Securities Regulation Daily Wrap Up, TOP STORY—Acting Chair Lee's latest ESG initiative seeks public input on climate risk disclosure, (Mar. 15, 2021)

Securities Regulation Daily Wrap Up

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Under Lee's directive, the staff will evaluate the SEC's current disclosure rules with an eye toward facilitating the disclosure of information on climate change.

In a speech at a virtual event hosted by the Center for American Progress (CAP), Acting SEC Chair Allison Herren Lee announced that she is asking the staff to evaluate the SEC's rules relating to the disclosure of climate change risk. The statement also requests input from stakeholders about several questions, which the Commission will take into account in developing a framework for consistent, comparable, and reliable information on climate change. This move marks the acting chair's latest action towards a more comprehensive framework regarding environmental, social, and governance (ESG) disclosure, including the creation of an ESG task force in the Enforcement Division and directing CorpFin to focus on climate-related disclosure in company public filings.

Climate disclosure. Lee's announcement came during a wide-ranging speech on all three aspects of ESG disclosure. Lee remarked that last year, the perceived barrier between social value and market value has broken down, citing a COVID-driven focus on worker safety and supply chain disruptions, as well as protests against racial injustice. Human capital, human rights, and climate change are issues fundamental to the markets, and ESG disclosures now underpin many traditional aspects and represent a core risk management strategy for portfolio construction, according to Lee.

Describing the newly-issued statement requesting public comment on climate disclosure, Lee said it is time to move from the question of "if" to the question of "how." Acknowledging that it is a complex issue, Lee encouraged engagement from all parties on these issues, including "those who may see them differently." Some members of Congress and even Lee's fellow commissioners have voiced some skepticism about requiring climate disclosure, expressing the view that the SEC's current materiality standard is sufficient.

Regarding materiality, CAP Vice President for Economic Policy Andres Vinelli asked Lee in a Q&A session following her remarks how the Commission should approach materiality and ESG disclosure. Lee noted that case law establishes that materiality is what is important to a reasonable investor. From her discussions with investors, Lee said that they have made clear that ESG maters are material and that they are not getting the information that they need. Responding to a question from Vinelli about whether investors should consider ESG factors in their investment decision, Lee replied it was not her job or the SEC's to tell investors what to invest in, but they should listen to investor needs. The SEC should not substitute its own judgments regarding what is material for those of investors, but it is the SEC's job to get that information out to investors, she said, especially with mounting evidence that ESG disclosure correlates with performance.

Lee's statement on climate disclosure outlines 15 categories of questions for consideration. The questions include what information related to climate risks can be quantified and measured; whether disclosures should be tiered or scaled based on the size of a registrant; the advantages and disadvantages of developing different climate change standards for different industries; whether disclosure should be incorporated into specific rules such as Regulations S-X and S-K as opposed to implementing an entirely new rule; the possibility of using a "comply or explain" framework; and how the Commission's climate-related priorities should consider information from private companies.

ESG beyond climate. Lee also addressed a number of other issues that implicate ESG disclosures beyond climate change. Noting that disclosure only works for shareholders if they can effectively use the information in overseeing their investments, Lee advocated for protecting shareholder rights, including proxy voting and shareholder proposals. Regarding proxy voting, Lee said the Commission should revisit its August 2019 guidance on the proxy voting responsibilities of investment advisers, expressing her concern that it discourages fiduciaries from voting in some circumstances. Lee said she has asked the staff to consider recommendations for enhancing, supplementing, or replacing that guidance. She has also asked the staff to examine whether to update Form N-PX, which discloses fund voting decisions and was adopted nearly two decades ago. In addition, the staff should look into re-opening the comment file on the SEC's 2016 universal proxy rule proposal, she said.

Lee also recommended giving serious thought to revisiting rules the SEC adopted last year that changed the criteria for the submission of proposals by shareholders to make it more difficult for smaller shareholders to access the process, a rulemaking Lee opposed. The shareholder proposal process is a key mechanism for engagement by shareholders with company management, including on ESG-related issues such as climate change, workforce diversity, independent board leadership, and corporate political spending, she said.

Advising that ESG risks and climate risks in particular do not observe jurisdictional boundaries, Lee reiterated her support for IOSCO's statement calling for the creation of a Sustainability Standards Board. Within our own borders, Lee stated that one of the most challenging questions for the SEC is how to devise a flexible ESG reporting framework, positing that perhaps a dedicated ESG standard setter that is similar to FASB and subject to SEC oversight could complement its financial reporting framework.

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