CADWALADER

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Table of Contents:

Cadwalader Climate

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In this week's edition, we take a detailed look at the Financial Conduct Authority's guidance on the anti-greenwashing rule, which requires in-scope firms to ensure that their sustainability claims are consistent, fair, clear and not misleading. The UK government confirmed its target to mandate at least 10% sustainable aviation fuel in the UK jet fuel mix by 2030. European Union Member States are set soon to approve the controversial Corporate Sustainability Due Diligence Directive (CSDDD) following a greenlight from the European Parliament. A report by Fitch Ratings explores the consequences of uncertainty around the Sustainable Finance Disclosure Rules (SFDR). The International Sustainability Standards Board (ISSB) also announced its intention to develop a disclosure framework for biodiversity- and human capital-related risks and opportunities.

UK Financial Regulator Publishes Guidance on New Anti-Greenwashing Rule

The FCA's anti-greenwashing rule (the Rule) is due to come into effect on May 31, 2024, prompting the regulator to publish **industry guidance** aimed at assisting firms with compliance.

The Rule requires firms to ensure that any references to the sustainability characteristics of a product or service are consistent, fair, clear and not misleading. The Guidance sets out what the effect of the Rule is in practice and provides example scenarios of both non-compliance and good practice. Sustainability references should be:

1. Correct and capable of being substantiated;
2. Clear and presented in a way that can be understood;
3. Complete – they should not omit or hide important information and should consider the full lifecycle of the product or service; and
4. Fair and meaningful where comparisons are made to other products or services.

We discuss these requirements in further detail in a **related Cadwalader publication**.

The adoption of the Rule is part of a wider package of measures introduced by the FCA in November 2023 through its **statement on Sustainability Disclosure Requirements (SDR) and investment labels (PS23/16)**. The wider package of measures includes: (i) naming and marketing rules for investment products, to ensure that the use of sustainability-related terms are accurate; (ii) four labels to help consumers navigate the investment product landscape; (iii) consumer-facing information to provide consumers with more accessible information to help understand key sustainability features of a product; (iv) detailed information targeted at institutional investors and consumers seeking more information in pre-contractual, ongoing product-level and entity-level disclosures; and (v) requirements for distributors to ensure that product-level information (including the labels) is made available to consumers.

Greenwashing is a recurring theme throughout Cadwalader Climate, and although the facts and the context differ in each case, the message remains that sustainability claims must be clear, accurate and capable of being substantiated.

UK Commits to 10% Sustainable Aviation Fuel Target

On April 25, 2024, **the UK government announced** that it would mandate a target for all jet fuel to be comprised of at least 10% of sustainable aviation fuel (SAF) by 2030. The mandate is due to become effective in January 2025, and will make the UK the first country to mandate such a target aimed at decarbonizing air travel. In November, the first commercial transatlantic flight using 100% SAF took off from Heathrow Airport, and was supported by a GBP1 million government investment. The government estimates that the SAF industry could generate over GBP1.8 billion for the economy and create over 10,000 new jobs. The plan outlined by the Department of Transport includes a review mechanism which would help manage prices and reduce the impact on ticket fares for passengers.

SAF has been the subject of some attention in the greenwashing context. On March 20, **a Dutch court held** that airline KLM misled customers through vague environmental claims and depicted an “overly rosy picture” of its use of sustainable aviation fuel (SAF). In our April 1 edition, we discussed several similar findings by the UK’s Advertising Standards Agency (ASA) against Ryanair, Etihad Airways and Lufthansa, as well as a consumer class action in California against Delta Air Lines’ alleged false sustainability claims.

European Parliament Approves Sustainability Due Diligence Directive

On April 24, 2024, Members of the European Parliament (MEPs) approved a scaled-back Corporate Sustainability Due Diligence Directive (CSDDD), which is now ready for final approval by Member States in May. The CSDDD contains rules "for companies regarding actual and potential human rights adverse impacts and environmental adverse impacts, with respect to their own operations, the operations of their subsidiaries, and the value chain operations carried out by entities with whom the company has an established business relationship," and liability for violations of those obligations.

The CSDDD has been the subject of considerable publicity due to the onerous obligations the new requirements would have placed on companies. Prior to the amendments, the CSDDD would have applied to 80% of companies operating in the EU and would have included medium-sized enterprises for whom the obligations were considered particularly burdensome. Following several amendments which **we discussed previously**, the CSDDD will come into force from 2027. Large companies with more than 5,000 employees and a turnover of EUR1.5 billion or more will be the first set to report under the directive. From 2028, companies with more than 3,000 employees, and a turnover of EUR900 million will be brought in-scope, and from 2029, firms with more than 1,000 employees and a turnover of EUR450 million will commence reporting. The amendments made to the draft directive between February and April included limiting the scope of companies that the CSDDD would be applicable to, introducing a three-stage phase-in approach, removing financial incentives for directors linked to the implementation of transition plans, removal of disposal and recycling responsibilities, removal of civil liability provisions and removal of the list of high-impact sectors.

Companies are well-advised to plan ahead and prepare to comply with the rules. The CSDDD is likely to have significant global impact given that companies not headquartered in the EU, but operating there, will be in-scope. In addition, penalties for non-compliance include being publicly censured, and fined up to 5% of net global turnover.

Fitch Reports Predicts Limited Increase in Article 8 Funds Due to Regulatory Uncertainty

In a report published in April 2024, ratings agency Fitch notes that potential consequences of misinterpreting the Sustainable Financial Disclosure Rules (SFDR) will likely prevent the introduction of new Article 8 funds.

Under the SFDR, Article 8 funds must promote environmental and social characteristics, but do not have this as the overarching objective. The framework has attracted significant scrutiny since it came into force in 2021 due to the uncertainty around how the rules should be applied. **As we reported previously**, this resulted in mass downgrades of Article 9 funds, which encompass funds that invest specifically in sustainable assets. Should a fund be classified an Article 9 rather than an Article 8, for example, firms would risk being accused of greenwashing.

In 2023, **the European Commission launched a consultation** to explore whether to overhaul the regime and replace the article labels with more precise categories. The majority of respondents to the consultation “totally or mostly” agreed that the SFDR’s sustainable investment requirements were “not sufficiently clear.” In its report, Fitch notes that uncertainty would likely result in fund managers not upgrading Article 6 funds to Article 8 during 2024, as well as leading to hesitations over whether to launch new Article 8 funds. Still, Fitch reports that at the end of 2022, the proportion of European funds’ AUM categorized as Article 8 increased to 74% from 56% which the agency says reflects “investor demand and the reclassification of funds” from Article 6.

Concerns over the consequences of incorrect application of the rules is well-founded. **We often discuss** the reputational and legal risks attached to greenwashing, which we also discuss in detail in this edition in the context of the UK’s Financial Conduct Authority’s recently published guidance for the anti-greenwashing rule. **We have also previously discussed** the damage that regulatory ambiguity can cause.

ISSB to Develop New Disclosure Standards for Biodiversity and Human Capital

On April 23, 2024, the IFRS Foundations’ **International Sustainability Standards Board (ISSB) confirmed** that it would launch new projects researching corporate disclosures on the risks and opportunities in biodiversity, ecosystems and ecosystem services, and human capital, in order to inform future work on developing related sustainability reporting standards.

ISSB Chair Emmanuel Faber noted that the work follows market feedback which “indicated a significant and growing need among investors for improved disclosures” regarding nature and human capital “as a key source of value for companies.”

In 2023, the IFRS published its inaugural reporting standards IFRS S1 (General Requirements for Disclosure of Sustainability-related Financial Information) and IFRS S2 (Climate-related Disclosures). IFRS S1 and IFRS S2 have been used as the basis for equivalent national reporting regimes for a number of their jurisdictions, **including the UK**, Canada, Brazil, Japan and South Korea.

When announcing its newest initiative, the ISSB noted that market feedback also led the agency not to proceed with projects related to the risks and opportunities associated with human rights beyond those that relate to a company’s own workforce.