

Materiality and Disclosure: Evolving SEC Requirements for Corporate Disclosure of Environmental, Social and Governance Activities



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Environmental, Social and Governance (“ESG”) related disclosures became a topic of contention in March of 2021 with the introduction of an ESG related task force by the Securities and Exchange Commission (“SEC”). Facing increased pressure to aggressively investigate ESG misconduct, the 22-member task force situated in the Department of Enforcement, seeks to proactively identify ESG violations through an analysis of corporate disclosures regarding ESG funds and activities. Despite efforts to implement a robust policy, however, the SEC’s visible shift in prioritizing ESG matters has resulted in ambiguity. Sample comment letters providing ESG guidelines and press releases have caused corporations to question whether their disclosures match SEC requirements altogether. So how can the corporate world ensure proper compliance with the SEC’s guidelines on ESG disclosure as those guidelines continue to evolve? The answer lies in understanding what ESG matters may entail and the materiality of those matters to the reasonable investor.

For instance, “E” activities may include matters such as sustainable investing, socially responsible investing, and impact investing. Further, “S” and “G” practices may involve commitments to diversity and inclusion and corporate social governance and transparency. Corporations can tailor these ESG initiatives in a variety of ways, including adopting transparent goals, building a corporate framework of responsibility, and committing to future initiatives.

Nevertheless, in understanding a corporation’s ESG policies and initiatives, businesses must remain aware of disclosure requirements. Historically, the SEC’s disclosure requirements have been based on the “materiality of the disclosure as it relates to reasonable investors.” In federal securities law, information is material if “there is a substantial likelihood that a reasonable investor would consider the information important in deciding how to vote or make an investment decision.” In September 2021, the SEC released a sample comment letter that provided a guideline to public companies regarding ESG disclosure requirements. The letter predominantly referenced environmental initiatives such as climate change transition risks, purchases of carbon offsets, climate related legislation, and information regarding a company’s corporate social responsibility reports. However, the comment letter did not specifically outline a strict standard of disclosure requirements regarding the “S” and “G” components of the ESG framework. The SEC expects to release new disclosure requirements involving “S” and “G” initiatives such as corporate board diversity, human capital management and cybersecurity risk governance in the upcoming year.

While the SEC has not promulgated any rules in 2022, public companies can expect additional rule proposals, followed by public comment, in early 2023. In the meantime, companies will need to flesh out their ESG initiatives in ways that embrace accountability and transparency and adopt strict governance frameworks focused on corporate responsibility to accommodate the SEC’s rapidly evolving disclosure requirements.