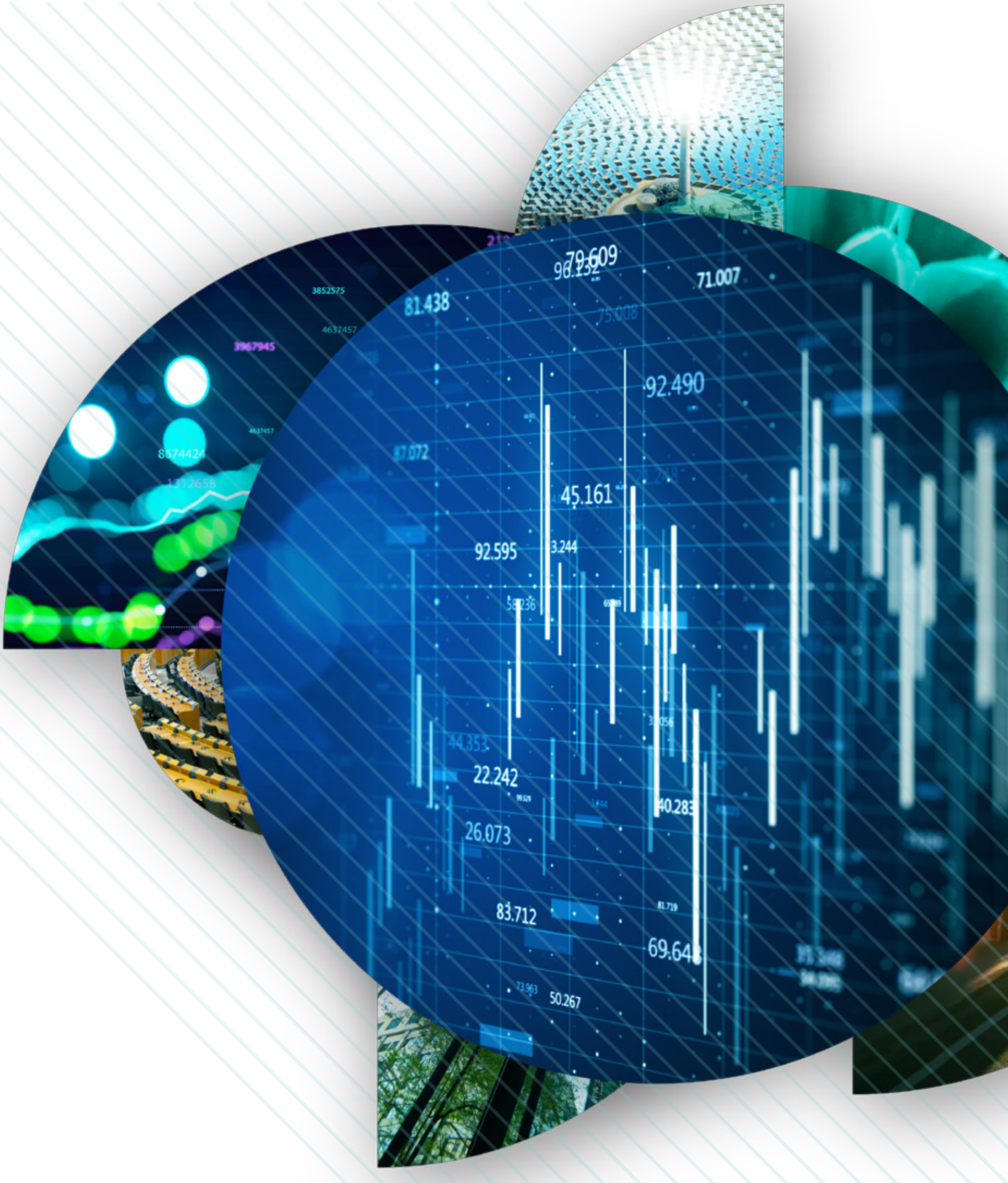
NORTON ROSE FULBRIGHT

ESG | Sustainability

Financial Services regulatory ESG updater

6 January – 6 February 2025



Introduction

Environmental, Social and Governance (**ESG**) is changing the landscape for financial institutions as a wide range of stakeholders including investors increasingly expect them to make their operations more sustainable. Financial services regulators also view ESG as a priority, embedding the principles of climate-related financial risks into their supervisory frameworks and dealing with institutions that may be making exaggerated or unsubstantiated sustainability-related claims that do not stand up to closer scrutiny (so-called 'greenwashing'). However, the key problem for institutions, particularly those operating cross border, is that there is limited uniformity in regulation, financial services regulators are at different stages in developing their ESG regulatory framework particularly in relation to disclosures and taxonomy. It is therefore critical that institutions monitor the latest announcements from the regulators.

The purpose of this updater is to track ESG regulatory developments from the period 6 January 2024 to 6 February 2025, from the United Kingdom, France, Europe Union, the Netherlands United States, Australia, and certain international regulators.

This month's highlights

28 January 2025 - FCA publishes climate change adaptation report 2025

The Financial Conduct Authority (**FCA**) published its Adaptation Report 2025, in which it responds to the Department for Environment, Food and Rural Affairs' (**DEFRA**) invitation to report on climate change adaptation challenges faced by financial services firms.

The report is based on informal engagement with financial services firms and the FCA's understanding of market dynamics, but the FCA flags that it is not a comprehensive assessment, and further research is needed to verify the findings. It also notes that the report is not intended to set out regulatory expectations for firms.

Issues

The FCA identifies 3 major issues affecting climate change adaptation in the financial services industry:

- Data and modelling to help financial services quantify and manage climate risks.
- Barriers and enablers to insurance underwriting for climate risks and, as a consequence, lending and investment.
- Barriers and enablers to financial services in allocating capital to adaptation.

Areas of focus

The report emphasises the need for financial services firms to adjust their risk management practices in response to climate change. It also highlights the crucial role of financial products in facilitating and supporting adaptation and transition within the broader economy. These two areas are closely connected, as a thorough understanding of climate risk is essential for both.

Additionally, the report warns that firms must protect their critical infrastructure, particularly IT systems, while ensuring that net-zero transition plans consider necessary adaptation.

United Kingdom

30 January 2025 - PRA publishes Climate Change Adaptation Report 2025

The Prudential Regulation Authority (**PRA**) has also published its Climate Change Adaptation Report 2025.

Background

This is the PRA's third climate change adaptation report, which has been produced in response to an invitation by DEFRA to participate under the fourth round of the climate change adaptation reporting power.

What is in the report?

The report sets out the PRA's response to the risks that climate change poses to its operations and policy objectives. It looks at the steps taken by banks and insurers since 2021 to respond to the impacts of climate change, and how the PRA's regulatory work has evolved in that period. The report also outlines several areas of focus for the PRA in the coming months.

The PRA notes that the current goal of the Bank of England's (**BoE**) policy work on climate change and the transition to net zero is to play a leading role in enhancing the resilience of the UK financial system and in understanding the impacts on the macroeconomy. As part of that work, the PRA is taking action to ensure that firms identify, measure, manage and, where outside risk appetite, mitigate the climate risks they face.

Areas covered in the report include:

- The role of the BoE and the PRA, as well as the PRA's role alongside other regulators and governments.
- Climate-related operational and financial risks to PRA-regulated firms.
- The PRA's response to climate-related risks, including how they have evolved and the PRA's latest view of firms' progress and preparedness.

Next steps

The PRA plans to update its supervisory expectations, with a consultation paper expected later this year seeking views on its proposals.

Once the final supervisory statement is published, the Climate Financial Risk Forum (an industry forum co-chaired by the PRA and the Financial Conduct Authority) intends, in due course, to provide a forum for industry to share experiences and build on its existing guidance and tools to help firms evolve their integration of climate risk consistent with the revised supervisory expectations.

The BoE also plans to continue, in parallel, to assess the potential build-up of systemic risks relating to climate change (as set out in the November 2024 Financial Stability Report), supported by continued collaboration in international fora in support of its statutory objectives and wider remit as they relate to matters of climate risk.

4 February 2025 - FCA speech on culture

The FCA published a speech delivered by its chief operating officer, Emily Sheppard, on the topic "Culture is contagious" at the 10th Annual Culture and Conduct in Financial Services Summit.

In the speech, Ms Sheppard explains that:

- Culture drives conduct and decision-making, which directly impact outcomes for consumers, markets and the economy. As a result, it will continue to be a regulatory concern for the FCA.
- The informed, responsible risk-taking that is required for long-term economic growth must be "built on a strong foundation of healthy firm cultures", as cultures that encourage open dialogue, constructive challenge and learning from failure, fuel innovation, agility and longer-term success.
- Non-financial misconduct (**NFM**) – including behaviours such as bullying, harassment and discrimination – is one of the clearest warning signs of a failing culture, and regulators have an important role to play in tackling these behaviours.
- The FCA is actively working with stakeholders to drive up culture and conduct standards.

In terms of actions to address concerns around culture, Ms Sheppard notes that:

- The FCA has been updating its rules and guidance on NFM and expects to set out more detail on its proposed next steps shortly.
- In relation to diversity and inclusion more broadly, the FCA and the PRA are considering the next steps following their consultation, including how their work dovetails with planned activity from the Government (e.g. on employment rights, gender action plans and disability and ethnicity pay gaps).
- Rules and guidance will not be enough on their own and firms will also need to take action when NFM occurs.
- The FCA is working alongside HM Treasury and the PRA on reviewing the Senior Managers and Certification Regime to make it "even more efficient and effective" and will publish a consultation paper in due course.

European Union

9 January 2025 - EBA Final Report – Guidelines on the management of ESG risks

The European Banking Authority (**EBA**) published a Final Report containing Guidelines on the management of ESG risks (the Guidelines).

The Guidelines address ESG risk management processes of 'financial institutions' (as per Article 4(1) point 3 of the Capital Requirements Regulation (**CRR**)) as part of their broader risk management framework. They specify robust governance arrangements financial institutions need to have in place in accordance with Articles 87a(1) and 74 of the Capital Requirements Directive IV (**CRD IV**) covering:

- The minimum standards and reference methodologies for the identification, measurement, management, and monitoring of ESG risks, in accordance with Article 87a(5)a) of the CRD IV.
- Qualitative and quantitative criteria for the assessment of the impact of ESG risks on the risk profile and solvency of institutions in the short, medium, and long term, in accordance with Article 87a(5)c) of the CRD IV.
- The content of plans to be prepared in accordance with Article 76(2) of the CRD IV by the management body, which includes specific timelines and intermediate quantifiable targets and milestones, in order to monitor and address the financial risks stemming from ESG factors, including those arising from the process of adjustment and transition trends towards the relevant Member States and EU regulatory objectives in relation to ESG factors, in particular the objective to achieve climate neutrality by 2050 as set out in Regulation (EU) 2021/1119, as well as, where relevant for international active institutions, third country legal and regulatory objectives, in accordance with Article 87a(5)b) of that Directive.

The Guidelines also complement and further specify the EBA Guidelines on internal governance and EBA Guidelines on loan origination and monitoring in relation to the management of ESG risks.

Next steps

The Guidelines will apply from 11 January 2026 except for small and non-complex institutions for which the Guidelines will apply at the latest from 11 January 2027.

17 January 2025 - EBA consults on draft guidelines on ESG scenario analysis

The EBA issued a consultation paper on draft guidelines on ESG scenario analysis.

The draft guidelines are addressed to Member State competent authorities and to financial institutions as defined in Article 4(1) of Regulation No 1093/2010 which are also institutions in accordance with Article 4(1) point 3 of the CRR.

The draft guidelines complement the EBA guidelines on the management of ESG risks, published on 9 January this year. The draft guidelines specify the criteria for setting the scenarios that institutions should use to test their resilience to the negative impacts of ESG factors, starting with climate factors, in accordance with Article 87a(5) of the CRD IV. The draft guidelines also complement the EBA guidelines on institutions' stress tests by specifying the way in which ESG factors, and in particular climate, should, over time, be integrated into stress testing programmes. In addition, the draft guidelines assist institutions resorting to the internal ratings-based approach in the use of scenarios that include ESG risks.

Next steps

The deadline for comments on the consultation is 16 April 2025.

The EBA will hold a virtual public hearing on the consultation paper on 17 March 2025 from 14:30 to 16:00 CET. The EBA invites interested stakeholders to register using this link by 13 March 2025 at 16:00. The dial-in details will be communicated to those who have registered for the meeting.

It is planned that the guidelines will be finalised by the second half of 2025 and apply from 11 January 2026 to institutions other than small and non-complex institutions (**SNCI**) and, at the latest, from 11 January 2027 for SNCI.

24 January 2025 - Building trust in transition: core elements for assessing corporate transition plans

The Platform on Sustainable Finance issued a report, Building trust in transition: core elements for assessing corporate transition plans.

The report provides initial analysis to support financial market participants' assessment of the core elements of transition plans, aligning with the European Commission's (**Commission**) Recommendation on Transition Finance. It identifies core elements for evaluating these plans, offering recommendations to the Commission for enhancing the effectiveness of its policy framework and supporting the market to provide and access transition finance.

The Platform on Sustainable Finance will present the report in a webinar on 27 January from 14:00 to 15:00 CET.

5 February 2025 - EU Platform on Sustainable Finance report: Simplifying the EU taxonomy to foster sustainable finance

The EU Platform on Sustainable Finance (**Platform**) issued a report Simplifying the EU taxonomy to foster sustainable finance.

The report builds on previous Platform work and responds to a Commission mandate to help simplify and improve the effectiveness of the framework of the Taxonomy Regulation by enhancing its usability. The report identifies key areas for improvement, including simplification, data access and coherence with other regulations. It offers recommendations to the Commission grounded in two years of market observations, pilot projects and outreach to stakeholders, including investors, credit institutions, insurers, corporates, small and medium-sized enterprises (**SMEs**), auditors and consultants, that are affected by the EU sustainable finance regulatory framework. The report also provides suggestions on areas that it believes should be prioritised during its next mandate.

The report makes four core proposals to the Commission for simplifying taxonomy reporting:

- More than one-third reduction in corporate reporting burden with:
  - Adjusting the operational expenditure key performance indicator (**KPI**) as a voluntary disclosure, except for research and development.
  - Introducing a materiality threshold for reporting the turnover, operational expenditure, capital expenditure KPIs and the combined KPIs of financial companies, in line with the Accounting Directive.
  - Enhancing the alignment with financial reporting.
  - Simplifying reporting templates, with a clear reduction of data points to limit the reporting to information that is relevant for making business decisions.
- A simplified green asset ratio that encourages green and transition lending:
  - Ensuring a symmetrical green asset ratio with similar numerator and denominator composition.
  - Simplifying retail exposure reporting, focusing on substantial contribution.
  - Allowing for estimates and proxies for reporting, in conjunction with safe harbours to protect against greenwashing allegations.
- The materiality principle should apply to the combined KPI for financial undertakings, excluding immaterial business segments not consolidated under the Accounting Directive.

- A practical approach to do no significant harm (**DNSH**) criteria:
  - Introducing a lighter compliance assessment process (regarding evidence of compliance, documentation and/or on EU regulations).
  - All DNSH criteria should be reviewed as part of the scheduled reviews of various delegated acts, prioritising their usability and practicality for financial and non-financial companies.
  - Introducing a "comply or explain" approach for DNSH assessment of the turnover key performance indicator, as a temporary measure.
- Helping SMEs access sustainable finance:
  - Adopting a streamlined and voluntary approach for banks and investors' exposures to unlisted SMEs.
  - Adopting a simplified approach to the EU taxonomy for listed SMEs.

France

7 January 2025 – AMF updates its policy following its decision to comply with ESMA guidelines on the names of ESG funds

The Autorité des marchés financiers (**AMF**) has decided to comply with the guidelines issued by the European Securities and Markets Authority (**ESMA**) on the names of funds using ESG, or sustainability-related terms. As such, AMF Position-Recommendation DOC-2020-03 has been amended.

The previous criteria for fund names have been replaced by those set out in the ESMA guidelines and extended to all collective investment undertakings, including funds reserved for professional clients, which are subject to the guidelines.

These guidelines applied from 21 November 2024 for funds created after that date and from 21 May 2025 for existing funds.

The changes also aim to clarify the interaction between these requirements for fund names and existing rules, in particular, for the marketing materials of French or foreign funds marketed in France to the retail investors. If a fund marketed to retail investors wishes to include terms relating to environmental, social and governance criteria, or to sustainability in its name, and communicate centrally on non-financial criteria in its marketing materials, it will have to comply with both the ESMA guidelines and the criteria of Position-Recommendation DOC-2020-03.

The Netherlands

There have been no reported updates this month.

United States- SEC and CFTC

There have been no reported updates this month.

Australia

20 January 2025 - New Green Aluminium Production Credit will support the transition to green metals

The AUS $2 billion Green Aluminium Production Credit, available from 2028–29, will support Australia's aluminium smelters to transition to renewable electricity.

The Australian Government has committed $1.5 million over 3 years. This will help shape and influence standards for green aluminium with our international partners and give technical expertise about definitions for other green metals.

Green metals are pivotal for global decarbonisation and if smelters can demonstrate significant decarbonisation before 2036, they can negotiate credit contract payable per tonne of green aluminium produced. In 2030, a review will be conducted to assess the effectiveness and market impact of the credit.

28 January 2025 - New ESG standards introduced by the AUASB

The International Foundation for Ethics and Audit (**IFEA**) has introduced two new directives as part of their 'crackdown' on greenwashing and ESG related fraud. These new standards aim to boost confidence and transparency, and better protect investors.

The first directive provides a framework for credible sustainability assurance. The second is described as a foundation for ethical mindset and trust.

In response, the Australian Auditing and Assurance Standards Board (**AUASB**) has set two new standards to take effect from January 2025:

1. Australian Standard on Sustainability Assurance (**ASSA**) 5000: Adopted from the IFEA's equivalent requirement, this standard provides general requirements for sustainability assurance engagements in Australia. The new standard aims to support confidence in information disclosed in the annual reports of Australia's largest companies.
2. ASSA 5010: Timeline for Audits and Reviews of Information in Sustainability Reports under the *Corporations Act*: This standard outlines slightly relaxed timelines for reasonable assurance over the transitional period.

The new standards permit internal auditors to directly assist sustainability assurance practitioners. In Australia, questions have been raised about whether this is best practice to preserve the independence and objectivity of the assurance process.

The AUASB is in the process of consulting with stakeholders to work out local modifications and consider whether a ban on internal auditors should be implemented.

International regulators – FSB, IOSCO, Basel Committee, NGFS, SASB, IFRS, ISSB

There have been no reported updates this month.

Resources

ESG is high on the regulatory agenda. Businesses, governments, regulators, financial services firms and individuals all have a part to play in tackling climate change and this view is increasingly shared across society. In terms of financial markets, investors are increasingly seeking sustainable financial products and ESG investing, traditional investing combined with sustainable or otherwise philanthropic aims, has seen huge growth in recent years. Regulated firms are also seeking to improve their own ESG performance more generally to build stronger relationships with their stakeholders, including those who use their services. Whilst the growing emphasis on ESG presents opportunities for financial services providers, it also brings with it a number of risks, which need to be properly managed with a view to avoiding future regulatory investigations and enforcement.

We have produced a number of resources, including articles, podcasts and newsletters, to help clients navigate this evolving, complex landscape:

Financial services: Regulation tomorrow

Our blog, Financial services: Regulation tomorrow offers a convenient resource for those keeping track of the evolving and increasingly complex global financial services regulatory environment.

Financial Services Regulatory Developments in ESG

Developed by our global financial services regulatory lawyers and integrated risk advisory group, our Financial Services Regulatory Developments in ESG Hub provides resources and insights to help clients stay informed of key regulatory developments in the sector.

ESG and Sustainability Insights newsletter

Our ESG and Sustainability Insights newsletter brings together recent insights and resources on key topics affecting your business, including climate change and regulation, business and human rights, sustainable finance, energy transition and more.

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