On the Horizon – What's Next For SEC Enforcement of ESG Priorities?

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March 8, 2022

This is the eighth post in this year's series examining important trends in white collar law and investigations. Our previous post discussed trends in False Claims Act enforcement. Up next: trends in Federal Cryptocurrency Enforcement in 2022.

Key Takeaways:

- Sensitive to criticism of regulation through litigation, the SEC's Enforcement Division has not pursued cases dealing with cutting edge ESG issues before the SEC decides what, if any, new ESG disclosure requirements to impose.
- Pressure from leading voices in both the private and public spheres will likely lead the SEC to adopt a set of standards public companies must follow in making ESG disclosures.
- While the SEC's next step on ESG disclosure rules remains unclear, it is a good bet that the SEC will try to align with efforts underway by international standard-setting organizations to adopt a globally accepted ESG baseline reporting standard.

It was one year ago, in March 2021, that the SEC's Enforcement Division created its ESG Task Force. The Task Force's mission was to develop initiatives proactively identifying ESG-related misconduct. As we noted at the time, the ESG Task Force's mandate raised questions. The term "ESG" is convenient shorthand for a collection of complex and distinct topics that – it can be fairly said – are not intuitive to all participants in the capital markets. The *E*, or environmental, relates to how a company deals with risks and opportunities related to climate, pollution and other environmental factors, and the company's impact on the environment. The *S*, or social, concerns a company's values and business relationships, including human capital topics like employee health and safety, as well as diversity and inclusion efforts. The *G*, or governance, refers to corporate governance issues, including the composition and diversity of the board of directors, political contributions, and policies to prevent bribery and corruption.

How could the Task Force aggressively pursue misconduct related to ESG disclosures, where SEC leadership acknowledged at the same time that the rules governing how companies disclose complex ESG risks and opportunities are, at best, less than clear, and at worst, non-existent in certain respects? At the same time the Task Force was formed, the SEC sought public comments on disclosure rules for public companies targeted to ESG. Until the SEC decided upon the disclosure regime it would put in place for ESG, wouldn't public companies push back against aggressive enforcement efforts in this area, charging the SEC with regulating through enforcement?

As we have seen recently, the SEC has been sensitive to those concerns. In November 2021 remarks, Gurbir Grewal, Director of the SEC's Division of Enforcement, noted that the SEC was "starting to hear the popular refrain 'regulation by enforcement' in the context of ESG." Pushing back against that "refrain," Grewal emphasized.

There is nothing "new" about how the Task Force – or the Enforcement Division as a whole – investigates possible climate and ESG-related misconduct. As with any investigation, we look to make sure our current rules and laws are being followed. For issuers, this means that we apply long-standing principles of materiality and disclosure. If an issuer chooses to speak on climate or ESG – whether in an SEC filing or elsewhere – it must ensure that its statements are not materially false or misleading, or misleading because they omit material information – just as it would when disclosing information in its income statement, balance sheet, or cash flow statement.

Director Grewal went on to highlight two Enforcement cases, one from 2008 and the other from 2020, that while touching upon ESG matters, were essentially run-of-the-mill misleading disclosure cases where the companies in question took it upon themselves to make representations regarding ESG matters that were, it turns out, false. According to Grewal, these cases "demonstrate that the requirements that companies' disclosures be accurate and not misleading … are not new, and should be of surprise to no one."

Grewal's comments suggest that until the SEC settles on a final disclosure regime moving forward, the Enforcement Division is not going to pursue cases on the vanguard of ESG disclosure issues. So, where do things stand on new ESG disclosure rules at the SEC, and where is the SEC likely to come out on this question?

SEC Implementation an ESG Disclosure Regime

While not much has happened outwardly since the SEC announced the beginning of efforts to reassess ESG disclosure requirements, the momentum seems to favor the adoption of a uniform disclosure framework that would allow tailoring to fit industry specific needs. Senator Elizabeth Warren has implored the SEC to adopt industry specific standards mandating disclosure with respect to climate risks, arguing that the existing climate disclosure framework adopted in 2010, which relies on a basic materiality without specific disclosure guidance, does not go far enough.

Private sector actors have likewise called for the SEC to adopt a set of ESG disclosure standards. Many, including heavily influential BlackRock, have advocated the SEC to incorporate standards developed by private sector standard setters, similar to the SEC's incorporation of financial reporting standards promulgated by the Financial Accounting Standards Board (FASB). There is no shortage of existing disclosure frameworks from which the SEC could choose. The CDP (formerly the Carbon Disclosure Project), the Climate Disclosure Standards Board (CDSB), the Global Reporting Initiative (GRI), the International Integrated Reporting Council (IIRC), the Sustainability Accounting Standards Board (SASB), and the Task Force on Climate-Related Financial Disclosures (TCFD) have all published standards intended to help companies enhance the quality of their ESG disclosures.

Deloitte & Touche LLP, a Big Four accounting and consulting firm which has emerged as a thought leader on ESG disclosure issues, has commented that the SEC should be mindful of efforts already underway to globalize the many existing ESG reporting frameworks. Deloitte, and others, have noted the efforts of the International Financial Reporting Standards (IFRS) Foundation in establishing an International Sustainability Standards Board (ISSB) to adopt a globally accepted baseline for sustainability reporting standards. The IFRS Foundation's influence in financial reporting is undeniable. It oversees the International Accounting Standards Board, which has promulgated financial reporting standards adopted by 140 jurisdictions across the world. Adhering to a global framework developed by the ISSB could allow companies to avoid the inefficiencies and uncertainties of having to meet multiple and sometimes conflicting reporting standards across different jurisdictions.

The SEC has previously signaled its support of efforts to converge the various existing standards into a global baseline framework like the one being developed by the ISSB. Indeed, in a recent article, a trustee of the IFRS Foundation noted that the SEC was actively involved in the technical readiness working group supporting the development of ISSB standards. No matter the next step the SEC decides to take on ESG reporting and disclosure requirements, it is a good bet that the SEC will have in mind ways to align with efforts already underway to converge existing standards into one framework that public companies can rely on to meet various international reporting requirements. Until the SEC settles on an ESG disclosure regime, it appears likely that the Enforcement Division, as it has thus far, will continue to take a conservative view of its mandate to pursue cases in the ESG domain.

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