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Creating a climate of change digest

Climate risk regulatory developments in the financial services industry

Leading off

On March 6, 2024, the Securities and Exchange Commission (SEC) issued a final rule that requires registrants to provide climate-related disclosures in their annual reports and registration statements, including those for IPOs, beginning with annual reports for the year ending December 31, 2025, for large accelerated filers.[1]

The final rule scales back the proposed rule in several key ways.[2] For example, companies will not have to provide Scope 3 GHG emission disclosures, their financial statement disclosure requirements will be less extensive, and they will have more time to implement the disclosures and related assurance requirements.

Disclosures required outside of the financial statements include:

- For large, accelerated filers, material Scope 1 and Scope 2 GHG emissions, subject to assurance requirements that will be phased in.
- Governance and oversight of material climate-related risks.
- The material impact of climate risks on the company's strategy, business model, and outlook.
- Risk management processes for material climate-related risks.
- Material climate targets and goals.

In the footnotes to the financial statements, registrants must disclose financial statement impacts and material impacts on their financial estimates and assumptions due to severe weather events and other natural conditions. Companies will also need to disclose a roll-forward of carbon offsets and renewable energy credits or certificates (RECs) in the notes to the financial statements if carbon offsets and RECs are a material component of meeting their climate-related targets and goals.

In his statement about the final rule, SEC Chair Gary Gensler noted that the final rule will provide "investors with consistent, comparable, decision-useful information, and issuers with clear reporting requirements."[3]

On February 13, 2024, the National Association of Insurance Commissioners (NAIC) announced its 2024 strategic priorities.[4]

The NAIC strategic priorities provide guidance to state insurance regulators in addressing the evolving issues that are affecting consumers and the industry at a national level.

The NAIC 2024 priorities that more directly relate to environmental, social, and governance (ESG) matters are summarized below.[5]

1. **Climate risks/natural catastrophes and resilience**
   - Prioritize mitigation, consumer education, and collaboration to address climate-related risks.
   - Create new resilience tools, advocate for pre-disaster mitigation funding, and develop scenario-analysis resources for state regulators.
   - Launch a comprehensive NAIC Climate Risk Dashboard to measure and evaluate protection gaps.
2. **Race and insurance, financial inclusion, and protection gaps**
   - Continue to identify these interrelated and multifaceted issues in 2024, focus on closing protection gaps and widening financial inclusion, receive updates, and recommend statutory or regulatory changes.

The above strategic priorities reflect NAIC's commitment to pursuing innovative and effective solutions to the crucial issues affecting consumers, the insurance sector, and markets.

On January 30, 2024, a coalition led by the US Chamber of Commerce and American Farm Bureau Federation launched a federal lawsuit against the California Air Resources Board, challenging the constitutionality of climate disclosure laws enacted in October 2023.[6]

The lawsuit challenges the constitutionality of two recently enacted California laws, Senate Bills 253 and 261, which compel businesses—irrespective of their location—to make extensive statements about their operations and climate-related risks, allegedly violating the First Amendment. Signed into law on October 7, 2023, by Governor Gavin Newsom, the legislation aims to hold businesses accountable for their perceived inadequate response to the climate crisis. However, the plaintiffs argue that these laws overstep California's jurisdiction, conflicting with federal control under the Clean Air Act and constitutional principles of federalism.

Plaintiffs, while supporting emissions reduction and transparency, contend that the laws disregard scientific considerations, alternative analysis, and legal rights. They highlight the impracticality of a state-by-state regulatory approach and the adverse impact of conflicting regulations on businesses and consumers. The compelled speech includes public statements on climate change risks and greenhouse gas emissions disclosure, allegedly serving the purpose of exerting political and economic pressure on companies, a violation of the First Amendment.

Additionally, the lawsuit claims that the laws have an extraterritorial reach, attempting to regulate conduct worldwide. This, according to the plaintiffs, exceeds California's authority, violating the Constitution's Supremacy Clause, which grants Congress exclusive power over interstate and foreign commerce.

On January 29, 2024, the International Ethics Standards Board for Accountants (IESBA) released two exposure drafts to set forth the first comprehensive suite of global standards on ethical considerations in sustainability reporting and assurance.[7]

The exposure draft is titled "Using the Work of an External Expert"[8] and proposes an ethical framework to guide professional accountants or sustainability assurance practitioners, as applicable, in evaluating whether an external expert has the necessary competence, capabilities, and objectivity in order to use that expert's work for the intended purposes.[9]

The exposure draft, titled "International Ethics Standards for Sustainability Assurance (including International Independence Standards) and Other Revisions to the Code Relating to Sustainability Assurance and Reporting,"[10] proposes a clear framework of expected behaviors and ethics provisions for use by all sustainability assurance practitioners regardless of their professional backgrounds, as well as professional accountants involved in sustainability reporting.

The exposure drafts are aimed at ensuring the integrity and objectivity of publicly communicated sustainability information and have been developed in coordination with the International Auditing and Assurance Standards Board (IAASB) to align the proposals with IAASB's standards.

IESBA will conduct a series of global webcasts where the primary proposals in the exposure drafts would be explained. The deadline for providing comments on the "Using the Work of an External Expert" exposure draft is April 30, 2024. The deadline for providing comments on the sustainability exposure draft is May 10, 2024.

The International Capital Market Association (ICMA) introduced a globally consistent, voluntary Code of Conduct for ESG ratings and data product providers.[11]

This initiative stemmed from the Financial Conduct Authority (FCA) commissioning ICMA and the International Regulatory Strategy Group (IRSG) in November 2022 to establish an industry-led working group, known as the Data and Ratings Working Group (DRWG). The aim was to develop a globally applicable voluntary Code of Conduct for ESG data and ratings providers, with both organizations collaborating under a joint Secretariat.

The Code is heavily based on the International Organization of Securities Commissions' (IOSCO) recommendations for ESG ratings and data products providers in its November 2021 report.[12] IOSCO's report contains 10 recommendations in total; however, the DRWG only focused on IOSCO recommendations 2, 3, 4, 5, 6, 8, and 9, which pertain to "ESG ratings and data products providers."

The Code of Conduct focuses on the following four pivotal areas for reform:[13]

1. **Good governance:** ESG ratings and data products providers are expected to ensure appropriate governance arrangements are in place that enable them to promote and uphold the principles and overall objectives of the Code.
2. **Systems and controls:** ESG ratings and data products providers are expected to adopt and implement written policies and procedures designed to help ensure the issuance of high quality ESG ratings and data products.
3. **Management of conflicts of interest:** ESG ratings and data products providers are expected to identify, avoid, or appropriately manage, mitigate, and disclose actual or potential conflicts of interest that may compromise the independence and objectivity of ESG ratings and data products providers' operations.
4. **Transparency:** ESG ratings and data products providers are expected to make adequate levels of public disclosure and transparency a priority for their ESG ratings and data products.

This comprehensive approach aims to enhance the integrity and reliability of ESG ratings and data products globally.

The Code of Conduct is expected to improve the ability of asset managers, asset owners, and banks to better understand and utilize ESG ratings and data products by promoting good governance, systems, and controls; managing conflicts of interest; and transparency.

Additional Deloitte US perspective on climate risks

For additional insights, please see our ongoing series on how climate risks are shaping US financial regulatory initiatives and the impact these developments may have on the financial services industry and the broader economy:

- *Deloitte 2023 CxO Sustainability Report*
- 2024 financial services industry outlooks
- Climate change and financial risk digest | Deloitte US
- Center for Regulatory Strategy - Sustainability, climate & equity | Deloitte US

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Endnotes

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3. Chair Gary Gensler, "Statement on final rules regarding mandatory climate risk disclosures," SEC, March 6, 2024.
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5. Ibid.
6. Stephanie Noble et al., "Business groups sue California to block recent climate disclosure laws," Vinson & Elkins, February 2, 2024.
7. International Ethics Standards Board for Accountants (IESBA), "IESBA launches public consultation on new ethical benchmark for sustainability reporting and assurance," press release, January 29, 2024.
8. IESBA, "Using the Work of an External Expert," January 26, 2024.
9. Ibid.
10. IESBA, "International Ethics Standards for Sustainability Assurance (including International Independence Standards) (IESSA) and Other Revisions to the Code Relating to Sustainability Assurance and Reporting," January 29, 2024.
11. The International Capital Market Association, "ICMA publishes voluntary Code of Conduct for ESG ratings and data products providers," press release, December 14, 2023.
12. International Organization of Securities Commissions (IOSCO), *Environmental, social and governance (ESG) ratings and data products providers*, November 2021.
13. ICMA and International Regulatory Strategy Group (IRSG), "Code of Conduct for ESG Ratings and Data Products Providers," December 2023.