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Insights and perspectives on governance, disclosure & litigation

ESG Matters

This monthly update helps you keep up with the latest developments in ESG governance, disclosure and litigation. In this edition, we also take a look at the agenda of the authorities who supervise the financial market participants.

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1 2024 outlook for supervision on sustainability in the financial sector

As the year draws to a close, the European regulatory authorities in the financial sector have published their work programmes for the coming year. These supervisory 'agendas' enable the market to prepare for next year's supervisory focal points. As expected, sustainability remains high on all agendas. We present some highlights of the relevant 2024 work programmes.

EBA 2024 work programme – Focus on financial stability

The European Banking Authority (EBA) will continue to build its ESG risk monitoring framework, aiming to efficiently oversee ESG risks in the banking sector and further develop the green financial market. This will include a gradual increase in the use of external data relevant to ESG risks.

The EBA specifies some milestones:
- Q1: approval of the revised EU-wide ESG stress test framework.
- Q2: call for evidence on greenwashing - final report.

- Q3: annual report on the SFDR's Principal Adverse Impact (PAI) disclosures and due diligence practices.
- Q4: Pillar 1 follow-up report on capital requirements directly linked to ESG risks (see also the recent EBA report in the spotlight section).

EIOPA 2024 work programme – Focus on models and data to identify and monitor sustainable activities

The European Insurance and Occupational Pensions Authority (EIOPA) aims to make progress in analysing biodiversity-related and social risks and impacts. EIOPA will implement activities to establish itself as a Centre of Excellence in catastrophe models and data.

Some highlighted topics:

- Prudential framework: integration of ESG risks and consolidation of the macro/ micro-prudential ESG risk assessment.
- Greenwashing: monitoring and supervision of insurance products marketed as sustainable.
- Protection gaps: contributing to increased risk awareness of risk-based prevention measures with the aim to reduce insured losses.
- Data and source modelling: positioning itself as a relevant open-source data hub, providing climate-related data and models.

ESMA 2024 work programme – Focus on greenwashing and green bonds

The European Securities and Market Authority (ESMA) will continue to provide guidance to promote the convergence of ESG-related supervision on the key Directives and Regulations that fall within its remit. These include MiFID II, the Taxonomy Regulation, the CSRD and the Benchmark Regulation.

Specific output of the ESMA in 2024:

- Greenwashing: final report proposing actions to combat greenwashing.
- Green Bonds: publication of technical standards (see also the spotlight below).
- Credit Rating Agencies: technical advice on CRA's review of ESG-related data and reports.
- IT and data: feasibility assessment of new data and IT-projects relating to ESG disclosures.

ESAs 2024 work programme – Focus on SFDR implementation

The European Supervisory Authorities (EBA, EIOPA and ESMA, jointly: ESAs) outline their intention to publish their third annual report under Article 18 of the SFDR, on Principal Adverse Impact (PAI) statements and due diligence practices. In particular, the ESAs will monitor the practical application of the SFDR Delegated Regulation to determine whether Q&As or other Level 3 supervisory convergence tools should provide specific guidance to national competent authorities and market participants.

2024 and beyond: consultation for a revised SFDR

While the SFDR has only been in force since March 2021, the European Commission (EC) has recently launched a targeted and public consultation on the SFDR. This may lead to significant adjustments to the SFDR, particularly regarding the Level 1 Regulation on sustainability transparency by financial market participants.

The EC is consulting on the following topics:

- Should the SFDR become a true labelling system? The SFDR is designed as a transparency regulation, requiring financial market participants to report on how they handle sustainability following a prescribed format at the entity and product levels. In practice, however, the SFDR is primarily perceived as a labelling regulation, indicating whether a product is dark green, light green, or grey. Several questions in the consultation suggest that the EC is considering to align the SFDR with market perceptions (e.g.: ‘what would be the benefits of a labelling system and how could it be structured?’).
- Should product information be (more) standardised? In the discussion on standardised product disclosures, the EC is exploring the introduction of product disclosure requirements that would apply to all financial products offered in the EU, regardless of the underlying sustainability-related claims or other considerations. Which disclosure requirements are considered useful, and which are not?
- Marketing of sustainable products – use of the word ‘green’. The EC is consulting on whether the current SFDR requirements are sufficient to combat greenwashing. Are additional rules needed, such as a ban on words as ‘ESG’, ‘green’ and ‘sustainable’? Should there be a mandatory link between certain product characteristics and words?

What it means for you:

- ESG remains high on the agenda of all regulators. It is important to keep track of what lies ahead.
- The potential SFDR revision will have a significant impact. Although any revisions will not be implemented in 2024, the outcome of the consultation may shed light on what is expected of financial market participants.
- It is clear that regulators are moving towards the implementation of firm capital requirements related to ESG risks. This is an important development to watch.

Contact our experts

Frans van der Eerden | partner
Financial Law
+31 6 51 86 97 12
Frans.vanderEerden@nautadutilh.com

Kim Heesterbeek | associate
Financial Law
+31 6 31 74 31 85
Kim.Heesterbeek@nautadutilh.com

2 Spotlight on ESG developments

Governance & transition

Dutch Climate and Energy Outlook 2023: estimates of greenhouse gas emissions, renewable energy and energy savings

On 26 October, the Dutch Environmental Assessment Agency (PBL) published its annual Climate and Energy Outlook 2023 (*Klimaat- en Energieverkenning 2023*). The report shows that well-developed Dutch and European transition plans could yield an additional 5 percentage points of emission reductions, allowing for a reduction of 46 to 57%. To achieve the highest target all elements have to be aligned, including unmanageable factors such as weather and electricity imports, and a more concrete transition plan is required.

EBA recommendations: enhance the Pillar 1 framework to capture environmental and social risks

On 12 October, the EBA published a report on the role of environmental and social (E&S) risks in the prudential framework for credit institutions and investment firms. The EBA recommends short-term and medium- to long-term improvements to the risk categories of the Pillar 1 framework, using a risk-based approach. The short-term improvements should be implemented over the next three years as part of the revised Capital Requirements Regulation and Capital Requirements Directive (CRR3/CRD6). The EBA is for instance proposing to incorporate environmental risks in stress testing programmes, encourages financial institutions to incorporate E&S risk factors into external credit assessments, and require identification whether E&S factors constitute triggers of operational risk losses. The EBA recommendations follow the Basel Committee's agreement on 5 October to consult on a Pillar 3 disclosure framework for banks' exposure to climate-related financial risks. The Committee's consultation paper is expected to be published by November 2023.

Dutch consultation on renewable hydrogen initiatives

On 6 October, the Ministry of Economic Affairs (EZK) launched a consultation on the main proposed changes to the subsidy scheme for scaling up fully renewable hydrogen production via electrolysis (OWE). The consultation connects to EZK's intention to organise a new round of the subsidy scheme in 2024. The scheme is aimed at companies interested in developing electrolysis projects.

ACM policy rules on the supervision of sustainability agreements

On 4 October 2023, the Dutch Authority for Consumers and Markets (ACM) published its final policy rules on the application of competition law in the supervision of sustainability agreements between corporates. The key message of the rules is that the ACM wants to allow businesses to collaborate in order to achieve sustainability goals. The rules inter alia provide for an informal guidance process and a description of collaborations that will not be fined by the ACM. Some of these collaborations are complementary to the EC Guidelines on horizontal cooperation agreements. The ACM's policy rules entered into force on 6 October.

NGFS publishes a conceptual note on short-term climate scenarios

On 3 October, the Network for Greening the Financial System (NGFS), a group of central banks and financial supervisors, published a Conceptual note on short-term climate scenarios. The note proposes five short-term climate impact scenarios (i.e., for the next three to five years) that explore the potential short-term macro-financial risks associated with climate change. The scenarios will serve as a basis for future work by the NGFS and its members on short-term climate stress tests.

ESMA to launch a Common Supervisory Action on MiFID II sustainability requirements

On 3 October, the ESMA announced the launch of a Common Supervisory Action (CSA) with National Competent Authorities (NCAs) on the integration of sustainability into firms' suitability assessments and product governance processes and procedures in 2024. The CSA will cover specific aspects, such as how firms collect information on clients' sustainability preferences and assess the sustainability-related suitability of investments. The ESMA expects that these efforts will contribute to a consistent application of EU rules and enhance investor protection. The launch of the CSA follows ESMA's recent update of the guidelines on suitability and the product governance guidelines.

Supervisory framework for assessing nature-related financial risks

On 28 September, the OECD published a methodological supervisory framework for assessing nature-related financial risks, as part of a broader project of the EC to incorporate biodiversity-related risks into financial supervision. By translating biodiversity-related risks into financial risks, the report aims to enable central banks and financial supervisors to assess biodiversity-related financial risks, impacts and dependencies in the financial sector. The report also contains a useful list of references.

Updated IEA Net Zero Roadmap

On 26 September, the International Energy Agency (IEA) released an update of its influential Net Zero Roadmap, which was last published in May 2021. The report re-explores how the energy sector can achieve the IEA's cost-efficient Net Zero Emissions by 2050 Scenario (NZE). Despite global CO2-emissions reaching record highs in 2022, the report is generally positive about the global uptake of renewable energy since 2021. CCUS and green hydrogen deployment are relative laggards. Annual coal, oil and natural gas usage is projected to peak before the end of this decade under current climate policies. The updated report supports the first global stocktake of the Paris Agreement, in preparation for the COP28 climate conference in Dubai. In addition, the IEA's World Energy Outlook 2023, published on 24 October, provides an in-depth analysis of the global energy system outlook.

Disclosure

ESMA common enforcement priorities for 2023 annual financial reports

On 25 October, the ESMA published its annual public statement on the European common enforcement priorities for the 2023 financial reports of issuers admitted to trading on European (EEA) regulated markets. Together with national enforcers, in its enforcement on IFRS financial statements a priority is to focus on climate-related matters and some specific macroeconomic matters. In non-financial statements, enforcement priorities are: disclosures under Article 8 Taxonomy Regulation; disclosures of climate-related targets, actions and progress; and scope 3 emissions.

ESMA report: 'The heat is on: Disclosure of climate-related matters in financial statements'

On 25 October, ESMA published a report on the disclosure of climate-related matters in financial statements, which aims to assist and enhance the ability of issuers to provide more robust disclosures and create more consistency in the way climate-related matters are accounted for. The report focuses on climate-related disclosures under IFRS in the 2022 annual financial statements of European non-financial corporate issuers. ESMA expects issuers (including their management, supervisory boards and audit committees) and auditors to consider the illustrative examples in the report when deciding how to assess and disclose the degree to which climate-related matters play a role in the preparation and audit of IFRS financial statements.

Two Taxonomy FAQs on reporting requirements and technical screening formally adopted

On 20 October, the EC published two Frequently Asked Questions (FAQs) on the interpretation and implementation of certain provisions of the Taxonomy Regulation. This is the formal adoption of the draft FAQs that were published in December 2022. The first FAQ is addressed at non-financial undertakings that will have to start reporting their Taxonomy Key Performance Indicators (KPIs) as of 1 January 2023, and aims to provide those undertakings with further interpretative and implementation guidance. The second FAQ relates to the technical screening criteria for Taxonomy-aligned economic activities. It provides answers on respectively horizontal questions, sector-specific questions, and questions relating to recurring DNSH-criteria.

CSRD: EC proposes to postpone the adoption date for sector specific ESRS with two years

On 17 October, the EC proposed to postpone the deadline for the adoption of the sector-specific and 'Article 40b' (i.e., standards applicable to large third country groups) European Sustainability Reporting Standards (ESRS) by two years. This is relevant for companies in scope of the CSRD, including listed SMEs, who are required to report on sustainability. The postponement will allow these companies to focus on the implementation of the first set of ESRS adopted on 31 July 2023. It will also allow EFRAG to develop efficient sector specific ESRS, limiting the regulatory burden to the minimum necessary. The EC believes that reducing the regulatory burden is essential to maintain competitiveness of the EU, without undermining policy objectives. See also the draft list of data points published by the EFRAG on 25 October.

PSF launches consultation on new economic activities under the Taxonomy Regulation

On 17 October, the Platform on Sustainable Finance (PSF) has launched an ongoing consultation on the economic activities in scope of the Taxonomy Regulation. Stakeholders can suggest the addition of new economic activities to the Taxonomy Regulation's technical screening criteria, or the revision of existing technical screening criteria. Proposals submitted before 15 December 2023 will be taken into account in the PSF's recommendations to the EC in early 2024.

TCFD 2023 Status Report: more work needed on climate-related financial disclosures

On 12 October, the Task Force on Climate-related Financial Disclosures (TCFD) has published its 2023 Status Report. The report states that while TCFD-aligned reporting continues to increase, only 4% of corporations disclose in line with all 11 TCFD-recommended disclosures. The report also describes international developments on sustainability reporting and climate-related risk management, providing several case studies. This marks the last progress report published by the TCFD, as the ISSB will take over monitoring TCFD progress as of next year. The TCFD recommendations have been incorporated into the ESRS.

FSB 2023 progress report on climate-related disclosures

On 12 October, the Financial Stability Board (FSB) published its annual progress report on climate-related disclosures. From a global perspective, the report highlights progress made by the International Sustainability Standards Board (ISSB), in particular the publication of the IFRS S1 and IFRS S2 disclosure standards, as well as progress in the area of assurance. The FSB welcomes the publication of the ISSB standards, which will serve as a global framework for sustainability disclosures, and will work with other relevant bodies to promote the timely and widespread use of the standards. The report also outlines progress made by jurisdictions in promoting climate-related disclosures. All FSB jurisdictions either currently have requirements, guidance, or expectations in respect of climate-related disclosures in place, or have taken steps (e.g. proposals) to do so.

2023 FSB annual report: promoting global financial stability

On 11 October, the Financial Stability Board (FSB) published its annual report, describing its work to assess and address current and emerging vulnerabilities in the global financial system. The FSB highlights the publication of sustainability disclosure standards by the ISSB to address the financial risks posed by climate change. In addition, the FSB reports on its progress on (i) the development of global open access repositories, (ii) the assessment of climate-related vulnerabilities; (iii) the integration of climate-related risks into risk management and prudential frameworks; and (iv) the review of the incorporation of climate-related objectives into financial institutions' compensation frameworks, with a view to identifying common challenges and sharing practices to effectively align compensation with prudent risk-taking.

ESMA study: do issuers benefit from an ESG pricing effect?

On 6 October, ESMA published an article on the European sustainable debt market, analysing the existence of an ESG pricing effect (or 'Greenium') across different types of sustainable-labelled debt instruments. The empirical results confirm that the standard drivers of bond prices and yields – i.e. credit, maturity and liquidity risk – and the explanatory power of the models are encouraging, but do not confirm the systematic existence of a Greenium for the investigated sustainable bond categories. Nevertheless, ESMA finds the results encouraging from a financial stability perspective, as price differences between sustainable and conventional debt instruments seem to stem from the same fundamental risk factors, such as the issuer's creditworthiness, and not solely from a bond's ESG status.

EP adopts EU Green Bonds Regulation

On 5 October, the European Parliament has adopted the proposal for a Regulation on European Green Bonds (EuGBs). The adopted text requires 100% of the proceeds of an EuGB to be invested in (a portfolio of) certain EU Taxonomy-aligned assets, or in capital or operating expenditure for which a Taxonomy transition plan is in place. Under certain conditions, 15% of the proceeds of an EuGB may be allocated to economic activities that are Taxonomy-aligned but do not (yet) align with the technical screening criteria. The regulation contains mandatory disclosure templates for EuGBs and voluntary disclosure templates for bonds marketed as environmentally sustainable, and sustainability-linked bonds. Lastly, the Regulation sets out rules on external review, organisation and governance, and supervision.

AFM updates guidelines on sustainability claims

On 4 October, the Dutch Authority for Financial Markets (AFM) published an updated version of its Guidelines on Sustainability Claims for financial institutions and pension providers (*Leidraad duurzaamheidsclaims*). The updated guidelines, which were consulted on earlier this year, apply to voluntary communications, as well as to mandatory disclosures insofar as applicable legislation does not prescribe a certain design. The guidelines require a sustainability claim to be (1) accurate, representative and up-to-date; (2) specific and substantiated; and (3) understandable, appropriate, and easy to find. Practical examples are provided for each requirement.

ECB adopts position in favour of introducing an ESG Rating Regulation

On 4 October, the ECB published an own-initiative opinion welcoming the proposed ESG Rating Regulation. The Regulation introduces a common regulatory approach to enhance the adequacy, integrity, transparency, responsibility, good governance, and independence of ESG rating activities. The ECB suggests an amendment to the section of the proposed Regulation stating that it does not apply to (certain) ESG ratings issued by central banks. The ECB considers that this section may unintentionally result in a narrow scope, and recommends drafting the exemption in a similar way to the exemption granted to ESG ratings issued by the EU or Member States' public authorities.

ESMA study: ESG language on the rise in the EU fund industry

On 2 October, the ESMA published an article exploring the use of ESG-related language in the names and documentation of EU investment funds. To carry out this study, ESMA has inter alia applied natural language processing techniques to examine more than 100,000 fund documents. The study shows that the share of EU UCITS investment funds with ESG-related words in their name has increased from less than 3% in 2013 to 14% in 2023. The study also highlights that fund managers tend to use generic language (such as 'ESG' and 'sustainable') rather than more specific words, which can hinder investors in verifying whether the fund's portfolio aligns with its name.

Litigation

London High Court dismisses legal challenges to new North Sea oil and gas exploration

On 19 October 2023, London's High Court dismissed legal challenges by NGOs Greenpeace and Uplift to the UK's 2022 licensing round for new oil and gas exploration in the North Sea. The claimants argued that the Secretary of State had acted unlawfully or 'irrationally' by not considering the scope 3 emissions (arising from consumer end-use of oil- and gas-derived fuels) that can be attributed to the licensing round. After the claimants were granted permission for judicial review in April 2023, the Court has now dismissed their argument on the merits. Greenpeace said it will appeal the Court's decision.

Do you have any questions or comments on a particular ESG topic? Please do not hesitate to contact our Sustainable Business & Climate Change team. If you or members of your team would like to receive our monthly ESG Matters update by email, you are most welcome to sign up.

NautaDutilh's Sustainable Business & Climate Change team

Gaike Dalenoord | partner Corporate M&A. Focus on chemicals and hydrogen

Frans van der Eerden | partner Financial Law. Focus on financial regulatory & sustainability

Marieke Faber | partner Dispute Resolution. Focus on climate litigation and sustainability strategy

Maartje Govaert | partner Employment & Pensions. Focus on social pillar of ESG (employment law matters)

Harm Kerstholt | partner Corporate M&A. Focus on Energy, ESG due diligence, and human rights

Iris Kieft | partner Public & Regulatory. Focus on public regulatory, energy, climate change and the circular economy

Suzanne Kröner-Rosmalen | counsel Corporate Governance. Focus on sustainable corporate governance, ESG disclosures and strategy

Geert Raaijmakers | partner Corporate Governance. Focus on sustainable corporate governance

Arjan Scheltema | partner Finance. Focus on green bonds, green covered bonds, green securitisations and energy efficient mortgages (hub)

Freerk Vermeulen | partner Dispute Resolution and head of the Supreme Court Litigation Team. Focus on climate litigation and sustainability strategy

David Wumkes | partner Real Estate & Infrastructure. Focus on real estate, substainability and energy projects

Petra Zijp | partner Capital Markets. Focus on green bonds and ESG-linked issuances

Meet the whole team

Editors: Kim Heesterbeek, Erik van Engelenburg & Dorine Verheij