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DISCLOSURE REGULATION AND SUSTAINABILITY

Kern Alexander and Aline Darbellay

1. Introduction

This chapter considers disclosure obligations of environmental sustainability risks that apply to companies. It analyses recent international developments by highlighting how the disclosure requirements for environmental and social governance (ESG) risks have evolved in the European Union, Switzerland, United Kingdom and United States. A shift of paradigm relating to sustainability disclosure regulation is underway. This chapter explains the disclosure requirements in light of the growing importance for companies to disclose environmental and social risks and related factors that are relevant to their operations. It also discusses potential cross-border strategies for countries to develop international standards to support global convergence. In recent years, both international standard-setters and national policymakers and regulators have established some standards and principles for sustainability-related disclosure. Despite limited progress internationally, the European Union adopted a Sustainable Finance Disclosure Regulation (SFDR)[1] in 2019 applicable to regulated financial firms and a delegated regulation in 2022 that intends to harmonise sustainability-related disclosures across member states for financial sector firms.[2] The EU also adopted a Corporate Sustainability Reporting Directive (CSRD) in 2022 that aims to harmonise ESG reporting for all EU-based companies and all non-EU companies doing business in Europe.[3] The different sustainability disclosure requirements between EU countries and non-EU countries suggests, therefore, that cross-border regulatory coordination is important.

The chapter addresses the question of what regulatory approach for cross-border coordination would be most beneficial for the convergence and eventual harmonisation of sustainability disclosure standards. The application of home-state rules versus the application of host-state rules is a recurring issue in financial regulation, and sustainability-related disclosure is no exception. Moreover, issues may arise such as how to avoid redundant and conflicting requirements. In considering an appropriate

[1] Regulation 2019/2088/EU of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector, OJ L 317, 9.12.2019 (hereinafter referred to as "SFDR").

[2] Commission Delegated Regulation 2022/1288/EU of 6 April 2022 supplementing Regulation 2019/2088/EU with regard to regulatory technical standards (RTS), OJ L 196, 25.07.2022 (hereinafter referred to as "SFDR RTS").

[3] Directive 2022/2464/EU of the European Parliament and of the Council of 14 December 2022 amending Regulation No. 537/2014/EU, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as regards corporate sustainability reporting, OJ L 322, 16.12.2022 (hereinafter referred to as "CSRD 2022").

model, the overarching principle of investor protection should be given priority.[4] In addition, the interests of broader stakeholders should be taken into account. Given the global reach of sustainability risks, the chapter suggests that extraterritorial application of a country's regulations and laws may be necessary to promote convergence and eventual harmonisation of regulatory disclosure standards.[5]

Besides the analysis of how to resolve conflicting jurisdictional requirements for sustainability-related disclosures, the chapter will also discuss the transparency duties of corporations and more specifically the mandatory disclosure of non-financial or extra-financial information by companies. Particular focus will be given to the 2022/2464/EU CSRD,[6] which increases the non-financial disclosure obligations of European companies and non-European companies doing business in Europe, and the CSRD's predecessor legislation, i.e. the 2014/95/EU Non-Financial Reporting Directive (NFRD), which required the disclosure of non-financial and diversity information by certain large undertakings and groups.[7]

Part II considers the international developments justifying the rationale for sustainability-related disclosures and related economic and legal theories of corporate governance along with a discussion of the three models of cross-border disclosure regulation. The three models of disclosure regulation countries can adopt are presented with a view to assessing what rules apply to cross-border activities. These models are (i) the home state approach, (ii) the host state approach and (iii) the equivalence approach. By referencing to these three models, part III analyses the EU CSRD legislation for corporate sustainability reporting to argue that it has adopted a mix-and-match model between the host state approach and the equivalence approach. Our analysis emphasises the extraterritoriality of EU sustainability disclosure regulation. Part IV analyses the models followed by the UK, the US and Switzerland with a view to assessing the cross-border challenges posed by evolving sustainable disclosure regulation. Part IV recommends a model of ESG disclosure for capital markets that is based on the EU policy of equivalence modified by the selective substituted compliance approach.

[4] Tafara and Peterson 2007, 31, 32.

[5] Avi-Yonah 2003, 16.

[6] CSRD 2022 (n 3).

[7] Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups, OJ L 330, 15.11.2014 (hereinafter referred to as "NFRD 2014").

2. International Developments

2.1. Evolving Perspectives on Sustainability

Sustainability disclosure regulation relies on the definition of sustainability by the scientific community. The 1987 report of the World Commission on Environment and Development, also called the "*Brundtland Report*", was one of the first documents of an international body wherein a definition of the notion of sustainable development could be found.[8] Sustainable development was defined as " [the] *development that meets the needs of the present without compromising the ability of future generations to meet their own needs.*"[9] This concise definition has raised awareness of the need for the current generation to act in a way that is not harmful for future generations' development.[10] Other international bodies, such as the IPCC or the United Nation Educational, Scientific and Cultural Organisation (UNESCO), have adopted this definition in official statements.[11] More precisely, a strong emphasis has been laid on climate change risks. In 2014, the IPCC made it clear that climate change is increasingly manifesting itself in more extreme weather events.[12] Since the pre-industrial era, the concentration of green-house gases (GHG) in the atmosphere has increased to unprecedented level.[13] Scientists tend to attribute high GHG levels to industrial development and related economic activity, resulting in significantly warmer average temperatures.[14] The seas and oceans are also facing an increase in their temperature.[15] Given human influence on this phenomenon, the scientific community has called for action to be taken.

Standard economic models have been designed on the assumption that the market can efficiently allocate resources and typically do not incorporate the environmental and social costs of economic activity.[16] However, asymmetric information and negative externalities[17] arising from inadequate investor understanding of the risks to which they are exposed can lead to misallocation of capital that can cause social and environmental

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[8] World Commission on Environment and Development (WCED), Our Common Future (March 1987) (hereinafter referred to as "Brundtland Report"); Richelle 2021, 147; Yohe et al. 2007, 819; Rankin 2014, 1379.

[9] Brundtland Report (n 8), 41; Lambooy 2006, 221; Scanlan 2021; Monsma and Buckley 2004, 170.

[10] Scanlan 2021, 13.

[11] *See* Brundtland Report (n 8) 41 or UNESCO 2011.

[12] Landrigan et al. 2017, states that the: "*Evidence of observed climate change impacts is strongest and most comprehensive for natural systems.*"; IPCC 2014, 6 (hereafter referred to as "The Fifth Assessment Report").

[13] *Ibid.* 4: "*Anthropogenic greenhouse gas emissions have increased since the pre-industrial era, driven largely by economic and population growth, and are now higher than ever.*"

[14] *See Ibid.* 6: "*In recent decades, changes in climate have caused impacts on natural and human systems on all continents and across the oceans*". *See* also de Cendra de Larragán 2017,150; Moulin 2020; *see* also United Nation 2015 (hereafter referred to as "Paris Agreement"), 1.

[15] Landrigan et al. 2017, 40.

[16] Koopmans 1951; Cobbaut 2018*,* 405.

[17] *See* Pigou 1920, stating the classic externality problem of dirty smoke generated by a firm in its production process and the need to impose 'bounties' or 'taxes' on the polluting firm. *See* also Helbing 2010; and Mitchell Polinsky 1979; Yandle 1999.

costs.[18] In this respect, the current environmental and climate crisis can be seen as a consequence of inefficient allocation of capital caused in part by inadequate disclosure to investors of the material financial risks arising from environmental degradation.

From the corporate law perspective, the shift from shareholder primacy (i.e., shareholder wealth maximisation) to alternative concepts and practices of corporate purpose is underway.[19] We argue that disclosure is a key topic of sustainable corporate governance. Transparency has always played an essential role in ensuring good corporate governance. Traditionally, mandatory company reporting requirements focused on the disclosure of information that was economically and financially material, but in recent years more jurisdictions have begun requiring the disclosure of a broader array of information, much of it not directly financially material in the short-term. Also, company boards, under pressure from longer-term investors such as pension funds and insurance companies, have begun to disclose more information to investors about their long-term strategies to support ESG objectives.[20] In that sense, disclosure is a core element in the assessment of the viability and long-term view of the corporation.[21]

Companies are also under pressure to disclose non-financial information related to their perceived corporate social responsibilities. Such disclosures are often made in order to enhance their reputation with investors and the public.[22] This can potentially improve financial results and have a positive impact on the company's share price.[23] Disclosure of such information can also lead to enhanced stakeholder confidence in the company.[24] Furthermore, from a competition point of view, the disclosure of non-financial information can influence competitor firms to disclose more non-financial information as well. The lack of standards and definitions, however, regarding non-financial disclosures has led to calls for more regulation to protect investors against misleading disclosures and the lack of comparability between companies in what they disclose.[25] As a result, policymakers and regulators around the globe have responded with a variety of approaches to encourage companies to provide more relevant and

[18] Lee 2006; de Cendra de Larragán 2017, 149.

[19] *See* Helleringer and Skinner, Chapter 4 in this volume; Christensen, Hail and Leuz 2019, calling for corporations to account for their social responsibilities; George et al. 2022; Henderson and Ramanna 2015 (stating that managers are 'agents not only of their shareholders but also of the system that sustains market capitalism').

[20] Coibion and Filbiche 2021, 62; CDBS 2020, 8.

[21] Ahern 2016, 600.

[22] European Commission 2001, para. 66 (European Parliament Resolution C24/28 of 6 February 2013 on corporate social responsibility: accountable, transparent and responsible business behaviour and sustainable growth, OJ 2016 C 24/28, para 23, 22 January 2016 (hereinafter referred to as "European Parliament 2013 Resolution"): "[the European Parliament] stresses that corporate responsibility must not be reduced to a marketing tool […]".

[23] Gasser 2020, 46.

[24] *Ibid.* 46.

[25] Ahern 2016, 626; European Parliament 2013 Resolution (n 22), para. 24.

comparable information for investors regarding ESG and other socially responsible reporting.

2.2. The Rise of International Standards

The Paris Climate Change Treaty of 2015 sets forth binding requirements on countries to reduce the level of carbon in their economies.[26] Under the Paris Treaty, states have committed to limiting global warming to well below 2, preferably to 1.5 degrees Celsius, compared to pre-industrial levels. The Treaty requires states to disclose carbon emissions and to report on whether they are achieving their reduction targets.

International standards on the disclosure of climate change risks have emerged with the adoption of the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) in 2017.[27] The TCFD serves as an international catalyst by contributing to enhancing corporate reporting in the realm of climate change risks. A large number of states have adapted their laws to comply with the TCFD recommendations. Annual reviews have shown progress among various states in adjusting their company reporting requirements to meet the TCFD standards.[28] Yet, annual reviews have also reported that companies should have more precise and comparable standards upon which to base their disclosures. With respect to materiality, the TCFD has recognised the insufficiency of disclosure around material financial risks.[29] A major recommendation consists of including material climate-related risks in the mainstream annual financial filings.[30] It includes a recommendation to disclose the actual and potential impacts of climate-related risks and opportunities as well as metrics and targets in the annual financial filings where such information is material.[31] In addition, the TCFD makes the recommendation that certain large companies provide such information in other reports even when the information is not deemed material in terms of short-term effect on share price because of the likelihood that these companies will be financially impacted over time.[32] In so doing, the TCFD has recognized the importance and the evolution of the notion of materiality; however, it does not mark a significant departure from the traditional notion of financial materiality that is the basis for most company reporting requirements.[33] In so doing, it contributes to the financialisation of sustainability.[34] Further, the TCFD has determined what sustainability-related information has to be disclosed separately from

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[26] United Nations 2015.
[27] TCFD 2017.
[28] E.g., TCFD 2022.
[29] TCFD 2021a.
[30] *Ibid.*, 14.
[31] *Ibid.*, 15.
[32] *Ibid.*, 14.
[33] Darbellay and Caballero Cuevas 2023, 47.
[34] Hösli and Weber 2021.

an assessment of the information's materiality: initially, such information only covered disclosures relating to governance and risk management.[35] In its 2021 Annex, the TCFD recommends a wider scope of disclosure to include metrics such as Scope 1 and Scope 2 green-house gas (GHG) emissions independent of a materiality assessment, while recommending that Scope 3 GHG emissions remain subject to a materiality assessment.[36]

Regarding securities regulation, the International Organisation of Securities Commissions (IOSCO) has played a leading role in promoting disclosure requirements on a global scale. In 2021, the IOSCO issued a report on sustainability-related issuer disclosure, thereby aiming at promoting sustainability disclosures for the capital markets.[37] The IOSCO has positioned itself as the global standard setter for ESG capital markets. It has attempted to place itself in a position to influence the development of disclosure requirements for sustainability information. Similarly, the International Accounting Standards Board (IASB), which promulgates the International Financial Reporting Standards (IFRS), has established the International Sustainability Standards Board (ISSB). Enhanced coordination between the IOSCO and ISSB would add more coherence and consistency between company sustainability disclosure standards and accounting reporting standards.

2.3. Three Models of Cross-Border Disclosure Regulation

With a view to regulating on a cross-border basis, national jurisdictions can adopt one or more of the three following models, thereby typically using a mix-and-match of different approaches as follows. First, the home state of the company approach, which is also referred to as the country-of-origin principle, mandates the application of the law of the country of origin of the company and restricts the application of the rules of the country of destination.[38] An example stems from the passporting mechanism prevailing among EU/EEA states. The country-of-origin approach between EU/EEA states is built on the idea of mutual recognition. Accordingly, the home country license provides a passport that suffices for the entire Single Market, meaning that no further authorisation is required to provide financial services in other EU/EEA Member States.[39]

At the global scale, regulators in home countries may apply their national law on an extraterritorial basis. For instance, whenever the unilateral application of the law to the entire multinational corporate group (consisting of many subsidiaries established in

[35] TCFD 2017, 14.
[36] TCFD 2021a, 7; TCFD 2021b.
[37] IOSCO 2021.
[38] Ralf 2006, 196.
[39] Alexander 2022, 17-18.

multiple jurisdictions) is justified, the home country would typically be the one applying its law to the entire corporate group on an extraterritorial basis.[40] In various areas of regulatory law, the public interest justifies the unilateral and extraterritorial reach of the home state's regulatory requirements.[41] In terms of sustainability disclosure regulation, it is understandable that home jurisdictions may seek an extraterritorial application of their laws. Indeed, it makes sense for home-state regulators to ensure that entities registered in their territories comply with the same sustainability disclosure requirements with respect to their conduct abroad.

Second, under the host state approach, foreign entities have to comply with host-state regulation.[42] Financial services providers may only access the market if they have registered with host-state authorities and obtained an authorisation or a license. This approach often results in an extraterritorial application of host-state law and regulation to foreign entities. For instance, the US Sarbanes-Oxley Act of 2002 had – at the time of its entry into force – unexpected extraterritorial implications for foreign issuers with securities listed on US exchanges.[43] Further, in the realm of derivatives regulation, the US Dodd-Frank Act of 2010 gives authority to the SEC and CFTC to prevent the evasion of US rules requiring the central clearing of derivatives by authorizing US regulators to impose uniformity through the extraterritorial application of US law.[44] In terms of sustainability disclosure regulation, it is not surprising that host jurisdictions may consider applying their laws to the cross-border activities of foreign entities in host countries, thereby pursuing the regulatory objective of investor protection.

The extraterritorial application of laws, however, has drawbacks. If a host state applies its laws extraterritorially to foreign business entities and the latter are already subject to home-state regulation, they would be required to comply with the rules of two jurisdictions. Multiple compliance with two or more jurisdictions may impose unnecessary burdens on regulated entities or may even lead to conflicting obligations, thereby making it difficult to operate on a cross-border basis. This leads to consideration of a third approach based on an equivalence determination by the host-state regulator. A host state's decision to grant equivalence to the home country of a firm seeking market access into the host country market is based on a comparability assessment of the home country's regulatory standards, rules and laws. This can lead to exemption from certain compliance requirements for the firm whose home country's regulations and laws have been granted equivalence.

There is no uniformly accepted global approach for granting market access to foreign financial firms. A recurring issue in the EU-US financial services dialogue concerns

[40] Avi-Yonah 2003, 17.
[41] *Ibid.*, 20.
[42] Host states may for instance be the countries where investors are based and/or the countries where securities are listed.
[43] Alexander et al. 2007, 3.
[44] Griffith 2014, 1329-30.

the issues related to the extraterritorial application of local laws and the solution provided by exempting foreign entities from host-country requirements provided that they are subject to acceptable regulatory oversight in their home jurisdiction.[45]

Alternatively, some consideration might be given to the principle of reciprocity. Reciprocity would condition cross-border coordination on mutual recognition of regulations and laws by home and host countries. Nevertheless, mutual recognition has its weaknesses.[46]

As a subset of the equivalence approach, the theory of substituted compliance consists of accepting foreign legal requirements as an acceptable substitute for domestic requirements.[47] This involves avoiding the requirement to register with host-state regulators and being deemed in compliance with host-state law and regulation by complying with their home-state law and regulation.[48] Substituted compliance is the opportunity for a foreign entity to substitute compliance with its home-state regulator for compliance with host-state regulation.[49] Host-state regulators may make their determinations by taking into account several factors for determining comparability, including (i) comparable scope and objectives, (ii) comparable comprehensiveness of regulation, and (iii) comparable supervisory capacity and enforcement authority.[50]

Selective substituted compliance may be designed as to give regulators the opportunity to influence substantive components of foreign regulatory systems or as to grant exemptive relief without regard to the quality of supervision in foreign jurisdictions.[51] One possibility is to perform a subjective evaluation of the quality of supervisory oversight in individual jurisdictions.[52]

For instance, the SEC did not offer a blanket exemption but merely an exemption for foreign issuers that comply with IFRS standards.[53] Further, substituted compliance consists of the primary instrument of extraterritoriality in the Dodd–Frank Act's OTC derivatives reforms.[54] Selective substituted compliance can be tailored to discourage regulatory arbitrage.[55] In fact, it promotes a regulatory diversity in the context of derivatives regulation while combating regulatory arbitrage through the exercise of extraterritorial jurisdiction.[56]

[45] Alexander et al. 2007, 22.
[46] Yadav and Turing 2015.
[47] Jackson 2015, 178.
[48] Artamonov 2015, 209.
[49] Griffith 2014, 1334.
[50] *Ibid.*
[51] Jackson 2015, 182.
[52] *Ibid.*, 179.
[53] *Ibid.*, 177.
[54] Artamonov 2015.
[55] Tafara and Peterson 2007, 67.
[56] Griffith 2014, 1294.

Regarding the EU equivalence approach, the EU Commission examines whether the third-country state complies with international standards that are implemented in the EU. For instance, the European Market Infrastructure Regulation (EMIR) established an equivalence regime, which provided the EU Commission with the power to declare that the legal, supervisory, and enforcement arrangements of a third country are equivalent to the EMIR requirements towards derivatives transactions.[57] While making an equivalence determination, the EU Commission can request ESMA's technical advice with respect to third-country regulatory frameworks, which consists of a line-by-line analysis of the similarities and differences between the requirements as well as an objective-based approach.[58]

Further, the equivalence approach may be divided into equivalence subject to dispute resolution *versus* policy-based equivalence. If it is subject to dispute resolution, it is possible to challenge the host state's refusal to grant equivalence in court. If it is policy-based, granting equivalence is discretionary for the host state and no legal appeal is possible against the decision. The EU equivalence process has been policy-based. The challenges it can generate include the contingent nature of the Commission equivalence decision, the opacity of the equivalence process, and its limited justiciability.[59] In fact, the EU explicitly adopted the policy of equivalence in 2003 as a market access mechanism to assist in assessing the quality and acceptability of third-country regulations as part of its decision to accept or decline market access. Following the June 2016 decision of the United Kingdom to leave the EU (Brexit), the EU has used the process of granting equivalence as a political bargaining tool.[60] The political nature of the equivalence assessments has also affected other third countries such as Switzerland.[61]

In terms of sustainability disclosure regulation, since there has been a fragmentation of international standards and national rules, the equivalence approach may be useful for jurisdictions that have relatively similar regulatory requirements and processes. Equivalence decisions can lead over time to regulatory convergence.

[57] Artamonov 2015, 217; Art. 13 of the Council Regulation 648/2012 of 4 July 2012 on OTC derivatives, central counterparties and trade repositories, OJ 2012 No. L201, 27 July 2012. *See* also Yadav and Turing 2015, 11-12.

[58] Artamonov 2015, 218.

[59] Moloney 2023, 858.

[60] Conac 2019, 77.

[61] *Ibid.*

3. EU Legislative Developments on Sustainable Disclosure Regulation

3.1. Major Developments

The EU has been at the forefront of sustainable corporate governance, in particular by reforming disclosure regulation.[62] The desire to work towards the development of a sustainable economy was one of the political objectives set by the European Council in Lisbon at its special meeting in March 2000.[63] One year later, in 2001, the European Commission published its Green Paper in which it highlighted the increasing trends of large companies to act and assume their corporate social responsibility (CSR), in particular, by doing reporting.[64] At the same time, some international initiatives were gaining attention from major companies. These international developments – in parallel with the EU's increasing focus on CSR and environmental reporting – have had a direct impact on the legislation adopted by the EU from 2014 onwards. Moreover, one of the points to be improved was the disclosure of social and environmental information by companies. Information needed to be published to "[…] *facilitate engagement with stakeholders and the identification of material sustainability risks.*"[65]

A few Member States had already taken steps in this direction prior to the call of the European Parliament to take action. The French legislator had adopted important CSR instruments since 2001.[66] For instance, the Grenelle II Act adopted in 2010 imposed an extra-financial reporting obligation for large companies listed on the stock exchange.[67] The extra-financial reporting framework was, at the time, focused on 42 reporting indicators.[68] Among other Member States, Denmark also introduced a disclosure requirement for non-financial information in 2008.[69] The legislative initiatives were adopted under the pressure from civil society and different stakeholders.[70] The main difference underlined by the literature between the two

[62] Conac 2022, 112.

[63] European Council, Presidency Conclusion (Lisbon, 23/24 March 2000) EUCO 10/00 (2000): "*The Union has today set itself a new strategic goal for the next decade: to become the most competitive and dynamic knowledge-based economy in the world capable of sustainable economic growth with more and better jobs and greater social cohesion.*"

[64] European Commission 2001, para. 66.

[65] European Commission 2011, 11.

[66] Delbard 2008; Schweizerisches Institut für Rechtsvergleichung 2018, 27; Knudsen and Moon 2017, 85; Doucin 2017, 480-481.

[67] Art. 225 of the French Legislative Act No. 2010-788 of 12 July 2010 on national commitment for the environment, NOR: DEVX0822225L, OJ 2010 No. 610, 13 July 2010 (Loi n 2010-788 du 12 juillet 2010 portant engagement national pour l'environnement, NOR: DEVX0822225L: JO n 610, 13 Juillet 2010); *see* generally Szabo and Sorensen 2015.

[68] French Legislative Act on national commitment for the environment (n 67); Schweizerisches Institut für Rechtsvergleichung 2018, 27.

[69] Danish Legislative Act No. 1403 of 27 December 2008 on the amendment of the Annual Accounts Act, j.nr. 2008-0017695 (Lov n 1403 af 27 December 2008 om om ændring af årsregnskabsloven, j.nr. 2008-0017695). *See* also Buhmann 2013.

[70] *See* Doucin 2017, 481.

approaches is the level of flexibility given to firms.[71] In Denmark, the choice of the model was left at the discretion of the firms, while in France, the requirements were specified in detail by the legislator.[72]

3.2. Non-Financial Reporting (NFR) as a Regulatory Concept

In 2014, the EU legislator amended the Accounting Directive by adopting the Non-Financial Reporting Directive (NFRD).[73] The European legislator defined the notion of NFR as referring to "*a non-financial statement containing information to the extent necessary for an understanding of the undertaking's development, performance, position, and impact of its activity, relating to, as a minimum, environmental, social and employee matters, respect for human rights, anti-corruption, and bribery matters*".[74] The adoption of the NFRD marked the first legislative action at the EU level for disclosing a company's non-financial activities.[75] The NFRD made it mandatory to disclose environmental and social information that is relevant to a company's economic activity.[76] However, the NFRD was only applicable to certain large undertakings and groups and not applicable to small and medium enterprises.[77]

The EU NFRD adopted a hybrid model which permitted reliance on standards derived from market practice with some new legally binding rules.[78] In terms of disclosure obligations, companies were required to make a statement containing information of a non-financial nature. Reporting requirements ranged from business models of the undertakings in question, to pursued goals and policies, including due diligence processes that had been implemented.[79]

In addition, the European legislator opted for a 'comply or explain' approach, i.e. a methodology that combines self-regulation and hard law. Accordingly, if they were required to provide information regarding, for instance, the policies put in place to reduce their environmental footprint, a company that decided not to publish this information had to provide a clear and reasoned explanation for not doing so.[80] Furthermore, the European legislator gave the choice to the Member States, when implementing the Directive, to allow, in exceptional cases, companies to not have to

[71] Szabo and Sorensen 2015.
[72] Blin-Franchomme 2015.
[73] NFRD 2014.
[74] *Ibid.* Art. 1(1) as modifying Directive 2013/34/EU by inserting Art. 19a.
[75] Scanlan 2021, 26.
[76] NFRD 2014, preamble para. 8.
[77] *Ibid.* preamble para. 14. NFRD 2014 imposed a reporting obligation on large firms which exceeded an average number of 500 employees during the financial year and had a balance sheet total of € 20 million or a net turnover of € 40 million.
[78] *See* Wagner 2018.
[79] Art. 1(1) of the NFRD 2014, as modifying Directive 2013/34/EU by inserting art. 19a(1)(b)(c).
[80] *Ibid. See* discussion in Ahern 2016, 620.

publish certain pieces of information covered by the NFR duty, if "[…] *the disclosure of such information would be seriously prejudicial to the commercial position of the undertaking* […]."[81] Altogether, the NFRD followed a minimum harmonisation approach that left the question of which model to follow to the discretion of companies.[82]

3.3. The Corporate Sustainability Reporting Directive (CSRD) – A Paradigm Change

In April 2021, the Commission published a proposal to amend the NFR framework. In November 2022, the CSRD was enacted as a part of the EU Sustainable Finance package.[83] The revised directive amends four existing pieces of legislation as follows: the Accounting Directive, the Transparency Directive, the Audit Directive, the Audit Regulation. The scope of the directive is significantly extended to apply to a larger number of European and non-European companies listed and operating in the EU regulated markets.[84]

The CSRD marks a shift of paradigm in corporate sustainability reporting. Above all, it moves to a hard law model. Companies that have to report under the CSRD will be required to use a set of sustainability reporting standards developed by the European Financial Reporting Advisory Groupe (EFRAG).[85] The CSRD departs from the previous qualification of sustainability information as non-financial. In so doing, the EU seeks to treat sustainability reporting on an equal footing with financial reporting. The CSRD consistently requires the publication of sustainability-related information through the management report.[86] In order to guarantee the reliability of the reported information, the CSRD mandates independent auditing and certification of the reports.[87] To clarify its far-reaching approach, it explicitly adheres to the double

[81] NFRD 2014; La Torre et al. 2018. For example, in Belgium, use was made of this provision: art. 3(6), para. 4; *see* also: Gollier 2018.

[82] NFRD 2014, preamble para. 9: "[…]*, undertakings which are subject to this Directive may rely on national frameworks, Union-based frameworks such as the Eco-Management and Audit Scheme (EMAS), or international* […]". In this regard, different institutional frameworks can be referred to, such as the United Nations (UN) Global Compact, the Guiding Principles on Business and Human Rights implementing the UN 'Protect, Respect and Remedy' Framework, the OECD Guidelines for Multinational Enterprises, the International Organisation for Standardisation's ISO 26000, the ILO's Tripartite Declaration of principles concerning multinational enterprises and social policy, the Global Reporting Initiative, or other recognised international frameworks.

[83] CSRD 2022 (n 3).

[84] *Ibid.* Art. 1 as amending Art. 19a(1) and art. 29a(1) of Directive 2013/34/EU.

[85] EFRAG, Draft European Sustainability Reporting Standards: Due Process Note, November 2022; *see* also EFRAG, Draft European Sustainability Reporting Standards: Explanatory Note of How Draft ESRS Take Account of the Initiative and Legislation Listed in Article 1 (8) of the CSRD Adding Article 29(b)-5 to the Accounting Directive, November 2022.

[86] CSRD 2022 (n 3) preamble para. 79.

[87] *Ibid.*

materiality perspective.[88] Accordingly, reporting companies have to disclose both exposure of the company to ESG and companies impact on ESG. Owing to the fact that the selection of a disclosure regulation model reflects the legal approach to corporate governance, mandatory disclosure requirements relating to more sustainability-related information than before supports the modern view of the corporation. Accordingly, this approach falls within the evolving concept of the company as seeking a corporate purpose. This is transforming how companies approach their decision-making processes by adopting governance mechanisms taking into account the interest of stakeholders.

3.4. Financial Sector-Specific Sustainable Disclosure Regulation under the Sustainable Finance Action Plan

Disclosure has so far been the main regulatory tool deployed in the realm of EU sustainable finance regulation.[89] While corporate reporting as addressed by the CSRD is part of the EU Sustainable Finance Action Plan, there are also other types of information covered by the law that are more specifically related the financial sector. The cornerstones of the sustainability disclosure regulation relating to financial institutions consist of the SFDR and the Taxonomy Regulation, which are complementary to and aligned with the CSRD.[90]

The High Level Expert Group (HLEG) on Sustainable Finance appointed by the Commission in 2016 made important recommendations in its final report in January 2018.[91] The HLEG report recommended enhanced disclosure as one of the measures and governance practices that could be explored and made a proposal for a green taxonomy so that definitions of green assets are set by official public bodies and not the banks themselves.[92] In March 2018, the Commission published a Sustainable Finance Action Plan with a view to incentivising investors to make sustainable investments.[93]

[88] *Ibid.*, preamble para. 29 (stating that the double materiality perspective is often misunderstood and clarifying the fact that the directive 2013/34/EU requires to report both on the impacts of the activities of the undertaking on people and the environment, and on how sustainability matters affect the undertaking).

[89] Moloney 2023, 58.

[90] SFDR (n 1); Regulation 2020/852/EU of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation 2019/2088/EU, OJ L 198, 22.6.2020 (hereinafter referred to as "Taxonomy Regulation"); CSRD 2022 (n 3).

[91] European Commission High Level Experts Group on Sustainable Finance 2018.

[92] Alexander and Fisher, 'Banking Regulation and Sustainability', in F.-J. B. Van den Boezem, C. Jansen and B. Schuijling (eds.), *Sustainability and Financial Markets* (Alphen aan den Rijn/Philadelphia: Wolters Kluwer, 2019).

[93] European Commission 2018.

The EU introduced the SFDR with a view to imposing sustainability disclosure obligations on banks and other financial institutions.[94] The SFDR requires them to be transparent about their integration of sustainability risks into their investment policies, remuneration policies, general pre-contractual disclosures, and their marketing of financial instruments. Articles 8 and 9 of the SFDR are more remarkable, as they impose additional requirements for those financial products, including investment funds, that promote sustainable characteristics or have sustainability objectives, respectively.[95] The SFDR has been completed by regulatory technical standards (RTS) adopted by the European Commission to ensure that sustainability-related disclosures in the financial services sector are sufficiently clear, concise, and prominent to enable end investors to make informed decisions.[96]

In addition, the Taxonomy Regulation supports the EU objective of reorienting capital flows toward a more sustainable economy. With respect to financial institutions, it established the framework of criteria to be met in order to consider an activity or a product as environmentally sustainable. So far, the focus has been limited on environmental risk. The idea is to expand it in the future with a view to involving all ESG aspects.[97] While transparency standards have existed long before they were amended to incorporate sustainability requirements, green taxonomies have emerged in recent years as a new, unorthodox instrument of financial regulation. They are meant as dictionaries of those investments and economic activities that are environmentally sustainable, i.e. that can be labelled as green. To determine those activities that are environmentally sustainable, the Taxonomy Regulation refers to six environmental objectives: climate change mitigation, climate change adaptation, the sustainable use and protection of water and marine resources, the transition to a circular economy, pollution prevention and control and the protection and restoration of biodiversity and ecosystems.[98] In this respect, the EU goes beyond other taxonomies focusing on climate change. To qualify, an economic activity should substantially contribute to one or more of these environmental objectives, not do any significantly harm to any of those objectives, be carried out in compliance with minimum human rights and labour safeguards, and comply with the technical screening criteria of the actual EU Taxonomy to be adopted by the European Commission via delegated acts.

[94] *See* Busch 2021; Hooghiemstra 2020.
[95] *See* further de Arriba-Sellier and Van Caenegem, Chapter 10 in this volume.
[96] SFDR RTS (n 2), preamble para. 1.
[97] Taxonomy Regulation (n 88), preamble para. 6.
[98] *Ibid.*, Art. 9.

4. Sustainable Disclosure Regulation and Cross-Border Coordination

4.1. UK, US and Swiss Law Approaches to Sustainable Disclosure Regulation

This section summarises the ongoing developments relating to sustainable disclosure regulation in the UK, the US and Switzerland. The comparative analysis underlines the major differences between the approaches, thereby emphasising the need to select a model of cross-border coordination. The question arises as to whether national law should provide a legal basis for cross-border coordination with other national authorities, and also whether to create a regulatory mechanism for national authorities to coordinate and interact with international financial standard setting bodies.

Similar to the EU SFDR, the UK's Green Finance Technical Standards Commission has also recommended that sustainability risks should be subject to mandatory disclosure requirements under the UK's post-Brexit prospectus, market abuse and *ad hoc* disclosure requirements. The Financial Conduct Authority (FCA) consulted in 2021 on how to incorporate the sustainability-related disclosures of the Sustainable Finance Disclosure Regulation into the UK listing rules.[99] The FCA issued a policy statement in late 2021 that provides an overview for the application of the climate-related financial disclosure requirements and how they can be extended to issuers of standard-listed shares and Global Depositary Receipts representing equity shares.[100]

The FCA will likely recognise the financial materiality of sustainability-related information in terms of the UK market abuse rules.[101] Given the increasing importance of sustainable finance to UK financial regulation, the FCA will define the situations in which sustainability-related information is deemed to be inside information, that is, likely to have a significant effect on the prices of an issuer's financial instruments, if such information were made public. Another question relevant to the UK market abuse regime is to what extent sustainability-related information is subject to *ad hoc* disclosure requirements. Finally, as sustainability-related information is increasingly recognised as financially material to an issuer, the FCA may well consider it to be 'specific' or 'precise' information as defined under UK criminal insider dealing law. As a result, corporate issuers have substantial criminal and civil liability exposure for failing to disclose sustainability-related information (or mis-reporting it) if the information is likely to have a significant impact on the price of the issuer's securities. With respect to corporate law, the UK 2006 Companies Act Section 172 continues to primarily focus on the interest of shareholders, nevertheless while also listing other stakeholders. In so doing, the UK moved toward the enlightened

[99] *See* FCA 2021a.

[100] FCA 2021b; *cf* also for enhanced climate-related disclosures by asset managers, life insurers and FCA-regulated pension providers FCA 2021c.

[101] In relation to financial materiality of sustainability-related information, *see* Ruth 2019.

shareholder value (ESV) model.[102] This has an effect on the scope of sustainability information that has to be disclosed.

Recent US regulatory initiatives have required the disclosure of climate finance risks. For example, in March 2022, the Securities and Exchange Commission (SEC) proposed a rule that will impose transparency obligations for publicly listed companies in the US related to their climate risk exposure.[103] Given the integrated disclosure system prevailing in the US, the SEC's proposed rules would apply to all listed companies, which not only include large systemically-important banks, but also other issuers from various sectors. The SEC proposal establishes a mandatory sustainability disclosure regime that broadly follows the framework proposed by the Task Force on Climate-Related Disclosures (TCFD). If adopted, the SEC's proposed rule will require securities issuers to disclose all climate-related financial risks likely to affect their businesses in their annual reports, including relevant information on governance and risk management processes.[104] Issuers will have to be transparent about the climate-related risks and opportunities, including in their financial statements.[105] Disclosure of scope 1 and 2 emissions will be required, while value chain emissions disclosure will only be mandatory where those scope 3 emissions are material to the business.[106] Also, the proposal only partly responds to widespread doubts about the quality, methodological underpinnings, comparability, and integrity of corporate sustainability metrics, which have represented a major obstacle to having effective disclosure requirements for climate finance risks. Regarding scope 1 and 2, the SEC's proposed rules would require an attestation report by an independent third party, which will at least provide limited assurance in a first phase and then scale up to reasonable assurance after a transition period.[107] Despite the high likelihood of judicial challenges, the SEC's rule may be considered on par with the US Supreme Court's definition of financial materiality, which centers on disclosure of information that a "reasonable investor" would view as significant in making an investment decision.[108]

The more cautious US approach, which focuses only on disclosing climate finance risks, can be contrasted with the EU approach, which involves a series of laws and

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[102] Helleringer and Skinner, Chapter 4 in this volume.
[103] SEC 2022.
[104] *Ibid.*, 21336.
[105] *Ibid.*, 21349.
[106] *Ibid.*, 21468; *see* TCFD, 2021a, 7.
[107] SEC's proposed rules, 21395.
[108] *See*, e.g., Securities Act of 1933, Section 7, 15 USC § 77g and Securities Exchange Act of 1934, Sections 12, 13, and 15, 15 USC §§ 78l, 78m, and 78o (regarding SEC's authority to promulgate disclosure requirements that are necessary or appropriate in the public interest or for the protection of investors); *see* Susko 2018, 10989, 10990, 11000 (analysing the uncertain judicial treatment of compelled commercial disclosures and proposing a return to a balanced rational basis review so that the SEC can adopt mandatory disclosure requirements in the realm of corporate sustainability reporting); Strine 2022 (stating that the SEC's statutory authority to require climate-related financial disclosures is firmly rooted in the statutory text).

regulations requiring disclosures of most ESG risks. Therefore, the EU disclosure rules cover a broader definition of sustainability risks, by reference to three dimensions of ESG. Moreover, the US approach is essentially limited to disclosure and is not combined with corporate law reforms at the state level. Overall, while a couple of US states have adopted provisions that include some form of stakeholder governance, most US states still rely on the more traditional shareholder-centric view of the firm.[109]

In Switzerland, the financial market authority FINMA has amended its circulars in July 2021 to include the disclosure of climate-related reporting based on TCFD recommendations.[110] The scope of FINMA's disclosure requirements is limited to regulated financial intermediaries. Corporate sustainability reporting is part of the corporate law framework. In this regard, the Swiss Code of Obligations (SCO) was amended in 2020 to include an obligation to disclose non-financial information.[111] It is worthwhile noting that these amendments were based to a great extent on the EU NFRD approach. In so doing, this gives the advantage of not imposing additional compliance burdens on Swiss companies who are also subjected to the extraterritorial reach of the EU requirements. However, the framework is already outdated at the time of entry into force of the EU CSRD. Therefore, the Swiss sustainable disclosure regulation regime may eventually lag behind. With respect to international standards, Switzerland seeks to adopt TCFD-aligned disclosure requirements. The Federal Ordinance on climate reporting makes a static reference to the 2017 TCFD recommendations and its 2021 Annex.[112] In terms of corporate governance, Swiss corporate law tends to follow the enlightened shareholder value (ESV) model. Adherence to the Business Judgment Rule has awarded some level of discretion to company boards with a view to taking into account the interest of stakeholders.

4.2. The Preferred Model of Cross-Border Sustainable Disclosure Regulation

Since the EU, the UK, the US and Switzerland diverge in the regulation of ESG disclosure, it is crucial to select a particular model of cross-border coordination. The preferred model should seek the overarching objective of investor protection whilst also taking into account other stakeholder interests. The features of the three main models should be analysed with these objectives in mind, thereby allowing an

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[109] Helleringer and Skinner, Chapter 4 in this volume (stating that most US corporations incorporate in the state of Delaware and that the Delaware General Corporation Law (DGCL) has not directly taken up ESG).

[110] FINMA, Amendments to Circular 2016/01 on the public disclosure of banks and 2016/02 on the public disclosure of insurance companies (May 2021).

[111] Art. 964*a-c* of the Federal Act of 30 March 1911 on the Amendment of the Swiss Civil Code (Part Five: The Code of Obligations), SR 220.

[112] Art. 3 para. 1 of the Federal Ordinance on Climate Disclosures (OCD) of the Swiss Federal Council, as adopted by the Federal Council in November 2022 and entering into force on 1st January 2024, SR 221.434.

assessment of which of the three models of cross-border disclosure regulation are the most suitable.

First, the preferred model discourages regulatory arbitrage. The divergences between the EU, the UK, the US and Switzerland in the regulation of ESG disclosure result in the risk of regulatory arbitrage. Due to different rules, regulated actors may pick the jurisdiction where compliance costs are lower. It is indeed problematic if some states have lower standards. The risk exists in the three models of cross-border disclosure regulation. The only way to eliminate regulatory arbitrage would be to achieve global convergence, raising the question of how to reach a convergence of standards. The end goal should be to achieve standardisation internationally. However, the diversity of the sustainable disclosure regulation will not be overcome in the near future. Nevertheless, it is argued that regulatory arbitrage may be reduced under the equivalence approach. According to selective substituted compliance, legal systems are recognised provided that they are equivalent in quality. This approach limits the incentive for national jurisdictions to lower standards to attract businesses.

Second, the best model promotes competitiveness in the realm of achieving sustainability objectives. There are two sides of the same coin. On the one hand, competition and regulation are intertwined. The diversity of law and regulation remains a positive point as we are in a trial and error phase. On the other hand, the issue arises as to promoting competitive markets, i.e. ensuring a level playing field where all market participants compete on an equal footing. This is linked with the question of regulatory arbitrage. States would like to ensure that actors do not move elsewhere.

Third, the preferred model promotes standardisation. This contributes to achieving the regulatory objective of investor protection. Indeed, users of information need comparable, relevant and reliable ESG information. The question arises as to whether substitute compliance may be promoted as a way of promoting standardisation. For instance, selective substituted compliance may be realised by looking at the implementation of international standards. While assessing the quality of foreign law regulation, it makes sense to take into account the implementation of international standards, for instance TCFD-aligned disclosure. Also, the ISSB is developing a comprehensive global framework for sustainability-related disclosure standards. Since the IOSCO has expertise in comparing regulatory regimes, a possibility may come from strengthening the role of the IOSCO in promoting cross-border regulation.[113]

Finally, the best model promotes the integration of ESG capital markets. There is a need to avoid market fragmentation. "Host country regulations are often an excuse for financial protectionism".[114] The equivalence approach may be used as a liberalisation

[113] Conac 2019, 79.
[114] Persaud 2010.

tool provided that it is designed to facilitate cross-border activities.[115] Also, the objective should consist of avoiding duplicative and conflicting rules. Drawing upon the application of substituted compliance in the case of the transatlantic agreement between the ESMA and the CFTC with respect to clearing derivatives, we argue that this could also be achieved in the area of ESG.

4.3. The Benefits of the Equivalence Model in the Light of the Extraterritorial Reach of EU Sustainable Disclosure Regulation

One of the most ground-breaking aspect of the EU CSRD is its extraterritorial reach, which is commonly referred to as the Brussels effect. This directive is a particularly good example of a mix-and-match of different approaches, including both the host state model and the equivalence model. Concern has thus been raised about the application of the equivalence approach to the NFR framework.

The scope implies extraterritorial reach. Owing to the reference to Art. 2 and 3 of the Directive 2013/34/EU, the approach is aligned with the regime prevailing for the disclosure of financial information. The CSRD covers both EU and non-EU issuers whose securities are listed on EU regulated markets and the disclosure obligations apply to the entire enterprise.[116] This means that large third-country firms that have debt securities listed on EU regulated markets will be subject to the rules regardless of the place of listing of their shares.[117] It covers large EU undertakings and third-country undertakings with substantial activity on the EU Single Market with a European subsidiary or a European branch. The fact that the presence of third-country undertakings implies the disclosure of a sustainability report by the parent company applying to the entire enterprise was debated in the legislative process. This is a question of the entity versus enterprise approach. The EU decided to require reporting at the consolidated level. If an EU subsidiary or branch is subject to the CSRD, the third-country parent company is indirectly subject to it. To this end, an intermediate solution was found. The subsidiary or branch must make its best efforts to obtain the necessary information from the third-country undertaking. If not all required information is provided by the third-country undertaking, the subsidiary or branch provides the information in its possession and indicates that the third-country undertaking did not make the required information available.[118] Due to the extraterritorial application of the CSRD, this approach corresponds to the trend of

[115] Conac 2019, 76.
[116] Art. 1 of the CSRD 2022 (n 3) as amending Art. 19a(1) and art. 29a(1) of Directive 2013/34/EU.
[117] Conac 2022, 115.
[118] Art. 1 of the CSRD 2022 (n 3) preamble para. 20.

going for host country regulation, which is unfortunately a step back in terms of global integrated markets.

Nevertheless, the CSRD provides for a legal basis for the equivalence approach.[119] Accordingly, the Commission should be empowered to establish a mechanism for the determination of equivalence of sustainability reporting standards applied by third-country issuers of securities. The idea is to seek consistency with accounting standards. This has the advantage of consistency but misses the fact that sustainability disclosure regulation is different from traditional disclosure requirements in the capital markets.

In particular, the CSRD has addressed the topic of the exempted subsidiary undertaking[120] as well as the exempted parent undertaking.[121] For instance, accordingly, there is a possibility of exempting a subsidiary undertaking on the basis of the sustainability reporting of the parent undertaking. The exemption should not apply to large listed undertakings. Finally, due to the concern of the competitiveness of EU markets, there is a possibility to exempt a parent undertaking established in the EU when its subsidiary in a third-country applies sustainability reporting abroad, which is a form of deference to host country regulation from the perspective of the enterprise.

In sum, the use of the concept of equivalence may help the EU export its sustainable disclosure regulation to other jurisdictions and to promote the widespread adoption of international standards.[122] There is a need to strike the right balance between adopting a far-reaching sustainability disclosure regulation framework and accepting foreign rules as sufficient. Further, the standards may avoid disproportionate compliance burdens on companies by taking into account the work of global standard-setting initiatives for sustainability reporting.

5. Conclusion

This chapter shed light on recent developments in the realm of sustainable disclosure regulation. We analysed the shift of paradigm relating to sustainability reporting disclosure requirements in the context of the evolving debate over whether company boards have a duty to focus mainly on shareholder wealth maximisation, and/or on broader ESG stakeholder interests. Accordingly, companies are required to disclose more information to the public, including both their exposure to ESG risks and their impacts on achieving ESG economic and social objectives. Nevertheless, even under the shareholder primacy view of the firm, the concept of financial materiality may be expanded as to encompass a broader array of information, including ESG information,

[119] *Ibid.*, preamble para. 24 and Art. 2 as amending Art. 23 para. 4 of Directive 2004/109/EC.
[120] *Ibid.* as amending Art. 19a(9) of Directive 2013/34/EU.
[121] *Ibid.* as amending Art. 29a(8) of Directive 2013/34/EU.
[122] Conac 2019, 76.

that is necessary for investors to make an informed investment decision. This chapter addressed the international standards of sustainability disclosure from a cross-border perspective with a focus on EU legislative developments and how they contrast with those in Switzerland, the United Kingdom and the United States with a view to assessing the feasibility for developing a framework to support global convergence. The regulatory approach for cross-border coordination is an important regulatory consideration in light of the divergences between various jurisdictions in the regulation of ESG disclosure. Emphasis was laid on EU legislative developments in the field of corporate sustainability reporting, given the fact that the EU has been at the forefront of sustainable disclosure regulation. The chapter further suggests that the extraterritorial application of the EU sustainability disclosure regulations under the CSRD will influence the emerging sustainable finance architecture. Finally, we concluded that selective substituted compliance may help address the cross-border aspects relating to ESG capital markets.

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