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Sustainability Reporting—Today's Top Three Trends

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Special to the Legal

For corporate managers and in-house counsel responsible for sustainability reporting, sorting through the daily deluge of email and news about new developments can seem overwhelming. There's a sense of urgency in the need to analyze and understand how today's rapidly changing sustainability landscape will impact existing and future programs and how best to position the company to meet the challenges and communicate tangible progress. Climate change, COVID-19, diversity, equity, inclusion, resource conservation, clean energy and water, which are so often called out in the headlines, are just the tip of the iceberg. Looking beneath the surface reveals a complex interrelationship of cross-cutting issues where progress on one performance indicator may have contraindicatory impacts that drive down results on another, yet both are material to the company and to key stakeholders. Staying abreast of new developments is critical for making informed decisions about current and future risk management. To help distill what you need to know now, this article highlights today's top three trends in sustainability reporting and offers insights on managing the uncertainty while moving forward.

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> *"Given the heightened interest in regulation and enforcement in the ESG arena, public and private companies are working with their attorneys to carefully evaluate the contents of their sustainability reports."*

1. HARMONIZING REPORTING FRAMEWORKS AND STANDARDS.

In response to growing demand from investors, shareholders and other stakeholders for greater transparency and disclosure of sustainability metrics, many companies have grappled with questions of what and how to report their data. The majority have turned to the existing array of voluntary sustainability reporting frameworks and standards. However, the multitude of options available often presents a complex and confusing array of choices, each with a unique approach and emphasis. Further, stakeholders and rating agencies may require the use of different frameworks or standards, necessitating duplicative reporting of environmental, social and governance (ESG) metrics in multiple forms and on multiple platforms. This process can be time-consuming and complicated for the reporting companies and can result in the lack of comparable data across companies. As a result, there have been many calls for development of a more streamlined, uniform and harmonized approach to sustainability reporting.

A group of five leading global frame-work—and standard-setting institutions responded to the outcry for uniformity last September by announcing plans to work collaboratively to create a more pragmatic and harmonized approach to reporting. The group includes some of the most recognized names in sustainability reporting, including the Global Reporting Initiative (GRI), CDP, Climate Disclosure Standards Board (CDSB), International Integrated Reporting Council (IIRC) and Sustainability Accounting Standards

Board (SASB) (collectively, the group). The group is seeking to reduce complexity and burden on reporting companies (including overlapping, redundant and duplicative disclosures) while facilitating disclosure of consistent and comparable metrics important to stakeholders. Their plan is to develop joint guidance on how their frameworks and standards can be applied in a complementary and additive fashion and to also pursue a joint vision on how these elements could complement financial generally accepted accounting principles (GAAP) and serve as a starting point for progress towards a more coherent and comprehensive global corporate reporting system.

The group describes themselves as a nested ecosystem, with each addressing distinct materiality concepts. For example, the GRI standards were developed as a guide for reporting significant impacts on people, the environment and the economy. SASB and CDSB, however, focus on the subset of financially material metrics that are generally relevant to value creation and economic decision-making. IIRC connects sustainability reporting to financial and other reporting. CDP provides a platform where stakeholders can access reported information on climate, water and forests. The group acknowledges significant confusion in the marketplace over the various reporting frameworks and the myriad of data aggregators, analytics providers, ratings and indices. The group's goal is to coalesce around a set of commonly accepted frameworks and standards that have global legitimacy through regulatory mandates or recognition by policymakers similar to the United States. GAAP in the financial reporting sector. In doing so, they hope to improve the quality and consistency of reported sustainability information, cease the rapid proliferation of new frameworks, reduce frustration of companies in the reporting process, and meet the needs of varied stakeholders.

The group is not alone in its pursuit of harmonization. Other organizations, governmental authorities and institutions have been moving forward on parallel paths to create their own version of a harmonized approach to reporting. For example, the international financial reporting standards (IFRS) foundation trustees formed a working group in March 2021 to focus on harmonizing global reporting standards and to provide a forum for the various standard-setting organizations to converge their standards. Likewise, the World Economic Forum's (WEF) International Business Council (IBC) released its own set of recommended common metrics for ESG reporting in September 2020, drawing upon existing standards such as GRI and aligning metrics to the UN Sustainable Development Goals (SDG). The European Commission, whose rules currently require reporting of certain ESG data by large companies but afford flexibility in terms of format, is exploring potential enhancements to the nonfinancial reporting directive (NFRD) in pursuit of a more consistent and unified approach to reporting. Numerous initiatives to harmonize reporting now seem to be proliferating apace with many hoping to have their own version of a harmonized standard be adopted globally.

Echoing the call for more uniformity are high-profile investment firms like BlackRock. BlackRock is a global investment management company reportedly having over $8 trillion in assets under management and a significant focus on ESG in risk management. In his 2021 Annual Letter to CEOs, BlackRock CEO Larry Fink strongly advocates for a single global standard to assist investors in comparing ESG metrics and making more informed decisions. Until there is a single harmonized standard, he asks all companies to report in alignment with the recommendations of the task force on climate-related financial disclosures (TCFD) and SASB, noting that TCFD reports help investors understand a company's most material climate-related risks and how they are managed.

2. SETTING AMBITIOUS NET ZERO CLIMATE COMMITMENTS.

Spurred by the growing frequency of severe and destructive weather events around the world, and scientific consensus reflected in the Paris Agreement that urgent action is required to address climate change, there has been a groundswell of climate commitments over the past year from corporations, governments and others announcing plans to make rapid and meaningful reductions in greenhouse gas (GHG) emissions. President Joe Biden announced in his executive order on tackling the climate crisis at home and abroad that both significant short-term global reductions in GHG emissions and net-zero global emissions by mid-century will be critical to avoiding a potentially catastrophic climate trajectory. Around the globe, efforts are being undertaken to collectively limit the average increase in global temperature to no more than 1.5 degrees C by 2050 to avoid catastrophic effects.

Many companies are making commitments to achieve net zero emissions by 2050, while others are going above and beyond that target with more ambitious plans. Microsoft, for example, has announced plans to be carbon negative by 2030 and, by 2050, to remove from the environment all the carbon attributable to its operations since its founding in 1975. Google claims to be the first major company to have achieved carbon neutrality and has plans to operate carbon-free by 2030. Amazon had led an initiative to get companies around the world to sign on to The Climate Pledge and commit to achieving net zero carbon emissions by 2040. The UN's Race to Zero Campaign reports that 21% of the world's largest public companies, representing sales of nearly $14 trillion, have made net zero commitments. BlackRock and dozens of other investment firms, representing over $22.8 trillion of assets under management, have joined together in the Net Zero Asset Managers initiative pledging to pursue the net zero emissions goal by 2050 or sooner.

While the trend toward corporate net zero climate commitments has exploded over the past year, there has also been criticism lodged around whether corporate actions, rather than words, are sufficiently robust to meet targeted goals. Critics are looking beyond the commitments touted in sustainability reports and evaluating what actions companies are actually taking to reduce carbon emissions. They are also looking deeper to understand the extent of the commitments and whether they apply only to Scope 1 or 2 emissions (e.g., direct or closely affiliated emission sources) or also to Scope 3 emission (e.g., indirect emissions in the value chain such as from suppliers). Some critics also argue that net zero is insufficient as a goal and that actual zero should be the imperative. However, because we are not yet at a point where we can achieve zero actual emissions from most operations, netting or offsetting of emissions is a practical first step. Some industry leaders are pursing more aggressive strategies to actually remove carbon from the atmosphere, including through nature-based strategies like reforestation or engineered strategies such as carbon capture and storage. United Airlines, for example, is investing in a multimillion-dollar Direct Air Capture project called 1PointFive that is expected to permanently sequester approximately 1 million tons of carbon dioxide underground each year, which is said to be the equivalent of what 40 million trees can achieve in terms of carbon removal.

There are many varied approaches to setting and achieving net zero climate targets. However, best practices for doing so (and for avoiding undesired stakeholder criticism) are to ensure that sustainability reports clearly articulate the nature and extent of the climate goal, the plans to achieve it, and the metrics that the company is using to track and report its progress.

3. INCREASING THREAT OF REGULATION AND USE OF REPORTING AS A RISK MANAGEMENT TOOL.

Today, sustainability is often viewed as a proxy for good governance and corporate sustainability reports serve as a guide to how a company is managing risk. The report itself has become more than simply a glossy report card and serves as a key tool to help focus initiatives, align and validate data and information, and communicate accurately and authentically with stakeholders. Further, as policymakers increasingly look to regulate in the ESG space, regulators and other stakeholders are paying increasing attention to what companies are disclosing—and not—in their mandatory and voluntary reporting. As a result, attorneys are playing a larger role in helping companies use their sustainability reporting as an effective risk management tool.

One example of the looming threat of increased regulation is the growing interest in ESG matters at the U.S. Securities and Exchange Commission (SEC). Under the Biden administration, the SEC has moved quickly to elevate focus on climate and ESG. Recognizing that investor demand for information about related risks, impacts and opportunities has grown dramatically over the last decade, the SEC is taking action on multiple fronts.

Acting SEC Chair Allison Herren Lee announced in February that she had directed the Division of Corporation Finance (DCF) to enhance its focus on climate-related disclosures in public company filings. SEC staff will be assessing the extent to which companies are complying with disclosure obligations under federal securities law and following the SEC's 2010 guidance on disclosure applicable to climate change matters. In addition, the SEC will begin work to update its 2010 guidance taking into account how the market is managing climate-related risks. Lee has underscored the role of the SEC in making sure that investors considering climate-related issues have access to material information to inform investment decisions. The SEC has requested public input on a variety of related issues, including if there are potential frameworks that the SEC could incorporate into its rules to facilitate disclosure of consistent, comparable, and reliable information on climate risks so as to appropriately inform investors about known material risks and uncertainties.

Looking beyond climate risk to broader ESG disclosure, several SEC committees have recommended that the commission pursue work to update disclosure requirements to address material ESG risk factors. John Coates, DCF's acting director, has remarked that while there is not yet consensus on a single set of ESG metrics to properly cover all issues for all companies, he believes the SEC should help lead the way toward creation of an appropriate system for disclosure of useful, reliable and comparable metrics, noting that the status quo is costly for companies who must respond to numerous and conflicting or redundant investor requests for different forms of ESG information. He favors development of a baseline global ESG reporting framework that jurisdictions around the world can build upon to address the individual needs of their constituencies and noted that the work of the IFRS Foundation to establish a sustainability standards board appears promising.

The SEC also recently announced the creation of a climate and ESG task force in the Division of Enforcement to develop initiatives to proactively identify ESG-related misconduct and its work will include the use of sophisticated data analysis to mine and assess information across registrants, to identify potential violations. The initial focus of the task force will be to identify material gaps or misstatements in issuers' disclosure of climate risks under existing rules. The task force will also analyze disclosure and compliance issues relating to investment advisers' and funds' ESG strategies. On April 9, the SEC Division of Examinations issued a risk alert addressing instances of potentially misleading statements in its recent exams of investment advisers and funds offering ESG products and services and offered guidance on effective practices to avoid compliance deficiencies related to ESG investing. The SEC underscored the importance of ensuring that disclosures, marketing claims and other public statements related to ESG investing are accurate and consistent with internal policies and actual practices.

While not within the cross-hairs of the SEC, private companies are not immune from potential ESG-related risks. As a growing number of consumers seek out "green" products and services, federal regulators and environmental activists are monitoring for, and taking action against, greenwashing. Exaggerated or unsubstantiated green claims may qualify as unfair or deceptive under the Federal Trade Commission (FTC) Act. The FTC's Green Guides document offers a roadmap for making environmental claims in a manner that avoids running afoul of the FTC Act's prohibition. Given that sustainability reports often contain substantial amounts of information on topics covered by the Green Guides, the FTC guidance should be considered in report preparation. In addition to managing liability at the federal level, it is also important to consider and manage potential state law liability for deceptive or misleading advertising and communications.

Given the heightened interest in regulation and enforcement in the ESG arena, public and private companies are working with their attorneys to carefully evaluate the contents of their sustainability reports and disclosures to ensure accuracy, consistency and compliance with existing and evolving legal requirements. They are using the sustainability report preparation process as the opportunity to validate data, substantiate and qualify claims, focus initiatives, and ensure clear consistent communication on goals and achievements. In doing so, they are helping to identify and manage potential legal liabilities and creating a key risk management tool. Once completed, the sustainability report can then serve as the key baseline document from which all other corporate communications, including financial disclosures, are aligned. This can reduce the potential risk of exposure to government enforcement actions or third-party claims related to false or misleading claims. The current trend of companies using sustainability reporting as a risk-management tool is expected to continue to grow substantially with the increasing interest in ESG-related regulation. •

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