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March 10, 2024

The SEC's Climate Disclosure Rule

The SEC (in a 3-2 vote) has approved new climate disclosure rules that are less stringent than the initial proposal, focusing on how public companies should report climate risks and greenhouse gas emissions. The revised rules require large companies to disclose emissions from their operations if deemed "material," but have eliminated the requirement to report Scope 3 emissions across their value chain. Smaller businesses are largely exempt from GHG reporting, a change from the original proposal that sought disclosures from all publicly traded companies. You can find the SEC's fact sheet summarizing the rule's key provisions here. Additionally, numerous law firms, consulting firms, and Fintechs have put out their own guides to the new rules as well.

The SEC Disclosure rule requires registrants to disclose board and management oversight and material climate related impacts and risks. Larger registrants will also be required to report Scope 1 and 2 GHG emissions *if they are deemed by the company to be material*, which eventually will be subject to certain assurance requirements. Also, if registrants have undertaken risk mitigation/transition activities, set climate-related targets/goals, used scenario analysis to determine climate risks are likely to be material, or used internal carbon prices in a material way, they will be required to disclose details regarding these issues as well. The rules further require certain financial statement disclosures related to the costs of severe weather events, subject to de minimis thresholds. A number of aspects of the final rule are built on the TCFD reporting framework and the GHG protocol.

Some key differences between the final SEC rule and the Commission's original proposal include: (1) eliminating a Scope 3 reporting requirement; (2) tying Scope 1 and 2 reporting to a company's determination that the information is material; (3) eliminating a requirement to report on board members' climate experience; (4) softening the disclosure of the impact of severe weather, transition activities, and natural conditions so that it does not need to appear in each line item of the company's financial statement; (5) allowing companies to report climate information later in the year (at the time of their second quarter reports); (6) elimination of a quarterly update requirement; and (7) additional phase-in flexibility.

Despite the SEC's compromises when adopting the final climate disclosure rule, a coalition of 10 republican led states have sued the Commission to overturn the rule -- filing a petition in the 11th Circuit Court of Appeals in Atlanta. When the Commission's staff was asked whether the SEC rule would preempt the recent California climate disclosure legislation, they responded that the rule does not expressly preempt state climate rules -- but whether implied preemption could apply would be determined by the courts on a case-by-case basis.

More Regulation and Reporting

Ropes & Gray has reported that several U.S. states have introduced anti-ESG legislation and that legislative activity has increased over the past year, with 61 pending anti-ESG bills (many in such states as Oklahoma, South Carolina, Missouri, and West Virginia). Still, a number of bills are facing opposition, leading to watered-down versions or failure in courts. In light of such legislation, asset managers are advised to be measured and careful in communications with state officials, respond thoughtfully to even innocuous seeming inquiries, and to understand their contractual obligations amidst varying state and federal laws.

The integration of ESG metrics into executive pay incentives has surged, with 76% of S&P 500 companies incorporating at least one ESG metric into their incentive plans according to Willis Tower Watson. This represents a 14% increase since 2020. Approximately 70% of these companies report metrics on Human Capital (the most widely used ESG category), while the incorporation of climate and environmental metrics into incentive compensation has increased to 44% from 12% in the last three years. According to the report, this rise is driven by regulatory pressures, including climate risk disclosure mandates in regions such as Europe and California. Additionally, "'many companies still believe that these factors are important business priorities: keeping employees safe, engaged and productive; better customer satisfaction; maintaining a good relationship with the community that is their customer base; stronger governance of risk; creating more sustainable products for their customers.'"

Investing

MSCI's recent research highlights that companies with high MSCI ESG Ratings have outperformed lower-rated companies primarily due to stronger earnings fundamentals. The study further found that focusing on financial materiality relating to industry-specific risks has helped to identify firms that outperform the market on a risk-adjusted basis. According to MSCI, despite differing opinions as to which specific E, S, G issues matter most, considering these issues together has added value over time. The study also found that exposure to companies with high ESG ratings aided performance during two recent crises – the Covid pandemic and the outbreak of the Russia-Ukraine war.

ISS ESG conducted its inaugural ESG Corporate Rating Survey of institutional investors, corporate sustainability departments, and consultants. Key findings include: (1) a significant emphasis on the EU Taxonomy for ESG Corporate Rating methodology; (2) a strong view that double materiality is relevant to their business; (3) a belief that analyst opinions, ESG letter grades, and ESG performance scores are the most useful Corporate Rating measurements; (4) a view that climate change, audit risk and oversight, and worker health and safety are the top three most relevant topics across sectors.

The New York State Common Retirement Fund (CRF) will divest and restrict approximately $26.8 million in bonds and equities from eight integrated oil and gas companies, including ExxonMobil. The divestments/restrictions are based on fund's assessment that the companies are not sufficiently ready for the energy transition and follow similar steps taken in 2023 with regard to 50 additional companies. Additionally, the CRF is doubling its investment in the Sustainable Investments and Climate Solutions program to $40 billion by 2035, after announcing that it had hit its initial $20 billion target.

Resources & Membership

You can now watch a video replay of our March 1st panel on "Promoting Sustainability, Equity, and the Freedom to Invest in Today's Environment." Learn how investors are responding to attacks on the ability to consider environmental, social, governance, diversity, and other sustainability-related issues, and why they see protecting the freedom to invest as critical to the capital markets. Speakers include Steven Rothstein (Managing Director, Ceres Accelerator for Sustainable Capital Markets); Rachel Robasciotti (Founder & CEO, Adasina Social Capital); Heidi Ridley (Co-Founder & CEO, Radiant Global Investors); and Rachel Kahn-Troster (Executive Vice President, Interfaith Center for Corporate Responsibility).

Finpublica's **membership portal** is live. If you are interested in joining a community more than 300 finance leaders from 25 countries focused on sustainable finance and ways to implement initiatives inside and outside their organizations, we invite you to apply.

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