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ALERTS

ISSB's Inaugural Sustainability Disclosure Standards Put The Spotlight On Scope 3 Emissions In The U.S.

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Highlights

The ISSB has approved sustainability disclosure standards that will be issued in June 2023 and become effective in 2024

The portion of the ISSB standards that phase in requirements for disclosure of Scope 3 emissions ups the ante considerably for the U.S.

As the world moves forward with the ISSB standards, including Scope 3 emissions, the U.S. needs to act quickly and decisively to keep up

ISSB Puts the Pedal to the Metal

One of the major hot button ESG issues in recent times has been the lack of common, transparent and reliable standards for measuring environmental, social and governance (ESG) performance or comparing performance within or across sectors. In an effort to fill this gap globally, at the UN Climate Change Conference in November 2021, the International Financial Reporting Standards Foundation (IFRS) announced the creation of the International Standards Sustainability Board (ISSB).

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The ISSB was formed in response to international investors' demand for "high-quality, transparent, reliable and comparable reporting by companies on climate and other environmental, social and governance matters." The ISSB was tasked with developing a comprehensive global baseline of sustainability related disclosure standards that provide investors and other capital market participants with information about companies' risks and opportunities to help them make informed decisions.

At the ISSB meeting on Feb. 16, 2023 – just 15 months after its launch – the members agreed on the final technical content of its first two draft Sustainability Disclosure Standards:

- Exposure Draft IFRS S1 – General requirements for disclosure that prescribe the core content for complete sustainability related financial disclosures for investors to assess companies' value

- Exposure Draft IFRS S2 - Climate-related Disclosures, which seek to generate comparable climate-related disclosures, consistent with existing standards and frameworks, and particularly the Task Force on Climate-Related Financial Disclosures (TCFD) recommendations.

According to the ISSB's statement, its members unanimously approved entering the thorough drafting and formal balloting process (standard review before formal publication), ahead of expected issuance of the standards at the end of Q2 2023.

The ISSB further agreed that S1 and S2 would become effective quickly, starting January 2024, in response to "the strong demand from investors for companies globally to disclose comprehensive, consistent and comparable sustainability-related information." This would require reporting in 2025 on information collected for 2024. Because adoption of the ISSB standards is subject to approval by each jurisdiction, the first application and reporting dates could differ from country to country.

The ISSB also voted to include references to the Global Reporting Initiative Standards and the European Sustainability Reporting Standards as sources of guidance for companies to consider when applying the general sustainability reporting standard in the absence of a specifically applicable ISSB guideline.

The ISSB's work is backed by the G7, the G20, IOSCO, the Financial Stability Board, African Finance Ministers and Finance Ministers and Central Bank Governors from over 40 jurisdictions. While there has been some criticism of the ISSB standards, expectations are that many of the 150 countries that follow the IFRS will adopt them.

ISSB's Action Puts the Spotlight on Scope 3 Emission Disclosures in the U.S.

Notwithstanding its support of the ISSB standards via the G7 and G20, the U.S. may find itself at odds with the ISSB – and potentially much of the rest of the world – on disclosure requirements for Scope 3 emissions. Scope 3 covers indirect emissions that occur within a company's value chain (e.g., upstream via suppliers and raw materials, or downstream through use and disposal of products). For many companies, Scope 3 emissions are the majority of their greenhouse gases (GHG) impact.

As expected, the final version of ISSB's initial standards include disclosure of Scope 3 emissions, when material, in addition to Scope 1 (direct emissions from a company) and Scope 2 (indirect emissions from electricity purchased and used). Disclosures on material categories of Scope 3 emissions will be based on application of the current version of the GHG Protocol Corporate Standard.

In the U.S., potential requirements for disclosure of Scope 3 emissions have become one of the most controversial and hotly disputed aspects of the SEC's proposed climate-related disclosure rule, which is expected to be finalized this spring shortly before issuance of the final initial ISSB standards. Various politicians and interest groups have continued to weigh in on both sides of this issue long after the SEC's formal comment period ended.

The ISSB's formal confirmation that its standards will include Scope 3 emission disclosures ups the ante considerably for the U.S. The rest of the world is moving rapidly toward a set of consistent baseline standards for climate and sustainability disclosures to protect investors that include Scope 3 emissions. If the SEC chooses not to follow suit, the U.S. could find itself isolated as an outlier, the U.S. capital markets may become less equitable, and U.S. investors may be left without sufficient protection.

The ISSB's approach to the feedback on its initial proposal to include Scope 3 emission disclosures provides a practical model for SEC consideration. While support for inclusion of Scope 3 emissions in the ISSB standards was more favorable overall than the public reaction to the Scope 3 provisions in the proposed SEC rule, some concerns paralleled those related to the SEC. These focused on the lack of reliable identification, tracking, and measurement methodologies and dearth of high quality Scope 3 data. In response, among other relief provisions included in the final version, the ISSB provided for a minimum one-year extension of the effective date of the Scope 3 disclosure requirements to address the transitional challenges associated with data availability. The ISSB also committed to develop implementation guidance and a framework for measuring Scope 3 emissions to address persistent data quality issues. (The ISSB considered and rejected the alternative of limiting Scope 3 emission disclosure requirements to Tier 1 suppliers only.)

SEC adoption and incorporation of these same types of relief provisions in the final climate rule would go a long way toward addressing the objective concerns of commenters regarding the Scope 3 disclosure requirements. Doing so would allow time, and provide a structure for reporting parties and those in their value chains, to make the transitions necessary and implement the technology that may be required to collect and measure Scope 3 emission data and prepare disclosures recording Scope 3 emissions that are material to their business operations. To facilitate those efforts, the U.S. could take advantage of the ISSB's ongoing initiative to engage on the interoperability of individual countries' standards with the ISSB's global baseline standards.

Bottom line, the ISSB's standards reflect a growing international consensus on the need for comprehensive disclosure of sustainability related information, including Scope 3 emissions. The anticipated adoption of these standards by major countries and financial markets, including the EU and UK, only highlights the importance of these issues and the need for consistent, standardized approaches. As the world moves forward with the ISSB standards, the U.S. needs to act quickly and decisively to keep up.

For more information, please contact the Barnes & Thornburg attorney with whom you work or Bruce White at 312-214-4584 or bwhite@btlaw.com.