



## **ESG Disclosures and Associated Risks**

**Compliance and Ethics**

**Environmental**

**Corporate, Securities, and Governance**



ESG, the examination of a company's environmental, social, and governance practices, has gained the world's attention in recent years. ESG reporting is an area of growing focus for a myriad of interested parties ranging from consumers, investors, credit rating agencies, regulators, and policymakers.

ESG requirements impact investment and lending appetites of financial institutions across the globe. From the US Securities and Exchange Commission (SEC), to the European Commission, to the Board of the International Organization of Securities Commissions (IOSCO), financial regulators across the globe are paying more attention to ESG disclosures. Hence, companies, however big or small, must work within this ESG reporting framework in order to survive and thrive.

This translates into increasing pressure on companies to provide more [ESG disclosures](#) to comply with the new regulations introduced by international financial regulators — and there are potential legal risks and litigation costs associated with making such disclosures.

## **Complexity of ESG disclosures**

As ESG disclosures are coming under an intense spotlight, the complexities of such disclosures are also becoming apparent.

First, the diversity of the disclosures is as broad as the companies that are subjected to them. Each sector has various nuances that will affect them differently. Second, while there are several global initiatives led by international financial regulators, the national responses by local financial regulators differ broadly.

These differentiating factors only serve to highlight the gaps in reporting practices and leaves room for companies to interpret the extent and manner in which they need to comply with such ESG

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disclosures. Inconsistent disclosures and gaps in reporting practices could result in unnecessary scrutiny and potential legal risks.

Apart from the challenge of having to comply with varying ESG disclosure requirements, companies could also expose themselves to various state and local consumer protection laws. While such claims might not ultimately be successful, merely having a claim initiated against a company can have serious reputational damage and result in unnecessary legal and public relation costs.

As gatekeepers of the companies' interests, what can we, as in-house counsel, do to protect the companies we operate in?

## **Ensure that ESG disclosures can be supported by fact**

In-house counsel should ensure that ESG disclosures are not overly aspirational and/or marketing statements. There should be a single source of truth for each ESG disclosure made. Given the nuances in reporting requirements, it is crucial that companies strike the right balance when making ESG disclosures. Disclosures should only be limited to what is accurate and relevant to the company — and always be supported by data.

In order to ensure that the disclosures are as consistent as possible, the underlying supporting evidence should be based on facts that remain true notwithstanding the differentiating laws and regulations.

Despite the differences in ESG reporting at both the international and national levels, the disclaimers should be as consistent or similar as possible while still ensuring that the disclaimers meet the regulatory requirements relevant in the jurisdictions where the companies operate and/or the standards set by the financial institutions where such companies trade.

## **Include tailored ESG disclaimers**

Currently, all public companies listed on major stock exchanges have a generic disclaimer. These generic disclaimers are not tailored for issues mentioned in the ESG disclosures. While it may be said that having a disclaimer is better than not having one, such a disconnect might not be ideal in protecting the companies and reducing risks.

In-house counsel are best placed to wordsmith more tailored ESG disclaimers to ensure that they explicitly cover ESG data, thereby reducing potential legal risks that may arise from investors misunderstanding or misinterpreting the ESG data.

More specifically, if the ESG data was not audited and not subject to the [Generally Accepted Accounting Principles](#) but reflected in the earnings report, this should be flagged and highlighted in the disclaimers.

Given that ESG disclosure requirements apply across the board regardless of industry or company, having a specifically tailored disclaimer would ensure that the company's risks are appropriately mitigated. After all, not all ESG metrics would apply equally; some may not even be relevant.

Having generic disclaimers does not explain this nuance to investors, leaving room for stakeholders to wonder how and if the disclaimers apply to the ESG data included in the company's ESG

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disclosure.

Once a market standard of ESG specific disclaimers have been cast in stone, companies should also be mindful to work within such market standards while trying to establish its ESG disclaimers that are more relevant to the company and/or the industry.

## **Ensure that the ESG language follows through in company policies and contracts**

In-house counsel should work with relevant stakeholders within the company, in particular but not limited to the business and finance teams, to better understand key ESG metrics, ratings, and reporting methodologies. This would better equip in-house counsel with the requisite knowledge to draft appropriate ESG disclosures that are relevant and accurate, and yet not overly aspirational, and pair them with specifically tailored ESG disclaimers.

Additionally, in-house counsel may want to consider weaving the ESG language into company policies and incorporating them into contracts with vendors and subcontractors, where appropriate. This would serve to ensure the company's accountability to its customers and investors in terms of upholding its ESG values. Thus, protecting the company from potential legal risks from various angles.

This would also assure investors and consumers that the disclosures provided are more than mere aspirational marketing lines for the sake of compliance with regulations. It would also serve to protect the companies and reduce exposure to potential legal risks, as underlying company policies support the disclosures and are appropriately flowed down to the relevant vendors and subcontractors.

ESG reporting and metrics serve as an important indicator of a company's overall health, and ESG reports establish a compelling story about the impact a company is making on the world. As the world is increasingly focused on ESG, in-house counsel should monitor ESG requirements and work with relevant stakeholders to ensure best practices are incorporated while protecting the companies from potential legal risks and litigation.

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