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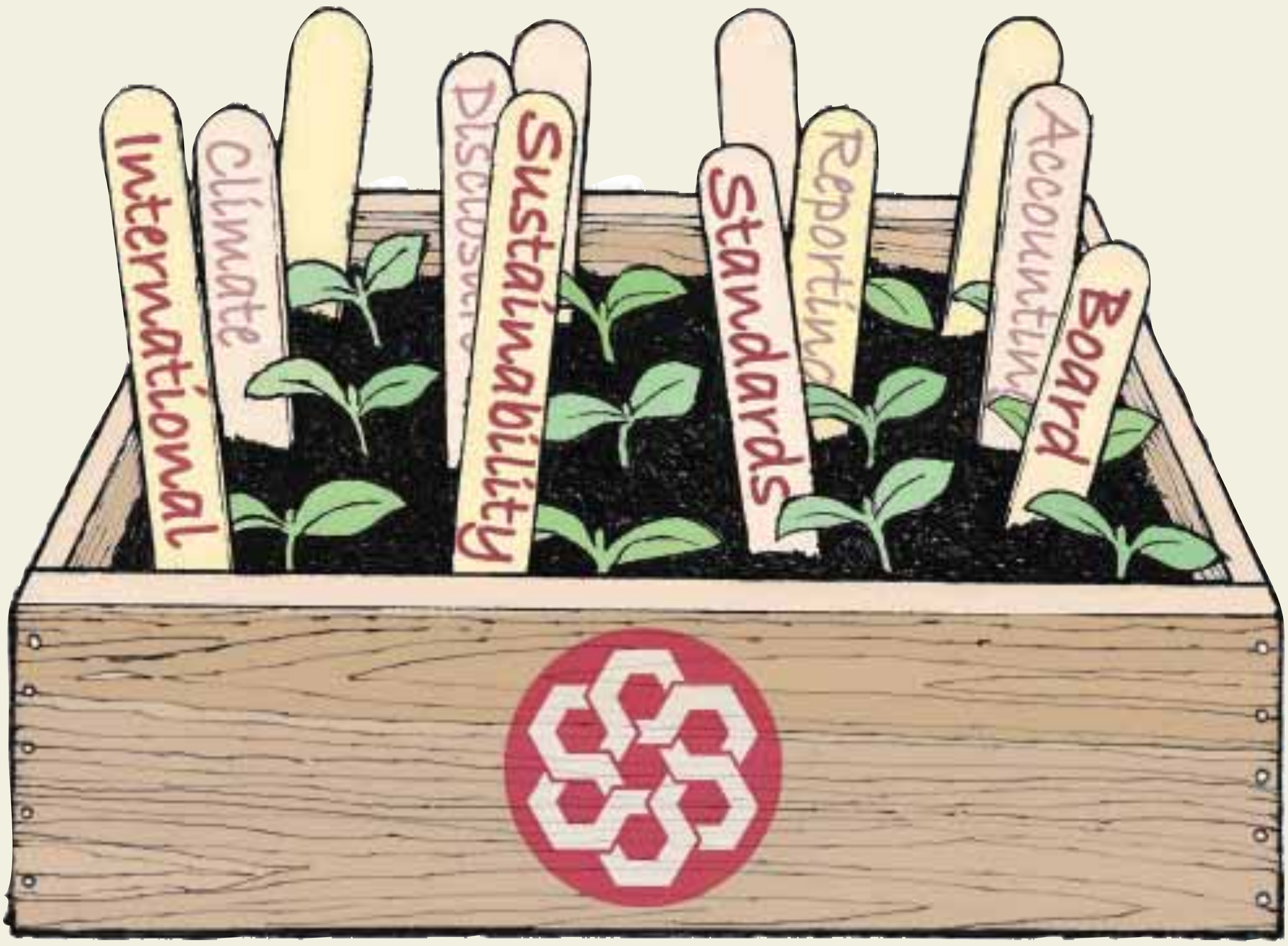

SUSTAINABILITY AND REPORTING

NEW STANDARDS COME TO LIFE

US follows EU's lead on ESG reporting standards

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Europe has made significant strides in recent years toward identifying and prioritising its environmental, social, and governance ("ESG") objectives through its financial markets. In March 2018, the European Commission ("EC") adopted its action plan on sustainable finance, which was intended to integrate environmental, social and governance considerations into its policy framework. Among the plan's action items are reorienting capital toward sustainable activities, managing financial risks stemming from climate change, and fostering transparency and long-termism in financial and economic activity. To achieve its goals, the European Union ("EU") pledged to make at least 20% of its budget directly climate relevant. For example, almost one third of investments mobilised by the European Fund of Strategic Investments ("EFSI") were committed to energy, environment, and resource efficiency projects and social infrastructure. These investment goals demonstrate the EC's continued advocacy for corporate transparency on sustainability issues. A heightened level of transparency with respect to environmental and social factors not only informs market participants, but also encourages companies to prioritise sustainability and longevity, which in turn leads to more informed and responsible investment decisions.

In July 2020, the EU introduced a Taxonomy Regulation aimed at providing businesses and investors with commonalities to identify whether an investment may be considered environmentally sustainable. Under this classification system, an economic activity is "environmentally sustainable" if it makes a substantial contribution to at least one of the EU's climate and environmental objectives while not significantly harming any of its objections and meeting minimum social safeguards. By creating a streamlined way to identify "environmentally sustainable investments" by definition, market participants will be encouraged to upgrade their existing practices to achieve this environmentally sustainable status.

Not only is this regulation aimed at encouraging environmentally sustainable behavior, but it provides an objective and uniform way for investors to compare investments that fund environmentally sustainable economic activities and increase transparency among sustainable investments. Though the EU Taxonomy does not set mandatory requirements on environmental performance for companies or for financial products, it does introduce mandatory disclosure obligations for certain large companies and financial market participants aimed at helping investors make more informed decisions.

The EU Taxonomy is not working alone. The Sustainable Finance Disclosure Regulation ("SFDR") creates a comprehensive framework for financial products and entities. The SFDR makes sustainability reporting mandatory and will encourage investment firms marketing ESG funds to change the way they market and sell products. The SFDR requirements are intertwined with those under the EU Taxonomy—utilising the EU Taxonomy's definition of "environmentally sustainable economic activities" in the SFDR's definition of "sustainable investments." These regulations put sustainability-related risks in investments at the forefront for investors and portfolio managers. Under this regulation, asset managers, pension funds and insurers are required to disclose how they consider ESG risks in their investment decisions. The aim of these regulations is to provide a common set of rules on sustainability risks and to prevent greenwashing. This regulatory change is one of the first major steps in the EU's efforts to prioritise sustainability and transparency through ESG-related investment risks.

One thing is clear: universal adoption of standardised ESG disclosures is key to providing clear information to investors. The International Financial Reporting Standards Foundation, whose goal is to establish a uniform set of understandable and globally accepted accounting and sustainability disclosure standards, is initiating an international sustainability standards board to develop ESG disclosure standards to do just that. The EC also requested that the European Financial Reporting Advisory Group prepare a set of proposals for possible EU nonfinancial reporting standards in June 2020 as part of the Corporate Sustainability Reporting Directive aimed at creating uniformity across reporting standards.

Most recently, on October 30th and 31st of 2021, leaders of the world's 20 largest economies attended the G20 Heads of State and Government Summit in Rome, Italy. The Summit acts as the final stage of the Summit's work throughout the year, which includes meetings, working groups and special events aimed at resolving key issues—focusing this year on tackling climate change and recovery from the COVID-19 pandemic. The focus of this year's event demonstrates the growing importance of ESG-related issues and the need for global consistency and comprise.

Increased ESG scrutiny in the US

Compared to the EU, the US currently lacks a uniform evaluation of sustainable investing and finance. The US Federal Trade Commission ("FTC") provides guidelines for green marketing claims, which gives the FTC the right to pursue a legal enforcement action against misleading or false claims. In connection with its Green Guides (16 CFR Part 260), the FTC outlines principles that apply to all environmental marketing claims and explains how consumers are likely to interpret each claim to prevent deception. Among its general principals includes "overstatements of environmental attribute," which prohibits an environmental marketing claim from overstating, directly or by implication, an environmental attribute or benefit, and states companies should not state or imply environmental benefits if the benefits are negligible.

Most shareholder proposals in the US are made under Rule 14a-8 of the Securities Exchange Act of 1934 which limits proposals to particular topics. Recently, the staff of the US Securities Exchange Commission ("SEC") issued a legal bulletin under this rule shifting the agency's focus toward the social policy significance of an issue in a shareholder proposal, rather than the nexus between that policy issue and the company. This increases the likelihood that companies will be required by the SEC to hold shareholder votes on public policy issues, such as ESG. These changes in SEC policy are significant because they give investors concerned with a company's ESG issues a greater opportunity to push their measures onto corporate voting ballots by the second and third quarters, a popular time for annual shareholder meetings among major U.S. corporations. Notably, these resolutions will have filing deadlines in December, which gives shareholders enough time to take advantage of this new policy. This new guidance is likely to lead to an increase in not only the number of shareholder proposals but the number of ESG measures included in those proposals.

Because the US has yet to adopt mandatory ESG reporting requirements, some companies have chosen to include ESG disclosures in SEC documents based upon its interpretation of what ESG topics should be addressed in corporate disclosures. This can include risks that impact a company's long-term sustainability or its financial performance over time. Yet, this type of ad-hoc disclosure can disadvantage investors based on the lack of comparability among companies.

How far should US regulators go?

This poses the question: Should public companies be audited for ESG-specific compliance? On one hand, the recent changes in the US regulatory framework dispel the idea that ESG has nothing to do with financial performance and investor demands. However, these policy changes will open the door for businesses to take positions on a broader range of social policy matters as well.

As ESG moves to the forefront of investor considerations, the trend of companies integrating ESG into their public-facing disclosures creates another area for the investing public to evaluate, and in turn criticise, a company's commitment to prioritise ESG. For example, many companies have created ESG taskforces or ESG-focused board committees. It remains to be seen, however, whether and to what degree companies are able to successfully integrate these changing priorities beyond the public relations messaging.

Going forward, another key question for both investors and issuers raising funds in the US will be the impact of ESG disclosure requirements on class action securities litigation, a cornerstone of the hybrid public-private enforcement model for securities regulation in the US.