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ESG Disclosures — Considerations for Companies

Recent months have seen institutional investors, multinational organizations and the private sector emphasize the lack of (and importance of) comparable and decision-useful ESG disclosures. Some of the key issues in considering ESG disclosures are:

Choice of Framework and Content. Despite the growing recognition of the need for standardized reporting metrics, companies continue to face a myriad of choices as to how and where to present ESG disclosures. To date, the largest US public companies that disclose this information often report against some portion or combination of the Global Reporting Initiative (GRI), the Sustainability Accounting Standards Board (SASB), and the Task Force on Climate-Related Financial Disclosures (TCFD) standards. Other significant frameworks include those developed by the International Integrated Reporting Council (IIRC), the UN Global Compact and related Reporting on the Sustainable Development Goals (SDGs), the CDP (formerly the Carbon Disclosure Project) and the Climate Disclosure Standards Board. Some or all of the common metrics proposed in the World Economic Forum's (WEF) consultation draft will also likely become part of this landscape.

Materiality Standards. While each of the frameworks recognizes that specific ESG topics have varying impact on companies, the frameworks have significant differences in determining which topics should be covered. SASB, for example, references *financial materiality* with 77 industry guides outlining the material issues in any particular industry, while GRI requires disclosure against topics that affect a company's *stakeholders* and that reflect a company's "significant economic, environmental, and social impacts" or "substantially influence the assessments and decisions of stakeholders." GRI contemplates that an organization will determine the issues that are material to it in consultation with stakeholders, and provides corresponding detailed issue-by-issue guidance. The TCFD keys off the standard used in financial filings, and the WEF draft contemplates a "comply or explain" standard. In making disclosures, companies should be clear if references to materiality differ from (or are more expansive than) historical securities law constructs.

Disclosure Formats. The frameworks accommodate disclosure in a variety of documents. SASB's standards are designed to be "used in core communications to investors" but it requests companies to "assess the pros and cons" of each channel, taking into consideration input received from shareholders and consultation with auditors. GRI disclosures can be made in "a variety of locations and formats" as long as they reference the GRI standard they are reporting on, and are cross-referenced into a central index. The TCFD contemplates disclosure in mainstream filings, but recognizes that at least some disclosures may be in supplemental reports.

Many companies disclose the most material elements of their ESG governance and strategy in their SEC reports, focusing on qualitative discussions of items that are material to management and strategic planning of the business in accordance with the SEC's guidelines concerning climate change information and non-financial disclosures, and include more detailed metrics in separate sustainability reports, which often include an index demonstrating compliance with one or more of the major disclosure frameworks. Within the past year, several major companies have also issued inaugural human capital management reports. Other reporting avenues include integrated reports that combine financial data with ESG disclosures and sustainability-related information as well as more general

investor relations websites, proxy statements, presentations during earnings calls, investor days and non-deal road shows (NDRs) and sustainability-specific forums, as well as regulatory filings.

Foreign Disclosures. Outside of the US, certain ESG disclosures have become mandatory. Under the EU Commission's Non-Financial Reporting Directive, certain large EU companies are required to report on environmental protection, social responsibility and treatment of employees, human rights, anti-corruption and bribery, and board diversity. This disclosure is required where necessary to understand the company's financial performance *or* the impact of its activity.

ESG Ratings. The primary direct consumers of ESG information now include ratings agencies and investors, with ESG metrics affecting investment decisions and availability of capital. Sustainalytics, one of the largest ESG ratings agencies, evaluates companies on a sector-specific basis focusing on ESG risk management. State Street has developed its own proprietary ESG ratings system called R-Factor™, which draws on ESG data from the ratings agencies Sustainalytics, ISS-ESG, Vigeo-EIRIS and ISS-Governance, and is focused on financial materiality. There are many other providers of ESG ratings; as companies provide more uniform and comparable data and metrics, the utility and impact of third-party rankings will increase.

Strategic Opportunities. In addition to direct effects on investment decisions, ESG disclosures present an opportunity for companies to highlight the integration of ESG factors into longer-term business strategies. Such disclosures can be made alongside specific metrics and may prove useful for companies seeking to demonstrate plans to change or improve their business, including new business opportunities, as well as actual or intended improvement in areas where they lag behind peers and industry leaders. In making such disclosures, it is important to consider the time horizons of the company's key stakeholders and provide information that tie disclosed metrics with long-term business resilience and sustainability.

Risks. As noted in our prior memoranda, ESG-related statements and failures to disclose material trends can become the basis for securities litigation and enforcement action. Companies should ensure that appropriate controls are in place and consider whether external assurance, validation or review is necessary or appropriate as to specific ESG disclosures.

Targets and Goals vs. Descriptive Data. Currently, ESG disclosures primarily focus on expanding transparency regarding current (and historical) ESG performance against various metrics. However, providing forward-looking ESG performance-related information, both qualitative and quantitative, will become increasingly common. How a company conveys aspirations and shows progress in ESG areas, whether a company selects specific targets or goals to achieve and when and whether a company publicly discloses any ESG-related targets, goals or forecasts will become important strategic decisions with significant legal and practical implications in this new era.

The ESG disclosure and performance landscape is evolving rapidly, and we are monitoring that evolution. Companies would also do well to monitor disclosure trends and evaluate if they have the internal capacity to meet emerging reporting demands and requirements.

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