SEC Establishes Enforcement Division Climate and ESG Task Force

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Yesterday, the Securities and Exchange Commission announced a newly created **Climate and ESG Task Force** in the Division of Enforcement. The Climate and ESG Task Force will work closely with other areas of the SEC as part of the agency's recently enhanced efforts to address climate and environmental, social and governance, or ESG, matters.

Materiality

The 22-member task force will develop initiatives to identify ESG-related misconduct. Its initial focus will be to review public company disclosures to identify "material" gaps or misstatements regarding climate risks. The Climate and ESG Task Force will also review investment adviser and fund disclosures and compliance systems relating to their ESG strategies. Use of the term "material" is significant because of the current debate about whether climate change poses a material risk to all public companies. The question of materiality is likely to be a key issue in any novel enforcement investigations regarding climate change disclosures.

Use of Data Analytics

The Climate and ESG Task Force will leverage sophisticated data analytics to identify potential investigation targets. This practice is consistent with the Division of Enforcement's current use of internal, risk-based data analytics to identify potential case leads, such as in the recent earnings per share (EPS) initiative that led to several case filings. We expect that, as with prior data analysis initiatives, Enforcement will use automated searches of SEC filings to identify potential outliers in disclosures or other practices.

Coordination with Other SEC Initiatives

The Climate and ESG Task Force is the SEC's latest initiative concerning climate change and ESG. Last week, SEC Acting Chair Allison Lee directed the Division of Corporation Finance to **review** company disclosures, including an assessment of compliance with federal securities laws and the SEC's **2010 climate change disclosure guidance**. In addition, the Division of Examinations announced this week an increased focus on climate-related risks and investment adviser disclosures and practices relating to their ESG products and services as part of its **2021 examination priorities**. Last month, the SEC **created a new position**, Senior Policy Advisor for Climate and ESG in the office of the Acting Chair, to advise the agency on ESG matters and push forward initiatives across the agency. Finally, on the same day, the SEC named John Coates Acting Director of the Division of Corporation Finance. Acting Director Coates **stated last month** at an Institute of Internal Finance meeting that the SEC "should help lead" the creation of an ESG disclosure system. On the topic of materiality, he noted that public companies are increasingly issuing sustainability reports and suggested that investor demand for these disclosures is transforming what was once voluntary, into something "less voluntary."

Skepticism from Republican Commissioners

Commissioners Hester Pierce and Elad Roisman expressed skepticism of the Climate and ESG Task Force in a **public statement**. They asked: "[S]houldn't we wait for our Corporation Finance staff to complete its assessment of our existing rules relating to ESG disclosures to find out if they are unclear or in need of updating before we announce an initiative aimed at bringing enforcement actions in this area?"

Different From Prior Task Forces

The Climate and ESG Task Force is different from prior task forces that focused on traditional enforcement issues. Examples include the **Financial Reporting and Audit Task Force,** the **Microcap Fraud Task Force, and** the **Retail Strategy Task Force**. The new task force is unique in focusing on a single disclosure issue that has not been the subject of significant prior enforcement actions.

Takeaways

If the Climate and ESG Task Force results in enforcement actions, ESG funds might be the first targets because SEC examiners have been reviewing them for several years and because of significant investor demand for the funds. Funds should avoid ESG puffery, self-audit to ensure practices and policies conform to what they are advertising, and provide appropriate disclosures about the evolving nature of ESG products. Public companies should prepare for enforcement scrutiny by confirming the accuracy of statements in public filings about ESG programs, initiatives, and plans, and by maintaining internal documentation supporting the basis for ESG statements. Companies also should include their sustainability reports in these reviews, even if they are not incorporated into SEC filings.

Overall, the SEC has taken several steps to signal change in the enforcement program in the short time since the change in administration. We previously discussed the greater delegation of authority to issue **formal orders of investigation** (which grant subpoena power to SEC staff) and a change in policy regarding **applications for waivers** from disqualifications that result from some types of enforcement actions. Combined with these prior changes, the new task force signals an effort to portray an enforcement program that is both more aggressive and increasingly focused on specific policy objectives.

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