Update: ESG Laws Across the World

Global – October 2023

Environmental, Social and Governance (ESG) Regulations

ESG regulations are government standards for ESG-related actions, reporting or disclosures. While the ESG space is mostly unregulated, various legal requirements have already passed in some jurisdictions, with the EU leading in this regard, but implemented at different paces. Some businesses may already be undertaking ESG reporting and disclosures, depending on their size and industry.

EU

The EU has introduced several regulations concerning ESG – the Taxonomy Regulation, the Non-Financial Reporting Directive (NFRD), the Corporate Sustainability Reporting Directive (CSRD), the Sustainable Finance Disclosure Regulation (SFDR) and the Corporate Sustainability Due Diligence Directive (CSDDD).

The Taxonomy Regulation

The Taxonomy Regulation was published in the Official Journal of the EU on 22 June 2020 and entered into force on 12 July 2020. It can be described as a green classification system that translates the EU's climate and environmental objectives into criteria for specific economic activities for investment purposes.

The environmental objectives are:

1.	Climate change mitigation
2.	Climate change adaptation
3.	Sustainable use and protection of water and marine resources
4.	Transition to a circular economy
5.	Pollution prevention and control
6.	Protection and restoration of biodiversity and ecosystems

The Taxonomy positively recognises green, or "environmentally sustainable", economic activities that make a substantial contribution to achieving the six climate and environmental objectives, while meeting minimum social safeguards.

It is a transparency tool that introduces mandatory reporting obligations on some companies and investors, requiring them to disclose their share of taxonomy-aligned activities, allowing for the comparison of companies and investment portfolios.

The overall taxonomy framework consists of:

- The Taxonomy Regulation
- The delegated act with assessment criteria for the first two environmental objectives
- The delegated act on transparency obligations

This is supplemented by further delegated acts on:

- Gas/atoms
- Assessment criteria for the other four environmental objectives
- A social taxonomy

In addition, the taxonomy reflects transition efforts by companies – "transition finance".

The delegated act on the first two environmental objectives will be extended to include activities such as agriculture.

In 2023, in accordance with Article 10(4) of the Disclosures Delegated Act, large non-financial undertakings will need to report activities that are considered as aligned with the EU Climate Delegated Act. Similarly, and in accordance with Article 10(5) of the Disclosures Delegated Act, large financial institutions should disclose their taxonomy-eligible and aligned activities in 2024 for activities related to climate objectives.

Non-Financial Reporting Directive

Under the NFRD (Directive 2014/95/EU), certain large EU public-interest companies must disclose non-financial and diversity information in their annual reports. This information relates to the following ESG areas – environmental protection, social responsibility and treatment of employees, respect for human rights, anticorruption and anti-bribery, and diversity on company boards.

Large public-interest corporations are defined as companies with more than 500 employees, including listed entities and insurance companies.

According to the EU Taxonomy, companies falling within the scope of the existing NFRD – approximately 11,700 EU companies – are expected to report on the extent to which their activities are sustainable, as specified in the relevant commission Delegated Act, in alignment with SFDR and existing EU Taxonomy requirements.

The Corporate Sustainability Reporting Directive

The CSRD broadens the existing applicable NFRD and looks to address key structural weaknesses in current ESG regulation reporting. The new regulation affects a higher number of large EU-listed entities than the NFRD, including businesses, banks and insurance companies, with approximately 50,000 entities impacted by the CSRD, almost five times as many as the previous NFRD legislation.

Each company within scope is required to report more broadly on sustainability-focused topics, including environmental matters, social responsibility, respect for human rights, anti¬corruption measures and board diversity. Entities also need to report on how environmental and social matters influence their development – this is called "double materiality".

Companies that meet two of the following three conditions must comply with the CSRD:

- More than €40 million in net turnover
- Balance sheet total assets greater than €20 million
- 250 or more employees

In addition, non-EU companies with a turnover of at least €150 million in the EU over two consecutive years must comply.

The new rules will apply for the first time in financial year 2024 for reports that will be published in 2025. As the CSRD will cover all listed companies in EU-regulated markets (except listed micro-enterprises), affected businesses should start to familiarise themselves with it now. The sooner entities are compliant with the CSRD, the better prepared they will be for 2024.

CSRD Reporting and ESRS

Under the CSRD, the management report must disclose both actual and potential impacts related to a company's operations, as well as across its value chain, including products, services, business relationships and supply chains. It needs to discuss any management or supervisory boards the company utilises regarding matters of sustainability, and it needs to be wrapped up in a forward-looking, time-bound manner and provide progress on achieving environmental targets. There is also an obligation for "double materiality", meaning the company's sustainable activities and any sustainability activities affecting the company need to be reported. Reports need to be freely available.

The European Sustainability Reporting Standards (ESRS) set out detailed reporting requirements for EU companies in scope of the CSRD, including EU subsidiaries of non-EU companies. Companies will need to report in compliance with these new ESRS as early as the 2024 reporting period. The ESRS cover:

- General reporting principles
- A list of mandatory disclosure requirements for EU companies related to the identification and governance of sustainability mattersThe 10 ESG topics where disclosure is required are subject to a materiality assessment

While this is the first set of ESRS, further sets of standards also will be adopted in the near future for specific industry sectors, small and medium-sized enterprises (SMEs), and non-EU parent companies.

Sustainable Finance Disclosure Regulation

The SFDR aims to enhance transparency in the sustainable investment market. Its purpose is to prevent misleading environmental claims – also known as "greenwashing" – against investment products and to increase investment into sustainable products to accelerate the transition to a low-carbon economy.

The SFDR mandates that investment products be categorised into three distinct groups based on their degree of sustainability and related features. Additionally, financial market participants that are now subject to these regulations are required to comply with specific disclosure obligations.

The SFDR requirements are linked with those under the EU taxonomy by including environmentally sustainable economic activities as defined by the Taxonomy Regulation in the definition of "sustainable investments" in the SFDR.

The SFDR came into effect in March 2021. Since then, financial market participants and financial advisers have been expected to disclose:

- Sustainability risks policy
- Integration of sustainability risks into investment decisions and investment advice
- Principal adverse impacts (PAI) of investment decisions on sustainability factors at entity level (or an explanation of no consideration of PAI at entity level)
- Consistency of remuneration policies with the integration of sustainability risk

Financial market participants and financial advisers have until the end of June 2023 to disclose mandatory and additional PAI indicators in their PAI statement (covering the calendar year 2022).

Corporate Sustainability Due Diligence Directive

The CSDDD is an EU proposal that will require companies to exercise reasonable due diligence in their own business and in their "value chains" to prevent or minimise human rights or certain environmental risks, and to end human rights violations or certain environmental violations.

The draft proposal was approved by the EU Parliament on 1 June 2023. Following the vote, negotiations with EU member states will begin, focusing primarily on disagreements around the scope of the new rules and the timeline for their implementation. Depending on the results, it is quite possible that the due diligence obligations could apply as soon as 2025.

Which EU Regulations Should Most Corporations Be Considering?

Compared with the current NFRD, under the CSRD, there will be a near fivefold increase in companies affected – from approximately 11,700 to 50,000. This is how the CSRD breaks down in terms of who will comply and when:

- **Large European public interest entities already subject to NFRD –** The CSRD regulation will apply from 1 January 2024, with reports due in 2025.
- **Large companies not already subject to the NFRD** – The CSRD regulation will apply from 1 January 2025, with reports due in 2026.
- **Smaller organisations** – The CSRD regulation will apply from 1 January 2026, with reports due in 2027.

Related Legislation

- On 23 October 2023, the Council of the European Union adopted the European Green Bond Regulation (EuGBR), which intends to foster consistency and comparability in the green bond market by introducing disclosure requirements and a supervisory framework.

  The regulation provides uniform requirements for bond issuers who wish to label their bonds as "European green bond" or "EuGB". The EuGB is a voluntary standard.

- On 3 October 2023, European Securities and Markets Authority (ESMA) guidelines on certain aspects of the Markets in Financial Instruments Directive 2014 (MiFID II) suitability requirements came into force. ESMA expects these guidelines to promote greater convergence in the interpretation of and supervisory approaches to the MIFID II suitability requirements by emphasising several important issues and thereby enhancing the value of existing standards.
- On 29 June 2023, the regulation on Deforestation-Free Products (EU VO 2023/1115) entered into force. This regulation is to contribute to the reduction of global deforestation and forest degradation. Companies based in the EU that place products listed in the Regulation on the internal market will be subject to extensive compliance obligations that must be met by December 30, 2024. Small and medium-sized enterprises have to comply by June 30, 2025.
- On 13 June 2023, the European Commission published a proposal for a regulation on ESG ratings. The legislative proposal lays out a regulatory framework for the provision of ESG ratings in the EU.

Upcoming Related Legislation

- Further legislative changes are anticipated in relation to Art. 449a CRR.

Competent Authorities

EU member states must ensure that the relevant competent regulatory authorities monitor the compliance of market participants, and that they have the necessary supervisory and investigatory powers to exercise their functions under the regulations.

Australia

- **Legislation** – Prudential Practice Guidance on Climate Change and Financial Risks CPG229 November 2021
- **Regulatory body** – Australian Prudential Regulation Authority
- **The Australian Accounting Standards Board** (AASB) announced, on 23 October 2023, the release of a new exposure draft, outlining its proposed standards for companies to report climate-related information, based on the recently released sustainability disclosure standards by the International Financial Reporting Standards (IFRS) Foundation's International Sustainability Standards Board (ISSB).

Brazil

- **Legislation** – Management and Disclosure of Social, Environmental and Climate Risks 2021
- **Regulatory body** – Central Bank of Brazil (BCB)
- **Legislation** – Circular 666 of 06/27/2022 on providing for the requirements for sustainability, to be observed by companies, insurance companies, open supplementary pensions (EACPCs) capitalisation companies and local reinsurers (in force on 1 August 2022)
- **Regulatory body** – Superintendence of Private Insurance (SUSEP)
- **The Brazilian Ministry of Finance**, in conjunction with the Comissão de Valores Mobiliários (CVM), has unveiled plans to incorporate the ISSB standards into the nation's regulatory framework. This significant move will see the rollout of the ISSB's IFRS S1 and IFRS S2 begin on a voluntary basis in 2024, ultimately becoming mandatory on 1 January 2026.

Canada

- **Legislation** – The Corporate Diversity Reporting rules went into effect on January 1, 2020, and apply to federally incorporated public companies and non-venture reporting issuers.
- **In development** – ESG-related Investment Disclosure for Funds guidance CSA Staff Notice 81-334 2022.
- **In development** – Climate-related Disclosures for Listed Issuers 2021.
- **Climate Disclosures for Federally Regulated Institutions** – Starting in 2024, federally regulated institutions, like banks and insurance companies, will be required to disclose their climate-related risks and exposure.
- **Climate Investment Taxonomy Regulation** – The Climate Investment Taxonomy criteria's objective is to provide financial market participants with greater clarity on what constitutes a climate investment. Specifically, these regulations were intended to lay out the criteria for investments and other economic activities that can contribute to Canada's ambition to reach net zero emissions by 2050. The regulation was introduced by the Canadian Sustainable Finance Action Council (SFAC) in March 2023. In its current form, participation in and engagement with the taxonomy is not mandatory.
- **Regulatory body** – Canadian Securities Administrators (CSA).

China

- **Legislation** – ESG-related Amendments to the Disclosure Rules Applicable to Listed Companies
- **Regulatory body** – China Securities Regulatory Commission 2021
- **Legislation** – Guidance for Enterprise ESG Disclosure (effective from 1 June 2022)
- **Organisation:** CERDS

Germany

- **Legislation** – New Supply Chain Due Diligence Act

  The act requires large companies to observe social and environmental standards across their supply chains. Companies must monitor their own operations and their direct suppliers worldwide and act if any violations are found.

  The act came into effect on 1 January 2023, and its coverage will be broadened in 2024 by reducing the employee threshold from 3,000 to 1,000. Companies that fail to comply or submit the required documentation risk facing fines and sanctions, including fines of up to 2% of their annual turnover for larger companies, exclusion from public contracts for up to three years, and damage to reputation and trust.

Hong Kong

- **In development** – Green and Sustainable Finance Strategy (Climate-related Disclosures)
- **Regulatory body** – Hong Kong Securities and Future Commission (SFC), Hong Kong Monetary Authority (HKMA)
- **In development** – Enhancement of Climate-related Disclosures under the Environmental, Social and Governance Framework – consultation paper April 2023
- **Regulatory body** – Hong Kong Exchange (HKEX)

India

- **Legislation** – The regulatory framework in India governing ESG issues is not codified under a consolidated legislation. Instead, various laws address ESG-related matters that apply to the operations of corporate entities in India, covering issues such as:
  - Environmental protection (e.g. the Environment Protection Act, 1986; the Water (Prevention and Control of Pollution) Act, 1974)
  - Employee benefits (e.g. the Factories Act, 1948; shops and establishment laws; bonus and gratuity laws)
  - Corporate governance (e.g. the Prevention of Money Laundering Act, 2002; the Prevention of Corruption Act, 1988; the Companies Act, 2013; the Securities and Exchange Board of India (SEBI) Act, 1992)

  Notably, certain parts of the ESG legislation have not been periodically updated to reflect contemporary sustainability standards. The Indian environmental laws may thus require a considerable overhaul, given India's emission reduction targets under various international agreements.
- **Regulatory body** – Under most laws that govern ESG-related matters, adjudicative bodies with investigative powers are responsible for implementing and enforcing the obligations of Indian companies thereunder. Examples include:
  - The central/state pollution control boards under the Environment Protection Act, 1986
  - Regional provident fund commissioners under the Employment Provident Funds and Miscellaneous Provisions Act, 1952
  - The regional registrars of companies under the Companies Act, 2013

Japan

- **Legislation** – Revisions of Corporate Governance Code 2021.
- **In development** – Mandatory Task Force on Climate-related Financial Disclosures (TCFD) reporting for prime segment listed companies (in March 2023, new rules designed by the Financial Services Agency (FSA) were made effective, representing what might be called the first stage of mandatory sustainability disclosure rules in Japan).
- **Regulatory body** – FSA and Tokyo Stock Exchange (TSE).
- The second stage of sustainability disclosure rules in Japan are expected to be made effective no later than April 2025. The rules will be drafted by the newly established the Sustainability Standards Board of Japan (SSBJ).
- **Regulatory body** – Japan FSA.

Singapore

- **Legislation** – Environmental Risk Management for Asset Managers, Banks and Insurers 2020.
- The Monetary Authority of Singapore (MAS) has introduced disclosure and reporting guidelines for retail ESG funds to mitigate greenwashing risks. Following a public consultation in 2021, SGX-listed issuers have been subject to a phased approach to mandatory climate reporting based on the recommendations of the TCFD. In April 2023, MAS unveiled a "Finance for Net Zero Action Plan".
- **Regulatory body** – MAS.

UK

- **In development** – Sustainability Disclosure Requirements (SDR) and Investment Labels.
- **Policy statement** – Diversity and inclusion on company boards and executive management PS22/3 2022.
- **In development** – Climate-related disclosure rules.
- **Regulatory body** – FCA.

  The FCA requires a disclosure regime for ESG matters under the TCFD. If a company is considered a "premium listed company, asset manager or FCA-regulated pension provider," among others, the business is required to make a statement on annual financial reports.

US

The US Securities and Exchange Commission (SEC) announced the creation of a climate and ESG task force. Initiatives are to be developed "to proactively identify ESG-related misconduct". Initially, the task force will focus on material gaps or misstatements in issuers' disclosure of climate risks under existing rules.

- **In development:** Climate Disclosures for Public Companies
- **Regulatory body** – SEC
- **In development** – Climate-related Financial Risks and Insurers
- **Regulatory body** – US Federal Insurance Office (FIO)
- The **Climate Corporate Data Accountability Act** (SB 253) was passed by the California State Assembly on 12 September 2023.
- **Regulatory body** – California Secretary of State Office
- **In development** – New York – Fashion Sustainability and Social Accountability Act (FSSAA)
- **Regulatory body** – New York State Department of Law

UAE

In development – The Dubai Financial Service Authority (DFSA) Task Force on Sustainable Finance (TFSF) issued a publication in November 2022 on "Climate and Environmental Risk Management", contributing to the global debate on how best to address and mitigate the physical and transition risks stemming from climate change, as well as broader environmental risks in the UAE.

The TFSF aims to drive forward discussions regarding sustainable finance in the Dubai International Finance Centre (DIFC) with the goal of supporting the consistent application and adoption of global regulatory standards for sustainable finance in the DIFC.

Legislation – On 4 July 2023, the Abu Dhabi Global Market announced the implementation of a sustainable finance regulatory framework with immediate effect. On 26 September 2023, members of the UAE Sustainable Finance Working Group launched a consultation on proposed Principles for Sustainability-Related Disclosures for Reporting Entities.

Switzerland

- **Legislation** – Articles 964a-964c CO – Transparency in non¬financial matters.
- **Legislation** – Articles 964j-964l CO – Due diligence and transparency in relation to minerals and metals from conflict zones and child labour, which has been further detailed in an ordinance (the ODiTr).
- **In development** – Guideline on Sustainability Reporting 2022.
- **Regulatory body** – Federal Audit Oversight Authority (FAOA).
- **Switzerland's Federal Department of Finance** (FDF) announced on 25 October 2023 that it will proceed with plans to propose regulations to address greenwashing in the financial sector, including investment and disclosure rules for financial products using labels such as "sustainable", "green", or "ESG". The FDF committed to submit a consultation draft for the proposed regulation by August 2024.

Global Standards

Currently, there are various sustainability disclosure standards and frameworks to be discussed:

- **ISSB** – An increasingly central point of reference for supervisors and financial institutions. The draft is currently under consultation and for climate disclosures, it largely replicates TCFD.
- **Sustainability Accounting Standards Board (SASB)** – A framework for reporting environment and social information via the mainstream corporate report.

What Do Organisations Need to Do Now?

If not started already, organisations must acquaint themselves with ESG reporting efforts, which will be beneficial in ensuring compliance and avoiding fines.

What Are We Doing to Assist Our Clients in This Area?

The reporting obligations arising from the taxonomy, NFRD, CSRD and SFDR are significant, and we can assist clients in fulfilling these.

In particular, the CSRD's scope is much broader given the breadth and relative sizes of many US, UK and non-EU entities with significant operations in various EU jurisdictions or listed on an EU-regulated market. As a result, the CSRD may lead to a marked increase in additional substantive disclosures (and increased costs), including multiple subsidiary-level reporting obligations, and the associated risks of divergent reporting.

With the CSRD's adoption, the SEC's proposed expanded climate change requirements in the US, and the UK government and relevant agencies rolling out mandatory TCFD-aligned climate disclosure requirements while also pushing for enhanced non-climate-related disclosures, it will be important for US and UK companies with significant EU operations to start compiling and developing standards and procedures to confirm the accuracy of sustainability disclosures and reporting.

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