

KEY ESG DEVELOPMENTS IN 2023



GOVERNANCE AND SUSTAINABILITY
Part of the Horizon Scanning series

The beginning of a new year is a good chance to reflect on the year that has passed. We have taken stock of the top 10 ESG topics for businesses that we considered at the beginning of 2023 (ESG in 2023 - Forward Look), and highlight the key developments over 2023 below.



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TOPICS

KEY DEVELOPMENTS IN 2023

1. A RED LINE ON GREENWASHING



A growing number of companies have been linked to misleading sustainability statements with tangible consequences

- Over the course of 2023 there was a notable increase in claims based on greenwashing allegations.
- Regulatory action has continued through 2023, with both the Competition and Markets Authority (CMA) and Advertising Standards Authority publishing guidance on green claims, highlighting a focus on consumers making informed decisions about ‘greener’ products and services.
- The CMA has taken a keen interest, as shown by the Digital Markets, Competition and Consumer Bill, providing the CMA with the power to issue fines of up to 10% of global turnover.
- There were also positive developments from new initiatives and frameworks that aim to increase transparency in corporate behaviour, for example the proposed EU Green Claims Directive, which would require companies to substantiate broad claims like “carbon neutral” or “made from recycled materials.”
- In the UK, the Financial Conduct Authority (FCA) is evaluating ESG statements made by asset managers, making it harder to market investments as green or sustainable without an accompanying ESG strategy.

2. TRANSITION PLANNING TO TAKE CENTRE STAGE



Corporates now have a gold standard on transition plans to follow

- In October, the Transition Plan Taskforce (TPT) launched its 'gold standard' disclosure framework for companies and financial institutions to tackle climate change.
- The TPT also ran a consultation on its sector-specific guidance for preparers and users of climate transition plans in the Asset Managers, Asset Owners, Banks, Electric Utilities and Power Generators, Food and Beverage, Metals and Mining, and Oil and Gas sectors which closed on 29 December.
- Large corporates and financial institutions have been proactive in this area, with many taking the advice of regulators such as the FCA in using the draft framework to work up credible transition plans in advance of the launch of the final framework.

3. THE JUST TRANSITION



Concept still highly relevant but further clarity is needed

- The concept of "just transition" has continued to gain further currency during 2023. However, the terminology has been criticised, including most recently by the UK Climate Change Committee's Chris Stark who has proposed that the movement is framed around "fairness", being easier to measure and less "vague".
- The TPT has emphasised the importance of transition plans linking to and accounting for the "just transition", setting up a working group on the topic.
- At COP28, the United Nations Environment Programme Finance Initiative and the International Labor Organisation released 'Just Transition Finance: Pathways for Banking and Insurance', the first roadmap for the financial sector to promote a just transition to low-carbon, resource-efficient and resilient economies.

4. HUMAN RIGHTS DUE DILIGENCE – PRESSURE INCREASING



Pressure has translated into an emerging body of legislation requiring mandatory human rights due diligence

- On 8 June 2023, the OECD published its updated Guidelines for Multinational Enterprises on Responsible Business Conduct (Guidelines).
- The 2023 updates include: encouraging alignment with internationally agreed goals on climate and biodiversity; recommendations on how companies should conduct value-chain due diligence; updates to expectations of disclosure; measures that recommend due diligence covers all forms of corruption; expectations of better protection for vulnerable groups; guidelines for lobbying; and measures to strengthen the OECD National Contact Points (non-judicial, national complaint mechanisms).
- However, the continuing increase in the volume of legislation requiring mandatory human rights due diligence means that many companies will have to choose between satisfying local law requirements and also meeting the higher standard set out in the UN General Principles and the Guidelines.
- More broadly in the business and human rights space, there has been an increasing focus on: the interrelation between climate and human rights; the rights of vulnerable groups such as indigenous populations, migrant workers and children; and the role of businesses in remedying human rights violations in their supply chains.
- These themes are reflected in the growing number of standards and laws addressing business and human rights issues worldwide, and claims against businesses for alleged human rights abuses – a challenge for multinationals with large and complex value chains.

5. REPORTING REQUIREMENTS SET TO BECOME MORE STANDARDISED

Certainty about climate and sustainability disclosures, along with expectations as to quality, continues to grow

- Taskforce on Climate-related Financial Disclosures-based reporting is widespread and now well bedded-in.
- The phased implementation of the EU's Corporate Sustainability Reporting Directive has begun, and the International Sustainability Standards Board's sustainability and climate change disclosure standards are being reviewed worldwide with a view to domestic implementation in the next few years.
- Reporting on transition plans is also starting to be introduced, with the TPT's disclosure framework offering some structure and guidance as to what these disclosures might look like in practice.

6. BIODIVERSITY AND NATURE – GROWING IMPORTANCE

Biodiversity accelerated up the business risk and opportunities agenda during 2023

- The framework produced by the Taskforce on Nature-related Financial Disclosures (TNFD) – released in September 2023 – provides a new pathway for businesses to act on biodiversity loss.
- The TNFD recommendations are structured around four thematic areas that represent core elements of how organisations operate: governance, strategy, risk management, and metrics and targets.
- Biodiversity is also a growing priority for governments and institutions. The EU released its biodiversity strategy for 2030, which is a long-term plan to protect nature and reverse the degradation of ecosystems, and has begun implementing legislation such as the Nature Restoration Law as part of its strategy.

7. CARBON CREDITS AND MARKETS

A focus on integrity in the voluntary carbon markets, coupled with proposals to address carbon leakage in the mandatory carbon markets

- The TPT disclosure framework contains a carbon credits disclosure sub-element and associated recommendations, which should assist users with understanding how the use of carbon credits might fit within a good practice transition plan.
- Privately-led initiatives which aim to develop high-integrity carbon crediting standards have continued to take strides during 2023, with the launch of the Integrity Council for the Voluntary Carbon Market's Core Carbon Principles, and the Voluntary Carbon Markets Integrity Initiative's Claims Code of Practice.
- There have also been notable updates in relation to the mandatory (or compliance) carbon markets during the year. The EU's Carbon Border Adjustment Mechanism (CBAM) came into force in May 2023, which aims to address the risk of carbon leakage by, in time, imposing tariffs on certain imports into the EU.
- The EU CBAM's design was shaped, in part, by the EU's desire to phase out free allowances under its Emissions Trading System (ETS). From 2026 onwards, free allowance allocations under the EU ETS will be replaced with import tariffs, in order to strengthen the EU ETS's capacity to achieve the EU's emissions targets.

8. SUSTAINABLE FINANCE CONTINUES TO GROW

Standards and guidelines for ESG-labelled products should support the functioning and integrity of the market

- 2023 saw continued focus on sustainable debt products, with both the LMA and ICMA, as expected, reviewing, updating and supplementing their voluntary recommended guidelines for ESG-labelled products, to better support the functioning and integrity of the market.
- The long-awaited EU Green Bond Standard was finally adopted towards the end of 2023 and the LMA published much anticipated template provisions for sustainability-linked loans.
- Beyond ESG-labelled products, as expected, there has been growing focus from lenders and investors on the sustainability profile and strategy of borrowers and issuers and, in the bond markets, increased regulatory focus on sustainability disclosures in prospectuses.

9. CLIMATE TECH ON THE RISE



Shift in investment towards technologies that can cut emissions the most

- Funding for climate technology markedly accelerated in 2023; this has facilitated a boom in activity in previously neglected technologies, such as carbon capture and green hydrogen – with it being widely considered that investment in innovative climate technology is an essential step in achieving net zero.
- There has been a shift in investment towards technologies that can cut emissions the most, with the International Energy Agency (IEA) projecting that 2023 will see \$1.7 trillion go towards renewables, grids and clean-energy technologies. Whilst this is a record high following six consecutive years of increases, it has also been noted by the IEA that over one-third of the emissions reductions occurring in 2050 depend on technologies that are currently only in development.

10. THE EVOLVING ENVIRONMENTAL LAW LANDSCAPE



Increasing EU-UK divergence is set to remain a key theme, as the UK strikes its own path post-Brexit

- The Retained EU Law (Revocation and Reform) Act (REUL Act) – much vaunted by the UK Government as a means of making the most of regulatory freedoms post-Brexit - has now become law. Some of the more controversial provisions of the REUL Act (including the ‘sunset’ clause, which would have meant that EU-derived laws were deleted automatically) were dropped as part of the legislative process. However, the effects are still likely to be significant, with the REUL Act effectively ending the supremacy of EU law by the end of 31 December 2023.
- Although the UK Government has made commitments on environmental protection, we expect that the EU and UK regulatory frameworks will start to diverge over time, with the EU pressing ahead more quickly in some instances.
- One example of this relates to the EU and UK’s different proposals on deforestation. The EU’s deforestation regulation has now entered into force, and in-scope companies will be required to diligence their supply chains in order to prove that certain commodities do not originate from recently deforested land and have not contributed to forest degradation from as early as late 2024. Meanwhile, the related UK proposals set out in the Environment Act 2021 have yet to be implemented, although the UK Government recently announced that it would lay secondary legislation to introduce the scheme “when Parliamentary time allows”.



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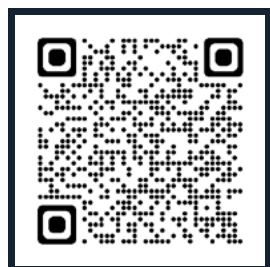
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