The David and Sharon Johnston Centre for Corporate Governance Innovation

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Resolving regional differences in environmental, social and governance disclosure with a global standard for jurisdictional requirements

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Table of Contents

Resolving regional differences in environmental, social and governance disclosure with a global standard for jurisdictional requirements **2**

Figure 1: *The Percentage Increase of Canadian ESG Report Issuers Listed on the S&P/TSX Composite Index* 4
Figure 2: *The Percentage of Corporate Issuers with Dedicated ESG Reports on the S&P/TSX 60 and S&P/TSX Composite Index* 5

What are the differences in ESG disclosure among the economic sectors? **7**

Figure 3: *The 2022 and 2021 Percentages of Global ESG Disclosures Amongst the 11 Sustainability Industry Classification Systems Sectors* 8

Does the social in ESG disclosure impact environment and governance issues? **9**

How did the Paris agreement of 2015 impact ESG disclosure reporting? **11**

What are the recent changes in ESG disclosure reporting frameworks? **12**

Figure 4: *4 Significant Ways Leading ESG Framework Providers Simplified the ESG Disclosure Process* 15
Figure 5: *The Percentage of Frameworks Used in Corporate ESG Reporting on the S&P/TSX Composite Index* 16

How are North America, the European Union, and the United Kingdom impacted by the changes in ESG disclosure frameworks? **18**

Canada *19*
Figure 6: *The Percentage of Climate Scenario Analysis and Scope 3 Emissions Reported by ESG Issuers on the S&P/TSX Composite Index* 20
Figure 7: *The Percentage of ESG Report Issuers on the S&P/TSX Composite Index Disclosing on Human Capital related Equity, Diversity & Inclusion Targets* 22

Canadian Financial Institutions and ESG Disclosure *23*

United States *24*

European Union *25*

United Kingdom *27*

What are the key jurisdictional differences in ESG disclosure regulations? **28**

References **33**

Footnotes **42**

Resolving regional differences in environmental, social and governance disclosure with a global standard for jurisdictional requirements

By Sandria Officer, PhD, Research Officer @JohnstonCentre

Demand for changes in environmental, social, and governance (ESG) disclosure has accelerated over the past decade driven by a **growing consensus among investors** that all companies should disclose material ESG information in their public filings. Material ESG information stands for the financial weight of a specific measure in a company's overall ESG analysis. Financial reporting practices, known for well-established accounting standards and required by publicly traded companies, differ substantially from ESG reporting practices that are known for inadequate structure and voluntary-based reporting principles.

The regulatory state of ESG disclosure has produced inconsistencies in corporate reporting across industries and sectors causing **intentional and unintentional greenwashing** from misreported ESG performance to improve perceived attainments. Companies operating within this environment have been persistently questioned about the quality of their disclosed information by investors and affected stakeholders who require comparable and credible information to make sound investment decisions.

In a **best-case scenario, ESG disclosure reports** would provide stakeholders with data on corporate performance that was methodologically collected and thoroughly validated. Those metrics would become a basis for comparative cross-corporation and cross-industry assessments, enabling benchmarking, and providing a foundation to discern ESG leaders from stragglers. But the current ESG disclosure environment is besieged by competing agendas that block those objectives.

A growing number of investors around the world aspire to have their sustainability values reflected in their financial portfolios.[1] They want the profits in their portfolios to come from investments in sustainable ESG-related company stocks and bonds. For some pragmatic investors, their interest in ESG performance is separate from environmental or social issues and connected to data that shows **higher ESG ratings are linked to higher profitability and lower instability**. Today's capital markets place sustainability within an ESG framework that is increasingly focused on quantitative metrics to assess corporate performance on a range of material investment-grade ESG issues that can financially impact companies.

Publicly traded companies that voluntarily selected their ESG framework in the past decade may lose the capacity to make that decision in the near future as ESG disclosure mandates steadily increase around the globe. A recent study by Millani[2] on corporate ESG disclosures on the S&P/TSX Composite Index revealed a long-running uptrend of companies that have issued reports dedicated to an array of ESG topics.

As Figure 1 shows, 80% of Canadian companies released a report dedicated to ESG disclosure in 2021, compared to 71% in 2020, 58% in 2019, 48% in 2018, 39% in 2017, and just 36%,

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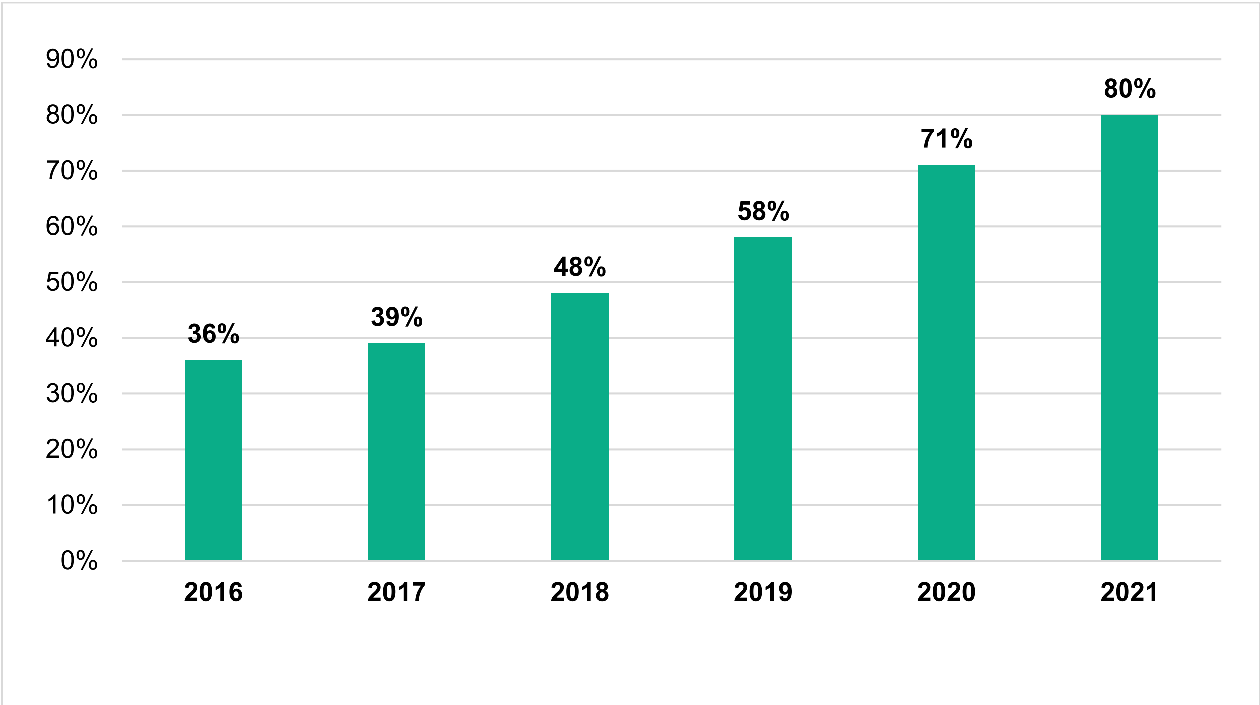
[1] Capital Group, (2022). "Capital Group ESG Global Study 2022" [Online]. Available: **https://www.capitalgroup.com/eacg/esg/global-study.html** [2022, September]
[2] See "Millani's 6th Annual ESG Disclosure Study: A Canadian Perspective," (2022, September) [Online]. Available: **https://www.tsx.com/company-services/learning-academy/esg-101?id=617&lang=en** [2022, October]

respectively, in 2016. The study also found that large companies listed on the S&P/TSX 60 reacted faster to market demand for ESG disclosures than their smaller market cap counterparts.

Figure 1:

The Percentage Increase of Canadian ESG Report Issuers Listed on the S&P/TSX Composite Index

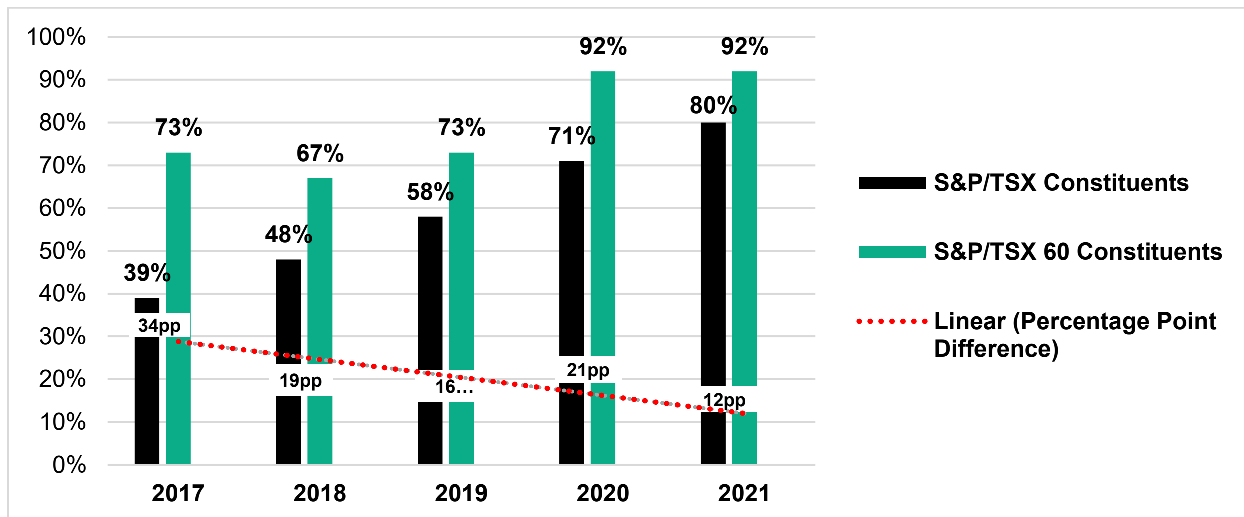


Note: The ESG reports assessed by Millani include reports released in 2021 or reports that disclose in the 2021 reporting period. From "Millani's 6th Annual ESG Disclosure Study: A Canadian Perspective" by Millani, September 14, 2022, p. 2 (https://www.tsx.com/company-services/learning-academy/esg-101?id=617&lang=en)

As Figure 2 indicates, 92% of S&P/TSX 60 companies published an ESG report in 2021, compared to 80% of companies on the S&P/TSX Composite Index.

Figure 2:

The Percentage of Corporate Issuers with Dedicated ESG Reports on the S&P/TSX 60 and S&P/TSX Composite Index



Source: From "Millani's 6th Annual ESG Disclosure Study: A Canadian Perspective" by Millani, September 14, 2022, p. 2 (https://www.tsx.com/company-services/learning-academy/esg-101?id=617&lang=en)

On balance, the findings indicate that large and small-cap companies have increasingly issued ESG disclosure reports as a best practice. The overall proportion of ESG corporate issuers are on the rise with small and medium-sized companies keeping up with large-sized companies by publishing their ESG disclosures whether that is done in a proxy filing, an annual financial statement, stand-alone corporate sustainability report, or on a corporate website.[3] However, most companies do not connect their personnel and operational processes associated with ESG reporting to those responsible for risk management or financial reporting.[4] This lack of corporate integration reduces the comparability and

[3] See Michel Coulmont, Sylvie Berthelot, and Vincent Gagné, "Sustainability Performance Indicator Trends: A Canadian Industry-based Analysis," *International Journal of Corporate Social Responsibility*, Vol. 7, No. 2 (2022), 1-17.
[4] From World Business Council for Sustainable Development (WBCSD) (2018, October). "Applying Enterprise Risk Management to Environmental, Social and Governance-related Risks" [Online]. Available: https://www.wbcsd.org/Programs/Redefining-Value/Making-stakeholder-capitalism-actionable/Enterprise-Risk-Management/Resources/Applying-Enterprise-Risk-Management-to-Environmental-Social-and-Governance-related-Risks [2022, October].

reliability of ESG disclosures. As well, it is widely known that **relatively few companies obtain external assurance of their ESG disclosures** to amend the situation.

In fact, ESG reporting is generally directed at a **broad range of stakeholders identified by the company, and it is subject to self-defined materiality standards** that are not supported by the financial definition of materiality that applies to public reporting. As a result, the content in voluntary ESG reports, even if based on the same framework, may vary widely across countries, sectors, and among companies in the same industry. All of these elements make ESG information in such reports costly to identify, obtain, and incorporate into investment analysis.

For example, in 2022 the **SustainAbility Institute by ERM** assessed the responses from thirty-nine corporate issuers and thirty-five institutional investors on their climate-related disclosure costs and found corporate issuers spent about $533,000 American dollars annually to measure, manage, and disclose climate-related activities, while institutional investors spent about $1,372,000 American dollars per year to acquire and analyze climate data to inform their investment decisions. Research[5] shows that the cost of non-compliance and deceptive disclosures exceeds the cost of compliance. In May 2022, the U.S. Securities and Exchange Commission fined **BNY Mellon Investment Adviser Inc. $1.5 million** because of misstatements and omissions in ESG mutual fund investments that it managed. In November, 2022, **Goldman Sachs Asset Management** was fined $4 million because it failed to have written policies, procedures, and compliance processes in place for the ESG research its investment teams used to select and monitor securities. As well, in January 2021, **Toyota Motor Corporation was fined $180 million** for inaccurately reporting the tailpipe emissions of the vehicles it sold. These findings clearly indicate that corporate ESG disclosure reporting should not be a perfunctory task but a corporate strategic imperative.

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[5] See Maha Faisal Alsayegh, Rashidah Abdul Rahman, and Saeid Homayoun, "Corporate Economic, Environmental, and Social Sustainability Performance Transformation through ESG Disclosure," *Sustainability*, Vol. 12, No. 3910 (2020), 1-20.

What are the differences in ESG disclosure among the economic sectors?

The recent study by Millani (see Footnote 2, p. 3) examined the level of ESG disclosure amongst 11 Sustainability Industry Classification Systems (SICS) sectors.[6] The SICS, developed in 2012 by the Sustainability Accountability Standards Board, includes eleven sectors that subdivide into seventy-seven industries located around the world. For each of those industries, standards were established on ESG issues most likely to be material to investors. As Figure 3 indicates, seven of the eleven sectors had 80% or more of their issuers release an ESG report in 2022, which was much higher than the prior year's study where only the renewable resources and the resource transformation sectors reached this measure.

The **global health care sector has historically performed poorly on ESG ratings.** Scandals that have involved disputes over opioid promotion, talc products, and generic price fixing plague the sector and contribute to its low ranking. As Figure 3 shows, 50% of companies in the global health care sector produced a dedicated ESG report in 2022 compared to just 25% in 2021. The sector's recent progress stems from its leadership in quickening vaccinations and therapeutic interventions in the fight against COVID-19, which helped to improve its public image. In addition, **President Biden's climate resilient infrastructure plans** in the United States that focused on strengthening communities against extreme weather and reducing climate pollution will probably benefit the sector's corporate pharmaceutical ESG position.

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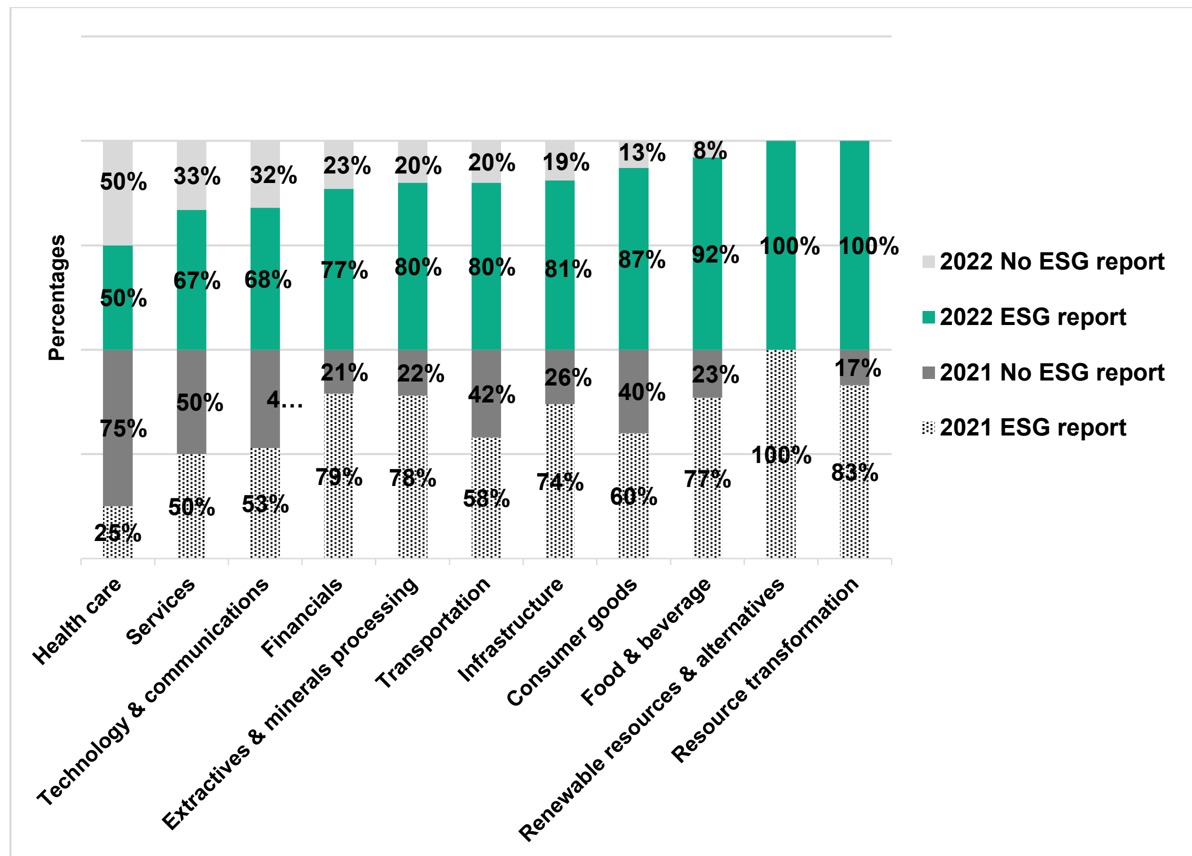
[6] See Sustainability Accounting Standards Board, "SASB's Sustainable Industry Classification System (SICS)" [Online]. Available: chrome-extension://oemmndcbldboiebfnladdacbdfmadadm/https://www.sasb.org/wp-content/uploads/2018/11/SICS-Industry-List.pdf

Figure 3:

The 2022 and 2021 Percentages of Global ESG Disclosures Amongst the 11 Sustainability Industry Classification Systems Sectors



Source: From "Millani's 6th Annual ESG Disclosure Study: A Canadian Perspective" by Millani, September 14, 2022, p. 3 (https://www.tsx.com/company-services/learning-academy/esg-101?id=617&lang=en). Note: 2021 data taken From "Millani's 5th Annual ESG Disclosure Study: A Canadian Perspective" by Millani, September 9, 2021, p. 3 (**https://www.tsx.com/company-services/learning-academy?id=527**)

Overall, the findings show that all sectors have increased their level of ESG disclosure since 2020, apart from the renewable resources and resource transformation sector, which have stayed at 100% with only one issuer.

Does the social in ESG disclosure impact environment and governance issues?

Socially conscious companies are widely known to perform better financially than their less socially mindful counterparts. The **COVID-19 pandemic drew attention to the importance of the social in ESG** when public systems and economies were brought to a near standstill in 2020 while income inequality surged around the world. Companies reluctantly changed their daily operations to manage concerns involving the reduced demand for services, problems with liquidity and the ease in which assets could be converted into ready cash, employee lay-offs, employee health concerns, customer safety, and their contributions to the well-being of the community. The employees who remained on the job often shouldered greater burdens, worked overtime at times with suboptimal resources and faced mental and physical burnout from experiences with indifferent leaders, unsustainable workloads, and career stagnation, which led to mass resignations. Of course, the **impact of the pandemic varied across industries** with the leisure and hospitality sector, as well as service and manufacturing reporting sharp declines in employment in excess of 50% while employment in finance, professional services, and real-estate related activities came through relatively unscathed with about a 10% drop as those industries were better able to shift to remote work.

The post pandemic labour market has remained more robust than anticipated despite ongoing fears of a recession and news of mass layoffs. According to **Statistics Canada**, job vacancies in 2022 dropped from a high of 1.03 million in May, to 960,000 in August, and steadily rose to 997,000 in September where rates stabilized. A recent report from the Bank of Canada[7] found that the elevated job vacancies, widespread labour shortages, and increased pace of wage growth to compete for

[7]See T. Macklem, (2022). "Restoring Labour Market Balance and Price Stability" [Online]. Available: chrome-extension://oemmndcbldboiebfnladdacbdfmadadm/https://www.bankofcanada.ca/wp-content/uploads/2022/11/remarks-2022-11-10.pdf [2022, November].

scarce workers was unsustainable long term. It called for a rebalancing of the labour market with a rise in interest rates to lower inflation back to a controllable 1% to 3% range. The report also projected that the elevated level of job vacancies in corporate Canada would moderate unemployment rates so that they did not rise to the extreme levels that were in prior economic downturns.

A worker shortage persists across industries except for the **technology sector** where demand dropped significantly in the fourth quarter of 2022. The end of pandemic lockdowns across the world reduced people's dependence on technology and rising inflation rates reduced digital advertisers' spending on advertisements, which all technology companies rely on for revenue. Job openings also fell more than 40% in the **finance and insurance industry** in recent times. Companies that had elevated hiring rates at the height of the pandemic profited from a decrease in mortgage rates, increase in home purchases and mortgage refinancing, and a surge in retail stock trading. However, those trends have been upended. Similar to the Bank of Canada, the U.S. Federal Reserve, the European Central Bank, and the Bank of England have **raised interest rates** and made it more expensive to borrow money. The **European Central Bank** predicted that corporate demand for workers now may drop enough to slow the rate of wage growth and lower inflation but not enough to cause massive job losses as companies that struggled to find employees may be unwilling to dismiss them.

The increase in employee attrition along with the growth in competition for talent has become a critical ESG challenge for many companies. Industries universally still face human capital shortages now. As a result, companies must devise new ways to recruit talent, keep, and train them within this era of worker shortages. For example, **in 2021, the Royal Bank of Canada added to its workforce by 2% but their human resources total expenses rose by 8.4%** emphasizing the financial difficulties of human capital management.

The social issues in ESG are intertwined with environmental and governance issues that can have financial macro-level consequences. For example, in **March 2022, many Canadian Pacific Railway employees went on strike** after negotiations between the union and management stalled over wages, benefits, and pensions. The strike occurred simultaneously as fertilizer, now a prized commodity because of the Ukraine war, was scheduled to ship out for the start of farmers' seeding season, and as livestock feed was due to be shipped to areas affected by recent drought. A settlement was eventually reached between the two opposing parties, but if the dispute had intensified it would have become enmeshed in inflationary price increases and supply chain disruptions that would have had grave repercussions nationally for the operations of farms.

In addition, the dispute could have added to the increase in social discontent and income inequality that contradicts ESG principles and leads to economic consequences for companies and their investors in the short and long term. The current emphasis on the environment in ESG disclosure reporting clearly has social implications as humans are behind and impacted by corporate decisions related to the environment that impacts labour markets, workers, and their communities.

How did the Paris agreement of 2015 impact ESG disclosure reporting?

The **Paris Agreement of 2015** is based on a landmark international treaty on climate change that was adopted by 196 nations at the United Nations Climate Change Conference (COP26) in 2015. These nations agreed to a common goal of tackling climate change and its effects by limiting global warming to less than 2 °C above pre-industrial levels (preferably 1.5 °C). Corporate ESG disclosures report on the environmental, social, and governance activities that align with the Paris Agreement; and, as a result, many ESG frameworks are created with the Paris Agreement in mind.

The law for ESG disclosure encompasses securities regulation, shareholder activism, domestic and international case law, other disparate laws, and industry and market standard best practices to guide future laws. It is apparent that the trend towards a universal standard of ESG disclosure in companies and in the capital markets is inevitable and will require companies to monitor the continual changes in ESG law to ensure that they avert ESG liability risks, take advantage of ESG opportunities, and comply with their legal obligations.

What are the recent changes in ESG disclosure reporting frameworks?

Since 2022 began, over twelve major international frameworks have emerged to guide companies in completing their ESG disclosure reports. But most companies have relied on just one of five of the international ESG reporting guidelines created by the following professional organizations:

1. **Global Reporting Initiative**
2. **Sustainability Accounting Standards Board**
3. **Carbon Disclosure Project**
4. **International Integrated Reporting Council**
5. **Carbon Disclosure Standards Board**

These five prominent ESG framework providers and standard setters have simplified the ESG disclosure process in **four significant ways.**

As Figure 4 shows, first, in September 2020, the five organizations revealed their shared vision[8] for an in-depth corporate reporting system that integrated both financial accounting and sustainability

[8] See Impact Management Project World of Economic Forum and Deloitte (September, 2020). "Statement of Intent to Work Together Towards Comprehensive Corporate Reporting. Summary of Alignment Discussion Reporting Organizations CDP, CDSB, GRI, IIRC, and SASB" [Online]. Available: chrome-extension://oemmndcbldboiebfnladdacbdfmadadm/https://29kjwb3armds2g3gi4lq2sx1-wpengine.netdna-ssl.com/wp-content/uploads/Statement-of-Intent-to-Work-Together-Towards-Comprehensive-Corporate-Reporting.pdf [2022, October].

disclosure. Apart from the Global Reporting Initiative that announced in 2021 that it would remain independent, the four remaining organizations provided a plan for companies to use existing ESG frameworks tailored to their distinct needs and built on the specific needs of their stakeholders.

Second, in an earlier development in July 2020, the Global Reporting Initiative and Sustainability Accounting Standards Board launched the **collaborative work plan** to guide companies on how to unify the use of their standards. The Sustainability Accounting Standards Board presented sustainability issues as a *financial material impact* on companies and focused mainly on the needs of investors and other providers of investment capital; whereas the Global Reporting Initiative standards focused on the *economic, environmental, and social impacts* of companies related to sustainable development, which interested a broader spectrum of stakeholders including investors.

The Global Reporting Initiative and Sustainability Accounting Standards Board alliance simplified the ESG disclosure process to ensure that consumers of sustainability data understood how non-financial information could highlight material consequences, decrease risk, and increase opportunity for companies in the short and long-term. **A Practical Guide to Sustainability Reporting Using GRI and SASB Standards** launched April 21, 2021, to further show how companies that applied both standards in unison increased transparency in their reporting along with trust within and among organizations and their stakeholders.

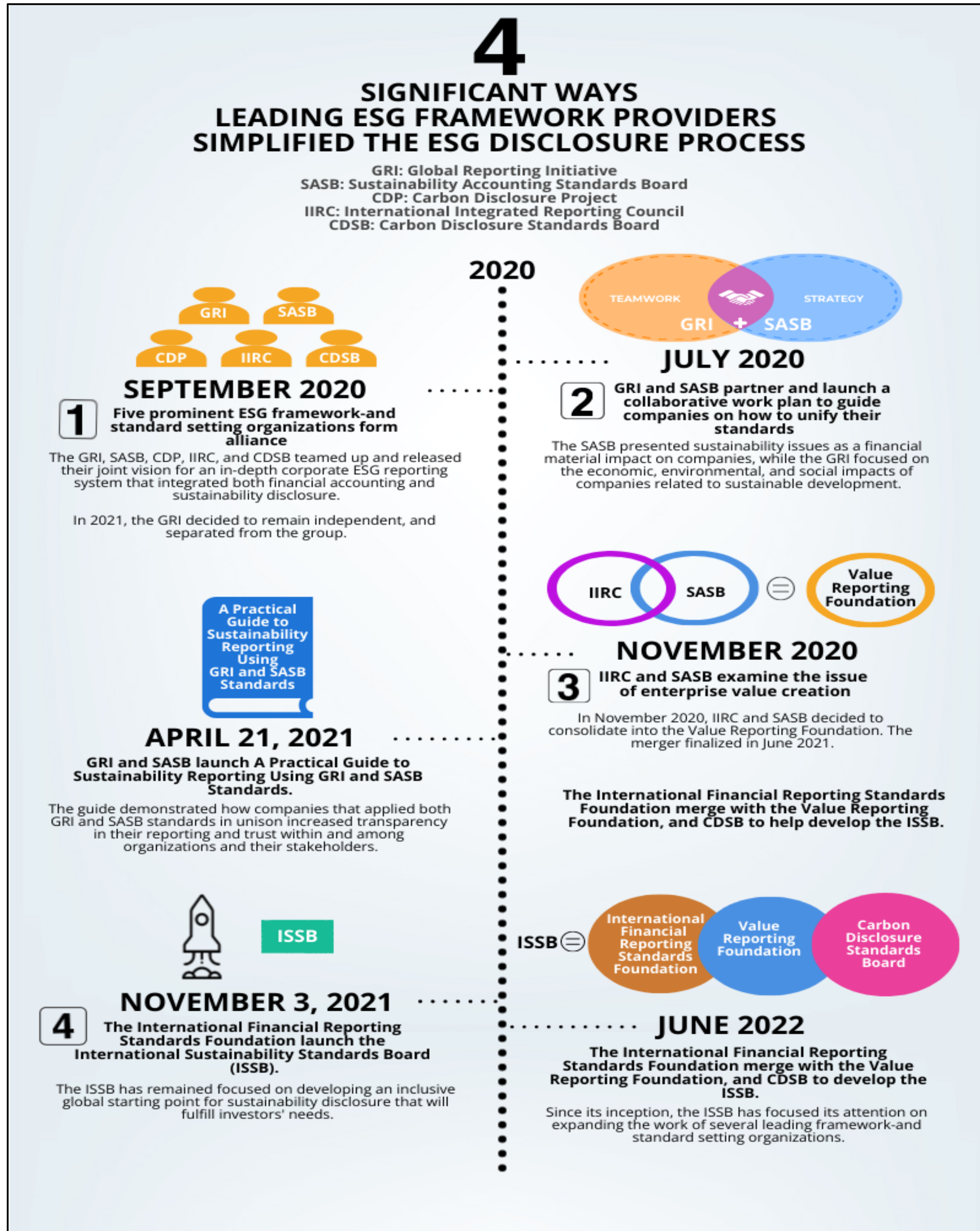
Third, the International Integrated Reporting Council and Sustainability Accounting Standards Board focused on **enterprise value creation** to examine the total value of a company based on its financing. For that reason, in November 2020, they consolidated into the **Value Reporting Foundation** with the merger finalized in June 2021. The partnership signaled major progress made in streamlining corporate ESG disclosure. The Value Reporting Foundation's global expertise in ESG disclosure showed through their comprehensive suites of resources such as the Integrated Thinking

Principles, the Integrated Reporting Framework, and the Sustainability Accounting Standards Board that were developed to assist companies. In August 2022, the Value Reporting Foundation consolidated into the **International Financial Reporting Standards Foundation.**

Finally, in November 2021, the International Financial Reporting Standards Foundation, a nonprofit organization established to develop a single set of globally accepted accounting and sustainability disclosure standards, reported the launch of the **International Sustainability Standards Board** to develop an inclusive global starting point of sustainability disclosure that would fulfil the informational needs of investors. In June 2022, the International Financial Reporting Standards Foundation merged with the Value Reporting Foundation, and the **Carbon Disclosure Standards Board** to help develop the International Sustainability Standards Board. Since that time, the International Sustainability Standards Board has focused on expanding the work of several of the leading frameworks. Overall, the work completed by the leading ESG framework providers and standard setters indicate progress towards the creation of a global streamlined global ESG disclosure process that will address the distinct needs of corporations and their stakeholders.

Figure 4:

4 Significant Ways Leading ESG Framework Providers Simplified the ESG Disclosure Process

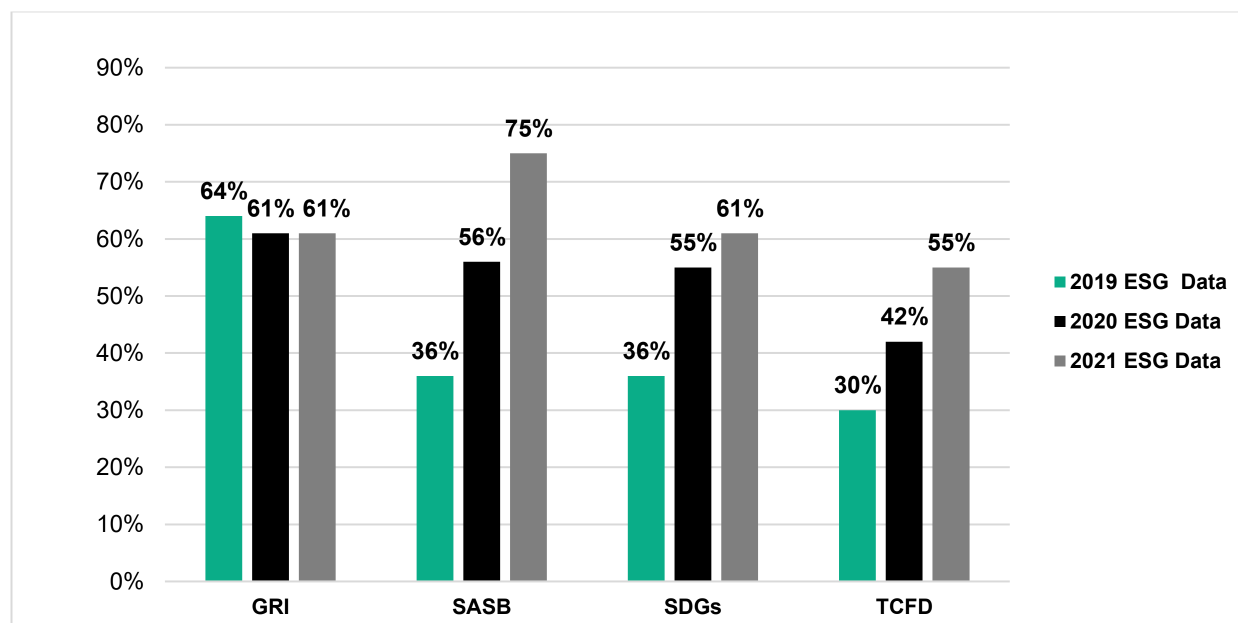


Note: The image was created from “SASB Standards & Other ESG Frameworks” by IFRS Foundation (https://www.sasb.org/about/sasb-and-other-esg-frameworks/)

Millani's report in 2022 (see Footnote 2, p. 3) examined the corporate adoption rates of ESG frameworks on the TSX Composite Index and found an increase in the use of the Sustainability Accounting Standards Board, **Task Force on Climate-related Financial Disclosures**, and **UN Sustainable Development Goals**, but a slight decline in the use of the Global Reporting Initiative. As Figure 5 shows, in 2022, 75% of issuers used the Sustainability Accounting Standards Board framework, compared to 61% for the Global Reporting Initiative, 61% for the UN Sustainable Development Goals, and 55% for the Task Force on Climate-related Financial Disclosures. In 2019, these numbers were up for the Sustainability Accounting Standards Board framework at 36%, UN Sustainable Development Goals at 36%, and the Task Force on Climate-related Financial Disclosures at 30% but fell slightly for the Global Reporting Initiative at 64%.

Figure 5:

The Percentage of Frameworks Used in Corporate ESG Reporting on the S&P/TSX Composite Index



Source: From "Millani's 6th Annual ESG Disclosure Study: A Canadian Perspective" by Millani, September 14, 2022, p. 3 (https://www.tsx.com/company-services/learning-academy/esg-101?id=617&lang=en).

The findings show a substantial increase in the use of the Sustainability Accounting Standards Board framework to complete ESG disclosure reports compared to the Global Reporting Initiative framework that showed a slight decline. The swift adoption of the Sustainability Accounting Standards Board framework is likely from its industry-centred focus on financial materiality, which responds to investors' needs to assess sustainability topics for investment decisions, and their persistent calls for Sustainability Accounting Standards Board aligned disclosures. The stability in the Global Reporting Initiative adoption rate is most likely from its expansive framework of standards that encompasses economic, environmental, and social measures. But the complexity in its revised G4 reporting guidelines,[9] especially as it relates to the impacts of the supply chain, made it more complex and costly, which may have deterred some companies from using it.

The findings also indicate that more Canadian issuers have used the UN Sustainable Development Goals framework; however, there have been problems with greenwashing[10] as companies have marketed positive impacts for some sustainable development goals while they have ignored the negative impact on other sustainable development goals. As well, some companies have promoted the attainment of sustainable development goals, but they have not provided the data to support their claims. In September 2018, the **SDG Impact Initiative** was launched by the United Nations Development Programme to resolve these problems by developing unified standards and verifiable processes in the attainment of sustainable development goals and in the discovery of sustainable development goal investment opportunities in emerging economies and developing countries.

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[9] KPMG Climate Change & Sustainability, (2013). "GRI's G4 Guidelines: The Impact on Reporting" [Online]. Available: https://www.globalreporting.org/about-gri/mission-history/

[10] Refer to Alvaro Cuervo-Cazurra, Jonathan P. Doh, Elisa Giuliani, Ivan Montiel and Junghoon Park, "The United Nations' Sustainable Development Goals: Pros and Cons for Managers of Multinationals," *AIB Insights*, Vol. 22, No. 1 (2022), 1-6.

Besides, the results from Millani's 2022 report show that Canadian issuers view climate change as a serious concern as over half of them adopted Task Force on Climate-related Financial Disclosures recommendations for climate disclosures into their ESG disclosure reports, representing an 83% increase since the Task Force was implemented in 2019. Overall, the report's findings indicate an upward trend of prominent ESG frameworks being used to guide Canadian companies in issuing their ESG disclosure reports.

How are North America, the European Union, and the United Kingdom impacted by the changes in ESG disclosure frameworks?

After a decade of criticism over greenwashing, ESG reporting, also referred to as sustainability reporting, appears to be headed in the right direction in recent years with Canada, the United States (U.S.), the European Union (EU), and the United Kingdom (UK), among other jurisdictions adopting new frameworks that standardize how ESG information is disclosed. In fact, some of the jurisdictions have already made ESG reporting mandatory.[11] Additionally, jurisdictions such as North America, the European Union, and the United Kingdom have committed to **carbon neutrality by 2050** as called for by the 2015 Paris Agreement and have implemented several key metrics to redirect their financial earnings to corporate sustainable objectives. The key changes in corporate ESG disclosure reporting from those jurisdictions are the following:

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[11] See Philipp Krueger, Zacharias Sautner, Dragon Yongjun Tang, Rui Zhong, "The Effects of Mandatory ESG Disclosure Around the World," *European Corporate Governance Institute – Finance Working Paper, No. 754/2021, Swiss Finance Institute Research Paper, No. 21-44* (December, 2021), 1-75.

Canada

Canadian companies disclose climate-related information now on a **voluntary basis** through ESG reports. But under **securities regulation**, companies may be required to disclose certain climate-based information if it is deemed material. Also, no Canadian regulations currently mandate companies to publicly disclose ESG metrics such as greenhouse gas (GHG) emissions in accordance with an ESG reporting standard, such as the Global Reporting Initiative.

The **Canadian Securities Administrators**, an organization that regulates the Canadian capital markets, are establishing requirements for publicly traded Canadian companies to disclose exposure to climate-related risks in their financial metrics. The reporting would address:

- Governance associated with company climate-risk management processes.
- Strategy associated with how identified risks would impact financial performance.
- How identified risks are managed and minimized.
- Metrics and targets.

In October 2021, the Canadian Securities Administrators issued **Proposed National Instrument 51-107 Disclosure of Climate-related Matters (NI51-107),** which supports the **recommendations** from the Task Force on Climate-Related Financial Disclosures except for two areas:

1. The Canadian Securities Administrators proposed a phased approach to climate disclosure that would not require companies to conduct a climate risk scenario analysis.
2. Reporting of Scope 1, 2, and 3 GHG emissions would be done on a comply or explain basis, which may not require a company to disclose all GHG emissions if it can provide an acceptable reason for the omission.

The Canadian Securities Administrator's proposal received 131 comment letters with two key concerns:[12] on 1) regulatory burden, and 2) on the administrative cost of climate-related disclosures that are of particular concern for companies in the oil and gas, agriculture, and mining sectors focused on Scope 3 emissions.

No requirements under Canadian securities legislation exists now that mandates specific requirements for environmental and social disclosure. As a result, issuers are only required to disclose substantive *material* information in their disclosure documents, which includes information that, if omitted or misstated, would probably impact an investor's judgment to buy, sell or keep a security.

The recent study by Millani (see Footnote 2, p. 5) examined corporate Canada's Carbon Disclosure Project ESG disclosures for the first time and found that 51% of the S&P/TSX Composite Index issuers submitted a climate change response in 2022. Figure 6 shows 31% of issuers also reported a climate scenario analysis in 2022 that was much higher than the 13% of issuers that reported in 2021. In addition, Figure 6 indicates that in 2021, 49% of issuers disclosed Scope 3 emissions, which was a slight increase from 45% in 2020.

Figure 6:

The Percentage of Climate Scenario Analysis and Scope 3 Emissions Reported by ESG Issuers on the S&P/TSX Composite Index

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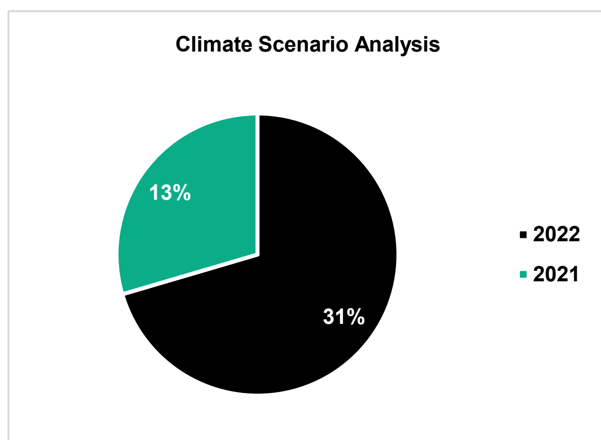
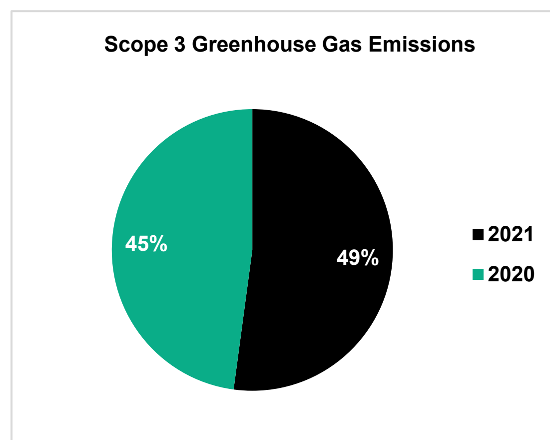
[12] Janis Sarra, Michael Irish, and Jenaya Capithorne, (March 2022). "Summary of Submissions to Canadian Securities Administrators on Proposed National Instrument 51-107 Disclosure of Climate-related Matters" [Online]. Available: chrome-extension://oemmndcbldboiebfnladdacbdfmadadm/https://ccli.ubc.ca/wp-content/uploads/2022/03/CCLI-Summary-of-submissions-to-CSA.pdf [2022, October].





Source: From "Millani's 6th Annual ESG Disclosure Study: A Canadian Perspective" by Millani, September 14, 2022, p. 5 (https://www.tsx.com/company-services/learning-academy/esg-101?id=617&lang=en).

The findings reveal a steady increase of issuers have disclosed on climate in their ESG reports ahead of the proposed regulations and have begun a climate change strategy to ensure that they meet the targets required for stakeholders' investment needs.

The social element of ESG was introduced through the issue of modern slavery and was the subject of a notice issued by Québec's securities commission, the Autorité des marches financiers, [13] which required them to provide guidance to issuers on disclosure requirements associated with modern slavery. The notice stated that this social issue affected industries related to construction, manufacturing, entertainment, and agriculture. But it did not alter pre-existing legal requirements or introduce new ones and has focused just on the issue of materiality and its effects on investors. In October 2020, **Bill S-216, An Act to enact the Modern Slavery Act and to amend the Customs Tariff** was presented to the Canadian Senate for its first reading. If passed, the Bill would endorse Canada's first modern slavery disclosure legislation, which would impose on an entity supply chain reporting requirements with respect to forced or child labour.

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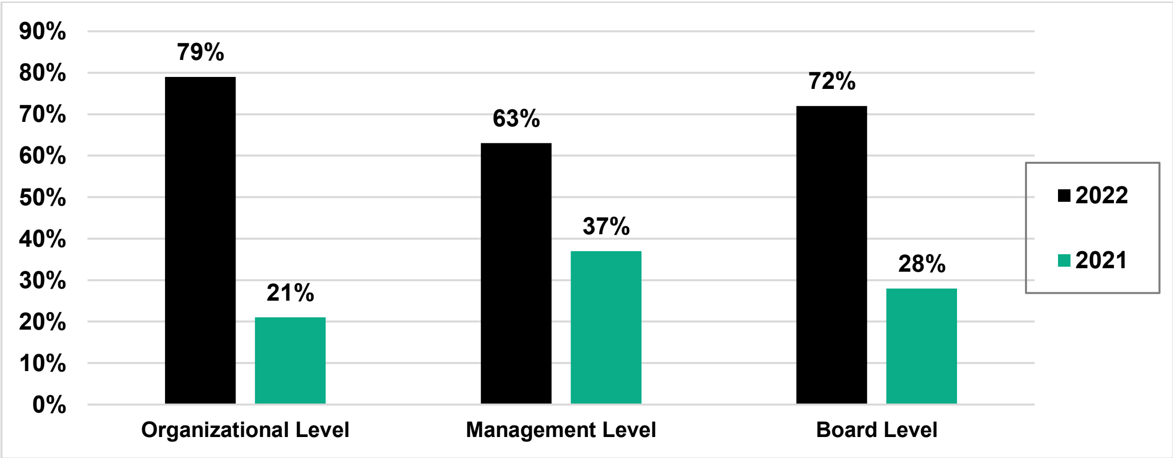
[13] See September 4, 2018 "Notice Relating to Modern Slavery disclosure Requirements" [Online]. Available: chrome-extension://oemmndcbldboiebfnladdacbdfmadadm/https://lautorite.qc.ca/fileadmin/lautorite/reglementation/valeurs-mobilieres/0-avis-amf/2018/2018sept04-avis_esclavage_moderne-en.pdf

Millani's recent study (see Footnote 2, p. 7) indicated that in 2022, 58% of Canadian companies with an ESG report on the S&P/TSX Composite Index abided by a **Supplier Code of Conduct** and respected human and labour rights within their supply chains. The findings show that a rising number of Canadian companies have issued ESG reports that address supply chain issues to remain competitive in the global economy. In addition, Millani's ESG sentiment study in 2022[14] revealed that 95% of corporate Canada on the S&P/TSX Composite Index reported on human capital related issues associated with gender diversity within some, or at all levels of their organizations. As Figure 7 shows, in 2022, 72% of companies reported an equality, diversity, and inclusion target at the board level, while 37% reported a set target at the management level, and just 21% of issuers reported a fixed target at the organizational level.

Figure 7:

The Percentage of ESG Report Issuers on the S&P/TSX Composite Index Disclosing on Human Capital related Equity, Diversity & Inclusion Targets



Source: From "Millani's 6th Annual ESG Disclosure Study: A Canadian Perspective" by Millani, September 14, 2022, p. 5 (https://www.tsx.com/company-services/learning-academy/esg-101?id=617&lang=en

[14] See "Millani's Semi-Annual ESG Sentiment Study of Canadian Institutional Investors." (2022, July). Available: chrome-extension://oemmndcbldboiebfnladdacbdfmadadm/https://www.tsx.com/resource/en/2894/ [2022, November]

The findings show that corporate transparent operational policies and procedures remain a critical component of strategic ESG disclosure risk management within an era of worker shortages and investor demands for relevant performance targets.

If N51-107 is endorsed as it relates to climate-related disclosure matters, on December 31, 2022, non-venture issuers would be required to begin producing ESG disclosures in March 2024, and venture issuers would be required to begin in April 2026 with each group reporting data from their prior fiscal year. On the surface, the Canadian Securities Administrator's proposed requirements seem less burdensome than other countries' proposed requirements; however, if Canadian companies do business with banks and insurers, or if they are within the value and supply chains of a U.S. public company, they will also need to collect and report on as much ESG data as their transnational peers.

Canadian Financial Institutions and ESG Disclosure

In May 2022, the **Draft Guidelines B-15 on Climate Risk Management** were issued by the Office of the Superintendent of Financial Institutions with a public comment period open until September 2022. The draft's expectations on climate-related financial disclosures support the Task Force on Climate-related Financial Disclosure's **recommendations**, and the International Sustainability Standards Board Exposure Draft on Climate-Related Disclosures (IFRS S2).[15]

In addition, the Canadian government announced plans to enact **mandatory climate-related reporting requirements** in January 2024 for federally regulated financial institutions such as

[15] See the "IFRS Sustainability March 2022 Exposure Draft IFRS Sustainability Disclosure Standard" [Online]. Available: chrome-extension://oemmndcbldboiebfnladdacbdfmadadm/https://www.ifrs.org/content/dam/ifrs/project/climate-related-disclosures/issb-exposure-draft-2022-2-climate-related-disclosures.pdf

insurance companies and banks. For that reason, on January 1, 2024, federally regulated financial institutions are expected to report and have full implementation by 2027 on:

- GHG emissions
- Climate-related risk, strategy, and management plans
- Climate transition plans
- Net-zero commitments

At present, the Canadian government has not declared whether mandatory climate-related reporting requirements apply to other sectors such as agriculture, mining, or oil and gas. But financial institutions will likely require more climate-related information from customers in those sectors to help them with their own ESG reporting requirements, and to assist them in determining when and under what conditions finance and insurance products will be provided to them.

United States

The U.S. Securities and Exchange Commission's proposed requirements for climate-related disclosure are similar to the Canadian Securities Administrators' proposed rules. In March 2022, the **U.S. Securities and Exchange Commission proposed new rules** on corporate climate-related disclosures, which would require companies to disclose exposure on climate-related risks and implications in their financial metrics. The reporting would address:

- Company climate-risk management processes.
- How identified risks would impact financial performance.
- How identified risks are managed and minimized.
- Scenario analysis, transition plans, and publicly declared climate targets.

The proposal is phased in, adjusts for company size, and begins in 2023. However, the proposal garnered concerned comments from extractive sectors such as oil and gas over Scope 3 emissions

reporting, implementation timelines, liability management, and compliance costs paralleling the comments expressed in Canada.

Equally important, Canadian companies under the **multijurisdictional disclosure system (MJDS)** now would not be subject to the U.S. Securities and Exchange Commission's proposed rule. But a public comment on the MJDS disclosure law has been requested by the U.S. Securities and Exchange Commission, which may result in inter-listed Canadian companies on the U.S. exchange being subject to the proposed rule.

The United States' scope of greenhouse gas reporting would expand significantly under the new proposed law and would no longer be required for just very heavy emitters. A recent **report** by the U.S. Securities and Exchange Commission found that only one-third of public companies mention climate change in their filings. As a result, the new law would compel public companies to seriously regard climate-related risk and add it in their governance and operational strategies.

There is also growing demand for social disclosures in the United States that provide more information related to human capital. In August 2020, the U.S. Securities and Exchange Commission released **Regulation S-K** requiring listed companies to disclose the number of employees for the year in Form 10-K. In November 2020, the U.S. Securities and Exchange Commission amended Regulation S-K requiring issuers to include a disclosure of their human capital resources in Form 10-K if the disclosure was *material* to understanding the company in general. The amendment did not provide a definition for the term *human capital*, but it expected issued disclosures to adhere to ESG-based principles. Also, the U.S. Securities and Exchange Commission did not include parameters related to the nature of the disclosure because it expected variation based on the issuers' industry.

European Union

Similar to North America's proposed requirements for climate-related disclosures, in April 2021, the European Union published a proposal for a **Corporate Sustainability Reporting Directive** to revise and reinforce rules introduced by the **Non-Financial Reporting Directive (2014/95/EU) (NFRD)**. In 2017, publicly listed companies with over five hundred employees were required to comply with the NFRD. Compliance required disclosure of social and environmental information in annual reports. The NFRD reporting addresses:

- → Environmental issues.
- → Social issues and employee treatment.
- → Respect for human rights.
- → Anti-corruption and bribery.
- → Board diversity in terms of age, gender, sexual orientation, religion, and disability.

The NFRD reporting requirements will expand when the Corporate Sustainability Reporting Directive takes effect in 2023. Both EU laws will build on existing nonfinancial disclosure law by delivering a more coherent and consistent reporting standard. The Corporate Sustainability Reporting Directive will extend compliance in three areas to include:

1. All publicly listed companies (including large companies with over 250 employees and those with balance sheets that exceed €20 million or with turnover that exceeds €40 million), which expands NFRD coverage from roughly 11,000 companies to over 50,000.
2. Stricter reporting requirements under the new **EU sustainability reporting standard**, and the **EU Taxonomy**, which is a scientifically directed enforceable definition of sustainability metrics to prevent greenwashing.
3. Enforcement of third-party verification of non-financial information, which differs now from NFRD requirements with most of the **28 EU member states.**

But successful implementation of the Corporate Sustainability Reporting Directive could be derailed from the lack of a common disclosure standard between North America, and the European Union,

which could hinder trade investment flows across the Atlantic and universally restrict the movement of ESG disclosure.

United Kingdom

Similar to the North American and EU's proposed requirements on climate-related disclosures, the United Kingdom, considered a leader in ESG, enacted the **Companies Act of 2006** ("2006 Act") that mandated ESG reporting in annual reports for all large UK companies and UK-listed companies with five hundred or more employees, or with over €500 million in annual revenue. From its launch, the UK's 2006 Act has required annual corporate reports to contain nonfinancial information. But in 2022, the **2006 Act extended its requirements** to include sustainability measures aligned with the recommendations from the Task Force on Climate-Related Financial Disclosure. As a result, UK companies are now required to disclose corporate strategy related to:

- The environment and corporate-specific impacts on the environment.
- Social issues and employee treatment.
- Respect for human rights.
- Anti-corruption and anti-bribery.

The disclosure must also address the following environment-specific information:

- Climate change-related risks and opportunities.
- How climate risks and opportunities are managed through targets and key performance indicators.
- How climate change is overseen in corporate governance.
- How climate risk affects strategy.

In addition, large UK companies must use **Streamlined Energy and Carbon Reporting** to disclose their UK energy use and carbon emissions. The rule also applies to companies with €36 million in annual revenue, €18 million on their balance sheet total or that have 250 employees. Generally, companies in the United Kingdom must report on their energy use and Scope 1 and 2 emissions.

Starting in 2023, ESG reporting in the United Kingdom will be further formalized through the implementation of the UN Sustainability Disclosure Requirements.[16] The sustainability disclosure requirements will direct companies to use a **double materiality** framework to manage sustainability-related risks, opportunities, environmental, and social impacts, as well as set relevant metrics and targets. In addition, the sustainability disclosure requirements will incorporate the **UK Green Taxonomy,** a classification system that determines what activities can be measured green. While the UN Sustainability Disclosure Requirements are rolled out over the next two years, fully mandatory disclosure is expected by 2025.

What are the key jurisdictional differences in ESG disclosure regulations?

The North American proposed laws on climate-related ESG disclosure under the Canadian Securities Administrators, and the **U.S. Securities and Exchange Commission are very detailed but narrow in scope compared to the EU's Corporate Sustainability Reporting Directive, and the UK's UN Sustainability Disclosure Requirements** that plan to provide a broad suite of standards in several environmental, social, and governance areas. For example, the Canadian Securities Administrators and U.S. Securities and Exchange Commission approach the issue of human capital disclosure from a perspective focused on *material* principle-based rules connected to corporate operations that will unlikely extend into other ESG areas.

[16] Refer to the Financial Conduct Authority Discussion Paper DP21/4 (November 2021). "Sustainability Disclosure Requirements (SDR) and Investment Labels" [Online]. Available: chrome-extension://oemmndcbldboiebfnladdacbdfmadadm/https:/www.fca.org.uk/publication/discussion/dp21-4.pdf

In addition, the Canadian Securities Administrators and the U.S. Securities and Exchange Commission's proposed laws do not provide a definition of human capital or list the required metrics to disclose them, which provides companies with discretion but also opportunities for potential greenwashing. For example, in 2014, the European Union adopted the directive on non-financial reporting[17] by which public companies with over 500 employees were required to publicly disclose sustainability development issues. As well, UK law under the UN Sustainability Disclosure Requirements rules, has extended focus on climate-related risks to address their effects on communities, and other socially related issues such as employee treatment. But the Canadian Securities Administrators and the U.S. Securities and Exchange Commission's mandated disclosures will only pertain to public companies that sell securities, which creates potential unfair competitive conditions among private companies. Moreover, their proposed disclosure rules are based on a *single materiality* principle focused on investor risk governance financial materiality.

Conversely, the EU's Corporate Sustainability Reporting Directive and the UK's UN Sustainability Disclosure Reporting use a *double materiality* rule that requires companies to disclose information that is material for investors and other stakeholders, and the environment. The Canadian Securities Administrators and the U.S. Securities and Exchange Commission provide narrow mandates to protect investors, but they do not advance a green transition, which occurs under the EU and UK's disclosure laws.

In fact, the approach to ESG disclosure by the Canadian Securities Administrators and the U.S. Securities and Exchange Commission avoids the question of whether climate change is real, and it does not require an explanation of how companies support it. They address climate-based physical and transition risks like other corporate risks already addressed by disclosure laws. Moreover, their

[17] See M. Janicka and A. Sajnóg, "The ESG Reporting of EU Public Companies – Does the Company's Capitalisation Matter?" *Sustainability*, Vol. 14, No. 4279 (April, 2022), 1-17.

approach presents the concept of risk as a probability, which minimizes the proof needed on climate science. In short, the Canadian Securities Administrators and the U.S. Securities and Exchange Commission's rules on climate risk currently meet the minimum requirements to satisfy the materiality standards of investors and are structured in a manner to ensure that they remain under their control.

Arguably, the EU's Corporate Sustainability Reporting Directive and the UK's UN Sustainability Disclosure Reporting disclosure requirements are more rigorous than the proposed Canadian Securities Administrators and the U.S. Securities and Exchange Commission's laws. The European Union adopted the national climate strategy under the **European Climate Law** and pledged to meet the Paris Agreement goals, similar to Canada and the UK's pledge. Although the United States rejoined the Paris Agreement under President Biden in January 2021, the United States **lacks a Congress mandated national climate transition strategy.** Also, the Canadian Securities Administrators and the U.S. Securities and Exchange Commission's narrow investor-centred idea of materiality limits the depth of the proposed disclosure rules. For example, under the EU's proposed rule, companies must disclose whether their activities support the Paris Agreement's goal to limit global warming to 1.5 degrees Celsius, whereas the Canadian Securities Administrators and the U.S. Securities and Exchange Commission's proposed rules lack sufficient disclosure information of corporate risk strategies that are under a range of potential future climate scenarios.

The current EU Corporate Sustainability Reporting Directive and **U.S. Securities and Exchange Commission's proposed rules on disclosure of GHG emissions** are based on direct energy consumption for Scope 1 and from purchased electricity or heat for Scope 2. But under Scope 3, the value chain activity emissions disclosure is required only when companies have Scope 3 emission reduction targets or if the emissions are considered material. The vast scope of climate risks that include abrupt weather or regulatory changes makes the Canadian Securities Administrators and

the U.S. Securities and Exchange Commission's proposed rules too general and open to interpretation to be effective.

The lack of a common standard among jurisdictions now has pushed Canada, the United States, the European Union, and the United Kingdom to develop their own disclosure standards. Canada, the United States, and the UK's disclosure rules align with the Task Force on Climate-Related Financial Disclosures to meet high disclosure comparability across jurisdictions. However, the EU's disclosure standards align with the Global Reporting Initiative, which is the most commonly used standard across the globe and will be more comprehensive and address five areas:

- Climate change
- Water and ecosystems
- Workers and communities
- Value chains
- Corporate governance

In addition, the EU's disclosure standard will require sector specific metrics, and disclosure rules for at least forty industries. It follows that the huge differences in the Task Force on Climate-Related Financial Disclosures and Global Reporting Initiative's scope will create comparability and compatibility gaps among the jurisdictions.

In fact, the failure to compare and rationalize disclosure standards between North America, the European Union and the United Kingdom will probably create transatlantic difficulties in the exchange of trade and investment. For example, the **Carbon Border Adjustment Mechanism** proposed by the European Union will authorize a carbon levy on carbon-intensive imports from countries without carbon taxes. Also, national disputes over sustainability disclosure are to be expected as American companies with subsidiaries in the European Union, and European companies with subsidiaries in the United States are forced to abide by two different standards.

This study has explained why corporate ESG disclosure reports should be governed by a coordinated and standardized global disclosure process that addresses the persistent issues that arise from inconsistent metrics and definitions. A standardized ESG disclosure process would create reliable universal metrics and improve the consistency and quality in disclosure reporting that stakeholders need to make sound investment decisions. In addition, a formalized global process for ESG disclosure would mitigate the potential jurisdictional conflicts that confront companies operating outside of their regulated zones. The implementation of the framework mandated by the International Sustainability Standards Board should bridge the gap between the regional differences in ESG disclosure reporting rules and enable the foundation of a global standard for jurisdictional requirements.

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