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The ESG Bandwagon in the United States: Squire Patton Boggs

Bandwagon

(band-wa-g n) noun

often attributive meaning 1. a usually ornate and high wagon for a band of musicians especially in a circus parade; 2. a popular party, faction, or cause that attracts growing support often used in such phrases as “jump on the bandwagon”; and 3. a current or fashionable trend.1

The US Securities and Exchange Commission (SEC) recently announced the creation of a Climate and ESG Task Force in the Division of Enforcement2. The SEC press release stated that “Consistent with increasing investor focus and reliance on climate and [Environmental, Social and Governance] ESG-related disclosure and investment, the Climate and ESG Task Force will develop initiatives to proactively identify ESG-related misconduct.” This announcement was made the day after the SEC announced its examination priorities for 2021, which includes a greater focus on climate related risks.3 A subcommittee of the SEC Asset Management Advisory Committee (AMAC) is working on recommendations to be considered by AMAC regarding ESG disclosure and investment products, the December 2020 draft of which includes a call for more consistent disclosure regarding ESG risks from issuers and disclosure “best practices” for ESG investment products. The Government Finance Officers Association (GFOA) released a “best practice” regarding ESG, which followed a June 2020 research report released by GFOA concerning ESG risk factors. The Investment Company Institute (ICI), as well as other buy-side associations, have called for more consistent and fulsome disclosure regarding ESG risks and, particularly, climate-related risks.

The interesting aspect of all the ESG talk, particularly with the SEC’s announcement of its enforcement task force, is that there is currently no specific requirement in securities laws or regulations that identifies ESG as a separately identifiable topic with respect to risk disclosure.4

This has been noted several times by SEC Commissioner Allison Herron Lee, the current Acting Chair of the Commission. In August 2020, upon enactment of a final rule amending certain line-item corporate disclosures, Commissioner Lee lamented about the lack of inclusion of specific ESG information in a public statement titled “Regulation S-K and ESG Disclosures: An Unsustainable Silence.”5 Commissioner Lee has also directed staff of the Division of Corporation Finance to “enhance its focus on climate-related disclosure in public company filings” and has also called for public input regarding how the SEC should address climate and other ESG disclosure.6 To underscore the importance the SEC attaches to ESG, it announced on March 22, 2021, that it has created a separate webpage for all SECrelated actions addressing ESG risk and opportunities.7

The ESG bandwagon, while fully accommodating all passengers, has two distinct drivers. The first driver is a credit driver grounded in the desire for good solid disclosure regarding ESG risks and the effect on the credit of the issuer of debt securities (or equity securities in the corporate market for that matter). The second driver is the so-called “values-based investor”8 and investment funds that market to values-based investors. The contrast of these two drivers of the ESG phenomenon have been described as “value versus values.”9 The credit investor is interested in little beyond the value of and return on the investment, while the values-based investor is motivated by sustainable investing in investments that are consistent with the investor’s own value system. This is not to say that an investor cannot be both at the same time but it is easier to understand the legal distinction to be made regarding disclosure if these investor types are considered mutually exclusive.

Satisfying the disclosure needs of the credit investor with respect to ESG risk-related disclosure should be no different than the disclosure of any other material credit risk. It may require thoughtful analysis of potential threats and risks, particularly from environmental concerns, but one would expect that, in many, if not most, cases, the municipal issuer or corporate issuer is (or soon will be) addressing those risks internally as a matter of long-term and strategic planning.

The rise of the values-based investor has resulted in a growing issuance of both corporate and municipal bonds labelled as “green bonds” or “social bonds” and the like that are specifically marketed to values-based investors and funds. Because of the specific targeting of values-based investors and the labelling of the bond as a “green bond” or “social bond,” one expects specific disclosure about the basis for the designation and continuing disclosure regarding the sustained or achieved “success.” In primary market disclosure for a labelled bond, it would be hard to say such disclosure is not material to the targeted investor. While some labelled bonds are “self-labelled” by the issuer, a growing number of labelled US municipal bonds marketed in the last few years include a third-party verification of the associated label that confirms the issuer’s satisfaction of the chosen designation criteria. With respect to enhanced ongoing reporting and disclosure regarding ESG in labelled bonds (whether self-labelled or independently verified), this requirement is expected and demanded by values-based investors and most issuers of labelled bonds recognize this need and have agreed to those demands.

But, what about non-labelled bonds, or, for that matter, equity securities for a corporation not describing itself as promoting sustainable concepts? Do issuers of non-labelled bonds owe a duty to all investors to provide additional disclosure of ESG policies and strategies beyond that necessary to disclose associated credit risks? Can or will the demand of valuesbased investors drive a requirement for disclosure of matters unrelated to business or credit risks in order for the valuesbased investor or fund to assess whether that security might meet its criteria for investing when those investors and funds have not been targeted by the issuer? And, if so, will that extend beyond primary market disclosure and become an ongoing obligation to provide metrics and data that the issuer may not currently track?

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