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Table of Contents:

- Regulation: NY Governor Signs Moratorium on Crypto Mining Pending Environmental Review
- Disclosure: Continued Uncertainty Over Sustainability Classifications Under SFDR
- Green Finance: Global Asset Managers Progress Toward Tracking Sustainability Profiles of Portfolios
- Investing: 17 Attorneys General Write Letter Supporting Consideration of Climate Change Issues in Investment Process

Regulation: NY Governor Signs Moratorium on Crypto Mining Pending Environmental Review

December 6, 2022

Regulation

By Jason Halper
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The Governor of New York, Kathy Hochul, has signed a **bill** establishing a two-year moratorium on new or renewal permits necessary to modify certain fossil fuel plants for cryptocurrency mining operations using proof-of-work (POW) authentication methods. This moratorium, which took effect immediately, is the first of its kind in the United States. It will only apply to fossil fuel power plants that house energy-intensive proof-of-work cryptocurrency mining operations and will not apply to individuals or companies that currently have valid permits. Mining operations that connect directly to the power grid or use renewable energy are not affected. Some miners, especially larger scale operations, bypassed the power grid and re-opened closed power plants in an attempt to produce lower cost electricity. The law, which was passed by the State Assembly in May and the State Senate in June, requires the Department of Environmental Conservation to study the environmental impact of POW crypto mining activities, including the amount of energy used and the carbon emissions produced. According to the **University of Cambridge**, global mining of Bitcoin, the largest of the cryptocurrencies, consumes more electricity than all residential lighting in the United States.

Hochul made the following statement: "As the first governor from Upstate New York in nearly a century, I recognize the importance of creating economic opportunity in communities that have been left behind" and "I will ensure that New York continues to be the center of financial innovation, while also taking important steps to prioritize the protection of our environment." The Business Council of New York State responded to the announcement by stating: "To date, no other industry in the state has been sidelined like this for its energy usage. This is a dangerous precedent to set in determining who may or may not use power."

Taking the Temperature: The moratorium's impact likely will be limited given the relatively narrow focus of the law, but it builds on other New York legislative initiatives addressing climate change that, considered in the aggregate, could make New York a state laboratory for efforts to balance climate change regulation with economic impact. The Climate Leadership and Community Protection Act, enacted in July 2019, requires New York to reduce greenhouse gas emissions 40% by 2030, and 85% by 2050, from 1990 levels, and establishes a Climate Action Council to develop recommendations to meet these targets. The Council consists of the heads of various state agencies as well as leaders of energy companies, environmental advocates, and academics. A bill titled "The Fashion Sustainability and Social Accountability Act" proposes to impose disclosure and sustainability regulations on global apparel and footwear companies with more than $100 million in revenue doing business in New York. The industry has long

been a target of environmental activists. The World Economic Forum estimates that the fashion industry contributes up to 10% of worldwide carbon emissions and ranks second in global water consumption. As we have previously discussed in relation to the bill, if enacted, it would require subject companies to map at least 50% of their supply chain, publish environmental due diligence policies, disclose actual and potential negative environmental impacts and set impact reduction targets. And, in November 2021, the New York Department of Financial Services issued guidance for New York domestic insurers on managing the financial risks from climate change, which includes a laundry list of actions (that also have been offered as best practices or required by federal and foreign regulators) such as utilizing scenario analyses, ensuring adequate board-level expertise on climate change, incorporating climate into enterprise risk management and assessment, and providing accurate related disclosures. The insurance-focused guidance is similar to DFS guidance issued a year earlier to all New York-regulated financial institutions.

The key takeaway is that while relative to other states New York may be more active in the area of climate change regulation, it is not unique when considered in the context of national and global activity. Regardless of where they are incorporated or do business, companies should anticipate having to (if they are not already) address climate change from governance (risk and opportunity assessment, scenario analysis, emissions measurement, board expertise, etc.), disclosure, and regulatory perspectives.

Disclosure: Continued Uncertainty Over Sustainability Classifications Under SFDR

December 6, 2022

Disclosure

By Kya Henley
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As we **discussed** last week, a number of European asset managers, including Amundi, AXA, and BNP Paribas, have announced their plans to reclassify the sustainability profile of investment funds from Article 9 to the less onerous Article 8 under the EU's Sustainable Finance Disclosure Regulation (SFDR). These announcements follow draft guidelines published on November 18 by the European Securities and Markets Authority (ESMA) as part of a consultation (closing February 20, 2023) on funds' names using ESG or sustainability-related terms. The main elements of ESMA's consultation paper are (i) a quantitative threshold (80%) for the use of ESG-related words; and (ii) an additional threshold (50%) for the use of "sustainable" or any sustainability-related terms only, as part of the 80% threshold. In addition, **guidance** from ESMA published in May suggests that Article 9 funds should be as close to 100% sustainable as possible. Some of these management companies identified as the reason for the change a lack of guidance regarding how to apply existing regulatory announcements in distinguishing Article 8 from Article 9 funds.

Further highlighting the difficulties in sustainability classifications, a **report** published last week posits that almost half of 838 funds classified as Article 9 under the SFDR, with approximately EUR 620 billion ($655 billion) of assets under management, have exposure to the fossil fuels or aviation industries (the latter of which accounts for approximately 2% of human-produced greenhouse gas emissions). The researchers reviewed 1,141 Article 9 classified funds and were able to gain access to the investment portfolios of 838 of them. This report also observes support for the idea that there is a lack of guidance as to what constitutes a sustainable investment under the SFDR. The report notes that several national European regulators take the position that the ESMA guidance is not sufficiently specific, even with respect to fossil fuel companies, for them to take enforcement action for including these investments in Article 9 funds, including regulators in France, Luxembourg, and the Netherlands.

Taking the Temperature: As we have discussed, the SFDR's sustainability classification system is under scrutiny because of criticisms that it lacks clarity and precision.   At the same time, concerns on the part of the asset management industry about being faced with greenwashing allegations continue to mount. Until enforcement activity is matched by regularity clarity, firms will continue to struggle with sustainability labels and may resort to greenhushing, thereby frustrating regulatory goals of greater, not less, disclosure.

Green Finance: Global Asset Managers Progress Toward Tracking Sustainability Profiles of Portfolios

December 6, 2022

Green Finance

By Duncan Grieve
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In its **2022 Global Asset Manager Survey** focused on emerging and frontier markets, consulting firm Mercer polled over 400 asset managers across the globe, representing over $51 trillion of assets under management. The survey found that only 27% of respondents have established climate transition targets such as net-zero in their portfolios, with only 16% having set science-based net-zero targets. On the other hand, 58% of managers track portfolio company emissions, 64% have established climate transition targets, 39% track forward-looking transition metrics such as target setting, and 59% have policies regarding how climate change is incorporated into their portfolios. In addition, 89% of respondents identified ESG-related transparency and disclosure as a barrier to investing in emerging markets, with 82% citing more regulation around financial reporting as a key to supporting increased allocations.

The survey results with respect to emerging markets are particularly noteworthy and confirm views we have previously expressed on increasing sustainable investment in developing markets such as **Brazil**. The report states that "of the 61% of managers reporting current exposure in emerging markets, less than one in 10 have invested in infrastructure, private debt or real estate across Africa, Latin America, Asia and Eastern Europe," and adds that a "significant step change in the robustness of data, and in transparency and disclosure around company reporting and ESG factors is required for investors to overcome current barriers to investment into emerging and frontier markets."

Taking The Temperature: We have written extensively on the challenges faced by the asset management industry as a result of climate change and sustainability issues, including navigating disclosures concerning the sustainability profiles of their portfolios, the need to obtain greater transparency from issuers, and the increasingly politicized atmosphere surrounding climate issues. The Mercer report underscores that the industry has not yet achieved consensus on how to approach the many different tests that climate change poses, but that overall, it appears that managers are increasingly incorporating climate considerations into portfolio selection and monitoring. Emerging markets appear to be particularly challenging terrain given, at times, the political uncertainty and less developed regulatory disclosure guidance in these regions. At the same time, developing countries require sustained increased investment in order to address the impacts of climate change. On a positive note, 54% of the managers surveyed by Mercer report that increased adherence to global reporting frameworks such as the Task Force for Climate-Related Financial Disclosure recommendations would be the biggest factor in increasing sustainable investment at

least in one such region, Africa, and more than one-third of surveyed managers expect to see such increased adherence develop over time.

Investing: 17 Attorneys General Write Letter Supporting Consideration of Climate Change Issues in Investment Process

December 6, 2022

Investing

By Douglas Gansler
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On November 18, 2022, Attorneys General from 16 states and the District of Columbia, led by D.C.'s Karl Racine, **wrote** to the chairs and ranking members of the Senate Banking, Housing, and Urban Affairs Committee and the House Financial Services Committee regarding "efforts to interfere with financial institutions' ability to make sound investment decisions on behalf of hardworking Americans." Their letter is in response to, among other things, a **letter to BlackRock** on August 4 on behalf of 19 other states' attorneys general, to which BlackRock provided a detailed **response** in early September. The November letter states that investment managers have a fiduciary duty to include ESG considerations as part of their investment decision-making process and that consideration of "ESG factors is consistent with legal responsibilities to evaluate potential risk and reward in assessing the merits of an investment. Consideration of those factors does not categorically block investment in any given industry or sector, but merely allows for an evaluation of the expected impact of environmental, social, and governance events on returns."

The letter also pushes back against views expressed by some state financial officials and others that participation in industry climate collaborations such as the Glasgow Financial Alliance for Net Zero or the Net Zero Asset Managers Initiative (NZAMI) raises antitrust concerns. According to the letter, an "expression of general recommendations or a statement in favor [for] or against certain policies does not, without more, constitute a violation of the Shearman Act." The letter adds that the NZAMI "commitment page, which the August 4 letter cites, does not appear to direct managers to avoid certain clients, or to suppress investment in particular energy resources." We have **previously commented** on the potential antitrust issues surrounding industry climate initiatives.

Taking The Temperature: This letter is yet another development in the highly charged and partisan political debate surrounding climate change regulation and the role of climate in investment decision-making. For example, as we discussed previously, Senator Pat Toomey has written to ESG ratings providers requesting details on their methodologies. Certain state financial officials have barred some financial institutions from municipal securities underwriting syndicates or managing public funds due to supposed "anti-energy" views. The recent change in control of the House of Representatives, resulting in a divided Congress, is likely to exacerbate the trend to politicize climate change and other ESG issues. While we do not perceive an end to this trend anytime soon, we anticipate that the temperature will come down as the asset management and other industries, and applicable regulators, approach greater

consensus on the need to consider and the quantum of disclosure regarding climate change and social impact factors in investment decisions.