CLEARY GOTTLIEB

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Climate and the Financial Sector

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

General

1 July 2024 [EU] – **European Commission launches consultation to update monitoring and reporting under EU ETS**

The European Commission launched a consultation [available here] on a draft Implementing Regulation to amend Implementing Regulation (EU) 2018/2066 on monitoring and reporting greenhouse gas emissions under the EU Emissions Trading System (EU ETS).

This initiative is part of a broader update of regulatory acts, following the ETS Directive's revision with the EU target set out in the European Climate Law to reduce net greenhouse gas emissions by 55% by 2030, compared to 1990 levels.

The draft Implementing Regulation makes technical amendments relating to the monitoring and reporting of greenhouse gas emissions from certain products (such as biomass fuels) and activities, either already in scope of the EU ETS (such as oil refining), or set to be in scope of the new emissions trading system for buildings, road transport and non-EU ETS industry.

The Implementing Regulation is set to be adopted within Q3 2024, with provisions either applying retrospectively from 1 January 2024, or from 1 January 2025. The consultation is open until 29 July 2024.

2 July 2024 [International] – **NGFS publishes two reports on nature-related risks**

The Network for Greening the Financial System (NGFS) published the final version of the Conceptual Framework for nature-related financial risk [available here] and a report on emerging trends and lessons learned from climate-related litigation [available here].

The Conceptual Framework sets forth minor revisions from its September 2023 beta version, focusing on alignments with other frameworks that have since entered into force. It is further supplemented with illustrative cases about forest and freshwater ecosystems, which show how the framework can be operationalized by central banks and financial supervisors.

The Nature-related litigation report comes after the two September 2023 climate-related litigation reports and highlights emerging trends in this field. It takes the position that nature-related legal actions will likely grow and encourages central banks, supervisors and financial institutions to closely monitor developments in this area of litigation. The report considers:

- Examples of strategic nature-related litigations, noting that while most cases have been directed at states and public entities, financial institutions are now being targeted.
- Nature-related legislation, suggesting that legislation may offer new grounds for future litigation, while litigation may fill gaps where legislation is weakly enforced.
- Potential risks arising from nature-related litigation, such as transition risk and compliance costs.

The NGFS press release [available here] notes that *"The two reports are complementary: the Conceptual Framework outlines the broad framework for nature-*

related risks, the second report aims to raise awareness more specifically about nature-related litigation risk."

5 July 2024 [EU] – **CS3D published in the Official Journal of the European Union**

On 5 July 2024, the Corporate Sustainability Due Diligence Directive (CS3D) was published in the Official Journal of the European Union, following its adoption by the Parliament and Council in June [final text available here].

The CS3D will introduce wide-ranging obligations on certain EU and non-EU companies to address adverse impacts across their value chain and to publish transition plans aligned with the Paris Agreement.

The CSDDD will enter into force 20 days after its publication, and Member States will have until 26 July 2026 to transpose it into their national law.

An analysis of the proposal is available here, and an analysis of the CS3D and the German Lieferkettensorgfaltspflichtengesetz and the French Loi de vigilance here.

5 July 2024 [Germany] – **German Chancellor advocates for a speedy incorporation of the CS3D into national law**

At a press conference [transcript available here], German Chancellor Scholz, Federal Minister of Economics Habeck and Federal Minister of Finance Lindner presented the main aspects of the federal 2025 budget. In this context, it was announced that the CS3D should be adopted into national law as quickly as possible in order to then use the new legal standard it creates to streamline the existing German Act on Corporate Due Diligence Obligations in Supply Chains (*Lieferkettensorgfaltspflichtengesetz*, "LkSG").

As of 1 January 2025, two-thirds of the companies that have so far been subject to the LkSG would no longer be. All the regulations that go beyond the LkSG and are contained in the CS3D would be implemented at the latest possible point in time under EU law, and there would be a choice as to whether the reporting obligations under the LkSG are directly replaced by sustainability reporting based on the CS3D or not.

This would constitute a very significant reduction in the bureaucratic costs of the supply chain due diligence law, compared to current regulations. It is still unclear when these announced changes will be implemented into law.

5 July 2024 [EU] – **ESMA publishes final report on the Guidelines on Enforcement of Sustainability Information and a Public Statement on the first application of the ESRS**

The ESMA published a Final Report on the Guidelines on Enforcement of Sustainability Information [available here] and a Public Statement on the first application of the European Sustainability Reporting Standards [available here].

The Guidelines, detailed in Annex VI of the report, will govern the supervision of the first ESRS sustainability statements published in 2025, and are limited to listed undertakings, despite the framework covering a broader scope.

- The Guidelines will apply to the supervision of undertakings with securities traded on EU regulated markets, including third-country issuers using ESRS or equivalent sustainability reporting requirements.

The ESRS Public Statement focuses on large, listed issuers and does not cover reporting requirements under Article 8 of the Taxonomy Regulation.

- ESMA in particular advises having high-quality sustainability reporting, which requires proper governance arrangements and internal controls, as well as systems allowing for granular sustainability information.
- Other recommendations include transparency on the design and conduct of the double materiality assessment and the use of transitional reliefs, as well as the incorporation of a level of connectivity between financial and sustainability information.

Asset Management

1 July 2024 [UK] – **UK FCA publishes further guidance on its sustainability disclosure and labelling regime**

The Financial Conduct Authority (FCA), the UK's financial services regulator, has published an update to the guidance on its sustainability disclosure and labelling regime [available here], relevant for firms making sustainability-related claims about financial products and services.

The update sets out the necessary steps for notifying the FCA about the use of an investment label when one of the four following scenarios applies: (i) an authorized fund is considered to meet the label criteria without changes; (ii) an authorized fund is considered to require changes to meet the label criteria; (iii) a new fund is considered to meet the label criteria; and (iv) an in-scope unauthorized alternative investment fund (AIF) is looking to use an investment label. Although the FCA itself will not approve a label, firms using them are required to notify the FCA about their use, revision or cessation. Notifications will be made directly to the FCA through its Connect online system.

Under the updated guidance, the notification requirements for an investment label are an additional, final step that sits alongside the pre-existing procedures applicable in each scenario. Firms will be able to display the new investment labels from 31 July 2024.

11 July 2024 [France] – **French AMF publishes the findings of three supervisory initiatives on sustainable finance**

The French market regulator (AMF) has published the results of two "SPOT Inspections" observing how sustainability-related risks are accounted for in asset management companies and in the marketing of funds incorporating non-financial aspects. Additionally, it published a study on sustainable thematic funds. [reports are linked to the press release here]

As concerns the implementation of the SFDR by asset management companies, the AMF has noted an increase in ESG-dedicated human resources, and in the use of ESG/SRI evaluation methods. On the other hand, none of the companies audited were in full compliance with the SFDR regulation regarding the information required, both at entity and fund level, with the missing information apparently linked to a lack of relevant external and/or historical data.

As concerns marketing materials of the collective investment undertakings (CIUs), the AMF notes that the panel institutions have taken *"little ownership of marketing material subject, a fortiori the requirements specific to extra-financial reporting"*, meaning distributors rely too heavily on the due diligence carried out by producers. The AMF reminds distributors that they must ensure that the marketing materials they distribute are accurate, clear and not misleading.

As concerns sustainable thematic funds, the study confirms the mismatches between the funds' contractual commitments and the communications provided by distributors and portfolio management companies on the sustainability of these thematic funds. These inadequacies have been observed, in particular, in the case of foreign funds marketed in France that have not been authorized by the AMF, leading it to issue a number of reminders.

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