University of Miami Business Law Review

Volume 30 | Issue 2 | Article 4

March 2022

The COVID–19 Pandemic Highlighted the Need for Mandated ESG Disclosures: Now What?

Nicholas P. Mack
Vanderbilt University Law School

Follow this and additional works at: https://repository.law.miami.edu/umblr

Part of the Environmental Law Commons, and the Law and Society Commons

Recommended Citation

Nicholas P. Mack, *The COVID–19 Pandemic Highlighted the Need for Mandated ESG Disclosures: Now What?*, 30 U. MIA Bus. L. Rev. 188 (2022)
Available at: https://repository.law.miami.edu/umblr/vol30/iss2/4

This Article is brought to you for free and open access by the Journals at University of Miami School of Law Institutional Repository. It has been accepted for inclusion in University of Miami Business Law Review by an authorized editor of University of Miami School of Law Institutional Repository. For more information, please contact library@law.miami.edu.

The COVID–19 Pandemic Highlighted the Need for Mandated ESG Disclosures: Now What?

Nicholas P. Mack*

This is not simply your run–of–the–mill COVID–19 article. Instead, this article highlights a salient issue that has been right in front of our eyes this whole time and COVID–19 simply took our blinders off. ESG—short for environmental, social, and governance—is gaining significant momentum both at the firm level and in investment strategy, yet the SEC is trailing behind in ensuring the market is adequately informed of firms' ESG information. It is important to note that the COVID–19 pandemic initially threw the market into an unanticipated downward spiral; however, many ESG funds still managed to outperform the market in the midst of this financial downturn. Why is that and where do we go from here?

I. INTRODUCTION……………………………………………...…189
II. DISCLOSURE: GENERALLY AND SPECIFICALLY……………....193
A. *The Role of SEC Disclosures*………………………….....193
B. *Drawbacks and Benefits to a Mandatory Disclosure Regime*……………………………………………..195
C. *ESG Disclosures in the United States*………………..…198
D. *ESG Disclosures Globally: A New Way of Thinking*…...203
1. Global Reporting Initiative…………………………204
III. THE IMPACT AND NECESSITY OF ESG DISCLOSURES………..206
A. *Can ESG Disclosures Make a Difference to Investors?*...206
1. ESG Performance in Times of Financial Stability….207
2. ESG Performance in Times of Financial Crisis…….208

* Vanderbilt University Law School, Candidate for Doctor of Jurisprudence, Class of 2022. The College of New Jersey, Bachelor of Science in Finance, Class of 2019. This Article was completed for author's seminar class entitled "Financial Markets in an Age of Technology and Crisis." The author wishes to thank Associate Dean Yesha Yadav for her guidance and thoughtful comments throughout writing this Article.

B. Investors' Use of ESG Information..........................212
C. Greenwashing and Its Potential Adversary................213
D. The Net Gain of Mandating ESG Disclosures..............216
IV. A MATERIAL APPROACH TO MANDATED ESG DISCLOSURES..219
V. CONCLUSION..223

I. INTRODUCTION

At the conclusion of 2020, assets under management in sustainable funds—funds typically characterized by analyses of companies' nonfinancial environmental, social, and governance (ESG) factors—hit a record high, nearly $1.7 trillion,[1] with Bloomberg forecasting that total ESG investments may reach $53 trillion by 2025.[2] Investments in sustainable index funds have seen record highs in the first quarter of 2020 despite financial downturn caused by the COVID–19 pandemic.[3] Sustainable funds have gained significant traction over the last few years as US ESG funds outperformed conventional funds in 2019.[4] Further, research conducted during the COVID–19 pandemic suggests that investing in ESG–focused funds mitigates financial risks, providing for a safer and perhaps overall better investment opportunity during times of financial crisis.[5] Moreover, companies with robust ESG policies have demonstrated resilience during the COVID–19–induced financial crisis,

---

1 Simon Jessop & Elizabeth Howcraft, *Sustainable Fund Assets Hit Record $1.7 Trln in 2020: Morningstar*, REUTERS (Jan. 28, 2021), https://www.reuters.com/article/us–global–funds–sustainable/sustainable–fund–assets–hit–record–1–7–trln–in–2020–morningstar–idUSKBN29X2NM.

2 Bloomberg Intelligence, *ESG Assets May Hit $53 Trillion by 2025, a Third of Global AUM*, BLOOMBERG PROF. SERVS. (Feb. 23, 2021), https://www.bloomberg.com/professional/blog/esg–assets–may–hit–53–trillion–by–2025–a–third–of–global–aum/.

3 Pippa Stevens, *Sustainable Investing is Set to Surge in the Wake of the Coronavirus Pandemic*, CNBC (June 7, 2020), https://www.cnbc.com/2020/06/07/sustainable–investing–is–set–to–surge–in–the–wake–of–the–coronavirus–pandemic.html.

4 Jon Hale, Ph.D., CFA, *U.S. ESG Funds Outperformed Conventional Funds in 2019*, MORNINGSTAR (Apr. 16, 2020), https://www.morningstar.com/articles/973590/us–esg–funds–outperformed–conventional–funds–in–2019.

5 *See* UBS Asset Management–Global, *How has COVID–19 Impacted ESG Investing?*, UBS, https://www.ubs.com/global/en/asset–management/insights/panorama/mid–year/2020/covid–19–impacted–esg–investing.html (last visited Nov. 1, 2020) (asserting that "higher rated ESG funds fared better in the COVID–19 induced market downturn"); *see generally* David C. Broadstock, et al., *The Role of ESG Performance During Times of Financial Crisis: Evidence from COVID–19 in China*, FIN. RESEARCH. LETTERS (2020) (finding in the context of the COVID–19 pandemic that ESG performance mitigates financial risks).

providing further evidence of the benefits of ESG investing.[6] Although ESG–focused funds and companies with robust ESG policies demonstrate economic resiliency and potential for outperforming conventional funds, federal securities laws generally do not require ESG–related disclosures.[7] As recently as August 2020, the US Securities and Exchange Commission (SEC) showed its reluctancy in mandating ESG disclosures by adopting a final rule addressing required disclosures under Regulation S–K that was noticeably silent on ESG–related matters such as human capital and climate risk.[8] This Article will advocate for the SEC to mandate stricter ESG–related disclosures by public companies, using information gleaned during the COVID–19–induced financial downturn as the primary support for such recommendations.

This Article will reference ESG in two respects: ESG policies and ESG investing. ESG policies refer to board– or management–implemented environmental, social, and governance related practices at a given company; ESG investing refers to investing in companies based on their ESG policies. ESG policies and ESG investing, as well as their constituent elements, are discussed in greater detail below.

Although some directors may think of ESG policies as simply a façade, investors are urging companies to develop long–term ESG strategies.[9] More than 50% of directors surveyed in PricewaterhouseCooper's 2019 Annual Corporate Directors Survey designated that they believe institutional investors devote too much attention to board gender and ethnic/racial diversity and environmental and sustainability issues.[10] However, the surveyed board members' opinions have had little effect on changing institutional investors' beliefs.[11] Large institutional investors continued to show a keen interest in ESG–related policies during 2020, declaring that they will hold directors

6 Comm'r Allison Herren Lee, *Regulation S–K and ESG Disclosures: An Unsustainable Silence*, U.S. Sec. & Exch. Comm'n (Aug. 26, 2020) https://www.sec.gov/news/public–statement/lee–regulation–s–k–2020–08–26 [hereinafter Comm'r Lee Public Statement].

7 *See* Connor Kuratek, et al., *Legal Liability for ESG Disclosures*, HARV. L. SCH. F. CORP. GOVERNANCE (Aug. 3, 2020), https://corpgov.law.harvard.edu/2020/08/03/legal–liability–for–esg–disclosures/#:~:text=Although%20the%20federal%20securities%20 laws,are%20materially%20misleading%20or%20false (stating that ESG–related disclosures are not generally required under federal securities laws).

8 Comm'r Lee Public Statement, *supra* note 6.

9 Governance Insights Center, *ESG in the Boardroom: What Directors Need to Know*, PWC'S ESG PULSE, 1, 2 (June 2020).

10 *Id.* at 3.

11 *See id.* (describing that large institutional investors are seeking to hold directors accountable who are not making progress in ESG–related reporting).

accountable through proxy voting for failing to make progress in providing ESG disclosures.[12]

Breaking down ESG into its individual factors, each letter represents various policy efforts that can be taken by a company. Firstly, the Environmental (E) element of ESG includes policies such as efforts to prevent the progression of climate change and combatting issues of resource scarcity through resource efficiency initiatives.[13] Secondly, Social (S) policies address issues such as labor practices, talent management, product safety, and diversity.[14] Lastly, Governance (G) relates to company management and oversight, addressing subjects such as board diversity, executive compensation, business ethics, and leadership accountability.[15] As a result, ESG investing will take into account the preceding factors, as well as many others not listed, when making investment decisions.

Using the factors just described, investment management firms typically build their ESG portfolios around three principles: Exclusionary, Single Theme, or Best in Class.[16] Exclusionary ESG funds designate categories of companies to prohibit from the portfolio; these companies commonly include weapons manufacturers, tobacco companies, and casino operators.[17] ESG funds can also take a "single theme" approach, selecting one guiding criterion for investment such as board diversity or renewable energy efforts.[18] Lastly, "Best in Class" funds focus on investing in companies that lead their sector (e.g., oil & gas, pharmaceuticals, technology, etc.) in ESG principles, which likely includes companies that understand the value of ESG principles and incorporate them as a means of increasing capital and as a long–term commitment to sustainability.[19] In considering the various guiding principles for ESG funds, it is clear that at their most basic level they all rely on company information to solidify their investment decisions.

Companies instituting robust ESG policies are not just attractive investments simply due to their "do good" mentality and positive impact on society. Involving ESG factors in a companies' decisions are correlated

---

[12] *Id.*
[13] *Id.* at 2.
[14] *Id.*
[15] *Id.*
[16] Wall Street Journal, *What Are ESG Funds and Why Are They Under Scrutiny?*, YOUTUBE (Oct. 22, 2020), https://www.youtube.com/watch?v=2DgiAIbTuRE.
[17] *Id.*
[18] *Id.*
[19] Eduardo Ascanio Gosling, *The importance of the best–in–class approach to sustainability*, MEDIUM (Sept. 4, 2019), https://medium.com/swlh/the–importance–of–the–best–in–class–approach–to–sustainability–46a28b45004e.

with superior risk–adjusted returns at a securities level, as well.[20] Companies with high ESG ratings have lower costs of debt and equity, signifying that the market views these companies as lower risk than other companies.[21] A lower cost of capital means a company can invest at a lower cost, allowing it to develop its business and expand its operations more easily than if the cost of capital were higher.[22] In addition, companies with strong ESG practices see market–based financial outperformance as compared to other companies with weak or nonexistent ESG practices.[23] This market outperformance may be attributed to companies' ESG policies allowing for risk reduction, enabling preemption of potential bad publicity.[24] Regardless of what causes the market outperformance, investors are taking advantage of the apparent anomaly of investing at lower risk while achieving higher returns—an occasion contrary to the well–known sentiment "high risk, high returns."[25]

The benefits of ESG investing have become increasingly clearer and more prevalent in recent years, especially with reference to the 2008–09 and 2020 financial crises. However, creation of regulations mandating ESG disclosures continues to lag despite ESG's growing popularity. Currently, much of the ESG disclosures in the United States that do occur come from voluntary reporting through companies' annual sustainability reports.[26] While some mandatory disclosure requirements exist for material ESG impacts and an array of regulatory reporting requirements under the Foreign Corrupt Practices Act and by the Environmental Protection Agency, the current US ESG disclosure framework remains a mixed bag of unclear requirements.[27]

ESG investing is at record highs and its superior market performance is hard to ignore.[28] With general investor dissatisfaction with companies'

---

[20] Mark Fulton, Bruce Kahn, & Camilla Sharples, *Sustainable Investing: Establishing Long–Term Value and Performance*, DEUTSCHE BANK GRP. at 5 (June 2012) [hereinafter Deutsche Bank Sustainable Investing].

[21] *Id.*

[22] *See* Brian O'Connell, *What Is Cost of Capital and Why Is It Important for Business in 2019*, THESTREET (Dec. 18, 2018), https://www.thestreet.com/investing/what–is–cost–of–capital–14814298.

[23] Deutsche Bank Sustainable Investing, *supra* note 20.

[24] Societe Generale, *How a sustainable approach to business leads to financial outperformance*, CNBC (Nov. 30, 2017), https://www.cnbc.com/advertorial/2017/11/30/how–a–sustainable–approach–to–business–leads–to–financial–outperformance.html.

[25] Deutsche Bank Sustainable Investing, *supra* note 20.

[26] Virginia Harper Ho, *"Comply or Explain" and the Future of Nonfinancial Reporting*, 21 LEWIS & CLARK L. REV. 317, 326 (2017).

[27] *See id.* at 323–24 (explaining the mandatory ESG disclosure requirements currently in place in the United States).

[28] Jessop & Howcraft, *supra* note 1; *see generally* Deutsche Bank Sustainable Investing, *supra* note 20 (providing that ESG investing outperforms the market).

annual voluntary ESG disclosures due to their inconsistency and non–comparability, the need for mandatory ESG disclosures is exceedingly warranted.[29] This Article aims to inform US policy by suggesting the adoption of certain SEC–mandated ESG disclosures. Part II of this Article will provide a background on the role of SEC disclosures, exploring whether such disclosures are beneficial to investors, and will provide a deeper analysis of how ESG disclosures are currently regulated in the United States. Part III will analyze the importance of ESG disclosures and examine whether investors actually utilize ESG information. Lastly, Part IV proposes a solution that draws reference to Part II and Part III, therein recommending certain SEC–mandated ESG disclosures.

II. DISCLOSURE: GENERALLY AND SPECIFICALLY

A. *The Role of SEC Disclosures*

Prior to further discussing ESG disclosures, it is helpful to provide a foundational understanding of the role of SEC disclosure requirements generally. The SEC has asserted that "accessible and usable disclosures are central to the SEC's mission of protecting investors, maintaining fair, orderly and efficient markets, and facilitating capital formation."[30] On its website, the SEC states that the federal securities laws it oversees are based on the concepts of fair treatment and access to certain factual information about investments, which is fundamentally achieved by requiring public companies to regularly disclose "significant financial and other information so investors have the timely, accurate, and complete information they need to make confident and informed decisions about when or where to invest."[31] Financial information most recognizably takes the form of company balance sheets and income statements, whereas "other information" takes the form of information that would be material to an investor's investment decisions, which may include certain ESG factors. Thus, the primary rationale for the SEC's disclosure regime is the

---

[29] *See* Thomas L. Riesenberg, Comment, *Principles Plus SASB Standards*, 50 ENVTL. L. REP. 10653, 10653 (2020) (citing outreach by the Sustainability Accounting Standards Board (SASB) to support the claim that investors are dissatisfied with annual ESG disclosures in voluntary corporate social responsibility reports).

[30] *Structured Disclosure at the SEC: History and Rulemaking*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/page/osdhistoryandrulemaking (last updated May 21, 2020).

[31] *What We Do*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/about/what–we–do#section1 (last updated Oct. 15, 2020).

understanding that investors who have the appropriate information can make rational and informed investment choices.[32]

Yet, it is important to recognize that SEC disclosures also impact shareholders' rights. For example, based on information in a company's mandatory disclosures, shareholders may conclude that the board or management misallocated or misused their invested funds.[33] Their rights as shareholders allow them to hold the board and management accountable for such actions, among many others.[34] Informed by SEC disclosures, shareholders can exercise their rights to hold the board and management accountable through voting at shareholder meetings to change the direction of the company thereby influencing management's decisions, or shareholders may choose to sell their stock.[35]

Conventional wisdom will assert that mandatory disclosures provide an efficient response to two economic issues, often referred to as market failures: (1) agency costs and (2) the underproduction of information.[36] "Agency costs" refers to the issue that corporate managers may steal from the company or pay themselves excessively high wages, which would likely go unreported in a voluntary disclosure regime.[37] Mandatory disclosures solve this issue by deterring that type of behavior under the premise that "bad" acts will be publicly disclosed.[38] "Underproduction of information" is exactly what it sounds like—companies failing to adequately provide information relevant to investors, which would likely be the case in a voluntary disclosure regime.[39] Likewise, the mandatory disclosure regime remedies this problem by requiring public companies to share various kinds of information that is often relevant to investor decision–making.[40]

However, conventional wisdom's persistent theory of the benefits of mandatory disclosures has not gone without its criticisms. In addition to arguments advocating for mandatory disclosures, there are also arguments dismissing the need for mandatory disclosures, calling into question the

---

32 Daniel M. Gallagher, *The Importance of the SEC Disclosure Regime*, HARV. L. SCH. F. CORP. GOVERNANCE (Jul. 16, 2013), https://corpgov.law.harvard.edu/2013/07/16/the–importance–of–the–sec–disclosure–regime/#1.

33 *See id.* (describing that shareholders may hold board members and management accountable for misallocating or misusing funds).

34 *Id.*

35 *Id.*

36 Andrew A. Schwartz, *Mandatory Disclosure in Primary Markets*, 2019 UTAH L. REV. 1069, 1071 (2020).

37 *Id.*

38 *Id.*

39 *Id.*

40 *Id.* at 1071–72.

efficacy of a mandatory disclosure regime.[41] Each side of this argument is explored in more detail below, examining the drawbacks and benefits of mandatory disclosures in the securities market.

B. Drawbacks and Benefits to a Mandatory Disclosure Regime

With arguments on both sides of mandatory disclosure's efficacy, it is challenging to determine which theory accurately describes the effectiveness of mandatory disclosures with regard to ESG factors. This subpart proceeds by first addressing the drawbacks of mandatory disclosures, then advances to discussing its benefits.

Perhaps the most evident drawback to mandatory disclosures is the cost that comes with it. The cost of mandatory disclosures can be seen through two different occurrences: one is the Initial Public Offering (IPO), and the other is the ongoing quarterly and annual reporting requirements.[42] If a company wishes to sell its securities to the public, it is required under the Securities Act to register its securities with the SEC, a process that is costly and can consume roughly 1,200 hours over the span of six months or more.[43] Public companies must pay $109.10 per million dollars to register their securities with the SEC in 2021, which decreased from the previous year's $129.80 per million dollars, but still remains a substantial cost.[44] In addition to the initial registration costs, companies by themselves are typically unable to compose the in–depth disclosure statement required by the SEC documenting bonus and profit–sharing agreements and financial statements from prior years.[45] This additional level of disclosure usually requires companies to expend significant capital on lawyers, accountants, and underwriters, thereby increasing the price tag of the IPO

---

[41] *Compare* Omri Ben–Shahar & Carl E. Schneider, *The Failure of Mandated Disclosure*, 159 U. PA. L. REV. 647, 647 (2011) (exploring the multiple failures of mandated disclosures), *and* Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L.J. 2359, 2373 (1998) (challenging mandatory disclosures on theoretical grounds), *with* Allen Ferrell, *The Case for Mandatory Disclosure in Securities Regulation Around the World*, 2 BROOK. J. CORP, FIN. & COM. L. 81, 81 (2007) (arguing in multiple contexts the benefits to a mandatory disclosure regime), *and* Gallagher, *supra* note 32 (proclaiming the importance of the SEC's current mandatory disclosure regime).

[42] Schwartz, *supra* note 36, at 1069.

[43] *Id.* at 1079.

[44] Press Release, Sec. & Exch. Comm'n, Fee Rate Advisory #1 for Fiscal Year 2021 (Aug. 26, 2020), https://www.sec.gov/news/pressreleases [choose "Press Releases" from left; then search in "Search by Headline" for "Fee Rate Advisory #1 for Fiscal Year 2021"; then follow hyperlink under "August 2020"].

[45] Schwartz, *supra* note 36, at 1079.

by roughly 10%.[46] Naturally, this means that this cost is then assumed by the investors. Additional disclosures in the IPO framework, such as for ESG–related activities, would only increase the cost to companies to IPO, ultimately making the process less attainable to companies wishing to conduct an IPO and less feasible for investors who will eventually carry the added disclosure costs.

After a company completes its IPO, it is then subject to multiple quarterly and annual mandatory disclosures. In contrast to IPO–related costs, these quarterly and annual reporting requirements are ongoing and last indefinitely. Not only do companies incur costs for compiling the requisite information—utilizing human capital, software programs for adequate data compilation, and outside costs for lawyers and accountants—they also spend a lot of money determining what disclosures are actually mandated because they are pulled in multiple directions by various third–party companies that intend to make this process easier.[47] However, this leads to confusion and, consequently, the need for companies to seek costly legal counsel.[48] These high costs effectively exclude startups and small businesses from going public because they do not have the capital to sustain such regular expenses.[49] Therefore, enhanced mandatory disclosure in both the primary and secondary securities markets would generally increase the barriers to entry for smaller business who cannot afford the burden of disclosure costs.

In addition to mandatory disclosure's high costs and its inherent nature of causing barriers to entry, mandated disclosures may be problematic in and of itself. Roberta Romano, Professor at Yale Law School, goes so far as to claim that there is little proof supporting the statement that information would be "underproduced" without mandatory disclosures.[50] Professor Romano supports this conclusion by stating that because companies need capital and investors need information, companies are incentivized to disclose adequate information in order to successfully compete in the market for investments.[51] This theory dispels the need for expending high costs on IPOs, quarterly, and annual disclosures as companies would likely only spend on disclosures what is proportional to their need for capital and to sustain a competitive edge.

Lastly, a major drawback to mandatory disclosures concerns its unpredictable scope. When regulators are uncertain of investors' needs,

---

46 *Id.*

47 *See* Ben–Shahar & Schneider, *supra* note 41, at 736 (describing the expense to disclosers in figuring out what information must be disclosed).

48 *Id.*

49 Schwartz, *supra* note 36, at 1069.

50 Romano, *supra* note 41, at 2373.

51 *Id.*

mandated disclosure has a tendency to multiply in an attempt to identify those needs.[52] Further, once that need is identified and a disclosure is mandated to satisfy that need, regulators are then pressured to address new contingencies as a result of the regulation.[53] Thus, mandated disclosures may facilitate a slippery slope if an identified need is uncertain. This demonstrates the importance of identifying investors' needs strictly and coherently to prevent overregulation and unneeded mandates.

While there are numerous other drawbacks to mandatory disclosures, the above few are most pertinent to this discussion of ESG disclosures. There are also many benefits to mandatory disclosures, some of which will be explored below.

Although high costs and, derivatively, barriers to entry are issues inherent to a mandatory disclosure regime, evidence suggests that this type of system may benefit companies financially by reducing cost of capital.[54] This is due, in part, to the regime's impact on the amount of information held solely by privately informed traders.[55] Mandatory disclosures act to displace information solely held by traders, effectively reducing the high level of private–information trading.[56] Theoretical and empirical research supports the proposition that significant private–information trading is related to higher expected returns, and, in turn, implies a higher cost of capital.[57] Therefore, displacing private information through disclosure to reduce the level of private–information trading may imply a lower cost of capital.

While mandatory disclosures may pose upfront and systematic costs, a company's opportunity to invest in itself at a lower cost is made possible through the same type of disclosure regime. In addition to mitigating disclosure costs, a lower cost of capital may provide opportunities to younger or smaller companies that have fewer internal sources of capital.[58] This likely provides that the barrier to entry for younger or smaller companies with limited sources of capital can be deteriorated by the same regime that causes the barrier. The mandatory disclosure regime may mechanize a lower cost of capital, effectively diminishing some of the drawbacks mentioned above caused by the same regime.

---

[52] Ben–Shahar & Schneider, *supra* note 41, at 685.

[53] *Id.*

[54] *See* Ferrell, *supra* note 41, at 95 (claiming that empirical evidence suggests that a rigorous disclosure regime allows companies to raise external financing on "favorable terms").

[55] *Id.* at 93.

[56] *Id.*

[57] *See id.* at 93–94 (asserting that the empirically–supported association between levels of private–information trading and expected returns suggests that there is value to a company to meet demanding disclosure requirements).

[58] *Id.* at 93.

An obvious point is that mandatory disclosures aid in combatting information underproduction in a market so heavily based on information consumption.[59] Increasing mandatory disclosures—to include, say, ESG—will provide the impetus to companies to disclose information they already have access to or could easily collect that would help investors value their company and other companies in the market.[60] Professor Andrew Schwartz of the University of Colorado suggests that absent compulsion for companies to this disclose information, companies will be worse off.[61] This point signals that mandatory disclosures not only benefit the market and investors, but also benefit companies in the market that can learn from such disclosures.[62] In turn, this creates a mutually beneficial reciprocal relationship among companies in the market.

Mandatory disclosures serve as a cornerstone of the SEC's mission to protect investors and maintain fair, orderly, and efficient markets.[63] Disclosures allow for informed investment decisions and provides the opportunity to hold boards and management responsible for misfeasance.[64] With the growth of ESG policies, investor reliance on ESG information, and outperformance of ESG funds vis–à–vis non–ESG funds, one may imagine that mandatory ESG disclosures are becoming just as prevalent. However, that is not the case.[65]

C. ESG Disclosures in the United States

Current US securities laws mandate disclosure of certain environmental and social information, but the vast majority of ESG reporting remains largely market–driven.[66] Most nonfinancial or ESG information does not reach investors, regulators, or corporate stakeholders in a company's typical annual report or other SEC–mandated filings; instead, companies typically opt to release a separate, free–standing report aimed at sustainability and other ESG initiatives.[67] Furthermore, these

---

59 Schwartz, *supra* note 36, at 1089.

60 *Id.*

61 *Id. But see* Romano, *supra* note 41, at 2373 (arguing that there is little proof that information will be underproduced in a market lacking mandated disclosures because companies are incentivized to disclose information to investors to compete in the market for investments).

62 *See* Schwartz, *supra* note 36, at 1089.

63 Gallagher, *supra* note 32.

64 *Id.*

65 *See* Kuratek, *supra* note 7 (stating that ESG–related disclosures are not generally required under federal securities laws).

66 Virginia Harper Ho, *Non–Financial Reporting & Corporate Governance: Explaining American Divergence & Its Implications for Disclosure Reform*, ACCT., ECON., & L.: A CONVIVIUM at 4 (Jul. 2020).

67 *Id.*

free–standing sustainability reports are almost entirely voluntary.[68] Due to a lack of regulatory guidance from the SEC, various companies' voluntary ESG reporting is driven largely by private actors such as the Global Reporting Initiative (GRI), the Task Force on Climate–related Financial Disclosure (TFCD), and the Extractive Industries Transparency Initiative.[69] Uncertainty in the US ESG disclosure framework and lack of adequate guidance by the SEC has led to law firms picking up the slack by releasing guidance to clients.[70]

While few US securities laws mandate disclosure on ESG topics (which is explored more below), some laws *potentially* require such disclosures.[71] Potential disclosures include material changes to the business, certain environmental compliance costs, material legal proceedings, ESG risks that are material risk factors for the company, and Management's Discussion and Analysis of "any known future trends or uncertainties" that could materially affect the firm's financial performance.[72] Most of these disclosure requirements focus on materiality, leaving out nonmaterial, albeit possibly important, ESG information.[73] In addition to the aforementioned disclosure requirements, Item 402(s) of the Sarbanes–Oxley Act of 2002 (SOX) requires disclosure of how a company's risk management policies relate to executive compensation, but only if those policies are "reasonably likely to have a materially adverse effect on the company" and Item 407 of SOX requires disclosure of a description of board diversity policies.[74] The focus on materiality evinces a nonfinancial regulatory regime that is principles–based, rather than rules–based, requiring investors to "trust" companies to act objectively and precisely when gauging the materiality of numerous complex ESG issues.[75] This causes both uncertainty in reporting

---

68 *Id.*

69 *Id.*

70 *See, e.g.*, Mark S. Bergman, et al., Client Alert, *The U.S. Regulatory Framework for ESG Disclosures*, PAUL WEISS RIFKIND WHARTON & GARRISON LLP (July 31, 2020), https://www.paulweiss.com/insights/esg–thought–leadership/publications/the–us–regulatory–framework–for–esg–disclosures?id=37633; Kerry Burke, et al., *Some Do's and Don't's for Voluntary ESG Reporting and Disclosures*, COVINGTON & BURLING LLP (June 2, 2020), https://www.cov.com/–/media/files/corporate/publications/2020/06/some–dos–and–donts–for–voluntary–esg–reporting–and–disclosures.pdf.

71 Ho, *supra* note 66 at 5.

72 *Id.*; *see also* David R. Woodcock, et al., *Managing Legal Risks from ESG Disclosures*, HARV. L. SCH. F. CORP. GOVERNANCE (Aug. 12, 2019), https://corpgov.law.harvard.edu/2019/08/12/managing–legal–risks–from–esg–disclosures/ (explaining that, "the current disclosure requirement for ESG issues under the U.S. securities laws thus hinges on whether the information would be material to a reasonable investor.").

73 Ho, *supra* note 66.

74 *Id.*

75 Comm'r Lee Public Statement, *supra* note 6.

requirements on the discloser side and the need for private actors to draw attention to sustainability issues and enhanced ESG disclosures.

Paired with voluntary and principles–based ESG reporting are a few "specialized disclosures" relating to social and human rights that are mandated by the Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd–Frank).[76] These rules are much more specific than the principles–based, materiality–focused nonfinancial disclosures discussed above. Dodd–Frank requires companies to disclose mine safety policies and government payments by extractive sector firms, the use of conflict minerals,[77] and business activities in Iran.[78] However, these rules have faced backlash from the business community, causing some to have been invalidated through legal challenges.[79]

The sparse usefulness and uncertainty of the nonfinancial disclosure regime, as referred to above, has led to many attempts in the last decade to reform Regulation S–K to include ESG factors.[80] The SEC, directed by Congress, began a substantive review of the effectiveness of disclosures under Regulation S–K in 2012.[81] In 2016, as part of this review, the SEC sought public comment relating to the need for improved ESG disclosures under Regulation S–K.[82] This initiative garnered over 25,000 responses with the overwhelming majority of respondents—over 80 percent—and nearly all investors favoring the SEC taking new steps to enhance ESG disclosures in mandated SEC filings.[83] Nonetheless, the SEC failed to act on the responses received in 2016, responses that overwhelmingly signaled the market's immense desire for mandated ESG disclosures.[84] Thus, the SEC's revisions in response to the 2016 public comment largely ignored ESG disclosures.[85]

---

[76] Ho, *supra* note 66.

[77] *What are conflict minerals?*, RESPONSIBLE MINERAL INITIATIVE, http://www.responsiblemineralsinitiative.org/about/faq/general–questions/what–are–conflict–minerals/ (last visited Oct. 22, 2021)(providing that "'Conflict minerals,' as defined by US legislation, currently include the metals tantalum, tin, tungsten and gold, which are the extracts of the minerals cassiterite, columbite–tantalite and wolframite, respectively. Downstream companies often refer to the extracts of these minerals as 3TG."

[78] Ho, *supra* note 66.

[79] *See id.* (citing Nat'l Ass'n of Mfrs. v. SEC, 800 F.3d 518 (D.C. Cir. 2015)) (striking down portions of the Dodd–Frank rules on conflict minerals disclosure).

[80] *See id.* at 5; *see generally* Comm'r Lee Public Statement, *supra* note 6.

[81] Ho, *supra* note 66, at 5.

[82] *Id.*

[83] *Id.*

[84] *Id.*

[85] *Id.*

As recently as August 26, 2020, the SEC has shown its resistance to and neglect in adopting mandated ESG disclosures.[86] The rule recently adopted in late August 2020 is, for the most part, silent on important and incredibly relevant ESG factors.[87] This rule comes close to requiring disclosure of certain aspects of human capital, but SEC Commissioner Allison Herren Lee fears that the rule leans too far in the principles–based direction to further any change.[88] The August 2020 rule did not expand disclosure requirements for simple human capital metrics like part–time versus full–time workforce, workforce expenses, and employee turnover.[89] Moreover, the rule is silent on the increasingly important topics of climate risk and diversity.[90] Despite receiving thousands of comments seeking mandated disclosures for workplace development, diversity, and climate risk, in addition to numerous letters explaining why principles–based disclosures would not produce the information investors need and what metrics are important to build long–term value for investors, the SEC has failed to listen and appropriately respond to the market's concerns and desires.[91]

Encouragingly, though, the US federal government has shown a renewed interest in mandating ESG disclosures in 2021. The push for enhanced mandated ESG disclosures reached an important milestone in early 2021 when House democrat Juan Vargas introduced to Congress H.R. 1187—colloquially known as the ESG Disclosure Simplification Act.[92] This bill, which has already passed the House and sits with the Senate at the time of writing this Article, would require issuers of securities to disclose certain ESG factors[93] and their connection to the long–term business strategy of the issuer.[94] However, this bill was met with significant opposition by congressional republicans who denounced the efficacy of SEC–mandated ESG disclosures, signaling a potentially

---

[86] *See* Comm'r Lee Public Statement, *supra* note 6 (explaining the implications of the SEC's adoption of the August 26, 2020 rule regarding non–financial disclosures).

[87] *Id.*

[88] *Id.*

[89] *Id.*

[90] *Id.*

[91] *Id.*

[92] *See* Corporate Governance Improvement and Investor Protection Act, H.R. 1187, 117th Cong. (2021) [hereinafter H.R. 1187].

[93] Please note these "certain factors" are to be established by the Sustainable Finance Advisory Committee created by the bill. Once the Committee establishes the relevant factors to be disclosed, it will recommend them to the SEC. The SEC will then determine which ESG factors to mandate issuers to disclose.

[94] H.R. 1187, *supra* note 92.

arduous task to pass this bill into law.[95] Nonetheless, although this issue appears partisan in nature, high–ranking officials at the SEC—an *independent* agency that is supposed to be insulated from politics—support a more robust mandated ESG disclosure regime.

SEC Commissioner Alisson Herren Lee—a vocal opponent of the SEC's current mandated ESG disclosure regime[96]—requested public input on potential climate disclosures.[97] Commissioner Lee's hope is that public comments will provide SEC staff with the ability to deliver climate disclosures that are actually useful to the investing public.[98] SEC Chair Gary Gensler also brought attention to the SEC's desire to further mandate ESG disclosures during his testimony before the Senate Committee on Banking, Housing, and Urban Affairs.[99] Chair Gensler expressed concern with the numerous funds labeling themselves as "green" or "sustainable" and has, in response, asked SEC staff to determine methods in which the SEC can ensure the public has adequate information to understand investments regarding these funds.[100]

As a final note on the federal government's support of mandated ESG disclosures, President Biden issued an executive order in late May 2021 instructing the Financial Stability Oversight Council, which Chair Gensler sits, to construct a plan to improve climate risk disclosures and related ESG factor disclosures.[101] This executive order was particularly aimed at systematizing the executive branch's efforts to identify financial risks posed by climate change, with emphasis on its effects on government and private assets.[102]

---

95 *See* Press Release, United States Senate Comm. on Banking, Hous., & Urban Affairs, Toomey: Gensler's Agenda Does Not Appropriately Reflect the Mission of the SEC (Sept. 14, 2021), https://www.banking.senate.gov/newsroom/minority/toomey–genslers–liberal–agenda–violates–secs–regulatory–role (Senator Pat Toomey claims that mandating "these political and social issues" are outside the SEC's scope of expertise); Press Release, Congressman Doug LaMalfa, LaMalfa Opposes the "Wokeness Report Card" for Businesses (June 17, 2021), https://lamalfa.house.gov/media–center/press–releases/lamalfa–opposes–the–wokeness–report–card–for–businesses (Congressman LaMalfa likens this bill to a "wokeness" report card, stating that it provides democrats the ability to "use bureaucrats to forcibly collect information that progressive interest groups will use to publicly harass American companies.").

96 Comm'r Lee Public Statement, *supra* note 6.

97 Comm'r Allison Herren Lee, Public Statement, Public Input Welcomed on Climate Change Disclosures, U.S. Sec. & Exch. Comm'n (Mar. 15, 2021).

98 *Id.*

99 Chair Gary Gensler, Testimony Before the United States Senate Committee on Banking, Housing, & Urban Affairs (Sept. 14, 2021), https://www.sec.gov/news/testimony/gensler–2021–09–14.

100 *Id.*

101 Climate–Related Financial Risk, 86 Fed. Reg. 27967 (May 20, 2021).

102 *See id.*

Because the climate crisis seems to worsen daily[103] and with racial division in the United States reaching a point unseen in decades,[104] it is important now more than ever for the SEC to mandate ESG–factor disclosures under Regulation S–K. With potential legislation in the pipeline and numerous facets of the executive branch of the US federal government rallying behind a more robust ESG disclosure framework, SEC–mandated ESG disclosures may come to fruition in the very near future. Part III provides more detailed reasoning on the impetus for such mandated disclosures and Part IV provides a starting point for the SEC.

D. *ESG Disclosures Globally: A New Way of Thinking*

The rise in interest in ESG investing and general sustainability proliferated the development of a global reporting standards ideology. International organizations including the GRI and TFCD, among others, have released standardized sustainability disclosures guidance to aid in streamlining and effectuating the release of accurate sustainability information.[105] Furthermore, as investors' use of and desire for more ESG–related disclosures continues to trend upwards,[106] more global reporting frameworks—such as the International Financial Reporting Standards Foundation (IFRS)—are focusing on the importance of such disclosures.[107] This subpart, however, only reviews the reporting

---

[103] *See generally A Crash Course on Climate Change, 50 Years After the First Earth Day*, N.Y. TIMES (Apr. 19, 2020), https://www.nytimes.com/interactive/2020/04/19/climate/climate–crash–course–1.html (describing the current climate crisis and issues the world may face in the upcoming years).

[104] *See generally* Jennifer Rubin, *What to do About America's Great Racial Divide*, WASH. POST (Nov. 5, 2020), https://www.washingtonpost.com/opinions/2020/11/05/what–do–do–about–race–big–divider–american–politics/ (describing the racial divide in America).

[105] Ho, *supra* note 66; *see, e.g.*, GLOB. REPORTING INITIATIVE, CONSOL. SET OF GRI SUSTAINABILITY REPORTING STANDARDS 2020 (2020) [hereinafter CONSOLIDATED SET OF GRI SUSTAINABILITY REPORTING STANDARDS]; TASK FORCE ON CLIMATE–RELATED FIN. DISCLOSURES, FINAL REP.: RECOMMENDATIONS OF THE TASK FORCE ON CLIMATE–RELATED FINANCIAL DISCLOSURES (2017).

[106] *See, e.g.*, Katanga Johnson, *Analysis: Investors Ask U.S. SEC for More ESG Disclosures as Companies Resist*, REUTERS (June 16, 2021), https://www.reuters.com/business/sustainable–business/investors–ask–us–sec–more–esg–disclosures–companies–resist–2021–06–16/.

[107] *See IFRS Foundation Trustees Announce Working Group to Accelerate Convergence in Global Sustainability Reporting Standards Focused on Enterprise Value*, INT'L FIN. REPORTING STANDARDS FOUND., Mar. 22, 2021. https://www.ifrs.org/news–and–events/news/2021/03/trustees–announce–working–group/ (announcing the IFRS's "formation of a working group to accelerate convergence in global sustainability reporting standards focused on enterprise value and to undertake technical preparation for a potential international sustainability reporting standards board under the governance of the IFRS Foundation.").

framework set out by the GRI due to its recent widespread use and worldwide adoption.[108]

1. Global Reporting Initiative

The GRI Standards increase accountability and enhances transparency among companies by helping them understand their own outward impacts.[109] GRI suggests that companies either use the Standards to prepare a sustainability report in accordance with the Standards or use selected Standards, or parts therein, to report information for specific users, such as investors and consumers.[110] While encouraging a company to develop a new sustainability report or overhauling a company's existing sustainability report to comply with these Standards would be ideal, the latter GRI recommendation seems to be more realistic. In the context of mandated ESG disclosures, the goal is to inform investors. Thus, companies may be keener on a select few disclosures with an eye toward keeping investors informed.

The Standards are broken into four categories: Universal Standards, Economic, Environmental, and Social.[111] Each category of disclosures is further broken down into subcategories addressing discrete topics within each category.[112] Most pertinent to this Article and the solution proposed in Part IV are the Standards listed in GRI 300 and GRI 400, which discuss Environmental and Social Standards, respectively.[113] The GRI 300 Standards that saliently highlight company operations and profitability are GRI 302, GRI 305, and GRI 307, suggesting disclosures for Energy (mostly in terms of usage and efficiency), Emissions, and Environmental

---

[108] *Sustainability Reporting is Growing, with GRI the Global Common Language*, GLOB. REPORTING INITIATIVE (Dec. 1, 2020), https://www.globalreporting.org/about–gri/news–center/2020–12–01–sustainability–reporting–is–growing–with–gri–the–global–common–language/ [hereinafter *Sustainability Reporting is Growing*] (citing RICHARD THRELFALL, ET AL., THE TIME HAS COME: THE KPMG SURVEY OF SUSTAINABILITY REPORTING 2020 (2020)) (The report "found almost all (96%) of the world's largest 250 companies (the G250) report on their sustainability performance. For the N100 – 5,200 companies comprising the largest 100 firms in 52 countries – 80% do so." Further, "[a]cross all companies surveyed, the GRI Standards is the only sustainability reporting framework that can demonstrate widespread global adoption. Around three–quarters (73%) of the G250 and two–thirds (67%) of the N100 now use GRI.").

[109] *How to Use the GRI Standards*, GLOB. REPORTING INITIATIVE, https://www.globalreporting.org/how–to–use–the–gri–standards/ (last visited Aug. 10, 2021).

[110] *Id.*

[111] *See generally* CONSOLIDATED SET OF GRI SUSTAINABILITY REPORTING STANDARDS, *supra* note 106.

[112] *Id.*

[113] *Id.*

Compliance, respectively.[114] The GRI 400 Standard that impacts the same are GRI 405, suggesting disclosures for Diversity and Equal Opportunity.[115]

GRI 302 suggests disclosures of energy and fuel consumption within the company, energy consumption outside the company, energy intensity (disclosed in a ratio by dividing the absolute energy consumption by the company–specific metric, which is a factor chosen by the reporting company), reduction of energy consumption achieved through conservation and efficiency initiatives and the accompanying standards and methodologies used, and reductions in energy requirements of products and services and the accompanying standards and methodologies used.[116]

As the climate crisis evolves daily and continues to worsen,[117] information on greenhouse gas (GHG) emissions and other environmentally harmful emissions has taken the spotlight in recent years. GRI 305 on Emissions suggests disclosure of direct, energy indirect, and other indirect GHG emissions.[118] GRI 305 also suggests disclosure of GHG emissions intensity (disclosed in a ratio by dividing the absolute GHG emissions by the company–specific metric, which is a factor chosen by the reporting company)[119] and reduction of GHG emissions resulting from an company's reduction initiatives and the accompanying standards and methodologies.[120] In addition to GHG emissions, GRI 305 suggests disclosing emissions of ozone–depleting substances and nitrogen oxides, sulfur oxides, and other significant air emissions.[121]

---

[114] *See generally* GRI 302: ENERGY, GRI SUSTAINABILITY REPORTING STANDARDS 2016 (2016); GRI 305: EMISSIONS, GRI SUSTAINABILITY REPORTING STANDARDS 2016 (2016); GRI 307: ENVIRONMENTAL COMPLIANCE, GRI SUSTAINABILITY REPORTING STANDARDS 2016 (2016); *see also generally* Witold Henisz, et al., *Five Ways That ESG Creates Value*, MCKINSEY & COMPANY (Nov. 14, 2019), https://www.mckinsey.com/business–functions/strategy–and–corporate–finance/our–insights/five–ways–that–esg–creates–value (discussing the impact of energy usage and efficiency on cost reduction and operating profits).

[115] *See generally* GRI 405: DIVERSITY AND EQUAL OPPORTUNITY, GRI SUSTAINABILITY REPORTING STANDARDS 2016 (2016).

[116] GRI 302: ENERGY, GRI SUSTAINABILITY REPORTING STANDARDS 2016 5–12 (2016).

[117] *See generally* CLIMATE CHANGE 2021: THE PHYSICAL SCIENCE BASIS, INTERGOVERNMENTAL PANEL ON CLIMATE CHANGE (2021); *see also* Rebecca Hersher, *A Major Report Warns Climate Change is Accelerating and Humans Must Cut Emissions Now*, NPR (Aug. 9, 2021), https://www.npr.org/2021/08/09/1025898341/major–report–warns–climate–change–is–accelerating–and–humans–must–cut–emissions–.

[118] GRI 305: EMISSIONS, GRI SUSTAINABILITY REPORTING STANDARDS 2016 7–12 (2016).

[119] *Id.* at 13.

[120] *Id.* at 14.

[121] *Id.* at 15–17.

GRI 307 suggests disclosing significant monetary and non–monetary sanctions for non–compliance with environmental laws and regulations.[122] Compliance with environmental laws and regulations, or lack thereof, could have significant financial impact on a company. Failing to comply with such laws and regulations could open a company to costly litigation, government sanctions, and public defame. Each of these scenarios could significantly impact an investor's investment decisions.

In the years leading up to this Article, tensions surrounding race in the United States has reached a tipping point and a rise in positive American views on ethnic diversity is proliferating.[123] GRI 405 suggests disclosing the percentage of individuals within the company's governance bodies and the percentage of employees per employee category (in terms of seniority level and job function) within the context of gender, age group, and other indicators where relevant, such as minority and vulnerable groups.[124] GRI 405 also recommends disclosing the ratio of basic salary and remuneration of women to men.[125]

III. THE IMPACT AND NECESSITY OF ESG DISCLOSURES

A. *Can ESG Disclosures Make a Difference to Investors?*

The majority of ESG funds consistently outperform non–ESG funds in both times of financial stability and in times of financial crisis. Possibly linked to ESG funds' success are their constituent investments[126] that implement robust ESG policies. Such success during market stability and crisis provides for an attractive investment. However, as discussed above, it is difficult to understand and analyze the extent of a company's ESG

---

[122] GRI 307: ENVIRONMENTAL COMPLIANCE, GRI SUSTAINABILITY REPORTING STANDARDS 2016 6 (2016).

[123] *See* Abby Budman, *Americans are More Positive About the Long–Term rise in U.S. Racial and Ethnic Diversity Than in 2016*, PEW RSCH. CTR. (Oct. 1, 2020), https://www.pewresearch.org/fact–tank/2020/10/01/americans–are–more–positive–about–the–long–term–rise–in–u–s–racial–and–ethnic–diversity–than–in–2016/ (explaining that Americans view more positively the increase in racial and ethnic diversity in 2020 than in 2016, indicating a trend upwards); *see also* Justin Worland, *America's Long Overdue Awakening to Systemic Racism*, TIME (June 11, 2020), https://time.com/5851855/systemic–racism–america/ (highlighting the racial divide in the United States and Americans' realization of the systemic issues at play).

[124] GRI 405: DIVERSITY AND EQUAL OPPORTUNITY, GRI SUSTAINABILITY REPORTING STANDARDS 2016 (2016).

[125] *Id.* at 7.

[126] A "constituent investment" is a single stock or company that is part of a larger fund or index. In this context, the constituent investments are the individual stocks or companies that comprise an ESG fund.

policies because the current regulatory framework fails to mandate coherent disclosures on the matter. Explored below is an analysis of the financial outperformance of ESG funds versus non–ESG funds in times of financial stability and crisis. This analysis seeks to convey the significance of ESG factors in investing, therein providing insight into the importance of establishing a coherent ESG disclosure regime that will better inform investors.

1. ESG Performance in Times of Financial Stability

Although the main point of analysis in this Article is to provide information supporting the resiliency of ESG funds during times of financial downturn to support mandated disclosures of ESG factors, it is still important to present facts showing ESG fund outperformance in times of financial stability to bolster that conclusion.

ESG funds have outperformed non–ESG funds in the years leading up to the 2020 financial downturn.[127] In a statistic reported by financial services company Morningstar measuring US fund returns in 2019, nearly two–thirds of ESG funds placed in the top two quartiles.[128] Further, only 14% of ESG funds placed in the bottom quartile, evincing a significant improvement in returns for ESG funds vis–à–vis non–ESG funds.[129] These results are not unique to the United States, either. A study containing a sample of 745 Europe–based sustainable funds provided the same results; the majority of the sample outperformed non–ESG funds over one, three, five, and ten years.[130] The Financial Times quotes Storebrand Asset Management chief executive Jan Erik stating, "ESG factors are not just 'nice to have' but drivers of performance."[131] This proposition is supported by Morningstar's Jon Hale, who claims that ESG investing provides no systematic performance penalty, while reducing risk or adding alpha.[132]

ESG investing has gained traction over the last decade and the importance of utilizing ESG factors in investment decisions has proven to drive success. However, the SEC remains resistant to mandating disclosure of ESG factors, effectively keeping pools of important and

---

[127] Hale, *supra* note 4.

[128] *Id.*

[129] *Id.*

[130] *See* Siobhan Riding, *Majority of ESG Funds Outperform Wider Market Over 10 Years*, FIN. TIMES (June 13, 2020), https://www.ft.com/content/733ee6ff–446e–4f8b–86b2–19ef42da3824 (referencing research conducted by Morningstar).

[131] *Id.*

[132] Hale, *supra* note 4; *What is Alpha?*, ROBINHOOD (Mar. 11, 2021), https://learn.robinhood.com/articles/2lwYjCxcvUP4lcqQ3yXrgz/what–is–alpha/ (stating that alpha is "a statistical measure of how an investment performs against a given benchmark such as the S&P 500 index over a selected period of time.").

accurate information from the market. Funds focusing on sustainability and ESG factors have shown brilliant success compared to their non–ESG counterparts during times of financial stability, which is an important argument for SEC–mandated ESG disclosures. However, that argument is secondary to ESG fund–outperformance during times of financial crisis, such as the 2020 financial downturn due to the COVID–19 pandemic.

2. ESG Performance in Times of Financial Crisis

Prior to discussing ESG performance during the COVID–19 pandemic and financial crisis, an analysis of ESG performance during the previous financial crisis in 2008–09 is helpful. The term ESG only gained prominence in 2019 and has become somewhat mainstream in 2020.[133] "ESG" was not necessarily prominent during the 2008–09 financial crisis, evidenced by its sudden rise in popularity and increased attention by investors. Nonetheless, ESG's predecessor, Corporate Social Responsibility (CSR), was quite prominent during the earlier crisis.[134] ESG and CSR share the objectives of bettering the company and the planet through various initiatives, but they are implemented in different ways. CSR typically takes the form of a disconnected department in the company, whereas ESG is integrated company–wide as a strategic objective connected to the mission of the company.[135] Therefore, CSR can be thought of as a portion of the overall ethos of ESG, with ESG expanding CSR's programming to a company–wide mindset. Thus, financial performance related to CSR policies may indicate a parallel to ESG performance.

In the decades leading up to the 2008–09 financial crisis, CSR dramatically increased in developed economies.[136] One benchmark referenced by Giannarakis and Theotokas in analyzing CSR performance during a financial crisis is the United Nations Global Compact (UNGC) principles.[137] The UNGC principles focus on corporate sustainability, referencing fundamental responsibilities in areas such as human rights,

---

[133] *See* Tine Thygesen, *Everyone Is Talking About ESG: What Is It And Why Should It Matter To You?*, FORBES (Nov. 8, 2019), https://www.forbes.com/sites/tinethygesen/2019/11/08/everyone–is–talking–about–esgwhat–is–it–and–why–should–it–matter–to–you/?sh=34429cc532e9 (describing ESG as a "new buzzword in business" in 2019).

[134] *See id.* (claiming that "ESG will likely replace CSR as the corporate vehicle for positive contribution").

[135] *Id.*

[136] Grigoris Giannarakis & Ioannis Theotokas, *The Effect of Financial Crisis in Corporate Social Responsibility Performance,* 3 INT'L J. MKTG. STUD. 1, 6 (2011).

[137] *Id.* at 2–3.

labor, environment, and anti–corruption.[138] Referencing a study conducted by Arevalo and Aravind in 2010 investigating 271 US members of the UNGC, Giannarakis and Theotokas state that CSR is a starting point for improving business operations.[139] Further, the study concluded that companies in the sample that conformed less to the UNGC principles were more affected by the financial downturn, whereas companies that adopted the UNGC principles more vigorously were impacted less by the crisis.[140]

Giannarakis and Theotokas also use companies' implementation of GRI Standards as a benchmark to conduct an empirical analysis of CSR performance during financial downturn.[141] GRI—as referenced in Part II—is an opt–in reporting initiative focusing on companies' reporting on operations that impact the economy, environment, and society.[142] The results of their study found that companies certified by the GRI reporting framework indicated increased CSR performance during the 2008–09 financial crisis.[143] Giannarakis and Theotokas even go so far as to declare "the benefits that may arise by the implementation of CSR strategy and initiatives are more important than ever before for the companies' survival."[144] The drivers for such importance to company survival may derive from the increased trust established by CSR. CSR allows a company to build and develop their brand name, effectuating a relationship with consumers and building trust.[145] Trust between companies and stakeholders is incredibly important, with many companies viewing CSR as an investment to differentiate its company and "redefine the trust between companies and society."[146] Building trust through CSR policies proved to be of great importance during the 2008–09 financial crisis. More than 60% of Americans in late 2008 believed that stricter regulations were needed to prevent big business from abusing its power, signaling a decline

---

[138] *The Ten Principles of the UN Global Compact*, UN GLOB. COMPACT, https://www.unglobalcompact.org/what–is–gc/mission/principles (last visited Dec. 2, 2020).

[139] *See* Giannarakis & Theotokas, *supra* note 136, at 3 (citing Jorge A. Arevalo & Deepa Aravind, *The Impact of the Crisis on Corporate Responsibility: The Case of UN Global Compact Participants in the USA*, 10 CORP. GOVERNANCE INT'L J. BUS. SOC'Y 406, 406–20 (2010)).

[140] *Id.*

[141] *Id.* at 2.

[142] *See generally* GLOB. REPORTING INITIATIVE, https://www.globalreporting.org/ (last visited Dec. 2, 2020) (describing the Global Reporting Initiative's framework and values).

[143] Giannarakis & Theotokas, *supra* note 137, at 2.

[144] *Id.*

[145] *Id.*

[146] *Id.* at 6.

in public confidence in market–based solutions to human problems caused by the financial crisis.[147]

The above analysis regarding CSR initiatives' link to company performance and the drivers relating to such performance can likely be imputed onto ESG funds. As ESG's predecessor, CSR shares much of the values and initiatives embedded in an ESG ethos. Likewise, ESG disclosures can be seen as a trust–building mechanism between companies and the market. Because of its inherent trust–building qualities, ESG disclosures necessarily support the SEC's mission to protect investors while maintaining fair, orderly, and efficient markets.[148]

Just as with its predecessor CSR during the 2008–09 financial crisis, companies that employ robust ESG policies showed resiliency during the 2020 COVID–19–induced financial downturn.[149] This phenomenon was measured earliest in China, immediately following the lockdown in Wuhan in December 2019. Professors at the Hong Kong Polytechnic University and Chinese University of Hong Kong performed regression analyses on returns related to ESG scores provided to various stocks listed on the CSI 300 Index based on certain environmental, social, and governance factors.[150] Controlling for leverage, book–to–market value, and firm size, the regression results support a positive and statistically significant relationship between ESG factors and cumulative stock returns.[151] Furthermore, companies with higher ESG scores, as provided by the authors, experienced smaller stock price declines during the COVID–19 pandemic.[152] In closing, the authors of this particular study purport that their research empirically illustrated the idea that ESG performance is a signal of future stock performance and risk mitigation in times of crisis.[153] Granted that this study utilized data recorded only days after the Wuhan lockdown and at the advent of financial downturn, the results speak volumes to the importance of ESG factors in investing.

---

[147] Alison Kemper & Roger L. Martin, *After the Fall: The Global Financial Crisis as a Test of Corporate Social Responsibility Theories*, 7 EUR. MGMT. REV. 229, 236 (2010).

[148] *See What We Do*, *supra* note 31 (explaining the SEC's mission and founding principles).

[149] *See* Broadstock, et al., *supra* note 5, at 1 (citing Rui A. Albuquerque, et al., *Resiliency of Environmental and Social Stocks: An Analysis of the Exogenous COVID–19 Market Crash* (Eur. Corp. Governance Inst., Finance Working Paper No. 676, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3583611); *see also* Attracta Mooney, *ESG Passes the Covid Challenge*, FIN. TIMES (June 2, 2020), https://www.ft.com/content/50eb893d–98ae–4a8f–8fec–75aa1bb98a48.

[150] Broadstock, et al., *supra* note 5, at 5.

[151] *Id.*

[152] *Id.*

[153] *Id.*

What is more is that the results of the above–referenced study are not distinct to China. Many funds in the United States with an emphasis on ESG criteria have outperformed the market during the pandemic.[154] Although much of this outperformance can be attributed to the technology stock boom,[155] nearly three–quarters of tech CEOs believe it is their responsibility to ensure their organizations' ESG policies reflect their customers' values, which is an attitude towards increasing ESG performance.[156]

While counterarguments to ESG's efficacy in investing exist, the reasoning for ESG–heavy companies' outperformance likely still holds true.[157] It is widely held that handling ESG issues well signals operational superiority within a company.[158] Superior operations attributed to strong ESG policies within a company can be explained by a multitude of reasons. For example, ESG aids in cost reduction by managing resources efficiently and increasing operational acuity; ESG may also enhance a company's workforce by helping attract and retain employees while rallying them behind sustainable initiatives.[159] ESG's internal importance is only magnified during times of crisis. Typically, in times of crisis, companies that are better at managing business risk outperform their lesser–prepared peers.[160] The heart of ESG policies is risk management, providing for high–quality leadership that has the ability to address and overcome environmental and social disruptions.[161] Lastly, companies with robust ESG policies likely create long–term value by solving

---

154 Esther Whieldon, et al., *ESG Funds Outperform S&P 500 Amid COVID–19, Helped by Tech Stock Boom*, S&P GLOB. MKT. INTEL. (Aug. 13, 2020), https://www.spglobal.com/marketintelligence/en/news–insights/latest–news–headlines/esg–funds–outperform–s–p–500–amid–covid–19–helped–by–tech–stock–boom–59850808.

155 *Id.*

156 *See The ESG Imperative for Technology Companies*, ASSETS KPMG (2020), https://assets.kpmg/content/dam/kpmg/us/pdf/2020/04/esg–imperative–for–tech–companies.pdf.

157 *See, e.g.*, Elizabeth Demers, *ESG Didn't Immunize Stocks Against the Covid–19 Market Crash*, HARV. L. SCH. F. ON CORP. GOVERNANCE 1, 2 (Sept. 8, 2020), https://corpgov.law.harvard.edu/2020/09/08/esg–didnt–immunize–stocks–against–the–covid–19–market–crash/ (arguing that ESG's role as a "vaccine against unexpected market shocks" is overstated).

158 *See* Matthew Nelson, *The Importance of Nonfinancial Performance to Investors*, HARV. L. SCH. F. CORP. GOVERNANCE (Apr. 25, 2017), https://corpgov.law.harvard.edu/2017/04/25/the–importance–of–nonfinancial–performance–to–investors/ (referencing a statement by BlackRock's CEO Larry Fink, echoed by many other investors, stating that "handling ESG issues well is often a sign of operational excellence at a company.").

159 *See* Henisz, et al., *supra* note 114.

160 Aegon Asset Mgmt., *Why ESG Matters in a Crisis*, INSTITUTIONAL INV. (June 9, 2020), https://www.institutionalinvestor.com/article/b1ly879667bxnt/why–esg–matters–in–a–crisis.

161 *Id.*

sustainability–related issues through their products and services.[162] This is made possible by sustainability efforts attracting and retaining customers, driving revenue growth, and generating lower operating costs.[163] A robust ESG policy can provide value in times of financial stability, financial crisis, and on a long–term financial horizon.

Global data supports the proposition that companies with robust ESG policies outperform ESG–lacking companies in times of both financial stability and financial crisis. While some ESG information must be disclosed to the public, disclosure of majority of the information is not mandatory. While companies try their best with annual sustainability reports, the fact of the matter is that not all public companies release such a report and not every report contains the data relevant to ESG investment decision–making.[164] The above analysis supports the idea that ESG information is vital to investment decision–making because of the proven resiliency of ESG–heavy companies and outperformance in the midst of financial downturn. Fundamentally, ESG information has proven to be of significant importance to understanding company operations and of great usefulness in investment decisions, squarely aligning ESG disclosures with the SEC's mission to provide accessible and usable disclosures so investors can make timely and informed investment decisions.[165] However, as recently as August 2020, the SEC has failed to mandate ESG disclosures on some of the most important ESG factors in the United States. The next question, then, is would investors utilize ESG information if it was released?

B. Investors' Use of ESG Information

According to management consulting firm McKinsey & Company, investors and asset owners adjust their investment strategies based on corporate sustainability disclosures.[166] Sustainable investing has also seen

---

162 *Id.*

163 *Id.*

164 *See generally id.* (explaining that most investors believe that companies do not disclose ESG risks that could affect their business).

165 *See What We Do*, *supra* note 31 (providing that federal securities laws achieve their goal by requiring disclosure of "significant financial and other information so investors have the timely, accurate, and complete information they need to make confident and informed decisions about when or where to invest."); *Structured Disclosure at the SEC: History and Rulemaking*, *supra* note 30 ("accessible and usable disclosures are central to the SEC's mission of protecting investors, maintaining fair, orderly and efficient markets, and facilitating capital formation.").

166 Sara Bernow, et al., *More Than Values: The Value–Based Sustainability Reporting That Investors Want*, MCKINSEY & COMPANY (Aug. 7, 2019), https://www.mckinsey.com/business–functions/sustainability/our–insights/more–than–values–the–value–based–sustainability–reporting–that–investors–want#:~:text=Corporate%20executives%20

a stark increase from $13.3 trillion to $30.7 trillion from 2012 to 2018, presenting an overwhelming development in investment strategies towards ESG investing.[167] Ernst & Young's (EY) 2016 report on ESG also indicates a global trend toward an increased interest in nonfinancial information by investment professionals.[168] EY's report importantly provides data suggesting that nonfinancial performance plays a "pivotal role" in most of the surveyed investors' decisions, with a "dwindling percentage" of surveyed investors believing that it is unclear whether nonfinancial disclosures are material.[169] Investors have shown a clear proclivity towards using ESG information in investment decisions, exemplifying the need for a regulatory framework dedicated to ESG.

The claims above by private entities are echoed by those in the public sector, as well. A July 2020 Government Accountability Office report on ESG disclosures found that most institutional investors seek information on ESG issues to better understand investment risks.[170] SEC Commissioner Allison Herren Lee stated in response to the Commission's passing of a final rule in August 2020, "It has never been more clear that investors need information regarding, for example, how companies treat and value their workers, how they prioritize diversity in the face of profound racial injustice, and how their assets and business models are exposed to climate risk as the frequency and intensity of climate events increase."[171] Information, survey results, and public statements coming from both the private and public sectors recognize the importance of ESG disclosures and the incessant use of such information by investment professionals today.

C. *Greenwashing and Its Potential Adversary*

Greenwashing is the practice of making one's company appear to be doing more to protect the environment than it really is.[172] Chairman of the International Accounting Standards Board, Hans Hoogervorst, warns that greenwashing is rampant in voluntary sustainability reports published by

---

and%20investors%20alike,could%20improve%20in%20some%20respects.&text=And%20many%20investors%20said%20they,and%20engage%20companies%20more%20effectively.

[167] *Id.*

[168] Nelson, *supra* note 158.

[169] *Id.*

[170] U.S. GOV'T ACCOUNTABILITY OFF., GAO–20–530, PUBLIC COMPANIES: DISCLOSURE OF ENVIRONMENTAL, SOCIAL, AND GOVERNANCE FACTORS AND OPTIONS TO ENHANCE THEM 1, 5 (2020).

[171] Comm'r Lee Public Statement, *supra* note 6.

[172] *See* Leyla Acaroglu, *What is Greenwashing? How to Spot It and Stop it*, MEDIUM (July 8, 2019), https://medium.com/disruptive–design/what–is–greenwashing–how–to–spot–it–and–stop–it–c44f3d130d5 (quoting Cambridge Dictionary).

companies.[173] This is largely the case due to ESG disclosures being voluntarily reported; companies can hand pick the information they want to disclose because sustainability reporting lacks a concrete disclosure framework.[174] The selective nature of ESG reporting opens the door to misleading or misguided statements that may not accurately represent the ESG policies or impact of the company. A study into randomly selected Fortune 250 companies' sustainability reporting efforts showed that the majority of the sampled multinational corporations (MNCs) could be accused of greenwashing due to the lack of detailed quantitative information regarding the environmental impacts on the MNCs' supply chain.[175] Greenwashing is rampant with most investors believing that companies do not disclose ESG risks that could affect their business.[176] These practices may only get worse as the United States' disposition towards sustainability strengthens.[177]

As greenwashing in the United States continues to evolve and become more sophisticated as time passes,[178] companies are realizing that "going green" and marketing themselves as such can drive profitability.[179] More specifically, Generation Z—typically understood to be those born after 1996—are more likely to spend their money on companies that are seen as ethical and sustainable.[180] In an attempt to capitalize on this imperative, companies have turned to exploiting the vagueness of "green"

---

173 Jennifer Thompson, *'Greenwashing is Rampant', Warns Chief of Global Accounting Body*, FIN. TIMES (Apr. 2, 2019), https://www.ft.com/content/fbc6e4f7–bd89–3971–af89–7c007cb57e8c.

174 Chris Gaetano, *Rise of Sustainability Reporting Brings Questions of Motivation, Agenda*, N.Y. ST. SOC'Y CERTIFIED PUBLIC ACCTS. (Sept. 20, 2019), https:// www.nysscpa.org/news/publications/the–trusted–professional/article/rise–of–sustainability–reporting–brings–questions–of–motivation–agenda.

175 John K. Lewis, *Corporate Social Responsibility/Sustainability Reporting Among the Fortune Global 250: Greenwashing or Green Supply Chain* (Faculty & Staff – Articles & Papers, Salve Regina Univ., Paper No. 56, 2016), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2850721.

176 Nelson, *supra* note 158.

177 *See* Drew Desilver, *Americans Say They're Changing Behaviors to Help the Environment – But is it Making a Difference?*, PEW RES. CTR. (Dec. 19, 2019), https://www.pewresearch.org/fact–tank/2019/12/19/americans–say–theyre–changing–behaviors–to–help–the–environment–but–is–it–making–a–difference/ (highlighting Americans' changing behavior towards a more sustainable lifestyle).

178 Bruce Watson, *The Troubling Evolution of Corporate Greenwashing*, GUARDIAN (Aug. 20, 2016), https://www.theguardian.com/sustainable–business/2016/aug/20/greenwashing–environmentalism–lies–companies.

179 Marthe de Ferer, *What is Greenwashing and Why is It a Problem*, EURONEWS. (Oct. 20, 2020), https://www.euronews.com/living/2020/09/09/what–is–greenwashing–and–why–is–it–a–problem.

180 *Id.*

terminology.[181] This is seen in the United States, where greenwashing can likely be attributed to the current state of ESG disclosures.[182] However, mandatory disclosure of environmental practices would make it more difficult for so–called "brown" companies to get away with greenwashing tactics.[183] This would allow for third parties to audit the disclosures, enabling investors, consumers, and nongovernmental organizations to compare a company's communications with reliably–audited information regarding the company's environmental practices.[184] The idea that regulatory oversight may diminish the rampancy and development of greenwashing can be seen most clearly through the lens of the SEC.

A core mission of the SEC is to protect investors by maintaining fair, orderly, and efficient markets by facilitating capital information.[185] Central to that mission is the Securities Act of 1933, often referred to as the "truth in securities" law, which prohibits deceit, misrepresentations, and other fraud in the sale of securities.[186] Regulation S–K, the SEC's nonfinancial disclosure mandate, comes under the authority of the Securities Act of 1933, extending the prohibition on deceitful statements to the very limited mandated ESG disclosures. Although federal securities laws currently do not directly require ESG disclosures, companies may be potentially liable for material misstatements and omissions in voluntary ESG disclosures under Section 11 of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934.[187] However, claims regarding ESG disclosures brought under these two sections have typically failed.[188] Perhaps, if ESG disclosures or sustainability reports were regulated under the Securities Act of 1933 pursuant to their inclusion under Regulation S–K, disclosers may be dissuaded from partaking in greenwashing due to enhanced scrutiny and accountability provided for under an SEC regulatory regime.

---

[181] *Id.*

[182] *See* Magali A. Delmas & Vanessa Cuerel Burbano, *The Drivers of Greenwashing*, 54 CAL. MGMT. REV. 64, 70 (2011) (explaining that the current state of voluntary disclosure of environmental information does little to deter greenwashing).

[183] *Id.*

[184] *Id.* at 74.

[185] *What We Do*, *supra* note 31.

[186] *The Laws That Govern the Securities Industry*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/answers/about–lawsshtml.html#:~:text=Often%20referred%20to%20as%20the,in%20the%20sale%20of%20securities (last updated Oct. 1, 2013).

[187] Kuratek, *supra* note 7.

[188] *Id.*

D. The Net Gain of Mandating ESG Disclosures

There are certain drawbacks and benefits to a mandatory disclosure regime as reviewed above. The same concept is true for the more specific issue of mandated ESG disclosures. This subpart will briefly discuss these issues, ultimately concluding that, on balance, mandated ESG disclosures will result in a net gain.

The pitfalls of mandated ESG disclosures will be realized mostly by the discloser. Firstly, companies may face enhanced liability face if the SEC mandates ESG disclosures. To this end, Section 11 of the Securities Act of 1933 and Rule 10b–5 of the Securities Exchange Act of 1934 are on point. If ESG disclosures are mandated by the SEC, Section 11 of the Securities Act may pose an issue to disclosers for IPOs and secondary offerings.[189] Section 11 allows investors to hold issuers, officers, underwriters, and others liable for damages caused by untrue statements of fact or material omissions of fact contained in registration statements if an investor can show that the shares were purchased pursuant to the misleading registration statement.[190] In addition, Rule 10b–5 of the Securities Exchange Act casts a wide net by prohibiting untrue statements of material facts in connection with the purchase or sale of any security.[191] Both of these securities laws place disclosers under enhanced scrutiny, subjecting them to a likely increase in litigation, increased compliance costs to ensure no misleading statements or material misstatements of fact are made, and perhaps criminal sanctions on the individual level.[192] This elevated liability will require disclosers to be exceedingly careful in their ESG disclosures and necessarily raises a danger to disclosers if their projected ESG initiatives are not realized—such as a claim to become carbon neutral in 10 years. Depending on what ESG information is mandated, such a regime could open the door to requiring statements that companies may fail to realize in the long run, necessarily exposing them to a risk of being sued under securities laws.

Secondly, research shows that mandatory nonfinancial disclosures, such as disclosure of ESG factors, may have a negative impact on ESG policy–development at the company level due to an increased "box–

---

[189] *See* Adam M. Apton, *Pleading Section 11 Liability for Secondary Offerings*, A.B.A. (Jan. 7, 2017), https://www.americanbar.org/groups/litigation/committees/securities/practice/2017/pleading–section–11–liability–for–secondary–offerings/#:~:text=Section%2011%20of%20the%20Securities,the%20time%20they%20become%20effective.

[190] *Id.*

[191] 17 C.F.R. § 240.10b–5 (2020).

[192] *See* Steve Thel, *Taking Section 10(b) Seriously: Criminal Enforcement of SEC Rules*, 2014 COLUM. BUS. L. REV. 1, 6 (2014) (arguing that Section 10(b) triggers the SEC's ability to bring criminal sanctions under Rule 10b–5 because Section 10(b) makes it "unlawful" to use manipulative or deceptive devices or contrivances in SEC rules).

ticking" mentality.[193] Phrased differently, companies may simply comply with their obligations under the regulation and not seek to go beyond what is required. This type of mentality could negatively impact the company, but it could also extend negatively to society as a whole. Take, for example, if the SEC were to mandate that at least one individual identifying as a woman be on a company's board, or that certain carbon emissions standards must be met. A company can comply with these minimum standards, disclose such data, and be done with it. This fundamentally disparages the purposes of ESG policies, which is to develop a better workplace and society through company initiatives.

The positive aspects of mandated ESG disclosures not only tip the scale in favor of such a regime, but also quell the concerns just raised above. Firstly, while mandatory ESG disclosures may subject disclosers to increased liability, the other side of the coin provides that companies will be held accountable for misstatements. Such a regime subjecting disclosers to higher scrutiny can enhance the quality of disclosed information by encouraging compliance under threat of litigation.[194] Of course, this positively impacts the market and investors who rely on truthful and high–quality information to exact investment decisions. In the same vein, mandating ESG disclosures will provide investors with more information that can be utilized to make investment decisions. The importance of ESG information in investing has been demonstrated throughout this Article time and time again, supporting the salience of investors' knowledge of ESG information. Importantly, ESG disclosures fall within the SEC's mission to provide significant and useful information to investors to allow informed investment decisions.[195]

Secondly, mandated ESG disclosures may reduce the level of complacency surrounding CSR efforts in companies that typically ignore CSR issues.[196] Research shows that enhanced nonfinancial disclosure regulation may lead to a larger increase in the level of CSR activity for

---

193 Gregory Jackson, et al., *Mandatory Non–financial Disclosure and Its Influence on CSR: An International Comparison*, 162 J. BUS. ETHICS 323, 335 (2020); *But see One Year Later, Companies and Investors are 'Still In' the Paris Agreement*, CERES (June 1, 2018), https://www.ceres.org/news–center/press–releases/one–year–later–companies–and–investors–are–still–paris–agreement [hereinafter *One Year Later*] (explaining that, although US companies are no longer obliged to conform to the Paris Agreement, over a thousand companies are continuing to maintain compliance with the Agreement and are developing sustainability initiatives).

194 Merritt B. Fox, *Civil Liability and Mandatory Disclosure*, 109 COLUM. L. REV. 237, 239 (2009).

195 *See The Role of the SEC*, INVESTOR.GOV, https://www.investor.gov/introduction–investing/investing–basics/role–sec (last visited Dec. 4, 2020).

196 Jackson, *supra* note 193, at 327.

those companies lacking robust CSR initiatives.[197] This is particularly important in smaller businesses that have put off the opportunity to develop progressive and sustainable business practices.[198] Spurring CSR activity within a company will positively impact society, company operations, and likely, in turn, financial performance.[199] Lastly, mandated ESG disclosures may reduce the widespread use of greenwashing tactics in sustainability reporting, effectively leading to more accurate, realistic, and truthful ESG information disseminated to the market.[200]

Although mandating ESG disclosures may increase compliance costs and expose companies to enhanced liability, it also causes companies to be more careful and truthful in disclosures. This allows for a better–informed market and an enhanced opportunity for investors to hold companies accountable for the information they disclose. Additionally, while mandating ESG disclosures can lead to a box–ticking mentality, companies have shown their willingness to innovate and develop sustainability initiatives even though they have met basic requirements.[201] Such a mandate may also lead to the development of CSR initiatives in businesses that lack sustainability programming or are falling behind in the current progressive business world. Therefore, while there are some costs to mandating ESG disclosures, those costs are not only mitigated by the benefits, they are also justified by the benefits. Thus, mandating ESG disclosures will have a net gain on companies, the market, and society as a whole.

Investment funds with a focus on ESG have a history of outperforming the market in times of financial stability and crisis.[202] This financial outperformance is likely due, in part, to the robust ESG policies employed by the funds' constituent investments.[203] It is increasingly evident that ESG–heavy stocks and ESG funds' demonstrated resiliency and financial outperformance in the midst of financial downturn. The rise in prominence of ESG investing and the proven impact of ESG policies on company performance signals a critical need for accurate mandated disclosures on

---

197 *Id.*

198 *See* Makoya Kageyama, *CSR Challenges and Strategies for Small Businesses*, TOKYO FOUND. POL'Y RES. (Apr. 10, 2017), https://www.tkfd.or.jp/en/research/detail.php?id=456 (discussing CSR practices at the small business level and what challenges such businesses face).

199 *See supra* Subpart III(A) (analyzing the impact of ESG policies on a company's operations and financial performance).

200 *See supra* Subpart III(C) (discussing greenwashing).

201 *See One Year Later, supra* note 193 and accompanying text.

202 *See* Hale, *supra* note 4 (evincing that ESG funds have outperformed non–ESG funds in recent years); Whieldon, et al., *supra* note 154 (providing that ESG funds have outperformed the S&P 500 during the COVID–19 pandemic).

203 Henisz, et al., *supra* note 114; Aegon Asset Management, *supra* note 160.

the matter. This need is only further supported by the market's desire for ESG information, with evidence suggesting that investors actively use ESG information in investment decisions.[204] Secondary to the previous point, but nonetheless important, is the fact that mandated ESG disclosures may reduce inaccurate or misleading disclosed ESG information. These arguments are supported by the SEC's three–part mission to ensure usable disclosures of significant information that (1) protect investors; (2) maintain fair, orderly, and efficient markets, and (3) facilitate capital information.[205] Mandating disclosure of ESG information will actively facilitate information vital to a company's capital development and formation, while ensuring a streamlined and orderly disclosure method that protects investors from otherwise misleading ESG disclosures.

IV. A MATERIAL APPROACH TO MANDATED ESG DISCLOSURES

This Article cannot suggest a drastic departure from the current SEC nonfinancial disclosure regime because the SEC so recently neglected to directly mandate disclosures on important ESG factors.[206] The SEC likely is not regulating ESG disclosures to the extent it could because it cannot be sure "which, if any, sustainability disclosures are important to an understanding of a registrant's business and financial condition . . . ."[207] Without departing from the SEC's current principles–based, materiality–focused nonfinancial disclosure regime, this Article recommends that the SEC adopt mandated disclosures for certain ESG factors that materially impact a company's operations. This solution addresses the SEC's repeated neglect to adopt mandated ESG disclosures by framing such disclosures in a principles–based manner—thus, conforming to the SEC's current nonfinancial disclosure regime. This Article has explored the importance of ESG policies on a company's operations and how superior operations attributable to a robust ESG policy can lead to financial

---

[204] *See* Bernow, et al., *supra* note 166 (referencing a study by McKinsey & Company stating that investors and asset owners adjust their investment strategies based on corporate sustainability disclosures); Nelson, *supra* note 158 (referencing a study by Ernst & Young indicating a global trend toward an increased interest in nonfinancial information by investment professionals).

[205] SEC, *The Role of the SEC*, INVESTOR.GOV, https://www.investor.gov/introduction–investing/investing–basics/role–sec (last visited Dec. 4, 2020).

[206] *See* Comm'r Lee Public Statement, *supra* note 6 (noting the SEC's failure in developing a final rule that mandates disclosures of climate risk and diversity).

[207] *See* Jody Grewal, et al., *Material Sustainability Information and Stock Price Informativeness*, 171 J. BUS. ETHICS 513, 513–14 (Feb. 2020) (quoting Concept Release on Business and Financial Disclosures Required by Regulation S-K Release Number 33-10064; 34-775599. (Accessed from: https://www.sec.gov/rules/concept/2016/33–10064.pdf)).

resiliency and outperformance, highlighting the need for investors to know this information. In addition, this solution ameliorates the pitfalls of mandatory disclosures by keeping costs low and limiting unpredictability.

Of course, this proposed solution needs to be distilled to reflect certain ESG factors that are most salient to company operations and, in turn, generate value. To avoid overextension of company resources, this solution suggests that the SEC adopt mandated disclosures for two important ESG factors that materially impact a company's operations and are timely given the state of the United States in 2021: resource efficiency and diversity, and related matters. After briefly discussing the importance of these two metrics, this Article recommends that the SEC adopt the framework set forth in the GRI Standards for such matters due to the Standards' global footprint and widespread adoption.[208]

In the midst of an ongoing climate crisis,[209] the saliency of a company's efficient use of resources is increasingly prominent.[210] Research by McKinsey & Company found that instituting resource efficiency programming can markedly affect operating profits by reducing expenses.[211] The same research shows a statistically significant correlation between resource efficiency and financial performance.[212] Resource efficiency fundamentally impacts a company's operations and generates value for the company, exemplifying the importance of investors' knowledge on this issue. This point is only furthered by the current climate crisis, which is largely dependent on the behaviors of businesses. Thus, resource efficiency is likely a very important factor for investors to consider.

To ensure that adequate information on resource efficiency and related matters is disclosed, the SEC should look to GRI 302, GRI 305, and GRI 307, as discussed above in subpart II.D.1.[213] This global framework easily lays out the disclosures pertinent to the climate crisis and how companies are playing a role in it. Respectively, these standards capture energy usage and efficiency, emissions, and compliance with environmental laws and

---

208 *See Sustainability Reporting is Growing, supra* note 108 (explaining the widespread adoption of the GRI Standards' reporting framework worldwide and among the largest companies globally).

209 *See The Climate Crisis – A Race We Can Win*, UNITED NATIONS, https://www.un.org/en/un75/climate–crisis–race–we–can–win (last visited Dec. 6, 2020) (addressing the world's current climate crisis and highlighting the all–time high levels of greenhouse gas emissions resulting from overuse of coal, oil, and gas).

210 Henisz, et al., *supra* note 114.

211 *Id.*

212 *Id.*

213 *See supra* Subpart II(D)(1) (discussing the GRI Standards pertinent to this Article).

regulations, each of which are related to the ongoing climate crisis and the efficient use of company resources.[214]

While the financial crisis has been the key point of this Article, the United States is also facing a race crisis, which has significantly developed in the years leading to 2021. Not only is a company's prioritization of diversity more important now more than ever, research suggests that prominent diversity policies can enhance company operations and generate value.[215] A robust diversity practice has proven to improve company performance and employee retention and engagement.[216] According to a study by well–known research and advisory firm Gartner, 75% of organizations with "frontline decision–making teams reflecting a diverse and inclusive culture will exceed their financial targets," with gender–diverse teams outperforming gender–homogenous teams by 50% through 2022.[217] Moreover, a 2018 study by management consulting firm Boston Consulting Group yielded a statistically significant correlation between management team diversity and overall company innovation.[218] Companies that reported above–average management diversity also reported innovation revenue that was 19% higher than companies with below–average management diversity.[219] Lastly, research finds that morale, culture, and employee engagement thrive in diverse and inclusive workplaces, effectively improving company operations.[220] Workplace diversity has proven to be an important metric for driving company value and improving operations. Given the backdrop of the race crisis in

---

[214] *See generally* GRI 302: ENERGY, GRI SUSTAINABILITY REPORTING STANDARDS 2016 (2016); GRI 305: EMISSIONS, GRI SUSTAINABILITY REPORTING STANDARDS 2016 (2016); GRI 307: ENVIRONMENTAL COMPLIANCE, GRI SUSTAINABILITY REPORTING STANDARDS 2016 (2016).

[215] *See* Comm'r Lee Public Statement, *supra* note 6 (stating that it is becoming increasingly clearer that investors need information regarding "how [companies] prioritize diversity in the face of profound racial injustice"); *see generally Does Workplace Diversity Actually Impact a Business*, PURDUE U. GLOB.: CAREERS (Apr. 2, 2020), https://www.purdueglobal.edu/blog/careers/how–does–workplace–diversity–affect–business/ (providing many resources on how diversity positively impacts business) [hereinafter *Does Workplace Diversity Actually Impact a Business*].

[216] *Does Workplace Diversity Actually Impact a Business*, *supra* note 215.

[217] Manasi Sakpal, *Diversity and Inclusion Build High–Performance Teams*, GARTNER (Sept. 20, 2019), https://www.gartner.com/smarterwithgartner/diversity–and–inclusion–build–high–performance–teams/.

[218] Rocío Lorenzo, et al., *How Diverse Leadership Teams Boost Innovation*, BOSTON CONSULTING GROUP (Jan. 23, 2018), https://www.bcg.com/en–us/publications/2018/how–diverse–leadership–teams–boost–innovation.

[219] *Id.*

[220] *See Does Workplace Diversity Actually Impact a Business*, *supra* note 215 (citing a Deloitte survey entitled "The Radical Transformation of Diversity and Inclusion" and a Yello survey entitled "Diversity in the Workplace Statistics: Job Seeker Survey Reveals What Matters").

America and the above–discussed research, workplace diversity is very important for investors to consider.

To ensure that adequate information on diversity within a company is disclosed, the SEC should look to GRI 405, as discussed above in subpart II.D.[221] This GRI section lays out the disclosures pertinent to diversity within the context of gender, age, and other factors like underrepresented groups, as the company deems necessary.[222] Additionally, GRI 405 suggests disclosing the ratio of salary and remuneration of women to men, adding another metric for companies to report their diversity initiatives.[223] For each of GRI 302, GRI 305, GRI 307, and GRI 405, due to the Standards' growing popularity, the SEC would be adopting a mandate that much of the of world's largest companies are already familiar with.[224]

Although mandated disclosures can carry a substantial cost burden, this solution likely would not impose unbearable costs on a company.[225] Companies likely already record the data necessary to comply with the suggested mandated disclosures. Until November 4, 2020 when President Trump formally withdrew from the Paris Climate Accord,[226] the private sector was recognized as an integral part of the global solution to climate change.[227] This is a clear signal for businesses to develop sustainability measures and aid in the national reporting of greenhouse gas emissions.[228] Therefore, a company's resource efficiency practices were likely recorded as a result of the United States' prior obligations under the Paris Climate Accord. Although the United States withdrew from the Accord under President Trump's direction, companies continued to grow and develop their sustainability practices as if the Paris Climate Accord obligations were still in place.[229] Additionally, President Joe Biden rejoined the Accord in February 2021, restoring the impetus for companies to record sustainability measures.[230] Moreover, human resources departments

---

[221] *See supra* Subpart II(D)(1) (discussing the GRI Standards pertinent to this Article).

[222] GRI 305: EMISSIONS, GRI SUSTAINABILITY REPORTING STANDARDS 2016 1, 6 (2016).

[223] *Id.* at 7.

[224] *Sustainability Reporting is Growing, supra* note 108 (explaining the GRI Standards' global adoption among the world's largest companies).

[225] Schwartz, *supra* note 36, at 1069–73 (describing the costs associated with mandatory disclosures for the primary and secondary securities markets).

[226] Matt McGrath, *Climate Change: US Formally Withdraws from Paris Agreement*, BBC (Nov. 7, 2017), https://www.bbc.com/news/science–environment–54797743.

[227] Edward Cameron, et al., *The Paris Agreement: What It Means for Business*, BSR (2016), https://www.bsr.org/reports/BSR_WeMeanBusiness_Business_Climate_Paris_Agreement_Implications.pdf.

[228] *Id.*

[229] *One Year Later, supra* note 193.

[230] Elian Peltier & Somini Sengupta, *U.S. Formally Rejoins the Paris Climate Accord.*, N.Y. TIMES (Feb. 19, 2021), https://www.nytimes.com/2021/02/19/world/us–rejoins–paris–climate–accord.html.

typically record company diversity statistics, making mandatory reporting easy and cost–effective.[231]

This solution also mitigates the issue of mandated disclosure's unpredictable scope.[232] This solution effectively limits unpredictability in disclosure because of its demonstrated specificity. While some uncertainty remains with regard to the operational materiality of the suggested mandated disclosures, the factors of resource efficiency, diversity, and the few related matters are quite particular and easily recordable. Perhaps, if the SEC were more open to straightforward nonfinancial disclosures—as opposed to principles–based nonfinancial disclosures—this solution would have recommended a more easily recognizable mandate. However, given the current regulatory framework for nonfinancial disclosures, recommending a principles–based reporting requirement with very specific principles seemed to best balance the scale between realistic implementation and usefulness to investors.

V. CONCLUSION

It is increasingly evident that a robust ESG policy signals financial outperformance. This proposition has only gained support due to the COVID–19–induced financial downturn, where data has shown financial resiliency and outperformance in companies that employ a robust ESG policy and funds that are ESG–focused. Research points to ESG's positive impact on a company's operations, causing an ESG–heavy company to be better suited to handle financial downturn and drastic market changes than the alternative. In addition, the last few years have seen an incredible uptick in ESG–based investing and investor use of sustainability disclosures in investment decisions. However, SEC–mandated ESG disclosures remain mostly nonexistent, leading to voluntary ESG disclosures in annual sustainability reports that are subject to greenwashing and potentially misleading data and reporting.

While it would be most beneficial to investors to suggest a solution that mandates disclosures of a sweeping list of ESG factors, the SEC, at least in the near future, likely would not enact such a mandate. Instead, the most viable solution is one rooted in the SEC's current principles–based, materiality–focused nonfinancial reporting regime. Reacting to scholarship on the negative implications of mandatory disclosures, this solution seeks to mitigate the costs and unpredictability of mandatory

---

[231] *How Does Diversity Affect HR Functions?*, CHRON, https://smallbusiness.chron.com/diversity–affect–hr–functions–59653.html (last updated July 13, 2020).

[232] *See supra* Subpart II(B) (addressing the issue of mandated disclosure's unpredictability).

disclosures by recommending disclosures of information that a company likely already records while maintaining a level of sufficient specificity. To that end, the best course of action to inform investors of relevant ESG information while staying true to the SEC's mission and current practices is to mandate disclosures of practices for resource efficiency and diversity based on the Standards outlined by the Global Reporting Initiative.