ESG UPDATE
EXECUTIVE SUMMARY
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Global ESG Disclosure Regimes

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COP27

- Climate COP27 did not yield major progress towards further limiting global greenhouse gas emissions. Many governments and stakeholders viewed the COP as a failure given its inability to reach agreement on aggressive efforts to tackle the root causes of climate change. The Parties did agree to create a loss and damage fund to help developing countries adapt to the impacts of climate change. Some developing countries met this agreement with skepticism, given the failure of the developed world to satisfy prior climate funding commitments.
- There were also two major announcements at COP27 on the ESG and climate disclosure front. First, CDP will incorporate the ISSB's IFRS S2 Climate-related Disclosures Standard into its global environmental disclosure platform. Second, the ISSB announced the launch of the Partnership Framework for Capacity Building in Developing and Emerging Economies: an effort to drive global adoption of an inclusive and implementable baseline for disclosure. (Please see IFRS-ISSB section for details on both initiatives.)
- The United Nations' High-Level Expert Group on the Net Zero Emissions Commitments of Non-State Entities issued a comprehensive report entitled, *Integrity Matters: Net Zero Commitments by Businesses, Financial Institutions, Cities and Regions*. UN Secretary-General António Guterres created the Group in March of this year to enhance standards for net-zero emissions pledges by non-State entities (i.e., businesses, investors, cities, and regions) and to accelerate their implementation. The report advances 10 comprehensive recommendations for non-state actors. The Secretary-General stated that we "must have zero tolerance for net-zero greenwashing," and described the report as "a how-to guide to ensure credible, accountable net-zero pledges."

EUROPEAN UNION

- The European Parliament and the European Council of Ministers – the twin legislative bodies within the EU system – each adopted the Corporate Sustainability Reporting Directive (CSRD). The Directive, which must be implemented by the EU Member States, will apply on a phased basis, beginning for some companies in 2025 (for FY 2024). All reporting companies must obtain third-party assurance of their reports. Assurance requirements will progress from "limited" assurance to more demanding "reasonable" assurance by 2028. The CSRD applies to non-European companies generating a net turnover of at least €150 million in the EU and which maintain at least one EU subsidiary or branch.

- EFRAG submitted the first set of draft European Sustainability Reporting Standards (ESRS) to the European Commission for formal consideration. Once adopted, the ESRS will set the detailed corporate reporting requirements under the CSRD. This initial set consists of twelve "sector-agnostic" drafts: two Cross-Cutting Standards; five on Environment; four on Social; and, one on Governance. The EU anticipates holding a public consultation on the ESRS in Q1/Q2 2023. Next, EFRAG will begin work on sets of sector-specific ESRS.
- Mairead McGuinness, European Commissioner for Financial Stability, confirmed Brussels' commitment to pursuing "as much alignment as possible" with ISSB standards. Commissioner McGuinness sought to qualm concerns from regulators and the regulated community regarding potential inconsistencies between emerging disclosure regimes. She acknowledged the need for global coordination and cooperation, while noting that "Europe is likely to go further and faster to meet our higher ambitions on climate." Commissioner McGuinness made her comments ahead of the final adoption of the CRSD by the EU Parliament and the EU Council of Ministers.

United States

- The members of the FAR Council proposed a new Federal Acquisition Regulation (FAR) entitled, *Disclosure of Greenhouse Gas Emissions and Climate-Related Financial Risk*. Federal contractors that secured at least $7.5 million in federal contracts in the prior fiscal year would be subject to annual Scope 1 and Scope 2 GHG emissions disclosure requirements. Significant additional disclosure obligations would attach to "major contractors," defined as those that received $50 million or more in federal contracts in the prior fiscal year. Only major contractors would be subject to the requirement to disclose Scope 3 GHG emissions, and to the science-based target requirements. The proposal leverages the TCFD, CDP and SBTi initiatives. The baseline compliance requirements would take effect one year after the publication of the final rule, while major contractors would have two years from publication to comply with their additional reporting obligations. The comment period closes on January 13, 2023.
- Even before the GOP had secured a House majority in the incoming Congress, Republican officials were promising to conduct oversight and investigations into the SEC and the financial sector over climate disclosures and ESG investing. Calling ESG investing "a cancer within our capital markets" and "a fraud on American investors," a GOP member of the House Financial Services Committee promised the Committee would focus on the practices. The incoming majority intends to bring SEC and Biden Administration officials before the Committee,

along with the CEOs of major investment advisers (such as BlackRock, Vanguard and State Street). Also, five GOP Senators "issued a warning to corporate law firms" over their work in ESG investing. The letter, sent to 51 major firms, threatened Congressional scrutiny of alleged "institutionalized antitrust violations being committed in the name of ESG." The Senators promised to refer violations to the FTC and the Department of Justice and advised firms and their clients "to preserve relevant documents in anticipation of those investigations."

- Five Democratic members of the U.S. House sent a letter to SEC Chair Gensler voicing reservations over the potential impacts of the proposed Climate Disclosure Rule on farmers and small businesses. The lawmakers raised concerns that the draft Rule's Scope 3 emissions disclosure requirements on large corporations might inadvertently force costly burdens down the supply chain. The members suggested that the final Rule clarify that companies that are required to disclose their Scope 3 emissions can rely on estimates, rather than on data collected directly from providers in their supply chains. The lawmakers also noted that the concerns over liability for Scope 3 disclosures could be driving large corporations to demand more data from their suppliers than is necessary. The members suggested that the SEC "clarify the safe harbors from liability to further protect our farms and small businesses."
- Referencing the proposed Climate Disclosure Rule, the Associate Director of the SEC Division of Enforcement noted that the Commission may not rely solely on a company's balance sheet when determining whether climate is "material" to a corporation. The Associate Director stated that an issue "can be material to a company — for example specific to that company's business or its operations — not just as financial statements. It's not just quantitative — it's not just 'does something impact the bottom line.'" As an example, she cited a company making marketing claims regarding its practices "in the climate space." The Associate Director stressed that her views do not necessarily reflect Commission policy.
- The Director of the SEC Division of Enforcement stressed that pursuing ESG cases would remain an enforcement priority for the Commission. Noting that ESG is "an important area for us because it's important for investors," the Director added: "We're not waiting for new rules here. What we're doing is we're using our existing rule set to hold issuers accountable." The SEC also charged Goldman Sachs Asset Management for failures in its policies and procedures over ESG marketing claims. Without admitting wrongdoing, GSAM consented to the Commission's findings and paid a $4 million fine.
- The SEC adopted amendments – the Proxy Voting Disclosure Rule – to require mutual funds to provide enhanced disclosures regarding their proxy votes on proposals including diversity and inclusion, executive compensation and ESG.

These amendments create a streamlined structure for reporting by combining descriptive categories, advancing consistency and requiring information be disclosed in a machine-readable format. A former senior SEC official stated: "This is the most important sustainability rule you've never heard of. Information about funds' voting records has been practically incomprehensible to ordinary investors seeking to hold them accountable." The new requirements will be effective for votes occurring on or after July 1, 2023, with the first filings subject to the amendments due in 2024.

United Kingdom

- The Financial Conduct Authority (FCA) of the United Kingdom announced the formation of a stakeholder group to develop a voluntary Code of Conduct for ESG data and ratings providers. The FCA acknowledged the central role that such firms play in the ESG investment space, while noting the lack of consistency and transparency – and potential conflicts of interest – within the sector. The FCA has also asked the Treasury Department to extend its "regulatory perimeter" to allow it to engage in a formal rulemaking in this space. Should Treasury grant the requested regulatory authority, the FCA stated its intention to "develop and consult on a proportionate and effective regulatory regime," by focusing on priorities including "transparency, good governance, management of conflicts of interest, and systems and controls."
- The FCA launched its long-awaited consultation on *Sustainability Disclosure Requirements (SDR) and Investment Labels*. The objective is to develop final rules to combat greenwashing and increase transparency in green investing by introducing sustainable investment labels, mandating additional disclosures and establishing naming and marketing rules for green investment products. The proposed SDR is intended to be broadly equivalent to the European Union's Sustainable Finance Disclosure Regulation. Industry experts nonetheless voiced concerns over the potential for inconsistencies or outright conflicts between the UK, EU and SEC approaches. The FCA consultation is open until January 25, 2023, and the Authority intends to publish final rules by the summer of 2023.

IFRS-ISSB

- At COP27 in Egypt, IFRS and CDP announced that CDP will incorporate the ISSB's IFRS S2 Climate-related Disclosures Standard into its global environmental disclosure platform. The two organizations hailed this announcement as "a major step towards delivering a comprehensive global baseline for capital markets through the adoption of ISSB standards. The Standard, currently being finalised, will be incorporated into CDP's existing

questionnaires, which are issued to companies annually on behalf of 680 financial institutions with over $130 trillion in assets." In 2022, nearly 19,000 companies representing half of global market capitalization disclosed environmental information through CDP. This integration, according to the two organizations, "means rapid accelerated early adoption of ISSB climate data disclosure across the global economy." The expectation is that this will drive global uniformity, reduce burdens on reporting entities and result in consistent, comparable, and decision-useful disclosures. The Financial Stability Board, the G20, G7 and others have welcomed the development of the ISSB standards.

- Also at COP27, the ISSB announced the launch of the Partnership Framework for Capacity Building in Developing and Emerging Economies (the "Partnership Framework"). The Paris Agreement and G20 Sustainable Finance Roadmap each cite the importance of undertaking capacity building activity in developing and emerging economies to accelerate progress towards the 2030 Agenda (the resolution that adopted the UN Sustainable Development Goals). The ISSB announced the Partnership Framework at COP27 along with representatives from over 20 public and private organizations from across the globe. The priority of the Partnership Framework, and a key goal for the ISSB, is to "drive adoption of the globally implementable baseline that is truly inclusive in nature."
- As part of its statement from COP27, the ISSB reaffirmed its commitment to cooperating with global jurisdictions creating disclosure standards. ISSB noted specifically that it "is working with the European Commission and EFRAG toward a shared objective to agree as soon as practicable a framework for maximising interoperability of their standards and aligning on key climate disclosures."
- The ISSB board voted unanimously "to confirm that companies are required to use climate-related scenario analysis to report on climate resilience and to identify climate-related risks and opportunities to support their disclosures." The ISSB acted in response to queries from stakeholders to clarify the definition of "climate-related scenario analysis". The ISSB further agreed to provide application support to preparers, including making use of materials developed by the TCFD to provide guidance to preparers on how to undertake scenario analysis. Scenario analysis is a key tool employed by some companies to assess the strategic and financial implications of potential climate-related risks and opportunities, including both transition risk and physical risk.