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SEC ramps up to get smart on ESG and climate risk disclosure

By Stephen M. LaRose

The U.S. Securities and Exchange Commission's (SEC) recent flurry of activity in the climate-risk and environmental, social, and governance (ESG) space is an indication that the agency is beginning to ramp up its efforts to address this emerging area of investor concern. Over the course of only a few weeks, the SEC announced a new task force to investigate misleading climate and ESG disclosures, appointed a senior advisor on climate and ESG issues, and instituted a formal review of the SEC's climate disclosure rules.

Why the focus on ESG and climate?

Recent trends show that many investors care a great deal about corporate climate and ESG practices, and more and more investors believe those practices will affect a company's future profitability. As changes in the globe's climate continues to progress and social issues have taken a larger stage in society, many investors now demand greater disclosure of ESG plans and practices. Indeed, the risks associated with ESG issues—damaging weather events caused by climate change, serious health events like endemics or even a global pandemic, and attention or inattention to changing social norms—all can affect corporate performance. Moreover, investment managers have heard the call of investors and established funds focused solely on assets that abide by ESG principles.

Yet, as a truly emerging issue, there is a lack of standards and predictability in how these disclosures should be made. Indeed, the SEC has established no mandatory disclosure of ESG information, beyond the federal securities laws' general standard that mandates the disclosure of material information that alters the "total mix" of information available to an investor. Further, where disclosure is made, the SEC has not set regulations that standardize the details of those disclosures. However, despite the lack of specifics and easy to follow regulatory standards, corporations and funds have heard loud and clear from investors that they must make this information available to stay competitive.

The SEC ramps up

The SEC appears to be quickly getting on board with the emerging trend. On March 4, the SEC announced creation of a task force in its enforcement division to address misleading statements in disclosure of climate and ESG information. The task force will be led by Kelly Gibson, the Deputy Director of Enforcement, and includes 22 members from the SEC offices across the country. In a press release on the announcement, the SEC explained:

> "the Climate and ESG Task Force will develop initiatives to proactively identify ESG-related misconduct. The task force will also coordinate the effective use of Division resources, including through the use of sophisticated data analysis to mine and assess information across registrants, to identify potential violations."

The announcement of the Climate and ESG Task Force comes on the heels of the SEC's February 1 appointment of Satyam Khanna, a new Senior Policy Advisor, to advise the agency on climate and ESG matters. Acting SEC Chair Allison Herren Lee commented at the time that "having a dedicated advisor on these issues will allow us to look broadly at how they intersect with our regulatory framework across our offices and divisions."

Finally, Acting Chair Lee also recently issued a directive in late February to the SEC's Division of Corporation Finance to immediately begin a comprehensive review of the extent to which corporations are adhering to 2010 guidance issued on climate disclosures. Based upon that review, the Division of Corporation Finance is tasked with updating the guidance to ensure that the market is properly accounting for climate-related risks.

What to expect next

The SEC's recent announcement of its enforcement division's Climate and ESG Task Force is a clear indication of the agency's attention to the market's concern for accountability on these issues. We expect the SEC to continue to sharpen its focus on the disclosure of climate risk and ESG topics, as the market continues to make the issues a priority. While the level of specificity is unknown for the moment, at some level, we fully expect that the agency will develop more direct guidance on disclosure. As the SEC gains further knowledge and gathers greater intelligence on how companies are disclosing or not disclosing material risks, increased enforcement will surely follow.

For more information on the content of this alert, please contact your Nixon Peabody attorney or:

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