FROM LAGGARD TO LEADER

Updating the Securities Regulatory Framework to Better Meet the Needs of Investors and Society

A REPORT FROM THE GLOBAL FINANCIAL MARKETS CENTER AT DUKE LAW

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Executive Summary

Climate change, systemic racism, and unprecedented income and wealth inequality pose direct and immediate threats to our capital markets. This report outlines the steps that the Securities and Exchange Commission (SEC) should consider taking to ensure that companies operating in the United States identify, assess, and disclose the risks and opportunities these challenges present.

Any of these crises alone threaten to cause sudden and widespread asset deflations, disrupt supply chains, strain work forces, and render entire business models and industries obsolete. Now more than ever, it is crucial that investors, stakeholders, and the public have the power to hold corporations accountable and the ability to efficiently allocate capital towards a sustainable future. But this will not be possible without bold action from the SEC.

The SEC needs to ensure that all companies, both private and public, are held accountable for how they address environmental, social, and governance (ESG) factors. To this end, the SEC should:

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1. Restore Public Accountability to the Unregulated Private Markets

There exists a stark contrast between the disclosure requirements for public and private companies. The extensive disclosure requirements for public companies ensures the widespread dissemination of consistent and decision-useful information about a firm's operations and finances. But private companies are generally not required to provide any substantive disclosures, and investors often receive inconsistent and limited information. As a result, investors and stakeholders are unable to hold private companies accountable.

Notably, the size of the private market is expanding, and the SEC has failed to address the growing number of "unicorn" private corporations with valuations greater than $1 billion. Predicating disclosure on the public / private divide no longer reflects the realities of the market, and private markets need to be better regulated in order to facilitate proper disclosure. The SEC should consider amending its definition of "shareholder of record," which currently permits private issuers to easily avoid the Section 12(g) trigger by obfuscating the actual owners of their securities. Further, the SEC should consider revising the application of exemptions to offering rules for private funds to capture funds with more than $1 billion in assets or more than 100 beneficial owners to require them to register as investment companies.

The SEC should consider revising Rule 144A, Rule 506, and Regulation AB to mandate disclosures for large "private" offerings to better align with the requirements for registered offerings. Additionally, the SEC should consider limiting exemptions from the federal securities law information and rights requirements.

Finally, the SEC should consider amending Rules 504, 505, and 506 of Regulation D. In general, Regulation D allows for the sale of an unlimited number of securities to an unlimited number of investors, provided that those investors are "accredited." Problematically, the definition of "accredited investor" is far too broad, and the SEC can no longer assume that these high-net-worth individuals (requiring an annual income exceeding $200,000 as an individual investor, or a net worth exceeding $1,000,000) are better suited to evaluate risk absent disclosure requirements. The SEC should consider revising the "accredited investor" definition to be based on a combination of sophistication, income, wealth, and access to "the kind of information which registration would disclose."[1]

2. Require Enhanced Public ESG-Related Disclosures

Investors are dissatisfied with the quality, consistency, and comparability of ESG disclosures. Though the proliferation of ESG-disclosure regimes by non-governmental organizations has helped fill the gap left by the SEC's failure to act in this critical area, the wide range of voluntary disclosure templates has led to inconsistent, incomplete, and inadequate disclosure practices. Absent a government-mandated disclosure regime for ESG factors, investors and stakeholders remain unable to compare firms, assess ESG-related risks, and instill corporate accountability. Ultimately, the SEC's failure to mandate consistent and decision-useful disclosure of relevant ESG-related information has made it impossible to efficiently allocate capital towards a sustainable future.

The SEC should therefore consider requiring financial and non-financial firms to enhance disclosure relating to, at a minimum, the following ESG factors:

- climate change;
- political spending;
- human capital;
- tax practices;
- stock buybacks; and
- any other issues that may arise.

Moreover, the SEC should address the unique climate risks faced by financial companies. First, the SEC should consider requiring banks and bank holding companies to disclose climate-related risks that may impact:

- their holdings directly; and
- the banking industry generally.

Second, to ensure that financial companies are adequately disclosing the transition risks associate with climate change, the SEC should consider requiring the inclusion of a new category of assets in "Distribution of Assets" disclosure to identify assets within "high impact sectors." Finally, the SEC should consider requiring banks and BHCs to disclose "climate impact" analyses based on financed emissions.

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[1] *SEC v. Ralston Purina Co.*, 346 U.S. 119, 127 (1953).

The SEC should also consider mandatory disclosures for all sales of unregistered securities that may be impacted by climate risks. These reforms are particularly relevant given the recent surge in debt issuances by U.S. oil and gas companies.

3. Enhance Stakeholder Rights and Engagement

Beyond disclosure, investors and stakeholders must be able to make efficient use of information in their decisions. They must also be empowered to effectively engage with companies, make informed and impactful votes, and have sufficient access to courts and class actions. Despite the overwhelming investor demand for greater access to information and the growing need for enhanced corporate accountability, the SEC has instead taken action to significantly limit shareholder rights. Notably, in 2020, the agency limited investment advisers' use of proxy advisors and curtailed the ability to offer shareholder proposals through Rule 14a-8. The current ubiquity of tiered share structures and the outdated director election process further restricts investor ability to exercise key rights.

Accordingly, the SEC should consider:

- increasing shareholder proxy access;
- creating a new process for investors to more easily compel corporate disclosures;
- increasing investor access and ability to rely upon expert advice from proxy advisors;
- ending dual class share structures;
- adopting universal proxy ballots to permit replacing management supported directors; and
- prohibiting unreasonable restrictions on private rights of action.

4. Modernize Expectations for Investment Fiduciaries

Investment fiduciaries are responsible for advising and directing the deployment of trillions of dollars in investor assets. Importantly, millions of American businesses, organizations, families, and retirees depend on investment fiduciaries for responsibly managing their assets.

Though the SEC has generally imposed no substantive or process requirements on investment fiduciaries related to consideration of ESG-related factors, thousands of these asset managers are incorporating ESG information into their decisions voluntarily. Importantly, they are doing so not only in response to an increase in investor appetite for "sustainable" investments, but because they understand that the consideration of ESG factors is crucial for long-term investment success and a critical component of their responsibilities to their customers and beneficiaries.

But investment fiduciaries are not required to report on how they have implemented these commitments, and the ESG information being made available voluntarily is often neither complete, specific, comparable, widely available, or well-verified. As such, stakeholders have struggled to match investment advisers' ESG-related claims to their investment-related decisions, and there is a growing concern than many advisers are engaging in "greenwashing."

To address these concerns, the SEC should consider:

- requiring sustainable investment policies (and related disclosures);
- adopting guidance to consider relevant ESG factors; and

- requiring investment advisers and brokers to identify and address customer preferences.

5. Promote Integrity of ESG-Related Labeling of Investment Funds and Products

Investor demand for ESG-related funds and financial products has grown drastically in recent years, and the market for funds and instruments labeled and marketed as "ESG," "green," or "sustainable," has expanded accordingly. Notably, during the COVID-19 pandemic, while stock markets registered an unprecedented increase in intra-day trading and volatility, ESG funds proved to be more resilient and greatly outperformed non-ESG funds.[2]

Despite the explosive growth, and success, of funds and products marketed as "sustainable," the SEC has failed to establish uniform standards or criteria for determining whether such funds or products are accurately labeled. Moreover, there is no government-sanctioned process for verification of "sustainable" status. Importantly, companies receive greater premiums and charge higher fees for products marketed as "sustainable" when compared to similar products without "ESG" or "sustainability" labeling.

This lack of standardization and transparency, coupled with the potential to garner higher fees and decrease borrowing costs, creates significant risk that firms are engaging in "greenwashing" by falsely labeling their products and practices as "sustainable."

Accordingly, the SEC should consider adopting clear, uniform taxonomies for securities and investment vehicles labeled or marketed as "sustainable." To this end, the SEC should consider requiring all ESG-labeled securities and funds to meet an independent, objective, and verifiable standard for such designation.

6. Enhance Oversight Over Gatekeepers: Credit Rating Agencies and Index Providers

Credit rating agencies and index providers allow companies, investors, and the public to identify, assess, and address key issues. Because of their essential role in the proper functioning of capital markets and their significant influence over trillions of dollars of investment capital, the SEC should enhance oversight over these key gatekeepers.

In the credit markets, credit rating agencies are in place to enable investors to evaluate the risks associated with particular securities and their issuers. Because of their expertise, resources, and unique access to information, credit rating agencies provide transparency and external oversight, allowing investors to allocate capital confidently and efficiently. But accurate credit ratings depend on complete, thorough, and transparent assessments.

As made clear by the surge in extreme weather events and the coronavirus fallout, climate- and worker-related risks are not only significant and growing concerns for companies and investors, but they are also insufficiently incorporated into the capital markets. Credit rating methodologies for evaluating ESG-related risks remain vague and permit a wide range of outcomes stemming from identical information. The SEC should ensure that credit rating agencies have sufficient expertise and methodologies to properly identify ESG-related risks and are accurately and transparently incorporating those ESG-related risks into their ratings. The SEC should therefore consider requiring credit rating firms to adopt, integrate, and publish policies regarding their consideration of ESG factors to ensure that investors understand exactly what is being factored into credit ratings.

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[2] Stefano Spinaci, *Briefing*, *Green and Sustainable Finance*, PE 679.081, Eur. Parl. Research Serv. (Feb. 2021), *available at* **https://www.europarl.europa.eu/RegData/etudes/BRIE/2021/679081/EPRS_BRI(2021)679081_EN.pdf**

Further, index providers, which cover equity securities, debt securities, and other assets, similarly influence trillions of dollars of investment capital. Despite widespread findings of fraud and manipulation in indexes, the United States currently has no federal regulatory requirements for index providers. The SEC should thus consider developing a regulatory framework designed to address index governance, quality, methodology, and accountability.

7. Enhance Auditing and Accounting Rules and Enforcement

It is clear that the current U.S. accounting and auditing regime does not sufficiently incorporate ESG-related risks. Importantly, the SEC has failed to sufficiently scrutinize ESG-related accounting methods and disclosures, ensure compliance with existing accounting and auditing standards, and update auditing standards to adequately reflect ESG-related risks.

First, the SEC should consider taking more aggressive steps to ensure compliance with existing ESG-related rules and guidance.

Second, the SEC should consider pressing the PCAOB to revise auditing standards to reflect updates in ESG-related requirements. Importantly, as the SEC updates and enhances disclosure requirements to ensure the disclosure of essential ESG-related risks, there will be significant pressure from companies and carbon-focused industries to “massage” the disclosed information. New, robust audit standards will thus be essential to ensure that market participants provide reliable, accurate, consistent, and comparable information as they incorporate new disclosure requirements into their practices.

Third, the SEC should consider identifying and announcing specific ESG-related priorities for inspections of audit firms. In particular, these priorities could include:

- the role of risk assessment in designing the nature and extent of audit procedures; and
- the auditor's responsibility regarding other ESG-related information.

Finally, the SEC should consider establishing a “Sustainability Standards Board” within the FASB. The Sustainability Standards Board would engage with regulators and market participants to develop harmonized disclosure standards for ESG-related information. In doing so, the Sustainability Standards Board could leverage and build upon the large body of private ESG-related disclosure standards.

8. Revise the SECs Staffing and Structure to Prioritize ESG Integration

To ensure that the SEC is focused on enhancing corporate accountability and addressing ESG-related issues, the agency will need to expand staff expertise and shift the orientation of its Divisions. Moreover, to effectively develop, implement, and enforce ESG-related rules and guidance, the SEC will need to seek assistance from market participants and outside experts.

First, the SEC Chair should consider establishing an “ESG Office” committed to racial justice, worker rights, and climate science. The ESG Office should be led by an executive with significant expertise on ESG-related issues who will report directly to the Chair. The ESG Office should be responsible for coordinating ESG-related efforts across the SEC and other federal regulatory bodies.

Second, the SEC should consider revising the process of appointing members to its advisory committees to ensure that all committees have sufficient expertise on ESG-related factors. Moreover, the SEC should consider establishing an “ESG Investing” advisory subcommittee of the Investor Advisory Committee.

Introduction

This report is intended to outline steps the Securities and Exchange Commission should consider taking to ensure that our capital markets are better informed and empowered to address the great challenges facing our society and the world, including climate change, systemic racism, and unprecedented income and wealth inequality.

These challenges are too great to be solved by government action alone. Private enterprise must play a role. At a time when many are questioning whether capitalism is up to the task, we boldly offer to modernize capitalism. The SEC establishes the rules for capitalism in the United States—it determines what information and rights companies must provide to investors and the public, and whether and how investors may make use of them.

In this way, the SEC sets the guardrails for capitalism and is responsible for facilitating the flow of capital and investments into a more sustainable economy. If capitalism is to become more “stakeholder” centric, the SEC must help lead the way. Central to this objective is ensuring accountability for key market participants, including companies, executives, and investors.

This report focuses on the actions the SEC should consider taking to promote greater corporate accountability. Enhancing corporate accountability necessarily includes ensuring greater accountability for how companies, and those who own and govern them, address environmental, social, and governance (ESG) factors. In the pages that follow, we propose SEC actions that will enable private market participants to better identify, assess, and address the risks and opportunities posed by these global challenges.

Substantively, these actions include:

- Reducing the exemptions to the federal securities laws;
- Enhancing public company and investment fund disclosures;
- Enhancing stakeholder rights and engagement;
- Modernizing expectations for investment fiduciaries;
- Adopting standards for ESG-related investment products and funds; and
- Enhancing oversight of indexing companies and other “gatekeepers” to investors.

Lastly, we recommend some modest revisions to the SEC’s organizational structure to better enable the agency to take these important actions.

For too long, the SEC has facilitated changes that have reduced corporate accountability to shareholders and the public. Now, more than ever, the SEC must promote corporate accountability to workers, investors, the public, and society.

The specific issues and recommendations included herein were collected from leading think tanks, academics, private market practitioners, current and former legislators, and current and former regulators.[3]

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[3] We recognize that many different organizations have similar (and perhaps dissimilar) issues to address and have recommended regulatory approaches. For example, we understand that many of the issues identified in this report are also the focus of reports, letters, and petitions urging regulatory actions by organizations such as the Americans for Financial Reform, Center for American Progress, Principles for Responsible Investment, Public Citizen, and US Sustainable Investment Forum. See, e.g., Tyler Gellasch and Alexandra Thornton, *Modernizing the Social Contract With Investment Fiduciaries*, Center for American Progress, Nov. 18, 2020, *available at* https://www.americanprogress.org/issues/economy/reports/2020/11/18/492982/modernizing-social-contract-investment-fiduciaries/

On January 5, 2021, the Global Financial Markets Center at Duke Law School hosted an event with more than fifty thought leaders to review, discuss, and provide greater details regarding many of these issues. To the extent possible, we have sought to incorporate their suggestions and feedback into this report.[4]

We understand that our recommendations may have modest impacts on the markets or specific market participants, while others may have trillion-dollar impacts and feed or eliminate common industry practices. Our objective is to identify what should be done. We also recognize that a list this ambitious is fraught with political peril, and some items may face fierce opposition from some industry or market participants. We nevertheless seek actions that the SEC could justifiably and reasonably take to make important progress on climate change, systemic racism, and unprecedented income and wealth inequality—which are at the center of President Biden's economic agenda.

(suggesting that investment fiduciaries be required to adopt policies and procedures designed to disclose how they identify, assess, and address key ESG-related risks and opportunities).

[4] We also acknowledge that portions of this report and ideas contained herein may borrow heavily from the work of others, including thought-leading organizations such as Principles for Responsible Investment, Americans for Financial Reform, and Public Citizen.

Restore Public Accountability to the Unregulated Private Markets

Amidst the Great Depression, Congress adopted the Securities Act of 1933 ("Securities Act") and Securities Exchange Act of 1934 ("Exchange Act") to require public offerings of securities to be registered with the government and companies who make such offerings to provide full and fair disclosure of the character of the securities being offered.[5] This detailed disclosure must include "information regarding the issuer's business operations, financial condition, risk factors, and its management,"[6] and is meant to allow investors to make "informed investment and voting decisions."[7] As the SEC explained on its website in 2019:

> *Only through the steady flow of timely, comprehensive, and accurate information can people make sound investment decisions. The result of this information flow is a far more active, efficient, and transparent capital market that facilitates the capital formation to our nation's economy.*[8]

This result generally only exists in the public markets. In the private markets, investors and the public may receive selected information, different information, unreliable or untested information, or no information at all. Further, investors in private offerings may have extremely limited rights, including no right to sue for misstatements.

Nevertheless, beginning in the 1980s, Congress and the SEC created and significantly expanded the exemptions and exceptions to those initial and ongoing disclosure requirements. Each time the application of the securities laws was limited, the justification was that it would "promote capital formation" by "easing" perceived regulatory burdens on issuers of securities or other sellers.

"Exempt offerings" are generally limited to "accredited investors" or "qualified institutional buyers"[9] who are assumed not to "need the protection" of the securities laws.[10] Exempt offerings are not subject to the "comprehensive disclosure requirements that apply to registered offerings."[11]

Under the current federal securities framework, there is a stark contrast between the disclosure requirements for "public companies" (subject to initial and ongoing reporting obligations) and "private companies" (which are not). These requirements generally have nothing to do with the size, importance, or ownership of the company—the focus is instead solely on the methods used by the company to raise capital.

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[5] *See* H.R. Rep. No. 73-85, at 1 (1933) (highlighting the purpose of the act "to provide full and fair disclosure of the character of securities sold in interstate and foreign commerce and through the mails").

[6] See, Memorandum from the Committee on Financial Services Staff, *September 11, 2019 Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets Hearing Entitled: "Examining Private Market Exemptions as a Barrier to IPOs and Retail Investment"*, Sept. 6, 2019, *available at* **https://financialservices.house.gov/uploadedfiles/hhrg-116-ba16-20190911-sd002_-_memo.pdf**.

[7] *See* H.R. Rep. No. 73-85, at 1 (1933).

[8] SEC, What We Do, *available at* **https://www.sec.gov/Article/whatwedo.html** (as of Sept. 30, 2019, but since removed).

[9] Notably, in 1990, the SEC created a safe harbor for the resale of securities offered under exemptions by persons other than the issuers of those securities to "qualified institutional buyers" ("Rule 144A"). *Concept Release on Harmonization of Securities Offering Exemptions*, SEC, 84 Fed. Reg. 30460, 30464 (June 26, 2019), *available at* **https://www.sec.gov/rules/concept/2019/33-10649.pdf**.

[10] *Concept Release on Harmonization of Securities Offering Exemptions*, SEC, 84 Fed. Reg. 30460, (June 26, 2019), *available at* **https://www.sec.gov/rules/concept/2019/33-10649.pdf** ("Concept Release").

[11] Office of Investor Education and Advocacy, *Investor Bulletin: Private Placements Under Regulation D*, Investor.gov, (Sept. 24, 2014), *available at* **https://www.investor.gov/introduction-investing/general-resources/news-alerts/alerts-bulletins/investor-bulletins-31**.

Historically, there has also been a significant difference in how "public" and "private" securities may trade. Public companies are often "listed" for trading on exchanges and are often traded in numerous venues. Private companies, by contrast, are much less "liquid," and are usually restricted in their trading. However, in recent years, there has been a proliferation of markets and trading venues that facilitate the resale of securities of private (aka non-reporting) companies.[12]

While the federal securities laws require very specific disclosures for public companies, the exemptions to those laws generally do not. For example, as the SEC explained in its 2019 Concept Release:

> *Issuers in [Rule 506] offerings are not required to provide any substantive disclosure and are permitted to sell securities to an unlimited number of accredited investors with no limit on the amount of money that can be raised from each investor or in total.*[13]

Further, companies and their insiders may choose to provide information to one investor or certain favored parties, but not others. This type of information discrimination is not permitted for public companies.[14] The lack of disclosure requirements for large private companies also has profound implications on corporate accountability to shareholders and other stakeholders.[15]

Importantly, the size of the public market is shrinking in relation to the private market. As of 2019, approximately 70% of all capital raised through sales of securities was exempt from SEC registration and reporting requirements, with the vast majority of the capital raised through exemptions such as Rule 144A and Rule 506.[16]

The rise of private markets and the concurrent fall of public companies was not accidental, but instead the result of policy choices by Congress and the SEC that have allowed companies to access the capital markets from an increasingly larger pool of investors without having to register their securities offerings.[17] Further, the SEC has similarly permitted executives and early investors to sell their shares to "accredited investors" and others in the private markets, generally without any concern or attention paid to information or rights asymmetries between the parties.

Because companies can raise unlimited sums from an effectively unlimited number of investors without being "public," and because these securities are becoming increasingly transferable without triggering disclosure requirements, companies are staying "private" longer, but also avoiding the scrutiny and

[12] *See id; See* Letter from Tyler Gellasch, Healthy Markets Association, to Office of the Secretary, SEC, at 8-9, Sept. 30, 2019, *available at* **https://healthymarkets.wpengine.com/wp-content/uploads/2019/09/SEC-Concept-Release-9-30-19-1.pdf** (identifying private securities trading offered by SharesPost, Nasdaq Private Market, and EquityZen); *see also* Testimony of Michael S. Pieciak, NASAA Past-President and Vermont Commissioner of Financial Regulation, *Hearing on Examining Private Market Exemptions as a Barrier to IPOs and Retail Investment*, House Financial Services Cmte, Subcmte on Investor Protection, Entrepreneurship, and Capital Markets, 116 Cong. 2019, at 5, *available at* **https://financialservices.house.gov/uploadedfiles/hhrg-116-ba16-wstate-pieciakm-20190911.pdf**.

[13] Concept Release, at 30470.

[14] See, e.g., Selective Disclosure and Insider Trading, SEC, 65 Fed. Reg. 51716 (Aug. 24, 2000), *available at* **https://www.govinfo.gov/content/pkg/FR-2000-08-24/pdf/00-21156.pdf** (adopting Regulation Fair Disclosure).

[15] See @ThomasFarley (Thomas Farley) Twitter (September 22, 2019), *available at* **https://twitter.com/ThomasFarley/status/1175786943231254531** (Former NYSE President explaining that the "Experiment (sic) of high-growth companies staying private an extra five years was a failure. Uber and WeWork floundered in private markets in last few years and would have benefited from being public. ...Uber. Public markets would not have tolerated lighting a couple billion on fire in futile China effort. Bad behavior by management would have been dealt with quicker. Focus on unit economics would have happened years ago. WeWork. Wave pools. Kindergarten. Questionable accounting. Self-dealing. Poor unit economics. The public market would have squashed this on first earnings call.").

[16] *Facilitating Capital Formation and Expanding Investment Opportunities by Improving Access to Capital in Private Markets*, SEC, 85 Fed. Reg. 17956, 17958 (Mar. 31, 2020), *available at* **https://www.govinfo.gov/content/pkg/FR-2020-03-31/pdf/2020-04799.pdf**.

[17] Elisabeth de Fontenay, *The Deregulation of Private Capital and the Decline of the Public Company*, 68 Hastings Law Journal, 445-502 (2017), *available at* **https://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=6431&context=faculty_scholarship**.

accountability that comes from public disclosures and rights regimes.[18] These exemptions have given rise to an unprecedented number of so-called "unicorns," which are "private" companies with more than a $1 billion valuation. Around the world, as of January 2021, there are more than 527 unicorns, many of which are based in the U.S. or China,[19] and many of which are accessing U.S. investors.

In general, public disclosures have many benefits, including providing:

- investors with material information about a company, so that they may most efficiently allocate capital to its best uses (i.e., make capitalism work);
- investors with information necessary to accurately assess risks for their investments, including risks of climate change or fraud;
- employees with information necessary to understand and negotiate wages and benefits;
- suppliers, customers, creditors, and other counterparties with sufficient information to assess their risks and opportunities of working with a company;
- employees, customers, and the public with information about worker treatment and diversity to inform their decisions on doing business with a company; and
- the public with accountability on use of government programs and funds.[20]

To restore and promote corporate accountability, we recommend that the SEC reverse course by narrowing the exemptions and exceptions to the federal securities laws and rules. Moreover, the SEC needs to improve corporate disclosures and ensure investors have sufficient rights to hold companies accountable. Importantly, the SEC needs to take action to directly address private markets. If the SEC enhances regulation under the current regulatory framework, it is highly likely that more companies will stay private and avoid those obligations altogether. Accordingly, the SEC needs to enhance corporate accountability in both the public and private markets.[21]

Require Large Companies to be Exchange Act Reporting Companies

A company generally becomes a "public" company after it engages in an initial public offering (IPO). However, the Exchange Act also provides that a company may become a "reporting company" if the company has a sufficient number of "shareholders of record."[22] As a point of historical accident, the SEC has defined "shareholder of record" under Section 12(g) in a manner that does not take into account the

[18] Testimony of Renee M. Jones, *Hearing on Examining Private Market Exemptions as a Barrier to IPOs and Retail Investment*, House Financial Services Cmte, Subcmte on Investor Protection, Entrepreneurship, and Capital Markets, 116 Cong. 2019, at 5, *available at* ***https://financialservices.house.gov/uploadedfiles/hhrg-116-ba16-wstate-jonesr-20190911.pdf*** (Explaining that "[a]s a result of these expansive statutory and regulatory reforms, the current panoply of exemptions available to issuers and trading shareholders show little fealty to the investor protection principles embodied in the securities laws as originally conceived. These statutory and regulatory reforms have contributed to the shrinking of the public securities markets, and have enabled the current trend toward prolonged delays in corporate IPOs. The aggregate impact of these recent reforms has been the wholesale reshaping of both public and private securities markets, and the emergence of a new class of companies, so-called unicorns, that lack the kinds of mechanisms for management accountability that investors in public and private companies have come to expect.").

[19] CBInsights, *The Complete List of Unicorn Companies*, *available at* **https://www.cbinsights.com/research-unicorn-companies** (last visited Jan. 26, 2021).

[20] For example, when it was reported that some funds from the Paycheck Protection Program created by the CARES Act had been awarded to public companies, the SEC required enhanced disclosures from all PPP recipients, the program was quickly retroactively modified, and companies returned the public funds. *See* Ben Popken, *Which companies are returning their PPP loans? Here's the list.*, NBCNews, Apr. 28, 2020, *available at* **https://www.nbcnews.com/business/business-news/which-companies-are-returning-their-ppp-loan-here-s-list-n1194566**.

[21] *See, e.g.*, Remarks of Larry Fink, Blackrock, before the Brookings Institution, Feb. 2, 2021.

[22] Section 12(g).

number of actual "beneficial owners."[23] While one might assume that the SEC would define "shareholders of record" to include the actual owners of the shares, the SEC instead considers only the nominal holding party. For example, if thirty different customers each buy $100,000 of stock in the same company through a single bank, the bank may aggregate those holdings into an omnibus account. As a result, the bank, and not the actual customers who own the stock, would be considered the "shareholder of record." Before the widespread adoption of modern clearing and settlement (when physical stock certificates were delivered to actual owners), the SEC's interpretation was of much lesser import than it is today.

Today, however, the SEC's curious definition of "shareholder of record" permits issuers, executives, and other interested parties to easily avoid the Section 12(g) trigger by simply aggregating owners into ownership vehicles or at a small number of broker-dealers. State securities regulators and many capital market experts have long sought to close this loophole.[24]

The SEC should consider adopting a rule revising its interpretation of the "shareholder of record" to reflect the actual owners of securities. This would ensure that large companies with a significantly broad ownership base cannot avoid triggering public company reporting requirements. This revision would also put the U.S. more on par with how other jurisdictions identify "large" companies that are subject to a public reporting regime.

This change can be made without legislation. The SEC should also consider exploring whether it has sufficient authority to adopt rules to ensure all large companies are public. Some potential triggers (which could be implemented through revisions to Section 12(g) or otherwise) could be if a company has:

- revenues above a threshold (e.g., $100 million annually);
- a "market cap" above a threshold (e.g., $1 billion) based on private market valuations;
- a "public float" in a private trading venue above a threshold (e.g., $75 million);
- a number of beneficial owners of "securities" above a threshold (e.g., 500), irrespective of "accredited investor" status; or
- a threshold number of employees (e.g., 250 full-time equivalents).

Further, to protect the public interest and guard against corruption, the SEC should also consider requiring companies that receive more than a certain dollar amount in revenues directly from government contracts or funds (e.g., $25 million) to become public reporting companies.

One of the key advantages of revising Section 12(g) or applying these types of "triggers" to pull companies into the public regulatory regime is that they can be applied to only large companies or securities offerings. This would avoid any claims that the changes would hinder the ability of small companies to raise capital.

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[23] Under Section 12(g) of the Exchange Act, any issuer that is not a bank, bank holding company, or savings and loan holding company is required to register a class of securities "if it has more than $10 million of total assets," and if the securities are held of record by "either 2,000 persons or 500 persons who are not accredited investors." See, Concept Release, at 30489, *available at* **https://www.sec.gov/rules/concept/2019/33-10649.pdf**. Though Section 12(g) does not impact capital raises, nor does it force a company to "list" its shares on a stock exchange, it does trigger ongoing public reporting obligations. Importantly, the majority of shareholders in the U.S. today own their securities as "beneficial owners" and not as "holders of record," as they hold their securities indirectly through a bank or a broker-dealer. See, e.g., **https://www.investor.gov/what-registered-owner-what-beneficial-owner#:~:text=A%20registered%20owner%20or%20record,a%20bank%20or%20broker%2Ddealer**. This allows companies to acquire a broad ownership base, consisting of thousands of beneficial owners, while avoiding triggering Section 12(g)'s registration and reporting requirements.

[24] See, e.g., Letter from Jack Herstein, North American Securities Administrators Association, to Sen. Jack Reed, Mar. 22, 2012, *available* ***at*** **https://www.nasaa.org/wp-content/uploads/2011/07/NASAA-Letter-of-Support-for-Reed-Amendment-1931-03-22-20122.pdf**.

Not surprisingly, revising the federal securities law framework to directly capture large offerings and companies is a high priority for many investor and consumer experts and advocates.[25]

Eliminate Exemptions for Large Private Offerings

Almost by definition, offerings made pursuant to Rule 144A are large, and typically involve very sophisticated parties. However, these offerings may often involve significant and underappreciated risks. And those risks have already led to catastrophic consequences. For example, Rule 144A was heavily relied upon to sell the so-called "toxic assets" at the heart of the 2008 financial crisis, leading some experts to call for the rule's repeal.

Require Disclosures for "Exempt" Securities and Asset-Backed Securities

Rather than maintain, or worse, expand the canyon between requirements on public companies and private companies, the SEC should instead impose some basic reporting requirements for large "private" offerings. For example, the SEC should consider revising Rule 144A, Rule 506, and Regulation AB to mandate disclosures similar to those required in a registered (aka public) offering.[26] The SEC should also consider mandatory disclosures regarding all sales of unregistered securities that may be impacted by climate risks. These reforms are particularly relevant as one considers the massive growth of corporate debt over the past several years, which may carry significant risks.

For example, in 2020, Exxon sold long-term debt at low rates, some of it not coming due until 2038. In fact, during 2020, fossil fuel companies accounted for a significant portion of the corporate debt sold, and yet almost none of it accounted for the various climate-related risks. Similarly, companies backed by private equity firms have also comprised a significant portion of the debt markets, and the risks to both investors and the workers of the more deeply indebted portfolio companies may be significant in the months and years ahead. If investors, customers, workers, and the public are to hold companies accountable, they need more information than is currently provided by the exemption framework.

Further, to the extent that banks and fund companies seek to assess their risks and exposures to issues like climate change, they will need more information on the securities held in their portfolios. If the large offering exemptions such as Rule 144A are permitted to continue, then the only way that these financial intermediaries can faithfully perform their assessments is if the SEC adopts standardized disclosure requirements that are similar to those imposed in the public markets.

Restore the "Integration" Doctrine

Over a period of decades, Congress and the SEC have added ad hoc exemptions and exceptions to the regulatory requirements for securities offerings. However, the SEC historically sought to limit the "integration" of different offerings to ensure that different offering exemptions could not be structured so as to effectively avoid the public disclosure and accountability regime.

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[25] Testimony of Renee Jones, at 13.

[26] *See, e.g.*, Statement by Hon. Luis Aguilar, SEC, Aug. 27, 2014, *available at* **https://www.sec.gov/news/public-statement/2014-08-27-open-meeting-statement-abs-laa** ("It is therefore crucial that the Commission … "requir[e] issuers to provide the same disclosure for ABS issued pursuant to private offerings and resold under Rule 144A, as is required for registered offerings.").

In November 2020, the SEC adopted revisions that effectively eviscerate the so-called "integration doctrine," which had previously limited private capital raising.[27]

To restore accountability by limiting exemptions from the federal securities law information and rights requirements, the SEC should consider harmonizing the various exemptions and separate out the various capital raising methods so that issuers are not able to easily avoid the registration requirements.

Revise the Accredited Investor Definition to Reduce Dependency on the Myths that "Sophisticated" Investors Do Not Need Information and that Wealth is a Proxy for Sophistication

In 1982, the SEC created (out of thin air) Rules 504, 505, and 506, which created specific exemptions from the SEC's registration requirements.[28] These rules exempt issuers from having to register a public offering and have generally allowed companies to remain private despite potentially raising significant sums.

As Professor Renee Jones has explained:

> *Under Rule 506, issuers can sell an unlimited amount of securities to up to 35 sophisticated investors, and to an unlimited number of [accredited investors]. Regulation D defines [accredited investor] to include institutional and individual investors who satisfy the financial thresholds set forth in the Regulation. Individuals can qualify as [accredited investors] if they have an annual income in excess of $200,000 (or $300,000 together with a spouse), or a net worth in excess of $1,000,000.*[29]

Prior to the adoption of Regulation D, wealth or income thresholds had never been used, neither by the SEC nor the courts, as direct proxies for "sophistication" or "information." But that is precisely what the SEC did. Subsequently, the SEC and Congress have revised the "accredited investor" definition – most recently in 2020 – in recognition that it is ill-suited to its stated purpose. While the concept was initially created by the SEC as a means to identify persons for whom the protections of the federal securities laws need not apply, the concept is misguided in several respects and further modifications are warranted.

First, the application of the accredited investor definition assumes that because some investors may be persons for whom the securities laws may not provide a material benefit, that there are no other parties that could materially benefit from disclosures. That assumption is false. Disclosure doesn't just serve investors, but also benefits workers, customers, suppliers, creditors, and the public.

Second, the "accredited investor" definition assumes that those who qualify are "sophisticated" enough to always fend for themselves – despite a lack of information and rights. This has repeatedly been proven wrong, as even extremely sophisticated private market investors often suffer significant losses that would likely have been avoided if they had received greater rights and information.[30]

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[27] *Facilitating Capital Formation and Expanding Investment Opportunities by Improving Access to Capital in Private Markets*, SEC, 86 Fed. Reg. 3496, Jan. 14, 2021, *available at* **https://www.govinfo.gov/content/pkg/FR-2021-01-14/pdf/2020-24749.pdf**.

[28] *Revision of Certain Exemptions From Registration for Transactions Involving Limited Offers and Sales*, SEC, 47 Fed. Reg. 11251 (Mar. 16, 1982), *available at* **https://s3.amazonaws.com/archives.federalregister.gov/issue_slice/1982/3/16/11247-11267.pdf#page=5**.

[29] Testimony of Renee M. Jones, at 3.

[30] For example, SoftBank, the highly sophisticated private market investor and controlling shareholder of WeWork lost billions as WeWork's valuation fell from $47 billion to $2.9 billion. *See* Brian Pietsch, *WeWork's valuation has fallen from $47 billion last year to $2.9 billion*, Business Insider, (May 18, 2020), **https://www.businessinsider.com/wework-valuation-falls-47-billion-to-less-than-3-billion-2020-5**.

Third, the "accredited investor" definition ignores that investors within it are not close to being "equal," and that different investors meeting the definition may receive very different investment terms. A dentist from Toledo and a $1 trillion investment adviser have different investment capabilities and market power. They will almost certainly not be treated equally in a "private" marketplace—or even when investing in the same security at the same time—and that will likely be to the severe detriment of the less-connected, less-informed, less-wealthy, and less powerful market participants. As Professor Elisabeth de Fontenay testified to Congress in 2019, "[i]n fact, it's very common for differential rights in private firms... This is really the opposite of the public markets, where … everyone has the same rights. Everyone has the same information."[31]

Fourth, as has been repeatedly acknowledged by members of Congress on both sides of the aisle, the "accredited investor" definition ignores the fact that income and wealth are poor proxies for sophistication and capabilities to assess investment risks and opportunities.[32]

Fifth, regardless of a market participant's level of expertise, without information, that expertise cannot be brought to bear. In fact, the Supreme Court case that is often relied upon as support for the creation of the "accredited investor" standard, *SEC v. Ralston Purina, Co.*, explicitly states that:

> *the exemption question turns on the knowledge of the offerees, [and] the issuer's motives, laudable though they may be, fade into irrelevance. The focus of inquiry should be on the need of the offerees for the protections afforded by registration. The employees here were not shown to have access to the kind of information which registration would disclose.*[33]

Similarly, a few years before the SEC adopted Regulation D, the Fifth Circuit explained:

> *[t]here must be sufficient basis of accurate information upon which the sophisticated investor must be able to exercise his skills. Just as a scientist cannot be without his specimens, so the shrewdest investor's acuity will be blunted without specifications about the issuer. For an investor to be invested with exemptive status he must have the required data for judgment.*[34]

Nevertheless, when the SEC adopted Rule 506 in 1982, it eliminated the requirement that the offerees have "knowledge" and "the required data for judgment," and instead essentially declared that if a purchaser had enough income or wealth (and so qualified as an "accredited investor"), he may enjoy the privilege of investing based upon absolutely no relevant information at all.

[31] Testimony of Elisabeth de Fontenay, Hearing on Examining Private Market Exemptions as a Barrier to IPOs and Retail Investment, Before the House Financial Services Cmte, Subcmte on Investor Protection, Entrepreneurship, and Capital Markets, 116 Cong. 2019, *available at* **https://financialservices.house.gov/uploadedfiles/hhrg-116-ba16-wstate-jonesr-20190911.pdf**.

[32] See, e.g., Statement of Hon. Patrick McHenry, Hearing on Examining Private Market Exemptions as a Barrier to IPOs and Retail Investment, Before the House Financial Services Cmte Subcmte on Investor Protection, Entrepreneurship, and Capital Markets, 116 Cong. 2019, *available at* **https://financialservices.house.gov/uploadedfiles/hhrg-116-ba16-wstate-jonesr-20190911.pdf** ("Because there is a societal decsion that if you're not a high net worth individual, you're dumb, and that is implicit in securities regulation.").

[33] *SEC v. Ralston Purina, Co.*, 346 U.S. 119, 126-127 (1953).

[34] *Doran v. Petroleum Management Corp.*, 545 F.2d 893 (5th Cir. 1977).

In 2020, despite significant opposition from investor and consumer advocates, the SEC extended this dubious “privilege” to even more investors by revising the “accredited investor” definition to add non-financial qualifications for potential purchasers, including securities markets licenses.[35]

However, the SEC again declined to ensure that investors in these offerings have any basis to make informed investment decisions or ability to absorb the potential risks and consequences. Further, by expanding the potential pool of “private” market investors, the SEC is reducing the pressure on issuers to access the traditional “public” markets.

The SEC should consider revising the “accredited investor” definition to be based not just on either “sophistication,” “income,” or “wealth" alone. Instead, it should be based on a combination of all of those features, as well as an investor’s access to “the kind of information which registration would disclose.” This would ensure that not only are investors capable of making informed investment decisions, but also that they have the information with which to do so.

Require Disclosures for Private Fund Offerings

As the amount of private capital raised has skyrocketed in recent years, some of the most significant beneficiaries have been private funds. The SEC should consider revising the application of exemptions to offering rules for private funds to capture funds with more than $1 billion in assets or more than 100 beneficial owners to require them to register as investment companies.

[35] *Accredited Investor Definition*, SEC, 85 Fed. Reg. 64234 (Oct. 9, 2020), *available at* **https://www.govinfo.gov/content/pkg/FR-2020-10-09/pdf/2020-19189.pdf**.

Require Enhanced Public ESG-Related Disclosures

The heart of the federal securities laws and regulatory framework is disclosure. In fact, when they were first adopted, Congress declared:

> *Whatever may be the full catalogue of the forces that brought to pass the present depression, not least among these has been this wanton misdirection of the capital resources of the Nation … The bill closes the channels of such commerce to security issuers unless and until a full disclosure of the character of such securities has been made.*[36]

But what, exactly, should be disclosed? The courts have said that the question should turn on the desires of a "reasonable investor." At the same time, as a practical matter, the corporate issuers cannot be expected to simply provide everything everybody might want. Further, there has to be some comparability across companies and industries. That's where the SEC's detailed disclosure requirements step in. As part of the registration process, and at various intervals thereafter, issuers of securities have to provide investors with essential information about the securities, including information regarding the company's management, operations, financials, and risks.

The SEC has argued that:

> *Only through the steady flow of timely, comprehensive, and accurate information can people make sound investment decisions. The result of this information flow is a far more active, efficient, and transparent capital market that facilitates the capital formation to our nation's economy.*[37]

"Comprehensive and timely" information is equally essential for the private sector to effectively identify the challenges to our nation's economy—as experienced by the companies, investors, and workers in it—which include racial justice, worker pay and treatment, and climate change.[38] Many investors have found that consideration of ESG factors improves investment performance,[39] and are increasingly relying upon these factors to monitor companies' management of risks, inform their vote at shareholder meetings, and make efficient investment decisions.[40] In fact,

> *asset managers responsible for trillions in investments, issuers, lenders, credit rating agencies, analysts, index providers, stock exchanges and other financial market participants have embraced sustainability factors*

[36] H. Rep. 73-85 (1933), at 2-3.

[37] SEC, What We Do, *available at* **https://www.sec.gov/Article/whatwedo.html** (as of Sept. 30, 2019, but since removed).

[38] *Climate Risk Disclosure and Practices*, Climate Risk Disclosure Lab, 2020, *available at* **https://climatedisclosurelab.duke.edu/wp-content/uploads/2020/10/Climate-Risk-Disclosures-and-Practices.pdf**.

[39] *See, e.g.*, Sioban Riding, *Majority of ESG funds outperform wider market over 10 years*, Financial Times, June 13, 2020, *available at* **https://www.ft.com/content/733ee6ff-446e-4f8b-86b2-19ef42da3824**; *see also* Blackrock, *Toward a Common Language for Sustainable Investment*, Jan. 2020, *available at* **https://www.blackrock.com/corporate/literature/whitepaper/viewpoint-towards-a-common-language-for-sustainable-investing-january-2020.pdf** ("Our investment conviction is that sustainability-integrated portfolios – composed of more sustainable building-block products – can provide better risk-adjusted returns to investors. With the impact of sustainability on investment returns increasing, we believe that sustainable investment will be a critical foundation for client portfolios going forward."

[40] *Public Companies: Disclosure of Environmental, Social, and Governance Factors and Options to Enhance Them*, US Government Accountability Office, GAO-20-530, July 2020, *available at* **https://www.gao.gov/assets/710/707949.pdf**.

> *and metrics as significant drivers in decision-making, capital allocation, pricing and value assessments.* [41]

Unfortunately, investors and their advocates have long expressed dissatisfaction with the quality, consistency, and comparability of public companies' ESG disclosures,[42] and have been calling on the SEC to enhance ESG disclosure requirements.[43]

In the absence of a government-mandated disclosure regime for relevant ESG factors, several non-governmental organizations have developed and promoted ESG-related disclosure frameworks, such as GRI, Value Reporting Foundation (formerly "SASB"), and the Financial Stability Board's Task Force on Climate-Related Financial Disclosures ("TCFD").[44] Though these frameworks provide guidance to issuers and investors, the wide range of voluntary templates has led to inconsistent and incomplete disclosure practices, making it difficult for investors and stakeholders to compare firms, assess ESG-related risks with any certainty, and instill corporate accountability.[45]

The SEC should consider creating a disclosure regime with two sets of disclosures for financial and non-financial firms. First, non-financial companies should be required to make basic ESG-related disclosures. Second, because the financial sector is responsible for funding the activities of other firms, their operations are both directly exposed to ESG risks and indirectly exposed to ESG risks through their financing activities. This latter point is important because, for example, over the past several years, the largest U.S. banks loaned, underwrote, or otherwise financed over $700 billion for fossil fuel companies.[46] Financial firms should thus be required to disclose basic ESG-related information as well as the ESG-related impacts of their financing activities.

Require Financial and Non-Financial Companies to Disclose Climate Change-Related Information

The SEC should consider requiring standardized disclosures of climate change-related information to ensure that investors and other stakeholders can accurately evaluate investment opportunities, allocate capital, and hold companies accountable. The SEC should build upon the standards established and proliferated by private actors by adopting disclosure requirements that are consistent with the TCFD and the European Commission's Non-Financial Reporting Directive.[47]

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[41] Remarks by Hon. Allison Herren Lee, SEC, before the Practicing Law Institute's 52nd Annual Institute on Securities Regulation, Nov. 5, 2020, *available at* **https://www.sec.gov/news/speech/lee-playing-long-game-110520**.

[42] *See, e.g.*, Letter from Lisa Woll, US Sustainable Investment Forum to Hon. Mary Jo White and Keith Higgins, SEC, Sept. 18, 2014, *available at* **https://www.ussif.org/files/Public_Policy/Comment_Letters/Disclosure_Effectivess_Review_Letter.pdf** ("Unfortunately, investor efforts to comprehensively incorporate ESG information into investment decisions have been hindered by a lack of comprehensive, comparable and reliable data. The primarily voluntary nature of corporate sustainability reporting means that the information available to investors remains inconsistent and incomplete.").

[43] *See, e.g., Business and Financial Disclosure Required by Regulation S–K*, SEC, 81 Fed. Reg. 23916, 23970 (Apr. 22, 2016), *available at* **https://www.govinfo.gov/content/pkg/FR-2016-04-22/pdf/2016-09056.pdf**.

[44] *Public Companies: Disclosure of Environmental, Social, and Governance Factors and Options to Enhance Them*, US Government Accountability Office, GAO-20-530, at 32, July 2020, *available at* **https://www.gao.gov/assets/710/707949.pdf**.

[45] A recent survey of institutional investors finds that sustainability disclosure is generally insufficient, uninformative, and imprecise. Emirhan Ilhan et al., *Climate Risk Disclosure and Institutional Investors*, Swiss Fin. Inst. Research Paper Series, Working Paper No. 19-66, at 3, *available at* **https://ssrn.com/abstract=3437178**; see also Concept Release, at 206.

[46] Rainforest Action Network et. al., *Banking on Climate Change: Fossil Fuel Finance Report Card 2019*, Mar. 20, 2019, *available at* **https://www.ran.org/wp-content/uploads/2019/03/Banking_on_Climate_Change_2019_vFINAL1.pdf**.

[47] If necessary to alleviate actual or potential unnecessary burdens on smaller companies, these requirements could be limited to "accelerated filers" or "large accelerated filers," which is only companies with more than $75 million and $700 million in public float, respectively.

In particular, the SEC should consider revising its annual filing requirements (Form 10-K), which includes sections on the business, risk factors, selected financial data, management's discussion and analysis (MD&A), and financial statements and supplementary data. While Form 10-K requires identification of risk factors that management determines pose the most significant risks to the company or its securities and an analysis of these risk factors in the MD&A, investors and the public have found that firms' willingness to identify, assess, or quantify climate-related risks in a robust manner vary significantly. In fact, climate-related risks are often under-appreciated.[48] Further, to the extent any disclosures are made, they are rarely reliable or comparable to other companies or industries.

Investors have urged the SEC to require enhanced disclosures of climate-related risks and impacts for years, and SEC Commissioners Lee and Crenshaw have both called for the agency to finally take action.

The SEC should consider requiring issuers to disclose the physical risks posed to the covered issuer by climate change,[49] the transition risks posed to the covered issuer by climate change, and the reputational, market, liquidity, or other risks posed to the covered issuer by climate change.

At a minimum, issuers should be required to disclose:

- an evaluation of the potential financial impacts of these climate risks; and
- the risk management strategies relating to these climate risks.

Substantively, these mandatory disclosures should include:

- a description of the resilience of the strategy of the covered issuer for addressing climate risks;
- a description of how climate risk is incorporated into the overall risk management strategy of the covered issuer;
- a description of how the company is modifying its business strategy to remain competitive to limit emissions (including Scope 3 emissions) in-line with the commitments of the Paris Agreement;
- whether (and how) the company's climate risks are based on assumptions that are aligned with the Paris Agreement and, if not, provide an audited pro forma presentation that is Paris-aligned as supplemental disclosure;
- greenhouse gas emissions from operations, broken down by country (to include Scope 1, 2, and 3 emissions);
- a description of the facilities and assets committed in 3, 5, 10 and 20 years in each of the regions with high or extremely high baseline water stress;
- facilities and assets committed in regions of high or extremely high potential for storms or fire within the next 3, 5, or 10 years;
- the issuer's total energy consumption, broken out by energy source and type;

[48] *See generally* Harrison G. Hong et al., Climate Risks and Market Efficiency, J. of Econometrics 208, 265–81 (2019).

[49] The physical risks associated with climate change can be chronic or acute. Acute risks threaten to endanger assets through extreme weather events such as flooding, wildfires, and power outages. Chronic risks threaten to create long-term impacts that will semi-permanently alter the environment, such as sea level rise, drought, hazardous air quality, and general threats to clean water access due to salt intrusion. *See* Climate Risk Disclosure Labe, *Climate Risk Disclosures and Practices* 1, 15 (2020), *available at* **https://climatedisclosurelab.duke.edu/wp-content/uploads/2020/10/Climate-Risk-Disclosures-and-Practices.pdf**.

- any potential production areas threatened by drought and water scarcity;
- any potential production areas threatened by water security issues;
- any potential production or services located in areas at risk of high heat stress for humans;
- potential unique threats from disease in areas of operations (e.g., meat processing plants); and
- climate-related political spending, including lobbying and direct and indirect campaign contributions (e.g., through 501(c)(6) and 501(c)(4) organizations).

The SEC should also consider requiring issuers to disclose defined climate-related scenario analyses. One analysis should assume compliance with regulations aimed at transitioning the economy to a point where warming is limited to 1.5 degrees Celsius above pre-industrial levels by 2050. Another scenario should be defined as one where firms are permitted to continue with business-as-usual, resulting in an increase of approximately 4.5 degrees Celsius above pre-industrial levels by 2050. Scenario analysis disclosures should include a description of established corporate governance processes and structures to identify, assess, and manage climate-related risks, as well as a description of specific actions that the covered issuer is taking to mitigate identified and assumed present and future risks.

The SEC should also consider directing the Division of Corporation Finance to offer comments on climate-related disclosures for specific industries that will likely be most directly impacted by climate risks.[50]

Require Financial and Non-Financial Companies to Disclose Relevant Non-Climate ESG-Related Information

In 2016, the SEC released a "Concept Release" seeking to reduce or streamline the agency's disclosure requirements. The SEC received more than 26,500 responses. In general,

> *[c]ommenters identifying themselves as institutional investment managers, public pension funds or trustees, private pension funds and trustees, religious investors, professional investment advisers, research analysts, public interest advocates, individual members of the public, academics, individual policy experts, broad-based investor organizations, investor organizations dedicated to improving disclosures, standards setting organizations, accountants, and members of Congress generally supported expanded and enhanced disclosures.*[51]

As those commenters (and many others before and since) have explained, many companies provide extremely little information on other ESG factors, such as political spending, worker pay, training, and diversity, tax practices, and stock buybacks. Each of these issues is increasingly coming in the forefront of

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[50] The SEC's Division of Corporation Finance staff routinely offers comment letters to companies on their disclosure filings. These comment letters boost the consistency and quality of corporate reporting and compliance with Regulation S-K, short of having to bring an enforcement action. *See, e.g.,* Andy Green and Andrew Schwartz, *Corporate Long-Termism, Transparency, and the Public Interest*, Center for American Progress, Oct. 2, 2018, *available at* **https://www.americanprogress.org/issues/economy/reports/2018/10/02/458891/corporate-long-termism-transparency-public-interest/** (noting that the SEC staff offered a number of letters to market participants following the adoption of 2010 guidance on climate-related disclosures, but that the comments dramatically reduced over time). The sectors most likely to be directly impacted from climate risks include the energy and transportation sectors, and the SEC staff could enhance and standardize reporting in those industries nearly immediately, and without a Commission vote.

[51] *Towards a Sustainable Economy*, at 16-17.

investors' and the public's minds, and has been the subject of years of examination, deliberation, and pleas for action from investors and other stakeholders.[52]

Require Disclosures of Political Spending

The influence of money in politics has always been a hot-button issue in the United States, and the Supreme Court's ruling in *Citizens United*[53] to permit greater corporate political activities has only exacerbated the issue. Following the insurrection at the United States Capitol Complex on January 6, 2021, many companies publicly announced the suspension of their corporate political contributions. Some companies announced "pauses" of their contributions to just those political leaders who clearly incited the violence, while others focused on those who voted against certifying the election, while others announced pauses of all activities. In making these public statements (and policy changes), all of these companies acknowledged that they believed the information is relevant to investors and the public.[54] Of course, the SEC has been aware of investor interest in corporate political spending for years, as it has received multiple petitions from experts and over a million comments on efforts to compel basic political spending disclosures.[55]

At the same time, direct political spending on candidates is likely only a small slice of the "political" contributions for a company and its executives. Companies may—and often do—donate funds to organizations that, in turn, contribute directly or indirectly to supporting candidates. Similarly, well-compensated executives, such as Charles Schwab (the person) often make political contributions that may exceed those of their employers or associated firms, such as Charles Schwab, the brokerage. Additionally, investors face risk when their companies make payments to organizations to lobby on their behalf for policies that stand in contrast to the company's stated mission. For example, many companies that promote "sustainability" as part of their brand belong to trade associations, like the U.S. Chamber of Commerce, that have lobbied to undermine climate regulation.

Despite this demand from "reasonable" investors and the significance of the contributions, the SEC has never proposed a rule to meaningfully address corporate political spending by companies or their senior executives, board members, or other prominent affiliated persons.

The SEC should consider requiring companies to disclose not just what they contribute, but to whom and what. This should include any organizations, such as trade associations, that may engage in political or policymaking activities, as well as contributions to such political candidates or organizations by executives, officers, or other highly compensated individuals.

Enhance Disclosures of Human Capital

One of the most direct and important disclosures companies could make, but generally don't, relate to how they hire, promote, retain, train, pay, and otherwise treat their workers. Again, the SEC has been petitioned

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[52] See *Towards a Sustainable Economy*, AFL-CIO *et. al.*, Sept. 2016, *available at* **https://www.ussif.org/Files/Public_Policy/Comment_Letters/Sustainable_Economy_Report.pdf** (reviewing comments received by the SEC to its "Concept Release") (drafted by the lead author of this report).

[53] *Citizens United v. Federal Election Comm'n*, 558 U.S. 310 (2010).

[54] In the wake of these announcements, this understanding has proven accurate. For example, several organizations sent an open letter to "Corporate America" calling on them to end all contributions to the 147 members of Congress who voted against the certification of the federal election results for President. Letter from Public Citizen *et. al.*, to Corporate America, Jan. 27, 2021, *available at* **https://mkus3lurbh3lbztg254fzode-wpengine.netdna-ssl.com/wp-content/uploads/letter-to-corporate-america.pdf?1**.

[55] See, e.g., Letter from the Committee on Disclosure of Corporate Political Spending to Elizabeth M. Murphy, SEC, Aug. 3, 2011, *available at* **https://www.sec.gov/rules/petitions/2011/petn4-637.pdf**; see also, Letter from Anne Weismann, Citizens for Responsibility and Ethics in Washington, to Elizabeth M. Murphy, SEC, May 8, 2014, *available at* **https://www.sec.gov/rules/petitions/2014/petn4-637-2-amended.pdf**.

to require enhanced disclosures.[56] Despite the clear social unrest related to systemic racism, many companies do not provide enough clear, consistent, comparable information regarding their treatment of minorities.

The SEC should consider leveraging existing reporting and certification regimes, such as the MLT Black Equity at Work Certification,[57] as well as upon requests for more disclosures from organizations such as the SEC's Investor Advisory Committee,[58] Human Capital Management Coalition,[59] and the AFL-CIO.[60] As discussed by those advocates and others, the SEC should consider requiring disclosures of metrics and key information related to the:

- number of full-time, part-time, and contingent workers along racial and gender lines;
- average dollars and hours invested in workforce training and education per year, along racial and gender lines;
- annual employee turnover (both voluntary and involuntary) along racial and gender lines;
- amount spent on third-party human resources (both third-party contracts and independent contractor expenditures);
- labor standards in the supply chain, including responsible contractor and supplier policies and commitments;
- health and safety violations;
- gender and racial pay disparities by job classification;
- the percentage of employees that are represented by a union by job classification, gender, and race;

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[56] See, Letter from Meredith Miller, Human Capital Management Coalition, to William Hinman and Brent J. Fields, SEC, July 6, 2017, *available at* **https://www.sec.gov/rules/petitions/2017/petn4-711.pdf**.

[57] *See, e.g.*, MLT Black Equity at Work Certification, Management Leadership for Tomorrow, *available at* **https://www.mltblackequityatwork.org/how-it-works/** (focusing on:

1. Increasing Black employee representation at every level of the organization, from the Board of Directors and senior leaders to middle management and professionals to the organization as a whole;
2. Ensuring pay equity between Black and White employees in similar roles and that lower paid roles receive a living wage and benefits, which has an outsized positive impact for Black employees and their families;
3. Creating an anti-racist workplace where Black employees feel they belong, are valued, and can advance;
4. Progressing toward proportionate vendor and supplier spending with Black-owned businesses and proactively utilizing organizational capabilities in support of Black equity; and
5. Contributing to non-profit organizations working to increase Black equity and investing a small portion of cash deposits in Black-focused financial institutions and/or investment products.) (last checked Feb. 1, 2021).

[58] *Recommendation of the Investor Advisory Committee: Human Capital Management Disclosure*, SEC Investor Advisory Committee, Mar. 28, 2019, *available at* **https://www.sec.gov/spotlight/investor-advisory-committee-2012/human-capital-disclosure-recommendation.pdf**.

[59] See, Letter from Cambria Allen-Ratzlaff, Human Capital Management Coalition, to Vanessa Countryman, SEC, Oct. 22, 2019, *available at* **https://www.sec.gov/comments/s7-11-19/s71119-6322887-194462.pdf**.

[60] AFL-CIO, *Valuing America's Greatest Asset: Corporate Disclosure of Human Capital Management*, Sept. 20, 2016, *available at* **https://www.sec.gov/comments/4-711/4711-2596141-161123.pdf** (Appendix B); see also Letter from Heather Slavkin Corzo, AFL-CIO, to Hons. Jay Clayton, Kara Stein, and Michael Piwowar, SEC, Sept. 22, 2017, *available at* **https://www.sec.gov/comments/4-711/4711-2596141-161123.pdf**.

- benefits (including health care, retirement funds, and other expenditures) to workers, delineated by job classification, gender, and race;
- general strategies and goals related to human capital management;
- legal or regulatory proceedings related to employee management; and
- potential for political instability and violence in areas of operation, and other risks to workers.

Put simply, for most companies, employees and executives are key assets. How they are treated is of utmost importance to not just their affiliated people, but also to those with whom the company may do business.

Enhance Disclosures of Tax Practices

While the SEC requires certain details about companies' taxes, the disclosures are often far from sufficient to determine a company's tax rate or risks in various jurisdictions. These factors may be significant for specific companies.

While leading extensive investigations by the U.S. Senate Permanent Subcommittee on Investigations into corporate offshore tax abuses, then-Senator Carl Levin introduced a number of measures to combat perceived corporate tax abuses, including the public disclosures of companies' country-by-country tax information.[61] More recently, there has been legislation in the Congress[62] that would require public disclosure of companies' offshore tax and other key financial information on a country-by-country basis.. That legislation has not yet been adopted.

Investors and other corporate stakeholders have nevertheless continued to seek more detailed tax information, including through offering tens of thousands of comments to the SEC in response to its Concept Release.

In response to these and other pressures, the Financial Accounting Standards Board is considering requiring enhanced disclosures of corporate taxes and other key financial information, and has received many comments in support of additional tax-related disclosures, including from the SEC's Investor Advisory Committee,[63] investors, market participants, and advocacy organizations.[64] The outgoing FASB Chairman Russell Golden publicly endorsed jurisdiction-by-jurisdiction reporting in February 2020.[65]

In addition, the Global Reporting Initiative (GRI), which publishes standards for corporate reporting on sustainability issues, adopted GRI Standard 207 on tax which includes public, country-by-country reporting of tax payments and other key financial information. The standard came into effect on January 1, 2021.[66]

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[61] Press Release, *Levin Unveils Stop Tax Haven Abuse Act*, Financial Transparency Coalition, July 12, 2011, *available at* **https://financialtransparency.org/levin-unveils-stop-tax-haven-abuse-act/**.

[62] See S.1609, *Disclosure of Tax Havens and Offshoring Act,* 116th Cong. (2019), *available at* **https://www.congress.gov/bill/116th-congress/senate-bill/1609/text**.

[63] Letter from John Coates, Investor as Owner Subcommittee of the SEC's Investor Advisory Committee, to the Director Cosper, FASB, July 12, 2017, *available at* **https://www.sec.gov/spotlight/investor-advisory-committee-2012/iac-letter-fasb-corporate-income-taxes-071217.pdf**.

[64] *See, e.g*., Letter from AFL-CIO, *et. al.*, to Shayne Kuhaneck, FASB, May 31, 2019, *available at* **https://thefactcoalition.org/investors-representing-more-than-1-trillion-in-assets-under-management-sent-a-letter-to-fasb-supporting-country-by-country-reporting/**.

[65] FASB Board Meeting, February 2020. **https://www.youtube.com/watch?v=JjOcYWHo_z0&list=PLRtxV_jsgMy_2YNd-klrordHnrQWgWSOC&index=23**.

[66] **https://www.globalreporting.org/media/sfcpcrt4/gri-207-tax-standard-2019-factsheet.pdf?id=1616**

We recommend that the SEC build upon these recommendations and require the disclosure of information on each tax jurisdiction, including the following:

- revenues generated from transactions with other constituent entities;
- revenues not generated from transactions with other constituent entities;
- profit or loss before income tax;
- total income tax paid on a cash basis to all tax jurisdictions;
- total accrued tax expense recorded on taxable profits or losses;
- stated capital;
- total accumulated earnings;
- total number of employees on a full-time equivalent basis;
- a complete list of subsidiaries; and
- net book value of tangible assets, which, for purposes of this section, does not include cash or cash equivalents, intangibles, or financial assets.[67]

This information would help investors and the public identify potential tax-related risks, as well as potential abuses.

Enhance Disclosures Relating to Stock Buybacks

In recent years, corporate stock buybacks have become a major expenditure for many companies. For years, workers groups, unions, investors, and others have pressed the SEC to enhance disclosures related to stock buybacks, which they argue may be the result of skewed executive compensation, and wasteful of corporate resources.

During the pandemic, it became exceedingly clear that some companies' stock buyback programs negatively affected their ability to survive the crisis. For example, the five largest U.S. airlines (Delta, American, United, Southwest, and Alaska), which received tens of billions of dollars in federal bailout funds, spent $44.9 billion in buybacks and dividends in the preceding five years,[68] equal to roughly 96% of their free cash flow.[69] Despite receiving federal bailout funds, tens of thousands of employees lost their jobs at these airlines.[70] Investors and other stakeholders (such as suppliers, creditors, and workers) have questioned whether the companies may have weathered the financial storm more effectively without the buybacks.

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[67] See, e.g., S.1609, *Disclosure of Tax Havens and Offshoring Act,* 116th Cong. (2019), *available at* **https://www.congress.gov/bill/116th-congress/senate-bill/1609/text**.

[68] William Turvill, *US airlines pushing for massive bailout gave $45bn to shareholders in five years*, The Guardian, Mar. 18, 2020, *available at* **https://www.theguardian.com/business/2020/mar/18/america-airlines-bailout-shareholders-coronavirus**.

[69] Brandon Kochkodin, *U.S. Airlines Spent 96% of Free Cash Flow on Buybacks*, Bloomberg, Mar. 16, 2020, *available at* **https://www.bloomberg.com/news/articles/2020-03-16/u-s-airlines-spent-96-of-free-cash-flow-on-buybacks-chart**.

[70] Leslie Josephs, *U.S. airline employment to reach lowest levels in decades after pandemic cuts 90,000 jobs*, NBC, Nov. 12, 2020, available at **https://www.cnbc.com/2020/11/12/us-airline-employment-to-reach-lowest-levels-in-decades-after-pandemic-cuts-90000-jobs.html**.

The SEC should consider requiring issuers to disclose information regarding the relationship between buybacks and the issuer's overall capital strategy, including:

- the source of funding for stock repurchases, including the impact on the issuer's cash holdings, debt, and credit ratings;
- the time frame over which the issuer expects to buy back its stock and an explanation of the objective of the stock repurchases;
- an analysis of the issuer's expenditures on stock repurchases compared to the issuer's spending on research and development and capital expenditures in the management discussion and analysis section of the issuer's annual 10-k filings;
- executive compensation performance metrics and the issuer's weightings and if those metrics are affected by repurchases; and
- an explanation of the rationale for the stock buybacks when the cost of the repurchases exceeds their net income or cash generated from operating activities during that period.

We note that there is often a strong connection between stock buybacks and executive compensation performance metrics (such as earnings per share and return on equity). This information about buybacks generally, and its relationship to compensation as well as other potential uses of corporate funds, would provide stakeholders with far greater insight into not just current risks facing companies, but also the companies' future investments, opportunities, and risks (including companies' abilities to weather future stresses).

Enhance Disclosure Requirements for Financial Companies

The SEC should consider requiring banks and bank holding companies (BHCs) to disclose climate-related risks that impact their holdings directly, as well as the risks that may impact the banking industry generally. The SEC should consider requiring banks and BHCs to disclose how the physical risks associated with climate change, including increased flooding, wildfires, and power outages, threaten to devalue specific assets, such as agricultural, real estate, and other loans or credit exposures. Banks and BHCs should also disclose how the physical risks of climate change threaten to damage critical infrastructure.

Additionally, the SEC should consider requiring banks and BHCs to disclose the potential impacts of climate-related transition risks. Specifically, the SEC should consider requiring the inclusion of a new category of assets in "Distribution of Assets" disclosure to identify assets within "high impact sectors" that have immediate and direct exposure to transition risks. First, banks and BHCs should be required to disclose investments in debt securities of issuers in high impact sectors (e.g., fossil fuels), including the weighted average yield of those investments. Second, banks and BHCs should disclose all loans to borrowers in high impact sectors, including maturity analysis,[71] interest rate sensitivity,[72] credit ratios and credit losses, and "foreign outstanding's." Finally, banks and BHCs should disclose loan loss experience in high impact sectors.

The immediacy of these risks and the need for more disclosure is highlighted by S&P Global Ratings' January 25, 2021 reclassification of the oil and gas industry risk assessment from "intermediate" to

[71] This should include both expected maturity and legal final maturity, particularly for structured finance products.

[72] This should include nonaccrual, past due, restructured, and "potential problem" loans.

"moderately high" risk.[73] As part of that change, thirteen oil and gas companies were put on CreditWatch and placed on notice of a potential downgrade.[74]

Further, the SEC should consider requiring banks and BHCs to disclose "climate impact" analyses based on financed emissions. The SEC should leverage the work of the Partnership for Carbon Accounting Financials (PCAF) for methodologies and approaches to "financed emissions."[75] Several large U.S.-based financial institutions, including the Bank of America, Citi,[76] and Morgan Stanley,[77] have already committed to the PCAF methodology, which may ease its U.S. uptake.

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[73] Press Release, *S&P Global Ratings Takes Multiple Rating Actions On Major Oil And Gas Companies To Factor In Greater Industry Risks*, S&P Global Ratings, Jan. 26, 2021, *available at* **https://www.prnewswire.com/news-releases/sp-global-ratings-takes-multiple-rating-actions-on-major-oil-and-gas-companies-to-factor-in-greater-industry-risks-301215457.html**.

[74] *Id.*

[75] Partnership for Carbon Accounting Financials, 2021, *available at* **https://carbonaccountingfinancials.com**.

[76] Press Release, *Citi Announces New Five-Year Sustainable Progress Strategy to Finance Climate Solutions and Reduce Climate Risk*, Citigroup, July 29, 2020, *available at* **https://www.citigroup.com/citi/news/2020/200729a.htm**.

[77] Press Release, *Morgan Stanley Joins Leadership of Global Carbon Accounting Partnership*, Morgan Stanley, July 20, 2020, *available at* **https://www.morganstanley.com/press-releases/morgan-stanley-joins-leadership-of-global-carbon-accounting-part**.

Enhance Stakeholder Rights and Engagement

The disclosure of material information alone is insufficient to maintain the health and reliability of capital markets and to ensure corporate accountability. It is also crucial that investors and other stakeholders have the ability to make use of that information in their decisions. Moreover, as investments and divestment alone are rough instruments, investors need to be empowered to effectively engage with companies, make informed voting decisions, and have sufficient access to courts and class actions.

Rather than empowering investors and stakeholders to better hold companies and executives accountable for their decisions, the SEC has been going in the other direction. In 2020, for example, the agency took actions to limit investment advisers' use of proxy advisors[78] and the ability of shareholders to offer shareholder proposals through Rule 14a-8.[79] Collectively, these efforts are intended to restrict investors from taking action like they did with Chevron, in which shareholders required the company to align its climate-policy lobbying activities with the goals of the Paris Agreement.[80]

The relatively newfound willingness of large investment advisers to vote for shareholder proposals on high-profile, impactful ESG issues is a significant (and likely concerning) development for issuers generally, but particularly for those in industries that are often "disfavored" by ESG-conscious investing, such as the oil and gas industry or the arms industry. Nevertheless, we urge the SEC to not only restore investor and stakeholder rights, but also expand upon them.

Increase Shareholder Proxy Access

Over the past few decades, corporate issuers and their advocates have successfully lobbied the SEC to limit investors' ability to put proposals forward to a vote. Issuers and their advocates have argued that shareholders are wasting precious resources on irrelevant and immaterial matters. Even more interestingly, some have even argued that shareholder proposals waste investors' time.[81]

That is, of course, not how most investors and their advocates feel. Many institutional investors have fought vigorously for more information and rights regarding their investments and have resisted the SEC's efforts to strip them of powers.[82]

The SEC should consider amending its recently revised Rule 14a-8 to permit all investors who have owned at least $1,000 worth of stock in a company for at least one year to submit shareholder proposals for inclusion in the company's proxy materials.[83] Similarly, the SEC should consider returning to lower proxy

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[78] *Exemptions From the Proxy Rules for Proxy Voting Advice*, SEC, 85 Fed. Reg. 55082 (Sept. 3, 2020), *available at* **https://www.govinfo.gov/content/pkg/FR-2020-09-03/pdf/2020-16337.pdf**.

[79] *Procedural Requirements and Resubmission Thresholds Under Exchange Act Rule 14a–8*, SEC, 85 Fed. Reg. 70240 (Nov. 4, 2020), *available at* **https://www.govinfo.gov/content/pkg/FR-2020-11-04/pdf/2020-21580.pdf**.

[80] Rachel Koning Beals, *For first time ever, majority of shareholders push oil giant Chevron to align with Paris climate pact*, MarketWatch, June 24, 2020, *available at* **https://www.marketwatch.com/story/for-first-time-ever-majority-of-shareholders-push-oil-giant-chevron-to-align-with-paris-climate-pact-2020-06-23**.

[81] *See, e.g.*, Remarks by Hon. Daniel Gallagher, SEC, before the Proxy Voting Roundtable, Feb. 19, 2015, *available at* **https://www.sec.gov/news/statement/opening-statement-proxy-voting-roundtable-gallagher.html** ("The cost to an individual shareholder—in time and effort to review scores of pages of proxy disclosures, form a reasoned view on how to vote the proxy, and then undertake the mechanics of casting that ballot—tends to outweigh the benefits of voting.").

[82] *See, e.g.,* Letter from Ken Bertsch and Jeff Mahoney, Council of Institutional Investors, to Vanessa Countryman, SEC, Jan. 30, 2020, *available at* **https://www.sec.gov/comments/s7-23-19/s72319-6729684-207400.pdf**; *see also,* Letter from Brandon Rees, AFL-CIO to Vanessa Countryman, SEC, Nov. 27, 2019, *available at* **https://www.sec.gov/comments/s7-22-19/s72219-6487251-199508.pdf**; *see also,* Letter from Marcie Frost, CalPERS, to Vanessa Countryman, SEC, Feb. 3, 2020, *available at* **https://www.sec.gov/comments/s7-23-19/s72319-6744100-207900.pdf**.

[83] Rule 14a-8 has long permitted shareholders owning a relatively small amount of a company's securities to have their proposals placed alongside management's proposals in that company's proxy materials for presentation to a vote at a shareholder meeting. Rule 14-a8 thus provides an avenue for

resubmission thresholds of 3%, 5%, and 10%. Lowering proxy resubmissions thresholds is particularly important as shareholder proposals typically require several years to gain support.

These reforms would directly contradict the controversial amendments made to Rule 14a-8 in September 2020, which were adopted over objections from the vast majority of commenters and investors.[84]

The SEC should also consider revising its guidance and no-action request process for companies seeking to exclude proposals from proxy materials. The SEC should favor the inclusion of shareholder proposals, particularly those that may be ESG-related, and should seek to limit its reliance on the "ordinary business" exemption. Proxy access plays a key role for many asset owners and other investors' efforts to engage with the executives of their portfolio companies to improve their behavior, including ESG-related practices.[85] It should be promoted, not restricted.

Create New Process for Investors to More Easily Compel Corporate Disclosures

One novel idea could be for the SEC to expand its proxy process for shareholder proposals related to corporate disclosures. As discussed above, the legal concept of "materiality" is based on what a "reasonable investor" would find important. Nevertheless, the SEC has traditionally limited its mandatory disclosures to information that is arguably directly related to the finances and operations of the company. Information that may not be financially "significant" to the company's overall finances is often not required.

As we have seen in recent years, many investors seek information from companies that may not be financially significant but may nevertheless be important. Shareholders have petitioned the SEC for political spending disclosures, for example. However, under the SEC's existing regulatory framework, when the disclosures are not explicitly mandated by the SEC, shareholders will be forced to submit a proposal, ensure that it survives the often-draconian no-action process, and then win the shareholder vote. That burden is far greater than what the law can support—which is that if a reasonable investor wants some information from the company, she should get it.

Accordingly, we recommend that the SEC adopt a rule that, for proposals seeking company disclosures, the proposal may only be excluded from vote under rare circumstances, and that if the proposal receives at least 20% of the vote, then the company shall make such disclosures in the next subsequent annual report. The tie to a 20% voting stake would ensure that the proposal has sufficient support from "reasonable" investors in the company and would help fill the gaps between the disclosures compelled by the SEC and the information that investors are actually seeking from the companies they own.

Increase Investor Access to and Ability to Rely Upon Expert Advice: Proxy Advisors

Proxy advisors play an essential role informing asset owners on a slew of issues of importance to investment outcomes, including corporate governance, executive compensation, risk management practices, and more. Unfortunately, because proxy advisors sometimes advise shareholders against

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communication between shareholders and companies, as well as among shareholders themselves. Pursuant to the September 2020 revisions, a shareholder who wishes to submit a proposal for inclusion must demonstrate continuous ownership of at least (1) $2,000 of the company's securities for at least three years, (2) $15,000 of the company's securities for at least two years, or (3) $25,000 of the company's securities for at least one year. *Procedural Requirements and Resubmission Thresholds Under Exchange Act Rule 14a–8*, SEC, 85 Fed. Reg. 70240 (Nov. 4, 2020), *available at* **https://www.govinfo.gov/content/pkg/FR-2020-11-04/pdf/2020-21580.pdf**.

[84] The controversial September 2020 amendments to Rule 14a-8 raised proxy resubmission thresholds to 5%, 15% and 25%. *Id.*

[85] *See, e.g.*, Letter from Marcie Frost, CalPERS, to Vanessa Countryman, SEC, at 2, Feb. 3, 2020, available at **https://www.sec.gov/comments/s7-23-19/s72319-6744100-207900.pdf**.

corporate management proposals (such as for executive compensation), these advisors have long been a target of issuers and their advocates. In 2020, over the objections of many investors and Commissioner Allison Lee,[86] the SEC adopted significant changes to the ability of proxy advisors to offer clear, timely, and informed advice to investors.[87] Those changes were, from an investor's perspective, unwarranted, unwanted, and unworkable.[88]

The SEC should reverse course and improve investor ability to obtain and rely upon expert advice when considering shareholder votes. In particular, the SEC should consider:

- revising Rule 14a-2(B) to improve the timeliness, content, and utility of proxy advice;[84]
- revising Rule 14a-1(l) and Section 14(A) to clarify that proxy advisers are only engaged in "soliciting" votes if they have either a direct financial stake in securities of the company at issue or a financial stake in the outcome;
- issuing guidance for investment advisers to allow for more direct and reasonable reliance on advice from proxy advisers for voting recommendations; and
- removing procedural obligations that require excessive deference to management when determining how to vote.

These revisions would have particular impact on proposals for which investors may lean more heavily upon proxy advisers, and those issues are often considerations like corporate governance and other ESG factors.

End Dual Class Share Structures

Historically, the basket of rights that accompanied ownership of equity securities included a right to vote on issues of relevance to the company, including at the shareholder meeting and through proxies. Unfortunately, in recent years, companies have been permitted to list despite having tiered share structures, with executives and early investors often receiving outsized voting privileges. These share structures directly inhibit shareholders' abilities to hold the executives accountable for any actions, including those related to how companies are addressing broader risks, such as climate change, but also how they hire, train, promote, treat, and pay their employees.

As the Council of Institutional Investors has argued, "When a company goes to the capital markets to raise money from the public, equity investors with the same residual claims should have equal protections and rights, including the right to vote in proportion to the size of their holdings."[89]

We recommend that the SEC determine that dual class share structures are not "in the public interest" and do not "protect investors."[90] Upon making that determination, the SEC should then direct the listing

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[86] Remarks of Hon. Allison Herren Lee, SEC, *Paying More For Less: Higher Costs for Shareholders, Less Accountability for Management*, July 22, 2020, *available at* **https://www.sec.gov/news/public-statement/lee-open-meeting-2020-07-22**; see also, Letter from Gary Retelny, Institutional Shareholder Services, to Vanessa Countryman, SEC, Jan. 31, 2020, *available at* **https://www.sec.gov/comments/s7-22-19/s72219-6732023-207470.pdf**; Letter from Marcie Frost, CalPERS, to Vanessa Countryman, SEC, Feb. 3, 2020, *available at* **https://www.sec.gov/comments/s7-22-19/s72219-6744092-207880.pdf**.

[87] *Exemptions From the Proxy Rules for Proxy Voting Advice*, SEC, 85 Fed. Reg. 55082 (Sept. 3, 2020), *available at* **https://www.govinfo.gov/content/pkg/FR-2020-09-03/pdf/2020-16337.pdf**.

[88] Remarks of Hon. Allison Herren Lee, SEC, *Paying More For Less: Higher Costs for Shareholders, Less Accountability for Management*, July 22, 2020, *available at* **https://www.sec.gov/news/public-statement/lee-open-meeting-2020-07-22**.

[89] *Dual-Class Stock*, Council of Institutional Investors, *available at* **https://www.cii.org/dualclass_stock** (last visited Jan. 26, 2021).

[90] See, 15 U.S.C. §78f.

exchanges to revise their listing standards to reflect the reality that prolonged dual class share structures are inconsistent with the requirements of the Securities Exchange Act, which requires that the Commission find that their rules:

- protect investors; and
- are in the public interest.[91]

While the vast majority of listed companies have one share one vote governance, there is a notable increase in frequency of dual-class companies making IPOs. If these structures persist, or worse, continue to expand, they will directly inhibit the ability of investors to hold companies or their executives accountable for how they are addressing (or not addressing) issues like climate change and systemic racism, or how they treat their workers.

Adopt Universal Proxy Ballots to Permit Replacing Management-Supported Directors

One of the most basic rights for shareholders is, at least theoretically, to fire underperforming, unqualified, conflicted, or otherwise unsupported directors. However, under existing rules, exercising this right may be essentially impossible. When there are more director candidates than seats, companies typically offer a "management slate" card and another "shareholder slate" card. Shareholders are then forced to choose one card, along with all of the members on it. However, there is a catch. In general, management can prevent a shareholder from putting the name of a person on the shareholder card if that person is also on the management card. This effectively prevents shareholders from being able to replace one director, while keeping others. In a number of companies, such as fossil fuel and utility companies, shareholders have sought to change board composition, for example, to add a "green energy" expert. However, unless the investors are willing to remove a full slate of directors, then the shareholders are likely to be unsuccessful. The current ballot system essentially protects all but the most egregious board members and positions from direct shareholder recourse.

In 2016, the SEC proposed fixing this problem with a so-called "universal proxy."[92] Under the proposed rule, shareholders would be able to mix and match candidates from both slates, which would give shareholders the ability to remove concerning directors without having to remove an entire slate. We recommend that the SEC simply adopt the universal proxy without delay.

Prohibit Unreasonable Restrictions on Private Rights of Action

Private rights of action allow investors to directly hold companies and their executives accountable, and the PSLRA and SLUSA both re-affirmed the Congress's commitment to protecting that private right of action.[93] Twice, companies have sought to go public with mandatory investor arbitration clauses, and both times, the companies backed down after facing stiff staff-level resistance to the arbitration demand.

[91] 15 U.S.C. §78f(a) and (b)(5). Notably, the SEC has recently begun relying on these requirements of the Exchange Act to challenge and disapprove some rule filings. However, the SEC has not yet used these provisions to more directly address listing standards.

[92] *Universal Proxy*, SEC, 81 Fed. Reg. 79122 (Nov. 10, 2016), *available at* **https://www.govinfo.gov/content/pkg/FR-2016-11-10/pdf/2016-26349.pdf**.

[93] *See, e.g.*, Joint Explanatory Statement of the Committee of Conference on H.R. 1058, reprinted in 2 U.S.C.A.A.N. 730 (104th Cong. 1995) (report to the Private Securities Litigation Reform Act of 1995) ("PSLRA"); see also Securities Litigation Uniform Standards Act of 1998, Pub. L. 105-353, 105th Cong. (1998) ("SLUSA").

Nevertheless, in recent years, some issuer advocates have sought the SEC's explicit or implicit approval for issuers to block shareholder derivative lawsuits.[94] In response, the SEC staff has provided "no action" relief to companies facing shareholder proposals to limit shareholders' rights to sue.

Still, through creative maneuvering, some shareholder proposals to limit shareholders' own rights have gone to investor votes. And while investors have won those votes thus far, we question whether that will necessarily always be the case—especially considering circumstances when there may be dual class share structures or other factors in play.

The SEC should thus consider adopting new rules under the Securities Act, Exchange Act, and Investment Advisers Act to prohibit corporate issuers from adopting unreasonable restrictions on investor ability to bring legal action. In particular, the SEC should consider prohibiting the use of mandatory arbitration clauses and limiting the use of forum selection clauses.[95]

[94] *See, e.g.,* Dave Michaels, *Johnson & Johnson Drafted Into Fight Over Shareholder Lawsuits*, Wall Street Journal, Dec. 13, 2018, *available at* **https://www.wsj.com/articles/johnson-johnson-drafted-into-fight-over-shareholder-lawsuits-11544737867**,

[95] *See generally*, Barbara Roper and Micah Hauptman, *A Settled Matter: Mandatory Shareholder Arbitration Is Against the Law and the Public Interest*, Consumer Federation of America, (2018), *available at* **https://consumerfed.org/wp-content/uploads/2018/08/cfa-mandatory-shareholder-arbitration-white-paper.pdf**.

Modernize Expectations for Investment Fiduciaries

Investment fiduciaries, such as investment advisers and broker-dealers, play key roles in helping millions of American families and businesses responsibly manage their assets. Because these firms advise and direct the deployment and use of investor assets, they can "either facilitate or undermine alignment between corporations and stakeholders."[96]

Thousands of asset managers representing trillions of dollars in assets under management are incorporating ESG information into their decisions voluntarily, as they understand that considering ESG factors is crucial for long-term investment success and a critical component of their responsibilities to their customers and beneficiaries.[97] In late 2019, the Principles for Responsible Investment (which is affiliated with the United Nations), has declared that asset managers' fiduciary duties "require them" to:

- incorporate environmental, social and governance (ESG) issues into investment analysis and decision-making processes, consistent with their investment time horizons;
- encourage high standards of ESG performance in the companies or other entities in which they invest;
- understand and incorporate beneficiaries' and savers' sustainability-related preferences, regardless of whether these preferences are financially material;
- support the stability and resilience of the financial system; and
- report on how they have implemented these commitments.[98]

That is, of course, not necessarily the current law. As discussed above, the law requires corporate disclosure of "material" factors, but it's not entirely clear that even fiduciary duties require the consideration of those disclosures or factors. On the one hand, it seems relatively easy to note how even a broad-based index fund of Fortune 100 companies could be impacted by various ESG factors in "material" ways. On the other, how would a quantitative investment adviser with a momentum trading strategy consider more "fundamental" issues related to ESG factors?

The SEC has failed to ensure that investment fiduciaries are taking any action to consider ESG-related issues, and to the extent that ESG information is being voluntarily made available today, it is often not complete, specific, comparable, widely available, or well-verified.[99] Not surprisingly, the press, asset owners, and other transparency advocates have often struggled to match investment advisers' ESG-related claims to their investment-related decisions.[100]

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[96] Tyler Gellasch and Alexandra Thornton, *Modernizing the Social Contract With Investment Fiduciaries*, Center for American Progress, (Nov. 18, 2020), *available at* **https://www.americanprogress.org/issues/economy/reports/2020/11/18/492982/modernizing-social-contract-investment-fiduciaries/**.

[97] Several reviews of the academic literature find clear a correlation between ESG criteria and corporate financial performance. And a range of academic evidence indicates that incorporating ESG factors into business operations has significant benefits (including overall lower costs of capital) and limited costs. Andy Green and Andrew Schwartz, *Corporate Long-Termism, Transparency, and the Public Interest*, Center for American Progress, (Oct. 2, 2018), *available at* **https://www.americanprogress.org/issues/economy/reports/2018/10/02/458891/corporate-long-termism-transparency-public-interest/**.

[98] Principles for Responsible Investment, *Fiduciary Duty in the 21st Century*, at 8, *available at* ***https://www.unpri.org/download?ac=9792***.

[99] Gellasch and Thornton.

[100] *See, e.g.*, Lucca De Paoli and Alastair Marsh, *BlackRock, Vanguard Show Little Favor for Shareholder ESG Votes*, BloombergQuint, Dec. 1, 2020, *available at* **https://www.bloombergquint.com/onweb/blackrock-vanguard-show-little-favor-for-shareholder-esg-votes** (Finding that "The world's

Perversely, these inconsistencies have given rise to new risks for investment advisers who make claims regarding their ESG-related practices. Put simply, they may face legal liability for what is essentially false advertising. For example, in late 2019, it was reported the asset managers who had joined the UN Principles for Responsible Investment were facing scrutiny from the SEC related to potential so-called "greenwashing."[101]

While the SEC has generally imposed no substantive or process requirements on investment fiduciaries related to consideration of ESG-related factors,[102] regulators in other jurisdictions are beginning to require not just the identification and consideration of ESG-related factors, but also specific actions by fiduciaries.[103]

Require Sustainable Investment Policies (and Related Disclosures)

Many investment advisers around the world have been integrating the consideration of ESG-related factors into their investment processes for years. ESG integration into investment processes, including consideration of climate-related risks, worker pay and policies, political spending, and tax practices, has been shown to significantly impact investment performance,[104] and some leading asset owners, such as the New York City Employees' Retirement System, have adopted contractor policies based in part upon findings that those policies were profitable.[105]

Unfortunately, it is generally unclear whether and to what extent different investment advisers and funds may be considering these factors. Further, given a lack of standard requirements, it is extremely difficult for investors, the public, or even third-party experts to meaningfully compare practices across firms. Disclosures, if any, often come in the form of glossy brochures or annual letters[106] to customers and may not be complete or accurate representations of the firms' actual practices. As SEC Commissioner Hester Peirce explained in a 2020 speech, "[i]dentifying asset managers who proclaim ESG, but don't live it, is not so easy."[107]

We suggest that the SEC help solve that problem by requiring investment advisers to adopt and implement standardized policies, procedures, and practices to accurately identify, assess, and address ESG-related

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two biggest money managers gave their support to less than a sixth of shareholder climate and social resolutions, despite commitments to do more to combat the effects of climate change.").

[101] Juliet Chung and Dave Michaels, *ESG Funds Draw SEC Scrutiny*, Wall Street Journal, Dec. 16, 2019, *available at* **https://www.wsj.com/articles/esg-funds-draw-sec-scrutiny-11576492201**.

[102] Notably, however, in late 2020, the Department of Labor issued a rule stating that ESG factors can only be incorporated into investment decisions if they can be *"justified solely on the basis of pecuniary factors," and it would be a violation of ERISA to choose investments with expected reduced returns to secure non-pecuniary ESG-related benefits. Financial Factors in Selecting Plan Investments*, Dep't of Labor, 85 Fed. Reg. 72846 (Nov. 13, 2020) *available at* **https://www.govinfo.gov/content/pkg/FR-2020-11-13/pdf/2020-24515.pdf**. The new rule also effectively prohibits fiduciaries from using as "Qualified Default Investment Alternatives" any fund, product, or model portfolio whose strategies include, consider, or indicate the use of any non-pecuniary ESG-factors. *Id.*

[103] *See, e.g., Taking action on climate risk: improving governance and reporting by occupational pension schemes*, U.K. Dep't of Work and Pensions, (2020), *available at* **https://www.gov.uk/government/consultations/taking-action-on-climate-risk-improving-governance-and-reporting-by-occupational-pension-schemes**.

[104] Andrew Green and Andrew Schwartz, *Corporate Long-Termism, Transparency, and the Public Interest*, Center for American Progress, Oct. 2, 2018, *available at* **https://www.americanprogress.org/issues/economy/reports/2018/10/02/458891/corporate-long-termism-transparency-public-interest/**; see also, Shanny Basar, *Cboe Launches ESG Options*, Markets Media, Oct. 6, 2020, *available at* https://www.marketsmedia.com/cboe-launches-esg-options/.

[105] Office of the New York City Comptroller, *New York City Employees' Retirement System: Statement of Investment Policy for Responsible Contractor Policy* (May 2017), *available at* **https://comptroller.nyc.gov/wp-content/uploads/2017/09/RCP-Final-052317_NYCERS.pdf**.

[106] *See, e.g.*, Letter from Larry Fink, Blackrock, to shareholders, Mar. 29, 2020, *available at* **https://www.blackrock.com/corporate/investor-relations/larry-fink-chairmans-letter**.

[107] Remarks of Hon. Hester Peirce, SEC, *before the Harvard Law School and Program on International Financial Systems*, Sept. 17, 2020, *available at* **https://www.sec.gov/news/speech/peirce-lucys-human-091720**.

risks and opportunities (*e.g.*, "Sustainable Investment Policies").[108] This concept, which has been suggested by SEC Commissioner Allison Herren Lee, could provide much greater clarity for investors, regulators, and the public about how investment advisers are considering (or not) various ESG factors.[109]

One way to implement this could be for the SEC to adopt a rule under Section 203(c)(1)(C) of the Investment Advisers Act to amend Form ADV[110] to require investment advisers to adopt and implement Sustainable Investment Policies, which would include an explanation of how the adviser identifies, assesses, and addresses key ESG issues.[111] Policies should also integrate all material ESG-related financial information and be publicly disclosed on Form ADV, reviewed and approved annually, and audited for compliance.

Further, the SEC could adopt a rule under the Investment Company Act to require funds to disclose ESG-related information on their Prospectus and Statement of Additional Information. Specifically, funds should disclose how they identify, assess, and address key ESG issues, including the manner in which they vote and otherwise engage with companies of portfolio securities. These disclosures should also include whether the fund has been audited for compliance with the Sustainable Investment Policies.

The widespread adoption of Sustainable Investment Policies would be particularly helpful in enabling third-party reviewers (e.g., Morningstar) to provide more informed and reliable comparisons of ESG-related policies, procedures, and practices across funds and advisers. This is an important step forward, because while many investors currently rely on these reviewers, policymakers and regulators are concerned that these third-party analyses of investors' ESG policies, procedures, and practices may be inaccurate, misleading, or wastes of time.

Improving the volume, quality, and comparability of the data that investors and third-party experts use for their analysis would help promote competition amongst investment advisers and funds based on Sustainable Investment Policies.

While these changes could be made without a direct legislative mandate, we note that legislation has already been introduced that would amend the Investment Advisers Act to require Sustainable Investment Policies.

Adopt Guidance to Consider Relevant ESG Factors

The SEC should consider offering guidance to investment advisers regarding their consideration of relevant ESG factors and related disclosures. As discussed below, this guidance should also make it clear that the fiduciary duty requires investment advisers to vote in the interests identified by the client or in the manner

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[108] *See generally*, Tyler Gellasch and Alexandra Thornton; see also, Sona Mahida, *Fiduciary Duty is Not an Obstacle to Addressing ESG*, Int'l Endowments Network, **https://www.intentionalendowments.org/fiduciary_duty_is_not_an_obstacle_to_addressing_esg**.

[109] Remarks by Hon. Allison Herren Lee, SEC, before the Practicing Law Institute's 52nd Annual Institute on Securities Regulation, Nov. 5, 2020, *available at* **https://www.sec.gov/news/speech/lee-playing-long-game-110520**.

[110] Generally, the SEC requires investment advisers to submit a "Form ADV," which includes information about the investment adviser's business, ownership, clients, employees, business practices, as well as a narrative description of the firm's operations. For more information, see **https://www.investor.gov/introduction-investing/investing-basics/glossary/form-adv#:~:text=Form%20ADV%20is%20the%20uniform,SEC%20and%20state%20securities%20authorities.&text=Part%201%20requires%20information%20about,the%20adviser%20or%20its%20employees**.

[111] Factors mandated for consideration should include climate and environmental risks; worker rights, compensation, health and safety, and diversity and inclusion; political spending and lobbying practices; corporate tax risks; competition strategy risks; and supply chain risks, including human rights, among others that are commonly required by national and internationally recognized independent sustainable investing standard-setters. *See, e.g.,* Tyler Gellasch and Alexandra Thornton; *see also*, H.R. 8960, *Sustainable Investment Policies Act of 2020*, 116th Cong. (2020), *available at* **https://www.congress.gov/bill/116th-congress/house-bill/8960/text?r=1&s=1**.

the adviser considers to be most consistent with the long-term interests of the beneficiaries (and discloses that to their customers).[112]

Require Investment Advisors and Brokers to Identify and Address Customer Preferences

The SEC should consider requiring both broker-dealers and investments advisers to identify and seek to effectuate the ESG preferences of their customers. We recommend that the SEC amend the "Know-Your-Customer" regime to ensure that advisers seek information about customers' ESG-related preferences and periodically "check in" to ensure those preferences remain accurate.

Similarly, the SEC should consider adopting revisions to Regulation Best Interests and the "suitability" doctrine to, in addition to integrating all material ESG-related financial information, require brokers to modify their approach to accurately reflect customers' articulated ESG-related preferences. This could, and should, also involve related suggestions to FINRA, which has significant oversight of broker-dealer sales practices.

[112] *See* Remarks by Hon. Allison Herren Lee.

Promote Integrity of ESG-Related Labeling of Investment Funds and Products

Investor demand for "sustainable" funds and products with ESG-related characteristics has skyrocketed. As a result, the market for financial instruments labeled and marketed as "ESG," "green," or "sustainable," has grown drastically in recent years. Over $200 billion in green bonds, intended to fund clean energy and environmental projects, were issued in 2020 alone, marking a sevenfold expansion in the market since 2015.[113] Similarly, "sustainable" or "ESG" branded funds have exploded in recent years.

Despite the explosive growth in the green-labeled financial market, there are no uniform standards or criteria for determining whether an investment product or fund is accurately labeled as "sustainable," and there is no government-sanctioned party or process for verification of "sustainable" status.[114] As Tensie Whelan (NYU Stern) wrote in the Wall Street Journal:

> *Not all ESG raters or fund managers agree on what constitutes a positive ESG investment, true. But just because the reviews on Yelp and Tripadvisor may not agree what restaurants are the best, that does not render them useless.*[115]

Absent standardization, transparency, and certification for "sustainable" labeled products and funds, there is a significant risk that fiduciaries may be misleading investors and the public by falsely labeling their products and practices as "sustainable."[116] At the same time, the preferential interest rates and fees charged for such products often exceed the fees for similar products without the "ESG" or other "sustainability" labeling.[117] This combination of factors seems ripe for potential abuses.

The SEC should consider adopting clear, uniform taxonomies for investment advisers and their funds, as well as for non-vehicle securities labeled or marketed as "sustainable," or with some other ESG-related designation.

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[113] Jinjoo Lee, *Green Bonds Need the Right Filter*, Wall Street Journal, July 1, 2020, *available at* **https://www.wsj.com/articles/green-bonds-need-the-right-filter-11593509402**. (noting that as the market for "sustainable" securities grow, so too will the temptation to loosen private standards, as certifiers will likely find it harder to reject business from large potential issuers, and green-designated funds will be tempted to broaden the definition of green when pressured to put more money to work.)

[114] Jinjoo Lee, *Green Bonds Need the Right Filter*, Wall Street Journal, July 1, 2020, *available at* **https://www.wsj.com/articles/green-bonds-need-the-right-filter-11593509402**.

[115] Mark L. Frigo, *ESG Funds Are Competitive and Doing Good*, Wall Street Journal, Sept. 28, 2020, *available at* **https://www.wsj.com/articles/esg-funds-are-competitive-and-doing-good-11601319254**.

[116] In 2017, for example, Spanish oil-and-gas company Repsol issued "green bonds" to fund energy-efficiency investments in chemical and refinery facilities. And in 2019, a subsidiary of crude-oil tanker company Teekay raised $125 million through issuance of green bonds to fund new tankers with electric motors. Jinjoo Lee, *Green Bonds Need the Right Filter*, Wall Street Journal, July 1, 2020, *available at* **https://www.wsj.com/articles/green-bonds-need-the-right-filter-11593509402**. Importantly, research shows that companies and governments selling green bonds can receive a premium as large as 0.11 percentage point, thus lowering the cost of borrowing. Issuing green bonds can also enhance a company's reputation or raise a company's profile with environmentally conscious investors. Matt Wirz, *Why Going Green Saves Bond Borrowers Money*, Wall Street Journal, Dec. 17, 2020, *available at* **https://www.wsj.com/articles/why-going-green-saves-bond-borrowers-money-11608201002?cx_testId=3&cx_testVariant=cx_24&cx_artPos=4#cxrecs_s**. *See also*, Dieter Holger, *As Funds Jump on the 'Sustainable' Bandwagon, Regulators Raise Concerns*, Wall Street Journal, Apr, 5, 2020, *available at* **https://www.wsj.com/articles/as-funds-jump-on-the-sustainable-bandwagon-regulators-raise-concerns-11586103274**.

[117] Danielle Walker, *Firms see embrace of ESG as way to garner more fees*, Pensions & Investments, Feb. 24, 2020, *available at* **https://www.pionline.com/esg/firms-see-embrace-esg-way-garner-more-fees**.

Establish Clear Labeling for ESG-Related Securities (Other Than Investment Vehicles)

The SEC should consider adopting standardized requirements for financial products that are labeled or marketed as "sustainable," "ESG," "green," or some other ESG-related description, such as "green" bonds.[118] Drawing upon the work of other jurisdictions and market participants,[119] the SEC should develop standardized criteria to determine whether securities qualify as "sustainable" according to an established taxonomy.

The SEC should consider requiring all issuers of such "sustainable" securities to disclose their specific policies, procedures, and practices for assessing how the products qualify for such status. This disclosure should include a description of the sustainability objectives of the securities, details of how those objectives are met, and the overall sustainability impact of both the securities and the issuer. For products intended to address climate change or environmental considerations, the SEC should consider requiring disclosure of:

- the identification and evaluation of potential financial impacts of, and any risk management strategies relating to, both the physical risks and transition risks posed to the covered issuer by climate change during the period;
- a description of any established governance processes and structures to identify, assess, and manage climate-related risks;
- a description of specific actions that the covered issuer is taking to mitigate identified present and future climate risks, taking into account different climate scenarios and including a description of the resilience of the strategies used;
- a description of how climate risk is incorporated into the overall risk management strategy of the covered issuer;
- a description of how the issuer is modifying its practices to remain in-line with the commitments of the Paris Agreement;
- whether (and how) the issuer's climate risks are based on assumptions that are aligned with the Paris Agreement and, if not, provide an audited pro forma presentation that is Paris-aligned as supplemental disclosure;
- the percentage split of the breakdown of the issuer's energy sources; and
- the percentage split of the borrower's revenue.

The SEC should also focus on the unique challenges for municipal securities due to their long-term nature and the longer-term risks associated with ESG-related factors, particularly climate change. Accurate and

[118] While "green bonds" are used solely for environmental purposes, "sustainable bonds" combine both environmental and social objectives. Lyubov Pronina, *What Are Green Bonds and How 'Green' Is Green?*, Bloomberg, Mar. 24, 2019, *available at* **https://www.bloomberg.com/news/articles/2019-03-24/what-are-green-bonds-and-how-green-is-green-quicktake?sref=K4GjzrU2**.

[119] For example, the EU is creating a "Green Bond Standard," which will build on current market practices, such as the International Capital Market Association's Green Bond Principles. The SEC should consider working with the Investment Company Institute, and should consider the European Commission's Technical Expert Group on taxonomy requirements.

comprehensive ESG-related disclosure is essential.[120] However, many municipal bond issuers currently provide only minimal details about how ESG-factors could negatively affect the ability to make bond payments over time.[121]

To ensure that ESG-risks are accurately incorporated into the municipal bond market, the SEC should consider revising Rule 15c2-12(b) to require:

- the identification and evaluation of potential financial impacts of, and any risk management strategies relating to, both the physical risks and transition risks posed to the covered issuer by climate change during the period;
- a description of any established governance processes and structures to identify, assess, and manage climate-related risks;
- a description of specific actions that the covered issuer is taking to mitigate identified present and future climate risks, taking into account different climate scenarios and including a description of the resilience of the strategies used;
- a description of how climate risk is incorporated into the overall risk management strategy of the covered issuer;
- a description of how the municipality is modifying its practices to remain in-line with the commitments of the Paris Agreement;
- whether (and how) the issuer's climate risks are based on assumptions that are aligned with the Paris Agreement and, if not, provide an audited pro forma presentation that is Paris-aligned as supplemental disclosure;
- the percentage split of the breakdown of the issuer's energy sources; and
- the percentage split of the borrower's revenue.

Similarly, the SEC should consider establishing criteria and standards for third-party "certifiers" of sustainable status.

Establish Clear Labeling for ESG-Related Investment Vehicles

Similar to other investment products, the SEC should consider requiring clear, standardized labeling practices for investment companies and private funds above a certain asset threshold that are labeled or marketed as "sustainable," "ESG," "green" or some other ESG-related description.[122] The SEC should also consider developing standardized criteria to determine whether securities qualify as "sustainable" according to an established taxonomy. This should include "a description of the sustainability objectives of the

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[120] Kevin DeGood, *Climate Change and Municipal Finance*, Center for American Progress, May 6, 2020, *available at* **https://www.americanprogress.org/issues/economy/reports/2020/05/06/484173/climate-change-municipal-finance/**.

[121]Danielle Moran, *Muni Bonds Contain New Fine Print: Beware of Climate Change*, Bloomberg BusinessWeek, Nov. 5, 2019, *available at* **https://www.bloomberg.com/news/articles/2019-11-05/how-serious-is-the-climate-change-risk-ask-a-banker?sref=K4GjzrU2**.

[122] *See, e.g.*, Blackrock, *Toward a Common Language for Sustainable Investment*, Jan. 2020, at 2, *available at* **https://www.blackrock.com/corporate/literature/whitepaper/viewpoint-towards-a-common-language-for-sustainable-investing-january-2020.pdf** (recommending "Agree on naming conventions for high-level categories of investment funds."). This should include revising the "Names Rule" (rule 35d-1 under the Investment Company Act of 1940). *See, e.g.*, *Request for Comments on Fund Names*, SEC, File No. S7-04-20, Mar. 2, 2020, *available at* **https://www.sec.gov/rules/other/2020/ic-33809.pdf**.

[investment company or private fund], details of how they are met, and the overall sustainability impact of the product."

Further, the SEC should consider requiring all funds labeled as "sustainable," "ESG," "green" or some other ESG-related description to meet an independent, objective, verifiable, third-party standard for such designation. The designation should be required for registered and non-registered funds above a certain asset threshold and should include funds based on indices.

For funds intended to address climate change or environmental considerations, the SEC should consider requiring disclosure of an evaluation of potential financial impacts of, and any risk management strategies relating to, both "physical" and "transition" risks of the fund, as well as other essential details, including "governance processes and structures to identify, assess, and manage climate-related risks" and opportunities, "a description of specific actions" that the fund is taking to address them,[123] and details as to how the fund's "climate risks are based on assumptions that are aligned with the Paris Agreement and, if not, []an audited pro forma presentation that is Paris-aligned as supplemental disclosure."

Further, the SEC should consider establishing a standard taxonomy to delineate whether a fund is:

- ESG exclusionary;
- ESG inclusionary;
- ESG impact investing;
- engaged in active ownership; or
- some combination thereof.

[123] Climate Risk Disclosure Act of 2019, H.R. 3623, 116th Cong. (2019).

Enhance Oversight Over Gatekeepers: Credit Rating Agencies and Index Providers

In the capital markets, certain gatekeepers will play a key role in helping companies, their investors, and the public identify, address, and assess key issues, including racial justice, worker treatment, and climate change. In the credit markets, Nationally Registered Statistical Ratings Organizations (aka credit rating agencies) have long played a key role in helping investors assess risks of particular securities, and at times, their issuers. For example, credit ratings often play a central role in investment processes and decisions of many pension funds, endowments, insurance companies, and other asset owners.[124] While Congress and regulators have attempted to reduce investors' reliance on credit ratings in their investment decisions, the phenomenon has nevertheless persisted, in part because the rating agencies have unique expertise, resources, and access to information that may be unavailable to many investors (particularly retail investors).

Unfortunately, rating agencies have often been notably slow to accurately assess ratings, and once they do, have demonstrated a tendency to take actions against many securities or issuers at the same time, which may imperil both the companies and their investors.[125]

Following the 2008 Financial Crisis, Congress and the SEC considered significant revisions to the credit rating agencies, including potential overhauls of the dominant business model in the United States (in which the issuers pay for the ratings). Some governance and conflicts of interest improvements have been made. However, there remains significant risks that credit ratings agencies' incentives may encourage them to chronically under-appreciate risks, including risks associated with ESG-factors.

For example, accurate credit ratings rely on complete and thorough risk assessments, and the increase in extreme weather events (*e.g.*, hurricanes and wildfires) and the coronavirus fallout have made clear that climate and worker-related risks are a significant and growing concern for many companies. But how are those risks being factored into credit ratings? Unfortunately, credit rating methodologies pertaining to ESG-related risks remain vague, and essentially permit a wide range of ultimate credit ratings.

Notably, in January 2021, S&P Global Ratings placed thirteen oil and gas companies (including Chevron, Exxon Mobil, Corp., and ConocoPhillips) on CreditWatch for potential downgrades, based on risks posed by "energy transition, price volatility, and weaker profitability."[126] The change was reportedly the result of a change in risk assessment by the agency. But what are the factors in that assessment?

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[124] See *Wall Street and the Financial Crisis: The Role of Investment Banks, before the Committee on Homeland Security and Government Affairs, Permanent Subcommittee on Investigations*, Apr. 27, 2010, (Statement of Ranking Member Susan Collins), *available at* **https://www.govinfo.gov/content/pkg/CHRG-111shrg57322/html/CHRG-111shrg57322.htm** (examining "rating-based" investors).

[125] See *Wall Street and the Financial Crisis: The Role of Credit Rating Agencies*, *before the Committee on Homeland Security and Government Affairs, Permanent Subcommittee on Investigations*, Apr. 23, 2010, (Statement of Chairman Carl Levin), *available at* **https://www.govinfo.gov/content/pkg/CHRG-111shrg57321/html/CHRG-111shrg57321.htm** ("[I]n July 2007, within days of each other, Moody's and Standard & Poor's announced mass downgrades of hundreds of subprime mortgage-backed securities. The mass downgrades shocked financial markets, and the subprime secondary market dried up overnight. Banks, securities firms, pension funds, and others were left holding billions of dollars of suddenly unmarketable securities. The value of those securities began dropping like a stone, and the financial crisis was on. Two months later, in October, Moody's began downgrading over $10 billion of CDOs. On January 30, 2008, Standard & Poor's downgraded over 8,000 securities, including 6,300 RMBS and 1,900 CDO securities, an unprecedented onslaught of downgrades. The CDO market, like the RMBS market, evaporated. Financial firms around the world were suddenly stuck with even more unmarketable securities, and by September 2008, major global financial institutions like Lehman Brothers, AIG, Citibank, Goldman Sachs, and Morgan Stanley were either bailed out, bankrupt, or struggling.").

[126] Press Release, *S&P Global Ratings Takes Multiple Rating Actions On Major Oil And Gas Companies To Factor In Greater Industry Risks*, S&P Global Ratings, Jan. 26, 2021, *available at* **https://www.prnewswire.com/news-releases/sp-global-ratings-takes-multiple-rating-actions-on-major-oil-and-gas-companies-to-factor-in-greater-industry-risks-301215457.html**.

The SEC should consider requiring credit rating firms to adopt, integrate, and publish policies regarding their consideration of ESG factors. This would ensure that credit rating agencies have sufficient expertise and methodologies to properly identify ESG-related risks and are accurately and transparently incorporating those ESG-related risks into their ratings. Moreover, to mitigate potential conflicts of interest, the SEC should consider prohibiting credit rating agencies from providing *non-credit* ESG ratings.

Over the past several years, index providers have come to represent perhaps even greater gatekeepers to the capital markets for issuers than credit rating agencies. Indexes may cover equity securities, debt securities, or other assets that may be directly or indirectly susceptible to various ESG factors.

Today, trillions of dollars of investment products are linked to indexes ranging from the S&P 500 to various credit market indexes. Further, some indexes are created to track or reflect specific ESG-related criteria. Some of these indexes are very broad and widely used (*e.g.*, the S&P 500), while others are customized for a single product sold to perhaps one or a handful of institutional investors.

Interestingly, despite the significant investment capital that may be influenced by indexing decisions and widespread findings of fraud and manipulation in indexes (e.g., interest rates, foreign exchange rates, and customized investment products), the United States has no federal regulatory requirements for index providers. This stands in sharp contrast to Europe, which adopted the Benchmark Regulation ("BMR") several years ago.[127] In 2019, former SEC Commissioner Robert J. Jackson, Jr. called for improved oversight into the governance of index providers,[128] as did Healthy Markets Association.[129]

What are the procedures to ensure that the inputs are an accurate reflection of the markets which they are purporting to measure? For example, if the index purports to account for worker equity or climate change, how does it do those things? Are the benchmark criteria objective, subjective, or a mix? Are the benchmark criteria and calculation methodologies public, auditable, and testable? How can the benchmark calculation or inputs be changed over time, and by whom? Who will maintain the benchmark over time and what are their financial incentives? Does the benchmark administrator have appropriate expertise, resources, compliance, and oversight functions to ensure quality and integrity?

The SEC should consider developing a regulatory framework designed to address benchmark governance, quality, methodology, and accountability. This effort should seek to answer the questions above and focus upon the principles outlined by the Board of the International Organization of Securities Commissions in 2013.[130]

[127] *ESMA-EBA Principles for Benchmark-Setting Processes in the EU*, European Securities and Markets Authority (ESMA) and European Banking Authority (EBA), 2013/659, June 6, 2013, *available at* **https://www.esma.europa.eu/sites/default/files/library/2015/11/2013-659_esma-eba_principles_for_benchmark-setting_processes_in_the_eu.pdf**.

[128] Hon. Robert J. Jackson, Jr. and Steven Davidoff Solomon, *What's Really in Your Index Fund?*, New York Times, Feb. 18, 2019, *available at* **https://www.nytimes.com/2019/02/18/opinion/index-fund.html**.

[129] Healthy Markets Association, *Benchmark-Linked Investments: Managing Risks and Conflicts of Interest*, Mar. 7, 2019, *available at* **https://healthymarkets.wpengine.com/product/benchmark-linked-investments**. This author serves as the Executive Director of Healthy Markets Association.

[130] *Principles for Financial Benchmarks Final Report*, The Board of IOSCO, FR07/13, July 2013, *available at* **http://www.iosco.org/library/pubdocs/pdf/IOSCOPD415.pdf**.

Enhance Auditing and Accounting Rules and Enforcement

The current U.S. accounting and auditing regime does not adequately reflect the unique challenges associated with ESG-related risks. The SEC has historically avoided implementing specific ESG-related standards. Instead, the agency has adopted an ad-hoc, principles-based approach to accounting and disclosure, allowing companies to assess the "materiality" of potential ESG-related risks according to differing metrics and subjective interpretations. Moreover, the SEC has failed to sufficiently scrutinize ESG-related accounting methods and disclosures, and has not meaningfully enforced compliance with existing ESG-related rules and guidance.

Absent updated data analysis methods, uniform metrics, and adequate enforcement practices, investors and financial analysts are unable to identify, monitor, and manage ESG-related risks. As a result, it is impossible to instill corporate accountability and to efficiently allocate and mobilize capital towards the low-carbon transition.

Enforce Existing Accounting and Auditing Standards

As an important initial step towards improving ESG-related accounting and auditing standards, the SEC should consider taking more aggressive action to ensure compliance with existing ESG-related rules and guidance. In particular, the SEC should ensure compliance with:

- the SEC's 2002 and 2003 guidance on critical accounting assumptions;
- the SEC's 2010 guidance on climate change;[131]
- the International Accounting Standards Board's guidance on climate change;
- existing GAAP standards regarding asset valuation, asset life, asset impairment, and depreciation;
- asset retirement obligations;[132] and
- the potential impacts of ESG-related corporate commitments, anticipated policy or regulatory changes, and other expected future developments that are likely to have material impacts on operations or financial positions.

The SEC Chair should consider establishing a specialized task force to implement, monitor, and ensure compliance with existing and future disclosure and auditing requirements. The cross-divisional, cross-agency task force should include staff from relevant SEC divisions and offices, the PCAOB and the FASB.

Adopt New Auditing Standards

One of the central benefits of requiring standardized, public disclosures in SEC filings is that they are intended to provide more reliable information for investors and the public than the voluntary, ad hoc disclosures that currently dominate the marketplace. However, as disclosures become mandatory, there will be significant pressure—particularly by those who may face negative commercial or investor

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[131] In the two years following the SEC's 2010 guidance on climate-related disclosures, the SEC issued 49 comment letters to companies addressing the adequacy of their climate change disclosures. But that number fell to three in 2012, and the SEC issued no such letters in 2013. David Gelles, *S.E.C. Is Criticized for Lax Enforcement of Climate Risk Disclosure*, N.Y. Times, Jan. 23, 2016, *available at* **https://www.nytimes.com/2016/01/24/business/energy-environment/sec-is-criticized-for-lax-enforcement-of-climate-risk-disclosure.html**.

[132] This is particularly important for assets with long "tail" risks, such as wells or other potentially "toxic" assets.

consequences based upon the disclosures—to "massage" the information or otherwise mitigate the risk. Robust audit requirements will be essential to ensuring companies, funds, and other market participants are making reliable, consistent, and comparable disclosures.

The SEC should consider pressing the PCAOB to revise auditing standards to reflect updates in ESG-related disclosure requirements and increased demand for ESG-related disclosure by companies, funds, and investment products. These requirements should include:

- requiring auditor reasonable assurance over ESG-related disclosure rules as they are promulgated, particularly in areas of employee wages, benefits, and other information along racial and gender lines, as well as climate risks;
- requiring, as part of the audits of the financial statements and internal control over financial reporting, that auditors test accounts against "baseline" assumptions and estimates and address inconsistencies with the audit committee; and
- requiring procedures to audit and report on emissions, including financed emissions.

Adopt ESG Priorities for Inspections of Audit Firms

If the SEC requires new disclosures and practices, then those disclosures and practices should be audited. But who's going to make sure that the auditors are doing the job? As we've seen many times, from Enron and WorldCom, to Luckin Coffee and Wirecard, auditors' financial incentives may limit their willingness to faithfully fulfill their responsibilities.

The SEC should consider identifying and announcing specific ESG-related priorities for inspections of audit firms. The SEC should work with the PCAOB to issue companion inspection priorities for auditors to cover audit planning, testing, and reporting. In particular, the priorities should include:

- the role of risk assessment in designing the nature and extent of audit procedures; and
- the auditor's responsibility regarding other ESG-related information.

The SEC should also consider adopting rules regarding the role of auditor and third-party assurance providers in reviewing and assuring disclosures. These rules should be amended when necessary to reflect changes in ESG-related non-financial and financial company disclosure requirements.

Establish a "Sustainability Standards Board" within the FASB

What will be the "standards" for particular disclosures and who will set them? To date, many private bodies have sprung up to offer voluntary reporting standards. As of early 2020, many of these standard-setting organizations have agreed to harmonize their efforts, and some have merged. These efforts can form an essential building block for government-sanctioned standards. However, each of those standard-setting organizations has been established and is used, to varying degrees, on a voluntary basis.

Regulators should be extremely cognizant of the reality that companies using such standards are more likely to comply when they believe it makes them appear more favorable than others. This may mean that existing standards may need to be supplemented or tweaked in ways that might provide more accurate, decision-useful information to investors. Further, we also note that the uptake of these voluntary standards may exhibit significant self-selection bias, which may cross industries. Again, the SEC should be cognizant that mandatory standards may need to be modified to reflect legitimate industry expectations and realities.

We recommend that the SEC work with stakeholders, including the Financial Accounting Foundation, the FASB, and the PCAOB, to develop a coordinated Sustainability Standards Board (SSB) within the FASB. The SSB should be funded through the FASB's existing funding mechanisms. The SSB should leverage and build upon existing private ESG-related disclosure standards and should be focused on:

- addressing the full range of sustainability factors that are material to enterprise value creation;
- developing industry-specific standards that include quantitative metrics and key performance indicators;
- building a funding model that can sustain high-quality, global standards development;
- developing the relationships and expertise necessary to develop standards for financially material sustainability disclosure;
- establishing processes to maintain an XBRL taxonomy for sustainability disclosure standards; and
- establishing processes to achieve interoperability with sustainability standards focused on multi-stakeholder communication.

Revise the SEC's Staffing and Structure to Prioritize ESG Integration

A central component of focusing the SEC as an agency on ESG-related issues is to expand staff expertise while also shifting the orientation of many of the Divisions. For example, the SEC's Division of Corporation Finance has, for years, been led by New York lawyers who previously served as issuer or underwriter counsel. It is not surprising then, that the Division of Corporation Finance has often focused on how to alleviate perceived burdens on issuers, and sought to limit shareholder interference in management affairs. If the Division were led by an investor or other expert who has typically focused on reading disclosures and exercising rights, we would expect the overall orientation to shift from limiting information and rights for investors, to maximizing them.

Similarly, the SEC should consider hiring professionals across the Divisions with relevant subject matter expertise, such as climate risk modeling and auditing. The onboarding of this expertise and shift in orientation would likely have a significant impact. In addition to shifting the agency's orientation by expanding its talent pool, the SEC should consider creating an "ESG Office" and revising its Advisory Committees.

Establish an "ESG Office"

The SEC Chair should consider establishing an "ESG Office" whose director reports to the Chair. The ESG Office should be led by an executive with a commitment to racial justice, worker rights, and climate science. Amongst other activities, the ESG Office should:

- be responsible for coordinating ESG-related efforts across the agency;
- work with the Division of Economic and Risk Analysis to gather relevant data, and undertake continuous research and issue publications aimed at understanding the impacts of climate-related risks on financial markets and financial market participants;
- coordinate efforts on climate change and other ESG issues with other federal financial regulators and environmental regulators;
- work with financial regulators in other countries and intergovernmental bodies involved in financial regulation and climate change; and
- engage with the ESG investment community.

Revise Appointments to Advisory Committees

The SEC should seek assistance from market participants and outside experts to develop, implement, and enforce effective ESG-related rules and guidance. To that end, the SEC should consider revising the process of appointing members to its advisory committees to ensure that all committees have expertise on ESG-related factors, including diversity, worker considerations, and climate change.

The SEC should consider establishing an "ESG Investing" advisory subcommittee of the Investor Advisory Committee to consider specific recommendations regarding disclosures and other matters for consideration by the SEC. The SEC should also consider establishing a "Climate Risk Advisory Committee," with the Director of the ESG Office (discussed above) serving as the agency's point person.

Conclusion

The wellbeing of our nation and the world depends upon the ability of capitalism to identify, assess, and address our most pressing challenges, from climate change to inequality and systemic racism. The SEC sets the rules for capitalism. For too long, the SEC has broken down the guardrails meant to ensure that investors and the public have the information they need and the ability to hold companies and their executives accountable for addressing the risks and opportunities posed by great challenges. It is time for the SEC to return to its founding principles. The SEC should demand more transparency and accountability for investors, the public, and the planet.

List of Recommendations

1. Restore Public Accountability in the Unregulated Private Markets

- The SEC should consider requiring all large companies to become "reporting companies" under the Exchange Act. Some potential triggers for requiring large companies to becoming "reporting companies" could be a sufficiently large:
  - annual revenue;
  - market cap;
  - public float in a private trading venue;
  - number of beneficial owners of securities; or
  - number of employees.
- The SEC should consider amending the definition of "shareholder of record" in Section 12(g) of the Exchange Act to include all of the actual owners of an issuer's stock.
- The SEC should consider requiring companies that receive more than a certain dollar amount in revenues directly from government contracts or funds to become public reporting companies.
- The SEC should consider eliminating exemptions for large private offerings.
- The SEC should consider imposing basic requirements for certain exempt securities and asset-backed securities. Specifically, the SEC should consider mandatory disclosures regarding all sales of unregistered securities that may be impacted by climate risk.
- The SEC should consider restoring the "integration doctrine" by harmonizing the multiple exemptions that separate out the various capital raising methods that currently allow issuers to avoid registration requirements.
- The SEC should consider revising the "accredited investor" definition. The new definition should be based on a combination of an investors access to information, sophistication, income, and wealth. This would reduce dependency on the myths that:
  - "sophisticated" investors do not require information; and
  - wealth is a sufficient proxy for sophistication.
- The SEC should consider requiring disclosures for private fund offerings to capture funds with more than $1 billion in assets or more than 100 beneficial owners.

2. Require Enhanced Public ESG-Related Disclosures

- The SEC should consider requiring both financial and non-financial firms to disclose specific climate-related information. At minimum, issuers should be required to disclose:
  - an evaluation of the potential financial impacts of climate risks;
  - the risk management strategies relating to climate risks; and
  - defined climate-related scenario analyses.

- The SEC should consider directing the Division of Corporate Finance to offer comments on climate-related disclosures for specific industries that will likely be most directly impacted by climate risks.
- The SEC should consider requiring both financial and non-financial firms to disclose specific non-climate ESG-related information. Specifically, the SEC should consider requiring disclosures relating to:
  - political spending;
  - human capital;
  - tax practices; and
  - stock buybacks.
- The SEC should consider requiring specific disclosures for financial companies to capture the climate-related risks that impact their holdings and the risks that may impact the banking industry generally.

3. Enhance Stakeholder Rights and Engagement

- The SEC should consider increasing shareholder proxy access by amending Rule 14a-8 to:
  - permit all investors who have owned at least $1,000 worth of stock in a company for at least one year to submit shareholder proposals for inclusion in the company's proxy materials; and
  - lower proxy resubmission thresholds to 3%, 5%, and 10%.
- The SEC should consider revising its guidance and no-action request process for companies seeking to exclude proxy materials to favor the inclusion of shareholder proposals.
- The SEC should consider creating a new process to enhance investors' ability to compel corporate disclosures. Specifically, the SEC should consider adopting a rule mandating that shareholder proposals seeking company disclosures may only be excluded from vote under rare circumstances.
- The SEC should consider increasing investor access and ability to rely upon proxy advisers. In particular, the SEC should consider:
  - revising Rule 14a-2(B) to improve the timeliness, content, and utility of proxy advice;
  - revising Rule 14a-1(l) and Section 14(A) to clarify that proxy advisers are only engaged in "soliciting" votes if they have either a direct financial stake in securities of the company at issue or a financial stake in the outcome;
  - issuing guidance for investment advisers to allow for more direct and reasonable reliance on advice from proxy advisers for voting recommendations; and
  - removing procedural obligations that require excessive deference to management when determining how to vote.
- The SEC should consider putting an end to dual class share structures by determining that, because they are not "in the public interest" and because they do not "protect investors," they are inconsistent with the requirements of the Securities Exchange Act.

- The SEC should consider universal proxy ballots to allow investors to more easily replace individual management-supported directors without being required to elect an entire new slate of directors.
- The SEC should consider prohibiting unreasonable restrictions on private rights of action, including by prohibiting the use of mandatory arbitration clauses and limiting the use of forum selection clauses.

4. Modernize Expectations for Investment Fiduciaries

- The SEC should consider requiring investment fiduciaries, including investment advisers and broker-dealers, to adopt and implement standardized "sustainable investment policies" and to make related disclosures.
- The SEC should consider adopting guidance to enable investment advisers to consistently and effectively consider and incorporate material ESG factors into their practices.
- The SEC should consider requiring broker-dealers and investment advisers to identify and effectuate the ESG preferences of their customers. To this end, the SEC should consider amending the "Know-Your-Customer" regime, as well as the "Regulation Best Interests" and the "suitability" doctrines.

5. Promote Integrity of ESG-Related Labeling of Investment Funds and Products

- The SEC should consider adopting standardized requirements for all financial products that are labeled or marketed as "sustainable," "ESG," "green," or some other ESG-related description.
- The SEC should consider requiring all issuers of ESG-labeled products to disclose the specific policies, procedures, and practices for assessing how the products qualify for such status.
- To ensure that ESG-risks are accurately incorporated into municipal the bond market, the SEC should consider revising Rule 15c2-12(b) to require enhanced identification and disclosure of climate-related risks.
- The SEC should consider establishing criteria and standards for third-party "certifiers" of sustainable status for financial products.
- The SEC should consider adopting standardized requirements for all investment companies and private funds above a certain size that are that are labeled or marketed as "sustainable," "ESG," "green," or some other ESG-related description.
- The SEC should consider requiring all funds labeled as "sustainable," "ESG," "green" or some other ESG-related description to meet an independent, objective, verifiable, third-party standard for such designation.
- The SEC should consider enhancing disclosure requirements for funds purporting to address climate change or environmental considerations.
- The SEC should consider establishing a standard taxonomy to delineate whether a fund is:
    - ESG exclusionary;
    - ESG inclusionary;

    - ESG impact investing;
    - engaged in active ownership; or
    - some combination thereof.

6. Enhance Oversight Over Gatekeepers: Credit Rating Agencies and Index Providers

- The SEC should consider requiring credit rating firms to adopt, integrate, and publish policies regarding their consideration of ESG factors.
- The SEC should consider prohibiting credit rating agencies from providing *non-credit* ESG ratings.
- The SEC should consider regulating index providers by developing a framework designed to address benchmark governance, quality, methodology, and accountability.

7. Enhance Auditing and Accounting Rules and Enforcement

- The SEC should consider taking more aggressive action to ensure compliance with existing ESG-related rules and guidance, including:
    - the SEC's 2002 and 2003 guidance on critical accounting assumptions;
    - the SEC's 2010 guidance on climate change;
    - the International Accounting Standards Board's guidance on climate change;
    - existing GAAP standards regarding asset valuation, asset life, asset impairment, and depreciation;
    - asset retirement obligations; and
    - the potential impacts of ESG-related corporate commitments, anticipated policy or regulatory changes, and other expected future developments that are likely to have material impacts on operations or financial positions.
- The SEC Chair should consider establishing a specialized task force to implement, monitor, and ensure compliance with all existing and future disclosure and auditing requirements.
- The SEC should consider pressing the PCAOB to revise auditing standards to reflect updates in ESG-disclosure requirements and increase demand for ESG-related disclosure by companies, funds, and investment products.
- The SEC should consider adopting "ESG priorities" for inspections of audit firms, including:
    - the role of risk assessment in designing the nature and extent of audit procedures; and
    - the auditor's responsibility regarding other ESG-related information.
- The SEC should consider adopting rules regarding the role of auditors and third-party assurance providers in reviewing and assuring disclosure.
- The SEC should consider working with stakeholders, including the FASB and the PCAOB, to establish a "Sustainability Standards Board" to the FASB. The Sustainability Standards Board

should be tasked with harmonizing the existing private ESG-related disclosure standards into one consistent and mandatory ESG-related disclosure framework.

8. Revise the SECs Staffing and Structure to Prioritize ESG Integration

- The SEC should consider revising its staffing policies to ensure that its Divisions are focused on maximizing information and rights for investors.
- The SEC should consider hiring professionals across the Divisions with relevant ESG expertise.
- The SEC should consider establishing an “ESG Office” whose director should have expertise on, and a commitment to, ESG-related issues.
- The SEC should consider revising appointments to advisory committees to ensure that all committees have expertise on ESG-related factors.
- The SEC should consider establishing an “ESG Investing” advisory subcommittee to the Investor Advisory Committee to consider specific ESG-related recommendations.
- The SEC should consider establishing a “Climate Risk Advisory Committee.”