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ESG ON THE RISE: NON-FINANCIAL REPORTING WILL INTRODUCE NEW CORPORATE PRESSURES IN 2021

by Julius Redd and Stacey Halliday

In 2021, global companies will undoubtedly face *significantly* increased pressure from investors, regulators, and customers to disclose Environmental, Social and Governance (ESG) impacts – even when such reporting is not mandatory. [BlackRock CEO Larry Fink referred to evolving ESG reporting demand as a “tectonic shift,”](#) where “[m]ore and more people do understand that climate risk is investment risk.”

This pressure has been building in recent years, driving voluntary ESG reporting to astounding levels that the numbers cannot help but bear out. In 2020, 96% of the world’s 250 largest companies reported on sustainability and 56% of those companies acknowledged the financial risks of climate change in their reporting, with a majority establishing targets to reduce carbon emissions. In the same year, the European Union (EU) [began review of its non-financial disclosure requirements to strengthen foundations for sustainable investment](#), and the world’s leading reporting frameworks (CDP, CDSB, GRI, IIRC, SASB¹) [committed to a goal of creating a comprehensive, unified ESG reporting standard](#). A global consensus appears to be growing that ESG criteria are critical for a full assessment of corporate risk and performance. Moreover, with the heightened social consciousness following the death of George Floyd and the international devastation brought on by the COVID-19 pandemic, investors, customers, and employees are simply demanding more from companies with respect to responsible, sustainable practices. As noted in the [OECD Business and Financial Outlook 2020](#), “[a]necdotal evidence from surveys of institutional and retail investors suggest that investors are increasingly seeking both enhanced financial returns over time, and the societal alignment of their investments, to maximize financial and social returns.”

This was all before President Joe Biden entered the White House. President Biden campaigned on the importance of corporate accountability, alongside a historically ambitious climate agenda. Since taking office, he has not slowed in those ambitions, issuing a number of executive orders and actions that suggest he plans to fulfill those campaign promises.

Background: ESG Disclosures and Climate Risk Reporting

A wide array of stakeholders—from regulators to financial analysts—use ESG criteria to evaluate the environmental and social impacts of a business. Though ESG reporting remains voluntary in the United States, public companies with operations in jurisdictions like the European Union, face

¹ These cited reporting framework authorities include the [CDP](#), the [Climate Disclosure Standards Board](#), [Global Reporting Initiative](#), [International Integrated Reporting Council](#), and [Sustainability Accounting Standards Board](#).

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specific disclosure requirements (see [EU Regulation 2020/852 on the establishment of a framework to facilitate sustainable investment](#); [EU Regulation 2019/2088 on sustainability-related disclosures in the financial services sector](#); [Directive 2014/95/EU \(EU Non-Financial Reporting Directive\)](#)). The current EU Non-Financial Reporting Directive requires large public companies (more than 500 employees) to report on policies that they implement with respect to: environmental protection; social responsibility and treatment of employees; respect for human rights; anti-corruption and bribery; and diversity on corporate boards.

When it comes to voluntary disclosures, issuers often map reports to third-party standards. GRI is the dominant global standard for sustainability reporting, used by approximately [75% of the world's largest 250 companies](#). Many also report on climate issues consistent with the Task Force on Climate-related Financial Disclosures' (TCFD) recommendations, a standards organization that is largely responsible for the rise in prominence of recognizing the financial risks of climate change.

In the U.S., public companies provide non-financial disclosures in accordance with a principles-based approach, based upon the "materiality" threshold. The U.S. Securities and Exchange Commission (SEC) finds a matter to be "material" when "there is a substantial likelihood that a reasonable investor would consider it important." Failure to include or accurately represent a material matter can expose issuers to liability under Section 11 of the Securities Act of 1933 (covering material misstatements and omissions in securities offering documents) and under Sections 10(b) and 10b-5 of the Securities Exchange Act of 1934 (anti-fraud provisions). While claims brought under these provisions [have been largely unsuccessful](#), recent successful litigation include cases related to internal financial integrity controls in public reports and SEC filings.

Biden Administration Goals for Mandatory Non-Financial Reporting

During his campaign, President Biden advocated for mandatory reporting of corporate environmental risks and greenhouse gas emissions as part of his broader climate agenda, reversing course from several Trump-era actions that softened ESG reporting drivers. Generally, implementation of President Biden's climate agenda underscores ESG factors—specifically the "E"—meeting the materiality threshold. This is particularly true for the energy sector, a focal point for many of the Biden Administration's policy goals.

On January 21, the second day of his presidency President Biden appointed Commissioner [Allison Herren Lee](#) as acting chair of the SEC, putting the pieces in place to shift the Commission's priorities to include climate and sustainability. Acting Chair Lee has been a staunch advocate for standardized, mandatory disclosures on climate-change risk, as well as amending Regulation S-K to require disclosure of workforce diversity data at all levels of seniority. Lee has referenced the use of third-party reporting organizations, like the TCFD, as a mechanism for informing climate-change rulemakings. The appointment will also give three of the five Commission seats to Democrats. On February 1, Lee named [Satyam Khanna](#) as Senior Policy Advisor for Climate and ESG, who will advise on ESG governance and new initiatives across the agency.

Other agencies may play less direct, but important, roles in encouraging ESG reporting. Brian Deese, former Blackrock executive responsible for sustainable investing strategies and economic advisor to President Obama, will lead the National Economic Council and may direct the Council to address climate and diversity issues in meaningful, far-reaching ways. In addition, President Biden's leadership choice for the Commodities Futures Trading Commission could shift the group's mandate to place greater focus on climate risk management. Overall, the President's climate ambitions—including increased regulation and enforcement to limit carbon pollution—will likely amplify the importance of ESG factors in assessing corporate risk.

Global Trends: Unified Standard and ESG Investing

On the global stage, ESG reporting is evolving quickly, with efforts to unify reporting standards and encourage ESG investing on the rise. As noted above, in fall 2020, the five leading standard-setting organizations pledged to create a comprehensive and unified reporting system to avoid continued confusion by market participants. Shortly thereafter, the World Economic Forum and leading accounting firms (Deloitte, EY, PwC, KPMG) released their own set of universal ESG metrics and disclosures with the same goal of establishing a single, global reporting standard. Other aspirations towards global standardization of ESG disclosures include the September 2020 paper by Trustees of the IFRS Foundation, discussing the option of creating a Sustainability Standards Board to set international standards alongside the International Accounting Standards Board. In addition, ESG investing is driving change in reporting. Several international stock markets, ratings agencies, and index providers offer metrics that help to determine ESG scoring and inform investors. [NASDAQ expects ESG spending by U.S. companies to rise to \\$5 billion by 2025](#), from current \$500 million. Sustainable funds have largely outperformed standard funds and [Deloitte predicts that ESG-mandated assets](#) will make up half of all managed U.S. assets by 2025.

Conclusion

These domestic and international trends towards mandatory ESG disclosures and unified reporting frameworks will not only bring new compliance obligations, but will also demand further action from corporations. In preparation of these changes, corporations should consider:

- Improving Board-level ESG oversight;
- Developing greater internal ESG controls, particularly with respect to tracking and ensuring accuracy of reported information to avoid misrepresentation, omission, and related liability; and
- Closely monitoring evolving disclosure requirements and guidance to assess whether business activities require reporting under evolving state, federal, and global standards.

Alongside new regulatory requirements, investors, customers, and other stakeholders will continue to demand more, seeking greater ESG transparency to inform decision-making. That said, with these greater pressures, will come greater rewards for strong performers. Companies with strong ESG records will be attractive investment targets, including in mergers and acquisitions transactions and for institutional and retail investors.