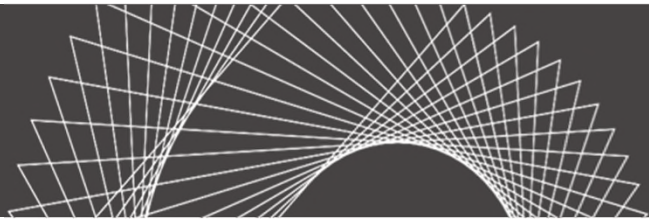


# Emergence of ESG Transparency – US and EU/UK Developments



**Akin Gump**  
STRAUSS HAUER & FELD LLP

15 April 2021

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Amy Kennedy

Stacey H. Mitchell

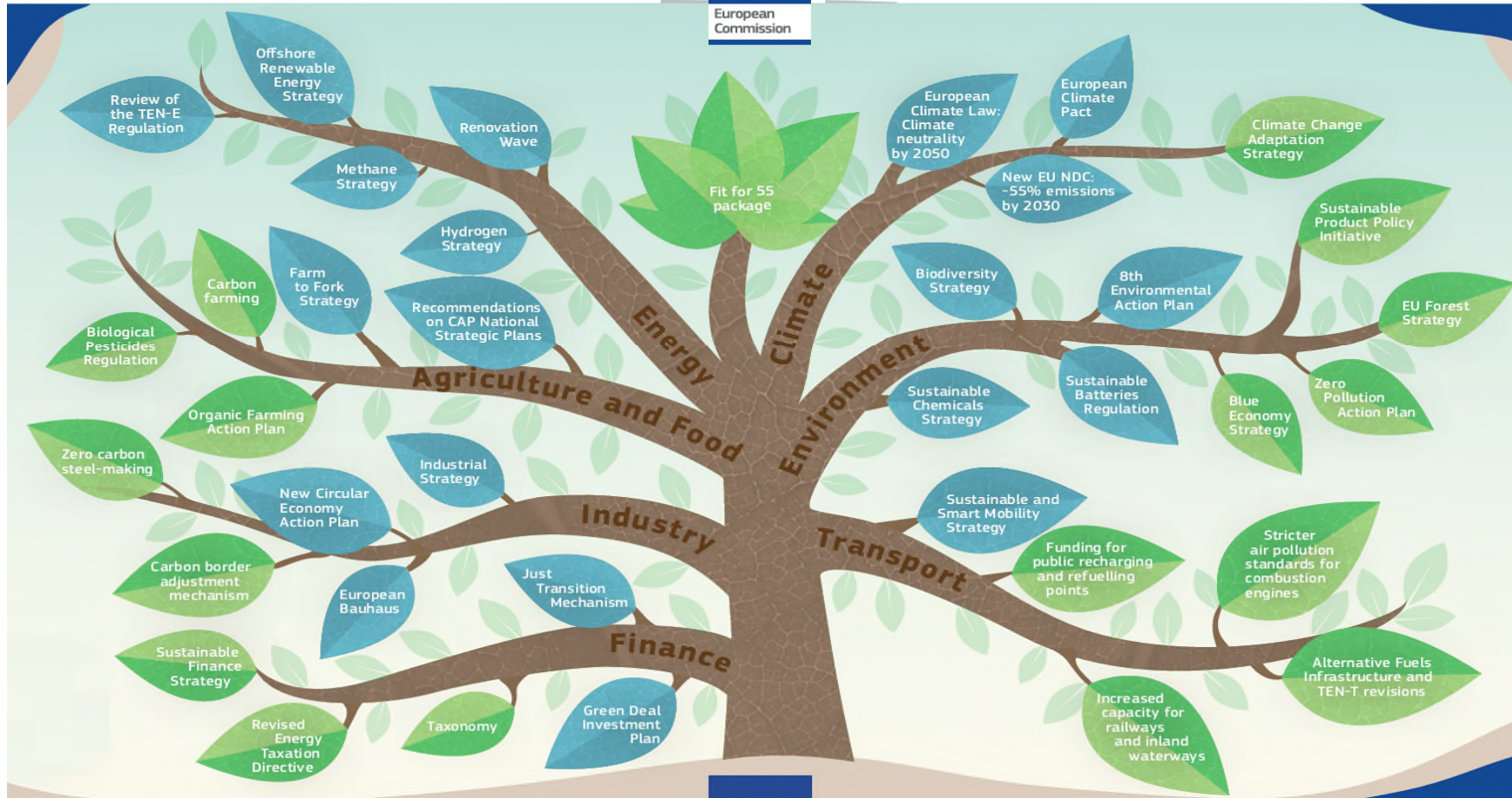
Ezra Zahabi

# Agenda

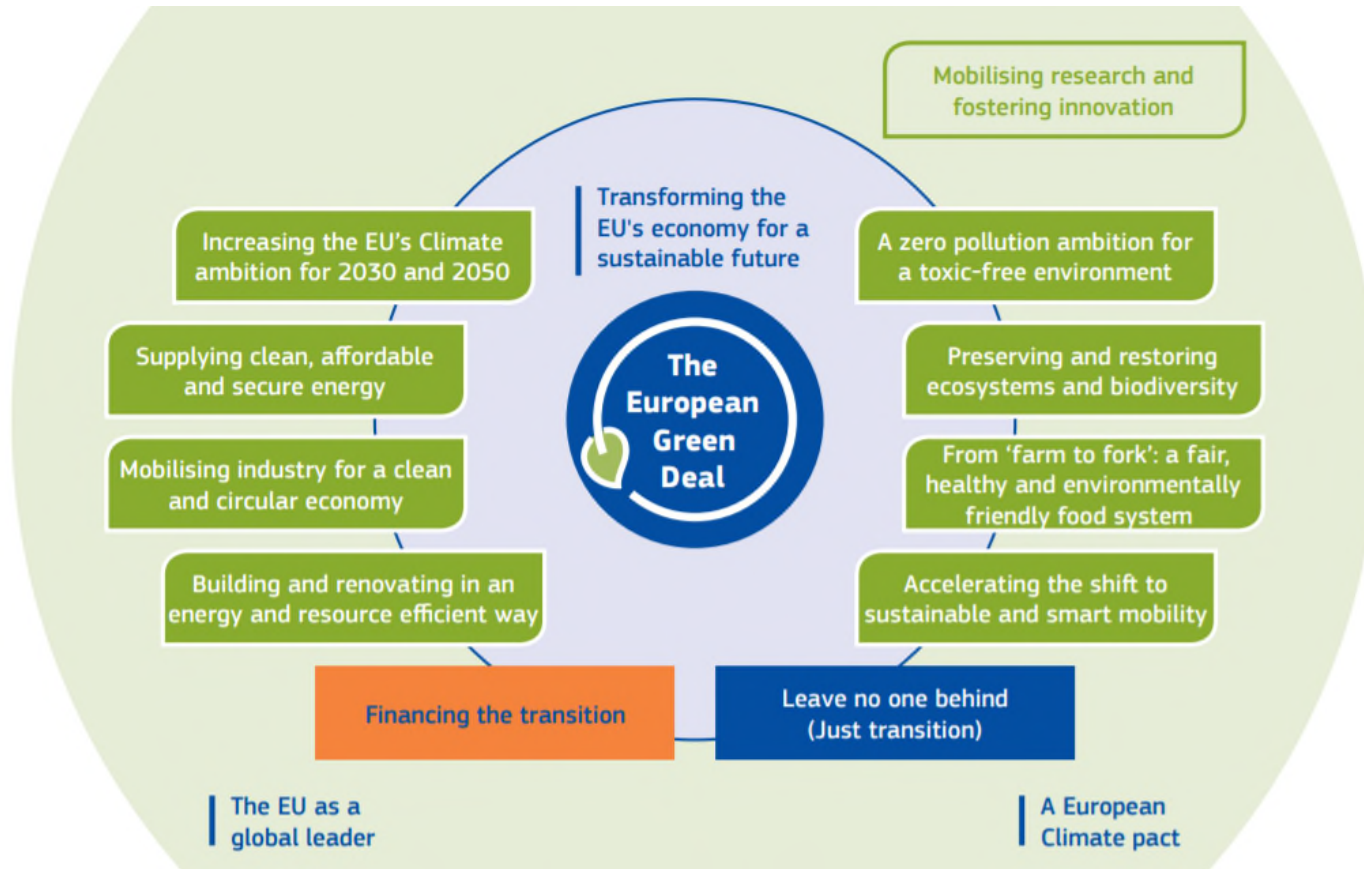
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- European Union (EU) Plans on Environmental, Social and Corporate governance (ESG) and Sustainable Finance
- United States (US) Overview of Climate and ESG Developments
- EU Sustainable Finance Transparency Requirements
- United Kingdom (UK) Sustainable Finance Initiative
- US Climate and ESG Transparency
- Sustainable Finance Disclosure Regulation (SFDR) Implementation
- Risks and Broader Implications

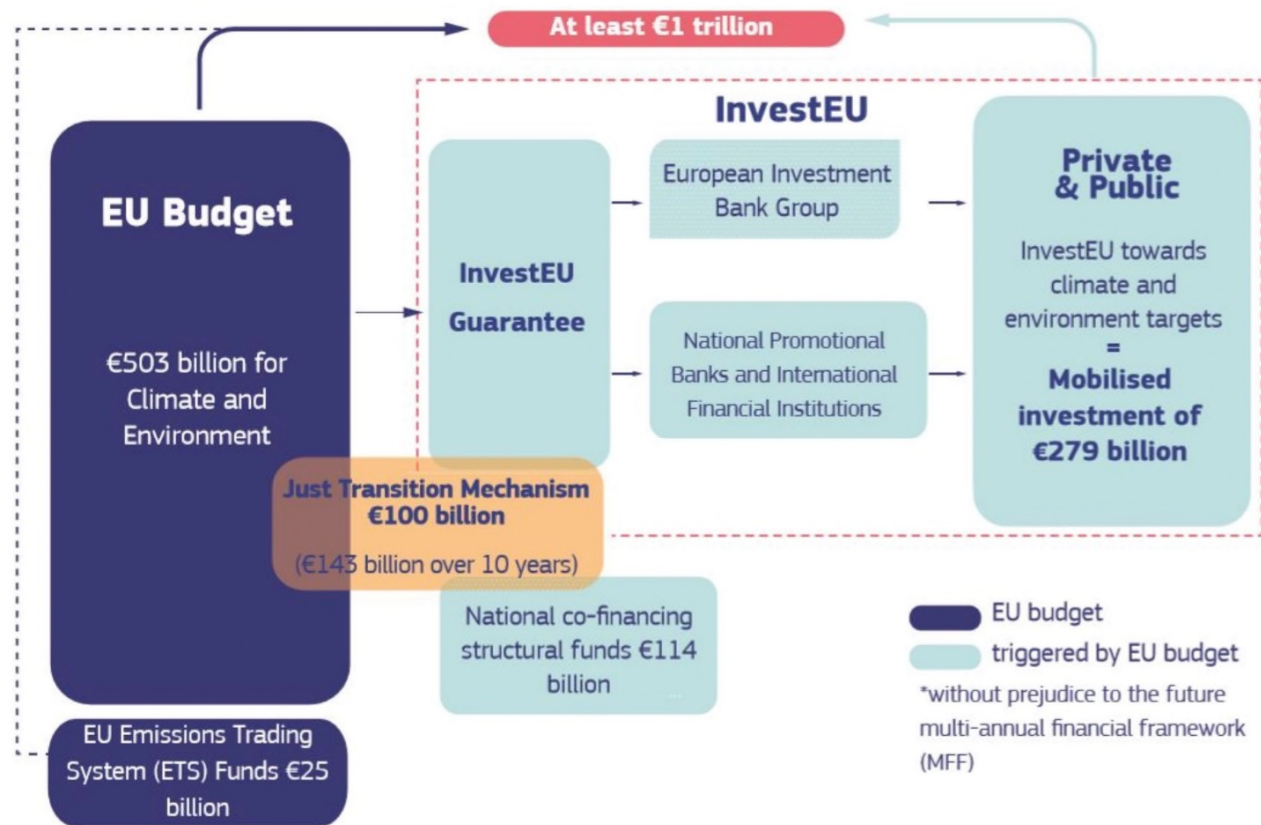
# EU Plans on ESG and Sustainable Finance



# European Green Deal



# European Green Deal/Sustainable Europe Investment Plan



\*The numbers shown here are net of any overlaps between climate, environmental and Just Transition Mechanism objectives.

# The European Climate Law

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## Proposal for a Regulation establishing the framework for achieving climate neutrality (“European Climate Law”)

- **Legal obligation:** Transforms political promises into a binding **legal obligation**
- **Framework Regulation:** Binding legal **framework** for the “irreversible” and gradual reduction of greenhouse gas emissions and enhancement of removals by natural or other sinks in the EU
- **Key objective:** “**Climate Neutrality**” (i.e. net zero greenhouse gas emissions) in the EU by 2050 in pursuit of the long term temperature goal set out in the Paris Agreement, that is:

### Article 2, Paris Agreement

“Holding the increase in the global average temperature to well below 2°C above pre-industrial levels and pursuing efforts to limit the temperature increase to 1.5°C above pre-industrial levels, recognizing that this would significantly reduce the risks and impacts of climate change.”

### Article 2(1), Climate-neutrality objective, European Climate Law

“Union-wide emissions and removals of greenhouse gases regulated in Union law shall be balanced at the latest by 2050, thus reducing emissions to net zero by that date.”

# Proposal for Corporate ESG Accountability

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- Proposal for a new EU directive on corporate due diligence and accountability
- Focus on sustainable corporate governance, including mandatory human rights and environmental due diligence with respect to impacts across supply chains
- Proposal currently in draft, publication expected in Q2 2021
- Proposed extra-territorial application to non-EU entities which sell goods or provide services in the EU
- “exercise of due diligence requires undertakings to identify, assess, prevent [...] and remediate the [...] adverse impacts on human rights, the environment and good governance that their own activities and those of their value chains and business relationships may pose.”
- New civil liability regime under which undertakings will be liable and remediate for any harm “arising out of [...] adverse impacts on human rights, the environment or good governance [they] [...] have caused or contributed to”



# US Climate Landscape



“It’s a whole-of-government approach to put climate change at the center of our domestic, national security, and foreign policy.” President Biden, January 27, 2021



Biden-Harris administration integrating climate policy broadly across legislative and administrative agendas to meet aggressive goals:

- Carbon pollution-free energy sector by 2035
- Net-zero emissions by 2050



Democrats control both legislative branches by thinnest of margins:

- VP Harris breaks 50/50 tie in Senate
- 11 seat majority in House



Absent filibuster reform or budget reconciliation, democrats will need to pursue bipartisanship.

# US: Overview of climate and ESG Developments

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## **Biden-Harris administration prioritizing addressing climate change**

- Rejoined Paris Climate Agreement
- Prioritizing climate matters across all agencies:
  - Established the White House Environmental Justice Interagency Council and a White House Environmental Justice Advocacy Council
  - Established the Interagency Working Group on the Social Cost of Greenhouse Gases
- The American Jobs Plan infrastructure bill
- Leaders' Climate Summit (April 22)



# EU Sustainable Finance Transparency Requirements



# Sustainable Finance

- Sustainable finance is a work stream supporting the European Green Deal channelling private investment to the transition to a climate-neutral economy
- The sustainable finance initiative seeks to make sustainability considerations an integral part of financial decision making

Three key areas	Legislation
Unified EU “green” classification System	Taxonomy Regulation (Regulation 2020/852).
Sustainability-related disclosures	Sustainable Finance Disclosure Regulation (Regulation 2019/2088).
Climate benchmarks and their ESG disclosures	Low Carbon Benchmark Regulation (Regulation 2019/2089).
Other areas	Other legislation
EU standards and labels	EU Green Bond Standard.  Extending the EU Ecolabel to retail investment products.
Sustainability preferences	Amendments to Alternative Investment Fund Managers Directive (AIFMD), Markets in Financial Instruments Directive (MiFID) 2 and the Undertakings for the Collective Investment in Transferable Securities (UCITS) Directive.
Enhanced transparency in corporate reporting	New guidelines for companies on how to report climate-related information.

# Legal Framework Requiring Transparency

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- **Sustainable Finance Disclosure Regulation (SFDR)** – from 10 March 2021
  - Requires public disclosure of how the manager integrates sustainability risk in the investment process (e.g. internal policies) across the manager’s business, and pre-contractual disclosure with respect to each fund or other product
  - Optional disclosure of ESG performance by the manager and at the product level (“principal adverse impact” disclosures)
  - Aims to improve transparency and comparability of sustainability information within the financial markets by standardising disclosure in order to prevent greenwashing
- **Taxonomy Regulation** – from 1 January 2021
  - Sets out a clear framework to assess which activities and investments are environmentally “sustainable”
  - Requires additional disclosure with respect to “light green” and “dark green” funds and other financial products
- **Non-Financial Reporting Directive**
  - Imposes qualitative non-financial performance reporting obligation on EU listed companies that have over 500 employees (or meet certain other criteria)
  - New ESG disclosure requirements; extended scope

# Sustainable Finance Disclosure Regulation (SFDR)

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- **Institution-level disclosures**

- Sustainability risk policy across products and strategies
- Integration of sustainability risk on remuneration policy
- Optional disclosure of ESG performance across products and strategies

- **Product-level disclosures**

- Sustainability risk policy with respect to the product
- Assessment of the likely impact of sustainability risks in returns
- Optional disclosure of ESG performance of product

- Additional disclosure and periodic investor reporting for “light green” and “dark green” products

- Secondary legislation prescribes content and methodology of disclosures in detail

- A “sustainability risk” is “an environmental, social or governance event or condition that, if it occurs, could cause an actual or a potential material negative impact on the value of the investment”

# SFDR – Disclosures Specific to Institution

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- Mandatory disclosure on the website of:
  - Policy “on the integration of sustainability risks in its investment decision-making process”
  - How remuneration policy “is consistent with integration of sustainability risks”
  - Certain additional product-specific information with respect to “light green” and “dark green” products
- Disclosures to be specific to the asset class and strategy
- Requirement to include a “Principal adverse impacts on sustainability factors” (PAI) statement applies on a “comply or explain” basis\*
- PAI statement to be made in a prescribed format with reference to detailed quantitative key performance indicators
- \*Derogation: “Large” financial market participants (with over 500 employees) are required to publish and maintain on their websites a statement on their due diligence policies “with respect to the principal adverse impacts of investment decisions on sustainability factors” from 30 June 2021

# SFDR – Disclosures Specific to Product

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- If the manager or product provider integrates sustainability risks into the investment decision-making process with respect to the product:
  - The manner in which sustainability risk has been integrated into investment decisions; and
  - The results of its assessment of the likely impact of sustainability risks on returns
- If the manager or product provider has decided to not consider the negative impact of investment decisions on “sustainability factors”, it must provide a “clear and concise” explanation giving reasons for its decision
- Additional disclosure requirements for “light green” and “dark green” products, explaining the sustainability focus and how the characteristics promoted, or the objectives set, by the product are achieved
  - Disclosures included in the pre-contractual documentation (e.g. PPM) to be included using a template set out in the secondary legislation (this also incorporates additional disclosures provided under the Taxonomy Regulation)
  - Further disclosures for each of the “light green” and “dark green” products of the manager or product provider must be included on its website



# NFRD – Non-Financial Reporting Directive

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- Currently requires publication of non-financial statements on the policies they implement in relation to environmental protection; social responsibility and treatment of employees; respect for human rights; anti-corruption and bribery; and diversity on company boards (in terms of age, gender, educational and professional background)
- Reports to be produced in accordance with non-binding guidelines
- Applies to “large public interest entities” in the EU, i.e.:
  - Undertakings admitted to trading on an EU regulated market
  - Credit institutions
  - Insurance undertakings
  - Other entities (as designated by member states)
- Provided that the entity is considered “large”, i.e.:
  - Has more than 500 employees or
  - Balance sheet of at least EUR 20 million/turnover of at least EUR 40 million

# NFRD – Enhanced disclosure

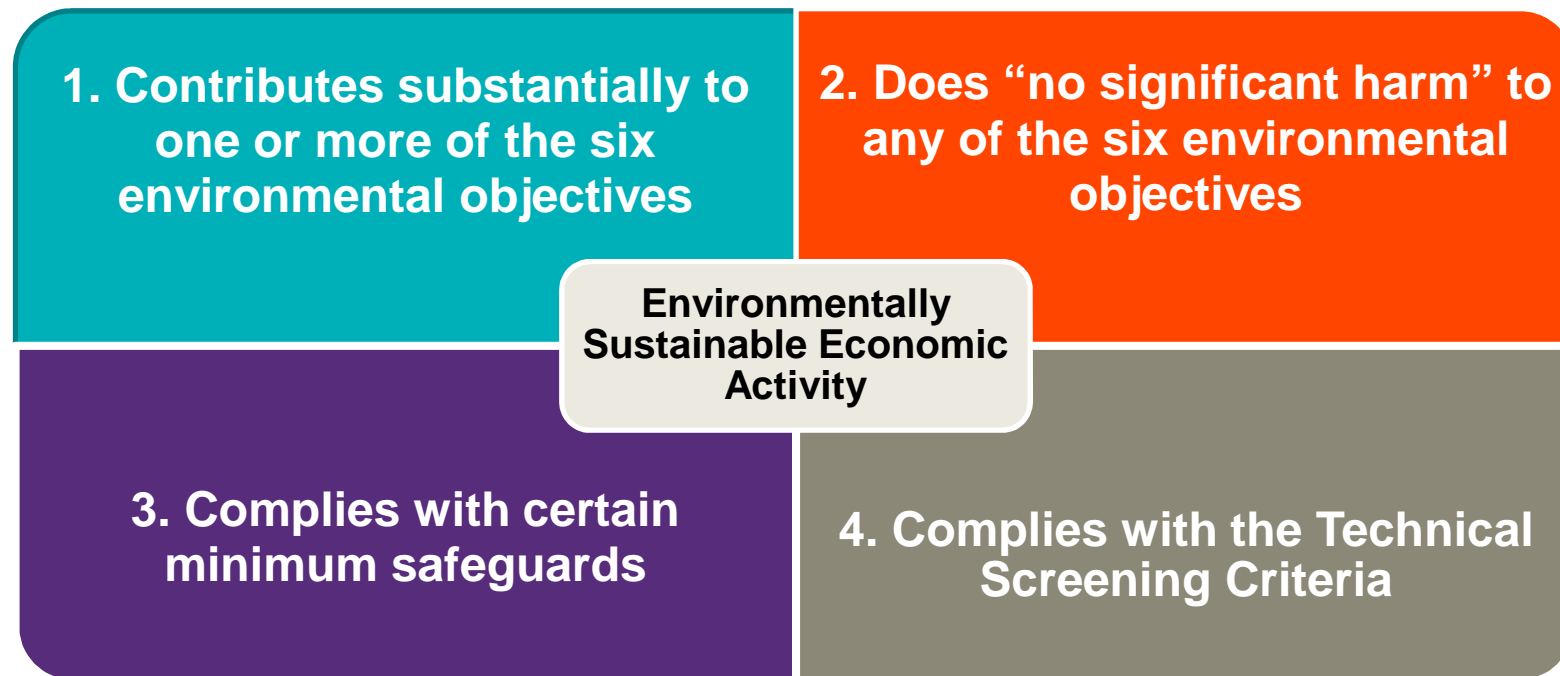
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- Additional disclosure requirements imposed:
  - Non-financial statements to set out how, and to what extent, activities are “associated with” environmentally sustainable economic activities, and non-financial undertakings shall disclose the proportion of their:
    - Turnover derived from products or services associated with economic activities that are “environmentally sustainable” under the Taxonomy Regulation
    - Capital expenditure and operating expenditure related to assets or processes associated with economic activities under the Taxonomy Regulation
  - Possibly also additional environmental performance indicators
  - Content and presentation of the information to be prescribed in secondary legislation in order to ensure comparability
- Proposal to incorporate alternative reporting standards, e.g. the Task Force on Climate-related Financial Disclosures (TCFD) standards
- Proposed extension to scope, e.g. to include all public interest entities or at least lowering the threshold from 500 to 250 employees; possibly include other large private companies

# Taxonomy Regulation

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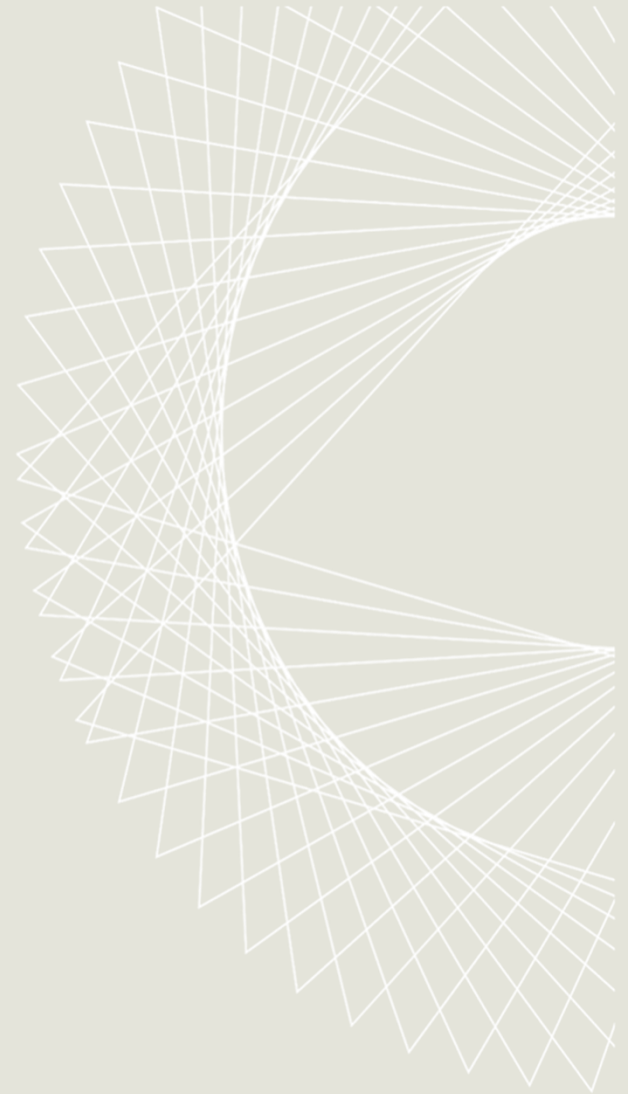
- Seeks to standardise “sustainable investment”
- An economic activity qualifies as environmentally sustainable where that economic activity meets four criteria:



# Taxonomy Regulation: Standardising “sustainable investment”

Environmental objectives	No “significant harm”	Minimum safeguards	Technical Screening Criteria
<ol style="list-style-type: none"> <li>1. Climate change mitigation.*</li> <li>2. Climate change adaptation.*</li> <li>3. Sustainable use and protection of water and marine resources.**</li> <li>4. Transition to a circular economy.**</li> <li>5. Pollution prevention and control.**</li> <li>6. Protection and restoration of biodiversity and ecosystems.**</li> </ol> <p>An “enabling activity” may also substantially contribute to an “environmental objective”.</p> <p>* Applies from 1 January 2022 **Applies from 1 January 2023</p>	<p>An economic activity must not significantly harm any of the six environmental objectives.</p> <p>Article 17 of the Taxonomy Regulation sets out what is considered to be a significant harm in relation to each environmental objective, such as:</p> <ul style="list-style-type: none"> <li>- Significant GHG emissions.</li> <li>- Significant increase in the emissions of pollutants into air, water or land, as compared to the situation before the activity started.</li> </ul>	<p>Complying with:</p> <ol style="list-style-type: none"> <li>1. The Organisation for Economic Co-operation and Development's (OECD) Guidelines for Multinational Enterprises.</li> <li>2. The United Nation's Guiding Principles on Business and Human Rights.</li> <li>3. The International Labour Organization's Declaration on Fundamental Principles and Rights at Work.</li> <li>4. The International Bill of Human Rights.</li> </ol>	<p>Granular requirements supplementing the environmental objectives adopted by way of Delegated Acts.</p>

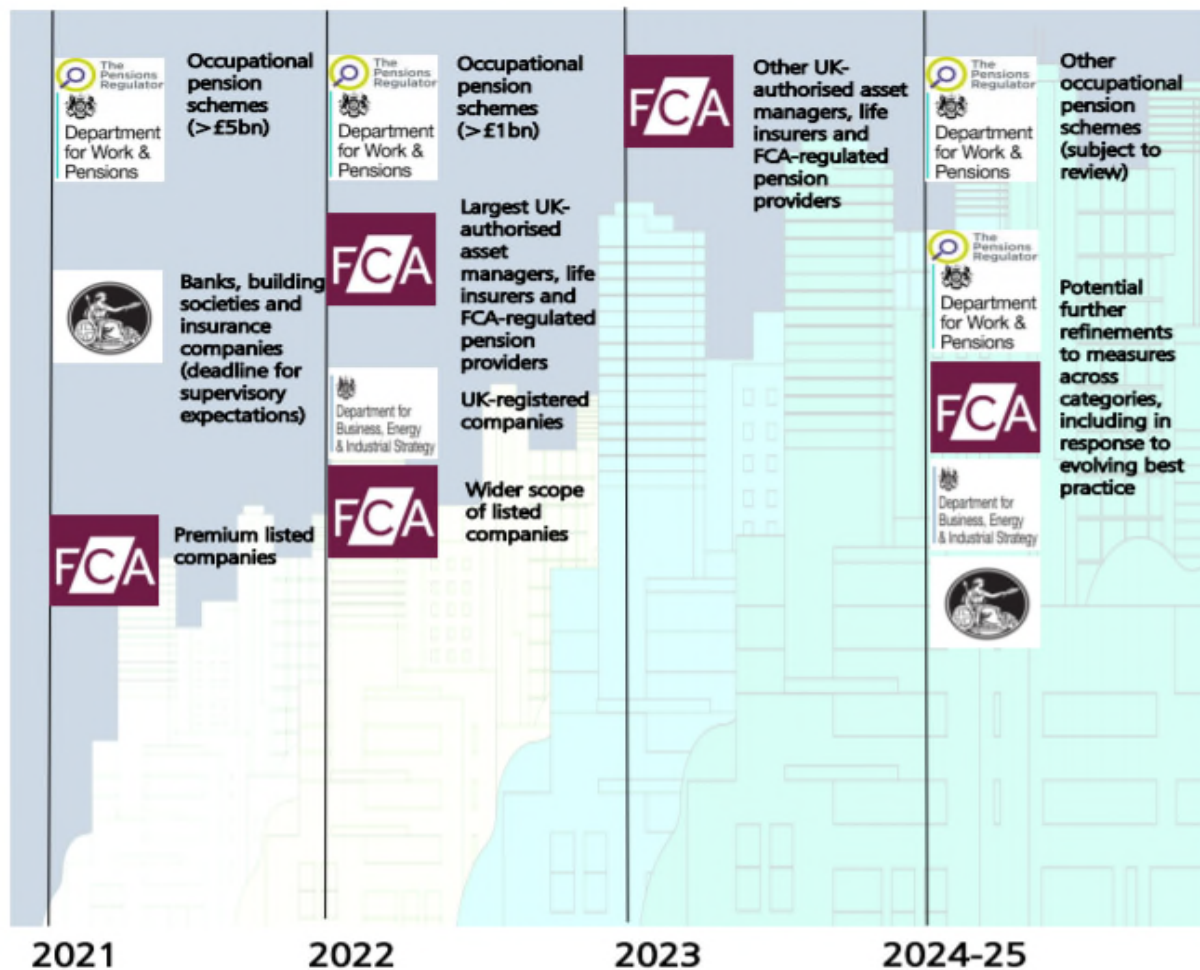
# UK Sustainable Finance Initiative



# UK: Task Force on Climate-related Financial Disclosures Recommendations

Governance	Strategy	Risk Management	Metrics and Targets
<p>Disclose the organization's governance around climate-related risks and opportunities.</p>	<p>Disclose the actual and potential impacts of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning where such information is material.</p>	<p>Disclose how the organization identifies, assesses, and manages climate-related risks.</p>	<p>Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material.</p>
<p><b>Recommended Disclosures</b></p>	<p><b>Recommended Disclosures</b></p>	<p><b>Recommended Disclosures</b></p>	<p><b>Recommended Disclosures</b></p>
<p>a) Describe the board's oversight of climate-related risks and opportunities.</p>	<p>a) Describe the climate-related risks and opportunities the organization has identified over the short, medium, and long term.</p>	<p>a) Describe the organization's processes for identifying and assessing climate-related risks.</p>	<p>a) Disclose the metrics used by the organization to assess climate-related risks and opportunities in line with its strategy and risk management process.</p>
<p>b) Describe management's role in assessing and managing climate-related risks and opportunities.</p>	<p>b) Describe the impact of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning.</p>	<p>b) Describe the organization's processes for managing climate-related risks.</p>	<p>b) Disclose Scope 1, Scope 2, and, if appropriate, Scope 3 greenhouse gas (GHG) emissions, and the related risks.</p>
	<p>c) Describe the resilience of the organization's strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario.</p>	<p>c) Describe how processes for identifying, assessing, and managing climate-related risks are integrated into the organization's overall risk management.</p>	<p>c) Describe the targets used by the organization to manage climate-related risks and opportunities and performance against targets.</p>

# UK: Timeline of Planned or Potential Regulatory Actions or Legislative Measures



# UK: Overview

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- Companies with a UK premium listing now required to confirm TCFD-aligned disclosure, and explain non-compliance. Applies to accounting periods beginning on or after 1 January 2021, with first annual financial reports published in H1 2022
- UK aims to make TCFD-aligned disclosures mandatory by 2025, with many requirements in place by 2023; disclosure proportional to the type of entity
- TCFD-aligned disclosure to become mandatory to large UK listed entities, Alternative Investment Market (AIM)-listed entities and large private corporations
- Expected to become applicable for accounting periods starting on or after 6 April 2022
- TCFD-aligned disclosure will apply to FCA-authorized firms, expected to apply initially on a comply or explain basis
- The UK will establish its own common framework for determining which activities can be defined as environmentally sustainable, using the scientific metrics in the EU taxonomy as its basis
- For financial institutions the emphasis is on managing climate-related risk

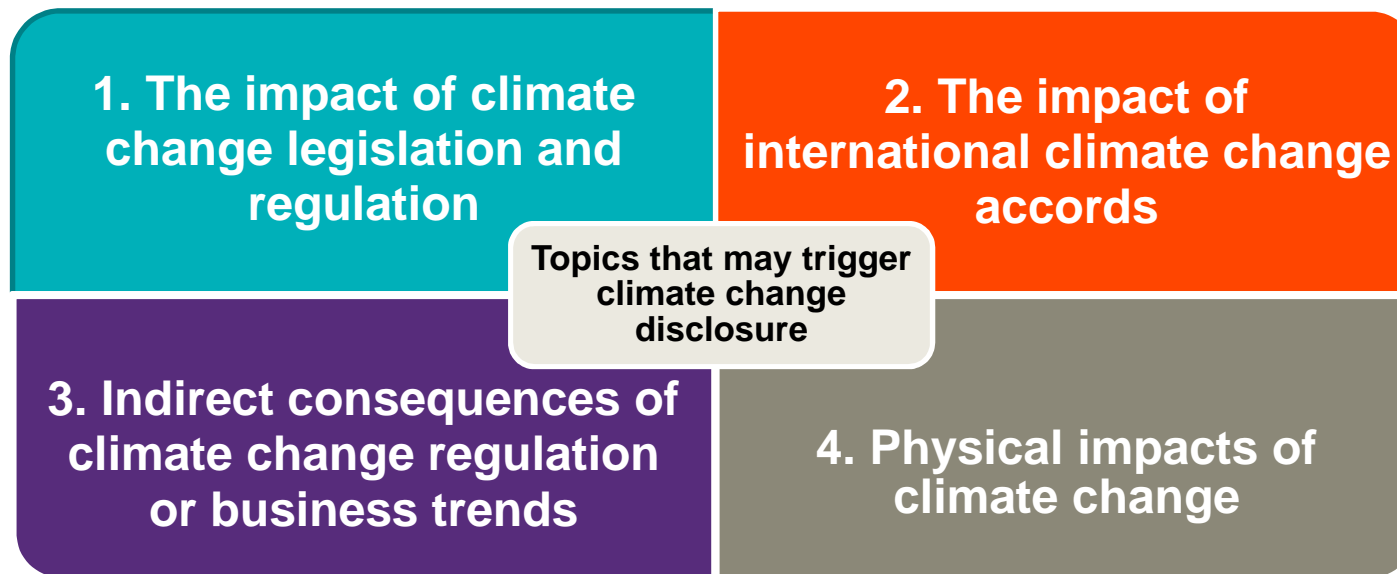


# US Climate & ESG Transparency: Requirements and Priorities



# US: SEC's 2010 Guidance on Climate Disclosures

- In 2010 the Securities and Exchange Commission (SEC) issued an interpretive release clarifying how existing SEC disclosure rules may require public companies to describe climate change matters.



- On April 9, 2021 SEC's Division of Examinations published a risk alert stating that the SEC's Climate and ESG Task Force will investigate potential materially misleading ESG statements and omissions by companies, investment advisers and funds.

# US - Increasing Regulation

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## Securities and Exchange Commission (SEC)

- Created Climate and ESG Task Force in Division of Enforcement
- Examination priorities include focus on climate-related risks and ensuring accuracy in ESG-related claims
- Likely additional ESG-related disclosures through rulemaking and additional interpretations of existing climate-related guidance
- Recently denied no action relief and allowed shareholder resolutions on environmental and social issues – no longer considering such proposals related to “ordinary business” or constituting “micromanagement”
- Call for public comment on climate related disclosures
- Satyam Khanna named Senior Policy Advisor for Climate and ESG

## Commodity Futures Trading Commission (CFTC)

- Established Climate Risk Unit



# SFDR Implementation



# Lessons Learned

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- Asset managers and investors must be able to articulate how they manage sustainability risk:
  - Use of external as well as proprietary risk assessment methodologies is important
  - Future expansion of risk factors
  - Thoughtful application to different asset classes and geographies
  - Understanding the ESG focus areas
- Managing sustainability risk is not the same as ESG performance:
  - The level of prescriptive disclosure required to complete the “principal adverse impacts” statements is expensive
  - Data quality is key; ESG ratings inconsistent; proprietary solutions
- What is a “light green” fund:
  - Frequent question given the attractiveness of advertising ESG credentials
  - Promotion of “social or environmental characteristics” by various investment approaches and strategies, e.g. best-in-class; sectoral exclusions
  - Binding quotas or other investment parameters vs ultimate discretion by the investment manager
  - Using ESG as a selling point risks claims of “greenwashing”
  - EU guidance still outstanding

# Principal Adverse Sustainability Impacts Statement

## Core Indicators: Investments in Investee Companies

### Climate and Other Environment-related Indicators

<b>Greenhouse gas emissions</b>	<ol style="list-style-type: none"> <li>1. Green House Gas emissions</li> <li>2. Carbon footprint</li> <li>3. Green House Gas intensity of investee companies</li> <li>4. Exposure to companies active in the fossil fuel sector</li> <li>5. Share of non-renewable energy consumption and production</li> <li>6. Energy consumption intensity per high impact climate sector</li> </ol>
<b>Biodiversity</b>	<ol style="list-style-type: none"> <li>7. Activities negatively affecting biodiversity-sensitive areas</li> </ol>
<b>Water</b>	<ol style="list-style-type: none"> <li>8. Emissions to water</li> </ol>
<b>Waste</b>	<ol style="list-style-type: none"> <li>9. Hazardous waste ratio</li> </ol>

### Social and Employee, Respect for Human Rights, Anti-corruption and Anti-bribery Matters

<b>Social and employee matters</b>	<ol style="list-style-type: none"> <li>10. Violations of UN Global Compact principles and Organisation for Economic Co-operation and Development (OECD) Guidelines for Multinational Enterprises</li> <li>11. Lack of processes and compliance mechanisms to monitor compliance with UN Global Compact principles and OECD Guidelines for Multinational Enterprises</li> <li>12. Unadjusted gender pay gap</li> <li>13. Board gender diversity</li> <li>14. Exposure to controversial weapons (anti-personnel mines, cluster munitions, chemical weapons and biological weapons)</li> </ol>
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# Principal Adverse Sustainability Impacts Statement

## Core Indicators: Investments in Sovereigns and Supranationals

### Climate and Other Environment-related Indicators

<b>Environmental</b>	1. Green House Gas intensity
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### Social and Employee, Respect for Human Rights, Anti-corruption and Anti-bribery Matters

<b>Social</b>	2. Investee countries subject to social violations
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## Core Indicators: Investments in Real Estate Assets

### Climate and Other Environment-related Indicators

<b>Fossil fuels</b>	1. Green House Gas intensity
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<b>Energy efficiency</b>	2. Exposure to energy-inefficient real estate assets
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# Principal Adverse Sustainability Impacts Statement

Indicators applicable to investments in investee companies					
Adverse sustainability indicator	Metric	Impact [year n]	Impact [year n-1]	Explanation	Actions taken
<b>CLIMATE AND OTHER ENVIRONMENT-RELATED INDICATORS</b>					
Greenhouse gas emissions	1. GHG emissions	Scope 1 GHG emissions			
		Scope 2 GHG emissions			
		From 1 January 2023, Scope 3 GHG emissions			
		Total GHG emissions			
	2. Carbon footprint	Carbon footprint			
	3. GHG intensity of investee companies	GHG intensity of investee companies			
	4. Exposure to companies active in the fossil fuel sector	Share of investments in companies active in the fossil fuel sector			



# Principal Adverse Sustainability Impacts Statement

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## ANNEX I

### Template principal adverse sustainability impacts statement

For the purposes of this Annex, the following definitions shall apply:

- (1) 'scope 1, 2 and 3 GHG emissions' means the scope of greenhouse gas emissions referred to in subpoints (i) to (iii) of point (1)(e) of Annex III of Regulation (EU) 2016/1011;
- (2) 'greenhouse gas (GHG) emissions' means greenhouse gas emissions as defined in point (1) of Article 3 of Regulation (EU) 2018/842 of the European Parliament and of the Council <sup>(12)</sup>;
- (3) 'enterprise value' means the sum, at fiscal year-end, of the market capitalisation of ordinary shares, the market capitalisation of preferred shares, and the book value of total debt and non-controlling interests, without the deduction of cash or cash equivalents;
- (4) 'current value of investment' means the value in EUR of the investment by the financial market participant in the investee company;
- (5) 'current value of all investments' means the value in EUR of all investments by the financial market participant;
- (6) 'GHG emissions' shall be calculated in accordance with the following formula:

$$\sum_n^i \left( \frac{\text{current value of investment}_i}{\text{investee company's enterprise value}_i} \times \text{investee company's Scope}(x) \text{ GHG emissions}_i \right)$$

# SFDR RTS: Pre-Contractual Disclosures

Article 8 Light Green	
1.	“What environmental and/or social characteristics are promoted by this financial product?”
2.	“What investment strategy does this financial product follow?”
3.	“What is the asset allocation planned for this financial product?”
4.	“To which objectives do the sustainable investments contribute to and how do they not cause significant harm?”*
5.	“Does this financial product take into account principal adverse impacts on sustainability factors?”
6.	“Is a specific index designated as a reference benchmark to determine whether this financial product is aligned with the environmental and/or social characteristics that it promotes/to meet the sustainable investment objective?”**
7.	“Can I find more product specific information online?”

\* *If the financial product includes sustainable investments.*

\*\* *If an index is designated as a reference benchmark.*

# Pre-Contractual Disclosure Template for “Light Green” Products

## Annex I

Template precontractual disclosure for financial products referred to in Article 8(1) of Regulation (EU) 2019/2088

Product name/legal identifier: [complete]

### Environmental and/or social characteristics

[tick when relevant]

This product:

Promotes environmental or social characteristics, but does not have as its objective a sustainable investment

- It does not invest in sustainable investments
- It invests partially in sustainable investments
  - In activities aligned with the EU Taxonomy
  - In activities not aligned with the EU Taxonomy

Has sustainable investment as its objective. Sustainable investment means an investment in an economic activity that contributes to an environmental or social objective, provided that the investment does not significantly harm any environmental or social objective and that the investee companies follow good governance practices.

- In activities aligned with the EU Taxonomy
- In activities not aligned with the EU Taxonomy

# Pre-Contractual Disclosure Template for “Light Green” Products

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## What environmental and/or social characteristics are promoted by this financial product?

*[for financial products referred to in Article 6 of Regulation (EU) 2020/852, in respect of sustainable investments with environmental objectives, list the environmental objectives set out in Article 9 of that Regulation to which the sustainable investment underlying the financial product contributes]*

- **What sustainability indicators are used to measure the attainment of the environmental or social characteristics promoted by this financial product?**

**Sustainability indicators** measure how the environmental or social characteristics promoted by the financial product are attained.



## What investment strategy does this financial product follow?

- **What are the binding elements of the investment strategy used to select the investments to attain each of the environmental or social characteristics promoted by this financial product?**

# Pre-Contractual Disclosure Template for “Light Green” Products

**Investment strategies** guide investment decisions based on factors such as investment objectives and risk tolerance.

- **How is that strategy implemented in the investment process on a continuous basis?**
- **What is the committed minimum rate to reduce the scope of the investments considered prior to the application of that investment strategy?** *[include question where there is a commitment to reduce the scope of investments by a minimum rate]*

- **What is the policy to assess good governance practices of the investee companies?**

**Good governance** practices include sound management structures, employee relations, remuneration of staff and tax compliance.

- **Where can I find further details on the investment strategy?**

Has a reference benchmark been designated for the purpose of attaining the environmental or social characteristics promoted by the financial product? *[tick relevant box]*

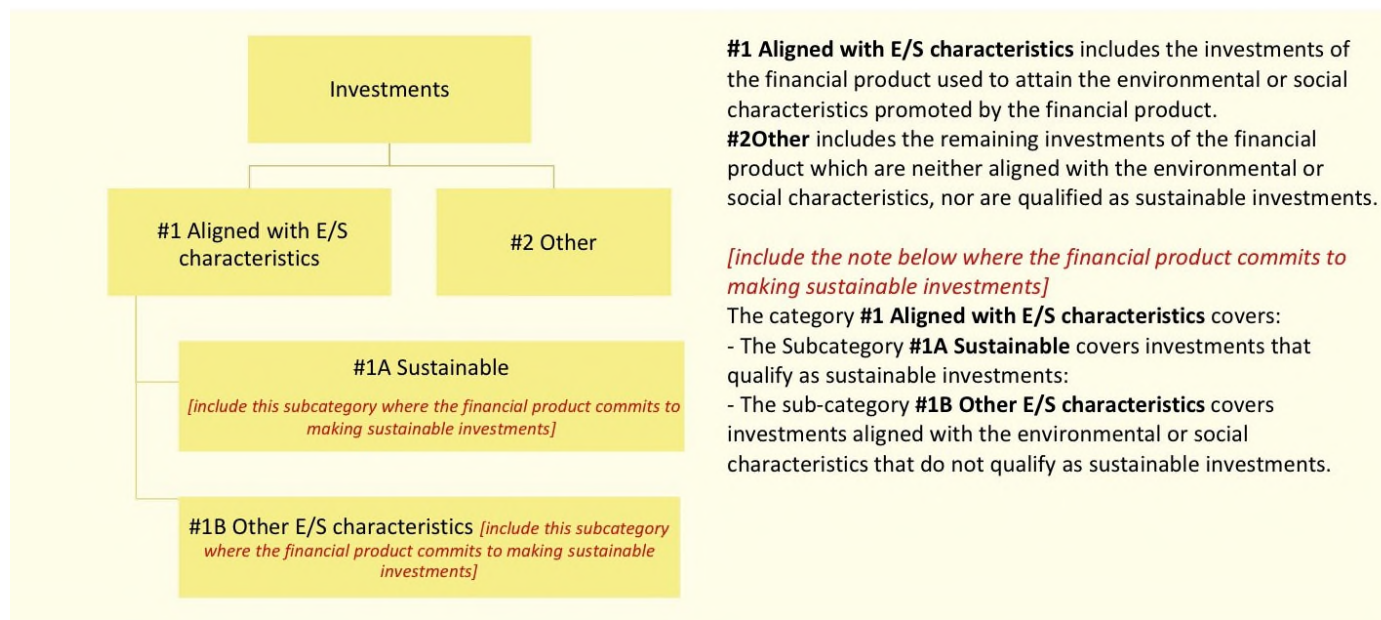
Yes  No



**What is the asset allocation planned for this financial product?**

**Asset allocation** describes the share of investments in specific assets.

# Pre-Contractual Disclosure Template for “Light Green” Products



- **What investments are included under “#2 Other”, what is their purpose and are there any minimum environmental or social safeguards?**

# Risks and Broader Implications



# Corporate Reporting and Disclosure Risks

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- Public Disclosures – whether through corporate reporting to regulatory agencies or other communications – are the primary source of ESG litigation and enforcement action
- Liability generally arises in two contexts:
  - Consumer protection or consumer fraud claims under federal or state laws
  - Enforcement provisions under securities laws
- Greenwashing:
  - Statements touting products as environmentally friendly
  - Statements regarding efforts to reduce greenhouse gas emissions
  - Statements regarding ESG Investing



# Managing Risk

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- Utilize aspirational language, forward looking statements and disclaimers
- Review ESG statements for accuracy
- Ensure consistency
- Assign responsibility
- Assess risks posed by climate change

# Broader Implications

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- Provenance of policies – managing potentially conflicting investor interests
- Additional procurement asks/requirements
- Broader disclosure for diligence processes, both mergers and acquisitions (M&A) and financial
- Covenants and reporting obligations in debt documentation
- Litigation risks

# Contact Details

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