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Making Capital Markets Work for Workers, Investors, and the Public: ESG Disclosure and Corporate Long-Termism

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Introduction

America is being roiled by economic and societal dislocations. Collapsing middle class wages and wealth—driven by globalization, growing market concentration, and fallout from the financial crisis and Great Recession—are disrupting politics and social inclusiveness. Meanwhile, climate change puts trillions of dollars in public and private assets at risk. What role do America's companies have to play in addressing these challenges?

Some say the question is who do America's public companies work for—shareholders, CEOs and executives, workers, communities, or the public—and are the interests of those various stakeholders inherently in conflict? Recent decades have been dominated by a managerial ideology and practice that says companies work solely for the pecuniary interests of shareholders. Management, it is argued, is held accountable to shareholders through stock-based compensation, as well as through

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short-termist hedge funds, high-debt buyout private equity, and the broader market for corporate control. Workers, communities, and the public have little role in corporate governance as they, fundamentally, have interests that are inherently in conflict with shareholders.

In theory, this attention to shareholders checks management from wasting money that shareholders could better spend themselves. Yet even under its own logic, it also appears to widely overcorrect, inhibiting longer-term investments.[1] More troubling, it appears to do little to check the outsized growth in executive compensation, while also supercharging the pressures on companies to squeeze workers. The combined trends are well-represented in the newly disclosed pay ratio between CEOs and median workers, which shows extraordinarily high ratios of CEO to median worker pay across a wide range of industries.[2]

The long-run stagnation of working class wages, and the enormous concentration of economic wealth and power at the top, are not simply theoretical challenges to social cohesion.[3] Their threat to the middle class way of life that defines America and its norm-driven approach to governance is very real. The return of extraordinary divisive forces in America, ones that threaten some of the very foundations of America's political order, are inextricably linked to the troubling economic outcomes for working Americans.[4]

Corporations stand at the center of a wide range of economic decision-making in America, with the results being felt by workers and society in myriad ways. The troubling economic trends affecting workers and inequality are mostly driven by powerful forces external to the corporation's decision-making hierarchy, such as globalization more than doubling the global labor force, attacks on collective bargaining through the regulatory process and in the courts, and weak antitrust enforcement. But the company's internal decision-making priorities—

1. Marc Jarsulic et al., *Long-termism or Lemons*, Ctr. American Progress (Oct. 21, 2015), https://www.americanprogress.org/issues/economy/reports/2015/10/21/123717/long-termism-or-lemons/ [https://perma.cc/DZ3W-YK5P].

2. Diana Hembree, *CEO Pay Skyrockets to 361 Times that of the Average Worker*, Forbes (May 22, 2018), https://www.forbes.com/sites/dianahembree/2018/05/22/ceo-pay-skyrockets-to-361-times-that-of-the-average-worker/#33bfaa7d776d [https://perma.cc/J3AV-CG22].

3. *Blueprint for the 21st Century: A Plan for Better Jobs and Stronger Communities*, Ctr. American Progress (May 14, 2018), https://www.americanprogress.org/issues/economy/reports/2018/05/14/450856/blueprint-21st-century/ [https://perma.cc/74RT-XMCZ].

4. Neera Tanden, *Toward a Marshall Plan for America: Rebuilding Our Towns, Cities, and the Middle Class*, Ctr. American Progress (May 16, 2017), https://www.americanprogress.org/issues/economy/reports/2017/05/16/432499/toward-marshall-plan-america/ [https://perma.cc/E4R6-G66U].

that is, corporate governance—has been a factor. And as such, it has a role to play in making the economy work for workers and communities.

The hopeful news is that there are important trends at work that hold the potential for corporate governance to play a more positive role in addressing these economic and societal challenges. As the Center for American Progress lays out in *Corporate Long-Termism, Transparency, and the Public Interest*,[5] on which this Article is based, the rise of long-term investors whose interests align more with those of workers, the environment, and communities opens the possibility for moving management and companies to act in ways that benefit all of these groups. Yet the shared interests of longer-term investors, workers, and the broader public in good jobs, a clean environment, and productivity-enhancing economic growth are stymied today by insufficient transparency and accountability in public (and, increasingly, private) company corporate governance.[6]

Regulators, in particular the Securities and Exchange Commission (SEC), need to catch up. In particular, shareholders and stakeholders need far more robust disclosure of environmental, social, and governance (ESG) information in a consistent, comparable, and reliable manner.[7] In addition, shareholders and stakeholders need enhanced tools to hold management accountable with respect to these long-termism-related matters.

Improved ESG disclosure and accountability is not just good for the public; it is good for shareholders. Some of the most under-

5. Andy Green & Andrew Schwartz, *Corporate Long-Termism, Transparency, and the Public Interest*, Center for American Progress (Oct. 2, 2018), https://www.americanprogress.org/issues/economy/reports/2018/10/02/458891/corporate-long-termism-transparency-public-interest/ [https://perma.cc/7XLR-HNTQ].

6. *Id.*

7. *See, e.g.*, letter from SEC Investor Advisory Committee to the Div. of Corp. Fin., U.S. Sec. and Exch. Comm'n (June 15, 2016), https://www.sec.gov/comments/s7-06-16/s70616-22.pdf [https://perma.cc/8K4E-3EYK]; Tyler Gellasch, *Towards a Sustainable Economy: A Review of Comments to the SEC's Disclosure Effectiveness Concept Release*, Pub. Citizen (Sept. 16, 2016), https://www.citizen.org/sites/default/files/sustainableeconomyreport.pdf [https://perma.cc/7LS4-ZDTQ]; letter from Ceres to Mary Jo White, Chair, U.S. Sec. and Exch. Comm'n (July 20, 2016), https://www.sec.gov/comments/s7-06-16/s70616-174.pdf [https://perma.cc/PW9X-JXL5]; letter from Int'l Corp. Accountability Roundtable to Mary Jo White, Chair, U.S. Sec. and Exch. Comm'n (July 19, 2016), https://www.sec.gov/comments/s7-06-16/s70616-161.pdf [https://perma.cc/4WKN-KR5X]; Lisa Gilbert & Rachel Curley, *The Historic Campaign for Corporate Political Spending Disclosure*, Pub. Citizen (Sept. 14, 2016), https://corporatereformcoalition.org/wp-content/uploads/2016/10/Corporate-Political-Spending-Disclosure-report.pdf [https://perma.cc/68SJ-PBC3].

appreciated systemic vulnerabilities of the U.S. financial system—and hence U.S. economic growth—lay in correlated yet hidden risks, some of which improved ESG disclosure can help unmask.[8] Quality corporate disclosure may also be increasingly important to defending the public and the economy from the growing threat of misinformation.

It is unsurprising then that investors overwhelmingly demand expanded disclosure.[9] Indeed, ESG matters are squarely material to market performance, in particular risk management, with the perceived trade-off between performance and social responsibility no longer relevant.[10]

Markets cannot do this by themselves. Decades of self-help by investors and stakeholders has made some, but insufficient, progress. Sustainability reports are more prevalent than ever, private standard-setters have pioneered new models for disclosure, and long-term investors engage with companies more than ever.[11] Yet investors lack access to complete, consistent, high-quality, and verified ESG information.[12]

Corporate long-termism is not a panacea to the world's problems. Yet disclosure and accountability can better align investors, managers, and other stakeholders for positive long-term results for all. This Article summarizes some of the arguments for (and against) boosting long-termism, focusing on ESG information and case studies on worker training and climate change. The same approach applies to many other ESG matters.

The Article also summarizes several recommendations for how the SEC, under its own mandate or as directed by a new Congress, make progress. As laid out in the Center for American Progress report, the

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8. *See, e.g.*, Robert J. Schiller, *From Efficient Markets Theory to Behavioral Finance*, 17 J. Econ. Persps. 83, 83–104 (2003), http://www.econ.yale.edu/~shiller/pubs/p1055.pdf [https://perma.cc/8NHW-E7KB]; Mark Carney, Gov., Bank of Eng., Chairman, Fin. Stability Bd., Speech at Lloyd's of London, *Breaking the Tragedy of the Horizon—Climate Change and Financial Stability*, (Sept. 29, 2015), https://www.bis.org/review/r151009a.pdf [https://perma.cc/GBN3-82Z4].

9. Gellasch, *supra* note 7, at 7.

10. Sustainable Value: Communicating ESG to the 21st Century Investor, Morgan Stanley Inst. for Sustainable Investing http://www.morganstanley.com/auth/content/dam/msdotcom/ideas/investor-relations/1910712-Sustainable-Value-Communicating-ESG.pdf [https:// perma.cc/VL5L-VT9F] (last visited Mar. 24, 2019).

11. *81% of S&P 500 Companies Published Corporate Sustainability Reports in 2015*, Governance and Accountability Inst. Inc., http://www.ga-institute.com/nc/issue-master-system/news-details/article/flash-report-eighty-one-percent-81-of-the-sp-500-index-companies-published-corporate-sustainabi.html [https://perma.cc/ZZN7-VM57] (last visited Mar. 24, 2019).

12. *See, e.g.*, Gellasch, *supra* note 7, at 7–8.

SEC and relevant policymakers should: directly mandate high quality, consistent ESG disclosure; look to external organizations for ESG disclosure standards; defend an investor-oriented, public-interest approach to disclosure, especially on questions of materiality; boost audit standards; bring enforcement actions and protect the rights of states and private investors; enhance board ESG expertise and focus on long-termism; and maintain the shareholder voice in favor of ESG and long-termism.[13]

I. Why ESG and Corporate Long-Termism?

American public companies matter greatly to the U.S. economy. They employ millions of people, help drive productivity growth, and offer many of the goods and services in the economy.[14] So how they perform matters a lot for how the economy evolves.

Indeed, the very premise of the capital market is that it will allocate investments to the best economic uses. Of course, we know markets are imperfect. But the most basic protection against market imperfection is information. Today, ESG information is far too lacking, making it challenging for markets to effectively allocate capital in ways that make sense over the long term.

Take, for example, worker training and climate change. Between 2001 and 2009, employers cut their training by more than 27 percent.[15] Yet this cut is not in line with the long-term interests of workers, the economy, or even the company. Many studies confirm that on-the-job training boosts productivity for workers, firms, and the entire economy.[16]

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13. Andy Green & Andrew Schwartz, *Corporate Long-Termism, Transparency, and the Public Interest*, Ctr. for Am. Progress (Oct. 2, 2018, 12:01 AM), https://www.americanprogress.org/issues/economy/reports/2018/10/02/458891/corporate-long-termism-transparency-public-interest/ [https://perma.cc/MYV4-8ZG2].

14. *See* William Lazonick, *Profits Without Prosperity: How Stock Buybacks Manipulate the Market, and Leave Most Americans Worse Off*, Ann. Conf. of the Inst. for New Econ. Thinking, Apr. 2014, at 2–3, https://www.ineteconomics.org/uploads/papers/LAZONICK_William_Profits-without-Prosperity-20140406.pdf [https://perma.cc/US5P-DJYK].

15. Angela Hanks et al., *Workers or Waste? How Companies Disclose—Or Do Not Disclose—Human Capital Investments and What to Do About It*, Ctr. for Am. Progress 5–6 (June 2016), https://cdn.americanprogress.org/wp-content/uploads/2016/06/03042031/HumanCapital.pdf [https://perma.cc/HVH6-KNWU].

16. *Id.* at 3–4; *see* Lawrence H. Summers & Ed Balls, *Report of the Commission on Inclusive Prosperity*, Ctr. for Am. Progress 15, 30, 81–82 (Jan. 2015), https://cdn.americanprogress.org/wp-content/uploads/2015/01/IPC-PDF-full.pdf [https://perma.cc/7X2L-FNFT].

Short-termist cost pressures are one of a number of reasons why companies reduce workforce training investment.[17] But financial markets also play a role. Worker training investments are grouped into other general and administrative expenses, which means companies that make those investments look more wasteful than others. A rather modest fix of worker training disclosure, modeled on how research and development (R&D) is disclosed, could help undue this perverse incentive. And indeed, unlike workforce training, R&D has risen in U.S. companies.[18]

Climate change offers an even larger-scale example of why greater ESG disclosure is essential for risk management and effective capital allocation.[19] From energy sector asset valuation to the risks that extreme weather poses to crops, coastal property, and supply chains,[20] climate change poses a direct and indeed systemic threat to the economy and society. Without sufficient, comparable, and reliable assessments of what this means to individual companies and to the entire market, investors and the public are left in the dark,[21] and capital markets cannot do their most basic job.

Ultimately, from political spending to human rights, tax strategies to cybersecurity risks, ESG covers a wide range of matters that are increasingly essential for how companies maintain and enhance their performance and manage their risks.[22] The old notion that an ESG focus

17. Hanks et al., *supra* note 15, at 7, 13–14, 18; Summers & Balls, *supra* note 16, at 86.

18. Kathleen M. Kahle & René M. Stulz, *Is the U.S. Public Corporation in Trouble?*, 1 (European Corp. Governance Inst., Finance Working Paper No. 495/2017, 2017), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2869301 [https://perma.cc/7C2E-Y7L3].

19. Task Force on Climate-Related Fin. Disclosures, Fin. Stability Bd., Recommendations of the Task Force on Climate-related Financial Disclosures 5–10 (2017), https://www.fsb-tcfd.org/wp-content/uploads/2017/06/FINAL-TCFD-Report-062817.pdf [https://perma.cc/GCX8-FL8Q].

20. *Id.* at 5–6.

21. Task Force on Climate-Related Fin. Disclosures, Fin. Stability Bd., Phase I Report of the Task Force on Climate-Related Financial Disclosures 3 (2016), https://www.fsb-tcfd.org/wp-content/uploads/2016/03/Phase_I_Report_v15.pdf [https://perma.cc/KSN4-W4M7].

22. *See, e.g.*, Usman Hayat & Matt Orsagh, Environmental, Social, and Governance Issues in Investing: A Guide for Investment Professionals, CFA Inst. 1, 6–7 (2009), https://www.cfapubs.org/doi/pdf/10.2469/ccb.v2015.n11.1 [https://perma.cc/N7V8-BGDT]; *see also* Gellasch, *supra* note 7, at 7, 23; SASB Conceptual Framework, Sustainability Accounting Standards Bd. 1, 3–5, 17 (2017), https://

and investor returns were inversely correlated is increasingly history. And indeed, academic research confirms that ESG information is important for long-term investment success and in particular the management of risk. In particular, one survey of 2,000 other academic studies highlights the correlation between ESG criteria and corporate financial performance.[23] Lower costs of capital and other benefits to companies and investors are also being shown to arise from considering ESG factors in decision-making.[24]

Yet far too little is being disclosed, precisely as the demand for this information has reached extraordinary levels. As of the latest available data, ESG-focused investing accounts for more than $8.72 trillion in total assets under management—making it no longer a niche investment category.[25] Moreover, 82 percent of mainstream, or non-ESG focused, investors consider ESG information when making investment decisions.[26] The dramatic growth in investor support for the United

www.sasb.org/wp-content/uploads/2017/02/SASB-Conceptual-Framework.pdf [https://perma.cc/9SUR-Y49R].

23. Gunnar Friede et al., *ESG and Financial Performance: Aggregated Evidence from More than 2000 Empirical Studies*, 5 J. Sustainable Fin. & Inv. 210, 210, 225 (2015); Mark Fulton et al., Sustainable Investing: Establishing Long-Term Value and Performance, Deutsche Bank 1, 21, 68, 71 (2012), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2222740 [https://perma.cc/s9JE-K77Y]; Mercer, Shedding Light on Responsible Investment: Approaches, Returns and Impacts 1, 1–2 (2009), http://www.sustainablefinance.ch/upload/cms/user/Shedding_light_on_responsible_investment_free_version.pdf [https://perma.cc/NE9Q-F8XW]; Michael Lee-Chin Family, Inst. for Corp. Citizenship, Academic Literature on ESG and Financial Performance: Preliminary Literature Search, Rotman 1, 1–2 (2016), https://www.rotman.utoronto.ca/-/media/Files/Programs-and-Areas/lee-Chin_Institute/LCI-Brief---Academic-Literature-on-ESG-and-Financial-Performance-2016.pdf?la=en [https://perma.cc/Z5X9-BHRZ].

24. Fulton et al., *supra* note 23, at 5, 7, 28, 70; Robert G. Eccles, Ioannis Ioannou & George Serafeim, *The Impact of Corporate Sustainability on Corporate Behavior and Performance*, Nat'l Bureau Econ. Res. 1, 1, 17–20 (2012), http://www.nber.org/papers/w17950 [https://perma.cc/Z4HS-Q9QJ]; *see also* Amir Amel-Zadeh & George Serafeim, Why and How Investors Use ESG Information: Evidence from a Global Survey 1, 2–4 (July 1, 2017) (unpublished), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2925310 [https://perma.cc/3JFG-LRLS]; Hiroshi Miyai & Yasuyuki Sugiura, Environmental, Social, and Governance Investment and Material Disclosure by Companies 1, 1–4 (Jan. 24, 2018) (unpublished), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3109050 [https://perma.cc/PT7P-XNH3].

25. U.S. SIF, Report on US Sustainable, Responsible and Impact Investing Trends 1, 5 (2016), https://www.ussif.org/files/SIF_Trends_16_Executive_Summary(1).pdf [https://perma.cc/7LYM-9BAZ].

26. Amel-Zadeh & Serafeim, *supra* note 24, at 4, 12; Emiel van Duuren, Auke Plantinga & Bert Scholtens, *ESG Integration and the Investment*

Nations Principles for Responsible Investment (PRI) is also striking. Since 2006, it has grown from 100 members to more than 1,800 signatories managing more than $80 trillion in assets.[27] Investor attention to ESG is, quite simply, where the market is today and is going in the future.

So have the disclosure rules kept up? As the section below shows, the answer is no. And the cost of this failure falls on the backs of those who would benefit from the improved alignment of interests that ESG disclosure and accountability offers: long-term investors, workers and communities, and the broader public interest.[28]

II. The Market and Regulators Fail

Investor and public demand for ESG information is not new. Fifty years ago, shareholders and public interest groups demanded the SEC require environmental disclosures and disclosures regarding equal employment opportunities.[29] The SEC responded with some environmental disclosure obligations, but less than hoped for.[30]

More recently, investors and the public have pressed the SEC to revamp its corporate disclosure framework with enhanced ESG disclosures, especially on political spending[31] and climate change.[32] More than 1.2 million commenters individually weighed in with the SEC on political spending alone.[33] Yet, the SEC has remained frozen, unable or unwilling to move forward.

The only thing it was able to do was guidance that simply repeats current requirements for disclosing all material information relevant to

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Management Process: Fundamental Investing Reinvented, 138 J. Bus. Ethics 525, 527, 530, 532 (2016).

27. *About the PRI*, Principles for Resp. Inv., https://www.unpri.org/about [https://perma.cc/XCR9-WJ8K] (last visited Mar. 8, 2019); *Circularity Capital Joins Un-Supported Principles for Responsible Investment*, Circularity Cap. (Nov. 28, 2017), https://circularitycapital.com/news/2017/12/1/circularity-capital-joins-un-supported-principles-for-responsible-investment [https://perma.cc/AV2G-U3ZZ].

28. *See infra* Part II.

29. Nat. Res. Def. Council, Inc. v. Sec. & Exch. Comm'n, 606 F.2d 1031, 1031, 1035–36 (D.C. Cir. 1979); *see also* Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 Harv. L. Rev 1197, 1199–1207, 1246–50 (1999).

30. *Nat. Res. Def. Council, Inc.*, 606 F.2d at 1036–42.

31. Gellasch, *supra* note 7, at 5, 22.

32. Cal. Pub. Emps' Ret. Sys. et al., Petition for Interpretative Guidance on Climate Risk Disclosure (Sept. 17, 2007).

33. Gilbert & Curley, *supra* note 7, at 3.

climate change impacts,[34] and even that proved short-lived in its impact. Public and private studies of the climate guidance's impact highlight its limited durability.[35]

In contrast, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 mandated a number of new ESG disclosures, specifically the pay ratio comparing the CEO's annual total compensation to employees' median annual total compensation, conflict minerals disclosures, mine safety disclosures, and resource extraction payments disclosures.[36] More recently, Congress mandated disclosure of Iran-related business activities.[37]

Many of these mandates are under attack, either at the SEC or in the courts.[38] And while some were both too prescriptive and insufficiently broad, they nevertheless advanced meaningful transparency for investors on ESG matters.

Separately, private efforts to advance transparency have made meaningful progress. More and more investors engage companies directly, put forth proposals under the SEC's Rule 14a-8 (which enables shareholders to vote on certain topics),[39] or seek change on boards of directors. The rise of ESG-focused funds, driven in part by the views of

34. Climate Change, Release Nos. 33-9106; 34-6149, 17 C.F.R §§ 211, 231, 241 (Feb. 8, 2010).

35. Jim Coburn & Jackie Cook, *Cool Response: The SEC & Corporate Climate Change Report*, Ceres 4–6 (2014), https://www.ourenergypolicy.org/wp-content/uploads/2014/11/Ceres_SECguidance-append_020414_web.pdf [perma.cc/866X-UHD9]; U.S. Gov't Accountability Office, GAO-18-188, Climate-Related Risks: SEC Has Taken Steps to Clarify Disclosure Requirements 15 (2018), https://www.gao.gov/assets/700/690197.pdf [https://perma.cc/ZJP3-TY3E] [hereinafter Climate-Related Risks].

36. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, §§ 953(b), 1502–04, 124 Stat. 1376, 1904, 2213–22 (July 21, 2010) (codified at 12 U.S.C. § 5301).

37. *See* Iran Threat Reduction and Syria Human Rights Act of 2012, Pub. L. No. 112-158, 126 Stat. 1214 (Aug. 10, 2012); *see also* U.S. Sec. & Exch. Comm'n, Notice required by the Iran Threat Reduction and Syria Human Rights Act of 2012 to be filed through EDGAR (2012), https://www.sec.gov/divisions/corpfin/cfannouncements/itr-act2012.htm [https://perma.cc/GV7D-M6NN].

38. *See, e.g.*, Dan Gallagher, Comm'r, U.S. Sec. & Exch. Comm'n, Statement at SEC Meeting: Proposed Rule to Implement Section 1502 of the Dodd-Frank Act—the 'Conflict Minerals' Provision, https://www.sec.gov/news/public-statement/2012-08-22-open-meeting-statement-dmg [https://perma.cc/7W6U-2Z48].

39. J. Robert Brown Jr., *Corporate Governance, Shareholder Proposals, and Engagement Between Managers and Owners*, 2017 Denv. L. Rev. (Special Issue) 300 (2017).

millennial investors, also mean that investors are voting with their feet.[40]

Thanks to the work of United Nations Principles for Reasonable Investing, many stock exchanges, including the London Stock Exchange, the Hong Kong Stock Exchange, and NASDAQ, have successively adopted new voluntary standards for ESG disclosure.[41]

Internationally, the European Union has pushed forward its EU Directive 2014/95/EU, which sets ESG reporting requirements for large public companies.[42]

Sustainability reporting has also taken off, with more than 85 percent of public companies now providing these ESG-focused reports.[43] Yet, despite the helpful work of private standard setters, the lack of uniformity, detail, completeness, and reliability are problems.[44] Indeed,

40. CalPERS & CALSTRS, The Importance of Corporate Engagement of Climate Change, https://www.calpers.ca.gov/docs/corporate-engagement-climate-change.pdf [https://perma.cc/3A2U-LZX7] (last visited May 8, 2019).

41. *SSE Campaign to Close the ESG Guidance Gap*, Sustainable Stock Exchanges Initiative, http://www.sseinitiative.org/esg-guidance/ [https://perma.cc/R6R7-PQ9B] (last visited May 8, 2019); *see also* Danielle Chesebrough et al., Sustainable Stock Exchanges Initiative, 2016 Report on Progress, (2016), http://www.sseinitiative.org/wp-content/uploads/2012/03/SSE-Report-on-Progress-2016.pdf [https://perma.cc/V8EM-SEHC]; *Exchange Guidance & Recommendation–October 2015*, World Fed'n Exchanges, http://www.sseinitiative.org/wp-content/uploads/2015/11/WFE-ESG-Recommendation-Guidance-Oct-2015.pdf [https://perma.cc/D6GG-V2AQ]; *Investor Listing Standard Proposals: Recommendations for Stock Exchange Requirements on Corporate Sustainability Reporting*, Ceres (Mar. 26, 2014), https://www.ceres.org/resources/reports/investor-listing-standards-proposal [https://perma.cc/BP2Z-LLNZ].

42. *Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups Text with EEA relevance*, EUR-Lex, http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32014L0095 [https://perma.cc/PNR2-FZ7L] (last visited May 8, 2019).

43. *85% of the S&P 500 Index Companies Publish Sustainability Reports in 2017*, Governance & Accountability Inst. Inc. (2018), https://www.ga-institute.com/press-releases/article/flash-report-82-of-the-sp-500-companies-published-corporate-sustainability-reports-in-2016.html [https://perma.cc/6UEM-D9DG].

44. Erst & Young With Boston College Center for Corporate Citizenship, Value of sustainability reporting 4 (2013), http://www.confluencellc.com/uploads/3/7/9/6/37965831/valueofsustainabilitysummary.pdf [https://perma.cc/T96S-2FEM]; Donato Calace, *The Battle Continues: GRI vs SASB vs IR*, GreenBiz (Mar. 15, 2016), https://www.greenbiz.com/article/battle-continues-gri-vs-sasb-vs-ir [https://perma.cc/X8CC-T5GK]; Eric J. Hespenheide & Dinah A. Koehler, Deloitte

sustainability reporting still looks more like public relations documents than rigorous disclosure documents.[45] Still, the wide prevalence of sustainability reports show that companies can and do believe that investors want and need this information, and that they can and do provide some of it.

Recently, investors, market participants, and public interest reformers have pressed to enhance disclosed through existing mandatory regulatory reporting channels. The most important of these is the work of the Sustainability Accounting Standards Board (SASB), which argues that U.S. securities laws already require mandatory reporting that companies, owing to lack of standardization, simply have not effectively met. To answer that market failure, SASB has issued detailed standards for nearly eighty sectors regarding what information public companies should be reporting in their SEC regulatory filings.[46] The approach has a number of advantages, including its ability to leverage input from issuers, investors, academics, and other experts in the standard-setting process. But, pressing all companies to fully utilize the standards will require more than persuasion.

Even though litigation takes years and has yet to bear fruit, state attorneys general and private litigants have an important role to play in advancing companies' ESG disclosures.[47] The leading case remains that of the New York State Attorney General, who began, in 2007, tackling questions of fraud around climate change disclosure by publicly listed oil companies.[48]

Univ. Press, Disclosure of Long-Term Business Value (2013), https://www2.deloitte.com/content/dam/insights/us/articles/disclosure-of-long-term-business-value/DUP150_Reporting_What_Matters.pdf [https://perma.cc/AEW6-EVGM].

45. *See* John K. Lewis, *Corporate Social Responsibility/Sustainability Reporting Among the Fortune 250: Greenwashing or Green Supply Chain?*, Salve Regina U., Winter I 2015, at5]; Olivier Boiral, *Sustainability Reports as Simulacra? A Counter-Account of A and A+ GRI Reports*, 26 Acct., Auditing & Accountability J. 1036 (2013).

46. SASB Conceptual Framework, *supra* note 22.

47. Climate Change, Release Nos. 33-9106; 34-6149, 17 C.F.R §§ 211, 231, 241 (Feb. 8, 2010).

48. Felicity Barringer & Danny Hakim, *New York Subpoenas 5 Energy Companies*, N.Y. Times (Sept. 16, 2007), http://www.nytimes.com/2007/09/16/nyregion/16greenhouse.html [https://perma.cc/DZ4D-CYT3]; Chris Mooney & Dino Grandoni, *New York City Sues Shell, ExxonMobil and Other Oil Companies over Climate Change*, Wash. Post (Jan. 10, 2018), https://www.washingtonpost.com/news/energy-environment/wp/2018/01/10/new-york-city-sues-shell-exxonmobil-and-other-oil-majors-over-climate-change/?utm_term=.a6fe4a6de9aa [https://perma.cc/Q7X8-9X72].

III. Paths Forward

Addressing investors' and the public's urgent need for information on public companies' ESG performance will require action by the SEC or, in its absence, by Congress. Here are a number of steps that the SEC should take.

First, the SEC should set forth specific disclosure requirements applicable to all corporate filers. Some of the topics that ought to be considered include human capital matters; climate risks and impacts; human rights risks; political spending; and tax strategies and risks.[49] Comments to the SEC's 2016 Concept Release on Regulation S-K, together with the efforts of other disclosure platforms, such as GRI and SASB, offer reasonable indicia regarding what disclosures investors are demanding and how to go about meeting that demand in detail.[50] Analysis and investor testing by SEC offices, such as the Division of Economic and Risk Analysis and the Office of Investor Advocate, will also be essential to ensuring disclosures adequately meet investor demand.

The SEC should also offer industry-specific guidance as well as review and comment on specific, industry-leading companies as means to move the market quickly. As the experience with the SEC's 2010 climate guidance shows, however, general guidance and comment letters are not enough.[51] A catch-all mandate for ESG disclosure would also be a useful way to encourage companies to begin offering more disclosure, as well as offer a flexible backstop to specific requirements.[52]

In addition, given the continuing growth of private markets and its impacts on investors and markets, the SEC should move towards expanding ESG disclosure mandates to cover private companies of a certain size, scope, or number of shareholders.[53]

Second, an alternative or additional approach would be for the SEC to look to an external organization for the detailed expertise that may

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49. Gellasch, *supra* note 7, at 21–23.

50. *Id.* at 8–9.

51. Coburn & Cook, *supra* note 35, at 4–5; Climate-Related Risks, *supra* note 35, at 15.

52. Comment Letter from J. Robert Brown, Jr., Professor, Univ. Of Denver, to Brent Fields, Sec'y, Sec. & Exch. Comm'n, on Concept Release on Disclosure Effectiveness (Oct. 3, 2016), https://www.sec.gov/comments/s7-06-16/s70616-374.pdf [https://perma.cc/9WSK-Q6FC]; *see also* Jill E. Fisch, *Making Sustainability Disclosure Sustainable*, 107 Geo. L. J. (forthcoming 2019) (manuscript at 29, 35–36), https://ssrn.com/abstract=3233053 [https://perma.cc/XNT4-TTCX] (exploring a new "sustainability discussion and analysis" mandate).

53. *See* Elisabeth De Fontenay, *The Deregulation of Private Capital and the Decline of the Public Company*, 68 Hastings L.J. 445, 449 (2017).

be required in setting specific ESG disclosures, especially those that vary by industry. For example, mandates for political spending and tax strategies may be best established by the SEC via line-item mandates, but climate change risk or human rights risks may be best considered on an industry-by-industry basis. Given that they may require detailed knowledge that the SEC may not be well-positioned to provide, relying on those that have established a transparent, investor-friendly process would make sense. Nor is this a new approach at the SEC, which has a long tradition of using self-regulatory organizations and other external organizations to set rules for and oversee particular aspects of the securities markets.[54] Over time, industry capture remains a serious risk at any organization, and the SEC should remain attentive to issues such as transparency, membership and participation, governance, and funding.[55]

Regardless of which entity sets disclosure requirements, it is particular important that a strongly investor-friendly approach to materiality be maintained. Some ESG matters are often asserted to not be material, owing to the small amount of money that can be involved. Take political spending, where investors have been winning numerous shareholder proposals,[56] yet the item is frequently critiqued as not being material on numerical grounds. But the SEC has "long recognized that investors may well have an interest in matters beyond the issue's direct relevance to the company's profits and losses."[57] It is not for

54. *See* Securities Act of 1933 § 19(b), 15 U.S.C. § 77s(d)(4) (2018); *Corporate Accounting Practices: Is There a Credibility GAAP? Hearings Before the H. Subcomm. on Capital Mkts., Ins. and Gov't Sponsored Enters., Comm. on Fin. Servs.*, 107th Cong. 51 (2002) (testimony by Robert K. Herdman, Chief Accountant, U.S. Securities & Exchange Commission); Sarbanes-Oxley Act of 2002 § 108, 15 U.S.C. 7218(b) (2018).

55. Karthik Ramanna, Political Standards: Corporate Interest, Ideology, and Leadership in the Shaping of Accounting Rules for the Market Economy 7–8 (2015); *see* Sustainable Accounting Standards Board, SASB Rules of Procedure 4–5 (2017), https://www.sasb.org/wp-content/uploads/2017/02/SASB-Rules-of-Procedure.pdf [https://perma.cc/ZTJ7-CSKU].

56. Gilbert & Curley, *supra* note 7, at 4–9; *see also Comments on Rulemaking Petition: Petition to Require Public Companies to Disclose to Shareholders the Use of Corporate Resources for Political Activities*, U.S. Sec. & Exchange Comm'n (June 20, 2018), https://www.sec.gov/comments/4-637/4-637.shtml [https://perma.cc/NE5U-QTYP]; Robert Yablon, *Campaign Finance Reform Without Law*, 103 Iowa L. Rev. 185, 211–12 (2017).

57. Lucian A. Bebchuk & Robert J. Jackson, Jr., *Responding to Objections to Shining Light on Corporate Political Spending (1): The Claim of Immateriality*, Harv. L. Sch. F. on Corp. Governance & Fin. Reg. (Apr. 4, 2013), https://corpgov.law.harvard.edu/2013/04/04/responding-to-objections-to-shining-light-on-corporate-political-spending-1-the-claim-of-immateriality/ [https://perma.cc/8T6V-K4AB] [hereinafter Bebchuk

management to substitute its determinations of materiality for that of regulators, acting on behalf of investors.[58]

Additionally, an unfortunate trend has been afoot to twist materiality from a general disclosure principle and a defense in an enforcement context to something that management would have to affirmatively find *before* a disclosure mandates attaches.[59] Through the Management, Discussion and Analysis section, management has its opportunity to indicate what it believes to be important. The materiality standard, though, is about whether disclosure is important to investors.[60] An affirmative finding requirement shifts the burden too much in favor of management discretion and against disclosure.

Third, the SEC should enhance audit standards for ESG information, which are less demanding than those for financial information.[61] This could also entail pushing audit committees to

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& Jackson, *Responding to Objections*]; Lucian A. Bebchuk & Robert J. Jackson, Jr., *Shining Light on Corporate Political Spending*, 101 Geo. L. J. 923, 943 (2013) [hereinafter Bebchuk & Jackson, *Shining Light*].

58. Bebchuk & Jackson, *Responding to Objections*, *supra* note 57; Bebchuk & Jackson, *Shining Light*, *supra* note 57, at 947–49.

59. *See, e.g.*, Press Release, Fin. Accounting Standards Bd., FASB Proposals Improvements to Materiality to Make Financial Statement Disclosures More Effective (Sept. 24, 2015), http://www.fasb.org/cs/ContentServer?c=FASBContent_C&pagename=FASB%2FFASBContent_C%2FNewsPage&cid=1176166401832 [https://perma.cc/YB9Q-F6L4]; SEC Inv'r Advisory Comm., Comment Letter on Proposed Amendments to Statement of Financial Accounting Concepts and Notes to Financial Statements (Jan. 21, 2016), https://www.sec.gov/spotlight/investor-advisory-committee-2012/iac-letter-fasb-materiality-012116.pdf [https://perma.cc/HR5Y-T7E2]; *see* SEC Investor Advisory Comm., *Minutes of the Meeting on October 15, 2015*, U.S. Securities & Exchange Comm'n, https://www.sec.gov/spotlight/investor-advisory-committee-2012/iac101515-minutes.htm [https://perma.cc/YED4-6EBH] (last visited Mar. 11, 2019); SEC Investor Advisory Comm., *Minutes of the Meeting on January 21, 2016*, U.S. Securities & Exchange Comm'n, https://www.sec.gov/spotlight/investor-advisory-committee-2012/iac012116-minutes.html [https://perma.cc/7DPL-ERF5] (last visited Mar. 11, 2019).

60. *See* Securities and Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(c)(1) (2018); Exchange Act Rule, 17 C.F.R. § 240.10b-5(b) (2018); TSC Indus. Inv. v. Northway, Inc., 426 U.S. 438, 449 (1976); *see also* SEC Staff Accounting Bulletin No. 99, 17 C.F.R. § 211 (Aug. 12, 1999), https://www.sec.gov/interps/account/sab99.htm [https://perma.cc/G3ZA-PXHC] (finding that information is material and must be disclosed to investors through the financial statements it files with the SEC "if there is a substantial likelihood that a reasonable person would consider it important").

61. Coburn & Cook, *supra* note 35, at 7; Climate-Related Risks, *supra* note 35, at 7–8; *see Attestation*, Public Comp. Accounting Oversight Bd., https://pcaobus.org/Standards/Attestation/Pages/default.aspx

engage in the same level of oversight for ESG matters as for that of ordinary financial information.

Fourth, enforcement needs to be part and parcel of any strategy to make ESG disclosure effective and reliable. Unless the SEC and state attorneys general brings cases that help establish these broader precedents, it will difficult for investors as plaintiffs to secure their rights to this information. Of course, protecting the rights of investors to secure their rights in court will be essential in retaining robust and accountable capital markets.[62]

Fifth, policymakers should push corporations to ensure their boards have greater ESG expertise and focus, as well as accountability to long-termism generally. Membership, culture, and incentives for boards have an important role in oversight of management and in setting the broader direction for the company.[63] Indeed, investors have recently called for greater board diversity, which the SEC and others could build upon by including ESG expertise within the definition of diversity of membership.[64] Board attention to ESG could also be enhanced through a disclosure that explained how the board was incorporating the views of workers, communities, and other major stakeholders in the corporation's governance, as well as how it is achieving its long-term-oriented goals.

[https://perma.cc/82GR-ERG5] (last visited Mar. 11, 2019) (describing the attestation standards adopted by PCAOB).

62. Andy Green, *Could the SEC Secretly Abolish Investors' Right to Sue?*, MarketWatch (Mar. 2, 2018), https://www.marketwatch.com/story/could-the-sec-secretly-abolish-investors-right-to-sue-2018-03-02 [https://perma.cc/P5YR-5G6].

63. Colin Mayer, *Reinventing the Corporation*, J. Brit. Acad. 4, 53–77 (2016); *see also* Martin Lipton, *The New Paradigm*, Harv. L. Sch. F. on Corp. Governance & Fin. Reg. (Jan. 11, 2017), https://corpgov.law.harvard.edu/2017/01/11/corporate-governance-the-new-paradigm/ [https://perma.cc/XWS6-HU8S]; *see also About the Investor Stewardship Group and the Framework for U.S. Stewardship and Governance*, Inv. Stewardship Group, https://isgframework.org/ [https://perma.cc/D2PG-V4SH] (last visited Mar. 22, 2019). For an alternative view of corporate governance but one that reaches largely the same conclusions regarding the importance of boards of directors for corporate performance, see, e.g., Lucian A. Bebchuk & Scott Hirst, *Private Ordering and the Proxy Access Debate*, 65 Bus. Law. 329 (Feb. 2010).

64. Letter from Anne Simpson et al., Sec. & Exch. Comm'n Inv'r Advisory Comm., to Elizabeth M. Murphy, Sec'y, Sec. & Exch. Comm'n (Mar. 31, 2015), https://www.sec.gov/rules/petitions/2015/petn4-682.pdf [https://perma.cc/F8KL-ZKWW]; *see* Cybersecurity Disclosure Act of 2017, S. 536, 115th Cong. (2017); *see also* Press Release, Office of Sen. Elizabeth Warren, Warren Introduces Accountable Capitalism Act, (Aug. 15, 2018), https://www.warren.senate.gov/newsroom/press-releases/warren-introduces-accountable-capitalism-act [https://perma.cc/P5GY-9TN2].

Sixth, and finally, shareholder voice has an important role to play in promoting ESG disclosure and corporate long-termism generally.[65] Indeed, shareholders bear the primary risks from insufficient ESG disclosure. To that end, shareholders must retain full access to shareholder proposals and to the independent governance advice of their choosing.[66]

In addition, with retail ownership of stocks overwhelmingly mediated by asset managers,[67] as well as millions of working Americans invested in 401(k)s or a pension fund for the long run, how their asset managers approach ESG is more important than ever.[68] Asset managers are fiduciaries and well positioned to take the longer-term view. That, however, can vary greatly in approach—with some asset managers increasingly focused on ESG-oriented matters, [69] while others do not engage or simply follow management for important shareholder votes.[70]

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65. *See, e.g.*, Kara Stein, Commissioner, Sec. & Exch. Comm'n, Remarks at Standford University: Mutualism: Reimagining the Role of Shareholders in Modern Corporate Governance, (Feb. 13, 2018), https://www.sec.gov/news/speech/speech-stein-021318 [https://perma.cc/EJ2Q-SJ3T]; Hester M. Peirce, Commissioner, Sec. & Exch. Comm'n, Remarks at the 17th Annual SEC Conference, Center for Corporate Reporting and Governance: My Beef with Stakeholders (Sept. 21, 2018), https://www.sec.gov/news/speech/speech-peirce-092118 [https://perma.cc/TZ2A-TFV6].

66. *See* Lisa M. Fairfax, *Making the Corporation Safe for Shareholder Democracy*, 69 Ohio St. L. J. 53, 72 (2008); Jill. E. Fisch et al., *Passive Investors*, Penn. L. Rev. (forthcoming 2019).

67. *2018 Investment Company Fact Book: A Review of Trends and Activities in the Investment Company Industry*, Inv. Company Inst., no. 58, 2018, at 1, https://www.ici.org/pdf/2018_factbook.pdf [https://perma.cc/4ZUA-8PQ2]; *see generally* Kara Stein, Commissioner, Sec. & Exch. Comm'n, Address at Brooking's Institute: Mutual Funds—the Next 75 Years (June 15, 2015), https://www.sec.gov/news/speech/mutual-funds-the-next-75-years-stein.html#_ftnref7 [https://perma.cc/8JKS-69UN.

68. Leo E. Strine Jr., Vice Chancellor, Del. Court of Chancery, Keynote address at the Journal of Corporation Law Spring Banquet: Toward Common Sense and Common Ground? Reflections on the Shared Interests of Managers and Labor in a More Rational System of Corporate Governance (Mar. 1, 2007), *in* 33 J. Corp. L. 1 (2007).

69. Annual Letter from Larry Fink, Chairman & Chief Exec. Officer, BlackRock, Inc., to Chief Exec. Officers (Mar. 2019), https://www.blackrock.com/corporate/en-no/investor-relations/larry-fink-ceo-letter [https://perma.cc/VNV4-2CN4].

70. *See, e.g.*, *The 100 Most Overpaid CEOs 2018: Are Fund Managers Asleep at the Wheel?*, As You Sow (Mar. 1, 2018), https://www.asyousow.org/report/the-100-most-overpaid-ceos-2018/; *see generally* Am. Fed'n of Labor & Cong. of Indus. Org. Office of Inv., AFL-CIO Key Votes Survey: How Investment Managers Voted in the 2018 Proxy Season (2019), https://aflcio.org/reports/afl-cio-key-votes-survey [https://perma.cc/X4K9-UJ22].

A better approach would be to enhance disclosure and accountability to ultimate investors. Building on the SEC's 2003 rule that required mutual funds to disclose how they voted their proxies,[71] the SEC should establish a new disclosure for how mutual funds approach ESG and long-term matters generally, including voting and any engagement. Funds dedicated to handling longer-term investments, such as college savings or retirement funds, should have to say how their approach matches their longer-term mandates.[72]

More may also need to be done to align asset managers' proxy votes with the views of their underlying mutual fund investors regarding long-termism. This could mean eliminating the practice of having abstentions count as votes against a resolution.[73] Mutual fund investors, especially those in generic funds or where little choice exists, could also be given the ability to ask their asset manager vote a proportional amount of the funds' proxies along certain ESG lines.

Ultimately, it is a welcome addition to corporate governance for asset managers with substantial shareholder heft to be oriented towards long-term-oriented engagement.[74] While challenges and questions regarding the details exist, this new trend should be encouraged.[75]

71. Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies Rule, 17 C.F.R §§ 239, 249, 270, 274 (2003).

72. Leo E. Jr. Strine, *Securing Our Nation's Economic Future: A Sensible, Nonpartisan Agenda to Increase Long-Term Investment and Job Creation in the United States*, 71 Bus. Law. 1081, 1108–09 (2016).

73. *See generally* Stephen J. Choi et al., *The Power of Proxy Advisors*, 59 Emory L.J. 869, 872–74, (2010); Cydney Posner, *Activists Seek to Exclude Abstentions from the Voting Standard for Shareholder Proposals*, Cooley (Apr. 1, 2015), https://cooleypubco.com/2015/04/01/activists-seek-to-exclude-abstentions-from-the-voting-standard-for-shareholder-proposals/ [https://perma.cc/U5Y3-25NM]; Rachel Curley, *Nearly 30,000 Americans Call for Vanguard to Hold Companies Accountable for Political Engagement*, Corp. Reform Coalition (Nov. 21, 2017), https://corporatereformcoalition.org/vanguard-petition [https://perma.cc/3BJA-6GH9]; *see* Leo E. Strine Jr., *Who Bleeds When the Wolves Bite?: A Flesh-and-Blood Perspective on Hedge Fund Activism and Our Strange Corporate Governance System*, 126 Yale L.J. 1870, 1966–67 (2017).

74. *See generally* Anat R. Admati, *A Skeptical View of Financialized Corporate Governance*, 31 Stan. J. Econ. Persps. 131 (2017).

75. *See, e.g.*, Dorothy Lund, *The Case Against Passive Shareholder Voting*, U. Chi. J. Corp. L., (forthcoming 2018); Fisch et al., *supra* note 66 at 31; Eric A. Posner et al., *A Proposal to Limit the Anti-Competitive Power of Institutional Investors*, 81 Antitrust L.J. 669 (2017); José Azar et al., *Anticompetitive Effects of Common Ownership*, 73 J. Fin. (forthcoming 2019); Einer Elhauge, *New Evidence, Proofs, and Legal Theories on Horizontal Shareholding*, Harv. L. Sch. F. on Corp. Governance & Fin. Reg. (Feb. 14, 2018), https://corpgov.law.harvard.edu/2018/02/14/new-evidence-proofs-and-legal-theories-on-horizontal-shareholding/ [https://perma.cc/7CHA-W5Q7].

Conclusion

The efficiency and effectiveness of America's capital markets depend upon the quality of information available. Right now, too little comparable, reliable ESG information is available for investors to make those markets work—which harms investors, workers and communities, and ultimately, economic growth. Policymakers should correct the market failure in the provision of this information and in doing so better align the interests of investors, companies, and the public. ESG disclosure is not a panacea; America must still address deep challenges of stagnant wages and inequality, climate change and more through a wide range of other means. But capital markets should assist, rather than hinder, those efforts.