

**Mandated ESG Disclosure:  
A discussion paper on current proposals for regulatory reform  
Eugene Ellmen, Executive Director  
Social Investment Organization  
Executive summary  
November 2009**

**Background**

Pressure for mandatory corporate disclosure on environmental, social and governance (ESG) issues is growing around the world. The US Social Investment Forum (SIF) has issued a proposal for mandated ESG disclosure to the Securities and Exchange Commission (SEC) and the European Sustainable Investment Forum (Eurosif) has issued a proposal to the European Commission. This paper sets out the case for mandated ESG disclosure, and reviews these proposals and analyzes their strengths and weaknesses according to the key issues outlined in the case for mandated disclosure.

**Why mandated ESG disclosure is necessary**

In spite of significant legal and financial drivers encouraging the spread of responsible investment (RI) and large numbers of investors and collaborations improving RI research and practice, the development of responsible investment is hobbled by a lack of widespread, easily accessible, comparable and systematic information on the ESG performance of companies. The current situation is marked by low rates of voluntary corporate reporting on ESG issues and inconsistent reporting and presentation of data.

As a result of this lack of meaningful, systematic reporting on ESG issues, asset managers, fund companies and other investors are unable to obtain the information they need to conduct thorough, comprehensive analyses of companies. This failure is slowing the development of analysis and practice on responsible investment, and represents a significant barrier to the integration of ESG issues into mainstream investing.

Because underlying ESG risks of investment valuations are so poorly understood, there is significant risk that undisclosed ESG risk could have catastrophic market impacts. Such catastrophes are examples of so-called "black-swan events." Undisclosed ESG risk was one of the factors in the 2008 collapse of global credit markets. Mandatory disclosure of ESG risk factors would provide better understanding of such potentially-catastrophic underlying risk situations, helping to prevent them altogether or to mitigate their effects.

ESG information must be widely disseminated and easily accessible in the market. Therefore, mandatory ESG reporting is essential from both a long-term perspective of enhancing returns and reducing risk and a short-term perspective of identifying unusual but potentially-calamitous possibilities. The costs to issuers of such reporting must be kept as low as possible, of course, but the benefits of mandatory ESG reporting to investors and society as a whole outweigh the costs to issuers.

**Review and analysis of the proposals**

The US proposal, outlined in a letter to SEC Chairman Mary Shapiro July 21, 2009 from SIF CEO Lisa Woll, contains two key recommendations: 1) that issuers should be subject to mandatory reporting under the highest reporting standard (G3 Guidelines A-plus) of the Global Reporting Initiative (GRI); and 2) that the SEC issue interpretive guidance to clarify sustainability-related disclosures required under Management's Discussion & Analysis (MD&A) filings.

The European proposal, outlined in Eurosif's *Public Policy Position Paper related to Sustainable and Responsible Investment (SRI)*, calls for mandatory ESG reporting through the use of "principles-based" key performance indicators (KPIs), some of which would be sector-specific. The recommended reporting framework should be genuinely informative and include forward-looking elements; be material, relevant and timely; describe company strategy, risks and opportunities; be accessible and integrated; use key performance indicators (KPIs) that are linked to strategy and facilitate comparisons; use objective metrics; and be strengthened where possible by independent assurance.

The key advantage of the US proposal is that it offers a clear, simple framework applied to all publicly-listed companies. It would encourage broad market reporting on ESG, thus increasing the amount of ESG information in the market. The clear rules of the GRI framework would facilitate comparability and systematic analysis.

The European proposal offers a better opportunity for leadership on ESG issues by companies or sectoral associations. This would provide the opportunity for forward-looking ESG indicators, providing a better early warning system about issues of undisclosed risk. This model would encourage companies and sectors to take leadership on ESG disclosure, rather than treating it as a compliance function. However, there is a risk that certain sectors would not be able to reach a consensus on appropriate KPIs, thereby leading to inconsistent reporting between sectors.

The US model would have higher compliance costs in the short-term, but the European model conceivably could have higher on-going costs because of the need for continuous review of the sectoral KPIs.

## **Conclusions**

Inaction is not an option. While there are compliance and regulatory costs to both of these frameworks, the cost of doing nothing is prohibitive in the loss of investor opportunity, higher long-term risk and the risk of catastrophic ESG-related events.

The US approach of mandatory disclosure under the GRI would provide suitable broad market ESG information. The US approach would also ensure a level of systematic reporting enabling comparisons within sectors. The European approach has the benefit of encouraging companies and sectors to take leadership on ESG disclosure, bringing to light emerging issues and developing appropriate sectoral consensus on relevant indicators. While the European approach alone would not ensure broad market information, it does encourage sectors and companies to think in a forward fashion, and not simply to treat ESG disclosure as a compliance function.

If Ontario can take a hard look at these state-of-the-art proposals and choose the best of both, it could develop the best mandatory ESG reporting system in the world. If implemented nationally through a CSA continuous disclosure instrument, Canada could become the leading jurisdiction globally for ESG reporting.