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# The SEC Climate Disclosure Proposal: A strong signal or a new paradigm ?

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## INTRODUCTION

**March 21st, 2022:** The Securities and Exchange Commission (SEC) proposes to include landmark climate-related disclosures in corporates' annual SEC filings[1].

**March 31st, 2022:** "Biden announces release of largest-ever strategic petroleum reserve as an attempt to tackle surging oil and gas prices following Ukraine crisis"[2].

We wonder whether the SEC proposal indicates a key milestone in the financing of our climate transition, or if this is yet a new paradigm – stressing about the climate urgency on the one hand and investing in new oil explorations programs on the other hand ?

Further, should we believe that this constitutes a one-off event, or can we expect it to be the beginning of a longer, wider, and stronger ESG journey ? In other words, will the SEC stop at Climate, or will the SEC effectively stop Climate change ?

## THE PROPOSAL'S BACKGROUND

We first wonder whether the United States (US) have always been behind Europe in terms of regulating ESG or climate change.

If the U.S. have recently been seen as lagging in terms of regulating ESG matters, it is interesting to note that this has not always been the case. To the contrary: one of the very first key landmark ESG requirements found its root on US soil back in 2010 when the SEC established the first mandatory Conflict Minerals Rule enshrined in the famous Dodd-Frank Act Section 1502[3]. Such a disclosure rule was specifically looking at the often under looked "S" factor[4], asking listed companies to disclose

[1] Note that the new requirements are very similar to already existing climate disclosure frameworks such as the Task Force on Climate-related Financial Disclosures and the Greenhouse Gas Protocol: https://www.sec.gov/news/press-release/2022-46. Requirements are: 1/ Information about the climate-related risks which are reasonably likely to have a material impact on companies' businesses, results of operations, or financial condition, 2/Greenhouse gas ("GHG") emissions associated with a public company that includes, in many cases, an attestation report by a GHG emissions attestation provider; and 3/Climate-related financial metrics to be included in a company's audited financial statements, according to https://www.whitecase.com/publications/alert/sec-proposes-long-awaited-climate-change-disclosure-rules

[2] Biden announces release of largest-ever strategic petroleum reserve as an attempt to tackle surging oil and gas prices following Ukraine crisis

[3] Section 1502 took effect in 2014: https://www.conflictmineralslaw.com/2021/03/24/recent-climate-and-esg-disclosure-activity-what-does-it-mean-for-the-secs-conflict-minerals-rule/

[4] "S" standing for the social factor, one of the environmental, social and governance (ESG) pillar.

whether they use “conflict minerals” (tin, tungsten, tantalum, and gold) and whether these minerals originate in the Democratic Republic of the Congo (RDC) or in any of the adjoining countries.

The US conflict mineral rule largely inspired the Organisation for Economic Co-operation and Development (OECD) to quickly issue its first “Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas”, confirming the seriousness of the existing situation of minerals’ extraction in conflict-affected areas and therefore confirming the need to raise global awareness on this new notion of “conflict minerals”.

Despite this urgency, it took almost seven years for the European Union (EU) to regulate on the matter and to mirror the US requirement with its “Conflict Minerals Regulation 2017/821” which took effect in 2021. Similar to Section 1502, the EU Regulation requires EU importers of the “3TG” minerals[5] to comply and report on their supply chain due diligence obligations for minerals originating from conflict-affected and high-risk areas.

Going back to the topic of climate disclosure, it is interesting to note that Climate Change Guidance was also first issued by the SEC back in 2010, with its “Guidance Regarding Disclosure Related to Climate Change”, which specifically aimed to assist publicly listed companies in identifying the climate change risks they may be exposed to and when they should disclose those to shareholders and to the wider public. This guidance established the SEC’s flexible “principles-based materiality disclosure framework” as opposed to a more uniform and standardized line-item ESG disclosure framework.

If the previous administration curtailed this ESG regulatory enthusiasm, it is essential to note that this did not stop projects developing in the shadows. Even the US could not resist the surging pressure from investors for more ESG disclosure. As such, the Governance & Accountability Institute (G&A) estimated that despite the absence of any mandatory ESG disclosure rule like the one we have had in Europe since 2014, not less than 86% of the S&P500 companies were voluntary publishing ESG or sustainability reports in the year of 2018[6]. The institute compared the 2018 percentage with figures from 2011, where just over 20% of the S&P 500 companies were found reporting on their ESG practices[7], confirming a sharp rise in the US voluntary reporting trend over the last 10 years.

KPMG’s survey and figures also confirm that US companies are far from being behind in terms of sustainability reporting[8], highlighting that North American companies overall have in fact the highest regional sustainability reporting rate (90% of companies in 2020), and that they are also leading the way in terms of acknowledging specific climate risks in their financial reporting[9].

5 The term Conflict Minerals describes 4 elements – Tin, Tantalum, Tungsten and Gold, and is commonly referred to as 3TG.

6 “According to the Governance & Accountability Institute, in 2018, 86% of S&P 500 companies published ESG or sustainability reports.”, https://corpgov.law.harvard.edu/2020/06/22/the-rise-of-standardized-esg-disclosure-frameworks-in-the-united-states/#1; https://www.ga-institute.com/storage/press-releases/article/flash-report-86-of-sp-500-indexR-companies-publish-sustainability-responsibility-reports-in-20.html

7 https://www.ga-institute.com/storage/press-releases/article/flash-report-86-of-sp-500-indexR-companies-publish-sustainability-responsibility-reports-in-20.html

8 https://assets.kpmg/content/dam/kpmg/xx/pdf/2020/11/the-time-has-come.pdf

9 https://assets.kpmg/content/dam/kpmg/xx/pdf/2020/11/the-time-has-come.pdf

It therefore comes as little surprise that when the SEC tested, through its 2021 consultation, investors' appetite to disclose on climate, the investment community largely welcomed those new reporting rules[10].

## IS THE U.S. BACK ?

As such, today we strongly feel that the current Administration is willing to catch-up, and catch-up fast, and that this new Proposal is far from being a one-off, isolated event[11].

If the US recently exported more crude and petroleum than they have since the 1990s[12], appearances can be deceiving and one should not dismiss that, in parallel, this Climate disclosure does not seem to be a standalone rule, but rather part of a wider and stronger ESG movement willing to regulate and establish ESG investing and transparency for good:

- April 2020: The SEC's Division of Examinations warns that its review of ESG funds identified a number of misleading statements regarding ESG investing processes and adherence to global ESG frameworks, among others.
- February 2021: The SEC appoints a new Senior Advisor for Climate and ESG in charge of overseeing the SEC's efforts relating to climate risk and other ESG developments.
- February 2021: The SEC posts an Investor Bulleting on ESG, observing the different criteria that ESG Funds use.
- March 2021: 2020: The SEC announces the creation of a Climate and ESG Take Force in the Division of Enforcement to analyse disclosure and compliance issues relating to ESG strategies
- March 2021: The SEC's Acting Director of the Corporate Finance Division advocates for an effective ESG disclosure system that is "adaptive and innovative".
- July 2021: SEC Chair notes the absence of a "standardised meaning" of such so-called ESG, green, or sustainable funds.
- July 2021: A new SEC staff is instructed to develop a mandatory climate risk disclose rule proposal.
- September 2021: The SEC issues sample letters for public companies to guide them in their climate-related corporate disclosures, using the old 2010 climate change guidance.
- 2022: the SEC expands the scope of greenwashing scrutiny to enhance investor protection. [13]

Importantly: what the US have now come to understand is that ESG investing without regulatory pressure, without teeth and without common parameters, has more bark than bite. The ESG Task Force's creation confirms the SEC's new role in protecting investors from greenwashing and similar misleading ESG campaigns. Today's new rules therefore mark an inflection point where the SEC will

[10] This proposal comes on the back of a public consultation period that saw 75% of nearly 600 responses submitted in favour of mandatory corporate climate disclosures – according to https://www.goldmansachs.com/insights/pages/gs-research/gs-sustain-esg-regulations-us-sec-proposes-major-new-climate-disclosure/report.pdf.

[11] On January 21, the second day of his presidency President Biden appointed Commissioner Allison Herren Lee as acting chair of the SEC, putting the pieces in place to shift the Commission's priorities to include climate and sustainability. https://www.bdlaw.com/publications/esg-on-the-rise-non-financial-reporting-will-introduce-new-corporate-pressures-in-2021/

[12] https://www.bloomberg.com/news/articles/2022-04-20/u-s-oil-exports-soar-as-world-works-to-replace-russian-supplies

[13] https://www.clarkhill.com/news-events/news/esg-in-2022-and-beyond-recent-and-emerging-trends/

now use its authority to regulate ESG investing, with SEC enforcement actions to focus on false and misleading statements[14].

As such, the ESG regulatory framework is becoming stronger, and many developments are expected, including:

- The SEC ESG rulemaking body will likely focus on diversity, equity and inclusion (DEI) and modernise the existing company disclosures of Regulation S-K Items 101, 103 and 105 (i.e.: Item 101: disclosure of human capital resources). The new rule might request to "provide non-exclusive examples of human capital measures and objectives, such as measures or objectives that address the attraction, development, and retention of personnel".
- Companies listed on the Nasdaq stock exchange will be required from August 2022 to disclose the composition and diversity of their boards using a standardised template.
- Supply chain issues will grow as a key theme with the new Uyghur Forced Labor Prevention Act (UFLPA) which will come into force in June 2022 requiring importers of record to provide evidence that imported products were not made with forced labour and will otherwise be banned from US markets.
- The Fashion industry is also coming under the radars with a proposed NY-based Fashion Sustainability and Social Accountability Act which is historic in its scope and approach.

All in, many of us are now fully aware that the question is not *whether*, but *how.*

## COULD THIS BE WIDER THAN THE EU AND THE US ?

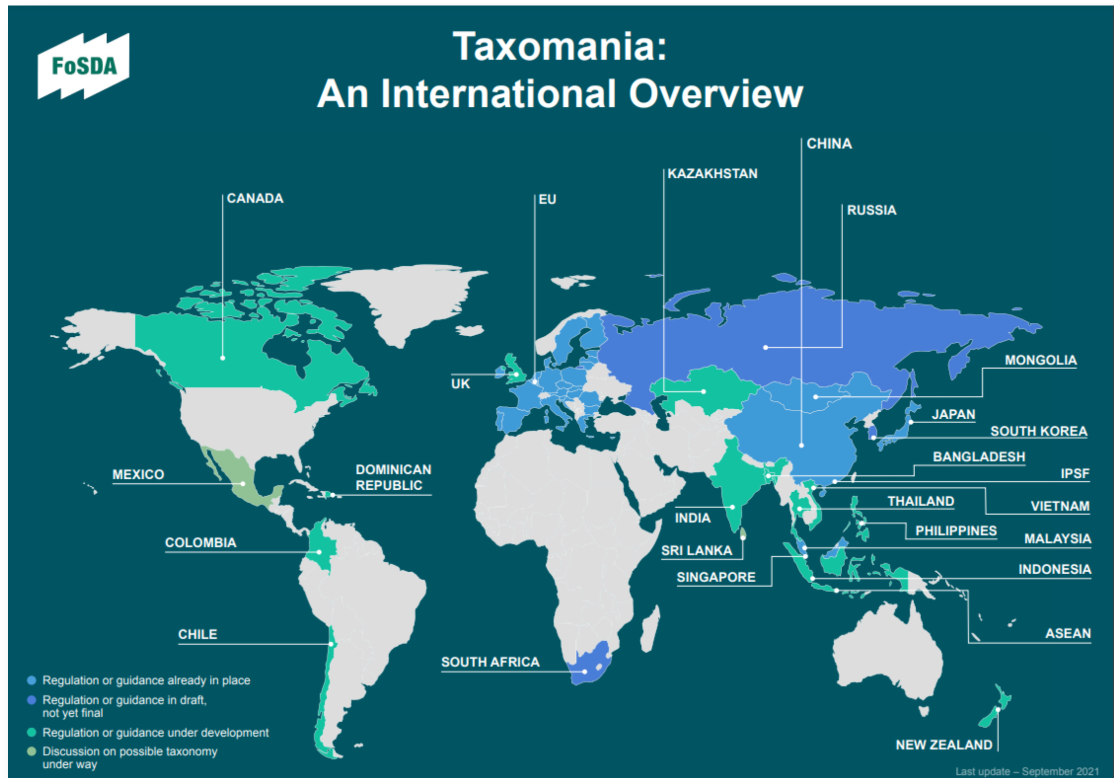
We now wonder whether this ESG investing regulatory development could in fact not be of a more widespread and global movement than the EU and US only.

Again, if 2021 saw a large rebound in coal and oil use and if today's outlook for oil is still projected to rise for now[15], we argue that one should not underestimate the global ESG regulatory trend, and which we believe is here to stay. We posit that this movement is not exclusive to the EU or to the US, but really does seem to be of a global one.

As an investor and as an engagement officer, I can confirm that no matter where we call our investee companies, may it be in Japan, the U.S., China, Sweden or Brazil, the vast majority of corporates today want to understand today's regulatory and market standards, they want to understand investors' expectations and they want to enhance their sustainability disclosures. As such, the ESG race for transparency has spread outside borders and today no country is immune from corporates' willingness to operate under a common ESG umbrella and to align with a global ESG market practice. The question is no longer whether corporates are willing to use those reporting frameworks, but how to gradually harmonise them as the headache is real. Therefore, if you believe that ESG disclosures and ESG investing is an isolated "EU thing", I believe you are only seeing the tip of the iceberg.

Today, the world is witnessing what is referred by some a "*Taxomania*": meaning a multiplication of Taxonomy developments all around the world:

[14] https://crsreports.congress.gov/product/pdf/R/R46766
[15] https://iea.blob.core.windows.net/assets/4ed140c1-c3f3-4fd9-acae-789a4e14a23c/WorldEnergyOutlook2021.pdf




*Source : https://futureofsustainabledata.com/taxomania-an-international-overview/*

In parallel with those taxonomy developments and to mention some of the landmark global ESG reporting regulatory developments, we may start with the UK, which launched a new green finance strategy back in 2019 and is today asking 1,300 of its large companies to report information under the framework set by the Task Force for Climate-related financial disclosures. Mark Carney's 2015 speech has marked the beginning of a long and solid ESG journey for the UK[16].

France is also of course a key driver of this ESG reporting regulatory race since it hosted the COP15 in Paris, which quickly led in 2016 to the adoption of a series of ESG regulation, including a law requiring investors to disclose on ESG.

The EU itself has of course developed its Green Package with an EU taxonomy but also a set of Principal Adverse Impacts reporting obligations and very soon new MiFID2 Suitability requirements, effectively obliging investors to ask their clients for any ESG preference and obliging them to propose a number of ESG products responding to those potential investors' needs.

Now looking outside Europe, China is also currently testing a mandatory climate disclosure model for companies whilst voluntary disclosure has already significantly increased over the past few years (from 371 companies in 2099 to 1,021 companies by mid-2020[17]). The 2018 Listed Company Governance

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https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/820284/190716_BEIS_Green_Finance_Strategy_Accessible_Final.pdf

17 https://www.china-briefing.com/news/what-is-esg-reporting-and-why-is-it-gaining-traction-in-china/#:~:text=China's%20ESG%20investment%20market%2C%20while,funds%20also%20surged%20in%202021.

Code is already requesting that companies disclose ESG information, and the Asset Management industry association has issued a few environmental and ESG guides. Following China's announcement in 2021 of carbon neutrality goals, the Government released an action plan including a "Common Ground Taxonomy" which, like the EU, aims to list the economic activities conducive to fighting climate change. Last but not least, a new measure came into force in February 2022 aiming to regulate and streamline the disclosures of environmental information for a number of business activities[18].

For the first time, the top 1,000 listed Indian companies will be required for the financial year 2022-2023 to prepare a "business responsibility and sustainability report" (BRSR) containing detailed ESG disclosures as part of their annual report. This will be notified to the stock exchanges and published on companies' websites, as well as sent to shareholders. Before this became mandatory, companies were again already publishing a shorter report on a voluntary basis. Smaller companies are also of course encouraged to voluntary report against this new BRSR framework. Additionally, the reserve Bank of India is also working on issuing ESG-based lending guidelines[19].

Across the Pacific and the Atlantic, Chile is also currently drafting ESG reporting rules, which again will establish that issuers of publicly traded securities will have to provide ESG information in their annual reports[20].

If you still are not fully convinced, the UNPRI, the UN-supported network of investors working on promoting sustainable investment through the incorporation of environmental, social and governance, also confirmed this global ESG trend itself by highlighting the soaring number of new signatories the organisation is welcoming every year and from all parts of the world. From 81 signatories in 2006, the network today counts almost 5,000 signatories, and they are increasingly widespread[21]:

- from 2 signatories based in Africa in 2006, today we count 118
- from 12 signatories in Australia and Asia, today we count 263
- from 12 signatories in the US, today we count 1,023
- from 6 signatories in France, today there are 381
- from the first signatory in China in 2012, today there are 99

[18] The business activities being key pollutant-discharging enterprises; enterprises that are subject to mandatory review for clear production; listed companies and their subsidiaries at all levels; enterprises that issue enterprise bonds, corporate bonds, and debt financing instruments for non-financial enterprises; and other enterprises that should disclose environmental information under laws and regulations.
[19] https://www.legal500.com/developments/thought-leadership/esg-reporting-and-its-framework-in-india/
[20] https://www.bnamericas.com/en/news/chile-readying-mandatory-esg-reporting-rules
[21] https://www.unpri.org/signatories/signatory-resources/signatory-directory

## CONCLUSION

If many feel that the world has not changed and that nothing is happening yet, the on-going and upcoming regulations evidence the opposite, particularly given that those now carry strong enforcement capabilities, like the SEC.

Both corporates and investors are becoming increasingly aware of this shift, a shift which is here to last, and the explosion of the carbon credits market over the last 18 months is just one example among many others attesting corporates' awareness that strong environmental credentials, together with social and governance safeguards, are needed and are needed quickly.

As Warren Buffet said, "Only when the tide goes out do you discover who's been swimming naked." Today the tide is still high, but we can expect that the upcoming wave of ESG transparency provided by corporates, together with the upcoming constraints on each and every activity as regulated with world-wide taxonomies aiming to curb emissions wherever possible, and together with a new generation and ever-growing public opinion to fight climate change, the advice is to take those developments seriously and be ready to be fully equipped when all those new standards and requirements converge and effectively begin a new order.