OSSERVATORIO ESG

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Sustainability disclosure continues to be of interest to investors and other market participants, and the very breadth of these issues illustrates the importance of a flexible disclosure regime designed to elicit material, decision-useful information on a company-specific basis.

ARE THE US REALLY LAGGING BEHIND ON ESG?

The article is written by Donato Calace, (donato@datamaran.com), VP of Innovation & Accounts at Datamaran.

Introduction
Well, the answer is yes. The US Securities and Exchanges Commission (SEC) is quite adamant on its current position concerning ESG - well represented in the speech by Bill Hinman[1], the SEC Director of the Division of Corporate Finance,
"Applying a Principles-Based Approach to Disclosing Complex, Uncertain and Evolving Risks".
Recent policies, like the controversial proposal of the Department of Labor against the inclusion of ESG considerations in retirement plans, or the revision of the procedure to nominate the members of the US SEC Investor Advisory Committee in order to exclude ESG or climate experts, clearly show the hostility of US institutions to step in this field.
The real question here is instead "*how quickly can the US catch up with the ESG policy trends?*" - as considering how other influential players are moving (the EU of course, but also Canada, China, and Japan) the US at some point will necessarily need to take action too or risk that capital flows migrate towards jurisdictions better equipped to deal with sustainable finance, and corporate america would have to adapt to the higher standards that are demanded by foreign regulators to operate in their markets (The Brussels Effect).

Beneath the surface of hostility mentioned above, there are also a number of signals that the US would be ready to act fast when the right time comes.

Government Accountability Office (GAO) For example, the GAO, published in July 2020 the report "Disclosure of Environmental, Social, and Governance. Factors and Options to Enhance Them". This report on ESG disclosures includes a number of policy recommendations for the US SEC. The suggested regulatory actions could take the form of new requirements for specific ESG disclosures, a new SEC regulation that endorses the use of an ESG disclosure framework, or new SEC interpretive releases on ESG disclosure topics. Interestingly, the US SEC responded to the report's recommendations stating that the Commission's approach is rooted in materiality, and has been time-tested for over 85 years. Wouldn't it be fair to argue that in 85 years the profile of the "reasonable investor" has changed? There's plenty of evidence of that. Just think to the AUM following the UN PRI, or the recent developments concerning double and dynamic materiality.

US SEC Investment Advisory Committee Similarly, the US SEC Investment Advisory Committee (the same Committee whose nomination procedure is being revised as explained above) issued last May 2020 their Recommendation from the Investor-as-Owner Subcommittee of the SEC Investor Advisory Committee Relating to ESG Disclosure (as of May 14, 2020) demanding that "*the US Should Take the Lead on Disclosure of Material ESG Disclosure*" as "*it is highly likely that other jurisdictions will impose standards in the next few years that US Issuers will be bound to follow, either directly or indirectly, due to the global nature of the flow of investment into the US markets.*"

SEC request for Comments on Fund Names
Earlier this year, in March, The Commission released a request for comment concerning the Names Rule that applies to

[1] Bill Hinman just announced his intention to conclude his tenure later this year

registered investment companies (like funds). The Names Rule introduced in 2001 an "asset test" demanding that funds whose names make reference to a specific investment type (e.g. ABC equity fund), must invest at least 80% of its assets in that investment type. The document proposes that the Names Rule needs now to be reviewed, in light of a number of new challenges, including:

"The number of funds with investment mandates that include criteria that require some degree of qualitative assessment or judgment of certain characteristics (such as funds that include one or more environmental, social, and governance-oriented assessments or judgments in their investment mandates (e.g., "ESG" investment mandates)) is growing. These funds often include these parameters in the fund name. The staff has observed that some funds appear to treat terms such as "ESG" as an investment strategy (to which the Names Rule does not apply) and accordingly do not impose an 80 percent investment policy, while others appear to treat "ESG" as a type of investment (which is subject to the Names Rule)".

In short, there are concerns that funds using the "ESG" label are using the limited scope of the Names Rule (which applies to "investment type" but not to "investment strategies") for greenwashing.
The SEC is seeking public comment[2] on how to address this limitation, specifically asking, for example, if the Names Rule should be applied to "investment strategies" kind of names too. The challenge the US SEC is facing here is in fact the ambiguity and lack of standardization around "ESG" - the same problem the EU is addressing thanks to the Taxonomy.

Commission Guidance on Management's Discussion and Analysis of Financial Condition and Results of Operations
Another example is the Management Disclosure & Analysis (MD&A) Guidance the US SEC published in January. The Guidance acknowledges that some companies are disclosing "*non-financial and financial metrics when describing the performance or the status of their business*" in their regulatory filings. A number of metrics familiar to non-financial reporters - total energy consumed, number of data breaches, employee turnover rate, percentage breakdown of workforce - are also mentioned in a footnote to provide concrete clarity on the scope of the Guidance. When such metrics are included in the filings, the Guidelines indicates that the MD&A is expected to include disclosures on "*the reasons why the metric provides useful information to investors*". In other words, a narrative explanation that enables investors to see "through the eyes of management" why the metric is material.

Conclusions

These examples demonstrate how policy work on ESG is anyway being carried out in the US, and it is reasonable to expect that, when the time is right, new regulations may be introduced quite rapidly - resulting in a swift acceleration of requirements in the space. The outcome of the presidential elections next week could represent a crucial moment to turn the policy tide in the US. Some companies are already prepared – as shown in Datamaran's research on climate disclosure in SEC filings featured on the Financial Times – but what about the others?

[2] Comments submitted to the US SEC are available here: https://www.sec.gov/comments/s7-04-20/s70420.htm