Congress Turns Up The Heat On ESG And Climate-Related Disclosures

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Political divisiveness has perpetuated dueling realities in Congress over ESG and climate related disclosures. While the rest of the world is moving forward to require such disclosures, this politicization has slowed parallel efforts in the U.S. If Congress cannot find common ground to support climate-related disclosures that align with those already approved by others, the U.S.' global leadership position in capital markets may be undermined. The U.S. needs to move quickly and act decisively to maintain its place on the world stage.

House Republicans and Democrats' Polarization Continues

Republicans on the U.S. House Financial Services Committee recently wrapped up their "ESG Month" that included a series of hearings on environmental, social, and governance (ESG) issues in July. The committee had more than a half-dozen hearings and advanced four pieces of legislation in opposition to ESG practices, policies and proposed rules. According to reports quoting the committee's GOP ESG working group, the bills are designed, in part, to prevent the Securities and Exchange Commission (SEC) from issuing regulations outside of the agency's scope.

One of the bills sent to the full House, H.R. 4790, the Guiding Uniform and Responsible Disclosure Requirements and Information Limits (GUARDRAIL) Act, would displace the Securities and Exchange Commission's (SEC)

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proposed climate-related disclosure rules and limit the type of disclosures the SEC can compel. The bill would amend both the Securities Act of 1933 and the Securities Exchange Act of 1934 by inserting statutory language directly into both acts saying an “issuer is only required to disclose information in response to disclosure obligation adopted by the Commission to the extent the issuer has determined that such information is material with respect to a voting or investment decision regarding the securities of such issuer.”

In response to ESG Month, House Democrats’ message was that attacks on ESG are attacks on capitalism and free markets. They emphasized the importance of access to ESG data in planning for long-term challenges and making prudent investment decisions. They also pointed to the record breaking July temperatures to highlight the need to hold corporations accountable for their climate impacts.

Most recently, on Aug. 7, 2023, 77 House Democrats responded, albeit indirectly, to the proposed GUARDRAIL Bill, with a letter to SEC Chair Gary Gensler urging the agency to quickly finalize a strong and durable climate rule. The letter includes a reminder that the proposed rule is “grounded in financial materiality” (the standard proposed in H.R. 4790). The letter also briefly addresses the SEC scope and authority issues that were a major focus of ESG Month and H.R. 4790:

“The proposed rule is squarely within the Commission’s authority and mission to protect investors; maintain fair, orderly, and efficient markets; and facilitate the formation of capital. The SEC has ‘longstanding and indisputable authority to regulate the disclosure practices of public traded companies’ to protect markets and market participants. It ‘has exercised its disclosure authority consistently—and without legislative override’ for over ninety years, and ‘has now done so once more with the Proposal on climate-related disclosure.’”

The letter asks the SEC to move forward with the rule without further delay, notwithstanding the partisan discord that resurfaced during ESG Month:

“We are not naive to the environment that has unfortunately injected politics into requirements that should not be controversial and will better enable investors to analyze investment risk and return, allocate capital efficiently, and prioritize investment stewardship and engagement. However, this should not be a reason for continued delay.”

What’s Next for the SEC’s Proposed Climate-Related Disclosure Rule?

Now that both parties in the House have staked out their positions on these issues (again), what is the status of the SEC’s proposed climate related disclosure rule? In the SEC’s most recent rulemaking agenda, the final climate disclosure rules target date was pushed from spring 2023 to October 2023. On July 28, 2023, in remarks before the Financial Stability Oversight Council on climate risk disclosure, Gensler made clear that the agency has a ways to go before issuing the final rule:

“We are considering carefully the more than 15,000 comments we’ve received on the proposal. We greatly benefit from public input and, given the economics and the law, will consider adjustments to the proposed rule that the staff, and ultimately the Commission, think are appropriate in light of those comments.”

In the meantime, the International Sustainability Standards Board (ISSB) finalized its sustainability disclosure standards, IFRS SI and S2 and they were endorsed on July 25 by the International Organization of Securities Commissions (IOSCO). This endorsement is expected to be a strong inducement for adoption of or adaptation to the ISSB standards by jurisdictions worldwide. These standards will available for use voluntarily starting in 2024 for 2025 reporting, and will become requirements at times specified by jurisdictions that formally adopt them.

On July 31, the European Commission (EC) issued its long awaited European Sustainability Reporting Standards (ESRS) required by the EU Corporate Sustainability Reporting Directive (CSRD). These standards, like those from the ISSB, come into effect in 2024, but are mandatory for companies doing business in the EU that meet specified revenue parameters.

The EC and ISSB have been working closely and recently confirmed a high degree of climate-disclosure alignment and interoperability. Subject to some provisions for flexibility, both sets of standards require disclosure of Scope 3 greenhouse gas (GHG) emissions by value chains. It is anticipated that thousands of U.S. companies operating in the EU will be required to comply with the ESRS, and will be subject to ISSB standards in jurisdictions where they are adopted.

Additionally, on Aug. 1, the United Kingdom Department for Business and Trade announced it will conduct a consultation on sustainability disclosure standards in Q1 2024 that “will only divert from the global baseline ISSB standards if absolutely necessary for UK specific matters.” The UK is aiming to endorse, by July 2024, corporate disclosures standards that will track IFRS SI and S2.

In the face of this global trend, the U.S. is falling behind. As nations around the world push for climate-related transparency, Congress remains hamstrung by political differences. This disparity could endanger the U.S.' standing in global capital markets unless it can quickly align with international norms. The House Democrats captured that predicament when they stated in their letter to Gensler “Enhanced climate-related disclosure is the direction of travel for capital markets around the world” and “…the SEC should lead, not follow, in implementing a strong climate-related disclosure rule…” Prompt issuance of the final SEC climate-related disclosure rule is of paramount importance for the U.S. to maintain its international financial stature.