GIBSON DUNN

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GIBSON DUNN ENVIRONMENTAL, SOCIAL AND GOVERNANCE UPDATE (MAY 2023)

To Our Clients and Friends:

We are pleased to provide you with Gibson Dunn's ESG monthly updates for May 2023. This month, our update covers the following key developments. Please click on the links below for further details.

I. International

1. PRI Minimum requirements reporting guidance on human rights

In May 2023, the United Nations Principles for Responsible Investment ("**PRI**") released a report on "Minimum Requirements for PRI Investor Signatories", which provides guidance to accompany the Policy, Governance and Strategy module of the 2023 Reporting Framework. The report outlines minimum requirements that investment managers and asset owner signatories must satisfy in their annual reporting obligations to PRI and can be used as a tool to determine whether companies are meeting certain mandatory key performance indicators. The guidance comprises three minimum requirements: (i) responsible investment policy – investor signatories must have formalised structures in place for responsible investment and more than the majority of assets under management must be covered by guidelines on ESG factors, (ii) senior-level oversight and accountability – senior individuals within an organization must have official oversight for the execution of a responsible investment strategy and any related policies and objectives, and be held accountable if such targets are not achieved, and (iii) responsibility for implementation – at least one individual within an organization must manage the organisation's overall performance in relation to its responsible investment strategy by fostering a forward-thinking and ESG-aware approach to investment decisions, ensuring that the business has robust ESG policies in force and/or seeking opportunities to improve the existing ESG practices of holdings, policy makers, or other key stakeholders through voting and engagement.

2. SBTN releases first corporate science based targets for nature

On May 24, 2023, the Science Based Targets Network ("**SBTN**") announced the release of inaugural science-based corporate targets for nature and biodiversity in an effort to encourage companies to voluntarily assess and prioritise their environmental impact and to set specific targets to address these issues. This follows initial guidance published in September 2020 and is the first release, which forms part of a multi-year plan to equip all businesses with comprehensive objectives founded on scientific research. In addition, the first release is just the beginning of SBTN's journey in supporting companies in setting nature targets with scientific backing, and such targets which continue to widen in scope in line with science and technology progress. A paper that explains the inclusion of biodiversity in the first release has also been published as well as initial guidance on local stakeholder engagement.

II. United Kingdom

1. Heightened consumer protection obligations for UK businesses

New regulatory obligations for the UK Consumer Duty ("**CD**") are due to come into force on July 31, 2023. This follows the publication of the final rules and guidance on July 27, 2022, which sets expectations to mitigate the risks to retail consumers investing in financial products and services. The CD applies to the regulated and ancillary activities of all firms authorised under the Financial Services and Markets Act 2000, the Payment Services Regulations 2017 and E-money Regulations 2011. Firms should now have completed their reviews to ensure that they align with the new regulations under the CD, which set higher and clearer standards of consumer protection for financial institutions. The new rules seek to ensure that consumer needs are prioritised by introducing: (i) a new Consumer Principle, which requires institutions to deliver positive outcomes for retail consumers, (ii) 'cross-cutting rules' with increased clarity to help businesses understand the four outcomes (which relate to (a) products and services, (b) price and value, (c) consumer understanding, and (d) consumer support) and (iii) requirements which reflect key components of the business-to-consumer relationship, which are central in driving good outcomes for customers. The underlying principle of the CD is reasonableness. This is an objective standard, which necessitates that firms act prudently, honestly and equitably in their dealings with consumers. Businesses have therefore been advised to incorporate their CD obligations into the relevant updates they are implementing to meet their ESG obligations to ensure that both sets of conditions are satisfied prior to the implementation deadline of the CD.

2. FRC introduces new corporate governance code and changes to audit committee

The Financial Reporting Council ("**FRC**") launched an ongoing public consultation on May 24, 2023, on proposed revisions to the UK Corporate Governance Code (the "**Code**"). The purpose of the review is to strengthen the Code's effectiveness in promoting good corporate governance, which plays a fundamental role in assessing sustainability-related risks and opportunities, and setting targets using internal controls, assurance and resilience. Five areas of development were identified in the report: (i) a revision to the sections of the Code which deal with the requirement for a framework of prudent and effective controls to provide a more solid springboard for reporting on and evidencing their effectiveness, (ii) emphasis on the importance of the board and audit committee's responsibility for sustainability and ESG reporting and appropriate assurance in accordance with the company's audit and assurance policy, (iii) the launch of the new Audit Committee Standard into the Code, (iv) an improvement to the application of comply-or-explain, where reporting is currently weaker, to reflect the latest FRC research and reports and (v) the relevance of the Code in remaining up to date with developments to legal and regulatory requirements as detailed in the UK government's response to the White Paper, including enhanced reporting on malus and clawback arrangements.

On ESG matters, the Code underlines the importance of management adopting a considered approach to investment decisions by factoring environmental and social impact into how the company generates and maintains long-term growth, and to ensure that remuneration outcomes are clearly aligned to the company's ESG objectives and overarching strategy. In addition, audit committees will need to report on how ESG targets were addressed and commissioned by the board in their annual report and conduct a review of sustainability matters. The consultation is expected to close on September 13, 2023, following which, the Code is anticipated to apply to accounting years commencing on or after January 1, 2025, to enable adequate time for implementation. The Code will form part of a broader reform package that seeks to improve accountability and therefore increased confidence by 'Restoring trust in audit and corporate governance' and supporting sustainable investments and stewardship decisions in the UK.

III. Europe

1. Update on the EU Artificial Intelligence Act

A draft negotiating mandate was adopted by the Internal Market Committee and Civil Liberties Committee on May 11, 2023, which sets out inaugural rules for artificial intelligence ("**AI**") with 84 votes in favor, seven against and 12 abstaining. Members of European Parliament ("**MEP**") are aiming to strike a balance between fostering AI innovation and protecting the general public. To that end, AI systems must be overseen by people and be used in a safe manner which is environmentally-friendly, transparent and traceable and not discriminatory or invasive. The mandate promotes the human-centric and ethical development of AI in Europe through a risk-based approach to the nascent technology. The environment has been identified as a high-risk AI area, which requires immediate and enhanced protection of fundamental rights, as well as an ongoing assessment of AI's impact on the environment to mitigate such risks and to ensure compliance. MEPs have also included a list of prohibited intrusive and discriminatory uses of AI systems such as "real-time" remote biometric identification systems in public spaces and biometric categorization systems using sensitive characteristics such as gender, race, ethnicity, religion or political orientation. Before negotiations can commence on the final legislation, this draft-negotiating mandate needs to be unanimously supported by Parliament. The vote is expected to take place during the week commencing June 12-15, 2023.

2. Sustainable finance package to come in June 2023

A significant sustainable finance package is due to be published later this month by the EU as part of their long-term vision to make Europe climate-neutral by 2050. The EU's financial services chief has said that the package will include a proposal on ESG ratings as well as new secondary legislation under the EU's classification of economic activities eligible for green finance; its 'green taxonomy.' The proposal on the green taxonomy will comprise of guidance and six environmental objectives to make the framework more accessible and to encourage transition finance. The framework has been criticised, however, from businesses claiming that it is difficult to measure how green they are, using the classifications, whilst others oppose the deeming of certain nuclear and gas projects as 'transitional' activities, justifying green investment. The legal challenges are currently ongoing. There are plans for the EU executive to publish standards on sustainability reporting shortly following the release of the June package. The standards, which will implement the Corporate Sustainability Reporting Directive, will include further detail on disclosure requirements and will expand the scope of these requirements to a greater number of EU companies. It is expected that there will be a delay to the release of the second set of standards in order to allow companies to implement the upcoming measures.

3. EU Parliament adopts new deforestation regulation

The final text of a new EU Regulation aimed at tackling deforestation and forest degradation was adopted by the European Parliament on April 19, 2023 (the "**Deforestation Regulation**"). Under the Deforestation Regulation, companies will be required to conduct due diligence into the origin of a range of commodities, including cattle, cocoa, coffee, palm oil, rubber, soya and wood, to verify that they have not be obtained through deforestation. The purpose of the Deforestation Regulation is to address the growing rate of deforestation and degradation, and will form part of the European Green Deal initiative, which includes proposals to ensure that EU consumption does not contribute to worldwide deforestation and forest degradation. The Deforestation Regulation will repeal and replace the existing regime under the EU Timber Regulation (995/2010/EU) and will cover a much broader scope than the former legislation. Before offering products to the EU market, businesses will be required to ensure that products are 'deforestation-free' by submitting a due-diligence statement to the authorities before placing products on the market or exporting products to confirm that an adequate verification procedure has been conducted and to identify the source of the commodities used in respect of such products. The level of due diligence will be subject to a benchmarking exercise set out by the EU, which will assess countries based on their current risk of deforestation and forest degradation. Once in effect, businesses will have 18 months to implement the new rules, meaning that the Deforestation Regulation will likely be applicable from early 2025.

4. ESAs publish progress reports on greenwashing in the financial sector

On May 31, 2023, the three European Supervisory Authorities (i) the European Banking Authority ("**EBA**"); (ii) the European Insurance and Occupation Pensions Authority ("**EIOPA**"); and (iii) the European Securities and Markets Authority ("**ESMA**") (collectively, the "**ESAs**") published a Progress Report on the risks associated with greenwashing (the "**Report**"), with a formal press release put out on June 1, 2023. The Report provides a high-level assessment of the impact of greenwashing on industry players across various financial industries, including banking, insurance, occupational pensions and European securities. In particular, it explores the practical implications of greenwashing whereby ESG-related statements, declarations, actions, or communications are disseminated and misconstrued so that they are not a transparent or fair reflection of the essential sustainability composition of an entity, financial product or services, which in turn can mislead consumers, investors and other market participants.

The ESMA section of the Report demonstrated that the sustainable investment value chain is at risk of greater exposure to greenwashing due to the proliferation of false or misleading claims which arise in respect of a product's sustainability profile. The EBA section of the Report focuses on greenwashing in the banking industry and its effect on banks, investment firms and payment service providers. The risk is perceived as low or medium for banks and medium to high for investment firms, however this is anticipated to increase in the future. The EIOPA section of the Report approaches greenwashing from the perspective of insurance and pension providers and concludes that the risk of greenwashing varies at different stage of the insurance and pensions lifecycle.

IV. United States

1. Latest ISS Report analysis

According to the latest Report by ISS Corporate Solutions, there has been a polarization of opinions in U.S. annual general meetings during the first half of this year, as shareholder proposals are divided between those in favor of supporting ESG-related issues with and those with a growing anti-ESG sentiment, albeit still a minority of proposals with none having been passed to date. The volume of shareholder proposals has increased by 14% in the last three years, particularly due to the rise in anti-ESG shareholder resolutions, which, although are still in the minority of opinions, have grown by more than 400% since 2020. ESG matters now account for more than 35% of proposals on social issues raised at annual general meetings and while the volume of environmental proposals has decreased in 2023, climate remains the most prevalent subcategory of proposals. While proposals have increased, support has fallen, with only 30.2% of shareholder proposals being submitted for final vote as of May 16, 2023.

2. U.S. states remain split on their approach to ESG matters

A bill was recently signed into law in Florida by Ron DeSantis, prohibiting public officials from investing state money into ESG objectives and banning ESG-bond sales. The legislation makes it obligatory for fund managers to include disclaimers in specific communications with portfolio companies to highlight that they do not represent Floridians' views. This is one of the most far-reaching steps introduced by U.S. Republicans against sustainable investment and is against a backdrop of a highly political influx of anti-ESG laws. This legislation will impact existing ESG initiatives of financial businesses operating in Florida, therefore it is advisable that such organizations audit and align their current ESG policies with the new requirements imposed by the bill. Similarly, in Kansas, the Senate approved a similar piece of legislature, which prevents Kansas state officials from referencing ESG factors when investing in public funds or determining who receives government contracts.

By comparison, in New York City in April 2023, two of the five employee pension funds (the Teachers Retirement System and the New York City Employees' Retirement System) adopted Net Zero Implementation strategies to achieve their ambitious goals of net zero emissions in their investment portfolios by 2040.

3. EPA proposes new rules to accelerate the use of "clean vehicles"

On April 12, 2023, the US Environmental Protection Agency ("**EPA**") introduced new federal emissions standards to promote cleaner vehicles and to fuel a more rapid transition to a carbon-neutral future. The proposed standards would prevent nearly 10 billion tons of carbon dioxide emissions, improve air quality throughout the U.S., promise financial savings on fuel for drivers and reduce the nation's reliance on oil imports.

4. Supreme Court adopts "Continuous Surface Connection" test for whether wetlands are covered by the Clean Water Act

On May 25, 2023, the Supreme Court held that the Clean Water Act only applies to those wetlands with a continuous surface connection to bodies of water that are "waters of the United States," and therefore wetlands that fall outside this scope will not be in the remit of the Clean Water Act.

V. APAC

1. Philippine SEC adopts ASEAN sustainable and responsible funds standards

The Philippine Securities Exchange Commission ("**SEC**") has adopted the Association of Southeast Asian Nations' ("**ASEAN**") Sustainable and Responsible Funds Standards ("**SFRS**"), setting out new guidance that will enable local and ASEAN-member investment companies, and collective investment schemes, to provide sustainable and responsible funds locally and across the region. The SFRS outlines minimum disclosure and reporting requirements, which address and target the need for a comparable, uniform and clear disclosure of information to safeguard against greenwashing.

2. Hong Kong consultation paper on mandatory climate-related disclosures for listed companies

The Hong Kong Stock Exchange published a consultation paper on April 14, 2023, proposing to make climate-related disclosures obligatory in ESG reports for all listed companies. There will be a two-year interim reporting period following the effective date of January 1, 2024, to enable businesses to adjust to the requirements.

3. India has approved new ESG disclosure rules to be made mandatory over time

The Securities and Exchange Board of India has approved new ESG disclosure rules, ratings and investing principles, which will develop the previous requirements under the Business Responsibility and Sustainability Report framework, outline ESG performance targets and will gradually make these items mandatory for the top 1000 listed companies over the next few years. The consultation paper recognizes that assurance of transparent disclosures is fundamental in enhancing the credibility of any sustainability related reporting.

4. MAS launches Finance for Net Zero Action Plan

The Monetary Authority of Singapore ("**MAS**") has published a net zero financing plan, which expands on MAS' Green Finance Action Plan launched in 2019, as part of Singapore's long-term climate and sustainability agenda. The Finance for Net Zero Action Plan ("**FiNZ**") seeks to achieve four strategic outcomes in connection with (i) data, definitions and disclosure, (ii) the climate resilience of the financial industry, (iii) the adoption of credible transition plans and (iv) the endorsement of green transition solutions and markets. The FiNZ includes finance mobilization strategies to catalyze Asia's net zero transition and to support decarbonization activities in Singapore.

Please let us know if there are other topics that you would be interested in seeing covered in future editions of the monthly update.

Warmest regards,

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Gibson Dunn lawyers are available to assist in addressing any questions you may have regarding these developments. Please contact the Gibson Dunn lawyer with whom you usually work, the authors, or any leader or member of the firm's Environmental, Social and Governance practice group:

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