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Client Memorandum

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SEC's Coates Calls for "Adaptive and Innovative" Policy on ESG Disclosure

This client alert, part of a series focused on ESG disclosure and regulatory developments, should be read together with our ESG Lexicon, available here, which provides definitions of some of the key terms used in ESG reports, disclosures and regulations.

Public Statement on ESG Disclosure

On March 11, 2021, the SEC published a statement by John Coates, acting director of the SEC's Division of Corporation Finance, in connection with remarks given at the 33rd Annual Tulane Corporate Law Institute (available here). This marks the first time Acting Director Coates's views on ESG disclosure standards have been published by the SEC, and is the most detailed expression to date of his position that the SEC "should help lead" the creation of an effective ESG disclosure system. His statement, titled "ESG Disclosure – Keeping Pace with Developments Affecting Investors, Public Companies and the Capital Markets," positions the effort as one required by the rapid acceleration of market interest in ESG disclosures. He noted that arriving at an effective ESG disclosure system requires "thoughtful engagement by trusted specialists seeking consensus among investors and companies," and that resulting disclosure standards would need to be flexible in order to remain relevant over time.

Questions to Address in the Creation of an Effective ESG Disclosure System

Acting Director Coates highlighted questions that must be addressed in this process and that the SEC should be a key part of answering, such as:

- What disclosures are most useful?
- What is the right balance between principles and metrics?
- How much standardization can be achieved across industries?
- How and when should standards evolve?
- What is the best way to verify or provide assurance about disclosures?

- Where and how should disclosures be globally comparable?
- Where and how can disclosures be aligned with information companies already use to make decisions?

Other Considerations

Acting Director Coates also looked more closely at three central issues as the SEC thinks about structuring an ESG disclosure system.

- *Costs*: responding to critics of ESG disclosure requirements that point to the costs for companies associated with preparing such disclosures, Acting Director Coates argued that it is the absence of a standardized ESG disclosure system that creates high costs. Companies not only must contend with great investor demand for ESG disclosures, but also with "numerous, conflicting and frequently redundant" requests for ESG information.
- *Mandatory vs. voluntary disclosures*: Acting Director Coates suggested that the debate about whether an ESG disclosure system should establish mandatory versus voluntary disclosure provisions obfuscates the fact that the SEC's existing disclosure regime is more nuanced than that. That is, while the U.S.'s existing disclosure system does contain some mandatory requirements, it also contains "comply or explain" requirements, such that the ability to explain provides flexibility and may sometimes be more informative for investors. Acting Director Coates also offered the reminder that companies making voluntary disclosures in sustainability reports or elsewhere have an obligation to ensure such disclosures are not materially misleading.
- *Global comparability*: noting that ESG issues are global issues and that ESG problems require global solutions, Acting Director Coates pointed to the virtues of achieving a single global ESG reporting framework. He acknowledged that establishing such a global framework is complex and faces several challenges, such as funding, governance and public accountability. He points to the IFRS Foundation's efforts to establish a sustainability standards board as promising in this regard.

Looking Ahead

Acting Director Coates has laid out an ambitious goal for the SEC: to "create and maintain an effective ESG-disclosure system that would promote the disclosure of decision-useful, reliable and, where appropriate, globally comparable ESG information." Considering that the United Kingdom and Europe Union, in particular, have already taken significant steps towards the establishment of their own ESG disclosure systems,[1] and that private standard setters have already begun to advance their own global ESG frameworks,[2] the SEC will have its work cut out for it as it aims to play a leading role going forward.

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1 *See* our prior client alerts: ESG Disclosures: The Push for Consistent and Comparable Standards – Europe; ESG Disclosures: The Push for Consistent and Comparable Disclosures – United Kingdom; and In Global First, the United Kingdom Moves Toward Mandatory Climate-related Disclosures by 2025.

2 *See* our prior client alert: Two Recent Initiatives Aim to Unify the ESG Reporting Ecosystem.

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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