

The SEC and ESG

Climate and ESG have become key topics of conversation at the SEC. The Commission's publication of proposed rules for public companies which would require that certain climate related information be disclosed by issuers sparked what has become a continuing debate since March 2022 when the proposals were published. Some argue that the agency has no statutory authority to promulgate such rules. Others claim the question of climate should be reserved for the EPA. Many argue that it is just inappropriate for the Securities and Exchange Commission to promulgate rules dealing with ESG. Yet the rules published in March of this year have little to do with ESG or specific metrics, except for certain proposals related to the carbon footprint of the company as discussed here.

Now, however, the SEC has published proposed rules which are tied directly to ESG metrics in its May 25, 2022 proposal. As with the earlier proposal the agency is not trying to take-over or write ESG standards. While the May proposals do deal more with ESG than the ones made in March 2022, in fact the latest proposal is built on a platform that is similar to the one used in March. There the agency focused its proposals on the disclosure of what material climate related information issuers utilize in making business decisions. The May proposals for the most part take the same approach.

As the Commission states in its May release, ESG has been around for a considerable period of time. In recent years many funds, for example, claim to be "green" or to incorporate ESG principles as part of those principles guiding investments. The difficulty with those statements is that the term ESG is at best ill-defined. This can lead to difficulties such as "greenwashing" where a firm claims to be following green principles and/or ESG theory. The vagueness of the concepts can make it difficult for investors to assess the question.

The May proposals seek at least in part to resolve the vagueness issue. The May proposal has in essence two key parts. First it seeks to divide ESG firms into three groups: 1) *Integrated funds*, which are those that integrate ESG factors along with

Related Capabilities

- Securities & Financial Services Litigation & Enforcement
- Investment Funds
- Investment Management
- FinTech
- Environmental, Social, Governance (ESG)

others into the investment process; 2) *ESG-focused funds*: This term is used to describe funds where “ESG factors are a significant or main consideration”; and 3) *Impact Funds*, defined as a “subset of ESG-Focused Funds” that seek to achieve a kind of targeted ESG impact.

The specific disclosures that funds and advisers would be required to make -- the second part of the proposals -- are keyed to which of the three approaches is being followed. Thus, for those which are integrated funds, the required disclosures would tell investors how the ESG factors are used along with others to arrive at an investment approach. In contrast, funds following the second approach – ESG focused funds – would be required to provide detailed disclosure that include a table recording the applicable metrics. Finally, those that claim to be impact funds would be required to disclose how the issuer measures progress. A table would then be presented.

While the overall proposal published in May on ESG is lengthy and does contain other provisions, at its core it seeks to give clarity to an important area of the law which lacks it. Perhaps more importantly, the proposals are built on self-selection – only the funds that claim to be investing using ESG principles will be asked to select a category and describe what they claim is being done when making investments for the fund. That approach is largely similar to the one used in March where the agency simply asked for disclosure of what material climate information is being used in investing.