Comment: EU environmental-disclosure wave will force hand of US companies, asset managers

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In Brief

US companies and asset managers will inevitably be pushed to disclose more of their environmental impacts by market-based incentives rippling from recent EU initiatives — even as Washington regulators decline to wade in, investment management specialists said. “The most direct impact will be felt among those in the US asset management community with an exposure to the EU,” said Caitlin McErlane, a Baker McKenzie asset-manager adviser in London. Meg Voorhees of the US Forum for Sustainable and Responsible Investment said European fund managers with investments in American companies might ask them to report their greenhouse gas emissions.

US companies and asset managers will inevitably be pushed to disclose more of their environmental impacts by market-based incentives rippling from recent EU initiatives — even as Washington regulators decline to wade in, investment management specialists said.

The EU has been trying to steer European asset managers to invest in sustainable finance and make European companies — as well as units of foreign corporations — report their climate-change footprints.

“The most direct impact will be felt among those in the US asset management community with an exposure to the EU,” said Caitlin McErlane, a Baker McKenzie asset-manager adviser in London.

Meg Voorhees, research director for the US Forum for Sustainable and Responsible Investment, said European fund managers with investments in American companies might ask them to report their greenhouse gas emissions.

These US companies will risk losing their European investments if they don’t reveal their impacts, she said. Similarly, American corporations seeking European investors will have an incentive to make global-warming disclosures.

Under the new rules, EU asset managers will be required to disclose how they’ve considered environmental, social and governance — or ESG — issues that might impact the value of an investment, among other things.

ESG investments are soaring in popularity among US investors. Disclosure expectations will be influenced by the EU measures, McErlane and Voorhees said.

“Advisers and investment managers are realizing there is a demand out there,” Voorhees said. “They are moving to catch up to that demand.”

Institutional investors and money managers considered ESG issues in their investment research, analysis and decision-making across US portfolios totaling $11.6 trillion in 2018, the most recent year for which this US Forum data was available. That's a 44 percent increase, from $8.1 trillion, in two years.

— EU initiatives —

A 2014 EU law requires about 6,000 listed companies with more than 500 employees to report their policies on the environment, corruption and diversity. Those same companies, under a more recent law (see here), must detail how much of their revenue and expenditures relate to climate-change measures.

An EU proposal last month (see here) would require unlisted companies such as Ikea or Aldi to report their climate-change impact. Listed companies, under another directive, would also have to provide more details of non-financial environmental issues. The European units of foreign groups also would come under the umbrella of the 2014 law.

“The needs of investors for corporate sustainability information are growing faster than any improvements in company reporting,” EU Commissioner Valdis Dombrovskis said last month. The non-financial reporting directive also sought to extend the reporting requirements on social and environmental performance for asset managers.

A formal proposal is due to be put on the table around the fourth quarter of 2020, with possible passage a few years after that.

Last October, the EU adopted the Disclosure Regulation, which requires most investment managers to report how they monitor companies in which they have invested for ESG matters that substantially affect the value of an investment.

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Managers also have to disclose whether they have considered the societal impacts of an investment.

“Ultimately, EU managers will need to ensure that whatever they disclose to their investors and the market can be backed up by data from investee companies,” McErlane said.

This disclosure regulation is to apply in principle starting in March 2021.

Definitions of ESG investments are contained in a pending EU proposal. This “green taxonomy” also would require companies to disclose ESG information in addition to what is required by the non-financial directive.The European Commission is due to outline further details by June 2021.

— US SEC —

As EU regulators zoom ahead, the US Securities and Exchange Commission is staying put on environmental-impact disclosure.

SEC Chairman Jay Clayton is leaving global-warming disclosure to individual companies and asset managers despite petitions from institutional investors seeking standardized ESG disclosure for public companies.

BlcakRock, the world’s largest asset manager, announced a public commitment last month to make investment decisions with environmental sustainability as a core goal.

“The market is moving at a far swifter pace than the legislative response,” McErlane said.

The SEC sometimes speaks by omission.

In a proposal last month to modernize companies' disclosure requirements, no mention was made of climate change.

Democratic Commissioner Allison Lee said: "We purport to modernize, without mentioning what may be the single most momentous risk to face markets since the financial crisis."

Clayton has outlined his approach in a couple of statements to the SEC’s investor-advisory committee.

“Each company, and each sector, has its own circumstances, which may or may not fit within a standard framework,” he told the panel in 2018 (see here). He reiterated this last November.

The key points of interest to him regarding disclosure, Clayton said, are what data companies use to make decisions and what data investors use.

“Even these two questions can lead to complex answers, including because not all companies in the same sector use the same or comparable data in their decision making, and investor analysis also varies widely,” he said (see here).

Fund managers’ use of the ESG term is under scrutiny by the commission. This week, the SEC requested public comment on use of the term, while also looking at whether fund-name rules should be changed to address the growing use of derivatives, an increase in index funds and investments that include convertible securities. (see here)

On the international stage, the SEC also has largely spoken by omission.

The SEC didn’t vote last year on an International Organization of Securities Commissions statement encouraging companies to consider disclosing major business risks stemming from ESG issues.

Investor advocates expect little effort by the SEC under President Donald Trump to try to match EU initiatives.

“We do not expect similar regulation will be coming out of the US, at least not under the current administration,” said Glenn Davis, the research director of the Council of Institutional Investors.

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