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Global Climate and Sustainability Reporting Continues to Grow with Proposed New International and Domestic Regulatory Initiatives

The momentum toward universal mandatory reporting and disclosure on climate risk and sustainability has gained additional strength with recent developments at the international, domestic and state levels. These steps follow years of calls from investors for standardized and comparable climate-related disclosures.

International. In June, the G7 Finance Ministers and Central Bank Governors issued a statement calling for mandatory climate-related financial disclosures based on the recommendations of the Task Force on Climate-related Financial Disclosures ("TCFD") framework. The G7 also indicated support for the efforts of the International Financial Reporting Standards ("IFRS") Foundation to develop baseline global sustainability reporting standards that draw on the TCFD framework and to establish an International Sustainability Standards Board ("ISSB") in connection with COP26 later this year, with the first set of ISSB standards due in mid-2022. In addition, the G7 endorsed the establishment of the Taskforce on Nature-related Financial Disclosures ("TNFD"), which seeks to build upon the TCFD framework to reach other nature-related risks, including plastics in the oceanic food chain and loss of soil fertility, with a view to releasing a disclosure framework by 2023.

Emissions-related disclosures will likely become more important for compliance with cross-border trade regulations. EU leaders have proposed various iterations of carbon pricing, including a Carbon Border Adjustment Mechanism that would tax goods imported into the EU based on the greenhouse gasses emitted in their production. Congressional Democrats have included a conceptually similar "polluter import fee" in proposed budget legislation, but the likelihood of passage is unclear at best.

U.S. and State Regulators. In the United States, federal and state regulators have already increased focus on encouraging — or mandating — climate-related disclosures. Earlier this year, the U.S. Securities and Exchange Commission announced that it would undertake a review of its 2010 guidance on climate-related disclosures. In June, Insurance Commissioners Mike Kreidler of Washington and Ricardo Lara of California formally requested that all insurers currently required to report to them annually on climate change start reporting climate risks in alignment with TCFD. The Federal Reserve has also turned its attention to climate risks, noting in a recent Financial Stability Report that climate change "increases the likelihood of dislocations and disruptions in the economy, [and] is likely to increase financial shocks and financial system vulnerabilities that could further amplify these shocks." Governor Lael Brainard remarked in a recent speech that "[g]iven the importance of consistent, comparable, and reliable disclosures to financial stability and prudential objectives, mandatory disclosures are ultimately likely to be important." The Fed has established the Supervision Climate Committee to identify and assess financial risks from climate change and to develop a framework to ensure the resilience of supervised financial institutions to climate risk. The Fed's new Financial Stability Climate Committee also aims to address climate-related risks to financial stability from a macroprudential perspective.

U.S. Congress. A similar push for climate disclosure has emerged in pending federal legislation. On June 16, the U.S. House of Representatives approved the Corporate Governance Improvement and Investor Protection Act (the "Act") that would mandate new ESG disclosures by companies. On matters of climate, the Act would require quantitative and qualitative disclosures relating to, among other things, climate-related risks, direct and indirect greenhouse gas emissions, ownership or management of fossil fuel assets, and the consideration of different climate-warming scenarios. The Act would require the development and use of industry-specific metrics, and issuers involved in the commercial development of fossil fuels would face further requirements on the disclosure of emissions related to different business activities. If the SEC failed to develop applicable implementing rules within two years of enactment, issuers disclosing in compliance with the TCFD framework would be deemed to be in compliance with certain climate-change provisions of the Act.

Beyond climate, other provisions of the Act would require issuers to disclose ESG metrics (yet to be developed), the issuer's views on the link between ESG metrics and its long-term business strategy, and the process the issuer uses to determine the impact of ESG metrics on its strategy. The Act would establish a permanent Sustainable Finance Advisory Committee to, among other responsibilities, recommend to the SEC the ESG metrics required to be disclosed and policy changes to facilitate the flow of capital towards environmentally sustainable investments. The SEC would be permitted to incorporate international ESG standards as part of the disclosure updates. Additional provisions of the Act would require disclosure related to political activity expenditures, executive compensation, human capital, workplace harassment, board and executive diversity, worldwide taxes on a country by country basis, cybersecurity, and the sourcing of goods from or through the Xinjiang Uyghur Autonomous Region. After a nearly party-line vote in the House, the bill likely faces hurdles to passage in the Senate, particularly considering its 50/50 partisan split.

California Legislature. Meanwhile, in California, the Climate Corporate Accountability Act currently passing through state legislative committees would require entities doing business in California with gross annual revenues in excess of $1,000,000,000 to make climate disclosures. Starting in 2024, companies would be required to disclose direct and indirect emissions (scope 1, 2 and 3) that have been verified by a third party. By 2025, the California Air Resources Board would be required to publish a report recommending the emission reductions that the reporting entities must make to align with warming levels at or below 1.5 degrees Celsius of preindustrial levels, and recommendations for how the reporting entities could accomplish such reductions.

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U.S. regulators implementing climate disclosure requirements are likely to rely on already established frameworks that have been endorsed by major institutional investors, notably TCFD, along with guidance implemented by regulators in the EU and UK, in formulating new disclosure requirements. The TCFD framework calls on companies to provide qualitative and quantitive disclosures on governance, strategy, risk management, metrics, and targets relating to climate change risks and opportunities. The framework's recommendations also call for scenario analyses assessing a company's resilience in different climate scenarios. According to a survey by the G&A Institute last year, approximately 5% of S&P 500 companies provided TCFD disclosures, although this number is expected to increase. Companies should expect increased investor demand and regulatory pressure for more extensive climate-related disclosures in the near future.

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