Gearing up for evolving ESG regulations

Operationalizing metrics and controls

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Contacts

To discuss the issues raised in this report, please contact:

Amy Matsuo
Regulatory and ESG Insights Leader
amatsuo@kpmg.com

Steve Estes
Risk Assurance ESG Leader
sestes@kpmg.com

Robert Fisher
IMPACT and ESG Leader
rpfisher@kpmg.com
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Introduction

Environmental, Social, and Governance (ESG) issues have become prominent focal points for the Administration, regulators, companies, and their stakeholders. Regulatory consideration of ESG topics has significantly increased at both the federal and state levels since 2021, with initiatives, proposed rules, and guidance focusing on a broad range of ESG issues or “themes”, including:

- Environmental Protection
- Environmental Justice
- Climate Risk Management
- Diversity, Equity, and Inclusion
- Consumer Protection
- Investor Protection
- Cybersecurity
- Corruption and Misconduct

This dynamic regulatory environment is driving the need for companies to assess and design effective metrics, enabled by data processes and controls that:

- Enable accurate measurement of ESG activities and reporting to key stakeholders, and
- Adapt to potential future disclosure requirements.

Key actions that companies can take to effectively operationalize this effort are outlined in the following pages.
Assess & design effective ESG metrics

ESG impacts organizations through three channels: Metrics & Reporting, Client-Based Decisions & Strategy, and Operational Decisions & Strategy. In order to adhere to evolving regulatory expectations around ESG, companies should take the following actions to assess and design effective metrics and data controls that can be operationalized to report to key stakeholders.

1. Set Metric & Control Governance
2. Assess Current & Target Data & Risks
3. Establish a Prioritized Roadmap
To set metric and control governance around the ESG metrics, companies should take action to:

- Establish an enterprise-wide ESG data governance and control framework, including risk management, to oversee clear and transparent monitoring and reporting
- Ensure the governance structure includes members from a wide array of business areas and all three lines of defense; identifies Board and management responsibilities for oversight and establishes reporting and escalation processes; and provides/requires training, as needed
- Define ESG terms and metrics to disclose
- Develop a methodology for collecting and measuring ESG data, with particular focus on accuracy, completeness, consistency, and timeliness
Assess current/target data & risks

Companies should next take action to assess both their current and target states of ESG data and associated risks, and perform a gap analysis around ESG data controls. In particular, they should:

• Assess data requirements; investing, as needed, in data and data systems that can measure, track, and support external disclosures and performance claims

• Integrate ESG risks into each risk discipline and develop quantifiable risk appetite statements that are consistent with the existing enterprise risk appetites

• Engage key stakeholders at the company to properly document the risk discipline and risk appetite statements

• Operationalize ESG risks into data collection, measurement, and monitoring and testing within each risk discipline for required metrics, commitments/targets, transition plans, controls, and reporting
Establish prioritized roadmap

Finally, as part of their effort to assess and design effective ESG metrics, companies should take action to establish a prioritized roadmap for operationalizing and reporting. The roadmap provides a visual explanation of the company’s ESG reporting journey as it works toward achieving its internal and external assurance goals.

Companies should develop a risk-based prioritization and implementation roadmap, with consideration for the level of effort, investment, and cost, including workstreams for:

- Program governance
- Data & scenario analysis
- Process & controls
- Reporting
- Technology
- Change management
- Value creation

Utilizing lessons learned from assessments and control gap analysis, developing an ESG reporting-focused roadmap can enhance the design of the ESG reporting program and target operating model across:

- Processes
- Controls
- Technology
- Organizational structure
- Assurance process
- Scheduling for remaining prioritized datasets & disclosures, or potential expansion to less prioritized metrics
ESG regulatory and policy efforts often join one or more of the E, S, or G factors. Key themes are outlined below, with highlights of select legislative, regulatory, and policy directives for each theme detailed on successive slides.

### ESG regulatory and public policy themes include:

<table>
<thead>
<tr>
<th>Theme</th>
<th>Description</th>
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<tr>
<td>Environmental Protection</td>
<td>Reduce climate and environmental pollution, improve public health, and leverage sustainable and efficient means of energy and production</td>
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<tr>
<td>Environmental Justice</td>
<td>Improve environmental, safety and public health in underserved and disadvantaged communities</td>
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<td>Climate Risk Management</td>
<td>Advance consistent, clear, comparable, and accurate measurement, mitigation, and disclosure of climate-related risk</td>
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<td>Corruption &amp; Misconduct</td>
<td>Increase transparency and accountability, foster a culture of ethics and compliance, and combat illicit finance activities</td>
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<tr>
<td>Diversity, Equity, &amp; Inclusion</td>
<td>Promote workforce diversity and inclusion, support social equity, and increase organizational transparency</td>
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<tr>
<td>Consumer Protection</td>
<td>Promote fair and responsible access to products and services, prevent unfair, deceptive, and/or discriminatory conduct, and improve the security and privacy of consumer data</td>
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<tr>
<td>Investor Protection</td>
<td>Improve the quality, accuracy, and transparency of information available to investors, including about ESG investment products and services</td>
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<tr>
<td>Cybersecurity</td>
<td>Improve cybersecurity risk management and disclosure of policies, practices, and incidents</td>
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Key environmental highlights timeline

The following are select examples of environmental legislation, regulations, and directives focusing on:
Environmental Protections (‡ ), Environmental Justice (§ ), and Climate Risk Management (‖ ).

Highlights and insights on each of these environmental themes are outlined on the following slides.
Environmental protection

Reduce climate and environmental pollution, improve public health, and leverage sustainable and efficient means of energy and production

**Highlighted Examples**

**EPA:** Issued federal GHG emissions standards for passenger cars and light trucks
- Dec 20

**California:** Senate passed the Climate Corporate Accountability Act
- Jan 26

**New York:** Legislature passed bill establishing a moratorium on reactivating fossil fuel power plants to operate cryptocurrency mining operations
- Jun 3

**EPA:** Seeks to leverage advances in fuel efficiency and clean car technology to unlock net benefits to consumers, including reducing climate pollution, improving public health, and saving drivers fuel costs

**California:** If signed into law, would require both public and private companies doing business in California and generating over $1 billion in gross annual revenue to disclose their Scope 1, Scope 2, and Scope 3 GHG emissions to the State of California on an annual basis, as well as to obtain third-party audits of disclosures

**New York:** If signed into law, would also require the state’s Dept. of Environmental Conservation to prepare comprehensive environmental impact statement review of these activities
Environmental justice

Improve environmental, safety and public health in overburdened, underserved, and disadvantaged communities

<table>
<thead>
<tr>
<th>2022 Regulatory Activity</th>
<th>Highlighted Examples</th>
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<tr>
<td>Executive Report</td>
<td><strong>HHS:</strong> Identifies priority actions and strategies to address environmental injustices and health inequities for vulnerable, low-income, marginalized and indigenous populations</td>
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<td></td>
<td><strong>New York:</strong> Focuses on environmental impact statements in minority and distressed communities</td>
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<td></td>
<td><strong>DOJ/EPA:</strong> Includes implementation of a new enforcement strategy, formation of a new, dedicated DOJ office, and publication of an associated report on environmental justice</td>
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<td><strong>FRB, OCC, FDIC:</strong> Includes opportunities for banks’ to earn CRA credits for financing certain climate-related projects</td>
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<td><strong>Executive Report:</strong> Outlines the Administration’s progress on it’s Justice40 (environmental justice) Initiative announced in a January 2021 Executive Order</td>
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<tr>
<td>FRB, OCC, FDIC</td>
<td>Issued an interagency proposal to update regulations under CRA May 13</td>
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<tr>
<td>DOJ/EPA</td>
<td>Announced new environmental Justice strategy May 5</td>
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<tr>
<td>New York</td>
<td>Legislature passed a bill on environmental justice Apr 27</td>
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<td>HHS</td>
<td>HHS requested comments on environmental justice strategy Apr 8</td>
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Click the underlined text to read more.
Climate risk management

Advance consistent, clear, comparable and accurate measurement and disclosure of climate-related risk

Highlighted Examples

**Executive Order**: Directs regulators to develop and execute a strategy for climate risk quantification, disclosure, and mitigation

**Treasury**: Highlights coordination between agencies and actions on data, disclosures, and analyses

**OCC**: Five questions related to climate change and associated financial risks

**OCC**: Proposed principles and risk areas to identify and manage climate-related financial risks

**SEC**: Proposed climate-related risk disclosure requirements, including both quantitative and qualitative elements

**FDIC**: Request for comment on general principles and risk areas to identify and manage climate-related financial risks
Key social highlights timeline

The following are select examples of social legislation, regulations, and directives focusing on:
Diversity, Equity, and Inclusion ( ), and Consumer Protections ( )..

Highlights and insights on each of these social themes are outlined on the following slides.
Diversity, equity, and inclusion

Promote workforce diversity and inclusion, support social equity, and increase organizational transparency

Highlighted Examples

**Executive Order:** Directs the modernization of regulatory review across numerous areas to promote equity and support underserved communities

**Texas:** Prohibits the State of Texas from doing business with banks that do not lend to those industries

**Executive Order:** Directs restoration of net neutrality rules and promotion of competition within industries

**SEC:** Designed to encourage board diversity for companies and standard disclosures for shareholders

**DOC:** Outlines Commerce’s objectives, including closing the digital divide, strengthening small and minority-owned businesses, and advancing racial equity and supporting underserved communities

**DOC:** Appropriated to award grants to underserved communities in need of broadband access and services

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**2021 Regulatory Activity**

- **Exec. Order:** Advancing racial equity and support for underserved communities
  - Jan 20

- **Texas:** Signed a law prohibiting banks to discriminate against the firearm or ammunition industries
  - May 5

- **Exec. Order:** Promoting competition in the American economy
  - Jul 9

- **SEC:** Approved a Nasdaq proposal to promote board diversity
  - Aug 6

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**2022 Regulatory Activity**

- **DOC:** Published its Equity Action Plan
  - Apr 14

- **DOC:** Created the Broadband Equity, Access, and Development Program
  - May 14
## Consumer protection

Promote fair and responsible access to products and services, prevent unfair, deceptive, and/or discriminatory conduct, and improve the security and privacy of consumer data

### 2021 Regulatory Activity

- **Connecticut**: Adopted comprehensive law on consumer data privacy and monitoring
  - **May 10**

### 2022 Regulatory Activity

- **FTC**: Issued statement on Children’s Online Privacy Protection Act (COPPA) and online learning
  - **May 19**
- **DOJ/FTC**: Sought input on how to modernize federal merger guidelines
  - **Jan 20**
- **CFPB**: Updated the UDAAP exam manual
  - **Mar 16**
- **Utah**: Adopted comprehensive law on consumer data privacy and monitoring
  - **May 10**

### Highlighted Examples

**FTC**: Updated rules regarding protection of consumer financial information at FTC-regulated FS companies
- **Oct 27**

**DOJ/FTC**: Stated objective is to improve detection of, and prevent, consolidation or anticompetitive mergers

**CFPB**: Focus on potential for discriminatory conduct across consumer-related products and services and throughout the product lifecycle

**Utah**: Provides consumers with rights related to their data, obligates companies to safeguard and protect consumer information

**Administration**: Will allow the free exchange of data between the U.S. and E.U., meeting the privacy requirements of both jurisdictions

**Connecticut**: Outlines responsibilities and privacy protection standards for companies and data processors, as well as rights of consumers related to their data and privacy

**FTC**: Indicated that the agency will crack down on companies that violate COPPA and force parents to surrender children’s privacy in order to access educational technology or online tools
Key governance highlights timeline

The following are select examples of governance regulations and directives, focusing on:
Investor Protections ( ), Cybersecurity ( ), and Corruption and Misconduct ( ).

Highlights and insights on each of these governance themes are outlined on the following slides.
Investor protection

Improve the quality, accuracy, and transparency of information available to investors, including about ESG investment products and services

### Highlighted Examples

**SEC:**
- Released a risk alert highlighting compliance issues in ESG investing
  - Apr 9

**DOL:**
- Proposed rule on ESG & Proxy Voting
  - Oct 14

**SEC:**
- Proposed Names Rule and ESG investment practices disclosure rule
  - May 25

**SEC:**
- Highlights observations, including deficiencies and internal control weaknesses, from examinations of registered investment advisers, investment companies, and funds offering ESG products and services

**DOL:**
- Covers ESG investment selection for ERISA-covered retirement plans and proxy voting

**SEC:**
- Intended to provide investors with consistent, comparable, and “decision-useful” information regarding ESG investment options
Cybersecurity

Improve cybersecurity risk management and disclosure of policies, practices, and incidents

Highlighted Examples

**Executive Order**: Directs a “whole of government” effort to enable more effective defense of federal IT assets and networks, and improve the nation’s overall cybersecurity

**FRB, OCC, FDIC**: Establishes reporting requirements for computer-security incidents

**SEC**: Proposed rules promoting cyber preparedness and resilience for registered advisers and funds

**SEC**: Rules to enhance and standardize disclosures around cybersecurity

**Legislation**: Requirements include notifying CISA within 72 hours after a covered cyber incident occurs and 24 hours after a ransomware payment is made

**Administration**: Recommended measures to ensure resiliency and technological security
Corruption and misconduct

Increase transparency and accountability, foster a culture of ethics and compliance, and combat illicit finance activities

Highlighted Examples

**DOJ**: Changes to corporate criminal enforcement policies and practices to strengthen accountability for noncompliance or misconduct

- Announced changes to corporate criminal enforcement policies and practices
  - Oct 28

**FinCEN**: Proposal to implement beneficial ownership information (BOI) reporting with the aim of providing critical information to law enforcement and impeding the ability to conceal and move illicit proceeds through legal entities like shell companies

- Issued:
  - 1. Proposed rule on beneficial ownership reporting requirements
    - Dec 8
  - 2. ANPR to strengthen anti-money laundering regulations for real estate transactions

**FinCEN**: Sought comment on how to address the risk of money laundering and other illicit activity associated with non-financed transactions in the U.S. real estate market

**GAO**: Outlined the techniques used by criminal organizations, as well as government efforts to combat illicit finance

- Released report highlighting trends in trafficking, money laundering
  - Dec 15

**Treasury**: Outlined a whole-of-government approach with the aim of strengthening the AML/CFT regulatory framework and increasing the transparency of the U.S. financial system

- Released 2022 National Strategy for Combating Terrorist and Other Illicit Financing
  - May 18
Relevant thought leadership

Operationalizing climate risks
Fairness and inclusion: Regulatory challenges
Climate and sustainability: Regulatory challenges

Regulatory Alerts
- CFPB Focus on Credit Card Penalty Fees
- Supervisory focus on overdraft practices
- Market structure: SEC remarks on potential updates
- Climate-Related Risk: CFTC Request for Information
- SEC proposed Names Rule and ESG Investment Practices Disclosure
- Diversity, Equity, and Inclusion: SEC’s Diversity Assessment Report
- Environmental Justice: New DOJ Strategy
- SEC Examinations Risk Alert
- Climate Risk: SEC’s Mandatory Climate Disclosures Proposal
- Fairness and Competition: Information requests on merger guidelines

SEC proposes climate reporting and assurance rules
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