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A Preview of ESG Regulation under the Biden Administration

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As the Biden Administration settles in and begins to appoint its designees to key executive and administrative agencies, a series of policy objectives are coming into focus. Chief among them is expanded attention and regulation in the ESG space regarding environmental, social and governance issues at American businesses. In this post, we survey the expected direction of these initiatives at, for example, the SEC, Department of Labor, and EPA.

Securities and Exchange Commission

As has been widely reported, President Biden has nominated Gary Gensler to be the next chairman of the Securities and Exchange Commission. After becoming one of the youngest partners at a leading Wall Street investment bank, Gensler transitioned into government service as a senior official in President Clinton's Treasury Department and as the chairman of the Commodity Futures Trading Commission (CFTC) under President Obama. While at the CFTC, Gensler was the principal architect of the sprawling Dodd-Frank Act's provisions regulating the swaps markets, and he worked tirelessly to implement new CFTC rules regulating the space. He has deep experience both in the financial markets and as a regulator and currently teaches on blockchain technology, digital currencies, financial technology, and public policy at MIT.

The SEC is not new to the ESG space. To resolve protracted litigation with the Sierra Club, the SEC adopted a series of required environmental disclosures for public companies in the 1970s. The proxy statement for a public company's annual shareholder meeting is entirely a governance document, packed with disclosures about executive compensation, board governance and investor relations. Under the SEC's Rule 14a-8 regarding shareholder proposals for public companies, the SEC staff has also become well-acquainted with a range of constantly-evolving ESG topics.

However, despite adopting by a 3-2 vote of commissioners interpretive guidance on climate change disclosure in 2010, the SEC has since said relatively little on those issues. Gensler's predecessor as

SEC chair, Jay Clayton, largely sidestepped the issue of mandating additional ESG reporting, preferring to rely on existing SEC disclosure standards that require the disclosure of various types of material information. Clayton's SEC did approve new disclosure rules regarding human capital matters, but those rules met with some internal opposition, with two SEC commissioners opposing the rules, because in their view, the new rule did not go far enough to advance the cause of ESG reporting.

Assuming the Senate confirms Gensler as SEC chairman, we expect the SEC to take up the issue of ESG reporting again. While there has been no formal announcement or agenda, topics that are ripe for consideration include (1) environmental disclosure rules focused on carbon footprint or greenhouse gas emissions, (2) board-level diversity disclosures, (3) disclosures of matters concerning workforce diversity, inclusion and equity, and (4) corporate political spending disclosure. SEC action on ESG reporting—in particular on climate change—would align with the European Union's upcoming amendment to its Non-Financial Reporting Directive that seeks to increase corporate disclosures of non-financial information on social and environmental impacts. Preparing disclosure rules that are comparable across industries likely will pose a challenge for the SEC. We also expect the SEC will be under political pressure to adopt rules that are more prescriptive, as opposed to those that are principles-based.

To these ends, Commissioner Allison Herren Lee, the SEC's current acting chair, recently announced the appointment of a senior advisor for climate and ESG matters. The acting SEC chair's somewhat unusual decision to name a law professor with an interest in ESG issues, as opposed to a capital markets lawyer from a major law firm, as acting director of the agency's Division of Corporation Finance—the operating unit charged with regulating public company disclosure—also foreshadows further action in the space. These announcements may have been made in consultation with Gensler in an effort to pre-position key senior staff for his arrival.

The new Congress is also likely to consider a range of bills on ESG issues over the next two years. We expect Gensler to closely monitor that process and play a leading role insofar as the SEC's jurisdiction is implicated. During the drafting of the Dodd-Frank Act, Gensler was a force of nature. He spent long hours at the Capitol, met with countless members of Congress and their staff, and he personally helped draft key provisions of the bill concerning swaps. He is clearly a skilled political operator, understands the inner workings of Congress, and is not likely to be blindsided by the adoption of any bill regarding the SEC with which he does not agree. Conversely, he has proven to have the skills to pass a bill should he see the need to do so.

Department of Labor

It is expected that the Biden administration will encourage ESG investing – investments that, for example, assess criteria like risks associated with climate change. The prior administration finalized a rule (effective January 12, 2021) that is viewed as a barrier to ESG funds in investment plans. Under that rule, plan sponsors and other fiduciaries selecting ESG funds must "separate the legitimate use of risk-return factors from inappropriate investments that sacrifice investment return, increase costs, or assume additional investment risk to promote non-pecuniary benefits or objectives." The rule does not use the term "ESG;" it refers to pecuniary and non-pecuniary factors. In removing references to ESG, the rule recognizes the complex interplay of ESG factors in investment decisions and the term ESG is not necessarily synonymous with "non-pecuniary." President Biden ordered review of the rule and—in the short term—DOL may issue guidance clarifying that ESG factors are "pecuniary." A permissive approach with respect to consideration of ESG factors in investments aligns with President Biden's climate change and sustainability goals.

Environmental Protection Agency

The tip of the spear of the Biden administration's approach to addressing climate change will be the EPA. The EPA does not itself enact regulatory changes specific to ESG, but the EPA's regulatory actions could impact ESG-related risks (*e.g.*, regulatory actions limiting greenhouse gas emissions). One notable area of focus will be environmental justice (EJ), which the Biden administration views as interrelated with its efforts on climate change.

Last week, the Senate Environment and Public Works Committee (EPW) voted 14-6 to advance President Biden's nomination of Michael S. Regan to run the Environmental Protection Agency. Biden's selection of Regan has signaled to many that EJ will indeed be a top priority for Biden's EPA. Regan said as much when he testified before EPW that he "will stand up for environmental justice and equity." Prior to his nomination, Regan was serving as secretary of North Carolina's Department of Environmental Quality, where he was dedicated to helping the low-income and minority communities most affected by pollution. He launched North Carolina's Environmental Justice and Equity Board Advisory Board tasked with achieving and maintaining fair and equal treatment with respect to environmental policies. Prior to joining Governor Cooper's administration, Regan was the associate vice president and southeast regional director of the Environmental Defense Fund. His career began as an EPA regulator under both the Clinton and Bush administrations, spanning a decade.

President Biden further signaled his commitment to EJ with his Climate Day Executive Orders issued on January 27th. His Executive Order on Tackling Climate Crisis at Home and Abroad establishes a White House Environmental Justice Interagency Council and a White House Environmental Justice Advisory Council (housed within EPA) to, among other things, "prioritize environmental justice and ensure a whole-of-government approach to addressing current and historical environmental injustices." These councils are tasked with carrying out Biden's campaign promise to "revise and reinvigorate" President Clinton's 1994 Executive Order on Federal Actions to Address Environmental Justice in Minority Populations and Low-Income Populations. The '94 order was landmark in that it was the first major federal EJ action, but it was limited in that it only required agencies like the EPA to consider marginalized populations in their regulations and rulemaking. If confirmed, Regan and his EPA will be charged with implementing the revamped Clinton order.

The Climate Day Order takes two additional steps to prioritize EJ – it creates a "Justice40 Initiative" with the goal of delivering 40% of the overall benefits of relevant federal investments to disadvantaged communities as well as initiates the development of a Climate and Environmental Justice Screening Tool, building off the Obama-era EPA tool, EJSCREEN, created to identify communities most vulnerable to pollution. These resources may help Regan comply with the order's directive for the EPA to "strengthen enforcement of environmental violations with disproportionate impact on underserved communities" The EPA could also push the Department of Justice (DOJ) to review its supplemental environmental projects (SEP) policy to reverse the current prohibition on SEPs to utilize them in these efforts. Moreover, EJ enforcement may be further bolstered by Biden's suggestion to the DOJ to create a new Office of Environmental Justice.

With the Biden administration's focus on environmental justice, deeper thinking is likely necessary to understand the interplay with EJ principles established by EPA and other agencies and applicable human rights standards. Under the "S" prong of ESG is a focus on human rights. Companies often seek to respect international human rights standards as part of ESG protocols, notably the UN Universal Declaration of Human Rights and UN Guiding Principles on Business and Human Rights. However, the focus has often been on operations in developing countries or international supply chain-related considerations in the context of human trafficking or child labor. Given the emphasis on EJ, it may be appropriate to examine and update existing ESG protocols, in particular as applied to operations in the US in areas with a high percentage of low-income, minority, or tribal populations.

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