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GAO Report Highlights Dearth of Comparable, Decision-Useful ESG Disclosures; Senator Warner Seeks Task Force on ESG Metrics

A report published by the United States Government Accountability Office (GAO) earlier this month has further highlighted the dearth of comparable, decision-useful ESG disclosures sought by investors. Commissioned by U.S. Senator Mark Warner, the report noted that most institutional investors contacted by the GAO seek ESG information to enhance their understanding of risks and to assess long-term value. The report also noted challenges with understanding and interpreting both quantitative and narrative ESG disclosures, and that the quality and relevance of such disclosures to investors remain highly variable. Following the release of the GAO report, Senator Warner called on the U.S. Securities and Exchange Commission (SEC) to establish a task force to determine a robust set of quantifiable and comparable ESG metrics to be disclosed by all public companies. Senator Warner had previously pushed for more extensive disclosure of human capital-related metrics in light of their materiality to most businesses.

The GAO's findings echo similar sentiments among the investor community, who, along with other stakeholders, have noted the growing need to establish a standardized ESG disclosure framework to facilitate the disclosure of decision-useful information. Various private-sector initiatives are already in progress—the World Economic Forum's International Business Council earlier this year released a consultation draft of core and expanded ESG disclosures drawing on metrics from existing ESG reporting frameworks. Likewise, the Sustainability Accounting Standards Board (SASB) and the Global Reporting Initiative (GRI) have pledged to work together to align ESG reporting standards.

Federal regulators in the U.S., however, have continued to proceed cautiously, and we expect that principles-based disclosure rooted in materiality will remain the core organizing framework for the application of U.S. securities laws. The SEC's Investor Advisory Committee has recommended that the SEC begin an effort to update reporting requirements of issuers to include material, decision-useful ESG disclosures. However, to date, the SEC has not indicated an interest in requiring disclosure of specific cross-industry metrics that would capture the full ESG universe. Meanwhile, the Department of Labor recently proposed for public comment rules that would further burden the ability of fiduciaries of private-sector retirement plans to select investments based on ESG factors and would bar 401(k) plans from using a fund with an ESG mandate as the default investment alternative for non-electing participants.

Among investors surveyed for the GAO report, most sought ESG disclosures primarily to better understand and compare risks. ESG disclosures were also used to inform shareholder voting, for the creation of ESG funds and portfolios and to inform decisions on whether to divest from a company. The investors noted faults with both qualitative and quantitative ESG disclosures currently offered by companies, particularly the challenge of deciphering the "variety of different metrics that companies used to report on the same topics, unclear calculations, or changing methods for calculating a metric." Investors also indicated that "some narrative disclosures contained generic language, were not specific to how the company addressed ESG issues, or were not focused on material information." The GAO's own review of ESG disclosures corroborated the investor perspectives, with the report's authors finding several cases where companies used different definitions or calculations for the same topics. Such inconsistencies were most frequently found in disclosures relating to climate change, personnel management, resource management, and workforce diversity—all of which are priority ESG issues for investors.

With the current pandemic bringing ESG issues closer to the fore, and growing evidence that ESG-oriented investments can help mitigate risk and potentially outperform the rest of the market, the demand among investors and other stakeholders for quality ESG data will likely continue to grow. In the near term, it appears that private-sector led initiatives will spearhead efforts to address some of the gaps and shortfalls in current ESG disclosures.

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