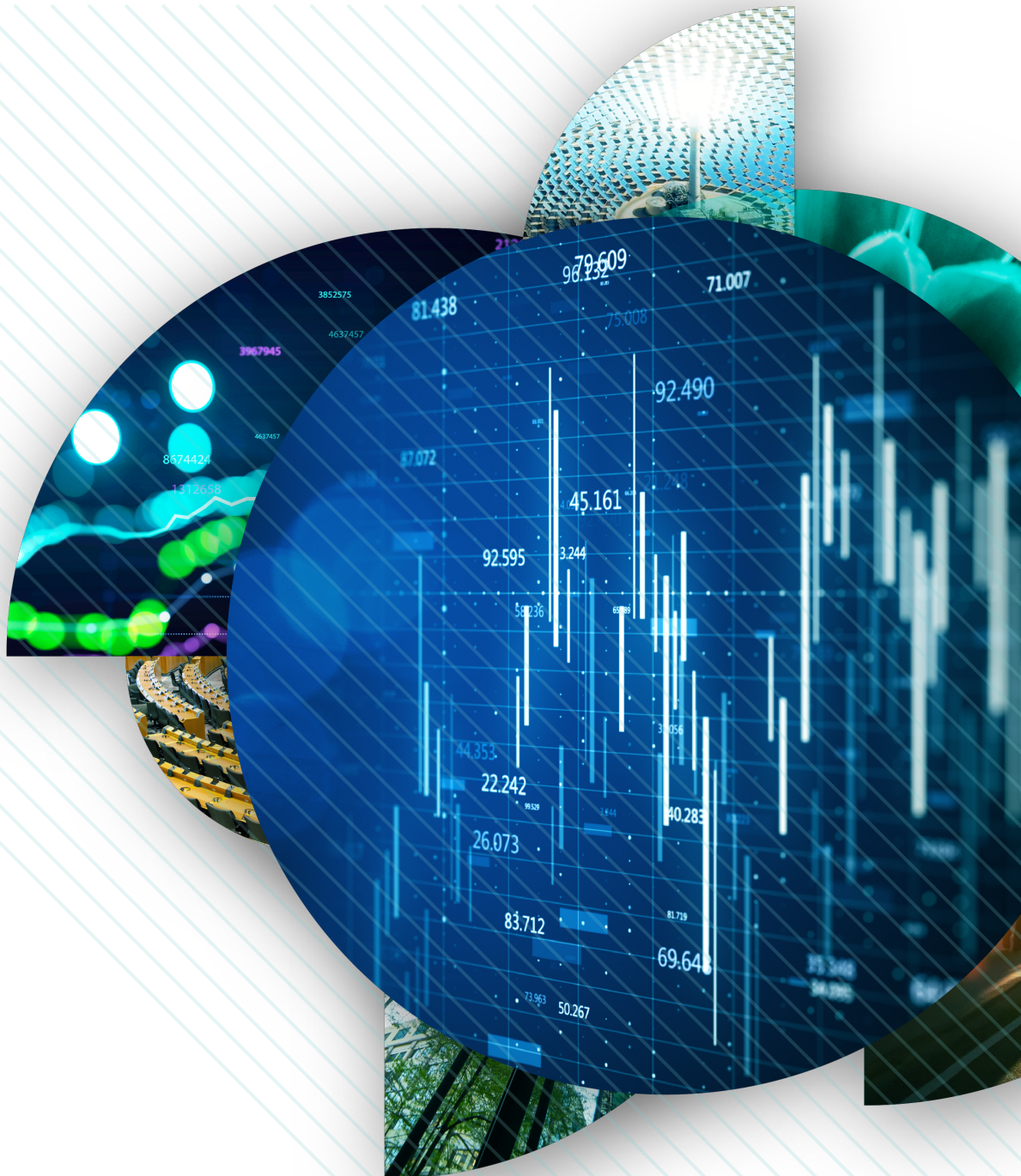


Financial Services regulatory ESG updaters

6 July – 6 August 2024



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 July 2024 to 6 August 2024, from the United Kingdom, France, European Union, the Netherlands, United States, Australia, and certain international regulators.

This month's highlights

July 2024 – The future of the SFDR – views from market participants

Introduction

The Sustainable Finance Disclosure Regulation (**SFDR**) was introduced, alongside other regulations, as part of a package of legislative measures arising from the European Commission's (**Commission**) action plan on financing sustainable growth. It entered into force on 10 March 2021, and is now part of an EU sustainable finance framework that includes in particular (i) Commission Delegated Regulation (**EU**) 2022/1288 of 6 April 2022 which provides a standardised framework for compliance with the disclosure duties set out in SFDR and (ii) the EU Taxonomy (collectively, the **SFDR Framework**).

The SFDR Framework requires 'financial market participants' (**FMPs**) and financial advisors (within scope of the SFDR) in the European Union (EU) to disclose, inter alia, how environmental, social and governance (**ESG**) factors are integrated and/or promoted in the investment process of 'financial products' (**FPs**) they manage/advise, both at FMPs/financial advisors and FPs levels.

With the objective of conducting a comprehensive assessment of the SFDR Framework, Commissioner Mairead McGuinness organized, between September and December 2023, open and targeted consultations in which stakeholders could share their perspectives on the current state of play and their expectation for its future. Forty-five questions were asked throughout the consultations, divided into 4 thematic sections. In total, 324 organisations and individuals participated in the targeted consultations, mostly FMPs, financial advisers, and non-governmental organization (the **NGOs**), predominantly from EU Member States.

On 3 May 2024, the Commission published a summary of the responses received in the course of the consultations, noting that this summary does not reflect the views of the Commission itself. Below is a high-level overview of the feedback received by the Commission on some of the key issues covered by the consultations.

Current requirements of the SFDR Framework

If respondents largely agree that the relevance of the SFDR Framework is no longer in question, they totally or mostly agree that it is not being used solely as a disclosure framework, as intended by the European legislator, but is also being used as a labelling and marketing tool.

Regarding its effectiveness in protecting end investors, the framework currently lacks clarity in its requirements and concepts, such as the concept of "sustainable investment" under the SFDR, making it challenging for financial actors to comply with the said requirements. This could lead to legal uncertainties, as well as reputational risks for FMPs and financial advisers, and risks of greenwashing and mis-selling.

One of the main difficulties brought to the table by respondents is obtaining high-quality data which is key to complying with the disclosures and reporting requirements under the SFDR Framework. Many respondents reported that they were engaging extensively with investee companies to encourage reporting of missing data.

When asked about the cost of the required disclosures under the SFDR Framework, more than half of the respondents indicated that they do not consider it proportionate to the benefits generated.

Interaction with other pieces of sustainable finance legislation

The SFDR Framework integrates and/or interacts with a wide range of EU directives and regulations, through the introduction of new regulations or amendments to existing ones. Among these can be listed, inter alia, (i) the Benchmarks Regulation (**BMR**) (ii) the Corporate Sustainability Reporting Directive (**CSRD**), (iii) the Markets in Financial Instruments Directive II; and (iv) Insurance Distribution Directive.

The SFDR Framework is a wide EU nexus of directives and regulations which should work together, in particular to ensure common and clear disclosures to retail investors. Respondents highlighted the necessity of aligning certain definitions between these pieces of legislation, in particular between the SFDR, the EU Taxonomy, and the BMR, in order to prevent confusion among retail investors. For the CSRD, the same conclusion was reached: the definitions need to be further harmonised, and there is still room to streamline FMPs-level disclosure requirements under the SFDR and the CSRD, especially regarding the future sectoral European Sustainability Reporting Standards (**ESRS**) for use by all companies subject to the CSRD.

Potential changes to disclosure requirements for FMPs and financial advisors

Entity-level disclosures

There is definitely a split across the different respondents' groups on whether the SFDR is the right place to set entity-level disclosure requirements for FMPs and financial advisors. While most FMPs and financial advisors do not consider it to be the right one, a majority of NGOs did express their support in having such disclosures. The usefulness of the 3 sets of the SFDR entity-level disclosures is also a split (the sets being: sustainability risk policies, sustainability impacts and remuneration policies), those in favour claimed that they provide valuable information to investors and the civil society, allowing them to assess the sustainability ambition of an FMP/financial advisor and serving as a tool against greenwashing, whereas those against claimed that they are not appropriate or useful to end-investors.

Product level disclosures

Half of the respondents agree that the EU should impose uniform disclosure requirements for all FPs offered in the EU, regardless of their sustainability claims. They argue that it would avoid sustainable FPs to be disadvantaged by more reporting burdens and costs as well as enhancing transparency and comparability for investors. But some expressed the opposite view, as it would in their opinion impose unnecessary costs on products without sustainability claims. When asked about what these disclosures should be, respondents mostly mentioned climate, diversity, and human rights as topics to be covered by such disclosures.

If most of the respondents agree that FPs with sustainability claims should be required to substantiate their claims with additional disclosure to ensure credibility and prevent greenwashing, there is less support among the respondents for imposing uniform disclosure requirements for some financial products regardless of their sustainability-related claims.

Potential establishment of a labelling system for FPs

Views on the potential establishment of an EU labelling system

Respondents largely support setting up a labelling system regulated at the EU level, which they believe is necessary for an efficient distribution system based on investors' sustainability preferences, to combat greenwashing, and to facilitate professional investors and retail investors understanding of products' sustainability-related strategies and objectives. Also, respondents supported the introduction of product labels being accompanied by specific rules on how market participants must label and communicate their products.

In such a scenario, where a labelling system is launched, respondents favoured including the relevant label in key information documents for packaged retail and insurance-based investment products, in an effort to further ensure that retail investors have access to uniform disclosures. Furthermore, were new EU ESG benchmarks be developed, a majority of respondents indicated their expectation that the criteria applicable to such benchmarks be closely aligned with the criteria applicable under the labelling system, noting that any fund tracking an EU climate benchmark (i.e., Paris-aligned benchmark/ Climate transition benchmark) should automatically fall under one of these future labels.

General views on the two proposed approaches

Respondents were asked whether they would prefer:

- Approach 1: a system that splits labels in a different way than according to existing concepts and categories under the SFDR (the so-called Articles 6, 8 and 9 categories under the SFDR); or
- Approach 2: a labelling system converting the above mentioned SFDR categories into formal product labels, clarifying and adding criteria to underpin the existing concepts of the SFDR.

Ultimately, no clear preference was found among respondents, but a large number indicated they would be in favour of a hybrid approach combining established SFDR concepts and categories with a voluntary labelling framework.

Next steps

Following the European Parliament elections, the new Commission is expected to publish a full review report with possible proposals for amending the SFDR by the end of 2024, although the priorities of those newly elected at the European Parliament will definitely be key in shaping the timing and the substance of any amendments. Firms will be keeping a close eye out for the report particularly as regards the possibility of the EU establishing a labelling system.

See more information [here](#).

17 July 2024 - New Regulation Tomorrow Plus Podcast: DE&I series "Non-financial misconduct"

In the sixth podcast in our DE&I series, Jonathan Herbst, Katie Stephen, Rebecca Dulieu and Simon Lovegrove discuss non-financial misconduct including previous FCA enforcement action, the FCA's proposals in CP23/20 and the practical steps that firms can take in this area. The podcast is the first in a planned mini-series that will focus on this complex and evolving topic.

Listen to the podcast [here](#).



United Kingdom

12 July 2024 - New briefing note - FRC Plan 2024-2025: Enforcement Aspects

Earlier this year the UK Financial Reporting Council (FRC) published its plan and budget for 2024-25 (the **24-25 Plan**), setting out its revised strategic objectives. The FRC is aiming for a year of "consolidation and prioritisation", with a key priority being to further embed the FRC's 'growth duty' into all regulatory decision making. We have published a new [briefing](#) which considers the enforcement aspects of the 24-25 Plan, including the FRC's key enforcement deliverables for the months ahead.

Enforcement often follows supervisory priorities and one area of particular note from the Supervision section of the 24-25 Plan is that the FRC intends to collaborate with the FCA in the monitoring of mandatory climate risk disclosures.



European Union

24 July 2024 - ESMA opinion on the functioning of the Sustainable Finance Framework

The European Securities and Markets Authority (ESMA) published an [opinion](#) on the functioning of the EU Sustainable Finance Framework, setting out possible long-term improvements. The opinion is the last component of ESMA's reply to the European Commission's (Commission) request for input related to greenwashing, next to the final report on greenwashing.

In summary the main recommendations of the opinion include:

- The EU Taxonomy should become the sole, common reference point for the assessment of sustainability and should be embedded in all Sustainable Finance legislation.
- The EU Taxonomy should be completed for all activities that can substantially contribute to environmental sustainability and a social taxonomy developed.
- The Sustainable Finance Disclosure Regulation (SFDR) definition of 'sustainable investments' should be phased out.
- A definition of transition investments should be incorporated into the Framework to provide legal clarity and support the creation of transition-related products.
- All financial products should disclose some minimum basic sustainability information, covering environmental and social characteristics.
- A product categorisation system should be introduced catering to sustainability and transition, based on a set of clear eligibility criteria and binding transparency obligations.

- ESG data products should be brought into the regulatory perimeter, the consistency of ESG metrics continue to be improved, reliability of estimates ensured.
- Consumer and industry testing should be carried out before implementing policy solutions to ensure their feasibility and appropriateness for retail investors.
- ESMA is of the view that the Commission could consider putting in place a stewardship code at EU level that would apply to asset managers and institutional investors but also other market actors such as benchmark administrators and investment service providers, leveraging off existing stewardship codes in other jurisdictions.

25 July 2024 - ESAs update consolidated Q&As on the SFDR

The European Supervisory Authorities (ESAs) issued an [updated version](#) of its consolidated questions and answers on the SFDR and the SFDR Delegated Regulation.

The ESAs have added answers to a number of new questions including:

- For financial products falling under Article 8 or 9 SFDR, where the financial market participant making available those products is a registered AIFM which has not set up a website, must that registered AIFM establish a website in order to comply with Article 10 of SFDR and Chapter IV of the SFDR Delegated Regulation for those financial products
- Can a financial market participant rely on disclosures under Article 6(1) second sub-paragraph of the SFDR (which allow financial market participants to disclose in pre-contractual disclosures that it "deems sustainability risks not to be relevant" for its investment decisions) in order to disapply other obligations on taking into account sustainability risks in EU law, such as Article 18(5) of Commission Delegated Regulation (EU) No 231/2013 which requires Alternative Investment Fund Managers to take into account sustainability risks when complying with their due diligence obligations?

- As regards Article 4(4) of Regulation 2019/2088, must the calculation of the 500-employee threshold to the parent undertaking of a large group be applied to both EU and non-EU entities of the group without distinction as to the place of establishment of the group and/or subsidiary and does the due diligence statement include impacts of the parent only or must it include the impacts of the group at a consolidated level?
- Should PAI indicator 4 in Table 1, Annex I of the SFDR Delegated Regulation (“Exposure to companies active in the fossil fuel sector”) be calculated on a look-through (i.e., share of fossil fuel activities) or pass/fail (i.e., whole company active within the fossil fuel sector) basis? I.e., is there a threshold level of fossil fuel related economic activity required before a company becomes “active in the fossil fuel sector” or is any activity sufficient to make a company “active in the fossil fuel sector”?
- How should values in currencies other than EUR be converted to EUR? E.g., at the point of reporting, the point of the impact or an average value in EUR of values in currencies converted to EUR at different reference points over the entire reference period.
- Can a sustainable investment pursuant to Article 2(17) SFDR also be made by investing in another financial product, e.g., a UCITS fund?
- An analysis into the solution space by focusing on risk reduction, risk sharing and risk transfer approaches, such as public-private partnerships and other insurance-based solutions, including evolving insurance-based approaches that have the potential to overcome some of the barriers of the climate protection gap (chapters 3 and 4).
- A deep-dive into the main climate-related perils in Europe, covering floods, wildfire, heatwave, drought and storms, including lessons, good practices, and potential solutions stemming from past events that could be implemented to increase climate resilience (chapter 6).

30 July 2024 - Climate Resilience Dialogue – final report

The Climate Resilience Dialogue published its [final report](#).

The Climate Resilience Dialogue is a temporary group of stakeholders set up at the initiative of the Commission to discuss ways to narrow the climate protection gap and increase the resilience of the economies and societies to the effects of climate change.

The final report provides:

- A brief overview of the main climate-related perils and hazards to which people, businesses, and assets are exposed and vulnerable to today in Europe (chapter 1).
- An analysis of the key contributing factors of the climate protection gap, encompassing risk awareness, risk assessment and other supply and demand factors such as affordability of the premiums, mistrust vis-à-vis insurance and limits to the insurability of risks (chapter 2).



France

11 July 2024 – The AMF publishes the findings of three supervisory initiatives on sustainable finance

The Autorité des Marchés Financiers (AMF) published the [findings](#) of three supervisory initiatives on sustainable finance.

As part of its 2023-2024 supervisory priorities, the AMF set itself the objective of stepping up its efforts to promote more sustainable finance, both in terms of financial products and their marketing. As such, the AMF has analysed how a panel of asset management companies have structured themselves to take account of the risks associated with sustainability.

The AMF has highlighted the following findings:

Implementation of the SFDR regulation by a panel of asset management companies

- The AMF has noted an increase in human resources, devoted by management companies, to the implementation of the SFDR, with the establishment of ESG analysts and internal committees dedicated to the deployment of ESG policy.
- All portfolio management companies in the panel apply an ESG/SRI assessment method for the issuers in which they wish to invest.
- The management companies in the panel have all published their SRI/ESG methodology on their websites. However, none of the audited companies are in full compliance with the SFDR regarding the information required, both at the entity level and at the level of the funds. Missing information is due, in particular, to a lack of available relevant external data and / or insufficient history of such data.

Commercial documentation of undertakings for collective investment (UCIs)

- The institutions in the panel did not take much ownership of the commercial documentation, let alone the specific requirements for communication on non-financial matters. As a result, distributors rely too heavily on the due diligence of producers.
- The AMF reiterates that distributors must ensure that the marketing documentation they distribute is clear, accurate and not misleading, even in the case where they are merely relaying the promotional documents produced by the producing management company.
- With regards to funds incorporating non-financial aspects, the AMF noted anomalies in the consistency of the elements between the regulatory documents and the promotional communications and, in the case of certain foreign funds distributed by distributors of the panel (mainly composed of private banks), the absence of warnings required by the AMF's doctrine.

Observations on sustainable thematic funds

- The AMF carried out a study on the regulatory and commercial documentation of 52 sustainable thematic funds, representing €64 billion in assets under management marketed in France to retail clients. The AMF observed inadequacies between the funds' contractual commitments, the ability to have adequate data and the communications made on the sustainability of these thematic funds by distributors and asset management companies.

24 July 2024 – AMF publishes summary of SPOT inspections of the promotional material for French and foreign CISs marketed by distributors – focus on ESG aspects

In its 2023-2027 strategic guidelines, the AMF announced that it would continue its commitment to promoting more sustainable finance. As part of this process, a series of short, thematic inspections (SPOT) have been carried out on the marketing materials of collective investment schemes (CISs), with a focus on extra-financial criteria.

The AMF has now published a [summary](#) of the SPOT inspections.



The Netherlands

16 July 2024 - Dutch regulator provides insights into CSRD reporting

The Corporate Sustainability Reporting Directive (CSRD) will come into effect for large, listed companies for the 2024 financial year. According to the Dutch Authority for the Financial Markets (*Autoriteit Financiële Markten*, AFM) an important part of the CSRD is the double materiality analysis. The aim is to demonstrate what effect a company has on the outside world (impact materiality) and how sustainability matters can have an effect on the wellbeing of a company (financial materiality). Moreover, the double materiality gives insight into the impact, opportunities and risks in the field of sustainability and can provide input for the strategic direction of a company.

To gain insight into how listed companies already provide information regarding the double materiality in current annual reports, the AFM conducted research into annual reports of 29 companies. Based on this research, the AFM prepared a report with three categories with a total of 10 waypoints to support companies on implementing the double materiality analysis in their reporting:

- Stakeholder engagement: show the manner in which stakeholders are engaged
 - Be transparent on the representativeness of stakeholder engagement.
 - Disclose input received from stakeholders.
- Due diligence: identify the sustainability matters
 - Use due diligence to identify sustainability matters.
 - Use international frameworks, such as the OECD [Guidelines](#).
 - Disclose the relationship between due diligence and the double materiality analysis.

- Double materiality analysis: disclose the analysis in a transparent manner
 - Disclose the role of the value chain.
 - Connect the business activities to identified material topics.
 - Provide insight into the materiality assessment of sustainability topics.
 - Disclose the materiality of impacts, risks and opportunities.
 - Report on the relationship between impact and risk in the short and long term.

The AFM will assess how companies deal with this CSRD requirement in their supervision on annual reporting for the 2024 financial year.

See more information [here](#).



United States- SEC and CFTC

8 July 2024 - SEC lays out upcoming rulemaking agenda

In its Spring Unified Agenda of Regulatory and Deregulatory Actions, the Securities and Exchange Commission (**SEC**) outlined short-and-long-term regulatory actions that administrative agencies plan to take.

The agenda is organized under two sections: (i) Proposed Rule Stage and (ii) Final Rule Stage. There are 15 rules at the proposal stage, including among them, rulemaking on corporate board diversity, human capital management disclosure, incentive-based compensation, fund fee disclosure and exchange traded products. There are 19 in the final rule stage, including among them, enhanced disclosures by advisers on ESG practices, cybersecurity risk management, adviser outsourcing, best execution and security-based swap position reporting, to name a few. See complete agenda [here](#).



Australia

8 July 2024 – ACCC draft guidance on “Sustainability collaborations and Australian competition law”

The Australian Competition and Consumer Commission (**ACCC**) has released their [‘Sustainability collaborations and Australian competition law’](#) guide, which provides guidance on the steps businesses should take when considering a sustainability collaboration, including recognising when they may be at risk of breaching competition law and how to apply for exemption (known as ‘authorisation’).

The draft guidance acknowledges that while businesses may contemplate working together to achieve positive environmental or sustainability outcomes, they may be a risk of breaching prohibitions in the [Competition and Consumer Act 2010 \(Cth\)](#) relating to cartel conduct and other anti-competitive practices which have the purpose, effect, or likely effect of substantially lessening competition in a market in Australia.

Recognising the “clear need for urgent action on environmental sustainability” and that “competition law should not be seen as an immovable obstacle for collaboration on sustainability that can have a public benefit”, the ACCC may grant authorisation for businesses to be exempt from competition law provisions if it is satisfied that the likely public benefit resulting from the proposed conduct or agreement outweighs the likely public detriment. The current authorisation test is sufficiently broad and flexible to enable the ACCC to take environmental sustainability benefits into account.

The draft guidance is open for consultation and a finalised guide is expected to be published in late-2024 following the ACCC’s consideration of submissions.

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

16 July 2024 - NGFS publishes an information note on “Improving Greenhouse Gas Emissions Data”

The Network for Greening the Financial System (NGFS) published an [information note](#) on improving greenhouse gas emissions data.

The information note:

- Outlines the use cases of Greenhouse Gas (GHG) emission data by supervisors, regulators and central banks. It describes the different countries' experience about the availability, sources, metrics, classifications and/or categorizations, methodologies of granular GHG emission data.
- Identifies the limits of the information currently being used by supervisors, regulators and central banks, drawing on insights and challenges from the different member's experiences.
- Consolidates the ideas and good practices being developed to bring some solutions to the challenges in building emission data.

18 July 2024 - FSB report – Stocktake on Nature-related Risks: Supervisory and regulatory approaches and perspectives on financial risk

The Financial Stability Board (FSB) issued a [report](#) providing a stocktake of member financial authorities' initiatives related to the identification and assessment of nature-related financial risks.

The report draws on a survey of participating FSB members and the work done by international organisations on nature-related risks. It summarises current and planned regulatory and supervisory initiatives, and presents the key challenges for authorities in identifying, assessing and managing nature-related financial risks. The report also includes some case studies on initiatives by authorities and international organisations.

Among other things the report notes that those embarking on analytical work face major data and modelling challenges and in particular there is a lack of reliable and consistent data on financial exposures to nature risks. Regulatory and supervisory work is also at an early stage globally, and approaches differ considerably across jurisdictions and institutions. Supervisory guidance, where it exists, typically covers nature-related risks as part of an overall focus on environmental risks, including climate, and specific guidance on nature-related risks is often less detailed than on climate-related risks.

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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