ESG Monthly Newsletter

April 2023

This memorandum highlights key recent developments in environmental, social and governance matters of relevance to public and private companies globally. For more information on this evolving business and legal landscape, we encourage you to reach out to your regular Sullivan & Cromwell contact or the lawyers listed on our ESG practice website.

Key Developments

- **ISSB announces transitional relief for Scope 3 and sustainability-related disclosures and prepares to consult on future projects, including amendments to SASB Standards.** The International Sustainability Standards Board (ISSB), which is finalizing standards for disclosure of climate- and sustainability-related financial information, announced that companies will have one-year transitional relief from Scope 3 and non-climate sustainability-related disclosure requirements. In the meantime, ISSB will seek public comment on its proposal for revising the SASB Standards. The ISSB will also seek public comment on the relative priority of four potential future projects—biodiversity, human capital, human rights and integration in reporting—as other standard-setters (including the International Accounting Standards Board, the Taskforce on Nature-related Financial Disclosures and the U.N. Principles for Responsible Investment) continue to advance efforts in these areas.

- **As regulators continue to emphasize internal controls, COSO publishes recommendations on building internal control over sustainability reporting.** The Committee of Sponsoring Organizations of the Treadway Commission (COSO) Internal Control – Integrated Framework (ICIF) is the most widely used internal control framework to meet the requirements of US public companies under Section 404 of the Sarbanes Oxley Act. On March 30, citing the prevalence of sustainability reporting among modern global companies, COSO published a 2023 update, which provides guidance on how companies can apply the ICIF principles to sustainability reporting.

- **Biden administration continues to focus on environmental justice and incentives for EVs and U.S. clean energy projects.** The Joe Biden administration recently issued executive orders on environmental justice and announced a number of federal actions to encourage clean energy projects, including proposed guidance on clean vehicle and energy community bonus tax credits available under the Inflation Reduction Act and a report on scaling carbon management technologies and markets.

In this Issue

Legislative and Regulatory Updates

1. *Global*

ISSB announces transitional relief for its standards. At an April 4 meeting, the ISSB (which is part of the IFRS Foundation) decided that companies will have enhanced transitional relief in their first year of applying IFRS S1 (*General Requirements for Disclosure of Sustainability-related Financial Information*) and S2 (*Climate-related Disclosures*). During the first year, companies would generally be required to report on climate-related information as set forth in S2, but can choose not to (1) provide disclosures about sustainability-related risks and opportunities beyond climate-related information; (2) provide annual sustainability-related disclosures at the same time as the related financial statements; (3) provide comparative information; (4) disclose Scope 3 greenhouse gas emissions; or (5) use the Greenhouse Gas Protocol to measure emissions, if they are currently using a different approach. The ISSB expects to issue S1 and S2 at the end of June, and has tentatively decided that the standards would be effective for annual reporting periods beginning on or after January 1, 2024.

ISSB prepares to consult on the international applicability of SASB Standards. As part of its work to maintain and enhance the SASB Standards, the ISSB is working on amendments to the SASB Standards to enhance their international applicability. The ISSB expects that the SASB Standards, a widely used voluntary framework for sustainability reporting, will support companies in implementing IFRS S1. The planned amendments are expected to affect approximately 20% of the metrics included in the SASB Standards. The ISSB will open a 90-day consultation in May on its proposed methodology for revising the SASB Standards.

ISSB prepares to consult on future priorities. On April 19, the ISSB announced that it will be publishing a request for information in May (with a 120-day comment period) to seek feedback on its future priorities for the next two years. Based on its research into the information needs of investors, the ISSB has identified four potential projects—biodiversity, ecosystems and ecosystem services; human capital; human rights; and integration in reporting—and will seek feedback on the relative priority of these projects.

IASB considers greater information regarding climate-related risks in financial statements. On March 23, the International Accounting Standards Board (IASB), which is also part of the IFRS Foundation and responsible for the IFRS Accounting Standards, announced that it is undertaking a project to explore whether and how companies can provide greater information regarding climate-related risks in their financial statements. Specifically, the project will assess the effectiveness of the educational material published in 2020 by IFRS in helping companies address climate-related risks in their financial statements and explore additional actions the IASB could take to further improve information on these matters. The IASB has stated that it will work to ensure that any proposals work well with the IFRS S1 and S2 Standards that will be issued by the ISSB, and that any information required by the two boards would be complementary.

COSO Releases Study and Supplemental Guidance on Internal Control Over Sustainability Reporting. On March 30, COSO published a study and supplemental guidance on effective internal control over sustainability reporting. This publication is intended to help companies apply COSO's Internal Control – Integrated Framework (the ICIF), which is the most widely used internal control framework to meet public companies' obligations under Section 404 of the US Sarbanes Oxley Act, to sustainability reporting. While recognizing that sustainability disclosures are often more qualitative, forward-looking and multidisciplinary than traditional financial reporting, the new COSO report emphasizes that its ICIF principles are nevertheless applicable to sustainability and ESG reporting and could facilitate interdisciplinary cooperation across an organization in meeting the increasing demand for high-quality ESG information. The publication offers recommendations and examples for applying each of the five components of ICIF to sustainability reporting: (1) control environment; (2) risk assessment; (3) control activities; (4) information and communication; and (5) monitoring activities.

TNFD releases final beta version of biodiversity-related disclosure framework. On March 28, the Taskforce on Nature-related Financial Disclosures (TNFD) released the fourth and final beta version of its Nature-Related Risk and Opportunity Management and Disclosure Framework, which is modelled on the Task Force on Climate-related Financial Disclosures' (TCFD) recommendations for disclosures on climate-related risks and opportunities. This final beta version presents a full representation of the TNFD framework, which includes 14 draft recommended disclosures with implemental guidance across all sectors and six general requirements along the four pillars of the framework's recommendations. A final version is expected to be released in September 2023.

2. *United States*

Biden administration continues to focus on electric vehicles and clean energy projects. The Biden administration recently announced a number of actions being taken by U.S. federal agencies to encourage clean energy investments. *See* S&C's memos on recently proposed guidance from the Internal Revenue Service on clean vehicle tax credits and energy community bonus tax credits. In addition, on April 12, the Environmental Protection Agency announced that they would be proposing new auto pollution limits that could result in electric vehicles accounting for 67% of new light-duty vehicle sales and 46% of new medium-duty vehicles by 2032.

Biden administration issues executive order on environmental justice. On April 21, the Biden administration issued an executive order that aims to improve how the federal government confronts environmental injustice. The executive order defines "environmental justice" and clarifies that the pursuit of environmental justice is a duty of all executive branch agencies. The order also directs federal agencies to consider measures to address and prevent disproportionate and adverse environmental and health impacts on communities, and charges agencies with conducting new assessments of their environmental justice efforts in developing, implementing and periodically updating an environmental justice strategic plan, which will be submitted to the White House Council on Environmental Quality and made public on a regular basis. The order also establishes a White House Office of Environmental Justice to coordinate the implementation of environmental justice policy across the federal government.

DOE releases new report on CO2 management ecosystem. On April 24, the DOE released a new report in its series of Pathways to Commercial Liftoff Reports focusing on carbon management. This report covers all stages of the CO2 management ecosystem, from point-source carbon capture, utilization, and storage (CCUS) to carbon removal (CDR). The report notes that the U.S. will likely need to capture and permanently store ~400–1,800 million tonnes of CO2 annually to meet its net-zero commitments by 2050, and outlines a pathway for reaching this objective.

3. *European Union*

European Union proposed new EU Taxonomy criteria for environmental activities. The European Commission has released for consultation a new set of criteria for economic activities that contribute substantially to the non-climate-related environmental objectives of the EU Taxonomy Regulation. The proposed delegated act, which is open for comment until May 3, proposes technical criteria for what economic activities can qualify as contributing substantially to the sustainable use and protection of water and marine resources, to the transition to a circular economy, to pollution prevention and control or to the protection and restoration of biodiversity and ecosystems. The proposed delegated act focuses on how activities in certain high impact industries, including manufacturing, construction and civil engineering, could qualify as meeting the Taxonomy's requirements for those four objectives.

4. *Hong Kong*

HKEx publishes market consultation paper on ESG-related disclosures. On April 14, the Stock Exchange of Hong Kong (HKEx) published a consultation paper seeking market feedback on proposed changes to its ESG reporting framework to enhance climate-related disclosures made by listed issuers. In the consultation paper, HKEx proposes to mandate that all issuers make climate-related disclosures in their ESG reports, compared to the current "comply or explain" standard. HKEx also notes that it will introduce new climate-related disclosure requirements based on the ISSB's IFRS S2 Standard, categorized in accordance with the four core TCFD pillars. The consultation period will end on July 14. Subject to the responses from the consultation, the revised listing requirements will apply to ESG reports in respect of financial years commencing on or after January 1, 2024. Recognizing that Scope 3 emissions and currently anticipated financial effects disclosure requirements may require more compliance time, HKEx has announced interim provisions for such disclosures for the first two reporting years following the effective date.

Financial Institutions Updates

1. *Global*

FSB releases report on climate-related financial risk factors in financial institution compensation frameworks. The Financial Stability Board (FSB) released a report reviewing how financial institutions across the banking, insurance and asset management sectors incorporate climate-related metrics into their compensation frameworks and related implementation challenges. The findings of the report indicate that financial institutions are increasingly linking climate-related metrics in compensation frameworks to their strategies and external commitments. However, where such metrics are included, they tend to be part of the non-financial measures (often part of an ESG category that incorporates factors such as diversity and inclusion), and their impact on total compensation is relatively modest. The FSB report acknowledges that climate-related compensation practices remain an area in the early stages of development and are expected to continue to evolve, and suggests that financial regulators can facilitate the process by sharing regulatory and industry practices with each other and with the industry. See S&C's memo for additional information on the FSB's report.

2. *United Kingdom*

UK Government launches consultation on regulating ESG ratings providers. On March 30, the UK Government launched a public consultation seeking views on initial proposals to bring providers of ESG ratings within the scope of UK financial services regulation. The consultation's core proposal is to regulate the direct provision of assessments of ESG factors to users in the UK, where the assessment is used in relation to a regulated investment. Firms providing such assessments would need to apply for authorization by the Financial Conduct Authority (FCA). The scope of this new regulated activity is proposed to be limited to the provision of ESG ratings to paying users, such that it would not extend to the provision of raw (or minimally processed) ESG data or to scenarios where UK users access a free rating. As proposed, overseas firms that provide ratings to UK customers would also fall within the scope of the regime. The consultation period will end on June 30. Implementation of the proposals will require legislation by the UK Parliament.

3. *European Union*

European Supervisory Authorities launch consultation on SFDR. On April 12, the European Banking Authority, European Securities and Markets Authority and European Insurance and Occupational Pensions Authority published a joint consultation paper seeking feedback on certain proposed changes to the SFDR's disclosure framework. The proposed amendments include potential simplifications of current disclosure templates to enhance comprehensibility for retail investors. Other proposed amendments include additional disclosures on investment products' GHG emissions reduction targets and additional disclosures of potential negative social impacts. The consultation period will end on July 4.

European Commission releases additional guidance on SFDR. On April 14, the European Commission published additional guidance on application of the EU's Sustainable Finance Disclosure Regulation ("SFDR"). The new Q&A from the Commission clarifies key open points with respect to interpretation of the SFDR, including, among other matters, the treatment of certain passively managed financial products under the SFDR's classification regime for sustainable investments. The Q&A also clarified that financial market participants in scope of the SFDR can invest in a company's general equity or debt, rather than only in funding instruments with specified uses of proceeds. In a statement released with the Q&A, Mairead McGuinness, EU commissioner for Financial Services, Financial Stability and Capital Markets Union, noted that the Commission was continuing to review the SFDR with "a focus on ensuring legal certainty, increased usability and the mitigation of greenwashing" and planned a public consultation for this autumn.

ECB publishes assessment of EU banks' environmental disclosures. On April 21, the European Central Bank ("ECB") announced that it had published its third annual supervisory assessment of EU banks' climate-related and environmental risks disclosures. The assessment covered 103 banks under direct ECB supervision and 28 smaller institutions supervised by their national authorities. The ECB noted that, although in 2022 most banks increased the information they publish, the quality of disclosures is often insufficient. The ECB found that only 6% of lenders disclosed adequate information across all five categories assessed (namely, materiality assessment, business model and strategy, governance, risk management and metrics and targets). The ECB cautioned that banks appear largely unprepared to meet the new Pillar 3 disclosure standards on ESG risks, under which qualifying banks are due to make their first disclosures by the end of June this year.

Litigation and Enforcement Developments

UN General Assembly requests advisory opinion from the International Court of Justice on climate change. On March 29, in a resolution initiated by Vanatu, the UN General Assembly adopted a resolution requesting an advisory opinion from the International Court of Justice on the obligations of States in respect of climate change. Specifically, the resolution requests an advisory opinion that outlines the obligations of States under international law to ensure protection of the climate system. It also requests information on the legal consequences under any obligations where States, by their acts and omissions, have caused significant harm to the climate system, in particular with respect to impacts on small island developing countries that are particularly vulnerable to climate change and people of present and future generations.

Shareholder Engagement, Governance and Proxy Advisory Updates

1. *Global*

PRI to encourage investor engagement on biodiversity-related political activity. On March 29, the United Nations Principles for Responsible Investment (PRI) announced an initiative to halt and reverse biodiversity loss by 2030. Specifically, this initiative seeks to enable policy change on biodiversity by having participating investors encourage their investees to engage in lobbying and political influencing practices. This initiative aligns with the goals and targets of the Kunming-Montreal Global Biodiversity Framework announced at COP15, and is a part of PRI's broader effort to address nature-related risks and opportunities.

2. *North America*

State Street releases 2023 proxy voting guidelines. In March, State Street Global Advisors (State Street) released its 2023 proxy voting and engagement guidelines for North America. Among other changes from 2022, State Street's 2023 guidelines no longer contain specific expectations around Scope 1 and 2 GHG emissions disclosures and emissions reduction targets, but note that State Street "may take voting action against" companies in the S&P 500 and S&P/TSC Composite that fail to provide sufficient TCFD-aligned disclosures. The 2023 guidelines remove specific overboarding limits, but note that State Street will "consider whether board members have adequate skills to provide effective oversight of corporate strategy, operations, and risks, including environmental and social issues."

3. *United Kingdom*

PLSA publishes 2023 Stewardship and Voting Guidelines. On March 30, the Pensions and Lifetime Savings Association (PLSA) published its 2023 Stewardship and Voting Guidelines. The PLSA now recommends that investors should consider voting against the re-election of a director or the chair if the company has not responded appropriately to the result of a climate-related resolution, whether binding or not, and whether actually passed or not. In respect of social matters, a new section has been added providing guidance on workforce concerns. In particular, the PLSA recommends that investors should consider voting against the approval of the annual report and accounts if: (i) FTSE 100 companies do not have a formal approach to workplace well-being disclosure, including mental health; (ii) after engagement initiatives with companies, there is insufficient progress on well-being activities disclosures; or (iii) FTSE 350 companies fail to address the legal minimum requirements of the Modern Slavery Act 2015. The guidelines also recommend that investors should consider voting against the re-election of the responsible director if companies do not adopt sufficient measures to prevent, monitor, mitigate or remediate negative human rights impacts within their operations.

Green Finance Institute works on nature-related financial risk estimates for businesses. On April 5, the Bank of England and the UK Government's Department of Environment, Food & Rural Affairs commissioned the Green Finance Institute (GFI) to assess the materiality of nature-related risks on UK businesses and financial institutions. As part of this assessment, the GFI will build on the UK Government's support for the TNFD by preparing a study revealing the financial impact of biodiversity loss and ecosystem degradation on UK businesses and financial institutions.

Sustainable Finance Updates

1. *Global*

The ASEAN Taxonomy Board (ATB) released a new version of its taxonomy for sustainable finance. On March 28, the ATB releases the ASEAN Taxonomy for Sustainable Finance Version 2. Version 2 puts forward a complete Foundation Framework with detailed methodologies, intended to allow users to qualitatively assess economic activities by using guiding questions, decision trees and use cases. Version 2 also highlights the importance of social aspects by incorporating it as one of the three essential criteria for assessing economic activities. Furthermore, Version 2 introduces the Technical Screening Criteria (TSC) for the energy sector, with an emphasis on coal phase-outs in support of the Paris Agreement goals. The ATB also noted that it will finalize the TSC for the energy sector in early 2024 and release TSC for the remaining focus sectors in phases by 2025.

Integrity Council for the Voluntary Carbon Market launches carbon credit framework. On March 29, the Integrity Council for the Voluntary Carbon Market (ICVCM) launched its Core Carbon Principles (CCPs), as well as the Program-Level Assessment Framework and Assessment Procedure. The CCPs are comprised of 10 key principles for high-integrity carbon credits organized under three broad categories: (1) governance—including the use of a registry for tracking, public disclosure on, and robust third-party validation of, mitigation activities; (2) emissions impact—focusing on the principles of additionality, permanence and robust quantification of GHG emissions reduction or removal; and (3) sustainable development—focusing on sustainable development benefits and safeguards as well as contribution toward the goal of reaching net zero GHG emissions by 2050. The ICVCM plans to work with stakeholders to strengthen the CCPs over time with the goal of launching the next version of CCPs in 2025.

2. *United Kingdom*

UK Government updates Green Finance Strategy. On March 30, the UK Government published an updated Green Finance Strategy. As part of its update, the UK Government announced its intention to undertake a number of public consultations on ESG-related policy proposals in the latter half of 2023. As soon as the IFRS S1 and S2 Standards are published, the UK Government will launch a formal assessment of whether the Standards endorsed by the UK Government for use in the UK are appropriate for UK companies. In Q3 2023, the UK Government intends to issue a call for evidence on Scope 3 reporting to better understand the costs and benefits of producing and using this information. The UK Government expects to consult on a UK Green Taxonomy in Autumn 2023 and has confirmed that, once the Green Taxonomy has been finalized, it will expect companies to undertake voluntary reporting for at least two years, after which it will explore whether to mandate disclosure. In Q4 2023, the UK Government will consult on new requirements for the largest UK-incorporated private companies to disclose their climate transition plans on a "comply or explain" basis (in line with current requirements for UK-listed companies).

In addition, the UK Government stated that it will explore how to incorporate the final TNFD framework into UK policy and legislation.

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