ESG and the SEC

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Virginia Harper Ho, Modernizing ESG Disclosure, 2022 **U. Ill. L. Rev.** 277.

As efforts to improve the sustainability of corporate operations advance, growing attention has naturally turned to the form and degree of sustainability-related disclosures that large publicly traded companies are required to make. Various constituencies, including institutional investors, have increasingly demanded robust disclosures of information related to a range of environmental, social, and governance issues impacted by corporate activities. These matters are typically lumped together as "ESG disclosure" in capital-market parlance, and the U.S. Securities and Exchange Commission (SEC) has recognized the need for reform.

However, a host of vexing issues complicate such reform efforts. These include the degree to which current disclosure rules already reach such issues; the extent of reforms that could be pursued within the SEC's market-oriented statutory mandate and financially driven conception of materiality; and – most significantly – the efficacy of disclosure-based regulation as a means of addressing complex global challenges like climate change. *Modernizing ESG Disclosure*, a recent paper by Virginia Harper Ho, tackles these weighty and interrelated challenges, providing detailed and nuanced analyses of where we stand, what the SEC could do within the current framework, and the more fundamental statutory reforms that would be required to produce an ESG disclosure regime more substantially contributing to the overarching goal of corporate sustainability.

Harper Ho observes that "many elements of the current federal disclosure framework should already elicit ESG disclosure in some form" – notably, those relating to risk. The lack of standardization and narrow focus on financial materiality, however, have led to under-reporting and heavy reliance on generic boilerplate. The result is a de facto voluntary regime characterized by limited information content and low comparability. In response, Harper Ho advocates adopting "a multi-faceted, tiered approach" that would balance specificity and flexibility by mandating disclosures "in three core areas that have been identified by investors as material to all companies" – climate risk, corporate governance, and human capital – and then "supplementing these core mandatory disclosures" with "principles-based approaches for sector-specific information." This tiered approach has already been widely embraced globally, and Harper Ho offers a detailed "roadmap" for reforms along these lines that could be implemented within the SEC's existing mandate, promoting fuller disclosure while containing regulatory costs through greater alignment with coalescing international standards.

In this spirit of disclosure, I should note that I personally tend toward skepticism regarding the merits of disclosure-based regulation; although robust disclosure is clearly an essential predicate for meaningful corporate reform, it too often substitutes for it. Harper Ho is clearly more optimistic about the potential for disclosure-based regulation as such, but the foregoing prompts me to emphasize another strength of her paper – its clear-eyed appraisal of the limits of strategies open to us within the current framework, combined with persuasive analysis of the structural reforms to the disclosure regime that would be required to promote more substantial reorientation toward corporate sustainability.

Harper Ho suggests that the reforms she advocates ought to be viewed as a "foundation" for a "comprehensive national strategy to address corporate environmental and climate impacts," and she emphasizes that "ESG disclosure alone cannot create strong enough incentives for companies to undertake ESG risk mitigation, much less address climate change or drive a sustainable finance transition." Ultimately, she urges Congress to consider "expansion of the SEC's statutory authority to undertake rulemaking in the public interest," construed broadly "to include environmental protection and sustainability goals" – an approach that in turn would require a broader conception of materiality. Here, again, international models and opportunities for improved global alignment present themselves. "The pace of sustainable finance reform worldwide," she concludes, "demands bold action if corporate reporting is to meet the information demands of a future where sustainability information is available to the markets, where ESG risks are priced far more efficiently across financial systems, and where companies begin to internalize the full social and economic costs of their operations."

Harper Ho's paper tackles a complex regulatory terrain replete with hotly contested issues and thorny technical challenges. Clearly much work remains to identify the most effective means of achieving corporate sustainability, let alone how to implement them. Her rigorous analyses, however, bring much needed clarity regarding how the corporate disclosure regime might contribute, depending on the depth of reforms for which requisite political will exists. The result is a paper that is at once descriptively rich, practically useful, and normatively compelling.

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