CLEARY GOTTLIEB

30 July 2024

Climate and the Financial Sector

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

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General

16 July 2024 [International] – **NGFS publishes information note on Improving Greenhouse Gas Emissions Data**

The Network for Greening the Financial System (NGFS) published an information note on improving greenhouse gas (CHG) emissions data, aimed at increasing awareness among central banks and supervisors about common challenges in compiling and using GHG emissions data, and to explore potential solutions for bridging data gaps. [The Information note is available here]

The NGFS, referring to the need for high-quality climate data, for financial institutions to integrate climate considerations into their operations and risk management practices, proposes measures designed at enhancing the granularity and comparability of emissions data, including:

- Harmonizing the metrics in reporting standards, as to facilitate emissions comparison and monitoring, thus supporting disclosures.
- Encouraging coordination between supervisors and government agencies in the collection and dissemination of emissions data, as to reduce operational costs and risks.
- Intensifying collaboration across public bodies, financial institutions, and businesses to address the challenges of emissions data.

The Information note generally considered that critical success factors included collaboration, standardization, reliance on new technologies, as well as the promotion of disclosure.

17 July 2024 [Germany] – **BaFin calls for improvements to the SFDR for more effective sustainable investments**

At a conference, the German Federal Financial Supervisory Authority (BaFin) emphasized the need for the Sustainable Finance Disclosure Regulation (SFDR) to better enable informed investor decisions. They noted that while the SFDR has increased transparency, its disclosures often lack the necessary detail for investors.

The BaFin pointed out that the impact of European sustainability regulation on financial flows into sustainable investments has been limited. To address this, they suggested that the next European Commission should simplify and enhance the regulations, integrating them into a cohesive ESG framework.

Key areas for improvement include aligning definitions of sustainable investments with other regulatory frameworks, such as the Taxonomy Regulation. Disclosures should be limited to a few critical indicators, like greenhouse gas emissions, biodiversity, and human rights. Establishing clear categories for sustainable, transition, and exclusion products would clarify financial product goals.

These changes would improve the SFDR's effectiveness, making it easier for investors to make informed decisions based on their ESG preferences.

The article is available here.

18 July 2024 [EU] – **President of the European Commission recommits to climate action and clean industry in 2024-2029 Political Guidelines**

In a speech before the European Parliament, and as part of the accompanying Political Guidelines for 2024-2029, European Commission President Ursula von der Leyen restated her commitment to climate objectives and clean industry. [The speech is available here, and Political Guidelines here]

During her speech Ms. von der Leyen vowed to put forward a new Clean Industrial Deal in her first 100 days in office, aimed at channelling investment in infrastructure and industry, in particular for energy-intensive sectors. The Political Guidelines mention that an Industrial Decarbonization Accelerator Act would be put forward, to support industries and companies through the transition. This was outlined as paving the way for the 90% emission-reduction target for 2040 to be enshrined in the European Climate Law.

The Political Guidelines further mention that a new Circular Economy Act would be set forward, in an effort to decarbonize the economy. The act will be aimed at creating market demand for secondary materials and a single market for waste, notably in relation to critical raw materials.

18 July 2024 [EU] – **FSB publishes stocktake of regulatory and supervisory initiatives on nature-related financial risks**

The Financial Stability Board (FSB) published a stocktake of member financial authorities' initiatives related to the identification and assessment of nature-related financial risks. The stocktake [available here] was a request made by the G20 Finance Ministers and Central Bank Governors in February 2024.

The stocktake report describes supervisory and regulatory initiatives, as well as analyses on how nature degradation, including loss of biodiversity, constitutes a financial risk. Amongst observations contained in the report, the FSB highlights:

- Discrepancies in financial authorities' approaches: While some financial authorities have already concluded that there is a material financial risk, others are still monitoring international work on the issue, and a few have decided not to work on this topic, due to data gaps and the need to give sufficient priority to climate risks.

- Data and modelling challenges in analytical work: Financial authorities are mainly categorizing nature-related risks into physical and transition risks, but some authorities have indicated that analytical work needs to be further developed to better translate estimates of financial exposures into measures of risk.
- Growing initiatives to address nature-related risks: The report notes that the regulatory and supervisory work is still at an early stage, with diverse approaches across jurisdictions, but that a number of authorities from both emerging markets and advanced economies already have initiatives underway.

24 July 2024 [EU] – **ESMA publishes an Opinion on the Sustainable Finance Regulatory Framework**

The European Securities and Markets Authority (ESMA) published an Opinion setting out its long-term vision for the functioning of the Sustainable Finance Regulatory Framework [link].

ESMA considers that the Framework could evolve in the longer term to facilitate investor access to sustainable investments and to support the effective functioning of the sustainable investment value chain. In this regard, ESMA makes key recommendations to the European Commission in relation to consumer and industry testing, the EU Taxonomy, effective support for transition, the adaptation of transparency requirements, the implementation of a product categorization system, ESG data quality and the conduct of actors in the Sustainable Investment Value Chain.

ESMA's recommendations include:

- Carrying out consumer and industry testing before implementing policy solutions to ensure their feasibility and appropriateness for retail investors;
- Making the EU Taxonomy becoming the sole, common reference point for the assessment of sustainability, embedding it in relevant Sustainable Finance legislation, and complementing it, including with a social taxonomy;
- Implementing a definition of transition investments and high-quality standards for transition bonds and sustainability-linked bonds to effectively support the transition;
- Developing minimum sustainability disclosures for all financial products consisting of a small number of simple sustainability KPIs;
- Establishing a product categorization system including strong categories for sustainable and transition investments subject to the supervision of national competent authorities, with regular review of eligibility criteria of categories, weighed against the need for regulatory stability.
- Including ESG data products into the regulatory perimeter, further improving the consistency of ESG metrics and ensuring the reliability of estimates.

25 July 2024 [EU] – **ESAs publish updated version of SFDR Q&As**

The EBA, ESMA and EIOPA (together, the "ESAs") published an updated version of the consolidated Q&As on the Sustainable Finance Disclosure Regulation (SFDR) and accompanying Commission Delegated Regulation [available here]. Several answers have been added to the initial May 2023 version, notably clarifying:

- That financial market participants are required to establish a website to comply with Article 10 of the SFDR.
- That the calculation of principal adverse impact indicators should be performed on a pass/fail basis.
- The methodology for calculating the share of sustainable investment qualifying as environmentally sustainable and its disclosure.
- That for a sustainable investment to be made by investing in another financial product, the financial market participant should look through the underlying investments.

25 July 2024 [EU] – **EFRAG publishes study on early implementation of ESRS**

EFRAG published its study: "State of play as of Q2 2024 - Implementation of European Sustainability Reporting Standards (ESRS): Initial Practices from Selected Companies" [link].

The study illustrates the practices and challenges observed in relation to the initial stage of the implementation of the ESRS among 28 large EU headquartered companies across eight sectors, split between financial and non-financial companies. Key highlights include:

- ***Double Materiality Assessment***: Most companies recognize the value of a thorough, objective, evidence-based double materiality assessment as a strategic exercise for reporting purposes and for setting ESG managerial priorities. Companies take different approaches to their double materiality assessment, ranging from a more data-driven approach to a more judgment-based approach.
- ***Datapoints***: Many companies (i) have not yet included the results of the double materiality assessment in their gap analysis of datapoints to be reported and (ii) use Implementation Guidance 3 (EFRAG IG 3) to perform a gap analysis.
- ***Value Chain***: Several companies have adopted a simplified aggregated mapping of the value chain (i.e., upstream, downstream, and own operations only) and use transitional provisions.
- ***ESG Reporting Organizational Approaches***: The companies agreed that CSRD reporting has (i) increased cross-departmental collaboration, (ii) highlighted the need to standardize ESG reporting processes, particularly in preparation for assurance, and (iii) required several additional capabilities and resources (FTE, knowledge, data, and technology) to be implemented on different timelines.

26 July 2024 [EU] – **EFRAG releases new ESRS Q&A Explanations**

EFRAG has updated its Compilation of Explanations for the period January-July 2024 with 23 new explanations, bringing the total number of explanations to 93 [Press release available here]. The Explanations [available here] address, among other things:

- The "may" and "shall" reporting requirements;
- The entity specific and ESRS 2 disclosure requirements;
- The calculation of metrics (annual average), risks and opportunities for financial materiality;

- The location of policies, actions and targets in the sustainability report;
- The use of appendix in the structure of the sustainability statement;
- The transitional provisions for value chain and scope 3 GHG emissions;
- The overlap of ESRS 2 and topical standards;
- The consideration of the general meeting as an ‘administrative, management and supervisory body’;
- The definition of revenue/net revenue, meaning of ‘activities in high-climate impact sectors’;
- The GHG emissions and annual update, as well as the disaggregation of total emissions;
- The definition of emissions trading schemes;
- The disaggregation of GHG emissions based on fossil resources and non-fossil resources; and
- The definition of ‘project’ in relation to GHG removals.

Banking

24 June 2024 [Italy] – **Italian Ministry of Economy launches a public consultation on “Sustainability Cooperation between SMEs and Banks”**

On 24 June 2024, the Italian Ministry of Economy and Finance launched a public consultation on the document “Sustainability Cooperation between SMEs and Banks,” a document drafted by the Sustainable Finance Platform [link], which aims to serve as a reference model for SMEs in the collection and presentation of ESG information [link, in Italian] to be collected by banks.

The document, which takes into account the voluntary reporting standards for SMEs proposed by EFRAG, outlines 45 sustainability information items divided into five sections (*i.e.*, general information, climate change mitigation and adaptation, environment, labor and society and governance and business conduct).

The aim of the project is to facilitate the interaction between SMEs and banks by promoting an exchange of information, ultimately increasing SMEs’ awareness of sustainability and their access to financing.

The consultation will end on 2 August 2024 [link].

18 July 2024 [Global] – **UNEP FI releases resources to help banks operationalize the links between the circular economy and sustainability impact**

The UN Environment Programme Finance Initiative (UNEP FI) has released two reports in its new “Circular Economy as an Enabler for Responsible Banking Series”: “Leveraging the Nexus between Circularity and Sustainability Impact” and “Circular Solutions to Achieve Climate Targets” [link].

These reports aim to help banks implement and benefit from the links between circularity and the key sustainability challenges of climate change, nature loss, and pollution. They encourage banks to embed circularity into internal policies and processes, engage with clients in their transition to circular business models, redirect financial flows towards circular solutions and opportunities, and advocate for the mainstreaming of circularity.

Asset Management

23 July 2024 [Global] – **NZAM initiative publishes report on signatories' target disclosures**

The Net Zero Asset Managers (NZAM) initiative has released its latest Target Disclosures Report [link], highlighting the increase in voluntary, individual net zero commitments and targets from the asset management industry over time. In particular, the report highlights:

- ***Geographical backdrop***: Signatories are headquartered in more than 35 countries, mostly in Europe (62.8%) and North America (22.9%).
- ***Target setting by asset class***: Listed equities and corporate fixed income have the highest inclusion rates in target setting, followed by real estate, infrastructure, private equity, others and sovereign bonds.
- ***Methodological approaches***: 51% of signatories use the Paris Aligned Investment Initiative's Net Zero Investment Framework; 22% use the Science Based Targets initiative for Financial Institutions; 14% use the Net Zero Asset Owner Alliance Target Setting Protocol, 12% use a combination of the above methodologies, and 10% have chosen to use their own methodology.
- ***Target types***: 62.5% of the signatories have set decarbonization targets, 53% have set alignment targets, and 23% have set engagement targets.
- ***Interim target years***: 98% of signatories have set interim targets for 2030 or earlier, and 26% have set an initial target for 2025.

Insurance

15 July 2024 [International] – **International Association of Insurance Supervisors launches public consultation on climate risk supervisory guidance**

The International Association of Insurance Supervisors (IAIS) launched its last consultation on climate risk in the insurance sector, in the context of a four-part consultation process relating to various insurance core principles and on new supporting material to better incorporate climate-related risk as part of effective supervisory practice. [Press release available here]

The consultation introduces new materials to enhance supervisory practices, focusing on supervisory reporting, public disclosure, macroprudential considerations, and supervisory cooperation. It includes two key documents:

- Draft Application Paper on public disclosure and supervisory reporting of climate risk [available here]: The document advises supervisors on developing supervisory reporting (ICP 9) and public disclosure regimes (ICP 20) for climate-related risks. It considers climate-related financial disclosure and supervisory reporting in tandem, and provides guidance to supervisors on tailoring approaches to meet the specific needs of their individual jurisdictions.
- Draft supporting material on macroprudential and group supervisory issues and climate risk [available here]: This document offers additional advice, examples, and best practices for supervisors on implementing ICP 24 (Macroprudential Supervision) concerning climate risk drivers. It extends the existing Application Paper on macroprudential supervision and highlights the importance of integrating climate-related risks into group-wide supervision of insurers.

22 July 2024 [Italy] – **Italian Insurance Supervisory Authority publishes 2024 Report and survey on monitoring of risks from natural catastrophes and sustainability in the insurance sector**

In line with the second objective of its Strategic Plan 2021-2023 of increasing the resilience of the national system against the potential consequences of climate change on the insurance business, and sustainable economic development, since 2022, the Italian Insurance Supervisory Authority, IVASS, has been conducting annual statistical surveys regarding aiming to assess both physical and transition risks from natural catastrophes and sustainability. The data measurements cover companies engaged in both life and non-life insurance sectors in Italy [link].

On 22 July 2024, IVASS issued its 2024 Report on risks from natural catastrophes and sustainability [link]. The Report includes a quantitative section (based on data as of 31 December 2022) and a qualitative section (based on data updated to 2023). The findings indicate a heterogeneous market in terms of awareness, preparation, and contributions toward a fair and sustainable transition, with medium and small-sized insurance companies lagging behind larger ones in integrating ESG factors into their strategies and practices.

On 12 July 2024, IVASS launched the 2024 survey. Insurance companies must submit their information as of 31 December 2023, by 31 October 2024, using a new version of the operational instructions for compiling and transmitting data and information.

Litigation

23 July 2024 [Germany] – **Higher Administrative Court Berlin declares implementation of the NEC Directive by the German Federal Government insufficient (Judgement of 23 July 2024 – OVG 11 A 16.20)**

In a recent decision, the Higher Administrative Court of Berlin-Brandenburg partially upheld a complaint by the German environmental NGO ‘DUH’ against the German Government. The lawsuit was directed against the implementation of the National Emission Ceilings Directive (NEC Directive) by the responsible environmental ministry and environmental agency, which provides for reductions in various pollutant emissions and extensive reporting obligations for member states.

The court found that the measures imposed were not sufficient. Furthermore, the underlying data was incorrect and outdated. However, contrary to the application, the Federal Government was not ordered to adopt a linearly increasing reduction path. The decision is in line with the ruling by the same court in May, in which the government was ordered to improve its climate plans.

While NGOs view the decision as an important step towards government accountability for clean air, others argue that the court only criticized the implementation of the plan, but that the plan itself was upheld. The court has permitted an appeal to the federal court. [See further here (English) and here (German)]

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