browne jacobson LLP

ESG

in 3D

A monthly digest of key publications, legal and regulatory developments and commentary relating to sustainability & responsibility and:

- Climate change & the environment
- Social impact, and
- Corporate governance

For all those interested in changes in the financial services and insurance markets, and other ecologies

Enhancing conduct, culture and capital in a changing environment

December 2022 Issue 12

Introduction

Welcome to 'ESG in 3D', covering developments and emerging trends across the environmental, social & governance (ESG) dimensions, and the sustainability & responsibility (S&R) involved in those dimensions.

This month's editor:

Jeremy Irving

Head of Financial Services, Governance Specialist

+44 (0)20 7337 1010

Jeremy.irving@brownejacobson.com

This month's issue ...

Highlights the intersection of the E, S and G dimensions, and also highlights the fact that addressing one dimension inevitably raises issues for at least one other.

Kirsty Finlayson has explained the scene-setting for COP15, and in the next edition we'll be looking at the outcomes of this for the correlation between biodiversity (as part and parcel of the natural environment) and global society and the economy.

Alistair Taylor looks at the issues around the UK's Clean Air bill, and the legal and social right to the environmental feature of air quality.

Ray Silverstein addresses proposals for a code of conduct for ESG data and ratings providers, which may be the first step towards wholesale regulation of that industry.

This month there are three articles from me. The first is on the FCA's recent speech about the nexus between culture, governance and D&I.

The second covers preliminary work done to bring effective governance and controls into the carbon offset markets.

The third covers considerations as to 'Decentralised Autonomous Organisations', and whether these phenomena are an evolutionary step in socio-economic collaboration, or just a misunderstanding of the laws as to the attribution of liability.

We hope all our readers enter 2023 with renewed vigour and enthusiasm for the challenges and opportunities ahead. For our part, we will be returning with a new look ...

Sharing the spotlight

The articles we have produced shed light on our approach to addressing the depth, breadth and inter-connectedness of ESG / S&R.

We have selected a choice set of recent announcements and other publications that relate to each of the ESG dimensions, giving their context, highlighting the potential consequences for businesses and commenting on their broader ramifications.

Some cases involve more than one dimension of ESG. Where this is the case, we have shown this in a heading to illustrate to which dimensions we are referring.

Contents

Environment & Society

Digest:

- COP15, the 15th meeting of the Conference of the Parties to the UN Convention on Biological Diversity, took place from 7-19 December in Montreal, Canada.
- Whilst COP27 generating significantly more attention than COP15, there is a growing consensus that both the loss of biodiversity as well as climate change are two of the biggest threats to the planet.
- Insurer Swiss Re has estimated that over half of global GDP (41.7 trillion US Dollars) is dependent on a healthy natural world.
- The outcomes from COP15 have generated controversy, and we'll be looking at these in the next edition.

COP15: The most important unknown summit?

Source/Context:

COP15, the 15th meeting of the Conference of the Parties to the UN Convention on Biological Diversity, took place 7-19 December in Montreal, Canada. It has been dubbed "the most important summit you've never heard of" by the New Statesman. Despite ecosystem services provided by biodiversity helping provide us with the water we drink, the air that we breathe and the food that we eat, biodiversity is declining faster than at any time in human history. According to the Intergovernmental Science-Policy Panel on Biodiversity and Ecosystem Services, 1 million species face extinction. Whilst COP27 generating significantly more attention than COP15, there is a growing consensus that both the loss of biodiversity as well as climate change are two of the biggest threats to the planet. With the summit viewed as a once-in-a-decade opportunity to set a new global deal for nature, it is likely that a number of decisions will have an impact on the corporate world.

What does this mean for the FS and other industries?

Insurer Swiss Re has estimated that over half of global GDP (41.7 trillion US Dollars) is dependent on a healthy natural world. To take just two examples of biodiversity's importance: more than 75 per cent of global food crops rely on animal pollination, whilst marine and terrestrial ecosystems are the *only* sink for anthropogenic carbon emissions. The aim of COP15 is to adopt the Post-2020 Global Biodiversity Framework, its vision being that by 2050 "biodiversity is valued, conserved, restored and wisely used, maintaining ecosystem services, sustaining a healthy planet and delivering benefits essential for all people". The long-term targets for both 2030 and 2050 will require national effort. We are likely to see a shift in attention from just carbon offsetting and planting trees to biodiversity offsetting and nature restoration. This was reflected in the establishment of the Taskforce for Nature-related Financial Disclosures in 2020 and the recent FCA consultation paper on Sustainability Disclosure Requirements and investment labels which outlined that "a firm managing assets likely to be impacted by measures to protect biodiversity may set out how and why it has prioritised the management of biodiversity-related risks and opportunities." To regard this summit as simply for conservationists and academics would therefore be wrong; decisions made at the summit could impact the financial services world for decades to come.

Environment & Society

Digest:

- Coal is the dirtiest of all fossil fuels, producing almost twice the emissions of natural gas
- The air quality plans drawn up by the Government to achieve air pollution targets set at EU level have been ruled unlawful three times by the Courts (in 2015, 2016 and 2018)
- On 16 December 2020 the Coroner for the inquest on the death of Ella Roberta Adoo Kissi-Debrah ruled that 'Air pollution exposure' was one of the three medical causes of Ella Roberta's death
- At COP 26 in Glasgow in 2021 the UK and other delegates had signed up to decisions that for the first time mentioned coal and other fossil fuels
- A study published in January 2022 confirms sudden policy changes have a considerable impact on renewable energy

Long live king coal?

Source/Context:

Around seventy years ago the Great Smog of London killed around 4000 people, according to the explanatory notes accompanying the Clean Air (Human Rights) Bill which passed from the House of Lords to the House of Commons on 6 December. The bill seeks to establish the right of individuals to breathe clean air precisely and explicitly in UK law.

In the same week the Government approved the first new UK coal mine in 30 years despite concern that the mine would conflict with the UK's climate targets. The new mine, in Cumbria, will produce coking coal, largely for export, to be used in steel making.

The decision on the Cumbrian mine comes soon after the end of the UK's presidency of the Conference of Parties (COP) to the United Nations Framework Convention on Climate Change (UNFCCC). Just two weeks before, on 24th November, a Ministerial Direction under the Environmental Permitting (England and Wales) Regulations 2016 came into force, temporarily relaxing permitting conditions for coal-fired power stations in England during the winter period 1 October 2022 to 31 March 2023. The measure is intended to "address energy security issues if they arise, whilst aiming to limit unnecessary pollution."

What does this mean for the FS and other industries?

For clean energy investors and businesses, the Government's inconsistency on climate change commitments is a source of significant short and long term uncertainty. Why invest in projects that can take several years to reach fruition if there is the risk of a sudden policy shift?

Although the Government has agreed to relax restrictions on building onshore wind farms, the Ministerial Direction indicates the extent to which the UK is still dependent on highly polluting energy sources. The manner of the shift in policy, resulting from multiple rebellions from Tory MPs, indicates the fragility of the Government's position. Just when a strategic shift to clean energy is most needed the political will to achieve it seems to have gone up in smoke.

E, S & G

Digest:

- ESG ratings providers are coming under increasing scrutiny over concerns of their reliability in this increasingly vital area
- FCA wants regulatory oversight of certain ESG data and ratings providers
- In the meantime action is being taken to develop a voluntary Code of Conduct
- FS and other industries are encouraged to re-visit their ESG programmes to ensure these are demonstrably authentic to protect their ESG rating
- SEC is developing new rules to combat "greenwashing"

Code of Conduct for ESG data and ratings providers

Source/Context:

As financial services firms integrate ESG into their activities and expand ESG-focused products, they are increasingly reliant on third party ESG data and ratings services. ESG providers are coming under increasing scrutiny over concerns of the reliability of their assessments.

The FCA recently expressed their support for introducing regulatory oversight of certain ESG data and ratings providers. The FCA consider that this would support greater transparency and trust in the market for ESG data and ratings services.

If the Treasury extends their regulatory perimeter, the FCA has committed to take the necessary steps to develop and consult on a proportionate and effective regulatory regime, with a focus on outcomes in areas including, transparency, good governance, management of conflicts of interest, and systems and controls.

Whilst the Government considers this the FCA has worked to convene, support and encourage industry participants to develop and follow a voluntary Code of Conduct.

The International Capital Market Association (ICMA) and the International Regulatory Group (IRSG) are to convene an independent group to develop the Code co-chaired by M&G, Moody's, London Stock Exchange Group and Slaughter and May.

What does this mean for the FS and other industries?

The demand for ESG information and its importance to the industry has increased dramatically in recent years and looks set to continue on an upward trajectory. A recent survey found that 88 percent of investment professionals use third-party ESG ratings as a part of their investment process, with 92 percent expecting to do in future.

This demand for ESG information has in many ways outstripped the ability of suppliers to provide the depth, detail, and accuracy of data required. This could, in part, be due to the immense number of factors that arguably fall under the heading of ESG, the issues with measuring ESG factors, and the challenges of determining their impact. Studies find low correlations across ESG ratings providers.

E, S & G

Digest:

- ESG ratings providers are coming under increasing scrutiny over concerns of their reliability in this increasingly vital area
- FCA wants regulatory oversight of certain ESG data and ratings providers
- In the meantime action is being taken to develop a voluntary Code of Conduct
- FS and other industries are encouraged to re-visit their ESG programmes to ensure these are demonstrably authentic to protect their ESG rating
- SEC is developing new rules to combat "greenwashing"

Code of Conduct for ESG data and ratings providers (continued)

What does this mean for the FS and other industries?

The growth in importance of ESG ratings to the asset management business is shown by the flow of funds into ESG-labelled products. Bank of America calculates that over $200 billion was invested in ESG bond funds between 2019 and 2022.

The prospect of the regulatory oversight of certain ESG data and ratings providers should encourage the FS and other industries to re-examine their ESG initiatives. Persuading a ratings provider that your approach to ESG is demonstrably authentic could well become significantly more challenging.

In the US, the SEC has warned ratings agencies they are developing new rules to encourage transparency and consistency to help combat "greenwashing".

Society & Governance

Digest:

- "The FCA expects senior leaders to nurture healthy cultures in the firms they lead. Cultures that are purposeful. That have sound controls and good governance. Where employees feel psychologically safe to speak up and challenge. Where remuneration does not encourage irresponsible behaviour that can ultimately damage the business and wider markets."
- Through Firm and Portfolio Assessment Models, FCA supervisors look at "purpose, leadership, governance and the approach to people. This includes diversity and inclusion (D&I) as well as psychological safety".

All the pieces of the conduct puzzle: Governance, culture, D&I, innovation

Source/Context:

"From Zeroes to Heroes: How culture in financial services can change for everyone's benefit"

In a speech on 28.11.22, the FCA said that: "[the] Consumer Duty... will do the most to address conduct – and therefore culture ...

We have asked firms to think about what a good outcome would be for their customers ... We have also asked that the thinking starts at board level and have requested that there is a consumer duty champion on every board.

The reason is simple: the Duty challenges you to ask significant questions about your purpose."

"One of the most direct ways managers and leaders can shape culture from the start – and spot when it needs changing – is through language ... the boss and those at C-suite level set the tone for culture."

What does this mean for the FS and other industries?

The FCA also said that "one of the issues we get the most questions about is the future rules around environmental, social and governance (ESG) products and promotions.

There is – rightly – always a major focus on the E and S part of ESG.

But perhaps less so on the g – or governance.

We are looking closely at what support firms offer to employees to improve their culture so that it boosts the conduct of their business or function."

D&I "can lead to unique insights that can fuel more innovative approaches, greater efficiency and reduced misconduct ...diversity of thought can foster innovation."

The FCA has "recently completed a study ["Understanding approaches to D&I in the FS industry', [which] will be published shortly"] into D&I across a range of organisations and found that firms were focused on improving representation at senior level but this dropped off at mid and junior level."

Environment & Governance

Digest:

- "Voluntary markets are markets where entities buy carbon credits to offset some or all of their own carbon emissions. These ... credits [operate] ... through carbon removals and through emissions reductions – for example, by investing in renewable energy or planting trees. Carbon credits may also be issued for projects that prevent GHG emissions from being released in the atmosphere."
- "... concerns raised about [VCMs include] ... (i) ... at project level, regarding the environmental integrity of the ... credits; (ii) issues relating to ... the trading environment ... and the behaviour of market participants ... (iii) issues regarding the overall communication around ... carbon credits by buyers ... leading to a risk of greenwashing."

Voluntary offset markets for carbon – a bad atmosphere?

Source/Context:

"CR06/2022 Voluntary Carbon Markets (iosco.org)"

IOSCO has published a Discussion Report "with the aim of advancing the discussion about what sound and efficient Voluntary Carbon Markets (VCMs) should look like and what role financial regulators may play in promoting integrity in those markets."

One proposition the report addresses is: "key participants and infrastructures [should] have appropriately robust governance frameworks" including to manage conflicts of interest.

What does this mean for the FS and other industries?

"IOSCO has identified a set of potential vulnerabilities that may merit specific attention ...

On environmental integrity, the main concern is about the quality of carbon credits, the lack of standardized methodologies to measure additionality of projects, leakage of carbon, and risks surrounding the permanence of the reduction or removal of greenhouse gas emissions ...

There are also concerns about transparency relating to the methodologies used for calculating emissions reductions and about potential conflicts of interest and lack of transparency relating to the remuneration of both project suppliers and others in the ecosystem."

"With regards to ... the trading environment ... it is worth noting that, at the moment, there is no regulatory oversight (financial services or otherwise) or framework for the issuance and trading of voluntary credits ...

In addition, there are uncertainties about the legal treatment of carbon credits in some jurisdictions ... IOSCO's analysis suggests the current lack of standardized documentation of carbon credits also creates challenges for scaling voluntary markets ...

Finally, data availability appears to be a concern."

Society & Governance

Digest:

- The Law Commission has been considering US litigation in relation to decentralised autonomous organisations (“DAOs”), which have been described as: “a way to organise people, a social-coordination technology that relies on blockchain-based smart contracts and incentives to facilitate individuals collaborating and taking actions with collective impact.”
- “By automating or programming some elements of organisational activity, and distributing or open-sourcing related software products and data, DAOs have the potential to reduce information and transaction costs, and so offer an alternative to existing organisational structural arrangements.”

‘Decentralised and autonomous’ – evolution or misunderstanding of unincorporated association law?

Source/Context:

Law Commission: Call for evidence: Decentralised Autonomous Organisations”

“A ... DAO ... is a novel type of technology-mediated social structure or organisation of participants made up of several composite elements. The novel part is that many of the actions and functions of this type of organisational structure (both in terms of governance and its activities) can be redesigned to use and / or facilitate the creation, modification and maintenance of open-source software-based systems. The primary example of these software-based systems is code that performs certain actions deterministically or programmatically, built into a network of smart contracts deployed to public blockchains.”

“Many thousands of DAOs exist today. Huge amounts of value flow through, are created, extinguished, used and sometimes lost by DAOs. This raises questions about the legal status and liabilities of DAOs ... very few DAOs have chosen to organise in the jurisdiction of England and Wales ...”

What does this mean for the FS and other industries?

The issue is, as a matter of English law, does the medium of terms and activity affect the allocation of liability. On a practical basis, do those who deal with DAOs understand the potential liability arguments? For instance, “... some software protocol-specified tokens allow holders to participate in “governance” decisions relating to a particular software protocol. Some software protocol-specified tokens give holders additional benefits or utility when interacting with that particular protocol.”

“However, DAOs are not completely operationally autonomous ... [and] rely heavily on individuals ... to perform certain tasks that automated processes cannot. ... Founders and developers will be involved at the start of a DAO’s life, and may be one and the same people. They might well continue to be associated with the DAO (or its associated software protocol) ... but be joined by other participants who may or may not also be holders of the software protocol-specified tokens.”

Additional matters

Further analysis, resources and events

[ESG for beginners]

Netting zero' # 1

"All Round ESG-ellence - Developing an effective ESG Sustainability and Responsibility Programme #1: The fundamentals

Should the UK Financial Conduct Authority bring "competitiveness" back into its regulatory agenda?

Greenwashing (manifestation and prevention): Part 1: Manifestation: 'How green is your wash?'

Greenwashing (manifestation & prevention): 'How green is your wash?' part 2: The genesis of 'ESG Compliance'

Culture, Conduct and Covid-19: Survey Report 2021

RECCE (reflect, evaluate, cohere, communicate, evolve) - Culture, Conduct and Covid report

The difficulties with a 'business case' for Equality, Diversity and Inclusion ("EDI") in the financial services workplace

"Good insurance business: can insurers save the world?"

Other useful information:

Events

Carbon Neutrality – Horizon Scanning – *More details to be shared once confirmed.*

Useful Links

Financial services | Browne Jacobson LLP

Meet the team

Jeremy Irving

Head of
Financial Services,
Governance Specialist

London

+44 (0)20 7337 1010

Jeremy.irving@brownejacobson.com

Jeniz White

Associate and
EDI Specialist

London

+44 (0)330 045 2226

Jeniz.white@brownejacobson.com

Kirsty Finlayson

Associate and
Environmental Specialist

London

+44 (0)330 045 2356

kirsty.finlayson@brownejacobson.com

Ben Standing

Partner, Government
and Environment
Specialist

Birmingham

+44 (0)121 237 3900

Ben.Standing@brownejacobson.com

Raymond Silverstein

Partner, Employment

London

+44 (0)20 7337 1021

Raymond.silverstein@brownejacobson.com

Alistair Taylor

Trainee, Environmental
Specialist

Birmingham

+44 (0)330 045 2970

Alistair.taylor@brownejacobson.com

Contact us

Birmingham

Browne Jacobson LLP
15th Floor
103 Colmore Row
Birmingham B3 3AG

+44 (0)370 270 6000

Exeter

Browne Jacobson LLP
1st Floor
The Mount
72 Paris Street
Exeter EX1 2JY

+44 (0)370 270 6000

London

Browne Jacobson LLP
15th Floor
6 Bevis Marks
London EC3A 7BA

+44 (0)370 270 6000

Manchester

Browne Jacobson LLP
3rd Floor
No.1 Spinningfields
1 Hardman Square
Spinningfields
Manchester M3 3EB

+44 (0)370 270 6000

Nottingham

Browne Jacobson LLP
Mowbray House
Castle Meadow Road
Nottingham NG2 1BJ

+44 (0)370 270 6000

Dublin

Browne Jacobson Ireland LLP
Viscount House
6-7 Fitzwilliam Square East
Dublin 2
D02 Y447

+353 (0)1 574 3910

@brownejacobson

Browne Jacobson LLP

Browne Jacobson is the brand name under which Browne Jacobson LLP and Browne Jacobson Ireland LLP provide legal and other services to clients. The use of the name "Browne Jacobson" and words or phrases such as "firm" is for convenience only and does not imply that such entities are in partnership together or accept responsibility for the acts or omissions of each other. Legal responsibility for the provision of services to clients is defined in engagement terms entered into between clients and the relevant Browne Jacobson entity. Unless the explicit agreement of both Browne Jacobson LLP and Browne Jacobson Ireland LLP has been obtained, neither Browne Jacobson entity is responsible for the acts or omissions of, nor has any authority to obligate or otherwise bind, the other entity.

ESG

in 3D

www.brownejacobson.com