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# From the European Union to the United States, Companies Prepare for New ESG Disclosure Rules

*Potential new regulations in the U.S. and EU require climate change and other ESG-related disclosures for companies listed and/or domiciled in these regions. We explain how to prepare.*

Two significant regulatory drivers in the United States (U.S.) and European Union (EU) will change the landscape of what companies need to disclose on environmental, social and governance (ESG) issues in the coming years. What's more, these regulations could set a new precedent of best practices and trigger additional regulations in other regions.

In this alert, we'll describe at a high-level what each disclosure regime would require and then actions companies — no matter where they are located — should be taking now to have a proactive stance on ESG disclosure.

## Proposed Climate Change Disclosure in the United States

In the U.S., the Securities and Exchange Commission (SEC) is poised to propose a new climate change disclosure rule likely by January 2022 or sooner. In July 2021, SEC Chair Gary Gensler said the agency received more than 550 comment letters in response to the commission's statement on climate disclosures months prior. "Three out of every four of these responses support mandatory climate disclosure rules," Gensler said. "The SEC should step in when there's this level of demand for information relevant to investors' decisions."

In the meantime, Gensler said companies should evaluate disclosure in the context of their evolving climate strategy, the financial impact of climate change on their business, relevant disclosure controls and procedures, and advertised environmental claims (e.g., net-zero emissions).

The chairman noted that staff will consider both qualitative and quantitative disclosure. Qualitatively, the proposal could include descriptions of how climate-related risk feeds into the company's strategy and how a business might adapt to these risks. Quantitatively, a proposal could require metrics related to greenhouse gas emissions, including Scope 1 and Scope 2 greenhouse gas emissions, and financial impacts of climate change.

The SEC's statement on climate disclosure received a boost of support in June 2021, when the U.S. House of Representatives passed the ESG Disclosure Simplification Act of 2021. This bill would require the SEC to define ESG metrics for disclosure purposes. On the heels of Gensler's statements around corporate climate disclosures and the House bill, the SEC followed up by proposing corporate enhancements to ESG disclosures. The agency

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said disclosures should be based on a materiality lens, standardizing ESG disclosures and language, and called for disclosure on tying executive compensation to ESG metrics.

## ESG Disclosure Rules One Step Closer in the European Union

Similar to the U.S., the EU is adding new regulation around ESG disclosure. The Corporate Sustainability Reporting Directive (CSRD), which applies to companies based in or listed on a stock exchange in the EU, mandates that companies report on ESG risk factors and provide third party assurance.

The directive was published in April 2021 and is working its way through the legislative process to be finalized. It is expected that the first set of standards will be adopted by October 2022 with adoption of the CSRD into national law by December 1, 2022. The CSRD is expected to take effect from January 1, 2023 (with a January 1, 2026 date for listed small and medium-sized enterprises or SMEs).

The directive would replace and expand existing ESG reporting in the EU by requiring companies to publish their ESG risks and how they affect their business, as well as achievement of ESG target goals.

Specific disclosure includes:

- environmental matters,
- social matters and treatment of employees,
- respect for human rights,
- anti-corruption and bribery, and
- diversity on company boards (in terms of age, gender, educational and professional background).

As mentioned, the EU directive applies to all large companies governed by or established in an EU member state and all European stock exchange-listed companies (except for micro companies) — an estimated 50,000 public companies in total. A large company is defined as meeting two out three of the following criteria: €40 million in net turnover, €20 million on the balance sheet, and/or at least 250 employees.

Since the directive is a post-Brexit rule, it does not apply to UK companies or non-EU companies listed in the UK. However, there is the possibility that the UK will replicate some or all the new rule, particularly if it becomes viewed as a common best practice.

The legislation aims to increase accessibility and transparency in ESG reporting by ensuring stakeholders are privy to the same ESG disclosure information, with a laser focus on corporate sustainability risk mitigation. The enhanced disclosure will lead to a bevy of new sustainability data collection efforts, which will provide investors and all stakeholders the opportunity to compare companies more broadly on ESG-related factors.

## Next Steps

Taken together, these two regulations have the potential to transform the landscape of ESG disclosures and make it critical that companies are proactive in their ESG preparedness and disclosure plans. Whether by legislation or through enhanced stakeholder expectations, companies need to be transparent about their sustainability issues and the impact it has on the bottom line of their business.

Companies should start preparing now for the pending legislation and enhanced disclosures that will be required. Your internal team should get acquainted with the various regulatory frameworks already in existence to get an idea of what lies ahead. If not, then corporate laggards will be up against the clock trying to figure out what to disclose and how to disclose this information, while investors and other key stakeholders will be holding the magnifying glass assessing your sustainability strategy.

We will continue to monitor the situation and update our clients when the EU and SEC finalize rules. In the meantime, if you have questions about this topic or other related matters and would like to speak with one of our experts, please email us at humancapital@aon.com.

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