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GS SUSTAIN

ESG regulations: US SEC proposes major new climate disclosure requirements

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As mentioned in our 2022 outlook report, we believe 2022 will be a watershed year for ESG-related capital markets regulation in the US, adding to momentum in Europe and in the Asia Pacific region. Today's climate disclosure rule proposal from the SEC opens the door for the broadest federally mandated corporate ESG data disclosure requirement ever in the US. This proposal comes amid a backdrop of broad shareholder support for greater and more standardized corporate ESG disclosure as well as a shifting regulatory landscape in the US. However, questions around the scope of any final rule will remain as legal challenges are anticipated.

What happened? The SEC unveiled a landmark proposal for companies to disclose a wide variety of data on their climate-related risks (and opportunities). The proposed rule includes already well disclosed metrics (Scope 1 & 2 GHG emissions), more expansive, less widely-reported Scope 3 emissions (only where material or where companies already have set an emissions target incorporating Scope 3), as well as some qualitative disclosures similar to those codified by the Task Force on Climate-Related Financial Disclosures (TCFD), exceeding our expectations of a more modest Scope 1 & 2-focused framework.

What to watch for? The proposal kicks off a 60-day public comment period during which investors and registrants can offer feedback for the commission. Legal challenges are widely expected. Beyond this proposed rule, additional corporate disclosure requirements around human capital and political spending as well as increased process disclosures for funds labeling themselves as sustainable or ESG are near-term areas of focus for the commission.

Why now? Examining recent ESG-related federal regulatory developments and proxy trends of the past several years, scrutiny on corporate ESG disclosure and performance has continued to grow. We believe the number of and support for shareholder resolutions related to climate, diversity and corporate accountability is poised to increase further in 2022.

Implications for companies and investors. The aim of the proposed rule is to improve the consistency, quality and comparability of company-reported climate-related risks, enabling investors to more effectively incorporate these risks and opportunities into their fundamental assessments while simplifying and clarifying the reporting expectations for companies. Proposed requirements would also increase transparency accountability of oft-scrutinized corporate GHG emissions targets. While provisions in the rule reduce the near-term disclosure requirements for smaller businesses and provide safe harbor protections for Scope 3 disclosures and forward-looking statements, smaller companies not yet reporting on climate exposure, and businesses with sizable Scope 3 footprints are likely to push back the most on the proposed rule. These rules would represent a higher bar, not only for US companies but foreign issuers listed in the US.

The latest regulatory developments in the US broadly resemble trends seen in other regions. However, with the SEC's latest proposal, there is scope for disclosures to accelerate in the US and potentially narrow gaps with some of APAC's leading jurisdictions on ESG disclosures (Australia, ASEAN, HK). Outside of the US, ESG fund labeling requirements are also beginning to strengthen, led by Europe's launch of SFDR, which requires funds sold into and created in Europe to be classified as either ESG (Art. 8 or 9) or non-ESG (Art. 6). These developments impose greater disclosure requirements for ESG-labelled funds via frameworks like the EU Taxonomy to mitigate greenwashing risks. Regulators across APAC are also developing ESG fund labeling requirements (case in point India and Taiwan's proposal to set specific AUM thresholds tied to "ESG themed stocks") and are in early stages of developing locally tailored Taxonomies, although the latter are still mostly limited to bond and loan issuance.

SEC moves to mandate new climate disclosure

After having begun with a request for comments in March 2021, the SEC on March 21 has formally proposed a new rule on corporate climate disclosure. This proposal comes on the back of a public consultation period that saw 75% of nearly 600 responses submitted in favor of mandatory corporate climate disclosures.

The rule would require foreign and domestic public companies to report on greenhouse gas (GHG) emissions as well as a variety of climate-related financial metrics and qualitative disclosures:

- Oversight and governance of climate-related risks by the registrant's board and management.
- How identified climate-related risks have or will have a material impact on the business, consolidated financial statements, strategy, business model and outlook.
- The registrant's process for identifying, assessing and managing these climate-related risks.
- If the registrant has adopted a transition plan as part of its climate-related risk strategy or uses scenario analysis to assess the resilience of its business to climate risk. A description of the plan or scenarios used and parameters, assumptions, analytical choices and financial impacts with relevant metrics.

- If the registrant uses an internal carbon price and how it is set.
- Impact of climate-related events and transition activities on the line items of the registrant's consolidated financial statements, including estimates and assumptions.
- Scope 1 (direct emissions from owned or controlled sources) and Scope 2 (indirect emissions from purchased electricity, steam, heat and cooling consumed by the reporting company) GHG emissions, broken out by GHG, in the aggregate, and in absolute (not including offsets) and intensity terms.
- Scope 3 (all other indirect emissions occurring in a company's value chain; up & downstream) GHG emissions, only to be disclosed if material[1], or if the registrant has set a GHG emissions target/goal that includes Scope 3. *The proposed rule includes a safe harbor for liability for this disclosure.*
- If the registrant has a public climate target/goal:
  - Scope of activities and emissions included in the target, defined time horizon and any interim targets
  - How the registrant intends to meet these targets/goals
  - Relevant data indicating where progress is being made and how it has been achieved
  - If carbon offsets or renewable energy certificates have been employed as part of any targets/goals, the amount of carbon reduction generated by these tools must be disclosed.
- *To the extent any disclosure includes forward-looking statements, it would be covered by a forward-looking statement safe harbor pursuant to the Private Securities Litigation Reform Act.*

Disclosure are to be included in annual reports and audited financial statements, e.g., in Form 10-K. Accelerated or large accelerated filers[2] must obtain an attestation report from an independent attestation service provider covering, at minimum, Scope 1 & 2 GHG emissions disclosures. Much of this disclosure currently occurs outside company filings.

Large accelerated filers would be expected to report on proposed disclosure above (save Scope 3 emissions) by fiscal year 2023, i.e. filed in 2024. Scope 3 emissions, where required, would need to be reported the following year by large accelerated filers (i.e., fiscal year 2024, filed in 2025). Accelerated and non-accelerated filers would need to report each of these data sets one year after large accelerated filers, respectively. Smaller reporting companies (those with <$250 million in public float) are exempted from Scope 3 disclosures and would be required to report all other climate-data at a further one year lag from accelerated and non-accelerated filers (Exhibit 1). Staggered deadlines based on filer-status would also be in place for assurance requirements on all reported data (Exhibit 2).

1 Consistent with the Commission's definition of "material" and Supreme Court precedent,a registrant would be required to disclose its Scope 3 emissions if there is a substantial likelihood that a reasonable investor would consider them important when making an investment or voting decision.

2 Large Accelerated Filers have a public float exceeding $700 million; Accelerated Filers have a public float >$250 million and <$700 million

Exhibit 1: Disclosure compliance timeline for SEC enhancement and standardization of climate-related disclosures
The following table assumes that the proposed rules will be adopted with an effective date in December 2022 and that the filer has a December 31st fiscal year-end

Registrant Type	Disclosure Compliance Date	
	All disclosures, including GHG metrics: Scope 1, 2, and associated intensity, but excluding Scope 3	GHG emissions metrics: Scope 3 and associated intensity metric
Large Accelerated Filer	FY 2023 (filed in 2024)	FY 2024 (filed in 2025)
Accelerated Filer and Non-Accelerated Filer	FY 2024 (filed in 2025)	FY 2025 (filed in 2026)
SRC	FY 2025 (filed in 2026)	Exempted

Large Accelerated Filers have a public float exceeding $700 million; Accelerated Filers have a public float >$250 million and <$700 million

Source: SEC

Exhibit 2: Assurance timeline for SEC enhancement and standardization of climate-related disclosures
The following table assumes that the proposed rules will be adopted with an effective date in December 2022 and that the filer has a December 31st fiscal year-end

Filer Type	Scopes 1 & 2 GHG Disclosure Compliance Date	Limited Assurance	Reasonable Assurance
Large Accelerated Filer	FY 2023 (filed in 2024)	FY 2024 (filed in 2025)	FY 2026 (filed in 2027)
Accelerated Filer	FY 2024 (filed in 2025)	FY 2025 (filed in 2026)	FY 2027 (filed in 2028)

Large Accelerated Filers have a public float exceeding $700 million; Accelerated Filers have a public float >$250 million and <$700 million

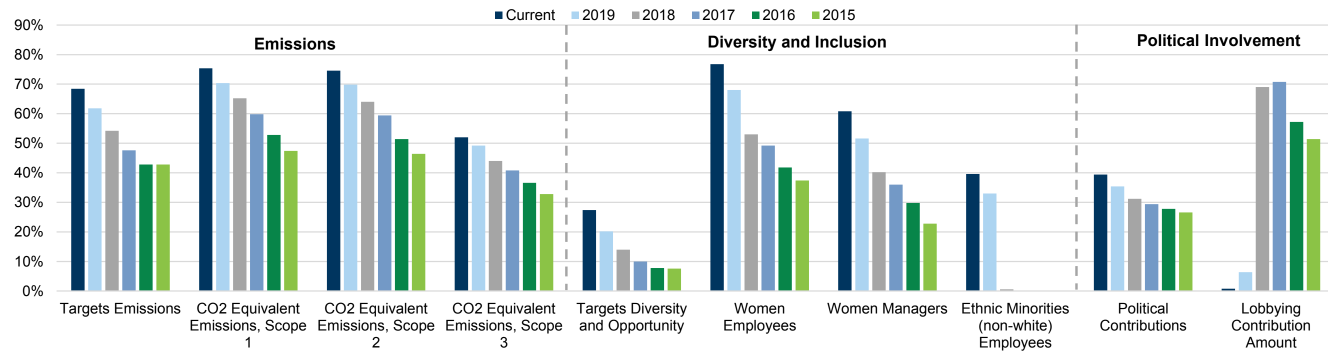
Source: SEC

The proposed rule is now subject to a public feedback period (running through May 20, 2022), at which point the SEC can then respond to comments, ask for additional comments or propose a final rule which can then be voted on and adopted. **It is widely expected that there will be legal challenges to the proposed rule.** Several points of push back voiced by Commissioner Hester Peirce in opposition to the rule include that it falls outside the scope of both the SEC's legal mandate and realm of expertise, may be seen as requiring some companies to disclose non-material information, currently underestimates the costs it would impose on businesses, may undermine the credibility of existing financial statements and obfuscate investor focus from financial performance.

Climate-related (and broader ESG) disclosures have been growing, but a market cap gulf exists

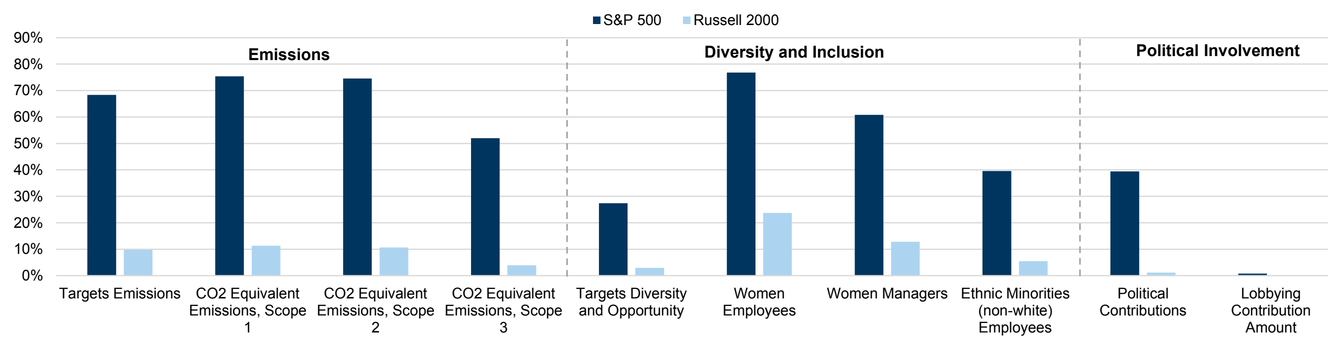
As noted by all commissioners during the proposed rule's vote today, voluntary disclosure of ESG metrics in the United States has steadily trended upward over the last decade. For example, over 70% of S&P 500 companies already report Scope 1 GHG emissions and nearly 75% report on their % of women employees (Exhibit 3). This proposal's biggest impacts would be in the standardization of corporate climate disclosures and increasing the tail of smaller companies also providing climate disclosures. However, these disclosures could have greater relative costs of compliance for smaller companies where voluntary disclosure is currently much lower — for Russell 2000 companies, for example, there is an approximate 60-point disclosure gap vs. the S&P 500 for many common ESG metrics (Exhibit 4).

Exhibit 3: CO2, diversity and political contributions disclosure has picked up over the last five years
Disclosure of select ESG metrics related to CO2 emissions, diversity and political spending, S&P 500



Source: Refinitiv, Goldman Sachs Global Investment Research

Exhibit 4: Larger companies tend to have significantly higher rates of ESG disclosure, a consideration for implications of potential regulation
Disclosure rates of select ESG metrics, latest available information, S&P 500 vs. Russell 2000



Source: Refinitiv Eikon, Goldman Sachs Global Investment Research

Climate disclosure mandate proceeds several recent notable ESG-related regulatory developments in the US

In the past six months, there has been an array of new ESG-related regulatory action at the federal level implying greater consideration of ESG issues in corporate disclosures and investing.

Strengthening American Cybersecurity Act (March 2022): This act, requires critical infrastructure companies, including those in the communications, defense, and financial services sectors, to report all significant cyber-incidents and ransom payments to the Department of Homeland Security's Cybersecurity and Infrastructure Security Agency (CISA).

SEC No Action Process Interpretation (November 2021): Under the current administration, the SEC has made a shift toward stricter acceptances of no action letters. No action requests allow companies to petition the SEC for permission to exclude proxy proposals, particularly those relating to ESG issues, such as emissions reduction targets.

Universal Proxy Rules for Director Elections (November 2021): The SEC now requires the use of universal proxy cards for contested director elections, which list all director candidates, regardless of whether the candidates were nominated by management or shareholders. Previously, shareholders voting by proxy were unable to vote for a combination of directors from competing slates.

Uyghur Forced Labor Prevention Act (December 2021): The UFLPA imposes a preemptive prohibition on all imports from China's Xiinjiang Uyghur Autonomous Region (XUAR) to combat the forced labor of Uyghurs and other minority groups.

Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights (October 2021): The proposed rule clarifies the permissibility of ESG factors in investment decisions for ERISA fiduciaries by accepting that a fiduciary's duty of prudence may include climate-change or other environmental, social and governance factors, in addition to typical risk and return factors. If adopted as proposed, this would be a marked shift from prior Department of Labor Guidance which has been more conservative about the incorporation of ESG considerations in ERISA investing.

What's next?

Beyond the above highlighted regulations, other key ESG-related areas of interest recently discussed by the SEC include broader ESG data disclosures (namely around diversity and political spending) and greenwashing.

Broader ESG disclosures. The ESG Disclosure Simplification Act (H.R. 1187), approved in the US House of Representatives in June 2021, requires the SEC to define exact ESG disclosure standards for the purposes of disclosures. Although the Act does not specify where these disclosures must be made, the SEC is authorized to require companies to disclose ESG metrics regarding corporate political spending, worker pay, CEO compensation, board diversity, climate risk and country-by-country tax reporting in filings that require audited financial statements. The Act also requires public filers to disclose the registrant's views on ESG metrics and description of the registrant's method in determining the impact of ESG metrics, relative to the registrant's long-term business strategy. H.R. 1187 has now moved to the US Senate where it faces a more uncertain path to passage.

ESG fund classification ("greenwashing") The Division of Examinations at the SEC has identified tackling 'greenwashing' as one of its priorities, creating a Climate and ESG Taskforce to pursue instances of ESG-related misconduct. The SEC Division of Examinations issued a Risk Alert in April 2021 that detailed instances of deficiencies and weaknesses of investment advisors and funds in ESG investing. This alert highlighted the types of compliance issues identified and under scope for review by the SEC, including the following:

1. Lack of adherence to ESG frameworks despite claims of adherence.
2. Lack of adequate controls around implementation and monitoring of negative screens and other ESG-related directives.
3. Proxy voting inconsistent with advisors' stated approaches.
4. Misleading and unsubstantiated claims regarding ESG approaches.

5. Inadequate controls to ensure ESG disclosures and marketing match the firm's practices.
6. Lack of knowledge by compliance professionals regarding ESG investments, disclosures and marketing, and compliance programs that do not adequately address relevant ESG issues.

The Names Rule, introduced in 2001, requires funds to invest at least 80% of assets in the manner suggested by its name. As it exists now, the rule does not apply to fund names that describe a fund's investment objective, strategy or policies. However, under direction of Chair Gary Gensler, the SEC is in the process of creating formal guidance that builds upon naming rules and conventions such as the Names Rule and considering recommendations on whether fund managers should disclose the criteria and underlying data they use in their ESG process.

Effective practices identified by the same SEC risk alert included clear disclosures around approaches to ESG investing, especially in instances where ESG factors are considered alongside other metrics and considerations; detailed policies that address written procedures and due diligence for ESG investing; and educated compliance departments and personnel that are integrated into firms' ESG-related processes.

US proxy voting: Increased support across ESG topics highlights greater investor scrutiny and growing demand for corporate disclosure

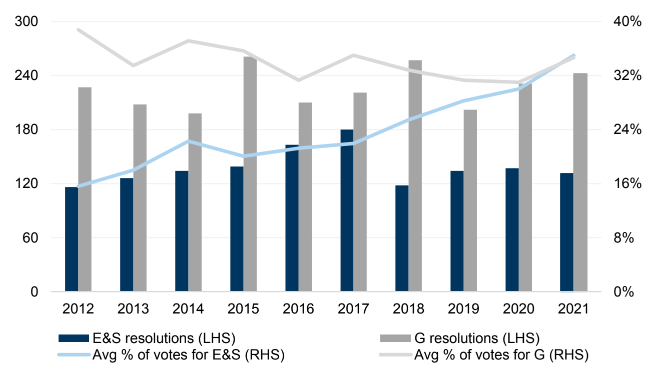
As the most active market for shareholder resolutions, the US is a global bellwether for engagement. While the volume of resolutions in other geographies has ramped in recent years, the US still made up 1/3 of the global total in 2021. Increasing support for environmental & social resolutions has been the standout proxy voting dynamic in the past decade, including a further upward inflection in 2021. Average support for environmental & social resolutions among S&P 500 companies is now equal to governance at about 35% (Exhibit 5). Standout categories of momentum include climate action; diversity, equity & inclusion; and ESG accountability (including ESG-linked compensation and say-on-climate proposals) (Exhibit 6 and Exhibit 7).

Rising corporate scrutiny appearing in director elections. While it remains exceptionally rare for a director to not receive majority support (only 4 directors among S&P 500 companies in 2021), pressure applied directly to boards is on the rise. 91% of S&P 500 directors received >90% support in 2021, on a downward trend from 94% three years prior (Exhibit 8).

GHG emissions still garnering a lot of attention. As of the end of February 2022, there have been 145 shareholder proposals about the environment, up from 91 at the same point in 2021. Of the 110 climate change resolutions, 92% are focused on GHG emissions, specifically proposing a transition to net-zero by 2050. Environmental footprint management proposals are also on the rise, with most focusing on plastic usage, as well as the concept of "right to repair," which enables customers to more easily repair equipment and thus reduce waste. The latter is the topic of a pending proposal at Alphabet.

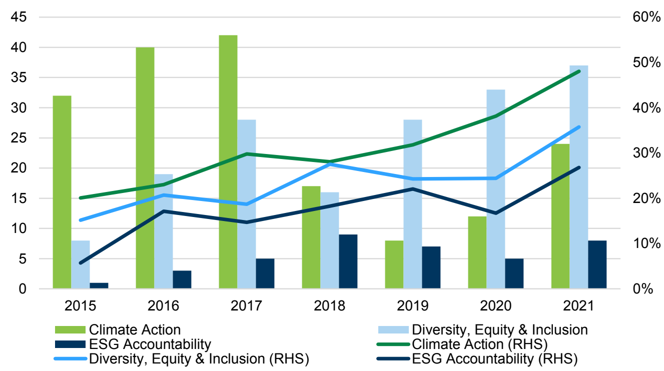
A broad range of social issues are seeing greater focus. This year has seen a surge of filings across corporate political influence, decent work, and human rights. Many proposals seek to understand which issues are supported by company money and how company policies align with political lobbying and election campaign funding. The 65 decent work proposals address discriminatory pay gaps, disclosure about working conditions, and worker safety and benefits. Accounting for the surge in filings was a 40% increase related to human rights, and specifically, racial justice. Proposals include commitments to representation, addressing systemic racism, and discussing environmental justice.

Exhibit 5: Support for E&S resolutions in 2021 accelerated in the US
No. of shareholder proposals and average % of votes for, S&P 500 (as of 12/14/2021)



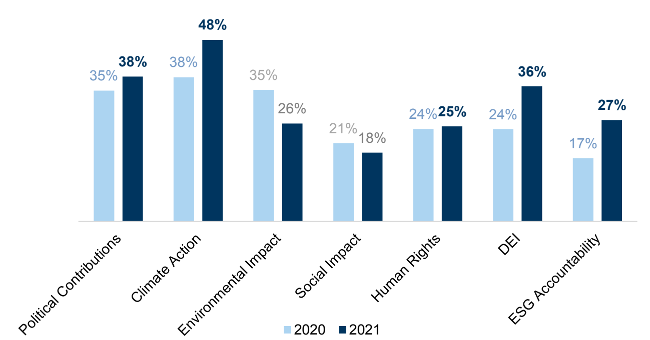
Source: Proxy Insight, Goldman Sachs Global Investment Research

Exhibit 6: Support for climate-related proposals stands out, though momentum was broad-based in 2021
No. of focal E&S shareholder proposals by type (LHS) and avg. % of votes for focal E&S resolution by type (RHS), S&P 500



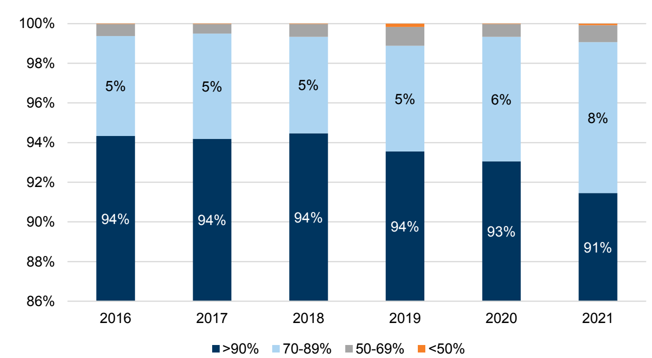
Source: Proxy Insight, Goldman Sachs Global Investment Research

Exhibit 7: Climate, DEI and ESG Accountability are riding the greatest momentum by resolution topic
Avg. % of votes for key E&S resolutions by type, S&P 500



Source: Goldman Sachs Global Investment Research, Proxy Insight

Exhibit 8: Votes against directors appears to be a building trend
% of total no. of votes in favor of director re/election by % vote for band, S&P 500

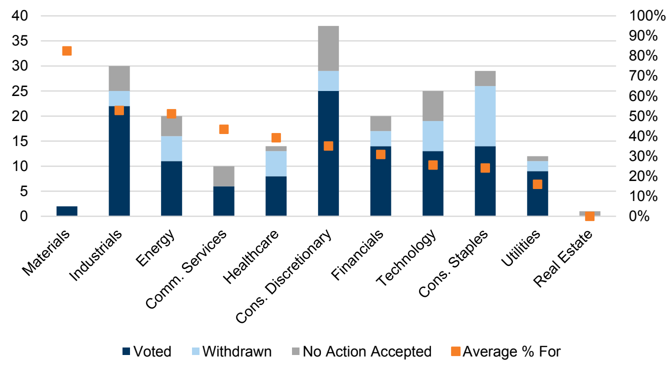


Source: Proxy Insight, Goldman Sachs Global Investment Research

E&S resolutions have seen the greatest success of late in natural resource-intensive sectors. In 2021, Materials, Industrials, and Energy led the S&P500 in average support for E&S proposals, with over 50% voting in favor in each sector. Energy also has the highest relative number of resolutions proposed, with roughly one E&S resolution (.95) being filed per company in the index in 2021. Consumer Staples stands out as the sector with the most proposals withdrawn prior to the vote, generally an indication of an agreement between the company and shareholders (Exhibit 9).

Exhibit 9: Materials, industrials, and energy lead in average % in support of E&S resolutions

2021 E&S Resolutions voted on, withdrawn, and no action accepted in the S&P500 vs. average % for by sector



Source: Proxy Insight, Goldman Sachs Global Investment Research

Implications for companies - questions on cost and liability remain

The SEC's proposed climate-disclosure rule was framed by commissioners as an effort to standardize costs in reporting of climate-related metrics and targets, all while improving consistency, comparability and ease of access for investors. Staggered phase in periods for both reporting and assurance requirements could alleviate near-term pressure on any issuers who have yet to disclose any climate-related information, particularly for smaller companies. Similarly, safe harbor protections may alleviate concern from some issuers around increased liability from including these disclosures in audited financial statements.

However, questions remain around the extent of coverage existing safe harbor provisions would provide to companies, namely that all disclosures are made with "reasonable basis" and "in good faith". Additionally, the most significant condition requiring Scope 3 GHG emissions to be disclosed, "if material [for an issuer]," leaves considerable room for interpretation as to where that threshold of materiality lies and will certainly be a point both investors and corporates demand greater clarity on. Companies already disclosing robust climate-related data, particularly those with assured emissions figures (employing Greenhouse Gas Protocol standards) and/or TCFD reports are least likely to see any increased reporting cost burden should this proposed rule be adopted by the SEC.

Disclosure Appendix

Reg AC

We, Derek R. Bingham, Brendan Corbett, Brian Singer, CFA, Evan Tylenda, CFA, Sharmini Chetwode, Ph.D., Keebum Kim and Emma Jones, hereby certify that all of the views expressed in this report accurately reflect our personal views about the subject company or companies and its or their securities. We also certify that no part of our compensation was, is or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

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