

**Recommendation of the SEC Investor Advisory Committee**  
**Relating to ESG Disclosure**  
**(May 21, 2020)**

For close to 50 years, the SEC has periodically contemplated whether ESG<sup>1</sup> disclosures are material and should be incorporated into its integrated disclosure regime for SEC registered Issuers.<sup>2</sup> This recommendation asserts that the time has come for the SEC to address this issue. Addressing ESG disclosure now will (a) provide investors with the material, comparable, consistent information they need to make investment and voting decisions, (b) provide Issuers with a framework to disclose material, decision-useful, comparable and consistent information in respect of their own businesses, rather than the current situation where investors largely rely on third party ESG data providers, which may not always be reliable, consistent, or necessarily material, (c) level the playing field among all US Issuers regardless of market cap size or capital resources, (d) ensure the continued flow of capital to US Issuers, and (e) enable the SEC to take control of ESG disclosure for the US capital markets before other jurisdictions impose disclosure regimes on US Issuers and investors alike.

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<sup>1</sup> The term, “ESG” is very broad. It generally refers to Environmental, Social or Governance matters. Another term is “Sustainability”. For purposes of this Recommendation, we use the term ESG as a broad set of subjects germane to businesses as highlighted by The Business Roundtable August 19, 2019 in its Statement of Purpose: customers, employees, suppliers, the community (environment), and shareholders.  
<https://opportunity.businessroundtable.org/wp-content/uploads/2020/04/BRT-Statement-on-the-Purpose-of-a-Corporation-with-Signatures-Updated-April-2020.pdf>

<sup>2</sup> See, e.g., Disclosures Pertaining to Matter Involving the Environment and Civil Rights, Release No. 33-5170, (July 19, 1971); Proposed Amendments to Registration and Report Forms to Require Disclosure with Respect to Compliance with Environmental Requirements, Release No. 33-5235, (Feb. 16, 1972); Disclosure of Environmental Matters, Release No. 33-5569, (Feb. 11, 1975); Environmental and Social Disclosure, Release No. 33-5627 (Oct. 14, 1975); Environmental Disclosures, Interpretive Release No. 33-6130 (September 27, 1979); SEC, Senate Comm. on Banking, House & Urban Affairs, 96th Cong., Staff Report on Corporate Accountability 276 (Comm. Print 1980); Proposed Amendments to Item 5 of Regulation S-K Regarding Disclosure of Certain Environmental Proceedings, Release No. 33-6315 (May 5, 1981); Commission Guidance Regarding Climate Change Disclosure, Release No. 33-9106 (Feb. 2, 2010); Business and Financial Disclosure Required by Regulation S-K, Release No. 33-10064, at 204 (Apr. 13, 2016); Securities and Exchange Commission, Modernization of Regulation S-K Items 101, 103, and 105, Release No. 33-10668, (August 8, 2019).

## Background to Recommendation:

The SEC Investor Advisory Committee has held three sessions on the topic of ESG Disclosures in 2016, 2018 and 2019.<sup>3</sup> We have heard the perspectives of a variety of market participants and have evaluated their supporting documentation. Members of this Committee have also spoken with a number of investment advisors, asset managers and asset owners, US and foreign Issuers, third party data providers, NGO's, and proponents of third-party disclosure frameworks. The message that we have heard consistently is that investors consider certain ESG information material to their investment and voting decisions, regardless of whether their investment mandates include an "ESG-specific" strategy. Our work has informed us that this information is material to investors regardless of an Issuer's business line, model or geography, and is different for every Issuer. Yet, despite a plethora of data, there is a lack of material, comparable, consistent information available upon which to base some of these decisions.

The use of ESG-related disclosures has gone from a fringe concept to a mainstream, global investment and geopolitical priority. At the end of 2018, the US SIF Foundation identified \$11.6 trillion in US-domiciled sustainable, responsible, and impact investment strategy assets, of which \$8.6 trillion were managed on behalf of institutional investors and \$3.0 trillion were managed on behalf of individual investors. In 1995 when the US SIF Foundation first measured this universe, invested assets were only approximately \$639 billion.<sup>4</sup> This trend is not limited to the US. By the end of 2019, over 2,300 global asset owners and asset managers representing close to \$80 trillion had signed the UN Principles for Responsible Investment committing to incorporate ESG issues into their investment analysis and decision-making investment processes.<sup>5</sup>

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<sup>3</sup> Discussion of the State of Sustainability Reporting <https://www.sec.gov/spotlight/investor-advisory-committee-2012/iac071416-agenda.htm>; Discussion Regarding Disclosures on Sustainability and Environmental, Social, and Governance (ESG) Topics <https://www.sec.gov/spotlight/investor-advisory-committee-2012/iac121318-agenda.htm>; and Discussion Regarding Whether Investors Use Environmental, Social, and Governance (ESG) Data in Investment/Capital Allocation Decisions <https://www.sec.gov/spotlight/investor-advisory-committee-2012/iac110719-agenda.htm>

<sup>4</sup> US SIF Foundation; Report on US Sustainable, Responsible and Impact Investing Trends 2018; <https://www.ussif.org/files/Trends/Trends%202018%20executive%20summary%20FINAL.pdf>

<sup>5</sup> <https://www.unpri.org/pri/about-the-pri>

From the Issuer perspective, international pressure to address ESG geopolitical and economic priorities are also making sustainability one of the most significant set of business factors they face.<sup>6</sup> As stated in a KPMG report from September 2019 entitled, Impact of ESG Disclosures, Embracing the Future, “Individual jurisdictions are taking different approaches to sustainable finance. Some governments have developed over-arching strategies, some financial regulators have adopted specific requirements, and some have to date tended to leave it to market forces. Whatever the chosen approach, the volume of activity adds to the pressure on corporates to respond”.<sup>7</sup>

Asset managers and asset owners are a part of this larger ecosystem and are being required to comply with ESG reporting obligations, integrate related policies and procedures, and take ESG factors into account as part of their compliance with statutorily imposed fiduciary duties outside of the US and client-driven mandates within (and outside) the US. The best way for investment advisors to fulfill these obligations is for Issuers to report the material ESG data necessary to conduct analysis and make investment decisions.

All of this points to a global convergence of investor interest in ESG disclosure. Many US Investors (be them institutional or Main Street) are investing their savings and retirement funds globally, and international investors invest in US companies, all of which argues for a well-structured US response to these global investment priorities.

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<sup>6</sup> The EU’s Non-Financial Reporting Directive (“NFRD”) came into effect in 2018. [https://ec.europa.eu/info/business-economy-euro/company-reporting-and-auditing/company-reporting/non-financial-reporting\\_en](https://ec.europa.eu/info/business-economy-euro/company-reporting-and-auditing/company-reporting/non-financial-reporting_en). Its objective was to help investors, consumers, policy makers and other stakeholders evaluate the non-financial (mainly, sustainability) performance of large companies and encourage these companies to develop a responsible approach to business. The NFRD requires listed companies, banks and insurance companies with more than 500 employees to include a non-financial statement as part of their annual public reporting obligations. This is just one example of the wider EU regulatory Taxonomy to force compliance with the Paris Climate Accord and other political and environmental priorities. [https://ec.europa.eu/info/publications/sustainable-finance-teg-taxonomy\\_en](https://ec.europa.eu/info/publications/sustainable-finance-teg-taxonomy_en). But the drive to address ESG issues is not only being driven by the EU. Markets all over the globe are putting ESG disclosure front and center. For example, The China Securities Regulatory Commission, in collaboration with the Ministry of Environmental Protection, has mandated that by 2020, listed companies and bond Issuers must disclose ESG risks associated with their operations. [Latham & Watkins, “China Mandates ESG Disclosures for Listed Companies and Bond Issuers,” February 2018](#)

<sup>7</sup> KPMG Publication: Impact of ESG Disclosures, September 2019

Because of the patchwork approach to disclosure outside of the US and the lack of clear disclosure obligations in the US, third party ESG data providers, many of whom provide a scoring or ratings system, have sprung up to fill the void between what companies disclose publicly and the information investors seek to make investment and voting decisions. In March 2019, State Street Global Advisors published a report entitled, The ESG Data Challenge.<sup>8</sup> In it, its authors, Rakhi Kumar and Ali Weiner, stated:

Quality data is the lifeblood of investment analysis. While “quality” can be defined in several ways, most investors agree that consistency and comparability in the availability of data across companies are essential elements of an effective data set ... Asset owners and their investment managers seek solutions to the challenges posed by a lack of consistent, comparable, and material information. Investors increasingly view material ESG factors as being critical drivers of a company’s ability to generate sustainable long-term performance. In turn, ESG data has increasing importance for investors’ ability to allocate capital most effectively ... As of 2016, there were more than *125 ESG data providers* [emphasis added], according to The Global Initiative for Sustainability Ratings ... Despite the valuable contributions these data providers have made in advancing ESG investing globally, it’s important for asset owners and managers to understand the inherent limitations of this data.

The plethora of ESG data providers, all with different standards and criteria, has led to a significant burden on US Issuers. Each data provider uses different information sources to conduct its analysis and produce its work product. Many provide lengthy questionnaires to companies (some with many hundreds of questions). Responding to these forms takes a great deal of time and effort, which often depends on internal reporting systems. In speaking with a variety of Issuers, it has become apparent that larger, or better financed companies are better able to commit resources to responding to queries from ESG data providers, whereas smaller or less well financed companies must make choices on how to allocate resources and whether to hire dedicated staff and/or invest in costly data and reporting systems that may not otherwise be the highest and best use of scarce capital. Due to the sheer number of queries on these questionnaires, it is difficult to conclude that all queries are material or that they, individually or in the aggregate, add up to the level of materiality being demanded by investors. Companies are inundated with requests for ESG information from multiple data providers compounding the burden to sometimes-geometric proportions. Companies that ignore these reports, do not

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<sup>8</sup> <https://www.ssga.com/investment-topics/environmental-social-governance/2019/03/esg-data-challenge.pdf>

complete them fully or are unable to answer a given query with a “yes or no” answer, risk being rated poorly or being issued with low ESG ratings or scores. This can have a direct impact on their stock price and ability to access capital when being evaluated by investment managers with or without ESG-related investment mandates. We have learned that Issuers that do not allocate enough time or resources to these extensive reporting requests by multiple data providers do so at their peril.

Issuers themselves have taken a variety of approaches to providing ESG related information. Some publish lengthy stand-alone reports; others include ESG related information in their annual reports or SEC ’34 Act filings; some provide information according to third party standards such as GRI<sup>9</sup>, the Sustainability Accounting Standards Board (SASB)<sup>10</sup>, the Task Force on Climate-Related Financial Disclosures (TCFD)<sup>11</sup>, etc.<sup>12</sup> Others do not report directly but, as noted above, reply to third party surveys requested by ESG data providers, which in turn provide ESG information or scoring systems to investors. Some Issuers engage in a combination of all of these and other methods. The point is that, despite a great deal of information being in the mix, there is a lack of consistent, comparable, material information in the marketplace and everyone is frustrated – Issuers, investors, and regulators.

As Ms. Kumar and Ms. Weiner point out, “A critical part of any ESG scoring is determining which factors are material to a company’s financial performance; the importance of materiality has been supported by academic research.<sup>13</sup> As part of the proprietary nature of their solutions,

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<sup>9</sup> <https://www.globalreporting.org/>

<sup>10</sup> <https://www.sasb.org/>

<sup>11</sup> <https://www.fsb-tcfid.org/>

<sup>12</sup> Note in his 2020 annual letter to the chief executives of the world’s largest companies, Larry Fink, Chairman and Chief Executive Officer of BlackRock, one of the largest asset managers in the world with \$6.84 trillion assets under management, as of June 30, 2019, to CEO’s, he stated, “BlackRock has been engaging with companies for several years on their progress towards TCFD-and SASB-aligned reporting. This year, we are asking the companies that we invest in on behalf of our clients to: (1) publish a disclosure in line with industry-specific SASB guidelines by year-end, if you have not already done so, or disclose a similar set of data in a way that is relevant to your particular business; and (2) disclose climate-related risks in line with the TCFD’s recommendations, if you have not already done so” <https://www.blackrock.com/us/individual/larry-fink-ceo-letter>

<sup>13</sup> Mozaffar Khan, George Serafeim, and Aaron Yoon, Corporate Sustainability: First Evidence on Materiality (November 9, 2016).

ESG data providers typically make their own determinations on materiality issues — and don't provide full transparency into how these determinations are made.”<sup>14</sup> We assert that the SEC is best-placed to set the framework for Issuers to disclose material information upon which investors can rely to make investment and voting decisions.

Recent statements by Chair Clayton and SEC Director of Division of Corporation Finance, William Hinman, on the topic of ESG disclosure make clear that they understand both the emergence of ESG factors in investment decision making, the presence of ESG data providers in this ecosystem, and the call by many for a regulated, uniform approach by Issuers to ESG disclosure. Chair Clayton remarked as follows to this Committee on December 13, 2018:

Disclosure is at the heart of our country's and the SEC's approach to both capital formation and secondary liquidity. As stewards of this powerful, far reaching, dynamic and ever evolving system, a key responsibility of the SEC is to ensure that the mix of information companies provide to investors facilitates well-informed decision making. The concepts of materiality, comparability, flexibility, efficiency and responsibility (i.e., liability) are the linchpins of our approach. This group knows these concepts well, knows that they are interrelated, and knows that, when we consider changes to our approach to disclosure, these concepts should be front of mind. Turning to “ESG”, a broad term, we are increasingly seeing disclosure of ESG information by issuers in the marketplace and requests for ESG information by investors. I am also aware of efforts by third parties to develop disclosure frameworks relating to ESG topics as well as calls by some market participants for issuers to follow third-party disclosure frameworks relating to ESG topics.<sup>15</sup>

Chair Clayton and Director Hinman, however, have both pointed out the caution that is necessary when contemplated expanding any SEC-mandated disclosure regime. When addressing this Committee in November of last year, Chair Clayton stated that:

As I have mentioned to many of you, key points of interest for me in virtually all matters of disclosure regulation include (1) what data do companies use to make decisions and (2) what data do investors use to make investment decisions... I also recognize that even these two questions can lead to complex answers, including because (1) not all companies in the same sector use the same or comparable data in their decision making and (2)

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<sup>14</sup> Id at 13

<sup>15</sup> <https://www.sec.gov/news/public-statement/clayton-remarks-investor-advisory-committee-meeting-121318>

investor analysis also varies widely. In the areas of “E” and “S” and “G,” in particular, the approach to investment analysis appears to vary widely, in some cases incorporating objectives other than investment performance over a particular time frame or frames.<sup>16</sup>

In his remarks to the 18<sup>th</sup> Annual Institute on Securities Regulation in Europe on March 15, 2019, on the topic of sustainability disclosure, Director Hinman recognized investors’ interest in sustainability or ESG disclosures and the breadth of topics that could be covered under these broad terms. In particular, he noted that, “the very breadth of these issues illustrates the importance of a flexible disclosure regime designed to elicit material, decision-useful information on a company-specific basis.”<sup>17</sup>

Recommendation:

For all of these reasons, today we are recommending that the Commission begin in earnest an effort to update the reporting requirements of Issuers to include material, decision-useful, ESG factors. To begin this process, for example, the Commission could undertake a series of outreach efforts to investors, Issuers and other market participants which could include roundtables, RFI and other actions on this topic. Both investor and Issuer input is crucial to this process. The learnings from these actions/consultations would help the Staff to review and evaluate multiple options or approaches to updating the reporting requirements regarding material ESG issues. The reasons for our recommendation are as follows:

1. Investors Require Reliable, Material ESG Information Upon Which to Base Investment and Voting Decisions: Trillions of investment, savings and retirement dollars are invested globally in businesses where material ESG information is relevant to investment and voting decisions. Investment and voting based in part on ESG disclosure is front and center in today’s global investment ecosystem. Major business risks, decisions and strategies stand upon ESG factors and investors are not being served or protected by the piecemeal, ad-hoc, inconsistent information currently in the mix. ESG is no longer a

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<sup>16</sup> <https://www.sec.gov/news/public-statement/clayton-remarks-investor-advisory-committee-110719>

<sup>17</sup> <https://www.sec.gov/news/speech/hinman-applying-principles-based-approach-disclosure-031519>.

fringe concept. It is an integral part of the larger investment ecosystem of our modern, global, interconnected world.

2. Issuers Should Directly Provide Material Information to the Market Relating to ESG Issues Used by Investors to Make Investment and Voting Decisions: Issuers are not always the primary source of the ESG data that investors are using to make investment and voting decisions. Currently, there is a patchwork of information in the mix and third-party data sources are filling the void. Varying degrees of data upon which third party sources are based is coming from Issuers themselves, rendering the information in the market inconsistent and unreliable. We note that ratings agencies and proxy advisory firms, both of which are heavily relied upon by investors in making their investment and voting decisions, as relevant, are basing their ratings and recommendations on *primary information provided by the Issuers themselves* in their public disclosure filings. We think it is entirely consistent therefore that both investors and third-party data providers have accurate, comparable and material Issuer primary-source information upon which to base their analysis, and that there are consistent standards and oversight governing the disclosure of this data.
  
3. Requiring Material ESG Disclosure Will Level the Playing Field Between Issuers: Larger Issuers, or those with greater resources, are currently able to produce more ESG-related data, while smaller Issuers, or those that are capital constrained, are not always able to provide the same amount or level of detail. This can put small, mid-cap, or capital constrained companies at a disadvantage for investment, particularly when they are unable to build the staffs and/or reporting systems required to reply to numerous requests for ESG data from third party data providers. To the extent that basic SEC reporting obligations would require a single standard of material, decision-useful information, as relevant to each Issuer, and based upon data that companies already use to make their business decisions, such an approach would level the playing field between large and small, well financed, and capital constrained issuers. Today's boards and Management teams are grappling with these issues on a regular basis (particularly now in response to the impact of the Covid-19 epidemic on every aspect of their businesses) and therefore

disclosure is not as amorphous, subjective, or as difficult to contextualize as it once seemed.

4. Ensure the Flow of Capital to the US Markets and to US Issuers of All Sizes: Many investors view material ESG factors as critical drivers of risks and returns in their investment making decisions, both in the short and long term. Requiring disclosure of this information directly by the Issuer will facilitate the flow of capital to US Issuers of all sizes from investors with or without ESG-related investment mandates. In time, without the availability of reliable ESG-related material information for all US Issuers, capital could be redirected by investors with their own sets of mandated ESG duties to companies outside the US that are required to report ESG data pursuant to disclosure obligations of non-US regulators, rendering US Issuers at a distinct disadvantage to access future international capital.
  
5. The US Should Take the Lead on Disclosure of Material ESG Disclosure: The US capital markets are the largest and deepest in the world.<sup>18</sup> Therefore, the SEC should take the lead on this issue by establishing a principles-based framework that will provide the Issuer-specific material, decision-useful, information that investors (both institutional and retail) require to make investment and voting decisions. This disclosure should be based upon the same information that companies use to make their own business decisions. If the SEC does not take the lead, it is highly likely that other jurisdictions will impose standards in the next few years that US Issuers will be bound to follow, either directly or indirectly, due to the global nature of the flow of investment into the US markets.<sup>19</sup>

We recognize that any new reporting regime is difficult and comes with related litigation risk. But well-constructed, principles-based reporting that enables each Issuer, regardless of industry

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<sup>18</sup> [As of 2018, the total market capitalization of U.S. listed domestic companies was five times larger than that of the next largest country and comprised roughly 45% of total global market capitalization. See https://data.worldbank.org/indicator/CM.MKT.LCAP.CD](https://data.worldbank.org/indicator/CM.MKT.LCAP.CD)

<sup>19</sup> [The Treasury Department calculated that, as of Jan. 2020, foreign residents held \\$9.3 trillion worth of U.S. long-term securities. See https://ticdata.treasury.gov/Publish/slt2d.txt](https://ticdata.treasury.gov/Publish/slt2d.txt)

or business line, to set out its risks, strategies and opportunities in relation to material ESG factors should be no different than current disclosure of business risk, strategy and opportunity. ESG matters are part and parcel of the business of every Issuer and are unique to every Issuer.

To the extent that such disclosure would require forward-looking analysis, where material, we note that material forward-looking disclosure is already embedded into the SEC's disclosure regime, for example, in the context of MD&A discussions, M&A transaction disclosures around projected synergies, and pro forma financial statements.

As the SEC contemplates an ESG disclosure framework, there are many useful standards such as GRI, SASB and TCFD, to name a few, that may help shape its thinking. This Committee is not recommending or endorsing any particular standard, simply pointing out that some thoughtful work has already been done in mapping out what investors consider to be material, decision-useful information.

We understand that this area is multi-layered and complex but would encourage the Commission's timely action to address investor need for relevant, material, decision-useful ESG disclosure.

We remain grateful to the Staff of the SEC for their diligence, hard work, and dedication to the millions of investors in our US capital markets, especially in these challenging times.

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