THE MATERIALITY OF ENVIRONMENTAL, SOCIAL, AND CORPORATE GOVERNANCE ("ESG") INDICATORS: IS IT TIME FOR MANDATORY DISCLOSURE?

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INTRODUCTION

Today, companies have no comprehensive mandatory requirements to disclose environmental, social, or corporate governance ("ESG") details to their shareholders or the public.[1] Corporations traditionally operate to make profits for their shareholders, and fifty years ago, that might have been the sole sufficient factor. Public corporations follow a number of disclosures guidelines, including those mandated by the Securities and Exchange Commission ("SEC"). The threshold disclosure standard set by the SEC is one of "materiality," where a corporation need only disclose what is important or necessary for the public to make a confident investment.[2] Under this standard, indicators like the company's carbon footprint or its organizational diversity would not matter. However, there seems to be a sea-change in recent years, calling to hold public corporations more accountable in these issues.[3] Companies are being held accountable to look past profits and people are starting to greatly care about a corporation's environmental, social, and corporate governance.

The push for change was recently shown in the Securities and Exchange Commission Investor Advisory Committee's May 2020 recommendation to

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1. *See generally* Conner Kuratek et al., *Legal Liability for ESG Disclosure*, HARV. L. SCH. F. ON CORP. GOVERNANCE ON CORP. GOVERNANCE (Aug. 3, 2020), https://corpgov.law.harvard.edu/2020/08/03/legal-liability-for-esg-disclosures/.

2. Material disclosures includes Rule 10b-5 actions, or in accordance with Rule 12b-20 in Exchange Act filings, or pursuant to Rule 408 in Securities Act filing, or pursuant to Item 101 of Regulation S-K.

3. *See* Helee Lev, *The New Normal—Investors Demand More ESG Disclosures*, GOBY (Jan. 2, 2021), https://www.gobyinc.com/new-normal-investors-demand-esg-disclosure/ ("ESG disclosure is becoming universally important. In a survey by Ernst & Young, 91% of institutional investors consider nonfinancial performance core to their investment decision making process over the past year.").

promulgate specific disclosure policies regarding ESG topics and incorporate them into the integrated disclosure regime for SEC-registered issuers.[4] This recommendation came as the COVID-19 pandemic and Black Lives Matter protests captivated United States, uncovering and underscoring the absence of unified requirements for ESG reporting in companies. Many commentators have questioned whether mandatory disclosure is necessary when the United States runs on a "market-based approach."[5] However, more recently, it seems mandatory disclosure may help alleviate inconsistencies in current ESG standards, which currently offer no legally-mandated guidance or safe harbors to issuers.

The SEC should implement a mandatory disclosure regime for ESG factors based on its advisory committee's May 2020 recommendation because ESG indicators are increasingly a material component of the value that investors expect in companies. Part I of this Note explores some of the current ESG regulatory issues and ultimately argues for mandatory disclosure of ESG factors. Part II of this Note looks at the SEC's current methods of disclosure. Part III of this Note discusses background on environmental, social, and corporate governance indicators and how they are seen in the industry, discussing risks and benefits for both companies and investors in wanting ESG to be considered. This section also looks at the current rules the SEC has in place to regulate ESG indicators. Next, Part IV of this Note discusses the SEC's recent push for the mandatory disclosure of ESG indicators, looking at both the Securities and Exchange Commission Investor Advisory Committee's initial recommendation and the Securities and Exchange Commission Asset Management Advisory Committee's report.

Finally, Part V argues that ESG factors are material and, because of this, supports the SEC in thinking harder about a mandatory disclosure regime of ESG. First, the COVID-19 global pandemic has shed a spotlight on public health and shown how businesses must look for ways to protect workers and support long-term growth in their companies through social initiatives.[6] Second, the summer 2020 protests in light of the murder of George Floyd sparked a conversation within many companies about how to better social practices, creating more diverse and inclusive places to work for all people. The Black Lives Matter movement has made investors look more closely at how

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4. *See* U.S. SEC. & EXCH. COMM'N INV. ADVISORY COMM., RECOMMENDATION OF THE SEC INVESTOR ADVISORY COMMITTEE RELATED TO ESG DISCLOSURE 1 (2020), https://www.sec.gov/spotlight/investor-advisory-committee-2012/esg-disclosure.pdf [Hereinafter INVESTOR ADVISORY COMMITTEE RECOMMENDATION].

5. Andrew A. Schwartz, *Mandatory Disclosure in Primary Markets*, 5 UTAH L. REV. 1069, 1070 (2019) ("[O]pposition to mandatory disclosure has come from a small but persistent group of legal scholars . . . . These scholars generally rely on law-and-economics ideas suggesting that market incentives should be enough to induce companies to voluntarily provide investors with an appropriate level of disclosure, rendering mandatory disclosure wasteful, or at least unnecessary.").

6. *See* Hazel Bradford, *COVID-19 pushes social issues to ESG forefront*, PENSIONS & INVESTMENTS (Aug. 10, 2020), https://www.pionline.com/special-report-esg-investing/covid-19-pushes-social-issues-esg-forefront.

companies support social justice issues before investing. Third, millennials who are moving into investment firms to perform research and analysis are more likely than their older generational colleagues to hone in on ESG. Finally, Part VI makes a final observation of the increased likelihood of greater disclosure with the recent election of an environmentally friendly President, Joe Biden. It's likely his administration will call for greater corporate accountability in disclosing ESG indicators to further his agenda. The ultimate conclusion to this Note is that ESG has been pushed to the forefront, and based on recent events, the ESG indicators now fit within the SEC's materiality standard and therefore require greater disclosure requirements. Having a structured mandatory disclosure regime for companies will lead to better accountability and more transparency through investing.

I. REGULATION: THE SECURITIES AND EXCHANGE COMMISSION'S METHOD OF DISCLOSURE

The following section will lay the foundation of the SEC's current disclosure regulation method and will discuss where ESG indicators fall into the framework. This section will define the SEC's current method and show how the United States Supreme Court has interpreted the rules thus far. This section shows how ESG is already being regulated and the problems that regulation and deregulation have on corporations and the industry.

The SEC has long followed the "Prescription Approach" for disclosure.[7] This approach emphasizes "materiality"—the extent to which a reasonable investor would consider the information important to an investment decision.[8] Disclosure in the United States has largely been rule-based; however, recently, the SEC has shifted to a more "principles-based" approach.[9] Materiality has been the cornerstone of the federal securities laws since Congress incorporated

7. OICU-IOSCO, PRINCIPLES FOR ONGOING DISCLOSURE AND MATERIAL DEVELOPMENT REPORTING BY LISTED ENTITIES: A STATEMENT OF THE TECHNICAL COMMITTEE OF THE INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS 3 (2002).

8. *See* Mark S. Bergman et al., *The U.S. Regulatory Framework for ESG Disclosure*, PAUL WEISS (Jul. 31, 2020); *see also* BUSINESS ROUNDTABLE, THE MATERIALITY STANDARD FOR PUBLIC COMPANY DISCLOSURE: MAINTAIN WHAT WORKS 1 (2015) ("[T]he principle of materiality has been embedded in the disclosure framework that governs how public companies disclose information to the investing public. Not only does this foundational principle serve investor protection well by filtering out irrelevant material, but the concept also naturally evolves to address new issues and developments and takes into account the facts and circumstances that are relevant to each company."). It's important to note that the SEC does not make companies disclose all information; we only make them disclose "material" information.

9. Bergman et al., *supra* note 8, at 1 (citing William Hinman, *Applying a Principles-Based Approach to Disclosing Complex, Uncertain and Evolving Risks*, Remarks at the 18th Annual Institute on Securities Regulation in Europe (Mar. 15, 2019) ("[The] principles-based disclosure requirements offer flexibility that 'should result in disclosure that keeps pace with emerging issues, like . . . sustainability matters, without the need . . . for the [SEC] to continuously add to or update the underlying disclosure rules as new issues arise.'").

this principle in the first set of securities laws in the 1930s.[10] Materiality has been incorporated in SEC rules and has also been interpreted by the United States Supreme Court.

Congress first included the concept of materiality in the Securities Act of 1933 (the "Securities Act"). Section 17(a)(2) of that Act provides, for example, that

> [i]t shall be unlawful for any person in the offer or sale of any securities . . . to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements, in light of the circumstances under which they were made, not misleading.[11]

Congress also included the concept in the Securities Exchange Act of 1934 (the "Exchange Act"). Section 18(a) of the Exchange Act subjects persons liable for making, or causing to make, any statement, "in any application, report, or document . . . which . . . was at the time and in light of the circumstances under which it was made false or misleading with respect to any material fact . . . ."[12]

As early as 1947, the SEC adopted rules incorporating and defining "materiality," making clear that the focus should be on information relevant to informed investment decisions. Rule 405 under the Securities Act defined the term "material" as follows: "when used to qualify a requirement for the furnishing of information as to any subject, [materiality] limits the information required to those matters to which . . . a reasonable investor would attach importance in determining whether to purchase the security registered."[13]

The Supreme Court has defined the standard of disclosure to determine whether the information is material in a series of decisions beginning in 1970. In *Mills v. Electric Auto-Lite Co.*,[14] which dealt with proxy voting, the Court stated that:

> [w]here the misstatement or omission in a proxy statement has been shown to be "material," as it was to be here, that determination itself

10. *See* BUSINESS ROUNDTABLE, *supra* note 8.

11. Securities Act of 1933, § 17(a)(2).

12. Securities Exchange Act of 1934, § 18(a); *see* John A. Occhipinti, *Section 18 of the Securities Exchange Act of 1934: Putting the Bite Back into the Toothless Tiger*, 47 FORDHAM L. REV. 1 (1978); *see also* STEVE LYDENBERG, HAUSER CTR. FOR NONPROFIT ORGS. INITIATIVE FOR RESPONSIBLE INV., ON MATERIALITY AND SUSTAINABILITY: THE VALUE OF DISCLOSURE IN THE CAPITAL MARKETS (2012) ("With the passage of the Securities Exchange Act of 1934, Congress created the Securities and Exchange Commission (SEC) and empowered it to require disclosure of corporate data material to the public interest and the protection of investors. Congress mandated this disclosure in part to assure fair and honest markets, reliable prices, and unencumbered interstate commerce.").

13. Securities Act of 1933, § 405. In 1982, the SEC amended the definition of "material" in Rule 405 (in keeping with U.S. Supreme Court decisions) to: "when used to qualify a requirement for the furnishing of information as to any subject, [materiality] limits the information required to those matters to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to purchase the security registered." *Id.*

14. 396 U.S. 375 (1970).

> indubitably embodies a conclusion that the defect was of such a character that it might have been considered important by a reasonable shareholder who was in the process of deciding how to vote.[15]

In 1976, Justice Thurgood Marshall, writing for the majority in *TSC Industries, Inc. v. Northway, Inc*.,[16] noted the importance of the concept of materiality as a filtering mechanism: "Some information is of such dubious significance that insistence on its disclosure may accomplish more harm than good."[17] In discussing the harms of a low materiality standard, the Court stated that "not only may the corporation and its management be subjected to liability for insignificant omissions or misstatements, but also management's fear of exposing itself to substantial liability may cause it to bury the shareholders in an avalanche of trivial information – a result that is hardly conducive to informed decisionmaking."[18] The Court then articulated the standard for materiality that is still widely used today:

> An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote . . . . It does not require proof of a substantial likelihood that disclosure of the omitted fact would have caused the reasonable investor to change his vote, but contemplates a showing of a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the reasonable shareholder's deliberations.[19]

Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information available.

The Supreme Court reaffirmed this standard for materiality in *Basic Inc. v. Levinson* in 1988.[20] The Court made clear that the determination of whether a piece of information is material is "inherently fact-specific finding," and the

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15. *Id.* at 384.

16. 426 U.S. 438 (1976).

17. *Id.* at 448.

18. *Id.* at 448–49.

19. *Id.* at 445; *TSC Industries* was consistent to the definitions set out by the SEC in 1999. *See* LYDENBERG, *supra* note 12 ("In order to help managers, auditors, and investors determine what information to disclose, verify, or use, the SEC, the accounting profession, and the courts have provided guidelines on what data should be considered 'material.' The SEC's definition of materiality is spelled out in its 1999 'Staff Accounting Bulletin: No. 99—Materiality.' At the outset of SAB 99, the SEC states simply that 'A matter is 'material' if there is a substantial likelihood that a reasonable person would consider it important.' The SEC's Regulation S-K, Rule 1-02 defines 'material' as follows: 'The term "material," when used to qualify a requirement for the furnishing of information as to any subject, limits the information required to those matters about which an average prudent investor ought reasonably to be informed.'").

20. 485 U.S. 224, 230 (1988).

purpose of the analysis is again to prevent management from burying shareholders in an "avalanche of trivial information."[21]

Since then, courts have used this standard across the country when determining whether the information at issue in a securities suit was material to investors. For example, both the United States Courts of Appeals for the Second Circuit and the Ninth Circuit have concluded that to satisfy the materiality requirement, "there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the total mix of information made available."[22] Further, the Supreme Court most recently reaffirmed this standard for materiality in its June 2014 decision, *Halliburton Co. v. Erica P. John Fund, Inc*.[23]

The question of what information is material to an investor is always changing and, because of this, the SEC has made modifications to its approach described above to a reporting requirement of a limited number of sustainability issues in an attempt to create a more comprehensive disclosure regime.[24] For example, in 2007 a number of institutional investors called for the SEC to create stronger guidelines on climate change disclosures.[25] Institutional investors argued that climate change fell into the SEC's disclosure requirements under

21. *Id.* at 236

22. Dalberth v. Xerox Corp., 766 F.3d 172, 183 (2d Cir. 2014) (quoting *Basic*, 485 U.S. at 231–32); *see also* Petrie v. Elec. Game Card, Inc., 761 F.3d 959 (9th Cir. 2014).

23. *See* LexisNexis, *Law School Case Brief: Halliburton Co. v. Erica P. John Fund, 573 U.S. 258 (2014)*, https://www.lexisnexis.com/community/casebrief/p/casebrief-halliburton-co-v-erica-p-john-fund-inc-2008969752 ("The U.S. Supreme Court unanimously held that the corporation was entitled to present price impact evidence in addressing class certification to rebut the presumption of reliance in the securities fraud case. The presumption remained viable and could be rebutted by proof of a lack of market efficiency, and the purchaser was not required to prove price impact at the class certification stage. However, the corporation was entitled to an opportunity to rebut the presumption of reliance before class certification with evidence of a lack of price impact, and such evidence was appropriate to counter the purchaser's showing of market efficiency in an attempt to establish that common issues did not predominate for purposes of class certification.").

24. *See* Jill E. Fisch, *Making Sustainability Disclosure Sustainable*, 107 GEO. L.J. 923, 937 (2019) ("One example is the SEC's shift toward broadening the required disclosure about executive compensation. After years of taking a restrictive approach in which the SEC regularly went so far as to allow corporations to exclude shareholder proposals seeking to address executive pay, the SEC changed its position and imposed extensive mandatory disclosure requirements. The SEC subsequently modified and expanded these disclosure requirements. Notably, even accepting the view that the size and structure of executive compensation is economically material to investors . . . .").

25. *See id.* at 937; *see also* Cal. Pub. Emps.' Ret. Sys. et al., *Petition Before the United States Securities and Exchange Commission* 2, SEC (Sept. 18, 2007), http://www.sec.gov/rules/petitions/2007/petn4-547.pdf (The petition asserted that "the risks and opportunities many corporations face in connection with climate change fall squarely within the category of material information that is required to be analyzed and disclosed in many corporate filings.").

Regulation S-K,[26] but argued these disclosures were both "inadequate and inconsistent."[27] It wasn't until three years later that the SEC issued the institutional investor's requested disclosure guidelines.[28] This was substantial from an ESG perspective as SEC staff began to provide insight on how to think about the decision of which climate risks are material.[29] Following this, corporate disclosure of climate change-related information increased. However, there was no clear, comprehensive way to measure these indicators, and therefore the quality of information was inconsistent.[30] "Climate change disclosure remains limited due in large part to the vagueness of the disclosure obligation and issuers' ability to determine, in their judgment, that a given issue is not material enough to warrant disclosure."[31]

The definition of materiality is not keyed to financial materiality or to things that would change the stock price.[32] Materiality is keyed to something that would assume significance to a reasonable shareholder.[33] Reasonable shareholders may attach signifiance to nonfinancial things.[34] What if the reasonable shareholder is "pro-social" and in addition to a good return they also want the company to do well in the world? The following section discusses the SEC's disclosure rules, taking a narrow perspective and focusing on environmental, social, and corporate governance indicators.

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26. *See generally Rules, Regulations, and Schedules*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/divisions/corpfin/ecfrlinks.shtml (last modified Oct. 13, 2017) (Regulation S-K is a prescribed regulation under the US Securities Act of 1933 that lays out reporting requirements for various SEC filings used by public companies).

27. Fisch, *supra* note 24, at 937; *see also* Cal. Pub. Emps.' Ret. Sys. et al., *supra* note 25, at 13, 45.

28. Fisch, *supra* note 24, at 937; *see also* Commission Guidance Regarding Disclosure Related to Climate Change, Securities Act Release No. 9106, Exchange Act Release No. 61,469, 75 Fed. Reg. 6289, 6290 (Feb. 8, 2010) ("The [SEC] is publishing this interpretive release to provide guidance to public companies regarding the Commission's existing disclosure requirements as they apply to climate change matters.") [hereinafter Commission Guidance].

29. *See* Commission Guidance, *supra* note 28.

30. *See* Fisch, *supra* note 24, at 937.

31. *Id.* (emphasis omitted).

32. *See* Oliver Hart & Luigi Zingales, *Should a Company Pursue Shareholder Value*, J. OF L., FIN., & ACC. 22 (2016) ("Since [Milton] Friedman's . . . celebrated piece, the dominant view in the financial and legal literatures has been that the appropriate objective function for a firm is to maximize profits or more broadly 'long-term shareholder value.' In this paper we accept Friedman's premise that management's responsibility is to conduct business in accordance with shareholder wishes. We depart only from Friedman's (implicit) assumption that the pursuit of monetary objectives and that of nonmonetary ones can be costless separated.").

33. *See id.*

34. *See id.*

II. ENVIRONMENT, SOCIAL, AND CORPORATE GOVERNANCE (ESG) INDICATORS

For this Note, it's important to define environmental, social, and corporate governance terms (or lack thereof) and explain how environmental, social, and corporate governance indicators function within the financial services industry. At the most preliminary level, it's important to break down the "ESG" acronym to highlight what ESG investors look for when seeking stocks to analyze. ESG investing is a developing definition in the financial services industry, and there is currently no set of standardized definitions with which to identify the terms.[35] This leaves the industry the opportunity to create their own terms and phrases for their reinvestment practices pertaining to environmental, social, and corporate governance indicators.[36] Over the years, academics have developed standardized definitions for different relevant ESG concepts widely accepted today by the investment industry.[37] The most widely-accepted definition and the one used in this Note is: "ESG investing is the research and investment strategy framework that evaluates environmental, social, and governance factors as non-financial dimensions of a security's valuations, performance, and risk profile."[38]

First, the "E" in ESG stands for the environment. Topics that are considered under environment are climate change policies, plans and disclosures; greenhouse gas emissions goals, and transparency into how the company is meeting those goals; carbon footprint and carbon intensity; water-related issues and goals, such as usage conservations and water disposal; recycling practices; and the use of green products, technology, and infrastructure.[39] Environmental criteria can be used to evaluate any environmental risks, for example, if there are issues related to a company's contaminated land, its disposal of hazardous waste, its management of toxic

35. *See* MATTHEW W. SHERWOOD & JULIA POLLARD, RESPONSIBLE INVESTING: AN INTRODUCTION TO ENVIRONMENTAL, SOCIAL, AND GOVERNANCE INVESTMENTS 2–3 (2018).

36. *Id.* at 2 ("Institutional investors, asset managers, service providers, and consultants generally use the terms and definitions for ESG investing that are chosen by their governing boards, or at the request of the clients they serve. In practice, such ESG-related terminology is often interchangeable in implementation and intended meaning.").

37. *Id.* ("Impact Investing: Impact investments are investments made into companies, organizations, and funds with the intention to generate social and environmental impact alongside a financial return; Social responsibility investing: Sustainable, responsible, and impact investing is an investment discipline that considered environmental, social, and corporate governance criteria to generate long-term competitive financial return and positive societal impact; Responsible investing: an approach in investing that aims to incorporate environmental, social, and governance (ESG) factors into investment decision, to better manage risk and generate sustainable, long-term returns.").

38. *Id.* at 3.

39. *See* Alyce Lomax & John Rotonti, *Environmental, Social, and Governance Investing*, MOTLEY FOOL (Apr. 3, 2019), https://www.fool.com/investing/stock-market/types-of-stocks/esg-investing/.

emissions, or its compliance with government environmental regulations.[40] To obtain a company's environmental matrix, one can look to local sustainability reports prepared using respected sustainability standards such as Global Reporting Initiative (GRI) and Principles for Responsible Investment (PRI).[41] Corporate websites will also sometimes have a sustainability page that investors can use. Still, investors should be wary when the company does not disclose enough details to paint a complete picture, where a company might demonstrate a commitment to recycling or limiting its toxic emissions. Still, the commitment alone would not merit a check in the "E" category.[42]

The SEC issued guidance in 2010 which addressed how current disclosure requirements could apply to "E" issues like climate change.[43] SEC reporting companies are required to evaluate their disclosure obligations with respect to certain climate-related issues regularly. Because of the SEC's long-standing materiality standard, companies are called to consider the materiality of factors like direct and indirect impacts of legislative and regulatory changes on the company's operating and financial decisions.[44] In 2016, the SEC issued a concept release on business and financial disclosures, which touched on sustainability themes.[45] The SEC noted that Congress had mandated disclosure addressing specific policy concerns, such as conflict minerals, payments by resource extraction issuers to foreign governments, and health and safety violations at mining-related facilities.[46] The SEC also noted that there were

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40. *See Environmental, Social, and Governance (ESG) Criteria*, INVESTOPEDIA (Feb. 25, 2020), https://www.investopedia.com/terms/e/environmental-social-and-governance-esg-criteria.asp.

41. *See* Lomax & Rotonti, *supra* note 39; *see also Global Sustainability Standards Board*, GRI, https://www.globalreporting.org/about-gri/mission-history/ (2021) ("GRI envisions a sustainable future enabled by transparency and open dialogue about impacts. This is a future in which reporting on impacts is a common practice by all organizations around the world. As provider of world's most widely used sustainability disclosure standards, we are a catalyst for that change."); *see also About the PRI*, PRINCIPLES FOR RESPONSIBLE INVESTMENT, https://www.unpri.org/pri/about-the-pri (last visited Nov. 28, 2021) ("The PRI is the world's leading proponent of responsible investment. It works . . . to understand the investment implications of environmental, social and governance (ESG) factors [and] to support its international network of investor signatories in incorporating these factors into their investment and ownership decisions . . . . The PRI is truly independent. It encourages investors to use responsible investment to enhance retunes and better manage risks, but does not operation for its own profits; it engages with global policymakers but is not associated with any government; supported by, but not part of, the United Nations.").

42. *See Global Sustainability Standards Board*, *supra* note 41.

43. *See* Commission Guidance Regarding Disclosure Related to Climate Change, *supra* note 28.

44. *See* Bergman et al., *supra* note 8.

45. *Business and Financial Disclosure Required by Regulations S-K*, Release No. 33-10064; 34-77599, 17 C.F.R. Parts 210, 229, 230, 232, 239, 240, and 249 (2016).

46. *See id.* at 204.

calls for greater disclosure of public policy and sustainability matters and asked for comment on both topics, including around line-item disclosure requirements.[47] Even in 2016, the SEC was aware of the emergence of sustainability reporting frameworks and inquired about which frameworks should be used for additional disclosure requirements should the SEC mandate some form of line-item disclosures.

The second letter in ESG is "S," which stands for social. This component consists of people-related elements like company culture and issues that impact employees, customers, consumers, and suppliers—both within the company and society.[48] Social topics could be "employee treatment, pay, and benefits; employee engagement and staff turnover; employee training and development; employee safety policies including sexual harassment prevention; diversity and inclusion in hiring; awarding advancement opportunities and raises; creating ethical supply chain sourcing; mission or higher purpose of the business; and the company's public stance on social justice issues."[49] Investors can look on sustainability reports, where environmental information can be found, because companies will sometimes also give information on employees, suppliers, and their impact in the community.[50] Paying attention to media reports related to how companies treat employees and their effort to stand with or against social justice issues can also help investors.[51]

Today, a board of directors' diversity is not mandated for public companies under either the SEC rules or the stock exchange listing standards. In 2009, the SEC required companies to disclose whether—and, if so, how—a nominating committee considers diversity in identifying board nominees.[52] If the board has such a policy, companies must also disclose how the policy is implemented, and how the board, or the nominating committee, assesses the policy's effectiveness.[53] In 2019, the SEC issued two Compliance & Disclosure Interpretations (116.11 & 133.13) clarifying what disclosure of "self-identified diversity characteristics" of directors and director nominees is required.[54] The

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47. *See id.* at 204–05.

48. *See* Lomax & Rotonti, *supra* note 39.

49. *See id.*

50. *See Global Sustainability Standards Board*, *supra* note 41; *see also About the PRI*, *supra* note 41.

51. *See Global Sustainability Standards Board*, *supra* note 41; *see also About the PRI*, *supra* note 41.

52. *See* Press Release, U.S. Sec. & Exch. Comm'n, SEC Approves Enhanced Disclosure About Risk, Compensation, and Corporate Governance (Dec. 16, 2009), https://www.sec.gov/news/press/2009/2009-268.htm.

53. *See id.*

54. *Regulation S-K: Questions and Answers of General Applicability, Question 116.11, 133.12*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/divisions/corpfin/guidance/regs-kinterp.htm#116-11 (last updated Sept. 21, 2020); *see also* Laura Richman et al., *Disclosure of Board Self-Identified Diversity Characteristics*, MAYER BROWN ("If a director or a nominee has self-identified diversity characteristics in response to a specific question on a director and officer questionnaire or voluntarily provided such information, and the board has considered such

most recent developments on the "S" front came in 2019 when the SEC proposed changes to Item 101 of Regulation S-K that would add "human capital" as one of the topics to be disclosed.[55] However, the existing rule only requires companies to disclose their number of employees and has not been finalized.[56]

Lastly, the "G" in ESG stands for corporate governance. The corporate governance risks concern how companies are run. Topics covered under corporate governance could be a corporate brand; corporate risk management and excessive "executive compensation; diversity of the board of directors and management team; board of director composition regarding independence and interlocking directorates; proxy access; majority vs. plurality voting for directors; and transparency in communicating with shareholders."[57] Investors here are interested in how corporate managements and boards relate to different shareholders and whether the corporate incentives are in line with the business's success.[58] Many corporate governance details are found with environmental and social details in sustainability reports; however, these reports don't always give the best and most accurate representation of the company's demonstration of corporate governance.[59] If one wants to know the company's corporate governance they already own stock in, the best place to look is the annual proxy statements.[60] The SEC also has some information, such as CEO compensation

information in evaluating the person for board membership, before making any disclosure in a proxy statement or other SEC filing, the company should confirm that such director or nominee has expressly consented to public disclosure of their information. If a company intends to include a discussion of self-identified diversity characteristics in a proxy statement or other SEC filing in accordance with the C&DIs, it should draft the appropriate disclosure sufficiently far in advance to allow the director(s) and/or nominee(s) who provided such information to assess whether their respective information is being accurately portrayed in the public documents. If a company has considered such self-identified diversity characteristics in evaluating a person for board membership, the company should also make sure to revisit the description of its diversity policy as well as the related discussion as to how the policy is implemented to make sure that the disclosure aligns with the current practices of the board in this regard.").

55. *See* Modernization of Regulation S-K Items 101, 103, and 105, 17 C.F.R. § 229, 239, 240 (2019).

56. *See id.*

57. *See* Lomax & Rotonti, *supra* note 39.

58. *See id.* ("Corporate governance issues come up every year during proxy season, when most companies file their proxy statements announcing their annual meetings. These documents cover a variety of corporate governance topics. Shareholders vote on a variety of issues presented to them annually, such as executive compensation ("say-on-pay"), director appointments, and shareholder proposals.").

59. *See id.*

60. *See id.*

of public companies and proxy statements, on its websites to research before deciding to invest in a company.[61]

When the SEC adopted the disclosure rules on diversity under "social," it also mandated disclosure rules covering various governance matters.[62] The point of these disclosure requirements was to increase accountability for officers and directors, and to benefit investors directly.[63] These new rules changed "the relationship of compensation policies and practices to risk management; the background and qualification and directors and nominees; legal actions involving a company's executive officers, directors, and nominees; board leadership structure and the board's role in risk oversight; stock and option awards to company executives and directors; and potential conflicts of interests of compensation consultants."[64] When a corporation uses information and attempts to assemble their ESG "portfolio," it is still important when determining any ESG indicators to keep in mind whether or not the corporation believes the above factors are material to a company's finances.[65]

Briefly mentioned above, the SEC currently has two types of rules that relate to environmental, social, and corporate governance.[66] The first is a general "line item" requirement for special subject matters, and the second is several antifraud rules which require materially accurate and complete disclosures.[67] There are both general and specific line item requirements under SEC regulations.[68] For example, Regulation S-K requires that public companies disclose "the terms and conditions of compensation for executive management and board members and certain of their transactions with the company"; "the ratio of the compensation of the company's principal executive officer to the median of the annual total compensation of all other employees"; and "ownership of and transactions in securities of the company by board members, executive managers, and certain large shareholders."[69] The SEC also regulates disclosures in a specific matter that falls into the scope of ESG, one example being coal and areas concerning mine safety.[70]

61. *See Proxy Statement*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/answers/proxy.htm (last modified Sept. 8, 2011).

62. *See* Press Release, U.S. Sec. & Exch. Comm'n, *supra* note 52.

63. *See id.*

64. *See* Bergman et al., *supra* note 8.

65. *See* Mozaffar Khan, George Serafeim & Aaron Yoon, *Corporate Sustainability: First Evidence on Materiality*, 91 ACCT. REV. 1697 (2016).

66. *See* Leonard W. Wang, *Insight: SEC Regulation of ESG Disclosures*, BLOOMBERG TAX (Aug. 27, 2019), https://news.bloombergtax.com/financial-accounting/insight-sec-regulation-of-esg-disclosures ("The antifraud rules apply to voluntary ESG disclosures as well as mandatory disclosures.").

67. *Id.*; 17 C.F.R. § 229.401–229.407.

68. *See* Wang, *supra* note 66.

69. *Id.*; *see also* 17 C.F.R. § 229.401–229.407.

70. *See* Wang, *supra* note 66. ("Another is the obligation of companies engaged in the extraction of natural resources to disclose payments made to governments for the purpose of the commercial development of oil, natural gas, and minerals. A third is a requirement for disclosure of

There are a number of antifraud rules the SEC has in place that affect environmental, social, and corporate governance disclosures.[71] One rule is that when a company makes any environmental, social, and corporate governance disclosure in an SEC filing, whether it is voluntary or according to regulatory requirements, it must comply with SEC's antifraud rules.[72] Another rule is the stock exchange rules that require disclosures of all material news and information.[73] Stock exchange rules require disclosure of all material news and information relating to a listed company.[74] These rules incorporate information that contributes to the movement of a company's stock price, for which ESG information can also be included in the category of information that moves a company's stock price.[75]

At one point, the Dodd-Frank Act required the SEC to create disclosure requirements concerning conflict minerals and resource extraction.[76] The SEC adopted rules following this mandate, but Congress soon eliminated both rules.[77] Importantly, at the time of Dodd–Frank's enactment, the SEC objected

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information concerning the source of certain minerals, if used by the company, that may originate from the Democratic Republic of Congo."); *see also* Mine Safety Disclosure, 17 C.F.R. § 229.104.

71. *See id.*; *see also* U.S. SEC. & EXCH. COMM'N, § 240.10b-5, *Employment of Manipulative and Deceptive Devices* ("It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, (a) To employ any device, scheme, or artifice to defraud, (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.").

72. *See id.* ("SEC Rule 10b-5 prohibits materially untrue statements and lying through material omission. This rule creates a potential source of legal liabilities for ESG disclosures, especially because it requires a company to include all material negative information necessary to make its statements completely truthful.").

73. *See id.*; NYSE Rule 202.05 requires a listed company "to release quickly to the public any news or information which might reasonably be expected to affect the market for its securities materially." *See generally* NYSE Rule 202.05.

74. Keith P. Bishop, *NASDAQ Stock Market LLC Adopts Ten-Minute Warning Rule*, ALLEN MATKINS (Dec. 10, 2009), https://www.allenmatkins.com/real-ideas/nasdaq-stock-market-llc-adopts-ten-minute-warning-rule.html#:~:text=NASDAQ's%20listing%20rules%20require%20that,securities%20or%20influence%20investors'%20decisions ("NASDAQ's listing rules require that companies make prompt disclosure to the public of any material information that would reasonably be expected to affect the value of their securities or influence investors' decisions.").

75. *See* NYSE Rule 202.05, *supra* note 73.

76. *See* Fisch, *supra* note 24, at 938; *see generally* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111- 203, § 1502(b), 124 Stat. 1376, 2213–18 (2010).

77. *See* Fisch, *supra* note 24, at 939; Conflict Minerals, Exchange Act Release No. 67,716, 77 Fed. Reg. 56,273 (Sept. 12, 2012); Disclosure of Payments by Resource Extraction Issuers, Exchange Act Release No. 67,717, 77 Fed. Reg. 56,365 (Sept. 12, 2012). *But see* David M. Lynn, *The Dodd-Frank Act's Specialized Corporate Disclosure: Using the Securities Laws to Address*

to the mandates, claiming that the required disclosures fell outside its core mission and were apparently "geared more toward influencing social policy than informing investors."[78]

The problem with the SEC's current doctrine of disclosure under its materiality method is that ESG is voluntary, and the SEC does not require companies to report on many environmental, social, and corporate governance factors. Professor Jill E. Fisch from the University of Pennsylvania Carey Law School has written on the lack of SEC-mandated financial reporting for sustainability.[79] One concern Fisch points out is that current disclosure practices that exist for sustainability reporting are voluntary, which means companies get to pick and choose what they will disclose, resulting in a "lack of standardization," leaving investors in the dark and unable to compare companies to choose which to invest in.[80] A second concern is that "sustainability reporting is typically characterized as 'non-financial,'" making it difficult to locate, format, and resend.[81] A third concern Professor Fisch points readers to is that sustainability reporting can vary in quality, calling into question its accuracy, which is rarely audited or monitored. If the goal of ESG investing is to improve companies' accountability, however, problems can arise when ESG indicators are inaccurate, poorly monitored, and difficult to obtain.[82] The following section illustrates the SEC's attempt to create a more accurate and rich monitoring system for ESG.

III. THE SECURITIES AND EXCHANGE COMMISSION'S ANNOUNCEMENT FOR GREATER ENVIRONMENTAL, SOCIAL, AND CORPORATE GOVERNANCE ("ESG") DISCLOSURE

On May 21, 2020, the investor-as-owner subcommittee of the Securities and Exchange Commission Investor Advisory Committee published a recommendation to require disclosure under the SEC rules of ESG:

> For close to 50 years, the SEC has periodically contemplated whether ESG disclosures are material and should be incorporated into its integrated disclosure regime for SEC-registered Issuers. This recommendation asserts that the time has come for the SEC to address this issue. Addressing ESG disclosure now will (a) provide

Public Policy Issues, 6 J. BUS. & TECH. L. 327, 331, 339 (2011) (criticizing the SEC's implementation of this mandate).

78. *Id.*; Aruna Viswanatha, *SEC Chair Chastises Congress Over New Disclosure Rules*, REUTERS (Oct. 3, 2013, 7:25 PM), https://www.reuters.com/article/us-sec-disclosures/sec-chair-chastises-congress-overnew-disclosure-rules-idUSBRE99215Q20131003.

79. *See* Fisch, *supra* note 24.

80. *Id.* at 927.

81. *Id.*

82. *Id.* ("These limitations impede the ability of investors and researchers to evaluate the sustainability practices of issuers and to analyze the relationship between sustainable practices and economic performance. Investors are demanding greater sustainability, and issuers are responding to these demands, without reliable evidence of sustainability's economic impact.").

> investors with the material, comparable, consistent information they need to make investment and voting decisions, (b) provide Issuers with a framework to disclose material, decision-useful, comparable, and consistent information in respect of their own businesses, rather than the current situation where investors largely rely on third-party ESG data providers, which may not always be reliable, consistent, or necessarily material, (c) level the playing field among all US Issuers regardless of market cap size or capital resources, (d) ensure the continued flow of capital to US Issuers, and (e) enable the SEC to take control of ESG disclosure for the US capital markets before other jurisdictions impose disclosure regimes on US Issuers and investors alike.[83]

This ESG disclosure recommendation came after comprehensive discussions with investment advisors, asset managers, and asset owners, United States and foreign issuers, non-governmental organizations, and third-party data providers.[84] The response was that certain ESG information is *material* in a person's investment and voting decisions.[85]

Following the Securities and Exchange Commission Investor Advisory subcommittee's recommendation in May, a subcommittee to the Securities and Exchange Commission Asset Management Advisory Committee was tasked with assessing the current environmental, social, and corporate governance disclosure issue that resulted in the May recommendation.[86] "The subcommittee's purpose [was] to look into ESG practices of investment products, and to explore, within the areas of the SEC's mandate, whether any recommendations were warranted to improve practices."[87] In the subcommittee's report, three recommendations were made regarding issuer disclosures of ESG risks.[88] The first recommendation was that the SEC "should require the adoption of standards by which corporate issuers disclose material ESG risks."[89] To keep these standards uniform across all companies, they should be authorized and binding, following generally accepted accounting principles ("GAAP"), apply to the disclosure of material ESG risks, and assist

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83. INVESTOR ADVISORY COMMITTEE RECOMMENDATION, *supra* note 4, at 2.

84. *See id.* at 2.

85. *See id.*

86. *See* Matthew Miller, *Mandating Standard ESG Risk Disclosure—Is The Tide Tuning At the SEC?*, JD SUPRA (Dec. 4, 2020), https://www.jdsupra.com/legalnews/mandating-standard-esg-risk-disclosures-18858/; *see also* U.S. SEC. & EXCH. COMM'N ASSET MGMT. ADVISORY COMM., POTENTIAL RECOMMENDATIONS OF ESG SUBCOMMITTEE (2020), https://www.sec.gov/files/potential-recommendations-of-the-esg-subcommittee-12012020.pdf.

87. U.S. SEC. & EXCH. COMM'N ASSET MGMT. ADVISORY COMM., *supra* note 86, at 2.

88. *See id.* at 1.

89. *Id.* at 1; "Existing disclosure rules are already very clear that material risks must be disclosed by issuers. What is lacking is consistent standards by which to make these disclosures." *Id.* at 5.

issuers in determining whether or not an ESG risk is material, or has the potential to become material in the future.[90] The standards would also ensure ESG disclosures comprehensively address all material risks, including the issuer's exposure to each material ESG risk, and a uniform comparison of material ESG risks across industries and specific comparison within industries.[91]

The second recommendation from the SEC subcommittee is that ESG "should utilize standards setters' frameworks to require disclosure of material ESG risks."[92] To ensure the framework be adopted and implemented by issuers, the subcommittee recommended that the SEC designate those environmental, social, and corporate governance disclosure frameworks as authoritative and binding, putting them at "parity with standards promulgated under GAAP."[93] The third and final recommendation by the SEC subcommittee regarding issuer disclosure was that the SEC "should require that material ESG risks be disclosed in a manner consistent with the presentation of other financial disclosures."[94] This would assist in the current problem, where disclosures appear in various types of documents and do not always match with other issuer data. Material ESG risks should be presented in a manner consistent with the presentation of other financial disclosures.[95]

The subcommittee's view here has not always been widely accepted by others in the SEC and business community. Critics to the new ESG disclosure proposal rules have responded that a new SEC disclosure framework for ESG "seems an unnecessary response" as the existing disclosure is sufficient.[96]

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90. *See id.* ("Standards should be material, limited by industry, and provide clear guidance on relevant metrics; SASB's work currently meets these requirements . . . and other bodies may also do so in the future.").

91. *See id.*

92. *Id.* (This framework should "[c]learly articulate the principles by which an issuer determines the backward-looking quantitative and forward-looking qualitative metrics and disclosures it should present on material ESG risks; [p]rioritize disclosure of material ESG risks applicable to most issuers, such as climate risk, while also requiring disclosure of specific material ESG risks pertinent to the issuer's business and industry; [and] [m]andate disclosure of all material ESG risks by all issuers, with appropriate exceptions considered for issuers that the SEC determines might suffer undue burdens in meeting the requirements, such as smaller issuers").

93. *Id.* at 5. "In doing so, the SEC should encourage third-party standard setters to prioritize further development of: Forward-looking disclosures, and backward-looking measures, of material ESG risks; analysis of various climate-change scenarios; discussion of efforts being undertaken to mitigate those material risks; and industry-specific disclosures on material climate-change risks, supported by refined industry classifications that promote comparability."

94. *Id.* at 5–6.

95. *See id.* at 6 (". . . including temporally aligning data with financial metrics, integrating ESG disclosure into required SEC filings and reports, and making the presentation machine-readable in a standard format and taxonomy.").

96. *Remarks by Commissioner Peirce at Meeting of the SEC Investor Advisory Committee*, HARV. L. SCH. F. ON CORP. GOVERNANCE (May 22, 2020), https://corpgov.law.harvard.edu/2020/05/22/remarks-by-commissioner-peirce-at-meeting-of-the-sec-investor-advisory-committee/.

Critics have concerns about multiple ESG data providers bombarding issuers with too many questionnaires to produce questionable value assessments.[97] They believe in trying to treat ESG factors as separate, and because the term "ESG" can be broad and thought of as encompassing many different factors, it leaves regulating quite difficult. Another argument commentators have with ESG is that "portfolios managed with ESG overlays have to underperform [other] conventional peers."[98]

IV. ARGUMENTS FOR MANDATORY DISCLOSURE OF ENVIRONMENTAL, SOCIAL, AND CORPORATE GOVERNANCE ("ESG")

Social unrest was a trend in 2020, and companies without structured ESG platforms are starting to fall behind.[99] The COVID-19 pandemic has created added obstacles for corporations, implementing "effective remote workplace communication, accessibility, and security, and to major challenges like layoffs, racial and gender inequalities, brand damage, and associated public accountability and boycotts."[100] Because of this, investors and stakeholders are beginning to ask corporations important questions to ensure ESG challenges are properly dealt with transparently and robustly.[101] ESG factors are more material now to investors the ever before. The following section gives several arguments for mandatory disclosure of ESG indicators. These three examples show the materiality of ESG indicators and therefore the demand for greater enforcement on ESG disclosures in the future.

A. COVID-19

As of July 2020, only six months in, more than ten million people worldwide have contracted the COVID-19 virus, making the outbreak one of the most economically destructive events of the past 125 years.[102] As a result of the drastic impact COVID-19 has had on the global economies in only a few months, policymakers and investors are viewing the crisis as a wake-up call to accelerate the need for a different approach to investing due to the similarities

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97. *See id.*

98. Joachim Klement, *The Truthfulness of ESG Criticism*, CFA INST. (Dec. 21, 2020), https://blogs.cfainstitute.org/investor/2020/12/21/the-truthiness-of-esg-criticism/.

99. *See* Helee Lev, *The New Normal—Investors Demand More ESG Disclosures*, GOBY (Jan. 2, 2021), https://www.gobyinc.com/new-normal-investors-demand-esg-disclosure/.

100. *Id.*

101. *See id.* ("With enough pressure and demand from investors, a significant milestone passed on December 1st of this year: Nasdaq is now requiring all companies listed on Nasdaq's stock to publicly disclose transparency statistics about their board of directors. Additionally, 'the rules would require most Nasdaq-listed companies to have, or explain why they do not have, at least two diverse directors, including one who self-identifies as female and one who self-identifies as either an underrepresented minority or LGBTQ+.'").

102. *See Why COVID-19 Could Prove to Be a Major Turning Point for ESG Investing*, J.P. MORGAN (July 1, 2020), https://www.jpmorgan.com/insights/research/covid-19-esg-investing.

between the unforeseen risks of a pandemic and issues such as climate change.[103]

On the environmental (or "E") front, there is potential post-COVID-19 to see the benefits of cleaner air in the atmosphere due to the rise of people working from home, the use of video technology, and the decrease in daily commutes.[104] COVID-19 also has the ability to drastically cut CO2 emissions with the reduction of business travel world-wide.[105] COVID-19 has shown a spotlight on social ("S") factors, like human capital, in some of the most critical corporate sectors such as health, food supply, and retail.[106] COVID-19 reveals the effectiveness of a company's governance ("G") structures and throwing up questions on flexibility to social and economic stress, along with business continuity plans.[107]

Carlo M. Funk, Head of EMEA ESG Investment Strategy, published an article in April 2020 looking at whether the current pandemic will further accelerate ESG investing, which is amongst the fastest growing areas in finance, or slow it down.[108] He found that the global pandemic might actually boost ESG investing needed to become truly mainstream.[109] Critics of his theory believe that although ESG is "nice to have," companies and investors will not have the same financial resources because of the crisis and will make it less of a priority in the future.[110] "The crisis, [however, actually] uncovers the importance of key ESG performance indicators for long-term value creation."[111] Due to the crisis, for the first time we are seeing environmental factors becoming less important. Instead, engagement with companies on the other two ESG indicators, such as employee health, and serving and protecting customers, is shifting to the forefront.[112] A spotlight on ESG factors, plus a call from the public, show the importance these indicators have in whether a person supports a company, thus making it "material" under the SEC's materiality standard.

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103. *See id.*

104. *See How Has COVID-19 Impacted ESG Investing?*, UBS (2020), https://www.ubs.com/global/en/asset-management/insights/panorama/mid-year/2020/covid-19-impacted-esg-investing.html.

105. *See id.*

106. *See id*. ("Investment into health and safety and good supply chain management, will likely become a priority for more businesses.").

107. *See id.*

108. CARLO M. FUNK, STATE STREET GLOBAL ADVISORS, COVID-19 AND ESG: FOUR DIMENSIONS (2020), https://www.climateaction.org/white-papers/covid-19-and-esg-fourdimensions.

109. *See id.*

110. *Id.* at 1.

111. *Id.* at 2.

112. *See id.* at 6.

B. Black Lives Matter Movement

The Black Lives Matter moment and subsequent protests in the summer of 2020 have brought up new issues relating to environmental, social, and corporate governance. The death of George Floyd on May 25, 2020, sparked protests across the United States over racial injustice. This incident occurred as a majority if the country was already feeling the widespread "economic and social impact of the COVID-19 pandemic, especially people of color."[113] Racial inequality is not a new topic of discussion in our country, "but the flurry of reactions from the usually silent corporate sector is.[114] The quality of demonstrations across the United States, all calling for justice in the form of change, are made up of corporate consumers, suppliers, and shareholders; placing pressure on corporate boards to "show how their policies contribute to a more equitable and inclusive workplace.".[115] "Companies have also been quick to take a stand after video clips of incidents involving employees flooded social media. Many have also publicly condemned discrimination, pledging to review policies and committing to diversity and inclusion initiatives."[116] Not only are employees pressing down on their company, investors have also began to leverage their ownership interests to push companies to display greater transparency and accountability regarding diversity.[117] Companies are now at risk of losing future investments if they fail to adequately address investors' growing concerns regarding racial injustice.[118]

There are other compelling reasons for companies to take a hard look at their business practices. The results of a 2019 McKinsey study make a case for diverse corporate cultures; finding that "companies' profitability in the top quartile for ethnic diversity was 36% higher than for those in the bottom quartile."[119]

As a result of the Black Lives Matter protests, "diversity and labor issues have a prominent spot on the agenda this year at annual general meetings, where investors file and vote on topics they want companies to address".[120] For example, on Juneteenth (June 19, 2020), the annual holiday commemorating the end of slavery in

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113. Neesha-ann Longdon, Caitlin Harris & Dimitri Henry, *Why Corporations' Responses to George Floyd Protests Matter*, S&P GLOBAL (July 23, 2020), https://www.spglobal.com/ratings/en/research/articles/200723-environmental-social-and-governance-why-corporations-responses-to-george-floyd-protests-matter-11568216.

114. *Id*.

115. *Id*.

116. *Id*.

117. *Id*.

118. *Id*.

119. VIVIAN HUNT ET AL., MCKINSEY COMPANY, DIVERSITY WINS: HOW INCLUSION MATTERS, (2020), https://www.mckinsey.com/~/media/mckinsey/featured%20insights/diversity%20and%20inclusion/diversity%20wins%20how%20inclusion%20matters/diversity-wins-how-inclusion-matters-vf.pdf.

120. *See* Longdon, Harris & Henry, *supra* note 111.

the United States, "around 70% of investors in network security firm Fortinet voted in favor of a resolution request the release of quantitative diversity data."[121] Similar shareholder motions filed at companies like Gilead Sciences, Morgan Stanley, and Mastercard were withdrawn before the annual meetings, once companies had committed to improving the reporting and disclosure of diversity data.[122] The growing involvement in the corporate world to put a spotlight on diversity, equity, and other social issues makes the ESG a material aspect to an investor's portfolio. Having a mandatory disclosure regime in place for social indicators will serve the demands put on corporations and meet the desires of investors.

C. Generational Change

The most data-driven argument for the materiality of ESG indicators is a result of the generational movement in the investment industry as millennials dominate the workplace and begin to contribute to the investment sector.[123] Today, millennials represent almost eighty million people living in the United States and they are gearing up to be the next big investing generation with a "$30 trillion intergenerational wealth transfer from baby boomers to their children."[124] A 2018 survey indicated that over 85% of investing millennials considered a company's environmental, social, and corporate governance track record an important consideration in their decision about whether to invest in it or not.[125] That same survey found that roughly 90% of millennials wanted to tailor their investments to their values.[126] Millennials are concerned not only with seeing a return on their investments, but also putting their money in companies that "align with their personal values and contribute to the social good."[127] Ninety percent of millennial investors are interested in ESG investing, and two-thirds of those millennials have actually adopted sustainable investing over the last several years.[128] One reason for this is that millennials are under the impression that a sustainable investment will lead to strong financial

121. *Id*. ("Votes carrying resolutions on workforce management issues are also becoming more common.").

122. *Id*. ("This demonstrates how investor pressure can also lead to corporate action.").

123. *See* MSCI ESG RESEARCH LLC, SWIPE TO INVEST: THE STORY BEHIND MILLENNIALS AND ESG INVESTING (2020), https://www.msci.com/documents/10199/07e7a7d3-59c3-4d0b-b0b5-029e8fd3974b ("[M]illennials are defined as those born between 1981 and 1996. With ages between 24 and 39 in 2020, members of this generation have entered their prime earning years.").

124. *Id.*

125. *See* MORGAN STANLEY INST. FOR SUSTAINABLE INVESTING, SUSTAINABLE SIGNALS: THE INDIVIDUAL INVESTOR INTEREST DRIVEN BY IMPACT, CONVICTION AND CHOICE (2019), https://www.morganstanley.com/pub/content/dam/msdotcom/infographics/sustainable-investing/Sustainable_Signals_Individual_Investor_White_Paper_Final.pdf.

126. *See id*.

127. U.S. SEC. & EXCH. COMM'N INV. ADVISORY COMM., *supra* note 4, at 2.

128. *See* Neil Yeoh, *Sustainable Investing? Here's What Millennials Need to Know in the U.S.*, FORBES (Oct. 26, 2019), https://www.forbes.com/sites/neilyeoh/2019/10/26/sustainable-investing-heres-what-millennials-need-to-know-in-the-u-s/?sh=71b0d5951e8a.

returns.[129] Another reason is a "[l]ack of transparency" and availability of impact measurements tracking of investments.[130]

Millennials get most of the attention for driving ESG to the forefront of investing, but the older generations are also interested.[131] According to a study done by Allianz Life, while millennials are more likely to make investment and purchasing decisions based on important ESG issues, Gen Xers and Baby Boomers are also expressing growing interest and putting their values into action.[132] In the study, 64% of millennials said ESG issues are important to them when deciding where to invest, while Gen Xers and Baby Boomers were not significantly far behind at 54% and 42% respectively.[133] The study also found that the three generations shared a single most important issue when doing business with a company—social issues such as diversity in the workplace and consumer protection, followed by corporate governance issues and environmental topics.[134] One interesting result from Allianz's study was that Baby Boomers are more likely than millennials and Gen Xers to say the reason they wanted to participate in ESG investing is to encourage companies to be good corporate citizens.[135] Even though millennials are seen as the ones that will bring ESG into a new age as they take over the investments, older generations are willing to contribute to social investing to better corporations and their practices. The data indicates that the future generation of investors want to see ESG indicators because these indicators align with their own personal values. The reason a person invests in a company, and therefore what they look for and what they view as material information, continues to change. Having disclosure requirements for corporations that reflect an investor's motive for investing will aid in increasing investments and transparency from corporations.

V. ESG DISCLOSURE UNDER PRESIDENT BIDEN

This final section is meant to reaffirm the likelihood of more robust ESG disclosure requirements in addition to the three materiality arguments listed above. Initially brought on by the public health crisis of the COVID-19 pandemic, and racial tension of the Black Lives Matter movement, or because of his political policy views, the election of Joe Biden as President of the United

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129. *See id.* ("Climate change is among one of the top three concerns for institutional investors. However, only half of the investors in the U.S. claim to be involved in at least one sustainable investing activity, leaving a big market opportunity for investment providers.").

130. *Id*.

131. *See* Press Release, Allianz Life, Social Responsibility Investing and ESG: It's Not Just a Millennial Trend (Aug. 12, 2019), https://www.allianzlife.com/about/newsroom/2019-press-releases/socially-responsible-investing-and-esg.

132. *See id.*

133. *See id.*

134. *See id.*

135. *See id.*

States has companies bracing for further regulation relating to diversity, carbon emission and other types of stability metrics.[136] Biden spent his presidential campaign saying he would require companies to provide greater detail on environmental risks and greenhouse gas emission as part of a broader agenda to combat climate change.[137] He also advocated for addressing long-standing racial inequality and holding corporate executives personally accountable for violations that affect workers' and communities' health and safety.[138]

Over the last year, the United States Department of Labor (DOL) under former President Trump proposed several rules that reflected ESG as not of great priority.[139] The first proposed rule would have categorized any investment choices that deviated from maximizing shareholder returns as, in effect, "illegal for trustees overseeing the $10 trillion in retirement plans under the Department's jurisdiction."[140] The second rule would have changed the laws surrounding pension plan voting—shifting the burden against voting in annual director elections for companies they own, and requiring pensions first to undertake a costly legal and economic analysis to justify their voting, which would ultimately deter voting altogether.[141] These rules are highly unlikely to see fruition and are counterproductive to Biden's economic plan he campaigned for.

It is likely that because of President Biden's position on climate change and promises for greater ESG regulation, we will see some heightened requirements from companies in the future. Biden has promised fighting climate change would be one of his administration's top goals.[142] This was evident in the President's first few days in office when he signed executive orders to cancel the Keystone XL Pipeline and rejoin the Paris Climate Agreement.[143] President

136. Emily Glazer, *Companies Brace Themselves for New ESG Regulations Under Biden*, WALL STREET J. (Jan. 19, 2021), https://www.wsj.com/articles/companies-brace-themselves-for-new-esg-regulations-under-biden-11610719200.

137. *See id.*; *see also* Louis Rambo & Frank Zarb, *Expect New SEC Leadership to Require More ESG Reporting*, JD SUPRA (Jan. 12, 2021), https://www.jdsupra.com/legalnews/expect-new-sec-leadership-to-require-6303414/ ("An element of President-elect Joe Biden's platform has been '[r]equiring public companies to disclose climate risks and the greenhouse gas emissions in their operations and supply chains.' More recently, Biden has made clear that climate risks will be a financial regulatory priority when introducing his key economic and financial advisers.").

138. *See id.*

139. *See* Michal Barzuza et al., *Why Millennials Will Win Trump's War on Socially Responsible Investing*, THE HILL (Oct. 27, 2020), https://thehill.com/opinion/finance/522955-why-millennials-will-win-trumps-war-on-socially-responsible-investing.

140. *Id.*

141. *See id.*

142. *See* Aaron Nicodemus, *Biden's SEC Set to Require Disclosure of ESG, Climate Change Risk*, COMPLIANCE WEEK (Dec. 3, 2020), https://www.complianceweek.com/regulatory-policy/bidens-sec-set-to-require-disclosure-of-esg-climate-change-risk/29788.article.

143. *See* Coral Davenport & Lisa Friedman, *Biden Cancels Keystone XL Pipeline and Rejoins Paris Climate Agreement*, N.Y. TIMES (Jan. 20, 2021),

Biden's newly appointed U.S. Department of the Treasury secretary, Janet Yellen, shares similar views as the President on climate change, promising in her confirmation hearing to advance "investments that will create jobs and address the tremendous challenge of climate change."[144] Under the new administration, its likely there will be more mandated disclosure requirements for environmental, social, and corporate governance.

CONCLUSION

This Note argued that due to recent developments in the United States, such as the COVID-19 pandemic, growing racial injustice, and new generational investing—environmental, social, and corporate governance indicators have become material under the SEC's materiality standard for disclosure. The year 2020 has placed a spotlight on environmental, social, and corporate governance investing, proving that future investors would like to know a company's carbon footprint, the diversity of a company's board of directors, and transparency in the corporation's incentives. However, there still exists a gap in current SEC disclosure rules and what investors and the public want to see from corporations. Moving from an involuntary disclosure regime and implementing mandatory disclosure rules specifically for environmental, social, and corporate governance indicators into federal securities law is a step in the right direction to create a more robust ESG disclosure regime ultimately. The SEC subcommittees' reports, which call for greater disclosures of environmental, social, and corporate governance indicators, come uncoincidentally at an unprecedented time in American history. The COVID-19 pandemic, protests over racial injustice, and a generational change rise in the

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https://www.nytimes.com/2021/01/20/climate/biden-paris-climate-agreement.html; *see also* Vipal Monga, *What is the Keystone XL Pipeline and Why Did President Biden Issue an Executive Order to Block It?*, WALL STREET J. (Jan. 21, 2021) ("Keystone XL is an expansion of an existing pipeline, called Keystone, which carries Canadian crude into the U.S. It was first proposed in July 2008 by TC Energy., then known as TransCanadaCorp., a pipeline company based in Calgary, Alberta, and ConocoPhillips, which was a joint owner until 2009."), https://www.wsj.com/articles/what-is-the-keystone-xl-pipeline-and-why-did-president-biden-issue-an-executive-order-to-block-it-11611240342; *see also The Paris Agreement*, UNFCCC, https://unfccc.int/process-and-meetings/the-paris-agreement/the-paris-agreement (last visited Feb. 18, 2022) ("The Paris Agreement is a legally binding international treaty on climate change. It was adopted by 196 Parties at COP 21 in Paris, on 12 December 2015 and entered into force on 4 November 2016. Its goal is to limit global warming to well below 2, preferably to 1.5 degrees Celsius, compared to pre-industrial levels. To achieve this long-term temperature goal, countries aim to reach global peaking of greenhouse gas emissions as soon as possible to achieve a climate neutral world by mid-century. The Paris Agreement is a landmark in the multilateral climate change process because, for the first time, a binding agreement brings all nations into a common cause to undertake ambitious efforts to combat climate change and adapt to its effects.").

144. Rambo & Zarb, *supra* note 137. ("While a new U.S. Securities and Exchange Commission chairman has not yet been named, he or she is almost certain to emphasize the new administration's priorities.").

investment industry demonstrate a desire to move away from an involuntary and unorganized ESG disclosure framework and move towards a comprehensive method that fits the needs of future investors. This Note also noted that with a President supporting greater accountability from corporations on climate change and diversity and inclusion, it's likely the time is near for greater federal disclosure rules on the environmental, social, and corporate governance front. ESG is not going anywhere, and with the increased call for transparency from investors and the public, it only seems to be getting greater in scale.