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

4 December 2023 [International] – **GFANZ publishes 2023 Progress Report**

The Glasgow Financial Alliance for Net Zero ("GFANZ") has published its 2023 Progress Report (here), highlighting the significant progress made in mobilising the financial sector to make voluntary, ambitious, science-aligned commitments in support of net zero.

For 2023, GFANZ had three core priorities:

i. **Mainstreaming transition planning.** In this context, the report notes increasing industry uptake of the 2022 GFANZ Net-Zero Transition Plan framework (here), and that GFANZ is working to accelerate the mainstreaming of transition plans by providing resources to financial institutions, and developing supporting technical tools and guidance. The report further sets out the strategic focus on energy and real economy transitions in heavy-emitting industries, with GFANZ having proposed a set of voluntary guidance to support the early retirement of coal-fired power plants in Asia Pacific.

ii. **Broadening and deepening GFANZ membership and participation.** The report notes that signatories to the sector-specific alliances continue to grow steadily (from 450 as at COP26 to more than 675 members from 50 jurisdictions as at

COP28), and that, in April 2023, GFANZ introduced a new sector-specific alliance, the Venture Climate Alliance, to define, facilitate, and realise net zero-aligned pathways for early-stage investments within the venture industry.

iii. **Mobilising capital to emerging markets and developing economies.** The report highlights in this respect GFANZ's work on country platforms (e.g., the Just Energy Transition Partnerships in Indonesia and Viet Nam) to support country-led transitions and bring together public and private development, and GFANZ's work with global stakeholders (e.g., multilateral development banks) to create the right conditions to support increased investment.

13 December 2023 [EU] – **ESMA announces common supervisory action on ESG disclosures under Benchmarks Regulation**

The European Securities and Markets Authority ("ESMA") has announced (here) that it will launch and carry out a common supervisory action ("CSA") with national competent authorities ("NCAs") on ESG disclosures under the Benchmarks Regulation ("BMR").

The CSA will focus on benchmarks administrators that have acquired an authorisation, registration, recognition, or endorsement of their benchmarks under the BMR, whether they are located in the EU or in a third country. The CSA will cover (i) disclosure of ESG factors in the benchmarks statement and in the benchmarks methodology; and (ii) specific disclosure requirements regarding climate benchmarks methodology.

The CSA aims to contribute to enhancing transparency and addressing greenwashing, one of ESMA's Union Strategic Supervisory Priorities for NCAs, with a view to protecting investors and further supporting the development of a credible ESG market.

ESMA and the NCAs will carry out the CSA during 2024 and until Q1 2025.

13 December 2023 [International] – **NGFS publishes guidance on developing scenarios for assessing nature-related economic and financial risks**

The Network for Greening the Financial System ("NGFS") has published a technical document containing recommendations on the development of scenarios for assessing nature-related economic and financial risks (here). The guidance addresses the growing consensus among financial actors that nature degradation poses risks to individual firms and the financial ecosystem at large.

The guidance envisions consistent narratives through which different hazards can be identified and explores methods and tools through which the economic (and ultimately financial) impacts of these hazards and the ability to mitigate them can be assessed. More specifically, the guidance (i) proposes approaches to developing narratives that could serve as starting points for the assessment of nature-related financial risks, distinguishing between approaches for physical risks and approaches for transition risks; (ii) reviews a range of modelling approaches for nature-economy models and biophysical models; (iii) examines alternative modelling approaches, with a focus on those that are able to both represent multiple hazards in multiple sectors and capture the indirect (cascading) impacts of these hazards throughout value chains (e.g., Multi-Regional Input-Output tables and models); and (iv) concludes with a list of options for central bankers and supervisors, to help them with the development of quantified nature-related scenarios in the short-term and within a longer-term programme while guiding them to respond dynamically to emerging nature-related risks.

13 December 2023 [EU] – **Platform on Sustainable Finance publishes draft report on Taxonomy-Aligning Benchmarks**

The EU Platform on Sustainable Finance has published a draft report on proposals to introduce EU taxonomy-aligning benchmarks ("TABs") with and without exclusions (here).

The main objective of the TABs is to support the development of innovative tools that contribute to the decarbonisation and greening of investment portfolios. More specifically, the TABs aim: (i) to ensure comparability of Taxonomy-aligning benchmarks methodologies while leaving benchmarks' administrators with flexibility in designing their methodology; (b) provide investors with an appropriate tool to align the Taxonomy with their investment strategy; (c) increase transparency on investors' impact; and (d) disincentivise greenwashing.

Against these objectives, the report defines TABs as investment benchmarks that incorporate, next to financial investment objectives, specific objectives related to greening of capital expenditure, greenhouse gas emission reductions, and the transition to a low-carbon economy through the selection and weighting of underlying constituents.

The main users of TABs are institutional investors, such as pension funds, foundations and (re)insurance companies, with the objective of protecting a significant share of their assets against investment risks related to climate change and the transition to a low-carbon economy. TABs could be used as (i) the underlying benchmark for passive investment strategies; (ii) an investment performance benchmark for greenhouse gas emission-related strategies which aim to scale environmentally sustainable capital expenditure; (iii) an engagement tool; and (iv) a policy benchmark to help guide strategic asset allocation.

The draft report is open for feedback until 13 March 2024 (here).

14 December 2023 [UK] – **Working Group publishes final version of voluntary code of conduct for ESG ratings and data product providers**

The Data and Ratings Working Group ("DRWG") has published a new, globally consistent, voluntary Code of Conduct for ESG ratings and data products providers (the "Code") (here), reflecting the recommendations put forward by the International Organization of Securities Commission ("IOSCO") in a 2021 report (here).

The Code sets out six principles which aim to support four key outcomes: (i) good governance; (ii) management of conflicts of interest; (iii) transparency; and (iv) sound systems and controls (with separate principles relating to securing quality, confidentiality, and engagement).

Once an ESG ratings or data product provider has signed up to the Code, this will be followed by an implementation period. At the end of this period, the principles should be embedded within the provider's organisation. By signing up to the Code, ESG ratings and data products providers agree to make available publicly, and to review at least annually (updating where appropriate), a statement explaining their approach to the implementation of the Code.

The Code is expected to be internationally interoperable, and it is hoped that it will represent an important step towards a globally consistent regulatory framework (while legally binding frameworks in the UK and the EU are still being developed).

The International Capital Market Association will publish and maintain on its website a list of providers that agreed to adhere to the Code.

15 December 2023 [EU] – **ESMA consults on supervision of corporate sustainability information under CSRD**

In response to its mandate under the Corporate Sustainability Reporting Directive ("CSRD"), ESMA has published a consultation paper (here) on draft guidelines on the supervision of sustainability reporting by national competent authorities ("NCAs").

The main goals of the draft guidelines are to (i) ensure that national competent authorities carry out their supervision of listed companies' sustainability information in a converged manner, and (ii) establish consistency in, and equally robust approaches to, the supervision of listed companies' sustainability and financial information with a view to facilitating increased connectivity between the two types of reporting.

The draft guidelines cover a number of issues, including: (i) basic concepts (e.g., the objective of enforcement); (ii) enforcers' internal organisation; (iii) the selection of issuers whose sustainability information will be examined; (iv) the examination of sustainability information; (v) enforcement actions in case an infringement is discovered during the examination; and (vi) European coordination of enforcement.

ESMA will receive feedback to the consultation paper (here) until 15 March 2024 and expects to publish the final guidelines by Q3 2024.

18 December 2023 [UK] – **UK Government launches Transition Finance Market Review**

As part of the UK's March 2023 Green Finance Strategy (here), the Department for Energy Security & Net Zero and HM Treasury have commissioned a review (here) to consider what the UK financial and professional services ecosystem needs to do to become a leading hub for, and provider of, transition financial services, i.e., financial products and services that support higher emitting companies and activities to decarbonise over time.

Specifically, the review will consider what market tools would be most impactful, and explore how best to create the conditions for, (i) scaling transition focused capital raising, while maintaining the integrity of climate goals and helping to build trust in financial solutions; (ii) maximising the opportunity for UK based financial services to develop, structure and export high integrity transition finance services; and (iii) positioning the UK's professional services ecosystem as a global hub, including by supporting this innovative activity and ensuring market confidence.

The review aims to report back to government by July 2024.

Banking

11 December 2023 [EU] – **ECB publishes study on environmental impact of euro banknotes**

The European Central Bank ("ECB") published a study of the environmental footprint of euro banknotes as a payment instrument (here).

The study shows that the average environmental footprint for payments with banknotes was 101 micropoints (µPt) per euro area citizen in 2019. This is equivalent to driving a car for 8 km, or 0.01% of the total environmental impact of a European's annual consumption of activities.

The study forms part of the ECB's broader research aimed at reducing the environmental impact of paying with euro bank notes and is expected to feed into the development of the ECB's future series of euro banknotes with a view to make them as environmentally friendly as possible.

12 December 2023 [EU] – **EBA publishes annual risk assessment report**

The European Banking Authority ("EBA") has published its annual risk assessment of the European banking system (here). The report is accompanied by the publication of the 2023 EU-wide transparency exercise, which provides detailed information for 123 banks from 26 countries across the EU and the EEA (here).

The report reveals that climate-related and broader ESG risks are increasingly in banks' focus. Institutions bear the risk of possible deterioration in their asset quality through the occurrence of climate-related physical risk events, as well as transition risks through their lending and investment activities, notably those banks with exposures that significantly contribute to climate change. ESG factors are potential triggers of financial risks to banks' balance sheets, and a source of reputational risk. Banks regard ESG considerations as a key priority going forward to offering sustainable lending to a broad spectrum of clients, including retail, despite the obstacles identified by the banks, such as lack of data, transparency, and regulatory uncertainty.

15 December 2023 [EU] – **proposes voluntary EU green loan label to help spur markets**

In response to a European Commission call for advice, the EBA published an Opinion (here) and Report (here) on green loans and mortgages.

The EBA highlights that green lending currently represents a limited share of overall lending by the banking sector. To facilitate a more active participation by banks in the green loans market, the EBA proposes the introduction of a voluntary EU label for green loans based on a common EU definition. The EBA also proposes to integrate the concept of green mortgage and its key sustainability features in the Mortgage Credit Directive.

More specifically, the EBA proposes that (i) the EU definition and labelling framework for green loans, while based on the Taxonomy, incorporate a degree of flexibility to facilitate market participants' credible efforts in contributing to environmental objectives; (ii) the labelling framework for green loans provide the necessary information and transparency for prospective borrowers (e.g., long-term benefits of investing in energy-efficient solutions, documentation requirements and availability of financial support schemes); and (iii) when reviewing the Mortgage Credit Directive, it consider integrating the concept of green mortgages as well as the expected features of these loans.

18 December 2023 [EU] – **ECB and ESRB publish report on impact of climate change on the EU financial system**

The ECB and the European Systemic Risk Board ("ESRB") published a joint report on the impact of climate change on the EU financial system (here).

The report sets out detailed frameworks for addressing risk to the financial system:

i. **a surveillance framework** and accompanying Chartbook (here) to gather evidence on the most important financial stability indicators. The report notes that banks have a key role to play within the financial system when it comes to managing and reducing risks to financial stability that arise from emissions of the EU economy, given that they lend disproportionately to sectors with high exposure to climate-related risk. Reassessing and repricing climate risk could create financial instability through numerous channels, including the transmission of climate shocks through global value chains and the potential for financial contagion as both banks and financial markets seek to simultaneously reposition their asset portfolios against the backdrop of a significant insurance protection gap.
ii. **a macroprudential policy framework** for addressing climate risk, including considerations for operationalising that framework with existing instruments. The report suggests a system-wide prudential approach that would (A) focus on managing risks not only for the banking sector but also for borrowers, (B) tackle risks in non-bank financial intermediation, notably gaps in insurance protection and information, including the need for reliable disclosures and robust green labels, and (C) complement ongoing microprudential efforts, including ECB Banking Supervision's work on climate-related and environmental risk. This approach could draw on existing instruments in the EU macroprudential toolkit (including, in particular, systemic risk buffers or risk concentration limits).
iii. **a framework for nature-related risks**, i.e., how the degradation of nature potentially poses additional risks for financial stability.

The report follows three previous ECB/ESRB reports on climate risk and is part of the ECB's broader response to climate change, which includes, on the prudential side, the ECB's latest economy-wide climate stress test (here) and its climate-related and environmental risk management expectations for supervised banks (here).

Asset Management

14 December 2023 [EU] – **ESMA proposes changes and updates timeline for its Guidelines on funds' names**

Following a November 2022 consultation paper (here) and consideration of the responses thereto, ESMA has published a statement (here) updating its plans for the adoption of guidelines on funds' names using ESG or sustainability-related terms.

Reflecting the consultation feedback ESMA has received, the following changes will be made to the guidelines: (i) with regard to the question of a threshold for sustainable investments, ESMA proposes that funds should (A) apply the 80% minimum proportion of investments used to meet the sustainability characteristics or objectives, (B) apply the Paris-aligned Benchmark (PAB) exclusions, and (C) invest meaningfully in sustainable investments as defined in the SFDR, reflecting the expectation investors may have based on the fund's name; (ii) introducing a new category for transition-related terms (for which, in addition to the 80% threshold, Climate Transition Benchmark exclusions should be applied); (iii) separating "E" from "S" and "G" terms (to avoid overly restricting funds promoting social characteristics or objectives in their investment universe by fossil fuel exclusions); and (iv) clarifying that funds using "transition" or "impact"-related terms in their names should ensure that relevant investments generate measurable impacts or are on a clear and measurable path to social or environmental transition.

In terms of timing, ESMA will postpone the adoption of the guidelines to allow for full consideration of the outcome of the reviews of the Alternative Investment Fund Managers Directive (2011/61/EU) and UCITS Directive (2009/65/EC). ESMA will adopt and publish the final guidelines shortly after the date of entry into force of those amended legal texts.

Insurance

11 December 2023 [EU] – **EIOPA publishes annual financial stability report**

The European Insurance and Occupational Pensions Authority ("EIOPA") has published its December 2023 Financial Stability Report (here) alongside a data and figures sheet (here), which explores the challenges the changing macroeconomic landscape poses for insurers and pension funds.

Discussing key developments and risks, the report highlights the recurring droughts and fires across Europe in the summer of 2023, and emphasises that the risks of climate change for insurers and pension funds remain a key priority of the EIOPA work.

The report also sets out results of the questionnaire to national competent authorities, including that the materiality of ESG risks is also expected to increase in the next 12 months with climate physical risks as the main driver.

Lastly, the report notes that, in 2024, EIOPA will focus its financial stability activities on stress test and scenario analyses. In parallel with the Fit-for-55 cross financial sector climate scenario analysis, EIOPA will run its regular EU-wide insurance stress test exercise. It will test the resilience of the capital and liquidity positions for European insurers in an adverse economic scenario with higher yields and inflation.

12 December 2023 [EU] – **EIOPA consults on sustainability claims and greenwashing in the insurance and pensions sectors**

EIOPA has published a consultation paper on the Opinion on sustainability claims and greenwashing in the insurance and pensions sectors (here). The consultation paper follows a Joint Call for Evidence on greenwashing carried out by the European Supervisory Authorities in December 2022 (here).

The draft Opinion aims to facilitate a more effective and harmonised supervision of sustainability claims across Europe and thereby limit the risk of greenwashing in the insurance and occupational pensions sectors.

With that aim in mind, the consultation paper sets out four principles that should be observed when providers make sustainability claims (illustrated by examples of good and bad practices for each principle): (i) sustainability claims made by a provider should be accurate, precise, and consistent with the provider's overall profile and business model, or the profile of its product(s); (ii) sustainability claims should be kept up to date, and any changes should be disclosed in a timely manner and with a clear rationale; (iii) sustainability claims should be substantiated with clear reasoning and facts; and (iv) sustainability claims and their substantiation should be accessible by the targeted stakeholders.

The EIOPA will receive responses to the consultation until 12 March 2024 (here).

13 December 2023 [EU] – **EU legislators reach political agreement on Solvency II review**

The European Council and Parliament have reached a provisional agreement on amendments to the Solvency II directive, and new rules on insurance recovery and resolution ("IRRD"). This deal will ease the European Union's capital rules for insurers, to free up capital for investing in green technology. These new rules aim to boost the role of the insurance and reinsurance sector in providing long-term private sources of investments to European businesses, while making the sector more resilient and able to better protect insurance policyholders.

Importantly, according to a press release by the Council (here), the provisional agreement will incentivise insurers to invest in long-term capital for the economy, notably towards the Green Deal. According to members of the committee who led negotiations on behalf of parliament, the changes to Solvency II include new provisions that will require insurance firms to better take into account sustainability-related risks, and to report more about these risks so that policyholders can understand a firm's green credentials (here).

The texts of the provisional agreements will now be finalised and presented to member states' representatives and the European Parliament for approval. If approved, the Council and the Parliament will have to formally adopt the texts.

13 December 2023 [EU] – **EIOPA consults on prudential treatment of sustainability risks**

In response to its mandate to assess the potential for a dedicated prudential treatment of assets or activities associated significantly with environmental or social objectives, or harm to such objectives, EIOPA has published a consultation paper on the prudential treatment of sustainability risks (here). The consultation paper follows a 2022 discussion paper which outlines the scope, methodologies, and data sources for the analysis on prudential treatment of sustainability risks (here).

The consultation paper focuses on three conceptual areas: (i) the potential link between prudential market risks in terms of equity, spread and property risk and transition risks; (ii) the potential link between non-life underwriting risks and climate-related risk prevention measures; and (iii) the potential link between social risks and prudential risks, including market and underwriting risks.

Responses to the consultation paper will be received until 22 March 2024 (here). The consultation paper will form the basis of the report envisaged to be submitted to the European Commission after consulting the European Systemic Risk Board.

14 December 2023 [EU] – **EIOPA launches open-source Catastrophe Data Hub as a key part of its climate change adaptation strategy**

In the context of its 2023 Sustainable Finance Conference, EIOPA has launched a Catastrophe Data Hub (here).

The Catastrophe Data Hub is an open-source collection of catastrophic risk data at European level. As threats from climate change evolve, losses attributable to rising global temperatures are expected to increase, and the already substantial insurance protection gap could expand further. Against the background of these risks, the Catastrophe Data Hub is designed to support (i) supervisors (to understand the size of the insurance exposure and natural catastrophe losses, assess capital requirement calibrations and quantify the insurance protection gap); (ii) the insurance sector (to benefit from access to loss data and a complete view of the market, while facilitating further development of catastrophe models); (iii) policy and decision-makers (to take adequate prevention measures); and (iv) academics (to develop independent model and studies on the increase in losses due to climate change).

The Catastrophe Data Hub contains links to a technical note (here) which sets out a technical description of the hub, as well as to spreadsheets setting out historical loss data (here) and flood windstorm exposure data (here).

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