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CLEARY GOTTLIEB

17 October 2023

Climate and the Financial Sector

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

General

4 October 2023 [EU] – **ESAs Publish Joint Committee 2024 Work Programme**

The European Supervisory Authorities (ESAs) (i.e. the European Banking Authority, the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority) published their work program for 2024. In the area of sustainable finance, the ESAs plan to (i) publish their third annual report under Article 18 of the Sustainable Finance Disclosure Regulation (SFDR) on the extent and quality of voluntary reporting of the principal adverse impacts of investment decisions on sustainability factors and (ii) monitor the practical application of the SFDR, the Delegated Regulation in particular, to determine whether Q&As or other Level 3 supervisory convergence tools are needed to provide further guidance to national competent authorities and market participants. [link]

5 October 2023 [EU] – **European Parliament Adopts the EU Green Bond Standard Regulation**

The EU Parliament adopted the EU Green Bond Standard (EU GBS) Regulation, which sets uniform standards for issuers wishing to use the term “European Green

Bond" or "EuGB" to market their bonds. The EU GBS is designed to help investors choose sustainable companies and avoid greenwashing or misleading climate friendly claims. Any company that chooses to use the EU GBS, and, therefore, the EuGB label, when marketing a green bond, will be required to disclose significant information about how the proceeds of the bond will be used and how these investments fit into the company's overall transition plans. The EU GBS are aligned with the EU taxonomy framework. Until this framework is fully operational, issuers of a EuGB will need to ensure that at least 85% of the funds raised by the bond are Taxonomy-aligned. [link - link]

5 October 2023 [Global] – **Basel Committee Agrees to Consult on Climate Disclosures**

The Basel Committee agreed to consult on a Pillar 3 disclosure framework for banks' exposures to climate-related financial risks. The consultation paper on the proposed framework is expected to be released by November 2023. [link]

5 October 2023 [UK] – **ISDA comments on UK draft Voluntary Code of Conduct for ESG Ratings and Data Product Providers**

In July, the UK's ESG data and ratings working group's (DRWG) published for consultation a draft voluntary code of conduct for ESG ratings and data product providers (here). The International Swaps and Derivatives Association (ISDA), a trade organisation for over-the-counter derivatives, has now responded to this consultation (here).

ISDA generally supports the introduction of a code of conduct as a temporary solution until a regulatory regime in the UK for ESG ratings providers is implemented. However, ISDA provided a few comments on the proposed draft code: in terms of scope, ISDA would propose that proxy advisory services should not be excluded from the scope of the code, and it considers that the code should also apply to second-party opinions and controversies alerts. Regarding the provisions of the draft code relating to systems and controls (which aim to ensure high quality of ratings), ISDA recommends that these provisions should also deal with questions of outsourcing. Another comment from ISDA is that conflict-of-interest recommendations could include the establishing of a firewall between sales and evaluation divisions.

For an analysis of the proposed code, please refer to the dedicated article written by Cleary Gottlieb attorneys (here, and also available on request).

6 October 2023 [EU] – **ESMA Provides Analysis on Issuers' Potential Benefits from an ESG Pricing Effect**

The European Securities and Markets Authority (ESMA) published a study on the European sustainable debt market, analysing the existence of an ESG pricing effect (the "'greenium") across different types of sustainable-labelled debt instruments. It notes that the results as of March 2023 do not confirm the systematic existence of a greenium for any sustainable bond category. However, ESG bond issuers have historically benefited from statistically significant pricing driven by their ESG credentials at the issuer level. In addition, ESMA finds that issuer-level public ESG commitments have no impact on bond prices overall. Finally, according to ESMA, the results are encouraging from a financial stability perspective, as price divergences between sustainable and conventional debt instruments appear to be driven by the same fundamental risk factors, such as an issuer's creditworthiness, and not solely by a bond's ESG status. [link]

6 October 2023 [EU] – **European Parliament's draft report on legislative proposal to regulate ESG ratings**

In June, the European Commission published a proposal for a regulation on the transparency and integrity of ESG rating activities (the "**Proposal**") (here). The European Parliament's Committee on Economic and Monetary Affairs now published a draft report on the Proposal (here).

The draft report sets out a set of amendments to the Proposal which may form the basis of the Parliament's position on it.

The background to these amendments is set out in an explanatory statement. Amongst other things, the rapporteur notes the following in the explanatory statement: (i) the disclosure requirements in the Proposal should be more stringent and instructive (especially as regards the type of materiality that is being considered and aggregation of E, S and G scores); (ii) encouraging competition among ESG rating providers and fostering an environment where smaller rating providers can enter the market is essential; (iii) following landmark legislative initiatives (e.g., SFDR, Taxonomy, CSRD), ESG rating providers should actively incorporate this standardized data into their assessments; (iv) as the ESG ratings market currently suffers from a lack of transparency, the reliability and transparency of ESG ratings activities needs to be improved; (v) the objectives of the rating providers need to be clarified (keeping in mind that a complete and relevant evaluation should not be limited to assessing financial materiality but also considered the consequences of the company's activity on society).

The draft report will in due course be subject to consideration by the Parliament's Committee on Economic and Monetary Affairs, and, following that, by the European Parliament itself.

For further information on the Proposal, please refer to our firm's dedicated alert (here).

9 October 2023 [UK] – **Transition Plan Taskforce published its final framework for disclosure of private sector transition plans**

The UK Transition Plan Taskforce (TPT) published its final disclosure framework for climate transition plans and accompanying implementation guidance (here).

The TPT's framework builds on the IFRS's S2 Standard definition of transition plans as "an aspect of an entity's overall strategy that lays out the entity's targets, actions or resources for its transition towards a lower-carbon economy, including actions such as reducing its greenhouse gas emissions." It recommends disclosures in 19 areas, grouped under the broad headings of foundations, implementation strategy, engagement strategy, metrics & targets, and governance.

Further sector specific guidance is expected to be consulted on in November 2023 and to be published in early 2024.

The UK Financial Conduct Authority (FCA) has welcomed the publication of the TPT's framework, noting that it is committed to drawing on the TPT framework as it further develops its disclosure expectations for listed companies, asset managers and FCA-regulated asset owners (here). The FCA also plans, in 2024, to consult on guidance that will set out the FCA's expectations for listed companies' transition plan disclosures (see here).

For further information on transition plan related disclosure requirements across the UK, EU and the US, please refer to our firm's dedicated alert (here).

9 October 2023 [EU] – **ESMA speech on European Supervisory Authorities' work on financial education**

Verena Ross, the Chair of the European Securities and Markets Authority (ESMA), gave a welcome speech at the Joint ESAs Consumer Protection Day 2023 (here).

The speech highlighted "consumer centric culture" across the EU and the importance of financial education to consumer protection, a topic which is generally a priority for the European Supervisory Authorities. The speech also noted that ESMA developed interactive factsheets directed at consumers to educate them on various key themes, including sustainable finance. These factsheets are expected to be published in November 2023, will be available in all EU languages and will be proactively promoted at national level with consumers.

11 October 2023 [International] – **FSB publishes annual report highlighting their work to assess and address vulnerabilities in the global financial system**

The Financial Stability Board (FSB) published an Annual Report on promoting global financial stability (here). Amongst a number of other areas, the report contains information on certain climate-change related aspects.

In respect of assessing vulnerabilities, the report notes that exposure to climate-related vulnerabilities is becoming more evident, and that any potential under-pricing of climate risks relating to assets could, if they subsequently materialise, adversely impact banks and non-bank investors that hold those assets.

With regard to addressing financial risks arising from climate change, the FSB highlighted the publication of sustainability disclosure standards by the ISSB. Other key initiatives include: (i) developing global repositories that provide open access to data, (ii) continuing work to assess climate-related vulnerabilities, including by setting out a conceptual framework for the impact of climate shocks on financial stability and by developing metrics and using the outputs from scenario analysis to monitor these vulnerabilities at the cross-sector and cross-jurisdiction level; (iii) embedding climate-related risks into risk management and prudential frameworks; and (iv) reviewing how climate-related objectives are incorporated into financial institutions' compensation frameworks in order to identify common challenges and share practices to ensure effective alignment of compensation with prudent risk taking.

12 October 2023 [International] – **TCFD publishes final status report**

The Task Force on Climate-related Financial Disclosures (TCFD) published its sixth and final status report (here). Like the TCFD's previous five reports, the Report provides an overview of current climate related financial disclosure practices, in terms of their alignment with the TCFD's recommendations.

Key findings of the report include: (i) the percentage of public companies disclosing TCFD-aligned information continues to grow, but more progress is needed; (ii) the percentage of companies reporting on climate-related risks or opportunities, board oversight, and climate-related targets has increased significantly; (iii) the disclosure of climate-related financial information in financial filings is limited; (iv) the majority of jurisdictions with final or proposed climate-related disclosure requirements specify that such disclosures be reported in financial filings or annual reports; (v) over 80% of the largest asset managers and 50% of the largest asset owners reported in line with at least one of the 11 recommended disclosures; and (vi) asset managers and asset owners indicated the top challenge to climate-related reporting is insufficient information from investee companies.

As key areas of further work, the report highlighted: (i) ensuring interoperability of the ISSB standards with jurisdictional frameworks; (ii) developing implementation guidance; (iii) companies' disclosure of the resilience of their strategies under different climate-related scenarios; (iv) decision-useful disclosure on other sustainability topics linkages between climate-related and other sustainability issues (for example, in the context of companies' transition plans); and (v) a consistent climate-related financial disclosure framework for use by countries and other sovereign entities.

12 October 2023 [International] – **FSB publishes 2023 progress report on climate-related disclosures**

The FSB has published its annual progress report on climate-related disclosures (here).

From a global perspective, the report highlights the ISSB's progress (in particular the publication of the IFRS S1 and IFRS S2 disclosure standards), as well as progress in the area of assurance, including the work by the International Auditing and Assurance Standards Board (IAASB), the International Ethics Standards Board for Accountants (IESBA), and the progress made by the International Organization of Securities Commissions (IOSCO) on supporting the work on both disclosure and assurance standards. From a jurisdiction-level perspective, the report describes various jurisdictions' progress on climate-related disclosure practices, including implementation of TCFD recommendations, scope of climate-related disclosures, and jurisdictions' processes for adopting, implementing or otherwise making use of the ISSB Standards. From a company-level perspective, the report discusses the progress on companies' climate-related financial disclosures, including TCFD alignment and considerations related to financial statements.

With the ISSB's inaugural Standards having been released, the TCFD's work is now complete, and the FSB has requested the ISSB to assume responsibility for monitoring progress on the state of climate-related financial disclosures by companies as of next year.

12 October 2023 [UK] – **CMA launches green agreements guidance**

Following a consultation earlier this year, the Competition and Markets Authority (CMA) has published its "Green Agreement Guidance" on the application of the Chapter I prohibition in the Competition Act 1998 to 'environmental sustainability agreements' (here). The guidance aims to provide legal certainty, and to ensure competition law does not impede legitimate industry collaboration on environmental initiatives.

The guidance discusses which types of (sustainability) agreements between competitors are unlikely to raise competition concerns in the first place, e.g., agreements which do not relate to the way businesses compete with each other, or agreements which do not appreciably affect competition. In respect of agreements that do raise competition concerns, the guidance explains in what circumstances such agreements may benefit from an exemption from the prohibition. Specifically, the guidance provides helpful clarification of the circumstances in which the following four requirements may be satisfied: (i) that the agreement must result in objective benefits to production, distribution or technical or economic progress; (ii) that the agreement must be indispensable; (iii) that consumers must receive a fair share of the benefit; and (iv) that the agreement must not substantially eliminate competition. A particularly tolerant approach is adopted in respect of climate change agreements.

The guidance also sets out the CMA's "open-door policy": business considering entering into an environmental sustainability agreement may request informal guidance where there is uncertainty or where they seek clarity or comfort as to the application to specific circumstances. Where the CMA provides advance guidance under the open-door policy, the CMA will not subsequently issue fines against the parties nor seek disqualification of any directors (provided that no material information was withheld when approaching the CMA).

For further information on the Proposal, please refer to our firm's dedicated alert (here).

Banking

12 October 2020 [EU] – **EBA publishes report on the role of environmental and social risks in the prudential framework**

The European Banking Authority (EBA) published a report on the role of environmental and social risks in the prudential framework of credit institutions and investment firms (here).

The report recommends targeted, risk-based to the risk categories of the Pillar 1 framework, and develops considerations on the potential use of macroprudential tools.

In the short-term (to be implemented over the next three years), the EBA recommends to: (i) include environmental risks as part of stress testing programmes under both the internal ratings-based (IRB) and the internal model approaches (IMA) under the Fundamental Review of the Trading Book (FRTB); (ii) encourage inclusion of environmental and social factors as part of external credit assessments by Credit Rating

Agencies; (iii) encourage the inclusion of environmental and social factors as part of due diligence requirements and valuation of immovable property collateral; (iv) require institutions to identify whether environmental and social factors constitute triggers of operational risk losses; and (v) progressively develop environment-related concentration risk metrics as part of supervisory reporting.

The report also presents possible revisions of the Pillar 1 framework in the medium-to-longer term.

Asset management

2 October 2023 [EU] – **ESMA Publishes a Report on ESG Names and Claims in the EU Fund Industry**

ESMA published a Trends, Risks and Vulnerabilities (TRV) risk analysis report on ESG names and claims in the EU funds industry, which examines the use of language related to ESG factors in the names and documentation of EU investment funds. According to ESMA, "*the assessment of how investment funds signal themselves (via their name or via their documents) is an important first step in the detection and monitoring of potential greenwashing, given that greenwashing stems – first and foremost – from misleading, confusing, or inaccurate claims*". Through the study, ESMA found in particular that an increasing number of funds are including ESG terms in their names and that, of the ESG terms included, funds prefer to include less specific terms (i.e. broad ESG terms rather than more specific "E" or "S" terms). In addition, ESMA notes that funds with ESG-related language in their names provide more extensive ESG disclosures in their investment strategy and KIID/KID than other funds. Finally, ESMA highlights that funds sold to retail investors are associated with more ESG language in the KIIDs/KIDs compared to funds sold to institutional investors. However, this is not the case for the investment strategy or marketing material, suggesting that fund managers adapt their communication strategies to the expected types of readers. [link]

3 October 2023 [EU] – **ESMA to Launch Common Supervisory Action on MiFID II Sustainability Requirements in 2024**

The ESMA announced that it will launch and conduct a common supervisory action (CSA) with national competent authorities in 2024 on the integration of sustainability into firms' suitability assessment and product governance processes and procedures under MiFID II. The objective of the CSA is to assess the progress made by intermediaries in applying the key sustainability requirements that came into force in 2022. According to ESMA, the CSA will cover how firms (i) collect information on their clients' sustainability preferences, (ii) ensure the suitability of an investment from a sustainability perspective and (iii) specify any sustainability-related objectives with which a product is compatible as part of the target market assessment of the investment product. The CSA will also address the arrangements firms have put in place to understand and correctly categorise investment products with sustainability factors for the purposes of suitability assessment. [link]

12 October 2020 [EU] – **European Commission publishes speech on SFDR**

Commissioner McGuiness delivered a speech (here) on the EU's sustainable finance framework (including the Taxonomy, various disclosure-related frameworks, benchmarks regulation, and the European Green Bond Standard), and what the next steps in this area might be, especially in respect of the Sustainable Finance Disclosure Regulation (SFDR).

While noting that the SFDR has improved transparency about sustainability claims by marketers of financial products, the speech highlighted that some problems remain, especially because the regulation is effectively being used as a labelling scheme, while it was intended to address transparency issues. This use as labelling scheme is problematic, McGuinness considers, given that the SFDR does not currently set out any binding thresholds, nor strict definitions for certain key concepts (e.g., 'sustainable investment'). This lack of certainty could lead to lack of clarity for investors and a risk of greenwashing or mis-selling.

The speech also noted that another key element that needs to be examined and understood is how the SFRD interacts with other parts of the sustainable finance framework and financial regulations as a whole, including the Taxonomy and the Corporate Sustainability Reporting Directive, as well as in the international context.

Insurance

6 October 2023 [EU] – **EIOPA integrates ESG into its 2024-2026 strategic priorities**

In its 2024-2026 work program, the European Insurance and Occupational Pensions Authority (EIOPA) states that it will focus on integrating sustainable finance considerations into the insurance industry. In particular, EIOPA aims to integrate ESG risks into the prudential frameworks applicable to insurers and pension funds. [link]

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