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ESG Metrics in MD&A Disclosures – SEC Legal Guidance

In the midst of the public market push for a standardized ESG disclosure framework, the SEC has published guidance on including key performance indicators (KPIs) and metrics in Management's Discussion and Analysis (MD&A) disclosures. While not aimed specifically at ESG measures, nor mandating any new disclosures, the guidance references several ESG-type measures (such as energy consumption and employee turnover) as KPIs that might be included in MD&A. The guidance applies to non-financial and financial metrics and may prove useful for companies looking ahead to their first-quarter (and future) disclosures.

The SEC affirms that companies should, in MD&A, identify and address "those key variables and other qualitative and quantitative factors that are peculiar to and necessary for an understanding and evaluation" of the business and accordingly material to investors. KPIs and metrics may meet the foregoing test, in which case MD&A disclosure would be required, and may also be voluntarily disclosed. The SEC believes that metrics disclosed in MD&A should not "deviate materially from metrics used to manage operations or make strategic decisions."

Where metrics or KPIs are disclosed in MD&A, the guidance requires that companies include any material information that may be necessary to make the measures not misleading as presented, including defining the measure clearly and laying out how it is calculated and explain why the metric is useful to investors and how it is actually used in monitoring or managing business performance. In addition, companies should, where material, set forth estimates or assumptions necessary to prevent a disclosed measure from being misleading and provide the information necessary to understand how a calculation or presentation has changed as compared to prior disclosures and, potentially, recast prior metrics to conform to current presentation depending on the significance of the change. The SEC also reminds issuers of the need to maintain effective controls and procedures in connection with disclosure of KPIs and metrics. Companies considering including new metrics in their MD&A should involve both their audit committees and their external auditor appropriately in advance of any such disclosure.

In applying the new guidance, companies are reminded to confirm whether specific ESG-related metrics to be disclosed are measures of operating performance or statistical measures rather than non-GAAP financial measures

subject to additional regulation and disclosure requirements. In addition, companies should review metrics and KPIs disclosed outside of the MD&A to determine whether similar disclosure is required within the MD&A.

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. The SEC's guidance in the MD&A context that supplemental disclosures may be required to make metric-related statements not misleading could be applied to similar legal frameworks made outside of the MD&A (including in registration statements and proxy statements) and may be cited by shareholder plaintiffs asserting that a company's disclosures are false and misleading or feature material omissions.

Public companies considering disclosure of KPIs, including ESG-related metrics, in financial reports or other publicly released information should consider this new guidance carefully. The new guidance will impact how companies make such disclosures and encourage companies to provide appropriate context and implement necessary supporting processes. Companies should continue to monitor ongoing developments in voluntary ESG disclosure frameworks, including the considerations highlighted in our recent ESG-related guidance.

David M. Silk
David B. Anders
Mark F. Veblen
Sabastian V. Niles
Lauren M. Kofke
Carmen X. W. Lu