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Regulation: Oversight for Carbon Offset Market

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Regulation

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A group of Democratic senators have written a **comment letter** to the Commodity Futures Trading Commission (CFTC) asking for improved regulation of the market for carbon offsets in response to the CFTC's June 2022 **request for information on climate-related financial risk**. The senators include Bernie Sanders, Elizabeth Warren, Cory Booker and Kirsten Gillibrand. Trading in the offset market has expanded rapidly in recent years, from approximately $520 million in 2020 to approximately $2 billion only one year later. The senators' letter states that often times the offsets do not genuinely deliver the promised environmental benefits and instead may constitute "fraudulent investments" that are "a convenient and profitable way to market climate consciousness without requiring real action to reduce emissions." According to the letter, offsets have allowed companies "to make bold claims about emission reductions and pledges to reach "net zero", when in fact they are taking little action to address the climate impacts of their industry." This appears to be consistent with criticisms raised elsewhere with respect to carbon offsets. For instance, the UK's Climate Change Committee, an advisory group to the government, last week warned that without reform the offset market risked undermining net zero emission plans. The Committee has asked the government to introduce "guidance, regulation and standards."

Taking the Temperature: The carbon offset market has grown rapidly in the last two years driven both by higher prices and strong demand from industry. Some analysts are predicting that the market for carbon credits could be worth in excess of $50 billion by 2030. But there are concerns that carbon credits do not provide real greenhouse gas mitigation unless they are tied to carbon-saving projects and may even reduce incentives for corporates to actively work towards carbon reduction. As a result, the future of carbon markets remains uncertain, including potential regulatory activity. As the market develops, companies utilizing carbon credits should consider additional carbon reduction initiatives to avoid potential greenwashing challenges.

In addition, some of the suggested directives in the letter may not be feasible given the CFTC's current authority. Carbon credits typically do not constitute derivatives, and the CFTC only has limited power with respect to "commodities" in the absence of a derivative component. Under that view, the CFTC would not be able, for instance, to "establish the qualifying standards for carbon offsets that effectively reduce greenhouse gas emissions," or "create a registration framework for offsets, offset brokers, and offset registries."

Disclosure: TCFD Publishes Report on Climate-Related Financial Disclosure

October 18, 2022

Disclosure

By Jason Halper
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On October 13, the Task Force on Climate-Related Financial Disclosures (TCFD) published its **2022 Status Report**. The TCFD was established by the Financial Stability Board to give guidance on climate-related financial disclosure. The report marks five years since the TCFD published its final recommendations and it assesses progress made since then. The TCFD reviewed disclosure from over 1,400 companies across eight industries and five regions to assess the state of climate-related financial disclosure practices.

According to the report, the average number of recommended disclosures addressed per company has steadily increased each year for the past five years, from 1.4 in 2017 to 4.2 in 2021 fiscal year reporting. However, while 80% of companies disclosed in line with at least one of TCFD's eleven recommended disclosure categories for fiscal year 2021, only 43% disclosed in line with at least five of the recommended categories. Certain geographical distinctions were evident, with 60% of European companies disclosing across the 11 recommended disclosures for 2021 whereas 29% of North American companies disclosed in all eleven areas. The report also revealed distinctions between industries. Companies in the energy industry boasted the highest average percentage of disclosure of the eight industries reviewed while the technology and media industry had the lowest average percentage of disclosure in 2021. The TCFD's 11 recommended disclosures address a variety of topics including governance, strategy, risk management, metrics and targets.

Michael Bloomberg, Chair of the Task Force, stated that: "The 2022 TCFD Report underscores the increasing adoption of climate-related financial disclosures since the Task Force's 2017 recommendations – as well as the urgent need for greater progress on this front and in the global fight against climate change. Climate risks are also financial risks, and more measurement and disclosure are crucial to building a more sustainable and resilient economy and a safer future."

Taking the Temperature: The TCFD's report confirms that, in general, companies increasingly are reporting climate-related financial information, although the extent of disclosure varies across jurisdictions and industries. And the TCFD disclosure framework is one of the most influential reporting standards (if not the most) as numerous regulators and large institutional asset managers have coalesced around its recommendations as the appropriate basis for issuer disclosure.   For instance, the SEC's proposed rule regarding climate change disclosure states that it intends to consider the TCFD recommendations in formulating the agency's final rule, and

BlackRock, State Street and Vanguard each have urged issuers to make disclosure based on the TCFD framework. Nonetheless, well-intentioned issuers confront numerous challenges to making enhanced climate disclosure. For instance, there still is no consensus concerning the standards and metrics companies should use for measuring Scope 1, 2 or 3 greenhouse gas emissions; multi-national companies confront different materiality standards in the U.S. and Europe, with the latter having adopted the concept of "double materiality" whereby an issuer's external impact is deemed material even if not impactful on the issuer itself; it is often difficult to obtain information necessary to make accurate disclosure, especially if the information has to come from third parties; and more generally climate change is a dynamic situation and companies risk having to deviate from prior good faith disclosure of plans or correct past disclosure of historical information such as GhG emissions in light of real-time developments or improvements in GhG measurement. All of which counsels for thoughtful disclosure with an emphasis on current initiatives or impacts. These could include a board's ongoing efforts to assess risks and opportunities associated with climate transition or increase climate-related board expertise, or discussion of the financial impact of physical assets as a result of climate-related events. The basis for any predictions of future outcomes or disclosure of amounts of GhG emissions or emissions reductions needs to be carefully described along with the limitations on the accuracy of any such statements.

Investing: LSE Announces Launch of Voluntary Carbon Market

October 18, 2022

Investing

By Samantha Hutchinson
Partner | Fund Finance

By Matthew Smith
Partner | Finance

The London Stock Exchange (LSE) has announced the launch of its voluntary carbon market (VCM) together with the publication of its final admission and disclosure standards for companies to be eligible to participate. The LSE first announced its intention to establish a VCM marketplace in November 2021. The new market is open to closed-ended investment funds and operating companies admitted to LSE's markets. It permits qualified funds or companies to raise funds through the VCM for climate mitigation projects.

According to LSE, eligible "issuers will be seeking to finance projects directly or indirectly and may issue carbon credits as a dividend." The designation also "requires issuers to produce additional disclosures relating to the projects they are directly or indirectly financing, including but not limited to: the qualifying bodies whose standards will be applied to the projects, project types, expected carbon credit yield and the extent to which they are expecting to meet the United Nations Sustainable Development Goals."

Julia Hoggett, CEO of the LSE, stated that: "Our goal is to facilitate the financing of projects that are focused on climate change mitigation. Today's publication of our admission and disclosure standards marks the launch of the first public markets solution to help raise capital for the voluntary carbon market. It paves the way for capital at scale to be channeled into a range of climate change mitigation projects, while providing corporates and other investors with net zero commitments with the ability to access a diverse supply of high-quality carbon credits."

Taking the Temperature: As highlighted in our update above, the carbon credit market is controversial, has attracted high-profile criticism and can expect further regulatory and investor scrutiny. Despite these concerns, there is increasing demand for carbon credits as part of a pathway to make good on net-zero goals. As companies face increased pressure from investors to adhere to climate-related targets, many are turning to carbon offsetting as a method of meeting these obligations. By tying a participating company's issuance of carbon credits to specific GhG reduction projects, the LSE's VCM market offers the potential to address criticism that carbon credits do not meaningfully promote sustainability goals. The magnitude of the possible beneficial impact of the LSE's initiative will depend in large part on issuers' utilization of the market and the pricing of the resulting carbon credits relative to other potentially less expensive credits not

subject to the LSE's controls. But the LSE's VCM approach appears to be a useful way to mitigate concerns over the accuracy of climate-related disclosure impacted by the use of carbon credits.

Green Finance: Mercedes-Benz 11 Billion Euro Sustainability-Linked Loan

October 18, 2022

Green Finance

By Simon Walsh
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Mercedes-Benz announced last week that it has converted an €11 billion revolving credit facility into a sustainability-linked loan (SLL), with its commitment fee tied to certain KPIs aligned with the company's sustainability strategy. The Revolving Credit Facility was arranged for risk-management purposes to provide additional liquidity.

Sustainability-linked debt is a rapidly developing area of the sustainable finance market and can offer increased flexibility to use proceeds for general corporate purposes when compared to other financial products such as certain green bonds that require funds to be allocated to specific green projects and which is something smaller issuers in particular find difficult.

Steffen Hoffmann, Head of Treasury and Investor Relations of Mercedes-Benz Group AG, stated that: "Our path towards a CO2 neutral future has been set out clearly with our Ambition 2039. We will therefore align our sustainable business strategy with our financing instruments and transform our existing Revolving Credit Facility into a Sustainability-Linked Loan. This follows on from our previous two green bond issues in 2020 and 2021 and paves the way for Mercedes-Benz to play a leading role in the area of sustainable finance."

Taking the Temperature: The sustainable finance markets are rapidly developing and it is likely that companies will utilize different products in order to meet both their ongoing liquidity requirements and large expenditures to reduce their climate impact. The SSL market has grown across all sectors in recent times and, as demonstrated by Mercedes-Benz, companies in the automotive sector are particularly strongly motivated to promote their green credentials and commitment to carbon neutrality. As with any climate-related disclosure or initiative, however, companies need to be careful not to over-promise and under-deliver, or risk challenges from regulators or investors based on claims of greenwashing. This is relevant to SSLs in particular in terms of the specific KPIs any SSL is tied to and the potential pricing impact depending on the KPIs achieved, each of which often vary on a deal by deal basis.