



PROJECT FOR GROWTH, OPPORTUNITY & INNOVATION

ESG REPORTING
BEST PRACTICES

2019

ESG REPORTING **BEST PRACTICES**

Policymakers have been debating here in the U.S. as well as globally on how companies should disclose Environmental, Social, or Governance (ESG) information, both to investors as well as other stakeholders. Currently, to the extent that ESG information is material under the U.S. federal securities laws, public companies are already required to include it in their filings with the Securities and Exchange Commission (SEC). However, given the progress that companies have made in regards to voluntary ESG reporting not filed with a particular regulator or government body, we believe more regulatory requirements mandating ESG disclosures are not warranted.

To advance the work made so far towards more effective ESG disclosures on a voluntary basis, the Center for Capital Markets Competitiveness at the U.S. Chamber of Commerce has developed the following best practices around stand-alone ESG reports. We believe that these best practices can help steer the development of a widely-approved approach to voluntary ESG reporting without the need for additional regulatory mandates. Furthermore, some disclosure variability is appropriate, because the relevance of certain ESG factors differs from industry-to-industry and company-to-company, and based on business model, geography, customer base, and other considerations. That said, these best practices can serve as a useful guide as companies continue to enhance their ESG disclosures:

- ▶ When possible, ESG disclosure should focus on a company's risks and opportunities with sufficient potential to impact the company's long-term operational and financial performance in light of its business and should discuss the company's approach to risk management, making the connection, to the best of their ability, between the ESG topics on which they report and the company's long-term value creation strategy;
- ▶ Before preparing its ESG disclosures, a company should consider which audience (or audiences) is the intended recipient of its reports and should tailor the tone and content of its reports accordingly, particularly regarding information that would be most useful for investors or whether for other ESG-oriented stakeholders;
- ▶ Preparers of ESG reports should consider how best to liaise with relevant departments and functions within the company to ensure that all relevant information is collected and addressed and that diverse perspectives and inputs are accounted for. However, when it comes to determining whether information is material or not as a matter of law, that assessment should reside with a company's legal department;
- ▶ In their ESG reports, companies should clearly define in plain English technical terms and terms that do not have a universally accepted definition;

- ▶ It is important to allow companies discretion in how they report and discuss ESG information. Each company should maintain the flexibility to determine which ESG factors and related metrics are relevant to it and what disclosure is meaningful for its stakeholders and not necessarily what is identified in various third-party frameworks and standards;
- ▶ Issuers preparing ESG reports should explain why they selected the metrics and topics they ultimately disclose, including why management believes those metrics and topics are important to the company;
- ▶ ESG information should be easy for users to find, such as through dedicated ESG disclosure web pages and links. ESG reports need not be incorporated into SEC filings to accomplish this objective, nor should ESG information be required as part of an SEC filing if it is not material under the Supreme Court's well-established definition of materiality for federal securities law purposes; and
- ▶ Finally, a company should consider including in its voluntary ESG reports a description of the company's internal review and audit process or any external verification of the information that the company received.

BACKGROUND

There is considerable interest in information relating to corporate sustainability and how companies are addressing and approaching relevant environmental, social and governance (ESG) topics. That interest only continues to increase. Companies have responded to demand for this information, whether it is coming from investors, employees, customers, non-governmental organizations (NGOs), or other constituencies. For example, the number of companies that have chosen to publish annual sustainability or ESG reports has grown significantly in recent years, with 86% of companies in the S&P 500 publishing such reports.

Even as ESG reporting by companies has become increasingly robust, companies still face diverse disclosure demands that they must grapple with when determining what's appropriate to disclose and how best to disclose it. Additionally, many jurisdictions and policymakers are considering further regulation around ESG disclosures, despite the progress that has been made by the private sector. These best practices can help serve as a useful guide as companies continue to enhance their ESG disclosures and help steer the development of a widely-approved approach to voluntary ESG reporting without the need for additional regulatory mandates.

THE PRIMARY OBJECTIVE OF ESG REPORTING

For purposes of promoting informed investor decision making and broader stakeholder awareness, ESG disclosure should focus on a company's risks and opportunities with sufficient potential to impact the company's long-term operational and financial performance in light of its business and should discuss the company's approach to risk management. Disclosure should not be a tool for advancing interests that are not aligned with the company's ability to create value over time.

AUDIENCE

Various constituencies, with different needs and expectations, may be interested in ESG information. These may include, for example, investors, customers, employees, regulators, NGOs, vendors, contractual counterparties, competitors, insurers, lenders, people who reside near company properties, academics, and students. Before preparing its ESG disclosures, a company should consider which audience (or audiences) is the intended recipient of its reports and should tailor the tone and content of its reports accordingly. Importantly, given investor interest in ESG information, companies should take steps to determine what would be most helpful to their investors and strive to provide their investors with ESG information the investors would find most useful when making an

investment or voting decision. Preparers of ESG reports should consider how best to liaise with relevant departments and functions within the company to ensure that diverse perspectives and input are accounted for, such as with Investor Relations and the Corporate Secretary's office to account for investor perspectives. However, when it comes to determining whether information is material or not, as a matter of law, that assessment should reside with a company's legal department, and legal personnel should be tasked with reviewing and vetting all disclosures generally.

TERMINOLOGY

In their ESG reports, companies should clearly define in plain English technical terms and terms that do not have a universally accepted definition.

Additionally, it should be noted that while the word “materiality” is used by some constituencies to connote different meanings, the term has a well-established definition under the U.S. federal securities laws as set out in the U.S. Supreme Court's longstanding *TSC Industries v. Northway* decision, which stated there must be a substantial likelihood that a reasonable investor would consider the information important.¹

¹ For a detailed discussion of materiality under the federal securities laws, see “Essential Information: Modernizing Our Corporate Disclosure System,” available at https://www.centerforcapitalmarkets.com/wp-content/uploads/2013/08/U.S.-Chamber-Essential-Information_Materiality-Report-W_FINAL-1.pdf

UTILITY

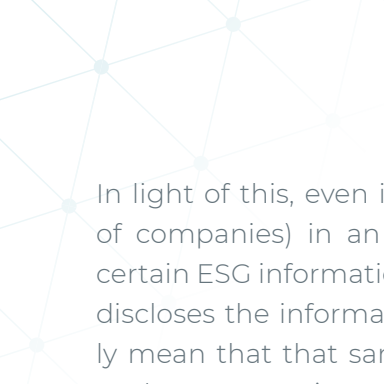
Each company should prioritize disclosing ESG information that would be of greatest interest to the intended audience (or audiences). Not all ESG factors lend themselves to quantitative disclosures. However, if available, including meaningful quantitative information based on data in reports, even where this is other qualitative disclosure, could enhance the utility of ESG reports by reducing the ambiguity or miscommunication sometimes associated with purely qualitative information, as different users may ascribe different meanings to qualitative concepts. Likewise, qualitative discussions of quantitative information can help elucidate data by providing instructive context and explanation. Where possible, a combination of both quantitative and qualitative disclosure can be particularly effective.

Issuers preparing ESG reports should explain why they selected the metrics and topics they ultimately disclose, including why management believes those metrics and topics are important to the company. Where possible and useful, baseline metrics and other relevant points of reference should also be identified so as to place current metrics in an appropriate context.

COMPARABILITY

Each company's business and operations have their unique characteristics when it comes to ESG factors. While there are a number of ESG factors that companies have chosen to report consistently, there are other ESG factors that companies, even when they are in the same industry, may disclose in different ways. It is important to allow companies discretion in how they report and discuss ESG information. Each company should maintain the flexibility to determine which ESG factors and related metrics are relevant to it and what disclosure is meaningful for its stakeholders. That said, when a company provides quantitative metrics, those metrics should be based on a sound methodology and derived, where possible, from any consensus that exists in the scientific or other relevant expert community on the issue.

Further, even though not bound by the numerous ESG disclosure frameworks and standards that have been developed, companies nonetheless may choose to consult them as the frameworks and standards indicate the interests of various constituencies in ESG. Companies may also engage with their peers and investors, along with considering other viewpoints, to shape ESG disclosure frameworks and standards that are fit for their purpose. Ultimately, though, disclosures should be based on what a company determines is important, and not what is identified in various third-party frameworks and standards.



In light of this, even if a company (or collection of companies) in an industry determines that certain ESG information is material to it and thus discloses the information, it does not necessarily mean that that same information is material to the company's peers, let alone companies in other industries. As noted above, the materiality determination may differ based on the diverse characteristics of different companies. Allowing companies to tailor their disclosures to meet the interests of those they are communicating with is more effective than imposing one-size-fits-all disclosure mandates or concluding that because one company (or a small number of companies) decides to disclose information that it should therefore be required of all companies.

AVAILABILITY

ESG information should be easy for users to find, such as through dedicated ESG disclosure web pages and links. ESG reports need not be incorporated into SEC filings to accomplish this objective, nor should ESG information be required as part of an SEC filing if it is not material under the Supreme Court's well-established definition of materiality for federal securities law purposes. On the other hand, if ESG information is included in a mandatory report because it is deemed material, there may be value in also referencing it in a voluntary report for the benefit of different audiences.

Market participants should consider the feasibility of the private sector developing a centralized repository (such as a public web page similar to

the SEC's EDGAR database) where issuers could voluntarily post ESG reports, leading to a single, searchable destination for users. We understand that some discussions on this topic are currently underway. Individualized databases relating to particular industries or geographies may also be desirable.

RELIABILITY

Companies' voluntary ESG reports should be subject to a rigorous internal review process to ensure their accuracy and completeness, in part because, under certain circumstances, a material misstatement or omission could give rise to liability. The accuracy of disclosed information is critical regardless of the format or location of

the disclosure. While the process may vary by company or industry, it should include approval by those with relevant subject-matter expertise, appropriate senior management, and appropriate departments and functions at the company, notably the Legal department. When feasible, assessment by third-party advisers may also support quality control and user confidence. Finally, a company should consider including in its voluntary ESG reports a description of the company's internal review and audit process or any external verification of the information that the company received.



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