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

1 June 2023 [EU] – **ESAs publish Progress Reports on Greenwashing in financial sector**

After the European Commission's May 2022 request for input related to greenwashing risks and supervision of sustainable finance policies [link], the European Supervisory Authorities (**ESAs**) now published their progress reports on that topic.

The ESAs arrived at a common high-level understanding of 'greenwashing' as a "practice where sustainability-related statements, declarations, actions, or communications do not clearly and fairly reflect the underlying sustainability profile of an entity, a financial product, or financial services" and which "may be misleading to consumers, investors, or other market participants". In addition, the progress reports – considered further below – highlight each ESA's current thinking on greenwashing and related risks in their respective sector.

The report by the European Securities and Markets Authority (**ESMA**) highlights that misleading claims may relate to all key aspects of the sustainability profile of a product or an entity, including governance aspects, sustainability strategy, targets and metrics, or claims about impact. Important causes of greenwashing include insufficient availability of high-quality sustainability data, and challenges in keeping up with fast-moving regulatory developments and in implementing governance tools and processes generally. To mitigate greenwashing risks, ESMA considers that market participants will need to improve the comprehensibility of sustainability disclosures to retail investors (including by establishing a reliable and well-designed labelling scheme for financial products), and the regulatory framework will need to mature and become better integrated. [link]

The report by the European Banking Authority (**EBA**) notes that there are multiple ways in which banks can engage in greenwashing, both at entity level and also at product level (especially in relation to investment products), and that pledges about future ESG performance are considered to be particularly prone to greenwashing. The EBA's data shows a clear increase (since 2012) in the total number of potential cases of greenwashing across all sectors, including EU banks. This increase may be driven either by increased greenwashing practices by market participants or by increased scrutiny by stakeholders. Key risks arising from greenwashing include reputational risk, followed by operational and strategic/business risk. While the materiality of greenwashing risk to banks is currently perceived as rather low, it is expected to increase in the future. [link]

The report by the European Insurance and Occupational Pensions Authority (**EIOPA**) considers that greenwashing can occur at all stages of the insurance (*e.g.*, entity level, product manufacturing, delivery and management) and pensions (*e.g.*, scheme design, delivery and management) lifecycles. The potential impact of greenwashing involves: (i) from a consumer perspective, purchasing products that are not aligned with a consumer's preferences and, more generally, mistrust towards insurance and pension providers; (ii) from the perspective of insurance/pensions providers, reputational and financial damage; and (iii) from a wider economic perspective, hindering the financing of the green transition. Further, the report notes that some early supervisory challenges include resource constraints, limited expertise on sustainable finance requirements and the lack of methodologies to assess greenwashing in the insurance and pensions sectors. EIOPA considers the current EU sustainable finance regulatory framework to provide a good initial basis to tackle greenwashing in the insurance and pensions sectors but sees some gaps and limitations; it therefore plans to propose improvements to the regulatory framework in its final report. [link]

The ESAs' mandate requires them to publish final greenwashing reports and recommendations, including on possible changes to the EU regulatory framework, in May 2024.

## 1 June 2023 [EU] – **European Parliament adopted amendments to draft Corporate Sustainability Due Diligence Directive**

In February 2022, the European Commission published its proposal for a Corporate Sustainability Due Diligence Directive [link]. The draft directive would put in place obligations for companies regarding actual and potential human rights adverse impacts and environmental adverse impacts, with respect to their own operations, the operations of their subsidiaries, and the value chain operations carried out by entities with whom the company has an established business relationship.

The European Parliament now adopted its negotiating position, voting in favour of the proposal, subject to certain amendments. The Council having adopted its negotiating position in December 2022, the Parliament's vote allows trialogue negotiations between Commission, Parliament and Council to begin, with a view to reaching an agreement on the final text of the directive. [link]

### 6 June 2023 [Global]: **World Economic Forum and ISSB join forces on sustainability reporting**

The World Economic Forum announced the signing of a Memorandum of Understanding (MoU) with the International Sustainability Standards Board (ISSB) to collaborate and share best practices in sustainability reporting. The goal of the partnership is to create a comprehensive global baseline for sustainability reporting. Best practices and lessons learned from companies reporting against the forthcoming ISSB Standards will be shared. The MoU also includes other areas of collaboration and the provision of corporate case studies in order to achieve the global baseline for sustainability reporting. [link – link]

### 6 June 2023 [EU]: **The ECB issues an opinion on a proposal for corporate sustainability due diligence directive**

The ECB has issued an own-initiative opinion on the proposed Directive on corporate sustainability due diligence ("CSDD") based on Articles 127(4) and 282(5) of the TFEU. The ECB justifies the issuance of this opinion by the fact that the CSDD contains provisions that would have an impact on the prudential supervision of credit institutions. The ECB recommends that an exchange of information between prudential supervisory authorities and other authorities responsible for supervising the compliance with activities outside the scope of ECB's competence should be agreed, since, for example, human rights and environmental due diligence do not fall within the ECB's competence. The ECB underlines that litigation risks for banks may increase significantly as the CSDD would introduce a new civil liability regime for companies. The ECB expects supervised credit institutions to manage these risks in line with the ECB's prudential supervisory expectations communicated by the ECB. In addition, the ECB notes that transition planning will be a component of the Capital Requirements Directive, which is currently under review. The ECB underlines that the aim and purpose of transition planning is not fully aligned between the CRD, the CSRD and the CSDD.

Finally, the ECB proposes an amendment to Article 21(1) of the CSDD aimed at integrating the ECB into the European Network of Supervisory Authorities that is to be established by the Commission. [link]

### 9 June 2023 [EU]: **The Commission consults on a proposed Delegated Regulation on first set of EU sustainability reporting standards**

The Commission published a consultation on proposal for a Delegated Regulation to set the first EU sustainability reporting standards. The proposed Delegated Regulation sets out the EU sustainability reporting standards that would apply to all companies within the scope of the CSRD. The proposed Delegated Regulation has two annexes. Annex 1 contains proposed cross-cutting standards (on general requirements and general disclosures, namely governance, strategy, risk and opportunity management,

…) and, specific standards on environmental or social disclosures and on governance. Annex 2 contains the list of acronyms and definitions to be used.

Feedback is expected no later than July 7, 2023.

This consultation is part of the expected timetable for the CSRD, according to which the Commission will adopt the first set of standards by June 2023, and sector-specific standards, proportionate standards for listed SMEs, and the standard for non-EU companies by June 2024. [link]

## 9 June 2023 [EU]: **the NGFS publishes results of survey on its climate scenarios**

The "Network for greening the financial system" (**NGFS**) (a ground of central banks and supervisory authorities launched at the Paris One Planet Summit in December 2017) has summarized the key findings of a public survey on climate scenarios, launched last February. Among the key findings, more than 70% of respondents use NGFS scenarios to assess the impact of climate risks on their organizations. Respondents highlighted the need for technical improvements to these scenarios, in particular to strengthen sectoral and geographic granularity. NGFS announced that a new version of the NGFS scenarios will be released by the end of 2023. [link]

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