GLOBAL SUSTAINABILITY STANDARDS TAKEOFF, WHILE THE SEC CLIMATE-DISCLOSURE RULES REMAIN ON THE TARMAC

On Monday, following 18 months of work, the International Sustainability Standards Board ("ISSB") formally issued its inaugural corporate disclosure standards – IFRS S1 (General Requirements for Disclosure of Sustainability-related Financial Information) and IFRS S2 (Climate-related Disclosures) (collectively, the "Standards"). The Standards respond to longstanding demands from investors and other stakeholders for consistent, comprehensive and comparable, decision-useful information to enable them to gain an understanding of a company's performance and prospects from a sustainability standpoint. In the words of the ISSB, these Standards establish a global baseline for sustainability disclosure – a common language for disclosing the effects of climate-related risks and opportunities on a company's "prospects." Ultimately, the Standards are designed to provide users of corporate financial reporting with information relevant to investment decisions in the subject reporting companies. (For an overview of the ISSB efforts, *see* two of my previous briefing notes, available here and here; my Lexicon of sustainability terms is available here.)

The ISSB did not set out to, and in fact did not, recreate the wheel. The Standards build upon pre-existing voluntary disclosure frameworks, such as the industry-specific Sustainability Accounting Standards Board ("SASB") standards, and "fully incorporate" the Task Force on Climate-related Financial Disclosures ("TCFD") recommendations. IFRS S1 and IFRS S2 are geared towards investors and the markets, rather than the broader stakeholder landscape (covered, for example, by the Global Reporting Initiative ("GRI") standards). The Standards have been developed in parallel with the EU corporate disclosure standards, and are intended to be "interoperable" with the EU standards (note that the Corporate Sustainability Reporting Directive, for example, is broader as it is geared to a broader universe of stakeholders – see my previous briefing note, available here), and a Memorandum of Understanding with the GRI is intended to ensure that the ISSB, in the words of its Chair, Emmanuel Faber, "can provide a comprehensive and seamless suite of reporting standards."

As was the case for International Financial Reporting Standards ("IFRS"), the IFRS Foundation does not have the authority to establish mandatory requirements. Jurisdictions, however, will be free to make the Standards mandatory, and to impose more stringent requirements if they wish to do so. Disclosure may be provided under the Standards regardless of whether the reporting company presents its financial statements in accordance with IFRS or other financial reporting standards (*i.e.,* GAAP).

The Standards are effective for reporting periods beginning on or after January 1, 2024. Earlier adoption is permitted provided both Standards are applied. The issuance of IFRS S2 reflects the decision of the ISSB to focus first on climate-related risks (*i.e.,* physical risks and transition risks) and opportunities, rather than on the broader sustainability landscape. Broader sustainability disclosure would be provided in the second year of reporting.

In its Monday press release, the ISSB announced that it will now work with jurisdictions and companies to support adoption and, as a first step in that effort, is establishing a Transition

Implementation Group to support companies that apply the Standards. The ISSB also announced that it will continue to work with jurisdictions wishing to require incremental disclosure standards that are more stringent than the ISSB baseline and will work with the GRI to support efficient and effective reporting when the Standards are used in combination with other reporting standards (*e.g.,* those prepared by the European Commission or the SEC).

In short, IFRS S1 requires reporting companies to disclose information about all sustainability-related risks and opportunities that could reasonably be expected to affect their cash flows and their access to finance or cost of capital over the short, medium or long term (collectively referred to as "sustainability-related risks and opportunities that could reasonably be expected to affect the reporting company's prospects"). IFRS S1 prescribes how sustainability-related financial disclosures are to be prepared and presented, and sets out general requirements for the content and presentation of those disclosures. The disclosure requirements essentially have four pillars:

- the governance processes, controls and procedures used to monitor, manage and oversee sustainability-related risks and opportunities;
- the strategy for managing sustainability-related risks and opportunities;
- the processes used to identify, assess, prioritize and monitor sustainability-related risks and opportunities; and
- performance in relation to sustainability-related risks and opportunities, including progress towards any targets the reporting company has set or is required to meet by law or regulation.

IFRS S2 adopts the same general framework around governance, strategy, risk management, and metrics and targets, but then takes a deep dive setting forth detailed requirements for climate-related risks and opportunities. IFRS S2 also provides sector guidance based on the SASB Sustainable Industry Classification System: consumer goods; extractive and mineral processing; financial services; food & beverage; health care; infrastructure; renewables; resource transformation; services; technology and communications; and transportation – each with their own subsections (68 in total). The ISSB has also provided illustrative examples, illustrative guidance and industry-based guidance.

There is transitional relief under IFRS S2, permitting delay of one reporting cycle for comparative information for the period prior to application, and for reporting companies that measure their GHG emissions other than in accordance with the 2004 Greenhouse Gas Protocol (that other standard may be used during the first year) and for reporting companies involved in asset management, commercial banking or insurance activities, which can skip for one year Scope 3 disclosures about financed emissions.

The Scope 3 disclosure standards illustrate the collaborative nature of the ISSB endeavor. ISSB Chair Faber notes that investor feedback (reflected in over 1,400 comment letters) made clear that Scope 3 disclosure is important, particularly to assess transition in portfolio companies, and confirmed for the ISSB the imperative of including Scope 3 requirements. The feedback also highlighted the challenges reporting companies would face, particularly in respect of mapping

the full value chain or supply chain. The one-year delay, proportionality measures and guidance for Scope 3 are intended to mitigate this burden. Investor feedback also prompted the adoption of the same definition of "materiality" as is used in IFRS, in light of the connection between accounting and sustainability disclosures. More broadly, scalability and proportionality, via structural and transitional relief, reflect an awareness of the breadth of reporting companies in capital markets portfolios, in terms of size as well as phase of development.

Concluding Thoughts

The ISSB has been crystal clear in its mission. It is responding to a robustly articulated demand for a global baseline that is seen by the markets as urgent and necessary. Next steps include obtaining the endorsement of the International Organization of Securities Commissions (IOSCO), to facilitate engagement with national and regional regulators. The ISSB will also be finalizing a digital taxonomy to enhance cost effectiveness and interoperability. Longer term, the ISSB will be rolling out sustainability standards for biodiversity, ecosystems and ecosystem services; human capital; and human rights, and will also be considering how best to integrate information in financial reporting beyond the relationship embedded in IFRS S1 and IFRS S2.

What is both heartening and disheartening of where we are today in the evolution of climate- and broader ESG-related disclosure standards is that while global standard setters are moving with alacrity in responding to the needs of investors and the markets, there is a growing anti-ESG movement in the United States, largely driven by the weaponization of culture wars for political gain, supported by an opaque campaign finance ecosystem that benefits well-funded vested interests. Stakeholder feedback underscores the imperative of overcoming resistance and embracing the global effort.

Assuming the SEC climate-related disclosure requirements do take flight, they are likely to be less onerous than the ISSB Standards. In light of the strong desire for a single global standard, the ISSB Standards may well become the global default even if adoption means providing more granular disclosure.

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