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Driving Transparency and Aligning Climate-Related Risk Disclosure Requirements

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As the impacts of climate change accelerate, companies face growing risks, including worsening natural disasters, changing consumer preferences, and evolving regulatory landscapes. These climate-related risks can create financial risks for companies. At the same time, many companies have set greenhouse gas reduction targets, including net zero goals, but it is hard for stakeholders to obtain reliable, complete information about companies' progress toward those targets.[1] As climate risks grow, regulators around the globe are taking steps to require companies to disclose the climate-related risks that affect their business and provide more information about target setting and planning within the company.

In light of new corporate climate-risk disclosure requirements from the Securities and Exchange Commission (SEC), the state of California and other jurisdictions, regulators, and stakeholders are considering ways to ensure that mandatory disclosures make climate-related reporting more accurate and transparent. As mandatory reporting grows, it is important to ensure that regulators achieve their goals, and that unintended adverse or counter-productive consequences are limited. For example, regulators will want to ensure the information they require companies to report aligns with global best practices already in place and drives greater transparency without creating a chilling effect on corporate climate ambition. And regulators, investors, and consumers must be able to verify that companies making net zero commitments, or setting other climate targets, are making progress toward those goals, and achieving measurable emissions reductions.

In this paper, we describe the rise in mandatory climate-related reporting by the SEC, California, and the European Union, and briefly compare requirements across these jurisdictions. We discuss recent studies assessing how these requirements are affecting corporate behavior and anticipate some important questions that are likely to arise and emerging areas for research as the shift from voluntary to mandatory disclosure takes hold.

Increasing Mandatory Climate-Related Reporting

Many companies report their climate-related risks, targets, and progress in annual sustainability reports, voluntary databases, and to a more limited extent, public filings.[2] To date, producing this

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[1] *See, e.g.,* Comello, Stephen et al., *Corporate Carbon Reduction Pledges: An Effective Tool to Mitigate Climate Change?* ZEW - Centre for European Economic Research Discussion Paper No. 21-052 (2021) https://ssrn.com/abstract=3875343; Arnold, Jack & Perrine Toledano, *Corporate Net-Zero Pledges: The Bad and the Ugly*, Columbia Center on Sustainable Investment (2021) https://ssrn.com/abstract=4042058.

[2] 929 of the Forbes 2000 have set net zero targets, compared with 417 in 2020. Net Zero Tracker, *Net zero targets among world's largest companies double, but credibility gaps undermine progress* (June 12, 2023) https://zerotracker.net/insights/net-zero-targets-among-worlds-largest-companies-double-but-credibility-gaps-undermine-progress.

information has been largely voluntary, piecemeal, and inconsistent, as companies respond to different requirements established by non-governmental organizations.[3]

However, governments are increasingly requiring climate-related disclosures, which they justify in part as necessary to respond to investor demand for more consistent, accurate, and complete information about companies' exposure to climate-related risk.[4] The new rules are enforceable and include civil or administrative penalties for inaccurate or incomplete reporting.

Mandatory disclosure is intended to help stakeholders assess the climate risks that companies face, and it can help stakeholders understand how companies with greenhouse gas reduction targets and net zero commitments are progressing toward their goals. In the US, the SEC finalized a climate-related risk disclosure rule that requires all public companies to provide information in SEC filings about material climate-related risks and requires a subset of large companies to report their material scope 1 and 2 greenhouse gas emissions.[5]

In California, the governor signed three laws designed to enhance climate disclosures by companies doing business in the state, including reporting greenhouse gas emissions, climate-related risks, and

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[3] Historically, one way that companies have shared these targets and their progress toward them is through voluntary reporting to CDP (formerly Carbon Disclosure Project), and other NGOs provide guidance and best practices for GHG measurement, climate target setting, and sustainability reporting. Since 2000, CDP has solicited voluntary annual climate reporting from private and public actors worldwide, and in recent years, over 20,000 companies have filed such reports. Though CDP data shows that more companies worldwide are setting climate targets, voluntary surveys may not tell the full story about how companies are managing climate-related risks and progressing toward their targets. Even though there might be reputational penalties associated with inaccurate or incomplete voluntary reporting, companies may be selective with what they choose to report. Additionally, voluntary reporting does not elicit consistent and transparent information about how companies manage the full suite of climate-related risks that can affect their financial performance.

[4] One global survey of 439 institutional investors found that nearly 80 percent of them consider climate risk to be at least as important as financial disclosure, and that over 70 percent of surveyed investors prefer mandatory, standardized reporting over existing voluntary regimes, which they consider to be "uninformative and imprecise." 67 percent of investors reported that existing company disclosures are not precise enough and 73 percent of investors wanted mandated and standardized climate disclosures. The researchers sent the survey to 1,018 institutional investors, but only 439 investors responded. Investors that chose to respond to the survey may skew towards those that care about climate risk. The study reported that investors in countries with stewardship codes or climate-conscious norms and investors from very large firms generally place significant importance on climate risk reporting. Emirhan Ilhan, Phillip Krueger, Zacharias Sautner, Laura Starks, *Climate Risk Disclosure and Institutional Investors*, 36 Rev. Fin. Studies, 2617, 2619–2626 (2023), https://academic.oup.com/rfs/article/36/7/2617/6978207?login=false. The SEC's final rule explicitly responds to these concerns, with the commission explaining that it promulgated the rule to ensure "consistent, comparable, and reliable disclosures…which will enable investors to make more informed investment and voting decisions." Securities and Exchange Commission, The Enhancement and Standardization of Climate-Related Disclosures for Investors ("Final Rule") (March 6, 2024), https://www.sec.gov/files/rules/final/2024/33-11275.pdf at 18.

[5] Legal challenges to the SEC final rule have been filed by states, private industry, and environmental groups in multiple courts. On March 21, nine circuit court challenges were consolidated in the Eighth Circuit. On April 4, the SEC voluntarily stayed the rule, noting that "the Commission will continue vigorously defending the Final Rules' validity in court and looks forward to expeditious resolution of the litigation." In Re: Securities and Exchange Commission, The Enhancement and Standardization of Climate-Related Disclosures for Investors, Issued on March 6, 2024, J.P.M.L., MCP No. 180.

information about carbon offsets. These laws apply to both public and private companies[6] of a certain size that do business in California, while the SEC requirements apply only to public companies. Other states, including New York and Illinois, are now considering similar bills.[7]

US companies doing business abroad also need to comply with a growing number of disclosure requirements in other countries. For example, the European Union Corporate Sustainability Reporting Directive (EU CSRD) will apply to some US companies doing business in Europe in coming years.[8] The EU CSRD requires companies to report based on a concept known as double materiality — meaning that companies must report not only the impact of climate change on their operations but also how their operations affect the environment, including how they contribute to climate change.

Depending on their size and scale of operations, public and private companies may be reporting on both a mandatory and voluntary basis to different regulators in multiple jurisdictions concurrently. As these disclosure regimes proliferate, there is potential for confusion, inconsistency, duplication, and unintended consequences that could undermine the goals of climate-related financial disclosure: accurate and transparent reporting of decision-useful information relevant to investors. Below, we anticipate some key questions that regulators, regulated companies, investors, and other stakeholders will want to consider as these regimes go into effect.

Aligning Voluntary and Mandatory Reporting

Ideally, climate-related disclosure to multiple entities on climate impacts, risks, and planning would be aligned over time so that companies could submit substantially similar reporting for all entities. International efforts, including the Taskforce on Climate-related Financial Disclosures (TCFD) and International Sustainability Standards Board (ISSB), which have informed IFRS S2,[9] have worked to create global alignment on reporting best practices to facilitate streamlined disclosure.[10] California included a provision in its new greenhouse gas reporting law that allows companies disclosing

[6] A recent report from Net Zero Tracker found that private companies are making net zero commitments at a lower rate than public companies and argued that "[a]s regulatory systems ramp up, staying silent on net zero increases transition risks for themselves [as private companies], and undermines genuine emission-cutting efforts by nations and other non-state entities." Net Zero Tracker, A Distinctly Private Pursuit: Not Going Net Zero (April 22, 2024), https://zerotracker.net/analysis/private-companies-not-going-net-zero.
[7] S.B. 897A, 2023-2024 Leg. Sess. (N.Y. 2023); S.B. 5437, 2023-2024 Leg. Sess. (N.Y. 2023); H.B. 4268, 103d Leg. Gen. Assemb. (Ill. 2024)
[8] Commission Delegated Regulation of 31.7.2023 supplementing the 2013/34/EU of the European Parliament and of the Council as regards sustainability reporting standards. The timeline for non-EU company reporting was delayed by 2 years in early 2024. Commission Regulation amending Directive 2013/34/EU as regards the time limits for the adoption of sustainability reporting standards for certain sectors and for certain third-country undertakings (Feb. 2024), https://www.consilium.europa.eu/en/press/press-releases/2024/04/29/council-adopts-directive-to-delay-reporting-obligations-for-certain-sectors-and-third-country-companies/.
[9] See more about the IFRS S2 standard at IFRS, *IFRS S2 Climate-related Disclosures* https://www.ifrs.org/issued-standards/ifrs-sustainability-standards-navigator/ifrs-s2-climate-related-disclosures/ (last visited Feb. 28, 2024).
[10] For more information about the TCFD and ISSB processes, see IFRS, https://www.ifrs.org/sustainability/tcfd/ (last visited Feb. 28, 2024).

climate-related information to the SEC or another entity may submit the same information to the state as long as those requirements are at least as comprehensive as California's.[11]

After the focus on target setting in the early 2020s, companies are now shifting to implementation. Mandatory disclosure is one tool to ensure that companies are transparent about the steps they are taking to achieve their climate commitments. For example, the SEC rule requires disclosure related to a company's climate plans, targets, and internal carbon price, information that can help investors and stakeholders track a company's progress toward its greenhouse gas reduction, net zero, or other climate goals.

Research Findings include Decrease in Voluntary Reporting, Impact on Corporate Behavior

Mandatory disclosure regimes must be carefully designed to avoid unintended adverse consequences. For example, if the legal obligation to disclose information is triggered only when a company announces a climate target, will companies hesitate to set climate targets and goals in the interest of avoiding disclosure? And for companies that were relatively early actors in setting goals without clear plans to achieve the longer-term targets, will increased transparency and disclosure requirements lead some to now weaken their ambition?

Researchers are beginning to study the early effects of the shift from voluntary to mandatory climate-related disclosure to determine if it could have such a "chilling effect" by discouraging companies from making commitments. One 2023 study looked at 1,041 firms that had set CDP emissions targets ending in 2020 and found that while about 60 percent achieved their 2020 climate targets, over eight percent of firms failed their 2020 targets and almost 31 percent had "disappeared," meaning they stopped voluntarily reporting on their 2020 targets.[12] The researchers found that in countries with environmental disclosure mandates, there is a higher rate of disappeared firms that stop reporting their progress on a voluntary basis to CDP.[13] The authors speculate that firms may be trying to avoid heightened scrutiny of their commitments by "going dark" and ending their voluntary commitment reporting, or that firms in countries without mandatory reporting can more easily present favorable data.[14] Another 2023 study on the behavior of companies with climate pledges found that for companies in high-emitting sectors climate goals are not yet aligned with emissions-reducing initiatives or outcomes.[15]

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[11] When the California Air Resources Board promulgates implementing regulations, the agency may give more clarity as to which jurisdictions it deems as comprehensive. *See* S.B. 253, 2023-2024 Leg. (Cal. 2023) (which allows for emissions reports prepared for other jurisdictions as long as they "satisfy all the requirements of this section")*;* S.B. 261, 2023-2024 Leg. (Cal. 2023) (which allows for reports prepared for other jurisdictions if they are prepared pursuant to a law, regulation, or listing requirement for an exchange or government or where they are voluntarily creating a report under the standards of the ISSB).

[12] Xiaoyan Jiang, Shawn Kim, Shirley Lu, *Accountability of Corporate Emissions Reduction Targets* 4 (Working Paper, No. 4676649, 2023), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4676649

[13] In some cases, "disappeared" firms updated their targets to a target that ends in a later year, in other cases, the authors note that firms' emissions lagged behind their targets. *Id.* at 17–18.

[14] *Id.*

[15] Simone Cenci, Matteo Burato, Marek Rei, & Maurizio Zollo, *The alignment of companies' sustainability behavior and emissions with global climate targets*, Nat. Commc'n Dec. 1, 2023 at 4–6, https://www.nature.com/articles/s41467-023-43116-2.

Although studies on the effects of mandatory disclosures on company behavior are limited, some initial research suggests that disclosures may contribute to emissions reductions. One study found a decrease in pollution associated with a mandatory corporate social responsibility disclosure requirement,[16] and another found an increase in mine safety in firms that were required to disclose their mine safety provisions under the Dodd-Frank Act.[17] As mandatory reporting in the US, EU, and other jurisdictions generates more data, we can expect to see new studies assessing the effect of disclosure requirements on corporate management of climate-related risk, including how companies are implementing their climate plans, whether they are making progress toward their greenhouse gas reduction and net zero commitments, and the extent to which their behavior measurably and materially reduces emissions.

Looking Ahead

The shift from voluntary to mandatory reporting raises questions for regulators, scholars, NGOs, businesses, and other stakeholders to consider as the climate-related disclosure landscape rapidly evolves.[18] While academic research and emerging regulations have started to explore these issues, we raise questions that warrant further consideration regarding policy design, legal risk, and business strategy.

How can regulators incentivize accurate and complete disclosures? Recent research highlights a tension inherent to mandatory disclosure regimes: investors want regulators to add safeguards to ensure that companies share accurate information without discouraging companies from setting ambitious climate goals. Regulators designing mandatory regimes should consider how to strike this balance. The SEC's final rule, for example, includes a safe harbor from private litigation for forward-looking information related to climate transition plans, scenario analysis, internal carbon pricing, and targets and goals to reduce the legal risk of disclosure and the potential chilling effect of having to disclose information about climate-related plans.[19] As that rule is implemented, it will be important to assess how companies respond and identify regulatory design options to avoid potential chilling effects.

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[16] Specifically, the study found a decrease in SO_2 emissions and industrial wastewater associated with China's 2008 corporate social responsibility mandatory disclosure requirements. Yi-Chun Chen, Ming-yi Hung, & Yongxiang Wang, *The effect of mandatory CSR disclosure on firm profitability and social externalities: Evidence from China*, 65 J. Acct. & Econ. 169, 173–179 (2018), https://www.sciencedirect.com/science/article/pii/S0165410117300757.

[17] Hans B. Christensen, Eric Floyd, Lisa Yao Liu, Mark Maffett, *The real effects of mandated information on social responsibility in financial reports: Evidence from mine-safety records,* J. Acct. & Econ. 284, 288–95 (2017), https://www.sciencedirect.com/science/article/pii/S0165410117300538.

[18] In 2021, Hans Christensen, Luzi Hail, and Christian Leuz published a literature review outlining academic literature on corporate social responsibility reporting. This literature review provides a thorough explanation of early research into the topic, and as more mandatory requirements take effect, academic research can build off these early studies. Hans B. Christensen, Luzi Hail, & Christian Leuz, *Mandatory CSR and Sustainability Reporting: Economic Analysis and Literature Review*, 26 Rev. Acct. Stud. 1176 (2021).

[19] SEC Final Rule at 397-398. In addition, commenters on the SEC's climate risk disclosure *proposal*, which would have required firms to report their scope 3 GHG emissions only if they had set an emissions target that includes scope 3, argued that the proposal would have chilled companies from setting targets. The final rule pulled back the GHG reporting requirement.

How can nongovernmental organizations continue to drive voluntary reporting? Even before the recent proliferation of mandatory standards, organizations like CDP and independent voluntary standard-setting bodies like ISSB helped thousands of companies report climate-related information. As mandatory reporting becomes more common, how can CDP and others continue to inform, streamline, and improve standards? Can CDP help companies prepare for mandatory reporting as timelines remain uncertain in many jurisdictions? Can standard-setting bodies like the International Financial Reporting Standards Foundation help to harmonize reporting across jurisdictions so that companies are not responding to a patchwork of regulations? Can nongovernmental agencies hold companies accountable and drive transparency on companies' progress on their net zero goals?[20]

How can reporting align as more jurisdictions set requirements? Regulators have worked to support the interoperability of reporting regimes. For example, the SEC's climate risk disclosure rule and California's climate risk disclosure law were informed in part by the TCFD reporting framework. Consistent requirements will help companies improve their ability to measure and report their impacts and risks accurately and control the costs of doing so. How can jurisdictions operating under different legal frameworks and policy objectives build in comparability across regimes to enable regulators, investors, consumers, and others to understand and interpret the data being reported, control costs, and reduce duplication or unnecessary complexity which inhibits transparency?[21]

Can we design mandatory regimes that will adapt over time? As companies become adept at climate-related reporting, regulators may want regimes that evolve to reflect changing reporting capacity, new information for investors, updated targets, and more. How can regulators use the information that they receive in early reporting years to adjust and refine reporting frameworks over time to improve transparency while balancing the need for companies to have regulatory certainty?

Can mandatory disclosure regimes reduce political pressure on companies? In the US, some members of Congress and in several states have caused companies to back away from environmental, social, and governance (ESG) investments and net zero industry alliances, threatening a variety of legal challenges if they do not.[22] How can mandatory disclosure regimes help companies avoid and defend against such legal challenges?

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[20] *CO2 Watchdog Delists Net Zero Pledges of More than 200 Companies*, Bloomberg, Mar. 22, 2024, https://www.bloomberglaw.com/product/blaw/bloomberglawnews/esg/BNA%200000018e-665f-d509-adee-6fdfb5820003.

[21] In their 2021 literature review, Hans Christensen, Luzi Hail, and Christian Leuz discussed how voluntary reporting was leading to a heterogeneity of corporate social responsibility disclosures and determined that it "remains an open issue to what extent CSR reporting standards can rein in the current heterogeneity in voluntary CSR disclosures and lead to harmonization effects." Hans B. Christensen, Luzi Hail, & Christian Leuz, *Mandatory CSR and Sustainability Reporting: Economic Analysis and Literature Review*, 26 Rev. Acct. Stud. 1176, 1230 (2021).

[22] For a summary of state anti-ESG legislation and other efforts, see Ropes and Gray, Navigating State Regulation of ESG, https://www.ropesgray.com/en/sites/navigating-state-regulation-of-esg. In Congress, Republicans attempted to block a Dept. of Labor retirement investment rule allowing consideration of ESG among other factors. Dept. of Labor, Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights (Dec. 2023) (codified at 29 CFR 2550) https://www.federalregister.gov/documents/2022/12/01/2022-25783/prudence-and-loyalty-in-selecting-plan-investments-and-exercising-shareholder-rights.

How might disclosure affect litigation risk related to companies' net zero claims? As companies disclose more information to regulators, we could see an increase in consumer protection lawsuits related to companies' net zero and other sustainability claims.[23] Consider, for example, litigation challenging Evian and Delta's claims of carbon neutrality.[24] Such suits have typically focused on claims made about specific goods and products, but the risk to companies may expand. The Federal Trade Commission intends to release new guidance on environmental marketing claims.[25] How will this guidance and requirements for new disclosures affect companies' legal and reputational risk, and how will that affect their willingness to set and work towards greenhouse gas reduction targets?

What other data do stakeholders need to understand the emission reductions of net zero commitments? As companies move from target setting to implementation and from voluntary to mandatory reporting, stakeholders will have more complete information about the greenhouse gas impact of net zero commitments. The broader the disclosure coverage, the more complete the picture will be across the U.S. economy so stakeholders can understand how emissions might shift across the economy and, for example, if companies are selling off polluting assets to private equity, which simply shifts the emissions to a different actor. Mandatory disclosure will likely help stakeholders begin to understand what is happening in terms of overall emissions levels and leakage since it will provide a more comprehensive picture of emissions than the current piecemeal reporting. What additional data or other disclosures will we need to develop this more comprehensive picture of emissions across the economy?

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[23] For more on these potential legal risks related to net zero claims, see our piece on climate alliances and legal risk.

[24] *Berrin v. Delta Airlines*, No. 2:23-cv-04150 (C.D. Cal. May 2023); *Dorris v. Danone Waters of America*, Docket No. 7:22-cv-08717 (S.D.N.Y.).

[25] Guides for the Use of Environmental Marketing Claim, 88 Fed. Reg. 7656 (proposed Dec. 20, 2022).