Why Corporate Sustainability Disclosure Has Become a Mainstream Demand

Jill E. Fisch, Keith L. Johnson, and Cynthia A. Williams*

Abstract

On October 1, 2018, these authors were among the petitioners to the Securities and Exchange Commission (SEC), seeking a rule to require clearer, more consistent, and more easily comparable disclosure of material environmental, social, and governance (ESG) information from companies subject to the SEC's jurisdiction.

The petition, which was supported by close to $ 6 trillion of invested capital relied on a number of premises. First, much ESG data is relevant to the strategic risks and opportunities facing American companies, including longer-term risks. Second, many of America's largest asset managers and other institutional investors have recognized the financial value of ESG information and have started to integrate such information into their financial analyses. At the same time, investors have also recognized that there are substantial problems with the quality of the information currently being produced pursuant to voluntary disclosure initiatives. And third, in response to changing business norms and pressure from investors, 92% of America's largest 100 public companies are voluntarily producing reports containing such "sustainability information" but without the clarity to companies and assurance to investors that would come from using standardized reporting frameworks.

In this paper, we set out some of the empirical support for those premises and then discuss how better ESG disclosure might contribute to a renewed American economy. The remainder of the paper discusses two policy design ideas to move mandated ESG disclosure forward: Prof. Fisch's proposal that reporting companies be required to include a "Sustainability Discussion and Analysis" in their annual reports, and a mandate that reporting companies be required to disclose in accordance with metrics developed by the Sustainability Accounting Standards Board. In each case, the emphasis would be on producing reliable information targeted to the needs of investors, and to provide insights into managements' strategies for addressing long-term environmental and social risks and opportunities.

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Disclosure of material environmental, social, and governance (ESG) information is a topic that has developed from being predominantly of interest to "values" investors in the 20th Century, such as socially responsible investors, to being of substantial interest as well to 21st Century "value" investors such as Blackrock, Goldman Sachs, Fidelity, JP Morgan, State Street, and Vanguard, among others.[1] Global assets under management with sustainability screens have risen 34% between 2016 and 2018 to $30.7 trillion in five major markets (the EU, US, Canada, Japan, and Australia/New Zealand).[2] Just under 40% of this total ($12 trillion) is held by U.S. investors and asset managers, comprising 25% of money under professional management, with the dominant strategy being ESG integration into fundamental value analysis for portfolio selection and management ($9.5 trillion).[3] Climate change is a particular focus for many investors' evaluations of risks and opportunities, given its importance as a risk multiplier and the inability of investors to diversify fully away from that risk. As of 2019, US $ 96 trillion of invested capital backs the Carbon Disclosure Project (CDP)'s global work to gather data on greenhouse gas emissions.[4] The CDP analyzes these data and provides them to Bloomberg for incorporation with other ESG data that Bloomberg sells to 18,000 investors around the world, a number of investors that has more than tripled in the past seven years.[5]

In parallel, and in recognition of growing social and environmental expectations of business, few global companies today fail to highlight their social and environmental initiatives on their websites. Ninety-three-percent of the Global 250 companies voluntarily disclose more ESG information than required by law, including 78% that integrate some type of financial and non-

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[1] *See* Morningstar, *Sustainable Funds U.S. Landscape Report: More funds, more flows, and strong performance in 2018* (Feb. 2019), *available at* https://www.morningstar.com/lp/sustainable-funds-landscape-report.

[2] Global Sustainable Investment Alliance, *The 2018 Global Sustainable Investment Review*, *available at* http://www.gsi-alliance.org/wp-content/uploads/2019/06/GSIR_Review2018F.pdf.

[3] *Id.*, at 4.

[4] Carbon Disclosure Project, Catalyzing Business and Government Action, *available at* http://www.cdp.net/en-US/Pages/About-Us.aspx. The CDP work reaches 120 states and regions and 7000 companies.

[5] *See* Bloomberg ESG Data, *available at* https://www.bloomberg.com/impact/products/esg-data.

financial ESG data in their Annual Financial Reports, and 67% that disclose their greenhouse gas (GHG) reduction targets.[6] In the United States, 92% of the top 100 companies now publish corporate responsibility reports,[7] responding to changing norms of responsible corporate behavior, and increased social expectations of business. Just weeks ago, the Business Roundtable issued a statement signed by 181 CEOs of American businesses supporting a definition of business purpose adopting explicit responsibility to a broad group of stakeholders. In that statement, the signatories make commitments to treat customers, employees, suppliers, communities, the environment and long-term shareholders fairly, with respect, and with attention to long-term value creation and sustainability.[8] The rationale, as articulated by the Chairman of the Business Roundtable, Jamie Dimon, Chairman and CEO of JP Morgan Chase, is to support the free market system while recognizing that "[t]he American dream is alive, but fraying."[9]

Despite the significant recognition of the financial value of ESG information, and the social and political imperatives that companies align their economic activities with broadly inclusive and sustainable principles, neither companies nor investors in the U.S. are satisfied with the state of sustainability disclosure. Companies rightly complain about the cacophony of surveys seeking reliable data about their ESG performance and the proliferation of voluntary disclosure standards. Investors rightly complain about the low quality of much ESG data, given those different disclosure frameworks, and the absence of consistent, comparable, reliable data by which to evaluate companies. In light of those complementary concerns, these authors were amongst the academic petitioners to the SEC, joined by $5.7 trillion of invested capital, seeking SEC rule-making to improve reporting standards for material ESG factors at public companies.[10]

Here, we highlight a number of aspects of that policy proposal: (1) the financial materiality of ESG data; (2) the need for higher quality data, which would come from disclosure according

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[6] *See* KPMG, *The KPMG Survey of CR Reporting 2017*, 9 (Oct. 12, 2018), *available at* https://assets.kpmg/content/dam/kpmg/xx/pdf/2017/10/kpmg-survey-of-corporate-responsibility-reporting-2017.pdf.
[7] *Id.*, at 15.
[8] *See* Business Roundtable, *Statement on the Purpose of the Corporation,* Aug. 19, 2019, and updated signatures Sept. 6, 2019, *available at* https://opportunity.businessroundtable.org/wp-content/uploads/2019/09/BRT-Statement-on-the-Purpose-of-a-Corporation-with-Signatures-1.pdf
[9] *Id.*
[10] *See* Cynthia A. Williams & Jill E. Fisch, *Petition to the Securities and Exchange Commission for Rulemaking on ESG Disclosure*, Oct. 1, 2018, *available at* https://www.sec.gov/rules/petitions/2018/petn4-730.pdf. *See generally* Jill E. Fisch, *Making Sustainability Disclosure Sustainable,* 107 Georgetown L.J. 923 (2019); Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 Harvard L. Rev. 1197 (1999).

to SEC (or even Congressional) guidance; (3) the clarifying effect of required disclosure for companies; and (4) the potential importance of such disclosure for the development of an economy that values companies' long-term orientation towards risks and opportunities. We then go beyond the Petition to the SEC to identify potential starting points for a disclosure mandate that would provide investor-relevant data and insights into how a company's management is thinking about long-term challenges and opportunities.

I. The Financial Value of Sustainability Data

The clearest indication that ESG data is perceived to have financial value comes from the fact that major asset managers and investors say it has financial value, and are using such data as part of their investment processes. Fund research entity Morningstar has noted a quite recent trend for major mainstream financial institutions and mutual fund families such as Goldman Sachs, Fidelity, JP Morgan, RBC, and Vanguard, among others, to add sustainability criteria to the prospectuses of existing funds.[11] It reported that "[w]hile this rarely happened prior to 2017, 32 funds added sustainability criteria during 2017. The trend gained considerable traction in 2018, with 62 funds adding sustainability criteria."[12]

Recent investment industry analyses confirm the financial materiality of much ESG information. For instance, a June 2017, Bank of America Merrill Lynch study found sustainability factors to be "strong indicators of future volatility, earnings risk, price declines, and bankruptcies."[13] Also in June of 2017, Allianz Global Investors produced a research report with similar findings, concluding that the heightened transparency of ESG disclosure lowered companies' cost of capital by reducing the "investment risk premium" that sophisticated investors would require.[14] In September of 2017, Nordea Equity Research published an analytic research report concluding that there is "solid evidence that ESG matters, both for operational and share price performance."[15] Goldman Sachs stated in April of 2018 that "integrating ESG factors allows for greater insight into intangible factors such as culture, operational excellence

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[11] Morningstar, *supra* note 1, at 7-8.
[12] *Id.* at 7.
[13] Bank of America Merrill Lynch, *Equity Strategy Focus Point—ESG Part II: A Deeper Dive* (June 15, 2017), *cited in* Sustainability Accounting Standards Board (SASB), *The State of Disclosure Report 2017* (December 2017).
[14] Allianz Global Investors, *ESG matters, Part 2: Added value or a mere marketing tool? What does ESG mean for investments?,* (June 2017).
[15] Nordea Equity Research, *Strategy & Quant: Cracking the ESG Code,* 5 Sept. 2017, *available at:* https://nordeamarkets.com/wp-content/uploads/2017/09/Strategy-and-quant_executive-summary_050917.pdf.

and risk that can improve investment outcomes."[16] This latter report is particularly illuminating, as Goldman analyzed questions and discussions about ESG matters reflected in earnings call transcripts and social media; asset manager initiatives, and rising assets under management utilizing ESG screens. It concluded that "the ESG Revolution is just beginning, as the logical, empirical and anecdotal evidence for its importance continue to mount."[17]

These industry studies are consistent with, and indeed rely upon, a number of influential academic studies. Two such studies are of particular note. Deutsch Asset & Wealth Management, in conjunction with researchers from the University of Hamburg, analyzed 2,250 individual studies of the relationship between ESG data and corporate financial performance. From this analysis, the researchers concluded that improvements in ESG performance generally lead to improvements in financial performance.[18] A comprehensive review published in 2015 found that 90% of empirical studies show that sound sustainability standards lower firms' cost of capital; 80% of studies show that companies' stock price performance is positively influenced by good sustainability practices; and 88% of studies show that better E, S, or G practices result in better operational performance.[19]

A recent report by Mercer, a consultant to $10 trillion of institutional investors, shows the critical importance of aligning investment with sustainability data today.[20] Mercer evaluated the effects on various portfolios, such as a growth portfolio and a sustainable growth portfolio,[21] under three different scenarios: one showing a 2°C increase in preindustrial temperatures by 2100, which would require "aggressive" climate action; one a 3°C increase by 2100, which assumes "some climate action but not transformative"; and the third a 4°C increase by 2100,

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[16] Goldman Sachs Equity Research, *GS Sustain ESG Series: A Revolution Rising-From Low Chatter to Loud Roar [Redacted]*, 23 April 2018, *available at* https://www.goldmansachs.com/insights/pages/new-energy-landscape-folder/esg-revolution-rising/report.pdf.

[17] *Id.*

[18] Deutsche Asset & Wealth Management, *ESG and Corporate Financial Performance: Mapping the Global Landscape*, December, 2015, *available at* https://institutional.deutscheam.com/content/_media/K15090_Academic_Insights_UK_EMEA_RZ_Online_151201_Final_(2).pdf.

[19] *See* Gordon L. Clark, Andreas Feiner & Michael Viehs, *From the Stockholder to the Stakeholder: How Sustainability Can Drive Financial Outperformance* (2015), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2508281. This report analyzes the empirical literature on the financial effects of sustainability initiatives by type of initiative (E, S or G) and by various financial measures of interest (cost of debt capital; cost of equity capital; operating performance; and effect on stock prices).

[20] Mercer, *Investing in a Time of Climate Change: The Sequel 2019* (2019), *available at* https://www.mercer.com/our-thinking/wealth/climate-change-the-sequel.html.

[21] *Id.*, Appendix 1, Portfolio Construction, p. 75.

which is Mercer's estimate of the increases to be expected under today's business-as-usual pathway.[22] Mercer relied on data and analysis from Cambridge Econometrics that integrates "the treatment of economics, energy systems and the environment to capture linkages and feedbacks," in order to evaluate the effects of the different scenarios on its model portfolios.

Under even the most optimistic scenario evaluated, which assumes the world takes "aggressive" action on climate and limits warming to 2°C by 2100, the potential effects on a long-term investor of holding oil, gas, and coal, or of not investing in equities using a sustainability theme, are eye-popping:

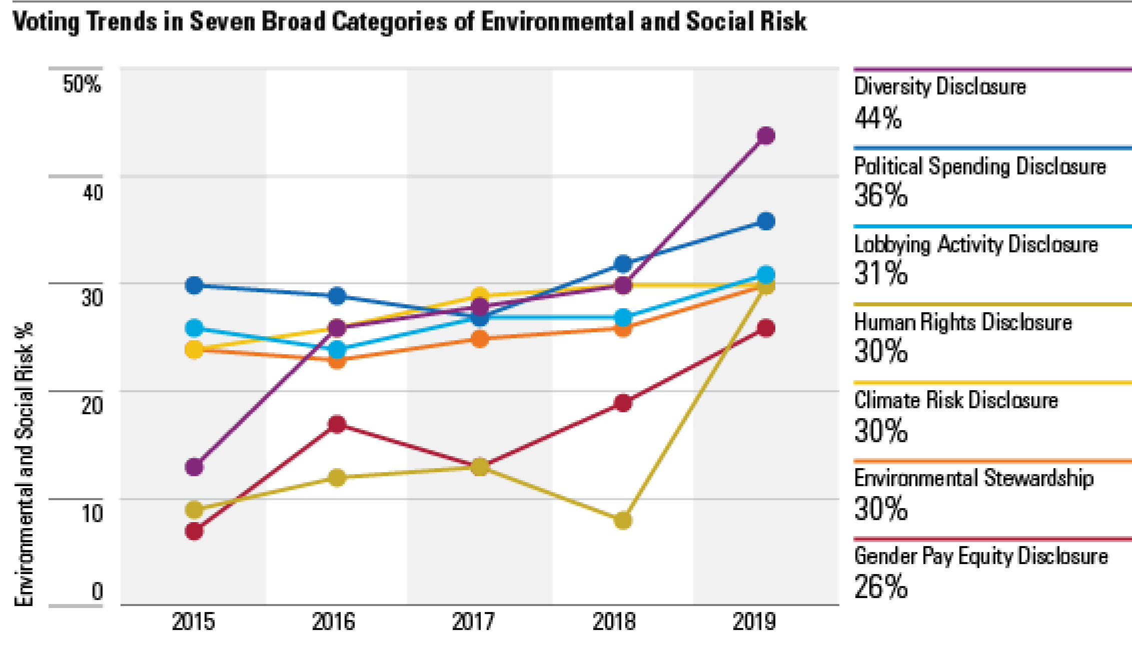
Industry or Asset Class	**% p.a. to 2030 in 2°C scenario**	**% cumulative to 2030 in 2°C scenario**	**% p.a. to 2050 in 2°C scenario**	**% cumulative to 2050**
Coal	-7.1	-58.9	-8.9	-100.0 (by 2041)
Oil and gas	-4.5	-42.1	-8.9	-95.1
Renewables	+6.2	+105.9	+3.3	+177.9
Electric utilities	-4.1	-39.2	-3.3	-65.7
Developed market equities	0.0	-0.5	-0.2	-5.6
Emerging market equities	+0.2	+1.8	-0.1	-4.0
All world equities—sustainability themed	+1.6	+21.2	+0.9	+32.0
Infrastructure	+2.0	+26.4	+1.0	+39.4
Infrastructure-sustainability themed	+3.0	+42.3	+1.6	+67.1

[22] *Id.*, Appendix 2, Methodologies, pp. 81-83.

Source: Mercer, *Investing in a Time of Climate Change,* p. 10 (2019) (excerpted).

In its executive summary, Mercer concludes that "[i]nvestors need to consider both climate-related mitigation and adaptation in an active way to develop climate resilience in their portfolios."[23] Relevant, reliable sustainability (ESG) data are necessary in order to create portfolios that are sustainability themed, and select among companies within relevant asset classes. As the Mercer projections show, sustainability-themed investments are critical to investors, and their beneficiaries,' future economic well-being.

In addition, recent proxy voting trends demonstrate the materiality of ESG factors. Morningstar reported at the end of the 2019 proxy season that 14 shareholder resolutions seeking corporate transparency on diversity, sustainability, political spending, lobbying, governance of opioids, gun safety and human rights received majority votes this year.[24] Over the past 16 years, average shareholder support for environmental and social resolutions has increased from 12% to 29%, with the trend accelerating over the last two years.[25]



[23] *Id.*, at 7.

[24] John Hale & Jackie Cook, *Proxy Season Shows ESG Concerns on Shareholders' Minds*, Aug. 22, 2019, *available at* https://www.morningstar.com/articles/943448/proxy-season-shows-esg-concerns-on-shareholders-minds.

[25] *Id.*

ISS Analytics found that voluntary withdrawal rates for environmental and social shareholder proposals reached 48 % for 2019 resolutions, indicating that companies are increasingly agreeing to the underlying shareholder demands.[26] ISS Analytics also reported that the gap between support for governance proposals versus environmental and social resolutions has been rapidly closing. Through June, a record 48% of environmental and social proposals this year received more than 30% support (up from 28% receiving such support in 2011), while 58% of governance proposals received more than 30% support.[27]

Clearly, proxy voting results demonstrate that ESG matters are material considerations in the investment processes of an increasingly large number of investors. These matters merit the same clarity of standards to ensure consistent and comparable reporting as other material investment data.

II. The Quality of ESG Data Today is Patchy at Best

In response to an April 2016 SEC Concept Release on Disclosure that included a number of questions about sustainability disclosure, asset managers, institutional investors, individual investors, foundation executives, and public pension funds, among others, submitted extensive comments to the SEC that "overwhelmingly expressed support" for more required ESG disclosure.[28]

For example, BlackRock, the world's largest asset manager, with assets under management of $6.84 trillion as of June, 2019, has publicly recognized the strategic value of ESG information:

> Environmental, social, and governance issues are integral to our investment stewardship activities, as the majority of our clients are saving for long-term goals. It is over the long-term that ESG factors – ranging from climate change to diversity to board effectiveness – have real and quantifiable financial impacts. Our risk analysis extends across all sectors and geographies, helping us identify companies lagging behind peers on ESG issues.[29]

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[26] ISS Analytics, *Early Review of 2019 US Proxy Season Vote Results,* June 5, 2019, *available at* https://www.issgovernance.com/library/early-review-of-2019-us-proxy-season-vote-results.

[27] *Id.*

[28] Tyler Gellasch, *Joint Report: Towards a Sustainable Economy: A review of Comments to the SEC's Disclosure Effectiveness Concept Release*, 17 (Sept. 2016), *available at:* https://static1.squarespace.com/static/583f3fca725e25fcd45aa446/t/5866d3c0725e25a97292ae03/1483133890503/Sustainable-Economy-report-final.pdf.

[29] *See* BlackRock, *Viewpoint, Exploring ESG: A Practitioners Perspective* (June 2016)*, available at* http://www.blackrock.com/corporate/en-fi/literature/whitepaper/viewpoint-exploring-esg-a-practitioners-perspective-june-2016.pdf.

Significantly, however, BlackRock asserts that current reporting practices are insufficient for the kinds of in-depth investment analysis that it seeks with its ESG integration, making it "difficult to identify investment decision-useful data."[30] As a result, it has advocated for public policy changes to require companies to disclose such information, assuming appropriate safe harbors are also provided.[31]

Bloomberg, a global company that sells capital markets data, has reached conclusions similar to those of BlackRock about the quality of ESG data. Since 2009, Bloomberg has incorporated ESG data into the data that it sells to dealers, brokers, and investors around the world.[32] Even so, its CEO Michael Bloomberg has written that:

> [F]or the most part, the sustainability information that is disclosed by corporations today is not useful for investors or other decision-makers. . . . The market cannot accurately value companies, and investors cannot efficiently allocate capital, without comparable, reliable and useful data on increasingly relevant climate-related issues….[33]

An SEC disclosure mandate would be an efficient solution, and one that supports markets in their function as allocators of capital.

III. A Regulatory Framework Would Reduce Burdens on Companies

In addition to benefiting investors, SEC rulemaking regarding ESG disclosure would benefit America's public companies by providing clarity to them about what, when and how to disclose sustainability information. Today companies are burdened with meeting a range of investor expectations for sustainability information without clear standards about how to do so. Although private market participants have developed a number of voluntary frameworks over the previous decades, the absence of an authoritative standard has led to different companies using different frameworks and multiple mechanisms to disclose sustainability information. This leads

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[30] *Id.*
[31] *Id.* at 1.
[32] *See* Bloomberg, *Impact Report Update 2015* 2, (2015), *available at* https://www.bloomberg.com/company/press/2015-bloomberg-impact-report-a-message-from-our-founder.
[33] *Id.*

to a lack of comparable sustainability information, even among companies in the same industry.[34]

That ESG disclosure requirements could actually reduce burdens on America's public companies was well-stated in the CFA Institute's Comment Letter to the April 16 Concept Release on Disclose which explained:

> Many issuers already provide lengthy sustainability or ESG reports to their investors, so many issuers will not face a new and burdensome cost by collecting, verifying and disclosing ESG information. Costs may be saved if instead of producing large sustainability reports that cover a broad range of sustainability information, issuers can instead focus on only collecting, verifying and disclosing information concerning the factors that are material to them and their investors.[35]

Similarly, Yafit Cohn, an attorney at The Travelers Company, explained in testimony before the SEC Investor Advisory Committee that Travelers and its peer public companies face an overwhelming burden in responding to the requests for ESG information from rating agencies, various for-profit and non-profit groups, and investors.[36] She notes that these requests "have not only resulted in huge expenditures of corporate resources and shifted the focus of senior management but have created an almost-unmanageable situation, with companies struggling to figure out how to get their arms around it all and make informed calls as to what truly matters to their investors and what doesn't – in other words, where to turn their attention and spend their limited resources."[37]

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[34] *See* PwC, *Sustainability Disclosures: Is your company meeting investor expectations?* (July 2015), *cited in* Jean Rogers, SASB Comment Letter to the SEC's April, 2016 Concept Release, July 1, 2016, at 7 fn.20 (79% of investors polled said they were dissatisfied with the comparability of sustainability information between companies).

[35] CFA Institute Comment Letter to the Concept Release, October 6, 2016, at 19. On the question of the SEC requiring sustainability disclosure, the CFA Institute concluded that "[i]t is imperative that the SEC develop disclosure requirements that require companies to disclose material sustainability information while allowing issuers the flexibility to disclose that which is germane to their industry/sector . . . " Thus, the Institute supported differentiated sustainability disclosure according to industry and sector, along with a general requirement for companies to disclose the corporate governance arrangements for sustainability issues. *Id.*

[36] Yafit Cohn, *Remarks before the SEC Investor Advisory Committee, Discussion Regarding Disclosures on Sustainability and ESG Topics*, Dec. 13, 2018, http://scsgp.informz.net/SCSGP/data/images/Alert%20Documents/Yafit%20Cohn%20Remarks%20Before%20IAC.pdf. Travelers subsequently named Cohen its first Chief Sustainability Officer. See *Travelers Names Yafit Cohn First Chief Sustainability Officer*, Bus. Wire, Aug. 15, 2019, https://www.businesswire.com/news/home/20190815005341/en/Travelers-Names-Yafit-Cohn-Chief-Sustainability-Officer

[37] Id. at 2.

Formal SEC rulemaking would create a level playing field among companies. Today, some but not all companies provide sustainability information, in formats that differ, using different mechanisms for disclosure (sustainability reports, company websites, SEC filings), and different timing. As recognized in an analysis of sustainability reporting by PwC in 2016, this has created a situation where information is not comparable between companies in the same industry and sector; where "an increasing volume of information is being provided without linkage to a company's core strategy," and where there are no clear standards that all companies within the same industry are using.[38] Indeed, it may be with respect to the companies that are not providing any ESG data on critical industry-specific sustainability challenges where an SEC mandate is most needed.

An SEC mandate could include one or a mixture of different approaches – general requirements to provide information about firms' identification and governance of sustainability issues applicable to all issuers, more detailed industry specific requirements, and principles-based elements to act as a materiality backstop. We provide a number of specific suggestions below. By providing clarity to issuers on what sustainability disclosure is required, the SEC would create comparability between firms in the same industry. Comparability would allow actual sustainability leaders to be recognized as such by investors, consumers, and regulators, with attendant financial benefits such as increased investment and a lower cost of capital.[39] At the same time, SEC oversight would reduce the potential for greenwashing and outright fraud.[40]

IV. The Relevance of ESG Data to Long-Term Risks and Opportunities

An important reason for the SEC to act to promote comparable, clear, and consistently presented ESG data is to provide capital market support for long-term business strategies, including strategies that have short-term costs but may reduce social stress, environmental degradation, and other systemic risks. Many ESG issues are of a systemic nature, such as

[38] PwC, *Point of View: Sustainability reporting and disclosure: What does the future look like? (July 2016),* at 1, *available at* https://www.pwc.com/us/en/cfodirect/publications/point-of-view/sustainability-reporting-disclosure-transparency-future.html.

[39] *See, e.g.,* Clark et al., *supra* note 20 (summarizing empirical literature through 2015, and finding that 90% of studies show lowered cost of capital for firms with sound sustainability practices; 88% of studies show that better E, S, or G practices (the latter specific to sustainability) result in better operational performance; and 80% of studies show stock market out-performance for firms with good sustainability practices.

[40] Greenwashing is "[t]he practice of emphasizing positive and omitting negative information to make an issuer's business practices appear to be more sustainable than they actually are." Fisch, *supra* note 10, at 948.

climate change, biodiversity loss, water scarcity, income inequality, or cybersecurity problems.[41] Many systemic issues have both serious political and macroeconomic consequences. Growing economic inequality has given rise to polarized politics, even in the U.S., populism from both left and right, and economic consequences, given the importance of consumer spending to the health of the U.S. economy. As such, these issues are impossible for individual companies to solve alone, but over time they need to be addressed through smart incentives and investment addressed to individual companies and other economic actors.

Other ESG issues are industry specific. So, for instance, active investor Neuberger, Berman identified nine ESG issues that it uses to evaluate investing in chemical companies: GHG emissions; air quality; water management; energy management; hazards and waste management; workforce health and safety; environmental stewardship of chemicals; legal compliance and regulatory management; and operational safety and emergency preparedness.[42] The list highlights the extent to which ESG issues are often industry specific; only three of the chemical company issues would seem to apply to investing in a financial institution. Yet one aspect in common for ESG issues generally, whether systemic or industry specific, is that they likely have consequences that extend beyond the traditional 3-month and 12-month cycles of current financial reporting. It is only by developing high quality, reliable information on these matters that companies can manage their long-term economic risks, and investors with a long-term perspective can evaluate and reward company leadership in managing those risks.

V. *Potential Frameworks for Mandatory ESG Disclosure*

In this final section, we sketch out two current proposals for mandated ESG disclosure. One is a proposal developed by Prof. Fisch in more detail elsewhere, that reporting companies be

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[41] Of these, the World Economic Forum's Global Risk Report 2019, based on a survey of 1,000 CEOs, government officials and other stakeholders, identified extreme weather events and the global failure of climate change mitigation and adaptation as both within the top five likely risks (1, and 2, respectively), and also with the highest impact (3, and 2, respectively). Each of the other issues identified in the text as systemic issues were identified as within the top 10 global risks or top three trends likely to affect global development over the next ten years. World Economic Forum, Marsh & McLennan, and Zurich Insurance Group, *Insight Report: The Global Risks Report 2019* 2-3 (2019), *available at http://www3.weforum.org/docs/WEF_Global_Risks_Report_2019.pdf*.

[42] Neuberger, Berman, *ESG Investing: A Long-Term Approach to Value Creation*, *available at* https://www.nb.com/pages/public/global/insights/esg-investing-an-active-approach-to-long-term-value-creation.aspx.

required to include a "Sustainability Discussion and Analysis (SD&A)" in their annual reports.[43] The second is the proposal that reporting companies be required to disclose in accordance with metrics developed by the Sustainability Accounting Standards Board (SASB). The two proposals take very different approaches to mandated disclosure. The SD&A proposal is a form of qualitative disclosure, would apply across-the-board to all issues, and would serve primarily as a tool for improving information flow to corporate managers and board oversight of ESG issues by enabling investors greater visibility into the quality of management oversight. The SASB metrics, which were developed through a multi-year consultative process with issuers and investors, consist of a complete set of 77 industry-specific qualitative and quantitative disclosure standards. Combined, disclosure according to the two approaches would provide investors with good insights into a company's sustainability challenges and opportunities.

A. Sustainability Discussion and Analysis

The Sustainability Discussion and Analysis (SD&A) approach to ESG disclosure would require issuers to include a narrative discussion of ESG issues in their annual financial reporting, modeled after the existing Management Discussion and Analysis and Compensation Discussion and Analysis requirements. Specifically, the proposal would require issuers to identify, in their SD&A, the three ESG issues most significant to their operations, to describe the potential impact of those issues on the issuer's economic performance, and to explain the basis for the issuer's determination of significance.[44] Borrowing from the MD&A requirement, the SD&A proposal would require issuers, in evaluating their disclosure obligation, to assess known trends, demands, events or uncertainties that are "both presently known . . . and reasonably likely to have material effects on the registrant's financial condition or results of operation."[45] The proposal would, however, shift responsibility for adhering to the SD&A requirement from management to the board of directors. Specifically, the SD&A mandate would require both that the board or a board committee oversee the SD&A reporting process and sign the SD&A, effectively implementing a

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[43] For a more detailed explanation of the proposal and an evaluation of its potential costs and benefits see Fisch, supra note 10.
[44] *Id*. at 956.
[45] Management's Discussion and Analysis of Financial Condition and Results of Operations; Certain Investment Company Disclosures, Securities Act Release No. 6835, Exchange Act Release No. 26,831, Investment Company Act Release No. 16,961, 54 Fed. Reg. 22,427, 22,429 (May 24, 1989).

certification process akin to that mandated by Sarbanes-Oxley with respect to issuer financial reporting.[46]

The SD&A mandate offers several advantages. Perhaps most important, by mandating board oversight, the SD&A would increase information flow to the board on ESG issues and encourage board awareness and oversight of ESG-related issues and risks. The board of directors is legally and practically in the best position to analyze the importance of ESG considerations with respect to an issuer's long-term business plan, and the structure of the SD&A requirement offers a mechanism for encouraging greater board attention to ESG issues while, at the same time, retaining the board's authority to determine the extent to which such considerations warrant operational changes. [47] By bringing ESG disclosure into the core management of the issuer rather than siloing responsibility for ESG within communications or marketing, the requirement would lead to a more thoughtful incorporation of ESG-related risks into operational decision-making. Similarly, the disclosure requirement increases the transparency of the board's oversight of ESG considerations to investors and enhances investors' ability to hold boards accountable for ESG-related decisions. In addition, like the MD&A requirement, the SD&A would offer issuers the flexibility of identifying ESG issues on a firm-specific basis without the need to report on or justify the failure to report on issues and metrics that are not relevant to that company or its industry, while nonetheless limiting the potential for greenwashing by requiring issuers to disclose on the most significant ESG issues. In an era in which issuers face substantial regulatory and compliance costs, the limited scope of the SD&A would minimize any additional regulatory burden. Finally, incorporating ESG disclosure into an issuer's financial reporting would improve the reliability of disclosure because disclosures would be prepared by the same personnel who prepare the issuer's financial disclosure, they could be subject to SEC staff review, and an issuer's omission or mischaracterization of a critical ESG-related risk would subject it to potential enforcement liability.

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[46] See SOX § 304(a), 15 U.S.C. § 7243(a).

[47] The SEC has recognized elsewhere that the board is well positioned to assess the importance of a particular policy issue to the company's business. See SEC Division of Corporation Finance, Shareholder Proposals: Staff Legal Bulletin No. 14J (CF), Oct. 23, 2018, https://www.sec.gov/corpfin/staff-legal-bulletin-14j-shareholder-proposals (expressing staff position that "a well-developed discussion of the board's analysis of whether the particular policy issue raised by the proposal is otherwise significantly related to the company's business, in the case of Rule 14a-8(i)(5), or is sufficiently significant in relation to the company, in the case of Rule 14a-8(i)(7), can assist the staff in evaluating a company's no-action request.")

The primary disadvantage of the SD&A proposal is its scope. By limiting its requirement to qualitative disclosure and mandating the disclosure only of the three most important ESG issues, SD&A would not provide investors either with a complete picture of all material ESG issues or provide the kind of standardized quantitative information suitable for empirical analysis. Nonetheless, the proposal offers a viable first step that would produce valuable information for both issuers and investors.

B. The SASB Approach to ESG Disclosure

Like the SD&A, SASB's proposal would mandate that ESG disclosure be incorporated into SEC filings rather than provided in stand-alone sustainability reports. Unlike the SD&A proposal, SASB's approach is primarily quantitative. In collaboration with investors and representatives from each specific industry, SASB has developed industry-specific disclosure standards for seventy-seven industry sub-sectors in eleven industry sectors.[48] In many cases, these standards identify specific ESG actions and activities and identify precise metrics for measuring those activities. For example, with respect to issuers in the household and consumer goods industry, SASB requirements include reporting on total water withdrawn and consumed, in thousand metric meters; total weight of packaging, in metric tons, including the percentage made from recyclable and renewable materials; and the amount and percentage of palm oil sourced through the Sustainable Palm Oil supply chain, in metric tons.[49]

There are a number of advantages to the SASB standards. First, they have been developed with investor and industry input to identify the financially-material sustainability topics for each industry. Each of the standards is supported by technical guidance documents and metrics to ensure comparability between companies. Their specificity ensures that companies would not be required to respond to disclosure requirements inapplicable or only marginally relevant to their industry. Second, they are parsimonious. Many of the sub-sectors identified in the SASB "materiality map" show between four and seven topics on which to report, reducing burdens on companies, but also directing company management to core topics.

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[48] The general industry categories are consumer goods; extractives and minerals processing; financials; food and beverage; health care; infrastructure; renewable resources and alternative energy; esource transformation; services; technology and communications; and transportation. Sustainability Accounting and Standards Board, *Materiality Map*, *available at* https://materiality.sasb.org/.

[49] https://www.sasb.org/wp-content/uploads/2018/11/Household_Personal_Products_Standard_2018.pdf

Third, they have been developed since 2011 in a transparent process with broad, expert participation. It would require many years for the SEC to replicate such a process, if it chose to do so. Presumably, as with accounting standards, the SEC may decide to delegate authority to SASB, subject to its continuing regulatory oversight. And fourth, they have been developed with one goal in mind: to "enable businesses to identify, manage, and communicate financially material sustainability information to their investors."[50] While other stakeholders may well find the information useful, SASB has not adopted a broad mandate for their standards development.

We conclude that reporting that combined an SD&A discussion with industry-specific SASB disclosure would provide a comprehensive picture of a company's sustainability challenges and how they are being managed, without unduly burdening companies subject to the SEC's jurisdiction.

Conclusion

Notwithstanding the problems with the quality of voluntarily produced ESG information in the markets that this policy paper has emphasized, the substantial growth in voluntary sustainability disclosure globally and in the United States is important for a number of reasons. First, companies are responding to investors who are increasingly aware of the relevance of ESG data to a full evaluation of company strategies, risks, and opportunities. This investor awareness shows the materiality of this information, as this paper has also emphasized, particularly to shareholders with a long-term orientation. Second, to produce sustainability reports companies have developed internal procedures to collect and evaluate the kinds of information that an SEC mandate would likely require, thus showing that costs to companies should not be an impediment. While not all companies have embarked on sustainability reporting, particularly smaller companies, the SEC is well-positioned to provide "on-ramps" or differentiated requirements for smaller companies, as it has done historically with many of its regulations. Third, and perhaps most important, twenty-five years of development of voluntary sustainability disclosure has not led to the production of consistent, comparable, highly-reliable ESG information in the market. SEC leadership providing a mandate for ESG disclosure in the

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[50] Sustainability Accounting and Standards Board, *Standards Overview, available at:* https://www.sasb.org/standards-overview/.

world's largest, and arguably most important, capital market can significantly contribute to solving this problem.