The DOL and the EU on ESG

The Securities and Exchange Commission ("SEC") isn't the only regulator actively facilitating environmental, social and governance ("ESG") investment strategies. Last week saw major developments at the U.S. Department of Labor ("DOL") and the European Union ("EU"). The DOL removed potential roadblocks established by the previous administration, while the EU began implementing new disclosure regulations. On Monday, the acting chair of the SEC also continued her push for enhanced climate change and ESG disclosures.

DOL Shifts Course

On March 10, 2021, the DOL announced that it will not enforce its recently published final rules on "Financial Factors in Selecting Plan Investments" and "Fiduciary Duties Regarding Proxy Voting and Shareholder Rights." These rules together stood to hamper the access of retirement plan investors to ESG strategies by: (i) preventing ERISA retirement plan accounts from investing based on "non-pecuniary" factors in ESG strategies if doing so would sacrifice returns or increase risks for participants and (ii) prohibiting retirement plan fiduciaries from voting on shareholder resolutions with no direct economic impact on a plan. The rules were adopted late in 2020 and were widely criticized by the asset management industry and others. As the DOL notes, stakeholders questioned whether the rulemaking was unnecessarily rushed and whether the DOL adequately considered "the substantial evidence" on the use of ESG considerations "in improving investment value and long-term investment returns for retirement investors." The DOL also notes the "chilling effect" the rules have had "on appropriate integration of ESG factors in investment decisions, including in circumstances that the rules may in fact allow." Accordingly, instead of enforcing the rules, the DOL will revisit them. In doing so, the DOL will conduct significant stakeholder outreach "to determine how to craft rules that better recognize the important role that [ESG] integration can play in the evaluation and management of plan investments."

SFDR Compliance Date Arrives in Europe

March 10, 2021, was also the compliance date for the European Union's Sustainable Finance Disclosure Regulation (SFDR). The SFDR requires EU asset managers, insurers, and pension funds to disclose sustainability risks in their investments. Sustainability risks under the SFDR include potentially adverse impacts (PAIs) on the natural environment (such as those related to climate change) or society (such as those related to labor issues, human rights, corruption, etc.). EU asset managers, whether or not they are ESG-focused, must integrate ESG factors and PAIs into their investment decisions as part of their fiduciary duties. The SFDR includes disclosure requirements for ESG funds and other financial products in the EU.

- "Sustainable investments" that have environmental or social objectives are subject to the strict requirements of Article 2(17) of the SFDR and pre-contractual disclosure requirements of Article 9 of the SFDR; and
- Products that promote environmental and/or social characteristics, but are not "sustainable investments," are subject to the pre-contractual disclosure requirements of Article 8 of the SFDR.

The disclosure requirements of the SFDR are designed to encourage ESG-oriented investing and discourage exaggerated or unfounded claims of "greenness." While the SFDR does not apply to U.S. asset managers not offering products in the EU, it has reached U.S. companies as EU asset managers invested in U.S. companies must obtain ESG data from them to comply with their fiduciary and disclosure obligations under SFDR. Regulatory technical standards related to the SFDR are expected to be published later this year. The compliance date for the EU's anti-greenwashing taxonomy regulation is also schedule for December of this year. The taxonomy will be used by EU asset managers to determine whether an economic activity is fairly characterized as "environmentally sustainable." ESG financial products marketed in the EU will be required to make disclosures that conform with the EU Sustainable Taxonomy.

Back at the SEC

Meanwhile, on March 15, 2021, acting SEC chair Allison Herren Lee delivered a speech entitled "A Climate for Change: Meeting Investor Demand for Climate and ESG Information at the SEC" that sheds clear light on the SEC's prioritization of climate-related and other ESG disclosure matters. She also invited public input on climate change disclosures from financial market participants. We'll cover these developments in our next post.

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