Emerging Trends in ESG within the Financial Services Sector

ESG litigation and regulatory risks are an increasing focus for financial institutions and financial services companies. In the US, the federal regulatory regime is not yet set, while a number of individual states have enacted legislation directed at climate change disclosures. A political split between “red states” and “blue states” remains, and the outcome of the 2024 elections will impact the regulatory environment around ESG. Greenwashing is already unlawful under consumer protection laws, including false advertising and unfair competition statutes. These claims continue to grow and are increasingly diversified, presenting both direct risk to banks and financial services companies and indirect risk through credit risks to lenders and insurers, who increasing are threatened by litigation and regulatory risk.

Federal and State Regulators Focus on Mandatory ESG Disclosures

- **Federal**
    - On March 6, 2024, the Securities and Exchange Commission (SEC) adopted final rules to Enhance and Standardize Climate-Related Disclosures for Investors, which are currently stayed pending judicial review.
    - On September 20, 2023, the SEC adopted the rule Enhancements to Prevent Misleading or Deceptive Investment Fund Names.
    - On Nov. 14, 2022, the Federal Acquisition Regulatory Council proposed a rule to amend the Federal Acquisition Regulation to require certain federal contractors to disclose their GHG emissions, climate-related financial risks and to set Green House Gas (GHG) emissions reduction targets.
- **States**
    - Pro ESG states are requiring mandatory ESG disclosures for companies that conduct business within their states above certain financial thresholds.
    - In 2023, California passed three bills requiring mandatory GHG emission (scope 1,2, and 3 emissions), climate related financial risk disclosure and voluntary carbon offset related disclosures.
    - New York, Illinois, and Washington have pending regulations requiring disclosure of GHG emissions.

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The fallout from the 2023 bank failures have created emerging trends and new risks that apply to the banking and financial services industry across the world. We discuss the business, regulatory, and litigation activities that have occurred in the aftermath of the collapses and predictions of what’s to come. Use the below QR code to access these insights.

Climate-Related Financial Risk Oversight Intensifies

- **Federal**
  - In April 2022, the National Association of Insurance Commissioners (NAIC) approved a revised Climate Risk Disclosure Survey. This followed adoption of the 2010 Climate Risk Disclosure Survey (a voluntary risk management tool for state insurance regulators to request an annual non-confidential disclosure of climate-related risks).
  - In September 2023, the US Department of Treasury released Principles for Net-Zero Financing & Investment.
  - In October 2023, the Federal Reserve System issued principles for Climate-Related Financial Risk Management for Large Financial Institutions (those with $100 billion or more in total assets).
- **States**
  - In December 2023, the New York Department of Financial Services (NYDFS) issued Guidance for New York State Regulated Banking and Mortgage Institutions Relating to Management of Material Financial and Operational Risks from Climate Change. This followed 2021 guidance to New York domestic insurers describing NYDFS's expectations on the approach insurers should take for managing financial risks from climate change.

Anti-ESG Pushback Creates Complex Regulatory and Litigation Risk

- **Red State Challenges**
  - Anti-ESG states have directed divestment from investments that have an ESG focus and challenged ESG investment practices as violating duties to prioritize investment returns.
  - In 2023, more than two-thirds of U.S. state legislatures introduced anti-ESG legislation, and 13 states passed statutes that:
    - Prohibit state or governmental entities from using banking and finance firms that discriminate or boycott against fossil fuel, energy, transportation, and firearms manufacturers and sellers' companies based on ESG criteria.
    - Prohibit insurers from incorporating ESG principles to assess coverage availability or applicable rates.
  - State Attorney Generals and U.S Senators are warning Asset Managers (March 2023) and investment managers (August 2022) against pursuing ESG based investments.
  - Anti-competition challenges were raised to participation in the UN Net Zero Insurance Alliance (NZIA) (May 2023) and UN Net Zero Banking Alliance (October 2022) (January 2024) (February 21, 2024).

Increasing Focus on Greenwashing Enforcement and Class Action Litigation Risks

- **Enforcement**
  - In March 2021, the SEC launched the Climate and ESG Task Force within the Division of Enforcement to develop initiatives to proactively identify ESG-related misconduct consistent with increased investor reliance on climate and ESG-related disclosure and investment. The Task Force has imposed multimillion-dollar penalties against investment advisers and funds.
  - The Federal Trade Commission (FTC) has long focused on greenwashing, and it is active in enforcement.
  - State Attorneys General are also becoming more engaged, especially in the environmental context.
- **Litigation**
  - Putative consumer class actions are a significant and growing risk. Greenwashing is unlawful under both federal and state consumer protection laws.
  - Key areas of focus for financial services and insurance clients are alleged misrepresentations of ESG commitments, achievability of ESG goals, and non-disclosure of relationships with fossil fuels and similar companies.
  - Class action litigation may also attract regulatory attention and create reputational, headline, and regulatory risk.
  - Greenhushing (intentionally not publishing ESG goals and commitments) is an emerging trend.
  - Risks for financial services and insurance companies go far beyond just the "E" in ESG, and include cybersecurity/operational resilience, challenges to financing disfavored businesses (such as prisons, firearms), diversity and inclusion initiatives, redlining/availability of credit or insurance, and disparate impact issues.

For more information about DLA Piper's financial services practice, please get in touch with your DLA Piper contact. For further insight about this information, please contact Isabelle Ord or Jeremy Sher.