the EU financial sector. The purpose of the test is to assess the ability of the EU financial sector to withstand shocks related to the emission reductions required by 2030. The test should cover severe but plausible scenarios that could have an impact on the financial system in the period up to 2030. According to the European Commission, one scenario should focus on climate risks that could materialise in the short term, and a second scenario should combine the climate-risks with other stress factors. The EU Commission then asks the ESAs to compare the two scenarios with a baseline scenario in which the EU climate legislation in the "Fit for 55" package is implemented as planned. *"This one-off exercise should go beyond the usual climate stress tests, as a cross-sectoral exercise looking also at contagion and second-round effects"*, said the EU Commission in the letter. Test results are expected by the first quarter of 2025. [link]

9 March 2023 [France] – **CSRD Directive to be transposed into French law by decree**

The French Parliament has authorized the government to transpose the CSRD Directive by decree (*Ordonnance*). The French legislator indicates that the aim is to complete the implementation as soon as possible, in order to give all stakeholders sufficient time to implement the major adaptation efforts required for the first reporting exercise, which will cover the year 2024. [link]

13 March 2023 [EU] – **European Supervisory Authorities and ECB call for improved climate-change disclosures in context of structured finance products**

Securitisation transactions are often backed by assets that could be directly exposed to physical or transition climate-related risks, and are therefore particularly sensitive to such risks. In recognition of this, the ESAs (ESMA, EBA, EIOPA) and the ECB issued a joint statement calling for improved climate-change related disclosures in respect of assets underlying securitisations. The statement notes that the ESAs have already been working towards enhanced disclosure standards and templates for securitised assets as well as related guidance. The statement also calls on issuers, sponsors and originators of securitised assets at EU level to proactively collect high-quality and comprehensive information on climate-related risks during the origination process. [link]

13 March 2023 [International] – **Over 700 financial institutions request disclosure from companies as part of CDP's annual environmental impact questionnaire**

CDP is a non-profit organisation involved in standard setting for environmental reporting and supporting entities in measuring and managing their risks and opportunities on climate change, water security and deforestation. This year's annual CPD request to companies across the globe for voluntary disclosure of environmental data is supported by 746 leading financial institutions holding over US$ 136 trillion in assets. The request is in the form of a letter to the Boards of these companies, highlighting the urgent need for the business community to engage on environmental reporting. In addition to data on climate change, deforestation, water security and biodiversity, the letter is also requesting disclosure on plastic through CDP's 2023 questionnaire. [link]

13 March 2023 [UK] – **Bank of England publishes report on climate-related risks and regulatory capital frameworks**

Following its Climate Change Adaptation Report published in October 2021, the Bank of England (BoE) published a report with its current thinking on how prudential frameworks capture climate-related risks. The report highlights that existing capability gaps (i.e., difficulties in estimating climate risks) and regime gaps (i.e., challenges in capturing risks in the existing capital regimes) create uncertainty over whether banks and insurers are sufficiently capitalised for future climate-related losses. Accordingly, the report states that, as a short-term priority, the BoE will focus on ensuring firms make progress to address capability gaps, to improve their identification, measurement, and management of climate risks. In addition, the BoE will undertake further analysis to explore whether changes to the regulatory capital frameworks may be required. [link]

16 March 2023 [International] – **ISSB decides to consult on integrated reporting rules**

In December 2022, the International Sustainability Standards Board (ISSB) had tentatively decided to seek stakeholder feedback on four potential projects, including one focused on connectivity in reporting, building on the IASB's Management Commentary project and the Integrated Reporting Framework. At its latest meeting, the ISSB unanimously voted, amongst other things, to expand the scope of the potential project on connectivity in reporting to (i) focus on integration in reporting and, (ii) consider integrated disclosures beyond the requirements related to connected information in IFRS S1 (General Requirements for Disclosure of Sustainability-related Financial Information) and IFRS S2 (Climate-related Disclosures). The ISSB also agreed that it should seek feedback on the priority and urgency of the potential project on integration in reporting relative to other potential research projects. In terms of next steps, the ISSB now needs to decide on the length of the comment period and the publication date of the consultation. [link]

20 March 2023 [UK] – **FCA outlines where improvements are needed in ESG benchmarks and warns of enforcement action**

In September 2022, the FCA sent a letter to benchmark administrators outlining its supervisory priorities and view of the risks within the sector. Since then, the FCA has conducted a preliminary review on ESG benchmarks, assessing the quality of disclosures made by a sample of UK benchmark administrators. Having found that the overall quality of ESG-related disclosures made by benchmark administrators was poor, the FCA now sent a further letter to benchmark administrators outlining the issues identified. These include: (i) insufficient detail on the ESG factors considered in benchmark methodologies; (ii) failure to ensure that the underlying methodologies for ESG data and ratings products used in benchmarks are accessible, clearly presented and explained to users; (iii) failing to fully implement ESG disclosure requirements; and (iv) failing to implement their ESG benchmarks' methodologies correctly (e.g., using outdated data and ratings or failing to apply ESG exclusion criteria). The letter emphasises that ESG matters are high on the FCA's regulatory agenda and that, given its initial findings, it will be doing more work in this area across the portfolio. The FCA also warns that, where firms fail to consider its feedback, its will deploy formal supervisory tools and, where appropriate, consider enforcement action in line with the its approach to enforcement. [link]

The FCA also highlighted that it is working with the Government on regulating this sector and expects to shortly consult on whether and how to extend the FCA's perimeter to include ESG ratings providers. Our analysis of the FCA's latest thinking on this is available here.

22 March 2023 [UK] – **FCA's Climate Financial Risk Forum publishes new guides for addressing climate-related financial risks**

The CFRF (a consultative body set up by the FCA in 2019, comprising members from, amongst other things, the asset management, insurance and banking industry) published a further set of documents relating to the management of climate-related risk and opportunities. These include a detailed guidance document as well as a set of webinar recordings on climate-related disclosures, data and metrics, as well as a set of documents relating to scenario analysis. [link]

23 March 2023 [EU] – **European Commission proposes a directive on substantiation and communication of environmental claims**

The Commission has adopted a proposal for a Directive to address greenwashing, and protect consumers against misleading environmental claims. The proposal aims to make green claims reliable, comparable and verifiable across the EU. In particular, the proposal sets out criteria for how companies should substantiate their environmental labels and claims and how they should communicate them. Companies will be required to provide evidence to ensure that their environmental labels and claims are credible. The proposal now needs to be approved by the European Parliament and the Council before being published in the Official Journal. [link]

23 March 2023 [International] – **International Accounting Standards Board launches project to consider climate-related risks in financial statements**

The International Accounting Standards Board (IASB) is launching a project to assess whether and how financial statements can better communicate information about climate-related risks. The outcomes of this project may include minor amendments to IASB Standards, limited new application guidance, new illustrative examples, or the publication of further educational materials, depending on the sources of stakeholder concerns. The IASB emphasises that the project will not aim to (i) develop an IASB Standard on climate-related risks or extensive application guidance on how to consider the effects of such risks in applying IASB Standards; (ii) expand the objective of financial statements or change the definitions of assets and liabilities; or (iii) develop accounting requirements for pollutant pricing mechanisms. [link - link]

Banking

15 March 2023 [EU] – **FitchRatings issues statement highlighting banks' increased litigation risk**

Fitch's statement highlights several sources of climate-related litigation and enforcement risk. For example, it notes that climate activism in Europe has grown over the past two years and that equity investors and NGOs have been urging banks to publish strategies and targets on reducing their exposure to fossil fuel assets, with many banks pledging to reduce their fossil fuel financing in response. However, investors and other stakeholders will now look out for any watering-down of targets or slippage in meeting them, meaning that banks will have to keep their commitments credible and on track. The statement also notes that banks could be exposed to greenwashing-based liability indirectly if a large customer is subject to legal action.

Whilst potential fines should be absorbable in the short term through earnings generation, at least for the largest European banks, Fitch considers that the publicity surrounding legal claims could lead to heightened reputational risks and damage banks' franchises if failings are not swiftly remedied. While the threat of climate-related litigation is not, at this stage, enough to result in changes to Fitch's ESG Relevance Scores for European banks, rising litigation risks could lead to increasing differentiation in ESG relevance scores in the coming years. [link]

23 March 2023 [EU] – **ECB discloses climate impact of corporate sector portfolios and ECB non-monetary policy portfolios**

The ECB has published two reports containing its first climate-related financial disclosures. The disclosures cover the Eurosystem's corporate security holdings under the corporate sector purchase programme (CSPP) and the pandemic emergency purchase programme (PEPP) [link], as well as the ECB's euro-denominated non-monetary policy portfolios (NMPPs), including its own funds portfolio and its staff pension fund [link]. The disclosures provide information on the portfolios' carbon footprint and exposure to climate risks, as well as on climate-related governance, strategy and risk management, and indicate that the ECB's portfolios are on a decarbonisation path. In particular, issuers' carbon intensity has gradually declined in recent years, and the ECB has also tilted its holdings towards issuers with a better climate performance.

Going forward, the ECB intends to disclose climate-related information on these portfolios every year, while seeking to continuously improve the disclosures. Moreover, the ECB intends to expand the scope of the disclosures to cover other monetary policy portfolios, such as those under the public sector purchase programme (PSPP), the third covered bond purchase programme (CBPP3) and other assets under the PEPP.

27 March 2023 [EU] – **ECB Vice-Chair Frank Elderson gives speech emphasising need to step up management of climate and environmental risks**

Elderson's speech, the keynote speech at the Foreign Bankers' Association (FBA) 30th anniversary, highlights recent reports on climate change and observes that addressing the increasing risks from the ongoing climate and environment crises is both highly urgent and vitally important. It is for this reason that supervisors insist that *"not taking into account the transition towards a more sustainable economy is no longer compatible with sound risk management"*. Reflecting on the current state of banks' climate and environmental risk management, Elderson considers the results to be mixed. In particular, he noted that (i) three in five banks still do not have a climate stress testing framework in place; (ii) virtually all banks have blind spots in the identification of climate and environmental risks (e.g., lack of consideration of the physical risks posed by the climate and environmental crises); and (iii) there are broader environmental risks (e.g., biodiversity loss) that go beyond purely climate-related risks that banks still focus too little on.

Elderson highlights that the ECB expects all banks under its supervision to be fully aligned with its expectations by the end of 2024 at the latest, and that the ECB will closely monitor banks' progress with respect to the deadlines. If necessary, the ECB will use all measures in its toolkit to ensure compliance with its expectations, including periodic penalty payments and setting Pillar 2 capital requirements as part of the annual Supervisory Review and Evaluation Process. [link]

Insurance

1 March 2023 [EU] – **EIOPA analyses insurers' green investments**

The European Insurance and Occupational Pensions Authority (EIOPA) publishes a brief analysis of how much of the investments made by insurers can be considered environmentally sustainable. EIOPA focuses on direct investments in corporate bonds and equities. The analysis shows that 2.6% of insurers' direct investments in corporate bonds and equities are in line with the Taxonomy, while another 15.5% are eligible. Excluding securities issued by financial firms, the proportion of taxonomy-aligned investments rises to 5.7%, with a further 34.1% eligible, EIOPA said. [link]

16 March 2023 [International] – **International Association of Insurance Supervisors consults on climate risk supervisory guidance**

Climate change is a key source of financial risk impacting the resilience of individual insurers as well as the stability of the financial system more broadly. In recognition of this, the International Association of Insurance Supervisors (IAIS), in 2022, performed a gap analysis of existing IAIS supervisory material to assess how climate risk is already captured and to identify possible further work in terms of standard-setting and/or providing further guidance on supervisory practices. In consideration of the gap analysis outcome, the IAIS now published a consultation document on part one of draft climate risk supervisory guidance. The consultation (i) outlines proposed changes to the Insurance Core Principle (ICP) introduction, which positions climate risk within the global framework for insurance supervision; (ii) discusses whether it is necessary to make changes to the existing supporting material related to governance, risk management and internal controls (ICP 7 and 8); and (iii) seeks stakeholder feedback on the overall climate-related work as it relates to supervisory guidance. [link]

Asset management

7 March 2023 [France] – **Financial industry stakeholders reiterate their expectations for the "Say on Climate" resolutions**

In their efforts to accelerate the energy transition, the French Sustainable Investment Forum and asset managers call for a better dialogue with shareholders and a partnership with companies. The financial industry is also calling on policymakers to establish a clear legal framework to generalize and harmonize the content of the "Say on Climate". This publication comes on the eve of the 2023 General Meeting season and the publication of the *Haut Comité Juridique de Place*'s new report on "Say on Climate" resolutions. [link]

9 March 2023 [UK] – **Treasury Sub-Committee on Financial Services Regulations asks FCA to clarify financial impact of greenwashing on investors**

In a letter to the Financial Conduct Authority (FCA), the Treasury Sub-Committee on Financial Services Regulations asks for clarifications following the FCA's consultation paper on sustainability disclosure requirements and investment labels. UK regulations require the FCA to carry-out a cost-benefit analysis of the "sustainability disclosure requirements and investment labels". The Treasury Sub-Committee is concerned that the FCA has failed to consider the costs to consumers as part of the cost-benefit analysis. The Treasury Sub-Committee therefore asks the FCA to provide a new cost-benefit analysis and seeks clarification on the divergence of the UK disclosure requirements from EU and US rules. [link]

23 March 2023 [France] – **The AMF publishes a study on the classification and exposure to fossil fuels in the French market**

Nine months after its entry into force, the Autorité des marchés financiers has published an initial assessment of the classification introduced by the European Sustainable Finance Disclosure Regulation (SFDR). The AMF examines the classification of funds in terms of their exposure to the fossil fuel industry. The AMF points out that the study is based on data up to the end of 2021 and does not take into account possible reclassifications of certain funds at a later date. The AMF notes that one fifth of French funds (i.e., 1,963 funds) fall under either Article 8 or Article 9 of the SFDR. If Article 8 and Article 9 funds are less exposed to the fossil fuel industry, the study highlights that the definition of Article 8 funds is too broad. The AMF reiterates its proposal to introduce minimum environmental criteria in European regulation for financial products with sustainability ambitions.[link]

23 March 2023 [UK] – **The Pensions Regulator analyses pension schemes' annual climate reports**

The UK Pensions Regulator published its first observations following the introduction of climate risk governance and reporting requirements for large occupational pension schemes. The UK Pensions Regulator notes that 43 out of the 71 reports it analysed have set a formal net zero target. While good practice is emerging, the UK Pensions Regulator highlights a lack of disclosure on strategy, scenario analysis and metrics activities, as well as issues around the accessibility of data and reports. [link]

27 March 2023 [International] – **International Association of Insurance Supervisors releases Year in Review 2022**

In its Year in Review 2022 report, the International Association of Insurance Supervisors (IAIS) highlights the progress made over the past year to protect policyholders and contribute to maintaining global financial stability. It identifies climate-related risks as a key risk for the insurance sector. In 2022, the IAIS has encouraged supervisors to increase their focus on the accelerating transition and physical risks to the insurance sector and to ensure that insurers take appropriate action in response. The IAIS also notes that, from an insurance product perspective, gaps in protection against climate-related risks are in many cases significant. Supervisors expect these gaps to widen and the impacts of climate change to increase, with significant impacts on insurers' assets, risk management and product development. [link]

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