A Primer on ESG Reporting Frameworks

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As Peter Drucker, the father of modern management, said: "you can't improve what you don't measure." Yet, how to measure and report on corporate environmental (and other ESG) impacts is one of the biggest challenges in the ESG space. This is true for several reasons – including the fact that ESG data is often siloed, inconsistent, and unorganized. But, even before a one tries to gather the data to report, there is a key question: which of the existing ESG reporting frameworks should one use? Indeed, there is a literal alphabet soup of different reporting standards. It seems that new standards are emerging (while existing standards are merging) every day. Organizations who are just starting to work to report asking – what standards should we report against, and will they even be relevant next year?

This article (which is current as of August 1, 2022) will try to help answer this question by providing a high-level overview of the state of ESG reporting, as well as a "cliff notes" summary of certain key frameworks (along with links to where you can get more detailed information). Hopefully this information will clarify the lay of the land and help organizations and their leaders get over decision (or indecision) paralysis. Both the United States and the EU are poised to impose significant new sustainability disclosure requirements.[2] If a firm starts reporting with one of the major frameworks today it will be far better positioned to continue reporting on a going forward basis – even as things change – given that locating and understanding a company's ESG data is often half the battle.

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[2] For example, and as will be discussed, in March 2022, the SEC published a proposed Climate Disclosure Rule (which would apply to U.S. public companies), while in June 2022 the EU reached a preliminary agreement in June 2022 on the Corporate Sustainability Reporting Directive (CSRD), which would apply to tens of thousands of public and private companies.

Overview

Most of the ESG reporting frameworks that exist today are voluntary. A number of organizations have put significant time and effort into crafting comprehensive ESG reporting frameworks – especially regarding environmental issues. These have historically included (among others) the:

1) CDP: The Carbon Disclosure Project
2) CDSB: The Climate Disclosure Standards Board
3) GHG: The Greenhouse Gas Protocol
4) GRI: The Global Reporting Initiative
5) IIRC: The International Integrated Reporting Council
6) SASB: Sustainability Accounting Standards Board
7) SBTi: The Science Based Targets Initiative
8) TCFD: The Task Force on Climate Related Financial Disclosures
9) WEF: The World Economic Forum Stakeholder Capitalism Metrics

In September 2020 five of the above frameworks (the CDP, CDSB, GRI, IIRC, and SASB) announced a shared vision for comprehensive reporting that would include sustainability disclosures and financial accounting, linked through integrated reporting.[3] And, in December 2020, this "group of five" published a prototype climate-related financial disclosure standard to illustrate how their five standards could be used together.[4]

Since then, there has been even more coordination, and even consolidation, within the ESG reporting space. In June 2021, the IIRC and the SASB merged[5] into the Value Reporting Foundation (VRF).[6] And, in November of 2021, the International Financial Reporting Standards Foundation (IFRS) (which houses the International Accounting Standards Board (IASB))[7] announced that it would be consolidating with the CDSB and VRF and developing a new standard-setting board: The International Sustainability Standards Board (ISSB). As part of this process, the new IFRS has completed merging with both the CDSB (in January 2022)[8] and the VRF (in August 2022).[9]

Even though the IFRS completed its consolidation with the VRF and the CDSB, the creation of the new ISSB standards will take time. Still, the IFRS has previewed that

[3] https://www.cdp.net/en/articles/media/comprehensive-corporate-reporting
[4] https://29kjwb3armds2g3gi4lq2sx1-wpengine.netdna-ssl.com/wp-content/uploads/Reporting-on-enterprise-value_climate-prototype_Dec20.pdf
[5] https://www.integratedreporting.org/news/iirc-and-sasb-form-the-value-reporting-foundation-providing-comprehensive-suite-of-tools-to-assess-manage-and-communicate-value/
[6] https://www.valuereportingfoundation.org/
[7] https://www.ifrs.org/groups/international-sustainability-standards-board/issb-frequently-asked-questions/
[8] https://www.ifrs.org/news-and-events/news/2022/01/ifrs-foundation-completes-consolidation-of-cdsb-from-cdp/
[9] https://www.ifrs.org/news-and-events/news/2022/08/ifrs-foundation-completes-consolidation-with-value-reporting-foundation/

it plans to build its new standards on five existing frameworks and guidance – including, *inter alia*: (1) the CDSB Framework (2) the IIRC's Integrated Reporting Framework, (3) the SASB Standards, (4) the TCFD Recommendations, and (5) the WEF Stakeholder Capitalism Metrics.[10] Until the new ISSB standards are completed, the IFRS has recommended that companies continue using these voluntary frameworks and guidance as appropriate.

Additionally, the IFRS and GRI have entered into a memorandum of understanding whereby they will work to coordinate their programs and standard setting activities.[11] The MOU contemplates that, by working together, the IFRS and GRI will provide "two 'pillars' of international sustainability reporting": the ISSB's "investor-focused capital markets standards" and the GRI's sustainability reporting requirements, which will be compatible with the ISSB framework, and "designed to meet multi-stakeholder needs."[12]

In light of these recent developments, this article will:

- Provide a summary of the five frameworks identified as supporting the upcoming ISSB standard;

- Summarize certain other major widely used reporting frameworks;

- Briefly explain how these framework tie into proposed and/or existing U.S. and European disclosure regulations; and

- Discuss factors companies should consider when evaluating what disclosure frameworks to adopt.

A Summary of the ISSB-Supporting Frameworks

This section summarizes the five frameworks expected to serve as the foundation for the new ISSB standards. These include: (1) the IIRC's Integrated Reporting Framework, (2) the SASB Standards (which, together with the IIRC, made up the VRF framework), (3) the CDSB Framework, (4) the TCFD Recommendations, and (5) the WEF Stakeholder Capitalism Metrics.[13]

Integrated Reporting <IR> Framework

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[10] https://www.ifrs.org/groups/international-sustainability-standards-board/issb-frequently-asked-questions/

[11] https://www.globalreporting.org/news/news-center/ifrs-foundation-and-gri-to-align-capital-market-and-multi-stakeholder-standards/

[12] https://www.globalreporting.org/news/news-center/ifrs-foundation-and-gri-to-align-capital-market-and-multi-stakeholder-standards/

[13] https://www.ifrs.org/groups/international-sustainability-standards-board/issb-frequently-asked-questions/

The International Integrated Reporting Council ("IIRC") sought "to advance communication about value creation, preservation and erosion" through reporting on capital allocation and how it affects "financial stability and sustainable development."[14] The IIRC aimed to, among other things, "[s]upport integrated thinking, decision-making and actions that focus on the creation of value over the short, medium and long term." [15]

The IIRC established an International Integrated Reporting Framework ("the <IR> Framework") whose purpose "is to establish Guiding Principles and Content Elements that govern the overall content of an integrated report and to explain the fundamental concepts that underpin them." [16] The <IR> Framework, which focuses on a broad set of issues beyond sustainability, takes a principles-based approach and does not seek to require "specific key performance indicators, measurement methods or the disclosure of individual matters."[17] Still, reporting under the <IR> framework will generally discuss: (1) "the external environment that affects an organization;" (2) the resources and the relationships used and affected by the organization" ("the capitals"); and (3) "how the organization interacts with the external environment and the capitals to create, preserve or erode value over the short, medium and long term."[18]

Specifically, an Integrated Report will address eight content elements:[19]

1. Organizational overview and external environment
2. Governance
3. Business model
4. Risks and opportunities
5. Strategy and resource allocation
6. Performance
7. Outlook
8. Basis of preparation and presentation

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[14] https://www.integratedreporting.org/the-iirc-2/
[15] https://www.integratedreporting.org/resource/international-ir-framework/
[16] https://www.integratedreporting.org/wp-content/uploads/2021/01/InternationalIntegratedReportingFramework.pdf
[17] https://www.integratedreporting.org/wp-content/uploads/2021/01/InternationalIntegratedReportingFramework.pdf
[18] https://www.integratedreporting.org/wp-content/uploads/2021/01/InternationalIntegratedReportingFramework.pdf
[19] https://www.integratedreporting.org/wp-content/uploads/2021/01/InternationalIntegratedReportingFramework.pdf

The Values Reporting Foundation has published sample reports that have been recognized for their leading practice.[20]

Sustainable Accounting Standards Board (SASB)

The SASB Standards "are designed for communication by companies to investors about how sustainability issues impact long-term enterprise value."[21] These standards, first published in 2018, may "be used by companies as a practical tool for implementing the principles-based framework recommended by the Task Force for Climate-related Financial Disclosures (TCFD)," and also "enable robust implementation of the Integrated Reporting <IR> Framework . . . ."[22] Many companies report using both the SASB and GRI standards and the two organizations have published a practical guide on how to do so.[23]

The SASB Standards "identify the subset of environmental, social, and governance issues most relevant to financial performance," for 77 different industries and are "designed to help companies disclose financially-material sustainability information to investors."[24] The standards focus on five broad areas of reporting: (1) the environment, (2) social capital, (3) human capital, (4) business model and innovation, and (5) leadership and governance.[25] Each of these areas is then comprised of more specific topics:[26]

- The Environment, including, *e.g.*:
    - GHG emissions
    - Energy Management
    - Water & Wastewater Management

- Social Capital, including, *e.g*.:
    - Human Rights & Community Relations
    - Customer Privacy
    - Access & Affordability

- Human Capital, including, *e.g*.:
    - Labor Practices
    - Employee Health & Safety
    - Employee Engagement, Diversity & Inclusion

[20] https://examples.integratedreporting.org/recognized_reports
[21] https://www.sasb.org/about/sasb-and-other-esg-frameworks/
[22] https://www.sasb.org/about/sasb-and-other-esg-frameworks/
[23] https://www.sasb.org/knowledge-hub/practical-guide-to-sustainability-reporting-using-gri-and-sasb-standards/
[24] https://www.sasb.org/standards/
[25] https://www.sasb.org/standards/materiality-finder/?lang=en-us
[26] https://www.sasb.org/standards/materiality-finder/?lang=en-us

- Business Model and Innovation, including, *e.g.*:
    - Business Model Resilience
    - Supply Chain Management
    - Materials Sourcing & Efficiency

- Leadership and Governance, including, *e.g.*:
    - Business Ethics
    - Management of the Legal & Regulatory Environment
    - Systemic Risk Management

The SASB Standards are specific to each industry – so an auto parts company may report on one set of issues, while a health care delivery company would report on a different set of topics.[27] The VRF website allows users to download SASB Standards individually for each of the nearly 80 industries covered.[28] For each industry, the SASB Standards include: [29]

- Disclosure topics: "A minimum set of industry-specific disclosure topics reasonably likely to constitute material information, and a brief description of how management or mismanagement of each topic may affect value creation";

- Accounting Metrics: "A set of quantitative and/or qualitative accounting metrics intended to measure performance on each topic";

- Technical Protocols: "Each accounting metric is accompanied by a technical protocol that provides guidance on definitions, scope, implementation, compilation, and presentation, all of which are intended to constitute suitable criteria for third-party assurance"; and

- Activity Metrics: "A set of metrics that quantify the scale of a company's business and are intended for use in conjunction with accounting metrics to normalize data and facilitate comparison."

<u>Climate Disclosure Standards Board (CDSB)</u>

The Climate Disclosure Standards Board (CDSB) was founded in 2007 at the World Economic Forum. Unlike certain other organizations that provide bespoke metrics for environmental reporting, the CDSB aims to integrate climate change-related disclosures into pre-existing financial reports (such as 10-K filings or other annual

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[27] https://www.sasb.org/standards/materiality-finder/?lang=en-us
[28] https://www.sasb.org/standards/download/?lang=en-us
[29] https://www.sasb.org/wp-content/uploads/2018/11/Investment_Banking_Brokerage_Standard_2018.pdf

reports).[30] Accordingly, rather than providing its own metrics, the CDSB relies upon metrics developed by other organizations (such as the CDP or SASB). And, through the CDSB's reporting framework, it provides companies "guidance to communicate that content in mainstream reports… [in order to] inform their investors and stakeholders, while providing regulators with a comprehensive set of information."[31]

The CDSB framework includes seven guiding principles, that disclosures should: (1) apply the principles of relevance and materiality, (2) be faithfully represented, (3) connect environmental, social, and other information, and be (4) consistent and comparable, (5) clear and understandable, (6) verifiable, and (7) forward looking.[32] With these principles in mind, the framework requires reporting on a dozen topics:[33]

1) Governance;
2) Management's environmental policies, strategy and targets;
3) Business risks and opportunities;
4) Sources of environmental and social impacts;
5) Performance and comparative analysis;
6) Outlook;
7) Organisational boundary;
8) Reporting policies;
9) Reporting period;
10) Restatements;
11) Conformance; and
12) Assurance.

According to the CDSB, its framework "supports compliance with regulatory reporting requirements with current & emerging requirements for sustainability reporting, (*e.g.*, the EU Non-Financial Reporting Directive)," and aligns with "the

[30] https://www.cdsb.net/what-we-do/reporting-frameworks/environmental-information-natural-capital
[31] https://www.cdsb.net/cdp
[32] https://www.cdsb.net/sites/default/files/cdsb_framework_2022.pdf
[33] https://www.cdsb.net/sites/default/files/cdsb_framework_2022.pdf

recommendations of the Task Force on Climate-related Financial Disclosures" (TCFD).[34] Moreover, the CDSB has formed strategic alliances with several other reporting organizations – including the CDP, GRI, IIRC, and SASB.[35]

Task Force on Climate-Related Financial Disclosures (TCFD)

The TCFD was created by the Financial Stability Board to improve and increase disclosure of climate-related financial information.[36] The reporting recommendations, released in 2017, are structured around four themes: (1) governance, (2) strategy, (3) risk management, and (4) metrics and targets.[37] These themes are "supported by 11 recommended disclosures that build out the framework with information that should help investors and others understand how reporting organizations think about and assess climate-related risks and opportunities."[38] The recommended disclosures, by topic, include:[39]

- Governance: Board oversight and management's role.

- Strategy: Description of the climate-related risks and opportunities over the short, medium, and long term; the impact of these risks on business, strategy, and financial planning; and the strategy's resilience.

- Risk Management: The process for identifying and assessing climate-related risks; managing those risks; and integrating them into overall risk management.

- Metrics and Targets: Disclosure of the metrics used by the organization to assess climate-related risks and opportunities; Scope 1, 2 and (if appropriate) 3 GHG emissions; and the targets used by the organization and its performance against those targets.

In 2021, the TCFD published general and industry specific guidance for each of the recommended disclosures.[40] General guidance applies regardless of the company's sector and provides additional detail regarding the specific information to be included by all companies in each of the 11 recommended disclosures. For example, with regard to board oversight, the TCFD's general guidance suggests that companies specifically report on (among other things): the "processes and frequency by which the board and/or board committees . . . are informed about climate-related issues;" "whether the board and/or board committees consider climate-related issues when reviewing and guiding strategy, major plans of action, risk management policies,

[34] https://www.cdsb.net/what-we-do/reporting-frameworks/environmental-information-natural-capital
[35] https://www.cdsb.net/strategic-alliances
[36] https://www.fsb-tcfd.org/
[37] https://www.fsb-tcfd.org/about/
[38] https://www.fsb-tcfd.org/about/
[39] https://assets.bbhub.io/company/sites/60/2020/10/FINAL-2017-TCFD-Report-11052018.pdf
[40] https://assets.bbhub.io/company/sites/60/2021/07/2021-TCFD-Implementing_Guidance.pdf

annual budgets, and business plans;" and "how the board monitors and oversees progress against goals and targets for addressing climate-related issues."[41]

Beyond the general guidance, the TCFD has issued supplemental guidance for the financial sector -- including banks, insurance companies, asset owners, and asset managers. The TCFD has also issued supplemental guidance for four non-financial groups, including: (1) energy, (2) transportation, (3) materials and buildings, and (4) agriculture, food, and forest products. Different supplemental guidance may apply to certain of the 11 recommended disclosures, depending on the industry. Thus, banks may be called upon to consider supplementing their risk management disclosures by "characterizing their climate-related risks in the context of traditional banking industry risk categories such as credit risk, market risk, liquidity risk, and operational risk." [42] Whereas insurance companies should consider supplementing their risk management disclosures by identifying and assessing climate-related risks "by geography, business division, or product segment," focusing on physical risks of weather-related perils, transition risks resulting from carbon regulation, and liability risks from a potential increase in litigation.[43]

Other reporting frameworks, such as the CDSB's, are designed to be aligned with the TCFD recommendations. Additionally, as will be discussed, certain EU reporting guidelines (*e.g.*, the EU Non-Financial Reporting Directive's 2019 guidelines) have integrated the TCFD's recommendations,[44] and the U.S. SEC's proposed climate disclosure rule also was modelled in part on the TCFD framework.[45]

<u>WEF Stakeholder Capitalism Metrics</u>

The WEF Stakeholder Capitalism metrics were developed following the 2020 Annual Meeting in Davos.[46] Supported by 120 of the world's largest companies, the "core and expanded set of 'Stakeholder Capitalism Metrics' and disclosures can be used by companies to align their mainstream reporting on performance against environmental, social and governance (ESG) indicators and track their contributions towards the SDGs on a consistent basis." [47] These metrics, which are based on existing standards (such as GRI and SASB), are intended to accelerate "convergence among the leading private standard-setters and bring[] greater comparability and consistency to the reporting of ESG disclosures." [48]

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[41] https://assets.bbhub.io/company/sites/60/2021/07/2021-TCFD-Implementing_Guidance.pdf
[42] https://assets.bbhub.io/company/sites/60/2021/07/2021-TCFD-Implementing_Guidance.pdf
[43] https://assets.bbhub.io/company/sites/60/2021/07/2021-TCFD-Implementing_Guidance.pdf
[44] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52019XC0620(01)
[45] https://www.sec.gov/rules/proposed/2022/33-11042.pdf
[46] https://www.weforum.org/reports/measuring-stakeholder-capitalism-towards-common-metrics-and-consistent-reporting-of-sustainable-value-creation/
[47] https://www.weforum.org/reports/measuring-stakeholder-capitalism-towards-common-metrics-and-consistent-reporting-of-sustainable-value-creation/
[48] https://www.weforum.org/reports/measuring-stakeholder-capitalism-towards-common-metrics-and-consistent-reporting-of-sustainable-value-creation/

The WEF Stakeholder Capitalism metrics and disclosures (including 21 core and 34 expanded) are divided into four major areas: (1) people, (2) planet, (3) prosperity, and (4) governance.[49] The metrics focus on such issues as:[50]

- People, including, *e.g.*:
  - Diversity and inclusion
  - Pay equality
  - Living Wage
  - Health and Safety

- Planet, including, *e.g.*:
  - GHG emissions
  - TCFD implementation
  - Land use and ecological sensitivity
  - Water consumption and withdrawal

- Prosperity, including, *e.g.*:
  - Rate of employment
  - Total R&D expenses
  - Total tax paid
  - Social value generated

- Governance, including, *e.g.*:
  - Setting purpose
  - Governance body composition
  - Anti-corruption
  - Alignment of strategy and policies to lobbying

Other Major Reporting Frameworks

<u>Global Reporting Initiative (GRI)</u>

GRI (founded in 1997) is a global, independent organization focused on helping institutions take responsibility for their impacts.[51] The GRI Standards (which GRI believes are the most widely used sustainability reporting standards in the world) are meant to enable organizations "to understand and report on their impacts on the economy, environment and people in a comparable and credible way . . . ."[52]

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[49] https://www.weforum.org/stakeholdercapitalism/our-metrics
[50] https://www.weforum.org/stakeholdercapitalism/our-metrics
[51] https://www.globalreporting.org/about-gri/mission-history/
[52] https://www.globalreporting.org/standards/

The GRI standards are divided into three categories: (1) Universal Standards, which focus on the GRI's basic requirements and how to disclose general information about the reporting organization; (2) Sector Standards, which seek to improve reporting by organizations in specific sectors such as oil, electronics, or agriculture, and (3) Topic Standards, which discuss how to disclose on specific topics such as tax or waste.[53]

There are three types of Universal Standards: (1) Foundational, which are the "requirements and principles for using the GRI Standards," (2) General Disclosures, which contain the general "disclosures about the reporting organization" such as practices or policies, and (3) Material Topics, which represent an organization's greatest impact "on the economy, environment, and people . . . ."[54] The Foundational standards (GRI 1) can be thought of as the instructions for GRI reporting. General Disclosures (GRI 2) focus on reporting about activities and workers; governance; strategies, policies, and practices; and stakeholder engagement. And, Material Topics (GRI 3) govern the process by which companies determine and disclose those topics that are most important to the organization – which generally will be drawn from the relevant Sector Standards.

Expanding upon the Universal Standards, GRI has identified 40 Sector Standards, which will eventually apply to different sectors of the economy.[55] Each sector standard goes over the overall sector's characteristics, lists topics that are likely to be material for organizations in the sector, and allows for additional disclosures that are not a Topic Standard.[56] So, an organization in the oil and gas sector will report on one set of issues, while a coal company might report on a different set of topics. Notably, these sector standards are a work in progress. As of April 2022, GRI has published two sector standards: one for oil and gas[57] and a second standard for coal.[58] A third sector standard, for agriculture, aquaculture, and fishing, is now open for public comment.[59] A list of the 40 different prospective GRI sectors can be found on its website.[60]

The GRI's Topic Standards "contain disclosures that the organization uses to report information about its impacts in relation to particular topics."[61] Each topical standard gives an overview of the topic and its specific disclosures. An organization will use "the Topic Standards according to the list of material topics it has determined using GRI 3," which in turn will be guided by the specific Sector

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[53] https://www.globalreporting.org/media/wtaf14tw/a-short-introduction-to-the-gri-standards.pdf
[54] https://www.globalreporting.org/media/wtaf14tw/a-short-introduction-to-the-gri-standards.pdf
[55] https://www.globalreporting.org/media/mqznr5mz/gri-sector-program-list-of-prioritized-sectors.pdf
[56] GRI 3: Material Topics (2021)
[57] https://www.globalreporting.org/standards/standards-development/sector-standard-for-oil-and-gas/
[58] https://www.globalreporting.org/standards/standards-development/sector-standard-for-coal/
[59] https://www.globalreporting.org/standards/standards-development/sector-standard-project-for-agriculture-aquaculture-and-fishing/
[60] https://www.globalreporting.org/media/mqznr5mz/gri-sector-program-list-of-prioritized-sectors.pdf
[61] GRI 3: Material Topics (2021)

Standards.[62] GRI's topics are broken down into the 200, 300, and 400 series.[63] The 200 series focuses on economic issues, such as economic performance (201), procurement practices (204), anti-corruption (205), and tax (207). The 300 series address environmental issues, such as energy (302), emissions (305), and waste (306). And, the 400 series focuses on people issues, including employment (401), diversity and opportunity (405), customer health and safety (416), and customer privacy (418).[64]

Science Based Targets Initiative (SBTi)

The SBTi Corporate Net-Zero Standard is "the world's first framework for corporate net-zero target setting in line with climate science," and provides "the guidance, criteria, and recommendations companies need to set science-based net-zero targets consistent with limiting global temperature rise to 1.5°C."[65] It is intended for corporations with more than 500 employees.[66]

Pursuant to the SBTi Net-Zero Standard, achieving corporate net-zero means "[r]educing scope 1, 2, and 3 emissions to zero or to a residual level that is consistent with reaching net-zero emissions at the global or sector level in eligible 1.5°C-aligned pathways" and "neutralizing any residual emissions at the net-zero target year and any GHG emissions released into the atmosphere thereafter."[67] The Corporate Net-Zero Standard includes four key elements: (1) a near-term science-based target; (2) a long-term science-based target; (3) mitigation beyond the value chain; and (4) neutralization of any residual emissions.[68]

SBTi provides detailed guidance[69] and criteria[70] for achieving each of these elements – including sector specific projects[71] for financial institutions[72] and several other sectors. Additionally, SBTi has several tools[73] to assist companies in fulfilling their goals, including a Commercial Real Estate and Residential Mortgage Tool,[74] a Private Equity Sector Science-Based Target Guidance,[75] and a finance tool for temperature scoring and portfolio coverage.[76]

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[62] GRI 3: Material Topics (2021)
[63] https://www.globalreporting.org/media/nmmnwfsm/gri-policymakers-guide.pdf
[64] https://www.globalreporting.org/how-to-use-the-gri-standards/gri-standards-english-language/
[65] https://sciencebasedtargets.org/net-zero
[66] https://sciencebasedtargets.org/resources/files/Net-Zero-Standard.pdf
[67] https://sciencebasedtargets.org/resources/files/Net-Zero-Standard.pdf
[68] https://sciencebasedtargets.org/resources/files/Net-Zero-Standard.pdf
[69] https://sciencebasedtargets.org/resources/files/Net-Zero-Standard.pdf
[70] https://sciencebasedtargets.org/resources/files/SBTi-criteria.pdf
[71] https://sciencebasedtargets.org/sectors
[72] https://sciencebasedtargets.org/sectors/financial-institutions
[73] https://sciencebasedtargets.org/resources/?tab=develop#resource
[74] https://sciencebasedtargets.org/resources/?tab=develop#resource
[75] https://sciencebasedtargets.org/resources/files/SBTi-Private-Equity-Sector-Guidance.pdf
[76] https://www.cdp.net/en/investor/temperature-ratings/cdp-wwf-temperature-ratings-methodology

In addition to its Corporate standard (which has been completed), Science Based Targets is also in the process of developing a Finance Net-Zero Standard to "enable financial institutions to use their influence to achieve economy-wide net-zero emissions by 2050."[77] In April 2022, SBT published a paper discussing the foundations for science based net-zero target setting for the financial sector.[78] SBT expects to launch its Finance Net-Zero Standard in the first quarter of 2023.[79]

Carbon Disclosure Project (CDP) Framework

Founded in 2000, the Carbon Disclosure Project is an international non-profit that runs a "global disclosure system for investors, companies, cities, states, and regions to manage their environmental impacts."[80] As of April 2022, more than 13,000 companies and 1100 cities, states and regions have made environmental disclosures through the CDP.[81] The organization "takes the information supplied in its annual reporting process and scores companies and cities" measuring "corporate and city progress and incentivize action on climate change, forests and water security." [82] The CDP's goal is to build "a sustainable economy by measuring and acting on their environmental impact" with the focus on reducing emissions "in line with a 1.5°C pathway" and having "a net-zero, nature-positive world by 2050…."[83]

The CDP has three separate business questionnaires (which are aligned with TCFD recommendations) for: (1) climate change, (2) forests, and (3) water security.[84]

- The Climate Change Questionnaire focuses on such issues as how the company's corporate governance structure addresses climate change; how the company identifies climate risks and opportunities; and a wide variety of emissions-related information – including emissions methodology, targets/performance, scope 1, 2 and 3 data, and how the company breaks down emissions data. [85]

- The Forest Questionnaire is split into nine categories, focusing on such issues as the current state of the company's impact on forests, whether the company undertakes a forests-related risk assessment, how the organization

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[77] https://sciencebasedtargets.org/net-zero-for-financial-institutions
[78] https://sciencebasedtargets.org/resources/files/SBTi-Finance-Net-Zero-Foundations-paper.pdf

[79] https://sciencebasedtargets.org/net-zero-for-financial-institutions
[80] https://www.cdp.net/en/companies-discloser
[81] https://www.cdp.net/en/info/about-us/what-we-do
[82] https://www.cdp.net/en/info/about-us/what-we-do
[83] https://cdn.cdp.net/cdp-production/comfy/cms/files/files/000/005/094/original/CDP_STRATEGY_2021-2025.pdf
[84] https://www.cdp.net/en/guidance/guidance-for-companies
[85]https://guidance.cdp.net/en/tags?cid=30&ctype=theme&gettags=0&idtype=ThemeID&incchild=1&microsite=0&otype=Questionnaire&page=1&tgprompt=TG-124%2CTG-127%2CTG-125

is governed to best aid the environment, and the company's business strategy and how it will aid the environment.[86]

- The Water Questionnaire is composed similarly to the forest questionnaire, with ten categories -- including the waterways the company interacts with, the company's impact on the aquatic environment and how much water is utilized, and the business impacts of the company's interactions with water.[87]

Data from the questionnaires[88] and company rankings[89] are publicly available on the CDP's website.

<u>Greenhouse Gas (GHG) Protocol</u>

The GHG Protocol "establishes comprehensive global standardized frameworks to measure and manage greenhouse gas (GHG) emissions from private and public sector operations, value chains and mitigation actions."[90] Of the Fortune 500 companies who respond to the CDP, more than 90% used the GHG Protocol (directly or indirectly) to do so.[91] The GHG Protocol has developed several standards for use by different entities and in a variety of situations. These include:[92]

- Corporate Standard (requirements and guidance for preparing "a corporate-level GHG emissions inventory");

- GHG Protocol for Cities (a framework "for accounting and reporting city-wide" emissions);

- Mitigation Goal Standard (guidance for designing "national and subnational mitigation goals" and reporting on progress to their achievement);

- Corporate Value Chain (Scope 3) Standard (guidance on how companies can assess their "entire value chain emissions impact");

- Policy and Action Standard ("a standardized approach for estimating the greenhouse gas effect of policies and actions");

- Product Standard (a way to "understand the full life cycle emissions of a product"); and

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[86] https://guidance.cdp.net/en/tags?cid=31&ctype=theme&gettags=0&idtype=ThemeID&incchild=1&microsite=0&otype=Questionnaire&page=1&tgprompt=TG-124%2CTG-127%2CTG-125
[87] https://guidance.cdp.net/en/tags?cid=35&ctype=theme&gettags=0&idtype=ThemeID&incchild=1&microsite=0&otype=Questionnaire&page=1&tgprompt=TG-124%2CTG-127%2CTG-125
[88] https://www.cdp.net/en/investor/data-and-tools
[89] https://www.cdp.net/en/companies/companies-scores
[90] https://ghgprotocol.org/about-us
[91] https://ghgprotocol.org/about-us
[92] https://ghgprotocol.org/standards

- Project Protocol (a "policy-neutral accounting tool for quantifying the greenhouse gas benefits of climate change mitigation projects").

The GHG Protocol's website provides numerous tools to assist in the implementation of its standards – including online training courses,[93] guidance on a variety of issues (including Scope 2 and 3 calculations, agricultural measurements, fossil fuel reserves, and emissions of loans and investments),[94] and several calculation tools (including cross-sector tools, sector-specific tools, country-specific tools, and tools for countries and cities).[95] Notably, the U.S. SEC has incorporated the GHG Protocol's concept of scopes and related methodology into its proposed public company disclosure rule.[96]

Connection Between Voluntary Reporting Frameworks and U.S./EU Regulations

In assessing potential disclosure frameworks, organizations should consider what disclosure obligations are (or may soon be) required by regulation in the jurisdictions in which they operate. Below we briefly discuss the regulatory environment in two jurisdictions: the United States and the European Union.

The United States currently does not impose mandatory framework for reporting on ESG issues. On March 21, 2022, however, the U.S. Securities and Exchange Commission (SEC) proposed a rule that would enhance and standardize public company climate disclosures. Although the rule has not yet been finalized, according to the SEC the proposed disclosures are based on such frameworks as the TCFD and the GHG Protocol. Indeed, the SEC stated that it "modeled the proposed disclosure rules in part on the TCFD disclosure framework," which "should enable companies to leverage the framework with which many investors and issuers are already familiar," while it based its "proposed GHG emissions disclosure requirement primarily on the GHG Protocol's concept of scopes and related methodology. . . ." [97]

Additionally, on May 25, 2022, the SEC proposed a rule that (if adopted) would require ESG-Focused Funds, Impact Funds, and Integration Funds (that integrate ESG and non-ESG factors in making investment decisions) to make a variety of disclosures supporting their strategies.[98] The greater a fund's ESG focus, the greater the reporting requirement would be. For example, under this proposal, ESG-Focused funds would need to provide a table that: (1) provides an overview of the fund's ESG strategy, (2) explains how the fund incorporates ESG factors in its

[93] https://ghgprotocol.org/training-capacity-building
[94] https://ghgprotocol.org/guidance-0
[95] https://ghgprotocol.org/calculation-tools
[96] https://www.sec.gov/rules/proposed/2022/33-11042.pdf
[97] https://www.sec.gov/rules/proposed/2022/33-11042.pdf
[98] https://www.sec.gov/news/press-release/2022-92

investment decisions, and (3) describes how the fund votes proxies and/or engages with companies about ESG issues.[99] Additionally, ESG-Focused Funds that consider environmental factors in their strategies would be required to disclose both their carbon footprint and the weighted average carbon intensity (WACI) of their portfolio.[100] Environmentally focused funds would also be required to disclose the financed Scope 3 emissions of its portfolio companies (to the extent that the portfolio companies report such information).[101]

In Europe, the EU's Non-Financial Reporting Directive (NFRD), which has applied to certain large companies since 2014, requires disclosure on a variety of issues – including the environment, social matters, human rights, and board diversity.[102] While the NFRD itself does not impose a specific reporting framework (though member countries have done so under national law), the European Commission has published non-mandatory guidelines in 2017[103] and 2019[104] to assist with reporting. In adopting these guidelines, the EC consulted with several voluntary frameworks, including, *inter alia*, those issued by the CDP, CDSB, GRI, SASB, and TCFD.[105] Indeed, the 2019 guidelines specifically integrated the TCFD's recommendations and provided guidance meant to be consistent with them.[106]

Additionally, effective March 2021, the EU adopted the Sustainable Finance Disclosure Regulation (SFDR), which requires covered investment advisors and asset managers to report on "Sustainability Risks" (ESG risks that could impact the value of an investment) and "Principle Adverse Impacts" (the negative impacts investments might have on sustainability factors).[107] Different levels of disclosure are required depending on whether a product integrates ESG considerations, promotes ESG (without sustainable investing as a core objective), or has a sustainable investment objective.[108] While there are nearly 20 different potential requirements (the details of which are beyond the scope of this article), these may include (for funds with sustainable investment objectives) a description of the objectives, the methodologies used to measure them, and "the overall sustainability-related impact of the fund by means of relevant sustainability indicators. . . ."[109]

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[99] https://www.sec.gov/rules/proposed/2022/ia-6034.pdf
[100] https://www.sec.gov/files/ia-6034-fact-sheet.pdf
[101] https://www.sec.gov/rules/proposed/2022/ia-6034.pdf
[102] https://ec.europa.eu/info/business-economy-euro/company-reporting-and-auditing/company-reporting/corporate-sustainability-reporting_en
[103] https://ec.europa.eu/info/publications/non-financial-reporting-guidelines_en
[104] https://ec.europa.eu/info/publications/non-financial-reporting-guidelines_en#climate
[105] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52017XC0705(1)
[106] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52019XC0620(01)
[107] https://am.jpmorgan.com/kr/en/asset-management/institutional/investment-strategies/sustainable-investing/understanding-SFDR/
[108] https://am.jpmorgan.com/kr/en/asset-management/institutional/investment-strategies/sustainable-investing/understanding-SFDR/
[109] https://www.matheson.com/docs/default-source/sustainable-finance/165_sfdr-factsheet--new-esg-disclosure-requirements.pdf?sfvrsn=ec986007_4

Most recently, in June 2022, the European Parliament and Council reached a provisional agreement on the Corporate Sustainability Reporting Directive (CSRD), which significantly updates and strengthens the NFRD by (among other things) expanding its scope to more companies and introducing more detailed reporting requirements.[110] The CSRD "envisages the adoption of EU sustainability reporting standards," which would be developed by the European Financial Reporting Advisory Group (EFRAG).[111] To-date, the EFRAG has published two reports: one proposing a roadmap for developing these standards and a second suggesting reforms to the EGRAG's governance model.[112] The roadmap itself is more than 200 pages long and sets forth more than 50 proposals relating to the creation of the standards.[113] While a full discussion of this roadmap is beyond the scope of this article, it is worth noting that the model:[114]

- contemplates a principles-based approach that would meet the needs of an inclusive range of stakeholders;

- envisions a "building block" approach that builds upon and contributes existing reporting initiatives;

- incorporates the concept of "double materiality," which focuses on both impact materiality (identifying matters that materially impact a company's operations and value chain) and financial materiality;

- Contemplates reporting on environmental, social, and governance topics;

- Anticipates a phased approach, with the development of an initial set of standards for reporting years 2023 and 2024.

Consistent with its building block approach, the EFRAG has met with representatives of many of the major reporting frameworks – including the CDP/CDSB, GRI, IFRS, SASB/IIRC, WEF, and TCFD.[115] While the EFRAG generally has not detailed how most such frameworks could be incorporated into its model, there is one notable exception. Indeed, the report specifically stated that certain topics are more mature and thus ripe to be included in the first set of standards, noting that this "is particularly the case for climate-related disclosures, for which

[110] https://ec.europa.eu/info/publications/210421-sustainable-finance-communication_en#csrd
[111] https://ec.europa.eu/info/business-economy-euro/company-reporting-and-auditing/company-reporting/corporate-sustainability-reporting_en#standards
[112] https://ec.europa.eu/info/publications/210308-efrag-reports_en
[113]https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/210308-report-efrag-sustainability-reporting-standard-setting_en.pdf
[114]https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/210308-report-efrag-sustainability-reporting-standard-setting_en.pdf
[115]https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/210308-report-efrag-sustainability-reporting-standard-setting_en.pdf

the TCFD recommendations are widely supported by policymakers, users and preparers." [116]

Factors to Consider When Selecting a Voluntary Reporting Framework

Given nearly a dozen voluntary reporting frameworks, one set of reporting requirements that may be implemented by the U.S. SEC, and a potentially new set of reporting requirements yet to be articulated in Europe, organizations are left with a key question: which voluntary reporting frameworks should they use? For better or worse, there is no simple or universal answer to this question. Rather, organizations will need to consider what makes the most sense given their specific circumstances. That said, there are a number of considerations that can help narrow down the choices.

First, an organization should consider whether it wishes to report primarily on environmental issues, or whether it wants to focus on social and governance topics as well. The answer to this question will be informed by what disclosures an organization's stakeholders (investors, employees, customers, etc.) are most interested in. The answer may also be influenced by its regulatory jurisdiction – companies that will be likely be covered by the EU's Corporate Sustainability Reporting Directive may want to work to begin reporting on ESG issues more broadly and consider the frameworks established by GRI, IIRC/SASB, and/or WEF (which focus on a full panoply of environmental, social, and governance issues).

Second, an organization may wish to consider what frameworks have been utilized by similar companies in its industry. This can provide guidance regarding what frameworks have worked for similar organizations in the past.

Third, an organization should consider whether potential reporting frameworks appear to be aligned with its business. Certain frameworks have reporting requirements tailored towards particular industries (banking, energy, transportation, etc.). An organization may benefit from using a framework designed for its specific business.

Fourth, to the extent that an organization is likely to be subject to reporting regulations, it may wish to consider utilizing a framework that will likely undergird the upcoming regulatory reporting requirements. For example, the SEC has stated that its proposed rule is based on the TCFD and GHG protocols. And, the EU's existing NFRD guidance involved consultations with the CDP, CDSB, GRI, SASB, and TCFD,[117] while its 2019 guidelines specifically integrated the TCFD's recommendations[118] and its report on the upcoming EU Sustainability Standards

[116]https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/210308-report-efrag-sustainability-reporting-standard-setting_en.pdf
[117] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52017XC0705(1)
[118] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52019XC0620(01)

noted that the TCFD's climate-related disclosure recommendations "are widely supported by policymakers, users and preparers." [119]

Fifth, although certain standards are being retired in the move towards consolidation, the IFRS has stated that it intends to build the ISSB standards off the CDSB, IIRC, SASB, TCFD, and WEF frameworks.[120] Thus, organizations that use these frameworks now might have a head start when it comes to ISSB reporting in the future.

Finally, organizations should remember that choosing reporting frameworks does not have to be mutually exclusive. Several frameworks have focused on ways to work together. For example, the CDSB and SASB have jointly released a TCFD Implementation Guide.[121] And, the CDP, CDSB, GRI, IIRC, and SASB have published a prototype climate-related financial disclosure standard to illustrate how their five standards could be used in tandem.[122] Indeed, many companies report with the help of multiple frameworks.[123]

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Given the number of different potential ESG-related reporting frameworks, organizations might be tempted to hold off on reporting until a dominant standard emerges. That, however, is unlikely to be a viable option. There is no telling when, or even if, a single reporting framework will become dominant. And, stakeholders and regulators already expect companies to report on a variety of ESG-related topics and investors looking for such information to make informed investment decisions. Clearly, the time to begin ESG reporting is now. And, as this article hopefully demonstrates, companies have many viable options for doing so.

[119]https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/210308-report-efrag-sustainability-reporting-standard-setting_en.pdf
[120] https://www.ifrs.org/news-and-events/news/2021/11/ifrs-foundation-announces-issb-consolidation-with-cdsb-vrf-publication-of-prototypes/
[121] https://www.cdsb.net/tcfd-implementation-guide
[122] https://29kjwb3armds2g3gi4lq2sx1-wpengine.netdna-ssl.com/wp-content/uploads/Reporting-on-enterprise-value_climate-prototype_Dec20.pdf
[123] https://www.goldmansachs.com/a/2021-sustainability-report.pdf (discussing Goldman's use of CDP, SASB, and TCFD frameworks in its reporting).