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by H. Veselka Vizcarra

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Breaking Down "E, S, and G": Climate Change as a Material Concern for the Energy Sector

by Hana V. Vizcarra¹

Climate change impacts are increasingly apparent in our communities and acknowledged by the public, private sector, and governments. A recent study in the journal *Nature Communications* found that the global economy could lose between $150 trillion to $792 trillion by 2100 if nations fail to meet their current greenhouse gas reduction targets.² Shifting investor expectations for corporate disclosures of climate change risks and opportunities have led to increased calls for regulatory action but have yet to result in regulatory action. For the oil and gas sector, the conversation about evaluating and disclosing climate change risks is rapidly evolving and, as it does, legal obligations evolve as well. When it comes to climate change and the energy sector, the question is no longer whether energy companies must consider climate change-related information when developing their required and voluntary disclosures, it is instead a question of what information considered should be disclosed, when, and in what form.

Investors of all types are increasingly concerned that they lack information necessary to evaluate the firm-level risks associated with climate change or a transition to a low-carbon economy.³ They are pressing for improved and expanded disclosures. A recent survey of institutional investors found that over half considered climate risk as important as traditional financial reporting.⁴ Large asset managers are relying on the Environmental, Social and Governance (ESG) practices of firms to guide their investment decisions, believing that factors such as sustainability and limiting risk from climate change promote long-term economic value.⁵

¹ Hana Vizcarra is a staff attorney at the Harvard Law Environmental & Energy Law Program (EELP) and leads EELP’s portfolio on private sector approaches to climate and environmental issues. She would like to thank Martin Levy (HLS JD 2020) for very helpful research assistance and comments on this piece.
³ See Hana V. Vizcarra, *The Reasonable Investor and Climate-Related Information: Changing Expectations for Financial Disclosures*, 50 Environmental Law Reporter 2-2020, 10106-10114 (discussing the shift in views among investor about the importance of climate-related information and how they are incorporating such information into their decisionmaking processes, likely shifting the definition of what is material information under U.S. securities law in the process), https://eelp.law.harvard.edu/2020/01/the-reasonable-investor-and-climate-related-information-changing-expectations-for-financial-disclosures/.
⁴ See Emirhan Ilhan et. al., Swiss Finance Institute Research Paper Series N. 19-66, Institutional Investors’ Views and Preferences on Climate Risk Disclosure at 4 (last revised Jan. 7, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3437178 (“We find that the survey respondents share a strong general belief that climate disclosure is important. In fact, 51% of respondents believe that climate risk reporting is as important as traditional financial reporting, and almost one-third considers it to be more important.”).
⁵ See, e.g., BlackRock ESG Investment Statement (Aug. 29, 2019) (“At BlackRock, we define ESG integration as the practice of incorporating material environmental, social, and governance (ESG) information into investment decisions in order to enhance risk adjusted returns. Some of our clients call this responsible investing - to us, integrating ESG information, or sustainability considerations, should be part of any robust investment process and means adapting our research and core investment processes to account for additional sources of risk and return that are explained by ESG
But what is important to investors and other stakeholders is not necessarily material to a company’s mandatory disclosures. Public companies must determine how to incorporate climate change risks and opportunities in their securities filings without the benefit of guidance from regulators taking into account the significant changes in the type of information available for disclosure, investors’ expanding interest in and use of that information over the last ten years. The wide array of organizations offering competing climate-disclosure frameworks and guidance about what information industry should disclose (TCFD, GRI, SASB, WBSCD, IEPCA, Science Based Targets Initiative, and others) further muddies the picture. These groups advocate disclosure for varying purposes, not always aligned with the legal requirements of U.S. securities law; again, leaving companies to evaluate their advice and its relationship to the regulatory structure that governs their actions without the benefit of regulator viewpoints on applicability.

Notably, changing investor expectations may modify legal requirements even without new regulatory guidance. U.S. securities legal standards evolve over time and will ultimately require some disclosure of climate-related information across industries, regardless of whether the Securities and Exchange Commission (SEC) imposes explicit new rules to that effect. With its high carbon footprint and the possibility of significant impact in the face of an energy transition, the energy sector has faced more intense pressure to adjust its disclosures practice than other industries. How it responds will shape this evolving climate-risk disclosure regime. In this article, I evaluate the current state of U.S. regulation of climate-related disclosures, discuss the evolving nature of the materiality of climate change as a disclosure topic, outline how the diverging approaches by U.S. financial regulators influence that evolution, and comment on how this impacts the oil and gas sector.

**Current U.S. Regulation Provides Few Guiderails for Determining the Materiality of Climate-Related Disclosures**

In the U.S., our financial regulatory bodies appear to be of two minds about directly addressing climate change risks. The SEC has so far resisted calls to incorporate explicit disclosure obligations into its regulations, and the Department of Labor’s Employee Benefits Security Administration has proposed a new rule that demonstrates substantial skepticism of environmental, social, and governance factors’ connection to financial outcomes in investing. In contrast, the Commodities Future Trading Commission and Federal Reserve are actively exploring climate-related impacts on the financial system. As the financial impacts of climate change on companies become more readily apparent, setting off an evolution in the materiality of climate-related information, these differing regulatory approaches influence how this evolution develops.

**A. SEC: A Hands Off Approach**

Existing regulatory guidance from the SEC does not fully address the rapidly changing climate discussion, its importance to investors, and the certainty of climate-related impacts. The Commission faces increasing pressure from investors, lawmakers, other financial regulators, advocacy organizations, and even its own advisory committees to take action. Yet, it has been...
reluctant to move forward with considering new regulations or guidance specific to climate change.

The SEC’s only concrete action addressing the materiality of climate change-related information was in the form of guidance released in 2010 after investors, environmental groups, and the New York attorney general (AG) petitioned the Commission. The release also followed a series of investigations into power company disclosures by the New York AG that led to settlements requiring the investigated companies to disclose some climate-related information in their SEC filings. The 2010 guidance largely sidestepped the question of how companies should incorporate such information into their internal materiality analyses. The Commission listed broad categories of potentially material information (the impacts of legislation and regulation, international accords, indirect consequences of regulation or business trends, and the physical impacts of climate change) but did not provide much explanation of what it expected of corporate management. It emphasized that firms should consider all relevant information in their materiality analyses even if not all of that information must be disclosed but provided little to no guidance on what that would look like in practice.

One way for the regulator to encourage companies to develop substantive processes for analyzing the materiality of climate change information is to use its enforcement authority to evaluate whether companies are properly analyzing and disclosing all required material information. The SEC failed to follow the 2010 guidance with substantive enforcement efforts, issuing only a handful of letters requesting additional information from issuers. Reviews of corporate disclosures in the subsequent years revealed little significant change and climate-related disclosures that were made varied in format and specificity while relying on boilerplate language.

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7 See Vizcarra, supra note 6, at 759-72 (tracking the evolution of attorney general engagement in corporate climate disclosure in Part IV).


9 Id. at 6294-95 (in disclosing “known trends, events . . . [or] uncertainties” in Item 303 (MD&A disclosure), companies should remember that “[w]hile these materiality determinations may limit what is actually disclosed, they should not limit the information that management considers in making its determinations.” The SEC emphasized that “registrants are expected to consider all relevant information even if that information is not required to be disclosed.”).

10 SEC staff sent a handful of comment letters to companies about their climate change disclosure decisions (25 letters to 23 companies from 2010 to 2013 out of more than 45,000 comment letters and 14 letters to 14 companies out of over 41,000 letters issued from 2014 to 2017). As of 2012, SEC staff had noticed little change in climate-related disclosures as a result of the 2010 guidance. U.S. Gov’t Accountability Off., GAO-18-188, SEC Has Taken Steps to Clarify Disclosure Requirements at 14-15 (2018) (describing the letters issued after the 2010 guidance and noting that in the 2012 report to the Senate Committee on Appropriations examining climate-related disclosures after the 2010 guidance, the SEC found no notable changes).

11 See Vizcarra, supra note 6, at 756 (citing Jim Coburn & Jackie Cook, Ceres, Cool Response: The SEC & Corporate Climate Change Reporting 4 (2014), https://www.ceres.org/sites/default/files/reports/2017-03/Ceres_SECGuidance-append_020414_web.pdf (reviewing disclosures and finding little discussion of specific material information or quantification of climate impacts in the first few years after the 2010 guidance was issued)).

An effort to go behind the disclosures and evaluate how companies made their materiality determinations could have more precisely defined for issuers when climate-related information is material and resulted in more substantive disclosures. The SEC again opened a door to new guidance or regulation on climate-related and ESG issues in a 2016 concept release that specifically requested comment on whether to require additional disclosures specific to climate change and whether additional guidance was needed. The Concept Release recognized the potential for a shift in what boards should consider when making materiality determinations as investor expectations change. The agency has not moved forward with new actions on climate change information along the lines of those suggested in the Concept Release.

Three current SEC commissioners have expressed significant skepticism about furthering ESG investing practices, pushing back on calls for new guidance or requirements. Relying on the “principle based” nature of disclosure law to emphasize that ESG or climate change-specific disclosure requirements are unnecessary when companies already have an obligation to disclose material information, whether it is climate-related or not. Commissioner Elad Roisman has claimed “corporate governance stands by itself and rarely has a direct relationship to environmental or social issues” and hinted that requiring ESG disclosures may be beyond the

14 Id. at 23971 (“The role of sustainability and public policy information in investors’ voting and investment decisions may be evolving as some investors are increasingly engaging on certain ESG matters . . .”).
15 COMMISSIONER HESTER PIERCE, Scarlet Letters: Remarks before the American Enterprise Institute (June 18, 2019) (“While ESG advocates can point to studies that certain ESG policies serve companies well, the amorphous nature of such policies makes it hard to generalize. In any case, the research, even on discrete points, is mixed. Other research has highlighted the cost of ESG investment strategies. The ambiguity of ESG makes research inherently difficult.”);
16 COMMISSIONER ELAD L. ROISMAN, Keynote Speech at the Society for Corporate Governance (July 7, 2020). (“In my experience, there is not consensus on what, exactly, “ESG” means. I often wondered how the three concepts of environmental, social, and governance matters got lumped together.”); Chris Flood, SEC chair warns of risk tied to ESG ratings, FINANCIAL TIMES (May 28, 2020) (Jay Clayton - “In my experience, there is not consensus on what, exactly, “ESG” means. I often wondered how the three concepts of environmental, social, and governance matters got lumped together.”) available at https://www.ft.com/content/2c662135-4fd3-4c1b-9597-2c6f8f17faed.
17 COMMISSIONER ELAD L. ROISMAN, Keynote Speech at the Society for Corporate Governance (July 7, 2020). (“In my mind, corporate governance stands by itself and rarely has a direct relationship to environmental or social issues” and hinted that requiring ESG disclosures may be beyond the
SEC’s legal authority, arguing the Commission cannot require disclosures beyond what a reasonable investor would consider important in making an investment or voting decision. Commissioner Hester M. Pierce has described ESG as a “modern scarlet letter,” i.e. a “labeling based on incomplete information, public shaming, and shunning wrapped in moral rhetoric preached with cold-hearted, self-righteous oblivion to the consequences, which ultimately fall on real people.”

Contrary to these commissioners’ views, evidence is growing that at least for climate-related information the reasonable investor does consider such disclosures material. By refusing to engage in discussions about the materiality of the more prominent topics within the scope of ESG, like climate change, these Commissioners avoid considering the harder questions of what role the SEC needs play in guiding companies’ materiality analyses as they must make increasingly harder decisions about what climate change information must be disclosed and when. Investors, academics, and other stakeholders have continued to highlight the inadequacy of the SEC’s action to date. An October 2018 petition by Professors Cynthia Williams and Jill Fisch (and signed by investors reporting over $5 trillion in assets under management) asks the SEC “develop a comprehensive framework for clearer, more consistent, more complete, and more easily comparable” ESG disclosures. Arguments against additional action that lump all ESG topics together largely miss the point that companies need help determining how to properly disclose specific risks that are rapidly becoming financially material but require companies to incorporate new types of information into their analyses.

The SEC’s relative inaction starkly contrasts the concern expressed by high profile leaders like Larry Fink and Mark Carney, action taken by the international corporate and investment leaders who make up the FSB’s Task Force on Climate-Related Disclosures, and corporate and financial regulators of other countries who are in the process of developing or have released climate change-specific disclosure requirements. The Commission’s advisory committees are coming around to the view that the SEC must act. Last May, the commission’s Investor Advisory Committee’s Investor-As-Owner Subcommittee recommended the SEC update reporting requirements to include “material, decision-useful ESG factors” and specifically referenced climate-related information. The SEC’s Asset Management Advisory Committee has created a subcommittee to

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18 Id. (“Let me be specific. If I were to use the securities laws to pursue my own environmental and social vision for the world, I would be subordinating the SEC’s mission to my personally held objectives. In other words, I would be acting outside the scope of my responsibility and authority. Imagine the unintended consequences that could flow from such an abuse of power.”)

19 COMMISSIONER HESTER PIERCE, Scarlet Letters: Remarks before the American Enterprise Institute (June 18, 2019).

20 See, Vizcarra, supra note 3.

21 Cynthia A. Williams & Jill E. Fisch, Petition for a rulemaking on environmental, social, and governance (ESG) disclosure, Securities and Exchange Commission (October 1, 2018) [hereinafter WILLIAMS & FISCH]

consider ESG issues, including climate, and released an update on its progress in September 2020.\textsuperscript{23}

\textbf{B. Possible Paths Forward for the SEC}

Various academics have proposed ways the Commission could revise disclosure requirements to account for sustainability and climate-risks. In 2016, Robert Eccles and Timothy Youmans suggested in the \textit{Journal of Applied Corporate Finance} requiring a statement of significant audiences and materiality to better define what ESG issues boards consider material and the specific stakeholders to which they relate.\textsuperscript{24} Last year, Jill Fisch proposed in the \textit{Georgetown Law Journal} creating a new sustainability, disclosure, and analysis section of SEC filings, modeled after the management discussion and analysis section.\textsuperscript{25} Her idea was that companies could then identify and explain their choice of the three sustainability issues most significant to their operations. Also last year, Dan Esty and Quentin Karpilow suggested a three-tiered mandatory ESG reporting regime in the \textit{Yale Journal on Regulation}.\textsuperscript{26} In addition to new regulations to enact these proposals, the SEC would need to provide specific guidance on how climate-related topics should be treated under the new disclosures.

The Director of SEC’s Division of Corporate Finance argued last year that enacting “prescriptive sustainability disclosure requirements” ten years ago would have “stymied” the “marketplace evolution of sustainability disclosures.”\textsuperscript{27} But the marketplace has evolved rapidly with regard to climate-related information since that time. The U.S. Government Accountability Office (GAO) has highlighted that a challenge for the SEC in ensuring newly material issues are disclosed is its limited ability to gain access to detailed information companies use to make their materiality determinations.\textsuperscript{28} The SEC division responsible for reviewing these disclosures for compliance (CorpFin) can ask companies whether they considered certain topics in their materiality analyses


\textsuperscript{24} Robert Eccles & Tim Youmans, \textit{Materiality in Corporate Governance: The Statement of Significant Audiences and Materiality}, 28 J. Applied Corp. Fin. 39 (2016) (discussing investor appetite for reporting material ESG information, how such reporting fits within directors’ fiduciary duties, and the role of the director in determining the materiality of ESG information; also proposing a statement of significant audiences and materiality to help provide a clearer view of what is considered “material” by a company’s board).


\textsuperscript{26} Daniel C. Esty & Quentin Karpilow, \textit{Harnessing Investor Interest in Sustainability: The Next Frontier in Environmental Information Regulation}, 36 Yale J. on Reg. 625 (2019) (proposing a three-tiered mandatory ESG reporting regime and discussing how materiality should be considered, including some discussion of climate-related reporting).

\textsuperscript{27} William Hinman, “Applying a Principles-Based Approach to Disclosing Complex, Uncertain and Evolving Risks,” Remarks at the 18th Annual Institute on Securities Regulation in Europe, London, England, (March 15, 2019) (“The marketplace evolution of sustainability disclosures is ongoing – companies certainly provide more sustainability information than they did ten years ago – and allowing this evolution to continue should provide market participants with a continued opportunity to sort out the types of information they find useful. Had we leapt into action and issued prescriptive sustainability disclosure requirements when people first began calling for them, I believe we would have stymied that evolution and stifled efforts to develop useful disclosure frameworks.”), \textit{available at} https://www.sec.gov/news/speech/hinman-applying-principles-based-approach-disclosure-031519.

(as it did a few times after the 2010 guidance) but it does not have the authority to subpoena information. Instead, it must refer a possible material inadequacy to the enforcement division who can seek a formal order of investigation and issue a subpoena. The substantial effort and resources required to subpoena information from companies about how they determined materiality makes it unlikely that CorpFin staff would attempt to do so absent policy to follow on the Commission’s expectations for how issuers should evaluate climate-related risks for materiality.

There remains substantial concern among issuers about when and what climate-related information is material and among investors about whether they are really getting a full picture of material information from current corporate disclosures. Commissioner Allison Lee has noted that the broad, principles-based “materiality” standard has not produced sufficient disclosures to ensure that investors are getting comparable and reliable information. In a recent piece in the New York Times, she writes:

> There is a misconception that securities laws already operate to produce enough climate risk information through existing broad requirements to disclose important or “material” information. If not, the argument goes, the SEC will come after them.

As a former SEC enforcement lawyer who spent over a decade spotting failed and misleading disclosures, I can attest that enforcement of broad-based materiality requirements does not work with this kind of near-magical efficiency.

Encouraging consistency in disclosure practices would help investors manage a portfolio’s exposure to the climate crisis in the medium-to long-term. As Commissioner Lee notes, “[d]ealing with and adapting to the coming calamities means we must price climate risk accurately and drive investment toward an orderly, sustainable transition to green portfolios — rather than panicked scrambles and stock sell-offs as we see more and more climate disasters.” Williams & Fisch argue that “without consistent, comparable, reliable, and complete [ESG] information, capital markets are constrained in promoting allocational efficiency as many industries embark on the transition to a low-carbon economy.” They also argue that adopting new disclosure requirements would promote competitiveness of American capital markets and bring order to the “irregular

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29 Id.
30 Id.
31 See, e.g. Task Force on Climate-Related Financial Disclosures, Phase I Report of the Task Force on Climate-Related Financial Disclosures (2016) (“[U]sers of climate-related financial disclosure commonly identify inconsistencies in disclosure practices, a lack of context for information, and incomparable reporting as major obstacles to incorporating climate-related risks as a consideration in the investment, credit, and underwriting decisions over the medium and long term.”); see also COMMISSIONER ALLISON LEE, Remarks before the Investment Adviser Association Compliance Conference 2020 (March 5, 2020) (“The lack of consistent, reliable, and comparable disclosure in this area undermines investors’ and investment professionals’ ability to evaluate the relevant risks when making investment decisions, and thus undermines efficient capital allocation”).
34 Id.
35 WILLIAMS & FISCH at 4.
Despite no movement on guidance specifically addressing climate-related disclosures, the SEC has moved forward with increasing the monetary threshold for requiring disclosure of environmental penalties and making it more challenging for shareholder proposals to reach a vote.

Comprehensive new disclosure requirements covering a broad array of ESG topics may not be necessary to guide the development of better climate-related disclosures. Updated guidance on what the Commission expects companies to do to evaluate climate change risks and opportunities in their materiality analyses, what disclosure standards the Commission views as most compatible with US securities law, and that takes into account the significant developments of the last ten years in understanding climate-related risks and use of that information by issuers and investors could go a long way towards cutting through the confusion. If the Commission followed such guidance with additional efforts to educate issuers and enforcement designed to ensure they are properly incorporating the guidance into their processes, it could more quickly transform disclosure practices. By failing to provide additional guidance, the SEC makes enforcement more challenging and leaves corporate managers to navigate differing opinions from investors and advocacy organizations. The voluntary standards organizations are taking it upon themselves to provide some clarity for issuers with a recently announced effort to align their various separate standards, but SEC guidance would more quickly encourage alignment among practices across issuers. Concerns over using non-GAAP accounting methods should fall away as accounting firms work to account for the growing materiality of climate-change and other ESG information. The Big Four accounting firms are also providing guidance on how to report metrics associated with such issues and working towards better quality assurance of reports.

Climate-Related Information is Becoming Material even Without New Disclosure Requirements

Even without significant regulatory changes, expectations for corporate disclosures are changing and along with those expectations, legal obligations. The definition of material information in U.S. securities law guides a company’s financial reporting to the SEC and communications with its

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36 Id. at 5-6.
shareholders and other stakeholders. Improper reporting (e.g., reporting false or misleading information or omitting material information) can lead to legal liabilities. Because the investor sits at the center of the definition of material information – that is, information a reasonable investor is substantially likely to view as significantly altering the total mix of information available to him – significant, verifiable shifts in how investors view and use certain information ultimately influence what must be disclosed. When it comes to climate-related information, particularly as it pertains to the oil and gas sector, the demands of the investor have shifted significantly in the last ten years and these changes have only accelerated in the last five. This shift is and will continue to move more climate-related information into the material category for disclosure purposes whether or not new regulations specifically addressing this type of information appear. If the SEC does not provide additional guidance on how to disclose climate-related information, the guideposts may be set by courts and the process will be much less smooth for companies and less efficient for the market.

A. Financial Sector Pressures to Disclose Climate-Related Risks

Concern over climate change risk goes beyond investors and firm-level corporate disclosure. Lenders are making commitments and changing their policies in ways that will place pressures on the companies that rely on them for financing. They are also increasingly disclosing their own exposures to climate-related risks, with reports guided by Task Force on Climate-related Financial Disclosures (TCFD) on climate-related risks in their assets and estimates of the environmental and climate impacts of their lending practices. Various banks have said they will not finance Arctic drilling, coal companies, or tar sands development. Morgan Stanley and Bank of America have committed to disclosing the climate change impacts of their financing through the Partnership for

42 The Supreme Court defined material information in the 1970s and that definition has been incorporated into the relevant regulations as well. See Vizcarra, supra note 6, at 750 (citing TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438 (1976), and noting SEC adjusted its definition to align with the Supreme Court in Rule 12b-2, which defines “material” as limiting the disclosure required to “those matters to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to buy or sell the securities registered.” 17 C.F.R. §240.12b-2 (2019) (also citing Business and Financial Disclosure Required by Regulation S-K, Concept Release, 81 Fed. Reg. 23916, 23925 (Apr. 22, 2016) (explaining that SEC changed the definition of materiality used in Rule 12b-2 in 1982 to that adopted by the Supreme Court in TSC Industries, Inc. v. Northway, Inc.)).

43 See Vizcarra, supra note 3 (describing how the expectations of the “reasonable investor” for climate-related disclosures are shifting).

44 Id. (discussing how courts could respond to these shifting expectations).

45 For a discussion of the recent New York v. ExxonMobil case considering the materiality of certain kinds of climate information and whether some of the company’s disclosures were misleading to investors, see Hana Vizcarra, Understanding the New York v. Exxon Decision, Harv. Envtl. & Energy L. Program (Dec. 12, 2019), https://eelp.law.harvard.edu/2019/12/understanding-the-new-york-v-exxon-decision/.

46 David Benoit, JPMorgan Pledges to Push Clients to Align With Paris Climate Agreement, WALL STREET JOURNAL (Oct. 6, 2020), https://www.wsj.com/amp/articles/jpmorgan-pledges-to-push-clients-to-align-with-paris-climate-agreement-11602018245 (“Other banks have made various pledges to stop supporting Arctic drilling and coal companies. British banks NatWest Group PLC (the former RBS Group PLC) and Barclays PLC have both committed to using their business to further the Paris agreement, the 2015 deal that called on global governments to curb rising temperatures. Citigroup Inc. earlier this year said it would walk away from clients that aren’t taking climate change seriously.”); Christopher Flavelle, Global Financial Giants Swear Off Funding an Especially Dirty Fuel, THE NEW YORK TIMES (Feb. 12, 2020), https://www.nytimes.com/2020/02/12/climate/blackrock-oil-sands-alberta-financing.html; Tsevetana Paraskova, Deutsche Bank Immediately Ends Funding For Oil Sands And Arctic Oil Projects, OILPRICE.COM (July 27, 2020), https://oilprice.com/Latest-Energy-News/World-News/Deutsche-Bank-Immediately-Ends-Funding-For-Oil-Sands-And-Arctic-Oil-Projects.html.
Carbon Accounting Financials.\(^{47}\) JP Morgan recently announced it will establish emission targets for its financing portfolio and become carbon neutral in its operations in 2020.\(^{48}\) It will advocate for a price on carbon and will engage clients on their strategies and carbon disclosures and track their carbon intensity. Adding to the divestment pressures, the Rockefeller family has committed to pressuring banks to stop investing in fossil fuels, creating the organization BankFWD to engage on the topic.\(^{49}\)

### B. Financial Regulator Interest in Climate-Related Information

Financial and bank regulators, with substantial independence from the White House, are considering whether climate change poses systemic risks to the financial system. While U.S. regulators are generally behind their European counterparts in grappling with how to address climate risks in their supervisory and regulatory capacities, they are not ignoring the issue.\(^{50}\) The Commodity Futures Trading Commission’s (CFTC) Market Risk Advisory Committee (MRAC) commissioned a report on climate-related systemic risk that was released in September.\(^{51}\) The subcommittee responsible for the report was given a broad mandate – to evaluate climate-related risk across the U.S. financial system and markets, not just limited to the jurisdiction of the CFTC. The report identifies and examines climate-related risks and provides specific recommendations for addressing them.

The recommendations of MRAC’s Climate-Related Market Risk Subcommittee range from establishing an economy-wide price on carbon to having federal financial regulatory agencies incorporate climate-related risks into their mandates and monitoring and oversight functions.\(^{52}\) They recommend that Financial Stability Oversight Council (FSOC) research the financial implications of climate-related risks, including sub-systemic shocks to markets, and the CFTC research how the risks impact markets and market participants under its oversight. The report recommends that U.S. regulators join international groups designed to address these risks, that

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\(^{52}\) *Id.*
financial supervisors require financial firms address climate-related risks through their risk management frameworks and pilot climate risk stress testing. It asks state insurance regulators to require insurers assess, address, and disclose climate risks to their underwriting activity and investment portfolios and focuses on how financial regulators can help improve disclosure and well as standardize classification systems.

Some recommendations in the report run directly counter to current SEC and Department of Labor positions. The subcommittee supports the calls for regulators to issue additional guidance regarding the materiality of climate-related information, acknowledging that material climate risks must be disclosed under existing law but arguing financial regulators should clarify the definition of materiality for disclosing medium- and long-term climate risks both quantitatively and qualitatively, including by reviewing and updating SEC’s 2010 climate risk guidance. It also recommends that regulators review and clarify the law on using climate-related factors in investment decisions for retirement and pension plans under the Employee Retirement Income Security Act (ERISA) and non-ERISA fiduciary duties. While the SEC has resisted action on climate-related disclosures, the Department of Labor (DOL) has actively created barriers for ESG-focused funds under the current administration. President Trump issued a directive to the Department of Labor in 2019 to review data on Employee Retirement Income Security Act plans, identify trends in investments in the energy sector, and review guidance on fiduciary responsibilities for proxy voting. In June, the Employee Benefits Security Administration (EBSA) released proposed amendments to the investment duties regulation under ERISA. The proposal discourages considering ESG factors in ERISA-covered plans, emphasizing financial outcomes above all else, and restricts the ability of fiduciaries to offer ESG-themed funds as default options. It also departs from previous guidance by requiring potentially burdensome documentation of equal economic returns and risks for investment choices. The onerous requirements could severely restrict fiduciaries of ERISA plans from having a voice in overseeing corporate decisionmaking around climate change preparedness and planning and other ESG topics. As Prof. Ann Lipton notes, it “may functionally disenfranchise ERISA fiduciaries.”

In addition to the work on behalf of the CFTC, the Federal Reserve has actively engaged on how climate change could impact the health of our financial system. Federal Reserve Chair Jerome Powell said in January that the Fed has a role to play “to ensure that the financial system is resilient and robust against the risks of climate change” and is working to understand how to do so. Powell has also indicated a willingness to join the Network of Central Banks and Supervisors for Greening the Financial System and has sent representatives to participate in its meetings. The Federal Reserve Bank of San Francisco hosted a conference on climate change in 2019, commissioning a series of papers. The executive vice president of the Federal Reserve Bank of New York, Kevin

Stiroh, delivered remarks on climate change and risk management in bank supervision at an event at Harvard Business School earlier this year. Stiroh is serving as the co-chair of the Basel Committee on Banking Supervision’s high level Task Force on Climate-related Financial Risks and has said that the Federal Reserve is devoting “a lot of resources” to climate change risk research. The Fed is closely following central banks and regulators in other countries who are developing stress testing and additional disclosure requirements.

Should new requirements for risk management across the financial sector develop from these efforts, they would likely increase pressure on public companies to incorporate climate-related information into their risk management and disclosure processes. As financial regulators encourage or require banks, insurers, and other financial entities to address climate change risks in their portfolios, it can provide additional pressure on companies to share their climate-related risks and strategies to gain access to financing or insurance products.

Potential for Change Under a New Administration or Congress

A change in the makeup of Congress or occupant of the White House could result in different pressures on the relevant regulators. Financial regulators do not need additional authorities in order to require consideration and disclosure of material climate risks. However, Democratic presidential nominee Joe Biden’s platform says he would take executive action to “[r]equir[e] public companies to disclose climate risks and the greenhouse gas emissions in their operations and supply chains.”

Various legislative proposals have emerged on climate-related financial risks and disclosures or more general ESG disclosures. Senator Brian Schatz introduced the Climate Change Financial Risk Act in November 2019 that would require the Federal Reserve to develop climate scenarios and require large financial institutions to submit capital policies for climate risk planning and undergo stress tests to evaluate their resilience to climate-related financial risks. It currently has 10 Democratic co-sponsors. The Climate Risk Disclosure Act attracted 16 Democratic cosponsors in the Senate and 35 in the House (no Republicans) in 2019. The bill would require the SEC to develop sectoral disclosure guidance, with a specific emphasis on the “finance, insurance, transportation, electric power, mining, and non-renewable energy” sectors. The SEC would also have to require that public companies disclose their direct and indirect greenhouse gas emissions as well as their total fossil fuel related assets. It directs the SEC to “establish a minimum social cost of carbon” for companies to use in their financial risk analyses over “5-, 10-, and 20-year time

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frames” and asks companies to disclose risk management strategies related to the physical risks and transition risks posed by the climate crisis.59

Another 2019 bill in the House, the ESG Disclosure Simplification Act, would require issuers to provide disclosures in their proxy statements describing the link between ESG metrics and the issuer’s long-term business strategy, as well as the process used to determine such impacts.60 It would also require the SEC to adopt rules mandating disclosure of ESG metrics,61 which would be deemed de facto material disclosures.62 Other bills targeted corporate political and lobbying spending, a significant topic of concern for many climate activists. The Shareholder Protection Act and For the People Act would requiring shareholders to authorize corporate political budgets and individual expenditures over a certain amount.63 The Shareholder Political Transparency Act of 2020 would require disclosures of corporate political expenditures, but would not require board or shareholder approval of such expenditures.64

None of these bills saw a real chance of success in the current Congress. However, should the majority in the Senate shift after the November 2020 elections, some of the ideas in these bills could become viable and, if there is a new president, attract the support of the White House as well. Vice President Biden’s campaign platform indicates a likelihood to support requiring public companies to disclose climate risks and greenhouse gas emissions. As we have seen with DOL’s EBSA, shifts in administration can impact certain investors’ ability to act on concerns about climate change risks. In addition to having more direct control over offices like EBSA, a White House interested in evaluating and acting on climate change concerns could better coordinate and encourage more comprehensive reviews of the issue that could result in additional action by independent financial regulators as well as more prominently participate in international forums.

Outlook for the Oil and Gas Industry

Energy sector response to the shareholder demands for more comparable, comprehensive disclosures about climate-related risks and opportunities has been mixed. Yet the adoption of new

60 See ESG Disclosure Simplification Act of 2019, Sec. 2 (“Each issuer the securities of which are registered under section 12 or that is required to file annual reports under section 15(d) shall disclose in any proxy or consent solicitation material for an annual meeting of the shareholders— (A) a clear description of the views of the issuer about the link between ESG metrics and the long-term business strategy of the issuer; and (B) a description of any process the issuer uses to determine the impact of ESG metrics on the long-term business strategy of the issuer.”)
61 See Id. (The Securities and Exchange Commission (in this Act referred to as the “Commission”) shall amend part 210 of title 17, Code of Federal Regulations (or any successor thereto) to— (A) require each issuer, in any filing of the issuer described in such part that requires audited financial statements, to disclose environ- mental, social, and governance metrics (in this Act referred to as ESG metrics); and (B) define ESG metrics.”)
62 Id. (“It is the sense of Congress that ESG metrics, as such term is defined by the Commission pursuant to paragraph (2), are de facto material for the purposes of disclosures under the Securities Exchange Act of 1934 and the Securities Act of 1933.)
64 H.R. 5929 §3.
disclosure processes and more open consideration of climate change risks and opportunities has resulted in significant progress in just the last few years. Companies have moved from barely if at all mentioning “climate change” in voluntary or mandatory disclosures to preparing voluntary, climate-specific reports in line with the TCFD’s recommendations and incorporating more information about the potential for climate change impacts in their SEC filings (if not the detailed, quantitative information that some investors have continued to push for). The quality remains uneven and while consensus is growing around how to approach certain types of information, others, such as the disclosure of scenario analyses remain elusively complex.

European companies, contending with more aggressive regulatory developments, are forging ahead to incorporate more climate-related information into their mandatory financial disclosures. As some major oil and gas companies begin to publicly plan for a less fossil fuel dependent world, others are betting that staying the course will give them their best financial outcomes, at least for the next couple of decades.65 Investors seek more information with which to make their own determinations as to which strategies are the best bets. Regulatory developments in Europe and elsewhere are pushing many companies to develop more substantial commitments to new business strategies and at the least more expansive disclosure practices.

The current U.S. regulatory environment has not yet reached a consensus around what it wants to see from companies, leaving them to design their own approaches in consultation with stakeholders and investors. However, companies should not count on the status quo remaining stable for very long. As I have discussed above, financial regulators are taking an active interest in the topic and their actions would create pressures that ripple out to individual issuers even if the SEC did not impose new requirements. The SEC may be outflanked by investors, other regulatory entities, and state attorneys general66 in maneuvering to define the parameters of climate-related disclosures. Depending on the outcome of the 2020 elections, the Commission could also encounter new statutory requirements to take more direct action in the next few years.

65 Clifford Kraus, U.S. and European Oil Giants Go Different Ways on Climate Change, THE NEW YORK TIMES (Sept. 21, 2020).
66 For more discussion of the actions of state attorneys general, see Vizcarra supra note 6.