

## **ISSB Sustainability Reporting Standards and Certain Jurisdictional Observations**

On June 26, 2023, the International Sustainability Standards Board (“ISSB”), an organization established by the IFRS Foundation to develop sustainability standards, issued two sustainability reporting standards — IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information* (“IFRS S1”) and IFRS S2 *Climate-related Disclosures* (“IFRS S2”, and, collectively with IFRS S1, the “ISSB Standards”).

This article considers the scope of IFRS1 and IFRS2 and the extent of their interoperability both with pre-existing standards and with various jurisdictions’ approaches to sustainability standards (with a particular spotlight on the ongoing rulemakings in this area being introduced by the US, Canada, the UK and the EU).

### **1. IFRS S1 and IFRS S2**

The ISSB Standards require a reporting entity to disclose information about its sustainability-related and climate-related risks and opportunities as part of such entity’s general purpose financial reports.

#### **(1) *IFRS S1***

##### **A. Structure of IFRS S1**

IFRS S1 sets out the overarching requirements on a set of sustainability-related financial disclosures that a reporting entity is required to provide to users of its financial reports. IFRS S1 comprises six parts, namely (i) objective, (ii) scope, (iii) conceptual foundations, (iv) core content, (v) general requirements, and (vi) judgements, uncertainties and errors, and five appendices.

Two supporting resources accompany IFRS S1, but they are not part of it. One provides illustrative guidance (especially on understanding of SASB Standards and CDSB Framework) and illustrative examples (on applications of SASB Standards). The other is about basis for conclusions and presents background and considerations of IFRS S1.

##### **B. Objective and Scope**

The objective of IFRS S1 is to require a reporting entity to disclose information about its sustainability-related risks and opportunities, so that users of the entity’s financial reports can have a full picture about how the entity’s interactions with its stakeholders, society, the economy and the natural environment throughout its value chain could reasonably be expected to affect the entity’s cash flows, its access to finance or cost of capital over the short, medium or long term (referred to as the entity’s “prospects”).

With respect to scope, IFRS S1 only covers sustainability-related “financial information”, namely sustainability-related risks and opportunities that could reasonably be expected to affect an entity’s prospects. A reporting entity is required to apply IFRS S1 in preparing IFRS S2 and any future specific IFRS sustainability disclosure standards.

##### **C. Conceptual Foundations**

For sustainability disclosure to be useful, a reporting entity is required to provide fair presentation, material information and connected information of the same reporting entity that reports financial statements. Under the ISSB Standards, information is **material** if omitting, misstating or obscuring that information could reasonably be expected to influence decisions that primary users (mostly investors, also including lenders

and other creditors) of general-purpose financial reports make on the basis of the reporting entity's financial statements and sustainability-related financial disclosures.

## **D. Core Content**

The core content that a reporting entity is required to disclose under IFRS S1 includes four aspects: governance, strategy, risk management, and metrics and targets, which aligns with the disclosure structure required under the Taskforce on Climate-related Financial Disclosures (TCFD) recommendations. This may facilitate interoperability because, in practice, some public companies, asset managers and other organizations in various jurisdictions have already voluntarily made TCFD disclosures, and certain jurisdictions such as the UK, the EU, and New Zealand have announced policies requiring TCFD-aligned disclosures.

## **E. Source of Guidance**

In identifying sustainability-related risks and opportunities to be disclosed under IFRS S1, companies are **required** to apply IFRS sustainability disclosure standards (such as IFRS S2 for climate-related disclosures) and the SASB Standards (which cover 77 industries), while they are **allowed** to consider CDSB Framework Application Guidance (for water-related and biodiversity-related disclosures), the Global Reporting Initiative (GRI) Standard, the European Sustainability Reporting Standards (ESRS), the most recent pronouncements of other standard-setters, and risks and opportunities identified by peers in the same industry(s) or geographical region(s).

Among the above sources, SASB Standards are organized by industry. Each SASB Standard contains industry descriptions, disclosure topics, metrics, technical protocols and activity metrics.

### **(2) IFRS S2**

#### **A. Structure of IFRS S2**

IFRS S2 sets out the specific requirements on climate-related financial disclosures that a reporting entity is required to provide to users of its financial reports. IFRS S2 comprises three parts, namely (i) objective, (ii) scope, and (iii) core content, and three appendices. IFRS S2 does not contain specific parts on conceptual foundations, general requirements, judgements, uncertainties and errors, but a reporting entity is required to refer to these parts provided in IFRS S1. For example, when deciding whether to disaggregate greenhouse gas ("GHG") emissions under IFRS S2, an entity is required to apply the principles of aggregation and disaggregation set out in IFRS S1.

Two supporting resources accompany IFRS S2, but they are not part of it. One provides illustrative guidance (on cross-industry metric categories), illustrative examples (on aggregation and disaggregation of GHG emissions), and an introduction to Industry-based Guidance on Implementing IFRS S2 (which is published in 68 separate volumes and is derived from SASB Standards). The other is about basis for conclusions and presents background and considerations of IFRS S2.

#### **B. Objective and Scope**

Similar to IFRS S1's objective, IFRS S2 also targets at requiring a reporting entity to disclose useful information that could reasonably be expected to affect the entity's prospects, but IFRS S2 specifically focuses on climate-related risks and opportunities.

With respect to scope, IFRS S2 covers climate-related physical risks and transition risks an entity is exposed to, as well as climate-related opportunities available to the entity.

## C. Core Content

Similar to IFRS S1, IFRS S2 also derives its core content from TCFD recommendations and therefore includes four aspects: governance, strategy, risk management, and metrics and targets. Most of the requirements are similar to IFRS S1, except for certain climate-related variations.

In particular, the parts about strategy and metrics have significant climate-related specific requirements. For example:

- with respect to strategy, a reporting entity is required to (i) use climate-related scenario analysis to assess climate resilience, (ii) consider the applicability of the industry-based disclosure topics and metrics and cross-industry metric categories, (iii) disclose its current and anticipated changes to business model, current and anticipated direct and indirect mitigation and adaptation efforts, climate-related transition plan, and plans to achieve climate-related targets, and (iv) disclose expected changes to its financial performance and cash flows given its strategy to manage climate-related risks and opportunities.
- With respect to metrics, a reporting entity is required to disclose information relevant to the cross-industry metric categories of (i) greenhouse gases (scope 1, scope 2 and scope 3) measured in accordance with the Greenhouse Gas Protocol, (ii) climate-related physical risks, transition risks, and opportunities, (iii) capital deployment, (iv) internal carbon prices, and (v) impact on executive remuneration. For disclosure of industry-based metrics, an entity is required to refer to the Industry-based Guidance on Implementing IFRS S2.

## D. Relationship to IFRS S1

IFRS S2 relates specifically to climate-related risks and opportunities and complements the overarching requirements in IFRS S1. However, to avoid unnecessary duplication with IFRS S1, if an entity's oversight of sustainability-related risks and opportunities is managed on an integrated basis, instead of providing separate disclosures for each risk and opportunity, the entity may provide integrated governance disclosures and integrated risk management disclosures in its IFRS S1 report and add corresponding cross-references in its IFRS S2 report.

### (3) Targeted Exemption

IFRS S1 permits a reporting entity to omit certain information in limited circumstances where such information is (i) about sustainability-related **opportunities**, (ii) commercially sensitive, (iii) not already publicly available, and (iv) impossible to be disclosed at an aggregated level or in any other manner without omission. This exemption also applies to information about climate-related **opportunities** in IFRS S2.

## 2. Interoperability with Existing Standards

To end the “alphabet soup” of sustainability reporting, the ISSB Standards consolidated and inherited market-leading investor-focused sustainability-reporting initiatives, such as the TCFD recommendations, SASB Standards, and CDSB Framework.

- The ISSB Standards fully incorporated the TCFD recommendations, which have already been adopted in some jurisdictions and by some businesses worldwide. On July 6, 2023, the Financial Stability Board asked the IFRS Foundation to take over TCFD monitoring responsibilities from 2024. On July 24, 2023, the IFRS Foundation published a comparison between IFRS S2 and the

TCFD recommendations, which indicated that companies applying the ISSB Standards will meet the TCFD recommendations, although IFRS S2 has more requirements in addition to the TCFD recommendations.

- The ISSB Standards also built on the work of SASB Standards. Specifically, IFRS S1 requires a reporting entity to consider SASB industry-specific topics and metrics in absence of a specific ISSB standard. As for IFRS S2, the accompanying Industry-based Guidance on Implementing IFRS S2, which contains climate-related topics and metrics, is derived from SASB Standards. Effective August 1, 2022, the Value Reporting Foundation – home to SASB Standards – was consolidated into the IFRS Foundation, and SASB Standards were since under the oversight of the ISSB. In June 2023, the ISSB released updated SASB Standards to align the climate-related topics and metrics with IFRS S2.
- According to IFRS S1, a reporting entity is allowed to consider CDSB Framework Application Guidance for water-related and biodiversity-related disclosures. Effective January 31, 2022, CDSB was consolidated into the IFRS Foundation.

In addition to the above investor-focused reporting initiatives, the ISSB Standards also allow a reporting entity to consider stakeholder-focused sustainability-reporting initiatives (such as the GRI Standard) in identifying sustainability-related risks and opportunities to be disclosed under IFRS S1. On the other hand, if a reporting entity plans to meet more stakeholders’ needs than merely investors’, it may choose to report in accordance with the ISSB Standards to disclose financially material sustainability information and then refer to stakeholder-focused reporting initiatives such as the GRI Standard to add more building blocks relating to the entity’s external impacts.

### **3. Interoperability with Certain Jurisdictional Regulations**

#### ***(1) In General***

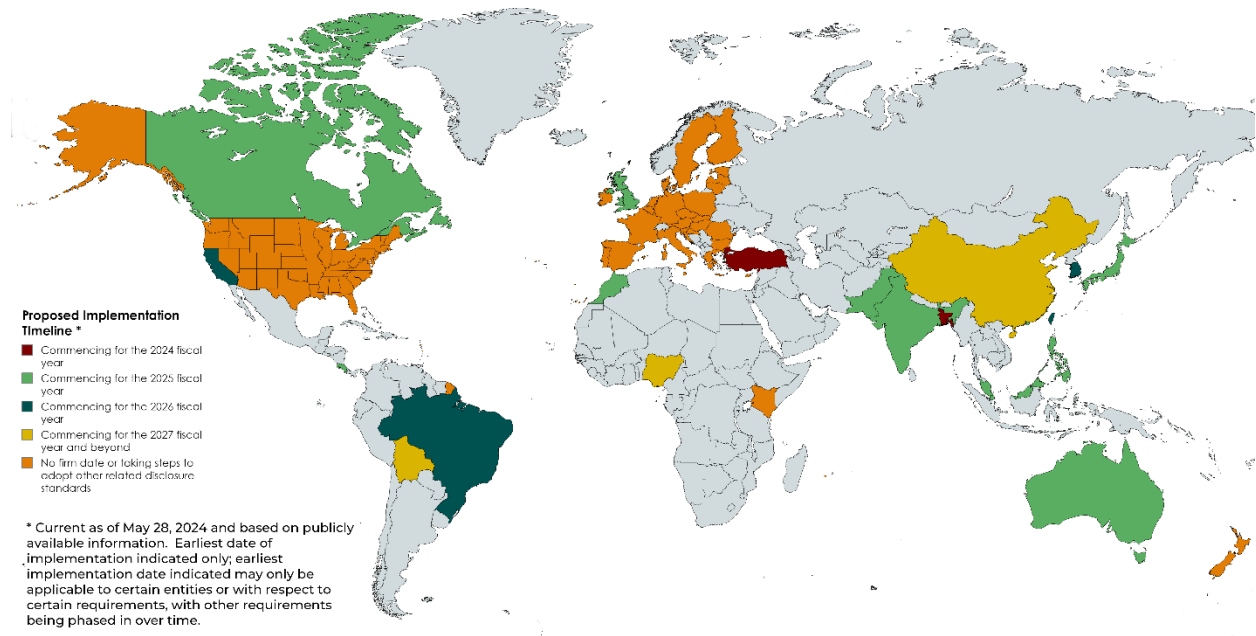
Because the sustainability reports will be part of an entity’s financial reports to complement its financial statements, the ISSB Standards use certain accounting concepts and requirements that are consistent with the conceptual framework of IFRS accounting standards. However, the ISSB Standards are intended for entities all over the world, whether such entities apply IFRS accounting standards, US GAAP or otherwise. While the ISSB Standards mainly focus on an entity’s sustainability-related information useful for investors to be presented as part of financial reports, jurisdictional regulations may cover a broader base of stakeholders and may require disclosures separate from financial reports. As a general rule, to the extent a jurisdictional regulation also requires an entity to disclose sustainability-related information in its financial reports, according to IFRS S1, the entity is:

- permitted to include non-material information if required under jurisdictional regulation;
- required to disclose material information even if not required under jurisdictional regulation; and
- allowed not to disclose material information if prohibited under jurisdictional regulation.

Currently, business entities may voluntarily apply the ISSB Standards. It would be up to individual jurisdictions to decide whether to make applying such standards mandatory. Before finalizing the ISSB Standards, the ISSB considered feedback from securities regulators of various jurisdictions and the International Organization of Securities Commissions (IOSCO). On July 25, 2023, IOSCO endorsed the ISSB Standards as a “global framework of investor-focused disclosures on sustainability- and climate-related risks and opportunities” fit for capital markets’ use, and called on its over 130 member jurisdictions worldwide to “adopt, apply or otherwise be informed by” the ISSB Standards. In July 2023, the IFRS Foundation issued an Adoption Guide overview to support jurisdictions in their adoption of the ISSB Standards. In May 2024, the IFRS Foundation published the Inaugural Jurisdictional Guide for the adoption or other use of ISSB Standards (the “Jurisdictional Guide”) and the Regulatory Implementation Programme

Outline, highlighting the importance of comparable sustainability-related disclosures between entities and jurisdictions and elaborating how the ISSB Standards can help jurisdictions reduce regulatory fragmentation.

On May 28, 2024, the ISSB announced that more than 20 jurisdictions have decided to use or are taking steps to introduce the ISSB Standards in their legal or regulatory frameworks, which jurisdictions together account for: (i) nearly 55% of global GDP; (ii) more than 40% of global market capitalization; and (iii) more than half of global greenhouse gas emissions. The below infograph depicts certain jurisdictions worldwide that have so far implemented or proposed implementing standards that specifically adopt the ISSB Standards and their proposed effective dates.



There is variance in the approaches being taken by jurisdictions across the world. For example, as discussed in further detail in later sections of this article, the UK and Canada have taken steps to implement standards based on the ISSB Standards, while the US and EU are taking somewhat different routes. The following table specifically zooms in from the above infograph the proposed implementation dates of those four jurisdictions.

Jurisdiction	Primary Rule -Making Body(ies)	Rule(s) / Proposed Rule(s)	Proposed Implementation Date(s)
United States	U.S. Securities and Exchange Commission (SEC)	“Climate Rules” (through rule changes to the Securities Act of 1933 and the Securities Exchange Act of 1934)	Disclosure for larger reporting entities could start in 2026 (for information related to fiscal year 2025). However, the SEC voluntarily stayed the Climate Rules pending completion of judicial review
		“ESG Proposal” (proposedly through rule changes to the Investment Advisers Act of 1940 and the Investment Company Act of 1940)	Slated for final adoption in 2024. Proposedly, compliance with disclosure requirements would be 12 – 18 months following effectiveness
	California Senate / State Air Resources Board (California) (SARB)	“Climate Corporate Data Accountability Act” (Senate Bill No. 253)	Disclosures required starting in 2026 on a date to be determined by SARB
		“Climate-Related Financial Risk Act” (Senate Bill No. 261)	Disclosures required starting on or before January 1, 2026

Jurisdiction	Primary Rule -Making Body(ies)	Rule(s) / Proposed Rule(s)	Proposed Implementation Date(s)
Canada	Canadian Sustainability Standards Board (CSSB)	Canadian Sustainability Disclosure Standards (CSDS) Proposed Criteria for Modification Framework	Disclosures required starting in 2026 (for reporting periods starting January 1, 2025)
	Canadian Securities Administrators (CSA)	National Instrument 51-107 - <i>Disclosure of Climate-related Matters</i> and companion policy	Currently halted pending completion of the CSSB's consultation
	Office of the Superintendent of Financial Institutions (OSFI)	Guideline B-15: Climate Risk Management	Guideline B-15 currently in force; updates related to ISSB Standards effective for the fiscal year-end 2024
United Kingdom	UK government	The Companies (Strategic Report) (Climate-related Financial Disclosure) Regulations 2021 (amending the Companies Act 2006)	In effect since April 6, 2022
	Government for UK registered companies and limited liability partnerships Financial Conduct Authority (FCA) for UK listed companies	UK Sustainability Disclosure Standards (UK SDS)	Disclosures required for financial years on / after January 1, 2025
	Financial Conduct Authority (FCA)	Final Policy Statement (PS23/16) (UK SDR)	Staggered implementation starting on May 31, 2024
European Union	European Commission European Financial Reporting Advisory Group (EFRAG)	Corporate Sustainability Reporting Directive (CSRD) (forming part of the EU's Sustainable Finance Package, and updates the EU's 2014 Non-Financial Reporting Directive (NFRD)) European Sustainability Reporting Standards (ESRS)	NFRD currently in force; CSRD to be applied for the 2024 fiscal year (audited reports to be published in 2025)

The sections below introduce sustainability-related rulemakings in the US, Canada, the UK and the EU one by one and analyse their respective interoperability with the ISSB Standards.

## (2) ISSB Standards vs. US SEC's Rulemakings

On March 6, 2024, the U.S. Securities and Exchange Commission ("SEC") promulgated rule changes to the Securities Act of 1933 and the Securities Exchange Act of 1934 to enhance and standardize climate-related disclosures by SEC-registered public companies and in public offerings (the "Climate Rules"), according to which, the first disclosures are due for larger registrants as early as 2026 (covering information related to fiscal year 2025). However, as discussed further below, the Climate Rules have been recently voluntarily stayed by the SEC in the face of pending litigations challenging the rules on various grounds.

Similar to the ISSB Standards (in particular, IFRS S2), the Climate Rules feature TCFD-based framework, Greenhouse Gas Protocol-aligned scopes concept and methodology, and single materiality, and is also investors-focused. However, there are many differences, for example:

- Different from IFRS S1, the Climate Rules do not cover sustainability-related information other than climate (although governance disclosure is required with respect to board oversight and management oversight of climate-related risks).
- The Climate Rules focus more on climate-related risks, less on climate-related opportunities (disclosure regarding opportunities is voluntary).
- The Climate Rules do not require disclosure of scope 3 GHG emissions.
- Only certain larger registrants are required to disclose GHG emissions (including scope 1 and scope 2 emissions, and only if those emissions are material), subject to a phase-in assurance timetable.
- In addition to integrating climate-related disclosures into financial statements, reporting entities are required to disclose climate-related information in their registration statements and annual reports.



The SEC will consider whether to explore interoperability with the ISSB Standards and jurisdictional climate reporting requirements after observing how the other reporting practices develop.

The Climate Rules streamlined certain requirements as compared to the 2022 proposed rules. However, right after the rules' adoption, nine petitions were filed in courts seeking review of the Climate Rules. Among them, seven petitions were filed by Republican states, pro-business non-profits, energy companies, etc., alleging, among other things, that the Climate Rules went beyond the SEC's statutory authority, ran afoul of First Amendment limitations on compelled speech, were procedurally flawed, arbitrary and capricious, and therefore should be overturned; while two petitions were filed by environmental groups, alleging that the Climate Rules failed to mandate adequate disclosures to protect investors. On March 21, 2024, the nine petitions were consolidated to be under the review by the U.S. Court of Appeals for the Eighth Circuit. Subsequently, two more petitions were filed against the Climate Rules on similar grounds. On April 4, 2024, the SEC voluntarily stayed the Climate Rules pending the completion of judicial review of consolidated petitions, although the SEC clarified that it planned to vigorously defend the rules' validity in court. The stay and the pending litigations brought uncertainties as to the timing of effectiveness and the validity of litigated substantive requirements of the Climate Rules.

In addition to the Climate Rules, on May 25, 2022, the SEC proposed rule changes to the Investment Advisers Act of 1940 and the Investment Company Act of 1940 to enhance disclosures by certain investment advisers and registered funds about their ESG practices (the "ESG Proposal"). Similar to the ISSB Standards, the ESG Proposal focuses on providing useful information for investors. Also, similar to IFRS S1, the ESG Proposal covers all sustainability factors. Similar to IFRS S2, the ESG Proposal requires disclosures about GHG emissions, but only for ESG-focused registered funds. However, different from the ISSB Standards, the ESG Proposal would ask the advisers and funds to describe the ESG factors they consider, instead of requiring following industry-based SASB Standards. In addition, instead of integrating into general purpose financial reporting, the required sustainability-related disclosures under the ESG Proposal are specific to fund prospectuses, annual reports, adviser brochures and Form ADV, with structures and contents different from the ISSB Standards. According to the SEC's released regulatory agenda, the ESG Proposal is slated for the SEC's final adoption in 2024.

### ***(3) ISSB Standards vs. California's Recent Rulemaking***

On October 7, 2023, California Governor Gavin Newsom signed into law two climate disclosure bills, namely Senate Bill No. 253 (the "Climate Corporate Data Accountability Act" or "SB 253") and Senate Bill No. 261 (the "Climate-Related Financial Risk Act" or "SB 261"). Under SB 253, the State Air Resources Board ("SARB") will adopt regulations requiring U.S. public and private business entities doing business in California with total annual revenues exceeding \$1 billion to disclose to a climate reporting organization scope 1 and scope 2 GHG emissions starting in 2026 on a date to be determined by SARB and annually thereafter, and disclose scope 3 GHG emissions starting in 2027 and annually thereafter. Such GHG emission disclosures will be made publicly available by such organization. Under SB 261, SARB will adopt regulations requiring U.S. public and private business entities doing business in California with total annual revenues exceeding \$500 million to disclose TCFD-aligned climate-related financial risks (including both physical risks and transition risks) as well as mitigating and adapting measures, on or before January 1, 2026 and biennially thereafter. Reporting entities need to make such climate reports publicly available on their internet websites.

Similar to the ISSB Standards, SB 253 also follows the scope 1, scope 2 and scope 3 concepts and methodology under the Greenhouse Gas Protocol. However, more explicit than the ISSB Standards, SB 253 requires reporting entities to obtain independent third-party assurance of their public disclosure. To facilitate interoperability and minimize duplication of reporting effort, SB 253 allows a reporting entity to submit reports prepared pursuant to other national and international reporting requirements as long as they

satisfy requirements under SB 253. Furthermore, starting in 2033 and every five years thereafter, SARB will assess whether it is more effective to adopt a then globally recognized alternative accounting and reporting standard. In addition, SB 261 provides that reports prepared pursuant to the ISSB Standards or a law, regulation or listing requirement would satisfy the disclosure requirements under SB 261.

California is the first state in the U.S. that imposes mandatory requirements on GHG emission disclosures and climate-related financial risks reporting. Certain other states such as New York and Illinois have taken steps in adopting similar bills.

#### **(4) ISSB Standards vs. Canada’s Forthcoming CSSB Standards**

In Canada, steps to implement the ISSB Standards are currently underway. In June 2023, the Canadian Sustainability Standards Board (“CSSB”) was established, with the mandate of interpreting and supporting the implementation of the ISSB Standards in Canada. Both the Canadian Securities Administrators (“CSA”), the umbrella organization of Canada’s provincial and territorial securities regulators, and the Office of the Superintendent of Financial Institutions (“OSFI”), which supervises federally regulated financial institutions (FRFIs) and pension plans, have announced their support for the work of the ISSB.

In March 2024, the CSSB published two exposure drafts for comment: Canadian Sustainability Disclosure Standard (CSDS) 1, *General Requirements for Disclosure of Sustainability-related Financial Information* (“CSDS 1”) and Canadian Sustainability Disclosure Standard (CSDS) 2, *Climate-related Disclosures* (“CSDS 2”, and collectively with CSDS 1, the “CSSB Standards”). CSDS 1 and CSDS 2 are almost identical to IFRS S1 and IFRS S2, respectively, with the exception of certain extensions of effective dates and transition relief periods for certain reporting requirements.

In conjunction with CSDS 1 and CSDS 2, the CSSB released a consultation paper, *Proposed Criteria for Modification Framework*, which sets out the basis upon which the CSSB could modify the ISSB Standards when formulating Canadian standards based on them. To keep global sustainability reporting consistent across jurisdictions and to help foster interoperability, the CSSB has indicated that it will consider the need for changes from the ISSB Standards, particularly in cases where a change is required to ensure compliance with Canadian law or to serve the Canadian public interest, but that it will not depart from the ISSB Standards if there is no clear need to do so. While the current proposed deviations from the ISSB Standards currently appear minimal, the CSSB has kept the possibility open for additional revisions to accommodate Canada-specific considerations, including the rights of First Nation, Métis, and Inuit Peoples. Consultations are currently set to commence in late 2024.

The CSSB is soliciting public feedback on the proposed CSDS 1 and CSDS 2 and its Proposed Criteria for Modification Framework and is targeting to finalize its standards by the end of 2024. The CSSB Standards, if adopted as currently proposed, would take effect for the annual reporting period starting January 1, 2025, with transition relief for certain reporting requirements.

In order to become mandatory under Canadian securities legislation, the CSSB Standards would first need to be incorporated into applicable securities legislation. In October 2021, the CSA published proposed National Instrument 51-107 - *Disclosure of Climate-related Matters* (NI 51-17) and its companion policy, which set out proposed climate-related disclosure requirements applicable to reporting issuers in Canada (excluding investment funds). The CSA halted consultations on these proposals pending completion of the CSSB’s work. The CSA anticipates that once the CSSB consultation is complete and its standards finalized, the CSA will seek comment on updated climate-related disclosure requirements applicable to reporting issuers, which will take into consideration the final CSSB Standards and may include modifications considered appropriate for the Canadian capital markets. The CSA has also indicated that it would consider international developments, including with respect to the SEC’s climate-related disclosure rules. At this



time, the CSA only anticipates adopting provisions of the CSSB Standards that are necessary to support climate-related disclosures.

In March 2023, OFSI published Guideline B-15: Climate Risk Management, its first prudential climate-related framework, which sets out OFSI's expectations on climate-related risk management and disclosure by federally regulated financial institutions (FRFIs). At that time, OFSI had indicated its intent to update Guideline B-15 to align with the ISSB Standards and, in March 2024, OFSI released updates designed to align Guideline B-15 with the climate-related disclosure standards set out in IFRS S2. The requirements are effective starting for the fiscal year-end 2024, with the effective dates for certain types of FRFIs and certain types of disclosure requirements phased in over time thereafter. OFSI has indicated that it will continue to review and amend Guideline B-15 as practices and standards in Canada evolve.

### **(5) ISSB Standards vs. UK's Forthcoming SDS Standards**

The UK was the first G20 country to implement mandatory TCFD-aligned disclosures into domestic law through The Companies (Strategic Report) (Climate-related Financial Disclosure) Regulations 2021 ("CSCR 2021"), which amended the Companies Act 2006. From April 6, 2022, TCFD-aligned disclosures were mandatory for over 1,300 of the UK's largest registered companies and financial institutions.

The UK government is currently in the process of incorporating the new ISSB Standards into domestic law, by creating the UK Sustainability Disclosure Standards ("UK SDS"). The UK SDS will form the baseline for any future requirements relating to sustainability reporting in UK regulation and legislation, and will mirror the ISSB Standards, unless divergence from them is "absolutely necessary" for UK-specific matters. The intention is to create the UK SDS by July 2024.

Decisions to require disclosure under the UK SDS (on a mandatory basis) will be taken by the government for UK registered companies and limited liability partnerships ("LLPs") and by the Financial Conduct Authority ("FCA") for UK listed companies. However, both regulators have been strong supporters of the ISSB to date, and the FCA has already published a bulletin in which it confirms its plans to consult on the implementation of disclosure rules that are based on the UK SDS in the first half of 2024. Assuming the UK SDS are finalized by July 2024, the FCA intends to finalize its approach by the end of this year with the new requirements applying to financial years on/after January 1, 2025.

The UK's commitment to aligning with the global baseline is crucial to the interoperability between the UK SDS and ISSB Standards, and aids both decision-making of investors and the smooth running of capital markets within the UK. Further, as the FCA highlighted, *"even if companies may not be initially affected by ISSB requirements, they are likely to feature in the value chains of those who are. Being able to show alignment with, and understanding of, the standards is likely to confer some degree of competitive advantage"*.

In addition to the implementation of the UK SDS, on November 28, 2023, the FCA also published its final policy statement (PS23/16) relating to sustainability disclosure requirements and investment labels ("**UK SDR**"). This package of measures was created with the intention of helping consumers source genuine sustainable investment products within the market by ensuring that financial products that are marketed as sustainable are validated by supporting evidence. It comprised of, amongst other things: an anti-greenwashing rule applicable to all FCA-authorized firms when making sustainability-related claims about their services or products; requirements for distributors to ensure that product-level information is made available to customers; and four labels which help consumers understand the sustainability intention behind the products/services. The final policy statement for the UK SDR makes it clear that the FCA *"at every stage of forming these rules have sought to create international interoperability,"* as they have done in creating the UK SDS. Whilst the UK SDR focuses upon marketing of financial products rather than financial reporting, it mirrors the intentions behind the UK SDS and the wider movement towards a more

sustainable economy, demonstrating that varied yet complimentary regulations are necessary to achieve this.

## **(6) ISSB Standards vs. EU's ESRS**

In January 2023, the EU adopted its Corporate Sustainability Reporting Directive (“CSRD”) which forms part of the EU’s Sustainable Finance Package. In essence, most small and medium-sized enterprises (“SMEs”) and large companies operating in, or listed on, the EU market (including EU subsidiaries of non-EU companies) will be required to disclose (and have independently audited) their sustainability information. This transparency should assist investors and other stakeholders to better evaluate sustainability performance as well as business impacts and risks.

The CSRD aims to modernize and strengthen existing sustainability legislation, namely the EU’s 2014 Non-Financial Reporting Directive (“NFRD”). The main updates are as follows:

- Reporting requirements have been expanded to include environmental considerations.
- Unlike the NFRD, the CSRD specifies the format of disclosure and the standards that companies have to meet.
- Companies’ sustainability information will now be reported within their management reports (as an integral element of their general-purpose financial reporting) rather than in separate sustainability reports (as was the case under the NFRD).

As part of the CSRD, the European Commission adopted the first set of European Sustainability Reporting Standards (“ESRS”) on July 31, 2023. Similar to the ISSB Standards, ESRS features TCFD-based framework, covers climate and other sustainability-related information, and requires value-chain reporting, climate-related scenario analysis, and disclosure of scope 3 GHG emissions. Although the ISSB Standards and ESRS managed to achieve a high degree of alignment in terms of climate disclosures and investor-relevant information, significant differences exist between the two types of standards, for example:

- ESRS reflects “double materiality”, namely financial materiality and impact materiality, because it aims to provide information useful not only to investors, but also to business partners, trade unions and social partners, civil society and non-governmental organizations, governments, analysts and academics; while the ISSB Standards only focus on financial materiality, with information mainly useful to investors.
- The released standards under ESRS include not only general requirements and specific climate-related standards, but also specific standards on social matters, governance matters and certain other environmental matters; while the released ISSB Standards only include general requirements and climate-related standards.

On September 5, 2023, GRI and EFRAG (the entity that prepared the draft ESRS) published a joint statement on the high level of interoperability achieved between ESRS and the GRI Standard in relation to impact reporting. On November 30, 2023, they jointly made publicly available a draft “GRI-ESRS Interoperability Index,” illustrating the item-by-item correlations between the disclosure requirements under GRI and ESRS.

On May 2, 2024, the IFRS Foundation and EFRAG jointly published ESRS-ISSB Standards Interoperability Guidance, to reduce risks of duplication and confusion. In the meantime, the IFRS Foundation and GRI have indicated they will continue collaboration to deliver similar interoperability guidance.

The CSRD is to be applied in the 2024 fiscal year with audited reports ready for publication in 2025. As such, companies should already be seeking to take steps to ensure full compliance. Crucially, companies will need to establish whether they fall within the regulatory scope of the CSRD and begin collating the relevant data and reporting categories. Perhaps the most laborious issue will be the anticipated introduction of contractual terms relating to the provision of data from entities in their value chain.

It should be noted that the CSRD needs to be implemented by each Member State into its national laws which could create some divergence across the EU. For example, penalties for non-compliance of the CSRD are not yet concrete and may not be uniform throughout the EU. This is because Member States will have the discretion to introduce their own financial sanctions. Under the NFRD, undertakings and individual directors risked facing fines up to the higher of €10 million or 5% of the company's global annual turnover. Whilst it is anticipated that penalties will be similar to those imposed under the NFRD, a high level of divergence between Member States may adversely affect the purpose of the CSRD to create a common reporting framework.

## **Conclusion**

With the adoption of the ISSB Standards and the accelerated legislative activities in various jurisdictions, sustainability reporting is migrating worldwide from “soft laws” to “hard laws”. Failure to compliance would make investors unhappy, and also result in statutory penalties. Entities all over the world, particularly those doing business in multiple jurisdictions, are not only anticipating concurrent jurisdictional and cross-jurisdictional mandatory sustainability reporting and regulatory scrutiny, but also digesting an unavoidable reality that they have to navigate in the coming years or even now.

The ISSB Standards were formulated with joint efforts after soliciting public comments and seeking recommendations from existing sustainability-related standard setters, jurisdictional regulators and international organizations. This will help foster interoperability. On April 23, 2024, the ISSB announced that it will commence further research projects and assess necessity of building additional specific disclosure standards on nature (biodiversity, ecosystems, and ecosystem services) and human capital under the umbrella of IFRS S1. However, the ISSB's priority for the next two years will be supporting the implementation of IFRS S1 and IFRS S2. On April 30, 2024, the ISSB published its digital sustainability taxonomy reflecting IFRS S1, IFRS S2 and their accompanying guidance, to enable reporting entities to consistently tag information prepared under the ISSB Standards and facilitate future interoperability with taxonomies from other standard setters.

In May 2024, the IFRS Foundation indicated in the Jurisdictional Guide that it plans to publish jurisdictional profiles once a jurisdiction's approach to sustainability reporting is finalized. To improve consistency, comparability, relevancy, and decision-usefulness, it would be helpful if the IFRS Foundation and other standard setters can issue such and other guidance and mapping tools on interoperability between the ISSB Standards and jurisdictional sustainability reporting requirements. It would help reporting entities avoid duplication and costly sustainability disclosures, if jurisdictional regulators can integrate the ISSB Standards in their rulemakings or provide a pathway for interoperability.

Editor's Note: This article was prepared by four law firms and was posted on the one-year anniversary of the International Sustainability Standards Board (ISSB) issuing its IFRS S1 and IFRS S2 (the “ISSB Standards”). If any reader is interested in discussing any jurisdiction specific analysis, please contact:

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