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FRUSTRATIONS EMERGE OVER LACK OF CLEAR ESG DISCLOSURE STANDARDS AMONG PATCHWORK OF PROVIDERS

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Fallout from the COVID-19 pandemic appears to be sharpening some investors' focus on ESG (Environmental, Social or Governance) matters, as evidenced by the SEC Investor Advisory Committee's recent recommendation that the SEC mandate disclosure of "material, decision-useful, ESG factors" as relevant to each company.

The desire for more clarity around ESG disclosure is understandable. More than a dozen non-profit and for-profit ESG data providers have emerged in this complex, booming market, according to a May 28, 2020 webinar of the Sustainability Accounting Standards Board and the Society for Corporate Governance. The data providers generally fall into four distinct groups: (1) providers who publish guidance for voluntary ESG disclosure, often with company feedback; (2) providers who request data from companies using questionnaires and then based on the answers issue reports or ESG ratings; (3) providers who compile publicly available ESG data about companies and issue ESG ratings based only on that publicly available information; and (4) providers who create assessments of companies based on public and/or private information to sell to investors.

Under the current patchwork, a public company can be the subject of an ESG assessment without knowledge that it occurred or an opportunity to give input or correct misperceptions, particularly in situations where the company has very limited ESG disclosures because ESG issues were not deemed material and not required to be disclosed under SEC rules. For public companies trying to navigate the maze of ESG issues and disclosures, frustration can easily emerge. The different ESG assessment methods and models are inconsistent and arguably unreliable in some cases, such as for small- and mid-sized companies that lack resources to complete requested questionnaires or provide feedback. The surprise effect of a negative rating sold or provided to institutional and other investors can lead to investor relations headaches, as companies try to sort through the sources used for the assessment, correct misinformation and address shareholder concerns.

Despite the confusion and frustration over ESG disclosure, it is unlikely that the SEC will move forward with proposals to mandate ESG disclosure in the near term. Commission Hester Peirce issued a statement at the May 21, 2020, Investor Advisory Committee meeting and appeared to be skeptical of the Committee's urgent recommendation: "A more general call to develop a new ESG reporting regime—without a clear explanation of why the past fifty years of discussion on the topic has not crystallized into a universally applicable set of material ESG items, but now is the magic moment—may not be as helpful. Otherwise, let's keep using our tried and true disclosure framework, which is rooted in materiality and is flexible enough to accommodate a wide range of issuers, each with its unique and ever-evolving set of risks."

To help fill the ESG leadership void, some institutional investors are advocating for a common framework, such as the Sustainability Accounting Standards Board (SASB), which is working to provide a clear set of standards for reporting sustainability information across a wide range of issues, including employment practices, business ethics and data privacy, among other things. Despite acknowledging the significant amount of effort required, some institutional investors have asked investee companies to report on ESG matters using the SASB framework by year end.

With or without SEC-mandated ESG disclosure requirements, most public companies will need to spend more time and energy considering ESG matters and what they believe may be material to investors in light of investors' heightened focus on these areas and the proliferation of ESG data providers whose public assessments about public companies' ESG disclosures can raise investor concerns.

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