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SEC ACTING DIRECTOR COATES PROPOSES FRAMEWORK FOR FUTURE ESG RULEMAKING

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Yesterday, John Coates, the acting director of the SEC's Division of Corporation Finance, announced a proposed framework for considering new ESG disclosure requirements, recognizing that while the scope of ESG issues is very broad, specific ESG issues affect particular companies differently based on industry, geography and other factors.

Need for "adaptive and innovative" policy

Coates compared ESG issues to asbestos-related risks, which evolved from invisible "non-financial" risks that were not addressed in SEC filings to visible and eventually clear financial risks that were increasingly disclosed in companies' filings. He believes that SEC policy needs to be adaptive and innovative and, for example, respond to climate risks that were formerly peripheral and now have greater significance.

Effective ESG disclosure system

Coates believes some of the questions the SEC should consider include:

- What disclosures are most useful?
- What is the right balance between principles and metrics?
- How much standardization can be achieved across industries?
- How and when should standards evolve?
- What is the best way to verify or provide assurance about disclosures?
- Where and how should disclosures be globally comparable?
- Where and how can disclosures be aligned with information companies already use to make decisions?

Costs from having no ESG requirements

Although recognizing that disclosure requirements impose costs on companies, Coates believes that failing to establish ESG requirements is itself costly – that the lack of consistent, comparable and reliable ESG data discourages investment and voting decisions. Companies incur higher costs in responding to multiple, conflicting or redundant investor requests for information due to the absence of a consensus on ESG disclosures.

Mandatory vs. voluntary disclosure

Coates suggests an ESG disclosure system need not choose between mandatory vs. voluntary disclosures and instead might employ a combination of approaches. He notes that some existing SEC ESG disclosures are mandatory (such as board consideration of diversity in director nominees), some require companies to "comply or explain" (such as audit committee financial expert disclosures) and some only require disclosures if material, or if needed to prevent other statements from being materially misleading.

Benefits of single global ESG disclosure framework

Coates favors pursuing a single global ESG reporting framework, because "ESG problems are global problems that need global solutions for our global markets." He recognizes that establishing such a framework is complex, and requires reliable and adequate funding, proper governance and public accountability. In light of its independence and transparency, he believes the SEC should play a leading role in developing a "baseline" disclosure system that other jurisdictions can adapt for their needs.

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