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JPMorgan Outlines Voluntary Carbon Market Principles

July 25, 2023

By Peter Malyshev
Partner | Financial Services

By Zack Schrieber
Associate | Global Litigation

In a recently published **white paper**, JPMorgan outlined its approach to improving and strengthening voluntary carbon markets to promote scalable decarbonization efforts. JPMorgan focused its analysis on voluntary carbon markets, i.e., markets where “companies or individuals to purchase carbon credits to meet their own emissions goals” independent of markets “created and regulated by mandatory international, national or regional carbon management regimes,” (i.e., compliance markets). JPMorgan also cautioned that voluntary markets are “not a substitute for robust public policies designed to address climate change.”

Under JPMorgan’s analysis, carbon markets provide benefits to the global effort to reduce carbon emissions beyond those offered by regulatory programs for three major reasons. First, they allow companies in industries that face challenges in reducing their carbon emissions where, for instance, “the technologies necessary to address emissions may not yet be commercially available or else may still be prohibitively expensive,” to offset their greenhouse gas emissions by purchasing carbon credits, thereby “enabling greater deployment of climate solutions elsewhere in the economy.” Second, by incentivizing investment, carbon markets “facilitate more rapid deployment of proven solutions, which can drive down net emissions more quickly.” Third, investing in projects via carbon credits can promote other environmentally friendly actions, including reforestation efforts, or a slowing of deforestation, which increases biodiversity, reduces other forms of pollution, and promotes stronger environmental resilience.

Still, JPMorgan recognized that carbon markets and the use of carbon credits may not be adopted on a global scale and across all industries as quickly as necessary to maintain net-zero targets without other efforts. Accordingly, it advises that companies should still devise business strategies and invest in technologies that will directly reduce their carbon emissions. While these actions may impose significant short-term capital expenses, they will likely increase business efficiency and reduce long-term costs, according to the bank. JPMorgan also cautioned that voluntary markets are “not a substitute for robust public policies designed to address climate change.”

The voluntary carbon markets provide for trading two main forms of credits: (a) avoidance credits and (b) removal credits. Avoidance credits are created when a company takes an action that either fully prevents or reduces the amount of carbon it normally would have produced under business operations. For example, companies can generate these types of credits by

transitioning to solar energy or by taking actions to reduce deforestation. Removal credits, on the other hand, are created when a company actively promotes removal of GHGs from the atmosphere. This can be accomplished through a variety of options, including nature-based solutions like reforestation, or through technological developments like investments in, or promoting the use of, carbon-capture technology. JPMorgan noted that while nature-based solutions like reforestation tend to be more readily accessible and cheaper, they only store carbon for short periods of time. Technology like carbon-capture provides long-term removal of GHGs from the atmosphere, but tends to be expensive and is not yet fully developed.

Avoidance credits and removal credits work in tandem to complement each other. In the near-term, avoidance credits reduce the amount of GHGs released and slow the accumulation of carbon in the atmosphere. In the long-term, deployment of more expensive carbon-capture technology has the potential to partially reverse historic GHG emissions and counteract the continued release of GHGs from industries where emissions-reduction is prohibitively expensive or technologically difficult. As JPMorgan observed, while the goal of net-zero emissions by 2050 will largely be accomplished through reducing carbon emissions, "the large-scale removal of GHGs from the atmosphere will be [also] be necessary[.]"

JPMorgan also identified eight major factors it utilizes when assessing the value and utility of carbon credits, given widely recognized issues associated with "variation in the availability and quality of information needed to assess credit quality, resulting in a lack of confidence for many market participants." Under its framework, the GHG emission reductions underlying each carbon credit should be: (1) real and proven to have actually taken place; (2) measurable and quantifiable according to recognized methodological approaches; (3) in addition to what would have already been undertaken by the company; (4) unique and traceable to each initiative; (5) independently verified by a reputable GHG accreditation program; (6) not simply a displacement of carbon emissions from one sector of the economy to another; (7) durable and long-term; and (8) equitable by promoting and supporting marginalized communities.

JPMorgan highlighted additional challenges facing the development of effective and efficient voluntary carbon markets. These include, in addition to a lack of quality information about each carbon credit, a scarcity of high-quality carbon credits that would promote and support large-scale efforts at decarbonization; the existence of "multiple marketplaces, competing frameworks and principles;" and an inability to "support more sophisticated forms of trading, which limits its ability to meet the needs of different kinds of participants. Improved trading infrastructure and further development of advanced features such as forward market instruments and reference contracts are needed to support increased liquidity, transparency and risk management, which can contribute to greater scale and efficiency."

Taking the Temperature: JPMorgan's report highlights the potential value to companies of integrating high-quality carbon credits into their overall sustainability plans, while also acknowledging the challenges in doing so. The integrity of carbon credits is an ongoing source of controversy and challenge. Last year, for instance, the Chair of the International Organization of Securities Commissions cited concerns around the "appropriate levels of integrity, transparency, and liquidity" of voluntary markets.

Of note, the integrity of credits traded on voluntary carbon markets is not outside of federal regulatory oversight. Earlier this year, the Chairman of the Commodity Futures

Trading Commission (CFTC), Rostin Behnam, announced a speech that the CFTC recognizes environmental products as "commodities" and therefore "can play a role in voluntary [carbon] markets, and that carbon markets must be transparent and have integrity and adhere to basic market regulatory requirements." The CFTC Chair's statement followed a letter to the CFTC sent in the fall of 2022 by a group of Democratic senators asking for improved regulation of the market for carbon offsets. It remains unclear how the CFTC would exercise this authority in practice and what the implications are for the developments of voluntary markets; however, the CFTC has identified as a top priority addressing financial risks posed by climate change as well as prosecuting fraud and manipulation in carbon and environmental markets. In June of 2023, the CFTC published guidance for whistleblowers to report fraud in spot and forward carbon markets, and then announced the creation of an environmental fraud enforcement task force. Further, on July 19, 2023, the CFTC held its second convening to discuss the development of voluntary carbon. Nonetheless, carbon markets are likely to remain active, and have been growing around the world, including in the UK, Brazil, Australia, and Africa.

Non-Profit Targets U.S.-Based Bank's ESG Investment Strategies

July 25, 2023

By Jason Halper
Partner and Co-Chair | Global Litigation

By Timbre Shriver
Associate | Global Litigation

Consumers' Research, a nonprofit organization claiming to challenge "companies that have chosen to put woke politics above consumer interests," **announced** in June 2023 that it was launching a publicity campaign against a global U.S.-based financial institution. According to the organization, Bank of America is pursuing an "ideologically driven agenda" and advocating "ESG fanaticism." In a statement supporting the campaign, which includes national television advertisements, billboards in major U.S. cities, including one in New York City's Times Square, and a dummy "Bank of America" website, Will Hild, CEO of Consumers' Research, accused Bank of America of using its access to capital to help force a progressive political agenda. According to Hild, Consumers' Research identifies Bank of America and its CEO as among the most outspoken lenders on climate-related topics, as well as other issues that some lump under the umbrella of ESG, such as gun laws, LGBTQ+ rights, and abortion and reproductive health protections. Hild also took issue with other measures taken by the bank, including calculating greenhouse gas emissions for clients and its internal diversity, equality and inclusion training.

The campaign against Bank of America is the most recent in the group's wider "Consumer First" initiative, which focuses on companies' ESG policies. For instance, it has targeted Blackrock which, as **we reported** earlier this year, also received a letter from 19 Republican state attorneys general, critical of the company's ESG position. BlackRock defended its ESG policies, stating, among other things, that climate risk and the economic opportunities from the energy transition are top concerns for many of its clients and that its participation in ESG initiatives is "entirely consistent with our fiduciary obligations."

In a statement, Bank of America said that its focus on "responsible growth is how [it] deliver[s] industry-leading service to [its] 68 million American consumers, being a great place to work for our employees and supporting communities across the United States while delivering strong returns for [its] shareholders." The financial institution added resources to its Sustainable Banking Solutions Group in 2022 to advise clients on ESG issues that affect their funding requirements, valuations and strategic decisions as they transition to net zero GHG emissions. According to its **2022 Annual Report**, Bank of America's Global Corporate & Investment Banking (GCIB) line of business became number one in the world in ESG debt issuance volumes.

Taking the Temperature: The political divide in the U.S. over ESG issues shows no signs of abating. We've covered efforts by Republican-led state legislatures to impose various types of penalties on financial institutions deemed insufficiently supportive of the energy industry. On March 30, 2023, 21 Republican Attorneys General (AGs) wrote a letter addressed to over 50 U.S. asset managers citing "concerns about the ongoing agreements between asset managers to use Americans' savings to push political goals during the upcoming proxy season." The AGs state their intent to "enforce [their] states' civil laws against unfair and deceptive acts and practices and state and federal civil laws prohibiting agreements to restrain competition."

Blackrock in particular has been a focus of these efforts, with certain state officials withdrawing state funds it had been managing. While it is difficult to assess whether these efforts are having an impact, we have observed that last year BlackRock increased assets under management by $230 billion, while losing approximately $4 billion AUM as a result of state government reaction to ESG issues. On the other hand, some commentators have claimed that Blackrock's support for ESG shareholder initiatives dropped over the past year or two and just days ago it appointed to its board of directors the CEO of Saudi Aramco, the world's largest oil producer. In the insurance industry, in May 2023, 23 Republican state attorneys general wrote to members of the Net-Zero Insurance Alliance expressing "serious concerns" about whether the NZIA's requirements comply with state and federal laws. And, several insurers have withdrawn from the industry group in light of these types of expressed concerns.

Financial institutions in the U.S. have to balance these anti-ESG challenges with calls for greater action to promote net-zero goals and to assure financial resiliency against climate-related risks. Regulators in Europe and elsewhere are requiring banks to undergo climate risk stress tests as one component of assessing climate risk, while investors have pressured banks in the U.S. and elsewhere to cease or curtail financing for fossil fuel projects.

Science-Based Targets Initiative Releases Consultation Papers for Financial Institutions, Highlights Need for Renewable Power Financing

July 25, 2023

By Sukhvir Basran
Partner | Financial Services

By Simon Walsh
Special Counsel | Global Litigation

In June 2023, the Science Based Targets initiative (SBTi) **published a draft** of its Financial Institutions Net Zero (FINZ) Standard to enable financial institutions to establish targets consistent with achieving net-zero emissions by 2050, in line with the Paris Agreement. The SBTi framework aims to foster a globally standardized approach for reporting and assessment for financial institutions.

The consultation draft on the FINZ Standard sets out the framework and what it labels as high-level criteria for financial institutions advancing towards climate-neutrality. The FINZ Standard outlines three main objectives for the finance sector, namely that financial institutions cease financial support for new high-emitting projects; focus on decarbonizing existing portfolios through transition financing; and support activities aligned with net-zero emissions targets. The FINZ Standard provides that a financial institution's complete net-zero framework should include 5-10 year near-term science-based targets that allocate a greater allocation of financial resources towards 1.5°C pathways, complemented by long-term science-based targets to achieve complete net-zero alignment by 2050.

In parallel, the SBTi also published its **Position Paper on Fossil Fuel Finance**, which details the criteria for financial institutions' activities with fossil fuel companies and projects. The position paper advocates for the immediate halt of fossil fuel financing and encourages financial institutions to engage with fossil fuel companies to transition to a net-zero economy. The recommendations set out in the position paper include: (1) publicly disclosing climate-related information annually, including GHG emissions, financial exposures, and transition plans of fossil fuel portfolio companies; (2) immediately ending new financial investments in the coal value chain and unabated oil and gas activities at project level; (3) setting targets for financial support for existing fossil fuel activities at the company and portfolio levels, aiming for a 1.5°C transition; and (4) committing to phasing out financial activities linked to unaligned companies and projects within specified timeframes.

In addition, SBTi also released updated **Near-Term Financial Sector Science Based Targets Guidance**. The key updates are the inclusion of fossil fuel finance items in the near-term and a requirement for financial institutions to align their scope 1 and 2 targets to a 1.5°C climate transition with a 5-10 year timeframe (as opposed to the previous version's requirement of "well

below 2°C” for scope 1 and 2 targets with a timeframe of 5-15 years). This increased ambition, as SBTi reports, is in line with the fact that a majority of financial institutions already are aligning their near-term targets with the 1.5°C climate scenario. The guidance offers recommendations for communicating targets and actions, examples of actions to achieve targets, and instructions for committing to the SBTi and submitting targets for validation.

The draft papers are open for public consultation and stakeholder engagement until August 14, 2023. The complete FINZ Standard together with tools and guidance on how to implement the standard is expected to be published in 2024.

Taking the Temperature: The SBTi’s focus on the financial sector reflects that industry’s importance to climate change efforts globally, particularly with respect to financing renewable energy projects. We recently reported on the Columbia Center on Sustainable Investment’s (CCSI) research report, which also focuses on financial institutions and their climate-action initiatives, and emphasizes the need for a significant increase in non-fossil fuel investments. In that vein, on May 4, 2023, the United Nations announced the formation of a 35-member bank-led working group to promote nature- and biodiversity-related target setting, and part of the group’s mandate is to focus on how the banking sector can close the biodiversity financing gap. In April 2023, the Centre for Climate Finance & Investment and the International Energy Agency issued a report identifying and addressing the investment gap in renewable and clean energy in the Association of Southeast Asian Nations (ASEAN) region. We also have previously discussed the focus on the need for financing at last year’s COP27 climate change conference in Egypt, where an agreement was reached to establish a dedicated fund to assist developing countries in responding to loss and damage caused by climate change; at the COP15 biodiversity conference in Montreal, where the main area of contention involved how to pay costs that will be incurred to realize the Global Biodiversity Framework’s goals; and at the February 2023 meeting of G20 Finance Ministers in Bengaluru, India, where attendees called for the creation of a common global framework to facilitate financing the United Nations’ Sustainable Development Goals.

Financial Conduct Authority Publishes Draft Voluntary Code of Conduct for ESG Ratings and Data Product Providers

July 25, 2023

By Duncan Grieve
Special Counsel | White Collar Defense and Investigations

By Sharon Takhar
Associate | White Collar Defense and Investigations

On July 5, an industry-led working group convened by the UK's financial regulator published a **draft voluntary code of conduct** for ESG data and ratings providers (the Code). The Code would apply to all companies based in the UK that compile the ESG ratings of different firms. The development of the Code is part of the UK's wider **green finance strategy** and comes a year after the Financial Conduct Authority (FCA) **announced the launch** of its consultation.

The Working Group comprises the International Capital Market Association (ICMA) and the International Regulatory Strategy Group (IRSG) and is co-chaired by M&G, Moody's, the London Stock Exchange Group and law firm Slaughter & May. Over the course of developing the Code, the Working Group met with regulators in other jurisdictions including Singapore, Japan and Canada.

In order to demonstrate consistency with international standards, the Code is **based on recommendations** made by the International Organization of Securities Commissions (IOSCO). IOSCO's recommendations form the basis of six Principles (each underpinned by a series of actions) in the Code, which in turn are focused on four outcomes:

- **Good governance:** Ensure appropriate governance arrangements are in place to enable companies to promote and uphold the Code.
- **Systems and controls:** Adopt and implement written policies and procedures designed to ensure companies issue high-quality ratings and data.
- **Management of conflicts of interest:** Identify, avoid or appropriately manage, mitigate and disclose actual or potential conflicts of interest that may compromise the independence and objectivity of operations.
- **Transparency:** Make adequate levels of public disclosure and transparency a priority. This includes methodologies and processes to enable users to understand the product and associated conflicts of interest while maintaining a balance with any proprietary or confidential information, data and methodologies.

The Working Group is currently running a consultation on the Code that is due to close on October 5, 2023. It is envisaged that the final version will be published by the end of the year.

In parallel, HM Treasury has been assessing whether ESG ratings providers should be brought within the FCA's regulatory perimeter. If that occurs, the FCA will be required to draft and introduce applicable regulations. In the short-term therefore, the Code will provide the requisite guidance, consistency and transparency for investors and stakeholders. If the FCA is selected as the regulator for ESG ratings and data providers, the Code will nonetheless continue to apply to out-of-scope firms.

Taking the Temperature: We have previously discussed the growing demand for regulation of the ESG ratings market and its importance to facilitating ESG-related investment.

The development of the draft Code coincides with the announcement that the European Commission, as part of its sustainable finance package, proposed regulation of EU ESG ratings providers, as we have discussed. The Commission proposes measures to prevent obvious conflicts of interest, such as prohibiting ratings providers from providing consulting services to investors or the sale of credit ratings. The regulation also "provides requirements on disclosures around" ratings methodologies and objectives, and "introduces principle-based organizational requirements on" provider activities. Under the EU's proposed regime, providers would be authorized and supervised by the European Securities and Markets Authority. The movement toward regulation, reflects the lack of consistency among ESG ratings providers and the absence of established industry norms relating to disclosure, measurement methodologies, transparency and quality of underlying data – issues also cited in a recent study. For instance, earlier this year MSCI announced significant changes to its ESG investment fund ratings methodology that "aim to raise the requirements for a fund to be assessed as 'AA' or 'AAA' rated, improve stability in Fund ESG Ratings and add transparency through simpler attribution analysis." However, these changes will result in downgrades to 31,000 of the funds currently rated by MSCI.

Climate Action 100+ Launches Phase 2 of Benchmarking Program Focusing on Taking Action

July 25, 2023

By Sara Bussiere
Special Counsel | Global Litigation

By Jayshree Balakrishnan
Associate | Global Litigation

In June 2023, Climate Action 100+, a climate-focused investor initiative, **launched the second phase** of its benchmarking program to help investors assess and engage with public companies on climate-related issues. Phase 2 makes reference to Climate Action's recent updates to its **Net Zero Company Benchmark** assessment tool. The Net Zero Company Benchmark uses public data, as well as self-disclosed company information, to evaluate the efforts of 166 focus companies to achieve a net zero transition. The publicly available data and self-disclosed company information will now be categorized into two types of indicators: disclosure framework indicators, evaluating the adequacy of corporate disclosure, and alignment of a company's goals with the Paris Agreement.

Climate Action 100+ develops its programs relative to three objectives: taking action to reduce emissions, implementing strong corporate governance and accountability around climate-related risk, and enhancing climate-related financial disclosures. The companies selected for assessment and engagement by the initiative's investor signatories account for 80% of global corporate industrial greenhouse gas emissions.

During the five-year Phase 1, the climate-focused investor initiative increased the number of participating companies from five to 166 and secured pledges from 75% of those companies to commit to net zero. Phase 2 extends until 2030, with the goal of shifting the focus from corporate climate-related disclosure to the implementation of climate transition plans.

In Phase 2, Climate Action 100+ will encourage signatories to ask companies to: implement a strong governance framework that articulates the board's accountability and oversight of climate change risk; reduce greenhouse gas emissions across the value chain, including by engaging with policymakers to address barriers to transition; provide enhanced corporate disclosures on and implement transition plans to deliver on robust targets; and improve and expand the ways investors can participate to ensure engagement is effective and optimized to drive real change.

Climate Action 100+ details the updates to its strategy in its **"Phase 2: Summary of Changes,"** which include:

- Updated goals to reflect key areas where signatories plan to engage with companies in the lead up to 2030.
- Marginal changes to the current focus company list to remain focused on the top greenhouse gas emitting companies globally.
- A new "lead sector investor" category "to help create the ecosystem conditions needed for sectors to transition," with the opportunity for leads to disclose their organizations' identities on the Climate Action 100+ website.
- A new 'lead thematic investor' category, "allowing signatories to engage on specific themes in any given year," with additional transparency around the initiative's thematic priorities for each region in a given year.
- New sector engagements.
- Expectations for lead and other investors to disclose voting records on Climate Action 100+ where appropriate and allowable by jurisdiction.
- Enhancements to the governance model of Climate Action 100+.

Taking the Temperature: As we have noted, Climate Action 100+ reaches a sizable investor constituency — 700 investors with over $68 trillion in assets under management. Its benchmarking program is voluntary, however. It therefore remains to be seen how influential or effective the initiative's Phase 2 action plan will be. Earlier this year, Climate Action 100+ released its 2022 progress report, which indicates the initiative has made headway in some areas but notes the need for progress in others. In the foreword to the progress report, Andrew Gray, current chair of the global Steering Committee for Climate Action 100+, concedes that "the lack of credible short- and medium-term decarbonization strategies across the majority of focus companies needs to be tackled. So, too, does the clear lack of capital allocation commitments towards climate-change mitigation."

Meanwhile, Climate Action 100+ continues to come under fire in the United States, driven in large part by the politicization of climate-related issues. In December, we reported that Climate Action 100+, along with Ceres and the California Public Employees' Retirement System (CalPERs), was the subject of an inquiry brought by Republican members of the House Judiciary Committee regarding antitrust compliance. The state of Louisiana also launched an investigation in April of CalPERs and investment firm Franklin Templeton for their roles on Climate Action 100+'s steering committee.