ESG UPDATE
EXECUTIVE SUMMARY
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Global ESG Disclosure Regimes

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EXECUTIVE SUMMARY

General

- Companies are scrambling to introduce the same rigor to their ESG reporting that they apply to their financial disclosures. Many are moving accountants from the financial side to the ESG side or are establishing new structures and roles to drive consistency. Several blue-chip companies have appointed accountants to lead new ESG or sustainability controller roles. The “Big 4” accounting firms are collectively investing billions of dollars to hire and train ESG auditors in anticipation of this lucrative emerging practice area.
- The Institute of Management Accountants released the results of an international survey of finance officials in over 500 companies concerning corporate “readiness to identify, consider, and assess various categories of business risks related to climate change.” The survey results revealed a lack of preparedness, with 32% of respondents stating they do not consider climate-related risks in their Enterprise Risk Management (ERM) process, and another 16% acknowledging they have no ERM process. Overall, the lack of attention to climate is most pronounced among privately held companies, with the authors concluding that, “private companies … have neither identified climate as a relevant matter nor acted on it”. The lack of readiness overall, and especially among privately held companies, represents a threat throughout the value chain. Large, publicly-traded companies will encounter significant challenges in meeting their own compliance and reporting requirements until and unless their suppliers take the steps necessary to improve their own processes.

European Union

- As part of its assessment of the proposed European Sustainability Reporting Standards (ESRS), the European Commission requested formal Opinions from three European financial Authorities. These Opinions were requested by the Commission in accordance with the mandate established by the Corporate Sustainability Reporting Directive. Each Authority provided support for the drafts while proposing some areas for improvement. Collectively, the Authorities stressed the need to drive further consistency and interoperability with other European legislation and with parallel international efforts; provide further guidance regarding the materiality assessment process; clarify terms and data requirements; and, set boundaries for proportionality and risk management. The Commission plans to adopt ESRS Set 1 by June 30, 2023.
- Professor Kerstin Lopatta, the Vice Chair of the EFRAG Sustainability Reporting Board, has been appointed as the Special Liaison to the International

Sustainability Standard Board to drive further consistency between those parallel efforts. She added that the two organizations are developing an "interoperability table which brings together the global baseline of the ISSB with the ESRS." Professor Lopatta noted three major improvements that EFRAG realized between the initial ESRS Exposure Drafts and the proposals forwarded to the European Commission in November 2022.

- Enhancing comparability with the work of the ISSB and other international standards to the maximum extent possible to avoid double reporting.
- Giving the materiality assessment process a more central role in selecting the material items that have to be reported in the management discussion and analysis report.
- Significantly reducing the number of reporting items to lower the reporting burden for the companies.

UNITED STATES

- According to published reports, the U.S. Securities and Exchange Commission is considering easing the requirements of its proposed Climate Disclosure Rule. The proposal has come under withering criticism from certain business organizations and from (mostly Republican) federal and state elected officials; lawsuits are all but certain to be filed. Even politicians, investors and businesses that support the overall approach have raised concerns with its expansive scope and requirements. In response, the Commission is reportedly considering raising the threshold at which companies must report climate costs. As proposed, companies would have to analyze climate-related costs and risks for each line item of their financial statements and report climate costs that are 1% or more of any entry. The Commission still intends to release the final rule in April 2023.
- Major corporations have added climate change risks to their regulatory disclosures following demands from the SEC. General Dynamics and Halliburton are among at least 10 companies that have taken such action. Several of these new corporate disclosures are in response to letters the SEC has been sending to companies asking them to clarify their public statements on climate. Expert observers believe the Commission could use this information to defend its climate rule in court next year against expected legal challenges.
- Republican SEC Commissioner Mark Uyeda made extensive public comments regarding ESG investing. He stressed what he saw as the subjectivity of ESG metrics; questioned the role of ESG ratings services; and, raised the specter of an emerging Orwellian system. He also challenged whether ESG ratings systems exist to prevent greenwashing or are a means in to disguise to drive a given political or social agenda.

- As expected, House Republicans plan to use their new majority to hold hearings on ESG investing, with SEC Chair Gary Gensler as their top target. Representative Patrick McHenry, Chairman of the House Financial Services Committee, did allow for some nuance on the issue, stating that he is not totally opposed to ESG. He is reportedly concerned “with corporations that pay more attention to politics than to the bottom line for shareholders.” Meanwhile, several House Democrats announced they were forming a sustainable investing caucus to “advocate for policies sought by the sustainable investment industry.” They plan to invite moderate Republicans to join the effort.
- In the latest salvo against ESG investing in the states, Florida’s Chief Financial Officer has blocked asset managers from investing a $5.1 billion state pension pool in sustainable funds. This is merely the most recent action in Florida, which has already taken other steps to prevent the investment of state funds in ESG financial vehicles. Given the politically charged atmosphere around ESG disclosures at both the federal and state levels, companies may want to keep their powder dry when it comes to addressing climate goals. This had led to a new trend among companies known as “green hushing” – staying quiet on climate goals unless those are key to its mission and branding.

United Kingdom

- The UK’s Financial Reporting Council (FRC) announced its areas of supervisory focus for 2023/24, including priority sectors, for corporate reporting reviews and audit quality inspections. The FRC’s Supervision Division will supplement its routine reviews with a number of “thematic” reviews, including a focus on the TCFD metrics and targets disclosures of companies from “four relevant sectors.” In concert, the FRC’s Audit Quality Review team will target its audit quality inspections on priorities to include: “Climate-related risks, including the linkage between the audited financial statements and climate-related disclosures elsewhere in the Annual Report.”
- FTSE Russell has delisted 34 companies from its FTSE4Good All-World benchmark after determining they failed to meet its newly introduced Climate Change Score. The benchmark’s updated climate standards “are based on parameters drawn up by the Transition Pathway Initiative, which is backed by 130 investors collectively managing $50tn in assets.” Officials noted that the delisted companies had been given ample time to comply with the new requirements, and added that they would continue to raise the bar on climate.

IFRS-ISSB

- ISSB Chair Emmanuel Faber noted that the body is "on track" to publish its first two climate standards "by the end of Q2 this year." The ISSB is modifying the draft standards on the basis of reactions received to the 2022 Exposure Drafts. Mr. Faber added that ISSB hopes to "finalize redeliberations of feedback received next month in Montreal before moving to final balloting of the standards." Mr. Faber also noted that ISSB is prioritizing activities to strengthen and enhance use of the standards globally and on driving consistency with existing approaches and parallel initiatives. ISSB Vice Chair Sue Lloyd noted that ISSB is engaged in an ongoing dialogue with the International Organization of Securities Commissions seeking endorsement of the disclosure rules.
- ISSB is planning to "offer some relief" related to reporting greenhouse gas emissions data from the value chain. At its January meeting in Frankfurt, the ISSB "tentatively decided" under certain conditions, "to provide relief that would allow an entity to measure its GHG emissions using information for reporting periods that are different from the entity's own reporting period when that information arises from entities in its value chain with reporting periods that are different from the entity's own." Mr. Faber noted: "Some relief we've already agreed for Scope 3 emissions related to data from the value chain – there is a difference in reporting periods for companies in the value chain – we extended that notion to Scope 1 & 2 emissions to make it consistent overall."

CALIFORNIA

- California legislators reintroduced the Climate Corporate Data Accountability Act. The introduction is virtually identical to last year's version of the Act – SB 260 – which failed narrowly in the waning days of the 2021-22 California legislative session. The bill directs corporations with more than $1 billion in annual revenues to disclose all scopes of their greenhouse gas emissions. In tandem, state senators introduced the Climate-Related Financial Risk Act – to require "a covered entity … to prepare a climate-related financial risk report disclosing the entity's climate-related financial risk and measures adopted to reduce and adapt to climate-related financial risk disclosed."