Securities Regulation Daily Wrap Up, SEC NEWS AND SPEECHES —Advisory committee urges SEC to update ESG reporting requirements, (May 21, 2020)

Securities Regulation Daily Wrap Up

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Advocates of the proposal stated that investors want consistent and comparable ESG disclosures, but some committee members, as well as Chairman Clayton and Commissioner Peirce, remain skeptical of the need for a new ESG framework.

The SEC's Investor Advisory Committee (IAC) voted 14-to-4 to approve a recommendation encouraging the Commission to address reporting of environmental, social, and governance (ESG) factors. The recommendation does not advocate a specific framework but asks the SEC to undertake outreach efforts of all market participants allowing the staff to review approaches to updating its requirements relating to material ESG issues. Several members of the committee, including some long-serving members attending their last meeting, expressed strong support for the recommendation. Other members felt that this undertaking would be unnecessary given that material disclosures are already mandated, a view echoed by Commissioner Hester Peirce.

Committee recommendation. According to the recommendation, ESG disclosure is an integral part of the "larger investment ecosystem." More importantly, the SEC should work to improve the current framework of ESG disclosure, which is a patchwork of information from primary and third-party sources that make it difficult for investors to rely on when making investment decisions. The SEC should investigate ways to ensure that investors have accurate, comparable, and material issuer information on which they can base their investment decisions, the recommendation stated.

The recommendation also noted that larger issuers are equipped with greater resources than smaller issuers to provide ESG-related data, which puts small and mid-cap companies at a disadvantage. In addition, the recommendation urges the SEC to take the lead on disclosure of material ESG information as other regulators across the globe consider it. According to the IAC, investors view material ESG factors as crucial drivers of risks and returns in their investment-making decisions. If the SEC does not address this investor need, it is likely that other jurisdictions will impose standards that U.S. issuers will be bound to follow due to the global nature of the flow of investments into the U.S. markets, the committee cautioned.

Committee weighs in. The recommendation, which was developed by the IAC's Investor-As-Owner Subcommittee, came about after three IAC sessions about ESG disclosures, said Allison Bennington, a former partner and chief global affairs officer at Value Act Capital. The current "patchwork" approach can put U.S. companies at a disadvantage while other jurisdictions are taking steps to put an ESG framework in place, she said.

Issuers are bombarded with questionnaires about ESG factors, some of which may not even be material, Bennington said. Issuers who can afford it might spend a lot of money on compiling a report disclosing ESG factors when most of it is green washing, she remarked. Instead of relying on these types of reports that are not useful to investors, the SEC should examine how take a flexible, principles-based approach to material disclosures and develop guidance to modernize the current disclosure framework that will incorporate ESG.

Committee members who opposed the recommendation expressed skepticism about the SEC's ability to adopt an ESG disclosure framework without massive costs in relation to investor benefits. Stephen Holmes of Inter West Partners said that ESG is best addressed by private parties, rather than according to SEC or other regulators' mandate. Expressing a common sentiment among ESG skeptics, Holmes emphasized that

issuers are already required to make material disclosures. He also voiced concern that any SEC mandates on ESG disclosure might inhibit the independence of FASB. He added that investors would not benefit from ESG disclosure that ends up being just a massive amount of boilerplate legalese and check boxes.

Professor J.W. Verret of George Mason University's Antonin Scalia Law School reiterated his past doubts regarding a mandated ESG disclosure framework. He also expressed concern that SEC action on ESG disclosures might step on private initiatives championed by private sector actors such as the Sustainability Accounting Standards Board (SASB).

Professor John Coates of Harvard Law School spoke in favor of the recommendation. He noted that just because issuers can make disclosures on their own, it does not eliminate the value of a standardized disclosure regime for ESG factors. He also said that the recommendation was very broad and allows room for the SEC to examine the disclosures of the largest issuers and move on from there. Coates added that as other regulators around the world adopt standards on ESG disclosure, U.S. companies will have to comply with them regardless. He remarked that he wanted U.S. constituencies to be involved in the development of an ESG disclosure framework and not be left on the sidelines.

Damon Silvers of the AFL-CIO echoed other committee members in describing the recommendation as a broad suggestion: "It just calls for a conversation," he said. While he acknowledged that there currently is a general requirement for issuers to disclose all material information, he noted that the SEC has also adopted specific rules about disclosures, such as those relating to company debt. While ESG disclosures may be complicated and company-specific, so are other required disclosures, Silvers explained.

Outgoing IAC Chair Anne Sheehan, former CalPERS director of corporate governance, praised the private sector for its work on ESG disclosure. However, she stated that the SEC can no longer ignore the issue. She emphasized, however, that the recommendation was not prescriptive, but rather an encouragement to start a conversation about developing a new ESG framework.

Commissioner views. Commissioner Hester Peirce, whose reluctance to embrace a mandated ESG framework is well-known, praised the committee's work while expressing her reservations about its recommendation. "A new SEC disclosure framework for ESG information seems an unnecessary response when our existing securities disclosure framework is very good at handling all types of material information," Peirce said. The SEC's current regime is rooted in materiality and is flexible enough to accommodate a wide variety of risks, according to Peirce.

SEC Chairman Jay Clayton remarked that disclosure should be "decision-useful" information. He added that "E, S, and G are quite different baskets of disclosure matters and lumping them together diminishes the usefulness, including investor understanding, of such disclosures."

Commissioner Allison Herren Lee voiced her support for the recommendation. Lee acknowledged that the debate around ESG disclosures is controversial but noted that in her experience, investors overwhelmingly want these disclosures.

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