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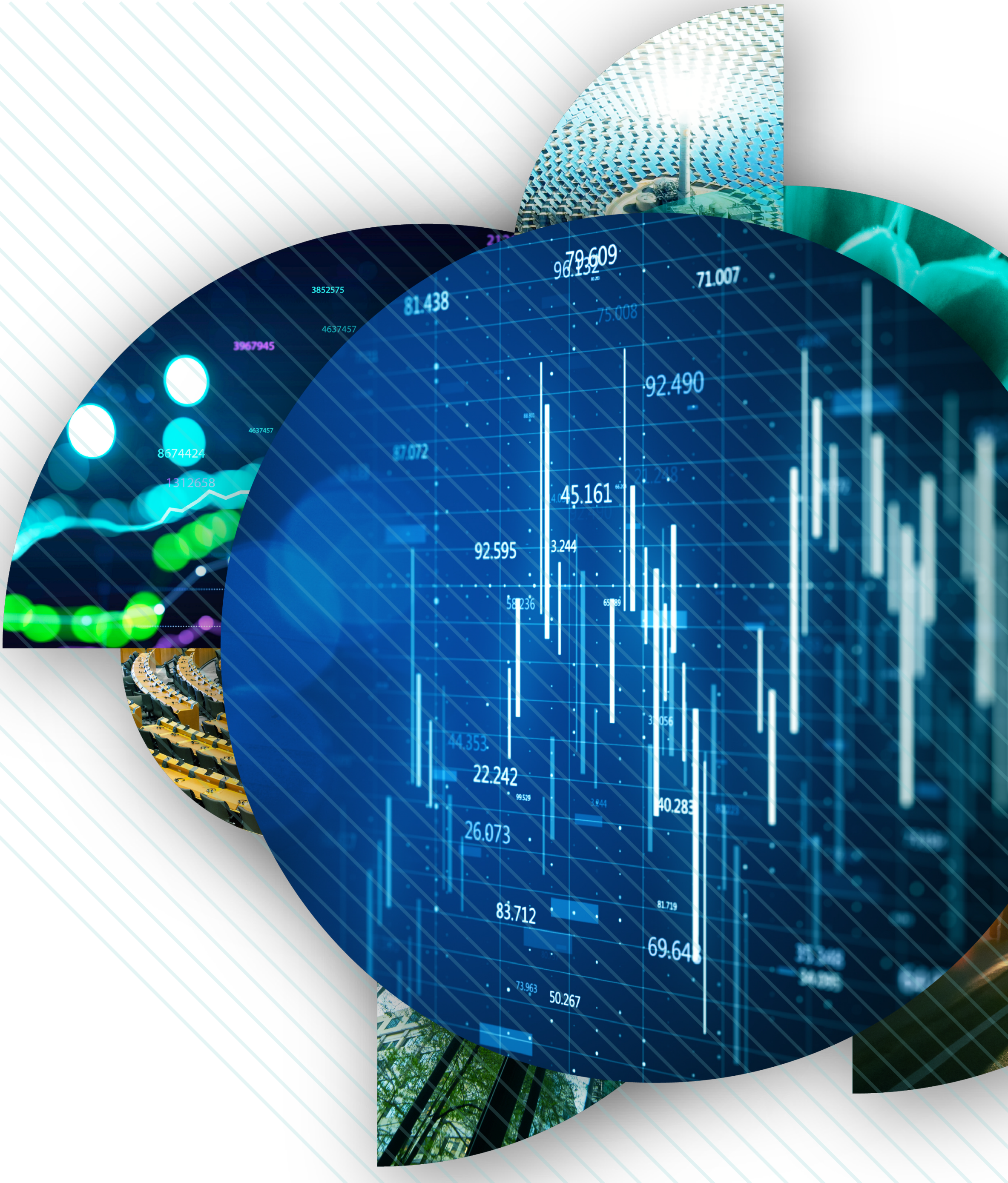
ESG | Sustainability

Financial Services regulatory ESG updater

August 2023



Introduction

Environmental, Social and Governance-related (ESG) matters are high on the global agenda with a focus not only on climate change, but also on wider environmental issues, such as, diversity and inclusion.

Greenwashing is the term given to a practice of making misleading statements about the environmental credentials of a business and/or product in order to attract investment or customers more broadly. Mitigating the risks of greenwashing is a particular focus for regulators.

The purpose of this updater is to track ESG regulatory updates from the period 14 July – 17 August 2023, from UK, EU, US and global regulators.

Contacts

Jonathan Herbst
Partner
Tel +44 20 7444 3166
jonathan.herbst@nortonrosefulbright.com

Simon Lovegrove
Global Director of Financial Services Knowledge, Innovation and Product
+44 20 7444 3110
simon.lovegrove@nortonrosefulbright.com

Haney Saadah
Director of Risk Consulting
Tel +44 20 7444 2519
haney.saadah@nortonrosefulbright.com

Katie Stephen
Co-Head of the Contentious Financial Services Group
Tel +44 20 7444 2431
katie.stephen@nortonrosefulbright.com

Jane Caskey
Global Chief Client Officer and Head of Risk Advisory
Tel +44 20 7444 3811
jane.caskey@nortonrosefulbright.com

This month's highlights

Updated timeline

The timeline on our Financial Services Regulatory Developments in ESG hub has been updated. The timeline sets out the key ESG milestones in the UK and EU from a financial services regulatory perspective so that businesses may keep track of developments in 2023. The timeline will be updated every quarter.

Governance and sustainability

Good sustainability governance is particularly critical at a time of increased scrutiny from both regulators and investors. Without a robust governance structure, a firm will find it incredibly challenging to implement its sustainability strategy across its business, manage reporting processes or strengthen its relations with external stakeholders.

We have published a new briefing note Governance and sustainability in which we try to bring together the different governance requirements in the ESG space. First, we take a look at some simple steps that a firm may take to update their governance arrangements in light of their sustainability commitments. Second, we summarise the governance requirements set out in key international, EU and UK standards.

Commission adopts Delegated Regulation on first set of ESRS

On 31 July 2023, the European Commission (**Commission**) announced that it had adopted the first set of European Sustainability Reporting Standards (**ESRS**) for use by all companies subject to the Corporate Sustainability Reporting Directive (**CSRD**). The CSRD amends the Accounting Directive to introduce requirements for in-scope companies to report against the ESRS.

The Commission published a Commission Delegated Regulation supplementing the EU Accounting Directive as regards sustainability reporting standards together with Annex 1 and 2. It also published Q&As on the ESRS. The Commission Delegated Regulation and the Annexes do not come into force until they are published in the Official Journal of the EU (**OJ**).

The Delegated Regulation adopted by the Commission will be formally transmitted in the second half of August to the European Parliament and to the Council for scrutiny. The scrutiny period runs for two months, extendable by a further two months. The European Parliament or the Council may reject the Delegated Regulation, but they may not amend it.

The ESRS will be mandatory for use by companies that are obliged by the EU Accounting Directive to report certain sustainability information. By requiring the use of common standards, the EU Accounting Directive, as amended by the CSRD, aims to ensure that companies across the EU report comparable and reliable sustainability information.

In accordance with the provisions of the EU Accounting Directive, as amended by the CSRD, the standards adopted by the Commission are based on technical advice (draft standards) from the European Financial Reporting Advisory Group (**EFRAG**). Earlier this year, as required by the EU Accounting Directive, the Commission consulted Member States on the draft standards submitted by EFRAG, along with various EU bodies such as the three European Supervisory Authorities, the European Environment Agency, the European Union Agency for Fundamental Rights, the European Central Bank, the Committee of European Auditing Oversight Bodies and the Platform on Sustainable Finance.

As required by the EU Accounting Directive, as amended by the CSRD, the ESRS take a "double materiality" perspective, obliging companies to report both on their impacts on people and the environment, and on how social and environmental issues create financial risks and opportunities for the company.

The Commission has made several modifications to the draft standards submitted by EFRAG. The modifications fall into three main categories: phasing-in certain reporting requirements (the additional phase-ins mainly apply to companies with fewer than 750 employees); making more of the reporting requirements "subject to materiality" (i.e., allowing companies to omit information if it is not relevant in their particular circumstances), as opposed to being mandatory for all companies; and making some of the proposed requirements voluntary (the Commission has converted a number of the mandatory datapoints proposed by EFRAG into voluntary datapoints).

The Commission has suggested that EFRAG prioritises the development of guidance on materiality assessment and on reporting with regard to value chains. EFRAG expects to publish draft guidance on these two issues for public consultation in the near future.

EFRAG will also shortly host a portal for technical questions that companies, or other stakeholders may have about the application of ESRS.

Companies will have to start reporting under ESRS according to the following timetable:

- Companies previously subject to the Non-Financial Reporting Directive as well as large non-EU listed companies with more than 500 employees: financial year 2024, with first sustainability statement published in 2025.
- Other large companies, including other large non-EU listed companies: financial year 2025, with first sustainability statement published in 2026.
- Listed SMEs, including non-EU listed SMEs: financial year 2026, with first sustainability statements published in 2027. However, listed SMEs may decide to opt out of the reporting requirements for a further two years. The last possible date for a listed SME to start reporting is financial year 2028, with first sustainability statement published in 2029.
- In addition, non-EU companies that generate over €150m per year in the EU and that have in the EU either a branch with a turnover exceeding €40m or a subsidiary that is a large company or a listed SME will have to report on the sustainability impacts at the group level of that non-EU company as from financial year 2028, with first sustainability statement published in 2029. Separate standards will be adopted specifically for this case.

United Kingdom

18 July 2023

The Financial Reporting Council (**FRC**) has issued a call for evidence to inform the proposed endorsement of the International Sustainability Standards Board (**ISSB**) IFRS Sustainability Disclosure Standards – IFRS S1 (General Requirements for Disclosure of Sustainability-related Financial Information) and IFRS S2 (Climate-related Disclosures).

The call for evidence seeks views on whether the application of the ISSB standards in a UK context will result in disclosures that are understandable, relevant, reliable and comparable for investors. It also considers technical feasibility, timeliness alongside financial reporting, and proportionality of costs to benefits.

The deadline for responding to the call for evidence is 11 October 2023.

The responses to the call for evidence will be used to inform the UK Sustainability Disclosure Technical Advisory Committee's assessment of IFRS S1 and IFRS S2.

26 July 2023

The FRC has published a thematic review which assesses the quality and maturity of climate-related metrics and targets disclosures. The review analysed Taskforce on Climate-related Financial Disclosures (**TCFD**) disclosures from twenty companies' 2022 annual reports across four sectors – materials and buildings, energy, banks, and asset managers – and identified areas of better reporting practice as well as opportunities for improvement.

Key findings showed an incremental improvement in the quality of companies' disclosure of net zero commitments and interim emissions targets. However, disclosures of concrete actions and milestones to meet targets were sometimes unclear, and comparability of metrics between companies remains challenging. The review found that, given the large volume of information presented, many companies are finding it challenging to explain their plans for transitioning to a low-carbon economy clearly and concisely.

The review also found that explanations of how climate targets affect financial statements still need improvement; for example, boilerplate language on climate being 'considered' provides little insight on impacts.

Commenting on the thematic review, the FRC's executive director of regulatory standards, Mark Babington, said: *"This review highlights the continued need for clearer, more decision-useful disclosures of companies' plans to transition to a low-carbon economy. We encourage companies to focus on explaining targets, actions, and any impacts on the financial statements."*

10 August 2023

The Financial Conduct Authority (**FCA**) has published Primary Market Bulletin 45.

Primary Market Bulletin 45 focuses on the ISSB's publication of its first 2 IFRS Sustainability Disclosure Standards (**ISSB standards**):

- IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information.
- IFRS S2 Climate-related Disclosures.

The FCA welcomes the publication of the two standards which deliver, for the first time, a global reporting standard for corporate sustainability disclosures.

In this edition of the Primary Market Bulletin, the FCA outlines the following:

- The key features of the FCA's process for implementing the standards and plans for consultation.
- How the FCA will continue to supervise existing disclosures under the TCFD framework, until any new requirements are implemented.
- Advice for issuers on what they can do now to prepare for any future obligations relating to reporting on the ISSB standards.

The Government is committed to introducing mandatory reporting against the ISSB standards, subject to a formal assessment and endorsement process. The Secretary of State for Business and Trade will be responsible for the endorsement decision. It aims to complete this assessment and endorsement process within 12 months of the final standards being published. Two advisory committees are being established to support the Secretary of State's decision-making on endorsement and to coordinate the implementation of reporting requirements by Government and the FCA. One committee will focus on public policy and implementation (the UK Sustainability Disclosure Policy and Implementation Committee), and the second committee – the UK Sustainability Disclosure Technical Advisory Committee – will focus on the technical aspects of the standards for endorsement.

The FCA expects to consult in the first half of 2024 on proposals to implement disclosure rules referencing UK-endorsed IFRS S1 and IFRS S2 for listed companies. It will consider inputs to the Government's endorsement process and its own cost-benefit analysis. Assuming the Government's endorsement process is completed in the timeframe envisaged, the FCA's aim is to finalise its policy position by the end of 2024, with a view to bringing the new requirements into force for accounting periods beginning on or after 1 January 2025. The first reporting would begin from 2026. The FCA will also consult on the scope and design of the new regime. At the same time as consulting on its policy approach in relation to the ISSB standards, it will consult on guidance that will set out its expectations for listed companies' transition plan disclosures.

France

17 July 2023

The Autorité des Marchés Financiers (**AMF**) has announced that it has conducted a study on the legibility of the information annexed to the prospectus of funds promoting environmental and/or social characteristics (known as "Article 8" within the meaning of the Sustainable Finance Disclosure Regulation (**SFDR**) or having a sustainable investment objective ("Article 9")).

18 July 2023

In the wake of the Ecological Transition Financing Committee's meeting, the AMF has published the results of its biannual survey, which demonstrates a growing interest in responsible finance. The results show that awareness and interest in sustainable investment, within France's population, has increased since the previous survey conducted in June 2021. Overall, awareness of this financial universe has improved, 57% of respondents can define what sustainable investments are, 50% know about socially responsible investments and 49% are familiar with ESG criteria or ESG.

Furthermore, the survey shows that the number of people holding these investments has also increased. Nearly one in five people say they own at least one investment 'linked to sustainable development.' In addition, among holders of responsible funds, more than a quarter invested recently, in 2022 or early 2023. Half of these new investors in sustainable funds are under 35. Women also account for half of recent subscribers.

2 August 2023

The AMF has published Position-Recommendation DOC-2020-03 which defines the disclosures to be made by collective investment schemes incorporating non-financial approaches. The update extends the scope of this policy to include French and foreign European long-term investment funds marketed to retail investors in France.

12 August 2023

The AMF has published a summary of a study and its findings following a series of short thematic inspections called SPOT. The study analyses the responses to a detailed questionnaire from 176 generalist portfolio asset management companies (**AMCs**) that have at least one contractual non-financial commitment for at least one of their funds. The inspection campaign targeted five of these 176 AMCs, whose ESG funds (incorporating ESG criteria) or socially responsible investment (**SRI**) funds account for between 20% and 90% of their total assets under collective management.

The study highlights the following:

- Five institutions inspected have put in place important and increasing human and technical resources to define, manage and monitor non-contractual commitments.
- Although their ESG rating systems were often developed by the AMCs themselves, they remain dependant on external ESG data providers.
- Only one of the five AMCs checks the quality of this non-financial data before it is incorporated into the ESG rating algorithm.

- There is an inadequacy of permanent controls to justify corrections made to ESG ratings calculated by the rating algorithm (known as override). Only 40% of the AMCs on the SPOT panel have a satisfactory process for this diligence.
- With respect to the creation and review of the investment universe for ESG/SRI funds, the AMF found that five AMCs inspected used a team that was independent of the management activity.
- Only two of the five AMCs concerned by the SPOT inspection carry out ex post checks to ensure that the investment universe is consistent with the fund's ESG policy.

EU

18 July 2023

The European Banking Authority (**EBA**) has published a decision of 6 July 2023 concerning ad hoc collection by Member State competent authorities (**NCAs**) to the EBA of institutions' ESG data. Under this decision ESG data will be collected from large, listed institutions based on their Pillar 3 quantitative disclosures on ESG risks. The collection will provide NCAs with data to monitor ESG risks and support the EBA in fulfilling its ESG mandates, including to set up a risk monitoring framework and contribute to the Commission's Strategy for financing the transition to a sustainable economy.

The ad hoc collection of ESG data from NCAs to the EBA in accordance with the decision does not replace the monitoring of ESG risks by NCAs, including through the collection of relevant information from supervised institutions, that NCAs may already have in place.

20 July 2023

The EBA has issued a consultation on draft templates for collecting climate related data from EU banks.

The consultation is part of the one-off Fit-for-55 climate risk scenario which the EBA carries out with other European Supervisory Authorities with the support of the European Central Bank and the European Systemic Risk Board.

The draft templates are designed to collect climate-related and financial information on credit risk, market and real estate risks. Banks are asked to report aggregated and counterparty level data as of December 2022. Collecting counterparty level data will allow the assessment of concentration risk of large climate exposures, as well as capture amplification mechanisms and assess second round effects. Aggregated data will inform on the climate-related risks of the banking sector more broadly. The draft templates are accompanied by a template guidance, which includes definitions and rules for compiling the templates.

The consultation runs until 11 October 2023.

The one-off Fit-for-55 climate risk scenario analysis is expected to start by the end of 2023, with publication of results envisaged by Q1 2025.

28 July 2023

The Commission has published an interim report on Climate Resilience Dialogue (the **Dialogue**).

The Dialogue, set up by the Commission, aims to reduce the climate protection gap through facilitating exchanges between insurers, reinsurers, public authorities, and other stakeholders, such as real-estate developers and infrastructure operators, as set out in the 2021 EU Adaptation Strategy and in the Strategy for Financing the Transition to a Sustainable Economy. Both strategies are part of the European Green Deal and aim to increase and accelerate the EU's efforts to protect nature, biodiversity, people and livelihoods against the unavoidable impacts of climate change.

The purpose of the interim report is twofold; it aims to take stock of the discussions held so far and prepares the ground for future work of the Dialogue, which will culminate in the publication of a final report.

United States – SEC and CFTC

19 July 2023

The Commodity Futures Trading Commission (**CFTC**) has published the opening statement of Commissioner Christy Goldsmith Romero, on the CFTC's role with voluntary carbon credit markets, delivered at the CFTC's second convening on voluntary carbon markets.

Highlights in the opening statement include:

- Some market participants see potential in voluntary carbon credit markets as another opportunity to manage climate-related risk. There are currently carbon credit futures products trading on CFTC-regulated exchanges. This puts the CFTC in a unique position.
- Well-designed markets help deliver liquidity and price transparency. However, one of the biggest challenges in spot voluntary carbon markets is fragmentation, which prevents market confidence.
- There are different registries and standards setters, and much of the market happens in opaque over the counter transactions. A lack of transparency through consistent, comparable data with an agreed-upon taxonomy can present challenges to proper functioning of markets, including price discovery.
- The recent slowdown in markets may reflect concerns over a lack of transparency and trust. Those interested in participating in the markets want to be assured that they are purchasing high quality credits. Some companies have pivoted away from carbon markets entirely out of concerns that using carbon credits leaves them open to accusations of greenwashing.
- Buyers of carbon credits are becoming clearer about how they will use credits, in order to avoid accusations of greenwashing.
- Last year, Commissioner Romero proposed that the CFTC would work with exchanges on listing standards through guidance related to environmental products. These standards would be designed to guide exchanges in fulfilling the Commodity Exchange Act core principles. The guidance could involve looking at the standards developed by the Integrity Council on Voluntary Carbon Markets and the Voluntary Carbon Market Integrity Initiative and other due diligence.
- In March, at ISDA's ESG conference, Commissioner Romero proposed that the CFTC adopt a similar oversight and approach to environmental products as those adopted for digital assets.

International regulators – FSB, IOSCO, Basel Committee, NGFS, SASB, IFRS, ISSB

24 July 2023

The Network for Greening the Financial System (**NGFS**) has released a report Monetary policy and climate change: key takeaways from the membership survey and areas for further analysis.

The report analyses the feedback received from NGFS members on the implications of climate change and the net zero transition on their economies and monetary policies, as well as the next steps taken to integrate climate change considerations into their monetary policy operation frameworks.

The report highlights the following key findings:

- Over half of responding central banks have work underway, or further macroeconomic analysis planned to build up their understanding of these effects over the monetary policy relevant horizon.
- On the implementation of monetary policy, four out of ten respondents have already taken steps to integrate climate change considerations into their operational framework and many are considering further measures, particularly to protect their own balance sheets from climate-related financial risks. Responses highlight the variety of approaches taken to date among central banks, consistent with differing national circumstances, in addition to a clear desire to share practical experiences and draw lessons from efforts so far.

- There is a common desire, among central banks, to further improve their analytical toolkits.

27 July 2023
The ISSB has published the proposed IFRS sustainability Disclosure Taxonomy for public comment. The proposals reflect the disclosure requirements in the ISSB's first two Standards – IFRS S1 and IFRS S2.

The IFRS Sustainability Disclosure Taxonomy will play the same role as the IFRS Accounting Taxonomy in enabling digital tagging of information required by the IFRS standards. These taxonomies differ from taxonomies established by jurisdiction to classify economic activities as environmentally sustainable.

The deadline for the feedback to this consultation is 26 September 2023.

1 August 2023
The IFRS Foundation has announced the completion of the consolidation of the Value Reporting Foundation (**VRF**) into the IFRS Foundation. It follows the commitment made at COP 26 to consolidate staff and resources of leading global sustainability disclosure initiatives to support the IFRS Foundation's ISSB work to develop a comprehensive global baseline of sustainability disclosures for the capital markets.

The VRF's SASB Standards serve as a key starting point for the development of the IFRS Sustainability Disclosure Standards, while the Integrated Reporting Framework provides connectivity between financial statements and sustainability-related financial disclosures.

Resources

ESG is high on the regulatory agenda. Businesses, governments, regulators, financial services firms and individuals all have a part to play in tackling climate change and this view is increasingly shared across society. In terms of financial markets, investors are increasingly seeking sustainable financial products and ESG investing, traditional investing combined with sustainable or otherwise philanthropic aims, has seen huge growth in recent years. Regulated firms are also seeking to improve their own ESG performance more generally to build stronger relationships with their stakeholders, including those who use their services. Whilst the growing emphasis on ESG presents opportunities for financial services providers, it also brings with it a number of risks, which need to be properly managed with a view to avoiding future regulatory investigations and enforcement.

We have produced a number of resources, including articles, podcasts and newsletters, to help clients navigate this evolving, complex landscape:

Financial services: Regulation tomorrow

Our blog, Financial services: Regulation tomorrow offers a convenient resource for those keeping track of the evolving and increasingly complex global financial services regulatory environment.

Financial Services Regulatory Developments in ESG

Developed by our global financial services regulatory lawyers and integrated risk advisory group, our Financial Services Regulatory Developments in ESG Hub provides resources and insights to help clients stay informed of key regulatory developments in the sector.

ESG and Sustainability Insights newsletter

Our ESG and Sustainability Insights newsletter brings together recent insights and resources on key topics affecting your business, including climate change and regulation, business and human rights, sustainable finance, energy transition and more.

Contacts

Global

Jonathan Herbst
Global Head of Financial Services, London
+44 20 7444 3166
jonathan.herbst@nortonrosefulbright.com

Haney Saadah
Head of Risk Consulting, EMEA, London
+44 20 7444 2519
haney.saadah@nortonrosefulbright.com

Simon Lovegrove
Global Director of Financial Services Knowledge, Innovation and Product, London
+44 20 7444 3110
simon.lovegrove@nortonrosefulbright.com

Europe

Claire Guilbert
Partner, Luxembourg
+352 28 57 39 298
claire.guilbert@nortonrosefulbright.com

Sébastien Praicheux
Partner, Paris
+33 1 56 59 54 25
sebastien.praicheux@nortonrosefulbright.com

Roberto Cristofolini
Partner, Paris
+33 1 56 59 52 45
roberto.cristofolini@nortonrosefulbright.com

Salvatore Iannitti
Partner, Milan
+39 02 86359 429
salvatore.iannitti@nortonrosefulbright.com

Floortje Nagelkerke
Partner, Amsterdam
+31 20 462 9426
floortje.nagelkerke@nortonrosefulbright.com

Anna Carrier
Senior Governance and Regulatory Affairs Advisor, Brussels
+32 2 237 61 46
anna.carrier@nortonrosefulbright.com

Michael Born
Counsel, Frankfurt
+49 69 505096 421
michael.born@nortonrosefulbright.com

UK

Daniel Nevzat
Regulatory Affairs Advisor, London
+44 20 7444 3326
daniel.nevzat@nortonrosefulbright.com

North America

Tim Stewart
Partner, Canadian Head of Financial Services and Regulation, Toronto
+1 416 216 3985
tim.stewart@nortonrosefulbright.com

Thomas J. Delaney
Partner, Washington, DC
+1 202 662 4531
thomas.delaney@nortonrosefulbright.com

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