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How Do You Determine the “Materiality” of an ESG Issue?

We can all agree that "materiality" decisions can be tough. The determinations tend to be highly subjective on the margins. In the gray areas. And that's just when you're trying to put yourself in the shoes of a "reasonable investor." What happens when it comes down to ESG and you're trying to apply a "double materiality" threshold?!? Whoa, Nelly! A brief primer on "double materiality." "Single materiality" is inwardly focused: "how does this impact the company?" In comparison, "double materiality" is both inwardly and outwardly focused: "how does this impact the company? As well as how does this impact our stakeholders?" That's the distinction at a glance. Sweat starts to form on the brow. Very few companies are applying a form of double materiality. The Shareholder Commons **announced** last year that it had withdrawn a shareholder proposal at Yum! because the company agreed to disclose the systemic effects of the use of antibiotics in its supply chain by the end of last year. The press release notes that Yum! will be first public company in the United States to disclose its impacts on the global economy and the interests of diversified shareholders. So what happens in practice for those companies still operating with "single materiality" as their mandate? In their SEC filings, companies are mostly reactive when it comes to what they're choosing to disclose about their E&S issues. Through shareholder engagement – or by complying with the policies of their major investors and the proxy advisors – they have signposts of where they need to be to keep those stakeholders happy. (By the way, I say all this putting aside the potential environmental liability disclosures you may be required to make in your "Legal Proceedings" section. The ones triggered by Item 103 of Regulation S-K.) Aside from pressure from investors and other stakeholders—who might even include employees these days, who actually are your shareholders, too, in many cases – an ESG issue is not likely to have a big impact on your numbers or rise to the level of a material "trend" for discussion in the MD&A, particularly considering that the timeframe for trend disclosure is near-term. The reality is that E&S isn't otherwise likely to come up as part of the quarterly process unless related issues are proactively raised. It's not likely to be teed up unless it comes up as part of the general discussion of risk factors. But it's now likely to come up because ESG is first and foremost on almost everyone's mind—and so, E&S likely will be raised. I should also mention there are also concepts of "nested" and "dynamic" materiality in the various ESG standards. "Nested materiality" essentially is a hybrid of the single and double materiality standards. "Dynamic materiality" is materiality that may be changeable or fluid over time. A little confusing? See this article entitled "**Materiality Across Asset Classes: A Look At Fixed Income ESG Integration**." And SEC Commissioner Allison Herren Lee delivered this **speech** a while back on materiality in the ESG context to dispel four common myths. Her four myths are: – Myth #1: ESG matters (indeed all matters) material to investors are already required to be disclosed under the securities laws. – Myth #2: Where there is a duty to disclose climate and ESG matters, we can rest assured that such disclosures are being made. – Myth #3: SEC disclosure requirements must be strictly limited to material information. – Myth #4: Climate and ESG are matters of social or "political" concern, and not material to investment or voting decisions.

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