Financial Markets Law Committee ("FMLC")

ESG Scoping Forum

Date: Wednesday 3 March 2020

Time: 2.00pm to 3.30pm

Virtual meeting

Attendees:

Stuart Doxford (Moderator)	Simmons & Simmons LLP
Phil Bartram	Travers Smith LLP
Lauren Butchart	J.P. Morgan
Tamara Cizeika	Allen & Overy LLP
Claire Doust	BNP Paribas
Gabrielle Ereira	Slaughter and May
Leland Goss	International Capital Market Association
Selmin Hakki	Slaughter and May
Mindy Hauman	White & Case LLP
Lorraine Johnston	Ashurst LLP
Ida Levine	Impact Investing Institute
Caitlin McErlane	Baker & McKenzie LLP
Sarah Oliver Scemla	Bank of America
Ashar Qureshi	Fried, Frank, Harris, Shriver & Jacobson (London) LLP
Selina Sagayam	Gibson, Dunn & Crutcher UK LLP
Joanna Treacy	K&L Gates LLP
Ayesha Waheed	Morgan, Lewis & Bockius UK LLP
Simon Witney	Travers Smith LLP
Simon Wright	Dechert LLP
Ezra Zahabi	Akin Gump Strauss Hauer & Feld
Jana Zupikova	Dechert LLP
Venessa Parekh	FMLC Secretariat
Katja Trela-Larsen	FMLC Secretariat

Regrets:

Gregg Beechey	Fried, Frank, Harris, Shriver & Jacobson (London) LLP

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Paul Double	City of London Corporation
Imogen Garner	Norton Rose Fulbright LLP
Katy Hyams	The London Metal Exchange
Neil Robson	Katten Muchin Rosenman UK LLP
Matthew Townsend	Allen & Overy LLP
Peter Werner	International Swaps & Derivatives Association

Minutes:

1. Introductions

1.1. Mr Doxford opened the meeting and introduced the topics scheduled for discussion.

2. FMLC Scoping Forums (Venessa Parekh)

2.1. Ms Parekh explained that the FMLC's remit covers the entirety of the wholesale financial markets. In order to identify issues of legal uncertainty, the FMLC Secretariat runs ten Scoping Forums, each focused on a specific area of the financial services. Ms Parekh reminded members how Scoping Forums work in practice to further the aims of the FMLC, their role in Forum and the Forum's conduct of business rules.

3. Application of the Sustainable Finance Disclosure Regulation to Third Country Alternative Investment Fund Managers (Lorraine Johnston)

3.1. Ms Johnston reminded attendees that Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector (the "**Sustainable Finance Disclosure Regulation**" or "**SDFR**") and its potential extraterritorial application had been discussed at previous ESG Scoping Forum meetings. She noted that, while the new disclosure obligations under SFDR will come into force on 10 March, there remains uncertainty as to its application for Third Country alternative investment fund managers ("**AIFMs**").

3.2. The SFDR introduces various disclosure-related requirements at entity, service and product level for AIFMs. Ms Johnston observed that given the uncertainty around the application of the SFDR a number of different approaches were being taken by non-E.U. market participants: a number of firms have prepared to apply the SDFR's product level requirements rather than entity level, others are applying both SFDR entity and product level requirements on a best-efforts basis, and some firms have decided on a lighter-touch approach to implementation. She observed that a consensus has developed among market participants that funds solely sold into the E.U. on the basis of reverse solicitation are not generally required to comply with the SFDR.

3.3. Ms Johnston queried whether market participants were weighing the risks, such as enforcement action or reputational considerations, in their decisions as to how far to try to comply with the SFDR. Ms Johnston gave her opinion that this would be an area to watch, in particular in the context of the letter sent by the European Supervisory Authorities requesting clarification on the application of the SFDR (the "**ESA Letter**").[1] The European Commission's response, when published, might shed light on the future obligations firms would have to take into account.

3.4. A member posited that if market participants choose to be cautious, owing to the European Commission's delay in responding to the ESA Letter, they will apply the SFDR. Ms Johnston observed that Articles 3 and 5 of the SFDR should be easier to comply with than Article 4, which requires more consideration. A member remarked that she had observed some firms considering adopting a sectoral argument to explain why they might not need to comply with the SFDR. Members discussed how the SFDR might apply to European affiliates and delegation arrangements.

4. Speech by Fabio Panetta (Member of the Executive Board of the European Central Bank): Sustainable finance—Transforming Finance to Finance the Transformation (Ida Levine)[2]

4.1. Ms Levine explained that the speech by Fabio Panetta—a board member of the European Central Bank ("**ECB**")—to the Italian Association for Financial Analysts (the *Associazione Italiana per l'Analisi Finanziaria,* or "**AIAF**") in January had drawn her attention because it seems to reflect the E.U.'s approach of utilising policy objectives to further financial regulation. Ms Levine stated that the E.U. is the vanguard of using "green" policy to drive regulation.

4.2. Ms Levine went on to give an overview of Mr Panetta's speech which speech considered how sustainability and climate-related risks can be evaluated in light of the disruption

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1 Joint Committee of the European Supervisory Authorities, Letter to the European Commission on priority issues relating to SFDR application (7 January 2021) available at: https://www.esma.europa.eu/sites/default/files/library/jc_2021_02_letter_to_eu_commission_on_priority_issues_relating_to_sfdr_application.pdf

2 Mr Fabio Panetta, Member of the Executive Board of the European Central Bank, Keynote speech at the 50th anniversary of the Associazione Italiana per l'Analisi Finanziaria, "Sustainable finance- transforming finance to finance the transformation" (25 January 2021), available at: https://www.bis.org/review/r210127f.htm

caused by the COVID-19 pandemic. Mr Panetta notes that sustainability was brought to the fore in 2015 when the United Nations launched its 2030 Agenda for Sustainable Development and the Paris Agreement was signed.[3] The COVID-19 pandemic has increased the focus on social considerations as it has exacerbated the risk of poverty and social exclusion.

4.3. Ms Levine explained that Mr Panetta examined the ECB's role in tackling climate-related risks. Article 127 of the Treaty on the Functioning of the E.U. ("**TFEU**") states that the primary objective of the ECB is to maintain price stability. The TFEU also states that, as a secondary aim, the ECB shall support the achievement of the E.U.'s objectives and Article 3 of the TFEU includes sustainable development among these objectives. Mr Panetta states that the monetary policy stance has at best only a negligible impact on environmental risks, however the ECB can contribute to environmental policies in the implementation of monetary policy. Ms Levine stated the speech looks for a broader role for central banks in addressing climate change. A member commented that the speech's focus on how sustainable investment projects might support growth was positive.

5. Contentious risk arising from ESG considerations (Stuart Doxford)

5.1. Mr Doxford commented that ESG issues have increased in prominence. Institutions must comply with an increasing number of rapidly-evolving reporting and disclosure requirements. Regulation around ESG is developing rapidly, in addition to pressures from stakeholders and/or reputational concerns. He suggested the most obvious litigation risks centre around greenwashing: for example, there may be misrepresentation claims or action in relation to shareholders' disclosures. Mr Doxford noted, however, that litigation, including that arising from "greenwashing" claims, and regulatory action in this space are in their infancy in the U.K.

5.2. Mr Doxford observed an increasing global trend in public interest litigation and stakeholder action. For example, REST, a large Australian pension fund, recently agreed to settle a landmark climate risk litigation brought by one of its members. Another example provided by Mr Doxford was the recent publication, by environmental charity ClientEarth, of a letter to HSBC in respect of climate change risk and the Paris Agreement. The letter urged HSBC's board members to support a climate resolution at the bank's

[3] The United Nations, The 2030 Agenda for Sustainable Development available at: https://sustainabledevelopment.un.org/content/documents/21252030%20Agenda%20for%20Sustainable%20Development%20web.pdf

upcoming Annual General Meeting.[4] Mr Doxford provided an overview of the actions firms might take to minimise their risk regulatory action and litigation in this area. He remarked that courts appear to be placing more weight on documentation than witness statements as evidence in this area which suggests that a good audit trail and record of decision making are essential.

5.3. Mr Doxford moved on to discuss issues around the divergence in quality and comparability of ESG data. A member echoed Mr Doxford's concern, explaining that many firms turn to information provided by ratings agencies as a proxy for data on ESG matters. Mr Doxford stated that ESG ratings can differ significantly as between different ratings agencies, highlighting the difficulties funds face in relying on ESG ratings for the basis of their investment decisions. Mr Doxford gave the example of the recent controversy over Boohoo's supply chain issues and disclosures around modern slavery, and variation in its treatment by rating agencies before this issue came to light.

5.4. Members discussed the litigation risk that may arise under the SFDR. A member posited that they could envisage the SFDR, overlayed by Regulation (EU) 2020/852 on the establishment of a framework to facilitate sustainable investment (the "**Green Taxonomy Regulation**"), alleviating the burden of ESG information. Members discussed the classification of funds into three categories by Articles 6, 8 and 9 of the SFDR. A member suggested bucketing funds under Article 6 might reduce commercial risk. A member posited that any positive ESG related claim in relation to a fund in its literature or name might be enough to classify it as an Article 8 fund under the SFDR.

6. Any other business

6.1. No further business was raised.

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[4] ClientEarth, Letter to HSBC (11 February 2021), available at: https://www.clientearth.org/latest/documents/letter-from-clientearth-to-noel-quinn-of-hsbc/