White Paper

Toward Enhanced Sustainability Disclosure: Identifying Obstacles to Broader and More Actionable ESG Reporting

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LIST OF ACRONYMS

CDSB	Carbon Disclosure Standards Board
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CFTC	Commodity Futures Trading Commission
ESG	Environmental/Social/Governance
ESMA	European Securities Market Agency
FASB	Financial Accounting Standards Board
GC	General Counsel
GHG	Greenhouse gas
GRI	Global Reporting Initiative
HES	Health, Environment, and Safety
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
ISO	International Standards Organization
NFRD	Non-Financial Reporting Directive
OECD	Organisation for Economic Co-operation and Development
SASB	Sustainability Accounting Standards Board
SDG	Sustainable Development Goals
SEC	United States Securities and Exchange Commission
SSE	Sustainable Stock Exchange
TCFD	Taskforce on Climate-related Financial Disclosures
WBCSD	World Business Council for Sustainable Development
WEF	World Economic Forum

Toward Enhanced Sustainability Disclosure:
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EXECUTIVE SUMMARY

As a growing number of investors place increasing importance on corporate performance regarding Environmental/Social/Governance (ESG) issues, the calls to bring order and consistency to corporate sustainability data and disclosure grow louder and more frequent. At present, ESG reporting is marked by significant inconsistency in when, how, and what companies disclose. More specifically, some companies make deep, meaningful disclosures, while others provide little or no disclosure at all. Likewise, some companies follow established ESG methodological protocols, and others report on a self-defined (and often self-serving) basis.

The ESG data and information made public are collected, moreover, by private data companies – including MSCI, Sustainalytics, Bloomberg, ISS/Oekom, Refinitiv and others – and then redistributed (in wide-ranging and often fundamentally inconsistent ways) as sustainability metrics that are sold to the investor marketplace. In light of the manifest inconsistencies and resulting doubt created about the quality and integrity of ESG data, many investors have expressed a need for better corporate sustainability disclosures and are frustrated with the lack of comparability and usefulness of the metrics and information presently available.

In the face of this disclosure disorder, the U.S. Securities and Exchange Commission has been largely silent, leaving it to companies to determine which ESG information to disclose, on what basis, and in what format. In the absence of prescriptive guidance from the SEC, a host of "voluntary" disclosure regimes has emerged – sometimes referred to as an "alphabet soup" of ESG standards. Companies lack meaningful guidance as to which reporting frameworks and standards to follow – and investors are getting no closer to having the carefully structured, consistent, and decision-useful information that they want.

Third-party rating firms (including those listed above and now dozens of others) have taken advantage of this void, sending companies extensive (many would say "burdensome") questionnaires to complete. Their surveys often solicit information that is not material to the targeted companies or their industries. Companies spend significant time and money responding to these external sustainability surveys, but the data collected and metrics generated by the rating companies are of widely varying quality and aggregated in such disparate ways that investors have little confidence in their comparability, integrity, and utility. As a result, companies are overwhelmed with questionnaires – and investors still do not have the methodologically consistent and investment-grade information they need to properly integrate sustainability risks and opportunities into their portfolio analyses.

This White Paper builds on a survey undertaken by the Yale Initiative on Sustainable Finance of executives from more than 100 public companies – supplemented with extensive interviews with dozens of corporate leaders and outside advisors – aimed at deepening the understanding of corporate ESG reporting practices, challenges, and thinking about how best to track and scorecard corporate sustainability performance. The study and interviews demonstrate the range of reporting practices followed by different companies. They also reveal the desire of

many companies for greater clarity and guidance as to which ESG information to disclose and in what formats.

In light of the problems identified, this White Paper proposes the creation of a standardized ESG reporting framework building on the work of the Global Reporting Initiative (GRI), the Sustainability Accounting Standards Board (SASB), the Taskforce on Climate-related Financial Disclosures (TCFD), and the World Economic Forum (WEF). The proposal calls for mandatory disclosure by all public companies of: (1) a *core* set of ESG metrics under uniform data collection and indicator construction methodologies, and (2) an additional set of *industry-specific* disclosure obligations, along with (3) a framework for further reporting on a *company-determined* basis.

The recommendations also advance a set of four procedural mechanisms to help ensure the quality of the ESG data reported and a commitment to continuous improvement in the information available to investors on corporate sustainability performance. Specifically, the White Paper calls for:

(1) processes to validate the ESG data using *assurance* mechanisms designed to improve data quality and reliability;

(2) an initiative to harmonize disclosure requirements across jurisdictional borders;

(3) creation of sectoral working groups to refine industry-specific ESG reporting standards – building on the work of the TCFD, CFTC, and SASB; and

(4) training programs for the key people within companies responsible for the production, review, and verification of ESG information as well as their legal and accounting advisors.

In surveying the "state of play" regarding ESG reporting, highlighting the shortcomings that plague the existing patchwork of sustainability metrics, and suggesting a pathway toward a more robust framework for gauging corporate sustainability performance, this White Paper seeks to make it easier for investors to identify corporate sustainability leaders and laggards. Better data and methodologies should increase investor confidence in ESG scorecards and thus help steer capital toward those companies that are constructively responding to society's profound sustainability challenges – including climate change, water and waste issues, structural inequality, and systemic racial injustice – and away from those enterprises that are not.

INTRODUCTION

Mainstream investors have signaled a growing interest in environmental, social, and governance (ESG) performance metrics as they consider which companies to invest in, engage with, or divest from.[1] But this greater focus on ESG reporting has translated into deep dissatisfaction with the quality and comparability of the metrics currently available, as well as a widening recognition that the important sustainability issues have been left unaddressed.[2] The time has therefore come for a comprehensive re-evaluation of the coverage, substance, and process of corporate sustainability reporting as well as the framework for, and methodologies beneath, ESG metrics.

Recent events have brought a new focus on the "S" – social – element of ESG reporting. The COVID-19 pandemic, in particular, shined a light on the importance of corporate resilience, supply chain management, and the health and safety of employees and customers. And the Black Lives Matter movement in the United States has highlighted issues of racial justice, workplace diversity, discrimination, and structural inequality. Even before these watershed events, sustainability issues – and specifically climate change – had reached a critical tipping point in the public consciousness.[3] Time Magazine named climate change activist Greta Thunberg its Person of the Year in 2019, and protesters marched by the millions across the globe to urge world leaders to address climate change.[4] The Oxford Dictionary named "Climate Emergency" as the 2019 Word of the Year after its use increased 100-fold over the prior year.[5] The World Economic Forum's 2020 Global Risk Report declared "for the first time in the history of the Global Risk Perception Survey, environmental concerns dominate the top long-term risks by likelihood among members of the World Economic Forum's multi-stakeholder Community" and specifically, "failure of climate change mitigation and adaptation is the number one risk by impact and number two by likelihood over the next 10 years."[6] In addition, the CEOs of nearly 200 leading American companies across industries and sectors signed the Business Roundtable's Statement on the Purpose of a Corporation, which embraced "stakeholder governance" – the proposition that corporations exist to not just to deliver *shareholder value*, but also to meet their responsibilities to employees, customers, suppliers, and the communities in which they operate.[7]

As the focus on the broader impact of business on society has intensified, so too has the demand from investors for better ESG performance data and other information about sustainability-related risks and opportunities connected with the companies into which they are putting their money. This expectation has now reached the highest levels of the investment world.[8] Indeed, in 2020, two of the world's largest asset managers, BlackRock and State Street Global Advisors, issued statements urging companies to improve their ESG performance or face potential divestment or board no-confidence votes.[9] The call for companies to address their impact on the environment and acknowledge their broader sustainability risks and opportunities now rings loud and clear.

Companies nevertheless face significant challenges in determining precisely which ESG surveys to respond to, what information to disclose, and how to apply various disclosure frameworks. As a consequence, investors report that they are not receiving the methodologically rigorous, comparable, decision-useful ESG information that they need to support their integration of ESG factors into their capital allocation decisions.[10] In an effort to fill these informational gaps, investors and a growing number of ESG data firms routinely query companies on their ESG performance, inundating sustainability executives with ESG questionnaires and surveys, many of which seek information in idiosyncratic forms – causing what some describe as "survey fatigue." In short, neither investors nor corporate leaders are satisfied with the ESG reporting status quo.

This White Paper examines the disconnect between the need investors express for corporate sustainability information and the ESG metrics and reporting they receive from companies. It explores the process by which companies manage, develop, verify, and report ESG data. Informed by a survey of more than 100 corporate executives, lawyers, and consultants who participate in the preparation of sustainability reports and the integration of ESG metrics into regulated financial documents, we identify some key trends in corporate attitudes and practices with regard to ESG disclosure.

In brief, our survey reveals that: (1) most companies involve their Sustainability staff, Investors Relations group, and General Counsel's office in the drafting and review of ESG disclosures; (2) significant disparities exist across companies in data quality and controls – and the resulting data inconsistency and potential for inaccuracy is a major hindrance to investor confidence and trust in ESG metrics; (3) in the absence of standardized disclosure requirements, corporate ESG reporting teams exercise a significant degree of discretion in deciding what information to produce and release; and (4) many survey participants would like to see a more coherent framework of ESG disclosure requirements, including mandatory standards.

Building on the survey results, a series of more in-depth interviews with a selection of company officials and others involved in ESG reporting, and a close analysis of the emerging academic literature on ESG disclosure, we offer a set of five recommendations to improve the quality and comparability of the sustainability metrics that companies report to investors. Our recommendations are intended to provide greater clarity to reporting companies and to make sustainability disclosures more actionable and reliable for investors. With those goals in mind, we recommend adoption of:

(1) A standardized ESG reporting framework – building on existing structures from the Global Reporting Initiative (GRI), Sustainability Accounting Standards Board (SASB), Taskforce on Climate-related Financial Disclosures (TCFD), and the World Economic Forum (WEF) – that would establish a *core* set of ESG metrics and reporting methodologies for all companies and an additional set of *industry-specific* disclosure obligations as well as a framework for additional *company-determined* reporting;

(2) A *validation* mechanism in line with financial disclosure auditing practices that would provide for the reported ESG information to be reviewed and certified by third-party verifiers as a way to improve the integrity of the information reported and build investor confidence in ESG metrics. This *assurance* process could be tied to a safe harbor that would offer protection from litigation for validated disclosures and incentivize greater transparency;

(3) An initiative to harmonize disclosure requirements across jurisdictional borders – coordinated by a supranational organization such as the World Economic Forum (WEF), Organisation for Economic Co-operation and Development (OECD), International Organization of Securities Commissions (IOSCO), and/or the Sustainable Stock Exchange (SSE) Initiative – to enhance comparability and thus the value of the ESG metrics to investors, and to reduce the regulatory burden on companies;

(4) Creation of sectoral working groups to review and refine industry-specific ESG reporting standards – perhaps organized by or coordinated with SASB or hosted by the World Business Council for Sustainable Development (WBCSD); and

(5) Training programs for the key people responsible for the production, review, and verification of reported ESG data – including chief sustainability officers, corporate counsel (both in-house and external), and the auditing community – to ensure the use of consistent reporting methodologies and the creation of an epistemic community to manage the process of continuous improvement of ESG metrics and refinement of sustainability disclosures.

OVERVIEW OF ESG DISCLOSURE

ESG Metrics

ESG reporting covers a broad swath of issues that are relevant to all companies in some manner, and yet no two companies see the issues in precisely the same way. ESG disclosure thus requires a mix of standardized and customized responses and strategies – to provide both comparability and consistency and the opportunity for individual tailoring to meet company-specific needs.

Research on sustainability reports by standards organizations such as GRI and WBCSD indicates that companies generally report on a common broad set of issues, including greenhouse gas (GHG) emissions, water consumption, employee health and safety, and diversity, but the data lack comparability because the reports use different measurement and reporting methodologies.[11] The reports use different definitions, scopes, units of measurement, measurement time frames, and other methodological elements. For example, while most companies report on employee health and safety, some report the number of sick days, while others report the number of injuries, number of accidents, time lost due to injury, or number of fatalities.[12] The same disparities in reporting methodology are found in the reporting of environmental data and, specifically, carbon accounting.[13]

While there is a need for consistency and comparability in the data tracked, any reporting framework should also recognize that there are important differences among companies – and should thus allow companies to provide a tailored narrative about the unique context in which they operate and their company-specific issues and initiatives. For exactly these reasons, creating an appropriate framework is challenging, not only for companies but also for data aggregators, regulators, and investors. Simply put, no two companies are identically situated – nor are the interests of any two investors exactly the same. We therefore recommend a reporting framework that recognizes the need for: (1) a “core” set of ESG metrics that apply to all companies, (2) a structure of industry-defined metrics that would be common to all companies within a sector, and (3) a platform for company-specific sustainability data and narratives.

Sustainability Issues are Increasingly Seen as Material

While interest in sustainability issues broadly continues to grow, the sense of urgency around climate change risks and opportunities has rapidly intensified. A 2020 report of the Climate-Related Market Risk Subcommittee, Market Risk Advisory Committee of the U.S. Commodity Futures Trading Commission (CFTC Report) declared that “Climate change poses a major risk to the stability of the U.S. financial system and to its ability to sustain the American economy. Climate change is already impacting or is anticipated to impact nearly every facet of the economy, including infrastructure, agriculture, residential and commercial property, as well as human health and labor productivity.”[14]

The State Street Global Advisors letter reinforces the growing sentiment in the investment world that ESG issues now matter to many mainstream investors. Bank of America Merrill Lynch issued a report in 2018 noting the expansion of the Bank’s focus on ESG issues over the prior several years.[15] The report declared, “ESG is too critical to ignore. Asset potential is substantial: we conservatively estimate that flows into ESG-type funds over the next few decades could be roughly equivalent to the size of the S&P 500 today.”[16] The report furthermore drew a correlation between good environmental scores and financial performance, citing a study of S&P 500 companies between 2005 and 2017, which concluded that “ESG is a better signal of earnings risk than any other metric we have found.”[17]

A survey by Bloomberg and the Morgan Stanley Institute for Sustainable Investing came to a similar conclusion.[18] Based on written questions and interviews with 300 U.S. asset managers, each with at least $50 million in assets under management, this survey concluded that sustainable investing is "here to stay," with 89% of the participants declaring it to be a permanent feature of the investment landscape and 63% projecting growth in sustainable investments among asset managers over the next five years.[19] Eighty-two percent of respondents viewed strong ESG performance as central to improved profitability and investment returns.[20] Similarly, Ernst & Young conducted a survey of 260 institutional investors that found a "notable consensus that ESG information is critical to investor decision-making . . . [and] ESG information plays an increasingly important role in the investment decision-making process."[21]

In what might be seen as the strongest signal of the shifting foundations of the investment world and the growing importance of sustainability issues, Larry Fink, CEO of BlackRock, the world's largest asset manager, declared in his 2020 letter to CEOs that "climate change has become a defining factor in companies' long-term prospects" and as a result, we are "on the edge of a fundamental reshaping of finance."[22] Written just prior to the outbreak of the COVID-19 pandemic, Fink went on to say, "The evidence on climate risk is compelling investors to reassess core assumptions about modern finance. Research from a wide range of organizations . . . is deepening our understanding of how climate risk will impact both our physical world and the global system that finances economic growth." Fink emphasized the need for higher quality and more consistent ESG disclosures across companies. He further observed that more expansive sustainability analysis by investors would lead to greater capital allocation to companies that are transparent about their ESG performance and that integrate sustainability into their strategic planning processes. State Street Global Advisors, similarly, highlighted the central importance of climate change, noting in a market commentary that, "boards should regard climate change as they would any other significant risk to the business and ensure that a company's assets and its long-term business strategy are resilient to the impacts of climate change."[23]

In the wake of the COVID-19 outbreak, investors have taken note of the outperformance by sustainability-focused funds, when compared with their relevant benchmarks.[24] A number of analysts project that ESG-screened funds will continue to outperform their conventional benchmarks and will continue to draw investors looking for long-term outperformance and lower volatility.[25]

Investors Want Broader and Deeper ESG Disclosure

While investors' calls for ESG disclosure grow louder, many fund managers and investment advisors express concern that they are not receiving the information that they need from companies and ESG data providers to incorporate sustainability factors fully into their investment processes.[26] A report of the SEC's Investor Advisory Committee highlighted this point, noting 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."[27]

A recent report from the CFTC, furthermore, articulated that "the lack of common definitions and standards for climate-related data and financial products is hindering the ability of market participants and regulators to monitor and manage climate risks. While progress has been made in this area thanks to voluntary disclosure frameworks and work by foreign regulators, the lack of standards, and differences among standards, remains a barrier to effective climate change risk management."[28] The U.S. Government Accountability Office also issued a report on public companies' ESG disclosures and found companies' ESG disclosures lack consistency and comparability, citing "the variety of different metrics that companies use to report on the same topics, unclear calculations, or changing methods for calculating a metric."[29] Nasdaq similarly issued a report emphasizing that "one of the key observable ESG trends for both issuers and investors alike is the confusion in the market on which ESG topics are most relevant. More specifically, there is a disconnect between which ESG topics investors want to hear from issuers and how issuers translate those investor topics into ESG disclosures relevant to their respective business models."[30]

The OECD's 2020 Business and Finance Outlook Report was dedicated to ESG issues. The report explained, "the COVID-19 pandemic has highlighted an urgent need to consider resilience in finance, both in the financial system itself and in the role played by capital and investors in making economic and social systems more dynamic and able to withstand external shocks."[31] The report highlighted the growth in ESG investing, but also noted that investors are not getting the information they need to properly inform their investment decisions: "Market participants often lack the tools they need, such as consistent data, comparable metrics, and transparent methodologies, to properly inform value-based decision-making through a sustainability risk lens. This is despite a proliferation of ratings, methodologies and metrics on ESG performance."[32]

State Street's 2020 letter to directors found that "fewer than 25% of the companies we've evaluated have meaningfully identified, incorporated, and disclosed material ESG issues into their strategies."[33] The World Business Council for Sustainable Development (WBCSD), a

Geneva-based consortium of multinational companies, hosted a series of investor roundtables to understand the information that investors need to properly incorporate companies' ESG performance into their investment processes.[34] The investors indicated that they want companies to clearly discuss the ESG-related risks they face and to demonstrate good governance and effective internal controls over these risks. They noted the difficulty of incorporating non-financial information into their valuation models due to the lack of comparability of ESG reporting across companies and the absence of narrative explanations that would provide context for the metrics provided. More recently, the Carbon Disclosure Standards Board (CDSB), a London-based non-profit organization committed to getting companies to provide more climate change-related information in their ongoing financial reports, found that even companies offering disclosures pursuant to the European Union's Non-Financial Reporting Directive fail to provide investors the information they need to properly evaluate ESG factors. The CDSB Report specifically noted: "Substantive improvements are still required in the quality, comparability, and coherence of disclosures in order for the Directive to achieve its objective of providing investors and wider stakeholders with relevant, consistent and decision-useful disclosures."[35]

This gap between the corporate sustainability information that investors seek and the information they are receiving has led to the emergence of shareholder activists working to develop new ESG information. But these activists have their own agendas and do not necessarily help mainstream investors to gain the analytically rigorous ESG data that would allow them to separate the sustainability leaders from the laggards. As the State Street letter noted, activists sometimes "focus on specific or narrow ESG issues in piecemeal fashion – often creating confusion for investors, boards, and company leadership *without fundamentally tackling the ESG issues material to long-term shareholder performance.*"[36] Even more pointedly, Felix Preston, Director of Sustainability Insights at Generation Investment Management, recently declared: “[T]oday’s ESG data has real limitations. The risk is that it puts the spotlight on what is available, rather than what is most important.”[37] Preston goes on to note that what investors really need is “rich contextual information” that highlights true sustainability leaders and ensures “a future where high-quality companies are aligned with planetary and societal needs.”

The information gap between investors and companies has also spawned a proliferation of ESG questionnaires and third-party ESG rating systems that aim to provide more robust ESG information to the markets. A report by the U.S. Chamber of Commerce Foundation found that some companies have been asked to complete more than 250 surveys related to their ESG performance, a process that has left some companies “dazed and confused” and has required them to dedicate teams of employees to fill out surveys or respond to third parties about ESG matters.[38] Moreover, there now exist more than 600 different ESG ratings that seek to meet investor demand for sustainability information and analyses of companies.[39] While the proliferation of ESG ratings services and data providers has increased the number of ESG metrics available in the investment marketplace, it has not necessarily improved the quality of the data or the comparability of the metrics across companies. The different ratings have been criticized for inconsistency and deeply divergent conclusions as to who the ESG leaders really are. A recent State Street study of ESG data providers observed that “there is increasingly more ESG data available today, [but] the lack of standardization poses a real challenge for investment managers. Because disclosure on ESG metrics has not been required historically, significant variation exists across the methods used by the leading ESG data providers.”[40] SEC Chairman Jay Clayton has expressed concern over the quality and reliability of ESG ratings, particularly by ratings providers that combine their analyses of the separate environmental, social and governance factors into one aggregate ESG score that can be "significantly over-inclusive and imprecise."[41]

As Dan Esty has noted, the ESG metrics available today do not meet investor needs.[42] As he explains, the existing reporting is haphazard with significant methodological inconsistencies across companies. The data aggregators often accept corporate reporting without any attempt to: (1) normalize disparate data – to ensure comparability, (2) investigate or validate the information provided, (3) distinguish between missing data and poor performance, or (4) explain their approaches to filling data gaps. Moreover, they regularly assign scores to companies based on their analysts' subjective judgments in a manner that is neither transparent nor well explained. This lack of consistency creates substantial doubt about whether the existing sustainability scorecards highlight the true leaders or simply those who have cherry-picked the data they report or offered the most convincing sustainability narrative.

Likewise, the data offered to investors is often rather superficial, backward-looking rather than future-facing, and narrowly focused on risk rather than opportunities. As a result, most ESG data feeds do little to distinguish which companies will not only address the sustainability challenges they face but also manage the transition to a sustainable future, defined in particular by deep decarbonization, in a fashion that positions them for competitive advantage. In arguing for a *next generation* of ESG metrics, Dan Esty and David Lubin suggest that what many investors need are *high-resolution* ESG metrics that: (1) offer a perspective on a company's ability to transform its business model in response to the emerging *sustainability imperative*,[43] (2) illuminate the management team's *strategy* for addressing climate change and the emergence of a clean energy economy as well as other sustainability issues, (3) track a company's evolution toward a sustainable future, (4) highlight carbon exposure and the risk that certain lines of revenue or asset values will diminish as market expectations and requirements change, and (5) gauge *green revenue* and a company's capacity to be a *solutions provider* in response to climate change and other sustainability challenges.[44]

As long as there continues to be a lack of methodological consistency in ESG reporting, limited validation of the ESG data, and critical gaps in the corporate sustainability disclosures, investor trust in ESG metrics will be constrained. Expanded mainstream investor interest in sustainable investing – and the ability to steer capital toward companies addressing society's sustainability challenges – depends on the development of new ESG reporting frameworks that offer investment-grade ESG data.

ESG Reporting Framework in the United States

The problems described above would be ameliorated by ESG reporting standards imposed on companies by a government-structured disclosure framework that is both consistent and useful for decision-making. In thinking about how best to address this problem in the United States, we note that for U.S. public companies, much of the information that corporations disclose derives from the requirements of the Securities and Exchange Commission (SEC).

The mandatory corporate reporting framework in the United States builds on the U.S. securities laws (principally the Securities Act of 1933, which governs offerings of securities, and the Securities Exchange Act of 1934, which governs the reporting by public companies), as well as the rules and regulations promulgated by the SEC to implement those laws. Under the SEC's current rules, companies' disclosure obligations are meant to meet the informational needs of "reasonable investors" as guided by the concept of *materiality*. "Materiality," as defined by the U.S. Supreme Court in *TSC Industries v. Northway,* provides: "There must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information available."[45] Put differently, there must be "a substantial likelihood that a reasonable shareholder would consider [the omitted information] important in deciding how to vote."[46]

Any discussion of ESG issues thus turns on the definition of the "reasonable investor" or "reasonable shareholder," as required by current U.S. law. The interests of the "reasonable investor" have evolved over time, as has the understanding of what information should be considered material. Some years ago, activist groups waged campaigns demanding disclosure of corporate environmental and social performance information. Because those groups were not generally considered representative of the reasonable investor, their pleas generally fell on deaf ears. Environmental and social metrics were not at that time thought to be tied to the creation of financial value for shareholders – and were therefore not thought to be material. Times have changed, and ESG information is now understood to be important to many mainstream investors in their portfolio construction and analyses. In fact, a recent survey found 73% of Chartered Financial Analyst Institute members (portfolio managers and analysts) reported that they use environmental, social, and governance data in their investment analysis and decisions – leading a commentator to declare: "If 73 percent of sophisticated investors are using the information, we can almost stop right there when asking if this is material information."[47]

The SEC's disclosure regulations inform the question of what companies should disclose to their shareholders. The principal regulation underpinning the existing disclosure requirements is Regulation S-K.[48] Companies look to Regulation S-K to determine what information to include in specific sections of their disclosure documents. These sections include the description of the company's business, threatened or pending legal proceedings against the company, risk factors, and management's discussion and analysis (MD&A) of the company's financial condition and results of operations. The SEC rules spell out in some detail the information that companies must disclose in this regard. However, much of the SEC's disclosure framework is "principles-based," articulating disclosure guidelines and leaving it to companies to determine which information to disclose based on the application of the principles to their own circumstances.

In 2010, the SEC published guidance to provide companies with greater clarity on what disclosures might be required related to climate change issues.[49] This 2010 guidance described some of the ways in which climate change risks and opportunities might trigger disclosure obligations under the reporting provisions discussed above. For example, the release discussed how developments in foreign, federal, state, and local laws, rules, and regulations might trigger disclosure obligations under Regulation S-K if they materially affected a company's financial prospects. Laws or regulations that advanced emission allowance ("cap and trade") trading systems, pollution limitations, greenhouse gas emissions charges or controls, and other policies with significant cost consequences could all trigger disclosure obligations. The SEC guidance urged companies to consider not only the direct but also the indirect consequences of regulations or business trends, including changing consumer demand for goods and broader reputational effects, to the extent material. Finally, the SEC noted that companies should consider the physical effects of climate change – such as those related to sea level rise, severe weather, or drought – and disclose the material risks that those effects could pose.

In 2016, the SEC issued a "Concept Release," (a request for preliminary comments on an issue separate from an actual rule proposal), and solicited public opinion on modernizing the disclosure requirements in Regulation S-K on a broad range of topics pursuant to the SEC's "Disclosure Effectiveness Initiative."[50] Of the Release's 92 pages, four pages were devoted to sustainability, yet a significant majority of the comment letters addressed sustainability issues with many focused on climate change.[51] Commenters also discussed disclosures related to access to and stewardship of water, land tenure rights, diversity, gender pay equity, human rights, human capital management, sustainable palm oil, forestry, and supply-chain management. One comment letter concluded that "the sustainability topic is clearly on the table at this point, and the Commission will sooner or later have to — and should — address it."[52] Many of the comment letters articulated the need to improve the quality and consistency of ESG disclosures. Keith Higgins, then the Director of the SEC's Division of Corporation Finance, observed that a number of commenters found voluntary disclosures to be inconsistent, frequently not comparable, and often lacking in context.[53]

Notwithstanding the requests from many commenters for enhanced ESG disclosure requirements, the SEC has resisted calls to amend its rules to expand ESG disclosures. In 2019[54] and again in 2020[55] the SEC proposed amendments to Regulation S-K – but both proposals did little to address the demands for more sustainability information. The proposals largely maintained the status quo with regard to environmental disclosures and failed to act on the requests for enhanced ESG disclosure. Upon adoption of the first of the proposals, SEC Commissioners Allison Lee and Caroline Crenshaw expressed their dismay at the Commission's failure to use the opportunity to adopt rules that address ESG disclosures – or even to address ESG disclosures. Commissioner Lee declared that "the time for silence has passed. It's time for the SEC to lead a discussion – to bring all interested parties to the table and begin to work through how to get investors the standardized, consistent, reliable, and comparable ESG disclosures they need to protect their investments and allocate capital toward a sustainable economy."[56] Commissioner Lee has expressed her conviction that the SEC should address ESG disclosures many times and in multiple fora, including an Op-Ed in the New York Times, in which she emphasized that "both investors and the broader public need clear information about how businesses are contributing to greenhouse gas emissions, and how they are managing – or not managing – climate risks internally. Realistically, that can happen only through mandatory public disclosure."[57]

SEC Chairman Clayton has issued multiple statements in 2020 acknowledging the increased interest in ESG information, while noting the difficulty of regulating ESG disclosures.[58] He has stressed that "the landscape around these issues is, and I expect will continue to be, complex, uncertain, multi-national/jurisdictional and dynamic." The Chairman observed that he had been engaged in discussions with a variety of market participants as well as with his international counterparts on the issue of ESG disclosures and will continue to evaluate the issue. Commissioner Lee has adopted a different tone: "Today's proposal is most notable for what it does not do: make any attempt to address investors' need for standardized disclosure on climate change risk . . . investors are overwhelmingly telling us, through comment letters and petitions for rulemaking, that they need consistent, reliable, and comparable disclosures of the risks and opportunities related to sustainability measures, particularly climate risk."[59]

Clearly, many investors are not satisfied with the breadth, depth, quality, and comparability of the ESG information currently reported. As such, the current SEC framework has been criticized as failing to respond to investors' expressed needs.

Voluntary Disclosure Frameworks

In the absence of more authoritative SEC guidance or prescriptive disclosure rules, a number of *voluntary* disclosure standards have emerged that attempt to satisfy investors' demand for ESG information. Some of the more prominent frameworks are outlined below. While each of the voluntary disclosure frameworks provides a useful contribution to the reporting landscape, none is perfect nor comprehensive. Moreover, the proliferation of different reporting frameworks has in some cases brought confusion and uncertainty to the reporting process as companies grapple with which reporting frameworks to follow.

Global Reporting Initiative (GRI)

The Amsterdam-based GRI was formed in 1997 to help companies and governments better understand and communicate their impact on sustainability issues such as climate change, human rights, governance, and social well-being.[60] The GRI should be credited with providing the first substantial framework for sustainability reporting. To this day, GRI has a broad reach across reporting companies. According to the GRI, "of the world's largest 250 corporations, 92% report on their sustainability performance and 74% of these use GRI's standards."[61] However, in the absence of a contextual framing of the information, particularly with regard to financial materiality, the data reported pursuant to the GRI, standing on its own, can be of limited use to investors attempting to understand the importance of specific ESG factors.

Task Force on Climate-related Financial Disclosures

The Financial Stability Board formed the Task Force on Climate-related Financial Disclosures (TCFD) in 2015 to develop a consistent framework for companies to use in making voluntary climate-related financial disclosures for investors, lenders, and others.[62] The TCFD's recommendations articulate four core themes – seeking disclosures that: (1) describe the organization's governance with regard to climate-related risks and opportunities; (2) explain how climate-related risks and opportunities could impact the company's business, financial condition, and strategy; (3) discuss how the organization identifies, assesses, and manages climate-related risks, including through scenario analyses; and (4) use metrics and targets to evaluate and manage these risks and opportunities.[63]

The TCFD explains that organizations might face climate-related transition risks and risks associated with the physical impacts of climate change. Transition risks might include policy and legal developments, technological improvements that displace old systems, market risks, and reputational risks associated with changing customer perceptions of the organization's business. Physical risks might include damage to property due to rising sea levels or extreme weather in addition to resource scarcity and supply-chain risks. Companies also might find opportunities resulting from their climate strategies, including opportunities around energy efficiency, resource reuse, and the development of new products and markets.

The TCFD's recommendations provide a useful structure to help companies build strategies to manage and report on the effects of climate change. They articulate an important framework that has been adopted broadly, including by many of the signatories to the UN Principles for Responsible Investment.[64] Further, a number of other thought leaders have jumped on the TCFD bandwagon. In his 2020 letter to CEOs, for example, Larry Fink declared that BlackRock will be reporting under the TCFD in 2020 and expects the companies in which BlackRock invests to start following the TCFD's recommendations along with SASB standards.[65]

The TCFD's recommendations do not, however, prescribe specific reporting standards or metrics and therefore might not elicit disclosures that would enable direct comparisons across companies. The failure to specify a core set of climate change metrics and to mandate reporting methodologies limits the TCFD's value as a benchmarking tool. As such, the TCFD is of limited use to investors seeking to compare companies on the basis of their climate change risks and opportunities. Understanding which companies are leaders in the transition to a lower-carbon economy is increasingly important to investors. Indeed, as Esty and Lubin argue, in calling for a "value-driver" model of ESG reporting that tracks growth and productivity as well as risk, mainstream investors increasingly want information on who the sustainability leaders will be and not just who faces growing risks.[66] Moreover, as a disclosure standard focused on climate-change-related risks, the TCFD recommendations are helpful in sharpening the investor world's focus on climate change risks, but the information generated does not address the host of other environmental issues that many investors care about such as air and water pollution, waste management, and land use. Nor do they require attention to the social issues contemplated in the "S" element of ESG analysis.

Sustainability Accounting Standards Board

The Sustainable Accounting Standards Board was formed to help businesses to identify, manage, and report on the sustainability topics that are most important to investors.[67] Through an extensive stakeholder engagement process, SASB produced a set of 77 industry-specific standards that target the sustainability issues that generally are most significant within an industry. The industry focus is meant to help companies identify the issues most salient to their particular business activities and sharpen the focus of their ESG reporting. While many ESG issues are common to companies across all industries and should be subject to uniform disclosure standards, some issues are industry-specific and would not be appropriate disclosure items for companies in other industries. Reporting, for example, on the volume of mine tailings produced would be relevant to mining companies but not to companies in other industries. A number of commenters, including SASB officials themselves, have proposed that the SEC adopt the SASB standards in its disclosure requirements. As noted earlier, BlackRock's Larry Fink told companies in his 2020 letter to CEOs that he expects companies to report pursuant to the SASB standards.

While the SASB standards are an important framework on which to build, the disclosure topics articulated in the standards are narrowly drawn, with some industries having only a handful of issues identified as relevant. The focus of the standards, moreover, is tightly tied to financial materiality and shorter-term impacts. Because the SASB structure links sustainability reporting to information deemed financially material in the short term, it does not adequately capture long-term impacts or the issues of importance to the broader group of stakeholders whose environment concerns go beyond short-term market returns.

CDP

The CDP (formerly the Carbon Disclosure Project) operates a disclosure system that tracks the environmental impact of companies, municipalities, and other entities.[68] As an open platform, CDP has built a comprehensive matrix of self-reported environmental data, with more than 7,000 companies and 620 cities reporting in some fashion through the CDP framework in 2019.[69] The CDP's climate change metrics (although covering only about 2,000 of the 7,000 reporting companies) are especially highly valued. Indeed, most analyses of corporate GHG emissions are derived from CDP metrics. The CDP analyzes the data it has gathered with reference to climate change and other critical environmental risks and opportunities – and shares the resulting analyses and scores with investors and other stakeholders. Like the TCFD, the CDP does not address social or governance issues and therefore addresses only a piece of the disclosure puzzle. Nor does CDP provide consistent methodological requirements for its metrics, or independently verify the data reported on its platform. Thus, CDP provides a piece – but *only* a piece – of the sustainability framework that the diverse world of sustainability-minded investors need.[70]

United Nations Sustainable Development Goals

As part of its 2030 Agenda for Sustainable Development, the United Nations adopted 17 Sustainable Development Goals (SDGs) made specific through 169 defined policy targets.[71] The goals "recognize that ending poverty and other deprivations must go hand-in-hand with strategies that improve health and education, reduce inequality, and spur economic growth — all while tackling climate change and working to preserve our oceans and forests."[72] Many companies have begun to map their activities to the SDGs.[73] Some have honed in on a subset of SDGs most relevant to their industry and have established targets that will track how their operations will advance progress on the selected SDGs. The UN SDG framework does not, however, include any reporting requirements or metrics for companies. As a result, individual companies and other organizations are left to determine for themselves what goals to set, how to track progress, what metrics to report, and what methodologies to adopt. As such, the SDGs do not answer the need for a common reporting framework.

Fragmentation and the Need for a Common Set of Standards

The voluntary reporting frameworks discussed above are a few examples in a patchwork of different reporting regimes. Various initiatives have attempted to help market participants to navigate the different reporting frameworks. The WBCSD's Reporting Exchange is an online platform that aggregates nearly 2,000 mandatory and voluntary ESG reporting standards and frameworks in 70 countries.[74] The WBCSD's ESG Disclosure Handbook provides further guidance for companies as they approach their ESG reporting processes.[75] The Disclosure

Handbook is designed to help companies navigate the disclosure process, giving consideration to the informational demands of multiple stakeholders and the array of reporting standards.

The Corporate Reporting Dialogue – organized by the CDP, CDSB, GRI, International Organization for Standardization, SASB, International Financial Reporting Standards, and Financial Accounting Standards Board (FASB) – aims to rationalize the ESG reporting landscape.[76] It provides comparisons and summaries of the principal reporting frameworks, including a "landscape map" that compares the member organizations' disclosure standards.[77]

While these efforts to reconcile the different reporting regimes are helpful, they also highlight a fundamental problem with our existing disclosure system. The proliferation of standards and the lack of common reporting metrics lends to confusion for reporting companies and a lack of uniformity in the information available to investors. The disparate reporting methodologies make it difficult for investors to compare companies' ESG performance and to efficiently incorporate ESG factors into their investment processes. As such, the fragmentation serves as a barrier to the efficient flow of capital to more sustainable companies.

In response to this fragmented ESG reporting landscape, a number of initiatives have launched in 2020 with the goal of addressing the need for a unified reporting framework. The International Business Council of the World Economic Forum (WEF), together with the Big Four accounting firms,[78] developed a *consultation draft* for a common sustainability reporting framework designed to promote consistent corporate disclosure of ESG information. The WEF draft sought to address the "lack of consistency by which companies measure and report to investors and other stakeholders the shared and sustainable value they create."[79] It specifically proposed the adoption of two sets of metrics drawn from existing frameworks, including SASB, GRI, TCFD, and CDP. The core metrics are a set of 22 mostly quantitative measures in four categories: governance, planet, people, and prosperity. The proposed "expanded metrics" encourage reporting companies to provide further company-specific disclosure encompassing the entity's broader value chain and impacts.[80] In creating a standardized reporting framework, the WEF initiative offers a possible approach to consistent and comparable ESG disclosures. The challenge, of course, is in finding the right balance between fostering consistency and comparability on the one hand and eliciting the most meaningful and relevant disclosures for the specific company and industry on the other.[81] In September 2020, the WEF's efforts culminated in a final proposal that outlined the recommended disclosures and identified four pillars underlying its recommendations.[82]

In April 2020, the International Organization of Securities Commissions (IOSCO) published a report designed to "help achieve a degree of international consistency and harmonization, thereby assisting investors and issuers with the cross-border and global nature of sustainable instruments."[83] In August 2020 IOSCO created a taskforce to explore ways to harmonize the "plethora" of reporting standards that exist around the world.[84] The European Central Bank similarly observed, in June 2020, that "internationally consistent standards on climate-related and environmental information disclosure would foster comparable high-quality information and provide greater clarity to the industry on how to align their reporting internationally."[85]

The International Monetary Fund (IMF) confronted climate change disclosures in its Global Financial Stability Report in April 2020, noting that "developing global mandatory disclosures on material climate change risks would be an important step to sustain financial stability. In the short term, mandatory climate change risk disclosure could be based on globally agreed principles. In the longer term, climate change risk disclosure standards could be incorporated into financial statements compliant with International Financial Reporting Standards."[86]

The CFA Institute released a consultation paper in August 2020 that calls for the creation of consistent standards with regard to ESG investment products, noting "in the face of growing interest in ESG investing, we found widespread support from the investment community for the development of a standard to reduce confusion and facilitate better alignment of investor objectives with product intent."[87]

In September 2020, the Carbon Disclosure Standards Board, GRI, CDP, International Integrated Reporting Council, and SASB issued a "Statement of Intent to Work Together Towards Comprehensive Corporate Reporting," with the goal of forging greater alignment of ESG reporting standards."[88] The statement emphasizes the importance of streamlining sustainability standards to make sustainability information more useful to companies and to investors. Also in September 2020, the International Financial Reporting Standards Foundation issued a consultation paper soliciting input on the development of global ESG reporting standards, noting that "there is an urgent need to improve the consistency and comparability in sustainability reporting."[89]

Mandatory Disclosure Obligations

More than sixty countries have developed mandatory reporting requirements for listed companies.[90] The European Union took a leading position in adopting the Non-Financial Reporting Directive (NFRD). Within the European Union, France and the UK are leading the pack.

European Union

With respect to large companies, the primary ESG reporting obligation arises from Directive 2014/95/EU regarding the disclosure of non-financial and diversity information by certain large companies and groups, commonly referred to as the Non-Financial Reporting Directive.[91] The NFRD applies to large public-interest companies that have more than 500 employees (including listed companies, banks, insurance companies, and other companies designated by national authorities as public-interest entities). Such public-interest companies must publish reports on: (1) environmental protection; (2) social responsibility and treatment of employees; (3) respect for human rights; (4) anti-corruption and bribery; and (5) diversity on company boards. For each subject matter, companies must disclose their policies including due diligence processes (Provision 1.b), the outcome of those policies (Provision 1.c), the principal sustainability risks (Provision 1.d), and non-financial key performance indicators (Provision 1.e).

The European Commission developed non-binding guidance to support and guide companies in this reporting process. In 2019, the European Commission updated its guidance with respect to reporting on climate-related information with significant emphasis placed on reporting in line with TCFD, although this methodological recommendation is not mandatory.

The extent to which the Directive has improved corporate reporting is the subject of some debate. According to the European Securities Market Agency (ESMA), 60% of the European companies complied with the obligation to disclose their "principal risks" in the year 2019 (the second year of implementation of the Directive).[92] In addition, "[a]round three quarters of issuers in the sample provided sufficient disclosure on their due diligence processes for environmental matters."[93] On the other hand, a 2020 report by the CDSB found that climate-related disclosures under the NFRD still need to improve. While the CDSB report observed some improvement in companies' environmental and climate-related disclosures, it found "that reporting often still fails to offer investors a clear understanding of companies' development, performance, position and impact, as it lacks the necessary quality, comparability and coherence."[94]

The ESMA has noted that the Directive has failed to ensure greater comparability across EU companies.[95] The text of the Directive ensures a large degree of flexibility on how companies should report on those matters. Cognizant of the limitations of the NFRD in terms of comparability, the European Commission recently launched a public consultation to update the Directive as part of the EU's Green Deal and established target of achieving climate neutrality by 2050.[96] The EU Commission has thus begun to explore several ways to strengthen the existing requirements, with more extensive reporting obligations related to climate change as a central focus.

French Requirements

France has some of the world's most comprehensive and stringent ESG reporting requirements. Since 2012, companies with more than 500 employees and 100 million euros in turnover must report on 42 ESG metrics. The French framework employs a "comply or explain" approach, which allows companies to choose to provide the prescribed disclosures or explain why they have not done so.[97] The ESG report must be third-party verified. [98] Since, 2017, Article 173-IV of the Law on the Energy Transition mandates companies to systematically report their scope 3 emissions.[99] Specifically, companies are required to report on the financial risks they face due to climate change, the steps taken to reduce those risks, and the climate change impacts of the companies' own activities and of the goods and services they produce.[100]

Most notably, in 2017, the French Parliament adopted the Law on the Duty of Vigilance for Parent and Subcontracting Companies.[101] This law requires companies with over 5,000 employees in France or 10,000 employees worldwide to establish and implement a mechanism to verify human rights, environmental, and health and safety issues in their supply chains. This provision reinforces the due diligence obligation required by European Union rules. Each reporting company must develop a *vigilance plan* composed of five elements: (1) risk mapping; (2) assessment of subsidiaries, subcontractors, and suppliers; (3) actions taken to mitigate risks; (4) whistleblower procedures; and (5) a monitoring mechanism. Any concerned party (including employees, citizen, and investors) is authorized to file a complaint for failure to create or disclose this plan.

Importantly, Article 2 of the law[102] makes companies to which the law applies liable for environmental and social harm that materialize in their operations and in their supply chain as a result of a breach of the obligations set forth under the law. This provision represents one of the most ambitious requirements in the world in terms of integrating ESG considerations into corporate governance.[103]

England and Wales Requirements

In England and Wales, in addition to the implementation of the NFRD through its adoption of the Companies, Partnerships and Groups (Accounts and Non-Financial Reporting) Regulations 2016, certain entities are obliged to include information as follows in certain annual reports:

(1) The inclusion of non-financial KPIs (including environmental matters) in the entity's strategic report; and

(2) The inclusion of (a) greenhouse gas emissions (including the provision of an intensity metric in respect of such greenhouse gas emissions), (b) total UK energy use, and (c) energy efficiency steps that have been taken in the entity's directors' report

Further, the UK's Financial Conduct Authority has launched a consultation primarily focused on enhancing requirements on certain listed companies to make climate-related disclosures. It is proposed under the consultation that such listed companies will be required to state that they have reported in line with the recommendations made by the TCFD or explain why they have not yet complied.[104]

Inconsistencies Resulting from the Multiplication of Reporting Requirements

Many General Counsels, especially in large multinational firms, find the multiplication of legal requirements worrisome. They fear that the lack of consistent legal requirements may transform into a liability risk, as some jurisdictions require ESG disclosure in financial fillings while other jurisdictions do not. We take such concerns seriously, and thus argue in favor of the progressive harmonization of ESG reporting requirements worldwide (see Recommendation #4 below).

Private Data Provider Requests and "Questionnaire Fatigue"

In addition to the fragmentation of legal reporting obligations and voluntary reporting frameworks, companies sometimes find themselves overwhelmed with ESG reporting requests from dozens of different private sustainability data providers, many of which have their own structure of ESG metrics and unique methodological requirements (and sometimes no such requirements, which permits companies to report however they want). Because these requests often differ in form, unit, scope, and reporting formats, the burden on companies continues to rise. Yet companies feel compelled to respond for fear of getting an unfavorable "grade" that might negatively influence investors. Our proposed unified ESG reporting framework enhances the quality and comparability of the information companies report, and therefore reduces the need for these third-party ratings firms – or at least reduces the need for them to issue separate data requests of companies. Ultimately, this should reduce the reporting burden for companies.

Litigation Risk and Its Impact on Disclosures

As companies struggle with the plethora of reporting standards and questionnaires, and generally face pressure to disclose more ESG information, they also face the specter of litigation associated with their conduct, their suppliers' conduct, and their ESG statements or omissions. "Over the past decade . . . a growing market appetite for greater ESG information ha[s] subjected company ESG performance and disclosure to greater scrutiny in the court of public opinion and spawned new litigation."[105]

Companies have faced legal challenges to their ESG practices and disclosures under a number of legal theories, including securities fraud claims alleging material misstatements or omissions related to their environmental or social performance.[106] Private plaintiffs and government regulators have also brought claims under an array of less obvious theories, including claims by the FTC alleging unfair and deceptive business practices related to claims of "greenwashing," and private claims under consumer protection and unfair competition laws related to alleged deceptive green labeling.[107] Recent lawsuits have also attempted to hold companies responsible for alleged human rights abuses in their supply chains under the Alien Tort Statute and the Trafficking Victims Protection Act.[108] A recent analysis of these litigation trends concluded that "the ESG path forward for companies will grow increasingly treacherous, intensifying pressure to ensure comprehensive programs that achieve high-level ESG performance accompanied by accurate, complete, and aligned ESG statements and communications."[109] This threat of litigation only serves to exacerbate companies' concerns over what ESG information to share and in what format.

SURVEY OF CORPORATE ESG REPORTING PROCEDURES AND ROUNDTABLE DISCUSSIONS WITH GENERAL COUNSEL AND CORPORATE ESG LEADERS

Methodology

A number of studies have examined the factors that influence the adoption and implementation of corporate sustainability policies generally and ESG disclosure more specifically. External pressures have often been found to be among the key determinants of corporate sustainability reporting practices.[110] A company's international experience, size, exposure to media pressure, and the procedures of peer corporations were also identified as drivers of the growth of corporate sustainable policies.[111] As companies have become more globally connected, larger, and increasingly subject to media scrutiny and peer comparison, their focus on corporate sustainability has tended to intensify. Recent research has confirmed the observations that external pressures from market and non-market actors – together with operational factors such as cost efficiencies, evolving management attitudes toward environmental stewardship, and pressure from company owners all have become important factors driving corporate sustainability program development.[112]

Top management's attitude towards sustainability also emerges as a critical factor shaping when and how companies undertake ESG reporting.[113] Finally, internal dynamics, such as the role of corporate culture and stakeholder networks, also appear critical in the adoption and implementation of sustainability policies.[114]

Academic research has built on this literature and explored the factors driving climate risk disclosure more specifically,[115] including the role of external stakeholders,[116] institutional investors,[117] mandatory reporting regimes,[118] and economic motivations.[119] The literature helps to explain some of the factors that have led to the current state of fragmentation in the ESG metrics landscape. For example, an examination of the role of stakeholder engagement in the reporting process demonstrates that the wider the array of constituents to whom companies report, the greater the pressure to report in many ESG categories.[120]

The range of corporate motivations in making ESG disclosures lends further complexity to the reporting process. Companies might report on their sustainability performance to gain access to capital, for social acceptance (including customer demands), to meet political expectations or social needs, to respond to non-governmental organizations, or for organizational learning, among other reasons.[121] The diverse set of stakeholders with their varied interests certainly complicates the calculus for companies seeking to gather and report on their sustainability data. Moreover, different personnel within companies generally take ownership of different stakeholder relationships, which can lead to internal disconnects in the reporting on sustainability data.

Yet, the literature rarely focuses on the internal processes leading to the production of sustainability metrics for disclosure. Lozano et al.[122] review the impact of disclosure on organizational change. Windolph et al. and Schlategger et al.[123] explore the cognitive involvement of corporate functions toward sustainability disclosure. This White Paper adds to this literature by mapping the flow of ESG information production within companies – identifying which corporate functions and executives are involved in the selection, generation, control, review, and release (or withholding) of ESG information. It also provides some of the first research to explore the criteria that influence corporate leaders as they consider what sustainability reporting to do and which ESG metrics to develop and disclose.

Corporate ESG Disclosure Survey and Roundtable Discussions

Our research seeks to open the *black box* that constitutes ESG data generation and disclosure within companies. To this end, we surveyed more than 100 corporate officers, including Chief Sustainability Officers, investor relations staff, Chief Legal Officers, and strategy executives. We also held two roundtable discussions with general counsels and ESG officers of leading global companies.

The survey was distributed to a diverse set of corporate executives via several networks, including the WBCSD, Fiscal Note, and the client networks of four global consulting firms, two global law firms, and alumni of the Yale Executive MBA program. Participants were asked to answer the survey online through Qualtrics in February to May 2020. Responses were received from more than 100 companies across the globe with a large number coming from U.S.-based public companies. Figures 1, 2, and 3 provide statistical data for the respondents by country, sector, and corporate department within the company.

The first objective of the survey was to identify which corporate functions play a role in the selection, generation, review, and release of ESG information. Companies were asked to:

- Select the corporate functions involved in each of the following stages of ESG data collection and disclosure: selection, generation, quality control, and release. Respondents could select more than one function. A comment box invited companies to provide additional information to further explain their answers (Questions 1 to 5);
- List the corporate functions responsible for assessing the materiality of ESG information within the company (Q5);
- Provide observations on whether companies had sufficient guidance to aid them in the ESG data collection and disclosure process (Q6); and

- Describe how companies organized cross-functional efforts around the publication of complex information. In this regard, we specifically questioned respondents on their processes to design TCFD-aligned disclosures (Q7).

The second objective of the survey centered on understanding the factors that shape or inhibit the *production* of ESG data or limit the *disclosure* of such information (Q8 and Q9). Companies were asked to rate nine factors on a scale of importance from low (1) to high (4).

Interviews of Market Participants

In addition to the survey, the research team conducted a series of more in-depth interviews with a range of corporate executives who participate in the ESG data production process. These 32 interviews included:

- Chief Sustainability Officers (16),
- Manager of investor relations team (1)
- General Counsel/ lawyers (2)
- Accounting firm sustainability disclosure experts (7)
- Outside legal counsel/ lawyers (4)

Roundtable Discussions with General Counsel and Corporate ESG Leaders

To bolster our understanding and validate the survey results, we held two roundtable discussions in conjunction with the FiscalNote Executive Institute captioned, "From the Trenches: ESG Reporting Best Practices – Internal Processes and External Stakeholder Engagement." The roundtable discussions included a candid conversation among general counsels, corporate sustainability leaders, and corporate advisors for some of the world's most prominent corporations. The first of the discussions focused on the internal processes that companies use to develop and manage their ESG reporting strategies. The second roundtable discussion focused on the external pressures companies face and the processes they employ to shape their ESG disclosures.

Respondents Statistics

Figure 1. Respondents by Country

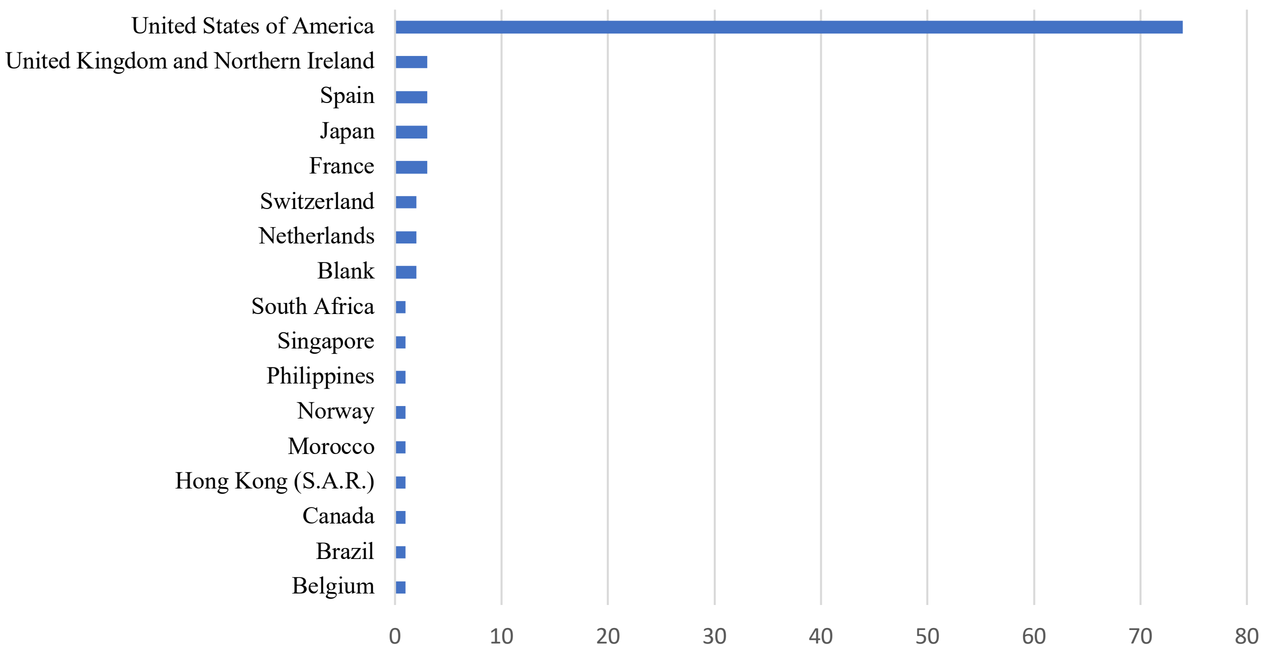


Figure 2. Respondents by Number of Employees

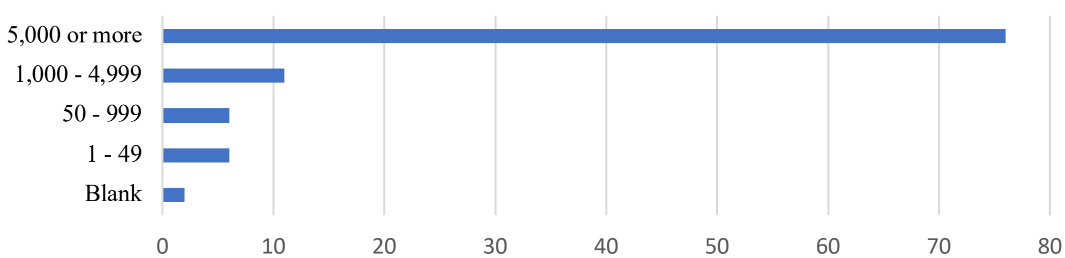
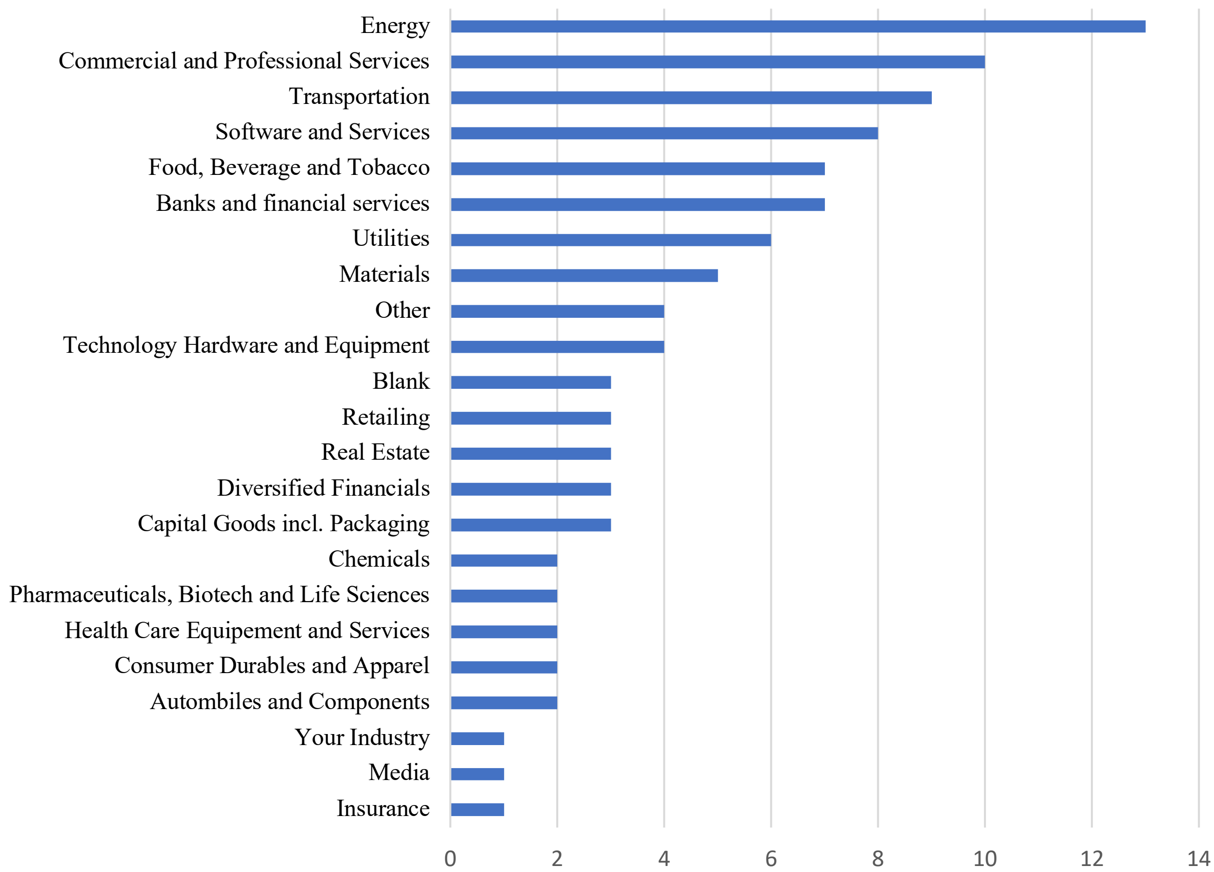


Figure 3. Respondents by industry



Factors Affecting the Production of the Data

Respondents shared their exhaustion when it comes to the proliferation of reporting frameworks. About 40% spontaneously raised the proliferation of frameworks and surveys as affecting ESG disclosures – echoing the "reporting fatigue" expressed by respondents in the interviews. Others complained about the divergent requirements across ESG reporting platforms.

The market seems to be ready for mandated, uniform disclosure standards. We posed the questions: "Are there other factors that limit the production and disclosure of ESG information in your company?" and "What would make ESG reporting easier?" One third of the respondents (32%) called for a compulsory standard:

> *"We would welcome a worldwide standard and a homogeneous regulation in US and Europe"; "Streamlining and uniform standards of reporting accepted by multiple groups";*
> *"Standardized reporting and rating methodologies are needed."*

These written requests for standardized disclosure regulations echo comments received by market experts and corporate officers in interviews. In seeking comment on our proposal for a tiered disclosure standard mandated by the SEC, we received positive support from 21 of the 22 respondents.

In the roundtable discussions, participants agreed that standardized disclosure provisions would help to create greater clarity and consistency. In addition, multinational companies specifically noted the difficulties associated with reporting under varied reporting regimes in different countries. Companies face challenges in ensuring that they report information in these different jurisdictions and reporting frameworks in a manner that is aligned and consistent. Moreover, companies are also wary of releasing too much information out of fear that their disclosures could present a litigation risk.

Internal Factors Affecting the Production of ESG Information

The survey explores eleven additional factors affecting the decision to make public ESG disclosures. Of these eleven factors, four appear to be decisive: stakeholder demand for the information (including but not limited to shareholders), the company leadership's attitude toward sustainability (particularly those of the CEO), the availability and accuracy of the data, and the legal and strategic implications of disclosure of sustainability information. The factors affecting the production of ESG disclosures seem to correspond, in part, to the factors affecting the adoption of sustainability policies at large. These include external pressure, the costs and benefits to the company of undertaking sustainability efforts, and the attitudes of company leadership toward sustainability. These three factors, which emerged as key to companies' disclosure decision, mirror those identified by Ervin et al. as affecting the adoption of sustainability policies.

Respondents also highlight additional considerations around the availability and accuracy of ESG data, as well as concern over the strategic and legal implications of disclosing ESG information. These two factors are correlated with the lack of clear disclosure regulations to guide the gathering and disclosure of ESG information. Robust ESG data remains difficult to produce. Unlike regulated financial data, the risks associated with this voluntary disclosure of ESG data are unclear and companies are hesitant to disclose information voluntarily if such disclosures might give rise to enhanced regulatory or private litigation risk.

Table 1. Factors affecting ESG information production and release.

Factors affecting the disclosure of ESG data	Mean	Median
Incoming requests from shareholders	3.8	4
Degree of CEO (or other C-suite executive) interest in ESG reporting	3.7	4
Incoming requests from other stakeholders ESG rating firms, NGOs, and other interested in sustainability performance	3.2	4
Difficulty of compiling non-standards ESG metrics (such as climate scenario analysis, products environmental and social impacts...)	2.7	3
Perceptions of competitiveness or reputational risks	2.6	3
Legal risk from too much/ too little disclosure	2.6	3
Limits of staff and/or financial resources leading the company to "triage" reporting activities	2.5	3
Difficulty of cross-functional cooperation in the production of ESG data	1.9	2
Skepticism about the quality of the underlying ESG data being assembled	1.6	1
Skepticism around the value of ESG data and reporting	1.5	1
Skepticism around the value of sustainability as a corporate focus	1.5	1

(1) **Shareholder and stakeholder** requests appear to significantly influence the decision to produce ESG data. Shareholder demand in particular plays a critical role in shaping ESG disclosure decisions (3.8/5 on average). Companies seem to evaluate external requests by balancing the financial and reputational reward against the effort required to compile and publish the data. One respondent summarizes this weighting process as follows:

> *"[We consider] who is requesting, our peers disclosing, do we have the information available and if not what effort it would take to produce."*

Figure 4 provides additional details on the criteria that influence companies' decision to disclose additional ESG information in response to external requests.

(2) **CEO buy in** ranks as the second most important factor influencing the decision to disclose ESG data (3.7/5 on average). This result echoes findings in the literature review, where we found that personal characteristics of the CEO are likely to significantly influence companies' adoption of sustainability policies.[124]

(3) **Poor availability and concerns over the accuracy of ESG data** ranks as the fourth factor most significantly influencing the decision to disclose ESG data. Respondents rate the difficulty of compiling non-standard ESG metrics with a 2.7/5. Data availability and accuracy is a recurring barrier at all stages of the production of ESG disclosures. Twelve percent of respondents mention data accuracy, including data quality, costs and time, as a determinant in the selection of which ESG information to disclose. Data accuracy is the first factor affecting the release of information, with 25% of respondents spontaneously mentioning this criterion in an open question prompt.

(4) **Strategic and legal concerns.** Before publicly releasing ESG data, companies consider data accuracy (25%), legal and liability concerns (20%), as well as competitiveness and financial

matters (17%) (see charts below). Legal concerns are generally addressed by General Counsel, and competitiveness matters tend to be spread across functions, including the CFO, and those responsible for innovation and risk management (Table 3).

C-suite officers might decide to refrain from disclosing certain data points because of reputational or marketing issues (9% of responding companies). Some of those interviewed echoed the tension between the incentive to disclose more ESG information and the fear of disclosing sensitive information or damaging the reputation of the company. The resolution of this tension depends significantly on management's attitude toward transparency and the company's culture:

> *"[M]y company has a limited disclosure on ESG data, but this is evolving very rapidly due to external pressure as well as internal wake-up on these topics. New top management had a great positive impact in the way ESG data are seen, monitored and it will certainly affect the way we disclose them."*

Consulting firms with expertise in corporate sustainability reporting that were interviewed in the course of this research reported a trend toward greater transparency. Nonetheless, mandatory reporting requirements appear to be the most effective way to restrain the practice of "cherry-picking."

The roundtable participants discussed the importance of corporate values, social expectations and public confidence in shaping their ESG programs and disclosures. The participants emphasized the importance of the direction and tone from the top of their companies in guiding their ESG messages. One participant discussed the tension that can arise between the values the company seeks to promote internally and how that might translate into public disclosures. Sometimes, articulating a statement of values can appear relatively simple and belie the challenges with incorporating those values throughout the company. As companies craft their disclosures, they must be mindful not only of their stated values but also of their values as implemented in practice to avoid claims of greenwashing or "social washing."

The participants broadly agreed that companies face a growing threat of litigation related to their ESG disclosures and the activities of their suppliers. One panelist expressed concern that, as companies report more, they invite "micromanagement" from outside parties and might face enhanced risk of legal challenges to their disclosures. With regard to supply chains, one panelist noted that companies are increasingly seen as responsible for the actions of their suppliers. This presents a concerning challenge, as managing ESG compliance – including specifically adherence to human rights principles – within the supply chain can be difficult. The challenge is exacerbated by the fact that suppliers frequently do not report on ESG information, such as human rights practices. If ESG reporting is based on representations made by suppliers, that requires trust in the information that is reported. One panelist noted that they were aware of a company that had sent drones to monitor working conditions instead of simply relying on supplier representations.

Figure 4. Criteria considered in selecting internal requests
(Respondents could mention more than one criteria)

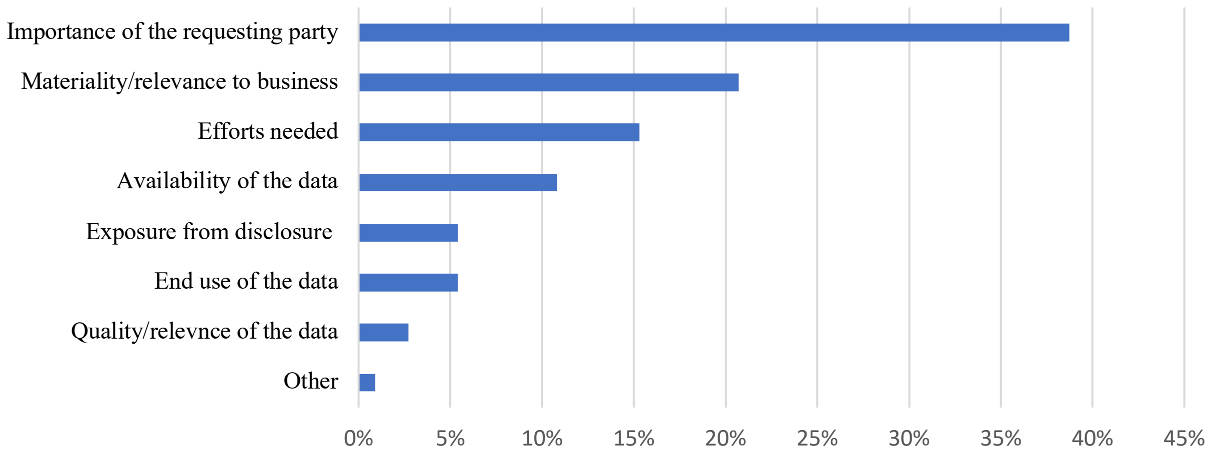


Figure 5. Criteria considered in the design of internally tracked metrics
(Respondents could mention more than one criteria)

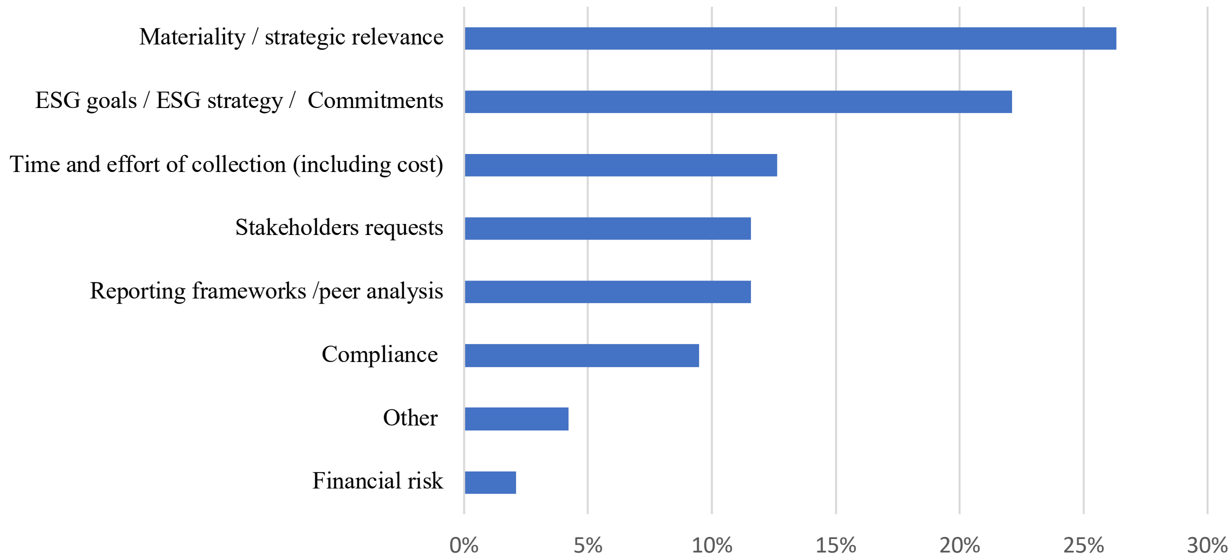
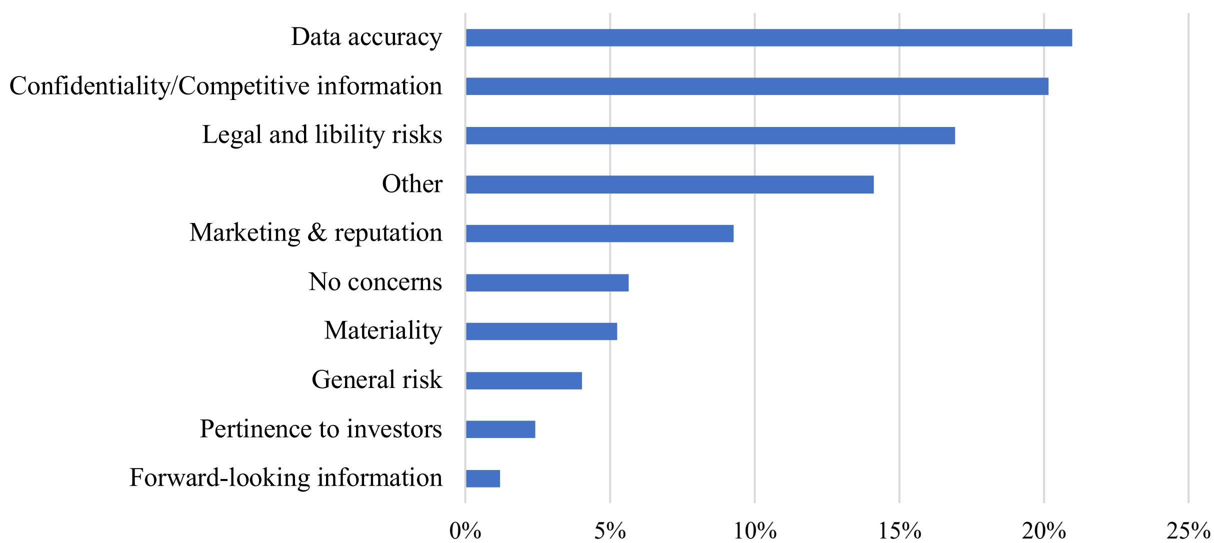


Figure 6. Criteria considered before the release of ESG disclosure
(Respondents can select more than one criteria)



Flow of Decisions Leading to the Disclosure of ESG Information

Figures 7 to 12 help to draw the internal flow of ESG disclosures, i.e., the corporate functions taking responsibility for the selection, generation, control, and release of ESG data.

Similarities: Cross-functional Work Involving the Sustainability Department, Investor Relations, and the General Counsel

The production of ESG disclosures has become a cross-functional effort. Responding companies involve on average 4 corporate offices or functions at each stage of the process with the average number of functions involved in companies with less than 50 employees being 2.5. Three functions are consistently involved across the process: Sustainability Departments, Investors Relations, and General Counsel (Table 2). These teams lead the discussions regarding the selection and the release of the information while operational teams handle the collection of the data.

Perhaps not surprisingly, the Sustainability Department often serves as the "conductor" of the effort to produce sustainability data within the company – organizing and scheduling the involvement of other corporate officials and functions. The widespread involvement of General Counsel reveals the legal relevance of ESG data – and a sense that mishandled disclosure could entail legal risk. This reality explains the "traffic cop" role that General Counsels typically play in the production and review of periodic reports and other documents filed with the SEC – with legal exposure being a reason for modifying or withholding information that might otherwise have been disclosed. The presence of Investor Relations teams across almost all of the stages of ESG data analysis and production again reflects the significant role of shareholder expectations in the generation and shaping of corporate sustainability disclosure choices. In virtually every company from which we gathered insights, operational teams contribute to the generation of the data – reflecting the fact that critical information must be gathered in a "bottom up" manner from functional or facility-level managers. In this regard, we were told that sourcing and supply chain officials are commonly involved and that Human Resource executives might also play a role in ESG data gathering.

Responses to our question 8 (identifying internal factors to ESG data generation) confirms the cross-functional aspect of ESG disclosure generation. Respondents indicated that poor cross-functional cooperation can be a significant barrier to complete and accurate ESG disclosure.

Figure 7. Functions involved in the selection of external requests

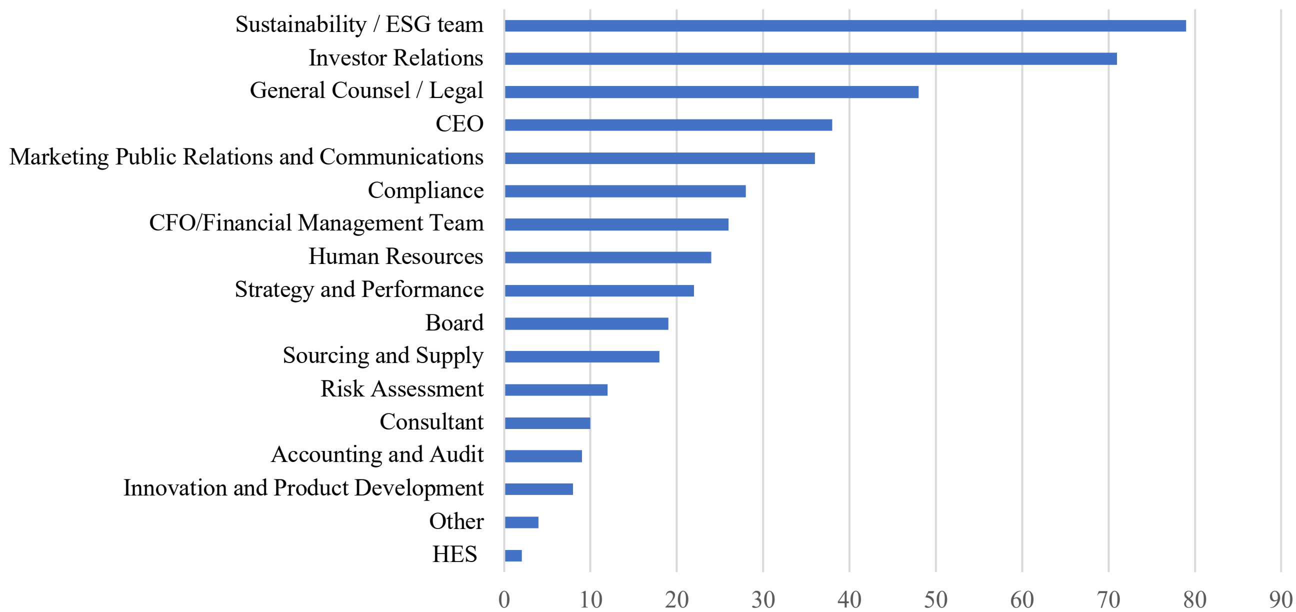


Figure 8. Functions involved in the definition of internally tracked metrics

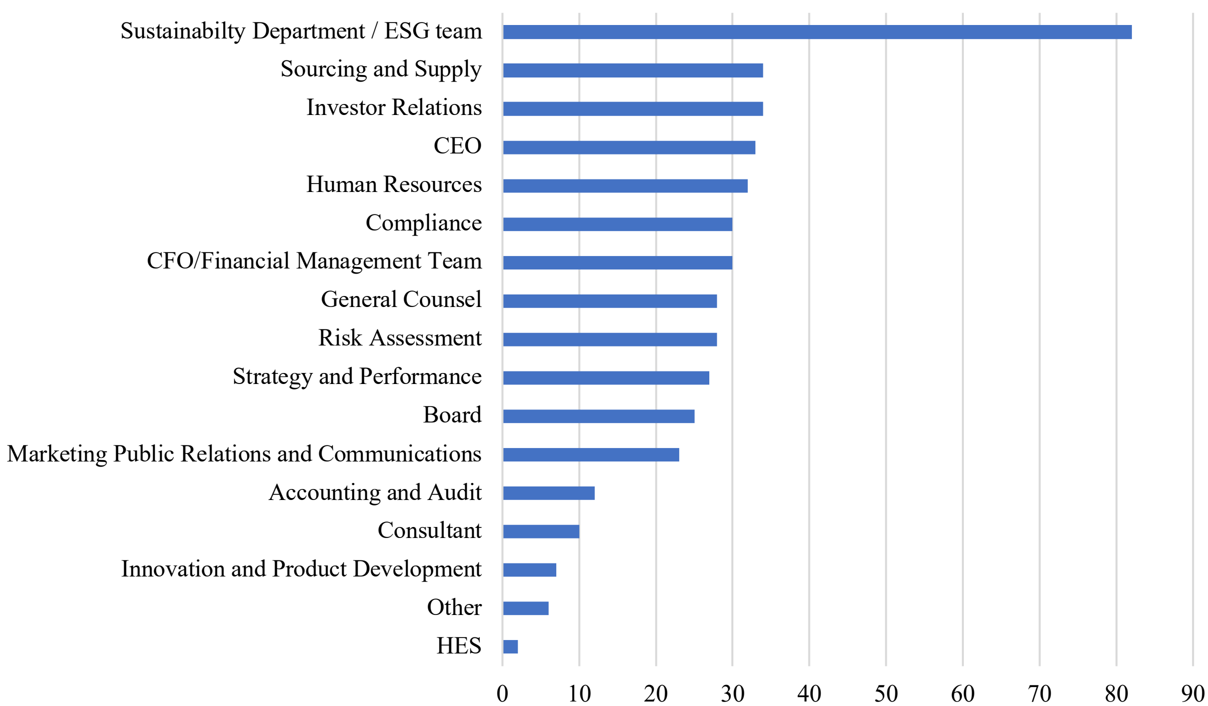
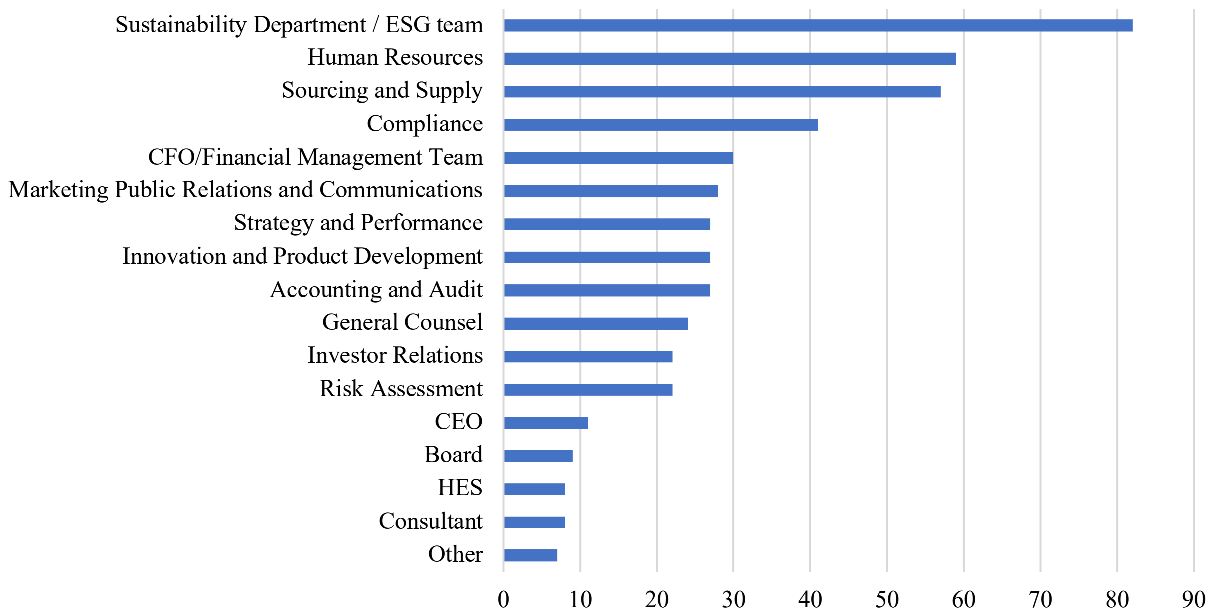


Figure 9. Functions involved in the generation of ESG data



Fingure 10. Functions involved in the quality control of ESG data

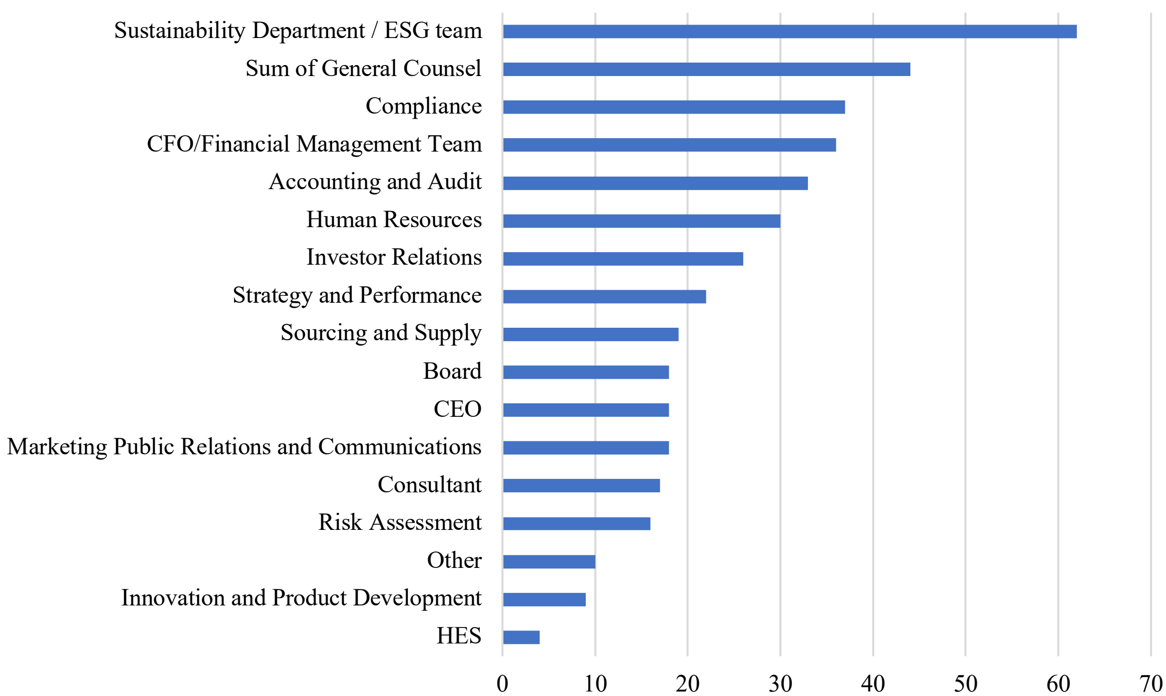


Figure 11. Comparative result: functions involved in the quality control of financial data

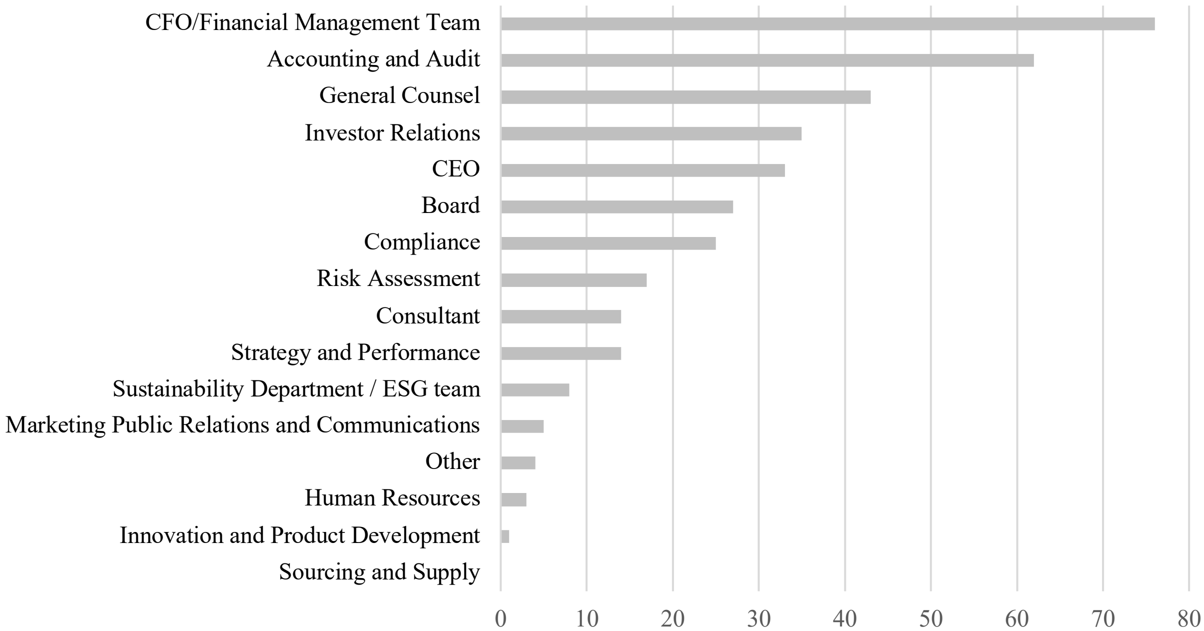


Figure 12. Functions involved in the review of ESG data prior to release

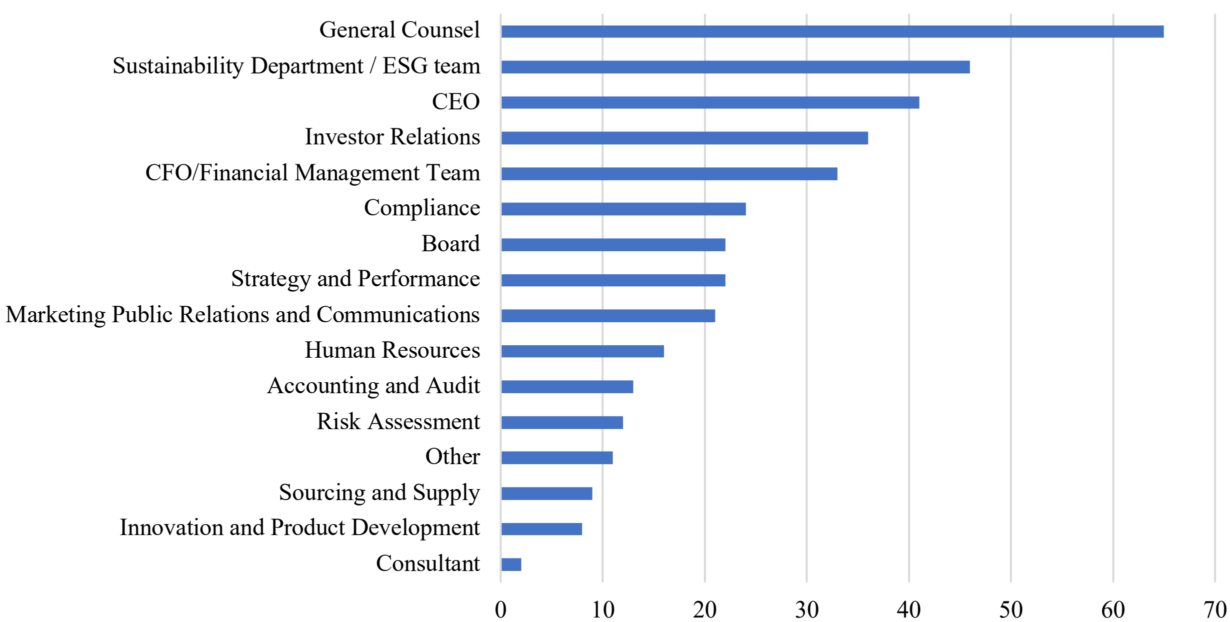


Table 2. Average participation of corporate functions in ESG data generation

Functions	Total count	Average participation in the five stages
Sustainability Department / ESG team	351	3
General Counsel	209	2
Investor Relations	189	2
Human Resources	161	2
Compliance	160	2
CFO/Financial Management Team	155	2
CEO	141	1
Sourcing and Supply	137	1
Marketing Public Relations and Communications	126	1
Strategy and Performance	120	1
Accounting and Audit	94	1
Board	93	1
Risk Assessment	90	1
Innovation and Product Development	59	1
Consultant	47	0
Other	38	0
HES	16	0

Strategic functions (such as boards, CEOs, CFOs, GCs, or the Strategy Department) are often involved in one or several stages of the ESG disclosure generation process. Such functions might contribute to:

- Definition of internally tracked metrics (97% of companies involve at least one of these functions);
- Control of sustainability data (69% of companies);
- Review of sustainability disclosure or the decision of material matters (93% of companies); and
- Definition of material ESG disclosure worth disclosing in financial reports (97% of companies).

Defining the materiality of ESG statements is frequently a cross-functional effort. Companies involve, on average, three functions in the determination of the materiality ESG data, most of which include the financial and legal departments (see Figure 13):

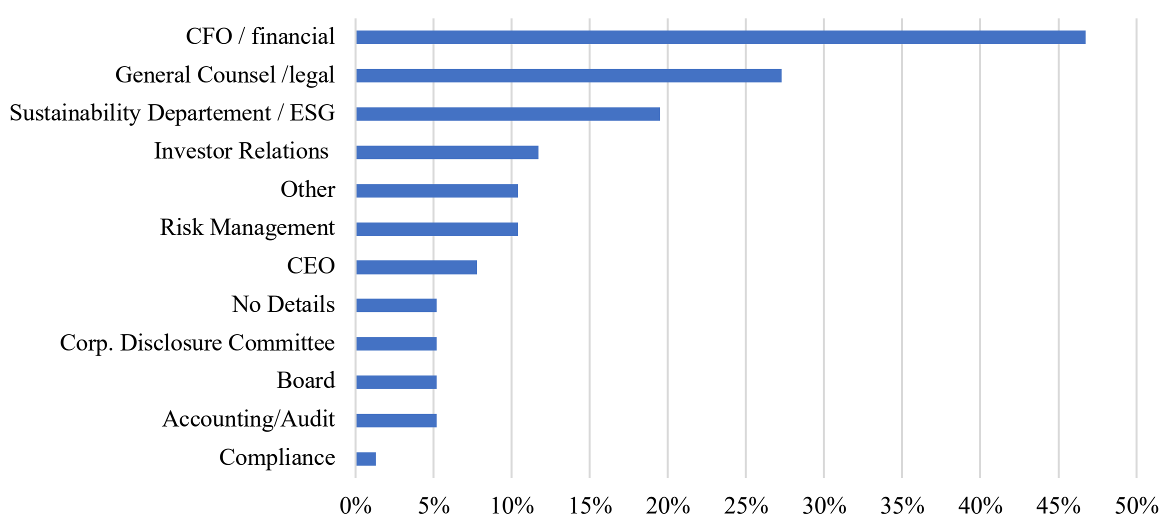
> *"[The decision to disclose material ESG disclosure in financial reports is a] joint decision-making between Sustainability, Investor Relations and Legal, with Legal having the final say."*

However, the involvement of sustainability teams is not a given:

> *"Finance and risk management own [material] disclosures but tend to not consult with CSR team. Unfortunately, they still work independently although it is getting better (main reason is TCFD and more interest on these topics by mainstream investors)."*

Eighty-seven percent of responding companies do not involve the Sustainability Department in the definition of material matters.

Figure 13. Percentage of responding companies involving the following functions to the materiality assessement of ESG data



While many respondents describe established processes to select, generate and review the information, some are still developing their processes:

> *"[We are] in the process of determining [our materiality assessment process]. Early days but [it] will capture attention of all C-suite as ESG rises in importance."*

The production of TCFD-aligned disclosure also appears to foster cross-functional efforts. 92% of large companies (>5,000 employees) are considering reporting pursuant to the TCFD. Most companies involve at least two departments among the legal, financial and sustainability departments in the preparation of TCFD disclosures:

> *"[We are] currently looking into [TCFD] for next year. Finance, Sustainability, Investor Relations, CEO are all involved."*

Methods to Organize ESG Disclosure Processes

The 425 comments provided in the survey responses reveal different approaches to organizing the preparation of ESG disclosures. The responses reveal two types of processes:

- **"Disclosure Committee" approach.** In this model, a selection of personnel from key functions meet collectively to discuss the ESG data collection and reporting strategy. One respondent explains:

  > *"[A]n internal Disclosure Committee approves all data/information prior to public disclosure."*

- **"Division of Labor" approach.** In this model, the Sustainability Department orchestrates the process with each of the functions bilaterally. A respondent explains:

> *"CSR is responsible for pulling info together for internal performance review which then is shared with steering council for review of risk."*

Discretion in the Selection of Data

Although there are some similarities in the ways companies organize their ESG disclosure processes, we observe two important points of divergence: (1) companies are not consistent in the degree of discretion afforded those responsible for the selection and release of data, and (2) companies apply varying levels of controls over the quality of the data.

Respondents' comments illustrate variability among companies with respect to the functions responsible for the selection of relevant ESG data. This decision may take place at various levels:

- **Corporate executives** set sustainability objectives.

  > *"Once leadership has determined what information will be tracked, teams throughout the company must capture and report the information."*

- **The sustainability department** often owns the responsibility.

  > *"Investor Relations and Corporate Sustainability have primary responsibility for external reporting; the other functions generate performance data for internal reporting and for Investor Relations and Corporate Sustainability to report publicly."*

- **Operational teams execute the ESG data production effort.**

  > *"Program managers and senior leaders of operational areas - with insight and guidance from the CSR team - determine what their programs track. Essentially, as long as external baselines are met, programs can capture any additional data needed to provide leaders with the insights needed for operations."*

Although reporting frameworks and peer benchmarking play a role in shaping the metrics chosen for selection (they are mentioned by 12% of respondents), the decision to produce specific data points – and how to produce them – frequently rests in the discretion of the relevant functions within the company. Moreover, once a reporting system has been adopted, it can become entrenched even in the face of changes in reporting practices by peers. Respondents to the interviews confirm that when operational teams collected data points in some fashion for several years, it is difficult for them to adjust their methodology in response to new reporting frameworks.

Table 3. Criteria for reviewing ESG information prior to release

Teams by criteria	Accuracy of the data	Confidentiality / Competitive information	Legal and liability risk	Marketing & Reputation	Other
Accounting & audit	6	2	2	0	4
Risk management team	3	1	1	0	3
Investor relations	4	5	2	0	8
CFO/ Financial team	7	4	3	1	6
Compliance	2	4	2	0	7
GC and legal teams	9	8	22	3	11
Innovation and products	1	4	1	0	1
Sustainability department	15	3	2	1	10
Communications	1	1	1	4	7
Sourcing and supply chain	2	2	1	0	2
Human resources	2	1	2	2	4
CEO	3	3	3	1	12
Board	2	1	0	4	4
Strategy	2	5	0	2	0
Consultant	1	0	0	0	0
Other	0	1	0	0	4
sum	60	45	42	18	83

Financial teams, boards of directors, CEOs, investor relations teams, and General Counsels can all bear responsibility for the review of strategic, legal, and reputational implications of the data. In some cases, the specific responsibilities of the different functions are poorly defined. In discussing responsibilities for the definition of materiality, one respondent explains:

> "*In theory it should be the general counsel's office and/or CFO [who decides upon materiality]. But in practice, it may be no one; this is a gap." "[Teams involved in the preparation of TCFD disclosures include] risk management [and] sustainability. Nothing [was] released as risk decided that it is not material.*"

Another respondent describes the challenge in the following way:

> *"We are still evaluating the appropriateness and feasibility of disclosing relative to TCFD. It's particularly challenging when it comes to financial data because our Finance team really is looking at the reporting REQUIREMENTS. Anything above and beyond what's strictly required gets significant scrutiny and won't be released until the[y] are comfortable that the release of that information will not be perceived as a negative impact on stock value. Their business directives are around financial performance and compliance...ESG is not primary to them. (Despite efforts to convince them otherwise)."*

The voluntary nature of the ESG disclosure process allows for wide variations with regard to who exercises judgement over the release of ESG data. Individual judgment is informed by a mix of expertise (knowledge of the legal or competitive context) as well as by individual perceptions.

The roundtable discussions revealed significant variation among companies as to where ESG compliance and reporting responsibilities reside. Some of the participants formed intracompany working groups to build corporate playbooks and long-term strategies. Some panelists conducted stakeholder engagement exercises and materiality assessments to help them to identify the issues on which to report. The panelists focused on the question of where ESG oversight and reporting should live within the company – and specifically, whether there should be a direct line to the CEO. While some companies concentrated their ESG reporting in the general counsel's office, others noted that corporate teams working on ESG matters are sometimes spread throughout their company. What was needed in those cases, one participant noted, was to have a "hub to the wheel." Another participant noted that ESG reporting needed to be linked to the business itself to ensure consistency between the business' strategy and its public reports.

Varying Levels of Quality Control Over the Data

Another obvious divergence arises from the different levels of quality controls over ESG data. Responsibility for internal controls and verification varies among companies.

- **Operational teams.** Some companies rely on the operational teams to provide data. One survey respondent notes the variability in methodologies applied by different departments within the organization when collecting data:

> *"Each department involved in data generation has its own controlling procedures."*

- **Sustainability team.** Other companies rely on the sustainability department to ensure the integrity of the data. One interview respondent, the head of the sustainability department of a large U.S. firm explains:

> *"If the General Counsel comes to me with questions around data accuracy, it means that I have failed in my job."*

- **Internal controls.** Some companies use internal controls and/or external assurance to ensure the quality of ESG disclosures:

> *"Our ESG data pulls from a number of teams, and each team is responsible for ensuring the quality of data and participating in the internal audit and assurance process. Our most significant ESG metrics are subject to Limited Assurance by an external third-party, while others go through Internal Audit."*

- **Financial and ESG data reviewed using the same standards.** Finally, three companies in our sample endeavor to verify ESG data using the same standard as financial data. A UK company explains:

> *"The review process does differ [between ESG and financial data] but we are trying to bring alignment through the use of ISAE3000 for non-financial data."*

Compliance continues to play a central role in quality control over ESG data. Nine percent of the firms surveyed rely solely on the compliance office to perform the quality control of their data and an additional 9% rely on their accounting and auditing functions. The remaining 82% involve at least one of the following functions: Finance, General Counsel, Strategy, CEO, or the Board of Directors.

When asked why the level of assurance and control for financial data may be different than for ESG data, most U.S. respondents do not question this difference:

> *"There is a sense that financial is required (vs ESG voluntary) and therefore requires a higher level review;" "ESG data is wider than financial."*

Three respondents point to the difference in resources available to the different functions:

"[We assure] ESG data [under] limited assurance, [we assure] financial data [under] reasonable assurance; [the] difference [is] due to amount of resources invested."

Survey Conclusions

Sustainability disclosure issues are integrated throughout most key functions of the participating companies, including the strategic, financial, and legal functions. In selecting the ESG data on which they report, companies balance such factors as the identity of the party requesting the information, the information's business relevance, and the availability of the data. C-suite officers tend to take the lead in decisions as to whether to release ESG data and which data to release, taking into account the strategic and legal implications of the disclosures.

Concerns over data integrity remains a barrier to the production of ESG data throughout the disclosure process, from selection to the release of data. We observe notable differences in the levels of quality controls, with a minority of firms using internal control systems. We also observe variances among companies with regard to who is responsible for the accuracy of the data.

The results point to a clear need for standards that guide companies in how to collect, compile, and verify ESG data, as well as how to establish basic guidance on what data to disclose. The recommendations below suggest ways to strengthen the disclosure of reliable and robust ESG information that would be seen as *actionable* by investors.

RECOMMENDATIONS FOR MORE ROBUST ESG REPORTING

We offer five recommendations to address the barriers to more effective ESG reporting as identified above. In brief, we propose the establishment of:

(1) A standardized ESG reporting framework (building on existing structures from GRI, SASB, TCFD, and the World Economic Forum) that would establish: (a) a *core* set of ESG metrics and reporting methodologies for all companies with additional standards for (b) industry-specific disclosure obligations as well as (c) a platform for company-determined additional information;

(2) A validation mechanism that would provide for all of the reported ESG information to be reviewed and certified by third-party auditors as a way to improve the integrity of the information reported and build investor confidence in ESG metrics. This assurance process would either be mandatory or voluntary and tied to a safe harbor that would offer protection from litigation for validated disclosures;

(3) An initiative to harmonize the disclosure requirements across jurisdictional borders – perhaps coordinated by the OECD, IOSCO, the World Economic Forum, and/or the Sustainable Stock Exchange Initiative;

(4) Sectoral working groups to review and refine the industry-specific ESG reporting standards – perhaps organized by SASB, or hosted by the WBCSD; and

(5) Training programs for critical actors responsible for the production, verification, and assurance of reported ESG data – including chief sustainability officers, corporate counsel (both in-house and external), and the auditing community.

1. Standardized ESG Corporate Reporting Framework

We recommend the adoption by the SEC, of a mandatory ESG reporting framework for U.S. publicly traded companies. The framework we envision would build on the work of the GRI, TCFD, SASB, CDP, and the WEF. Specifically, we suggest that these multiple reporting platforms be woven into a common framework that would ensure the methodological rigor and consistency of standardized ESG metrics. Consistency must be addressed at three levels:

- *Consistency in the information released*. Our research demonstrates that, in the absence of a clear standard, corporate agents use their own individual judgment in deciding what information should be released and what methodology should be followed in generating metrics. A tiered approach to standardization – described below – will clarify the reporting requirements for all companies and consolidate the existing voluntary reporting frameworks.
- *Consistency in the methodologies underpinning the production of similar metrics*. We recommend the articulation of defined methodologies for compulsory metrics. Reporting companies and auditing firms would then be expected to align their ESG data gathering and assurance activities with these methodologies, thereby working toward the standardization of reported ESG data.
- *Consistency in the data collection and review processes*. Our survey shows disparities in the implementation of internal controls. The standardized framework would provide a set of best practices for internal systems.

Such a framework would help to drive the comparability of data and processes across companies, thereby facilitating benchmarking and comparison across companies. To meet the dual objectives of comparability and completeness, we envision a tiered reporting structure.

- The *first tier* would specify a core set of ESG metrics on which all companies would be required to report. It would also provide clear guidance as to the appropriate methodology for calculating each metric.
- The *second tier* would identify an additional set of industry-specific metrics, reflecting the salient sustainability issues of that industry group or sector. The goal would be to capture critical issues that vary from industry to industry, similar to and building on the approach taken by SASB.
- The *third tier* would provide a company-specific platform for the disclosure of any additional sustainability issues or metrics that a company deems material or any other sustainability data or information on the company's sustainability activities or initiatives that help to explain or contextualize the reported ESG data. This third tier of ESG reporting would provide a flexible framework for companies to share both quantitative and qualitative information with markets and stakeholders.[125]

The three ESG disclosure tiers are discussed below in more detail.

We propose that companies furnish this sustainability document annually, as an exhibit to the company's annual report on Form 10-K filed with the SEC (or Form 20-F for Foreign Private Issuers). By furnishing the document rather than filing it, the document will be subject to the antifraud provisions of Section 10(b) of the Exchange Act, and will be broadly accessible to shareholders, but it will not be subject to the heightened liability risks associated with documents that are *filed* with the SEC. Companies would continue to be required to disclose information in the body of the Form 10-K or incorporate such information by reference to the sustainability report if such disclosure is required by the Exchange Act rules and by Regulation S-K.

Simply put, the proposed framework for ESG reporting provides a basis for separating sustainability leaders from laggards with a higher degree of confidence than under the existing disclosure system. The proposed framework is designed to provide "investment grade" ESG data, on which investors can rely in making their investment decisions. Investors clearly require more consistent, reliable ESG information from companies to properly steer capital toward climate change leaders and away from companies that are lagging in their response to climate change and the sustainability imperative more generally.

We believe that a mandatory ESG reporting framework backed by government regulations will be necessary to ensure consistency and comparability in reporting, provided that companies adhere to the standards and follow proper methodological standards. A uniform, prescribed ESG reporting framework would prevent companies from "cherry-picking" – that is to say, reporting only the most flattering ESG metrics and other sustainability information. It would also ensure that sustainability laggards do not sit silently on the sidelines while others report. And the standardization of reporting requirements would also eliminate fears related to litigation – so long as companies are being truthful in what they report. In addition, we recommend the adoption of a "comply or explain" disclosure provision to enable the omission of information by companies with a good basis for such exclusion, provided they disclose the reasons for the omission.

To incentivize disclosure transparency, we would propose the establishment of a *safe harbor* that would ensure that companies that disclose ESG information according to an established protocol would be free from liability for the information put forward. Because some ESG disclosures are retrospective, the existing safe harbor under the Private Securities Litigation Reform Act (which only provides protection for forward-looking statements), is of limited utility to companies currently contemplating ESG disclosures. Such a safe harbor should be subject to conditions designed to enhance the dependability and integrity of the information disclosed. For example, the safe harbor should be available only to companies that follow the disclosure rules as described in this White Paper. The safe harbor would be unavailable to companies unless they act in good faith in collecting and reporting their ESG data. Further, the safe harbor would be conditioned on the company's having obtained at least limited assurance or other prescribed level of audit review to verify the integrity of the ESG data that is disclosed.

Tier 1: Core Metrics

The first element of this reporting framework is a core set of metrics (quantifiable indicators), shared across all industries. These metrics will be limited in number to minimize the burden on companies and to ensure that the information disclosed is of significant interest to investors. Standardizing this set of disclosure metrics is important as it will bring consistency and comparability to the available ESG data and enable investors to make side-by-side comparisons of companies. At the same time, the universe of such mandatory disclosure metrics is necessarily small. It serves neither investors nor companies for companies to disclose volumes of immaterial information that might obscure the material information that investors need. Companies, for their part, should focus their disclosure time and effort on information that will be useful to investors. We envision this universe of core metrics as small, encompassing fewer than 30 data points across all ESG categories. The core metrics will build on existing ESG frameworks. The 2018 list of 30 metrics issued by the World Federation of Exchanges (supported by the Sustainability Stock Exchange Initiative) provides a good starting point in identifying the key universal ESG metrics that should be applied across companies.[126] These might be considered along with metrics articulated by other organizations, including the World

Economic Forum, GRI, SASB, CDP, TCFD, and CDSB. While firms' quantitative indicators will be disclosed in Section 1, qualitative elements – essential to describe existing processes and governance structures in connection with sustainability – will find their place in Tier 3, which will be dedicated to company-specific elements. The core set of metrics should consist of fundamental and universal ESG factors that would be important to investors in virtually any company. These metrics might, for example, include climate risk related to emissions, climate risk related to adaptation, supply chain environmental compliance, supply chain social compliance, product responsibility, workforce health and safety, workforce and board diversity, and workforce fair wages.

Tier 2: Industry-specific Standards, Including Salient Issues and Indicators

Sustainability challenges vary from one industry to another and not all industries present the same disclosure concerns. The second section of our reporting framework will consist of an industry-specific reporting standard, where firms will report on the most *salient issues* in their industry, disclose pursuant to broader-based disclosure principles, and provide associated metrics where relevant. The compulsory reporting scheme will build on the work developed by the SASB and the GRI, which have already identified material issues by industry. With regard to climate information, the framework could draw on the CDP and TCFD.

The industry-specific *indicators* could be based on existing reporting frameworks, such as the SASB or the GRI Sector Program. Each metric selected will be underpinned by a public-available disclosure methodology that will facilitate the use of consistent language and measurement processes. The design of industry-specific metrics might be more challenging than the design of a core set of metrics for all industries. A substantial number of respondents to our survey expressed skepticism as to the comparability of companies within their own sectors.

Other respondents expressed concern that such an endeavor would delay the publication of the core set of metrics, much needed for the company and investor communities.

Tier 3: Company-specific Platform, Including Salient Business Risks and Societal Impacts

The proposed framework will leave ample space for the description of company-specific information noteworthy to investors and a wide array of stakeholders. Of course, companies must make disclosures required by existing SEC regulations. However, mainstream and sustainability-minded investors expect a wider array of company-specific information, indicative of company's long-term value and societal impact. Moreover, many companies wish to voluntarily disclose additional information to supplement the required ESG disclosures.

This third section of the reporting framework should therefore encompass the reporting of additional *salient issues* specific to the company, including:

- Disclosure of company-specific governance structures. This information might be informed, for example, by the GRI and CDP.
- Additional ESG information important to company stakeholders, as revealed through a "stakeholder materiality matrix,"[127] constructed following the GRI's materiality assessment process. By engaging with their stakeholders, firms should be able to identify salient issues that might not otherwise be required disclosures, and that have not been identified under their industry framework.
- *Company-specific salient business risks* (which might be identified through established risk assessment processes such as enterprise risk management, or TCFD scenario analysis).

- *Societal and environmental risks* stemming from companies' core activities and their supply chains (with reference to the processes by which they have been identified).
- Publication of a risk mitigation plan to prevent and mitigate those environmental and social risks as well as corruption activities.

Companies operating in the European Union already comply with the last three provisions under the European Directive on Non-Financial Disclosure. Aligning U.S. and European requirements would represent an important step toward the standardization of reporting practices. The requirements would work as a compass for other jurisdictions. It would provide greater clarity to reporting companies and alleviate some of the difficult issues such companies face when reporting under different regulatory regimes.

Finally, this section would be the repository for any additional information, data or process related to the company's ESG matters that the company elects to make public.

Public Methodologies for Compulsory Metrics

Each core standard would be underpinned by specific methodologies and definitions that can help to ensure consistency and uniformity of disclosures. Following the example of the GHG Protocol,[128] these methodologies will provide guidance to corporate staff and auditors. They will enable the comparability of data and help to fill any data gaps that exist. A respondent to our interview, mindful of the importance of careful attention to the details, advised that the methodology be fashioned after the International Standard Organization (ISO)[129] standard setting processes – and perhaps framed by the ISO itself. According to this respondent, ISO's guarantees over the consultation process would facilitate the international uptake of such methodologies.

Standards for Internal Controls

Internal control plays an essential role in ensuring the quality of ESG data. We suggest that the standardized reporting framework mandated by the SEC include a set of standards on internal controls including the processes by which data is collected and aggregated, and the underlying documents necessary for the audits. The SEC could list best practices or refer to guidance from an external association like Committee of Sponsoring Organizations of the Treadway Commission.[130]

2. Mandatory Assurance Requirement

External assurance contributes to investors' confidence in the reported ESG information. As explained in the results section, external assurance not only ensures the integrity of corporate ESG data, but also strengthens internal processes in audited firms – working as a catalyst for staff training and the implementation of collection tools. Thus, we recommend that third-party assurance be compulsory for sustainability disclosure documents. If third party assurance is not compulsory, it could, at a minimum, be discretionary but tied proposed safe harbor protections, as described above.

Auditing firms will control the integrity of all the quantifiable metrics disclosed in the sustainability document. The SEC might raise the assurance expectations progressively, giving companies time to implement collection and verification processes. In the long run, the auditing requirements should equate to financial standards, as required in a few European countries.[131]

3. Harmonization of ESG Disclosure Requirements Across Jurisdictional Borders

The harmonization of ESG disclosure standards across jurisdictions is a desirable outcome both for companies, who express concern about the liability risk associated with their attempts to comply with disparate reporting requirements across jurisdictions, and investors who seek market-wide comparability. This harmonization process could be supported through two channels: (1) the promotion of cross-regional coordination among policymakers and regulators, and (2) the promotion of common best practices among stock-exchanges.

First, it is important to facilitate dialogue among policymakers and the regulators across the globe to facilitate the development of consistent and harmonized reporting requirements. The OECD and IOSCO are well positioned to connect governments and advise on the formulation of new regulatory developments. The regulators – ESMA, the SEC, and their Asian, African, and Latin-American counterparts – should probably have a space for additional exchange. While the IFRS does not plan to develop standards for sustainability reporting,[132] it could still facilitate discussion among regulators working toward the harmonization of their standards.

At the exchange level, the Sustainable Stock Exchange (SSE) Initiative, co-founded by the UNEP-FI and the PRI, spearheaded an effort by 33 stock exchanges to develop ESG disclosure guidance. Based on the SSE guidance, the World Federation of Exchanges has proposed 30 metrics to be adopted by local exchanges.[133] Working in collaboration with many of the leading stock exchanges, the SSE could facilitate the establishment of a common reporting framework fashioned on the proposal described herein.

4. Working Groups to Ensure the Refinement and Improvement of Reporting Standards

Best practices in corporate sustainability reporting continue to evolve. To keep pace with the latest developments, we suggest the establishment of an overarching ESG reporting working group, composed of financial institutions, companies, NGOs, and auditors. This working group will seek to refine and improve sustainability reporting, taking into consideration the latest developments in the field. Every two years, the working-group will produce a short non-binding guidance for companies on how to articulate new voluntary frameworks in the standardized reporting framework.

We also recommend the establishment, for each sector, of one industry-led working-group. These working groups, working in tandem with auditing firms, will pursue the standardization and operationalization of industry-specific standards. In simple terms, they will support the development of common processes, metrics, and methodologies in furtherance of the recommendations of, and drawing on the work of SASB, GRI, and the TCFD. Such initiatives have already taken place on an ad-hoc basis. In the banking industry, a dozen international banks partnered with the UN-PRI and co-developed two methodologies to assess the transition and physical risks of their assets, according to the TCFD recommendations.[134]

In global industries such as banking or energy, the WBCSD is well positioned to host these working groups. The WBCSD already animates similar working groups on targeted issues.[135] For dispersed industries on the other hand, domestic associations might be better positioned to host these discussions. In the long run, these intra-sectoral discussions could make an important contribution to the harmonization of reporting requirements worldwide.

5. Training and Development Programs for Critical Actors Responsible for the Production, Verification, and Assurance of Reported ESG Data

Investors' enhanced attention to ESG issues and the complexity of those issues creates challenges for companies and their officers, directors, and advisors in managing and reporting on their material ESG issues. Those interviewed in our survey expressed concern with regard to the best methodologies by which to identify, measure, and manage ESG risks and opportunities. How to identify material issues? To what extent can ESG disclosure reveal a competitive advantage? What liability arises from sustainability disclosures? How can the production and disclosure of ESG information across all operations be made more efficient? Most C-suite officers face the same questions, yet they have not found a space to learn and exchange ideas and information. We suggest using the outreach of organizations such as the WBCSD and the educational know-how of universities to develop a simple, yet effective, Executive Education Program (Exec-ed). This program could take the form of a two-day fast track Executive Program by function, including internal and external legal counsel.

At the company level, investor pressure for data integrity has percolated to operational staff in charge of the generation of the information. Operational teams are being asked to collect data from sites in a multitude of countries with uneven practices, regulations, and obligations. Corporate staff are rarely trained to perform such tasks. Trainings, developed in coordination with auditing firms, might facilitate the accurate and efficient collection of that data.

Finally, the auditing industry has recognized the need for a convergence of reporting standards for ESG information and sustainability reporting has been the subject of significant discussion by the IASB and FASB.[136] We would suggest that the auditing profession is a critical voice in this discussion as it serves an important role in ensuring consistency and quality of the data reported. At the same time, companies are under significant strains to meet their existing reporting obligations. As we construct a new reporting framework, engaging with the accounting profession as to how companies can cost-effectively gather and report useful information and obtain a reasonable level of assurance to validate the integrity of that information will be imperative.

CONCLUSION

The reporting landscape for ESG disclosures is vast, messy, and complicated. As investors place increasing importance on ESG data, the calls to bring order and consistency to the reporting systems around the world grow louder and more frequent. There are numerous different reporting frameworks and systems in different jurisdictions. In the United States, the reporting framework under the rules promulgated by the SEC are "principles-based," meaning that the SEC has set broad principles that it expects companies to follow and leaves it to reporting companies to determine what information to report and in what format. There is significant inconsistency in how companies report their ESG data. Some companies make deep, meaningful disclosures, while others make little or no disclosure. Investors have been clamoring for better ESG disclosures and have expressed frustration with the lack of comparability and usefulness of the information disclosed. In the absence of prescriptive guidance from the SEC, a host of "voluntary" disclosure regimes have emerged – sometimes referred to the alphabet soup of standards, including TCFD, SASB, CDSB, GRI, CDP, UN SDGs, and others. Companies have no meaningful guidance as to what standards to follow and investors are no closer to having the standardized, consistent, decision-useful information that they want.

Compounding the problem, a host of third-party ratings firms have emerged that ask companies to complete burdensome questionnaires and surveys that frequently elicit information that is not particularly relevant to the companies' operations. Companies spend significant time and money responding to these third-party surveys but the surveys themselves are of varying quality and utility – thus tending to yield reports that are not consistent with one another. Indeed, the top-line "sustainability" scores of the two leading private data providers – MSCI and Sustainalytics – show a shockingly low 0.32 correlation.[137] The result is that companies are over-taxed with questionnaires and investors still do not have the comparable, decision-useful information they need to properly integrate ESG risks and opportunities into their investment analyses. Investors need a standardized ESG reporting framework – and society would benefit from great clarity on which companies are leading the way to a sustainable future and which are not. Many initiatives are underway to strengthen sustainability reporting, including those led by the World Economic Forum, the WBCSD, and the proposal for an updated European Directive with consolidated standards. We call for these reporting standards to meet three objectives: (1) a consistent disclosure infrastructure organized around three tiers (a core set of metrics, sector-specific disclosure, and company-specific information) which would provide for comparability and integrity while providing space for individual company context; (2) public and common methodologies for development of core metrics; and (3) methodological standards for internal quality controls.

We hope that, in the United States, the SEC might be able to adopt such standards in short order in response to the growing demand from investors and companies. The foundations for such an initiative are all in place.

ENDNOTES

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