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Investors and Regulators Turning up the Heat on Climate-Change Disclosures: Attempting to Make Sense of the State of Play in the US, EU, and UK

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As investors' calls for greater climate-related corporate accountability grow louder, the "E" in ESG—environmental, social and governance—looms larger than ever, particularly from the perspective of directors facing oversight responsibilities and the challenge of providing adequate disclosure. That reality became even clearer when a little-known hedge fund with a relatively small stake in ExxonMobil successfully elected three insurgent directors at the company's annual meeting after quietly garnering the support of other stakeholders by appealing to their interest in environmental and governance issues.[1]

Of course, investors have been signaling the importance of environmental issues for years. In 2007, the $240 billion California State Teachers' Retirement System ("CalSTRS") formed a Green Initiative Task Force focused solely on "managing sustainability-related risks, including climate risks, and taking advantage of appropriate sustainability-themed investments."[2] Blackrock, the largest asset management company in the world by assets under management, has published guidance concerning its expectations with respect to climate-related disclosures, stating that "climate risk—physical and transition risk—presents one of the most significant systemic risk[s] to the long-term value of our clients' investments."[3] Earlier this year, Blackrock voted for two shareholder proposals requiring Berkshire Hathaway Inc. to issue disclosures addressing how the company is managing climate risk, noting that the company "is not adapting to a world where environmental, social, governance (ESG) considerations are becoming much more material to performance."[4] Though neither proposal was approved, Blackrock's dissatisfaction prompted other institutional investors to express their discontent, increasing pressure on the company to modify its approach. In 2017, research conducted by the Sustainability Accounting Standards Board ("SASB") found that climate change "is likely to have material financial impacts on companies in 72 out of 79 industries, representing 93 percent of the U.S. equity market, or $27.5 trillion."[5] And investors are increasingly demanding that companies change their approach to managing climate-related risks and more thoroughly disclosing those efforts. We expect these demands to hit a fever pitch following the "code red for humanity" recently issued by the United Nations' recent Intergovernmental Panel on Climate Change ("IPCC") report and in the months leading up to the United Nations' Conference of the Parties 26 ("COP26") in Glasgow in November of this year.[6]

Even before the recent IPCC report, regulators, too, increasingly have been focused on climate issues. The US Securities and Exchange Commission ("SEC") in particular has ramped up its scrutiny of corporate disclosure practices to assess whether they are generally thorough and accurate, based on reliable data, and comparable within and across industry sectors. The SEC recently has solicited market input regarding mandatory climate disclosure and signaled that more disclosure-related enforcement actions are coming.[7] Put simply, issuers, regulators, investors (particularly institutional asset managers), and other stakeholders are assessing how companies are responding to the opportunities and risks associated with climate change.

This article addresses the subject of corporate disclosure related to environmental and sustainability issues in the era of climate change.[8] It is the first in a series of articles addressing the challenges confronting companies and their boards as a result of rising temperatures and other climate changes caused by humans and associated primarily with greenhouse gas emissions. We also plan to analyze the implications of climate change as it impacts—in the US and abroad—corporate directors, asset managers and their clients, securities and other regulators, and financial institutions. We hope to use the different perspectives of these market participants and the specific legal framework and caselaw that has developed with respect to each to better understand how climate change is affecting corporations and their stakeholders, and to attempt to better understand what the future may hold.

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As explained below, attempts to address disclosures focused on climate change are not new, although the focus (particularly in the United States) has increased significantly after years when Europe and other regions were taking the lead in this area. Notwithstanding such efforts, however, there remains no consistent, comparable, and reliable publicly accepted sustainability disclosure that boards and investors can use to make informed voting and investment decisions. The SEC has not formally updated its guidance on corporate disclosures related to environmental issues impacting businesses in 11 years,[9] and that guidance relied on the existing, well-established materiality standard, whereby information is material and must be disclosed if there is "a substantial likelihood" that a reasonable investor would view a particular fact as "significantly alter[ing] the 'total mix' of information made available."[10] How this materiality standard applies to climate change disclosure, though, remains subject to debate. Some commentators, including SEC Commissioner Hester M. Peirce,[11] have touted this "reasonable investor" standard as sufficiently elastic to accommodate the evolution of changing investor priorities.[12] SEC Commissioner and former acting Chair Allison Herren Lee has criticized this viewpoint, stating that the reasonable investor standard presumes that corporate management and advisors accurately determine what information is material and noting that the extensive litigation concerning disclosure violations demonstrates that "lawyers, auditors, and managers can and do get the determination of materiality wrong."[13]

This debate took center stage during the SEC's recent solicitation of input regarding the adequacy and effectiveness of the SEC's disclosure rules as they apply to environmental disclosures.[14] The SEC received more than 550 responses, including opinions ranging from outright opposition of enhanced disclosure obligations to support for a comprehensive overhaul of the disclosure framework as applied to ESG topics.[15] As an example, at one end of this spectrum, Republicans on the Senate Banking Committee submitted a comment opposing any changes. In their view, existing federal securities regulations already require "extensive disclosures" concerning "material climate change" and therefore, "any further securities regulations to specifically address global warming are [not] necessary or appropriate, and will only serve to further discourage firms from becoming publicly traded, thus denying significant investment opportunities to retail investors."[16] On the other end of the spectrum are Senators Elizabeth Warren and Sean Casten, who argued that the current framework is "untenable" and urged the SEC to adopt a mandatory framework "to ensure that the market is able to appropriately assess the severe costs and risks of climate change."[17] Most expressed the view that at least some development is necessary—two-thirds of the comment letters submitted supported mandatory climate disclosure rules—but there is sharp debate over the appropriate substance of those rules.[18] The SEC has announced that changes to the disclosure framework are likely to arrive by the fall. But given the highly politicized nature of the proposals, what that change will look like remains to be seen.[19]

As the US grapples with how to deal with formal climate disclosure regulations, the EU's approach provides a useful framework against which the US response will be assessed. As discussed in greater detail below, for years the EU has required certain companies to provide ESG disclosures. While only select US companies are affected by these rules, many commentators have observed that the EU initiatives may serve as "a catalyst to accelerate" and guide the US—and the world's—transition to a greener economy.[20]

In this article, we summarize some of the recent key disclosure developments in the EU and the UK that may inform US regulators' views on a disclosure framework. We then highlight recent activity from US legislators and regulators indicating that the US disclosure framework may ultimately, at least to some extent, overlap with its European counterpart. In this rapidly evolving space, key takeaways include:

1. Most companies, investors, regulators, and other market participants and stakeholders largely appear to agree that climate change poses significant financial risk to (and also, potentially, opportunity for) corporations, financial institutions and their stakeholders;

2. Despite strong investor support for consistent, comparable, and accurate financial disclosures addressing climate-related risks, the US regulatory regime lags behind many of its international counterparts in this area;

3. If the US does not issue formal guidance soon, companies may increasingly take matters into their own hands, likely relying on globally accepted standards such as recommendations from the Financial Stability Board's Task Force on Climate-related Financial Disclosure ("TCFD"), SASB, and other nonprofit organizations, as have the European Union, the UK and other jurisdictions. Issuers are likely to perceive an imperative for greater climate disclosure in order to appease investor demand as well as, in certain circumstances, to comply with existing general disclosure requirements under the federal securities laws;

4. There is likely to be an increase in regulatory enforcement actions and civil litigation focused on a number of industries and/or types of disclosures, including the accuracy of statements by: (i) investment funds regarding their claims about ESG investing strategies, (ii) companies

in the fossil fuel, extractives and certain similar industries that are recognized as significantly impacting the environment regarding the unique challenges they face in connection with transition risk, (iii) public companies regarding their positive, optimistic sustainability statements (i.e., statements claiming progress on environmental matters), and (iv) board of director involvement in and oversight over the management of climate-related risks and opportunities, including by undertaking activities such as scenario planning and incorporating climate risks and opportunities into the fabric of corporate decision-making (*i.e.*, budgeting, capital expenditures, etc.); and

5. Even with additional regulatory guidance or mandates, it will remain challenging for companies and regulators here and abroad to develop disclosure regimes and provide reporting that is consistent across companies, comparable across and within industries, and based on reliable quantitative and qualitative data.

At this point, there is no uniform set of data on which to base disclosure about sustainability nor is there a unified set of metrics and analytical tools to assess and manage climate risks and opportunities. Inadequate data and analytical tools to measure and manage climate-related financial, physical, and transition risks are a material obstacle to enhanced disclosure.

Likewise, the quality of environmental data varies widely, and the market for data has not consolidated such that companies are able to rely on reputable, market-accepted data providers.

There is no consensus on what constitutes a sustainability activity, although a taxonomy has been developed by the EU. The lack of common definitions and standards for climate-related data and financial products undermines attempts by market participants to monitor and manage climate risk.

In short, regulators can mandate disclosure but it will remain to be seen how useful that disclosure is to investors and other consumers of the information in the short and medium term. The comprehensive framework under development in the EU and the UK for disclosing financial and non-financial information, including risks to physical assets, and risks and opportunities associated with transitioning to a greener economy, appears to be a likely blueprint for jurisdictions, including the US, that are not as far along in these efforts. That framework is discussed below. But until the market coalesces around uniform, reliable data, metrics, analytical tools and a taxonomy specific to climate risk assessment and disclosure, investors will continue to find it challenging to assess the quality and accuracy of issuers' sustainability disclosure, which is likely to vary considerably depending on, among other things, the size of the issuer and the industry in which it operates.

1. EU Environmental Disclosure Framework and Developments

Climate-related disclosure obligations have existed in some form in the EU since the 1990s. But the recent surge in climate-related regulatory action can at least in part be traced to the United Nations' 2015 publication of the 2030 Agenda for Sustainable Development, which established sustainable development goals such as the creation of sustainable cities and communities and the reduction of the impact of climate change, and the enactment of the Paris Agreement, the international treaty on climate change signed in 2015 by 190 countries at the UN's twenty-first Conference of Parties ("COP21").[21] As is by now well known, the Paris Agreement is intended to reduce global greenhouse gas emissions, mitigate the effects of climate change, and strengthen the resilience and enhance abilities to adapt to the impact of climate change.

Following these two initiatives, in March 2018, the European Commission published its Action Plan "Financing Sustainable Growth" (the "Action Plan") setting up an ambitious and comprehensive strategy on sustainable finance.[22] The Action Plan set out three primary goals: reorient capital flows towards sustainable investment to achieve sustainable and inclusive growth, mainstream sustainability into risk management, and foster transparency and long-termism in financial and economic activity. In connection with these goals, the EU offered four legislative proposals to implement the Action Plan reforms: (i) a unified classification system, or taxonomy, identifying and defining environmentally sustainable economic activities, (ii) regulated disclosures relating to sustainable investment and risks, (iii) new benchmarks for the carbon impact on investments, and (iv) sustainability preferences for investment firms and insurance distributors to offer clients.

In order to help achieve these goals, the Action Plan also proposed the adoption of a number of EU-wide directives (legislative acts identifying goals to be achieved by EU member states) focused on strengthening climate-related company disclosures and governance.[23] These measures, which comprise a significant aspect of the EU climate disclosure regime, are discussed below.

1. **Updates to the Non-Financial Reporting Directive and the Integration of the Task Force on Climate-Related Financial Disclosure and the EU Taxonomy**

In 2014, the EU adopted the Non-Financial Reporting Directive (Directive 2014/95/EU, the "NFRD"), which set forth disclosure rules for certain large companies concerning non-financial information such as environmental, social, human rights, anti-corruption and bribery, and diversity information.[24] Companies within the scope of the NFRD had to report in accordance with its provisions for the first time in 2018 (covering financial year 2017). The NFRD applies to large public-interest entities with an average number of employees in excess of 500, and to public-interest entities that are parent companies of a large group with an average number of employees in excess of 500 on a consolidated basis.[25] In practice, it includes large listed companies, and large banks and insurance companies (whether listed or not)—all providing they have more than 500 employees.

The NFRD introduced a requirement for companies to report both on how sustainability issues affect their performance, position and development (the "outside-in" perspective), and on their impact on people and the environment (the "inside-out" perspective). This is often known as "double materiality." In accordance with the NFRD, in 2017 the European Commission published non-binding reporting guidelines for companies.[26] In 2019, it published additional non-binding guidelines on reporting climate-related information, as part of the 2018 Action Plan (the "2019 Supplement").[27] Those guidelines clarified that the purpose of the "double materiality" standard is to address the fact that "[a]s markets and public policies evolve in response to climate change, the positive [or] negative impacts of a company on the climate will increasingly translate into business opportunities and/or risks that are financially material."[28] However, as discussed below, the European Commission has subsequently acknowledged that the non-binding guidelines have not sufficiently improved the quality of information companies disclose pursuant to the NFRD. Indeed, the NFRD itself is widely regarded as inadequate to meet the needs of intended users, and an European Commission-led initiative to improve the regime is currently underway following its commitment to perform a fitness check of EU legislation on public corporate reporting as part of the 2018 Action Plan.

While the NFRD did require large public-interest entities to disclose material information on key environmental aspects, including how risks stemming from them are managed—it enabled companies to report sustainability information in a flexible manner. As was recognized in the 2018 Action Plan, there was a need for this flexibility to be balanced with the standardization of disclosure necessary to generate the data needed for investment decisions. Specifically, there was a need for enhanced transparency over the way in which asset managers and institutional investors consider sustainability risks and their exposures to climate-related risks, as well as overall concern that the accounting rules were not conducive to sustainable investment decision-making. In this regard, while the EU has continued to make progress in creating a sustainable finance framework after its 2018 Action Plan, including by adopting various legislative measures in 2018 and beyond, its understanding of what is needed to meet sustainability goals has continued to evolve in the changing global context.[29] This includes the widening gap between the sustainability information companies report and the needs of the intended users of that information, which as well as being problematic for the companies that have to report, has the potential to create systemic risks that threaten financial stability.

Acknowledging these issues, on April 21, 2021, the European Commission adopted a proposal for a Corporate Sustainability Reporting Directive ("CSRD"), which if adopted will amend the existing reporting requirements of the NFRD.[30] The European Commission's proposal includes the development of mandatory common sustainability reporting standards, and aims to bring sustainability reporting on par with financial reporting. Its intent is to build and promote consistency with the NFRD, together with the Sustainable Finance Disclosure Regulation ("SFDR") and the Taxonomy Regulation (both discussed below), which are the central components of the sustainability reporting requirements underpinning the EU's sustainable finance strategy.[31] In summary, the key changes to the NFRD sustainability reporting requirements envisaged are: (i) to extend the scope of the reporting requirements to additional companies, including all large companies and listed companies (except listed micro-companies); (ii) to require assurance of sustainability information; (iii) to specify in more detail the information that companies should report, and require them to report in line with mandatory EU sustainability reporting standards; and (iv) to ensure that all information is published as part of companies' management reports, and disclosed in a digital, machine-readable format.

The CSRD would require NFRD compliance by all large companies (more than 250 employees and has a balance sheet total over €20 million or net sales of €40 million or more), all publicly listed companies (except listed micro-enterprises), and non-listed companies that voluntarily choose to comply with the CSRD.[32] The CSRD would require companies to satisfy the double materiality standard. It also would require companies to comply with reporting standards to be established by the European Financial Reporting Advisory Group, or "EFRAG," discussed in greater detail below, and to seek "limited" assurance from third parties (such as auditors) that there are not material misstatements in the company's disclosures.[33]

Additionally, non-financial disclosures must include a description of the (i) company's business model and strategy, including the company's ability to tackle risks related to sustainability, opportunities for undertaking sustainable initiatives, plans to ensure that the business model is compatible with a transition to a sustainable economy and the goals of the Paris Agreement, consideration of stakeholder interests, and attention to the impact of sustainability on its overall business strategy, (ii) targets related to sustainability matters; (iii) role of governing bodies within the company; (iv) policies concerning sustainability matters; (v) due diligence process concerning sustainability matters, potential adverse impacts connected to the business, and actions taken to prevent, mitigate, or remediate such potential adverse impacts; (vi) principal risks concerning sustainability matters and how they are being managed; and (vii) key performance indicators of the extent to which their activities are sustainable under the EU Taxonomy.[34] These disclosures would be included in companies' annual management reports. If adopted, EU member states will be required to implement the provisions of the CSRD by December 1, 2022.

In its April 2021 proposal, the European Commission made clear that: “No existing standard or framework satisfies the Union’s needs for detailed sustainability reporting by itself.” However, in order to minimize disruption to undertakings that already report such information, sustainability reporting standards are likely to take account of existing standards and frameworks for sustainability reporting and accounting where appropriate, including those published by the TCFD (discussed below), and to align with other EU legislation.

1. **The TCFD Recommendations**

The TCFD was formed in December 2015 by the Financial Stability Board (“FSB”), an independent, international body that promotes financial stability by coordinating national financial authorities and international standard-setting bodies, “to develop recommendations for more effective climate-related disclosures that could promote more informed investment, credit, and insurance underwriting decisions and enable stakeholders to understand better the concentrations of carbon-related assets in the financial sector and the financial system’s exposures to climate-related risks.”[35] The TCFD recommendations are “widely [recognized] as authoritative guidance on the reporting of financially material climate-related information, and the Commission encourages companies to implement them. A number of governments and financial regulators around the world have expressed support for the recommendations and are integrating them into their guidance and policy frameworks.”[36] In 2017, the TCFD published formal recommendations for a framework for climate-related financial disclosures, which have been widely endorsed, including by the Group of Seven.[37] This year, the Group of Seven issued a statement calling for compulsory disclosure of climate-related financial risks in accordance with the framework developed by the TCFD.[38]

At a high level, the TCFD has structured its financial disclosure framework around four key themes: Governance, Strategy, Risk Management, and Metrics and Targets.[39] Specifically, it recommends that companies across all industries disclose: (i) “the organization’s governance around climate-related risks and opportunities”; (ii) “the actual and potential impacts of climate-related risks and opportunities on the organization’s businesses, strategy, and financial planning where such information is material”; (iii) “how the organization identifies, assesses, and manages climate-related risks”; and (iv) “the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material.”[40] With respect to the fourth category, the TCFD specifically recommends that companies disclose the metrics used by the organization to assess climate-related risks and opportunities, publish information regarding greenhouse gas emissions and related risks, and describe the targets used by the organization to manage climate-related risks and opportunities. The TCFD also provided specific guidance for certain industries most affected by climate change.[41]

In June 2021, the TCFD issued “Proposed Guidance on Climate-related Metrics, Targets, and Transition Plans,” to provide “general guidance for organizations seeking to establish relevant metrics, targets, and transition plans around their climate-related risks and opportunities” and—as the name suggests—propose specific changes to its 2017 guidance on climate-related metrics for consultation before it issues its final guidance this fall.[42] The TCFD’s final guidance will address, among other things, standardized climate-related metrics, measurements relating to the climate-related financial impact, and “transition planning” metrics such as de-carbonization pathways. But the proposed guidance also offers helpful definitions for key terms, such as “climate-related metric” (“a quantity indicative of the level of historical, current, and forward-looking climate-related risks and opportunities for a given organization”); “climate-related financial impact” (“a historical or current quantity or forward-looking quantitative outlook (estimate, projection, or forecast) regarding the financial impact of climate-related risks and opportunities on an organization's financial performance or position"); "climate-related target" ("a specific level, threshold, or quantity of a metric that the organization wishes to meet over a defined time horizon in order to achieve the organization's overall climate-related ambition and strategy"); and "transition plan" ("an aspect of an organization's overall business strategy that lays out how an organization aims to minimize climate-related risks and increase opportunities as the world transitions toward a low-carbon economy, including by reducing emissions of its own balance sheet and that of its value chain").[43] The TCFD also issued the following recommendations:

Organizations should disclose climate-related metrics, climate-related financial impacts, climate-related targets, and aspects of its transition plan. Though some information may be most useful for internal decision-making, organizations should be mindful to not overly restrict market access to information. A company should carefully consider and support any reason for avoiding disclosure. In determining where to draw the line, organizations, as a matter of principle, should look to disclose more rather than less so that disclosures may be clearly understood and sufficiently comprehensive for users. Climate-related metrics and targets that are key to measuring and reporting material financial risk . . . should be disclosed in annual reports or publicly available investor meetings. Key aspects of communication and disclosure of climate-related metrics, climate-related financial impacts, climate-related targets, and transition planning are included in their respective sections.[44]

The proposed guidance also recommends that companies utilize "[q]ualitative and quantitative scenario analysis" to design and test the metrics, targets, and transition plans it creates.[45]

2. **EU Taxonomy**

The Taxonomy Regulation, which was published in June 2020, introduces an EU-wide taxonomy of environmentally sustainable activities.[46] It sets up "a classification system, establishing a list of environmentally sustainable economic activities" to facilitate the ability to make investments in sustainable businesses.[47] It requires companies within the scope of the NFRD to disclose certain indicators about the extent to which their activities are environmentally sustainable according to the taxonomy. To be considered an environmentally sustainable economic activity, the activity must (1) contribute to at least one of the six environmental objectives listed in the EU Taxonomy—climate change mitigation, climate change adaptation, sustainable use and protection of water and marine resources, transition to a circular economy, pollution prevention and control, or the protection and restoration of biodiversity and ecosystems; (2) do no significant harm to any of the other environmental objectives; (3) comply with minimum social safeguards; and (4) comply with Technical Screening Criteria.[48] By defining what constitutes an environmentally sustainable activity, the EU Taxonomy necessarily requires companies, if they claim to engage in such conduct, to make associated disclosures supporting that claim in line with EU Taxonomy's four elements.[49]

2. European Financial Reporting Advisory Group

EFRAG is a non-profit association established under Belgian law that provides technical advice to the European Commission on the endorsement of international financial reporting standards. EFRAG, which has an advisory mandate as part of the 2018 Action Plan and in relation to development of the proposed CSRD, is currently performing preparatory work for the elaboration of possible EU non-financial reporting standards. In March 2021, a multi-stakeholder task force set up by EFRAG published recommendations for the possible development of sustainability reporting standards for the

EU.[50] Those recommendations contain proposals to develop a coherent and comprehensive set of reporting standards, covering all sustainability matters from a double-materiality perspective. Those recommendations also contain a detailed roadmap for developing such standards and proposals for mutually reinforcing cooperation between global standard-setting initiatives and standard-setting initiatives of the EU.

In its report, EFRAG explicitly recognizes the importance of coordinating the development of EU sustainability reporting standards with existing and emerging global initiatives. Consistent with the Action Plan, EFRAG has developed recommended guidelines based on the operationalization of the key concept of double materiality, *i.e.*, addressing the definition and implementation of the concept of materiality in each of its two dimensions. It suggests that "the EU's future standard-setters" articulate the standards for "Impact Materiality" (the "inside-out" perspective of the double materiality standard), by

[i]dentifying sustainability matters that are material in terms of the impacts of the reporting entity's own operations and its value chain (impact materiality), based on:

a. the severity (scale, scope and remediability) and, when appropriate, likelihood of actual and potential negative impacts on people and the environment;

b. the scale, scope and likelihood of actual positive impacts on people and the environment connected with companies' operations and value chains; and

c. the urgency derived from social or environmental public policy goals and planetary boundaries.[51]

It further concluded that "[f]inancial materiality for sustainability reporting cannot be extrapolated from financial materiality for financial reporting."[52] Instead, EFRAG suggested that the determination of financial materiality could rely on non-monetary quantitative, monetary quantitative, or qualitative data, while recognizing the dynamic relationship between them. Many impacts on people and the environment may be considered 'pre-financial' in the sense that they may become material for financial reporting purposes over time (so-called 'dynamic materiality').[53]

The EU will consider the recommendations set forth in the report as well as stakeholder input in promulgating disclosure standards.[54]

3. **EU Sustainable Finance Disclosure Regulation**

The SFDR is another EU-wide regulation originating from the 2018 Action Plan.[55] The SFDR complements the other disclosure initiatives discussed above by providing a disclosure framework for asset management firms and financial services institutions, including banks, insurance companies, pension funds, investment firms and financial advisers, that operate, sell products or manage funds in the EU. It primarily aims to prevent "greenwashing"[56] of investment activities by imposing sustainability disclosure requirements.

Concerns about greenwashing have been attracting significantly enhanced regulatory scrutiny. To cite one recent example, German regulators along with the SEC and the United States Department of Justice are investigating Deutsche Bank AG's asset-management arm, DWS Group, for greenwashing.[57] The SEC and BaFin, Germany's Federal Financial Supervisory Authority, initiated the investigation after the group's former sustainability chief alleged that DWS had overstated the amount of assets it invested using ESG criteria.[58] The firm's 2020 annual report stated that $540 billion in assets under its management had undergone its "ESG integration" process in which it grades companies based on ESG criteria; however, an internal assessment of the company's ESG integration capabilities revealed that "only a small fraction of the investment platform applies ESG integration" and noted that there was "no quantifiable or verifiable ESG-integration for key asset classes at DWS."[59]

The SFDR framework addresses greenwashing by requiring financial market participants to account for sustainability risks in their investment decisions. Under SFDR, a "sustainability risk" is an environmental "event or condition that, if it occurs, could cause an actual or potential material negative impact on the value of the investment."[60] It requires financial sector institutions to disclose how sustainability risks are incorporated in their decision-making, the principal adverse impact of investment decisions on sustainability issues, and, if the firm markets sustainable characteristics or investments, it must disclose the basis for the accuracy of that statement. If they consider sustainability risks irrelevant, they must disclose their reasoning. Regulated institutions must also make product-level disclosures if their products "promote environmental or social characteristics" or "have as an objective a positive impact on the environment and society."[61] If the products do not integrate ESG or sustainability considerations, a company must disclose that as well. For example, products—such as bonds and ETFs—purporting to have a positive impact on the environment, "[p]ractically speaking, . . . must invest primarily in sustainable companies or companies that demonstrate improving sustainable characteristics that contribute positively to a particular outcome, such as a low carbon economy."[62] Under the SFDR framework, a company offering such a product would disclose, among other things, the sustainability indicators used to measure the success of the sustainable investment objective, the criteria used to select the investments, good governance practices at the investee company, benchmarks, and whether they have an objective of reducing carbon emissions.[63]

4. Sustainable Corporate Governance

Finally, the Action Plan called for fostering sustainable corporate governance and reducing short-termism in capital markets, and it directed the European Commission to consider whether there is a "possible need to require corporate boards to develop and disclose a sustainability strategy, including appropriate due diligence throughout the supply chain, and measurable sustainability targets" and "the possible need to clarify the rules according to which directors are expected to act in the company's long-term interest."[64] As part of this effort, it also invited evidence of "short-termism"—pressure from capital markets on companies to focus on short-term returns rather than long-term value.

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The EU's reliance on the TCFD and other third-party standards may encourage other jurisdictions to follow the same or a similar disclosure framework. A number of prominent US asset managers and corporations, including Blackrock, Apple[65] and Uber,[66] already have adopted and/or publicly supported the TCFD's framework. In contrast to the EU, however, US regulatory activity addressing climate-change disclosures is in the relatively early stages. Although lawmakers and regulators have been slow to issue formal guidance, recent legislative and other regulatory developments have demonstrated that change to the current disclosure framework is all but certain, but what form that change will take remains an open question.

2. **UK Environmental Policy and Disclosure Developments**

Although the EU has taken the global lead on environmental and sustainability initiatives, the UK has taken a number of recent steps to demonstrate its resolve in this area and align itself with European and US policy initiatives. In November 2021, the UK will co-host the COP26 in Glasgow from October 31 through November 2021, alongside Italy.[67] The goal of the conference is to "accelerate action towards the goals of the Paris Agreement and the UN Framework Convention on Climate Change."[68]

Taking heed of other high-profile climate pledges, the UK has announced investment plans as part of a "green industrial revolution," defined an interim target to reduce greenhouse gas emissions by 68% by 2030 (against 1990 levels) and committed to cease support for the fossil fuel sector overseas. Although concrete investment plans relating to the "green industrial revolution" initiative remain in their infancy, the UK Government has published a Ten Point Plan outlining details of £12 billion government investment with sector-specific targets for offshore wind, hydrogen, nuclear, electric vehicles and carbon capture storage and utilization.[69]

In line with this broader policy and investment goals, the UK is also in the process of rolling out a suite of climate-related disclosure requirements for companies and financial institutions.

1. **UK Rollout of Mandatory Climate Disclosure**

Against this backdrop of vocal government support for environmental initiatives, the UK is in the process of implementing mandatory corporate disclosure related to environmental and sustainability issues. The UK has announced plans to conduct a phased rollout of TCFD disclosure requirements aiming to be the first country to make climate-related disclosures under TCFD mandatory by 2025 for corporations, banks, asset managers and pension schemes. The UK Government published "*A Roadmap towards mandatory climate-related disclosures*" in November 2020 showing the roll out of the rules to different types of organizations.[70]

Premium listed companies on the London Stock Exchange are now required to report first in respect of the reporting periods starting after January 1, 2021 outlining how climate change affects their businesses, in line with the TCFD, on a "comply or explain" basis. Companies falling within the scope of these requirements must now include a statement in their annual financial report setting out:

- whether the company has made disclosures consistent with the TCFD's recommendations in their annual financial report;
- where the company has included some, or all, of its disclosures in a document other than its annual financial report, an explanation of why and a reference to where the disclosures can be found; and
- where the company has not made disclosures, an explanation of why, and a description of any steps the company is taking or plans to take to be able to make consistent disclosures in the future, including relevant time frames.[71]

In terms of further expansion of these requirements, the Financial Conduct Authority ("FCA") conducted a consultation process during mid-2021 on moving to mandatory disclosures for premium listed companies and extending the reporting obligations to other listed companies and has stated its intention to publish a Policy Statement with new regulations by the end of 2021.[72] During the course of 2021, the FCA has also consulted on introducing TCFD-aligned disclosures for asset managers, life insurers and pension providers and is aiming to introduce rules applicable to the largest firms by 2022.[73]

In parallel with the ongoing FCA consultation processes relating to the regulated sector, the UK Department for Business, Energy & Industrial Strategy conducted a consultation in early 2021 on requiring companies registered in the UK, including very large private companies, to make TCFD-aligned disclosures in their annual report and accounts. Regulations based on the consultation are expected to come into force in late 2021 or early 2022.[74]

2. Banks—Incoming Supervisory Requirements

In April 2019, the Bank of England's Prudential Regulation Authority ("PRA") issued a Supervisory Statement ("SS3/19"), setting out its expectations for banks and other regulated firms regarding their consideration of climate risk across four areas: governance arrangements, risk management, stress testing and scenario analysis, and disclosure.[75] Banks and insurers already have existing requirements to disclose information on material risks under European and UK legislation. In addition to these existing requirements, the PRA will now expect firms to address the financial risks from climate change through their existing risk management frameworks, and to consider disclosing how climate-related financial risks are managed through their governance and risk management processes. It is also envisaged that firms will describe the process through which they have determined whether climate-related financial risks present material or principal risk to the business.

The PRA has made it clear that it expects banks and other regulated firms to fully implement the supervisory expectations set out in SS3/19 by the end of 2021. The PRA expects firms to use a (long-term) scenario analysis to inform strategy setting and risk assessment and identification. The PRA intends to scrutinize the metrics and targets that firms are using, their comparability and how they are incorporated into existing risk and governance frameworks. There is a recognition that firms will not be able to cover a comprehensive analysis of all climate-related financial risks within their capital frameworks by the end of 2021. However, the PRA expects banks and regulated firms to explain what steps they have taken to confirm that, where necessary, capital levels are sufficient to cover the risks to which the firm is, or might be, exposed.

The Bank of England launched its "*Biennial Exploratory Scenario*," a climate stress test study, in June 2021. Participants include seven large UK banks and building societies, five large life insurers and six large general insurers. Participants will make initial submissions after three or four months, with results due to be published in Q1/Q2 2022.[76]

3. Corporate Governance Recommendations

The Financial Reporting Council ("FRC") conducted a thematic review throughout 2020, exploring climate-related considerations by boards, companies, auditors, professional bodies and investors. It published a report summarizing its findings in November 2020.[77] The report encourages UK public-interest entities to report voluntarily in line with the TCFD and the SASB metrics for their sector. The FRC report concludes that corporate reporting on climate change needs to improve to meet the expectations of investors and other stakeholders. The findings echo the emerging regulatory landscape and makes clear that both regulators and investors have a clear expectation that companies need to make disclosures regarding the future financial implications of climate change. The FRC set out some helpful detail in November 2020 regarding its expectations on climate-related information to be contained in annual reports from 2021 onwards in its annual end-of-year letter to CEOs, CFOs and Audit Committee Chairs.[78]

3. US Environmental Disclosure Developments

Disclosure-focused regulatory activity in the US, although lagging Europe, has recently accelerated. This year, the United States House of Representatives passed the Corporate Governance Improvement and Investor Protection Act, which would require the SEC to promulgate rules regarding corporate disclosures concerning climate and other ESG issues. Although unlikely to pass in the Senate based on partisan passage in the House, the fact that the bill passed at all evidences movement and focus on this issue. The bill states that it was drafted because "[i]nvestors have reported that voluntary disclosures of ESG metrics are inadequate," "[a] rule requiring reporting and standardization of ESG disclosures is in the interest of investors," and "ESG matters are material to investors, and the Commission must establish standards for disclosure of such matters."[79]

During his first week in office, President Biden issued a number of executive actions, making it clear that "climate considerations [are] an essential element" of the President's foreign and national security policies.[80] In his first days as President, he created the "Special Presidential Envoy for Climate" to "elevate the issue of climate change and underscore the commitment [the Biden] Administration will make toward addressing it."[81] The President also directed his Administration to integrate climate-related considerations into their strategies and action, established the White House Office of Domestic Climate Policy to coordinate domestic and foreign policy-making and oversee the implementation of such policies, and formed the National Climate Task Force, comprised of the President's cabinet, to "facilitate the organization and deployment of a Government-wide approach to combat climate change."[82] Thereafter, President Biden issued an executive order specifically on Climate-Related Financial Risk, which announced that it was the policy of his Administration "to advance consistent, clear, intelligible, comparable, and accurate disclosure of climate-related financial risk."[83] In furtherance of that policy, President Biden, among other things, directed Treasury Secretary Janet Yellen to utilize the Treasury Department's Financial Stability Oversight Council ("FSOC")[84] to assess the risk climate change poses to the US financial system; instructed the Directors of the Office of Management and Budget ("OMB") and National Economic Council, with Secretary Yellen, to develop recommendations for the National Climate Task Force to integrate climate-related financial risk into federal financial management and financial reporting (particularly as applied to federal lending programs); and, instructed the Director of the OMB to assess, plan for, and reduce long-term fiscal exposure to climate-related financial risk.[85]

In addition, regulatory agencies have already acted to advance the consideration of climate-related impacts on the US financial system. Last year, the Climate-Related Market Risk Subcommittee of the Market Risk Advisory Committee of the US Commodity Futures Trading Commission ("CFTC") issued a report, entitled "Managing Climate Risk in the US Financial System" (the "CFTC Report"), confirming that climate change "poses a major risk to the stability of the U.S. financial system and to its ability to sustain the American economy," and urging regulators and market participants to promptly ramp up research, analyses, and publication of climate-related risk.[86] In March 2021, the SEC created the Climate and ESG Task Force to "develop initiatives to proactively identify ESG-related misconduct," including to "identify any material gaps or misstatements in issuers' disclosure of climate risks under existing rules."[87] The SEC has taken other steps to address ESG issues, such as requesting input on ESG-focused disclosure, examining proxy voting policies and practices, and evaluating whether companies offering ESG products are accurately disclosing policies, procedures, and practices concerning their procedures (*i.e.*, are not greenwashing).

Other financial regulators have also addressed how their policies and oversight functions will address risks associated with climate change. For example, on March 19, 2021, the Federal Reserve published a note outlining how it is managing the impact of climate change on the stability of the US financial system, addressing both "shocks to the financial system and economy, which are difficult to predict, and vulnerabilities, which are underlying features of an economic or financial system that can amplify the negative effects of shocks," and "how climate-related risks may emerge both as shocks and as vulnerabilities that could amplify the effects of climate-change-related shocks or other shocks."[88] The Federal Reserve has also formed two committees to examine the risk that climate change poses to the US financial system.[89]

1. **Proposed Legislation: Corporate Governance Improvement and Investor Protection Act**

On June 16, 2021, the House of Representatives voted 215–214 to pass H.R. 1187, the "Corporate Governance Improvement and Investor Protection Act,"[90] which seeks to standardize corporate disclosures by amending the Securities Exchange Act of 1934 to require public companies to make potentially significant disclosures regarding ESG issues and to empower the SEC to define the parameters of such disclosures. Under H.R. 1187, the SEC would establish a permanent advisory committee to advise on finance sustainability, provide formal guidance on ESG metrics, and require publicly traded companies to disclose how those metrics affect their business strategies. Representative Juan Vargas of California, the bill's sponsor, explained that "[i]nformation from ESG disclosures will help investors have greater insight into what companies are doing to reduce their carbon footprints and to address important issues like climate change, diversity, and labor rights," and will "help ensure clarity and comparability in [the] disclosure of companies' practices, by developing a much-needed comprehensive ESG disclosure framework."[91]

The bill, however, appears unlikely to pass in the Senate (every Republican and four Democrats in the House of Representatives voted against the bill). The US Chamber of Commerce issued a letter "strongly" opposing the bill, urging that it proposes "an unworkable, one-size-fits-all disclosure regime for public companies on ESG issues including climate change, executive compensation, and pay practices" and that "this misguided approach would impose enormous compliance costs on public companies."[92] According to the Chamber of Commerce, the materiality standard articulated in the United States Supreme Court's decision in *TSC Industries, Inc. v. Northway, Inc.* provides sufficient ESG-related guidance to investors. In contrast, CalSTRS has urged the Senate to pass the bill, explaining that as the largest public defined benefit pension fund in the US, managing $465 billion in assets on behalf of two million members, it is "inhibited from adequately exercising their fiduciary duty without" and depends on "high-quality, consistent, and comparable disclosures by public issuers[.]"[93] These disclosures will "help investors allocate capital and exercise stewardship at companies to ensure long-term sustainable value creation" and "encourage corporations to be more mindful of these risks that could impact their financial success over the expenditures, and public policy engagement."[94]

2. **Executive Action**

President Biden recently issued the Executive Order on Climate-Related Financial Risk, announcing that it is “the policy of [the] Administration to advance consistent, clear, intelligible, comparable, and accurate disclosure of climate-related financial risk.”[95] In the Order, President Biden directed that the following steps be taken to advance this policy:

1. **The Development of Climate-related Financial Risk Strategy**

President Biden ordered the development of a government-wide strategy concerning, among other things, the:

- measurement, assessment, mitigation, and disclosure of climate-related financial risk to increase the long-term stability of Federal operations;
- financial needs associated with achieving net-zero greenhouse gas emissions for the US economy by no later than 2050; and
- areas where private and public investments can help the US meet those financing needs, while advancing the economic opportunity, worker empowerment, and environmental mitigation, especially for disadvantaged communities and communities of color.

2. **The Assessment of Climate-related Financial Risk by Financial Regulators**

The Executive Order also called for the Secretary of the Treasury (who is also the Chair of the FSOC) to:

- assess climate-related financial risk to the financial stability of the Federal government;
- share climate-related financial risk data and information among FSOC member agencies; and
- issue a report on the integration of climate-related financial risk into federal policies and programs.

The President further charged the Secretary of the Treasury with assessing climate-related issues or gaps in the supervision and regulation of insurers.

3. **Resilience of Life Savings and Pensions**

President Biden also instructed the Secretary of Labor to consider ways to protect the life savings and pensions of US workers and families from the threats of climate-related financial risk.

4. **Federal Lending, Underwriting, and Procurement**

The Executive Order instructed the Director of the OMB and the Director of the National Economic

Council, in consultation with the Secretary of the Treasury, to develop recommendations for the National Climate Task Force on approaches to integrate climate-related financial risk into Federal financial management and financial reporting. It also directed the Federal Acquisition Regulatory Council, with the Chair of the Council on Environmental Quality and other agencies, to consider amending the Federal Acquisition Regulations ("FARs") to require major federal suppliers to publicly disclose greenhouse gas emissions and climate-related financial risk, and take other steps to minimize their impact on and exposure to the effects of climate change. The Secretaries of Agriculture, Housing and Urban Development and Veterans Affairs were asked to consider approaches to better integrate climate-related financial risk into underwriting standards, loan terms, and related lending policies and programs.

In addition, federal agencies must explain to the Director of OMB, the National Climate Task Force and the Federal Chief Sustainability Officer actions that the agencies are taking to integrate climate-related financial risk into their respective agency's procurement process. The Director of OMB and the Federal Chief Sustainability Officer[96] are also required to provide guidance to agencies on existing voluntary standards for use in agencies' plans.

5. **Long-Term Budget Outlook**

Recognizing the government's broad exposure to increased costs and lost revenue as a result of the impacts of unmitigated climate change, the President also ordered the Director of OMB, in consultation with the Secretary of the Treasury, the Chair of the Council of Economic Advisers, the Director of the National Economic Council, and the National Climate Advisor, to identify the primary sources of federal climate-related financial risk exposure and develop methodologies to quantify climate risk within the economic assumptions and the long-term budget projections of the President's budget and publish annually the federal government's climate risk exposure, and improve the accounting of climate-related expenditures and, where appropriate, reduce the federal government's long-term fiscal exposure to climate-related financial risk.

3. Federal Regulatory Action

Federal agencies, including the CFTC, SEC, Federal Reserve, and FTC, have recently addressed climate-related considerations and how those considerations are impacting their strategies, policies and actions.[97] Though the SEC has not yet issued formal guidance concerning financial disclosure, the SEC and other agencies have made it clear that they will address the risks to the US financial system posed by climate change.

1. The US Commodity Futures Trading Commission Report

In 2020, the Climate-Related Market Risk Subcommittee of the Market Risk Advisory Committee of the CFTC issued the CFTC Report.[98] As noted above, in the CFTC Report, the committee declared that climate change "poses a major risk to the stability of the U.S. financial system and to its ability to sustain the American economy."[99] The CFTC Report found, among other things, that:

- climate change could pose systemic risks to the US financial system;
- existing legislation provides US financial regulators with wide-ranging and flexible authority that could be used to start addressing financial climate-related risk;

- insufficient data and analytical tools to measure and manage climate-related financial risks remain a critical constraint on the dissemination of accurate information, particularly as regulators struggle to balance transparency and privacy concerns;

- the lack of common definitions and standards for climate-related data and financial products is hindering the ability of market participants and regulators to monitor and manage climate risk;

- corporate disclosures on material, climate-related financial risks are necessary to ensure that climate risks are measured and managed effectively, but the existing disclosure regime has not resulted in disclosures of a scope, breadth and quality to be sufficiently useful to market participants and regulators;

- demand for the disclosure of information on material, climate-relevant financial risks continues to grow, and reporting initiatives have led to important advances, such as the Global Investor Statement to Governments on Climate Change,[100] which advocated for governments to improve climate-related financial reporting, as well as the TCFD; and

- international engagement by the US could be significantly more robust.[101]

The CFTC Report recommends that all federal financial regulatory agencies incorporate climate-related risks into their mandates and consider strategies on how to integrate such risks into their oversight functions. The CFTC Report also recommends that the FSOC incorporate climate-related financial risks into its oversight function and include such risks in its reporting to Congress.[102] The Report encourages US regulators to join international groups addressing climate risks, including the Central Banks and Supervisors Network for Greening the Financial System ("NGFS"),[103] Coalition of Finance Ministers for Climate Action, and the Sustainable Insurance Forum, as well as actively engage with the G7 and C20 meetings and bodies to ensure that climate risk remains an agenda item.

The CFTC Report further recommends that financial regulators:

- require that climate-risk monitoring be integrated into financial firms' governance frameworks, including "clearly defined oversight responsibilities in the board of directors";

- work with financial institutions to develop "pilot climate risk stress testing" as recommended by the NGFS, by creating broadly applicable scenarios, guidelines, and assumptions and require institutions to assess their exposure to those scenarios;

- consider integrating climate risk into balance sheet management and asset purchase programs;

- work with the private sector to support the availability of consistent, comparable, and reliable climate risk data and analyses to advance effective measurement and management of climate risk;

- work with the private sector to support the development of US-appropriate standardized and consistent classification systems for risk levels to define core terms supporting the comparison of climate risk data and associated financial products and services, and consider the establishment of a Standards Developing Organization;

- clarify the definition of materiality for disclosing medium- and long-term climate risks, including through quantitative and qualitative factors;

- review and update the SEC's 2010 guidance on climate risk disclosure to achieve greater consistency in disclosure reforms; and

- review relevant laws and regulations and provide clarifications to confirm the appropriateness of making investment decisions using climate-related factors in retirement and pension plans covered by the Employee Retirement Income Security Act ("ERISA") and non-ERISA managed situations where there is fiduciary duty.

2. The SEC Response

SEC's Climate and ESG Task Force in the Division of Enforcement

On March 4, 2021, the SEC announced the creation of a Climate and ESG Task Force in the Division of Enforcement.[104] The Task Force is designed to address "increasing investor focus and reliance on climate and ESG-related disclosure and investment"[105] and is charged with "develop[ing] initiatives to proactively identify ESG-related misconduct" and "coordinat[ing] the effective use of Division resources, including through the use of sophisticated data analysis to mine and assess information across registrants, to identify potential violations."[106] To date, the task force has not issued any further guidance on ESG-related issues or taken any action.

SEC's Focus on Climate-Related Disclosures

On February 25, 2021, the SEC acting Chair, Allison Herren Lee, directed the Division of Corporation Finance "to enhance its focus on climate-related disclosure in public company filings" and to update the 2010 guidance issued by the SEC.[107] In 2010, the SEC issued guidance on climate-related disclosures, such as suggesting that companies "should consider, and disclose when material, the risks or effects on its business of international accords and treaties relating to climate change" and "evaluate for disclosure purposes the actual and potential material impacts of environmental matters on their business."[108] As part of the SEC's new "enhance[d] focus" on climate-related disclosures, Lee has called for the 2010 guidance to be reviewed and updated "to take into account developments in the last decade."[109]

In addition, as previously mentioned, on March 15, 2021, the SEC called on the investment community to provide input regarding the adequacy and effectiveness of the SEC's disclosure rules as they apply to climate change disclosures, with "an eye toward facilitating the disclosure of consistent, comparable, and reliable information on climate change."[110] The SEC received more than 550 comments, largely favoring mandatory climate disclosure rules.

In a July 29, 2021 speech, SEC Chair Gensler reiterated the need for clearer guidance on disclosure obligations—"When it comes to climate risk disclosures, investors are raising their hands and asking regulators for more."[111] To that end, Gensler previewed that he has instructed the SEC staff to prepare a mandatory climate risk disclosure rule proposal by the end of the year, which would include qualitative (*e.g.*, how climate change risks impact company strategy) and quantitative (*e.g.*, greenhouse gas emission metrics) information about climate risks. Gensler further observed that "Labels like 'green' or 'sustainable' say a lot to investors. Which data and criteria are asset managers using to ensure they're meting investors' targets—the people to whom they've marketed as 'green' or 'sustainable'?" Gensler said that these are the types of questions that the SEC seeks to address.

SEC Makes ESG-Related Risks an Examination Priority

On March 23, 2021, the SEC announced that it is "enhancing its focus on climate and ESG-related risks by examining proxy voting policies and practices to ensure voting aligns with investors' best interests and expectations, as well as firms' business continuity plans in light of intensifying physical risks associated with climate change."[112] For registered investment advisors in particular, the SEC announced that it will focus on products and services publicized as "sustainable, socially responsible, impact, and ESG conscious" and will review the "consistency and adequacy" of those disclosures, "determine whether the firms' processes and practices match their disclosures," "review fund advertising for false or misleading statements," and "review proxy voting policies and procedures and votes to assess whether they align with strategies."[113]

SEC Risk Alert

In April, the SEC issued a Risk Alert highlighting concerns about the increased demand for "ESG investing" coupled with the lack of standardized ESG definitions.[114] In reviewing ESG-related investments, SEC staff observed that certain companies are greenwashing, *i.e.*, issuing potentially misleading statements regarding their ESG investments by claiming that they had certain formal processes in place for investing, but those processes were never implemented, not designed to prevent illegal activity, or not designed to prevent inaccurate or misleading ESG-related disclosures or marketing materials.[115]

The SEC also highlighted effective practices that it had observed, such as:

- issuing simple and clear disclosures regarding the firms' approaches to ESG investing, such as (i) prominently stating the firm's reliance on unaffiliated advisers to conduct its underlying ESG analysis and manage ESG-oriented funds; and (ii) including disclosures in client-facing materials and offering choices on ESG issues;

- issuing disclosures concerning how investments were evaluated using goals established under global ESG frameworks;

- preparing detailed investment policies and procedures concerning ESG investments, including the research, due diligence, selection and monitoring associated with those investments; and

- integrating compliance personnel that are knowledgeable about the firms' specific ESG-related practices to avoid materially misleading claims in their ESG-related marketing materials and other client/investor-facing documents.[116]

Office of Information and Regulatory Affairs Lists ESG Disclosures as SEC Rulemaking Area

On June 11, 2021, the Biden Administration announced its Unified Agency of Regulatory and

Deregulatory Actions, which reports on the short-term and long-term actions that administrative agencies plan to take, which included the SEC's recommendation for enhanced disclosures "relating to climate risk, human capital, including workforce diversity and corporate board diversity, and cybersecurity risk[.]"[117]

Asset Management Advisory Committee Recommendation

On July 7, 2021, the SEC's Asset Management Advisory Committee's ESG subcommittee recommended that the SEC "encourage securities issuers to adopt a 'commonly accepted disclosure framework' from third-party standard-setting organizations [such as the SASB] or other industry groups" and "fully disclose all material information in accordance with such framework."[118] It further recommended that the SEC "enhance" the quality, consistency and comparability of ESG disclosures.[119] The subcommittee also recommended that the SEC improve its investment product and gender and racial diversity disclosure requirements.

3. Other Financial Regulators' Responses

The Federal Reserve

As mentioned, on March 19, 2021, the Federal Reserve addressed its approach to managing the impact of climate change on the stability of the US financial system.[120] The Federal Reserve offered three conclusions, highlighting the need for flexibility, additional research and analysis, and transparency. The Federal Reserve stated:

First, the Federal Reserve's financial stability monitoring framework is flexible enough to broadly incorporate many key elements of climate-related risks. Second, although we believe that climate change increases financial stability risks, more research and analysis is needed to incorporate these risks fully into financial stability monitoring, including substantial improvements in data and models. Third, domestic and international transparency efforts around climate-related financial exposures may help clarify the nature and scope of financial stability risks related to climate change."[121]

The Federal Reserve has formed two committees to examine the climate change-related risks faced by the US financial system.[122] The Supervision Climate Committee ("SCC") will identify climate-related risks and design a program "to ensure the resilience" of the firms that the Federal Reserve oversees.[123] The Financial Stability Climate Committee ("FSCC") will "identify, assess, and address climate-related risks to financial stability" and, in so doing, consider the "potential for complex interactions across the financial system."[124] In carrying out its duties, the FSCC will coordinate with the SCC and the FSOC and its member agencies to ensure a coordinated approach to integrating climate-related risks. The FSCC is also charged with increasing the Federal Reserve's international engagement and influence on this issue.[125]

Federal Trade Commission

Though not directly tied to financial disclosures, the FTC plans to issue new guidance next year concerning marketing sustainability or climate-positive efforts. In 1992, the FTC published the "Green Guides," which set forth the FTC's views about environmental marketing claims.[126] The FTC recently announced that it would be revising the Green Guides next year.[127] Though not independently enforceable, practices that are inconsistent with the Green Guides could give rise to a violation of Section 5 of the FTC Act or state consumer protection laws. The Green Guides were last updated in 2012.[128] It is expected that the revisions will consider investor preferences as well as regulatory guidance from the EU and other jurisdictions, and will likely address the use of terms such as "sustainable," "organic" or "natural."

The FTC also recently confirmed its commitment to reducing carbon emissions and promoting environmentally-friendly innovation. In a December 22, 2020 statement, FTC Commissioner Rohit Chopra stated that "in addition to working with the Department of Energy on promoting energy efficiency through higher standards and labeling, the FTC can take a number of steps to protect consumers," including protecting energy consumers from "unscrupulous energy suppliers that employ deceptive marketing practices to entice consumers to switch from their local distribution company's services[,]" deter greenwashing and deceptive environmental claims, and condemn anticompetitive mergers and conduct in the energy sector. Indeed, the FTC cited studies showing that consumers are willing to pay a premium for environmentally friendly options, making how such options are marketed all the more important.[129]

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Although no definitive guidance has been issued in the US, all signs point towards a new framework for climate-related disclosure. In Commissioner Allison Herren Lee's dissent to the SEC final rule on the Modernization of Regulation S-K in 2020, she called for the SEC to lead a discussion as to which ESG risks and impact should be disclosed. She noted that the US is falling behind its international counterparts and encouraged the SEC to partner with private standard setters "to work through how to get investors the standardized, consistent, reliable, and comparable ESG disclosures they need to protect their investments and allocate capital toward a sustainable economy."[130] Given the wide support for the TCFD recommendations, and the UK and EU's recent adoptions of that framework, companies should monitor developments here and abroad as the disclosure landscape continues to evolve. In the meantime, companies can brace for change by auditing current disclosure policies and considering the adoption of TCFD recommendations.

FOOTNOTES

[1] Thomas Ball, *et al.*, "Was the Exxon Fight a Bellwether?" Harvard Law School Forum on Corporate Governance (July 24, 2021).

[2] CalSTRS, Green Initiative Task Force Annual Report Ending June 30, 2019 (Dec. 15, 2019) CalSTRS, Green Initiative Task Force (last visited Sept. 12, 2021).

[3] BlackRock, Our 2021 Stewardship Expectations 14 (Jan. 2021)

[4] Dawn Lim and Geoffrey Rogow, *BlackRock at Odds With Warren Buffett's Berkshire Hathaway Over Disclosures*, WSJ, May 6, 2021

[5] SASB, *Supporting the Work of the TCFD*, June 29, 2017

[6] Press Release, UN, *Secretary-General Calls Latest IPCC Climate Report 'Code Red for Humanity', Stressing 'Irrefutable' Evidence of Human Influence* (Aug. 9, 2021) IPCC, 2021: Summary for Policymakers. In: Climate Change 2021: The Physical Science Basis. Contribution of Working Group I to the Sixth Assessment Report of the Intergovernmental Panel on Climate Change [Masson-Delmotte, V., P. Zhai, A. Pirani, S. L. Connors, C. Péan, S. Berger, N. Caud, Y. Chen, L. Goldfarb, M. I. Gomis, M. Huang, K. Leitzell, E. Lonnoy, J.B.R. Matthews, T. K. Maycock, T.

Waterfield, O. Yelekçi, R. Yu and B. Zhou (eds.)]. Cambridge University Press. In Press., (Aug. 7, 2021)

[7] Al Barbarino, *Top SEC Official Suggests More ESG Enforcement is Coming*, Law360, July 13, 2021,

[8] Since this article focuses on disclosures related to the impact on companies and their businesses of rising temperatures and other climate changes caused by greenhouse gas emissions, for purposes of this article, references to terms such as "environmental disclosures" or "sustainability disclosures" should be understood as meaning disclosures associated with material issues related to human-caused climate change.

[9] Securities and Exchange Commission, Commission Guidance Regarding Disclosure Related to Climate Change (17 CFR PARTS 211, 231 and 241; Release Nos. 33-9106; 34-61469; FR-82)

[10] *TSC Indus. Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976); *see also Basic, Inc. v. Levinson*, 485 U.S. 224 (1988) (applying the *TSC Industries* Court's definition of materiality to a Rule 10b-5 securities fraud case); SEC Staff Accounting Bulletin No. 99, 64 Fed. Reg. 45,150, 45,151 (Aug. 19, 1999) (observing that the Supreme Court's definition is substantially identical to the FASB's definition: "The omission or misstatement of an item in a financial report is material if, in the light of surrounding circumstances, the magnitude of the item is such that it is probable that the judgment of a reasonable person relying upon the report would have been changed or influenced by the inclusion or correction of the item.").

[11] Public Statement, SEC Commissioner Hester M. Peirce, *Rethinking Global ESG Metrics* (Apr. 14, 2021) Public Statement, SEC Commissioner Hester M. Peirce, *Statement on Proposed Amendments to Modernize and Enhance Financial Disclosures* (Jan. 30, 2021)

[12] Speech, SEC Commissioner Hester M. Peirce, *Chocolate-Covered Cicadas* (July 20, 2021) ("If ESG opportunities are driving management decision-making, our existing disclosure rules also pull those in").

[13] Speech, SEC Commissioner Allison Herren Lee, Living in a Material World: Myths and Misconceptions about "Materiality" (May 24, 2021). The Sustainability Accounting Standards Board ("SASB"), which operates under the Value Reporting Foundation, is a nonprofit "that offers a comprehensive suite of resources designed to help businesses and investors develop a shared understanding of enterprise value[.]" In 2017, the SASB held a legal roundtable to consider and debate key questions concerning corporate sustainability disclosures. Among other topics, the roundtable participants discussed materiality, applying the "reasonable investor" standard articulated in *TSC Industries, Inc. v. Northway, Inc.* One key takeaway from the session was that there "is considerable evidence that investors are interested in certain sustainability information and that such information is 'material' under the federal securities laws." Legal Roundtable On Emerging Issues Related to Sustainability Disclosure (Nov. 2017) In addition, a number of existing SEC disclosure requirements—such as Items 101(c), 103, and 303 of Regulation S-K—may require meaningful ESG disclosures in some contexts, but none expressly addresses climate change disclosure. *Id.*; Final Rule, 17 CFR 229, 239, and 240, Modernization of Reg. S-K Items 101, 103, and 105

[14] Gabriel Rosenberg, Margaret Tahyar, and Betty Huber, *Commenters Weigh in on SEC Climate Disclosures Request for Public Input*, Harv. L. Sch. F. on Cor. Governance (July 24, 2021). The SEC requested input on 15 questions, including the costs and benefits associated with different

regulatory approaches. *Public Statement, Acting Chair Allison Herren Lee, Public Input Welcomed on Climate Change Disclosures* (Mar. 15, 2021)

[15] Gabriel Rosenberg, Margaret Tahyar, and Betty Huber, *Commenters Weigh in on SEC Climate Disclosures Request for Public Input*, Harv. L. Sch. F. on Cor. Governance (July 24, 2021)

[16] Letter, U.S Senate Committee on Banking, Housing, and Urban Affairs to SEC, *Re:* Public Input on Climate Change Disclosures (June 13, 2021)

[17] Letter, U.S Senators Elizabeth Warren and Sean Casten to SEC, *Re:* Public Input on Climate Change Disclosures (June 11, 2021)

[18] Speech, SEC Chair Gary Gensler, SEC, Prepared Remarks Before the Principles for Responsible Investment "Climate and Global Financial Markets" Webinar (July 28, 2021). In the same remarks, Gensler cited a 2020 report stating that 90% of the 500 largest companies in the Russell 1000 Index published sustainability reports in 2019 using third-party standards. *See* Governance & Accountability Institute, Inc., "2020 Russell 1000 Flash Report,"

[19] *But see* Sarah Solum, *et al.*, *The SEC's Upcoming Climate Disclosure Rules, Harv. L. Sch. F. on Cor. Governance* (Sept. 1, 2021).

[20] Jean Eaglesham and Anna Hirtenstein, *ESG Disclosure Rules From Europe Challenge U.S. Fund Managers*, WSJ (Mar. 22, 2021)(quoting BlackRock spokesman).

[21] The COP is the decision-making body responsible for reviewing the implementation of the United Nations Framework Convention on Climate Change ("UNFCCC"), which consists of 197 countries. *Conference of the Parties (COP)*, United Nations Climate Change (last visited Sept. 12, 2021). This year, the United Kingdom, in partnership with Italy, is hosting COP26 with four primary goals: (1) secure global net zero by mid-century and keep 1.5 degrees within reach; (2) adapt to protect communities and natural habitats; (3) mobilize finance; and (4) work together to deliver on these goals. *COP26 Goals*, UN Climate Change Conference UK 2021

[22] Communication from the Commission to the European Parliament, the European Council, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions Action Plan: Financing Sustainable Growth, Com/2018/097 final (Mar. 8, 2018)

[23] Directives, which set forth rules, norms, activities, or standards, are binding as to the result to be achieved upon each member state to which they are addressed. However, it is for the member states' national authorities to determine the form and methods by which directives are to be implemented (TFEU art 288). As such, in contrast to EU regulations, directives are not directly applicable law.

[24] Directive 2014/95/EU of the European Parliament and of the Council of Oct. 22, 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups

[25] Public-interest entities are defined in the Accounting Directive (2013/34/EU) as companies with securities listed in EU regulated markets, banks (whether listed or not), insurance companies (whether listed or not) and any other companies designated by Member States. Article 3 of the

Accounting Directive (2013/34/EU) defines categories of undertakings according to their size.

[26] Commission Communication, Communication from the Commission — Guidelines on non-financial reporting (methodology for reporting non-financial information) C/2017/4234

[27] Commission Communication, Guidelines on non-financial reporting: Supplement on reporting climate-related information C/2019/4490

[28] *Id.*

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[80] Press Release, White House, Executive Order on Tackling the Climate Crisis at Home and Abroad (Jan. 27, 2021)

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financial system. It is comprised of 10 voting members and 5 nonvoting members, who have financial regulatory experience, plus an independent insurance expert appointed by the President. US Dept. of the Treasury, *Financial Stability Oversight Council* (last visited Sept. 12, 2021).

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[86] FTC, *Managing Climate Risk in the U.S. Financial System* (Sept. 9, 2020)

[87] Press Release, SEC, *SEC Announces Enforcement Task Force Focused on Climate and ESG Issues* (Mar. 4, 2021)

[88] Celso Brunetti, *et al.*, Board of Governors of the Federal Reserve System, Climate Change and Financial Stability (March 19, 2021)

[89] Jeff Cox, *Fed Sets Up Panels to Examine Risks That Climate Change Poses to the Financial System*, CNBC, Mar. 23, 2021

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[91] Press Release, *Rep. Vargas' Corporate Governance Improvement and Investor Protection* (Jun. 17, 2021)

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[95] Press Release, Executive Order on Climate-Related Financial Risk (May 20, 2021); Exec. Order No. 14030, 86 FR 27,967 (May 20, 2021)

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[97] States have also called for a more comprehensive, consistent federal response. For example, on June 10, 2021, the New York State Comptroller and California Controller urged the SEC to "follow [President] Biden's lead" and mandate climate change disclosures. In a joint op-ed on Politico.com, the controllers said that it is "undeniable that climate change is an emergency that endangers" the

US financial system, pointing to the $95 billion in damages resulting from extreme weather in 2021, nearly double the amount in 2019. The controllers, therefore, recommended that the SEC adopt the TCFD's recommendations and mandate annual, industry-specific disclosures that include companies' climate risk exposure, strategies, and scenario planning. Press Release, New York State Comptroller, *New York State Comptroller DiNapoli and California Controller Yee Urge S.E.C. to Mandate Climate Change Disclosures* (June 10, 2021)

[98] FTC, *Managing Climate Risk in the U.S. Financial System* (Sept. 9, 2020)

[99] *Id.*

[100] The 2021 Global Investor Statement to Governments on Climate Crisis, signed by 457 investors representing over $41 trillion in assets, calls upon "all world governments" for a "global race-to-the-top on climate policy and warns that laggards will miss out on trillions of dollars in investment if they aim too low and move too slow." The statement identifies five actions governments should take:

Strengthen Nationally Determined Contributions for 2030 in line with limiting warming to 1.5°C.

Commit to a mid-century net zero emissions target with clear sectoral decarbonisation roadmaps.

Ensure ambitious pre-2030 policy action including strengthened carbon pricing, phasing out fossil fuel subsidies and thermal coal-based power, avoiding new carbon-intensive infrastructure (no new coal power plants) and developing just transition plans.

Ensure COVID-19 economic recovery plans support the transition to net zero emissions.

Commit to implementing mandatory climate risk disclosure requirement.

The Investor Agenda, *2021 Global Investor Statement to Governments on the Climate Crisis* (June 10, 2021)

[101] FTC, *Managing Climate Risk in the U.S. Financial System* ii–vi (Sept. 9, 2020)

[102] *Id.* at vi.

[103] The NGFS was established in December 2017 by eight central banks and supervisors (the Banco de Mexico, the Bank of England, the Banque de France and Autorité de Contrôle Prudentiel et de Résolution ("ACPR"), De Nederlandsche Bank, the Deutsche Bundesbank, Finansinspektionen (the Swedish FSA), the Monetary Authority of Singapore, and the People's Bank of China) to "help strengthen[] the global response required to meet the goals of the Paris agreement and to enhance the role of the financial system to manage risks and to mobilize capital for green and low-carbon investments in the broader context of environmentally sustainable development." In furtherance of that goal, the NGFS develops and publishes definitions and "best practices" to analyze and manage long-term climate-related risk, and analyzes and promotes the development of "green finance." The NGFS currently has 95 members, and 15 observers. See Press Release, Banque De France, Joint statement by the Founding Members of the Central Banks and Supervisors Network for Greening the Financial System – One Planet Summit (Dec. 12, 2017); NGFS, *Membership* (last visited Sept. 12, 2021); NGFS, *Origin and Purpose*

[104] Press Release, *SEC Announces Enforcement Task Force Focused on Climate and ESG Issues*

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[105] *Id.*

[106] Kevin Edgar, *et al.*, *ESG Disclosures, Congress, and the SEC*, JDSupra, July 20, 2021

[107] Acting Chair Allison Herren Lee, *SEC,* Statement on the Review of Climate-Related Disclosure (Feb. 24, 2021); Securities and Exchange Commission, Commission Guidance Regarding Disclosure Related to Climate Change (17 CFR PARTS 211, 231 and 241; Release Nos. 33-9106; 34-61469; FR-82)

[108] Press Release, SEC, *SEC Issues Interpretive Guidance on Disclosure Related to Business or Legal Developments Regarding Climate Change* (Jan. 27, 2010)

[109] Acting Chair Allison Herren Lee, SEC, *Statement on the Review of Climate-Related Disclosure* (Feb. 24, 2021)

[110] Acting Chair Allison Herren Lee, SEC, Public Input Welcomed on Climate Change Disclosures (Mar. 15, 2021)

[111] Chair Gary Gensler, SEC, *Prepared Remarks Before the Principles for Responsible Investment "Climate and Global Financial Markets" Webinar*

[112] Press Release, SEC, SEC Division of Examinations Announces 2021 Examination Priorities (Mar. 3, 2021)

[113] SEC Division of Examinations, 2021 Examination Priorities (Mar. 3, 2021)

[114] SEC Division of Examinations, The Division of Examinations' Review of ESG Investing (Apr. 9, 2021)

[115] *Id.*

[116] *Id.*

[117] Press Release, SEC, SEC Announces Annual Regulatory Agenda (June 11, 2021). The United Agency of Regulatory and Deregulatory Actions issues two reports a year providing information concerning the regulations under development at federal agencies.

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[121] Celso Brunetti, *et al.*, Board of Governors of the Federal Reserve System, Climate Change and

Financial Stability (Mar. 19, 2021)

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[124] *Id.*

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[126] Brook Detterman, *et al.*, *Environmental Marketing Claims: Regulatory and Litigation Outlook*, The Nat. L. Rev., Aug. 12, 2021

[127] FTC Regulatory Review Schedule, 86 Fed. Reg. 35239 (July 2, 2021), The FTC reviews its Green Guides every ten years.

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[129] Kevin Crowley, *Chevron 'Greenwashing' Targeted in Complaint Filed With FTC*, Investment News (originally published by Bloomberg), Mar. 17, 2021

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