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In this week's edition, we discuss the investor expectations set out by the Finance Sector Deforestation Action for banks to address the financial risks of deforestation; the Voluntary Carbon Markets Integrity initiative's consultation for Scope 3 emissions claims; and research which shows that nearly half of all FTSE 100 companies made restatements on climate, some due to errors.

Report Outlines Investor Expectations for Banks to Address Financial Risks of Deforestation

The Finance Sector Deforestation Action (FSDA) has **developed a set of expectations** for commercial and investment banks aimed at addressing deforestation risks in their lending and investment practices. These expectations were drafted in collaboration with the Institutional Investors Group on Climate Change (IIGCC) and aim to support investor engagement with banks to mitigate the risks associated with deforestation driven by agricultural commodities and other sectors. The report emphasizes the importance of forests in climate regulation, biodiversity, freshwater resources, and human livelihoods, and highlights the critical need for financial institutions to address deforestation-related risks by 2025 to keep global warming within 1.5°C of pre-industrial levels.

Deforestation is a significant driver of carbon emissions, accounting for about 11% of global emissions. Additionally, deforestation leads to biodiversity loss, affects water resources, and directly impacts the livelihoods of approximately 1.6 billion people. Financial institutions, particularly banks, face substantial risks from deforestation through their lending and investment portfolios. These risks include physical risks from environmental damage, transition risks from policy changes, and systemic risks from overall market instability related to deforestation. As major stakeholders in financing and investment activities, the report outlines that banks are well-positioned to influence and promote sustainable practices across the value chains they support.

The report outlines several key expectations for banks to mitigate deforestation risks:

1. **Risk Assessment:** Banks are expected to conduct comprehensive risk assessments to understand their exposure to deforestation-related risks. This includes evaluating their portfolios for involvement in high-risk sectors, regions, and commodities (such as palm oil, soy, beef, leather, and pulp and paper) that are closely linked to deforestation. Banks should classify clients by risk level and consider both the scale of financing and the extent to which clients are managing these risks.
2. **Commitment and Governance:** Banks are encouraged to set public commitments to achieve deforestation- and conversion-free banking across all material non-consumer financing activities. This includes commitments to address human rights and align with the goals of halting deforestation by 2025, and reversing it by 2030. The FSDA notes that banks should have clear oversight at the board level and allocate sufficient resources to integrate these commitments throughout their organizations.
3. **Client Expectations:** The report suggests that banks should set clear expectations for their clients to adopt deforestation-free production practices. This includes establishing traceability, managing non-compliance, supporting economic inclusion, and providing financial products to promote innovative solutions. Clients are encouraged to commit publicly to deforestation-free practices and adopt robust monitoring and grievance mechanisms.
4. **Monitoring and Compliance:** The FSDA notes that ongoing due diligence on client compliance is essential. Banks should integrate monitoring systems into their processes, require annual client reporting on deforestation risks, and set timelines for corrective actions in cases of non-compliance. Transparency about escalations and future financing conditions in the event of continued non-compliance is also recommended.
5. **Disclosure:** Banks are expected to disclose their deforestation policies and progress publicly on an annual basis. This includes reporting on risk assessment, governance, monitoring, engagement, and compliance. Banks should also disclose their involvement in initiatives to eliminate deforestation and their alignment with broader sustainability goals.

The FSDA acknowledges that the ability of banks to meet these expectations may vary depending on their legal and regulatory environments, individual circumstances, and existing commitments. For banks in emerging markets and developing economies, a phased approach to implementing these expectations may be more practical. The expectations are intended to establish global best practices, and banks are encouraged to begin with the most material and impactful activities, such as project finance and corporate lending, and expand coverage over time.

The FSDA report emphasizes that meaningful action from banks is crucial to achieving the goals of the Paris Agreement and the Global Biodiversity Framework. By aligning their lending and investment practices with deforestation-free commitments, banks can mitigate financial risks and contribute to global efforts to combat climate change and biodiversity loss. The FSDA expects that banks' deforestation policies will complement their net-zero commitments, particularly in high-impact sectors where climate and deforestation issues intersect. Regular reviews of these policies, at least every two years, are recommended to ensure ongoing alignment with sustainability goals.

As we discussed previously, over the last year, the spotlight has been trained on deforestation in a number of different contexts. For example, in June 2024, police in Brazil launched **"Operation Greenwashing"** with the aim of dismantling a criminal organization suspected of selling approximately R$180 million in carbon credits where the underlying projects involved the illegal invasion of areas across Brazil. In December 2022, the European Commission published the **Deforestation Regulation**, which will require companies to show that the products they are selling within the territory do not come from illegally deforested areas. In order to sell their products in the EU, companies will have to show their geographic origin, which in practice means providing the relevant GPS coordinates to prove the area has not been deforested. On May 13, 2024, **the U.S. Department of Agriculture announced** that, in partnership with 17 States, it will conserve nearly 168,000 acres of "economically and ecologically significant" forestlands.

Voluntary Carbon Markets Integrity Initiative Launches Consultation for Scope 3 Emissions Claims

In September 2024, the Voluntary Carbon Markets Integrity (VCMI) launched its **Scope 3 Claim Public Consultation**, an initiative to gather feedback on its beta framework for corporate Scope 3 emissions claims. Scope 3 emissions include all indirect emissions from a company's value chain, such as those generated by suppliers or customers. The aim of the consultation is to develop clear, robust guidelines that companies can use to make credible claims about reducing these emissions, which are often the most challenging to address, **as we have discussed previously**.

The beta framework includes methodologies for calculating emissions reductions and requirements for transparency in reporting. The consultation encourages a wide range of stakeholders—including businesses, policymakers, academics, and non-governmental organizations—to provide input on how these guidelines can be improved to ensure they are practical, scientifically sound, and aligned with global climate goals.

Key activities in the consultation process include a review period for the beta document, webinars, and workshops designed to engage participants and solicit diverse perspectives. The feedback collected will be used to refine the framework, with the ultimate goal of creating a trusted standard for companies to demonstrate their commitment to reducing Scope 3 emissions.

VCMI aims to close the consultation on October 7th, by synthesizing stakeholder feedback into a final version of the Scope 3 Claim framework, which will be made publicly available in late 2024. This consultation is part of a broader effort to enhance transparency, accountability, and effectiveness in the voluntary carbon markets, contributing to global climate mitigation efforts.

Research Shows Nearly Half of FTSE 100 Companies Made Climate Restatements

On September 2, 2024, Deloitte **published the results of an analysis** which showed that nearly half of the UK's largest companies recently made restatements concerning their climate and sustainability disclosures. This wave of adjustments comes as businesses prepare for the implementation of new regulatory requirements designed to enhance transparency and accountability in sustainability reporting.

The Deloitte study, which analyzed sustainability disclosures from some of the UK's largest publicly listed companies, found that 44% of these organizations made at least one restatement in their climate-related or sustainability data over the past 12 months. The changes were primarily driven by the need to align existing disclosures with upcoming regulations such as the Corporate Sustainability Reporting Directive (CSRD), which are expected to require more rigorous and standardized reporting practices. Approximately a quarter of these restatements (29%) were related to errors.

The findings highlight the growing pressure on companies to ensure the accuracy and consistency of their sustainability reporting. Deloitte's research also indicates that these adjustments are often the result of internal and external audits, which reveal discrepancies or inadequacies in the original data. As a result, companies are increasingly seeking to improve the quality of their disclosures.

The shift towards more robust and transparent sustainability reporting comes amid growing demands from investors, regulators, and other stakeholders for companies to disclose how they are managing their ESG risks. The focus on ESG-related risks has intensified in recent years, driven by increased awareness of the financial impacts of climate change and the growing importance of sustainable investment.

Deloitte's analysis suggests that companies may face further challenges in the coming years as they navigate the evolving regulatory landscape. Organizations will need to invest in new technologies and develop more sophisticated data management capabilities to ensure the accuracy, reliability, and consistency of their disclosures. Additionally, they may need to provide more detailed explanations of how they are addressing their climate and sustainability risks, as well as the steps they are taking to achieve their ESG targets.

The report concludes that while the new regulations present significant challenges for companies, they also offer an opportunity to enhance transparency and build trust with stakeholders. By improving the quality of their climate and sustainability reporting, companies can better demonstrate their commitment to managing ESG risks and contributing to a more sustainable future.

Regulatory authorities are increasingly focused on taking enforcement action against organizations that make misstatements in relation to their climate goals and disclosures, **as we have frequently discussed**. The Deloitte study underscores the need for UK businesses to act swiftly to align their disclosures with the new requirements, as failure to do so could result in reputational damage, increased scrutiny, and potential financial penalties.