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ESG and Sustainability: The SEC's Emerging Agenda

North America Financial Regulation & Enforcement Practice
Jen Klass and Amy Greer | October 2021

**Climate and ESG are
"front and center" at the SEC**

“ At the agency, we are taking a holistic look at all of the ways climate and ESG intersect with our regulatory framework, and moving ahead with efforts across our offices and divisions to account for that. ”

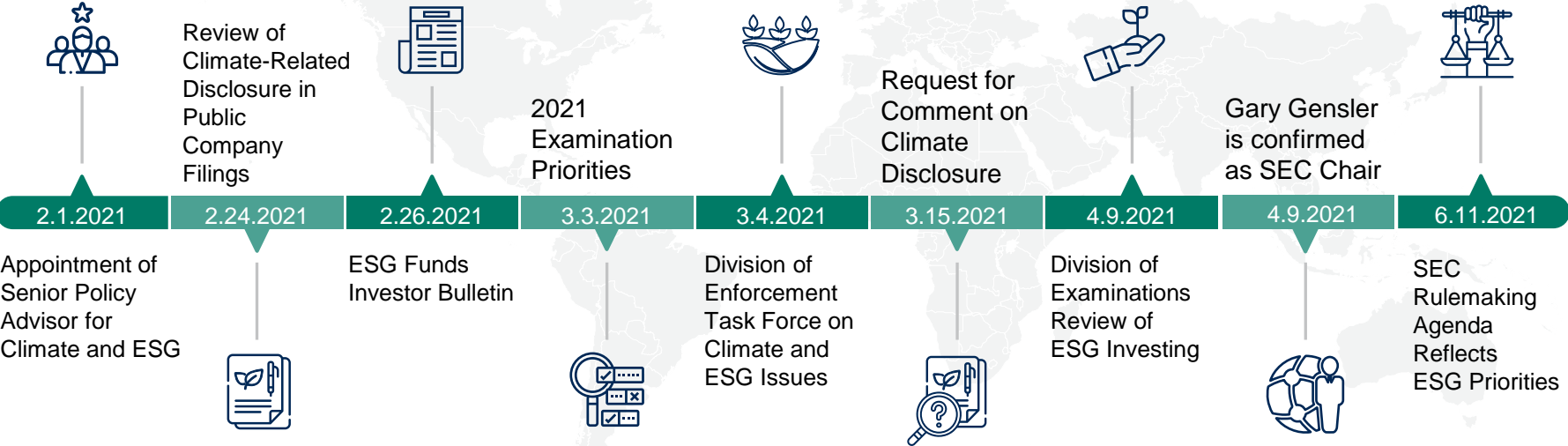
Acting Chair Allison Herren Lee

March 15, 2021



ESG Agenda under the Biden Administration

Beginning in February 2021, the SEC began to pivot – very publicly – to a focus on climate change and ESG. This focus includes a number of actions and statements that demonstrate an "all-agency" response to climate and ESG risks.



ESG Agenda under the Biden Administration

Comprehensive ESG disclosure framework

- Review by Division of Corporation Finance on compliance with 2010 climate disclosure guidance for public companies and request for comment on climate disclosure (comment period now closed)
- Chair Gensler has requested staff recommendations for mandatory public company disclosures on climate risk and human capital, including corporate board diversity
- Rulemaking agenda includes rules for investment companies and investment advisers on ESG factors, including ESG claims and disclosures

More flexible approach to shareholder proposals

- Rulemaking agenda includes consideration of new amendments to Exchange Act Rule 14a-8, which governs when shareholder proposals may be excluded from the ballot

ESG Agenda under the Biden Administration

Increased transparency in proxy voting

- Revisit proxy voting responsibilities of investment advisers
- Update fund voting disclosures
- Finalize the universal proxy rule (prior comment period for 2016 rule proposal was reopened)

Ensuring accountability through SEC examination and enforcement authority

- Division of Examinations ESG Investing Risk Alert
- Division of Enforcement Climate and ESG Task Force

Domestic and foreign regulatory cooperation

- Sustainability standard setter

Division of Examinations

ESG Investing Risk Alert

The Division of Examinations (Exams) issued a Risk Alert on April 9, 2021, that highlights observations from recent exams of investment advisers, registered investment companies, and private funds offering ESG products and services.

The SEC staff focus on ESG investing is based on the confluence of:

- Rapid growth in investor demand
- Increasing number of ESG products and strategies; and
- Lack of standardization and precise ESG definitions

Exams will evaluate whether firms are accurately disclosing their ESG investing approaches and have adopted and implemented policies, procedures, and practices that are consistent with their ESG-related disclosures.



Rapid growth in demand



Increasing number of ESG products and strategies



Lack of standardization and precise ESG definitions

Division of Examinations

ESG Investing Risk Alert

Areas of focus	Examinations will include a review of:
Portfolio management	<ul style="list-style-type: none">▪ Policies, procedures, and practices related to ESG and the use of ESG-related terminology▪ Due diligence and other processes for selecting, investing in, and monitoring investments based on the firm's disclosed ESG investing approaches▪ Whether proxy voting decision-making processes are consistent with ESG disclosures and marketing materials
Advertising and marketing	<ul style="list-style-type: none">▪ Regulatory filings▪ Websites and marketing materials▪ Reports to sponsors of global ESG frameworks, to the extent the firm has communicated a commitment to follow such frameworks▪ Client presentations, responses to due diligence questionnaires and RFPs▪ Investor-facing documents
Compliance Programs	<ul style="list-style-type: none">▪ Written policies and procedures and their implementation▪ Compliance oversight▪ Compliance review of ESG investing practices and disclosures

Division of Enforcement

Climate and ESG Task Force



22 members drawn from the SEC's headquarters, regional offices, and Enforcement specialized units



Designed to proactively identify ESG-related misconduct – including through the use of data analysis to identify potential violations



No need to wait for specific rulemaking relating to ESG disclosure

Division of Enforcement

Climate and ESG Task Force

Enforcement approach will be based on long-standing principles of disclosure, materiality, and fiduciary duty that are part of the existing regulatory framework

Initial focus:

- Identify material gaps, misstatements, or omissions in public company disclosure of climate risk
- Review disclosure and compliance issues relating to investment adviser and fund ESG strategies
- Close coordination with other SEC Divisions and Offices, including Divisions of Corporation Finance, Investment Management, and Examinations

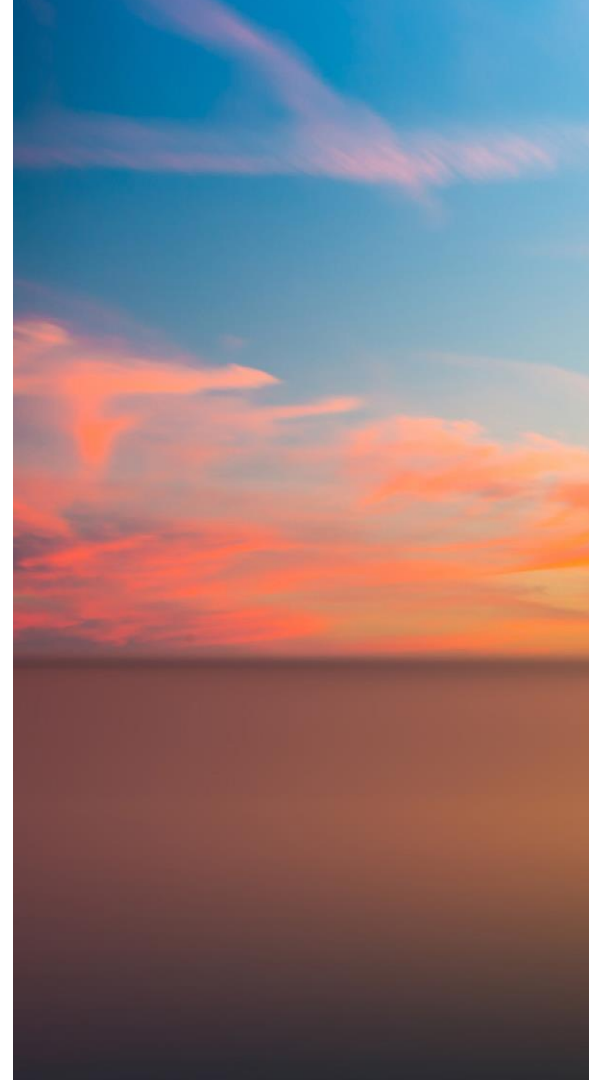
Many firms are arguably going well beyond existing climate-related disclosure requirements. Will those voluntary disclosures, on company websites and elsewhere, be scrutinized more heavily?

“ I think companies are disclosing the very real risks that they face regarding ESG-related issues, including climate change and social issues, and the effects on their bottom line. It's well-settled law that if a company or firm chooses to speak, they must do so fully and truthfully. So if they voluntarily choose to speak on ESG issues, they must make sure that those statements are not materially false or misleading, or that they're omitting material information. ”

Law360 Interview with Kelly Gibson,

Head of the SEC Division of Enforcement
Climate and ESG Task Force

April 9, 2021



Managing SEC Examination and Enforcement Risk

In order to manage SEC examination and enforcement risk, firms should evaluate their ESG strategy holistically, supported by

Governance process

Clear and consistent use of ESG definitions and terminology

Formalized policies and procedures for ESG integration

Marketing and communications review

Risk management and compliance infrastructure

Testing and review process



Managing SEC Examination and Enforcement Risk

Questions worth asking

What controls are in place to evaluate whether ESG disclosures and marketing are consistent with our investment and proxy voting practices?

- Do these controls evaluate corporate communications, public company disclosures, and compliance with voluntary standards?
- Does Form ADV disclosure adequately and accurately address ESG investment and proxy voting practices?

How are we reviewing and substantiating marketing claims relating to ESG?

How do we differentiate environmental, social, and governance factors?

Do we clearly and consistently define ESG terminology?

- How do we define what ESG means for purposes of the investment objectives of particular funds and strategies?
- Do we specify what ESG criteria is used to evaluate portfolio investments?

How do portfolio management teams memorialize consideration of ESG factors in the investment process?

- What specific documentation is required at various stages of the investment process - research, due diligence, selection, and monitoring?
- How do portfolio management teams substantiate the potential economic impact of ESG factors?

Managing SEC Examination and Enforcement Risk

Questions worth asking

Do we have adequate controls to define, maintain, monitor, and update client ESG guidelines?

- Do investment strategy policies routinely address ESG guidelines?
- What controls are in place to track ESG guidelines (inclusive or exclusive) and how does the firm evaluate portfolio company eligibility?

Do we have written policies and procedures that govern ESG integration into portfolio management and proxy voting practices?

- Do policies and procedures address whether and how ESG is incorporated into investment and proxy voting processes?
- Is there clear business line accountability for implementation and review?

How is ESG integrated into our compliance programs and risk management processes?

- How are ESG considerations reviewed, tested, and evaluated from a compliance perspective?
- To what degree are ESG factors and risks incorporated into risk management and internal audit reviews?

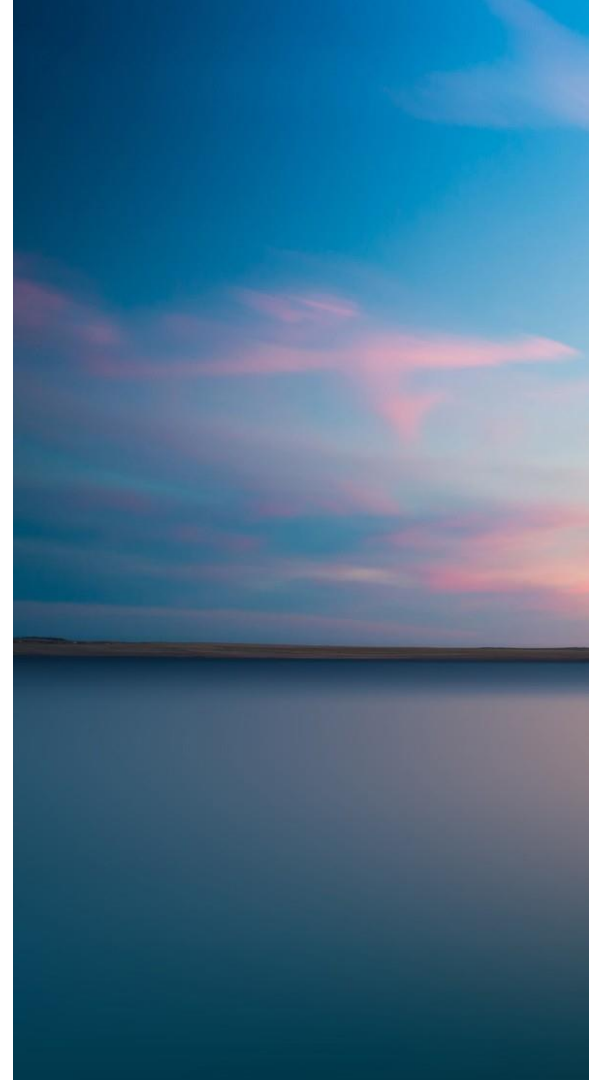
To what degree is new product development coordinated with ESG governance, control, and risk management?

- Are there processes for ensuring that the above factors are considered in reviewing and approving new ESG products and services?

“ That supposed distinction—between what's 'good' and what's profitable, between what's sustainable environmentally and what's sustainable economically, between acting in pursuit of the public interest and acting to maximize the bottom line—is increasingly diminished. ”

Acting Chair Allison Herren Lee

March 15, 2021



Meet the team



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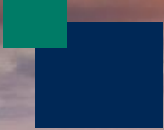
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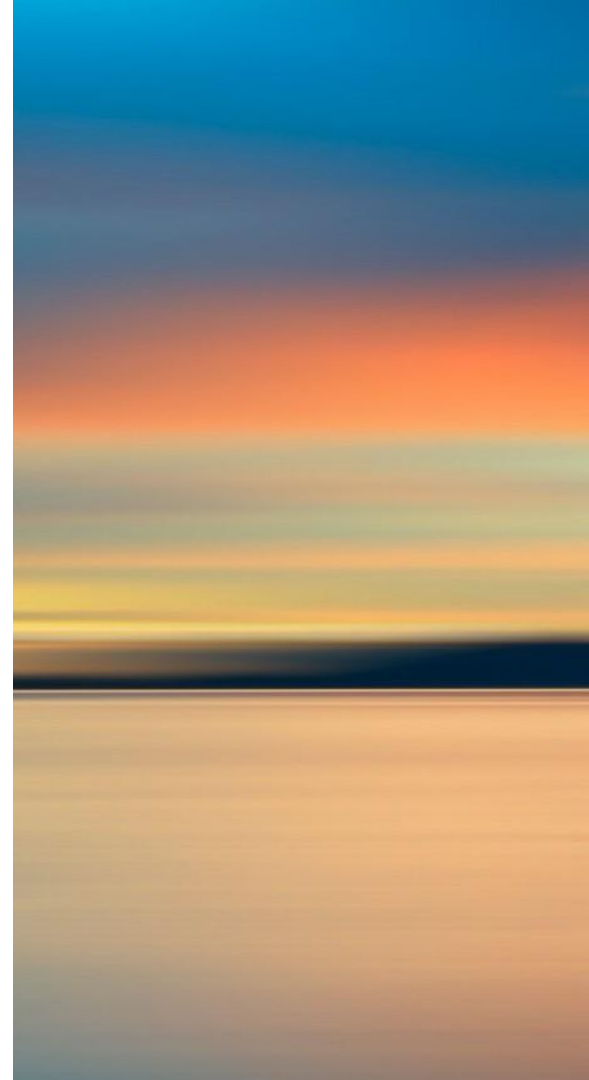
ESG principles for enduring business success

ESG principles for enduring business success

Business success is being redefined as focus shifts to a greater purpose beyond profit. The COVID-19 pandemic has put a renewed spotlight on corporate citizenship.

Strong Environmental, Social and Governance (ESG) practices relating to human rights, labor, governance, supply chains, environmental sustainability and corruption are no longer a 'nice to have' but a prerequisite for good business practice. This represents an enormous opportunity for many organizations. However, failing to take this responsibility seriously brings potential legal, financial and reputational liabilities, as well as a loss of trust among consumers and other stakeholders.

We help corporates, investors and financial institutions transform operations, manage risk, and drive growth as we make greater strides towards a more sustainable future.



ESG principles for enduring business success

Combining our global coverage with specialized local expertise, we are uniquely positioned to help you understand and respond to the opportunities posed by this rapidly changing landscape:



Responsible Growth

Sustainable Investment

- Responsible Investment
- Clean Energy Development & Financing

Sustainable Finance

- Green Debt Products
- ESG Assessments for Transactions

Transformative Technology

- Digital Asset Platforms
- Intellectual Property and Trademarks
- Hydrogen Production Technology
- Mergers & Acquisitions of New Technology



Responsible Operations

Supply Chain

- Diversification of Supply Chains
- Human Rights and Community impact

Responsible Product Sourcing

- Environmental Impact
- Circular Economy
- Resource Management – Chemicals, Water, Waste and Emissions
- Smart Cities and Green Buildings

Product Compliance and Consumer Protection

- Consumer Law
- Marketing and Advertising
- Labelling Requirements



Responsible Risk Management

Governance

- Development of ESG programs and policies
- ESG Reporting & Disclosure Requirements
- Environment, Health and Safety Requirements

Risk Management

- Climate Risk & Finance Advisory
- ESG Risk Assessments and Materiality Reviews
- Crisis Management
- Third Party Management & Compliance
- Litigation and Class Actions

Questions





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