Spotlight on Environmental, Social, and Governance (ESG) Disclosure

The Challenge: One of the more significant challenges for companies when it comes to ESG reporting is in navigating the maze of standards setters, third-party ESG raters, and the expectations of a diverse investor base. Businesses also determine what ESG matters meet the definition of materiality under the securities laws and therefore must be disclosed in SEC filings, versus those that would be more appropriate to include in a voluntary ESG or sustainability report.

The Wrong Approach: Proposals in Congress and the EU could make ESG reporting less impactful by imposing a one-size-fits-all disclosure regime. As SEC Chairman Jay Clayton recently said, ESG means different things to different businesses, industries, and constituencies, and “lumping them together will slow efforts” to advance a reasonable disclosure framework. If adopted, these mandates would make it impossible for a company to achieve its goal of releasing the right information. They would impose significant costs on public companies and make it even more unattractive for companies to go public at a time when the SEC chairman has prioritized the need for more initial public offerings (IPOs).

A Sensible Solution: Public and Private Sectors Working Together

Business Leadership
The number of companies that have chosen to publish annual sustainability or ESG reports has grown significantly, with 86% of companies in the S&P 500 proactively publishing such reports. We encourage companies to consider disclosing relevant and material information around ESG issues in a voluntary format for investors as well as for employees, customers, communities, and others.

Government Leadership
Congress and the SEC should reject proposals for one-size-fits-all disclosure frameworks and instead encourage companies to proactively communicate with their shareholders on ESG-related issues. Current SEC regulations on disclosing material information coupled with more companies adopting these best practices is a far better approach than some other pending legislative proposals.
Business Solutions Around ESG:

- A company should consider the risks and opportunities of ESG items and whether they have sufficient potential to impact the company’s long-term operational and financial performance. ESG disclosures also should discuss a company’s approach to risk management, making the connection between the ESG factors on which the company reports and the company’s long-term value creation strategy.

- Before preparing its ESG disclosures, a company should consider which audiences are the intended recipients of its reports and tailor the tone and content of its reports accordingly, particularly regarding information that would be most useful for investors or for other ESG-oriented stakeholders.

- Preparers of ESG reports should consider how best to liaise with departments and functions within the company to ensure that all relevant information is collected and addressed and that diverse perspectives and inputs are included. However, when it comes to determining whether or not 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 any terms that are technical or do not have a universally accepted definition.

- It is key to allow companies discretion in how they report and discuss ESG information. Each company should maintain flexibility to determine which ESG factors and related metrics are relevant to it and what disclosure is meaningful for its stakeholders.

- 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 webpages 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 U.S. Supreme Court’s well-established definition of materiality for federal securities law purposes.

- 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.

**In the spotlight: EEI and AGA ESG Reporting Template**

The Edison Electric Institute (EEI) and the American Gas Association (AGA) developed an ESG reporting template to help electric and gas companies provide more uniform and consistent sustainability data to the financial sector. The reporting template was designed by working with both issuers and investors, and as a result of increased information and data available, member companies have seen a significant amount of ESG-related proxy proposals withdrawn by proponents.