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The impact of incoming regulation on US-listed companies

By Mark Hillsdon

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The rules and regulations around disclosures and a company's material risks are in a constant state of flux. New threats and new impacts – many around the climate emergency – are keeping both companies and the standard setters on their toes, as stakeholders and investors look for consistent and trustworthy information.

Yet, as the climate disclosure non-profit CDP showed earlier in 2022, just 1% of companies are providing information that investors need to assess whether or not they have credible plans for mitigating risks and transitioning to a low-carbon future.

To address this, new regulations have been unveiled by three jurisdictions - some still at the consultation phase - around ESG disclosures, which together cover most of the world's major markets. In the US, the Securities and Exchange Commission (SEC) is looking to roll out a new Climate Disclosure Rule that will require all US-listed companies to disclose their material climate impacts, greenhouse-gas emissions, and any targets or transition plans by filing year 2024.

In the European Union (EU), the adoption of a new Corporate Sustainability Reporting Directive (CSRD) is imminent, while changes to the International Sustainability Standards Board (ISSB), which will be used in countries such as the UK, have now been ratified. All three new jurisdictions are based around the fundamental principles of the Task Force on Climate-related Disclosures (TCFD).

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The aim of all the changes is to improve corporate sustainability reporting's ability to deliver the consistent and comparable data that is fundamental to responsible investment. But there is an underlying message from regulators too, that a more rigorous form of reporting is needed to crack down on 'greenwashing'. Yet for all their good intent, some believe these changes could have the inadvertent effect of creating an even more elaborate web of standards and ratings, which lack inter-operability and ultimately make the job of the chief sustainability officer even harder.

The SEC recommendations haven't been universally well received, with a cabal of Republicans and US businesses claiming that the commission has over-stepped the mark with pressure to make disclosures mandatory. Technical glitches have also seen the final regulations delayed.

The essence of the SEC changes is to significantly strengthen climate disclosure rules. The new laws are pushing for much greater consistency, comparability and reliability, with a focus on how climate risks are identified, assessed, managed and disclosed. They will also look at transition activities and greenhouse gas emissions from supply chains, and if accepted will require all publicly-listed companies to disclose annually how they assess and manage climate financial risks.

Despite the delays around SEC, says Ivan Frishberg, chief sustainability officer at Amalgamated Bank, the largest B Corps bank in US: "there's a sense of inevitability about all of these things." Delays are just going to push the start date back, it's still going to happen, he says, because: "ultimately this is where investors are going."

As a result, more proactive companies are in the process of assessing the scope of the changes and planning for their implementation.

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>
> **MINDY LUBBER**
> CEO, Ceres

According to Frishberg, the Amalgamated Bank is taking advantage of the time to get ready and figure out how they are efficiently and effectively going to implement changes, with internal groups working to understand what data is needed, and how to gather and align it with the general ledger. "Everything that we are doing now is a dress rehearsal," he says.

Natali Ganfer, SVP, sustainability at risk assessment firm Moody's says the business is in regular collaboration with their peers, evaluating all the upcoming requirements. "What we are trying to do is have an holistic view of all the regulatory requirements so that we can have a centralised way to produce any report... collaboration is vital... we can't do this in a corner."

But when it comes to adopting this kind of regulation, the

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US traditionally lags behind the EU, and as Mindy Lubber, president of sustainability advocates Ceres, recently warned: "as the international community moves forward with their own disclosure rules, slow regulatory movement on our domestic front will hurt US competitiveness."

While the SEC reforms take an investor's lens to a company's impacts, focussing on how they could affect financial performance, the CSRD takes a wider stance, with a definition of materiality that also requires a company to look at how it has impacted, and will impact, the environment.

Like the SEC proposal, it too is a revision of existing laws, this time the EU's the Non-Financial Reporting Directive (NFRD) and the Accounting Directive. It is also part of a bigger Sustainable Finance package, which will support the EU's Green Deal by helping investors fund the type of projects and technologies needed to make the EU climate neutral.

The new proposals have been drawn up by the European Financial Reporting Advisory Group (EFRAG) and will significantly expand the scope of the EU's existing non-financial reporting regime, with new rules set to bring in a mandatory audit and assurance regime to ensure reliability of data and act as a bar to greenwashing.

From 2024, all US 10-K filers – the name given to the comprehensive report filed by public-traded companies about its financial performance - and US companies that operate within the EU must embed effective data collection frameworks, renewed auditing procedures, and brand-new reporting practices in order to comply. It will also make it mandatory for companies to have their sustainability information assured by third parties.

In October there was also an announcement from the

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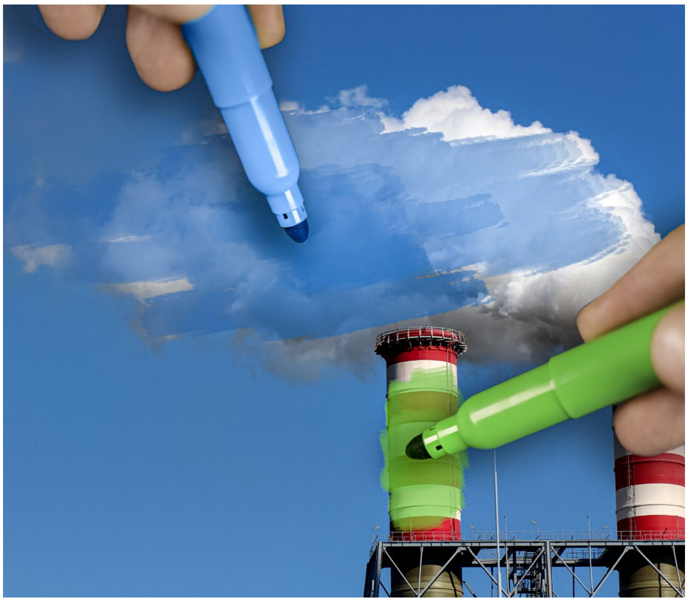

ISSB that "significant progress" had been made in refining its draft standards. Key was the decision to require company disclosures on Scope 1, 2 and 3 greenhouse gas emissions.

Scope 1 refers to the company's own direct emissions, Scope 2 to indirect emissions from purchased energy, with Scope 3 referring to all other indirect emissions, such as those from suppliers. The latter has proven particularly contentious, with companies pointing to incomplete data as a hurdle for accurate reporting, while critics counter that Scope 3, for many firms, captures the bulk of emissions and must be kept in the rules. As a something of a sop, the ISSB has promised 'relief provisions' on measuring emissions from a company's suppliers.

SO HOW ARE COMPANIES PREPARING FOR THE CHANGES?

Local Bounti is one of those businesses that has tried to get ahead of the curve. The company is a new player in the competitive market of controlled environment agriculture (CEA), growing a range of lettuces and salad leaves at four indoor facilities across the US.

Last year the company's first foray into sustainability reporting was a half yearly report, explains chief sustainability officer Gary Hilberg: "primarily to force ourselves to figure it out," and get on top of the process. This was followed by a full report, with the next due in 2023, after which they intend to hit the annual schedule likely to be set by the SEC regulations.

Although the company is only a few years old: "the business has grown, and so has the scale of the data reporting," says Hilberg. He has discovered that way in which data is collected is key and by beginning data collection for the report early, the company has longer to understand it and a head start when it came to changing things that aren't going right, he says.

"We collect data periodically during the year and then we know in advance if we're not meeting our commitments," he says.

Local Bounti uses the SASB accounting standard, which Hilberg says includes agricultural sub-sets which although making data collection more challenging, also forces them to look at aspects of their business they might overwise overlook. "We wanted to find international standards that forced us to report on everything, not selectively report."

"From a sustainability reporting side, we think it's best for the industry that we're all reporting openly and honestly," he says. "We believe the basis of all of it is just being transparent."

Hilberg wants to see more of the CEA sector adopt these kind of international standards. Many CEA companies use broad, sweeping figures, he says, particularly when comparing water use with traditional agriculture. But to show the true sustainable benefits, and the real water savings, of CEA: "it's better for everyone if we use tight, accurate data," he says.

Fyffes are another agriculture business, although one which operates on a far greater scale. With a history stretching back to 1888, they are one of the largest banana exporters in Europe, and the main player in the North American melon market.

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> SVP, Sustainability, Moody's

According to Julie Cournoyer, director of global sustainability, several years ago: "it was becoming apparent that the focus was moving away just from compliance," and in 2017 the business started to develop a more structured sustainability strategy and approach to materiality assessments.

The business had been a long-time supporter of Fairtrade, and completes regular due diligence checks around human rights and their environment impacts, while they also focus on the UN Guiding Principles and the OECD guidelines of responsible agricultural supply. "We knew that if we used those, we couldn't stray too far away from what would eventually be the legislation," says Cournoyer's colleague, Caoimhe Buckley, Fyffes' chief corporate affairs officer

The company are also strong advocates of the GRI methodology. "It doesn't tell you what you have to report, it tells you how to define what you have to report," says Cournoyer. "It tells you how to engage with stakeholders to define what is important."

Fyffes collect data across a range of material impacts, from water and energy use, to their impact on communities. They also monitor internal capacity building through training, the living wage and food loss.

The discipline of working to GRI means that with CSRD: "we don't need to reinvent the wheel… we just have to fine-tune and continuously improve and make sure that if there is any gaps with the new CSRD, we close them," says Cournoyer.

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> **JONATHAN FOWLIE**
> Chief External Relations Officer, Vancity

Reporting to this new level takes time because everything needs verification, she continues. "It is a challenge because it takes resources, but I think it is very positive… this part of CSRD will help to avoid greenwashing."

Buckley agrees. "Some of our peers are not as careful about validation and verification as we are. We want to be rewarded for taking that sort of thing seriously.

"I think it's all better that we are on a level playing field and that way we can see the strengths and weaknesses of each company."

The new emphasis on scope 3 emissions is a case in point, she says. "If you look at the average supermarket chain, the majority of GHG are scope 3 (from) their suppliers… so they are going to turn to the suppliers that are able to show that traceability and analysis, and they are going to prefer to work with suppliers who've already done all that measurement, and have validated and verified it."

Vancity is a credit union serving over 560,000 members across British Columbia in Canada, and while it works with ISSB, explains chief external relations officer Jonathan Fowlie: "We're always looking at where reporting guidelines are heading, even if they don't apply directly to us in Canada.

"The evolution of standards is essential," he says, and they: "have the potential to provide transparency around how all organisations are thinking about climate change and their impact on communities.

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Fowlie believes that: "climate risk is financial risk," and Vancity already makes voluntary disclosures through the Partnership for Carbon Accounting Financials (PCAF), a global alliance of financial institutions that work together to develop a harmonized approach to assess and disclose the greenhouse gas emissions associated with their loans and investments.

Measuring emissions around one common standard is crucial, he says, if the sector is to come together to make real changes, and he is pleased that scope 3 emissions are receiving so much attention in the current regulatory shake-up.

"The financial sector is such a driver for the global economy in terms of the lending decisions that are made every single day," he says. "We think (measuring) scope 3 is essential to really make sure that disclosures are covering the impact that comes from the decisions that banks are making every single day."

Vancity's track record of making voluntary disclosures puts it in a strong position to adapt to changing regulations,

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continues Fowlie. "We've been through what it takes to measure emissions in a $33 billion book and I can tell you it's not easy.

"A financial institution is used to dealing with data that is precise, that is suitable and that has predictable standards for disclosure," whereas so much around emissions is still estimated, he says.

"When you're a publicly traded company, any forward looking statements are going to be heavily scrutinised," he adds. "There are a lot of companies trying to understand what risks are presented by disclosing this data."

Fowlie also believes the financial sector needs to embrace double materiality and disclosures that don't just looks at the risk that climate presents to the health of the organisation but also at the impacts of the decisions that organisation is making on the world around it.

There is advice from CDP too, which has worked with thousands of businesses on their disclosures over the last 20 years. "Companies should be prepared for disclosure not simply because of regulation but because it's a business imperative," says Elizabeth Small, general counsel and head of policy, North America at CDP. "There's a business case that is already being made that is demanded by the market."

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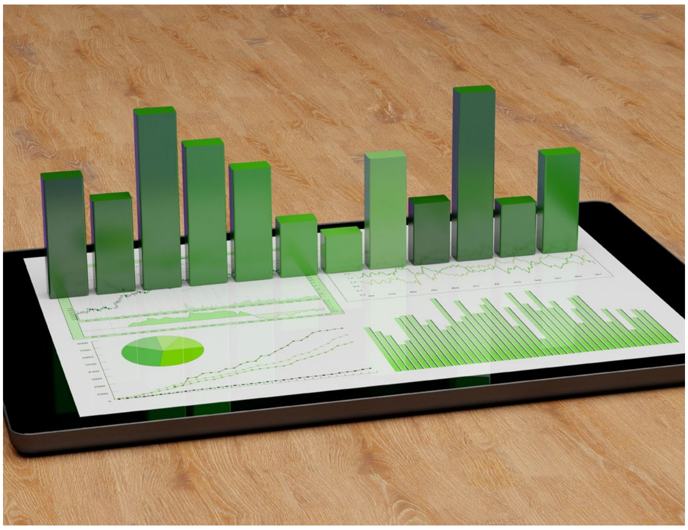
Describing the process of disclosure as: "a critical strategic illumination tool," she says that if, for instance, a company is disclosing poorly around its supply chain, then it is: "very likely it has other market failures that we should be aware of.

"I think it is wrong to fear compliance as a stick because what we see with disclosure is that it's revealing strategic gaps and opportunities."

Picking up Fowlie's point about double materiality, she believes that these: "are questions that companies have to be asking themselves not for compliance risk in the US but because of reputational risk… their employees demand it, and the market demands it.

"Companies that are not thinking about their impact on people and planet are not going to survive the transition," she warns. "Hundred-year cycles are shifting radically and if companies are not acknowledging reality then there will be a cost."

But will CSOs get the harmonisation they yearn for? The new disclosure rules may be designed to replace a patchwork of practices which have made it hard for investors to compare companies, but in what is already a crowded



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market for ratings and standards, businesses fear they could inadvertently make things worse.

The main grip from Local Bounti's Hilberg is the repetitive nature of so much ESG reporting, with different companies using different frameworks and ratings agencies all asking slightly different questions. "Consistency in data collection would be helpful to us," he says.

Fowlie wants to see regulatory frameworks that set common expectations across the economy. "Not only are they giving you the measuring stick that allows you to understand how to report," he says, "but also they are creating a common framework that say you're not going to be out of step with your competitors or shareholders."

Frishberg agrees that a common approach is more meaningful than everyone picking their own approach, which would make it impossible to scrutinise externally. "Consistency is essential for investors," he says.

In October, the G20's Financial Stability Board called on the standard setters to ensure "interoperability" between their norms and avoid "hardwiring" differences.

Klaas Knot, the Dutch central bank president who chairs the FSB, said developing the disclosures provides a unique opportunity to avoid "harmful fragmentation" in markets so that users can compare companies from across the world.

"Interoperability between the common global baseline and national and regional jurisdiction-specific requirements will be essential," Knot said in a letter to G20 finance ministers meeting in Washington this week.

"This needs to be built in early on, and certainly before frameworks are finalised and become hard to adjust."

"I think it can be a bit of a distraction to focus on some of the subtle differences (between jurisdictions)," adds Small, who says there is rarely such consternation around other forms of disclosure.

"The companies that are going to be most successful in this transitional period are companies that are treating this the way that they have treated everything else," she adds. "They have strong cross functional awareness, they have strong risk frameworks, they're looking at strategic opportunities and they're responding to market forces."

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