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Navigating the Sustainability Disclosure Conundrum:

A Practical Guide for Boards & Leaders

The U.S. Securities and Exchange Commission (SEC) recently adopted new disclosure rules focused on climate-related risks: *The Enhancement and Standardization of Climate-Related Disclosures for Investors*. The rules were scheduled to take effect as early as FY 2025 but are currently stayed pending litigation. Of importance to note, the SEC applies "materiality" in a new and highly complex context to these rules. Materiality is the gold-standard benchmark for information that must be publicly disclosed and traditionally applied in the context of tangible, quantifiable financial and operational results; new interpretations of it bring significant challenges for companies and their boards.

For boards seeking to establish oversight of compliance with these new climate-related disclosure requirements, difficulties may arise. While the rules intended to provide transparency to investors, the burdens they impose on public companies may be significant. Additionally, companies are expressing that the concepts of materiality in these rules are somewhat ambiguous, making compliance a difficult practice in the best of circumstances.

The fact remains that investment aligned with environmental and social topics are here for the long term, which means that stakeholders will likely continue to demand disclosure on these issues. The substance and integrity of disclosure on climate-related matters can directly or indirectly impact corporate reputation, access to capital, and stakeholder engagement. The risks of noncompliance are high. Moreover, EU reporting requirements are expected to flood the market with ESG data. Organizations in the U.S. and other non-EU countries may fear being left out of investment consideration if they don't report comparable data to their European peers.

Amid this complex and rapidly shifting environment, how can boards provide effective oversight of climate-related disclosures? In this practical guide, the Nasdaq Center for Board Excellence provides information on how boards can navigate disclosure conundrums and ensure their organizations have the right strategy in place.

Understanding the Organization's ESG Disclosure Strategy

Sustainability reporting in the U.S. continues to be delayed, even though the SEC and the State of California have passed climate-related disclosure rules. Both rules require disclosures of greenhouse gas emissions and climate-related impacts, and are currently being litigated.

Many large organizations in the U.S. voluntarily publish comprehensive sustainability reports that detail ESG initiatives and metrics.[i] This is likely due in large part to investor interest, as ESG assets are expected to surpass $40 trillion globally by 2030.[ii]

While board members do not need to dive into the granularity of the complex ESG disclosure landscape to provide effective oversight, it may be helpful to get a big-picture view. The landscape is filled with many acronyms that define the regulations and disclosure standards, as well as upwards of 600 reporting frameworks[iii] and dozens of rating agencies and indices that solicit sustainability data via annual scoring surveys:

- **ESG reporting standards** provide specific, detailed, and repeatable requirements for what should be reported for each topic, including metrics.
- **ESG reporting frameworks** harmonize how information is structured, prepared, and what topics are covered to facilitate comparisons across organizations and industries.
- **ESG scoring surveys** are requests for information from sustainability data providers (who share data with paid subscribers, usually investors), rating and ranking agencies (who grade ESG program performance), and indices (who assess organizations for inclusion in ESG investment vehicles).
- **ESG disclosure regulations** are mandatory disclosure rules imposed by government regulators in a variety of global markets.

ESG Disclosure Landscape

Reporting Standards and Frameworks

CDP	Carbon Disclosure Project framework reports on impacts of climate change, water security, and forests.
CDSB	Carbon Disclosure Standards Board framework integrates climate-related information into company mainstream financial reporting.
GRI	The Global Reporting Initiative framework facilitates corporate sustainability reporting across ESG issues.
IIRC	International Integrated Reporting Council framework puts company performance into environmental, social, and governance context.
ISSB	International Sustainability Standards Board standards harmonize sustainability reporting with already accepted standards for financial reporting.
PRI	Principles of Responsible Investment offer actions to incorporate ESG factors into decision making and public disclosure.
SASB	Sustainability Accounting Standards Board lays out sustainability reporting guidelines through 77 distinct industry-specific metrics.
SBTi	Science Based Targets initiative encourages companies to set science-based targets aligned with the goals of the Paris Agreement.
TCFD	Task Force on Climate-Related Financial Disclosures framework facilitates disclosures of climate-related financial risks.
TNFD	Task Force on Nature-related Financial Disclosures framework focuses on company interactions with nature and biodiversity.
UNGC CoP	UN Global Company Communications of Progress aligns business activities with principles in human rights, labor standards, environmental protection, and anti-corruption.
WEF	World Economic Forum frameworks seeks to measure stakeholder capitalism through disclosure of ESG-related risks and opportunites.

Disclosure Rules

Rule	Regulator	Effective Date
Climate Corporate Data Accountability Act and Climate-Related Financial Risk Act	California	2026
Enhancement and Standardization of Climate-Related Disclosures for Investors	SEC	Stayed pending litigation
Corporate Sustainability Due Diligence Directive (CSDDD)	European Union	Beginning 2027
Corporate Sustainability Reporting Directive (CSRD)	European Union	Phased 2024-2028
European Sustainability Reporting Standards (ESRS)	European Union	Phased 2024-2026

Top Raters

Rater	Stakeholder Audience
CDP	Institutional Investors and Supply Chain Partners
MSCI	Institutional Investors
ISS-ESG	Institutional Investors
S&P Global	Institutional Investors
EcoVadis	Supply Chain Partners
Sustainalytics	Institutional Investors
Bloomberg	Institutional Investors
JUST Capital	Stakeholders and Public
FTSE4Good	Institutional Investors
Moody's ESG	Institutional Investors
RepRisk	Other ESG Raters and Third-Party Due Diligence

Key Elements in the ESG Disclosure Space

As part of an organization's broader risk monitoring framework, the board can be effective in carrying out ESG disclosure oversight by gaining insight into the following:

1. **The scope and rigor of sustainability reporting.**
   Many organizations voluntarily publish annual sustainability reports to meet broad stakeholder requests for information across multiple sustainability factors. The board should ask whether or how the organization has engaged with stakeholders on their ESG disclosure strategy to ensure that reporting includes the sustainability factors that matter most to them. Oftentimes, investors and rating agencies directly engage with the organization's management to give their input on the scope of ESG reporting.

   ESG assurance is a growing expectation for sustainability reporting: attestation is required under the SEC, California, and EU CSRD rules. In addition, ESG disclosures are being scrutinized due to concerns over greenwashing. Boards should ensure that the data and metrics within their organizations' sustainability reports are subject to the same rigorous scrutiny as SEC financial disclosures. Is the data supported by documentation attested by internal or external experts? Does the organization have a process for collecting and verifying sustainability data across the supply chain? Is there a gap between the organization's voluntary disclosures and mandatory regulatory reporting in the U.S. and abroad?

   It is important to pay close attention to the language within sustainability reports. Any mention of "material" or "materiality" within a report that is made in reference to sustainability initiatives should be done in a way that it cannot be misconstrued with the definition of financial materiality, as set out in the federal securities laws and articulated by the Supreme Court.

2. **The frameworks an organization reports against and why.**
   Sustainability reporting frameworks facilitate comparison of data across organizations, industries, and investment portfolios. Some organizations and frameworks are consolidating to harmonize data reporting, while others are challenged to find a foothold with stakeholders, so the landscape continually shifts. It is important for a company to determine which sustainability frameworks are most relevant to its industry and operations. For those new to reporting, it is worthwhile to consider frameworks used by industry peers, mandated by regulations, and/or preferred by primary stakeholders.

3. **Whether the organization is taking a deliberative approach to ESG rating surveys.**
   ESG scores and rating agency reports are the most common source of data that investors leverage in allocating capital for investment.[iv] They are a widely used performance benchmark of sustainability initiatives and exposure to related risks. Some rating agencies publish ESG scores publicly, while others offer them only to subscribers. Organizations can receive dozens of sustainability survey requests each year, and it is not always feasible to respond to all of them. Boards should be aware of the organization's scoring on sustainability matters and the potential perceptions of the scoring by investors and other stakeholders.

4. **With which regulatory regimes the organization is obligated (or volunteers) to comply.**
   Organizations with global operations, customers, or supply chain partners may need to comply with disclosure mandates in foreign jurisdictions. It is important to be mindful that there may be discord between disclosure regimes, particularly between the U.S. and the EU, where sustainability reporting requirements are generally much broader. For example, requirements of the EU's recently implemented CSRD go beyond reporting greenhouse gas emissions to include elements like water pollution, energy use, environmental restoration, human rights, and workforce diversity. Currently, U.S. organizations doing business in the EU through subsidiaries can report on sustainability matters on an entity-by-entity basis. As CSRD compliance is phased in, U.S. parent organizations will be required to provide their own CSRD reporting. Organizations in this position are debating the risks and benefits of getting a head start on parent organization compliance with CSRD reporting.

5. **How resources are allocated to ESG disclosure.**
   Sustainability reporting can bring tremendous benefits but can carry burdens of equal proportions. To do it well, organizations need the bandwidth to collect and verify data, comply with disclosure regulations, and respond to key surveys. The board should probe into how this effort is resourced: Is there a dedicated sustainability controller and/or reporting team? Do legal, finance, and risk management have the additional resources needed to support mandatory sustainability reporting? Does the organization utilize technology tools to centralize the collection, reporting, and storage of sustainability data, or is data collection a manual and siloed exercise using spreadsheets? Has the organization engaged outside consultants to get its ESG "house" in order?

   To get ahead of expanding reporting requirements, organizations should consider putting the right processes in place to collect data and develop reporting methodology. For those that have determined the rewards of compliance or risks of noncompliance outweigh the opportunity costs, now is the time to enhance—or begin—sustainability reporting.

About the Nasdaq Center for Board Excellence

The Nasdaq Center for Board Excellence is a convener of board and executive leaders, dedicated to strengthening corporate governance in the boardroom and beyond. For more expert thought leadership and educational resources, we invite you to learn more and join our community at nasdaq.com/solutions/governance/nasdaq-center-for-board-excellence.

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[i] Nearly 100% of the S&P 500 and more than 80% of mid-cap companies in the Russell 1000 published sustainability reports in 2022. "2023 Sustainability Reporting in Focus." Governance & Accountability Institute. (n.d.). https://www.ga-institute.com/research/research/sustainability-reporting-trends/2023-sustainability-reporting-in-focus.html

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[iv] ESG Ratings at a Crossroads." ERM International Group, March 2023. https://www.sustainability.com/globalassets/sustainability.com/thinking/pdfs/2023/rate-the-raters-report-april-2023.pdf