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Regulation: Reelection of President Lula Raises Hopes for Brazilian Environmental Policy

November 4, 2022

Regulation

By Duncan Grieve
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On October 30, Luiz Inácio Lula da Silva (Lula) was elected President of Brazil for a third term, having previously governed Brazil for two consecutive terms between 2003 and 2010. Lula's narrow victory follows a divisive election campaign against incumbent Jair Bolsonaro and Lula's corruption convictions, which led to his imprisonment for 580 days. Lula was able to stand as a presidential candidate only after these convictions were quashed by the Brazilian Supreme Court for not having been heard in the appropriate court. He will assume office on January 1, 2023 and is expected to pursue progressive environmental policies.

In his victory speech, Lula reemphasized his policy ambitions, stating "Brazil is ready to resume its leading role in the fight against the climate crisis" and "we will prove once again that it's possible to generate wealth without destroying the environment." During the presidential campaign, he promised to grant protected status to new areas totaling half a million square km of Amazon rainforest, subsidize sustainable farming, crack down on deforestation and make changes to Brazil's tax code to facilitate green investment.

If the stated policy goals are able to be implemented, Brazil is likely to benefit from increased international investment into environmental and sustainability projects. Western governments and international investors were highly critical of Bolsonaro's climate-skeptic public statements and funding freezes of federal environmental protection agencies. Environmentally-focused financial think tanks such as Planet Tracker have published **reports** describing the negative long-term effects of Amazonian deforestation on the Brazilian economy. Policies aimed at slowing deforestation will be closely watched by international investors.

Taking the Temperature: Lula has outlined an ambitious agenda in relation to environmental policy. International investors have already indicated support for his program and have underlined the primary importance of slowing deforestation in the Amazon rainforest. However, Lula will face a tough challenge in passing legislation through the Brazilian legislature, where his party does not have a clear majority. He will also need to contend with the powerful and well-resourced agribusiness lobby. If policies can be implemented, Brazil could benefit from a green investment boom. We will continue to monitor concrete policy proposals as they emerge and provide updates accordingly.

Governance: ISS Publishes Report on Corporate Governance

November 4, 2022

Governance

By Jason Halper
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On October 27, Institutional Shareholder Services (ISS) published a report intended to "provide an overview of the different changes taking place in the corporate governance landscape in light of increasing awareness of sustainability issues." This builds on ISS' earlier report published on October 3 addressing global sustainable finance regulatory developments in 2022. The latest report states that investors across the globe increasingly are placing a greater importance on sustainability issues and this development is contributing to a change in issuers' corporate governance structures. Among other things, ISS pointed to an increase in the use of board-level sustainability committees, which in the U.S. is becoming "standard market practice," and that approximately 60% of S&P 500 companies had at least one director with ESG skills. However, only 7% of these companies had climate-specific expertise at the board level. The report also cited growth in the use of ESG metrics in calculating executive compensation.

The report concludes by stressing "the importance of traditional corporate governance dimensions such as shareholder rights and board attributes to address [environmental and social] issues."

Taking the Temperature: It would be difficult to overstate the importance of climate-related governance or the level of scrutiny it will continue to attract. In discharging their fiduciary duties, directors need to assess material physical asset and transition risks and opportunities associated with climate change and potential financial statement and operational impacts resulting from climate change, and then make appropriate disclosure on those governance efforts and potential impacts on the corporation. The SEC's proposed climate-change disclosure rule, for instance, would require disclosure of an issuer's oversight and governance of climate-related risks by the board and management and a description of how any climate-related risks identified by the company have had or are likely to have a material impact on its business and financial statements over the short-, medium-, or long-term. Likewise, the EU's Corporate Sustainability Reporting Directive (CSRD) requires companies to disclose information about the potential financial impacts resulting from climate change, their business strategy in light of climate risks, and the resilience of the business model and strategy to sustainability-related risks. Boards should consider whether existing monitoring and evaluation processes are sufficient in light of developing regulatory requirements and investor scrutiny, and whether the board and management have the appropriate level of climate-related expertise given the company's business operations.

Governance: New Reports Comment on Net-Zero Progress

November 4, 2022

Governance

By Sara Bussiere
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Recent reports show that over 90% of companies that have articulated net-zero targets will not meet their goals based on their current climate change plans. On November 1, Accenture published a **report** stating that 34% of an Accenture-created list of 2,000 of the world's largest public and private companies made public net-zero commitments, and that 93% of those that have made commitments will "miss their targets" unless they "accelerate progress" in reducing their emissions. The report also draws attention to the fact that over 90% of the global economy is now covered by national net-zero commitments.

In a similar vein, MSCI's October net-zero tracker **report** states that "Listed Companies are on track to warm the planet 2.9° Celsius by the end of the century," and that only 16% of listed companies "align with keeping global warming at or below" a Paris Agreement-aligned increase of 1.5°C, while about one-third of Listed Companies align with a 2°C increase. MSCI's data is based on its All Country World Investable Market Index (ACWI IMI), which includes large-, mid- and small-capitalization listed companies across 23 developed market and 27 emerging market countries, covering approximately 99% of global equities. The report also highlights the frequent use of carbon offsets, stating that companies representing 64% of global greenhouse gas emissions are using carbon offsetting to achieve net-zero goals.

Taking the Temperature: Companies face numerous challenges in meeting net-zero pledges, including wading through the debate over the true sustainability of carbon offsets, and navigating a lack of consensus on how to measure emissions and therefore whether a company has reached net zero, especially with respect to Scope 3 "supply chain" emissions. That, in turn, has raised concerns that making a net-zero pledge invites regulatory enforcement activity or civil litigation due to commentary regarding a company's lack of progress toward or inability to timely meet a disclosed net-zero commitment. "Greenhushing," where companies do not disclose the extent of their sustainability efforts, often is a reaction to such concerns. Private companies are even less likely to make public net-zero commitments, according to a report by Net Zero Tracker. While such concerns are understandable, we suggest that the answer is not to under-disclose. Rather, boards should make sustainability commitments consistent with the best interests of the corporation based on credible information available at that time. Net-zero pledges with appropriate qualifying language made with a reasonable basis that is contemporaneously documented should not subject directors or officers, or the company itself for that matter, to liability. And, increasingly, the markets and regulators are demanding greater, not less, sustainability efforts and related disclosure, such that greenhushing is not a viable long-term corporate strategy.

Regulation: ECB Publishes Results of Review on Climate-Related and Environmental Risks

November 4, 2022

Regulation

By Matthew Smith
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On November 2, the European Central Bank (ECB) published the **results** of its thematic review into climate-related and environmental risks. As part of its review, the ECB looked at 186 banks with total combined assets of €25 trillion (approximately $25 trillion). The review found "broad acknowledgement" of the materiality of both physical and transition risks within current business plans and that most institutions have devised "institutional architecture to address climate-related risks," meaning "they have performed an initial mapping of their risk exposures, allocated responsibilities within the organization, set initial key performance and risk indicators, and developed a qualitative mitigation strategy for at least part of their risk exposures." However, aside from certain "leading institutions," the ECB observed that a "wait and see" approach remained prevalent in terms of taking concrete action toward long-term goals, such that "strategic commitments are not supported by intermediate targets, limits and thresholds, or these are set such that there is negligible immediate impact on the institution's exposure profile taking action toward a climate-related strategy." The ECB also raised concerns that less than 10% of institutions use "sufficiently forward-looking and granular [climate and environmental] risk information in their governance and risk management practices." The ECB has sent feedback letters to all "significant institutions," which contained, on average, 25 shortcomings.

The ECB expects institutions to satisfy its articulated expectations by the end of 2024 according to the following milestones:

- By the end of March 2023, have in place "a sound and comprehensive materiality assessment, including robust scanning of the business environment"
- By the end of 2023, manage climate and environmental risks with an "institution-wide approach"
- By the end of 2024, fully align with all "supervisory expectations"

Taking the Temperature: The ECB's observation that a "wait and see" approach is prevalent is not surprising. Instead of a raft of "trailblazer" banks taking the lead on setting concrete steps, we expect the majority of regulated institutions to continue to be reactive to pressure and guidance from the ECB given the continually evolving nature of the climate and environmental landscape. And, as in other industries, regulatory guidance for financial institutions varies among jurisdictions and, in many cases, remains in formative stages. For example, in September, the Federal Reserve Board announced that, in 2023, six of the largest U.S. banks will participate in a climate

scenario analysis exercise to analyze the impact of various climate scenarios on climate portfolios and business strategies. Following the exercise, the Fed will publish guidance on climate risk management and practices. Nonetheless, even institutions not subject to ECB regulation would be well served to consider its climate-related guidance. Consideration of short- and intermediate-term targets for reaching long-term goals, looking for "blind spots in the identification of C&E risks in key sectors, geographies and risk drivers," and using more granular or scientific information, especially "at the counterparty, facility or asset level in order to develop measurement approaches at higher resolution," are all sensible approaches, even if complex to implement in practice.

Regulation: U.S. – UAE Clean Energy Partnership Signed

November 4, 2022

Regulation

By Jodi Avergun
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On November 1, in Abu Dhabi, the United States and the United Arab Emirates agreed to a clean energy framework called the Partnership for Accelerating Clean Energy (PACE). According to a U.S. Department of State **press release**, this partnership will lead to "$100 billion in financing, investment, and other support, allowing us to accelerate toward a goal of deploying 100 gigawatts of clean energy by 2035."

White House Press Secretary Karine Jean-Pierre **stated** that PACE would "catalyze $100 billion in clean energy financing in both countries, as well as robust commercial investment and other support for the emerging economies whose clean development is both underfunded and essential to the global climate effort." The United States and the UAE will set up an expert group to identify priority projects, remove potential hurdles, and measure PACE's progress in achieving its goals.

Taking the Temperature: The UAE, the fifth largest producer in OPEC, is a major oil exporter but has invested heavily in developing green fuel sources. Its 2050 targeted energy mix, for instance, combines renewable, nuclear and clean energy sources to meet the UAE's needs, with goals of 44% clean energy, 38% gas, 12% clean coal and 6% nuclear. Not long ago it might have been striking to see a significant OPEC member publicly articulate non-fossil fuel energy goals and make meaningful investments toward achieving those goals. The UAE's decision to do so reflects a recognition both of a global transition to a green economy occurring over time and the reality that fossil fuel energy is necessary to meet current global demand and enable that green transition to occur at all. In addition, as with the recently enacted Inflation Reduction Act in the U.S., PACE is one of a number of initiatives around the world that is likely to generate significant financing and investment activity in developing non-fossil fuel energy sources and carbon capture technologies.