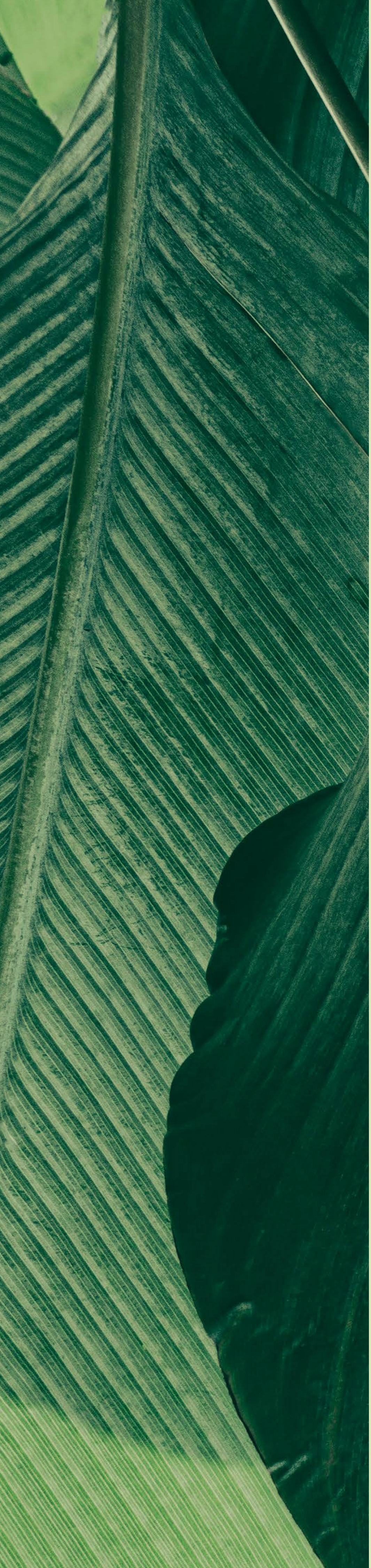
Through the ESG lens – A Six-Months Review

May 2023



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Our collection of monthly reviews is organized into two sections. The first section, named 'Legislation & regulation', includes all significant ESG legislation updates within the EU. This ensures that you are kept up to date with the advancement of new laws that fall under the EU Green Deal and the Fit for 55 plan. The second section, named 'News & reports', brings to your attention a variety of fascinating sustainability publications and reports that are released by NGOs, international organizations, and others.

Introduction

"Through the ESG Lens – A Six-Month Review" is our new publication filled with articles covering the latest legal developments on environmental, social, and governance (ESG) issues. The articles in this guide are regularly published on our blog, and we've curated them to provide you with a comprehensive overview of the key legal trends in the past six months.

Every business is deeply intertwined with ESG concerns, and staying informed on the latest developments is critical to mitigate risks of non-compliance.
By using information from this publication, you can stay ahead of the curve and ensure that your business is operating within the bounds of the law.

In this first edition we cover recent developments such as the EU's Green Bond Standard proposal, the German Supply Act, EU ETS and CBAM updates, as well as a wide range of topics, from regulatory changes to institutional views and emerging legal challenges. Our team of CMS experts, writers and editors has worked hard to provide insightful articles that offer practical guidance and analysis on the latest trends in the ESG space.

We have created this publication as a lookback resource for legal professionals and anyone interested in staying up to date on the latest legal developments in the ESG arena. By regularly checking in and using the information from the publication, you can mitigate risks and ensure that your business is on the right side of compliance.

We hope you find this guide informative and useful, and welcome your feedback and comments.

Our monthly reviews are published regularly in the form of Sustainability blogs and can be accessed by signing up for our newsletter to receive regular updates by following cms.law/en/hrv/innovation/online-services/sustainability-blog

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September 2022

Legislation

After a relatively slow August, September marked the return of fast paced developments in the European regulatory bodies regarding sustainability policies and legislation. The dust still hasn't settled from July, when the European Parliament rejected a motion to oppose the inclusion of specific nuclear and gas energy activities, under certain conditions, in the list of environmentally sustainable economic activities under the EU Taxonomy. The backlash was pretty sizeable and a lot of negative reactions were heard from member countries, organizations and expert bodies. On 14 September, five NGOs resigned from the Platform on Sustainable Finance (PSF) – the European body responsible for deciding the technical recommendations of the Taxonomy. These five NGOs (BEUC, Birdlife, ECOS, T&E and WWF) stated that the European Commission had "interfered politically" in the group, acting against the PSF's recommendations, despite its legal obligation to follow science-based advice.

However, despite the negative reactions, the decision by the European Parliament is final and further legislative actions will now naturally follow. Following the decision to include nuclear and gas activities in the Taxonomy, the European Commission sent a request to the European Supervisory Authorities (ESAs, comprising EBA, EIOPA, and ESMA) to propose amendments to the SFDR's regulatory technical standards (RTS) to take account of the exposure of financial products to investments in gas and energy activities. Following that, on 30 September, ESAs proposed their final report with draft RTS regarding the disclosure of financial products' exposure to investments in fossil gas and nuclear energy activities under the SFDR.

The European Commission also published the final version of its EU Biodiversity Strategy for 2030. The biodiversity Strategy is an ambitious long-term plan for protecting nature and reversing the degradation of ecosystems. The Strategy's goal is to put Europe's biodiversity on a path to recovery by 2030 with benefits for people, the climate and the planet. The final version of the Strategy emphasises the need to halt the loss of biodiversity and ecosystems across EU and to restore them as much as possible.

The European Commission has also proposed a Regulation prohibiting products made with forced labour on the Union market. The proposal is expected to affect corporate approaches to due diligence and supply chain management in addition to other EU and global measures in force or expected (primarily the proposed Corporate Sustainability Due Diligence Directive). As usual the proposed Regulation will now follow the EU's ordinary legislative procedure: the European Parliament and the Council of the European Union will adopt amendments and will have to find their mutual position in a final text which will be adopted by both institutions probably in around a year or longer.

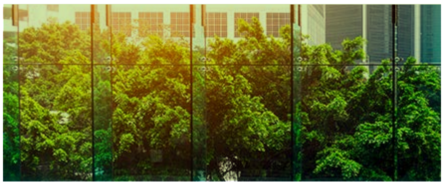
On 23 September, ESMA published final report on updated Guidelines on sustainability-related aspects of the MiFID II suitability assessment. The Guidelines provide instructions to national competent authorities and financial advisors on how client 'sustainability preferences' should be gathered.

News and Reports

On 8 September, the EU Commission published the third Environmental Implementation Review (EIR), a key reporting tool that supports environmental enforcement and raises awareness about the importance of implementing environmental rules.

The EIR report for Croatia reviewed Croatia's implementation of EU's environmental policies in 2022. The report states that more efforts are needed to ensure that its waste is managed in compliance with EU waste legislation. There is no comprehensive circular economy strategy, although the country has included reforms relating to the circular economy in its national recovery and resilience plan (RRP), including a new legal framework and a reform of the tourism sector. As for water management, the risk of floods is rising due to climate change. The progress on air quality has been limited even though key air pollutants have decreased significantly in Croatia.

Also, the UN published a report on the Progress on the Sustainable Development Goals: The Gender Snapshot 2022 which presents the latest evidence on gender equality in the World. This report was issued by the UN Women and UN Department of Economic and Social Affairs, and it states that violence against women remains high, while global health, climate, and humanitarian crises have further increased risks of violence, especially for the most vulnerable women and girls. Also, women's representation in positions of power and decision-making remains below parity. Data show that the world is not on track to achieve gender equality by 2030.



October 2022

Legislation

October was marked by a big step forward in the process of delivering the Directive on Gender Balance on Corporate Boards. On 17 October, Council of the EU gave its final go-ahead to EU rules to promote more balanced gender representation on the boards of listed companies. In the official press release by the Council, it's stated that "the new rules will help to remove the obstacles women often face in their careers", and that "companies would greatly benefit from women realising their potential in decision-making positions". The agreed text of the Directive lays down that at least 40% of non-executive director positions in listed companies should be held by members of the underrepresented sex by 2026. If member states choose to apply the new rules to both executive and non-executive directors, the target would be 33% of all director positions by 2026. So, what's next? It is expected that the European Parliament should vote on this Directive by the end of this year and after that Member states will have two years following the entry into force of the directive to adopt the required national measures.

Besides that, the Council also reached an agreement on a proposal to revise the Energy Performance of Buildings Directive (EPBD) which is a part of the Fit for 55 plan. The main objectives of the revision are that all new buildings should be zero-emission buildings by 2030, and that existing buildings should be transformed into zero-emission buildings by 2050. When it comes to new buildings, the Council agreed that from 2028 new buildings owned by public bodies would be zero-emission buildings, and that from 2030 all new buildings would be zero-emission buildings. Member states also agreed to add a new category "A0" to the energy performance certificates that would correspond to zero-emission buildings. Furthermore, member states will be able to add a new category "A+" corresponding to buildings, which in addition to being zero-emission buildings contribute on-site renewable energy to the energy grid. Because of this agreement, it is now possible for the Council to start the negotiations with the European Parliament.

Also, The Platform on Sustainable Finance (PSF) has released its Final Report on Minimum Safeguards, as laid out in Articles 3 and 18 of the EU Taxonomy. The report states that the sustainability of economic activity should be considered with reference to processes for compliance with human rights, anti-bribery and corruption, and fair competition. Moreover, it takes a look at the connection between the minimum safeguards and other EU climate-related legislations (CSRD, SFDR, CSDD). However, it's important to note that the PSF is only an advisory body, and the purpose of its reports is to provide advice. In the end, European Commission can, but doesn't have to oblige to the suggestions in the report.

News & Reports

On 21 October, at its October meeting, International Sustainability Standards Board (ISSB) decided to require company disclosures on Scope 1, Scope 2 and Scope 3 greenhouse gas (GHG) emissions, although relief measures will be developed in order to help firms tackle Scope 3. Thus, businesses will have to report on direct and all indirect emissions that occur in the value chain including both downstream and upstream. Since the ISSB and EFRAG are coordinated when it comes to their standards, this probably means that when EFRAG develops the European Sustainability Reporting Standards, Scope 3 reporting will be a requirement in the EU too.

Moreover, Task Force on Climate-related Financial Disclosures (TCFD) has issued the 2022 Status Report. The report provides an overview of current disclosure practices in terms of their alignment with the TCFD's Recommendations. It also highlights steady increase in firms making disclosures aligned with the TCFD Recommendations over the past five years. To be more precise, for fiscal year 2021, 80% of companies disclosed in line with at least one of the 11 recommended disclosures. On the other hand, only 4% disclosed in line with all 11 recommended disclosures and only around 40% disclosed in line with at least five. All regions have significantly increased their levels of disclosure over the past three years although Europe remains the leading region for disclosure (at 60% on average across the 11 recommended disclosures), and reporting on climate-related risks and opportunities is higher than any other recommended disclosure.

It's also interesting to note that the European Commission adopted its 2023 Work Programme. It includes 43 new policy initiatives, across 6 headline ambitions. The first ambition, however, is to deliver the European Green Deal. Because of that, next year the Commission will propose a comprehensive reform of the EU's electricity market, including decoupling electricity and gas prices. The Commission will also propose to create a new European Hydrogen Bank, which will invest €3 billion into kick-starting a hydrogen market in the EU.

Finally, The European Securities and Markets Authority (ESMA) announced that it is changing its Union Strategic Supervisory Priorities (USSPs) to include ESG disclosures alongside market data quality. ESMA's press release states that they "will foster transparency and comprehensibility of ESG disclosures across key segments of the sustainable finance value chain such as issuers, investment managers or investment firms and, hence tackle greenwashing."

November 2022

If October was a bit quiet for important sustainability developments, November was packed with plenty of interesting and significant news. Everything was expected to revolve around the COP27 conference; however the European Union was also particularly active this month, its bodies voting and deciding on important sustainability legislation, including the long-awaited Corporate Sustainability Reporting Directive (CSRD). One might conclude that the EU deliberately arranged for their decisions on sustainability legislation to coincide with the COP27 conference. They surely wanted to set an example for the rest of the World by taking initiative on battling climate change just as they took a clear stance as an international organization at the COP27 itself. And on top of that, they also cleverly exploited the two-week hype in November when everyone was invested in the topics of sustainability and climate change to highlight and promote the significance of their initiatives. This month, our blog will be structured a little bit differently as we are also going to give you a short overview of the most important developments at the COP27 conference in Egypt.

COP27

November was reserved for the COP27 conference, which took place in Egypt. Countless discussions, formal and informal meetings, speeches by the top political leaders and lots of lobbying took place in Sharm el-Sheikh over the first two weeks of November. Carbon trading, greenwashing, global health, as well as funding the energy transition and the preservation of nature and wildlife were just some of the talking points; however the main themes revolved around loss & damage, the achievement of the 1.5°C goal and many discussions were held about the process of adaptation and the reduced use of fossil fuels and gas.

The topic of 'Loss and damage' was one of the most important aspects of COP27 and is a particularly important topic for developing countries, many of which are small island territories. They are suffering huge (in many cases irreversible) economic and non-economic damage as they are devastated by both extreme weather events and by slow onset climate disasters which are a direct result of climate change. Their size and lack of wealth means they have neither the money nor capacities to deal with these disasters and so they've spent the last few decades seeking financial redress from the richer countries responsible for their situation. The end result was one of the success stories of the conference. After long negotiations, governments have agreed to establish a fund on loss and damage for the impact of climate change on developing countries. Many have called this a historic decision, but now comes the difficult part – setting up the fund and then finding the money needed to fill it.

Much was also discussed about the Global Goal on Adaptation and the measures necessary to build flood defences and preserve wetlands. This way, countries should become better adapted and more resilient to the water damage caused by climate change. However, as is the case with almost all global plans of this kind, poor countries are having trouble finding the funds to implement these preventive measures. That's why, last year in Glasgow, it was decided that developed countries would provide poorer countries with around $40 billion a year just for adaptation measures, and this decision was reaffirmed in Egypt. It was also agreed that the GGA will conclude at COP28 and develop a framework to guide delivery of the goal and track its progress, taking into account countries' vulnerability and capacity to cope.

Achieving the 1.5 °C goal was once again a big talking point at the conference. Although some countries tried to renege on their commitment to the goal, they ultimately failed. The goal still stands. However, a resolution to let emissions peak no later than 2025 was taken out.

The final text of the conference also emphasized the need for boosting low-emissions energy and phasing down the use of coal—both marking a continuation of negotiated targets from COP26.

Legislation

It finally happened. The year closes with a bang, as the European Union passed the most important piece of legislation on corporate sustainability reporting. On 10 November, the European Parliament passed the Corporate Sustainability Reporting Directive (CSRD) in a 525 to 60 vote (with 28 abstentions) and then the decision was approved by the EU Council on Monday, 28 November. So, what does that mean and what happens next? The CSRD is designed as a major update to the 2014 Non-Financial Reporting Directive (NFRD), which is the current EU sustainability reporting legislation. The NFRD served its purpose for the past seven years, but it was clear that the directive was too vague, imprecise and that its scope simply wasn't wide enough. The CSRD has a significantly expanded scope, with the number of companies required to provide sustainability disclosures rising from around 12,000 currently to over 50,000. There will also be more precise and strict reporting requirements on company impacts on the environment, human rights and social standards, and sustainability-related risks. Implementation of the CSRD will proceed in phases. First, in 2025, companies who are already complying with the NFRD will report on their previous financial year. The following year, large companies that didn't have to comply with the NFRD will have to do the same and then, from 2027, so will SMEs, small banks and insurance companies. This way, everyone should have enough time to adjust and prepare themselves for the corporate sustainability reporting obligations.

Moreover, as previously announced, the EFRAG (European Financial Reporting Advisory Group) has developed the European Sustainability Reporting Standards (ESRS), which will be the official sustainability standards used for reporting under the CSRD. A proposed draft set of ESRS was developed over the course of the last year and was submitted to the European Commission for consideration on 23 November. The ESRS consist of 2 cross-cutting standards and 10 topical standards on climate, environmental and social issues, and governance. The first set of standards is expected to be adopted by June 2023 in the form of a delegated act. You can find the final version of the ESRS here.

There were some developments on the Corporate Sustainability Due Diligence Directive (CSDDD) too. The Council of the EU made significant progress towards finding a common stance on this directive during November, and they finally reached a general approach on November 30. The text leaves out of the scope financial products (i.e., alternative investment funds and UCITS), and also introduces a phase-in period. This means that the CSDDD would first apply to companies with more than 1000 employees and €300 million net worldwide turnover before applying to the other companies. At the same time, the European Parliament is also carrying out internal discussions on this directive. The committee responsible for this is the Committee on Legal Affairs and they are expected to decide in March 2023.

News & Reports

On November 18, ESMA launched a Consultation on guidelines for the use of ESG or sustainability-related terms in funds' names. They are thereby gathering input in order to draft the guidelines on the use in funds' names of ESG or sustainability-related terms. Verena Ross, ESMA Chair, said: "With this consultation, ESMA continues to prioritise promoting transparency and tackling the risk of greenwashing as identified in the ESMA Strategy and Sustainable Finance Roadmap." Feedback can be sent by 20 February 2023, after which ESMA will consider the responses and finalise the guidance.

Also, on November 15, all three European financial regulatory agencies, the European Supervisory Authorities (ESMA, EBA, EIOPA), announced a Call for Evidence on greenwashing, aimed at gathering information on greenwashing risks and practices across the banking, insurance and financial markets sectors. Respondents are invited to submit their responses by 10 January 2023.

The annual Climate Change Performance Index (CCPI) report was also published in November. CCPI is an independent monitoring tool for tracking the climate protection performance of 59 countries and the EU and it aims to enhance transparency in international climate politics. Moreover, it's a great way of comparing climate-change efforts by different countries. The ranking list is interesting – the first three spots are empty because no countries in the report have good enough policies to have a very high rating in battling climate change. However, Denmark took 4th (and therefore best) place with a score of 79.61, followed by Sweden. Croatia is positioned 30th, one position lower than in 2021 with a score of 52.04. The report can be found here.

December 2022

Legislation

December kicked off with major developments regarding the corporate sustainability due diligence directive (CSDDD). The Council of EU adopted its negotiating position (general approach) regarding the CSDDD on 1 December which means that they now have a mandate to start negotiations with the European Parliament. The Council's press release states that "the rules of the directive will apply to a company's 'chain of activities', which covers a company's upstream and in a limited manner also downstream business partners as it leaves out the phase of the use of the company's products or the provision of services". The press release also highlights that with this general approach Council "strengthens the risk-based approach and the rules on the prioritisation of the adverse impacts to ensure that carrying out due diligence obligations is feasible for companies".

On 9 December, EU bodies agreed on the new law on more sustainable and circular batteries to support EU's energy transition and competitive industry. The agreement between the EP and the Council was built upon the Commission's proposal from December 2020 which addressed the social, economic and environmental matters related to batteries and which had a goal of making all batteries on the EU market more sustainable, circular and safe. The European Parliament and the Council will now formally have to adopt the new Regulation before it can enter into force. The new Regulation will replace the existing Batteries Directive from 2006.

Speaking of political agreements, on 9 December the EP and the Council also reached an agreement on the revision of the EU Emissions Trading System (EU ETS) on aviation. These new rules will have a big impact on achieving the Fit for 55 goals because they will accelerate the implementation of the polluter pays principle by phasing out free allowances for the aviation sector by 2026. Basically, the aviation industry would have a greater responsibility to pay for its carbon footprint, but also there will be more financial incentives for airlines to reduce emissions. This was followed by the reached provisional agreement between the EP and the Council on 18 December to strengthen the EU ETS, apply emissions trading to new sectors for effective economy-wide climate action, and to establish a Social Climate Fund. When it comes to strengthening and expanding EU emissions trading, the focus will be on reducing emissions from the EU ETS sectors by 62% by 2030, compared to 2005 levels. The speed of annual emission reductions would also increase, from 2.2% per year under the current system to 4.3% from 2024 to 2027 and 4.4% from 2028. Finally, the plan is to gradually phase out free emission allowances to certain enterprises and phase in the CBAM between 2026 and 2034 for the sectors covered. The new Social Climate Fund will provide dedicated financial support to Member States to help vulnerable citizens and micro-enterprises with investments in energy efficiency measures such as home insulation, heat pumps, solar panels, and electric mobility.

Moreover, The EP and the Council reached a political agreement on the Carbon Border Adjustment Mechanism (CBAM) on the morning of 13 December. The Commission issued an official press release which states that "the CBAM will initially apply to imports of certain goods and selected precursors whose production is carbon intensive and at most significant risk of carbon leakage: cement, iron and steel, aluminium, fertilisers, electricity and hydrogen. With this enlarged scope, CBAM will eventually – when fully phased in – capture more than 50% the emissions of the ETS covered sectors." The CBAM will enter into force in its transitional phase as of 1 October 2023.

Also, it's worth mentioning that following the formal adoption of the CSRD by the EP in November, the text of the directive was published in the Official Journal of the Union on 13 December. The member countries will now have 18 months to integrate it into their legislations.

News & Reports

On 8 December, the European Commission published its first Zero Pollution Monitoring and Outlook report and its third Clean Air Outlook report. The reports show that EU policies have contributed to reducing air pollution as well as pollution from pesticides. However, pollution levels are still too high. In other areas such as harmful noise, nutrient pollution or municipal waste generation, progress has stalled. The Commission states that the results show that overall, much stronger action is necessary if the EU is to achieve 2030 pollution reduction targets, by adopting new anti-pollution laws and better implementing existing ones.

The European Commission also raised €7.05 billion for SURE (Support to mitigate Unemployment Risks in an Emergency) and MFA programmes in its last syndicated transaction of the year on 7 December by issuing a € 6.548 billion 15-year social bond due in December 2037 and a €500 million tap of an existing bond due in 2052. The proceeds from the social bond will be used for the implementation of the SURE programme in Bulgaria, Cyprus, Czechia, Greece, Croatia, Lithuania, Latvia, Poland and Portugal, while the funds from the MFA programme are intended for Ukraine.

On 13 December 2022, the EBA (European Banking Authority) published its Roadmap on sustainable finance which outlines the objectives and timeline for sustainable finance and ESG risks. The EBA's work on ESG risks will primarily cover the three pillars of the banking framework (market discipline, supervision, prudential requirements). Besides that, the focus will also be on fostering transparency and market discipline on ESG issues through enhanced disclosures, and on maintaining a safe and resilient banking sector by having institutions' practices and exposures to ESG risks assessed and supervised by competent authorities under Pillar 2.

Finally, ECB (European Central Bank) issued a report on good practices for climate stress testing. The aim of the report is to provide banks with examples and suggestions on how to improve their climate stress testing capabilities based on identified good practices from the ECB's 2022 climate stress test, the results of which were published in July 2022. The report highlights amongst other things that, whilst banks have made some progress on incorporating climate-related risks into their stress testing frameworks, there is still a high level of inconsistency across banks' practices, and several areas of climate stress testing have identified where there is need for improvement.

January 2023

From 1 January 2023, the new German "Act on Corporate Due Diligence to Prevent Human Rights Violations in Supply Chains" (Supply Chain Due Diligence Act – German: Lieferkettensorgfaltspflichtengesetz, or "LkSG" for short) came into force. In legal terms, the Act primarily means that companies must make reasonable efforts to ensure that there are no violations of human rights in their own business operations and in their supply chain. The rules of the Supply Chain Act will affect all German companies directly, regardless of their legal form, head office, principal place of business or statutory registered office. The act will be implemented in phases – as of 1 January 2023, companies with 3000 or more employees have to comply with the LkSG if they have their statutory seat, principal place of business or a branch office in Germany. The number of employees includes employees of foreign subsidiaries who are working in Germany. From 1 January 2024 the threshold for the number of employees is lowered to include companies with 1000 or more employees.

You can find a CMS-Law article on Five myths about the German Supply Chain Act here.

The European Securities and Markets Authority (ESMA), has issued an opinion on the first set of draft European Sustainability Reporting Standards (ESRS Set 1) developed by the European Financial Reporting Advisory Group (EFRAG). ESMA stated that ESRS Set 1 broadly meets the objective of encouraging investor protection and of not undermining financial stability. However, in order to "bring Set 1 from broadly capable to fully capable of meeting that objective, the European Commission must address selected technical issues set out in the opinion". Specifically, there should be "improvements of the level of consistency vis-à-vis the requirements of the CSRD and other pieces of EU legislation, important clarifications of definitions and terminology and further guidance on the materiality assessment process." The Commission will now consider ESMA's opinion alongside opinions submitted by the EBA, EIOPA and other public bodies and adopt ESRS Set 1 into delegated acts by 30 June 2023.

Speaking of sustainability standards, The IFRS Foundation's International Sustainability Standards Board (ISSB) will be releasing the final versions for the first global standards for sustainability and climate-related reporting in June of 2023. This was confirmed by the chair of the IFRS Foundation Trustees Erkki Liikanen at the WEF in Davos.

On 16 January, the European Central Bank (ECB) released its opinion on a proposal for a directive on the energy performance of buildings (EPBD). The ECB broadly supports the proposed directive, however it also suggests some revisions to the proposal. The ECB has concerns regarding the proposed methodology for the definition of the new EPC classes, and calls for an increased degree of harmonisation across the Union. As stated in the opinion, "the proposed directive only defines common criteria for the best and worst EPCs for each Member State, without fully harmonising the underlying definitions and methodologies which are determined at national level." Moreover, the ECB also proposes full and timely access to EPC databases for credit institutions and financial institutions to manage their climate-related transition risks and transposition of the proposed directive before 2025.

Publications

On 26 January, UN Principles for Responsible Investment (PRI) launched its updated Reporting Framework for its 2023 reporting season, which opens in May. PRI issued a number of materials that can be found here. The materials released include an overview and structure guide to the Reporting Framework, the full Reporting Framework modules, and a guide to the logic that determines which questions are applicable to each signatory. It also includes supporting guidance such as the Reporting Framework glossary, high-level assessment methodology, and a diagram showing which modules are relevant to each signatory type (asset owner or investment manager).

European Law Institute (ELI) issued the Guidance on Company Capital and Financial Accounting for Corporate Sustainability. The Guidance includes a set of 20 recommendations on company capital and financial accounting for corporate sustainability which:

1. provide a frame of reference and analysis to understand corporate sustainability in the context of business and law;
2. point to specific issues which need to be addressed by European and national lawmakers and regulators;
3. establish a set of company law instruments recommending possible solutions to cope with these issues.

February 2023

On 23 February, the Loan Market Association (LMA), published updated versions of Green Loan Principles and Guidance, Social Loan Principles and Guidance and Sustainability-Linked Loan Principles and Guidance. These Principles and Guidance were developed to provide high level frameworks of voluntary recommended market standards across the sustainable loan markets. LMA stated that "the updates reflect recent market developments across global sustainable finance markets, ensuring the frameworks continue to promote the development, and integrity, of sustainable finance products." You can find the new Principles and Guidance here.

Besides various types of sustainable loans, another popular type of sustainable financial instruments are Green, Social, Sustainable and Sustainability-linked bonds. Like LMA's Principles for loans, ICMA (International Capital Market Association) also issues Principles and Guidelines for various types of sustainable bonds. However, regulating the green bond market is also important to the European Union, which issued an EU Green Bond Standard (EUGBS) proposal in 2021 as a part of the EU Green Deal. The EUGBS is a voluntary standard to help scale up and raise the environmental ambitions of the green bond market and it will be EU Taxonomy aligned. Last month, the EU has taken further steps towards implementing the EUGBS as negotiators of the Council and the European Parliament reached a provisional agreement on the creation of European green bonds (EuGB), thus ending the trilogue negotiations started on 12 July 2022. The agreement is provisional as it still needs to be confirmed by the Council and the European Parliament, and adopted by both institutions before it is final. However, after that, it will start to apply 12 months after its entry into force.

A big step forward was taken regarding the implementation of the Corporate Sustainability Due Diligence Directive (CSDDD) too. The Committee on the Environment, Public Health and Food Safety in the European Parliament has adopted its report on the CSDDD on 9 February. "The environment committee is sending a strong signal: we want to oblige companies to make their entire value chain climate-neutral by 2050. (…) No company should be able to relocate its particularly climate-damaging activities to countries outside Europe in order to circumvent the strict climate regulations in Europe," said Tiemo Wölken, rapporteur for the opinion. Opinion states that all large companies would need to develop and implement net-zero transition plans aligned with the CSRD and ESRS including the time-bound, science-based targets, and perform environmental and human rights due diligence. Moreover, company directors are responsible for overseeing the obligations regarding combatting climate change and they are also responsible for putting in place and overseeing the due diligence.

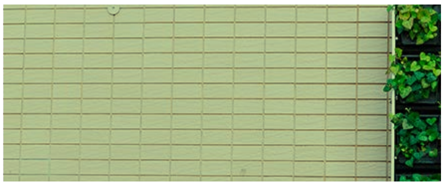
On 17 February, Commission Delegated Regulation (EU) 2023/363 was published in the Official Journal of the European Union. This Delegated Regulation amends and corrects the regulatory technical standards (RTS) laid down in SFDR RTS regarding the content and presentation of information about disclosures in pre-contractual documents and periodic reports for financial products investing in environmentally sustainable economic activities. The Delegated Regulation entered into force on 20 February, and you can find it here.

It's also important to note that February started with a big publication from the European Commission as they presented a Green Deal Industrial Plan to enhance the competitiveness of Europe's net-zero industry and support the fast transition to climate neutrality. The Plan aims to provide a more supportive environment for scaling up the EU's manufacturing capacity for the net-zero technologies and products required to meet Europe's ambitious climate targets. The plan revolves around four main pillars. The first pillar is about a simpler regulatory framework, the second will speed up investment and financing for clean tech production in Europe, the third pillar will focus on enhancing and developing skills and the fourth will be about global cooperation and making trade work for the green transition. The whole Green Deal Industrial Plan can be found here.

News and Publications

European Public Real Estate Association (EPRA) responded to the ESMA Consultation on Guidelines on funds' names using ESG or sustainability-related terms. You can find the whole response here.

The World Business Council for Sustainable Development (WBCSD) published an interesting report on what lies behind the increase in ESG-related litigations. Lawsuits against companies concerning ESG issues have grown by 25 percent over the last three decades and this report offers the key trends that has led to that. You can download the full report here.



March 2023

Legislation and Regulation

On 10 March, the European Commission, the European Parliament and the Council agreed on a provisional agreement to reform and strengthen the EU Energy Efficiency Directive. This deal will mark a further step in completing the ‘Fit for 55' package to deliver the European Green Deal and the REPowerEU Plan. The provisional agreement states that the annual energy savings obligation must nearly double in order to ensure continual progress. EU countries will be required to achieve new savings each year of 1.49% of final energy consumption on average, from 2024 to 2030, up from the current level of 0.8%. They will eventually have to reach 1.9% by the end of 2030. This provisional agreement now only needs to go through the formal adoption procedure before entering into force.

On 23 March 2023, the European Commission proposed the new Green Claims Directive which aims to tackle misleading environmental claims by companies about their products. The proposal marks a welcome step towards combating greenwashing by providing more specific rules and complementing the proposed changes to the Unfair Commercial Practices Directive. If eventually adopted, this Directive would have a significant impact on businesses making green claims about the products they sell in the EU. The list of requirements is pretty expansive and would require businesses to substantiate environmental claims (for example, all claims must rely on widely recognised scientific evidence) and there would be further requirements for environmental labelling schemes. Moreover, the Directive proposal states that businesses would only be able to use environmental labels that are EU-approved and included in a central EU list. Businesses would no longer be able to create and use an environmental label (either independently, or as a group). You can find the proposal here.

On 14 March the EP adopted its position on the proposed revision of the Energy Performance of Buildings Directive (EPBD). All new buildings should be zero-emission from 2028 and existing buildings will have to comply with MEPS (Minimum Energy Performance Standards) to reach climate neutrality by 2050. Moreover, residential buildings will have to achieve a minimum energy performance rating of Class E by 2030 and Class D by 2033. The difficult process of trilogues starts soon, although it seems that it’s going to be an uphill battle for EP negotiators against EU countries, where a large coalition of at least 16 countries strictly opposes mandatory renovations for individual buildings.

Also, it’s important to mention news regarding the European Sustainability Reporting Standards (ESRS). European commissioner Mairead McGuinness has publicly called on EFRAG to prioritise its efforts on capacity building for the implementation of the first set of ESRS over the preparatory work for the draft sector-specific standards. This means that the ESRSs will probably be delayed as EFRAG announced that they are “adjusting their workplan to this new priority whilst carrying on under a modified timetable”.

News and Publications

The SustainAbility Institute by ERM issued a 2023 Rate the Raters report on how investors and companies rate ESG raters and their services. The 2023 report is based on analysis of survey responses from a broad range of corporate sustainability professionals and investors, while survey data are supplemented by in-depth interviews and secondary research. The findings reveal ongoing evolution in the ESG ratings space, with the landscape becoming more complex as ratings increase in importance to investors and companies. Despite high usage, investors and companies are frustrated by the shortcomings of ESG ratings. Most investors and companies surveyed have only modest confidence that ESG ratings accurately reflect sustainability performance, while a sizeable minority of corporates feel they do not. You can find the entire report here.

On 9 March, The European Commission has adopted a new Temporary Crisis and Transition Framework to foster support measures in sectors key for the transition to a net-zero economy, in line with the Green Deal Industrial Plan. The new Framework amends and prolongs in part the Temporary Crisis Framework, adopted on 23 March 2022 to enable Member States to support the economy in the context of Russia's war against Ukraine.

April 2023

Legislation and Regulation

The Sustainable Finance Disclosure Regulation (SFDR) has applied since 10 March 2021, and its implementing provisions - the Regulatory Technical Standards (RTS) – since 1 January 2023. As it's clear that because this is a pretty new regulation, it has many gaps and uncertainties. Therefore, how to interpret it is still uncertain. The European Commission and the European Supervisory Authorities (ESAs) have therefore published guidance, interpretations and guidebooks over the last couple of years with the goal of making the process of implementing the SFDR as painless as possible.

This process is ongoing. On 5 April, the European Commission published a Commission Decision answering questions raised by the ESAs on the interpretation of the SFDR, together with amendments to certain answers the Commission had previously given on the same topic. Some important answers and clarifications were given, especially about the definition of sustainable investments set out in Article 2 para. 17. Moreover, some clarification was offered in the context of the 'economic activities' in the definition of sustainable investment set out in Article 2 para. 17, the SFDR seems to target cases in which funds are allocated to a specific project or activity, or to a company engaged in one single type of activity. However, financial market participants covered by the SFDR can invest in funding instruments that do not specify how proceeds are used, such as the general equity or debt of an investee company. Also, while a sustainable investment must meet the key parameters in Article 2 para. 17, the SFDR does not set any minimum requirements or prescribe specific methodologies. You can find the entire Commission Decision with all the answers here.

On 25 April, European Council also announced that it had adopted a series of new acts which are a part of the Fit for 55 plan, which aligns the EU's policies with its commitment to reduce its net GHG emissions by at least 55% by 2030 compared to 1990 levels and to achieve climate neutrality in 2050.

The new laws adopted on Tuesday include the establishment of the new EU Carbon Border Adjustment Mechanism (CBAM), aimed at avoiding "carbon leakage," a situation in which companies move the production of emissions-intensive goods to countries with less stringent environmental and climate policies. CBAM targets the import of carbon-intensive products to prevent offsetting the EU's greenhouse gas emissions reduction efforts through imports of products manufactured in non-EU countries where climate change policies are less ambitious. It will also help prevent the relocation of the production or the import of carbon-intensive products.

CBAM is designed to function in parallel with the EU's Emissions Trading System (EU ETS) which was also updated on 25 April. Sectors covered by the ETS (primarily energy-intensive industry sectors) are obliged to reduce their emissions even further than before. As stated in the provisional political plan, by 2030 these sectors are required to reduce their CO2 emissions by 62% compared to 2005 levels. Under the current ETS, energy-intensive industries and the power generation sector can purchase so-called "free allowances" to cover their carbon emissions. Also, under the new regime, the maximum number of free allowances is planned to be reduced gradually by 4.3 % per year from 2024 to 2027 and 4.4 % from 2028 to 2030, resulting in higher costs of polluting in Europe.

The EU Parliament and Council further agreed to establish a Social Climate Fund to help Member States cushion the impact of the newly established ETS for the buildings and road transport and fuels in additional sectors. The fund will reach approximately € 65 billion funded from the revenues generated by the ETS and should support vulnerable households, micro-enterprises and transport users from 2026 to 2032.

On 19 April 2023, the European Parliament voted for the EU Deforestation-Free Products Regulation (EUDR). While no country or commodity will be banned, companies will only be allowed to sell products in the EU if the supplier of the product has issued a so-called "due diligence" statement confirming that the product does not come from deforested land or has led to forest degradation, including of irreplaceable primary forests, since 31 December 2020. As requested by the EP, companies will also have to verify that these products comply with relevant legislation of the country of production, including on human rights, and that the rights of affected indigenous people have been respected. The text now also has to be formally endorsed by Council. It will then be published in the EU Official Journal and enter into force 20 days later.

News and reports

On April 4, Climate Bonds Initiative issued a new report called '101 Sustainable Finance Policies for 1.5 °C' which outlines how policymakers around the world can facilitate the rapid, robust, and credible transition of global economies into a net zero future. You can find the report here.

On April 20, UNDP issued its annual report for 2022 on the progress in the last year in terms of achieving Sustainable Development Goals. You can find the annual report here.

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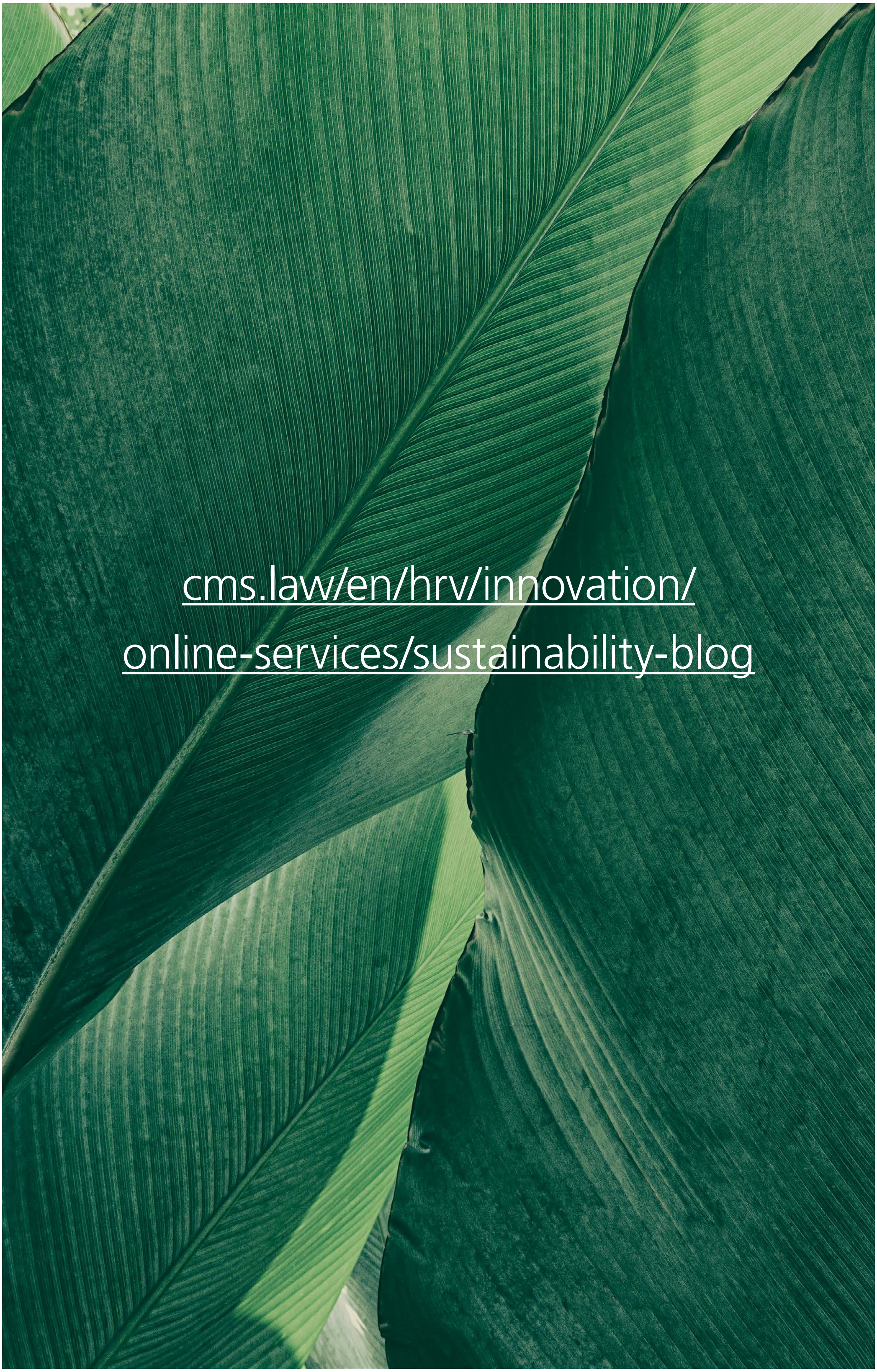
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