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CLEARY GOTTLIEB

4 June 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

22 May 2024 [EU] – **ESMA publishes recommendations for more effective and attractive capital markets in the EU**

ESMA has published a Position Paper on building more effective and attractive capital markets in the EU [Full Paper available here]. As part of its 20 recommendations to strengthen EU capital markets, ESMA recommends promoting EU capital markets as a hub for green finance, highlighting the economic opportunities tied to the EU sustainability goals, for both investors and businesses.

ESMA submits that it, along with the European Commission, should align regulations and incentives to steer public and private capital toward sustainable finance projects and EU decarbonization objectives. This should include efforts to simplify the disclosure of sustainability information, including through the use of labels and categories.

24 May 2024 [EU] – **GRI and IFRS Foundation to simplify sustainability reporting**

The Global Reporting Initiative (GRI) and the IFRS Foundation announced they would deepen their working relationship to enhance the integration of their standards and provide a "seamless, global and comprehensive sustainability reporting system."

The International Sustainability Standards Board (ISSB) and the Global Sustainability Standards Board (GSSB), i.e., the organizations' standard-setting bodies, will work together to align common disclosures across thematic and sector-based standards, beginning with a pilot project on biodiversity.

Key figures, including IFRS Foundation Chair Erkki Liikanen and GRI CEO Eelco van der Enden, emphasized the importance of this partnership in reducing reporting complexity and enhancing transparency. [Press release available here]

24 May 2024 [EU] – **Council of the EU formally adopts CS3D**

The Council of the EU formally adopted the corporate sustainability due diligence directive (CS3D). 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 CS3D will enter into force twenty days after its publication in the Official journal, following which Member States will have two years to transpose the directive's provisions into national law.

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

25 May 2024 [Italy/International] – **G7 Finance Ministers and Central Bank Governors publish commitments to advancing the green transition, following their Stresa (Italy) meeting**

The G7 Finance Ministers and Central Bank Governors reiterated, following the 23-25 May 2024 Stresa meeting (under Italian presidency), their commitment to paving the way for the global transition to a net-zero economy and to implementing effective policy frameworks for catalyzing substantial public and private investment necessary to achieve this goal. [Full Communiqué available here]

Key initiatives highlighted during the meeting include:

1. Welcoming a Menu of Policy Options for a Just Transition towards Net Zero [available here], developed by the G7 Finance Track, with the aim to develop appropriate climate policies;
2. Welcoming the International Sustainability Standards Board (ISSB) standards for reporting on sustainability and for climate-related disclosures, recognizing the benefits of enhancing the availability, comparability and credibility of robust and science-based transition-related information;
3. Increasing the understanding by the G7 central banks, thanks to the network of modelling experts, in cooperation with the Network for Greening the Financial System and other international organizations, of the macro-financial implications of climate change and the transition to net-zero, including impacts on inflation and economic activity both in the short and long term, as well as cross-border consequences and spillover effects;
4. Welcoming a High-Level Framework for Public-Private Insurance Programmes against natural hazards increased by climate change [available here], which was developed by the Finance track with the OECD and the International Association of Insurance Supervisors to support policymakers, regulators and insurance supervisors to incentivize risk prevention.

27 May 2024 [France] – **French AMF reports on its commitment towards sustainable finance in its 2023 Annual Report**

The AMF published its 2023 Annual Report, in which it targeted the promotion of more sustainable finance as a key priority. The Report notes that in 2023, the AMF prepared for the implementation of the European Green Deal, in particular as concerns CSRD, and published a position paper in favor of introducing environmental criteria for financial products, as part of the SFRD revision.

The Report describes the AMF's commitment to contribute to the finalization of a clear and coherent European framework on sustainable finance, and to guarantee the quality of extra-financial information, notably through a revision of its doctrine on the French Energy-Climate Law. [Press release here, and Full report here, in French only]

27 May 2024 [EU] – **Council of the EU gives final approval to the net-zero industry act**

The Council of the EU formally adopted the Net-Zero Industry Act (NZIA, full text available here), aimed at creating favorable conditions for investment in green technologies, in particular through the simplification of the permit-granting process, the facilitation of public procurement or auctioning of renewable energies and the creation of a platform to coordinate EU action in this area.

Progress towards the objectives of the NZIA will be measured through two indicative benchmarks, i.e., (i) having the manufacturing capacity of net-zero technologies reach 40% of the EU's deployment needs and (ii) having the EU's market-share for these technologies reach 15% of world production by 2040.

The European Commission welcomed this adoption [press release here], noting that it would put the EU on track to strengthen its domestic manufacturing capacities of key clean technologies, as well as increase the competitiveness and resilience of the EU's industrial base. The Commission used this opportunity to publish a Q&A on the NZIA [available here].

The NZIA still needs to be signed by the President of the European Parliament and the President of the Council, after which it will enter into force on the day of its publication.

Banking

23 May 2024 [France] – **International Monetary Fund recommends French banks integrate climate transition risks into their processes**

The IMF published its Concluding Statement following its annual discussion with French officials, which notably points out that French banks should continue to mitigate climate transition risks by integrating them into their governance, strategy, and risk management processes. [Full Statement available here]

In particular, the Fit-for-55 scenario simulation performed as part of the IMF's climate risk assessment showed that key systemic banks may be exposed to rising credit losses, as these are estimated to significantly increase over the medium term for the energy-intensive mining, chemical, and manufacturing sectors.

The IMF however outlined that despite relatively lower profitability, French banks' liquidity and solvency positions have remained robust, with adequate capital and liquidity buffers.

26 May 2024 [EU] – **Member of the Executive Board of the ECB gives speech about the role of the ECB in the green transition**

Piero Cipollone, Member of the Executive Board of the ECB, gave a speech at the Festival dell' Economia di Trento emphasizing the urgent need for Europe to address climate change and seize the economic opportunities presented by the green transition. [Full Speech available here]

The speech revolved around the increasing costs of climate change, with severe economic losses from weather-related events said to amount to around €650 billion since 1980, only a quarter of which are insured, and with the additional €620 billion annual investments required for the EU to meet its climate targets for 2030 and 2050.

This leads to implications for Central Banks, particularly regarding price stability, it being noted that climate change affects productivity and potential output, complicating monetary policy. Cipollone outlined that financial risks stemming from climate change must be accurately priced to protect the ECB's balance sheet and ensure the soundness of banks.

The ECB's response to this includes integrating climate considerations into monetary policy and supervisory activities – such as tilting corporate bond holdings towards greener issuers and evaluating climate-related financial risks in collateral policies – supporting the green transition while maintaining price stability and encouraging banks to manage climate-related risks.

Cipollone concluded his intervention with the following words *"The path ahead is challenging, but Europe has a proven track record of rising to the occasion when it matters most."*

Asset Management

27 May 2024 [EU] – **ESMA Final Report on the application of MiFID II marketing requirements notes lack of specific processes for sustainability-related claims in marketing communications**

ESMA published a combined report on its 2023 Common Supervisory Action and the accompanying Mystery Shopping Exercise on marketing disclosure rules under MiFID II. The report finds that marketing communications globally comply with regulatory requirements but that areas of improvement remain. In particular, NCAs raised concerned regarding sustainability claims in marketing communications, including advertisements. [Full Report available here]

NCAs reported that investment firms lack specific processes for sustainability claims in their marketing communications, applying the same procedures as for other products, and that internal systems and controls for sustainability claims are not differentiated between the firms' own products and third-party products. The report however outlines that some firms have implemented additional controls, such as involving sustainability officers, conducting consistency checks, and developing internal guidance to prevent greenwashing.

Based on these findings, ESMA emphasizes the need for control functions and senior management involvement in the internal processes and procedures related to the development, design and oversight of marketing communications when these include sustainability-related claims, in order to mitigate greenwashing risks and to safeguard that the sustainability claims are fair, clear and not misleading. [Press release available here]

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

The UK's Financial Conduct Authority (FCA) has published further guidance for firms seeking to label, name and market products with sustainability objectives (here). The guidance follows on from the FCA's policy statement (here) '*Sustainability Disclosure Requirements (SDR) and investment labels'* (PS23/16) and is designed to assist firms with two aspects of the new regulatory regime, namely (i) the application of new sustainability labels (which firms can use from 31 July 2024); and (ii) the new naming and marketing rules for products targeted at retail clients (which come into effect on 2 December 2024).

While the guidance directs firms to review the detail of the new requirements in PS23/16, it also sets out responses to some of the common questions the FCA has received on the new investment labels. In particular, the guidance provides high-level advice on the processes for using and displaying a label, the different criteria applicable to the new labels and the application of a label to different types of product. Additionally, the guidance provides a broad overview of the scope and exceptions to the new naming and marketing regime for sustainability-related products aimed at retail clients.

Insurance

22 May 2024 [France] – **Climate stress-test: the ACPR encourages insurers to keep up their efforts towards the integration of climate risk**

The French ACPR published the results of its climate stress test, solely dedicated to insurance undertakings. [Full report available here]

This climate exercise considers the impacts of climate change by taking into account both physical and transition risks, at long-term horizons (2050) but also factoring in a shorter-term horizon (2027), with the aim of measuring the impact of climate change on the solvency of insurance undertakings.

The short-term scenario relied on a sequence of extreme weather events resulting in an embankment dam failure, leading to impairment losses on financial assets, and ultimately affecting the whole portfolio of insurers. The ACPR, under a series of assumptions, found that these physical and transition shocks would adversely affect the solvency of insurers, with a Solvency Capital Requirements (SCR) coverage ratio dropping 60 points from end-2022 to end-2027.

In the long term, it is instead assumed that insurers will have the ability to adapt their business and balance sheet to mitigate the effects of climate change. As such, the exercise focuses less on the impacts on solvency than on the strategies implemented by insurers. The analysis of findings shows a 105% increase of total claims in the adverse scenario of a disorderly transition by 2050, compared with 2022, as well as a 42% increase in weather-related claims compared with the baseline scenario.

The ACPR stated it took note of progress made and encouraged insurers to keep up their efforts towards the swift and forward-looking integration of climate risk in their strategy, governance and internal models.

Litigation

30 November 2023 [Belgium] – **Brussels Court of Appeal imposes 55% reduction obligation on Belgian governments for 2030.**

On November 30, 2023, nine years after ASBL Klimaatzaak first issued a formal notice to the Belgian governments over their alleged negligent climate policies, the Brussels Court of Appeal issued a ruling, mandating the Belgian state, Flanders, and Brussels to adopt more ambitious climate policies, specifically reducing greenhouse gas emissions by 55% by 2030 compared to 1990 levels, surpassing European targets (which set a 47% reduction requirement).

Klimaatzaak had initially demanded a 40% reduction by 2020, but after failing to reach an agreement, lodged a claim against the Belgian authorities in 2015. In June 2021, a Brussels court found the authorities negligent but did not set specific reduction targets, prompting Klimaatzaak to appeal.

The Court of Appeal ruled that the federal State, Flanders, and Brussels violated human rights by failing to implement effective climate policies, and required responsibilities to be shared at all three levels to attain the 55% reduction. Wallonia, having made sufficient progress, is not subject to additional requirements. The court emphasized the ongoing nature of the violation and warned that penalties could be imposed if the targets are not met by 2024.

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