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ISSB Releases Final Global Sustainability Disclosure Standards

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On June 26, 2023, the International Sustainability Standards Board (ISSB), an investor-focused initiative of the International Financial Reporting Standards (IFRS) Foundation, released the final versions of its General Requirements for Disclosure of Sustainability-related Financial Information Standard (the “General Requirements Standard” or “S1”) and Climate-related Disclosures Standard (the “Climate Standard” or “S2”) (together, the “Standards”). The Standards underscore a growing focus on the connection between sustainability and financial materiality and are intended to provide baseline requirements for companies to disclose sustainability-related information alongside financial statements for annual reporting periods beginning on or after January 1, 2024.[1] The Standards are expected to influence voluntary sustainability reporting and to be incorporated into regulatory regimes in jurisdictions around the globe.

In a May 2022 *Alert*, we provided an overview of the draft Standards (released in March 2022) and discussed how they attempt to unite multiple overlapping approaches to sustainability disclosure. In this *Alert*, we provide background on support for the Standards and their potential to influence voluntary and mandatory reporting regimes, summarize key changes that have been made relative to the drafts and identify takeaways for investors and companies.

Potential Impact of the Standards on Voluntary and Mandatory Reporting Regimes

As discussed in our prior *Alert*, the Standards attempt to unite multiple overlapping sustainability reporting frameworks. In particular, the Standards lean heavily on the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD)

and the industry-specific disclosure topics issued by the Sustainability Accounting Standards Board (SASB).

In developing the Standards, the ISSB consulted with an investor advisory group comprising many of the world's largest asset managers and owners, and the World Economic Forum recently agreed to convene a group of sustainability reporting professionals to provide feedback on the Standards' implementation. The Standards have also received support from influential voluntary sustainability reporting organizations, with the Principles for Responsible Investment (PRI) calling for governments to align mandatory reporting regimes with the Standards and CDP planning to incorporate the Climate Standard into its platform in 2024. Together, these developments suggest the Standards are likely to influence investor expectations and, in turn, corporate sustainability reporting.

The Standards are also expected to be incorporated into regulatory regimes in a number of jurisdictions. For example, the UK, Canada, Australia, New Zealand, China, Hong Kong, Singapore, Malaysia, Nigeria and Japan have all signaled their intent to adopt the Standards.[2] Furthermore, the International Organization of Securities Commissions (IOSCO) intends to promptly review the final Standards; if it approves them, that could further galvanize regulatory adoption.

But while the Standards appear poised to make some progress toward the goal of a global *baseline* sustainability reporting standard, a complete coalescence of voluntary and mandatory sustainability reporting requirements appears unlikely. Notably, the European Commission's draft European Sustainability Reporting Standards (ESRS) for the Corporate Sustainability Reporting Directive (CSRD) — which will enter into force beginning next year — go further than the Standards, including by requiring disclosure based on the "double materiality" principle (i.e., information that is not financially material may still be required to be disclosed if it has a material impact on people or the environment).[3] Similarly, GRI, the world's most widely used voluntary sustainability reporting standard, requires companies to report significant impacts on the environment and society relative to a range of stakeholders beyond investors — so-called "impact materiality."[4] Finally, it is unclear to what extent the SEC's final climate disclosure rule, expected this fall, will be influenced by the Standards.[5]

Key Changes in Final Standards

The final Standards incorporate feedback from more than 1,400 global stakeholders. They remain structured around the TCFD's four core disclosure pillars — governance, strategy, risk management, and metrics and targets — and continue to focus on

disclosure of information relevant to investors. However, the content within the Standards has been reordered to some extent, and there are also several notable changes from the 2022 drafts, including:[6]

- **Revised Framework for Identifying Disclosure Topics**: The draft General Requirements Standard called for disclosure of a company's "significant sustainability-related risks and opportunities that [are] useful to the primary users of general-purpose financial reporting when they assess enterprise value and decide whether to provide resources to the entity." The final Standard omits the terms "significant" and "enterprise value" and instead calls for disclosure of information about all "sustainability-related risks and opportunities that could reasonably be expected to affect the entity's prospects," i.e., that could "could reasonably be expected to affect the entity's cash flows, its access to finance or cost of capital over the short, medium, or long term." For such risks and opportunities, the final Standard continues to require disclosure of "material" information.[7] Companies are also required to explain the relationships and trade-offs that arise between various sustainability-related risks and opportunities, and to provide — when possible — financial estimates.[8]
- **Additional Requirements for Metrics and Targets (Including Scope 3 Emissions)**: The final General Requirements Standard clarifies that companies must disclose *both* metrics and targets required by the Standards *and* any additional metrics or targets that are not included in the Standards but that the company uses to measure and monitor sustainability-related risks and opportunities.[9] Additionally, S1 requires that companies include in their disclosures both their progress toward any previously established targets and any sustainability-related performance metrics required by relevant laws or regulations. Furthermore, the Climate Standard includes supplemental guidance on sector-specific disclosure metrics — including industry categories, disclosure topics, metrics and measurement protocols — which are derived from the SASB Standards. In conjunction with publishing the Climate Standard, the ISSB also approved updates to the SASB Standards to keep them aligned with this supplemental guidance.[10] Notably, the final Climate Standard reaffirms the requirement in the draft for all companies to disclose absolute Scope 3 greenhouse gas emissions,[11] going beyond the SEC's proposed climate rule, which requires disclosure of Scope 3 emissions only if material or if the company has set a greenhouse gas emissions reduction target or goal that includes its Scope 3 emissions. In support of the Scope 3 requirement, the Climate Standard — and the SASB standards for asset management, commercial banking and insurance — now call for disclosure of financed emissions.[12]
- **Mandatory Scenario Analysis and Resilience Assessment, and Disclosure of Transition Plan Assumptions**: The Climate Standard requires that, to identify

climate-related risks and opportunities, companies *must* use "climate-related scenario analysis." This requirement goes beyond the SEC's proposed climate rule, which requires certain disclosures about scenario analysis if a company uses this tool but does not require use of the tool in the first instance. Required disclosures for scenario analysis under the Climate Standard, similar to the SEC's proposed rule, include: (i) information about the inputs used in the analysis, (ii) key assumptions made throughout the analysis and (iii) the reporting period during which the analysis took place. The Climate Standard notably differentiates between the narrower process of scenario analysis and the requirement to conduct a "resilience assessment," which is an extrapolation of the implications the outcomes of a scenario analysis may have for a company's business model and strategy. Also, similar to the SEC's proposed climate rule, the Climate Standard requires that if a company has a transition plan, it disclose information about it, including the assumptions used to develop it.

- **Exemption for Commercially Sensitive Information**: The Standards have been revised to allow companies to omit information on sustainability-related opportunities — though *not* sustainability-related risks — if the opportunities are deemed to be commercially sensitive. To qualify for this exemption, a company must determine that the opportunity cannot be reported in an aggregated way to relieve commercial sensitivity, and it must disclose that it has made an omission and reassess the omission during each reporting cycle.
- **Consideration of Reporting Resources**: The final Standards provide guidance clarifying under what circumstances and for what factors it is acceptable for a company to omit disclosures, citing an effort to make the Standards accessible to the broadest possible range of companies. The Standards clarify that companies need only use "all reasonable and supportable information that is available to the entity at the reporting date without undue cost or effort" to identify which (i) sustainability-related risks and opportunities, (ii) financial impacts, (iii) scenario analysis factors, (iv) Scope 3 emissions categories, (v) cross-industry metrics and (vi) value chain scope should be included in disclosures. It further provides that "[t]he assessment of what constitutes undue cost or effort depends on the entity's specific circumstances and requires a balanced consideration of the costs and efforts for the entity and the benefits of the resulting information for primary users. That assessment can change over time as circumstances change."
- **Relief for First-Year Reporting**: On April 4, the ISSB announced its intent to prioritize climate-related disclosures and provide other "transitional reliefs" to facilitate companies' initial reporting pursuant to the Standards. More specifically, in their first year of reporting, companies need not: (i) provide sustainability reporting at the same time as traditional financial reporting, (ii) disclose Scope 3 emissions, (iii) calculate Scope 1 and 2 emissions using the Greenhouse Gas Protocol if the

company has previously used a different framework for doing so, (iv) provide comparative information relative to prior reporting years and (v) provide disclosures around sustainability-related risks and opportunities beyond those required by the Climate Standard.

Key Takeaways

Although it remains to be seen how widely the Standards will be adopted, companies that are considering disclosing in line with the Standards may wish to consider the following:

- **Focus on Alignment with Financial Statements**: The Standards require a company to report information in a manner that enables stakeholders to understand the connections between identified sustainability-related risks and opportunities, the actions taken by the company to address them, and information in the company's related financial statements. Disclosures pursuant to the Standards are intended to be reported concurrently with a company's traditional financial statements, underscoring a growing focus by global regulators and investors on linking financial and sustainability-related information.
- **Interplay with Proposed SEC Climate Rule**: The Climate Standard requires the use of certain tools and the disclosure of related information — such as scenario analysis — that would trigger enhanced disclosure obligations under the SEC's proposed climate rule. Additionally, the Climate Standard goes beyond the SEC's proposed rule by requiring Scope 3 emission disclosures from all companies, which could make it harder for those companies to argue their Scope 3 emissions are not "material," and therefore not subject to disclosure, under the SEC's proposed rule. That said, the enhanced disclosure requirements for scenario analysis and Scope 3 disclosure are among the more controversial aspects of the SEC's proposed rule, and the final rule could differ — potentially significantly — on these points.
- **Potential Overlap with Existing Disclosures and Greenwashing Considerations**: There is a growing regulatory focus on greenwashing in the U.S., Europe and other jurisdictions around the globe, and regulators such as the SEC are probing potential discrepancies between companies' regulatory filings and voluntary sustainability disclosures. Accordingly, companies should carefully review potential overlap between the Standards and any other voluntary or regulatory standards pursuant to which they report sustainability information to ensure information is consistent, and be prepared to address any gaps across similar categories of disclosure. Companies should also consider implementing disclosure controls for sustainability-related reporting similar to those employed for traditional financial reporting, including

assurance for quantitative disclosures such as emissions, and think through the placement of and linkages between disclosures in these two types of reporting.

- **Potential Anti-ESG Risks**: As part of the growing "anti-ESG" movement in the U.S., a number of predominantly Republican policymakers have questioned the value of ESG investing, arguing it detracts from companies' duty to shareholders to focus on financial returns. Further, in a recent memo, the House Financial Services Committee's ESG Working Group expressed concern about the extraterritorial impact of EU disclosure regulations, such as the CSRD, on U.S. public companies. Notwithstanding the ISSB's efforts to tie the Standards to financial materiality, it is possible that certain anti-ESG proponents will express hostility toward the Standards, particularly given their international nature, which could create additional risks for U.S. companies that choose to adopt them in full. In such cases, consideration should be given to documenting how adoption of the Standards (in part or in full) aligns with a company's business strategy and investor requirements.
- **Additional Standards Forthcoming**: In April 2023, the ISSB announced plans to consult on additional standards related to: (i) biodiversity, (ii) ecosystems and ecosystem services, (iii) human capital, (iv) human rights and (v) integration in reporting. Regulators in the EU, UK, U.S. and other jurisdictions are simultaneously considering reporting regimes focused on one or more of those topics, and companies can monitor the development of the ISSB's standards for indications of the potential direction of future regulation.

Although the landscape of global sustainability reporting remains fragmented and evolving, the publication of the Standards represents an important step toward establishing a common understanding of the basic information required to assess the sustainability-related risks and opportunities businesses face. In deciding whether the Standards will provide a useful framework for communicating information regarding sustainability risks and opportunities, companies should consider their investor base and other stakeholders, as well as their existing and potential future regulatory obligations.

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1. Companies may elect to disclose pursuant to the Standards' requirements for earlier reporting periods. If a company does so, the Standards call for the company to disclose that fact and apply both S1 and S2 simultaneously. ↩

2. It is worth noting that the IFRS Accounting Standards are required for financial reporting in 146 global jurisdictions, though not in the U.S., which has its own set of Generally Accepted Accounting Principles developed

by the Financial Accounting Standards Board. ↩

3. The draft ESRS expressly refer to standards published by the ISSB, including by requiring companies to "carefully consider," when developing disclosures under the ESRS, whether disclosures aligned with those ISSB standards may support comparability between companies. The draft ESRS also provide that companies including "additional disclosures" stemming from standards published by the ISSB, GRI or others should clearly identify those disclosures and ensure that they meet the qualitative characteristics set out by the ESRS. ↩

4. In March 2022, GRI and ISSB committed to ensuring that the two organizations' standards will be complementary and interoperable, and on June 26, 2023, GRI and ISSB committed to developing technical mapping resources for companies seeking to report along both standards. ↩

5. In the proposed rule, which we discussed in a March 2022 *Alert*, the SEC asked whether it should incorporate an "alternative reporting provision" into its rule, and if so, whether that provision should encompass reports made pursuant to the Standards and be open to all registrants or limited to foreign private issuers. ↩

6. We focus here only on some of the more significant changes between the draft and final Standards, but note that there are also a number of wording refinements throughout the final Standards as compared to the drafts. ↩

7. Similar to the draft, the final Standard defines information as "material" if "omitting, misstating or obscuring that information could reasonably be expected to influence decisions that primary users of general-purpose financial reports make on the basis of those reports." ↩

8. The General Requirements Standard provides that companies may report potential financial impacts as either single estimates or a range of outcomes, and that companies must explain significant differences between the data and assumptions used to prepare sustainability-related financial disclosures and those used to prepare related financial statements. ↩

9. The General Requirements Standard directs companies to consider the SASB Standards in connection with identifying sustainability-related risks and opportunities that could reasonably be expected to affect the entity's prospects, as well as to identify potentially applicable metrics. The Standards leave room for a company to determine that certain SASB topics and metrics are not applicable given its particular circumstances. Additionally, the General Requirements Standard allows entities to consider the GRI Standards and ESRS to the extent they assist the entity with meeting the objectives of the Standard and do not conflict with IFRS Sustainability Disclosure Standards for specific sustainability risks and opportunities. ↩

10. The updates to the SASB standards also include changes designed to "increase the international applicability of the content." A second phase to the international applicability project, addressing metrics beyond climate, is planned to be completed by the end of 2023. The ISSB is accepting feedback on its update methodology until August 9, 2023. ↩

11. Unlike the draft, the final Climate Standard no longer requires the disclosure of emission intensity for any Scope. Also, the Climate Standard bases its emission disclosure requirements on the widely used GHG Protocol Corporate Standard but notes that if an entity is required by a regulator or exchange to use a different method to measure its emissions, it is permitted to use that method to report pursuant to the Climate Standard. ↩

12. The ISSB released supplemental guidance to assist with the disaggregation of Scope 3 emissions by factors such as investment strategy and asset class. ↩

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Suggested Reading

- 22 September 2023 Speaking Engagement American Bar Association's Environmental Transactions Masterclass
- 28 June 2023 Award Chambers Crisis & Risk Management 2023
- 28 June 2023 Speaking Engagement ESG: Emerging Regulatory Risks in the US and Europe

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