INTERNATIONAL CORPORATE ACCOUNTABILITY ROUNDTABLE

Setting the Record Straight

Common Myths about Environmental, Social, and Governance (ESG) Reporting

Over the past few decades, investors have become increasingly concerned not only with the short term profits of their investments, but also the long-term viability of the public companies in which they invest. As a result, investor calls for corporate disclosures of a company's environmental, social, and governance (ESG) policies, practices, and impacts as a means to assess the long-term health, profitability, and viability of companies have also increased. In response, public companies have begun voluntarily disclosing ESG information, and U.S. allies and peer countries have begun to, or have already enacted, mandatory reporting on ESG issues. The United States' lack of action puts the country at risk of falling behind the global curve in mandating the disclosure of ESG issues important to investor assessment of long-term profitability. Common misconceptions about ESG reporting must be addressed in order to push forth meaningful reporting requirements that respond to investor needs.

MYTH 1: *Only socially responsible or impact investors care about ESG issues*

Today, a wide array of investors are looking towards ESG factors as an integral part of their decision-making processes. Worldwide, investors with $68.4 trillion of capital are committed to incorporating ESG factors in their investing and voting decisions as part of the U.N. Principle for Responsible Investment ("PRI").[1] According to a recent Ernst & Young report, ESG factors are no longer a niche consideration, with "investor interest in non-financial information span[ning] across all sectors," and 61.5% of investors consider non-financial information relevant to their investments overall.[2] Accordingly, some ESG issues such as climate change or human rights are of increasing concern to investors. For example, investors with $95 trillion in invested capital support the Carbon Disclosure Project's ("CDP") annual survey of global companies regarding their greenhouse gas emissions and strategies for addressing climate change.[3] In relation to human rights, an Ernst and Young report found that 19.1% of investors would rule out an investment immediately and 63.2% would reconsider investing if there were significant human rights risks associated with the investment.[4]

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[1] *See, PRI-11 year growth of AO (all signatories (Asset Owners [sic], Investment Managers and seride [sic] providers) and respective AUM,* Excel sheet available for download at *About the PRI*, U.N. Principles for Responsible Investment, http://www.unpri.org/about.

[2] Value of Sustainability Reporting, Ernst & Young Boston Coll. Ctr. For Corporate Citizenship 18 (May 2013), *available at* http://www.ey.com/Publication/vwLUAssets/ACM_BC/$FILE/1304-1061668_ACM_BC_Corporate_Center.pdf.

[3] *Catalyzing business and government action,* Carbon Disclosure project, https://www.cdp.net/en-US/Pages/About-Us.aspx.

[4] Ernst & Young, Value of Sustainability, *supra* note 2 at 16.

MYTH 2: *ESG issues are not financially material*

ESG information is critical to assessing the long-term investment success of a company, especially in relation to assessing risks, and is therefore financially material. Numerous studies, including a June 2017 Bank of America Merrill Lynch study, found ESG factors to be "strong indicators of future volatility, earnings risk, price declines, and bankruptcies."[5] A 2014 review of empirical studies analyzing ESG data and corporate financial performance found overwhelming links between sustainability and profit: 90% of the analyzed studies showed that sound sustainability standards lowered firms' cost of capital; 80% of the studies showed that companies' stock price performance is positively influenced by good sustainability practices; and 88% of the studies showed that better ESG practices result in better operational performance.[6] These reports and statistics, coupled with the support of investors with trillions of dollars in assets under management, help to illustrate that ESG information is financially material to a reasonable investor. Furthermore, information need not be financially material, to be material to a reasonable investor.[7] There is growing global consensus that ESG disclosures should be seen from a "double materiality" perspective, as they provide both financially and environmentally/socially material information to investors.[8]

MYTH 3: *The SEC doesn't have the mandate to require ESG disclosures*

The SEC was granted broad authority by both the Securities Act and the Exchange Act to promulgate disclosure rules "as necessary or appropriate in the public interest or for the protection of investors."[9] As discussed above, ESG disclosures are material to investors, and therefore fall under the SEC's mandate of investor protection. In addition, disclosure of ESG information is also in the public interest, as it "promote[s] efficiency, competition, and capital formation."[10] Mandatory ESG disclosures would increase both informational efficiency, through the creation of consistent, comparable, and complete ESG reporting, and allocative efficiency, as investors would have a better understanding of the long-term profitability of their potential investments. These disclosures would also help U.S. markets keep their competitive edge. Today, more than twenty countries have mandated public company disclosures of certain ESG issues, and seven stock exchanges require social or environmental disclosures as a listing requirement.[11] As global investors increasingly demand and expect these types of disclosures, the SEC should also require the same in order to stay competitive. Such disclosures would increase investor confidence in the long-term profitability of U.S. markets and encourage increased capital formation in the form of new investments.

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[5] Bank of America Merrill Lynch, Equity Strategy Focus Point—ESG Part II: A Deeper Dive (June 15, 2017).

[6] *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.

[7] *See, e.g.* Cynthia Williams, et. al, "Knowing and Showing" Using U.S. Securities Laws to Compel Human Rights Disclosure (Oct. 2013), https://bit.ly/2FEyCSZ.

[8] European Commission, Consultation Document on the Update of the Non-Binding Guidelines on Non-Financial Reporting, https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/2019-non-financial-reporting-guidelines-consultation-document_en.pdf.

[9] Securities Act of 1933 §§ 7, 10, and 19(a); Securities and Exchange Act of 1934 §§ 3(b), 12, 13, 14, 15(d), and 23(a).

[10] Securities Act of 1933, §2(b); Securities and Exchange Act of 1934, § 23(a)(2).

[11] *See* Initiative for Responsible Investment, *Corporate Social Responsibility Disclosure Efforts by National Governments and Stock Exchanges* (March 12, 2015), *available at* http://hausercenter.org/iri/wp-content/uploads/2011/08/CR-3-12-15.pdf.

MYTH 4*: ESG disclosures would be too costly for reporting companies*

The value of complete, comparable, and consistent ESG disclosures far outweighs any related costs. Studies have shown that companies with strong disclosure practices have positive shareholder returns and better stock returns.[12] Additionally, a majority of the largest companies are currently making voluntary sustainability disclosures, with 85% of S&P 500 companies producing such reports in 2017.[13] Costs associated with larger companies are usually higher given complex supply chains and global operations. That a number of large companies are already disclosing ESG information voluntarily reinforces the notion that the benefits of ESG reporting outweigh the associated costs and that the cost of shifting from voluntary to mandatory reporting would be minimal.

MYTH 5: ***Voluntary ESG disclosures already provide investors what they need to know***

While a range of reporting standards exist for voluntary disclosure of ESG information, the application and consistency of these standards varies greatly. This variability makes it difficult for investors to compare ESG data across companies or time, hindering the effectiveness of such disclosures for investment decision-making.[14] Without a regulatory mandate, voluntary disclosures are often incomplete, inconsistent, and not comparable. The SEC has recognized the value and importance of standardized disclosures for these same reasons.[15] When reporting becomes mandatory, standards necessarily become clearer, and the disclosed information more relevant and pertinent to investor needs.

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The International Corporate Accountability Roundtable (ICAR) harnesses the collective power of progressive organizations to push governments to create and enforce rules over corporations that promote human rights and reduce inequality.

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[12] See, Andy Green & Andrew Schwartz, Corporate Long-Termism, Transparency, and the Public Interest (2018); Gordon L. Clark, et. al, *From the Stockholder to the Stakeholder: How Sustainability Can Drive Financial Outperformance, supra* note 6.

[13] Governance and Accountability Institute Inc., "85% of the S&P 500 Index Companies Publish Sustainability Reports in 2017" (2018), available at https://www.ga-institute.com/press-releases/article/flash-report-82-of-the-sp-500-companies-published-corporate-sustainability-reports-in-2016.html.

[14] See, e.g. Jim Coburn & Jackie Cook, Cool Response: The SEC & Corporate Climate Change Reporting (2014). See also, David Levy, Halina S. Brown, & Martin de Jong, The Contested Politics of Corporate Governance: The Case of the Global Reporting Initiative, 49 BUS. & SOC'Y 88 (2010); Carl-Johan Hedberg & Fredrik von Malmborg, The Global Reporting Initiative and Corporate Sustainability Reporting in Swedish Companies, 10 CORP. SOC. RESP. & ENVTL. MGMT. 153 (2003).

[15] See Chair Mary Jo White, Keynote Address at the 2015 AICPA National Conference: "Maintaining High-Quality, Reliable Financial Reporting: A Shared and Weighty Responsibility," Dec. 9, 2015, available at http://www.sec.gov/news/speech/keynote-2015-aicpa-white.html