CLIENT ALERT

SEC Sharpens Focus on ESG

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If the first months of the Biden administration are any indication, environmental, social, and governance ("ESG") considerations may well factor significantly in policies and priorities emanating from the White House, and specifically, those of the U.S. Securities and Exchange Commission (the "SEC"). Some key personnel placements at the SEC, and early signals regarding the relevance of climate change and related risks, could mark heightened focus on these issues and provide impetus for increased scrutiny, stakeholder engagement, and enforcement.

The SEC's historic approach to ESG disclosure emphasized a voluntary "principles-based" approach, but this could be about to change.[1] President Biden's pick to head the Commission, Gary Gensler, has long been interested in climate change and implications of related risks for financial markets,[2] and if confirmed, is likely to work with Democratic

[1] The SEC showed signs of a potential shift in this direction during the Obama administration. For example, in 2016, the SEC issued a "Concept Release" soliciting public input on modernizing the disclosure requirements in Regulation S-K, in response to calls from investors increasingly interested in the potential relevance of ESG issues. *See* William Thomas & Annise Maguire, *SEC Studying Change of Regulation S-K to Require ESG Disclosures* (Nov. 7, 2016), available here. Moreover, in 2019, the International Organization of Securities Commissions, of which the SEC is a member, released a statement regarding ESG disclosures, which "encourage[d] issuers to consider the materiality of ESG matters to their business and to assess risk and opportunities in light of their business strategy and risk assessment methodology." *Statement on Disclosure of ESG Matters by Issuers*, International Organization of Securities Commissions (Jan. 18, 2019). Notably, however, this statement indicated that the SEC did not vote on the publication of the statement and that it "should not be viewed as an expression of the Commission's views or an endorsement by the Commission." *Id.*

[2] Mr. Gensler reportedly indicated during his confirmation hearing that both investors and issuers would benefit from more robust disclosures regarding climate risk. *See* Tory Newmyer, *President Biden's SEC Pick Signals Companies Could Face Wave of New Disclosure Rules*, THE WASHINGTON POST (Mar. 2, 2021).

lawmakers and other transparency stakeholders to sharpen guidance and perhaps impose mandatory disclosure requirements addressing diversity, climate change, and other core dimensions of ESG. Notably, in November 2020, Acting SEC Chairperson Allison Herren Lee (then an SEC Commissioner) and SEC Commissioner Caroline Crenshaw also advocated "requiring companies to disclose specific information about climate risk and human capital management" in order to "allow market participants to accurately price and compare the risks and opportunities associated with these risks," rather than the "non-standardized, inconsistent, and incomparable disclosures" that result from a principles-based approach.[3]

Under the leadership of Acting Chairperson Lee, the SEC has already taken concrete steps towards prioritizing ESG-related disclosures. On February 24, 2021, she directed the SEC's Division of Corporate Finance "to enhance its focus on climate-related disclosure in public company filings."[4] Her announcement makes reference to the SEC's 2010 guidance to public companies regarding existing disclosure requirements as they apply to climate change matters and commits that the SEC will "review the extent to which public companies address the topics identified in the 2010 guidance, assess compliance with disclosure obligations under the federal securities laws, engage with public companies on these issues, and absorb critical lessons on how the market is currently managing climate-related risks."[5] On March 15, Chairperson Lee posed a series of questions for consideration in the development of further ESG disclosure, and invited public comments regarding the development of ESG disclosure requirements.[6] The SEC's Division of Examinations (formerly the Office of Compliance Inspections and Examinations) similarly indicated in its "2021 Examination Priorities" that it will "prioritize emerging risks, including those relating to climate and ESG."[7] And on February 26, 2021, the SEC's Office of Investor Education and Advocacy issued a bulletin "to educate investors about ESG Funds."[8]

In addition, the SEC has signaled its focus on climate change and other ESG issues through a series of recent personnel decisions. On February 1, 2021, Harvard Law School professor John Coates was named as the acting director of the

3 *Joint Statement on Amendments to Regulation S-K: Management's Discussion and Analysis, Selected Financial Data, and Supplementary Financial Information*, Allison Herren Lee & Caroline A. Crenshaw (Nov. 19, 2020), available here. These remarks stand in contrast to statements made by the two current Republican-appointed SEC Commissioners. *See, e.g.*, Elad L. Roisman, *Keynote Speech at the Society for Corporate Governance National Conference* (July 7, 2020), available here ("In my experience, and based on the many discussions I have had on the topic, this type of mandated disclosure is often fraught with subjectivity and agendas that are often unrelated to 'investor welfare.'"); Hester M. Peirce, *Scarlet Letters: Remarks Before the American Enterprise Institute* (July 18, 2019), available here ("If ESG disclosures mean disclosing what is financially material, there is little controversy, but the ESG tent seems to house a shifting set of trendy issues of the day, many of which are not material to investors, even if they are the subject of popular discourse.").

4 *Statement on the Review of Climate-Related Disclosures*, Allison Herren Lee (Feb. 24, 2021), available here.

5 *Id.*

6 Public Input Welcome on Climate Change Disclosure (March 15, 2021), available here.

7 *2021 Examination Priorities: Division of Examinations* (2021), available here .

8 *Environmental, Social and Governance (ESG) Funds – Investor Bulletin* (Feb. 26, 2021), available here.

SEC's Division of Corporate Finance.[9] Coates led an SEC investment advisory committee that urged the SEC last year to establish ESG disclosure policies,[10] and has already spoken about developing robust and thoughtful ESG disclosure standards.[11] Also on February 1, 2021, Satyam Khanna was named as the SEC's first-ever Senior Policy Advisor for Climate and ESG.[12] Khanna, who was most recently a fellow at NYU School of Law's Institute for Corporate Governance and Finance and also served as an advisor to President Biden's transition team, will be tasked with "advis[ing] the agency on environmental, social, and governance matters and advance[ing] related new initiatives across its offices and divisions."[13] Also in February 2021, Kristina Wyatt joined the SEC as Senior Counsel for Climate and ESG to the Director of the Division of Corporate Finance. Wyatt has written extensively regarding climate-related concerns for businesses and other ESG issues.[14]

On March 4, 2021, the SEC announced the creation of a Climate and ESG Task Force in its Division of Enforcement.[15] Kelly Gibson, the Acting Deputy Director of Enforcement, will lead the task force. The task force's "initial focus will be to identify any material gaps or misstatements in issuers' disclosure of climate risks under existing rules" and to "analyze disclosure and compliance issues relating to investment advisors' and funds' ESG strategies."[16] The Task Force announced that it will use the Commission's sophisticated data analytics and related resources to identify problematic disclosure and trends in the market. In addition to gathering evidence for the Commission regarding the state of ESG disclosure in the market that may inform rulemaking, the Division of Enforcement will use the antifraud provisions of the federal securities laws to bring cases in which ESG disclosures are materially misleading.

This heightened attention from the SEC comes at a time when ESG issues are rapidly becoming more important to investors and issuers in the private sector. The SEC's commitment to addressing ESG issues is both informed by, and shaping, this trend. And while it is clear that the Biden administration is dedicating significant institutional resources to these issues, the specific ways in which these thought leaders will implement policy and regulatory guidance remains to be seen. For now, companies that do not currently prioritize ESG issues would do well to begin doing so, take an active part in advocacy regarding related policy and rulemaking, and establish or refine strategies to ensure compliance with emerging obligations and minimize enforcement risk and stakeholder criticism. For the same reasons, asset managers

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9 *John Coates Named Acting Director of the Division of Corporate Finance* (Feb. 1, 2021), available here.

10 *ESG Reporting Top Priority for SEC Director on Leave from Harvard*, BLOOMBERG TAX (Feb. 24, 2021), available here.

11 ESG Disclosure – Keeping Pace with Investors, Public Companies and the Capital Markets (March 11, 2021), available here (noting that "[a]n effective ESG disclosure system … means thoughtful engagement by trusted specialists seeking consensus among investors and companies about useful, reliable and comparable disclosures under standards flexible enough to remain relevant").

12 *Satyan Khanna Named Senior Policy Advisor for Climate and ESG* (Feb. 1, 2021), available here.

13 *Id.*

14 *See, e.g.*, Kristina Wyatt et al., *Directors, Take Note: ESG Can Drive Value in 2020*, JDSupra (Feb. 19, 2020), available here; Kristina Wyatt et al., *Why the UN Sustainable Development Goals Matter to Clients*, American Bar Association (Aug. 28, 2018), available here.

15 *SEC Announces Enforcement Task Force Focused on Climate and ESG Issues* (Mar. 4, 2021), available here.

16 *Id.*

and funds may wish to consider their policies and practices that involve ESG issues, particularly related to disclosure matters. Regardless of the nature of the SEC's future course of action regarding ESG issues, there can be no doubt that issuers and managers will continue to face increasing scrutiny in these areas from both the public and the private sector.

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