ESG Investing Faces Changing Regulatory Landscape

By Jennifer L. Klass, Amy J. Greer, and Jonathan E. Hoffman

Investors increasingly are directing capital to sustainable investment strategies that reflect environmental, social and governance (ESG) factors.[1] This substantial growth in ESG investing is occurring against the backdrop of an evolving regulatory environment, with different US regulators, such as the Securities and Exchange Commission (SEC) and the Department of Labor (DOL) taking divergent approaches. Given that climate change and racial equality have been identified as key priorities for the Biden administration, we expect a significant shift in the US regulatory approach to ESG, although it may take some time for that regulatory framework to emerge. Meanwhile, the SEC Examination and Enforcement Staff will likely focus their efforts on identifying what they view to be inaccurate or incomplete disclosure on ESG-related issues, and on misconduct involving the management and sale of ESG investment products by asset managers and financial intermediaries.

The following discussion compares recent SEC and DOL activity relating to sustainable investing and offers steps asset managers can take to minimize the risk of potential SEC examination and enforcement activity.

SEC Debate on Disclosure of Sustainability Factors

The SEC regulatory framework is based largely on disclosure of existing practices and items that materially impact public companies and asset managers, rather than prescriptive rules designed to drive specific conduct. The ESG space is no different. As a result, the current debate around the SEC's approach to sustainable investing focuses largely on whether the SEC should mandate specific ESG disclosure for public companies and for asset managers. To date, the SEC has been hesitant to address ESG considerations through comprehensive rulemaking. Instead, much of this debate has played out in statements by SEC commissioners commenting on the activities of two SEC advisory committees—the Investor Advisory Committee (IAC) and the Asset Management Advisory Committee (AMAC)—as well as indirectly in regard to efforts to modernize certain rules.

Public Company Disclosures

In May 2020, the IAC voted to recommend that the SEC begin an effort "in earnest" to update issuer reporting requirements to specifically include material, "decision-useful" ESG factors. The IAC cited several reasons for the recommendation, including investors' need to have reliable material ESG information and to ensure the flow of capital to US companies. At the opening of the IAC's meeting, former SEC Chair Jay Clayton stated his belief that "E, S and G are quite different baskets of disclosure matters and that lumping them together diminishes the usefulness, including investor understanding, of such disclosures."[2] Former Chair Clayton expressed similar thoughts throughout his tenure regarding the need to think of "E," "S" and "G" separate from one another for regulatory purposes.[3] He also previously noted his "concerns that imposing a uniform, mandatory disclosure framework for many . . . 'E,' 'S' and 'G' disclosures runs the risks of sacrificing what may be the more relevant, company-specific disclosure for the potential for greater comparability across companies."[4] Commissioner Hester M. Peirce expressed reservations about a "new SEC disclosure framework for ESG information . . . when

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our existing securities disclosure framework is very good at handling all types of material information."[5] Democratic Commissioner Allison Herren Lee,[6] in contrast, supported the concept of the enhanced ESG disclosure framework envisioned by the recommendation.[7]

This tension between the existing, principles-based disclosure regime and the desire to institute specific disclosure requirements to facilitate comparison has been a consistent theme in the debate around ESG regulation. In August 2020, the SEC adopted amendments to certain issuer disclosure requirements under Regulation S-K as part of an effort to "modernize" issuers' disclosures to investors.[8] Among other changes, the amendments require a description of the issuer's human capital resources to the extent such disclosures would be material to an understanding of the issuer's business.[9] The final rule's adopting release acknowledged the view posited by advocates of more prescriptive disclosures compared to the amendments' principles-based approach. In response, the SEC noted that it does "not believe that prescriptive requirements or a designated standard or framework will ensure more comparable disclosure given the variety in registrant operations as well as how registrants define, calculate, and assess human capital measures."[10]

The SEC adopted the Regulation S-K amendments in August 2020 by a 3-2 vote, with Democratic Commissioners Allison Herren Lee and Caroline Crenshaw dissenting. Commissioner Lee was critical of the lack of specificity required regarding human capital, and highlighted diversity and climate risk as "particularly ill-advised omissions" from the disclosure amendments.[11] Commissioner Crenshaw stated that the rule's "failure to address climate change risk continues to hamper the efficient sorting and comparison of modern companies, as does the failure to adopt detailed, specific disclosure requirements concerning human capital"[12] (citation omitted). Commissioner Crenshaw called for the SEC to form an internal task force to study how investors use ESG metrics to assess companies' long-term financial performance.[13] In addition, Commissioner Crenshaw called for the SEC to form an external ESG Advisory Committee, composed of investors, issuers, and subject matter experts, to advise the Commission on ESG trends affecting all aspects of the market, and hold it accountable for taking action.[14] She noted that although the IAC and AMAC consider ESG issues, their mandates are very broad. A dedicated ESG Committee is necessary, Commissioner Crenshaw asserted, to focus specifically on ESG issues since they are relevant across all of the SEC's functions.[15] The SEC has not yet announced the formation of an ESG Committee. However, it would be a logical first step for the Biden Administration in an effort to develop consensus around the approach to ESG-related disclosure and sales practices.[16]

The SEC also adopted additional amendments to Regulation S-K on November 19, 2020, which did not add any new ESG-related disclosure requirements.[17] Democratic Commissioners Lee and Crenshaw dissented again and, in a joint statement, argued that the SEC was ignoring growing calls from investors for more specific ESG disclosure requirements.[18] Commissioner Lee joined Commissioner Crenshaw's call for an internal task force and ESG Advisory Committee that would be "dedicated to building upon the recommendations of leading organizations, such as the Task Force on Climate-Related Financial Disclosures, and defining a clear plan to address sustainable investing."[19] Perhaps in acknowledgement of the results of the Presidential election earlier in November, Commissioners Lee and Crenshaw noted that, while they were disappointed that the Regulation S-K amendments did not address ESG, they saw a "silver lining" with the potential opportunity to address ESG risks with new, focused rulemaking that establishes "requirements for standard, comparable, and reliable climate, human capital, and other ESG disclosures."[20]

As with the amendments to Regulation S-K, the Democratic Commissioners also voiced concern in connection with amendments to Exchange Act Rule

14a-8, the shareholder proposal rule, which the SEC adopted in September 2020.[21] The rule governs the process for a shareholder to have a proposal included in a company's proxy statement for consideration by all company shareholders. The amendments, among other things, raise the ownership threshold a shareholder must meet to submit a proposal for inclusion in the company's proxy statement and raise the levels of shareholder support a proposal must receive to be eligible for resubmission at the company's future shareholder meetings.[22]

The amendment to Exchange Act Rule 14a-8 was adopted by a 3-2 Commission vote. Although the changes to the shareholder proposal rule did not directly address ESG matters, dissenting Commissioners Lee and Crenshaw again cited the negative impact the amendments would have on ESG-related shareholder proposals. Commissioner Lee observed that ESG-related issues are increasingly important to investors and more present on proxy ballots, particularly environmental and social proposals. Commissioner Lee pointed to a marked increase in support for such proposals and expressed concern that the amendments to Rule 14a-8 would serve to restrain such efforts "just as they are gaining real traction."[23]

The ongoing debate came to the fore most recently at the December 2020 meeting of the AMAC, where the ESG Subcommittee reported that it is working "to arrive at final recommendations to the SEC . . . to improve the data and disclosure used for ESG investing, in order to create better transparency for investors, and better verifiability of investment products' ESG strategies and practices."[24] The ESG Subcommittee offered three potential recommendations to the SEC regarding issuer disclosure.

1. Require the adoption of standards (akin to GAAP) by which corporate issuers disclose material ESG risks. While existing disclosure rules require disclosure of material risks, the subcommittee noted the lack of consistent standards for disclosure of material ESG risks. The standards should be limited by industry and provide clear guidance for determining whether an ESG risk is material.[25]
2. Embrace third-party standard-setting frameworks to require disclosure of material ESG risks. This recommendation would have the SEC play an active role in coordinating development of ESG disclosure frameworks with outside organizations.
3. Require that material ESG risks be disclosed in a manner consistent with the presentation of other financial disclosures.

The ESG Subcommittee pointed out that, currently, issuer disclosures often appear in different types of regulatory filings and are not presented like other financial metrics. This lack of consistency makes it harder for investors to compare different issuers' disclosures, as well as the same issuer's disclosures across different time periods. ESG disclosures, the subcommittee stated, should be included in regulatory filings like any other financial metrics and presented in a standard format. The Republican Commissioners continue to be skeptical as to whether uniform standards are appropriate.[26] What the final recommendations of the ESG Subcommittee will cover remains to be seen, however, directionally, one can expect a more activist approach to future rule-making and guidance addressing ESG factors. For example, in her role as acting Chair, Commissioner Lee recently directed the Division of Corporate Finance to enhance its focus on climate-related disclosure in public company filings.[27]

Asset Manager Disclosures

Although debate continues on the public company disclosure side, there seems to be far more consensus around the need for further regulation on the asset manager side. In a speech on July 7, 2020, SEC Commissioner Elad Roisman warned that disclosures by asset managers would be the one area where he would support further regulation to elicit more ESG-related disclosures.[28] Commissioner Roisman expressed concern that asset managers may

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be marketing ESG investments in ways that do not clearly explain to investors whether managers invest based on environmental or social goals at the expense of investment returns. He also spoke about the related risk of "greenwashing," which involves asset managers making misleading representations to retail investors that a particular product is eco-friendly. In a September 17, 2020 speech, Commissioner Peirce echoed Commissioner Roisman's sentiments by stating that "funds must clearly disclose their investment strategies so that an investor can make informed decisions about whether a fund that claims to be an ESG fund is an ESG fund as that investor defines it."[29] Commissioners Peirce and Roisman do not support the adoption of a regulatory standard or definition for what qualifies as an ESG investment product. They instead advocate for clearer disclosure in the ESG space, so that investors are equipped to make better-informed choices.

Consistent with this approach, at the December 2020 meeting of the AMAC, the ESG Subcommittee presented two potential recommendations to the SEC regarding investment product disclosure. The subcommittee concluded that having the SEC suggest best practices would improve transparency, while a more prescriptive approach would be "counter-productive given the early state of the evolution of ESG investing [and that] strong rulesets might, at this point, freeze development of investment and measurement approaches in this investing style."

1. **Best practices to enhance ESG investment product disclosure.** These best practices would include alignment with the taxonomy developed by the Investment Company Institute (ICI) ESG Working Group, as well as a clear description of each product's strategy and investment priorities, including description of non-financial objectives such as environmental impact or adherence to religious requirements. The subcommittee found that relying on the ICI ESG Working Group's taxonomy would improve consistency and comparability across products. The subcommittee reported on the ICI ESG Working Group's finding that ESG investing strategies generally follow three nonexclusive investment approaches: (i) inclusionary, (ii) exclusionary, and (iii) impact.[30]
2. **Best practices to describe the approach to share ownership activities.** The subcommittee reported that it consulted the CFA Institute, which "noted that ESG investment products engage in share ownership activities as a more deliberate piece of their strategy than many, but not all, other investment products." Therefore, the subcommittee stated investors in ESG (and other) products would benefit from clear, consistent statements on the investment product's ownership-related activities (for example, voting proxies, engaging with management and leading shareholder motions). And, while proxy voting reporting is already regulated, other notable ownership activities (especially if relevant to the product's strategy) should be described in shareholder reporting.

Prior to the publication of the AMAC potential recommendations, the SEC had only indirectly approached ESG on the asset management side when considering updates to existing rules. For example, in March 2020, the SEC requested comment on potential updates to its Names Rule, which is designed to ensure that the names of mutual funds and other registered investment products accurately reflects the types of assets in which a fund is invested.[31] The SEC recognizes that a fund's name is a tool for communicating with investors and can have a significant impact on their investment decision.[32] As a result, the Names Rule is designed to protect investors from names that are materially deceptive or misleading.[33] The Names Rule generally requires that if a fund's name suggests a particular type of investment, industry, or geographic focus, the fund must invest at least 80 percent of its assets in the focus suggested by its name. The Names Rule does not apply to fund names that describe a fund's investment objective, strategy (such as growth

or value), or policies. Names describing a fund's objective, strategy, or policies remain subject to the general prohibition on misleading names in Section 35(d) of the Investment Company Act, as well as other antifraud provisions of the Federal securities laws, but they are not subject to the 80 percent test.

In considering revisions to the Names Rule, the SEC highlighted both the growth in ESG investing in recent years and that funds with ESG-related investment mandates "include criteria that require some degree of qualitative assessment or judgment."[34] The request for comment notes that SEC Staff "has observed that some funds appear to treat terms such as 'ESG' as an investment strategy . . . while others appear to treat 'ESG' as a type of investment."[35] Among a series of questions the SEC posed on how the Names Rule should treat ESG or "sustainable" funds, the SEC posited whether it should just require funds to simply explain to investors what is meant when terms such as "ESG" and "sustainable" are used.[36]

DOL Approach to Consideration of Sustainability Factors

While the SEC debate around ESG concentrates on disclosure, the DOL, as discussed below, has recently been wrestling with the degree to which plan fiduciaries may even consider "non-pecuniary" factors such as ESG factors in selecting plan investments. As of this writing, it is unclear to what extent the DOL under the Biden Administration will reverse recent DOL rulemaking. However, given the virtual certainty that the new administration will be markedly more supportive of ESG-friendly initiatives than the prior one, the DOL under the Biden Administration can be expected to at least consider paths to un-doing any Trump Administration rulemaking it views as likely to hinder ESG investing.

DOL Financial Factors Rule

In October 2020, the DOL adopted amendments to the "investment duties" regulation under ERISA, which codifies fiduciary standards for selecting and monitoring retirement plan investments.[37] According to the adopting release, this rulemaking was motivated by a "steady upward trend" in the focus on ESG among institutional asset managers, along with a significant increase in the number of ESG-focused investment vehicles, ESG metrics, services, and ratings offered by third-parties, and increasing asset flows into ESG funds.[38] Specifically, the DOL expressed concern that the proliferation of ESG-related products might cause plan fiduciaries to select investments that are not consistent with the economic interests of the plan, and might result in inappropriate marketing practices.[39]

The DOL has issued a series of guidance going back to 1994 addressing a plan fiduciaries' use of ESG-type factors in their investment decisions. The DOL has consistently taken the position that ERISA and its regulations require plan fiduciaries to invest plan assets to maximize investment returns, while diversifying investments to reduce risks of large losses. Although the DOL has reconsidered, restated, and clarified its guidance numerous times since 1994, it has consistently "cautioned that fiduciaries violate ERISA if they accept reduced expected returns or greater risks to secure social, environmental, or other policy goals."[40] The only times plan fiduciaries can use collateral considerations would be to essentially "break the tie" when multiple investment options have comparable expected returns and risks. This is known as an "all things being equal" test.

The final amendments do not explicitly refer to ESG as the proposed amendments did. The DOL acknowledged the many critical comments it received on the proposed rule. The DOL removed any reference to ESG in part because it was "persuaded by its review of the public comments that 'ESG' terminology, although used in common parlance when discussing investments and investment strategies, is not a clear or helpful lexicon for a regulatory standard."[41]

The final rule retains the "all things being equal" test from the DOL's previous guidance.[42] Under the final rule, a fiduciary may use non-pecuniary

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factors as the deciding factor in the investment decision when choosing between or among investment alternatives that the plan fiduciary is unable to distinguish on the basis of pecuniary factors alone. In this tie-breaking scenario, the plan fiduciary must document:

1. Why pecuniary factors were not sufficient to select the investment or investment course of action;
2. How the selected investment compares to the alternative investments; and
3. How the chosen non-pecuniary factor or factors are consistent with the interests of participants and beneficiaries in their retirement income or financial benefits under the plan.[43]

The DOL included the documentation requirement "to provide a safeguard against the risk that fiduciaries will improperly find economic equivalence and make decisions based on non-pecuniary factors without a proper analysis and evaluation."[44]

The final rule also contains language different from the proposal regarding investment offerings in participant-directed retirement plans. The proposal would have explicitly barred including an investment fund with an ESG mandate in a 401(k) plan's default investment offering in which participants are automatically enrolled (that is, qualified default investment alternatives).[45] The final rule removes reference to ESG investment mandates, rather it prohibits adding an investment option to a QDIA "if its investment objectives or goals or its principal investment strategies include, consider, or indicate the use of one or more non-pecuniary factors."[46]

DOL Proxy Voting Rule

As with the financial factors rulemaking, the DOL again addressed the distinction between pecuniary and non-pecuniary factors in recent amendments designed to clarify fiduciary obligations relating to proxy voting practices.[47] These amendments, which the DOL adopted in December 2020, set forth a number of factors that plan fiduciaries must consider when deciding whether to exercise shareholder rights. According to the final regulations, plan fiduciaries may not subordinate the interests of participants and beneficiaries to any non-pecuniary objective, or promote non-pecuniary benefits or goals unrelated to the financial interests of the plan's participants and beneficiaries.[48]

The final proxy voting rule removed language from the proposal that would have required a fiduciary to vote all proxies that it determined would have an economic impact on the plan, while taking into account the cost involved in the voting process.[49] In removing this prescriptive "economic impact" approach to proxy voting from the final rule, the DOL was "persuaded that the complexity involved in a determination of economic versus non-economic impact would be costly to implement."[50]

The DOL acknowledged that "[a] number of commenters asserted that the proposal was a not-so-thinly-veiled, policy-based judgment against the value of ESG shareholder proposals."[51] The DOL responded to these commenters' concerns by noting that the proxy vote rulemaking, along with the financial factors rulemaking, recognize that certain E, S, or G factors may present issues that qualified investment professionals would treat as economic considerations under generally accepted investment theories.[52] However, the DOL cautioned plan fiduciaries against assuming that sustainability factors, whether considered individually or through an aggregate rating, index, or score, are necessarily relevant to the exercise of shareholder voting rights or an evaluation of the investment or investment course of action.[53] As a practical matter, the rule appears to create a presumption that voting based on ESG factors promotes non-pecuniary goals.

Potential SEC Examination and Enforcement Activity

Regardless of whether (or when) the SEC takes on comprehensive rulemaking around ESG investing, the SEC Examination and Enforcement Staff will continue to focus on rooting out what they

view to be inaccurate disclosure and inappropriate sales practices regarding ESG investments, including deceptive "greenwashing" that exaggerates the ESG qualities of an investment. Importantly, SEC Staff already have many of the tools they need to address these concerns under existing laws, without the need to wait for any rulemaking efforts the SEC might undertake to specifically address ESG investing.

In recent years, the SEC has started to look at how asset managers set standards for ESG investing and how they market ESG-related investment strategies and products. The SEC's Office of Compliance Inspections and Examinations (OCIE), recently renamed the Division of Examinations, conducted a sweep in 2018 in which it asked firms with ESG product offerings about their criteria for defining ESG, whether firms were following established principles such as the United Nations' Principles for Responsible Investment (UNPRI), and to what degree firms were engaging on ESG matters with issuers in which they invest. OCIE also asked firms to describe any proprietary or third-party ESG scoring systems they use, their marketing of ESG products and the degree to which the products were advertised as sustainable or "green." More recently, in its statement of 2020 examination priorities, OCIE referred to ESG investment offerings as an area where examiners would pay particular attention.[54] OCIE specifically noted its interest in the accuracy and adequacy of disclosure provided by investment advisers offering new or emerging investment strategies, such as those focused on sustainable and responsible investing.

Meanwhile, a recent SEC enforcement action against a public company regarding misleading COVID-19 disclosures could serve as a blueprint for future enforcement activity surrounding ESG risk disclosures.[55] The SEC may be interested in bringing enforcement cases involving ESG disclosure against public companies in industries that may be particularly affected by certain ESG factors. For instance, the SEC could focus on disclosures by energy companies regarding risks related to environmental impacts or disclosures by apparel companies concerning factory conditions or labor issues that might present risks affecting branding and reputation with consumers. Finally, SEC Enforcement has been using data analytics to identify potentially improper disclosure by public companies. The Staff may proactively apply a similar data-driven approach to root out misleading ESG disclosures.

This article has not focused on DOL examination and enforcement activity since the SEC is more likely to take such action. While the SEC does refer cases to the DOL if it sees potential violations under ERISA or the Internal Revenue Code, the SEC would be the primary regulator involved in reviewing potential examination and enforcement issues.

Suggestions for Asset Managers

As discussed above, we anticipate that the Biden Administration may approach ESG more directly through rulemaking. However, there is no need for asset managers to wait for rulemaking, examinations, or enforcement inquiries to act. Following are some controls relating to sustainable investing that asset managers might consider addressing in the short-term:

Define and Disclose ESG Criteria. Asset managers that consider ESG factors in making investment decisions should consider the need to disclose their investment methodology and any associated risks in response to Item 8 (Methods of Analysis, Investment Strategies and Risk of Loss) of Form ADV, Part 2A.

Asset managers that sponsor investment funds based on ESG themes should be thoughtful about how they define what ESG means for purposes of that fund's investment objectives, and the criteria by which they evaluate underlying investments. The adviser's approach should be disclosed in both the offering documents for the investment funds and in the adviser's policies and procedures. Having clearly-defined criteria for what qualifies as ESG also will allow sales personnel to better understand any ESG

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strategies and products they offer to investors and make related suitability assessments.

Formalize Governance. Consider creating a centralized investment stewardship function or committee that is responsible for setting ESG standards for the firm and ensuring consistency in investment process across ESG-related investment strategies and products. Document the governance process.

Consider (and Document) Financial Impact of ESG. Given the recent DOL rulemaking on proxy voting and financial factors in selecting plan investments, it will be important to consider and document any determination that specific ESG factors should be considered "pecuniary," meaning that they have an economic impact on investment decisions. Certainly, plan fiduciaries will have to be cautious about how they evaluate and document reliance on non-pecuniary factors.

Focus on Due Diligence. Asset managers that are managing ESG-based investment strategies or funds should adopt appropriate due diligence process to evaluate the selection of underlying investments based on the adviser's defined ESG criteria, along with documentation to evidence the operation of that due diligence process.

Review Proxy Voting Processes. Proxy voting should align with, or at least not contradict, objectives or a stated purpose of any ESG investment strategy or fund. Firms that rely on proxy advisors will need to pay extra care to the proxy advisors' voting guidelines to make sure they adhere to ESG objectives. Plan fiduciaries should consider whether proxy voting activity advances the long-term value of plan assets and is consistent with applicable DOL guidance.

Be Cautious about Voluntary Standards. Absent a standard ESG taxonomy or definition that has been adopted by the SEC, investment advisers may adopt various third-party standards for measuring sustainability or rely on ESG ratings and scores. Although they may be voluntary, advisers adopting such standards will be measured against them—not just by clients, but by the SEC during examinations. Accordingly, advisers should have appropriate policies and procedures to ensure that they are acting in a manner consistent with public statements and contractual commitments relating to compliance with voluntary standards.

Consider Global Standards. Global asset managers, who are undoubtedly facing more stringent ESG investment regulations in other jurisdictions, will need to consider how to address inconsistent regulatory standards, including whether to take a uniform approach and apply the most restrictive standards to their US activities. At the same time, plan fiduciaries should be mindful of their obligations under the DOL financial factors rule and take steps to ensure that they invest in a manner consistent with their fiduciary duties.

Test Policies and Procedures. Advisers should review portfolio management, proxy voting, and due diligence practices to verify compliance with stated policies and procedures relating to the implementation of ESG factors.

Focus on Advertising and Sales Practices. Asset managers should review advertising materials and evaluate whether any marketing that promotes ESG characteristics of investment strategies or funds is consistent with their management. As noted above, the SEC Staff already has indicated its interest in "greenwashing"—promoting products and services based on misleading claims of sustainable and responsible investing.

Consider Public Company Disclosure. Asset managers that are themselves public companies should consider how their company's statements about ESG priorities square with their approach to managing sustainable investment strategies. Public companies have many opportunities and avenues for communication with the public, be it in regulatory filings or statements designed to generate goodwill. Investor relationship personnel should consider the need to coordinate public company communications to ensure that they are internally consistent with the adviser's management.

Conclusion

As the discussion above regarding various rulemakings makes clear, there continues to be movement in the US regulatory approach to ESG investing. We expect more of an evolution, and potentially significant change, under the Biden Administration. Even in the absence of a clear regulatory framework around sustainable investing, there is much that asset managers can do to enhance controls and manage risk ahead of SEC and DOL rulemaking, examination, and enforcement activity.

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NOTES

1 According to the Investment Company Institute, sustainable fund assets reached $2.6 trillion as of June 30, 2020, and for the first time now represent over 10 percent of mutual fund industry assets.

2 Chairman Jay Clayton, Remarks at Meeting of the Investor Advisory Committee (May 21, 2020), available at *https://www.sec.gov/news/public-statement/clayton-statement-investor-advisory-committee-meeting-052120*.

3 *See, e.g.,* Chairman Jay Clayton, Remarks to the SEC Investor Advisory Committee (Nov. 7, 2019), available at *https://www.sec.gov/news/public-statement/clayton-remarks-investor-advisory-committee-110719*; Chairman Jay Clayton, Remarks to the SEC Investor Advisory *Committee* (Dec. 13, 2018), available at *https://www.sec.gov/news/public-statement/clayton-remarks-investor-advisory-committee-meeting-121318*.

4 Chairman Jay Clayton, Remarks to the SEC Investor Advisory Committee (Nov. 7, 2019).

5 Commissioner Hester M. Peirce, Remarks at Meeting of the SEC Investor Advisory Committee (May 21, 2020), available at *https://www.sec.gov/news/public-statement/peirce-statement-investor-advisory-committee-meeting-052120*.

6 President Biden designated Commissioner Lee as Acting Chair of the Commission on January 21, 2021 and has nominated Gary Gensler to Chair. The Senate has not voted on Mr. Gensler's nomination as of this writing.

7 Investor Advisory Committee Meeting Webcast recording, available at *https://www.sec.gov/video/webcast-archive-player.shtml?document_id=iac052120*. Commissioner Lee's introductory remarks begin at 16:35 mark of recording.

8 *Modernization of Regulation S–K Items 101, 103, and 105*, 85 FR 63726 (Oct. 8, 2020).

9 *Id.* at 63760; Final rule 229.101(c)(2)(ii).

10 85 FR at 63739.

11 Commissioner Allison Herren Lee, Regulation S-K and ESG Disclosures: An Unsustainable Silence (Aug. 26, 2020), available at *https://www.sec.gov/news/public-statement/lee-regulation-s-k-2020-08-26*.

12 Commissioner Caroline Crenshaw, Statement on the "Modernization" of Regulation S-K Items 101, 103, and 105 (Aug. 26, 2020), available at *https://www.sec.gov/news/public-statement/crenshaw-statement-modernization-regulation-s-k*.

13 *Id.*

14 *Id.*

15 *Id.*

16 In a related development, on February 1, 2021, the SEC announced the appointment of Satyam Khanna as Senior Policy Advisor of Climate and ESG in Acting Chair Lee's office. The creation of this new position is an early sign that the SEC in the Biden administration will prioritize ESG-related initiatives.

17 *Management's Discussion and Analysis, Selected Financial Data, and Supplementary Financial Information*, 86 FR 2080 (Jan. 11, 2021).

18 Commissioner Allison Herren Lee and Commissioner Caroline Crenshaw, Joint Statement on Amendments to Regulation S-K: Management's Discussion and Analysis, Selected Financial Data, and Supplementary

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Financial Information (Nov. 19, 2020), available at *https://www.sec.gov/news/public-statement/lee-crenshaw-statement-amendments-regulation-s-k*.

[19] *Id.* In a 2020 year-end report to Congress, the SEC's Office of Investor Advocate (OIA) supported the creation of an internal task force and ESG advisory committee given its view that implementing an ESG disclosure framework will be a challenging undertaking "involving numerous complex issues." The OIA was critical of the Commission for not heeding investor demand for a "coherent framework" for ESG disclosures. The OIA report is available at *https://www.sec.gov/files/sec-investor-advocate-report-on-activities-2020.pdf*.

[20] Commissioner Allison Herren Lee and Commissioner Caroline Crenshaw, Joint Statement on Amendments to Regulation S-K: Management's Discussion and Analysis, Selected Financial Data, and Supplementary Financial Information (Nov. 19, 2020).

[21] *Procedural Requirements and Resubmission Thresholds Under Exchange Act Rule 14a-8*, 85 FR 70240 (Nov. 4, 2020).

[22] The shareholder proposal rule came on the heels of the SEC adopting another proxy-related rule. In July 2020, the Commission adopted, by a 3-1 vote, amendments and related guidance on proxy voting advice. *Exemptions From the Proxy Rules for Proxy Voting Advice*, 85 FR 55082 (Sept. 3, 2020). Commissioner Lee cast the only dissenting vote on the proxy voting advice amendments and guidance. Although the proxy voting rule amendments and guidance did not specifically address ESG considerations, Commissioner Lee envisioned that they would increase costs for shareholders in casting their votes and have a negative impact on shareholders' ability to promote various ESG issues with issuers' management facing "less accountability on climate risk, less accountability on executive pay, less accountability on diversity, on human capital, worker safety, and the list goes on." Commissioner Allison Herren Lee, Paying More For Less: Higher Costs for Shareholders, Less Accountability for Management (July 22, 2020), available at *https://www.sec.gov/news/public-statement/lee-open-meeting-2020-07-22*.

[23] Commissioner Allison Herren Lee, Statement on the Amendments to Rule 14a-8 (Sept. 23, 2020), available at *https://www.sec.gov/news/public-statement/lee-14a8-2020-09-23*.

[24] Potential Recommendations of ESG Subcommittee, Discussion Draft (Dec. 1, 2020), available at *https://www.sec.gov/files/potential-recommendations-of-the-esg-subcommittee-12012020.pdf*.

[25] The ESG Subcommittee cited the Sustainability Accounting Standards Board (SASB) as having developed standards that "[a]pply to disclosure of material ESG risks and guide issuers in determining whether an ESG risk is material, or could become so in the future[.]" SASB presented an overview of its disclosure standards to the ESG Subcommittee, available at *https://www.sec.gov/files/10152020-sasb-sec-amac-esg-subcommittee.pdf*.

[26] Commissioner Hester M. Peirce, Opening remarks at the December 1, 2020 Meeting of the Asset Management Advisory Committee (Dec. 1, 2020), available at *https://www.sec.gov/news/public-statement/peirce-opening-remarks-amac-meeting-120120* (noting that "[t]he concepts surrounding ESG and sustainability are simply too amorphous and open to manipulation and multiple interpretations to lead to a meaningful disclosure regime. To compare ESG disclosures to those governed and informed by GAAP principles is, in my view, mistaken").

[27] Acting Chair Allison Herren Lee, Statement on the Review of Climate-Related Disclosure (Feb. 24, 2021), available at *https://www.sec.gov/news/public-statement/lee-statement-review-climate-related-disclosure*.

[28] Commissioner Elad L. Roisman, Keynote Speech at the Society for Corporate Governance National Conference (July 7, 2020), transcript available at *https://www.sec.gov/news/speech/roisman-keynote-society-corporate-governance-national-conference-2020*.

[29] Commissioner Hester M. Peirce, Lucy's Human: Remarks at Virtual Roundtable on The Role of Asset Management in ESG Investing Hosted By Harvard

Law School and the Program on International Financial Systems (Sept. 17, 2020), available at *https://www.sec.gov/news/speech/peirce-lucys-human-091720*.

[30] The ESG subcommittee cited the ICI ESG Working Group's July 2020 paper, which is available at *https://www.ici.org/pdf/20_ppr_esg_integration.pdf*.

[31] *Request for Comments on Fund Names*, 85 FR 13221 (March 6, 2020); 17 CFR § 270.35d-1.

[32] 85 FR at 13221.

[33] *Id.*

[34] *Id.* at 13223.

[35] *Id.*

[36] *Id.* at 13224.

[37] *Financial Factors in Selecting Plan Investments*, 85 FR 72846 (Nov. 13, 2020). On January 20, 2021, the Biden White House announced that the DOL will review this rule to determine whether it is consistent with President Biden's January 20, 2021, Executive Order on Protecting Public Health and the Environment and Restoring Science to Tackle the Climate Crisis.

[38] 85 FR at 72847.

[39] *Id.*

[40] *Id.* at 72847.

[41] *Id.* at 72857.

[42] *Id.* at 72884; Final rule 404a-1(c)(2).

[43] 85 FR at 72884; Final rule 404a-1(c)(2)(i)-(iii).

[44] 85 FR at 72861.

[45] *Financial Factors in Selecting Plan Investments*, 85 FR 39113, at 39127 (June 30, 2020); Proposed rule 404a-1(c)(3)(iii).

[46] 85 FR at 72884; Final rule 404a-1(d)(2)(ii).

[47] *Fiduciary Duties Regarding Proxy Voting and Shareholder Rights*, 85 FR 81658 (Dec. 16, 2020).

[48] *Id.* at 81694; Final rule 404a-1(e)(2)(ii).

[49] *Fiduciary Duties Regarding Proxy Voting and Shareholder Rights*, 85 FR 55219, at 55242 (Sept. 4, 2020); Proposed rule 404a-1(e)(3)(i)-(ii).

[50] 85 FR at 81662.

[51] *Id.*

[52] *Id.*

[53] *Id.*

[54] Office of Compliance and Inspections, 2020 Examination Priorities (Jan. 7, 2020), available at *https://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2020.pdf*.

[55] *In the Matter of The Cheesecake Factory Incorporated*, Exchange Act Release No. 34-90565 (Dec. 4, 2020).

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