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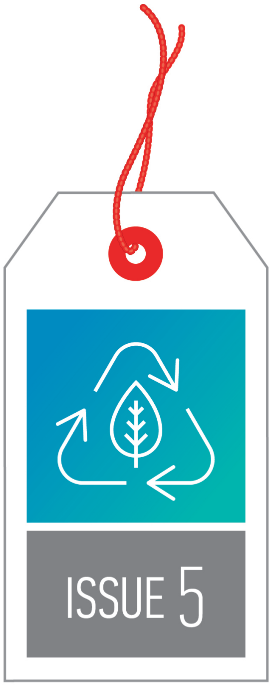

Companies across industries—from retail to high tech to financial services—are

touting their sustainability initiatives to attract and retain customers and employees. But investors are similarly clamoring for regular reporting on corporate sustainability efforts and achievements. Particularly for public companies, investor-facing sustainability disclosures are a pressing concern. In this issue of our Summer Sustainability Series, we provide an overview of public company sustainability disclosure drivers, obligations, and options.

Institutional Investor Interest in Sustainability Disclosures

In recent years, institutional investors have increasingly pressed public companies to engage with investors and report on topics beyond the traditional financial and corporate governance disclosures currently required by U.S. Securities and Exchange Commission (SEC) rules. Some large institutional investors, such as BlackRock CEO Larry Fink and State Street Chairman and CEO Ronald O'Hanley, argue that companies need to focus and report on sustainability in order to better promote long-term value. In addition, some funds and asset managers offer their customers products that screen out investments in certain industries or products, or target investments in companies or projects with particular social or environmental impacts.

Whether investors are seeking to engage with a company on its sustainability practices or screen out, or target, particular types of portfolio companies, they need access to disclosure and data regarding sustainability topics, such as environmental management and impacts, human rights, consumer privacy and data security, product safety, labor practices, employee diversity and inclusion, supply chain, and materials sourcing. Investors seek this information through private engagements with companies, shareholder proposals calling for reports on various sustainability topics, and SEC rulemaking petitions.

SEC Rules May Require Certain Sustainability Disclosures

SEC rules for public company reporting, with few exceptions, are primarily principles based, calling for disclosure of information that is material to investors. The SEC's overarching focus on disclosure of material information is consistent with Section 10(b) under the Securities Exchange Act of 1934 (Exchange Act), and related Rule 10b-5, which prohibit making untrue statements of material fact or omitting to state a material fact necessary in order to make statements made not misleading.

The exceptions to the general materiality-based requirements are largely areas that have come under scrutiny due to corporate scandals or increasing public and investor interest, such as financial statements, executive compensation, mine safety, and conflict minerals. For example, following the massive corporate accounting scandals that took place in the late 1990s and early 2000s, the SEC implemented enhanced financial disclosure requirements pursuant to the Sarbanes-Oxley Act of 2002. The SEC has also put out guidance for companies on particular topics that have been raised by institutional investors as possible areas for rulemaking, including a 2010 interpretive release that outlines the SEC's views on how existing disclosure requirements apply to climate change matters.

The benefit to a principles-based reporting scheme is that it allows any company, regardless of industry, to determine for itself what information may be material to its investors. And as demonstrated by the 2010 interpretive release on climate change disclosures, existing rules may require disclosure on sustainability issues. Topics that might be addressed in SEC reports include material effects on the company of compliance with environmental laws, climate-related risk factors, and identification of known climate change trends and uncertainties that may affect the company's future operating performance and financial condition.

Despite the existing drivers for companies to disclose material sustainability information in SEC filings, some investors have begun calling for SEC rulemaking on additional specific sustainability-related disclosures. In 2017, a group of investors petitioned the SEC to adopt or amend rules to require disclosure regarding human capital management policies, practices, and performance. In 2018, a group of law school professors and asset managers petitioned for a comprehensive framework for environmental, social, and governance disclosures.

These requests for rulemaking address a key challenge for investors—obtaining comparable and reliable data across companies. But, as SEC Chair Jay Clayton has noted, topics such as environmental and climate-related disclosures pose challenges in rulemaking because these topics are often forward looking and involve assumptions about complex and uncertain matters. While the SEC has included human capital management as a disclosure topic in proposed rule changes, there is little indication that it intends to mandate specific sustainability metrics before companies and investors coalesce around reporting standards.

Optional Reporting and Sustainability Rankings

Given the amorphous demands on companies to provide decision-useful sustainability information, what can a well-intentioned company starting out in sustainability reporting do? Companies can engage with their shareholders to identify the information that their investors want. They might also identify the information senior management and the board receive on these topics and consider reporting similar metrics or high-level qualitative information to investors. Consumer-facing companies or those in industries with existing practices around certain sustainability metrics, like utilities, may already track and promote sustainability and social efforts to their customers. Such companies might consider integrating some of these marketing efforts into investor-facing disclosures.

There are also several standard-setting bodies that provide frameworks for and guidance on sustainability reporting. Several prominent and widely used standards and frameworks are identified below.

- GRI is a nonprofit organization founded in 1997 that has established sustainability reporting standards. GRI's standards focus on the economic, environmental, and social impacts of a company, which may go beyond information that is material to investors.
- The Sustainability Accounting Standards Board (SASB) is a nonprofit organization that first published its set of 77 industry standards on financially material sustainability topics and associated metrics in 2018. SASB's goal is to identify potential disclosure topics and standardized metrics for companies to consider in preparing sustainability disclosures that are material to investors.
- The Task Force on Climate-Related Financial Disclosures (TCFD) is an international effort to develop consistent climate-related financial risk disclosures, which produced its recommendations in June 2017. The recommendations provide a framework for companies preparing disclosures relating to measuring and responding to climate change risks.

Unfortunately, these different standards and frameworks serve different purposes, and therefore may not be consistent. While the SASB standards and TCFD framework both seek to elucidate material disclosures that are suitable for including in traditional corporate reports like SEC filings, the GRI standards are more wide-ranging and encourage companies to disclose more information, whether or not it is material to the company and its investors. Recently, SASB and GRI announced a collaboration to provide guidance to assist companies in using their standards concurrently.

Companies that are already committed to sustainability efforts may imagine that preparing a sustainability report will be a straightforward project of repurposing their existing narratives about their commitments. But investor-facing disclosures generally require more rigor and care, including because of potential securities law liabilities, discussed below. To ensure that sustainability reports provide accurate and reliable disclosure, companies should consider treating these reports like SEC reports, including with review by the company's disclosure committee and factual backup procedures. As companies explore sustainability topics, they may also begin to identify information that rises to a level of materiality that should be discussed in SEC filings, such as sustainability-related risk factors and metrics.

Despite the challenges of preparing reliable and repeatable sustainability disclosures, larger companies have increasingly provided investor-facing sustainability reports that comply with GRI standards, and more recently, SASB standards. According to G&A Institute, in 2019, 90% of S&P 500 companies published sustainability reports, up from 20% in 2011. Of those, 50% used the GRI standards and 25% referenced or aligned with the SASB reporting framework. Some companies are also beginning to move some sustainability disclosures from standalone sustainability reports to their SEC filings.

Potential for Liability

One concern for companies as they begin providing reporting to investors on sustainability topics is whether such disclosures could increase the company's risks for securities law liability. This is an important concern that companies should consider carefully in preparing sustainability reports, just as they do in preparing SEC filings.

Section 10(b) of the Exchange Act and Rule 10b-5 create liability for any fraudulent statements made to investors, whether or not those statements are contained in SEC filings. Section 14(d) of the Exchange Act imposes similar liability for fraudulent statements in proxy statements. Sections 11 and 12(a)(2) of the Securities Act of 1933 have even greater potential for liability, creating strict liability for misstatements made in connection with securities offerings. In addition, SEC filings that include live hyperlinks to other reports can result in the hyperlinked material being subject to Section 11 and Section 12(a)(2) liability.

Some shareholders are attempting to use existing disclosure laws to hold corporations accountable for their sustainability disclosures. A shareholder recently sued Oracle Corporation, alleging that the company "made gross misrepresentations in [its] public statements by claiming to have a multitude of policies, internal controls, and processes designed to ensure diversity both at the management level and the Board itself", while failing to appoint any Black directors or officers. The lawsuit is pending, but it illustrates that litigation is a real concern with respect to public statements about sustainability matters.

Many sustainability disclosures are forward looking and may benefit from the protections the Private Securities Litigation Reform Act of 1995 (PSLRA) provides from federal securities law liability for forward-looking statements. To benefit from the safe harbor, disclosures must be clearly designated as forward-looking and be accompanied by "meaningful cautionary statements identifying important factors that could cause results to differ materially from" the statement. For this reason, forward-looking sustainability disclosures, whether contained in separate reports posted to a corporate website or in reports filed with the SEC, should be clearly identified as projections or expectations, and be accompanied by a cautionary disclaimer.

In light of the potential for securities law litigation and liabilities, companies providing metrics and firm statements regarding sustainability issues should ensure that the disclosures are thoroughly vetted and based on repeatable and verifiable data-gathering processes. As discussed above, existing internal procedures for SEC reports can be applied to sustainability reports as well. Some companies have begun seeking external assurance, similar to an audit of financial statements, for certain sustainability disclosures. According to the G&A Institute report mentioned above, 29% of S&P 500 companies that published sustainability reports in 2019 sought some kind of external assurance for their disclosures.

Time for Action on Sustainability Reporting

Sustainability reporting practices are an emerging area, but reporting is accelerating quickly among public companies. In coming years, we may see companies and investors coalescing around preferred practices. For those companies that have not yet considered sustainability reporting, now is the time to look at what the company is already doing to increase sustainability and begin exploring how best to communicate that information to investors. Key considerations include:

- Identify information about the company's sustainability efforts and results that is of interest to investors, including through engagement with significant shareholders.
- Determine whether any of the company's sustainability reporting should be integrated into SEC reports, rather than a standalone sustainability report.
- Consider aligning sustainability disclosures with existing standards and frameworks.
- Implement disclosure procedures for sustainability topics consistent with internal controls for financial disclosures.

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