Chapter 4

Environmental, Social, and Governance Matters: The Rapidly Evolving ESG Reporting Landscape

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PART I. INTRODUCTION

§ 4:1 Convergence of "alphabet soup," with a focus on climate-related financial disclosures

In the year since the publication of the last edition of this book, we have seen dramatic movement in the United States and across the world toward the harmonization of Environmental, Social, and Governance ("ESG") reporting standards broadly, and specifically toward the adoption of mandatory climate-related financial disclosure requirements. While the period between 2021-2022 was punctuated by a focus on racial inequality and diversity, equity, and inclusion, the year from 2022-2023 has seen a significant focus on climate change. As recently observed by the Financial Stability Board, "work to strengthen the comparability, consistency and decision-usefulness of climate-related financial disclosures has moved forward rapidly over the past year."[1]

We have previously discussed the "alphabet soup" of ESG reporting frameworks and voluntary reporting standards that has

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[1] Financial Stability Board, "Progress Report on Climate-related Disclosures" (Oct. 13, 2022), available at https://www.fsb.org/wp-content/uploads/P131022-2.pdf.

emerged in response to the growing investor demand for information about companies' ESG risks and opportunities.[2] In the last year, a number of the key independent standard setters came together to form an alliance that ultimately produced a prototype climate disclosure standard. That prototype helped to inform the proposed global sustainability standards issued by the International Sustainability Standards Board (ISSB), which was formed at COP26 in November 2021. The ISSB's proposed climate and broader sustainability standards hold the promise to harmonize disclosure requirements around the world, which should foster more consistent, comparable, reliable sustainability disclosures globally.

Also during this last year, the U.S. Securities and Exchange Commission issued proposed corporate climate disclosure rules in March 2022 and proposed investment fund and investment adviser rules related to ESG disclosures, and proposed amendments to the "Names Rule" in May 2022. The European Union, the United Kingdom, and jurisdictions around the world are also engaged in rulemaking on climate — and in some cases broader ESG — disclosure requirements. These jurisdictions have worked with the ISSB as it has formulated its proposed standards, either through direct engagement with the ISSB or through their participation with the International Organization of Securities Commissions (IOSCO). The disclosure rules and standards under development helpfully draw on the Task Force on Climate-related Financial Disclosures (TCFD) framework and the carbon accounting methodology of the Greenhouse Gas Protocol (GHG Protocol). While significant work remains to be done, this year has seen significant progress toward the harmonization of reporting standards and convergence on key reporting frameworks.

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[2] See BLOOMENTHAL AND WOLFF, EMERGING TRENDS IN SECURITIES LAW 2018-2029, 2019-2020, and 2020-2021 editions.

§ 4:2 Urgency to address climate-related risks

As we have observed in prior editions of *Emerging Trends*, ESG issues have become a critical strategic and operational concern for companies across a broad range of industries and around the world. The urgency around climate-related risks, in particular, has intensified in the last year. The growing magnitude and frequency of severe weather events and other physical climate impacts is tracked by the National Centers for Environmental Information, which has documented billion-dollar weather and climate events in the United States since 1980.[1] The data show a steady and dramatic increase in billion-dollar climate events during the 40-year period and particularly so in the last several years. Among the events that contribute to this data, tropical cyclones have caused the most significant damage at $1.2 trillion since 1980 with an average financial impact of $21 billion per event. Cyclones also account for the highest number of deaths over the period (6,864), followed by drought and heat waves (4,256) and severe storms (1,982).[2]

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[1] NOAA National Centers for Environmental Information (NCEI) U.S. "Billion-Dollar Weather and Climate Disasters (2022)," available at https://www.ncei.noaa.gov/access/billions/, DOI: 10.25921/stkw-7w73.

[2] NOAA National Centers for Environmental Information (NCEI) U.S. "Billion-Dollar Weather and Climate Disasters (2022)," available at https://www.ncei.noaa.gov/access/billions/, DOI: 10.25921/stkw-7w73.

Select Time Period Comparisons of United States Billion-Dollar Disaster Statistics (CPI-Adjusted)

Time Period	Billion-Dollar Disasters	Events/Year	Cost	Percent of Total Cost	Cost/Year	Deaths	Deaths/Year
1980s (1980-1989)	31	3.1	$201.5B	8.8%	$20.2B	2,970	297
1990s (1990-1999)	55	5.5	$307.7B	13.4%	$30.8B	3,062	306
2000s (2000-2009)	67	6.7	$576.1B	25.1%	$57.6B	3,102	310
2010s (2010-2019)	128	12.8	$918.8B	40.0%	$91.9B	5,227	523
Last 5 Years (2017-2021)	89	17.8	$788.4B	34.3%	$157.7B	4,557	911
Last 3 Years (2019-2021)	56	18.7	$315.2B	13.7%	$105.1B	1,030	343
Last Year (2021)	20	20.0	$152.6B	6.6%	$152.6B	724	724
All Years (1980-2022)	**338**	**7.9**	**$2,297.5B‡**	**100.0%‡**	**$53.4B‡**	**15,689**	**365**

‡Cost statistics not included for Hurricane Ian (September 2022), Western Wildfires (Spring-Fall 2022), Hurricane Fiona (September 2022)
**Statistics valid as of October 11, 2022*

The intensity and increasing frequency of climate-related disasters amplifies concerns over the growing risks posed to companies and the financial system as a result of climate change. As previously observed, a September 2020 report of the Climate-Related Market Risk Subcommittee, the Market Risk Advisory Committee of the U.S. Commodity Futures Trading Commission sounded the alarm as to the systemic threat climate change poses to the U.S. financial system. "Climate change is already impacting or is anticipated to impact nearly every facet of the economy, including infrastructure, agriculture, residential and commercial property, as well as human health and labor productivity. Over time, if significant action is not taken to check rising global average temperatures, climate change impacts could impair the productive capacity of the economy and undermine its ability to generate employment, income, and opportunity."[3]

Other policymakers have been focused on the threat climate change poses to the stability of national and global financial systems. In October 2021, the U.S. Financial Stability Oversight

3 Report of the Climate-Related Market Risk Subcommittee, Market Risk Advisory Committee of the U.S. Commodity Futures Trading Commission, "Managing Climate Risk in the U.S. Financial System" (Sept. 9, 2020).

Council (FSOC)[4] issued a Report on Climate-related Financial Risk[5] in response to President Biden's directive in Executive Order 14030.[6] The report provided that the FSOC "views climate-related financial risks as an emerging threat to the financial stability of the United States."[7] The Financial Stability Board "is coordinating internationally the work to address climate-related financial risks. These risks are global in nature, and will have effects across all entities, sectors and economies."[8] The FSB concludes "The occurrence of extreme climate events, as well as a disorderly transition to a low-carbon economy, could have destabilizing effects on the financial system, including through a rise in risk premia and falling asset prices in

[4] The Financial Stability Oversight Council was established by the Dodd-Frank Wall Street Reform and Consumer Protection Act to address emerging threats to the stability of the U.S. financial system. It includes ten members who head the U.S. Department of Treasury, Federal Reserve System, Consumer Financial Protection Bureau, Comptroller of the Currency, SEC, FDIC, CFTC, FHFA, and the National Credit Union Administration.

[5] Financial Stability Oversight Council, "Report on Climate-related Financial Risk 2021" (Oct. 21, 2021), available at https://home.treasury.gov/system/files/261/FSOC-Climate-Report.pdf.

[6] Executive Order No. 14,030, 87 Fed. Reg. 27967 (May 20, 2021), available at https://www.federalregister.gov/documents/2021/05/25/2021-11168/climate-related-financial-risk.

[7] Financial Stability Oversight Council, "Report on Climate-Related Financial Risk 2021" (Oct. 21, 2021), available at https://home.treasury.gov/system/files/261/FSOC-Climate-Report.pdf.

[8] Financial Stability Board, "Climate-related risks," available at https://www.fsb.org/work-of-the-fsb/financial-innovation-and-structural-change/climate-related-risks/.

the relatively short term . . . (these risks) are far-reaching and differ from other risks to financial stability."[9]

The World Economic Forum's Global Risks Report for 2022 found respondents ranked "climate action failure" as the "gravest threat to humanity" and the risk that carries the most significant impacts over the next decade.[10] Moreover, the second and third most severe risks — those posed by severe weather and biodiversity loss — also directly relate to climate change.[11] The report highlights the threats these risks pose to businesses and broader economic stability; "[b]usinesses may be unprepared for transition risks such as rapid shifts in policies and regulations, the need to develop low-carbon technologies and changes in consumer behaviour and investor preferences. These risks have the potential to destabilize the financial system."[12] The focus on "climate action failure" echoes the concern expressed in the FSOC report that a delay in addressing climate change intensifies the risk of a "disorderly transition" in which policy actions must be taken abruptly to address the mounting climate crisis, likely at a time when businesses and governments are ill-equipped to address those changes because of the stress placed on them by the climate crises with which they are then contending.

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[9] Financial Stability Board, "Climate-related risks," available at https://www.fsb.org/work-of-the-fsb/financial-innovation-and-structural-change/climate-related-risks/.

[10] World Economic Forum, "The Global Risks Report 2022," available at https://www3.weforum.org/docs/WEF_The_Global_Risks_Report_2022.pdf.

[11] World Economic Forum, "The Global Risks Report 2022," available at https://www3.weforum.org/docs/WEF_The_Global_Risks_Report_2022.pdf.

[12] World Economic Forum, "The Global Risks Report 2022," available at https://www3.weforum.org/docs/WEF_The_Global_Risks_Report_2022.pdf.

§ 4:3 Investors hit the accelerator — Making their own net zero commitments and keeping pressure on companies to report

Investors have for some years demanded climate and other ESG information from the companies in which they invest. The broad adoption of the UN Principles for Responsible Investment (PRI) illustrates the point. The UN adopted the PRI in 2006, establishing a set of investment principles by which the signatories incorporate ESG considerations in their investment processes. In its June 2022 quarterly signatory update, PRI announced it had surpassed 5,000 signatories.[1]

Blackrock CEO Larry Fink's 2020 annual letter to the CEOs was a significant inflection point. That letter established climate as central to Blackrock's investment approach and a mainstream investor issue. "Climate change has become a defining factor in companies' long-term prospects," and proclaiming "we are on the edge of a fundamental reshaping of finance."[2] Blackrock and other investors followed up by engaging with companies on their climate and broader sustainability performance, asking for disclosure pursuant to the TCFD and the Sustainable Accounting Standards Board (SASB) and voting against the directors of companies on the basis of inadequate climate action and/or disclosures.[3]

In his 2022 letter to CEOs, Fink observed the shift that has occurred. "It's been two years since I wrote that climate risk is

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[1] UN PRI "Quarterly Signatory Update" available at https://www.unpri.org/signatories/signatory-resources/quarterly-signatory-update.

[2] BlackRock, "Larry Fink's Annual Letter to CEOs" (2020), available at https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter.

[3] BlackRock, "Larry Fink's Annual Letter to CEOs" (2020), available at https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter.

investment risk. And in that short period, we have seen a tectonic shift of capital. Sustainable investments have now reached $4 trillion. Actions and ambitions towards decarbonization have also increased. This is just the beginning – the tectonic shift towards sustainable investing is still accelerating. Whether it is capital being deployed into new ventures focused on energy innovation, or capital transferring from traditional indexes into more customized portfolios and products, we will see more money in motion."[4]

While significant amounts of funds have poured into sustainable investments, there has also been a backlash. A conservative movement has emerged that criticizes companies and investors that address issues such as climate change as engaging in "woke capitalism."[5] They accuse asset managers such as BlackRock of using investment funds to promote liberal policy agendas rather than optimizing shareholder value in what has become a pitched battle.[6] Fink, for his part, has been clear that BlackRock's ESG focus is for the purpose of maximizing value. "Stakeholder capitalism is not about politics. It is not a social or ideological agenda. It is not 'woke.' It is capitalism, driven by mutually beneficial relationships between you and the employees, customers, suppliers, and communities your company relies on to

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[4] BlackRock, "Larry Fink's Annual Letter to CEOs" (2022), available at https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter?cid=ppc:blk:ll:na:ol:goog:na:v2:bhv:tl&gclid=Cj0KCQjw166aBhDEARIsAMEyZh7_DjxQ2cegTXoDK5TrNHaDpddvwk6eJKl5T98pM8YmZOoc8bdR-0MaAhXCEALw_wcB&gclsrc=aw.ds.

[5] Axios, "Conservatives' war on BlackRock" (Aug. 17, 2022), available at https://www.axios.com/2022/08/18/blackrock-esg-conservatives.

[6] Corporate Knights, "ESG squeezed between Republican attacks on 'woke capitalism' and climate investors" (Sept. 13, 2022), available at https://www.corporateknights.com/responsible-investing/esg-squeezed-between-republican-attacks-on-woke-capitalism-and-climate-investors/.

prosper."[7] Moreover, he continues, "[w]e focus on sustainability not because we're environmentalists, but because we are capitalists and fiduciaries to our clients."[8]

With this debate stirring in the background, asset owners and asset managers have stepped up their Net Zero emissions commitments. In April 2021, the Glasgow Financial Alliance for Net Zero (GFANZ) was launched by Mark Carney, the UN Special Envoy for Climate Action and former Governor of the Bank of England (and architect of the TCFD).[9] GFANZ now counts over 450 financial firms in 45 countries controlling over $130 trillion in assets as members.[10] The GFANZ members join one of seven sector-specific alliances to work to meet their net zero commitments.[11] Each member makes the following com-

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[7] BlackRock, "Larry Fink's Annual Letter to CEOs" (2022), available at https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter?cid=ppc:blk:ll:na:ol:goog:na:v2:bhv:tl&gclid=Cj0KCQjw166aBhDEARIsAMEyZh7_DjxQ2cegTXoDK5TrNHaDpddvwk6eJKl5T98pM8YmZOoc8bdR-0MaAhXCEALw_wcB&gclsrc=aw.ds.

[8] BlackRock, "Larry Fink's Annual Letter to CEOs" (2022), available at https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter?cid=ppc:blk:ll:na:ol:goog:na:v2:bhv:tl&gclid=Cj0KCQjw166aBhDEARIsAMEyZh7_DjxQ2cegTXoDK5TrNHaDpddvwk6eJKl5T98pM8YmZOoc8bdR-0MaAhXCEALw_wcB&gclsrc=aw.ds.

[9] UN Climate Change, "New Financial Alliance for Net Zero Emissions Launches" (Apr. 21, 2021), available at https://unfccc.int/news/new-financial-alliance-for-net-zero-emissions-launches.

[10] GFANZ "About us," available at https://www.gfanzero.com/about-announcement/.

[11] GFANZ "Our Members," available at https://www.gfanzero.com/membership/. The seven sector alliances are (1) Net-Zero Asset Owner Alliance, (2) Net-Zero Asset Managers Initiative, (3) Paris-Aligned Asset Owners, (4) Net-Zero Banking Alliance, (5) Net-Zero Insurance Alliance, (6) Net-Zero Financial Service Providers Alliance, and (7) Net-Zero Investment Consultants Initiative.

mitments, which it pursues through its sector-specific alliance: (1) using science-based guidelines to meet net zero emissions across all emission scopes by 2050, (2) setting interim targets for 2030 that represent a fair share of the 50 percent decarbonization needed by the end of the decade, (3) establishing and executing a net-zero transition plan, (4) transparent reporting and accounting on progress toward the targets, and (5) adhering to restrictions on the use of offsets.[12]

Corporations have also increasingly made net zero commitments, with a growing number of companies committing to the Science Based Target Initiative (SBTi) and The Climate Pledge. The SBTi was created in 2015 to encourage companies to reduce their emissions and ensure their GHG reduction targets align with climate science. Approximately 4,000 companies have set or committed to setting SBTi targets.

Amazon's Climate Pledge, established in 2019, requires signatories to commit to reach net zero emissions by 2040. As of September 2022, 376 companies with $18.6 trillion in total market capitalization had signed on to the Climate Pledge. The Climate Pledge signatories commit to regular GHG emissions reporting, implementation of decarbonization strategies in line with the Paris Agreement, and eliminating remaining emissions with quantifiable, permanent carbon offsets to achieve net zero annual emissions by 2040.

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[12] GFANZ "Our Members," available at https://www.gfanzero.com/membership/.

§ 4:4 Increased focus on climate change created a chaotic landscape of private sector questionnaires and voluntary disclosure standards

As investor demand for ESG information from companies increased over the last handful of years, so too did private sector ratings firms, which often issue lengthy questionnaires to companies to inform their scoring of companies' ESG performance. Hundreds of voluntary disclosure standards also emerged to guide companies' disclosures.[1] This state of affairs was unsatisfactory as companies complained that they were suffering from questionnaire fatigue, and investors were frustrated by the proliferation of information in various formats that made information difficult to compare from company to company, and information that frequently was of little relevance. A McKinsey survey of 107 executives and investors found that investors were unable to readily use companies' sustainability disclosures to inform investment decisions because of a lack of standardization and systematic data about the issues that were material.[2]

A report by the U.S. Chamber of Commerce revealed companies' concern over the proliferation of standard-setting bodies that had emerged to meet investors' demand for sustainability information from companies.[3] These organizations developed different recommendations as to the ESG disclosures companies should make. These recommendations were criticized for creating more uncertainty than clarity. According to the U.S. Chamber report, "[t]he vast differences in approaches these standard setters take has created a great deal of uncertainty for compa-

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[1] See BLOOMENTHAL AND WOLFF, EMERGING TRENDS IN SECURITIES LAW, 2018-2019, 2019-2020, and 2020-2021 editions for a more fulsome discussion of the evolution of climate reporting standards and the tensions between investors and companies with regard to climate and ESG disclosures.

[2] McKinsey, "More than values: The value-based sustainability reporting that investors want," available at https://www.mckinsey.com/business-functions/sustainability/our-insights/more-than-values-the-value-based-sustainability-reporting-that-investors-want.

[3] U.S. Chamber of Commerce Foundation, "Corporate Sustainability Reporting: Past, Present, Future" (Nov. 2018).

nies regarding what they are expected to disclose."[4] Further, the report found that the emergence of for-profit ratings services that summarize and compare companies' ESG performance is not helpful, as the ratings firms "do not employ any type of standardized metrics or methodologies, provide varying levels of transparency with respect to their rating methodologies, and often arrive at very different opinions regarding a company's ESG performance."[5] A State Street Global Advisors survey similarly found "a range of challenges that can inhibit investors' capacity to embrace ESG investing more fully. Issues around metrics and a lack of standardized performance measures can lead to confusing and contradictory results and prove particularly concerning."[6]

Participants in another roundtable concluded that confusion around the different voluntary reporting standards can cause companies and investors to fail to communicate effectively. "Coupled with the rapid pace of change, this profusion of initiatives — the 'alphabet soup,' as several participants called it — has created confusion in the marketplace that has neither benefited from nor facilitated a well-established, commonly accepted set of best practices."[7] A result of this confusion "has been a

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[4] U.S. Chamber of Commerce Foundation, "Corporate Sustainability Reporting: Past, Present, Future" (Nov. 2018), at 3.

[5] U.S. Chamber of Commerce Foundation, "Corporate Sustainability Reporting: Past, Present, Future" (Nov. 2018).

[6] State Street Global Advisors, ESG Institutional Investor Survey, "Performing for the Future: ESG's place in investment portfolios. Today and tomorrow" (2018), available at https://www.ssga.com/investment-topics/environmen-tal-social-governance/2018/04/esg-institutional-investor-survey.pdf, at 4.

[7] Sustainability Accounting Standards Board, "Dead Cobras and Faberge Eggs: Unlocking the Potential of ESG Data" (2018), available at https://library.sasb.org/dead-cobras-faberge-eggs-unlocking-the-potential-of-esgda ta/, at 2.

communication gap between companies and their investors. As one participant commented, '[t]hey are talking past each other.'"[8]

[8] Sustainability Accounting Standards Board, "Dead Cobras and Faberge Eggs: Unlocking the Potential of ESG Data" (2018), available at https://library.sasb.org/dead-cobras-faberge-eggs-unlocking-the-potential-of-esgda ta/, at 2.

§ 4:5 Alphabet soup — Information misalignment and the need for consistent, comparable, and reliable information

A number of market participants noted the disconnect between the data that companies report and the information that investors would find useful. The Director of Sustainability Insights for Generation Investment Management explained the challenge in a report on ESG data: "[C]overage remains patchy. Data are only currently available for some metrics, for some firms in some geographies. Indicators for social issues are relatively weak, at a time when societal challenges have never been higher on the agenda. The risk is that ESG data put a spotlight on what is available, rather than what is most important."[1] Further, the Generation report notes that "sustainability discussions focus on the need for transformation and unprecedented shifts in the way that companies operate. We think there is a disconnect here. If it is to help guide transformations underway in the economy and society, ESG data will itself need to undergo a transformation."

[1] "The Future of ESG Data," Generation Investment Management LLP. (Dec. 5, 2019), available at https://www.generationim.com/research centre/insights/the-future-of-esg-data/.

The World Business Council for Sustainable Development (WBCSD) conducted a series of investor roundtables and interviews to better understand the information that investors want in order to properly incorporate companies' sustainability performance in their capital allocation decisions. The WBCSD found:

> There is a clear appetite from investors for information outside of the financial statements. The investors interviewed said it gives important context to the financial information and insight into the long-term viability of the company. But investors can be skeptical about its relevance and reliability. Over a series of interviews and roundtables, investors explained the challenges they face in using (non-financial information) — with many of these arising from the numerous reporting frameworks and initiatives in this area, the sheer volume of information reported and the perceived lack of high-quality, consistent and comparable information.[2]

The study participants indicated the factors that would enhance their confidence in and ability to use the information provided. Investors expressed their wish that companies more clearly identify and discuss the risks specifically impacting them. Further, they expressed a desire to discern whether companies have good governance and effective internal controls, not only over financial reporting, but also over non-financial factors such as ESG risks.[3]

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[2] Prof. Dr. Rodney Irwin, Alan McGill, "Enhancing the Credibility of Non-Financial Information, the Investor Perspective," WBCSD and PwC (Oct. 2018), available at https://docs.wbcsd.org/2018/10/WBCSD_Enhancing_Credibility_Report.pdf.

[3] Prof. Dr. Rodney Irwin, Alan McGill, "Enhancing the Credibility of Non-Financial Information, the Investor Perspective," WBCSD and PwC (Oct. 2018), available at https://docs.wbcsd.org/2018/10/WBCSD_Enhancing_Credibility_Report.pdf.

Governments and regulators around the world have come to focus on the need for greater consistency and comparability in sustainability disclosures. A June 2021 report from the International Organization of Securities Commissions (IOSCO) illustrates the point, concluding that "there is an urgent need to work towards improving the completeness, consistency, comparability, reliability and auditability of sustainability reporting."

§ 4:6 Securities and Exchange Commission's 2010 climate disclosure guidance

In 2010, the SEC issued an interpretive release regarding disclosures related to climate change under the existing disclosure provisions of Regulation S-K (Interpretive Release).[1] The Interpretive Release identified developments in foreign, federal, state, and local laws, rules, and regulations as potential triggers for disclosure obligations under Regulation S-K. The Interpretive Release explained that companies might need to disclose the impacts of pending legislation, including costs to purchase or benefits from selling carbon allowances pursuant to cap-and-trade systems; costs of improving facilities or equipment to reduce emissions in order to comply with regulatory limits on emissions; and financial impacts from increased or decreased demand for goods either directly due to regulatory changes or indirectly due to increases in costs of goods sold (e.g., due to the imposition of a carbon tax on certain products).

The Commission focused on regulations governing GHG emissions, specifically. Such regulations would require disclosure in the company's business description, pursuant to Item 101 of Regulation S-K if they would require the company to make material capital expenditures for environmental control

[1] Sec. Act Release No. 9106 (Feb. 8, 2010).

facilities. If the laws or regulations led to material legal proceedings or threatened legal proceedings, they would trigger disclosure obligations under Item 103. Further, if the laws or regulations presented material risks for the registrant specific to the company and not merely generic risks applicable to all registrants, then risk factor disclosure would be required pursuant to Item 105. Finally, the Commission urged registrants to assess whether the laws or regulations are reasonably likely to have a material effect on the company's financial condition or results of operation, which would require MD&A disclosure under Item 303.

The Commission pointed out that companies should consider competitive benefits and other positive effects of new laws or rules as well as their negative effects. A registrant "should not limit its evaluation of disclosure of proposed laws only to negative consequences. Change in the law or in the business practices of some registrants in response to the law may provide new opportunities for the registrant. For example, if a 'cap and trade' type system is put in place, registrants may be able to profit from the sale of allowances if their emissions levels end up being below their emissions allotment."[2] The 2010 Interpretive Release also addressed the physical impacts of climate change and a company's potential disclosure obligations under Regulation S-K related to physical impacts such as hurricanes or floods. The Interpretive Release cited climate-related financial impacts including those resulting from disruption to the company's and its customers' and suppliers' operations; increased insurance claims for insurance companies and reinsurance companies and higher premiums for companies with higher risks

[2] Sec. Act Release No. 9106 (Feb. 8, 2010), at 23.

such as those in coastal areas; and decreased agricultural production and capacity in areas impacted by flooding or drought.[3]

Notwithstanding the Commission's guidance in the Interpretive Release, issuer disclosures related to climate change ultimately failed to meet investor needs. This became clear through investor responses to the Commission's 2016 Concept Release on Business and Financial Disclosure Required by Regulation S-K, which drew a disproportionate number of comments asking the Commission to conduct rulemaking on climate disclosures.[4] The investor drumbeat asking for enhanced disclosure rules only intensified in the years following the 2016 Concept Release.

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[3] Sec. Act Release No. 9106 (Feb. 8, 2010), at 27.

[4] Sec. Act Release No. 10064 (Apr. 13, 2016).

PART II.
CHANGING TIDE WITH SEC CLIMATE DISCLOSURE PROPOSALS

§ 4:7 U.S. Securities and Exchange Commission puts climate on the agenda

After President Biden was elected in 2020, SEC Commissioner Allison Herren Lee became Acting Chair and, shortly thereafter, Gary Gensler became Chair. Commissioner Lee had long advocated for the SEC to adopt rules to help meet investor demand for greater consistency, comparability, and reliability of ESG disclosures. In August 2020, the Commission amended Items 101, 103, and 105 of Regulation S-K, relating to the description of a company's business, risk factors, and legal proceedings.[1] The amendments were particularly notable for their failure to address ESG disclosures. Commissioner Lee dissented from the Commission's vote to adopt the amendments, lamenting "[t]he final rules today look largely like the proposal, ignoring both overwhelming investor comment and intervening events. We have declined to include even a discussion of climate risk in the release despite significant comment on this subject."[2]

In September 2020, Commissioner Lee published an opinion in the *New York Times* in which she made clear her view that the SEC must act to address climate disclosures. "The voluntary disclosure that companies have increasingly provided in recent years is still largely regarded as insufficient. It's not standardized, it's not consistent, it's not comparable, and it's not reliable. Voluntary disclosure is not getting the job done. And without better disclosure of climate risks, it's not just investors who stand to lose, but the entire economy."[3]

When Commissioner Lee became Acting Chair in January 2021, she took swift action to further the SEC's analysis of its oversight of ESG disclosure practices and related enforcement.[4] On February 24, 2021, Acting Chair Lee directed the Division

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[1] "Modernization of Regulation S-K Items 101, 103, and 105" Final Rule, Sec. Release Nos. 33-10825 and 34-89670 (Aug. 26, 2020), available at https://www.sec.gov/rules/final/2020/33-10825.pdf.

[2] "Regulation S-K and ESG Disclosures: An Unsustainable Silence," Statement of Commissioner Allison Herren Lee (Aug. 26, 2020), available at https://www.sec.gov/news/public-statement/lee-regulation-s-k-2020-08-26.

[3] Allison Herren Lee, "Big Business's Undisclosed Climate Crisis Plans," NYT (Sept. 27, 2020), available at https://www.nytimes.com/2020/09/27/opinion/climate-change-us-companies.html.

[4] See https://www.sec.gov/sec-response-climate-and-esg-risks-and-opportunities.

of Corporation Finance to enhance its focus on climate-related disclosures in public companies' filings.[5] She explained, "the staff will review the extent to which public companies address the topics identified in the 2010 guidance, assess compliance with disclosure obligations under the federal securities laws, engage with public companies on these issues, and absorb critical lessons on how the market is currently managing climate-related risks."

The Division released a statement on September 22, 2021 reminding companies that it was selectively reviewing SEC filings for climate-related disclosures and provided a sample letter that companies had received concerning their climate-related disclosures or the absence thereof. The letter directed specific comments to companies that provided information in sustainability reports but failed to provide similar information in their SEC filings. The letter also sought information regarding material risk factors related to climate change that may affect a company and the analysis the company has done regarding those risk factors.[6]

On March 3, 2021, the Division of Examinations announced its 2021 priorities, including an enhanced focus on climate-related risks. The announcement provided that the Division of Examinations was "enhancing its focus on climate and ESG-related risks by examining proxy voting policies and practices to ensure voting aligns with investors' best interests and expec-

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[5] Allison Herren Lee, "Statement on the Review of Climate-related Disclosure" (Feb. 24, 2021), available at https://www.sec.gov/news/public-statement/lee-statement-review-climate-related-disclosure.

[6] See Sample Letter to Companies Regarding Climate Change Disclosures (modified Sept. 22, 2021), https://www.sec.gov/corpfin/sample-letter-climate-change-disclosures.

tations, as well as firms' business continuity plans in light of intensifying physical risks associated with climate change."[7]

On March 4, 2021, the Commission announced the creation of an Enforcement Task Force focused on climate and ESG issues. "The initial focus will be to identify any material gaps or misstatements in issuers' disclosure of climate risks under existing rules. The task force will also analyze disclosure and compliance issues relating to investment advisers' and funds' ESG strategies. Its work will complement the agency's other initiatives in this area."[8]

On March 15, 2021, Acting Chair Lee issued a request for public input on climate disclosures. The request for public input included 15 questions to guide public input on climate disclosure requirements. She provided, "I am asking the staff to evaluate our disclosure rules with an eye toward facilitating the disclosure of consistent, comparable, and reliable information on climate change. To facilitate the staff's assessment, set forth below are questions that would be useful to consider as part of this evaluation."[9]

The SEC received more than 550 comments, with three out of four comments in favor of mandated climate-related disclosures. Of those in favor, many generally agreed that: (1) climate-related disclosures should be required if material to an

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[7] "SEC Division of Examinations Announces 2021 Examination Priorities" (Mar. 3, 2021), available at https://www.sec.gov/news/press-release/2021-39.

[8] "SEC Announces Enforcement Task Force Focused on Climate and ESG Issues" (Mar. 4, 2021), available at https://www.sec.gov/news/press-release/2021-42.

[9] "Public Input Welcomed on Climate Change Disclosures" (Mar. 15, 2021), available at https://www.sec.gov/news/public-statement/lee-climate-change-disclosures.

investment decision; (2) mandated climate-related disclosures should require the quantification and reporting of certain greenhouse gas (GHG) emissions; (3) specific metrics are needed for quantifying emissions; and (4) encouraging use of current frameworks, including the recommendations of the TCFD.

On April 17, 2021, Gary Gensler was sworn in as the SEC Chair. Shortly thereafter, in June 2021, the Commission published its Spring Regulatory Flexibility Act Agenda, which included rulemakings on disclosures related to climate risk, human capital, board diversity, and investment funds (including ESG funds).[10]

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[10] See https://www.sec.gov/news/press-release/2021-99.

§ 4:8 Commission issues proposed climate disclosure rules

On March 21, 2022, the SEC issued a proposal to revise Regulation S-K and Regulation S-X to require climate-related disclosures in reporting companies' annual reports on Form 10-K and in registration statements.[1] The proposal tipped the scales at over 500 pages, asking 737 questions in 201 requests for public comment.

The Commission explained "[w]e are concerned that the existing disclosures of climate-related risks do not adequately protect investors. For this reason, we believe that additional disclosure requirements may be necessary or appropriate to elicit climate-related disclosures and to improve the consistency,

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[1] Release 33-11042, "The Enhancement and Standardization of Climate-Related Disclosures for Investors" (Mar. 21, 2022).

comparability, and reliability of climate-related disclosures."[2] The release also noted the Commission's concern that registrants provide information in different formats and locations, using different methodologies that are not always transparent, and with varying degrees of completeness. These inconsistencies hamper investors' efforts to compare companies' climate risks and factor climate risks and opportunities into their investment decisions.

Referring to the various voluntary disclosure frameworks (GRI, CDP, CDSB, SASB, IIRC, and TCFD), the Commission observed that their voluntary nature lends to inconsistency in reporting from company to company and period to period. As a result, "[t]he situation resulting from these multiple voluntary frameworks has failed to produce the consistent, comparable, and reliable information that investors need. Instead, the proliferation of third-party reporting frameworks has contributed to reporting fragmentation, which can hinder investors' ability to understand and compare registrants' climate-related disclosures."[3]

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[2] Release 33-11042, "The Enhancement and Standardization of Climate-Related Disclosures for Investors" (Mar. 21, 2022).

[3] Release 33-11042, "The Enhancement and Standardization of Climate-Related Disclosures for Investors" (Mar. 21, 2022), at 29.

§ 4:9 Influence of other jurisdictions and organizations

The release noted the efforts in the international community to address the fragmentation of climate reporting and to provide investors with the consistent, comparable, reliable information they need to make well-informed investment decisions. It cited the efforts of the IFRS Foundation and IOSCO to develop a prototype climate disclosure standard that could form the basis for the work that the International Sustainability Standards Board would conduct in formulating proposed global climate disclosure standards. It also cited the work in jurisdictions, including the European Union, to develop or revise their climate disclosure rules to enhance the consistency and usefulness to investors of climate-related financial information.[1]

The proposing release borrowed from the TCFD and the GHG Protocol, which have gained broad acceptance around the world. "Both the TCFD and the GHG Protocol have developed concepts and a vocabulary that are commonly used by companies when providing climate-related disclosures in their sustainability or related reports."[2] The release emphasized the broad adoption of the TCFD, noting its use by more than 2,600 organizations around the world, and its adoption by a number of countries, including the UK, New Zealand, and Switzerland, as well as the European Union.[3] Moreover, the Commission noted that the TCFD framework is embedded in many of the commonly used voluntary reporting frameworks and the prototype standards that the ISSB was considering as it engaged in its standard-setting initiative. As such, the release drew on the TCFD framework, including its four pillars of governance, strategy, risk management, and metrics and targets, which are familiar to regulators, reporters and investors in many jurisdictions.

The other anchoring framework, broadly accepted around the world, is the GHG Protocol. The GHG Protocol defined the

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[1] Release 33-11042, "The Enhancement and Standardization of Climate-related Disclosures for Investors" (Mar. 21, 2022), at 33.

[2] Release 33-11042, "The Enhancement and Standardization of Climate-related Disclosures for Investors" (Mar. 21, 2022).

[3] Release 33-11042, "The Enhancement and Standardization of Climate-related Disclosures for Investors" (Mar. 21, 2022).

concept of emissions "scopes" to identify emissions for which a company is directly or indirectly responsible. Scope 1 emissions are direct emissions from sources in the company's ownership or control. Scope 2 emissions are indirect emissions associated with the generation of power that the company purchases and consumes. Scope 3 emissions account for all other upstream and downstream emissions in the company's value chain. Scope 3, in turn, includes 15 categories of value chain emissions, including goods and services purchased from other parties, transportation of goods, employee commuting, business travel, the use of goods by end users, and investments.

§ 4:10 Proposed new disclosure requirements in Regulation S-K

The proposed rule would add a new subpart 1500 to Regulation S-K, captioned "Climate-Related Disclosure." Principal elements of the proposed disclosure standards are summarized below:

Item 1500: *Definitions*. Proposed Item 1500 contains definitions of important terms, including carbon offsets, climate-related risks (including physical risks and transition risks), emission factors, carbon dioxide equivalent, GHG emissions, GHG intensity, internal carbon price, organizational and operational boundaries, Scopes 1-3 emissions, transition plans, and other terms used in the proposed rules.

Item 1501: *Governance*. The proposed rule would require a registrant to disclose the company's oversight and governance of climate-related risks at the board and management levels, including the board's oversight of climate-related risks[1] and management's role in assessing and managing climate-related

[1] Proposed Item 1501(a)(1).

risks.[2] A registrant may also describe the board's[3] and management's[4] oversight of climate-related opportunities.

Board oversight of climate-related risks. The proposal would require a registrant to disclose the identity of any board members or board committee responsible for the oversight of climate-related risk;[5] whether any board members have expertise in climate-related risks, describing the nature of such expertise;[6] how, and how frequently, the board and its committees discuss climate-related risks;[7] whether and how the board or committee considers climate-related risks as part of its business strategy, risk management, and financial oversight;[8] and whether and how the board sets climate-related targets and goals, including how it oversees progress toward those goals and any interim targets or goals.[9]

Management's assessment and management of climate-related risks.[10] The proposal would require disclosure of management's role in assessing and managing climate-related risks, including whether certain positions or committees are responsible for assessing and managing climate-related risks and, if so, the identity of those positions or committees and the expertise

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[2] Proposed Item 1501(b)(1).

[3] Proposed Item 1501(a)(2).

[4] Proposed Item 1501(b)(2).

[5] Proposed Item 1501(a)(1)(i).

[6] Proposed Item 1501(a)(1)(ii).

[7] Proposed Item 1501(a)(1)(iii).

[8] Proposed Item 1501(a)(1)(iv).

[9] Proposed Item 1501(a)(1)(v).

[10] Proposed Item 1501(b)(1).

of the person in such position;[11] the process by which such persons are informed about or monitor climate-related risks;[12] and whether and how often such persons or committees report to the board or a board committee on climate-related risks.[13]

Item 1502: *Strategy, business model and outlook*. The proposal would require disclosure of any climate-related risks reasonably likely to have a material impact on the registrant, including on its business or consolidated financial statements. These risks could manifest over the short, medium, and long term. A registrant may also disclose the actual and potential impacts of climate-related opportunities in this section.[14]

This section would require disclosure of climate-related risks, specifying whether they are physical or transition risks, and the nature of the risk. In the case of physical risks, disclosure would be required of whether the risks are acute or chronic and the location and nature of the properties or operations subject to the risk.[15] Further detail would be required if a risk relates to the flooding of properties in flood hazard areas[16] or areas of high water stress.[17]

For transition risks, disclosure would be required of the nature of the risk, and whether it relates to regulatory, technological, market (including changing consumer, business counterpar-

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[11] Proposed Item 1501(b)(1)(i).

[12] Proposed Item 1501(b)(1)(ii).

[13] Proposed Item 1501(b)(1)(iii).

[14] Proposed Item 1502(a).

[15] Proposed Item 1501(a)(1)(i).

[16] Proposed Item 1502(a)(1)(i)(A).

[17] Proposed Item 1502(a)(1)(i)(B).

ty, and investor preferences), liability, reputational, or other transition-related risks, and how they impact the registrant.[18] The registrant would be required to include the time horizon for each described impact (in the short, medium, or long term)[19] and explain how it defines short, medium, and long-term time horizons, including its assessment of the expected useful life of its assets and the time frame for climate-related planning processes.[20]

The registrant would be required to describe the impacts of its identified climate-related risks on its strategy, business model, and outlook, including impacts on its business operations, products or services, suppliers and others in its value chain, mitigation or adaptation activities, research and development expense, and other significant charges or impacts.[21]

Registrants would be required to discuss whether and how any impacts are considered as part of its registrant's business strategy, financial planning, and capital allocation.[22] Further, they would be required to provide a narrative discussion of how any climate-related risks have affected or are reasonably likely to affect the registrant's consolidated financial statements.[23]

If a registrant maintains an internal carbon price, it would be required to disclose that price, including the total price applied,

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[18] Proposed Item 1502(a)(1)(ii). The proposal notes that registrants operating in jurisdictions that have made a GHG reduction commitment might be exposed to transition risks associated with the achievement of those targets.

[19] Proposed Item 1502(b)(2).

[20] Proposed Item 1502(a)(2).

[21] Proposed Item 1502(b).

[22] Proposed Item 1502(c).

[23] Proposed Item 1502(d).

the boundaries for its measurement, how it might change over time, and how the price was selected.[24] It would also be required to explain how it uses the carbon price in the evaluation and management of climate-related risks.

Proposed Item 1502 would also require a description of the resilience of the registrant's strategy, given potential future changes in climate-related risks. This would include any scenario analysis and other analytical tools, if they are used.[25]

Item 1503: *Risk management.* The Proposed Rule would require registrants to describe any processes the registrant has for identifying, assessing, and managing climate-related risks. It may (but is not required to) also discuss climate-related opportunities in this section.

This section would require registrants to disclose how it evaluates the relative significance of climate-related risks compared to other risks; considers regulatory requirements or policies such as limits on GHG emissions; considers changes in customer or counterparty preferences, technological changes, or changes in prices when assessing transition risks; and determines the materiality of climate-related risks.[26]

When disclosing its processes for managing climate-related risks, the proposal would require a registrant to describe how it decides whether to mitigate, accept, or adapt to a particular risk; how it prioritizes climate risks; and determines how to mitigate those climate-related risks that it will mitigate.[27] The registrant would also be required to disclose whether and how its climate

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24 Proposed Item 1502(e).

25 Proposed Item 1502(f).

26 Proposed Item 1503(a)(1).

27 Proposed Item 1503(a)(2).

risk-management processes are integrated into its overall risk management processes or systems, and how that risk management process is governed.[28]

The proposal would not require registrants to adopt transition plans but if they do so, they would be required under Item 1503 to describe the plan, including the metrics and targets used to identify and manage both physical and transition risks. The disclosure should be updated annually.[29] If the registrant has adopted a transition plan, it would be required to discuss how it plans to mitigate or adapt to identified physical and transition risks.[30] It also may describe how it plans to achieve any climate-related opportunities that it has identified.[31] These might include the production of products that facilitate the transition to a lower carbon economy, the generation and use of renewable energy, and other low carbon products and processes.

Item 1504: *GHG emissions metrics*. The proposal would require disclosure of GHG emissions metrics, separately breaking out emissions by constituent gasses and in the aggregate, expressed in terms of carbon dioxide equivalents. Disclosure would be required for the most recent fiscal year and historical years included in the financial statements of the filing, as such information is reasonably available.[32] The emissions disclosures would be required excluding the impact of any offsets.

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28 Proposed Item 1503(b).

29 Proposed Item 1503(c)(1).

30 Proposed Item 1503(c)(2).

31 Proposed Item 1503(a)(3).

32 Proposed Item 1504(a).

All registrants would be required to disclose their Scopes 1 and 2 emissions.[33] Scope 3 emissions disclosure would be required if material or if the registrant has set an emissions reduction goal or target that includes Scope 3 emissions.[34] Smaller reporting companies would be exempt from the Scope 3 reporting requirements.[35]

If a registrant is required to disclose Scope 3 emissions, it must disclose those emissions separately from its Scopes 1 and 2 emissions. The registrant would be required to identify the categories of upstream and downstream activities included in the Scope 3 emissions calculation, providing separate data for all categories significant to the registrant. The registrant would also be required to disclose its total Scope 3 emissions. The data sources, including any data derived from economic studies, databases or industry associations would also need to be disclosed.

In addition to the volume of emissions, registrants would also be required to disclose the GHG intensity of their emissions.[36] The intensity calculation would be calculated using the metric tons of CO_2 equivalent per unit of total revenue and per unit of production for each fiscal year included in the consolidated financial statements. GHG intensity would be required for Scopes 1 and 2 emissions and, if Scope 3 emissions are disclosed, Scope 3 intensity should be separately disclosed.[37] The proposal provides some latitude to measure and disclose intensity using measures other than total revenue or unit of production if the registrant explains the reason for use of the other measure.

33 Proposed Item 1504(b).

34 Proposed Item 1504(c).

35 Proposed Item 1504(c)(3).

36 Proposed Item 1504(d)(1).

37 Proposed Item 1504(d)(2).

The proposal requires registrants to describe the methodology and significant inputs and assumptions that are used to calculate their emissions,[38] as well as the organizational boundaries used in its calculations.[39] The proposal also permits the use of estimates, third party data, and ranges of estimated Scope 3 emissions as long as the methodology, reasons and underlying assumptions are disclosed.[40] Any material data gaps or changes to methodologies or assumptions would also require disclosure.

The proposal provides a safe harbor for Scope 3 emissions disclosures.[41] Specifically, it provides that any statement made regarding Scope 3 emissions pursuant to new Items 1501-1506 and made in a document filed with the Commission is "deemed not to be a fraudulent statement . . . unless it is shown that such statement was made or reaffirmed without a reasonable basis or was disclosed other than in good faith."[42]

Item 1505: *Attestation of Scope 1 and Scope 2 emissions disclosure*. Large accelerated filers and accelerated filers would be required to include an attestation report covering its Scope 1 and Scope 2 emissions disclosures.[43] The attestation would be phased in with no attestation required during the first year of filing. During the second and third years of disclosing GHG emissions pursuant to the new disclosure requirements, accelerated and large accelerated filers would be permitted to provide attestation at the limited assurance level. In the fourth fiscal

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[38] Proposed Item 1504(e).

[39] Proposed Item 1504(e).

[40] Proposed Item 1504(e).

[41] Proposed Item 1504(f).

[42] Proposed Item 1504(f).

[43] Proposed Item 1505(a)(1).

year after the initial compliance date, the attestation would be required to be made at the reasonable assurance level covering at least Scope 1 and Scope 2 emissions.[44]

The attestation report must be provided pursuant to standards publicly available at no cost and established by a body that has followed due process procedures, including processes to obtain public comment.[45] This assurance does not need to be performed by a Certified Public Accountant (CPA) firm. Rather, assurance can be provided by another, independent service provider, as long as such provider meets the specified requirements related to independence and necessary experience.[46]

Item 1506: *Targets and Goals*. The proposal does not require companies to set GHG reduction or other targets or goals. However, if a registrant has set or sets targets related to GHG emissions or any other climate-related target or goal, it must provide certain information related to the target or goal. Other environmental targets beyond GHG emissions might include those related to energy or water usage, conservation, ecosystem restoration, or revenues from low-carbon products.[47]

If a registrant has set targets or goals, it must then describe:

- The scope of activities and emissions included in the target;
- The unit of measurement, including whether the target is absolute or intensity based;

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[44] Proposed Item 1505(a)(1).

[45] Proposed Item 1505(a)(2).

[46] Proposed Item 1505(b).

[47] Proposed Item 1506.

- The defined time horizon by which the target is intended to be achieved, and whether the time horizon is consistent with one or more goals established by a climate-related treaty, law, regulation, policy, or organization;

- The defined baseline time period and baseline emissions against which progress will be tracked with a consistent base year set for multiple targets;

- Any interim targets set by the registrant; and

- How the registrant intends to meet its climate-related targets or goals. In this regard, a registrant might describe its strategy to increase energy efficiency, transition to lower carbon products, engage in carbon storage or removal, or purchase offsets or renewable energy certificates (RECs).[48]

The proposal would also require registrants to include relevant data on whether it is making progress toward achieving its targets and goals, and how progress has been achieved. This information would be required on a year-by-year basis, with detail on the actions taken to achieve the targets and goals. If carbon offsets or RECs were used to make progress towards climate targets and goals, the registrant would be required to disclose the amount of carbon reduction associated with those offsets or the amount of renewable energy generated by the use of RECs, the source of the offsets or RECs, a description of the underlying projects, any registries or authentication of the offsets or RECs, and the cost of the offsets or RECs.[49]

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[48] Proposed Item 1506(b).

[49] Proposed Item 1506(d).

§ 4:11 Proposed amendments to Regulation S-X

The proposal would amend Regulation S-X to add climate-related disclosure provisions in a new Article 14 ("Climate-related disclosures") that would apply to registrants other than smaller reporting companies not engaged in oil and gas producing activities. The proposed amendments are briefly described below:

Rule 14-01 *Climate-related disclosure instructions*. The new rule would require registrants subject to the rule to include disclosures in a note to their financial statements included in the filing. The information required would be for the most recent fiscal year and for historical fiscal years included in the consolidated financial statements in the filing.

Rule 14-02 *Climate-related metrics*. Registrants would be required to provide contextual information explaining how each metric was derived, including the significant inputs and assumptions used and policy decisions applied.

The rule would require disclosure of the financial impact on a line item of the registrant's consolidated financial statements. However, if the sum of the absolute values of all impacts on a line item (i.e., positive and negative impacts added up) is less than one percent of the line item then disclosure would not be required. Similarly, disclosure of aggregate expenditures or capitalized costs would not be required if less than one percent of total expenditures or capitalized costs for the fiscal year.

Disclosure would be required of the financial impacts of severe weather events or natural conditions including flooding, drought, wildfires, extreme temperatures or sea level rise on related line items in the consolidated financial statements for the year. Disclosure would be required on a line-by-line basis and might include:

- Changes to revenues or costs from disruptions to business operations or supply chains;

- Impairment charges and changes to the carrying amount of assets due to the assets being exposed to physical climate impacts;

- Changes to loss contingencies or reserves due to impact from severe weather events; and

- Changes to expected insured losses due to flooding or wildfires.

The proposal would also require disclosure of the financial impacts of transition activities, including the impact of efforts to reduce emissions or otherwise mitigate transition risk. Impacts might include:

- Changes to revenue or cost due to new emissions pricing or regulations;

- Changes to operating, investing, or financing cash flow from changes in upstream costs, such as transportation of raw materials;

- Changes to the carrying amount of assets due to a reduction of the asset's useful life or a change in the asset's salvage value by being exposed to transition activities; and

- Changes to interest expense driven by financing instruments tied to climate performance.

The proposal would also require disclosure of expenditures made to mitigate exposure to physical or transition risk. It would require further disclosure of the assumptions and financial estimates impacted by either severe weather or transition activities.

For climate-related risks identified in accordance with Item 1502 of Regulation S-K, disclosure of the financial impact of those risks would be required.

§ 4:12 Required date of compliance and phase-in periods

The proposed rule includes a phase-in period for all registrants with the specific compliance period dependent on filer status, with additional phase-ins for Scope 3 disclosures and assurance requirements based on the level of assurance necessary. The proposing release provides illustrative phase-in periods assuming the final rules are adopted in December 2022, and apply to companies with a December 31 fiscal year end. At the time of this writing, it appears unlikely that the final rules will be adopted during 2022 and it appears reasonably likely that the SEC will adopt final rules in 2023, which will all but certainly extend the compliance period. Below is the proposed compliance schedule provided by the Commission:[1]

Registrant Type	Indicative Proposed Disclosure Compliance Date (Assumes Adoption of Final Rules in 2022)	
	All proposed disclosures, including GHG emissions metrics: Scope 1, Scope 2, and associated intensity metric, but excluding Scope 3 GHG emissions metrics: Scope 3 and associated intensity metric Large Accelerated Filer Fiscal year 2023 (filed in 2024)	GHG emissions metrics: Scope 3 and associated intensity metric

[1] SEC, Fact Sheet: Enhancement and Standardization of Climate-Related Disclosures, 2022.

Registrant Type	Indicative Proposed Disclosure Compliance Date (Assumes Adoption of Final Rules in 2022)	
Large Accelerated Filer	Fiscal year 2023 (filed in 2024)	Fiscal year 2024 (filed in 2025)
Accelerated Filer and Non-Accelerated Filer	Fiscal year 2024 (filed in 2025)	Fiscal year 2025 (filed in 2026)
SRC	Fiscal year 2025 (filed in 2026)	Exempted

Filer Type	Scopes 1 and 2 GHG Disclosure Compliance Date	Limited Assurance	Reasonable Assurance
Large Accelerated Filer	Fiscal year 2023 (filed in 2024)	Fiscal year 2024 (filed in 2025)	Fiscal year 2026 (filed in 2027)
Accelerated Filer	Fiscal year 2024 (filed in 2025)	Fiscal year 2025 (filed in 2026)	Fiscal year 2027 (filed in 2028)

§ 4:13 Public comments on the SEC's proposed climate disclosure rule

After the March 21, 2022 release, a 60-day comment period opened, which was subsequently extended for an additional 60 days to June 17th. Due to a computer error in October 2022, the comment period was reopened for an additional two-week period that expired November 1, 2022.

By the initial June 17th close of the comment period, the SEC had received thousands of comment letters from a wide variety of organizations. Analysis from George Washington University[1] reported that over 14,000 letters were received. Of those 14,000, around a thousand were "substantive," detailed letters. Approximately 3,000 were less detailed, but still nuanced, letters. The remaining 10,000 comments were form submissions.

The 1,000 substantive letters included responses from public companies, institutional investors, academics, industry trade associations, environmental activist groups, commercial trade groups, elected officials, professional services firms, climate industry companies, financial institutions, and others. A KPMG analysis of the letters found that climate rulemaking was generally viewed favorably, with 29 percent of commenters very supportive and 50 percent supportive. Two percent had a negative response, with 12 percent very unsupportive, and nine percent generally unsupportive.[2] Some of the areas of contention are whether the SEC is acting within the bounds of its authority, the extent to which investors need climate-related data, the one percent threshold for financial statement disclosure, the requirement that some companies report their Scope 3 greenhouse gas emissions, whether climate-related disclosures should be filed with the SEC, the cost of compliance, alignment with international frameworks, and whether audit and attestation should be required.

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[1] Lawrence A. Cunningham, George Washington University, "What the Volume and Diversity of Comment Letters to the SEC Say About its Climate Proposal," Harvard Law School Forum on Corporate Governance, 2022.

[2] KPMG, "Responses to the SEC's climate proposal: themes and observations," 5, 2022.

The U.S. Chamber of Commerce commented that while it agrees that "material climate risks and impacts should be disclosed to investors," it believes "the current Proposed Rules are vast and unprecedented in their scope, complexity, rigidity and prescriptive particularity, and exceed the bounds of the SEC's lawful authority as proposed."[3]

Democratic Congressional Representatives, including the Chair of the Select Committee on the Climate Crisis, Kathy Castor, disagreed, stating "[i]t is the Commission's responsibility to exercise its authority to address the needs of investors and issuers alike by requiring that registrants disclose consistent, comparable climate-related information that may affect financial performance."[4] Ceres, a nonprofit network of investors, companies and nonprofits, commented, "[t]his is a disclosure rule, designed for investor protection. It rests on the text and context of the securities laws passed by Congress in 1933 and 1934. It does not set the nation's climate policy. It does not require companies to change what they are doing with respect to climate risk. It only requires companies to disclose facts, not opinions."[5]

Many commenters focused on materiality. Some requested more clarity.[6] Others asserted that the one percent threshold in

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[3] See letter from U.S. Chamber of Commerce, available at https://corpgov.law.harvard.edu/2022/07/13/the-proposed-sec-climate-disclosure-rule-a-comment-from-the-u-s-chamber-of-commerce/, 2022.

[4] See letter from Kathy Castor, Sean Castren, Jared Huffman, Veronica Escobar, Mike Levin, et al., available at https://www.sec.gov/comments/s7-10-22/s71022-20133259-303498.pdf, 2022.

[5] See letter from Ceres, available at https://www.ceres.org/sites/default/files/Ceres%20Final%20Comment%20Letter%20to%20SEC%206-17-22.pdf, 2022.

[6] See letter from Gap Inc., available at https://www.sec.gov/comments/s7-10-22/s71022-20130104-296798.pdf, 2022.

the note to the financial statements would impose unreasonable costs on companies and impose an undue burden.[7] Amazon encouraged the SEC to "apply a materiality standard to the disclosures that would be required under Item 1502(b), (c), and (d) or, at a minimum, to require the disclosure to address the most likely and significant impacts and effects." The letter continues, "[a]doption of the disclosure requirements as proposed, without any materiality qualification, will result in extensive and possibly indiscriminate boilerplate disclosures that would be costly to prepare and of limited utility to investors."[8] On the other hand, investor advocate As You Sow took a different approach. "The incentives to ignore material climate risk are too great and a level playing field for companies is too important. Moreover, investors, not companies, should be the arbiter of materiality of emissions. Investors require full information to decide what is a material risk to their portfolios and to their constituents, beneficiaries, and fiduciaries."[9]

The requirement for companies (other than SRCs) to report on material Scope 3 GHG emissions drew both support and opposition. Some commenters called this requirement overly burdensome, and indirectly burdens small businesses throughout the value chain. Commenters wrote that the proposed Scope 3 disclosure provisions could result in companies asking small, privately-held companies to provide emissions data although they are out of the scope of the SEC's Proposed Rule. Others asserted that Scope 3 data is currently too difficult and costly to calculate, or too unreliable. Senate Republicans wrote in a

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[7] See letter from Fortive, available at https://www.sec.gov/comments/s7-10-22/s71022-20130706-299581.pdf, 2022.

[8] See letter from Amazon, available at https://www.sec.gov/comments/s7-10-22/s71022-20132266-302794.pdf, 2022.

[9] See letter from As You Sow, available at https://www.sec.gov/comments/s7-10-22/s71022-20132601-303123.pdf, 2022.

comment letter that the SEC must consider, "the substantial compliance costs that will be imposed on suppliers and vendors, many of which are small non-public companies, when public companies demand that they provide information on Scope 3 GHG emissions."[10]

On the other hand, some commenters argued that it is crucial for investors to see the full scope of a registrant's emissions and climate-risk profile. According to CDP, Scope 3 emissions make up a majority of an organization's emissions,[11] and that Scope 1 and 2 reporting without Scope 3 information does not provide sufficient information to investors. The Science Based Targets initiative (SBTi) wholly supports Scope 3 reporting, and its letter highlights the feasibility of reporting Scope 3 emissions. "Scope 3 emissions accounting and target-setting has already become a common practice in the corporate sector. As of December 2021, 96 percent of SBTi companies with approved science-based targets have targets for Scope 3 emissions."[12] Some organizations proposed that the SEC expand its Scope 3 reporting requirements. The California State Teachers' Retirement System (CalSTRS), for example, suggested that the SEC "[a]dd Scope 3 to the greenhouse gas emissions reporting requirement for all registrants instead of only those which refer-

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[10] See letter from Members of the U.S. Senate, available at https://www.sec.gov/comments/s7-10-22/s71022-20122544-278541.pdf, 2022.

[11] CDP Technical Note: Relevance of Scope 3 Categories by Sector, available at https://cdn.cdp.net/cdp-production/cms/guidance _docs/pdfs/000/003/504/original/CDP-technical-note-scope-3-relevance-by-sector.pdf?1649687608, 2022.

[12] See letter from SBTi, available at https://www.sec.gov/comments/s7-10-22/s71022-20132268-302797.pdf, 2022.

ence Scope 3 emissions in targets or determine Scope 3 emissions to be financially material.”[13]

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[13] See letter from CalSTRS, available at https://www.sec.gov/comments/s7-10-22/s71022-20132337-302902.pdf, 2022.

§ 4:14 Investment management proposals: U.S. funds

Beyond the corporate climate-related disclosure rule proposal, the SEC issued two proposals related to investment funds in May 2022. The first, an amendment to both the Investment Advisers Act of 1940 (Advisers Act) and the Investment Company Act of 1940 (Investment Company Act), would require enhanced disclosures about the ESG practices of registered investment advisers, investment companies, and certain other investment advisers. The second, an amendment to the “Names Rule” of the Investment Company Act, seeks to tighten compliance for companies whose names imply a particular investment approach.

Both proposals respond to the significant inflows of capital to ESG-focused funds and similar investment products over the last several years. These funds can vary widely in the ways they seek to factor in ESG, “green,” or “sustainable” strategies, and may warrant additional scrutiny.

§ 4:15 —ESG fund proposal

The ESG fund proposal aims to create a “consistent, comparable, and decision-useful regulatory framework” to inform and protect investors.[1] It would require most funds with an environmental focus to disclose in their fund prospectuses and annual reports their GHG emissions and intensity data in accordance with the Partnership for Carbon Accounting Financials (PCAF) methodology.

- The depth of disclosure required would vary depending on the ESG strategy employed by the fund.
- The proposal does not define "ESG" or similar terms. Rather, it would require funds to disclose to investors how they incorporate ESG factors into their investment strategies, putting the onus on investment managers and advisers to craft and report their own criteria. Though a lack of standard definitions may make comparison across products more difficult, it could also prevent innovation in ESG strategies from being stymied and prevent funds from circumventing the rules.[2]

The ESG Proposal would create three types of ESG funds: Integration Funds, ESG-focused Funds, and Impact Funds.

Integration Funds, as defined by the proposal, are funds that consider one or more ESG factors but do not treat them as more significant than other, non-ESG factors in their investment decisions.[3] These funds would only be required to provide high-

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[1] SEC Release No. IA-6034; IC-34594, "Proposed Rule: Enhanced Disclosures by Certain Investment Advisors and Investment Companies about Environmental, Social, and Governance Investment Practices," p.1, available at https://www.sec.gov/rules/proposed/2022/33-11068.pdf.

[2] SEC Release No. IA-6034; IC-34594; "Proposed Rule: Enhanced Disclosures by Certain Investment Advisors and Investment Companies about Environmental, Social, and Governance Investment Practices," pp.24-25, available at https://www.sec.gov/rules/proposed/2022/33-11068.pdf.

[3] SEC Release No. IA-6034; IC-34594; "Proposed Rule: Enhanced Disclosures by Certain Investment Advisors and Investment Companies about

level discussions—a few sentences—of how they incorporate ESG factors. Additionally, Integration Funds that consider GHG emissions would be expected to provide more detailed information about the methodology used.

The SEC is wary of these rules unintentionally leading investors to misinterpret the degree to which ESG plays a role in these funds' strategies, hence the requirement of only a few sentences on the topic in the funds' prospectuses. Indeed, the SEC recommends that the more detailed information related to GHG emissions be placed outside of an open-end fund's summary prospectus and later in a closed-end fund's prospectus for this reason.[4]

ESG-focused Funds use ESG factors as significant or primary considerations in their investment selection and engagement strategy, e.g., funds tracking an ESG-focused index or funds with ESG-aligned proxy voting policies. The SEC's proposed definition also includes any funds that market themselves as having an ESG focus, such as through names including the terms "ESG" or "green."[5]

These funds would be required to make detailed disclosures about their ESG-related investment strategies and decision-making processes in a tabular format, specified by the SEC, to

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Environmental, Social, and Governance Investment Practices," p.26, available at https://www.sec.gov/rules/proposed/2022/33-11068.pdf.

[4] SEC Release No. IA-6034; IC-34594; "Proposed Rule: Enhanced Disclosures by Certain Investment Advisors and Investment Companies about Environmental, Social, and Governance Investment Practices," pp.25-29, available at https://www.sec.gov/rules/proposed/2022/33-11068.pdf.

[5] SEC Release No. IA-6034; IC-34594; "Proposed Rule: Enhanced Disclosures by Certain Investment Advisors and Investment Companies about Environmental, Social, and Governance Investment Practices," pp.33-34, available at https://www.sec.gov/rules/proposed/2022/33-11068.pdf.

ensure consistency and comparability across investment products.[6] The proposed table has three top-level rows:

1. *Row 1 – Overview of the Fund's ESG strategy:* A concise description of the factors that are the focus of the fund's strategy and a "check the box" style list of comment ESG strategies that apply.[7]

2. *Row 2 – How the fund incorporates ESG factors in its investment decisions:* Specific information tied to each of the strategies identified in Row 1, such as the percent of a portfolio subject to an inclusionary or exclusionary ESG screen, and supported by supplements later in the prospectus.[8]

3. *Row 3 – How the fund votes proxies and/or engaged with companies about ESG issues:* A narrative overview of how the fund engages with portfolio companies on ESG issues, for funds that indicate in Row 1 that this is a significant method of implementing their ESG strategies.[9]

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[6] SEC Release No. IA-6034; IC-34594; "Proposed Rule: Enhanced Disclosures by Certain Investment Advisors and Investment Companies about Environmental, Social, and Governance Investment Practices," pp.35-37, available at https://www.sec.gov/rules/proposed/2022/33-11068.pdf.

[7] SEC Release No. IA-6034; IC-34594; "Proposed Rule: Enhanced Disclosures by Certain Investment Advisors and Investment Companies about Environmental, Social, and Governance Investment Practices," p.41, available at https://www.sec.gov/rules/proposed/2022/33-11068.pdf.

[8] SEC Release No. IA-6034; IC-34594; "Proposed Rule: Enhanced Disclosures by Certain Investment Advisors and Investment Companies about Environmental, Social, and Governance Investment Practices," p.41, available at https://www.sec.gov/rules/proposed/2022/33-11068.pdf.

[9] SEC Release No. IA-6034; IC-34594; "Proposed Rule: Enhanced Disclosures by Certain Investment Advisors and Investment Companies about

Impact Funds, as defined by the ESG Proposal, are a subset of ESG-focused Funds that seek to achieve specific ESG impacts. One example provided by the proposal is a fund with the goal of financing water treatment and conservation companies in order to increase the availability of clean water.[10] Impact Funds would be subject to the most stringent disclosure requirements, including all of the requirements placed on ESG-focused Funds and more. These funds would be required to disclose how they measure progress toward their stated impact, the time horizon used for that analysis, and the relationship between the fund's impact and financial returns.[11]

The ESG Proposal also introduces specific disclosure requirements for environmentally-focused funds. ESG-focused Funds that considered environmental factors as part of its strategy would be required to disclose the carbon footprint and weighted average carbon intensity of its portfolio. Notably, the SEC highlights that these metrics are aligned with the recommendations of the TCFD and PCAF, and based on emission data consistent with the GHG Protocol.

The proposal does include an exception to this requirement for any fund that explicitly states in its prospectus that it does

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Environmental, Social, and Governance Investment Practices," p.41, available at https://www.sec.gov/rules/proposed/2022/33-11068.pdf.

[10] SEC Release No. IA-6034; IC-34594; "Proposed Rule: Enhanced Disclosures by Certain Investment Advisors and Investment Companies about Environmental, Social, and Governance Investment Practices," pp.60-65, available at https://www.sec.gov/rules/proposed/2022/33-11068.pdf.

[11] SEC Release No. IA-6034; IC-34594; "Proposed Rule: Enhanced Disclosures by Certain Investment Advisors and Investment Companies about Environmental, Social, and Governance Investment Practices," pp.35, 56-58, available at https://www.sec.gov/rules/proposed/2022/33-11068.pdf.

not consider issuers' GHG emissions as part of its investment strategy.[12]

With this proposal, the SEC is also taking steps to link ESG factors to fiduciary standards for investment advisers.

The proposal would require investment advisers to disclose in their Form ADV brochure information concerning their ESG strategies, including whether they employ an Integration, ESG-focused, or Impact approach, and the related sub-considerations described in the context of fund disclosures above such as screening criteria and voting policies.[13]

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[12] SEC Release No. IA-6034; IC-34594; "Proposed Rule: Enhanced Disclosures by Certain Investment Advisors and Investment Companies about Environmental, Social, and Governance Investment Practices," pp.86-89, available at https://www.sec.gov/rules/proposed/2022/33-11068.pdf.

[13] SEC Release No. IA-6034; IC-34594; "Proposed Rule: Enhanced Disclosures by Certain Investment Advisors and Investment Companies about Environmental, Social, and Governance Investment Practices," pp.127-135, available at https://www.sec.gov/rules/proposed/2022/33-11068.pdf.

§ 4:16 —Names Rule Proposal summary

The second proposal, from here on referred to as the "Names Rule Proposal," seeks to curb greenwashing by investment funds. The SEC's Names Rule was first introduced in 2001 and requires funds with a name that suggests a particular investment focus (e.g., consumer goods, emerging markets, tax-exempt) to invest at least 80 percent of its assets in the type of investment indicated.

The rule was introduced to protect investors from materially misleading or deceptive behaviors but, in the SEC's words, "the current scope of the rule has created interpretive issues" with regard to what types of strategies, objectives, or policies are or are not subject to the 80 percent investment policy requirement.[1] These issues are "particularly evident" in the treatment of funds that suggest an ESG focus (e.g., names including the terms "ESG," "green," "sustainable," and "socially responsible").[2] Also worth noting is that the proposal would include "growth" and "value" funds within the scope of the Names Rule.

The Names Rule Proposal would clarify that funds with such names are subject to the 80 percent investment requirement policy. This means that these funds must maintain documentation of which investments are counted toward the 80 percent allocations and their basis for including those investments in the basket. The proposal does not specify the types of data that may form the basis for these allocations.

The Names Rule Proposal also defines certain uses of ESG terminology that are materially deceptive or misleading. Perhaps the most prominent consequence of the rule would be on the naming of Integration Funds, defined by the ESG Proposal. Because an Integration Fund does not elevate the significance of ESG factors above other kinds of investment factors, such that ESG factors may not be determinative in investment decisions,

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[1] SEC Release No. IC-34593 "Proposed Rule: Investment Company Names," p.13, available at https://www.sec.gov/rules/proposed/2022/33-11067.pdf.

[2] SEC Release No. IC-34593 "Proposed Rule: Investment Company Names," pp.13-14, available at https://www.sec.gov/rules/proposed/2022/33-11067.pdf.

the use of ESG terminology in the fund's name would be considered materially deceptive or misleading.[3]

[3] SEC Release No. IC-34593, "Proposed Rule: Investment Company Names," p.18, available at https://www.sec.gov/rules/proposed/2022/33-11067.pdf.

§ 4:17 —Comments in response to the proposals

As of September 2022, the SEC had received 207 comments in response to the ESG Proposal and 109 comments in response to the Names Rule Proposal. Although a majority of comment letters expressed support for the SEC's efforts to mitigate the risks of greenwashing, the comment letters submitted ranged widely in their degree of support or opposition to the proposed rules.

Some of the most ardent support for the proposals came from environmental non-profit groups including Ceres and the Sierra Club. The Sierra Club noted the criticality of such rules and suggested that further alignment with standards being proposed by other jurisdictions, such as the EU's Sustainable Finance Reporting Directive (SFDR), could reduce the costs of reporting and improve comparability.[1] Ceres urged the SEC to go even further, expressing concern that without subjecting *all* funds and advisers to the new disclosure rules, versus only ESG funds and

[1] Sierra Club, "Sierra Club Comments on ESG and Names Rules," available at https://www.sec.gov/comments/s7-17-22/s71722-20138070-308284.pdf.

advisers, there could be a chilling effect on ESG investing writ large.[2]

Other commenters were less supportive. The Investment Company Institute, commenting on the Names Rule Proposal, asserted that the changes "risk producing investor confusion and are not well suited to furthering the Commission's goals."[3] Rather, the ICI argued it is the responsibility of investors to diligence their investments beyond a fund's name and that the SEC should use the ESG Proposal as a vehicle for educating investors.[4]

JP Morgan Asset Management generally supported the inclusion of ESG-related terms within the scope of the Names Rule, but with the caveat that it does not support "the inclusion of fund names indicating that the investments have particular characteristics," particularly "growth" and "value" funds. Other concerns expressed by the bank centered around the practicality and cost of compliance. It urged the SEC to remove the requirement that temporary departures from the 80 percent investment policy be corrected within 30 days and recommended a compliance period of 24 months rather than the proposed 12 months.[5]

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[2] Ceres, "Ceres Comments on ESG and Names Rules," available at https://www.sec.gov/comments/s7-16-22/s71622-20137202-307797.pdf.

[3] Investment Company Institute, "ICI - Names Rule Comment Letter (Final), available at https://www.sec.gov/comments/s7-16-22/s71622-20136238-307259.pdf.

[4] Investment Company Institute, "ICI - Names Rule Comment Letter (Final), available at https://www.sec.gov/comments/s7-16-22/s71622-20136238-307259.pdf.

[5] JP Morgan Asset Management, "JPMAM Comments S7-16-22," available at https://www.sec.gov/comments/s7-16-22/s71622-20136188-307163.pdf.

BlackRock recommended that the SEC do away with the proposed Integration Funds category of funds, arguing that "funds that merely integrate ESG factors alongside other even more critical investment considerations that are core to a fund's stated investment objective should not be considered ESG investments," as it could confuse investors and increase the risk of greenwashing.[6]

BlackRock also offered suggestions around more clearly defining key terms and waiting for final rules on corporate GHG disclosures, among others, but generally expressed strong support for the SEC's proposals, in keeping with its public advocacy for environmental issues in finance.

Public officials and governmental offices also weighed in, with a divide along partisan lines. Representing political conservatives, West Virginia Attorney General Patrick Morrisey, along with 20 other states' Attorneys General, asserted that, "[t]he Proposed Rule is still deeply problematic for many reasons." The letter argues that the SEC does not have the authority to enact a rule of this type and that the proposal would violate the first amendment's free speech guarantees.[7]

On the other hand, New York Attorney General Letitia James, joined by six other states' Attorneys General, wrote in support of the proposals, noting that investors "who want to invest according to their values must navigate through inconsistent, ambiguous, and often misleading statements used to

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[6] BlackRock, "BlackRock Comments on ESG and Names Rules," available at https://www.sec.gov/comments/s7-17-22/s71722-20137500-307978.pdf.

[7] State of West Virginia Office of the Attorney General, "West Virginia Comments on ESG and Names Rules," available at https://www.sec.gov/comments/s7-17-22/s71722-20137837-308134.pdf.

promote various ESG strategies, or, worse, they must endure outright fraud."[8]

On October 7, 2022, the SEC re-opened the public comment periods for both proposals, due to a technological error that had prevented some comments submitted via online form from being received.

[8] State of New York Office of the Attorney General, "Comment letter ISO SEC ESG Investment Company rule proposal," available at https://www.sec.gov/comments/s7-17-22/s71722-20136434-307474.pdf.

PART III. EUROPEAN AND UK DEVELOPMENTS

§ 4:18 CSRD and ESRS

Background to CSRD. In the EU, one of the most notable stories in ESG[1] reporting legislation in 2021 and 2022 has been the development of the Corporate Sustainability Reporting Directive (CSRD).[2] The CSRD seeks to build on and strengthen the provisions and requirements of the Non-Financial Reporting Directive (NFRD).[3] Many investors and legislators believe the NFRD has not produced the quality (i.e., completeness, Relia-

[1] EU legislators use the phrase "sustainability" when discussing reporting requirements that would otherwise fall into the ambit of ESG. For the purposes of consistency with the original names of proposals, we therefore use the term "sustainability" in this section.

[2] https://finance.ec.europa.eu/capital-markets-union-and-financial-markets/company-reporting-and-auditing/company-reporting/corporate-sustainability-reporting_en.

[3] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0095&from=EN.

bility and comparability) of ESG-related corporate information that could lead to a shift in capital to ESG-aligned investments.

The NFRD established requirements on certain entities (including EU-listed companies, insurance companies, and banks) to include a non-financial statement in their annual report. At a minimum, the non-financial information should cover environmental, social and employee matters, human rights, anti-corruption, and bribery issues. The NFRD is not a standalone directive, and in fact operates by a number of amendments to various EU directives, in particular the Accounting Directive.[4] The same will be true of the CSRD, which will introduce further amendments, including to the Accounting Directive, in order to facilitate the implementation of its requirements.

In January 2020, the European Commission (EC) published a consultation seeking opinions on whether it should revise the non-financial reporting framework, including the NFRD. In February 2020, the EC published a further consultation, and a majority of respondents supported extending the application of the NFRD to a broader range of companies and establishing a common reporting standard for such companies.

These consultations led to the EC issuing a proposal for the CSRD in April 2021,[5] which included substantive updates to the pre-existing reporting framework under the NFRD, including:

- Extending the scope to all large companies (including private companies) and all companies listed on regulated markets (except listed micro-enterprises);

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[4] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32013L0034&from=EN.

[5] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52021PC0189&from=EN.

- Requiring the audit (assurance) of reported information;
- Introducing more detailed and standardized ESG/sustainability reporting requirements, with a requirement to report according to mandatory EU ESG/sustainability reporting standards (ESRS); and
- Requiring companies to digitally "tag" the report with tagged information to be published in a dedicated section of company management reports (i.e., reports to be provided electronically/digitally in XHTML format in accordance with European Single Electronic Format regulation).

Following the EC's proposal in April 2021, the CSRD was debated and discussed between the other branches of the EU's law making institutions, namely the European Parliament and the European Council. This negotiation process ended with an announcement of the Parliament and Council on June 21, 2022[6] that political agreement had been reached on the CSRD, and a draft of the agreed document was published on June 30, 2022.[7]

The agreed form draft was broadly aligned with the EC's initial proposal, although it contained some notable changes, such as the requirement for ESG information to be disclosed in relation to certain non-EU companies (see below for further information).

At the time of writing, this agreed form is yet to be published in the Official Journal of the EU, at which point it will be formally enacted. However, given that political agreement has now

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[6] https://www.consilium.europa.eu/en/press/press-releases/2022/06/21/new-rules-on-sustainability-disclosure-provisional-agreement-between-council-and-european-parliament/.

[7] https://www.consilium.europa.eu/media/57644/st10835-xx22.pdf.

been reached, it is not anticipated that any substantive changes will be made to the final version. Therefore, the below consideration of CSRD is based on the provisions of the agreed form draft that has been published.

Structure of the CSRD and ESRS. As noted above, while the CSRD sets out broad requirements, including the scope of the provisions, the specific reporting requirements that companies will face under the CSRD are to be detailed through a set of ESRS. These ESRS themselves are yet to be completed, with the EU setting a target date of November 2022 for the first ESRS to be submitted to the EC.

The EC mandated the European Financial Reporting Advisory Group (EFRAG) to develop draft ESRS requirements, and this work was delegated to a specific Project Task Force on ESRS (PTF-ESRS), consisting of members from 13 Member States, with expertise from a variety of sectors including companies, NGOs, auditors, and financial institutions.

During the winter of 2021-2022, EFRAG made available a number of Working Papers to be considered as work-in-progress documents, which provided stakeholders with an initial understanding of the conceptual thinking of the PTF-ESRS as to the structure and context of the ESRS.

EFRAG followed up with a public consultation on exposure drafts of the ESRS, which ran between April and August 2022.[8] The exposure drafts were published to seek the views of stakeholders on the various aspects of the ESRS, including their interoperability and the specific requirements that companies would face when disclosing ESG information.

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[8] https://www.efrag.org/lab3.

According to EFRAG, the exposure drafts' architecture was designed:

- To organize the reporting of relevant disclosures addressing ESG/sustainability subject matters as required by the CSRD proposal;
- To foster maximum comparability across sectors while ensuring appropriate room for and balance between sector agnostic, sector-specific, and entity-specific information; and
- To facilitate the navigation through the reported information.

To facilitate these objectives, the ESRS are organized by categories intended to interact with each other. There are three primary categories of ESRS, two of which were included in the public consultation (with sector-specific standards to be developed at a later date). These categories are:

- *Cross-Cutting standards*: These standards cover general provisions that apply to sustainability reporting under the CSRD, including principles that companies should follow when disclosing under the specific topical standards (both sector-agnostic and sector-specific). Such sustainability disclosure requirements also relate to how companies comply with the ESRS, the way sustainability is embedded into the companies' business models, and how sustainability risks are identified. Two cross-cutting standards were released as part of the public consultation: ESRS 1 and ESRS 2.
- *Sector-Agnostic Topical Standards*: These standards cover a specific sustainability topic or sub-topic from a sector agnostic perspective. They set disclosure requirements relating to sustainability impacts, risks, and

opportunities that are deemed to be material for all companies, regardless of the sectors they operate in. Such disclosure requirements complement those prescribed by the cross-cutting standards and cover information to be reported on the policies, targets, actions and action plans, resources adopted by the undertaking on a given sustainability topic or subtopic, as well as corresponding performance measurement metrics for each sustainability topic or subtopics. Eleven sector-agnostic topical standards were released as part of the public consultation, five of which covered environmental issues (ESRS E1-E5),[9] four for social issues (ESRS S1-S4),[10] and two for governance disclosures (ESRS G1 and ESRS G2).[11]

- *Sector-Specific Topical Standards*: The ESRS architecture foresees the preparation of sector-specific standards, not included in the public consultation. Such standards will prescribe disclosure requirements designed to provide for the preparation of information relating to sustainability risks, impacts, and opportunities that are deemed to be material for all undertakings operating in a given sector.

Scope of the CSRD. As noted above, the CSRD will apply to considerably more entities than are currently subject to the requirements of the NFRD. First, the CSRD will apply to all companies listed on EU-regulated markets, except for listed micro companies. Second, it will apply to a "large undertaking"

[9] Climate change; pollution; water and marine resources; biodiversity and ecosystems; and resource use and circular economy.

[10] Own workforce; workers in the value chain; affected communities; and consumers and end-users.

[11] Governance, risk management and internal control; and business conduct.

that is an EU company (including any relevant EU subsidiary of a non-EU parent). A large undertaking is a defined term in the Accounting Directive and means an entity that exceeds at least two of the following criteria:

- A net turnover of €40 million;
- A balance sheet total of €20 million; and
- 250 employees on average over a financial year.

In addition, EU parent companies of "large groups" (i.e., corporate groups consisting of parent and subsidiary companies to be included in consolidated accounts and which, on a consolidated basis, exceed at least two of the three criteria noted above with respect to a large undertaking) will be required to report on a consolidated basis on behalf of the entire group.

The CSRD will also apply to insurance undertakings and credit institutions regardless of their legal form.

There are exemptions to the application of the CSRD. Most notably, a subsidiary will be exempt if its parent company includes reporting on the subsidiary in the parent's CSRD-compliant non-financial report. This will include those parent undertakings that are located outside the EU but report in accordance with standards deemed "equivalent" by the EC in separate regulations (which have not yet been published). As mentioned above, listed micro companies and non-listed small and medium-sized enterprises, or SMEs (and micro companies) are not subject to the CSRD's requirements, but can (and may be encouraged by investors or other stakeholders to report in line with the CSRD on a voluntary basis.

Notably, one of the key differences between the EC's original proposal for a CSRD and the politically agreed version was the inclusion of reporting requirements in relation to non-EU companies. Non-EU companies that would face these requirements are those that generate a net turnover of more than €150 million in the EU (for two consecutive years) and which have either:

- A large subsidiary (see thresholds above — notably, this would not include EU subsidiaries that were not large in their own right but were the parent companies of a large group); or

- A branch in the EU with net turnover of over €40 million.

Reporting requirements under the CSRD would not fall directly on those non-EU companies, but instead would be obligations of the EU-based branch or subsidiary, which would be required to procure the relevant information from its non-EU parent and include it in reports.

To the extent that the EU subsidiary or branch is unable to procure all of the required information to report in accordance with the CSRD, it would be required to issue a public statement stating that the non-EU entity did not make the necessary information available, and the EC shall publish a list of those third-country undertakings that have not provided the required information on its public website.

Notably, separate reporting requirements will be published by the end of June 2024 for the non-EU companies that will have obligations under the CSRD. These are unlikely to be as granular or detailed as the ESRS (see below), but will likely contain many of the same requirements.

Specific disclosure requirements under the CSRD/ESRS. While the ESRS are still to be finalized, and the drafts that have been made public as part of the consultation may well be subject to significant revision before entering into effect (in particular, given that the drafts were based on the EC's proposed CSRD as opposed to the politically agreed draft), it is still possible to draw some high-level conclusions about the specific requirements that companies will likely face under the CSRD from the text of the CSRD and the exposure drafts of the ESRS.

While going into each of the reporting requirements is not feasible within the scope of this Chapter, some of the key highlights/most notable reporting requirements are:

- The requirement to disclose a transition plan, demonstrating how the company's business model and strategy are compatible with the transition to a net zero economy and with limiting global warming to 1.5 °C;

- Reporting on absolute greenhouse gas emissions, including Scope 3 emissions;

- The use of scenario analysis as part of climate change mitigation and adaptation planning and the identification of key climate risks for the company;

- Discussion of how the company mitigates its impacts on workers in its supply chain and on the communities in which it and its value chain operates;

- The alignment of the company's business operations with the EU Taxonomy (see below for further information in relation to the EU Taxonomy), including in relation to the Taxonomy's "minimum safeguards" in relation to human rights; and

- Details of the company's strategy and approach, processes, and procedures as well as performance with respect to business conduct. Business conduct in this context includes issues such as corporate culture, avoiding corruption and bribery, and transparency about anti-competitive behavior.

Notably, companies reporting under the CSRD will be required to ensure their reports are certified by an accredited independent auditor or certifier. This independent auditor or certifier must ensure that the sustainability information complies with the certification standards that are to be adopted by the EU. The reporting of non-EU companies that is subject to the CSRD must also be certified, which can be done by an auditor that is certified either in the EU or in their home country.

Timing and implementation. As noted above, the Parliament and Council must formally approve the political agreement before it is published in the Official Journal of the EU. It will enter into force 20 days after publication and its provisions must be integrated into Member States' national laws within 18 months from that date.

EFRAG intends to finalize the first ESRS and present it to the EC by November 2022, ahead of its adoption shortly after. The intended phase-in dates for the obligations of companies under the CSRD are staggered based on the type of company as follows:

- January 1, 2024 for companies already subject to the NFRD;
- January 1, 2025 for large companies and parent companies of large groups that are not presently subject to the NFRD;
- January 1, 2026 for listed SMEs, small and non-complex credit institutions, and captive insurance undertakings; and
- January 1, 2028 for non-EU entities required to report under CSRD.

The CSRD would not have direct effect, and so would have to be implemented by national legislation in each of the EU Member States.

Summary. While the exact details of the ESRS are yet to be finalized, the CSRD represents one of the most detailed, broad ranging, and challenging ESG/sustainability reporting requirements that companies will face globally in the short to medium term. The extension of the requirements to certain non-EU companies will also bring into scope entities that may not expect to be subject to EU requirements, and that largely operate in jurisdictions that have considerably less stringent or slower developing ESG reporting frameworks and requirements in place.

§ 4:19 CSDDD

Background. On February 23, 2022, the EC adopted a proposal for the corporate sustainability due diligence directive (CSDDD).[1] The EU's regulatory scrutiny board had twice rejected earlier proposals for CSDDD, and therefore the proposal finally adopted was an amended version of these earlier attempts. The CSDDD aims to better protect environmental and human rights, including labour rights throughout the supply chains of European companies and also companies operating in the EU.

The rules proposed in the CSDDD are wide ranging and include a number of notable developments that have not been publicized to the same extent as the core obligation of companies to perform diligence on their value chains. The CSDDD is

[1] https://eur-lex.europa.eu/resource.html?uri=cellar:bc4dcea4-9584-11ec-b4e4-01aa75ed71a1.0001.02/DOC_1&format=PDF.

considered part of the EU's Green Deal, and is a further example of the global trend toward regulatory oversight of supply chains. It follows related legislation such as the UK's Modern Slavery Act[2] and the French Duty of Vigilance Act,[3] which has gained further momentum through the U.S. Uyghur Forced Labor Prevention Act[4] and Germany's mandatory human rights due diligence law,[5] both passed in 2021.

Scope of the CSDDD. The CSDDD would extend to certain large companies operating or based in the EU. The thresholds are based on a combination of employee numbers, turnover, and industry type. Lower thresholds are set for both EU and non-EU companies that are viewed as operating in "high-impact" sectors, meaning that they generate over 50 percent of their revenue in sectors that the EU has determined to have higher-risk supply chains, including clothing, extraction of mineral resources, agriculture, and metals manufacturing.

The thresholds for each type of company are:

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[2] https://www.legislation.gov.uk/ukpga/2015/30/contents/enacted.

[3] https://respect.international/wp-content/uploads/2017/10/ngo-translation-french-corporate-duty-of-vigilance-law.pdf.

[4] https://www.cbp.gov/trade/forced-labor/UFLPA.

[5] https://www.bundesregierung.de/breg-en/federal-government/supply-chain-act-1872076.

Type of Company	Revenue Threshold	Employee Threshold
EU based *Non-high-impact company*	Global revenue of over €150 million	500+
EU based *High-impact company*	Global revenue of over €40 million	250+
Non-EU based *Non-high-impact company*	EU-wide revenue of over €150 million	No threshold
Non-EU based *High-impact company*	EU-wide revenue of between €40 million and €150 million	No threshold

Requirements of the CSDDD. Pursuant to the CSDDD, in-scope companies would have to publicly identify "actual and potential" adverse impacts on the environment and/or human rights of the operations of not only the company itself and its subsidiaries, but also "value chain operations carried out by entities with which the company has an established business relationship". Such adverse impacts include forced labor, inadequate worker health and safety, exploitation of workers, greenhouse gas emissions, pollution, and ecosystem degradation.

The CSDDD does not define the concept of "established business relationship," but notes that the "establishment" of such relationships should be reviewed at least every 12 months. Companies would then have to implement measures to prevent and mitigate potential adverse environmental and/or human rights impacts, and bring to an end or minimize the extent of any such actualized adverse impacts. The CSDDD includes a list of actions that companies in this context would be required to take, if relevant (e.g., seeking contractual assurances, making necessary investments, and providing targeted and proportionate support for SME suppliers).

In-scope companies would also be required to integrate due diligence into their corporate policies and implement a specific due diligence policy, which would need to be updated annually and the effectiveness of which must be regularly monitored.

Notably, the CSDDD would also introduce a requirement for certain companies (EU companies with global revenue over €150 million and over 500 employees and non-EU companies with EU revenue of over €150 million) to design a plan to ensure that their business models and strategies are compatible with the transition to a sustainable economy and with "the limiting of global warming to 1.5 degrees Celsius in line with the Paris Agreement." This plan would need to include details of the extent to which climate change is a risk for, or an impact of, the company's operations.

For those companies that identify climate change as a principal risk for, or principal impact of, their operations, the plan must also include emissions reduction objectives. The CSDDD also states that any director who has variable remuneration that is linked to their contribution to the company's business strategy and long-term interests and sustainability, should have the fulfillment of the plan factored into such variable remuneration.

Like the CSRD, the CSDDD would not have direct effect, and so would have to be implemented by national legislation in each of the EU Member States. The Member States would have two years from the enactment of the CSDDD to complete this process.

The CSDDD also introduces specific duties for the directors of in scope EU companies. These duties include the requirement that, when fulfilling their duty to act in the best interest of the company, directors take into account the consequences of their decisions for sustainability matters. Such matters include, if applicable, human rights, climate change, and environmental consequences in the short, medium, and long term. In addition, directors would have a specific duty to put in place and oversee the due diligence actions required by the CSDDD, with due consideration for relevant input from stakeholders and civil society organizations.

The CSDDD contains enforcement provisions in both public and private litigation. Public enforcement (by way of fines) would be left to Member States, with the EC noting that no new authorities would necessarily need to be created, and Member States could use existing national authorities that may be well-positioned to implement enforcement measures. However, the EC has proposed to establish a European Network of Supervisory Authorities to help implement the CSDDD, in order to facilitate bloc-wide coordination and convergence of regulatory, investigative, sanctioning, and supervisory practices.

The CSDDD would also create a separate civil liability regime under which private parties could sue and be sued in EU courts for damages incurred as a result of breaches. Persons negatively impacted by an EU company's operation could sue if the company did not sufficiently act to prevent, minimize, end, or mitigate the adverse impacts of its business activity. However, the proposed civil liability regime is somewhat limited in scope — if companies secure contractual assurances from business partners in relation to compliance with their supplier code of conduct (and undertake appropriate verification measures accordingly), then they may have defenses in respect of such civil claims.

Timing. The CSDDD, at this stage, remains a proposal of the EC, and therefore will be debated and discussed with the other relevant institutions (the Parliament and Council) through the EU's trilogue process before a final version is enacted.

This negotiation process may lead to significant revisions to the provisions of the CSDDD, and therefore the progress of the proposal should be carefully monitored through the coming months. Once adopted, the CSDDD will need to be transposed by each EU Member State into national law, as directives do not have direct effect in the EU. The CSDDD proposal states that Member States would have to apply the CSDDD provisions within two years from the entry into force of the CSDDD for the larger in scope companies,[6] and within four years for the other companies that are in scope.

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[6] I.e., those companies based in the EU with global revenue of over €150 million and over 500 employees, and those companies based outside of the EU with EU revenues of over €150 million.

§ 4:20 Sustainable Finance Disclosure Regulation

Background. The Sustainable Finance Disclosure Regulation (SFDR) imposes mandatory ESG disclosure obligations for asset managers and other financial undertakings.

The SFDR was introduced by the EC alongside the Taxonomy as part of a package of legislative measures arising from the EC's Sustainable Finance Action Plan. The EC's aim in developing the SFDR was to improve transparency, prevent greenwashing, and direct capital towards more sustainable investments/products and businesses, in response to the calls of investors, consumers, and other stakeholders for more accurate, comparable, and transparent ESG-related information from financial market participants.

Requirements of the SFDR. The SFDR was adopted by the EU in 2019, and entered into force in March 2021. The SFDR lays down certain sustainability disclosure obligations at both product level and entity level for financial advisers and financial market participants entities in relation to financial products, with the intention that these additional disclosures will lead to the redirection of capital toward more sustainable investment and mitigate greenwashing risks through improved transparency.

In addition, the SFDR includes disclosure obligations in relation to adverse impacts on sustainability matters at entity level and for specific financial products. These obligations require financial market participants and financial advisers to disclose whether they consider negative externalities on ESG issues of the investment decisions/advice and, to the extent applicable, how this is reflected at the product level.

In July 2022, Regulatory Technical Standards for the SFDR were published in the Official Journal, which include prescribed form templates that entities will be required to disclose against when offering certain sustainability-related financial products and a statement for presenting key performance indicators in relation to any adverse impacts that are identified. These Regulatory Technical Standards will enter into effect from 1 January 2023.

§ 4:21 EU Taxonomy

Background. An important component of the EU's Sustainable Finance Action Plan from 2018 is the EU Taxonomy Regulation, which came into effect in July 2020.[1] The Taxonomy Regulation tasks the EC with establishing a list of environmentally sustainable activities, and defining technical screening

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[1] Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088 (June 18, 2020), available at https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32020R0852.

criteria for each of six environmental objectives.[2] The aim of the Taxonomy Regulation is to develop a set of criteria that determine whether a specific economic activity (as opposed to a company or economic operator as a whole) is "sustainable".

These criteria for the climate change adaptation and mitigation objectives were formally adopted for the consideration of the Parliament and Council by the EC in June 2021, after a challenging set of negotiations was published in the Official Journal of the EU in December 2021. Criteria for the remaining objectives will be established through further delegated acts, which the EC is due to adopt before the end of 2022. See below for further information in relation to these delegated acts.

The operative provisions of the Taxonomy have applied since January 1, 2022 with respect to climate change mitigation and climate change adaptation environmental objectives, and will apply from January 1, 2023 when they relate to the other environmental objectives.

The Taxonomy Regulation applies at both a product level, which is relevant for those financial market participants making available financial products in the EU, and at an entity level, to those entities that are subject to the NFRD, or which will be subject to the CSRD (once the CSRD is in effect).

Structure of the taxonomy regulation. In order to be considered a "sustainable" economic activity (otherwise known as being "Taxonomy-aligned"), an economic activity must:

- Contribute substantially to one or more of the environmental objectives set out in the Taxonomy;

[2] For more details on the Regulation, including the legislative text: https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance/eu-taxonomy-sustainable-activities_en.

- Not significantly harm any of the other environmental objectives;

- Be carried out in compliance with the minimum safeguards; and

- Comply with the technical screening criteria that are established pursuant to delegated acts introduced by the EC.

In turn, the six environmental objectives that an activity may contribute to are listed in the Taxonomy Regulation. The Regulation itself contains high level information about how an activity may substantially contribute to each environmental objective, with more specific and granular requirements included (in the case of climate change mitigation and climate change adaptation) or to be included (in the case of the other four environmental objectives) in Technical Screening Criteria. The environmental objectives are:

- Climate change mitigation;

- Climate change adaptation;

- Sustainable use and protection of water and marine resources;

- Transition to a circular economy;

- Pollution prevention and control; and

- Protection and restoration of biodiversity and ecosystems.

Economic activities can also be considered Taxonomy-aligned if they are determined to be "enabling activities," or activities that directly enable other activities to make a substantial contribution to one or more of the environmental objectives, have a substantial positive environmental impact on the basis of life cycle considerations, and do not lead to a lock-in of assets that undermine long-term environmental goals.

The Taxonomy Regulation also sets out what may be considered "significant harm" in the context of each environmental objective. This can range from having significant GHG emissions (in the context of climate change mitigation), to significant inefficiencies in the use of materials and the direct or indirect use of natural resources (in the context of circular economy). The EC issued technical guidance on the application of the do-no-significant-harm principle in February 2021.[3]

The minimum safeguards that an activity must meet to be considered Taxonomy-aligned are based on international frameworks in relation to corporate conduct and human rights. These frameworks include:

- The OECD Guidelines for Multinational Enterprises;[4]
- The UN Guiding Principles on Business and Human Rights;[5]
- The International Labour Organization's Declaration on Fundamental Principles and Rights at Work;[6] and
- The International Bill of Rights.[7]

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[3] https://ec.europa.eu/info/sites/default/files/c2021_1054_en.pdf.

[4] https://www.oecd.org/daf/inv/mne/48004323.pdf.

[5] https://www.ohchr.org/sites/default/files/documents/publications/guidingprinciplesbusinesshr_en.pdf.

[6] https://www.ilo.org/wcmsp5/groups/public/---ed_norm/---declaration/documents/normativeinstrument/wcms_716594.pdf.

The technical screening criteria are a set of more granular and specific requirements (over and above the high level requirements of the Taxonomy Regulation itself) that economic activities are required to meet, in order for those activities to be Taxonomy-aligned. These requirements are set out in delegated acts that have been, and will continue to be, adopted by the EC, and will be regularly reviewed given the developing nature of science in this area. The technical screening criteria have a number of roles, including identifying the most relevant potential contributions to the given environmental objective, specify minimum requirements that are required to be met, and set quantitative and qualitative thresholds in relation to performance. Please see below in relation to the technical screening criteria that have already been developed and published as delegated acts.

Transparency requirements. Article 8 of the Taxonomy Regulation requires certain companies (namely financial market participants and those subject to CSRD) to provide information to investors about the environmental performance of their assets and economic activities. In this regard, the EC adopted the Article 8 delegated act (discussed below), which specifies the content, methodology, and presentation of information to be disclosed by large companies on their activities' alignments with the Taxonomy.

Financial products with objectives relating to sustainable investment or carbon emission reduction may also need to make additional pre-contractual and periodic reporting disclosures under Article 5 of the Taxonomy Regulation.

Delegated acts. Given the highly technical nature of many of the topics included in the Taxonomy, the Taxonomy Regulation

[7] https://www.ohchr.org/en/what-are-human-rights/international-bill-human-rights.

gives the EC the ability to adopt delegated acts relating to certain matters. Delegated acts are measures adopted by the EC under a specific mandate, which are used to supplement elements of framework primary legislation in the EU.

The EC published the first such delegated act in the Official journal of the EU on December 10, 2021, and concerned disclosure obligations for companies under Article 8 of the Taxonomy Regulation (the Article 8 Delegated Act).

Article 8 of the Taxonomy Regulation contains the provision that requires corporates that are subject to the NFRD (soon to be extended to those subject to the CSRD) to disclose the proportion of their turnover, capital, and operational expenditure that is Taxonomy-aligned. It also sets out common rules relating to key performance indicators. The Article 8 Delegated Act sets out certain application dates for companies to disclose this information, which in the case of the requirements to disclose Taxonomy-aligned activities was during 2022.

Another delegated act that entered into force in December 2021 was what has come to be known as the Taxonomy Climate Delegated Act. This delegated act specifies the technical screening criteria for the first two environmental objectives in the Taxonomy Regulation, namely climate change mitigation and climate change adaptation, including determination thresholds as to whether an activity aimed at climate change mitigation or climate change adaptation would in fact do significant harm to another one of the environmental objectives. The Taxonomy Climate Delegated Act has been in force since January 1, 2022, and the EC intends to supplement it with similar delegated acts with respect to the remaining four environmental objectives during 2022.

Finally, the EC, after much consideration and controversy, published on March 9, 2022, a complementary delegated act in relation to nuclear and natural gas energy activities (the Complementary Delegated Act). The Complementary Delegated Act applies from January 1, 2023, and sets out certain conditions under which nuclear and natural gas energy activities can be included in the list of taxonomy-aligned economic activities.

These conditions include:

- That the activities contribute to the transition to climate neutrality;
- In relation to natural gas, that the activities contribute to the transition from coal to renewables; and
- In relation to nuclear, that the activities fulfill nuclear and environmental safety requirements.

Future development in relation to taxonomy. Under Article 26(1) of the Taxonomy Regulation, the EC was due to publish a report on the Taxonomy Regulation and its implementation by July 2022, and the report is to be refreshed every three years. However, as of the date of writing, this first report has not yet been published. Given the continuing development of science in this area, the Taxonomy, and in particular the technical screening criteria, is intended to be continually refined over the years. Therefore, accurately disclosing to it over a period of time will likely require a level of expertise at disclosing companies and investors.

Social taxonomy. In addition to the Taxonomy, which focuses primarily on environmental sustainability, EU institutions have also been interested in the development of a Social Taxonomy. On February 28, 2022, the EU Platform on Sustainable Finance (PSF) published a final report[8] on a Social Taxonomy,

[8] https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/280222-sustainable-finance-platform-finance-report-social-taxonomy.pdf.

which set out a proposed structure within the current EU legislative framework on sustainable finance.

The PSF report utilized many of the structural aspects of the environmental Taxonomy, such as the development of "social objectives," types of substantial contributions, the do-no-significant-harm principle, and minimum safeguards.

A key difference was that the three social objectives identified in the report (which were (i) decent work, including for value chain workers; (ii) adequate living standard and wellbeing for end-users; and (iii) inclusive and sustainable communities and societies) were then divided into "sub-objectives." The sub-objectives focus on health and safety, healthcare, housing, wages, non-discrimination, consumer health, and communities' livelihoods.

The EC website states that the PSF report will be analyzed in due course, but specific timeframes for follow-up action have not been outlined to date.

§ 4:22 EU Green Bond Standard

Background. A further aspect of the EU's Action Plan was the proposed creation of an EU-wide standard for green bonds. This suggestion was brought into legislative form via a proposal for a regulation from the EC published on July 6, 2021, which followed an earlier consultation on the subject.

The EU Green Bond Standard (GBS) is intended to set out uniform requirements for issuers of bonds that wish to use the label "green" or market their bonds as environmentally sustainable in the EU. One key feature of the GBS is that it is proposed to be a wholly voluntary standard. Therefore, no (new) legal requirements would be imposed in relation to marketing bonds that were not GBS-aligned (in fact, the EU's own 2022 green bond issuance would not have been GBS-aligned). The GBS is therefore anticipated to form more of a "gold standard" or best practice outline, leaning on the principles of existing respected international frameworks such as the International Capital Market Association's Green Bond Principles.

To be considered GBS-aligned, an issuer must comply with the requirements of the GBS until the maturity of the bond. The GBS also relies heavily on the EU Taxonomy in determining whether or not activities underlying the issuance can be determined to be sustainable. The main requirement under the GBS is that all proceeds of the issue are fully allocated, before maturity, to economic activities that are Taxonomy-aligned (see above for further detail in relation to the Taxonomy).

The GBS expressly notes that it does not limit an issuer's ability to use the proceeds of a GBS-aligned issuance to cover losses from other activities, and a GBS-aligned bond may be refinanced by the issuance of a new GBS-aligned bond.

Requirements under the GBS. In order for a bond issuance to be considered GB-aligned, before the bond is offered to the public, a fact sheet must be prepared in a form prescribed by the GBS Regulation. This factsheet should then be approved by a third party reviewer, and published on the issuer's website, alongside with external reviewer's review.

After being issued, annual allocation reports should be prepared each year, again in a form prescribed by the GBS Regulation, until the full allocation of the net proceeds of the bond has been made. Once the proceeds have been fully allocated, the issuer must draw up a final allocation report and provide it to a third party reviewer for the purpose of obtaining a post-issuance review, and publish that post-issuance review.

In addition, after proceeds have been fully allocated, in order to be GB-aligned, the issuer is required to produce a report on the impact of the use of proceeds – once again in a form prescribed by the GBS Regulation.

The GBS Regulation also establishes criteria for registration with the European Securities and Markets Authority (ESMA) as an approved external reviewer for European green bonds. An external reviewer has to apply for registration from ESMA and is required to notify ESMA in case of material changes to the conditions for its registration before any such changes are implemented.

Next steps. The GBS Regulation will now be required to pass through the EU's ordinary legislative procedure, meaning that it will require a negotiated final position to be agreed between the Parliament and Council.

§ 4:23 UK mandatory ESG disclosures

In the UK, different pieces of legislation govern ESG matters. In July 2019, the UK adopted a Green Finance Strategy,[1] following closely on the heels of legislation committing the UK to achieve net zero greenhouse gas (GHG) emissions by 2050.[2] The Green Finance Strategy's objectives are "to align private sector financial flows with clean, environmentally sustainable

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[1] HM Government, Green Finance Strategy: Transforming Finance for a Greener Future (July 2019).

[2] UK Department for Business, Energy & Industrial Strategy and Chris Skidmore MP, "UK Becomes First Major Economy to Pass Net Zero Emissions Law: New target will require the UK to bring all greenhouse gas emissions to net zero by 2050" (June 27, 2019).

and resilient growth, supported by [UK] government action to strengthen the competitiveness of the UK financial sector."[3]

The strategies employed to meet these objectives include three pillars: Greening Finance, Financing Green, and Capturing the Opportunity.

Greening Finance involves ensuring that climate and environmental factors are integrated into mainstream financial decision-making, including the evaluation and incorporation of current and future financial risks and opportunities associated with climate change and other environmental factors. Greening Finance also involves ensuring a robust market for green financial products. To meet these Greening Finance objectives, the UK government stated its expectation that all listed companies and large asset owners disclose in line with the Task Force on Climate-related Financial Disclosures (TCFD) by 2022. The second pillar, Financing Green, encourages the flow of capital into projects and solutions that will help the UK meet its long-term carbon-reduction goals. The third pillar, Capturing the Opportunity, aims to capture the economic opportunities associated with the growth of the green financial markets and commercial innovations that arise through the transition to a greener economy.

As part of efforts to achieve the first pillar of the Green Finance Strategy, the UK introduced a new Listing Rule LR 9.8.6(8)[4] in December 2020, which requires companies with a premium listing in the UK to include in their annual report, for financial years beginning on or after January 1, 2021, information to comply with the TCFD's recommendations. In the

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[3] HM Government, Green Finance Strategy: Transforming Finance for a Greener Future (July 2019).

[4] https://www.handbook.fca.org.uk/handbook/LR/9/8.html.

alternative, companies can elect to explain in the annual report why they have not complied with the TCFD recommendations. Notably, LR 9.8.6(8) does not presently require third-party verification of ESG disclosures, although the FCA has identified that it considers third-party verification to be of value, and will continue to work towards coordinating a policy response in this regard.

In December 2021, the FCA announced that it was extending the TCFD reporting requirements to a wider scope of listed issuers, by including issuers of standard listed shares. The FCA also released an updated version of its handbook, including specific guidance for UK issuers as to how to report in line with the TCFD recommendations.

In a poll conducted by the members of the GC100 (the General Counsel of the FTSE100 group of companies) in June 2021, 73 percent of respondents indicated that they will include a statement of full compliance with the TCFD recommendations, with the remainder indicating partial compliance. Seventy-five percent of respondents also indicated that they will be seeking independent assurance of their TCFD-aligned disclosures, to be carried out by environmental consultants, sustainability ratings providers, or large accounting firms.

To further this aim, the UK government issued an additional consultation paper in March 2021 in relation to extending TCFD-based reporting requirements to all UK companies that are currently required to produce a non-financial information statement under the Companies Act 2006. Broadly, this includes UK companies and LLPs that have more than 500 employees and are listed or have an annual turnover of more than £500 million. This policy was implemented through the Companies (Strategic Report) (Climate-related Financial Disclosure) Regulations 2022 and the Limited Liability Partnerships (Climate-related Financial Disclosure) Regulations 2022 (together, the UK MCD Regulations), which were made on January 17, 2022.

The UK MCD Regulations do not directly incorporate a requirement for in-scope companies and LLPs to report in line with the TCFD recommendations. Instead, and different from the requirements under the Listing Rules, the UK MCD Regulations introduce specific additional reporting requirements for companies' directors to include in their annual strategic report. Such reporting requirements are aligned with, but not identical to, the TCFD recommendations.

In addition to the above, such strategic reports are already required to contain, alongside the general risks and uncertainties facing the company, information about environmental matters (including the impact of the company's operations on the environment), the company's employees, and social, community, and human rights issues. The strategic report also must contain (in the case of certain large companies)[5] a non-financial statement providing information relating to environmental matters (including the impact of the company's operations on the environment), the company's employees, social matters, respect for human rights, and anti-corruption and anti-bribery matters.

In addition to the UK MCD Regulations, the UK government has also indicated that the forthcoming Sustainability Disclosure Requirements (SDR) will introduce requirements for companies in the UK to report on ESG matters on the basis of double materiality. The SDR proposals are discussed later in this chapter.

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[5] (i) Large companies with over 500 employees and which are either (i) a traded company, (ii) a banking company, (iii) an authorised insurance company, or (iv) an insurance company.

The UK has also adopted regulations requiring certain companies to conduct energy efficiency audits and to disclose their energy consumption and GHG emissions. The Companies (Directors' Report) and Limited Liability Partnerships (Energy and Carbon Report) Regulation requires the disclosure of GHG emissions by quoted companies, large unquoted companies, and large limited liability partnerships (known as Streamlined Energy and Carbon Reporting (SECR)).[6] The Energy Savings Opportunity Scheme (ESOS) requires companies in the UK to carry out mandatory energy savings assessments by calculating their total energy consumption, carrying out energy audits and identifying where energy savings can be made.[7]

The UK Corporate Governance Code (the Code), issued by the Financial Reporting Council (the FRC), forms another piece of the ESG framework.[8] The Code consists of a set of principles of good governance in the areas of board leadership and company purpose, division of responsibilities between the board and the company's executive leadership, board composition, succession and evaluation, audit, risk and internal control, and executive and board remuneration. The Code does not impose rigid rules but rather provides flexibility through a set of principles for boards to use. It operates on the basis of "comply or explain" and applies to all companies with a premium listing, whether incorporated in the UK or elsewhere. Finally, the Code requires companies to include in their annual corporate reports

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[6] Companies (Directors' Report) and Limited Liability Partnerships (Energy and Carbon Report) Regulation, available at https://www.legislation.gov.uk/uksi/2018/1155/pdfs/uksi_20181155_en.pdf.

[7] https://www.gov.uk/guidance/energy-savings-opportunity-scheme-esos.

[8] UK Corporate Governance Code, available at https://www.frc.org.uk/directors/corporate-governance-and-stewardship/uk-corporate-governance-code.

and accounts a disclosure statement setting out how they have applied the principles.

The Companies Act imposes on directors a similar, but more general, duty to promote the success of a company.[9] In doing so, company directors must have regard to the impact of the company's operations on the community and the environment, and the likely consequences of any decision in the long term.

The UK has also been proactive in addressing the "S" element of ESG in its disclosure regulations. The Equality Act 2010 mandates gender pay gap reporting in the UK for large employers (more than 250 relevant employees), and voluntary for smaller companies.[10] In addition, the voluntary "Think, Act, Report" framework prompts companies to collect data, take action to address gender pay gaps, and publish information on their progress.[11] The Modern Slavery Act of 2015 requires large commercial organizations to publicly state each year what actions they have taken to ensure their business and supply chains are slavery free.[12]

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[9] Companies Act 2006 s. 172, available at https://www.legislation.gov.uk/ukpga/2006/46/contents.

[10] Equality Act 2010, Ch.3 Equality of terms, Sec. 78 Gender pay gap information, available at https://www.legislation.gov.uk/ukpga/2010/15/contents.

[11] https://www.gov.uk/government/publications/think-act-report/think-act-report.

[12] Modern Slavery Act 2015, available at https://www.legislation.gov.uk/ukpga/2015/30/contents/enacted.

§ 4:24 Sustainability Disclosure Requirements

Background. In addition to the EU, the UK government has indicated that it is looking to introduce legislative and regulatory changes that will provide more information to investors and consumers in relation to ESG issues. The key initiative in this regard to date has been the Sustainability Disclosure Requirements (SDR), which then UK Chancellor, Rishi Sunak, first mentioned in July 2021. It was then formally proposed in the UK government's Greening Finance: A Roadmap to Sustainable Investing[1] report that was published in October 2021 as an update to the UK's 2019 Green Finance Strategy.

The SDR is intended to provide an integrated framework for ESG reporting in the UK, and would introduce requirements both in relation to corporate ESG disclosures and ESG disclosures in relation to financial products. In doing so it therefore appears to be taking on both the roles that the EU has split out between the SFDR (with respect to financial companies) and CSRD (with respect to non-financial companies).

The development of SDR remains at an early stage (and, to a certain extent, has stalled — see below), and therefore understanding of its possible content is limited at this point. However, the UK government has indicated certain key aspects of the SDR will be its focus on double materiality, and the fact that it will extend past climate-related reporting to other aspects of ESG. In both of these ways, it is therefore an extension of the scope of the corporate ESG reporting requirements introduced by the mandatory climate disclosures regulations that took effect from April 2022.

In November 2021, the FCA issued a discussion paper[2] seeking industry participants' views on the proposed SDR and an

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[1] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1031805/CCS0821102722-006_Green_Finance_Paper_2021_v6_Web_Accessible.pdf.

[2] https://www.fca.org.uk/publication/discussion/dp21-4.pdf.

accompanying sustainability labeling system. The discussion paper was focused exclusively on the aspects of the SDR that are aimed at asset managers and regulated asset owners — i.e., companies involved in investment management and decision-making processes, and not on the disclosure requirements of other companies.

The discussion paper was meant to be followed up by an FCA consultation during Q2 2022. However, in July 2022, the FCA announced that this consultation was to be delayed until Q3 to "take account of other international policy initiatives and ensure stakeholders have time to consider these issues". This delay may be due to the ongoing development of the ISSB Standards, which the UK government has announced will be a key element of the SDR. However, in what may be seen as a related development, the UK government announced in May 2022 that it had scrapped the inclusion of the SDR in its proposed financial services bill. The government indicated that it believes the SDR is still very much moving forward, but the status of the proposals remain somewhat uncertain, especially given the change in Prime Minister in the UK in September 2022.

Potential requirements of the SDR. As noted above, given the nascent state of the SDR, the publicly available information as to its requirements is somewhat limited. However, it is possible to ascertain some aspects of what may be included in the SDR based on public statements of the UK government between July 2021 and the time of writing (assuming that SDR continues to go ahead).

The UK government has indicated that the SDR will focus on double materiality, and therefore require companies to disclose not only ESG impacts that may have a direct impact on their bottom line, but also ways in which those companies may impact the environment, societies, or other stakeholders. In addition, the UK government has indicated that, at least in the longer term, the SDR will require disclosures in relation to ESG issues covering broader topics than just the climate. Finally, the UK government has announced that it is monitoring the progress of the ESG standard being developed by the International Sustainability Standards Board (ISSB). The government's October 2021 roadmap indicated that the ISSB standards will "form a core component of the SDR framework, and the backbone of its corporate reporting element."

The appeal of the UK leveraging the ISSB standards is clear, given the resulting benefits in relation to consistent and comparable reporting internationally and that the ISSB standards will also cover ESG reporting topics beyond climate. However, it is, at this stage, unclear how the UK government will reconcile the fact that the ISSB standards are to be developed on the basis of financial materiality, and yet the SDR is intended to focus on double materiality.

In relation to the financial undertaking aspects of SDR, and also the related proposal in relation to sustainable product labels, we may garner some indication as to the content of the SDR from the FCA discussion paper, although we would note that this is subject to consultation and considerable revision before any eventual implementation.

The discussion paper introduces a system of disclosures for asset managers and asset owners and product labels as follows:

- Standardized disclosures containing product-level information, aimed at consumers;
- Detailed disclosures at product and entity level on ESG issues, aimed at professional investors; and
- Product categorization and labels.

The base level consumer-facing disclosures would be provided in a standardized format, describing the product's key ESG-related characteristics in a manner that would seek to improve comparability and accountability for any ESG-related claims made. These disclosures are likely to constitute a subset of the more detailed, investor-focused disclosures.

The proposed investor-facing disclosures would be designed to provide more granular and nuanced information for sophisticated investors in their decision-making process. These disclosures would be provided at both entity level and product level.

The proposed standardized product classification and labeling system would help consumers understand the sustainability attributes of different products. The FCA will develop and implement the labels, building on other international initiatives by regulators and the private sector.

The discussion paper proposes three "Sustainable" categories:

- Transitioning – Products with sustainable characteristics, themes, or objectives; low allocation to UK Taxonomy-aligned sustainable activities;

- Aligned – Products with sustainable characteristics, themes, or objectives; high allocation to UK Taxonomy-aligned sustainable activities; and

- Impact – Products with the objective of delivering positive environmental or social impacts.

The discussion paper considers that these three categories can be mapped against the categories of sustainable investment in the SFDR. Transitioning products would be seen as comparable to Article 8 products, while Aligned products would be comparable to Article 9 products, and Impact products would be limited to a small subset of Article 9 products.

Mandatory transition plans. The SDR may be complemented by the requirement, announced by the UK government at COP 26 in November 2021, that asset managers, regulated asset owners, and listed companies in the UK will be required to publish, by 2023, net zero transition plans that set out how they will decarbonize their business to transition to a lower carbon economy, in particular with respect to the UK's net zero 2050 target.

However, despite introducing that rule, the UK government acknowledged that a "gold standard" is yet to be established as to what a good or appropriate transition plan looks like for companies. It therefore announced that it would set up a Transition Plan Taskforce, bringing together industry, academia, and regulators to develop such a standard and relevant associated metrics.

The Transition Plan Taskforce was formally launched on April 25, 2022, with a two-year mandate and an aim to "drive decarbonization by ensuring that financial institutions and companies prepare rigorous plans to achieve net zero and support efforts to tackle greenwashing."

The taskforce is working with international frameworks that are preparing guidance on transition plan disclosures, including the Glasgow Financial Alliance for Net Zero and ISSB. It intends to build upon the work already carried out to develop detailed templates suitable for incorporation into regulation.

The taskforce will develop:

- A sector-neutral framework for private sector transition plans;
- Sector-specific guidance for finance and real economy sectors; and
- Recommendations for listed companies and stakeholders on preparing and using transition plans.

§ 4:25 UK Taxonomy

A further key aspect of the UK's Green Finance Strategy is the proposed development of a UK Green Taxonomy, also known as the UK Taxonomy. The UK has been able to see the development of the framework of the EU Taxonomy, and subsequently has affirmed its commitment to developing a complementary regime.

In June 2021, the UK government established the Green Technical Advisory Group (GTAG) to oversee the development of the UK Taxonomy, and to provide independent, non-binding advice to the UK government on developing and implementing a classification system in the UK regulatory context. GTAG is chaired by the Green Finance Institute, and is composed of members from businesses, taxonomy and data experts, and subject-matter experts from academia, NGOs, the UK Environment Agency, and the Committee on Climate Change.

The UK Taxonomy is expected to play a key underpinning role in the context of the SDR by determining whether economic activities can be considered sustainable — similar to the considerable interplay between the EU Taxonomy and both the CSRD and SFDR in an EU context. The UK government has indicated that it is aware of the importance of consistency between international standards such as Taxonomies. In that regard the UK Taxonomy will likely resemble closely its EU equivalent (and that is reflected in the information released to date in relation to the UK Taxonomy — see below). However, some amendments that make it specific to the UK market are also expected.

Little information as to the specifics of the UK Taxonomy have been released to date, and GTAG continues its work in developing the Taxonomy. However, the UK government's roadmap indicates that the UK Taxonomy will adopt the same six environmental objectives in the EU Taxonomy. It will also deploy similar requirements for activities to meet in order to become Taxonomy-aligned, specifically that an activity must:

- Make a substantial contribution to one of the six environmental objectives;
- Do no significant harm to the other objectives; and
- Meet a set of minimum safeguards.

How the UK Taxonomy develops as GTAG and the UK government release further information will be interesting to note, particularly whether we will see differing treatment in relation to some of the more controversial aspects of the EU Taxonomy, such as the inclusion of certain nuclear and gas activities. At this stage however, it is too early to tell how these particular issues will be dealt with in the UK.

The UK Taxonomy is one of the subjects that may be revisited as part of the UK government's plan to update its Green Finance Strategy by the end of 2022. In May 2022, the UK government issued a call for evidence to support this proposed update, which is intended to take stock of progress toward the Green Finance Strategy to date and set out how the UK can better ensure the financial services industry supports the UK's energy security, climate, and environmental objectives. The call for evidence included a number of specific questions that stakeholders were invited to comment on, as well as a space for general comments, and closed on June 22, 2022. The UK government has indicated that it will respond by the end of 2022, but has not done so as of the date of writing.

PART IV.
VOLUNTARY INTERNATIONAL ESG REPORTING STANDARDS

§ 4:26 Convergence of standards: Alignment of voluntary reporting standards and formation of the International Sustainability Standards Board

Consolidation and cooperation – Finding order in the alphabet soup. The last two years have seen significant consolidation among the sustainability reporting organizations responsible for what has been called the "alphabet soup" of standards (referencing the array of acronyms used to identify those standards). In September 2020, a group composed of the CDP (formerly the Carbon Disclosure Project), Climate Disclosure Standards Board (CDSB), Global Reporting Initiative (GRI), International Integrated Reporting Council (IIRC), and the Sustainability Accounting Standards Board (SASB) issued a joint statement of intent to collaborate in fostering a comprehensive corporate reporting system.[1]

The joint statement provided the organizations' rationale for coming together. "The independent sustainability standard-setters, together with the integrated reporting framework provider, are collaborating to provide a basis for progress towards a more comprehensive corporate reporting system. As organisations, we recognise how the combination of our framework and standards can help companies present, and users receive, more comprehensive information. However, we also recognise that

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[1] "Statement of Intent to Work Together Towards Comprehensive Corporate Reporting: Summary of alignment discussions among leading sustainability and integrated reporting organisations CDP, CDSB, GRI, IIRC and SASB" (Sept. 2020).

using our framework and standards as a single coordinated solution must be made easier for the market – and we are committed to working together urgently towards a global, comprehensive corporate reporting system."[2]

This "Alliance" of standard setters issued a prototype standard that formed the basis for the development of model sustainability standards by the International Financial Reporting Standards Foundation (IFRS Foundation) in preparation for its establishment of the ISSB to give it a "running start" as it began the standard setting process.

The ISSB folded in many of the key former players in the "alphabet soup," including the CDSB and the Value Reporting Foundation, which was formed through the merger of SASB with the IIRC. By incorporating these reporting frameworks, the ISSB was able to draw on the expertise of these well-established organizations. Furthermore, as it developed its proposals ("Exposure Drafts"), the ISSB engaged with the SEC and the EU to foster closer alignment and interoperability between their jurisdictional rules and the ISSB baseline standards. The ISSB also formed a Jurisdictional Working Group to enhance the compatibility among the ISSB's standards and the initiatives of other jurisdictions that are working to develop domestic sustainability disclosure standards.

The ISSB was officially established by the IFRS Foundation in November 2021 at the UN Climate Change Conference (COP26). The IFRS Foundation, which has for over 20 years stewarded internationally accepted accounting standards, had outlined earlier in the year its intention to expand its scope to

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[2] "Statement of Intent to Work Together Towards Comprehensive Corporate Reporting: Summary of alignment discussions among leading sustainability and integrated reporting organisations CDP, CDSB, GRI, IIRC and SASB" (Sept. 2020).

include a similar set of sustainability standards by focusing initially on climate-related reporting and building on existing frameworks, namely the TCFD and SASB recommendations, in partnership with standard-setters from key jurisdictions.[3]

On March 31, 2022, the ISSB released the Exposure Drafts for its first two sets of standards. When finalized, the proposed standards are intended to form a comprehensive baseline of sustainability-related disclosures for investors to factor into their decision making. The first proposal, *General Requirements for Disclosure of Sustainability-related Financial Information* (IFRS S1), lays out the overall requirements for disclosing financial information about all significant sustainability-related risks and opportunities. Additionally, IFRS S1 provides guidance on how to identify and develop disclosures about sustainability-related risks and opportunities not addressed by an IFRS standard using SASB Standards and the CDSB Framework application guidance for water- and biodiversity-related financial information.[4] The second proposal, *Climate-related Disclosures* (IFRS S2), sets out specific requirements for identifying, measuring, and disclosing climate-related financial information.[5]

Following the release of the Exposure Drafts, the ISSB opened a 120-day consultation period ending July 29, 2022 to

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[3] https://www.ifrs.org/news-and-events/news/2021/03/trustees-announce-strategic-direction-based-on-feedback-to-sustainability-reporting-consultation/.

[4] https://www.ifrs.org/news-and-events/news/2022/03/issb-delivers-proposals-that-create-comprehensive-global-baseline-of-sustainability-disclosures/.

[5] https://www.ifrs.org/news-and-events/news/2022/03/issb-delivers-proposals-that-create-comprehensive-global-baseline-of-sustainability-disclosures/.

solicit comments from public and private stakeholders, with overviews of the comments released the following September.

§ 4:27 —Intended use of the proposed standards

As the ISSB lacks authority to compel disclosures, its standards are being drafted such that individual jurisdictions and regulators can adopt the standards in conjunction with any other financial and sustainability reporting frameworks they may have in place. Accordingly, the proposals include the recommendations by the TCFD, which has been serving as a foundation for jurisdictional regulations including the recent proposals by the U.S. SEC and European Financial Reporting Advisory Group covered earlier in this chapter.

The ISSB proposals should be considered part of a "building blocks" approach to reporting. The ISSB proposal focuses on sustainability-related matters that may create or erode enterprise value. Additional building blocks may be layered on top of this foundation, as deemed appropriate in different jurisdictions.

§ 4:28 —Summary of IFRS S1 (General Sustainability-related Disclosures)

The ISSB has rightly recognized that "sustainability" as a topic for disclosure is extremely broad, encompassing all components of ESG, with room for disagreement over definitions and scope across industries and jurisdictions. Accordingly, IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information* was drafted as a general framework meant to sit at the core of any future sustainability disclosures.

IFRS S1 would require entities to disclose "material information about all of the significant sustainability-related risks and opportunities to which it is exposed."[1] Material information is not defined in absolute terms. Rather, IFRS S1 states that, in alignment with IASB standards, materiality is "an entity-specific aspect of relevance" assessed at the time and in the context of the entity's ordinary financial reporting, and based on the nature or magnitude of the item being disclosed.[2] In short, sustainability-related financial information is material if omitting or misrepresenting it could reasonably be expected to influence the decisions of the users of general purpose financial reporting.[3]

In order to ensure usefulness to investors, an entity's sustainability-related financial information must be disclosed as part of its general purpose financial reporting (i.e., at the same time as its financial statements).[4] It should also make clear the relation-

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[1] ISSB, "Exposure Draft IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information," p.6, available at https://www.ifrs.org/content/dam/ifrs/project/general-sustainability-related-disclosures/exposure-draft-ifrs-s1-general-requirements-for-disclosure-of-sustainability-related-financial-information.pdf.

[2] ISSB, "Exposure Draft IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information," pp.16, 44, available at https://www.ifrs.org/content/dam/ifrs/project/general-sustainability-related-disclosures/exposure-draft-ifrs-s1-general-requirements-for-disclosure-of-sustainability-related-financial-information.pdf.

[3] ISSB, "Exposure Draft IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information," pp.33-34, available at https://www.ifrs.org/content/dam/ifrs/project/general-sustainability-related-disclosures/exposure-draft-ifrs-s1-general-requirements-for-disclosure-of-sustainability-related-financial-information.pdf.

[4] ISSB, "Exposure Draft IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information," p.36, available at https://www.ifrs.org/content/dam/ifrs/project/general-sustainability-related-disclosures/exposure-draft-ifrs-s1-general-requirements-for-disclosure-of-sustainability-related-financial-information.pdf.

ships or connections between various sustainability-related information and general purpose financial information.[5]

The core disclosures that would be required by IFRS S1 map directly to, and borrow language from, the four thematic areas set out by the TCFD: Governance, Strategy, Risk management, and Metrics, and Targets. The draft proposal expands on the TCFD by expanding on the set of specific information and data required from reporters. The following paragraphs discuss in more detail the key disclosures required within each thematic area.

Governance. As described in the proposal, the purpose of disclosures on governance is "to enable users of general purpose financial reporting to understand the governance processes, controls and procedures used to monitor and manage sustainability-related risks and opportunities."[6]

Governance disclosures (a)-(c) deal with the identification, mandate, and qualifications of the individual or body responsible for overseeing sustainability-related risks and opportunities. Governance disclosures (d)-(f) solicit the process by which the above-specified body considers, communicates, and sets targets related to sustainability-related risks and opportunities when making major strategic and transactional decisions. Finally,

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[5] ISSB, "Exposure Draft IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information," p.31, available at https://www.ifrs.org/content/dam/ifrs/project/general-sustainability-related-disclosures/exposure-draft-ifrs-s1-general-requirements-for-disclosure-of-sustainability-related-financial-information.pdf.

[6] ISSB, "Exposure Draft IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information," p.24, available at https://www.ifrs.org/content/dam/ifrs/project/general-sustainability-related-disclosures/exposure-draft-ifrs-s1-general-requirements-for-disclosure-of-sustainability-related-financial-information.pdf.

governance disclosure (g) consists of a description of management's role in assessing and managing these risks and opportunities, including whether and how dedicated controls and procedures are integrated with other internal functions.[7]

Strategy. Disclosures on strategy are intended "to enable users of general purpose financial reporting to understand an entity's strategy for addressing significant sustainability-related risks and opportunities."[8]

Strategy disclosure (a) calls for a *description* of all the risks and opportunities that can reasonably be expected to affect the entity's business model, strategy, and financials over the short, medium, and long term, as well as definitions for each of these time periods. Strategy disclosures (b)-(d) include information about the *effects* of those risks and opportunities on the entity's business model, value chain, strategy and decision-making, and financial position and performance over the short, medium, and long term. Finally, strategy disclosure I instructs entities to provide a qualitative and, where appropriate, quantitative analysis of the resilience of their strategies to sustainability-related risks. Importantly, IFRS S1 notes that other IFRS Sustainability Disclosure Standards, such as IFRS S2 for climate-related disclo-

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[7] ISSB, "Exposure Draft IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information," p.24, available at https://www.ifrs.org/content/dam/ifrs/project/general-sustainability-related-disclosures/exposure-draft-ifrs-s1-general-requirements-for-disclosure-of-sustainability-related-financial-information.pdf.

[8] ISSB, "Exposure Draft IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information," p.25, available at https://www.ifrs.org/content/dam/ifrs/project/general-sustainability-related-disclosures/exposure-draft-ifrs-s1-general-requirements-for-disclosure-of-sustainability-related-financial-information.pdf.

sures, will specify the type of information required, including potential scenario analyses.[9]

Risk management. The objective of disclosures on risk management is to enable users to understand the processes by which sustainability-related risks and opportunities are identified, assessed, and managed, as well as the way these processes themselves are integrated into the entity's overall risk management system.

These disclosures should include specific details about how the likelihood and effects of risks and opportunities are qualitatively and quantitatively assessed (e.g., inputs, data sources), how thresholds for materiality are set, and how prioritization is determined.[10]

Metrics and targets. Disclosures on metrics and targets aim to provide an understanding of the metrics used by a reporter to measure, monitor, and track performance against sustainability-related risks and opportunities.

IFRS S1 allows for metrics to be defined by other applicable IFRS Sustainability Disclosure Standards (e.g., IFRS S2), third-party standard-setters (e.g., industry-based SASB standards), or the entity itself. In order to avoid greenwashing, any entity-created metrics that are used must be accompanied by a disclo-

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[9] ISSB, "Exposure Draft IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information," pp.25-27, available at https://www.ifrs.org/content/dam/ifrs/project/general-sustainability-related-disclosures/exposure-draft-ifrs-s1-general-requirements-for-disclosure-of-sustainability-related-financial-information.pdf.

[10] ISSB, "Exposure Draft IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information," p.28, available at https://www.ifrs.org/content/dam/ifrs/project/general-sustainability-related-disclosures/exposure-draft-ifrs-s1-general-requirements-for-disclosure-of-sustainability-related-financial-information.pdf.

sure of how it is defined and calculated, whether it is validated by a third party (and the identity of that third party), and the assumptions and limitations embedded in the metric. With regard to sustainability targets, reporters are required to disclose the relevant metric(s) used, the period over which the target applies, and any milestones or interim targets that have been set. In the event that a metric or target is revised or replaced, the reporter must explain the changes and explain the rationale behind the change. The reporter should also provide restated comparative figures, however, IFRS S1 includes a notably ambiguous carveout for cases where "it is impracticable to do so."[11]

Characteristics of useful disclosures. In order to be of use to investors and other stakeholders evaluating enterprise value, sustainability-related financial disclosures must be both relevant and a faithful representation of the entity's business. Indeed, the ISSB's draft proposal deems these the two fundamental qualitative characteristics.[12]

SFRS S1 describes a high-level test for relevance in disclosures: whether the information provided has predictive value and/or confirmatory value in the user's decision-making process. Having predictive value does not require that information be explicitly stated in the form of a prediction. In fact, only a small subset of the disclosed that would be required include an

[11] ISSB, "Exposure Draft IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information," pp.29-30, 33, available at https://www.ifrs.org/content/dam/ifrs/project/general-sustainability-related-disclosures/exposure-draft-ifrs-s1-general-requirements-for-disclosure-of-sustainability-related-financial-information.pdf.

[12] ISSB, "Exposure Draft IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information," pp.43-44, available at https://www.ifrs.org/content/dam/ifrs/project/general-sustainability-related-disclosures/exposure-draft-ifrs-s1-general-requirements-for-disclosure-of-sustainability-related-financial-information.pdf.

aspect of forecasting, such as Strategy disclosures (b)-(d) described above. Predictive value stems from whether the information may be usable as an input in the user's own decision-making process.

Materiality is another important factor in determining the relevance of disclosures. As discussed above, sustainability-related financial information is material if omitting or misrepresenting it could reasonably be expected to influence the decisions of the users of general purpose financial reporting. The formulation of materiality in the draft proposal is intentionally flexible, requiring context from the entity's business, industry, geography, and other factors that may vary over time as internal or external conditions change. This being said, the exact threshold for what is considered "material" will continue to be subject to debate and refinement, though it seems likely that the ISSB will opt to retain an anchor to the IASB definition.

Whether disclosures and the information contained therein is a faithful representation of what it purports to represent ultimately comes down to objectivity and accuracy. While many businesses will choose to frame certain disclosures such as their sustainability targets in ambitious or positive lights, they can retain objectivity by transparently communicating risks and other factors that could prevent the entity from succeeding. Accuracy can also be ensured through auditing for material error, use of precise descriptions, and the use of reasonable and transparent assumptions where necessary.

Enhancing qualitative characteristics. The draft proposal further lays out four "enhancing qualitative characteristics" of useful sustainability-related financial information, summarized briefly below:[13]

[13] ISSB, "Exposure Draft IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information," pp.45-48, available at

- *Comparability:* The information disclosed can be compared to information provided by the entity in previous periods and information provided by other entities; primarily driven by the adoption of reporting standards such as those set out here by the ISSB, which enable consistency in the types of information provided.

- *Verifiability*: The disclosures, delivered with information about the inputs and methodologies used, can be corroborated by a knowledgeable and independent third party; verification does not necessitate exact replication of the outputs, but does mean a consensus can be reached on the good faith representation of the disclosures and metrics.

- *Timeliness:* The information is made available in time for users to factor it into their decision making; timeliness is supported by the proposed requirement to make sustainability-related disclosures as part of its general purpose financial disclosures and by using the most recent data possible.

- *Understandability:* The meaning and interpretation of the disclosures should be clear to the user — a function of the language used, use of visualization, and other formatting choices — and concise in content, avoiding non-material content and content that is redundant with other disclosures; IFRS S1 further includes a warning that complex but material information should not be excluded for the purpose of improving understandability.

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https://www.ifrs.org/content/dam/ifrs/project/general-sustainability-related-disclosures/exposure-draft-ifrs-s1-general-requirements-for-disclosure-of-sustainability-related-financial-information.pdf.

§ 4:29 —Summary of IFRS S2 (Climate-related Disclosures)

Given IFRS S1's positioning as a general framework for sustainability-related financial disclosures, additional standards for specific ESG topic areas are required to make it practicable for reporting entities. Enter the exposure draft for IFRS S2 *Climate-related Disclosures*, proposed in conjunction with IFRS S1 to lay out requirements for entities to disclose information about significant environmental, or "climate-related," risks and opportunities.

IFRS S2's definition of climate-related risks and opportunities is a specific articulation of the "sustainability-related" risks and opportunities found in S1. Climate-related risks are categorized into two types: physical risks and transition risks. Physical risks result from event-driven (i.e., acute) or from longer-term (i.e., chronic) shifts in climate patterns and may lead to financial implications such as damage to physical assets or supply chain disruptions. Transition risks arise from changes made to address climate change mitigation and adaptation, and may result from evolutions in policy, technology, or other market determinants.[1]

The definition of climate-related opportunities remains open-ended in the proposal, referring to "the potentially positive climate change-generated outcomes for an entity."[2]

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[1] ISSB, "Exposure Draft IFRS S2 Climate-related Disclosures," pp.44-47, available at https://www.ifrs.org/content/dam/ifrs/project/climate-related-disclosures/issb-exposure-draft-2022-2-climate-related-disclosures.pdf.

[2] ISSB, "Exposure Draft IFRS S2 Climate-related Disclosures," pp.45, available at https://www.ifrs.org/content/dam/ifrs/project/climate-related-disclosures/issb-exposure-draft-2022-2-climate-related-disclosures.pdf.

IFRS S2 is organized along the same four TCFD-based disclosure themes as IFRS S1: Governance, Strategy, Risk management, and Metrics and targets. The following paragraphs summarize the climate-specific formulations of the disclosures within each thematic area. For an overview of the generalized types of disclosures pertinent to each theme, see the summary of IFRS S1 above. An overview of climate-specific disclosures is set forth below:

Governance. The proposed governance disclosures in IFRS S2 precisely mirror their counterparts in S1, substituting in “climate-related” in place of “sustainability-related.” The S2 recognizes that for many entities, the information disclosed may be the same as that required to fulfill the standards of S1. In this case, a single, integrated disclosure should be used to avoid redundancy.[3]

Strategy. The principal modifications IFRS S2 makes to the strategy disclosures set by S1 are the inclusion of disclosures around the entity’s transition plans — the actions and targets that lay out how it will transition toward a lower-carbon economy — and climate-related scenario analysis.[4]

Under the proposal, entities would be expected to disclose information about current and anticipated changes to its business model, such as the adaptation and mitigation initiatives it is undertaking and the resourcing behind them. Entities would also be required to detail the extent to which any climate-related targets will be achieved through greenhouse gas emission re-

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[3] ISSB, “Exposure Draft IFRS S2 Climate-related Disclosures,” p.33, available at https://www.ifrs.org/content/dam/ifrs/project/climate-related-disclosures/issb-exposure-draft-2022-2-climate-related-disclosures.pdf.

[4] ISSB, “Exposure Draft IFRS S2 Climate-related Disclosures,” pp.35-39, available at https://www.ifrs.org/content/dam/ifrs/project/climate-related-disclosures/issb-exposure-draft-2022-2-climate-related-disclosures.pdf.

ductions within the entity's value chain and carbon offsets, the latter of which would be subject to further scrutiny over the type, certification, and integrity of the credits.

Rigorous scenario analysis, which is only mentioned as a possibility in IFRS S1, is expressed as necessary for assessing and disclosing a business's climate resilience in S2. However, the draft language does include a significant and ambiguous exception for when an entity "is unable to do so," in which case an alternative method may be used.[5] Disclosures around scenario analysis (or the alternative method used) would include the methodology used and detailed descriptions of the scenarios considered, the results of the analysis including any areas of uncertainty, and the entity's corresponding ability to adapt its strategy and operations over different time horizons. When scenario analysis is not used, entities would be expected to explain why not and provide similarly detailed information about the inputs and outputs of the analysis.[6]

Risk management. Just as in the governance disclosures, the risk management disclosures proposed in IFRS S2 precisely mirror their counterparts in S1, substituting in "climate-related" in place of "sustainability-related." Again, if applicable, a single, integrated disclosure should be used to avoid redundancy.[7]

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[5] ISSB, "Exposure Draft IFRS S2 Climate-related Disclosures," p.37, available at https://www.ifrs.org/content/dam/ifrs/project/climate-related-disclosures/issb-exposure-draft-2022-2-climate-related-disclosures.pdf.

[6] ISSB, "Exposure Draft IFRS S2 Climate-related Disclosures," pp.37-39, available at https://www.ifrs.org/content/dam/ifrs/project/climate-related-disclosures/issb-exposure-draft-2022-2-climate-related-disclosures.pdf.

[7] ISSB, "Exposure Draft IFRS S2 Climate-related Disclosures," pp.39-40, available at https://www.ifrs.org/content/dam/ifrs/project/climate-related-disclosures/issb-exposure-draft-2022-2-climate-related-disclosures.pdf.

Metrics and targets. IFRS S2 requires a number of climate-specific metrics be disclosed, including the entity's Scope 1, Scope 2, and Scope 3 greenhouse gas emissions expressed in both absolute CO_2 equivalents and in units of intensity.

Other metrics to be disclosed include, but are not limited to:

- The amount and percentage of assets, business activities, and capital deployments impacted by physical risks, transition risks, and climate-related opportunities;
- The entity's internal carbon price — the price per metric tonne of GHG emissions used to assess the cost of its emissions; and
- The share of management remuneration ties to climate-related matters.[8]

Depending on the extent of the industry-related metric and targets that apply to an entity, the required disclosed proposed by the ISSB could be significantly more detailed than those being proposed by jurisdictions such as the U.S.

Industry-specific standards. Appendix B of the proposal elaborates on industry-specific disclosure requirements, which the ISSB has derived from SASB Standards. The SASB Standards are a set of 77 industry-specific sustainability accounting standards. Appendix B provides guidance on selecting the appropriate industry disclosures to comply with, and entities that already use SASB will likely find these relatively easy to navigate. Though these industry-related disclosures are structured as

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[8] ISSB, "Exposure Draft IFRS S2 Climate-related Disclosures," pp.39-40, available at https://www.ifrs.org/content/dam/ifrs/project/climate-related-disclosures/issb-exposure-draft-2022-2-climate-related-disclosures.pdf.

and located in an appendix, the draft proposal makes clear that they be considered an "integral part" of the standards overall.[9]

[9] ISSB, "Exposure Draft IFRS S2 Climate-related Disclosures," pp.40-43, available at https://www.ifrs.org/content/dam/ifrs/project/climate-related-disclosures/issb-exposure-draft-2022-2-climate-related-disclosures.pdf.

§ 4:30 —Key themes from the comment period

Following the release of the draft proposals, the ISSB opened a 120-day consultation period ending July 29, 2022 to solicit comments from public and private stakeholders. The ISSB has since published summaries of the letters received, which are discussed below.

As the ISSB put it, the stakeholder response was "robust," with approximately 1,400 letters received across both proposals. Letters came from all geographic regions and eight types of stakeholders. Just over 40 percent of all letters came from preparers/reporters of sustainability-related disclosures. Users of disclosures, public interest organizations, and accountants/ auditors together comprised another roughly 40 percent of commenters. The remaining letters were submitted by academics, regulators, policy makers, and standard-setters.[1]

General comments and concerns are as follows:

[1] ISSB, "AP3A: Summary of comments," pp.4-5, available at https://www.ifrs.org/content/dam/ifrs/meetings/2022/september/issb/ap3a-general-sustainability-related-disclosures-summary-of-comments.pdf; ISSB, "AP4A: Summary of contents, pp.3-4, available at https://www.ifrs.org/content/dam/ifrs/meetings/2022/september/issb/ap4a-climate-related-disclosures-summary-of-comments.pdf.

- The consultation period revealed widespread support for the ISSB and both exposure drafts. A large majority of commenters agreed that the proposed standards had important objectives and would accomplish those objectives if implemented by jurisdictions. Many commenters also commended and emphasized the importance of collaboration between the ISSB and the IASB within the IFRS Foundation umbrella.[2]

- This being said, many qualified their support with the need for greater clarity around key topics, terms, and disclosures, e.g., the difference between "materiality" and "significance," the definition of different time horizons, and the scope of "sustainability-related risks and opportunities."

- To be sure, serious concerns were raised that the ISSB will have to address as it iterates on its proposals. Concerns over the scalability of the proposed standards, as a broad theme, was among the chief takeaways from the consultation period, particularly where required disclosures rely on metrics and data that are at an early stage of development and quality assurance. Many expressed that aspects of the disclosures will prove prohibitively difficult for auditors and regulators to verify the completeness and accuracy of.[3] For climate-related disclosures in par-

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[2] ISSB, "AP3A: Summary of comments," pp.2-3, 7-9, available at https://www.ifrs.org/content/dam/ifrs/meetings/2022/september/issb/ap3a-general-sustainability-related-disclosures-summary-of-comments.pdf; ISSB, "AP4A: Summary of contents, p.2, available at https://www.ifrs.org/con tent/dam/ifrs/meetings/2022/september/issb/ap4a-climate-related-disclosures-su mmary-of-comments.pdf.

[3] ISSB, "AP3A: Summary of comments," pp.8-12, available at https://www.ifrs.org/content/dam/ifrs/meetings/2022/september/issb/ap3a-general-sustainability-related-disclosures-summary-of-comments.pdf.

ticular, there is a fear among some stakeholders that insufficient illustrative guidance will result in overly-general, "boilerplate" disclosures, a slippery slope to greenwashing.[4]

- On net, commenters believe that the benefits of sustainability-related and climate-related disclosures will outweigh their costs in the long-run. However, almost all said that the costs of implementation are likely to be substantial, even outweighing the benefits in the near-term, although almost all of even this group expects this dynamic to reverse over time.[5] This is consistent with SEC estimates that the annual cost of compliance with its proposed climate-related disclosures will decrease by 15 to 20 percent after the first year of compliance.[6] There is also general agreement that the ISSB's decision to build its standards on existing frameworks such as the TCFD and SASB will help reduce complexity and the effort required to comply with regulations in multiple jurisdictions, although more can be done to align the ISSB's proposals to their counterparts emerging from the SEC and EFRAG.[7]

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[4] ISSB, "AP4A: Summary of contents, p.11, available at https://www.ifrs.org/content/dam/ifrs/meetings/2022/september/issb/ap4a-climate-related-disclosures-summary-of-comments.pdf.

[5] ISSB, "AP3A: Summary of comments," p.28, available at https://www.ifrs.org/content/dam/ifrs/meetings/2022/september/issb/ap3a-general-sustainability-related-disclosures-summary-of-comments.pdf.

[6] SEC, "Proposed rule: The Enhancement and Standardization of Climate-Related Disclosures for Investors," p.373, available at https://www.sec.gov/rules/proposed/2022/33-11042.pdf.

[7] ISSB, "AP3A: Summary of comments," pp.3, 26, 28, available at https://www.ifrs.org/content/dam/ifrs/meetings/2022/september/issb/ap3a-general-sustainability-related-disclosures-summary-of-comments.pdf.

Climate-specific comments are as follows:

- With regard to climate-specific aspects of the drafts, proposals relating to Scope 3 GHG emissions and the use of scenario analysis were among the most contentious. A prominent split emerged between reporters and users, with the latter group being more favorable on requiring Scope 3 emissions disclosures.

- As expected, concerns from reporters primarily center around the limited availability of high-quality data and the potentially high cost of compliance. The banking sector in particular raised costs concerns, given their high exposure to financed emissions which require inputs from a large number of entities that may be difficult to wrangle.[8] Some of the recommendations put forth to address this concern center on ways to limit the information disclosed, such as only requiring information to suppliers that the reporting entity directly does business with (i.e., Tier 1 and Tier 2 suppliers).[9]

- Most commenters responding to questions related to transition plans expressed support for the proposed requirements, though some reporters expressed concern about the practicality of even establishing such plans to report, while other groups of commenters asked for more con-

[8] ISSB, "AP4A: Summary of contents, p.18, available at https: //www .ifrs.org/content/dam/ifrs/meetings/2022/september/issb/ap4a-climate-related -disclosures-summary-of-comments.pdf.

[9] ISSB, "AP4A: Summary of contents, pp.8, 18, available at https://www .ifrs.org/content/dam/ifrs/meetings/2022/september/issb/ap4a-climate-related -disclosures-summary-of-comments.pdf.

> sideration around the reliability and verifiability of underlying data.[10]

Ultimately, the international community has sent strong signals that the ISSB is on the right track with its exposure drafts of IFRS S1 and S2, but more work is needed to address these important themes, as well as the many points raised by commenters.

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[10] ISSB, "AP4A: Summary of contents, p.9, available at https://www.ifrs.org/content/dam/ifrs/meetings/2022/september/issb/ap4a-climate-related-disclosures-summary-of-comments.pdf.

§ 4:31 Next steps

The ISSB standards, when adopted, are expected to establish a common baseline that can work with countries' own rules and standards through a "building block" approach that will foster greater comparability and consistency in climate disclosures across jurisdictions. Jurisdictions will be able to use the common baseline as a consistent starting point from which they can build, depending on their jurisdictional mandates or priorities. This should bring order, and greater consistency to climate disclosures, which should serve both issuers and investors.

§ 4:32 What to expect in the year ahead

The last year has seen dramatic movement regarding proposed climate-related disclosure rules and standards. We expect that this was merely setting the stage for an eventful 2023. Some of the things we expect to see include:

More companies reporting on climate-related risks and opportunities. We expect to see companies calculating their GHG emissions and obtaining audits or attestation of those emissions calculations. Companies are also likely to engage with the TCFD framework, shoring up their climate governance, and applying greater rigor to the analysis of and strategies to address their climate-related risks and opportunities.

Integration across functions within companies. Part of good governance and incorporating climate-related risks and opportunities into their strategies is building controls and systems to gather and share information within companies. Information and strategy will be shared across functions and the board will be more involved in overseeing climate strategy.

Investment in innovation and decarbonization technologies. The adoption of the Inflation Reduction Act in the United States and other incentives to decarbonize are likely to drive the development of new systems, processes, and technologies to help companies to reduce their GHG emissions. The growing net zero commitments will also drive demand for offsets, and clean energy. Offset projects, including but not limited to renewable energy projects, are likely to proliferate.

Focus on the voluntary carbon markets. The market for offsets will continue to expand and efforts to bring consistency and reliability to that market will be areas of focus. Market participants will endeavor to create mechanisms by which to ensure the integrity of underlying projects, measure the carbon reductions, ensure the efforts go beyond business as usual ("additionality"), are permanent, and are traceable, assured, and tracked through recognized registries. Significant work must still be done and the voluntary carbon markets will be the focus of attention.

Governments and standard-setters finalizing rules and standards. Many important rulemaking and standard-setting proposals are under consultation, including those in the United States, Europe, and with the ISSB. A host of new rules and standards are likely to be adopted in 2023.

Rules and standards on other ESG topics. ESG rules and standards related to a broader range of topics beyond climate are likely to be proposed in 2023. These are likely to include human capital management and board diversity (as reflected on the SEC's Regulatory Flexibility Agenda), biodiversity, nature loss, deforestation, human rights, and other issues.

Litigation over SEC rules. The SEC's adoption of its climate rules likely will spawn litigation challenging them. Based on the comment letters submitted to the SEC, those challenges are likely to range from constitutional challenges asserting that the rules violate Companies' First Amendment Rights protecting them against compelled speech by the government, to claims that the rules exceed the SEC's statutory authority, to claims that the rules are unduly burdensome.

Potential legislation to roll back climate-related rule-makings. Depending on the outcome of the midterm elections in November 2022, there could be new legislation to block climate disclosure rulemaking. This would exacerbate the already highly charged political divide in the United States and push the United States back to a lagging position with the rest of the world on climate.

Tension between geopolitical and economic crises and climate action. We are likely to see companies and countries contending with challenges of the geopolitical instability caused by Russia's war on Ukraine and its economic, humanitarian, and political consequences, including severe economic slowdown. These pressures will compete with the climate crisis for attention and resources.

Continued severe weather. We will continue to contend with severe weather and weather-related disasters.