CORPORATE SUSTAINABILITY REPORTING:

Past, Present, Future

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EXECUTIVE SUMMARY

Demand for disclosure relating to corporate sustainability—sometimes referred to as environmental, social, and governance (ESG) reporting—continues to grow. The number of companies voluntarily publishing annual sustainability reports has grown significantly in recent years, while various constituencies—including investors, customers, employees, and others—increasingly call for greater disclosure. Today, more than 80% of companies in the S&P 500 publish an annual sustainability report, a roughly four-fold increase over the past decade. The broad consensus is that heightened attention to ESG topics offers value to the business community, investors, and the public, and is not expected to recede anytime soon.

The increase in ESG reporting has prompted the rise of numerous standard-setting bodies that develop a myriad of recommended disclosures related to ESG. The vast differences in the approaches these standard setters take has created a great deal of uncertainty for companies regarding what they are expected to disclose. A number of third-party, for-profit ratings services have also been created to provide investors with a summary of a company's ESG performance relative to peer groups. These ratings services do not employ any type of standardized metrics or methodologies, provide varying levels of transparency with respect to their rating methodologies, and often arrive at very different opinions regarding a company's ESG performance. As a result, there is a lack of clarity regarding the ESG information needs of various constituencies.

The U.S. Chamber of Commerce Foundation and the Chamber's Center for Capital Markets Competitiveness (CCMC) have observed developments in ESG reporting with great interest.

We believe the broad perspective of our members makes us an ideal convening forum to facilitate a continuing dialogue about the ESG landscape. In 2018, we held a series of roundtables across the country to gather the views of institutional investors, corporate secretaries, public company directors, sustainability officers, and other thought leaders.

These roundtables have made clear that views on the future of ESG disclosure are diverse, and that companies are already leading the way on how to approach ESG reporting. Many view ESG through an idiosyncratic lens and focus on a limited number of issues; others view it more holistically and believe that ESG should be incorporated into discussions about the long-term financial performance of companies. Because of these varying approaches to ESG and the multiple constituencies that have a voice, we believe it is more important than ever for the private sector to participate in an ongoing dialogue about this complex topic as it continues to evolve.

We hope that this paper serves as a valuable resource that helps the public better understand the current state of ESG reporting and lays the groundwork for greater engagement by various constituencies.

CORPORATE SUSTAINABILITY REPORTING: PAST, PRESENT, FUTURE

Demand for useful disclosure related to ESG continues to build in the United States and around the world. There are a range of views related to the proper scope and breadth of ESG reporting. Part of what underlies this range is the lack of a universally accepted definition of ESG beyond the simple acronym.

While many institutional investors in the United States view ESG as merely an extension of the risks and opportunities that an investor should examine before investing (i.e., the risks and opportunities that could impact the ability of the company to continue to provide shareholder value over the long term), other observers use the term to refer to values-based or "impact" investing. For the purposes of this paper, we use the term ESG to refer to the entire panoply of risks and opportunities that could impact the ability of a company to continue to provide shareholder value over the long term, but generally do not intend to connote an investment motive other than increasing shareholder value.

As it stands, companies already provide a great deal of ESG information. Nonetheless, both publicly held and private companies in the United States face increased pressure not only from investors but also from customers, employees, and others to publish more of this kind of information.

For a variety of reasons, this pressure is likely to intensify. In carbon-intensive industries, such as those involving manufacturing, transportation, and energy, the pressure has already become significant. Over the past several years, numerous standard-setting bodies have promulgated a myriad of recommended disclosures on ESG topics. These standards range from the generic to the specific; some are high level and principles based while others attempt to mirror the format, style, and specificity of financial accounting standards.

There is ongoing debate over whether these ESG reporting standards should be formally incorporated into the official pronouncements of financial standard setters (such as the Financial Accounting Standards Board [FASB]) or included in formal reports filed with stock exchanges or capital markets regulators (such as the U.S. Securities and Exchange Commission [SEC]). Part 1 of this paper surveys a number of ESG standards.

> **COMPANIES HAVE DEMONSTRATED THAT THEY DO RESPOND TO MARKET AND OTHER EXTERNAL PRESSURES, INCLUDING THE UNIQUE DEMANDS OF THEIR OWN INVESTOR BASES REGARDING ESG**

For many years, a collection of retail investors and specialized investment funds (including faith- and mission-based investors as well as public and union-affiliated pension funds) have advocated for more disclosure on a wide range of ESG topics, often availing themselves of the shareholder proposal process in the United States to do so.

More recently, other institutional investors have become more vocal in expressing their views on the value of ESG information, particularly to the extent that they believe non-financial information has the potential to contribute to a company's viability as a going concern over time. Still, other institutional investors have expressed little interest in these issues, or at least have not made a concerted effort to publicize their views.

Just as investors are not monolithic when it comes to advocating for enhanced ESG disclosures, the issuer community also has responded to the demand for ESG information in different ways. Not surprisingly, these efforts fall along a wide spectrum. Notably, a large number of companies now publish stand-alone corporate sustainability reports and make other ESG information available on their corporate websites. This is in addition to those SEC-mandated disclosures that have a bearing on ESG topics, such as certain material risks that can affect a company's operations and long-term prospects.

Indeed, some companies are choosing to go beyond disclosure, taking a substantive stance on significant environmental or social issues, as many look to business to influence social policy. This follows in the tradition of corporate social responsibility. Nevertheless, despite the proliferation of groups either advocating for greater ESG standards or providing disclosure standards of their own, no single set of reporting standards has to date emerged as the dominant template across all sectors of the economy in the United States.

The U.S. Chamber of Commerce Foundation and the CCMC have watched these developments with great interest. As with many aspects of corporate disclosure and governance, many in the business community have emphasized the benefits of private ordering—that is, of giving each company flexibility and choice to arrive at the solution that fits its particular circumstances instead of treating all companies as if they were the same. Companies have demonstrated that they do respond to market and other external pressures, including the unique demands of their own investor bases regarding ESG. We have never advocated for public companies to stop producing the kind of material operational and financial information that investors have traditionally received. Nor have we asserted that ESG information is never material to evaluating and understanding a company and its business. To the contrary, we support companies whenever they choose to make information available to investors, customers, or others.

This paper has two goals. First, we survey recent developments in ESG reporting, drawing from primary source materials as well as from a series of roundtables around the United States that we held earlier this year where, collectively, individuals representing numerous perspectives attended and voiced their opinions. Second, we hope to use this paper to expand the dialogue related to ESG going forward.

WE SUPPORT COMPANIES WHENEVER THEY CHOOSE TO MAKE INFORMATION AVAILABLE TO INVESTORS, CUSTOMERS, OR OTHERS

PAST DEVELOPMENTS IN ESG REPORTING AND SUSTAINABILITY

Corporate disclosure standards evolve. Sometimes this evolution is gradual, playing out over many years as technology and investor preferences change. Regulation changes too. For example, the SEC has steadily modified mandatory disclosure requirements for decades, and judicial developments sometimes impact what companies disclose and how the disclosures are made. Rulemaking, whether by the SEC or other regulatory bodies, is designed to be a deliberative mechanism that affords due process to all perspectives. Occasionally, on the other hand, change comes more rapidly, such as when Congress responds to a crisis with a statute like the Sarbanes-Oxley Act or the Dodd-Frank Act.

A full survey of each and every development in corporate disclosure in the United States since the first enactment of the federal securities laws 85 years ago is beyond this paper's scope. Several treatises and other publications are readily available to provide this information. The staff of the SEC, for example, prepared a thorough history of public company disclosure in a study mandated by Section 108 of the JOBS Act.[1]

Likewise, for the sake of brevity, this paper does not address each and every development in the ESG movement or catalog and describe all the literature and studies on the subject.[2] This section of the paper samples the current ESG landscape, focusing on more contemporary developments rather than those further in the past, and attempts to provide a cross-section of several different perspectives and trends involving ESG. It also overviews the various bodies that contribute to the ESG ecosystem, including certain international bodies, private standard setters, ESG ratings firms, and proxy advisory firms.

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1 *See* Report on Review of Disclosure Requirements in Regulation S-K, *available at* https://www.sec.gov/news/studies/2013/reg-sk-disclosure-requirements-review.pdf.

2 A recent query of the SSRN database for the search term "ESG" returned over 17,000 separate articles. The most frequently downloaded article had approximately 11,000 downloads; dozens of articles on the other end of the spectrum had one or zero downloads.

AFFIRMATIVE DISCLOSURE OBLIGATIONS UNDER THE FEDERAL SECURITIES LAWS

"Materiality" is a central concept for disclosure under the federal securities laws, as it determines what companies must disclose. More than 40 years ago, the Supreme Court in 1976 established the materiality standard with the landmark decision *TSC Industries, Inc v. Northway*.[3] In recognizing the risk of overwhelming investors with information, the court established a demanding standard that considers information to be material under the federal securities laws if there is a "substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote."[4] This standard was extended to determine if information is material to investment decisions as well.

Since *TSC*, the Supreme Court, along with lower courts and the SEC, have consistently reaffirmed that materiality tests the significance a reasonable investor would place on information when acting with an eye toward investment returns as compared with other non-financial objectives. In *Basic, Inc. v. Levinson*,[5] the Court made clear that the *TSC* materiality construct applies not just to voting decisions, as were at issue in *TSC*, but also to decisions to buy, sell, or hold a security. The *Basic* court also emphasized the role of the materiality requirement in filtering out "essentially useless information that a reasonable investor would not consider significant, even as part of a larger 'mix' of factors to consider" in making an investment decision.[6]

IN RECOGNIZING THE RISK OF OVERWHELMING INVESTORS WITH INFORMATION, THE COURT ESTABLISHED A DEMANDING STANDARD THAT CONSIDERS INFORMATION TO BE MATERIAL UNDER THE FEDERAL SECURITIES LAWS

3 426 U.S. 438 (1976).

4 *Id.* at 448-49.

5 485 U.S. 224 (1988).

6 *Id.* at 234 (citing TSC, 426 U.S. at 448-49).

CURRENT SEC RULES AND ESG

The SEC's disclosure rules for public companies build on the materiality concept in numerous ways that require the disclosure of ESG information. For example, Item 101 of Regulation S-K, Description of Business, requires disclosure of the material effects of compliance with federal, state, and local laws regulating the protection of the environment on a company's capital expenditures, earnings, and competitive position.[7]

Item 103 of Regulation S-K, Legal Proceedings, requires disclosure of material legal proceedings. Instruction 5 to Item 103 specifically requires the disclosure of certain environmental litigation. Environmental legal proceedings must be disclosed if any of the following three criteria apply: (1) the proceeding is material to the company's business or financial condition; (2) the proceeding involves a claim for damages or penalties exceeding 10% of the company's current assets; or (3) a government authority is party to the proceeding and the company reasonably believes the damages or penalties will be at least $100,000.[8]

Additionally, Item 303, Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A), contemplates a robust discussion of the current and future state of the company. It requires, among many other things, a discussion of

- financial condition, changes in financial condition, and results of operations;
- any known trends or any known demands, commitments, events, or uncertainties that will result in or that are reasonably likely to result in the company's liquidity increasing or decreasing in any material way;
- any known material trends, favorable or unfavorable, in the company's capital resources; and
- any known trends or uncertainties that have had or that the company reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations.[9]

7 17 C.F.R. § 229.101(c)(1)(xii).

8 *Id.* at § 229.103.

9 *Id.* at § 229.303.

In practice, companies' MD&A disclosure often features a range of ESG factors. Moreover, Item 503(c) of Regulation S-K, Risk Factors, requires a discussion of the most significant factors that make an investment in the company speculative or risky.[10] This discussion could include certain ESG disclosures, such as the effect of weather patterns on a business's operations or potential changes to consumer behavior based on changing attitudes about a particular product or service offered by an issuer.[11]

In February 2010, the SEC, demonstrating how its regulation already requires disclosures concerning the "E" of ESG, published guidance to public companies regarding existing disclosure requirements related to climate change.[12] The SEC issued this release in response to petitions from investor groups, state attorneys general, institutional investors, and environmental groups seeking formal SEC guidance on climate change disclosures. The release includes a number of hypothetical disclosure scenarios that clarify which climate-related disclosures may have to be made under Regulation S-K:

- **Item 101** *(Description of Business)* requires disclosure of the impact of existing and pending legislation and regulation in the United States, such as the costs to purchase allowances under a "cap and trade" system or for facility improvements to reduce emissions.
- **Item 103** *(Legal Proceedings)* requires disclosure of the impact of international climate change accords and agreements.
- **Item 303** *(MD&A)* requires disclosure of the indirect consequences of climate change regulation on business trends, such as decreased demand for carbon-intensive goods.
- **Item 503** *(Risk Factors)* requires disclosure of the physical impact of climate change, such as the direct impact on facilities or operations due to rising sea levels and the indirect operational and financial impact on a company's operations due to decreased demand for products or services as a result of warmer temperatures.

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[10] *Id.* at § 229.503(c).

[11] Regulation S-K includes a host of other provisions that require disclosure related to executive compensation and corporate governance. Examples include Item 401 (Information About Directors, Executive Officers, Promoters, and Control Person); Item 402 (Executive Compensation and, for larger reporting companies, Compensation Discussion and Analysis); Item 404 (Certain Related Party Transactions); Item 406 (Code of Ethics); and Item 407 (Corporate Governance, including information about director independence, board and committee composition and meetings, audit and compensation committee disclosures, shareholder communications, board leadership structure, and the board's role in risk oversight). A public company's annual proxy statement provides exhaustive disclosure related to these issues.

[12] SEC Commission Guidance Regarding Disclosure Related to Climate Change, Release Nos. 33-9106, 34-61469, and FR-82 (Feb. 8, 2010), *available at* http://www.sec.gov./rules/interp/2010/33-9106.pdf.

Matters involving ESG are increasingly making their way into the SEC's organic statutes. The Sarbanes-Oxley Act, passed in 2002 as a response to the Enron bankruptcy and other lapses in corporate governance and financial reporting at well-known companies, included a number of corporate governance provisions. The Dodd-Frank Act, enacted in 2010, followed suit with a range of measures devoted to executive compensation (including the CEO "pay ratio" disclosure), mine safety, conflict minerals, and royalty payments in the extractive industries.

> **A PRINCIPAL CRITIQUE OF THE DODD-FRANK PROVISIONS IS THAT THE REQUIRED DISCLOSURES ARE DIVORCED FROM THE CONCEPT OF MATERIALITY**

A principal critique of the Dodd-Frank provisions is that the required disclosures are divorced from the concept of materiality. Accordingly, several of the Dodd-Frank provisions have been the subject of significant debate and controversy. For example, the Chamber was co-plaintiff in the successful judicial challenge to the SEC's conflict minerals rule. The resource extraction rule the SEC adopted was overturned by Congress under the Congressional Review Act in 2017.

The SEC continues to seek public input on ESG issues. As an example, in April 2016, the SEC issued a concept release on "Business and Financial Disclosure Required by Regulation S-K" that includes a specific request for comment on "Disclosure of Information Relating to Public Policy and Sustainability Matters."[13]

[13] Business and Financial Disclosure Required by Regulation S-K, Securities Act, Release No. 10,064, Exchange Act Release No. 77,599, 81 Fed. Reg. 23,916 (proposed Apr. 13, 2016).

SHAREHOLDER PROPOSALS

SEC Rule 14a-8 permits an eligible shareholder to submit a proposal at a public company for inclusion in the company's proxy statement. The rule also permits companies to exclude proposals on one or more of 13 substantive grounds, such as a personal grievance, the company's lack of authority to implement the proposal, that the proposal relates to the company's ordinary business, or that the proposal relates to a matter economically insignificant to the company.

The SEC staff relies on a no-action letter process for mediating disputes between companies and their investors as to whether a particular proposal may be excluded from the company's proxy statement. In recent years the SEC staff has issued hundreds of no-action letters annually under Rule 14a-8[14], and hundreds more shareholder proposals are included by companies in their proxy statements or withdrawn by their proponents without any action by the SEC.

> **PUBLIC COMPANIES HAVE SEEN AN INCREASE IN THE NUMBER OF SHAREHOLDER PROPOSALS FOCUSED ON ESG ISSUES. FOR EXAMPLE, 56% OF ALL SHAREHOLDER PROPOSALS AT FORTUNE 250 COMPANIES DURING THE 2017 PROXY SEASON INVOLVED SOCIAL OR POLICY GOALS, WHILE 36% OF ALL 2017 PROPOSALS AT FORTUNE 250 COMPANIES INVOLVED CORPORATE GOVERNANCE ISSUES**

Public companies have seen an increase in the number of shareholder proposals focused on ESG issues. For example, 56% of all shareholder proposals at Fortune 250 companies during the 2017 proxy season involved social or policy goals, while 36% of all 2017 proposals at Fortune 250 companies involved corporate governance issues.[15] The social or policy proposals focused on, among other topics, environmental concerns, political spending or lobbying, board diversity, employment practices in Israel, and human rights.

[14] Based on data available on the SEC website, approximately 295 letters were issued in calendar year 2016, 289 in 2017, and 236 through October 1, 2018.

[15] Complete data are available at http://www.proxymonitor.org.

The corporate governance proposals addressed issues such as separating the chair and chief executive roles, voting rules for director elections or shareholder actions, shareholder powers to call special meetings or to act by written consent, and proxy access, among other topics.

As was the case in 2016, more shareholder proposals in 2017 involved environmental concerns than any other type of proposal, with most of these proposals involving greenhouse gas emissions, "portfolio risk" from climate change regulation, or general sustainability concerns. Proposals relating to political spending or lobbying constituted the second most common type of shareholder proposal in 2017.[16] In 2018, proposals concerning social policy issues and the environment were again the most common types.

Despite the prevalence of such proposals, shareholder support for them has remained relatively low. From 2006 through 2015, Fortune 250 companies faced 1,347 shareholder proposals principally involving social or policy goals, with none receiving majority shareholder support over board opposition.[17] In 2016, one proposal related to corporate political spending received the support of a slight majority of shareholders, and in 2017, two climate-related proposals received majority shareholder support over board opposition, with the 2017 proposals passing in large part due to support from institutional investors. In 2018, four more climate-related proposals received majority support.

PROPOSALS RELATING TO POLITICAL SPENDING OR LOBBYING CONSTITUTED THE SECOND MOST COMMON TYPE OF SHAREHOLDER PROPOSAL IN 2017. IN 2018, PROPOSALS CONCERNING SOCIAL POLICY ISSUES AND THE ENVIRONMENT WERE AGAIN THE MOST COMMON TYPES.

16 James R. Copland and Margaret M. O'Keefe, Proxy Monitor, *Proxy Monitor 2017: Season Review* (Fall 2017), *available at* http://www.proxymonitor.org/Forms/pmr_15.aspx.

17 *Id.*

INTERNATIONAL ORGANIZATIONS AND ESG STANDARDS

UNITED NATIONS

The United Nations (UN) has for many years undertaken efforts to promote sustainability. In 2005, for example, a UN affiliate issued a report titled *A Legal Framework for the Integration of Environmental, Social and Governance Issues Into Institutional Investment*, which focused on the integration of ESG factors into investment policy and corporate disclosure.[18] The United Nations Principles for Responsible Investment, first issued in April 2006, consist of six voluntary and aspirational investment principles that tie ESG issues to the long-term fiduciary role of institutional investors. The key principles are as follows:

Principle 1. We will incorporate ESG issues into investment analysis and decision-making processes.

Principle 2. We will be active owners and incorporate ESG issues into our ownership policies and practices.

Principle 3. We will seek appropriate disclosure on ESG issues by the entities in which we invest.

Principle 4. We will promote acceptance and implementation of the Principles within the investment industry.

Principle 5. We will work together to enhance our effectiveness in implementing the Principles.

Principle 6. We will each report on our activities and progress towards implementing the Principles.[19]

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[18] UNEP FI, *A Legal Framework for the Integration of Environmental, Social and Governance Issues Into Institutional Investment* (Oct. 2005), *available at* http://www.unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf.

[19] UN PRI, *What Are the Principles for Responsible Investment?, available at* https://www.unpri.org/pri/what-are-the-principles-for-responsible-investment.

More recently, the UN has been developing a series of 17 Sustainable Development Goals (SDGs),[20] which seek to create, by 2030, a "world free of poverty, hunger, disease and want, where all life can thrive."[21] The 17 SDGs are grouped into five areas of critical importance: people, planet, prosperity, peace, and partnership. The SDGs are intended to be implemented at the global, national, and regional levels, and they "call on all businesses to apply their creativity and innovation to solving sustainable development challenges."[22]

FINANCIAL STABILITY BOARD

The Financial Stability Board established the Task Force on Climate-Related Financial Disclosures (TCFD) to develop voluntary, consistent climate-related financial disclosures for use by companies in providing information to investors, lenders, insurers, and others. The TCFD's basic philosophy is that a company's disclosure of how its strategies might change to address potential climate-related risks and opportunities is a key step to better understanding the potential implications of climate change for the company. In June 2017, the TCFD published a final report focused on four overarching recommendations on climate-related financial disclosures that are intended for businesses across sectors and jurisdictions.[23] The four recommendations are, in the words of the TCFD:

Governance: Disclose the organization's governance around climate-related risks and opportunities.

Strategy: Disclose the actual and potential impacts of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning, where such information is material.

Risk Management: Disclose the processes used by the organization to identify, assess, and manage climate-related risks.

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[20] *See generally* United Nations Sustainable Development Goals, *available at* https://sustainabledevelopment.un.org/sdgs.

[21] UN Sustainable Development Knowledge Platform, *Transforming Our World: The 2030 Agenda for Sustainable Development, available at* https://sustainabledevelopment.un.org/post2015/transformingourworld.

[22] *Id.*

[23] *FINAL REPORT: RECOMMENDATIONS OF THE TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES* (June 2017), *available at* https://www.fsb-tcfd.org/wp-content/uploads/2017/06/FINAL-TCFD-Report-062817.pdf.

Metrics and Targets: Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities, where such information is material.

The TCFD developed specific climate-related financial disclosures to build out the framework with information that it says will help investors and others understand how reporting organizations think about and assess climate-related risks and opportunities. For example, one of the disclosures focuses on the resilience of a company's strategy, taking into consideration different climate-related scenarios, including a two degrees Celsius scenario. Furthermore, the TCFD recommends that companies provide their climate-related financial disclosures in their "mainstream" (i.e., public) annual financial filings.

PRIVATE STANDARD SETTERS

Many companies not only disclose ESG information in SEC filings, but now also publish stand-alone corporate sustainability reports and make other ESG information available on their corporate websites. Several independent organizations have created ESG disclosure standards that they believe companies should follow.

An early advocate of sustainability disclosure is the Global Reporting Initiative (GRI), an international organization that both focuses on voluntary ESG reporting and encourages local lawmakers to incorporate ESG standards into national law. The GRI Sustainability Reporting Standards ask companies to report about their specific impacts on 33 different topics under three broad categories: the economy (e.g., anti-corruption and anti-competition), the environment (e.g., biodiversity, emissions, and waste), and society (e.g., labor relations, occupational health and safety, child labor, human rights, and customer privacy).

> **SEVERAL INDEPENDENT ORGANIZATIONS HAVE CREATED ESG DISCLOSURE STANDARDS THAT THEY BELIEVE COMPANIES SHOULD FOLLOW**

DIFFERING ESG STANDARDS

A diverse collection of standards has emerged from a variety of organizations. Some have an international focus, while others center on domestic or sectoral issues.

- United Nations Framework for Integration of ESG into Institutional Investment
- United Nations Sustainable Development Goals
- FSB Task Force on Climate-Related Financial Disclosures
- Sustainability Accounting Standards Board
- Global Reporting Initiative
- CDP (formerly Carbon Disclosure Project)
- Climate Disclosure Standards Board
- International Accounting Standards Board
- International Integrated Reporting Council
- International Organization for Standardization

The GRI standards depend on the concept of "materiality," although the GRI's definition of materiality is not tightly linked to the term's definition under the federal securities laws. Instead, the GRI believes that "materiality is the principle that determines which relevant topics are sufficiently important that it is essential to report on them."[24] Compared with the standard used in financial reporting, the GRI believes materiality for the purposes of ESG reporting encompasses "a wider range of impacts and stakeholders." For the GRI, materiality is influenced by factors both internal and external to an organization, and can also be "determined by broader societal expectation."

In the United States, one of the more active organizations is the Sustainability Accounting Standards Board (SASB). The SASB organizes numerous ESG topics under five broad sustainability categories: environment, social capital, human capital, business model and innovation, and leadership and governance.[25] From this, the SASB has released industry-specific standards for 79 industries. The SASB also has developed the "SASB Materiality Map," which it says is derived from the standard of materiality under the federal securities laws.[26] This map identifies a variety of specific issues under the SASB's five sustainability categories and seeks to assign a range of probabilities that each issue is applicable to a given industry or sector within that industry. By way of illustration, issues under the human capital category include labor relations; fair labor practices; employee health, safety, and wellbeing; and diversity and inclusion.

CDP (formerly known as the Carbon Disclosure Project) focuses on greenhouse gas emissions and risks related to climate change. CDP's annual disclosure questionnaires differ by sector, with specific questions tailored to agriculture, chemicals, electric utilities, mining, forestry, transportation, oil and gas, food, and a number of other industries.[27] Companies can voluntarily complete a questionnaire in response to a request from a customer or investor, and CDP in turn acts as a clearing house to make the responses available to those who request them.

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[24] Consolidated Set of GRI Sustainability Reporting Standards (2018) at 10, *available at* https://www.globalreporting.org/standards/gri-standards-download-center/consolidated-set-of-gri-standards/.

[25] SASB Conceptual Framework (Fall 2017), *available at* https://www.sasb.org/wp-content/uploads/2017/02/SASB-Conceptual-Framework.pdf.

[26] *See* SASB Materiality Map, *available at* https://www.sasb.org/standards-overview/materiality-map/.

[27] CDP, *Disclosure in 2018, available at* https://www.cdp.net/en/companies-discloser/disclosure-in-2018.

CDP questionnaires also request detailed descriptions of specific climate risks and opportunities the company has identified, how those risks and opportunities have impacted business, and how they have factored into financial planning.[28] For example, the CDP climate change questionnaire seeks disclosure about risks in seven categories: (1) current and emerging regulation; (2) technology to support transition to a lower-carbon, energy-efficient economic system; (3) climate-related legal claims; (4) market shifts; (5) reputation related to an organization's contribution to or detraction from the transition to a lower-carbon economy; (6) acute physical risks from extreme events; and (7) chronic physical risks from longer-term shifts in climate patterns.[29]

There are numerous other private standard-setting organizations with varying degrees of influence on ESG reporting. In an effort to harmonize and align competing ESG reporting standards, the GRI, the SASB, and CDP recently teamed with four other standards organizations: the Climate Disclosure Standards Board, the International Accounting Standards Board, the International Integrated Reporting Council (IIRC), and the International Organization for Standardization. This initiative, led by the IIRC, is called the Corporate Reporting Dialogue. The Corporate Reporting Dialogue has released a document that summarizes the materiality standards promulgated by each of the member organizations,[30] and also has prepared a "landscape map" that compares and contrasts the ESG standards each member organization has produced.[31]

EDISON ELECTRIC INSTITUTE SUSTAINABLE REPORTING INITIATIVE

The Edison Electric Institute (EEI), an association representing U.S. investor-owned electric companies, launched an environmental, social, governance, and sustainability reporting template, with the goal of helping its member electric companies provide the financial sector with more uniform and consistent sustainability data and information.[32]

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[28] CDP offers questionnaires for climate change, forestry, and water security. *See generally* CDP, *Guidance for Companies, available at* https://www.cdp.net/en/guidance/guidance-for-companies.

[29] CDP, Climate Change Questionnaire 2018, *available at* https://guidance.cdp.net/en/guidance?cid=2&ctype=theme&idtype=ThemeID&incchild=1&microsite=0&otype=Questionnaire&tags=TAG-646%2CTAG-605%2CTAG-600#c1-governance.

[30] Statement of Common Principles of Materiality of the Corporate Reporting Dialogue, *available at* http://corporatereportingdialogue.com/wp-content/uploads/2016/03/Statement-of-Common-Principles-of-Materiality1.pdf.

[31] Corporate Reporting Dialogue, The Landscape Map, *available at* http://corporatereportingdialogue.com/landscape-map/.

[32] Edison Electric Institute, ESG/Sustainability, *available at* http://www.eei.org/issuesandpolicy/finance/Pages/ESG-Sustainability.aspx.

According to the EEI, its ESG template is the first and only industry-focused and investor-driven ESG reporting framework. It was developed by a working group comprising representatives experienced in asset management, sustainability, and investment banking; buy-side and sell-side analysts; and electric utility company officials.[33]

The EEI framework encourages voluntary reporting of ESG information in both quantitative and qualitative formats. The quantitative section includes a data reporting template that is customized for regulated electric companies to include metrics on owned or purchased generation data by technology and resource type, as well as other metrics related to capital investments, emissions, and natural and human resources. The qualitative section includes information on governance and strategy, including the management and oversight of sustainability and practices, programs, and initiatives designed to support the reporting company's transition to a lower-carbon future.

INTEGRATED REPORTING

In its simplest form, integrated reporting is the combination of a financial report and a sustainability report into a single report. Many proponents of integrated reporting, however, define it as more than that.[34]

The IIRC defines an integrated report as a "concise communication about how an organization's strategy, governance, performance and prospects, in the context of its external environment, lead to the creation of value in the short, medium and long term."[35] The IIRC describes itself as a "global coalition of regulators, investors, companies, standard setters, the accounting profession," and nongovernmental organizations with a mission to "establish an integrated reporting framework within mainstream business practice."

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[33] EEI, Press Release, Aug. 27, 2018, *available at* http://www.eei.org/resourcesandmedia/newsroom/Pages/Press%20Releases/EEI%20Launches%20Industry-Wide%20Environmental%2c%20Social%2c%20Governance%2c%20and%20Sustainability%20Reporting%20Template.aspx.

[34] For additional reading on the integrated reporting movement, Professor Robert G. Eccles and Michael P. Krzus have co-authored two books, *ONE REPORT: INTEGRATED REPORTING FOR A SUSTAINABLE STRATEGY (2012)* and *THE INTEGRATED REPORTING MOVEMENT: MEANING, MOMENTUM, MOTIVES, AND MATERIALITY* (2014).

[35] *See generally* IIRC, *Integrated Reporting, available at* http://integratedreporting.org/the-iirc-2/.

According to the IIRC, the integrated report's purpose is to explain to sources of capital how an organization creates value over time. More specifically, integrated reporting, in the IIRC's view, stresses how a company uses and affects six "capitals" that determine the company's ability to create value over time. Under the IIRC's approach, the measurable capitals that drive an organization's value are financial, manufactured, natural, intellectual, human, and social and relationship.[36] The IIRC explains that how a company uses the capitals holistically provides insight into the company's long-run prospects, as well as the company's impact on the capitals themselves.

UNDER THE IIRC'S APPROACH, THE MEASURABLE CAPITALS THAT DRIVE AN ORGANIZATION'S VALUE ARE FINANCIAL, MANUFACTURED, NATURAL, INTELLECTUAL, HUMAN, AND SOCIAL AND RELATIONSHIP

ESG SCORES AND RATINGS

Several third-party ratings services evaluate and rank companies based on their individual ESG performance and disclosures. These ESG ratings services use a wide variety of metrics and methodologies and provide investors with a summary of a company's ESG performance in relation to its peer group. Investment firms are increasingly factoring ESG ratings into their investment decisions.

Some of the more well-known ESG ratings services include MSCI ESG Rating, FTSE Russell, Sustainalytics, RepRisk, and ISS Environmental and Social Quality Score. Each service ranks thousands of companies and produces ratings based on a proprietary set of ESG indicators. As noted above, CDP uses questionnaires to elicit information from participating companies, analyzes the reported data, produces reports assessing a given company's policies and risks, and assigns an overall letter grade to the company.

[36] IIRC, *The International <IR> Framework, available at* http://integratedreporting.org/resource/international-ir-framework/

ESG RATINGS FIRMS

The ESG performance of individual companies is tracked by any number of third-party ratings services, each with its own ESG indicators, questionnaires and grading criteria.

- **MSCI ESG Rating**
- **FTSE Russell**
- **Sustainalytics**
- **RepRisk**
- **ISS Environmental and Social Quality Score**

CDP also provides information and assessments for the consideration of its institutional investor members, many of whom have pledged not to invest in companies that do not participate.

ESG ratings services are not regulated, and because there are no standardized metrics or methodologies, they often come to very different rankings. A recent article in *The Wall Street Journal* found that a single company can score very differently on each of the various rankings due to its volume of public disclosure and the subjectivity of the rankings' methodologies.[37]

[37] *See* James Mackintosh, "Is Tesla or Exxon More Sustainable? It Depends Whom You Ask," *WALL ST. J* (Sept. 17, 2018), *available at* https://www.wsj.com/articles/is-tesla-or-exxon-more-sustainable-it-depends-whom-you-ask-1537199931.

PROXY ADVISORY FIRMS

Proxy advisory firms play a role in shaping the standards public companies use to evaluate their ESG disclosures because of the proxy firms' ability to guide the votes of numerous institutional shareholders. The two predominant proxy advisory firms are Institutional Shareholder Services (ISS) and Glass, Lewis & Co. (Glass Lewis), both of which have taken positions on ESG.

ISS and Glass Lewis include ESG-related voting recommendations in their respective annual voting guidelines. For example, in its 2018 proxy season voting guidelines, Glass Lewis included a discussion of how it considers gender diversity on boards of directors.[38] Beginning in 2019, Glass Lewis will generally recommend voting against the board nominating committee chair if the board has no female members, and may extend this recommendation to other nominating committee members.[39] Similarly, in its 2018 guidelines, ISS made clear that it will highlight boards of directors with no female members, but will not issue adverse vote directions based solely on a lack of gender diversity.[40]

ISS and Glass Lewis have also taken positions related to shareholder proposals relating to ESG topics. For example, in its 2018 voting guidelines, ISS updated its policies to include guidance on its evaluation of shareholder proposals requesting information from a company regarding its practices and statistics concerning gender pay gaps.[41] In addition, ISS updated its guidance on climate change shareholder proposals in 2018 to generally recommend a vote for proposals requesting that a company disclose information on the climate-related financial, physical, or regulatory risks confronting it.[42] Likewise, Glass Lewis updated its 2018 guidelines on climate-related shareholder proposals, and will generally recommend in favor of proposals requesting that companies in industries with increased exposure to climate change risks provide information to shareholders concerning their climate change scenario analyses and other climate-related considerations.[43]

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38 Glass Lewis & Co., *2018 Proxy Paper Guidelines: An Overview of the Glass Lewis Approach to Proxy Advice (United States), available at* http://www.glasslewis.com/guidelines/.

39 *Id.*

40 ISS, *United States Proxy Voting Guidelines: Benchmark Policy Recommendations* (2018), *available at* https://www.issgovernance.com/file/policy/active/americas/US-Voting-Guidelines.pdf.

41 *Id.*

42 *Id.*

43 Glass Lewis & Co., *2018 Proxy Paper Guidelines: An Overview of the Glass Lewis Approach to Proxy Advice (Shareholder Initiatives), available at* https://www.glasslewis.com/wp-content/uploads/2017/11/ShareholderInitiatives_2018_Guidelines.pdf.

Beyond their voting recommendations, ISS and Glass Lewis have recently offered more general analysis of ESG issues. For example, in 2018, ISS launched a new component of its corporate profiling and scoring process called the Environmental & Social QualityScore, which provides to its clients analytics on corporate ESG disclosures.[44] In 2018, Glass Lewis announced that it will integrate guidance on material ESG topics from the SASB into its research reports and vote management application.[45] The stated point of this effort is to allow Glass Lewis clients to readily identify whether a company's ESG disclosures align with the SASB's ESG standards.

INVESTORS

Many institutional investors have become more vocal in expressing their views on the value of ESG (in particular environmental and social) information to their investment decisions.[46] Institutional investors such as BlackRock, State Street, and Vanguard have articulated their perspectives through proxy voting guidelines, open letters to companies, annual stewardship reports, and other publications, the collective purpose of which is to inform companies about what each investor considers important. For example, BlackRock's 2018 U.S. proxy voting guidelines state the following:

> **BlackRock expects companies to identify and report on the material, business-specific Environmental & Social risks and opportunities and to explain how these are managed. This explanation should make clear how the approach taken by the company best serves the interests of shareholders and protects and enhances the long-term economic value of the company. The key performance indicators in relation to E&S matters should also be disclosed and performance against them discussed, along with any peer group benchmarking and verification processes in place. This helps shareholders assess how well management is dealing with the material E&S factors relevant to the business.[47]**

[44] ISS, Press Release (Feb. 5, 2018), *available at* https://www.issgovernance.com/iss-announces-launch-of-environmental-social-qualityscore-corporate-profiling-solution/.

[45] Glass Lewis & Co., Press Release (Sept. 12, 2018), *available at* http://www.glasslewis.com/glass-lewis-to-integrate-sasbs-industry-specific-materiality-guidance-across-research-and-vote-management-products/

[46] Institutional investor focus on how ESG factors might affect a business's financial results and operating performance and thus the interests of shareholders is distinguishable from "socially responsible" or "values" investing, which uses investing to shape social outcomes and which has existed for decades in one form or another.

[47] BlackRock, *Proxy Voting Guidelines for U.S. Securities* (Feb. 2018), *available at* https://www.blackrock.com/corporate/literature/fact-sheet/blk-responsible-investment-guidelines-us.pdf.

Other examples include State Street's guidance on providing meaningful climate-related disclosure, which expresses the view that "boards should regard climate change as they would any other significant risk to the business and ensure that a company's assets and its long-term business strategy are resilient to the impacts of climate change."[48] Vanguard's guidance in its 2018 Investment Stewardship Annual Report suggests that companies provide "consistent, comparable, decision-useful disclosure on sustainability risks" that includes "both historical data and forward-looking information so that the market has context for what companies have done, what they plan to do, and how their governance structures enable the right decisions."[49]

Today, many institutional investors advocate for standardization of ESG disclosure. For example, Vanguard's 2018 Investment Stewardship Annual Report states that "[t]hrough our support of such organizations as the Sustainability Accounting Standards Board, the Task Force on Climate-related Financial Disclosures, and the Principles for Responsible Investment, we hope to see issuers and investors coalesce around a standard set of reporting frameworks that meet the needs of all parties."[50]

Some institutional investors have advised companies that they will encourage use of, and will monitor companies' compliance with, certain ESG disclosure frameworks. More to the point, institutional investors are increasingly engaging with those companies perceived to provide insufficient ESG disclosures. BlackRock has stated that it will engage with companies "most exposed to climate risk to understand their views on the TCFD recommendations and to encourage them to consider using this reporting framework as [it] evolves over time."[51] Furthermore, BlackRock's Investment Stewardship Engagement Priorities for 2018 state that many of BlackRock's engagements are "triggered because companies have not provided sufficient information in their disclosures to fully inform our assessment of the quality of governance, including the exposure to and management of environmental and social factors."[52]

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[48] SSGA's Perspectives on Effective Climate Change Disclosure (Aug. 14, 2017), *available at* https://www.ssga.com/investment-topics/environmental-social-governance/2017/perspectives-on-effective-climate-change-disclosure.pdf.

[49] Vanguard, *2018 Investment Stewardship Annual Report, available at* https://about.vanguard.com/investment-stewardship/perspectives-and-commentary/2018_investment_stewardship_annual_report.pdf.

[50] *Id.*

[51] BlackRock, *Investment Stewardship Engagement Priorities for 2018* (March 2018), *available at* https://www.blackrock.com/corporate/literature/publication/blk-stewardship-2018-priorities-final.pdf.

[52] *Id.*

State Street has stated that it will "assess how insurance companies improve their climate risk-related disclosure in line with initiatives such as the TCFD."[53] State Street has commented that companies should begin to report their activities in accordance with the SASB framework[54] and that State Street is "actively engaging and monitoring" companies' compliance with the principles of the Investor Stewardship Group.[55] Vanguard believes that "it is essential that company boards and senior management teams appropriately oversee . . . sustainability risks—and opportunities—as they would other material issues." Moreover, according to Vanguard, "It is equally important that companies be transparent about sustainability matters and disclose them to investors."[56]

Of course, not all institutional investors have been as focused on ESG issues. Some seem to have expressed less interest in these issues insofar as investing is concerned, while others have not publicized their views one way or the other.

In terms of invested amounts, a June 2018 survey of institutional asset owners conducted by Morgan Stanley found that worldwide more than $22.8 trillion is invested "sustainably," which the survey defined as "investments made in companies or funds achieving market-rate financial returns while at the same time pursuing positive social or environmental impact."[57] This amount represents more than 25% of investment assets under professional management. According to the findings, at least 84% of the asset owners surveyed are at least actively considering incorporating ESG criteria into their investment processes, with nearly half already doing so.

The Morgan Stanley survey also found that ESG investing is a somewhat recent phenomenon. Among survey respondents, 60% of asset owners have begun incorporating ESG criteria into their investment processes only over the past four years and 37% within the past two.

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53 State Street, *Annual Stewardship Report* (2017), *available at* https://www.ssga.com/investment-topics/environmental-social-governance/2018/07/annual-stewardship-report-2017.pdf.

54 R. Kumar, *Do You Know Your ESG Score?*, CORPORATE BOARD MEMBER, *available at* https://boardmember.com/know-esg-score/.

55 State Street, *Annual Stewardship Report* (2017), *available at* https://www.ssga.com/investment-topics/environmental-social-governance/2018/07/annual-stewardship-report-2017.pdf.

56 Vanguard, *2018 Investment Stewardship Annual Report, available at* https://about.vanguard.com/investment-stewardship/perspectives-and-commentary/2018_investment_stewardship_annual_report.pdf.

57 The survey polled 118 public and corporate pensions, endowments, foundations, sovereign wealth funds, insurance companies, and other large asset owners worldwide. The full study is available at https://www.morganstanley.com/assets/pdfs/sustainable-signals-asset-owners-2018-survey.pdf.

Notably, more than 25% of professionally managed assets now have a sustainability mandate, with more than 75% of institutional asset owners feeling they have a responsibility to address sustainability through their investments. A lack of reliable data is a common critique of asset owners, with 67% looking for mainstream third-party data providers; 57% looking for specialist third-party research; and 57% looking for third-party ratings, rankings, and indexes. Only 35% believe that developing in-house research would be most helpful. The United Nations SDGs, discussed above, were singled out in the survey, and, among respondents, 78% of institutions integrating or considering sustainable investing are also at least considering an alignment with the SDGs as part of that strategy.

Retail investors also have a growing interest in ESG investing according to a separate 2017 Morgan Stanley study. Among individual investors, Morgan Stanley found that 75% are interested in "sustainable" investing, which for purposes of the survey again included making investments in companies or funds to achieve market-rate financial returns while at the same time pursuing positive social or environmental impact.[58] Among millennials, the amount increased to 86%. Of the pool surveyed, 71% believe that leading ESG practices can potentially lead to higher profitability and may be better long-term investments.

PUBLIC COMPANIES AND MATERIALITY

In January 2017, the CCMC released a white paper titled "Essential Information: Modernizing Our Corporate Disclosure System,"[59] which provided the Chamber's perspective on the ongoing debate about ESG reporting. The paper emphasizes that materiality is the bedrock of corporate reporting, setting the threshold for what public companies are mandated to disclose, while realizing that companies can always choose to disclose more voluntarily. By grounding public company disclosure requirements in the well-established concept of materiality, the paper reasons against the emerging trend of using public company disclosure to advance social or political goals.

[58] The survey polled 1,000 individual investors and is available at http://www.morganstanley.com/pub/content/dam/msdotcom/ideas/sustainable-signals/pdf/Sustainable_Signals_Whitepaper.pdf.

[59] The full report is available at https://www.centerforcapitalmarkets.com/wp-content/uploads/2013/08/U.S.-Chamber-Essential-Information_Materiality-Report-W_FINAL-1.pdf.

INPUT FROM THOUGHT LEADERS AND THE NEED FOR CONSENSUS-BASED STANDARDS

In a series of recent roundtable discussions and interviews with a number of experts, we gathered different viewpoints on ESG to better inform us on the topic.

Our first roundtable discussion occurred in May 2018 at the Chamber's Washington, D.C., headquarters. A second and third roundtable were held in July 2018 in New York. Sessions were also held in Chicago, San Francisco, and St. Louis. Additionally, we interviewed a number of executives at public companies about their views on ESG issues.

We invited corporate secretaries, members of boards of directors, former SEC commissioners and staff members, asset managers, financial analysts, and academics to participate in wide-ranging discussions about ESG-related topics at these roundtables. One thing became abundantly clear through our efforts: businesses are all over the map when it comes to the how, why, and when firms should engage on ESG issues. That said, most participants agreed that disclosure should remain voluntary, but that the lack of a universally accepted set of standards is a major challenge for businesses when it comes to ESG reporting.

One corporate governance expert we interviewed referred to the myriad of standard-setting bodies as the "wild west." Another cited "ESG survey fatigue" and stated that companies in some instances are asked to fill out up to 250 different surveys to describe how they include ESG factors into disclosure or into corporate decision making. This has left many issuers "dazed and confused" and has required them to dedicate entire teams of employees to filling out surveys or responding to third parties about ESG matters.

We also heard serious concerns that the push toward more ESG reporting—and the threat that it could lead to more requirements like Dodd-Frank's conflict minerals or pay ratio rules—is yet another disincentive for companies to go public in the United States. Given that the number of public companies in the United States is roughly half of what it was 20 years ago, the concern is that greater ESG demands will further the disincentives to go or remain public.

Another common theme we heard throughout the interview process was that companies often spend a significant amount of time and resources to produce sustainability reports, but once those reports are published, the companies hear very little feedback from shareholders or other stakeholders. We were informed that companies frequently err on the side of disclosing more, but have difficulty determining what the most salient information or topics are to those most interested in ESG. Sustainability officers also reported that while companies are seeing market signals shift toward placing greater attention on ESG information, companies have yet to realize any kind of measurable return from their investment in ESG reporting.

> **BUSINESSES ARE ALL OVER THE MAP WHEN IT COMES TO THE HOW, WHY, AND WHEN FIRMS SHOULD ENGAGE ON ESG ISSUES.**

At the roundtables and during the interviews, the issuer community acknowledged that many investors and other interested parties have increased their demand for ESG disclosure, and these companies believe they have been responsive in providing useful information to satisfy the demand. But issuers struggle with the level of detail to provide, generally preferring to provide SEC-mandated disclosure in reports filed with the SEC and saving other kinds of ESG disclosure for stand-alone sustainability reports.

Issuers pointed out that their companies commit significant resources in working to make their communities better. Several issuer representatives noted that many companies have increased their ESG reporting in recent years, and that large numbers of companies now publish a corporate sustainability report that is available to the public on the corporate website. Periodic SEC reports include far more ESG disclosures than just a few years ago, and annual proxy statements contain a wide range of corporate governance and executive compensation data.

Asset managers in attendance at roundtables acknowledged the growing importance of ESG disclosures, especially at companies perceived to have poor corporate governance practices. “Good ESG is good risk,” stated one investment manager in New York. In most cases, ESG disclosure is helpful to institutional investors and financial analysts as they assess long-term risks to the viability of a given portfolio company’s business model. One institutional investor argued that neither institutional investors nor public companies are non-governmental organizations (NGOs), and should not be viewed as such. This investor stated that ESG can factor into the long-term financial health of a company but should not be used as a means to redefine the role of corporations in society.

At a roundtable of corporate sustainability officers in San Francisco, much of the discussion focused on sustainability reporting from a competitive standpoint. Competitive benchmarking within industries can influence how much (and what types) of reporting companies feel they need to produce. Attendees agreed that many in today’s labor market care about matters such as sustainability when searching for potential employers. Companies that operate internationally also must be cognizant about how different cultures and different regulatory environments may dictate how they tailor sustainability reports to certain audiences.

IN MOST CASES, ESG DISCLOSURE IS HELPFUL TO INSTITUTIONAL INVESTORS AND FINANCIAL ANALYSTS AS THEY ASSESS LONG-TERM RISKS TO THE VIABILITY OF A GIVEN PORTFOLIO COMPANY’S BUSINESS MODEL

More generally, participants expressed a desire to have greater access to tools that would permit them to share practices and experiences in reporting approaches.

Several sustainability officers expressed frustration with the third-party ratings services that employ various, non-transparent methodologies and "move the goalposts" from year to year when rating companies. There was broad agreement that the current system of rating companies based on ESG factors is not working particularly well and has created more confusion and cost than actual benefits.

The largest point of consensus among all groups was that the lack of a universally accepted set of standards remains a major challenge to effective ESG reporting. Nearly all parties agreed that a private-sector-driven solution is needed to mitigate confusion and unnecessary costs within the current system.

INDUSTRIES REPRESENTED IN CHAMBER ROUNDTABLES

- TELECOMMUNICATIONS
- ASSET MANAGEMENT
- DEFENSE
- BANKING
- PHARMACEUTICALS
- MEDICAL DEVICES
- ACCOUNTING/AUDITING
- DIVERSIFIED ENERGY
- RETAIL
- LODGING/HOSPITALITY
- RESTAURANTS
- INDUSTRIALS
- HEALTHCARE
- TECH
- MANUFACTURING
- STAFFING/RECRUITING SERVICES

DEVELOPING CONSENSUS-BASED STANDARDS

At present, companies that elect to publish sustainability information do not have a single set of common reporting guidelines. As identified in Part 1, a number of competing standards exist, and some companies produce an entirely bespoke ESG report based on no single standard. The private sector is capable of developing a single set of consensus-based reporting criteria. From our conversations with thought leaders, we are optimistic that a private-sector effort would be one way to account for variances that exist across industries and issuers insofar as the effects of ESG are concerned. Still it may be helpful to provide an overarching framework to facilitate a private-sector-led approach, and in that spirit we offer the following observations, informed by our roundtables, to guide future discussions:

> **THE PRIVATE SECTOR IS CAPABLE OF DEVELOPING A SINGLE SET OF CONSENSUS-BASED REPORTING CRITERIA**

Audience

Different audiences have different interests in ESG. A threshold question for any company, therefore, is to whom ESG disclosures should be addressed. Much of the debate has centered on investors as the primary audience, but ESG information is of interest to multiple audiences. Customers, employees, regulators, NGOs, vendors, contractual counterparties, competitors, insurers, lenders, people who reside near company properties, academics, and students are some of the audiences besides investors who also read ESG disclosures. Each of these users has different needs and expectations when reviewing ESG information. Accordingly, the goal of the integrated reporting movement is to provide a single, comprehensive report that is effective across different perspectives and priorities when it comes to ESG.

Materiality

Materiality is a key consideration because it effectively delineates when a disclosure is mandated under the federal securities laws versus left to companies to disclose voluntarily based on the interests of investors or others. To avoid confusion, the word "materiality" should be used precisely and in a manner that is consistent with TSC and its judicial and regulatory progeny.

Usefulness

Many of the current sustainability reports delve into esoteric measurements whose plain meaning is not readily apparent to reasonable investors. It might be better to consider whether there is broad-based interest in the information because of its value in assessing a large swath of companies if it is going to be disclosed. The time, effort, and expense to prepare disclosures can be considerable, and the cost and burden need to be worthwhile as measured against the information's usefulness.

Quantifiability

When possible, disclosure metrics should be grounded in science and data and derived from any consensus that exists in the scientific or other relevant expert community on a given issue. Quantitative, data-based disclosures reduce the inherent ambiguity often associated with qualitative concepts, as different people ascribe different meanings to qualitative concepts, creating the risk of miscommunication and misunderstanding. For qualitative disclosures, there should be an agreed-to set of exact definitions to help achieve consistency across companies.

Durability

Disclosure should not be politicized. ESG disclosure should have a primary connection to a company's operational and financial performance, including the risks it faces and how it manages them.

Risk

Investors who use ESG disclosure as part of their investment analysis often do so in an effort to price future risks attendant to investing in a particular company or industry. Some ESG disclosures address historical information, while others are forward looking. The focus should be on how ESG-related risks affect a company's future operational and financial performance in light of its business, how it conducts its operations, and its approach to risk management.

Availability

Sustainability reports should be easy for users to find, but need not be incorporated into SEC reports to accomplish this objective. 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 companies could voluntarily post sustainability reports, leading to a single, searchable destination for users.

Reliability

A common complaint from investors—and a frequent rationale for the suggestion that sustainability reports should be incorporated into SEC reports—is that the reports now being published do not go through the same rigorous internal review process to ensure their accuracy that reports filed with the SEC do. While this premise is subject to debate, it is worth considering the development of a uniform review process that companies typically follow for SEC reporting. In all cases, the accuracy of disclosed information is critical regardless of the format or location of the disclosure.

CONCLUSION

Consideration of how companies run themselves and manage risk to drive their long-term value is nothing new. The enhanced focus on how ESG factors can affect a company's ability to sustain its growth over time is what has changed. Today, more attention also centers on how the priorities, activities, and operations of companies can impact society and the environment we live in, aside from what ESG means for a company's operational and financial performance in isolation.

We hope that this paper is a constructive step in promoting cooperative dialogue among those engaged in considering ESG and corporate sustainability from whatever perspective. We also hope that it serves as a catalyst for a private-sector-led solution to address many of the shortcomings inherent in the current system of ESG reporting. The balance is to adhere to the traditional conception of materiality under the federal securities laws and yet develop a workable disclosure framework that recognizes that companies often make voluntary disclosures of non-material information to meet the interests of various constituencies.

We take seriously our role as conveners and stand prepared to continue engaging on ESG reporting with investors, directors and officers, governance professionals, standard setters, and others with an interest in this important topic.

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