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ISS: Challenges Remain in Interoperability of Sustainability Disclosure Standards

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In its annual Global Regulatory Update (the 2023 Update Report), Institutional Shareholder Services (ISS) determined that the application of different ESG disclosure and reporting frameworks presents significant challenges for companies. The 2023 Update Report delves into several recent regulatory developments and analyzes the state of ESG regulations internationally, describing these disparate regulatory initiatives as a collective “work-in-progress” that has created “a labyrinthine landscape for financial market participants to navigate.”

The 2023 Update Report addresses the comparability of the International Sustainability Standards Board’s (ISSB) Sustainability Disclosure Standards and the European Commission’s European Sustainability Reporting Standards (ESRS). The report describes the level of interoperability between the ISSB and ESRS as “an open question.” The two frameworks share the overall approach adopted by recommendations issued by the Taskforce on Climate-Related Financial Disclosure (whose work has not been taken over by ISSB), but they diverge on the definition of materiality, flexibility in companies’ application of materiality assessments, and time provided to implement certain disclosure requirements.

The 2023 Update Report cites regulatory fragmentation across the globe as a major concern for issuers of investment products and major fund managers that operate across jurisdictions. ISS flagged one example with respect to fund classification: the UK’s Financial Conduct Authority, the Hong Kong Securities and Futures Commission, and the Monetary Authority of Singapore have all referred to the European Union’s Sustainable Finance Disclosures Regulation (SFDR) in connection with their disclosure regimes, yet in both Hong Kong and Singapore, funds may ultimately be required to provide additional disclosures to be marketed to retail investors as ESG funds. Fund naming rules vary widely across jurisdictions: Hong Kong, for instance, requires that 70% of the fund’s net asset value (NAV) be aligned with the ESG strategy reflected in the fund name, Singapore requires that twothirds of the product's NAV be aligned with its ESG strategy, and in the U.S. the SEC's recently promulgated "Names Rule" requires 80% alignment.

Another area that the report explores, using the EU, U.S., and Japan as case studies, is the evolution of due diligence obligations in corporate supply chains. Japan has already introduced human rights due diligence guidelines, the first in Asia. As we discuss here and here the EU Corporate Sustainability Due Diligence Directive (CSDDD) and the EU Corporate Sustainability Reporting Directive (on which the CSDDD builds), could impact significantly corporate supply chain standards in Europe. If the CSDDD comes into force by 2024 as planned, EU member states will then transpose it into domestic legislation.

Final Thoughts

Overall the 2023 Update Report's findings are not surprising or unexpected. As we have discussed, different jurisdictions' evolving ESG regulatory regime poses challenges. Standardized regimes across jurisdictions would ease the disclosure burden. We report on this trend here with respect to specifics in the EU, here in terms of Asia's developments, and here with regard to Canada.

(This article originally appeared in Cadwalader Climate, a weekly newsletter on the ESG market.)
