



Regulatory Alert

Regulatory Insights



July 2020

Evolving focus on ESG post-COVID-19

Key points

- COVID-19 has amplified ESG awareness and expectations among investors, public policy makers, and consumers.
- ESG investment is accelerating, pushing investor demand for enhanced ESG-related disclosure and data; companies currently provide information voluntarily and the usefulness to investors is further limited by a lack of common definitions, measures, and standards as well as models and data.
- Social factors, including workplace safety and customer engagement, are rising in importance alongside better known “E” factors such as climate change.
- U.S. regulators are considering ways to address ESG issues but have not imposed ESG-specific regulatory requirements.

This Regulatory Alert is intended to supplement our January 2020 [Regulatory Alert | Focus on ESG](#).

Since 2015, the total number of U.S. open-ended and exchange-traded ESG funds has nearly tripled. In the first four months of 2020, investments in ESG funds more than doubled compared to the same period last year. And, during that same period, more than 70 percent of the ESG funds self-identified as “sustainable equity funds” performed better than their counterparts, across all asset classes. (WSJ May 12, 2020) Further, this level of performance held firm through the end of the second quarter. (Morningstar July 8, 2020)

Pressure from investors, employees, customers, and the general public has driven companies to commit to and act upon an ESG strategy, focusing primarily on environmental factors such as fossil fuels and climate change. With the advent of COVID-19, stakeholders are turning attention to “S” factors - including workplace safety; employee health and well-being; job security;

data privacy; customer engagement; supply chain management; community investment; and corporate leadership and innovation. The broad scale of COVID-19-related health and economic impacts has expanded ESG into a “Main Street” issue with significant reputation risk for companies, including financial services.

U.S. financial services regulators and public policy makers have taken a variety of actions and positions that touch on ESG-related concerns. Highlights follow.

Investments and disclosure

Asset managers suggest in the post-COVID-19 environment they and investors will be looking for indicators of firms’ corporate leadership and decision-making during periods of disruption; board leadership and accountability; realignment of mission/messaging regarding ESG initiatives; and preparedness planning for



significant unknown events. U.S. financial services regulators are responding cautiously, suggesting that climate change, and ESG concerns generally, are issues to be addressed by public policy makers.

The SEC:

- Publicly stated:
 - Combining an analysis of “E,” “S,” and “G” issues with a single “rating” or “score” would be “over-inclusive and imprecise,” would not facilitate meaningful investment analysis, and would diminish the usefulness of such disclosures, including investor understanding (see Clayton remarks [here](#) and [here](#))
 - Its principles-based framework *requires* disclosure of all material information (including with respect to ESG factors), but also *allows* each individual company to tailor that information so that it is useful to their investors (see Roisman remarks [here](#); Peirce remarks [here](#))
 - There is room to elicit more ESG disclosure in regulations for assets managers, including disclosure of how the term “ESG,” “green,” and “sustainable” relate to a fund’s objectives, constraints, strategies, and holdings; the relative weighting of “E,” “S,” and “G” factors when selecting a portfolio company; and whether ESG goals are prioritized over economic returns; these are deemed “material” to the investor. (see Roisman remarks [here](#)).
- Formally [requested comment](#) on its Names Rule, which generally requires that if a fund’s name suggests a particular type of investment, industry, or geographic focus at least 80 percent of the fund’s assets must be invested in that type of investment, industry, or geographic region. With respect to “ESG,” SEC sought input on whether:
 - The Names Rule should apply to terms such as “ESG” and “sustainable” that reflect qualitative characteristics of an investment
 - The term “ESG” implies a strategy or a type of investment
 - SEC should impose specific requirements on when an investment may be characterized as ESG or sustainable
 - ESG funds must be required to select investments that satisfy all three factors.
- Published [guidance](#) on key performance indicators and other metrics. To the extent companies choose to disclose ESG metrics, the SEC cautions them to

include any material information necessary to provide adequate context so that the metric is not misleading, including:

- A clear definition of the metric and how it is calculated
 - A statement indicating why the metric provides useful information to investors
 - A statement indicating how management uses the metric in managing or monitoring business performance
 - Underlying estimates or assumptions, as appropriate.
- Received [recommendations](#) from its Investor Advisory Committee to develop a principles-based framework for Issuers to provide “material, decision-useful, comparable and consistent information” about ESG factors to aid investors’ investment and voting decisions. The Investor Advisory Committee adds that the SEC should “take control of ESG disclosure for the U.S. capital markets before other jurisdictions impose disclosure regimes on U.S. Issuers and investors alike.”
 - Provided comment on a General Accountability Office (GAO) [report](#) on ESG disclosures and options to enhance them. The report looks at 32 public companies in eight industries, and considers a number of policy options, including specific regulations, endorsement of an ESG framework in regulation, interpretive rulings, industry-developed frameworks, and stock exchange listing requirements.

The Department of Labor:

- [Proposed](#) amendments to its [Investment Duties Rule](#) that would clarify ERISA (Employee Retirement Income Security Act) plan fiduciaries may not sacrifice financial results/investment returns to promote collateral or social goals, and impose increased fiduciary obligations and documentation requirements on ESG investments.

Other concerns

Additional actions taken by federal financial services agencies to address ESG issues include:

- Reviewing financial services entities’ pandemic preparedness plans, including provisions for employee health and safety, customer support, and continuity of critical operations. (See KPMG Regulatory Alert [here](#), and KPMG’s Mid-year Update on Key Ten Regulatory Challenges [here](#).)

- Implementing forbearance programs and selected regulatory relief, in some cases reinforced by the CARES Act, to assist consumers and investors and support communities.
- Adding [sensitivity analyses](#), using alternative scenarios and adjustments that “credibly reflect” the COVID-19 crisis, to bolster the FRB’s 2020 stress tests for large banking organizations. However, the FRB has stated that climate-related stress tests or ESG-related risk weights are not on its “near-term” agenda.
- [Outlining](#) how new risks associated with climate change are beginning to change the practice of risk management at financial institutions in terms of governance, risk identification and management, scenario analysis and transparency. Supervisors “can and should” use oversight tools to ensure financial institutions are prepared for and resilient to all types of relevant risks, including climate-related events, but are not in the position to advocate for, or provide incentives for, a particular policy outcome.

Industry Actions

Momentum in all things ESG is building. Although few specific regulatory requirements are in place, individual U.S. financial services companies have recently, independently, and publicly:

- Joined the FSB’s Task-Force for Climate-Related Financial Disclosure (TCFD) and begun to disclose under this framework
- Committed to measure and disclose greenhouse gas emissions financed through their lending portfolio

- Pledged to finance sustainable energy production and not to finance projects with a high carbon impact

Participated in the development of social bonds to promote health and economic systems, including COVID-19-specific medicines and vaccines.

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