ABCS OF ESG

Guide to North American and International ESG and Climate Disclosure Programs

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DELPHI GROUP

North American environmental, social, governance (ESG) and, more specifically, climate disclosure evolved significantly over the past year – particularly for those who are publicly listed or in the financial sector.

In October 2021, the Canadian Securities Administrator (CSA) released the proposed *National Instrument 51-107 Disclosure of Climate-Related Matters* ("Proposed Instrument"). This proposed mandate for Toronto Stock Exchange (TSX)-listed companies was modeled after the Task Force on Climate-related Financial Disclosures (TCFD) recommendations.

Shortly after the CSA announcement, the U.S. Securities and Exchange Commission (SEC) issued the *Enhancement and Standardization of Climate-Related Disclosures for Investors* ("SEC Proposed Rule"), which again hews closely to the TCFD-recommended guidelines.

A few weeks later, Canada released their 2022 Federal Budget, which committed the Office of the Superintendent of Financial Institutions (OSFI) to implementing TCFD-aligned climate disclosure mandates for banks, insurers, and pension fund managers.

The question we hear most from our clients is how, if at all, will these ESG and climate disclosure mandates – and others – impact my organization?

We're here to help. In this guide you will learn about the disclosure requirements associated with (1) voluntary frameworks (the TCFD and the International Sustainability Standards Board), (2) Canadian disclosure mandates (OSFI and CSA), and (3) the SEC proposal. Regardless of your sector, jurisdiction, or supervisory body, this guide will help you traverse the complex and shifting terrain of ESG and climate disclosure.

Climate Risk Explainer

Climate-related financial risks fall into two distinct categories:

Physical risk: This results from increased frequency and severity of weather events, which pose a threat to existing assets and operations. An organization's financial performance may be compromised due to weather-related events such as flooding, extreme temperature, forest fires, flooding, etc.

Transition risk: These are risks to existing assets and operations related to the transition to a lower-carbon economy. This transition will have significant policy, legal, technology, and market impacts. These will manifest differently based on the speed of change and the type of industry.

ESG Reporting Programs at a Glance

Program	Task Force on Climate-related Financial Disclosures	International Sustainability Standards Board	Canadian Securities Administrator Proposed National Instrument	Office of the Superintendent of Financial Institutions Draft Guideline	U.S. Securities and Exchange Commission Proposed Rule
Information required	Climate risks & GHG emissions (including scope 3)	Material ESG issues & GHG emissions (including scope 3 – or state the reason for omitting)	Climate risks & GHG emissions (including scope 3 – or state the reason for omitting)	Climate risks & GHG emissions (including scope 3)	Climate risks & GHG emissions (including scope 3 if material or included in targets)
Voluntary or Regulatory	Voluntary	Voluntary	Regulatory	Regulatory	Regulatory
Jurisdiction	Global	Global	Canada	Canada	US
Covered Entities/ Sectors	All organi-zations and sectors	All organizations and 77 sector-specific metrics	Publicly listed companies in Canada (with limited exceptions)[1]	Federally regulated financial institutions	Publicly listed companies that are trading on U.S. exchanges[2]
Scenario Analysis Requirement	Yes	Yes	No	Yes	Yes
Implementation Date	June 2017	Anticipated : end of 2022	December 31, 2022	October 31, 2023	Fiscal year 2023 for filing year 2024
Reporting Timelines	Annually or Bi-Annually	Annually	Annually ; aligned with Annual Report	Annually ; aligned with Annual Report	Annually ; aligned with Annual Report
Assurance	Limited	No	No	Limited	Limited – Scope 1 and 2 only
GHG Quantification Methodologies	Aligned with GHG Protocol	Aligned with GHG Protocol	Aligned with GHG Protocol	Aligned with GHG Protocol	Aligned with GHG protocol

1 The Proposed Instrument does not apply to investment funds, issuers of asset-based securities, designated foreign issuers, SEC foreign issuers, or exchangeable security issuers that are exempt under section 13.3 of National Instrument 51-102 *Continuous Disclosure Obligations* (“**NI 51-102**”) and certain subsidiary issuers.

2 The SEC proposal would apply to accelerated, large accelerated and non-accelerated filers; smaller reporting companies (with some relief); emerging growth companies; foreign private issuers; and companies filing registration statements including IPOs

Getting Into the Weeds on the Voluntary and Mandatory Frameworks

Voluntary Reporting Landscape

Task Force on Climate-Related Financial Disclosures: Global Gold Standard for Regulators

The TCFD was established to help deliver on the Paris Agreement's commitment to "holding the increase in the global average temperature to well below 2˚C above pre-industrial levels and to pursue efforts to limit the temperature increase to 1.5˚C above pre-industrial levels." In 2017, the TCFD published recommendations that were designed to be a global standard for identifying, mitigating and disclosing potential climate-related financial risks.

The TCFD recommendations consist of two fundamental components:

1. Scenario analysis, a "well-established method for developing strategic plans that are more flexible or robust to a range of plausible future states," and
2. "Mainstream" reporting of climate-related financial disclosures, i.e., disclosing climate-related risks in annual financial filings by integrating them into financial statements. The recommended disclosures are categorized into four core areas: governance, strategy, risk management, and metrics and targets. Organizations must respond to 11 questions across these four areas to specify how they are addressing their climate risk.

Two of the most important and controversial aspects of the TCFD recommendations are scenario analysis and scope 3 emission quantification. Beyond the oil and gas sector, experience and expertise with scenario analysis is thin, and there is a lack of clarity on both the most relevant scenarios to run and the most reliable and current data to incorporate.

Scope 3 are the emissions associated with an organization's indirect activities or assets not directly under their control but in their value chain, i.e., employee commuting, usage of sold goods, investment activities, etc. Quantifying these emissions can be challenging given that (1) they are not within your direct control so the data can be hard to obtain, and (2) while the World Resources Institute (WRI) and Partnership for Carbon Accounting Financials (PCAF) have developed standardized guidance for measuring scope 3 emissions, there are gaps in these standards. For example, there are not published methods for quantifying some scope 3 emissions, such as sovereign bonds. For these reasons, there has been push back from industry on mandating scope 3 disclosure.

International Sustainability Standards Board: One Standard to Rule Them All?

Are you ready for some acronyms?

In 2018, a World Business Council for Sustainable Development (WBCSD) study stated there were nearly 200 different ESG and climate frameworks/standards. In recent years, we have seen a consolidation of this landscape through mergers and acquisitions, competition, market forces, and regulatory pressures.

Most notably, in 2021 the **International Financial Reporting Standards (IFRS)**, an organization that is seen outside the U.S. as the global accounting standard setter, announced that they would be forming the **International Sustainability Standards Board (ISSB)**. The formation of the ISSB was part of a continued effort to create a unified standard for sustainability disclosure that is closely aligned with existing accounting standards.[3]

At COP26 in late 2021, the IFRS announced that it would begin a consolidation of three leading sustainability reporting frameworks under the ISSB. These included the **Sustainability Accounting Standards Board (SASB)**, the **International Integrated Reporting Council (IIRC)**, and the **Climate Disclosure Standards Board (CDSB)**. This amalgamated body developed the ISSB *Exposure Draft IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information*. This new proposed disclosure standard for sustainability reporting is closely aligned with international accounting standards and built on the foundation of SASB and TCFD. It is expected to become the accepted international framework for sustainability reporting in the future.

What you need to know about the proposed new standard:

- A final version is expected by the end of 2022 and will align with existing accounting standards.
- The ISSB disclosure framework details what is considered material climate and sustainability information, i.e., information that has a financial impact on a company's enterprise value.
- The standard will be voluntary but various jurisdictions, such as the US and Canada, have indicated the possibility of regulated disclosure based on this framework.
- While the ISSB draft framework is being finalized, companies should continue to use existing frameworks (e.g., SASB) as they underpin the foundation of these new standards and will be embedded within them.

3 ISSB Frequently Asked Questions

Canadian Mandatory Climate Disclosure Landscape

Canadian Securities Administrator's Proposed National Instrument: First-ever Proposed Climate Disclosure Mandate for Canadian Publicly Listed Companies

In October 2021, the CSA published the Proposed Instrument and a companion policy for public comment. The CSA is the umbrella organization of Canada's provincial and territorial securities regulators, and aims to coordinate and harmonize regulation of Canada's capital markets.

The Proposed Instrument creates mandatory climate-related disclosure requirements for reporting issuers in Canada, with limited exceptions. The disclosure requirements are intended to:

- Provide comparable and consistent climate-related information for investors,
- Improve issuer access to global capital markets, and
- Reduce the cost associated with reporting to multiple disclosure frameworks.

The requirements are mostly aligned with the TCFD recommendations, with a few notable exceptions, including not strictly mandating emission disclosures and not requiring scenario analysis. These exclusions generated significant pushback in the stakeholder consultations, with many commenters arguing that they would undermine Canadian global competitiveness, slow the development of transition plans, and increase risks for capital providers.

Since the release of the Proposed Instrument, there have been several major developments in the climate-related reporting space, including the launch of the ISSB and the release of the SEC's proposed rule for climate-related reporting standards (see below for more information). In its Financial System Review 2022, the Bank of Canada notes that the instrument is less prescriptive than the ISSB and SEC standards – and emphasizes that it is important for disclosure standards in Canada to be aligned with those adopted internationally.[4]

Given the discrepancies between the CSA and the SEC proposals, cross-listed issuers may face different disclosure burdens when reporting to the two systems. This challenge is in clear contrast to the CSA's stated objective of reducing costs by harmonizing frameworks.

Based on stakeholder feedback and the more prescriptive nature of other emerging disclosure frameworks, it's reasonable to expect that the CSA may look to enhance its reporting requirements.

4 https://www.bankofcanada.ca/2022/06/financial-system-review-2022/#climate-change-considerations

Office of the Superintendent of Financial Institutions Draft Guideline B-15: More Prescriptive Expectations for the Financial Sector

In May 2022, OFSI released *Draft Guideline No. B-15 Climate Risk Management* ("Draft Guideline") for public comment. The public comment period is open until September 30, 2022. The Draft Guideline establishes OFSI's expectations for federally regulated financial institutions' management of climate-related risks, including their reporting on these risks. The purpose is to reinforce OFSI's climate risk management expectations and to ensure financial institutions can better attract and maintain capital and liquidity channels.

The Draft Guideline's reporting requirements are aligned with TCFD, ISSB, and considered the proposed requirements of the SEC and CSA.

The Draft Guideline generally aligns with the Government of Canada's 2022 Federal Budget commitment that OSFI would (1) consult federally regulated financial institutions on climate disclosure guidelines in 2022, and (2) require financial institutions to publish climate disclosures—aligned with the TCFD framework—using a phased approach, starting in 2024.

U.S. Mandatory Climate Disclosure Landscape

The SEC Proposed Rule: One Upping Canada?

On June 17, 2022, the SEC closed the comment period for their Proposed Rule. If adopted, the rule would require any publicly traded companies that are listed on a US exchange to report climate-related information in certain SEC filings.

Like the CSA Proposed Instrument, the SEC Proposed Rule is modelled on the TCFD recommendations. However, the SEC's approach is more prescriptive than CSA's Proposed Instrument, most notably requiring scenario analysis and scope 3 emissions disclosure when material.

The Proposed Rule has received nearly 15,000 comments, with an overwhelming 82% expressing support.[5] In spite of this, several members of Congress have voiced their opposition and have stated they will seek review under the Congressional Review Act. This is not likely to result in the retraction of the Proposed Rule. In addition, the composition of the SEC Commission, which votes on the final rule, will change ahead of the vote. Incoming commissioners may have different views that could lead to changes to the final rules.

5 What Public Comments on the SEC's Proposed Climate-Related Rules Reveal—and the Impact They May Have on the Proposed Rules

Connecting the Disclosure Dots

Regardless of the final versions of the ISSB, CSA, OSFI and SEC proposals, the ESG and climate reporting landscape will continue to evolve and mature. As experience and expertise in the space deepens, we expect climate data to become more robust and available.

Key takeaways based on current trends:

- Climate-related risks are tightly tied to financial risks, therefore need to be managed and disclosed.
- Scenario analysis and scope 3 emissions may not make it into the final drafts of all the proposals, but they are two key components for evaluating climate-related risks.
- There is a global effort to reduce GHG emissions. Jurisdictions and organizations that are not aligned with international standards risk exposure to higher costs of capital, unmitigated asset depreciation and unmanaged climate risk.

Where to from here

The answer to this question depends on your business, industry, and where you are on your ESG journey. For companies that have been actively advancing their climate and ESG actions, the concept of ESG disclosure is nothing new. However, the new regulatory mandates will bring a higher level of scrutiny that could require companies to develop more comprehensive internal processes and controls with more oversight from finance and risk departments.

For companies that are in an earlier stage of their ESG and climate journey (often mid-market organizations that aren't large publicly traded entities or big banks), these mandates may usher in an entirely new way of thinking and operating. You may want to consider building executive capacity, engaging with stakeholders, quantifying your GHGs, and assessing your climate risks and opportunities.

Even if your organization isn't regulated by the likes of the CSA, SEC or OSFI, there will be down-stream impacts that will affect your business. These could include a bank loan application, or a request from a vendor or a customer because they are required to disclose their supply chain emissions to their governing bodies. Whether your organization is considering ESG and climate disclosure to identify risk, tell your sustainability story, or because it's required by your regulator, it's important to understand that this is not a sprint but a marathon. We can help you every step of the way.

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