Mandating Standard ESG Risk Disclosures – Is The Tide Turning At The SEC?

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Over the past decade, there has been an unprecedented shift in investor focus toward the analysis use of Environmental, Social and Corporate Governance (ESG) risks and impacts in investment decision-making. While the Securities & Exchange Commission has acknowledged this shift, it has to date resisted calls for the adoption of standards governing issuers' disclosure of ESG risks.

Outgoing SEC Commissioner Jay Clayton has repeatedly offered his view that the SEC already requires companies to disclose material risks, and that the agency's flexible approach is preferable to imposing an ESG disclosure regime across all industries, where ESG factors are "very company-specific and sector-specific."

But the SEC has certainly not spoken with one voice on this issue. In recent remarks, Commissioner Allison Herren Lee called for the Commission to support "uniform, consistent, and reliable disclosure" of ESG risks.

The SEC should work with market participants toward a disclosure regime specifically tailored to ensure that financial institutions produce standardized, comparable, and reliable disclosure of their exposure to climate risks.

And on December 1, 2020, a subcommittee to the SEC Asset Management Advisory Committee tasked with assessing EDG disclosure issues released a series of "potential recommendations." The ESG Subcommittee noted that while the disclosure rules did not need to change, given that issuers already have to disclose material risks, the "standards [for ESG disclosure] needed to be mandated as the state of data is poor without them." Among several specific recommendations, the ESG Subcommittee urged the SEC to utilize frameworks already adopted by standard setters, like the Financial Accounting Standards Board (FASB), to require the disclosure of ESG risks.

As the ESG Subcommittee noted based on its consultation of a panel of investors, investors want standardized disclosure because it will allow apples-to-apples comparisons across companies' disclosures, which will in turn facilitate their investment decisions. Ultimately, issuers, as well as ESG auditors, will welcome standardized disclosure rules as well, because standards form the basis for defenses to potential litigation and investigation exposure.

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