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March 21, 2023

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Beyond the Headlines – Three Global Banks Update Emissions Financing Reduction Targets

March 21, 2023

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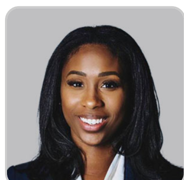

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Between February 23 and March 3, three leading global financial institutions announced updated environmentally linked targets aimed at reducing by 2030 their financed emissions in carbon intensive sectors, including oil & gas, cement, iron, steel and aluminum.

The new interim targets announced by **Citi** include the following **reductions**: auto manufacturing (31% reduction in emissions intensity); commercial real estate (41% reduction in emissions intensity); energy (29% reduction in absolute emissions); power (63% reduction in emissions intensity); and thermal coal mining (90% absolute emissions reduction).

Deutsche Bank has **reported** that its financing of oil and gas sector declined by more than 20% in 2022, thermal coal sector by around 18% and there were year-over-year reductions in all sectors where the bank had identified an emissions reduction target. **Current targets** include oil and gas (23% reduction in Scope 3 upstream financed emissions by 2030 and 90% by 2050), power generation (69% reduction in Scope 1 physical emission intensity by 2030 and 100% reduction by 2050), automotive - light duty vehicles (59% reduction in tailpipe emission intensity by 2030 and 100% reduction by 2050) and steel (33% reduction in Scope 1 and 2 physical emission intensity by 2030 and 90% reduction by 2050).

HSBC disclosed updated targets of a 34% reduction in absolute on-balance sheet financed emissions in the oil and gas sector and a 75% reduction in on-balance sheet financed emissions intensity in the power and utilities sectors by 2030. HSBC added that "the choice to adopt an emissions intensity metric for Power and Utilities reflects the need to reduce global greenhouse gas emissions from power generation while also meeting growing electricity demand." Emissions intensity is a metric that sets a target relative to an economic or operational variable. Absolute emissions reduction aims for a set target reduction.

In commenting on the process of reducing emissions financing, the banks emphasized the importance of a *transition* to a green economy that recognizes the current need for energy from fossil fuels and that issuers themselves are charting unfamiliar terrain in navigating a green transition. For example, Christian Sewing, CEO of Deutsche Bank commented on the revised targets noting that "[i]n most cases we can contribute more to reducing greenhouse gas

emissions by working with our clients. But in cases where we saw no willingness on the part of a client to embark on a credible transition, we would not shy away from exiting a relationship."

Jane Fraser, CEO of Citi, noted that the "global economy still runs primarily on oil and natural gas" and that energy security is still an important issue in developing nations where the resources and infrastructure to "make a quick shift to renewables" is limited.

Taking the Temperature: While at this point there is nothing particularly novel about banks setting and updating emissions financing reduction targets, some additional insights from the Citi, Deutche Bank and HSBC announcements bear mention. First, while media focus tends to rest on climate risk, there are opportunities as well. For example, a model jointly developed by Deutsche Bank and Bain & Company showed that additional investment of "$1.4 trillion per year will be required, by the end of 2030, to meet the target of limiting global warming to 1.5 degrees Celsius by 2050," but also that the additional "annual revenue potential for banks is more than $40 billion worldwide."

Second, as we previously discussed with respect to HSBC, the Citi and Deutsche Bank reports devote considerable attention to climate-related governance. For example, Citi states that it "expanded [its] Board of Directors' oversight of certain climate-related matters such as climate risk and climate and ESG disclosures;" "[c]odified the integration of climate-related issues with certain Board committees, including incorporating oversight of our climate disclosure risk and controls environment into the Audit Committee (AC) charter and climate risk oversight into the Risk Management Committee (RMC) charter;" "[c]ommenced an ESG Disclosure Committee to support the Board and AC and provide oversight of Citi's disclosure controls and procedures;" and "[e]xpanded and realigned our Climate Risk team to be part of the Enterprise Risk Management function within Risk and further added subject matter expertise." Citi added that it also continues to "educate [its] entire Board, as well as senior management, to build out climate-related expertise and capabilities," and that "sustainability and climate-related goals are incorporated into several executive scorecards, which are key elements of performance management tied to the determination of incentive compensation for these executives." Deutsche Bank similarly has multiple organizational structures at the board and management levels devoted to sustainability governance, a focus that, in our view, is essential to assess and act on enterprise-wide climate-related risks, opportunities and data collection.

Third, we often have commented on the challenges companies confront in obtaining quality climate metrics, such as Scope 1, 2 and 3 emissions. These reports underscore the complexity involved, including the lack of consensus on how to measure emissions, use carbon offsets, chart progress on a net-zero path, and otherwise proceed on a green transition pathway while accurately reporting on that progress. The Citi report, for example, states that "the quality and availability of climate-related data continues to be a significant challenge. At the time of the analysis disclosed in this report, the data available for calculating financed emissions and emissions intensity and measuring progress was nearly two years old, given the availability of the data at the time." The report adds that "currently, there is no single, global, cross-sector data provider that adequately and consistently covers our needed scope for data to analyze emissions and assess physical and transition risks across our operations and portfolios." Moreover,

according to Citi, climate-related reporting from the bank's clients "continues to fall short of the necessary quality, quantity and consistency to permit comparability across clients, industries and sectors, which underscores the necessity of client-level engagement." As we have discussed, these challenges reinforce the need for active board and management climate-focused engagement and accurate disclosure of the limitations on climate disclosure.

ShareAction Claims Asset Managers Lagging on Climate and Biodiversity

March 21, 2023

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In a recent report, the UK-based NGO ShareAction claimed that "[t]he asset management industry needs to change urgently if it is to demonstrate proactive stewardship that safeguards against key social and environmental risks in the best interests of the investors." The group's Point of No Returns report ranked 77 of the largest asset managers globally based on their responses to 107 questions across five "responsible investment themes," namely, stewardship, governance, climate, biodiversity, and social issues. Average performance across asset managers was best in the areas of stewardship, governance, and social issues. The report recognized improvement in the industry with respect to climate policies, but noted that "there is still room for improvement," particularly regarding the adoption of net-zero targets and "time-bound," action-based climate transition plans.

The report also observed geographic differences, with asset managers from the United States showing "notably weak performance on climate, with only three finishing in the top 30 for that section." European asset managers tended to outperform their North American and Asia Pacific peers, in part because of "[t]he development of sustainable finance legislation across Europe."

For asset managers hoping to improve their responsible investment performance, the report recommends, among other things, to "[s]trengthen dedicated responsible investment policies by explicitly covering climate, biodiversity, and social issues and by making ambitious commitments, such as setting net zero targets and developing transition plans to align all portfolios with the goals of the Paris Agreement and a 1.5C scenario." At the same time, the report urges asset owners to "[e]nd relationships with asset managers who do not live up to set expectations on managing responsible investment issues." The report further recommends that policymakers create regulatory environments conducive to responsible investment, in part by clarifying "that market abuse rules and anti-trust rules will not apply to institutional investors when they conduct collaborative engagement activities relating to sustainability issues like climate change."

Taking the Temperature: As we have previously discussed in depth, there is wide variation in methodologies for ESG rankings, so ShareAction's recent ratings report should be understood as just one data point among many. Four takeaways are: first, the report observes that a "passive investment style is not a barrier to having a leading

approach to responsible investment." Whether or not that is true, the issue of the appropriate stewardship activities on the part of passive investment managers is squarely in the crosshairs of the U.S. partisan divide over ESG issues in the investment context, and reaction to those concerns, at least in part, led at least one large asset manager to withdraw from the Net Zero Asset Managers initiative. At the same time, certain of these asset managers also have adopted programs to permit the beneficial owners of their investments to have a greater say in how their shares are voted, which could over time blunt any developing reluctance on the part of passive managers to engage in stewardship due to political pressure.

Second, after a long period of climate change mitigation receiving the bulk of regulatory, issuer, and stakeholder attention, these same constituencies increasingly are focusing on the potential material impacts from biodiversity issues. According to ShareAction, however, there remains "a lot of room for improvement" in the area of biodiversity, with the report observing that 62% of respondents "did not report having made any commitments regarding the conversion and protection of ecosystems," and just 10% had "a dedicated biodiversity policy covering all portfolios under management."

Third, we often discuss the importance of issuers and asset managers devoting significant attention to risk, opportunity, and data assessment with respect to climate change and other sustainability matters—in other words the "G" in ESG. The report states that "[a]sset managers are making progress on introducing governance mechanisms to ensure oversight of responsible investment-related issues compared to 2020. Two-thirds of asset managers reported that the board and trustees have responsibility for the oversight of responsible investment issues, up from 21% in 2020, although their responses revealed that their boards lack specific climate-related expertise. Asset managers have also started setting responsible investment-related key performance indicators (KPIs) and objectives that are linked to remuneration, though this most often applies to staff in responsible investment teams, and fewer than a third of managers have set such KPIs for all members of their executive board." However, biodiversity again lags, "with only 49% of policies referencing the topic, compared to 79% referencing climate and 70% mentioning social issues."

Fourth, in observing the need for improvement in the adoption of "time-bound," action-based climate transition plans, the report echoes concerns raised by other NGOs about a mismatch between issuer or asset manager emission reduction targets and concrete plans to achieve those goals. Companies can avoid greenwashing challenges by adopting leading data collection and assessment frameworks like the Science Based Targets initiative or applicable regulatory guidance and make related disclosure of climate goals and progress based on solid facts and consistent with disclosure frameworks such as the recommendations promulgated by the Task Force on Climate-Related or Nature-Related Financial Disclosure and the International Sustainability Standards Board.

Launch of State Alliance Against "ESG Investing"

March 21, 2023

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On March 16, 2023 the Republican governors of 19 states **announced an alliance** led by Florida Governor Ron DeSantis, to "push back against President Biden's environmental, social, corporate governance (ESG) agenda that is destabilizing the American economy and the global financial system." In their **joint statement**, the 19 state governors explained their intention to "work together and leverage [their] state pension funds to force change in how major asset managers invest the money of hardworking Americans, ensuring corporations are focused on maximizing shareholder value, rather than the proliferation of woke ideology." The statement references the Department of Labor Rule that permits retirement plan fiduciaries to consider ESG-related factors in their decision-making and **President Biden's intention** to veto a congressional measure to repeal the rule.

The states that make up the alliance are: Alabama, Alaska, Arkansas, Florida, Georgia, Idaho, Iowa, Mississippi, Missouri, Montana, Nebraska, New Hampshire, North Dakota, Oklahoma, South Dakota, Tennessee, Utah, West Virginia, and Wyoming.

The governors have agreed to "lead state-level efforts", which include:

1. blocking the use of ESG in all investment decisions at state and local level;
2. eliminating the consideration of ESG factors by state and local governments when issuing bonds;
3. prohibiting state fund managers from considering ESG factors when investing taxpayer funds;
4. banning the financial sector from considering "Social Credit Scores" in banking and lending; and
5. stopping financial institutions from discriminating against customers for religious, political or social beliefs including "owning a firearm, securing the border, or increasing . . . energy independence".

Taking The Temperature: The Department of Labor Rule permits, but critically does not compel, fund managers to take ESG-related considerations into account in making investment decisions. Asset managers have fiduciary obligations to consider all risk factors and other relevant information, including ESG-related issues, that are material to investment decisions and analysis. As we have previously discussed, it is the view of many in the financial sector that considering ESG factors is consistent with a fund

managers' fiduciary duties to its investors and that environmental impact should be assessed like any other material risk.

However, it could be construed as indicative of the current politicized situation in the U.S. that BlackRock CEO Larry Fink's annual letter to investors adopts a relatively more restrained stance (relative, for instance, to his prior year's letter) toward climate and other sustainability issues as a matter of investment risk. In last year's letter, he now famously stated that "stakeholder capitalism is not about politics. It is not a social or ideological agenda. It is not 'woke.' It is capitalism, driven by mutually beneficial relationships between you and the employees, customers, suppliers, and communities your company relies on to prosper. This is the power of capitalism." This year, he wrote that "it is for governments to make policy ... not for companies ... to be the environmental police." On the other hand, Blackrock's consistent publicly stated view over the years that material climate risk had to be taken into account by asset managers, and that issuers needed to provide more thorough and accurate disclosure in order for managers to make investment decisions, elevated the issue to the point where it is now accepted wisdom on the part of large swaths of the global economy. Viewed that way, BlackRock may deem it appropriate to let others now take the lead, including legislatures and regulators.

EU Publishes Green Bond Standard

March 21, 2023

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On February 28, 2023 the Council of the European Union and the European Parliament reached a deal to draw up European Green Bonds Standards ("EUGBS"). The aim of the EUGBS is to establish the leading global framework for green bonds. **According to Paul Tang**, rapporteur, this creates "a gold standard that green bonds can aspire to." The EUGBS have been designed to facilitate the financing of sustainable investments by companies and public authorities that issue green bonds, while meeting rigorous sustainability requirements and protecting investors against greenwashing.

Although the provisional agreement's full wording and details have not yet been disclosed, the **key details** announced to date are:

- **Transparency.** Companies that use the EUGBS when marketing a green bond must be engaged in a green transition, as they will be required to disclose substantial information about how the bond's proceeds will be used and how those investments feed into the transition plans of the company as a whole.

  In addition, "[t] he disclosure requirements, set out in template formats, will also be open to be used by companies issuing bonds which cannot fulfil all the requirements to qualify for the EUGBS. These companies would thereby subject themselves to ambitious transparency requirements and, as a result benefit from better trust among investors."
- **External reviewers.** The EUGBS establishes a registration system and supervisory framework for external reviewers of European green bonds. It is envisaged that independent entities will be responsible for assessing whether a bond is green. The EUGBS "stipulates that any actual or even potential conflicts of interest are properly identified, eliminated or managed, and disclosed in a transparent manner. Technical standards may be developed specifying the criteria to assess the management of conflicts of interest."
- **Flexibility.** Until the EU taxonomy framework is "fully up and running," which is projected to be January 2027, "legislators agreed to allow 15% of the proceeds from a green bond to be invested in economic activities that comply with the taxonomy requirements but for which no technical screening criteria have yet been established to determine if that activity contributes to a green objective (technical screening criteria)."

In its accompanying press release, the European Parliament acknowledges that the EUGBS will (i) “enable investors to identify high quality green bonds and companies, thereby reducing ‘greenwashing,’” (ii) “clarify to bond issuers which economic activities can be undertaken with the bond’s proceeds,” (iii) “set in place a clear reporting process on the use of the proceeds from the bond sale,” and (iv) “standardize the verification work of external reviewers which will improve trust in the review process.”

Taking the Temperature: The agreement on EUGBS is still provisional as it needs to be confirmed and adopted by the Council and the European Parliament before it is final. The overall effect of the EUGBS could be a sharp reduction in the volume of debt allowed to carry a sustainable label and, potentially, reducing misleading claims or greenwashing in the bond market. The framework is significant given that this is a large, and largely unregulated, asset class – over $400 billion of green bonds were issued in 2022, and nearly $600 billion of green bonds were issued in 2021.

However, given that the agreement is provisional, there remain various aspects of the EUGBS that are unclear. To cite just one example, it is unclear whether securitizations will be part of the EUGBS as per the European Banking Authority’s report on developing a framework for sustainable securitization. Further assessment will be required once the final text of the EUGBS is publicly available.