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Cadwalader Climate

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In this week's edition, our focus remains on carbon credits where the first ever set of "Core Carbon Principles"-labelled carbon credits were approved. The three European supervisory authorities publish their final reports on greenwashing, urging the European Commission to swiftly adopt the amended Sustainable Finance Disclosure Regulations. And, taking some of the focus from the "E" to "G", the UK Institute of Directors proposes a Code of Conduct for directors.

First "Core Carbon Principles"-Labeled Carbon Credit Approved

On June 6, 2024, the **Integrity Council for the Voluntary Carbon Markets (ICVCM) announced** that it had approved its first ever set of carbon crediting methodologies that meet its Core Carbon Principles (CCPs). ICVCM approved seven carbon crediting methodologies resulting in the CCP-approved label to be applied to an estimated 27 million carbon credits. These carbon credits are issued by projects that work to minimize greenhouse gas emissions by capturing methane from landfill sites, and by destroying ozone-depleting foams and refrigerant gases from discarded appliances such as refrigerators and air conditioners.

The CCP aims to be the leading framework denoting high-integrity carbon credits that meet a global benchmark for quality carbon credits. ICVCM works in tandem with the Voluntary Carbon Market Integrity Initiative which developed a Claims Code for the credible use of carbon credits by companies. Purchasing an ICVCM-approved carbon credit is intended to assure investors that they are contributing meaningfully to reducing and removing GHG emissions. To be awarded the CCP label, carbon credits undergo what ICVCM describes as a rigorous assessment process to decide whether the ten CCPs are met. These are:

1. Effective program governance to ensure transparency, accountability, continuous improvement and the overall quality of carbon credits.
2. The program shall operate or make use of a registry to uniquely identity, record and track mitigation activities and credits issued to ensure they can be identified securely and unambiguously.
3. The program shall provide comprehensive and transparent information on all credited mitigation activities. Information should be publicly available in electronic format and accessible to non-specialized audiences.
4. There should be program-level requirements for robust independent third-party validation and verification of mitigation activities.

5. The GHG emissions reductions or removals from the mitigation activities shall be additional and would not have occurred in the absence of the incentives created by carbon credit revenues.
6. The GHG emissions reductions or removals from the mitigation activity shall be permanent or where there is a risk of reversal, there shall be measures in place to address those risks and compensate reversals.
7. The GHG emissions reductions or removals form the mitigation activity shall be robustly quantified, based on conservative approaches, completeness and scientific methods.
8. The GHG emissions reductions or removals from the mitigation activity shall not be double counted including double issuance, double claiming and double use.
9. The program shall have clear guidance, tools and compliance procedures to ensure mitigation activities conform with or go beyond widely established industry best practices on environmental and social safeguards while delivering positive sustainable development impacts.
10. The mitigation activity shall avoid locking-in levels of GHG emissions, technologies or carbon-intensive practices that are incompatible with the objective of achieving net zero GHG emissions by mid-century.

We have frequently discussed the issues in the voluntary carbon credit market, including questions around quality, offsetting and allegations of greenwashing. A certification regime will undoubtedly be welcomed by those who call into question how effective carbon offsetting schemes are, **which we discuss in detail here**. If properly implemented the CCPs may significantly contribute to tackling such challenges and enhance the integrity and transparency of voluntary carbon markets. This is especially true against the backdrop of incoming or proposed regulation/guidelines in this space; **in April 2024**, Members of the European Parliament voted in favor of adopting a new certification framework for carbon removals which would include carbon credits **and in May of this year**, the Biden Administration launched a new set of standards to advance the responsible development of voluntary carbon markets.

EU Supervisory Authorities Publish Final Greenwashing Reports

On June 4, 2024, the European supervisory authorities (ESAs) published their final reports on greenwashing in the financial sector. The **European Securities and Markets Authority (ESMA)**, the **European Banking Authority (EBA)**, and the **European Insurance and Occupational Pensions Authority (EIOPA)** each called for "enhanced supervision and improved market practice on sustainability-related claims". In addition, ESMA urged the European Commission to swiftly adopt amended Sustainable Finance Disclosures Regulation (SFDR) which include a requirement to produce disclosures in a machine-readable format. The SFDR has been the subject of controversy for some time following uncertainty around how the rules ought to be applied, resulting in a mass downgrade of funds from Article 9 status, which should be applied to funds which invest specifically in sustainable assets; fund managers were concerned over greenwashing risks. **We have discussed this frequently**.

The final reports come close to a year after the initial drafts in which the ESAs agreed upon a common, high-level **definition of greenwashing**: "a practice where sustainability-related statements, declarations, actions, or communications do not clearly and fairly reflect the underlying sustainability profile of an entity, a financial product, or financial services. This practice may be misleading to consumers, investors, or other market participants." The reports

also outline greenwashing risks, impacts, proposed mitigation efforts and challenges for their respective industries.

ESMA

ESMA noted that the supervision of sustainability-related claims has become a priority for national competent authorities (NCAs) and that together they are taking steps to better monitor and detect greenwashing and to critically scrutinize sustainability-related claims in various sectors. ESMA's focus on greenwashing ties into a key focus of the European Green Deal. **As we discussed in our June 11 edition**, the regulator published a report on the sector's compliance with MiFID II marketing rules and highlighted concerns regarding sustainability claims. We also discussed a number of its other initiatives in that edition.

ESMA outlined priority areas for supervisors in order to allow them to better mitigate greenwashing risks:

- NCAs are expected to gradually deepen their critical scrutiny of sustainability-related claims. To achieve this, they are invited to continue increasing human resources and expertise, making investments in supervisory tools such as "SupTech" – technology used in regulatory compliance – solutions and further embed greenwashing risks in their respective supervisory work programs.
- ESMA will continue to support the monitoring of greenwashing risks, the deployment of SupTech tools, and capacity building. In addition, ESMA will prompt Common Supervisory Actions where needed. ESMA may produce additional guidance for market participants and supervisors in high-risk areas of greenwashing.
- The European Commission is invited to reinforce NCAs' and ESMA's mandates in certain areas, such as for benchmarks, and make sure all NCAs have the power to promote retail investors' financial education. Whenever possible, the Commission should ensure the legislative framework supports NCAs' access to data.

Going forward, ESMA intends to continue monitoring greenwashing risks and supervisory progress.

EBA

In its report, the EBA provides an overview of greenwashing risks in the banking sector as well as recommendations to institutions, supervisors and policy makers. The outcome of EBA's analysis of greenwashing demonstrated a clear increase in this trend across all sectors. The EBA reported that the total number of alleged cases increased in 2023 with a 21.1% increase in all regions and 26.1% in the EU compared with 2022.

The EBA analyzes alleged greenwashing occurrences reported by NCAs and provides updates on the impact that greenwashing can have on the market and its stakeholders.

The EBA noted that the existing framework provides key foundations to address greenwashing and that such efforts should continue. It also recommended that institutions take measures at entity and product level to ensure that sustainability claims are accurate, substantiated, up to date and that they fairly represent the institution's overall profile, or the profile of the product,

and are presented in an understandable manner. Finally, the EBA recommended that NCAs pursue their planned and ongoing efforts and activities to identify and monitor greenwashing risks.

EIOPA

EIOPA set out key proposals aimed at enhancing the supervision of greenwashing and improving the sustainable finance regulatory framework. In an accompanying opinion, NCAs can find four key principles that EIOPA recommends they consider when probing sustainability claims:

1. Sustainability claims made by a provider should be accurate, precise, and should fairly represent the provider's profile, and/or the profile of its products.
2. Sustainability claims should be substantiated with clear reasoning, facts and processes.
3. Sustainability claims and their substantiation should be accessible to the targeted stakeholders.
4. Sustainability claims should be kept up-to-date, and any material change should be disclosed in a timely manner and with a clear rationale.

UK Institute of Directors Consults on Proposed Code of Conduct

In June 2024, the Institute of Directors (IoD) **launched a consultation** on a proposed Code of Conduct to help UK businesses and their individual directors make the decisions to overcome complex challenges and trade-offs. Recognizing the crucial role that an independent and capable board structure plays in promoting good governance practices within companies, the Code is intended to equip directors with a behavioral framework to help them build the trust of stakeholders, including the wider public, through their business activities. It is structured around six key principles:

1. Leading by example: Demonstrating exemplary standards of behavior in personal conduct and decision-making.
2. Integrity: Acting with honesty, adhering to strong ethical values, and doing the right thing.
3. Transparency: Communicating, acting and making decisions openly, honestly and clearly.
4. Accountability: Taking personal responsibility for actions and their consequences.
5. Fairness: Treating people equitably, without discrimination or bias.
6. Responsible business: Integrating ethical and sustainable practices into business decisions, taking into account societal and environmental impacts.

Each principle is underpinned by specific undertakings in order to help achieve prescribed outcomes such as respect, confidence, trust, reputation, relationships, resilience, and legitimacy. The Code represents a voluntary commitment and is not intended by the IoD to create new compliance burdens.

The Consultation runs until August 16, 2024 and the IoD is particularly interested in receiving views from stakeholders on, for example, additional issues that should be addressed in the Code, how awareness of the Code could be encouraged among directors and the wider public, and whether there is a role for government, regulators or other professional bodies in encouraging adoption of the Code.