Buy, Sell or Hold – Important Considerations for Issuer Disclosure and Omissions as ESG Reporting Becomes More Universal Practice

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Addressing Questions about the Materiality of Corporate ESG Disclosure

In corporate financial reporting, guidance for the team preparing the public disclosures typically includes internal and external discussions around the *materiality* of information. Will *this* information if disclosed – or importantly, if omitted and *not* disclosed – influence the investors' decisions to *buy, sell or hold*?

In the historic *Securities & Exchange Act of 1934,* Section 14 prohibits material misrepresentations and omissions in the proxy statements sent to stockholders.

As explained by the Legal Information Institute of Cornell Law School: "To protect investors Congress crafted a mandatory disclosure process designed to force companies to disclose information that investors would find pertinent to making investment decisions."

The increasing focus by regulators on materiality of information disclosed or omitted led in time to Regulation Fair Disclosure ("Reg FD") as an important extension of the original Act. This rule, adopted by the SEC in 2000, addresses "…the selective disclosure of information by publicly-traded companies and other issuers…Reg FD aims to promote full and fair disclosure." The rule specifically seeks to prevent the selective disclosure of "material nonpublic information."

For companies based in the U.S., much of the usual ESG disclosures are still voluntary. The SEC has not yet established rules (typically built off the statutory authority of the '33 and '34 Acts) for corporate ESG disclosures. But there are now strong signs that such moves may be near. A new Chair is at the helm and the Commission Board has members firmly committed to taking some actions on mandating ESG disclosure.

In 2020, the SEC updated Reg S-K to encourage more disclosure about Human Capital Management (HCM) and in 2020 and 2021 companies began to significantly expand their disclosure of HCM metrics and narrative for context.

This year, the SEC opened a public comment period for stakeholders to provide input as to where the Commission might expand the rules or strong guidance for ESG disclosure by regulated entities. The feedback period ended on June 15th and we are closely watching now for SEC communications after the staff and Board reviews the public input.
As corporate ESG disclosure escalates, today's important question for the executive team is: What is material information in terms of reporting on the firm's ESG/sustainability/responsibility strategies, data sets, metrics, programs

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and actions taken, outcomes, and other issues and topics that are considered by investors in their decisions to buy, sell or hold?

In a recent webinar hosted by DFIN Solutions in collaboration with G&A Institute, there were over 1,000 executives registered, including IROs, CFOs, legal counsel, corporate secretaries, and members of corporate executive teams. Important questions were raised by participants related to ESG disclosures and structured reporting by companies, typically distributed in annual sustainability or corporate responsibility reports, proxy statements, 10-Ks, investor decks, and by other means.

For example: How do companies typically assess the materiality of their ESG disclosures? Do you need a third-party organization to do this? Are there prerequisites to performing a materiality assessment? How long does an assessment take?

And more: Do you need to have a completed "carbon emissions" assessment to determine the company's "carbon footprint" before publishing a sustainability report?

Participants also wanted to know which of the asset classes were most affected by investor perceptions regarding their ESG profile (e.g., equities, fixed-income) and which financial services players were most concerned about ESG disclosure. (The answer here is all of the above – a growing universe of asset owners/fiduciaries, their asset managers, insurers, lenders, banks, P/E firms, and lately the sponsors of SPACs who recognize the value of a positive ESG profile for the target company.)

Answering Questions & Concerns – Shared Perspectives

In this Issue Brief, G&A Institute addresses these questions and more and shares our experience in assisting public companies in their ESG disclosure and reporting practices.

The G&A Institute approach to ESG disclosure, frequently executed in collaboration with DFIN Solutions to assist client organizations, is to begin the reporting process with a thorough, rigorous *Materiality Assessment* to consider many possible issues and topics that *could be* material for the issuer's disclosures. There may be as many as 200 or even 300 *possible* topics at the start of the process.

As an external team, working with the internal team members, we help to whittle those down to a dozen or so critical issues that investors and other stakeholders consider to be important and material to them. In addition, we consider what the company's Board and C-suite regard as their most material concerns and the information to be shared with stakeholders.

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The ***Materiality Assessment*** exercise considers the company's existing public ESG disclosures (if any); those of industry peer companies that are perceived as ESG leaders by investors and important stakeholders; also, careful review of the topics that the leading ESG ratings and rankings organizations consider to be important for that firm – or its industry or sector. (Remember, the ESG raters are serving investor clients and therefore their output reflects the expectations of current and potential asset managers.)

We explore questions such as: What is it that internal stakeholders (the company's human assets) are seeking in the company's ESG strategy, policies and performance? What about the concerns of potential employees looking at the company from the outside? The leadership of communities in which the company is operating – what do they see as material? And on and on: Regulatory agencies? Industry organizations? Multilateral organizations including UN agencies such as the UN Global Compact, UN EP, or others? What are the G20 and G7 discussions around ESG disclosure that affect the enterprise? And very important: what are the firm's customers/clients actively seeking in ESG data and information?

Note: These are central to discussions about the corporate risks and opportunities as well.

Our comprehensive approach to *Materiality Assessment* takes into consideration the ESG performance ratings assigned by ISS, MSCI, Sustainalytics; the information provided in abundance by Bloomberg and Refinitiv; and the recommendations or requirements of the most widely-used ESG reporting frameworks/standards. These include the Global Reporting Initiative (GRI), Sustainable Accounting Standards Board (SASB), and The Task Force on Climate-related Financial Disclosures (TCFD).

Answering the DFIN Webinar Participants' Questions

How long does a materiality assessment take? The G&A Institute/DFIN approach to a comprehensive ESG materiality assessment is typically a two to three month exercise and involves collaboration with internal subject matter experts (SMEs), content owners, and those with specific responsibilities to oversee operations, finances and other matters. (Think about a team comprised of HR, IRO, CFO, EHS, Legal, Compliance, Risk Management, Marketing, Public Affairs, Branding and Communications, and more.)

Do you need to have a completed "carbon emissions" assessment to determine the company's "carbon footprint" before publishing a sustainability report? With the current appetite for climate-related disclosures (from investors and increasingly from regulators), if you are going to publish a sustainability report soon, in most cases it would be advisable to begin with a carbon emissions inventory (to establish your "carbon footprint"). This should be at least for Scopes 1 and 2; this can also be done simultaneously while working on other stages of the

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5 STEP PROCESS
6–9 months
1

process (such as in the G&A Institute's 5-step Process). This can be during the materiality assessment and the gap analysis exercises, for example.

What is the best way to use the information gathered in the materiality assessment to improve ESG disclosure? G&A Institute recommends leveraging the materiality assessment exercise to move towards publishing a structured annual sustainability report. G&A utilizes our proprietary **5-Step Process** to help companies prepare a report using a hybrid standards approach incorporating the three important reporting standards in a Content Index for ease of navigation (GRI, SASB, TCFD for 2021).

The first step in the 5-Step Process is *Strategic Planning & Fact Finding* to determine the scope of the project and determine the internal team to work with. Once the *Materiality Assessment* is completed, we develop a *Gap Analysis* to identify what material ESG content has been publicly disclosed in some manner that could be useful as a starting point; information that could be disclosed which is internal and not made public yet; identifying who and what function helped to develop those disclosures and data sets. We often identify existing programs or content such as internal policies and practices that have not yet been properly disclosed, which we can work to make available to ESG analysts and other stakeholders. There are gaps identified that we advise companies on how to fill – some can be filled in the short term, and others we help set a strategy and plan to address over the years to come.

The next step is *Sustainability Report Development*, in which we work with the company's designated SMEs to develop compelling content – such as environmental and other data sets and metrics, narrative to provide context for these…and to help the company tell a more complete story about its ESG performance.

The final step is *ASR Writing & Design*, in which we draft and edit E, S, and G content focused on producing decision-useful information for the report users. The design team follows best practices including the use of maps, navigation tools, infographics, charts, and more. The edited content is presented in text, photos, charts, graphs, sidebars, and more.
The 5-Step Process is usually conducted over a period of six to eight months. As described in the recent DFIN Webinar, DFIN/G&A client FIS followed our proprietary 5-Step Process to produce their inaugural ESG report in 2020, which won an *IR Magazine* award as Best ESG Report.

Can a company do a materiality assessment internally or should an outside expert be brought in, and should the assessment be audited? A firm can perform a materiality assessment internally or use an outside third-party for additional expertise and experience. Typically, materiality assessments are not audited; however, auditing of other components of ESG reports is on the rise – especially areas of disclosure like climate change and related emissions (Scopes 1, 2, and 3).

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There are variations in the approach to materiality assessments. Conduct bench research? Arrange interviews with key executives? Survey the firm's current and potential investors? Survey stakeholders? Conduct a thorough review of peer companies' reporting practices? Review the leading ESG ratings organizations' views (and methodologies) related to examination of material information and see where the enterprise "fits" in these?

All of these are important considerations which we regularly discuss with corporate managements; the steps taken as best practice for a very comprehensive assessment is "all of the above." Timetable and budgets are of course an element of deciding next steps.

G&A Institute Perspectives

The recent DFIN webinar was very informative and the panelists were forthcoming and expansive in sharing their experiences in materiality assessment and the steps thereafter to utilize the assessment results as the important mapping tool for developing content for an annual sustainability report.

The approach taken to prepare the traditional financial report is in general good guidance for moving beyond in developing the content for a voluntary sustainability/ESG report. Is the information focused on material topics, accurate, as complete as possible? (Of course, the company's financial disclosure considerations are different in many ways and have been honed and perfected over a long period of time.)
It is important to keep in mind that public companies are steadily moving toward a more *integrated* reporting approach, combining financial and ESG information. We have seen this in hundreds of proxy statements for this year with inclusion of ESG content and in the inclusion of ESG information in the 10-K. This is something to watch for when the SEC communicates future disclosure regimens to address ESG issues.
Disclosures related to carbon emissions, energy use, water use and water are omnipresent now in the sustainability reports of most large-cap companies. Elements of ESG report content can be leveraged for use in the proxy statement, the 10-K, the corporate web site, investor engagements and presentations, and for drop-in "sparklers" on earnings and other investor calls.

The results of the systematic ESG materiality assessment become the foundation stones for guiding the *sustainability journey* of the firm over the long term and serve as a guidepost for the steady expansion of ESG-related data and narrative reporting for investors and stakeholders.
For more information, contact G&A Institute at **info@ga-institute.com**.

Miss the Webinar?

Access the replay and download the presentation here:
https://info.dfinsolutions.com/navigating-corporate-ESG-journey-replay

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