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House Committee Chair Announces Probe into Bank ESG Practices

February 17, 2023

By Timbre Shriver
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Attacks on "ESG investing" in the U.S. continues to intensify as additional Republican lawmakers take aim at financial institutions' alleged "ESG agenda." Citing an effort to "promote the depoliticization of our capital markets" and to ensure that our financial institutions "provide equal access to capital to all kinds of businesses," **Representative Andy Barr (R-KY)**, chair of the House Financial Services Subcommittee, announced that Congress will probe the employment and lending practices of banks. He added that lawmakers will also be on the lookout for any attempts by the Federal Reserve to set climate-related goals for financial institutions and discouraged the inclusion of climate risk in its annual stress testing of banks. Any such actions would "kick [Republicans' reform agenda] into high gear." These warnings arise from concerns that the central bank will pursue policies that fall outside of the scope of its dual mandate of price stability and employment. Barr also reintroduced a Congressional Review Act (CRA) measure to nullify the **Department of Labor's (DOL) recently finalized rule** regarding consideration of ESG factors in employer-sponsored retirement plans. U.S. Senator Mike Braun (R-IN) is leading a companion measure in the U.S. Senate.

This announcement comes on the heels of the **launch** of the Congressional Sustainable Investment Caucus—which has set out to promote responsible and transparent ESG investing—and is another piece of a broader challenge to various aspects of ESG-related issues in the financial services industry, including **Congressional inquiries** into financial industry climate collaborations such as Climate Action 100+ and the **recent lawsuit** filed by certain Republican state Attorneys General to set aside the DOL ESG rule.

Taking the Temperature: The stark contrast between Representative Barr's actions with respect to ESG versus the formation of the Congressional Sustainable Investment Caucus highlights the deep partisan divide in the U.S. on this subject, particularly concerning whether or how financial institutions should consider climate-related matters in investment or lending decisions. With respect to the Federal Reserve, Chair Jerome Powell already has said publicly that the central bank will not be a "climate policymaker," but that "[t]he Fed does have narrow, but important, responsibilities regarding climate-related financial risks" and that "[t]hese responsibilities are tightly linked to our responsibilities for bank supervision." It is hard to conceive how banks could in the exercise of prudence and due care not consider climate-related material risks and opportunities in running their businesses, just as financial institutions in Europe and around the globe report that they are making (and in some jurisdictions are required to make) those same assessments.

European Central Bank and European Banking Authority Comment on Revised European Sustainability Reporting Standards

February 17, 2023

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In January 2023, the European Central Bank (ECB) and the European Banking Authority (EBA) released their opinions on the first set of European Sustainability Reporting Standards (ESRS). As we have **previously discussed**, a revised version of the ESRS was approved by the European Financial Reporting Advisory Group (EFRAG) in November 2022, providing enhanced guidance for companies performing environmental materiality assessments and disclosures of certain sustainability metrics.

The ECB **stated** that the ESRS appear to "substantially" improve the "quantity, quality, reliability and comparability of corporate sustainability disclosures" and will otherwise assist ECB in its efforts to set monetary policy, promote financial stability, and collect a wide range of environmental metrics. In particular, the ECB highlighted how the ESRS rely on quantitative metrics and estimations of physical and transition risks, propose disclosure obligations to promote transition plans in line with the Paris Agreement's goal of limiting global temperature increases to 1.5 degrees Celsius, and include "well-defined" greenhouse-gas emissions targets. The ECB also commented that the ESRS will enhance the ability of financial institutions to gather and disclose information relevant under Basel Pillar III (which sets out disclosure requirements for purposes of permitting market participants to assess an institution's material risks and capital adequacy). As we have **written**, climate-related disclosures under Pillar III would require around 150 European banks to semi-annually publish both qualitative and quantitative information related to climate risks and green-lending. Overall, the ECB praised the ESRS as a "significant improvement compared with the status quo."

Still, the ECB proposed a "limited number" of "beneficial" recommendations. For example, the ECB pointed out that the "materiality assessment would benefit from more granular and clearer guidance on the process to be followed by compilers," as well as clearer guidance for processing data-compilations, including the appropriate use of estimates and "further specification" for calculations of greenhouse-gas emissions. Additionally, the ECB suggested that the ESRS remove the exemption allowing for subsidiaries to be included in consolidated reporting by the controlling entities and commented that it "firmly" supports revisions focusing the ESRS on specific sectors, and in particular the financial sector due to its "key role...in the transition to a sustainable economy." The ECB observed that there is an "urgent need" for guidance on the definition of "value chain for financial institutions" and recommended that

future revisions to the ESRS take into account the experience of those tasked with preparing disclosure reports to promote a streamlined process in addressing questions and interpretation of ESRS provisions.

The European Banking Authority **echoed** that the ESRS promoted “significant improvement” in climate-related disclosures and demonstrated “overall consistency with international standards and relevant EU Law.” Most notably, the EBA recognized how the ESRS “better align[ed] with the disclosure requirements under the EBA’s Pillar 3 Framework.” Here, the ECB “welcomed” the ESRS’s requirements imposing the “mandatory publication of all indicators and qualitative information needed for banks to comply with the Pillar 3 ESG disclosures.” The ECB also recommended that the ESRS “enhance the alignment” with environmental standards set by the International Sustainability Standards Board (ISSB), including the use of similar terminology and promotion of quantitative disclosures over qualitative ones.

But the EBA also proposed four major technical revisions to the ESRS. First, the ESRS should improve its “interoperability” with other international standards. Second, the materiality assessment should contain additional specific guidance, in particular for how to properly implement the “value chain concept” for financial institutions. Third, in developing standards for specific sectors, ESRS should further increase alignment with the EBA’s Pillar III requirements. Lastly, the ESRS should promote consistency with the accounting and anti-fraud directives in the European Union.

Taking the Temperature: Although noteworthy for any number of reasons, we offer two takeaways from the ECB and EBA comments. First, financial regulators in Europe and elsewhere continue to be integrally involved in the development of standards for assessing climate-related financial risk, collecting and analyzing related data, and making appropriate disclosure. This includes the European Parliament’s recent adoption of proposals to implement Basel III, including as it relates to ESG concerns; the ECB’s publication of “new experimental and analytical indicators” that are intended to help analyze climate-related risks in the finance sector and monitor a green transition; and the Federal Reserve’s pilot climate scenario analysis involving six of the largest banks in the U.S. Second, the ECB and EBA comments highlight the elusive nature of global consensus on these same issues (i.e., climate-related risk assessment, data analysis and disclosure). Notwithstanding the focus on these subjects by financial and other regulators, standard setting organizations and market participants, the EBA in particular remarked on the continuing need to “align” with international standards, including the ISSB, and promote consistency with other EU directives. While a jurisdictional and, to some extent, global alignment process will continue, it remains to be seen how long it takes and the extent to which consensus ultimately is achieved.

British Government to Establish Department for Energy Security and Net Zero

February 17, 2023

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On February 7, the British government **announced** the creation of four new departments, including the Department for Energy Security and Net Zero. The new department has been tasked with "securing [Britain's] long-term energy supply, bringing down bills and halving inflation." The press release also states that the "move recognises the significant impact rising prices have had on households across the country as a result of Putin's illegal war in Ukraine, and the need to secure more energy from domestic nuclear and renewable sources as we seize the opportunities of net zero." The UK government has **stated** that the new department will be headed up by the current Department for Business, Energy and Industrial Strategy (BEIS) Secretary of State, Grant Shapps. The BEIS will be broken up as part of this reorganization. This decision comes almost seven years after the **Department of Energy & Climate Change** became part of the Department for BEIS in July 2016.

Before its breakup, BEIS had commissioned an independent review into the UK's delivery of Net Zero, which was **published** on January 13. This review follows the UK Government's initial publication in October 2021 of its **strategy** for achieving net zero greenhouse gas emissions by 2050.

Alexander Stafford MP, Chair of the All-Party Parliamentary Group on environmental, social, and governance, **stated** that the establishment "must lead to a scaling up of the UK's net zero ambitions, with ESG considerations positioned at the core of the Department for Energy Security and Net Zero's strategy. This newly created department must grasp the clear opportunities provided by ESG frameworks for the race to net zero."

Greenpeace UK director of policy Doug Parr, gave a different view, **stating** "[a]s climate disasters intensify, energy costs spiral and the world continues to sink under rising seas, without other fundamental reforms, re-establishing a department for energy will be as helpful as rearranging the deck chairs on the Titanic," and "[u]nless the new-look Department ... is given the freedom and funding to rapidly scale up renewable energy production — both offshore and on — to shore up domestic supply, as well as roll out a nationwide scheme to insulate the tens of millions of energy-wasting homes across the country, what's the point?"

This move follows similar statements from other government department heads, including by the Competition and Markets Authority's Chief Executive, who **stated** that it was her priority to "accelerate the UK's transition to a net zero economy."

Taking the Temperature: Until substantial policy intentions and timelines are published, it remains to be seen if this development is simply window dressing or something more

significant. The BEIS Review observed that the government must take significant steps in the short term to maximize net zero opportunities and that delay would be a "significant risk." The lack of change in leadership of the new department suggests that it is unlikely there will be a significant divergence in current policy as established in the October 2021 net zero policy.

According to CDP, 0.4% of Companies Have Published Credible Climate Transition Plans

February 17, 2023

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According to a report **published** by global environmental disclosure platform operator CDP on February 7, 2023, only 81 companies "demonstrated best practice by disclosing against all [of CDP's] 21 key indicators" denoting a **credible climate transition plan**. CDP (originally known as the Carbon Disclosure Project) is a **non-profit charity** that "runs the global disclosure system for investors, companies, cities, states and regions to manage their environmental impacts." CDP's **press release** states that over 4,000 companies, out of 18,600, disclosed that they had a climate transition plan, with 2,300 companies reporting on "many (14-20) of the key indicators demonstrating that they are on their way to disclosing a credible climate transition plan." According to CDP's report, six out of 1,448 UK-based companies disclosed to all 21 key indicators. In the U.S., five companies out of 3,718 disclosed to all of the indicators.

The report analyzed disclosure from over 18,600 companies across 13 industries in 135 countries. CDP assessed the companies' climate transition plan disclosure against 21 key indicators within CDP's climate change questionnaire. Examples of key indicators include: board-level oversight, scenario analysis, financial planning, and policy engagement. In the previous edition of the report, 135 companies disclosed against "all relevant indicators." In the accompanying press release, CDP explained the change in approach as "raising the bar, in accordance with latest science, on what constitutes a credible climate transition plan." CDP defines a climate transition plan as an "action plan that outlines how a company will achieve its strategy to align its assets, operations, and entire business model with the latest and most ambitious climate science recommendations."

Amir Sokolowski, Global Director, Climate at CDP, stated that: "The need for companies to develop a credible climate transition plan is not an additional element but an essential part of any future planning. Companies must evidence they are forward planning in order for us to avert the worst impacts of climate change and to send the correct signals to capital markets, that they will remain profitable." Kate Levick, Co-Chair of the Secretariat to the UK Transition Plan Taskforce, gave her view that it was "encouraging to see over 1,400 organisations in the UK disclose through CDP, as disclosure is a vital part of an organisation's sustainability journey." Levick also added that the "findings published today demonstrate the importance of regulation to encourage the development and disclosure of credible climate transition plans. As the Transition Plan Taskforce continues its work to set out what best practice looks like for businesses and financial institutions, we hope to see an increase in the quantity and quality of disclosed plans."

Taking the Temperature: The climate transition plan report published by CDP indicates slow progress globally. 6,520 companies (35% of total that disclosed) reported that they

will develop a transition plan within two years and 2,300 companies (13%) had disclosures meeting between 14 and 20 of 21 key indicators of a credible plan. It should be noted, however, that despite a general increase in reporting when compared to 2021, a smaller number of companies were found to have presented a credible transition plan. There is little legislation obligating companies to disclose transition plans. However, there is significant activity regarding transition plans apart from legislation. For example, environmental advocacy group As You Sow has recently submitted shareholder resolutions to various major U.S. banks requesting that the banks disclose their climate transition plans for meeting financed emissions reduction targets, "including the specific measures and policies to be implemented, reductions to be achieved by such measures and policies, and timelines for implementation and associated emission reductions." A group of institutional investors filed a resolution seeking details of the "specific plan" for Glencore PLC, a multinational commodity trading and mining company, "to align thermal coal production with emissions reductions commitments."