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Issues Affecting Sustainable Finance in 2022

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In the last few years, regulators in the European Commission (EC or the "Commission") have written and implemented a broad array of new obligations, particularly with regard to financial products and climate disclosures, to address the evolving importance of environmental, social and governance (ESG) considerations across all aspects of European economic activity. For instance, the Sustainable Finance Disclosure Regulation (SFDR) adopted by the Commission requires fund managers to disclose how they integrate sustainability risk in their investment decision-making processes, as well as certain pre-contractual disclosure requirements covering a specific fund or product. The SFDR is intended to enhance transparency and comparability of sustainability information with the financial markets by standardizing disclosures in order to prevent "greenwashing." Relatedly, the Taxonomy Regulation sets out a clear framework to assess which activities and investments are environmentally sustainable. The Taxonomy Regulation requires additional disclosures with regard to whether a fund or product is "light green" or "dark green." These new regulations have required fund managers to evaluate fund and product development policies and procedures to ensure that relevant and reliable information can be captured and disclosed in accordance with the new requirements. In light of these new requirements, boards of directors and relevant board committees are needing to reassess risk assessment methodologies and financial disclosure systems to more closely track the intersection of sustainable product offerings to ensure compliance with these new requirements.

Across the channel, regulators in the United Kingdom have undertaken their own rule-making initiatives on these matters, now that the U.K. is no longer a member of the European Union. For instance, the U.K.'s Financial Conduct Authority (FCA) has issued rules focused on enhancing transparency on climate-related risks and to align the disclosure requirements with the recommendations of the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD). The proposed new disclosure requirements for investment managers were published at the same time as the proposal to extend certain climate-related disclosure requirements to issuers of standard listed equity shares (excluding shell companies and investment entities). Relatedly, as we have previously discussed, in November 2021, the FCA moved forward with its plan to make the U.K. the world's "first net zero-aligned financial centre" by publishing Primary Market Bulletin 36.

In the United States, stakeholders are waiting for the SEC to publish updated disclosure requirements relative to ESG considerations, including what are expected to be enhanced disclosure obligations relative to risks posed by climate change. These new disclosure obligations are expected to be consistent with public statements by SEC Chair Gary Gensler and other SEC commissioners with respect to seeking to ensure that public companies are collecting and disclosing credible, comparable data and metrics relative to ESG principles and investment goals. In addition, the markets continue to witness the evolution of, and demand for, financial products and commercial transactions that are underpinned by ESG principles and demand for sustainable investment opportunities continues to rise dramatically. For example, commercial banks have begun to offer sustainability-linked lending products, including incentives to meeting certain targets. While incentives have thus far been relatively modest, incentives to meeting sustainability-linked targets may increase as the market continues to evolve. In addition to a robust marketplace, many companies are finding when they enter into certain ESG transactions that they're able to achieve cost-savings or profitable transactions in addition to achieving their ESG goals. Whether it is energy savings or purchasing carbon or renewable energy offsets, many such ESG transactions present a win-win scenario where a company can achieve its ESG goals while also generating revenue (or savings) for more ESG initiatives or a return on their ESG investment.

On that basis, the question is not whether companies and their boards of directors need to be prepared to address these matters; it is only a question of how quickly and thoughtfully can they do so. We believe boards of directors in the United States should be working now with senior management and outside advisors in order to continue addressing these issues. Smart boards of directors should be working with management and advisors to ensure that existing financial disclosure processes and procedures will be ready to integrate enhanced disclosure obligations into their public reporting. This work should include evaluating the collection of, and controls around, relevant data and metrics that will likely be included in disclosures going forward. Likewise, boards of directors—both as a whole and through board committees—should ensure that they are conversant with enterprise commitments to ESG principles and how a company is performing relative to those commitments. Relatedly, directors should continue to be mindful of how they communicate with shareholders, particularly relative to being held to account for how a company integrates sustainability and ESG considerations into its long-term strategic growth and operations. Finally, boards of directors should confer with legal and compliance personnel (as well as advisors) to ensure that a company is prepared to defend itself against evolving litigation strategies that intend to drive companies toward a more fulsome embrace of sustainable growth strategies. Taken together, boards of directors that proactively address these issues are more likely to realize significant returns when it comes to pursuing sustainable financing and opportunities for growth.

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