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Update 2: ESG Laws Across the World

Global – May 2024

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.

The ESG Rating Provider Regulation

With the regulation on environmental, social and governance (ESG) rating provider activities, the EU is the first jurisdiction in the world to move to regulate the ESG rating market. While credit ratings assess the default risk of a company, which can be influenced by ESG factors and other risks through various issues, ESG ratings assess the "sustainability" of companies. On 5 February 2024, the European Union (EU) published a draft proposal (Draft Proposal) for the regulation of ESG ratings.

It marks a significant step towards resolving the concerns raised by the European Securities and Markets Authority (ESMA) in early 2021 regarding the lack of transparency and potential risks for investors in the unregulated ESG rating sector. According to this, ESG rating providers that provide their services within the European Economic Area (EEA) should be subject to authorisation and supervision by ESMA. To achieve this aim, the Draft Proposal requires ESG rating agencies to evaluate and record the effects of companies on ESG factors in a more thorough manner, with the goal of enhancing transparency and integrity in the industry, with the social factor also including human rights.

According to the Draft Proposal, ESG ratings are to be clearly distinguished into environmental, social and governance categories, with the weighting of these three categories clearly defined. If the rating provider deviates from this, e.g. if this division is not viable, it must clearly indicate which category will be given the highest weight in relation to the others when it comes to the company ESG rating.

Furthermore, the parameters that define the future scope of the regulation and the conditions under which ESG ratings are subject to it are clearly outlined. While providers outside the EU/EEA will require the endorsement of an EU-authorised provider or recognition based on a quantitative criterion, EU-authorised providers will need to obtain an authorisation from ESMA; alternatively, they can obtain an equivalence decision through a dialogue between a relevant authority from their home country and ESMA. In addition, a temporary, lighter and voluntary registration program of three years is introduced for small ESG rating providers to facilitate their market access. At the same time, the principle of separation of business and activities is introduced. This means that rating providers can choose not to create a separate legal entity for specific activities if there is a clear separation, and if suitable measures are taken to prevent conflicts of interest.

Nevertheless, ESG rating providers that carry out consulting, audit and credit rating activities are an exception to this. If ESMA determines that adequate steps have been taken to address conflicts of interest, ESG rating providers may still create a benchmark.

The EU Council and EU Parliament must approve the Draft Proposal before it can proceed with the formal adoption procedure. The regulation is anticipated to go into effect fully 18 months after it is enacted. It was one of the final missing pieces for the European Commission to deliver on its sustainable finance commitments outlined in its EU Action Plan.

Corporate Sustainability Reporting Directive (CSRD)

The Commission Delegated Regulation (EU) 2023/2772 published on 19 April 2024, establishes the European Sustainability Reporting Standards (ESRS), These publication standards have been created to comply with the reporting obligations introduced by the CSRD besides IFRS.

The European Commission has proposed a two-year delay on the adoption date for the ESRS for all non-EU companies to June 2026 (instead of June 2024 as stipulated by the CSRD). Non-EU companies shall – provided that their European subsidiaries would not be required to report earlier – start reporting only in 2029 for the financial year 2028. As such, the proposed delay would not be problematic for the reporting purposes of non-EU companies. The proposed decision will now be submitted for publication in the Official Journal of the EU.

Corporate Sustainability Due Diligence Directive (CSDDD) Cleared Path for Formal Approval

The revised wording includes fewer companies in scope, namely:

- EU-incorporated companies with more than 1000 employees and more than €450 million of net worldwide turnover
- Non-EU companies of more than €450 million turnover in the EU The scope becomes more specific to both EU and non-EU companies:
- Where the ultimate parent company exceeds the above thresholds on a group level

- Where franchising or licensing agreements are established with more than €2.5 million royalties and more than €80 million worldwide turnover

Next steps – The European Parliament voted on the revised deal at its last plenary of this mandate, on 24 April. The Council will follow suit in May, after which the law will be published in the Official Journal of the EU. Obligations and reporting dates will kick in gradually, as analysed in our recent client alert.

Deforestation-Free Regulation (EUDR)

The EU's Deforestation-free Regulation, (EUDR) has been in force since 29 June 2023 and will apply from 30 December 2024, when an array of new obligations will affect the supply chains of commodities and products in scope.

China

- **Legislation** – Green Low-Carbon Transition Industry Taxonomy/ Guidelines (adopted/ soon to be effective)

  The "Green Low-Carbon Transition Industry Taxonomy/ Guidelines" is an update to the 2019 "Green Industry Taxonomy/Guidelines", that only included green activities, and were published in February. More transition activities, such as carbon capture, utilisation and storage (CCUS), are incorporated by the update, improving energy efficiency of industrial activities and the clean use of coal. However, no clear sectoral mapping of certain hard-to-abate sectors is included.

- **Regulatory body** – 10 ministries including the central economic planner, the central bank and the securities regulator.

India

- **In development** – Draft Disclosure Framework on Climate-Related Financial Risks

  Starting April 2025, lenders are required to disclose climate finance risks and to meet certain climate targets starting in 2027, as per announcement by the central bank in March 2023. The lender's disclosure obligation would include the impacts of various climate scenarios over the short, medium and long term. Notably, the latest draft of the new rules would make the disclosures mandatory, contrary to the central bank's suggestion in 2022.

- **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

Turkey

- **Legislation** – Turkish Sustainability Reporting Standards (TSRS) (adopted/ soon to be effective)

  In December 2023, it was announced that the TSRS will be imposed on eligible market participants. General Provisions on Disclosure of Sustainability-Related Financial Information are included under the title of TSRS 1, and Climate-related Disclosures are included under the title of TSRS 2. 2024 will be the first mandatory reporting period and the first sustainability reports will be due in 2025. Additionally, reports will need to be assured starting 2026. N-scope companies will not be required to disclose scope 3 emissions in their first two annual reporting periods, nor will they be required to give comparison information in their first reporting period, even though the specific disclosure requirements generally correspond with the standards set by the ISSB.

- **Regulatory body** – Public Oversight, Accounting and Auditing Standards Authority (POA).

Indonesia

- **Legislation** – Taxonomy for Indonesian Sustainable Finance (TKBI)

  As of February, the TKBI is an update to the sustainable finance taxonomy. The taxonomy constitutes a classification of economic activities. As such, it serves as a guide to increase capital allocation and sustainable financing. It includes certain coal projects as "transitional" and eligible for financing, as the science-based taxonomy classification for coal power plants is aimed to be abandoned.

- **Regulatory body** – Indonesian Financial Services Authority (Otoritas Jasa Keuangan, or OJK).

Malaysia

- **In development** – Consultation on Adoption of IFRS Sustainability Reporting (announced/ under consideration)

  In February 2024, a consultation on the proposed use of IFRS's ISSB reporting standards as the basis for mandatory reporting for listed and large companies was announced. The public consultation period was open until 21 March 2024, while the consultation itself follows the establishment of the Advisory Committee on Sustainability Reporting (ACSR) in 2023, with the goal of promoting the use of ISSB standards in a new national sustainability reporting framework. The consultation shows that companies in Malaysia are mainly concerned that they lack the capacity to comply with the new global disclosure standards. Although some larger companies are already taking steps to adapt to the standards, smaller companies may still need support to understand the basics of sustainability reporting.

- **Regulatory body** – Malaysia's Securities Commission (SC).

Sustainability Accounting Standards Board (SASB)

– Creation and promotion of sustainability accounting standards that assist public companies in providing investors with relevant, actionable information. Key Performance Indicators (KPIs) for sustainability that are sector-specific were developed by SASB to supplement the Climate Disclosure Standards Board (CDSB) Framework's guidelines for reporting environmental data in regular corporate reports. With reference to the CDSB Framework for environmental information and natural capital reporting, SASB offers a set of standards to reporting companies across all sectors.

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 various rules and regulations 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 Task force on Climate-related Financial Disclosures (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.

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 of the Sustainability Disclosure is currently under consultation and for climate disclosures, it largely replicates TCFD. A final standard for the Disclosure initiative — Subsidiaries without public accountability: Disclosures is expected in May 2024.

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