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Rethinking Global ESG Metrics

Many advocates behind the global environmental, social, and governance movement argue that prosperity alone is not a sufficient measure of society's progress, a position that I believe is unassailable. The challenge we face in addressing the ever-increasing number of issues underlying E, S, and G is daunting. The task before us is to find a way to bring about lasting, positive change to our countries on a range of issues without sacrificing in the process the very means by which so many lives have been enriched and bettered. Accordingly, a shared desire to address these and other societal problems should compel us to rethink our prescriptive approach to ESG and instead find ways to encourage our most precious resource—our people—to devise solutions to the climate-related and other challenges our societies face.

In the United States, the idea of enlisting the securities laws to achieve ESG objectives is gaining traction among activists and policy elites with a particular emphasis on requiring disclosure of specific ESG metrics. Some are urging us to closely align our rules with our European friends who long have been working on devising a comprehensive set of ESG disclosure metrics. Others would like to see us rely on standards developed and governed by an international body, such as the work being contemplated by the International Financial Reporting Standards Foundation. Indeed, there is mounting pressure to embrace a single global set of metrics, which would facilitate international capital flows and issuers' reporting obligations.

At first glance, everything sounds good—common metrics demonstrating a joint commitment to a better, cleaner, wellgoverned society. Common disclosure metrics, however, will drive and homogenize capital allocation decisions. A single set of metrics will constrain decisionmaking and impede creative thinking. Unlike financial accounting, which lends itself to a common set of comparable metrics, ESG factors, which continue to evolve, are complex and not readily comparable across issuers and industries. The result of global reliance on a centrally determined set of metrics could undermine the very people-centered objectives of the ESG movement by displacing the insights of the people making and consuming products and services.

Hampering the ability of the markets to collect, process, disseminate, and respond to price signals by boxing them in with preset, government-articulated metrics will stifle the people's innovation that otherwise would address the many challenges of our age. Moreover, converging standards would be antithetical to our existing disclosure framework, which is rooted in investor-oriented financial materiality and principles-based requirements to accommodate the wide variety of issuers.

The European concept of "double materiality" has no analogue in our regulatory scheme and the addition of specific ESG metrics, responsive to the wide-ranging interests of a broad set of "stakeholders," would mark a departure from these fundamental aspects of our disclosure framework. The strength of our capital markets can be traced in part to our investor-focused disclosure rules and I worry about the implications a stakeholder-focused disclosure regime would have. Such a regime would likely expand the jurisdictional reach of the Commission, impose new costs on public companies, decrease the attractiveness of our capital markets, distort the allocation of capital, and undermine the role of shareholders in corporate governance.