SULLIVAN & CROMWELL LLP

ESG Monthly Newsletter

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This memorandum highlights key recent developments in environmental, social and governance matters of relevance to public and private companies globally. For more information on this evolving business and legal landscape, we encourage you to reach out to your regular Sullivan & Cromwell contact or the lawyers listed on our **ESG practice website**.

Key Developments

U.S. Securities and Exchange Commission continues work on proposed new requirements for climate- and ESG-related disclosures amid delay in release of final rules. Due to a technological error, the SEC has reopened the comment period for its proposed rules that would expand the scope of climate- and ESG-related disclosures required from SEC registrants. The comment period will remain reopened until November 1, 2022. In recent remarks, SEC speakers have declined to address the content of the new climate disclosure rules and have instead focused attention on existing climate-related disclosure requirements applicable to registrants, including the SEC's 2010 interpretative release, which addressed how SEC reporting companies are required to discuss material climate-related matters.

Central banks continue focus on climate-related risks. The U.S. Federal Reserve and European Central Bank continue their focus on climate change. In the United States, the Fed announced that six of the U.S.'s largest banks will participate in a pilot scenario analysis designed to enhance the ability of supervisors and firms to measure and manage climate-related financial risks. In the EU, the ECB has published new details on how it is "tilting" its corporate bond purchases towards issuers with better emissions reductions, targets and disclosures.

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Upcoming COP27 expected to address boosting climate finance. Delegates at November's COP27 conference are expected to discuss, among other matters, how to fund climate-related mitigation and adaption measures in developing nations, as well as how to compensate for climate-related loss and damages. In September, Barbados became the first nation to access the IMF's new Resilience and Sustainability Trust, designed to provide affordable, long-term financing to help build resilience against climate change.

Legislative and Regulatory Developments

1. *United States*

SEC reopens comment period on proposed rulemaking on climate-related disclosures and other ESG matters. On October 7, the SEC reopened public comment periods for multiple rulemaking releases due to a technological error. The affected rulemakings include the SEC's proposed rulemakings on climate-related disclosures and ESG-related disclosures for investment advisers and investment companies. The SEC is advising affected commenters to check the relevant comment file on SEC.gov to determine whether their comment was received and posted. The reopened comment period will expire on November 1, 2022, and all interested persons, not just commenters affected by the technological error, will have the opportunity to comment on the affected releases during the reopened comment period. Final rules on new climate-related disclosures were expected to be released this autumn, but the reopened comment period will lead to a delay. S&C's memo on the reopening of the comment period is available here.

SEC's approach to climate-related disclosure proposal addressed at recent SEC conference. The SEC's Division of Corporation Finance discussed its approach to climate-related disclosures at the SEC's annual "SEC Speaks" conference, held on September 8–9. Representatives of the Division of Corporation Finance emphasized in their remarks that their goal in requiring climate-related disclosures is to provide investors with the information they need to evaluate climate risks, because of the role these risks play in long-term value creation. Speakers from the SEC noted that its proposed climate disclosure rules were not "ripe for discussion" and instead focused attention on the SEC's 2010 interpretative release and the SEC's sample comment letter published in 2021, which highlighted the SEC's expectations on climate-related disclosures. During a speech on October 17, SEC Commissioner Jaime Lizárraga noted that the SEC is reviewing thousands of comments on the SEC's proposed ESG-related rules and continuing to meet with stakeholders to receive public feedback. S&C's memo on the proposed rules is available here, and our memo on the 2021 sample comment letter is available here.

SEC advisory committee discusses human capital management as timing of new rules remains unclear. The SEC's Investor Advisory Committee discussed human capital management disclosure at its September meeting and highlighted the current "mismatch" between the data issuers disclose and the information they consider decision-useful to investors. Under rules adopted in 2020, a company is required to provide, to the extent material to an understanding of its business, a description of the registrant's human capital resources. In May 2021, Chair Gensler announced the SEC is working on a new rule that would require additional human capital management disclosure that could require disclosure of specific metrics related to the workforce. Speakers at the meeting suggested that the most useful information to allow investors to evaluate risks and opportunities could include information on wages (potentially benchmarked against an average "living wage"), hours worked, diversity, equity & inclusion statistics, turnover percentage, and investment in training. The Investor Advisory Committee also noted that its research showed a relationship between labor-related data, particularly data on turnover percentage, and an issuer's future returns. However, the speakers did not make a recommendation related to such disclosure to the SEC at the September meeting, citing continued discussions, including with respect to the impact of human capital management disclosure on shareholder value.

U.S. Senate ratifies international agreement on reducing use of potent greenhouse gases. On September 21, the U.S. Senate gave advice and consent to ratification of the 2016 Kigali Amendment to the Montreal Protocol on Substances that Deplete the Ozone Layer, which calls for a gradual reduction in the production and use of types of potent greenhouse gases known as hydrofluorocarbons ("HFCs") that are commonly used in refrigerators and air conditioners. The U.S. Environmental Protection Agency ("EPA") estimates that global phasing out of the use of HFCs is expect to avoid up to half a degree Celsius of warming by 2100. The Kigali Amendment supplements the Montreal Protocol, finalized in 1987, which required phase-out of production and consumption of ozone-depleting substances. The Biden-Harris administration has already announced measures, including an EPA rulemaking, to phase down the production and consumption of HFCs by 85% below baseline levels by 2036.

White House reviewing Department of Labor proposed rules on ESG investing and pension plans. The U.S. Department of Labor ("DOL") has submitted its proposed amendment to the Investment Duties regulation under Title I of the Employee Retirement Income Security Act of 1974 ("ERISA") to the White House Office of Management and Budget's Office of Information and Regulatory Affairs for review, suggesting that a final rule may be released in the coming weeks. The proposed rule would remove barriers implemented by the prior administration that the DOL believes limited fiduciaries' ability to consider climate change and other ESG matters as factors when selecting investments and exercising shareholder rights. S&C's memo on the proposed rules is available here.

2. *United Kingdom*

UK government launches review of UK's Net Zero Strategy. The UK Government's Department for Business, Energy and Industrial Strategy announced on September 26 a review of the UK government's Net Zero Strategy to ensure it is "delivering net zero in a way that is pro-business and pro-growth" while also supporting UK energy security and minimizing short-term costs for businesses and consumers. The current Strategy, published in October 2021, had called for measures such as an end to the sale of petrol and diesel cars by 2030 and the decarbonization of the power sector by 2035. However, the potential outcome of the review is unclear following the late October resignation of UK Prime Minister Liz Truss and appointment of her successor, Rishi Sunak, as it remains to be seen whether Mr. Sunak's administration will continue or abandon the Truss administration's reassessment of the UK Net Zero Strategy.

United Kingdom expands obligations for smaller pension plans to provide TCFD-aligned disclosures. From October 1, rules requiring occupational pension schemes to provide disclosures aligned with the Task Force on Climate-Related Financial Disclosures ("TCFD") recommendations now apply to schemes with £1 billion or more of assets, down from the prior threshold of £5 billion. TCFD reporting is increasingly widespread in the United Kingdom, where disclosures are also required by companies with shares or depositary receipts traded on the main market of the London Stock Exchange and AIM, large regulated asset managers and owners, and large unlisted companies. For pensions, under the Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021 (SI 2021/839), as amended, the trustees of schemes that meet the threshold are required to provide annual TCFD disclosures and to calculate and report on a portfolio alignment metric which describes the extent to which scheme investments support the Paris Agreement goal of limiting temperature rises to 1.5°C.

3. *European Union*

European Union moves to ban products made with forced labor. In September, the European Commission released a proposed regulation that would prohibit products produced, extracted or harvested with forced labor from being placed on the market within the EU or exported from the EU. Under the proposed regulation, products found to have been made with forced labor could not be sold in or exported from the EU, and companies would be required to withdraw such products from the market and dispose of them. The regulation would be enforced by relevant authorities of Member States, including customs authorities. The regulation complements a proposal by the Commission to require companies to conduct due diligence on their value chains to identify and, if relevant, prevent or end adverse impacts of their activities on human rights, including use of forced labor. Following a period of public feedback that will last until November 30, the European Parliament and the Council of the European Union will debate the proposal and reach agreement on its terms. As drafted, the regulation would apply beginning 24 months after adoption.

4. *Australia*

Australian Government launches public consultation on reforms to the Modern Slavery Act 2018. The Australian Federal Government has launched a public consultation period, closing November 22, during which submissions can be made on an Issues Paper regarding proposed changes to Australia's Modern Slavery Act 2018. Under that law, large government and private entities are required to review their operations and supply chains to ensure that slavery is not occurring, and must report annually on what actions they are taking to address related risks. Depending on the results of the review, the scope and requirements of the Act could be increased. Among the questions considered by the review are whether the Act should be amended to include additional enforcement measures or powers, including civil penalties for noncompliance, and whether to expand the number of entities the Act applies to by reducing the revenue threshold (currently AU$100 million of consolidated annual revenue) above which entities are in-scope.

Litigation/ Enforcement Developments

1. *United States*

U.S. state officials and legislators continue campaign against ESG investing. State officials and legislatures in multiple U.S. states, notably Republican-led states, continue advocating against ESG-focused investing via proposed legislation and divesting state monies from ESG-focused fund managers. Financial institutions such as BlackRock have recently received letters from a number of Republican state officials with respect to their climate commitments, including their membership in the Glasgow Financial Alliance for Net Zero. In addition, on October 19, attorneys general from over a dozen Republican-led states announced civil investigations into six large U.S. banks' involvement in global climate initiatives and how the banks have incorporated ESG factors into their operations.

2. *Australia*

ACCC launches internet 'sweeps' to combat greenwashing. On October 4, the Australian Competition and Consumer Commission ("ACCC") launched internet 'sweeps' to identify misleading environmental and sustainability marketing claims as part of its efforts to identify deceptive advertising and marketing practices. The ACCC will review at least 200 company websites as part of its review and has said it may take enforcement action if it considers that customers are being misled by environmental claims. The ACCC's action follows its announcement of 2022-23 Compliance and Enforcement Priorities in which the ACCC noted that it is prioritizing both consumer and fair-trading issues in relation to environmental and sustainability claims. Similar recent moves have been announced by regulators in the United Kingdom, where the U.K. Competition and

Markets Authority launched an investigation in July into whether fast fashion brands' eco-friendly claims were misleading consumers.

Climate Financing, Bank and Asset Management Developments

1. *Global*

Climate financing expected to be high on the agenda for upcoming COP27. Questions of how to help low- and middle-income countries finance climate mitigation and adaptation and whether to provide compensation for climate-related loss and damage are expected to be high on the agenda for the upcoming UN Climate Change Conference, known as COP27, to be held in Egypt from November 7 to November 18. High-income nations had promised at last year's COP26 to provide $100 billion in climate-related financing in 2023 for developing nations, but details on how that funding to support climate action will be provided thus far remain unclear. Discussion is also expected to cover whether and how wealthier nations will provide "loss and damage financing" as compensation to assist developing nations already adversely affected by climate change.

IMF provides Barbados innovative form of funding to build resilience to climate change. On September 28, the IMF announced that it had reached a staff-level agreement with Barbados to allow the island nation to access the IMF's new Resilience and Sustainability Trust ("RST"), which provides affordable, long-term financing to help build resilience against climate change. Barbados is the first country to reach a staff-level agreement to access the RST. Under the agreement, subject to approval by the IMF Executive Board, Barbados will get access to about $183 million of financing under the RST to assist the country with climate change adaptation and mitigation efforts.

Climate Week NYC addresses heightened membership requirements for the UN's Race to Zero Campaign and new 2040 net zero pledge. During Climate Week NYC, held from September 19–25, policymakers, corporate representatives and advocacy organizations discussed recent developments related to corporate net-zero commitments. Developments discussed included updates to the membership criteria for the UN's Race to Zero ("RTZ") initiative to require that its members "phase down and out all unabated fossil fuels". Current members will have until June 15, 2023 to comply with the updated criteria, while new members joining after June 15, 2022 would have to comply upon admission. Discussions also addressed The Climate Pledge, an initiative co-founded by Amazon whose nearly 400 signatories aim to reach net zero carbon emissions by 2040.

2. *United States*

U.S. Federal Reserve announces pilot climate scenario analysis exercise. Six of the U.S.'s largest banks will participate in a pilot scenario analysis organized by the U.S. Federal Reserve designed to enhance the ability of supervisors and firms to measure and manage climate-related financial risks. During the exercise, which will be launched in early 2023, participating banks will analyze the impact of various climate scenarios on specific portfolios and business strategies. In its announcement of the pilot, the Fed noted that scenario analysis can assist in understanding how climate-related financial risks may manifest and differ from historical experience. The participating banks are Bank of America, Citigroup, Goldman Sachs, JPMorgan Chase, Morgan Stanley, and Wells Fargo. The pilot will neither affect banks' capital requirements nor have supervisory implications. The Fed anticipates publishing insights gained from the pilot at an aggregate level, reflecting what has been learned about climate risk management practices. No bank-specific information will be released.

U.S. federal banking regulators are working on climate-related interagency guidance. The Federal Reserve, the Office of the Comptroller of the Currency ("OCC") and the Federal Deposit Insurance Corporate ("FDIC") are collaborating on interagency guidance for large banks on climate-related financial risk management, according to recent speeches by the Acting Comptroller of the OCC, Michael Hsu, the Vice Chair for Supervision of the Federal Reserve, Michael Barr, and the Acting Chairman of the FDIC, Martin Gruenberg. The interagency work follows the release by the OCC and FDIC of substantially the same proposed principles for climate-related financial risk management, which are designed to provide large banking institutions (those with over $100 billion in total consolidated assets) subject to their respective regulation with a high-level framework for managing climate-related financial risks.

U.S. Department of the Treasury engages with financial sector on climate risk. The U.S. Department of the Treasury has recently announced a series of engagements with financial institutions and climate experts aimed at assessing climate risk and supporting the United States' climate goals. On October 3, the Treasury-chaired Financial Stability Oversight Council ("FSOC") established the Climate-related Financial Risk Advisory Committee, a group of private and public sector experts who will help FSOC receive information and analysis on climate-related financial risks and better understand the economic and financial impacts of climate-related risks. The Treasury Department has also held discussions with major U.S. banks to better understand how they are setting, implementing and accounting for net-zero targets and their efforts to finance net zero-aligned activities.

SEC confirms investment advisers can consider DEI factors in recommending advisers for clients. The SEC staff has released an 'FAQ' confirming that investment advisers that recommend or select other financial advisers for their clients can consider diversity, equity and inclusion factors in making such recommendations, provided that the use of such factors is consistent with a client's objectives, the scope of the relationship, and the adviser's disclosures. The FAQ was issued following a 2021 report by the SEC's Asset Management Advisory Committee which addressed the lack of gender and racial diversity in the asset management industry. In addition to recommending that the SEC issue guidance on the selection of other asset managers, the committee also recommended that the SEC require additional disclosure by investment advisers and funds on gender and racial diversity of their owners, officers and workforce and take additional steps related to discriminatory practices in the industry.

3. *European Union*

European Central Bank to favor climate-friendly issuers in its long-term debt purchases. The European Central Bank has published additional details on how it will decarbonize its holdings of corporate bonds following the July 2021 decision of its Governing Council to further incorporate climate change considerations into its policy framework. As part of its climate policy, the ECB has begun "tilting" its corporate bond purchases towards issuers with better climate performance. The ECB announced that an issuer's 'climate score' will affect the issuer's weighting in the benchmark that guides the ECB's corporate bond purchases and the ECB's bids on the primary market, such that the ECB will ultimately purchase comparatively more bonds issued by companies with stronger climate performance. An issuer's climate score will be based on (1) its past emissions, (2) its decarbonization targets and (3) the quality of its reporting of its greenhouse gas emissions. The ECB will take the climate score into account in all purchases of corporate bonds settled from October 1, 2022. The ECB will begin publishing climate-related information on its corporate bond holdings from the first quarter of 2023.

Insurance Developments

1. *United States*

California enacts novel heat wave ranking law backed by state insurance regulator. On September 9, California's governor signed into law Assembly Bill 2238, making California the first U.S. state to enact a statewide ranking and early warning system for heat waves. The new law aims to protect vulnerable communities through a notification system for extreme heat events that will allow communities and local governments to better prepare for harmful heat waves. In addition, the legislation, which was sponsored by California's Insurance Commissioner Ricardo Lara, also directs the state's Department of Insurance to study the insured and uninsured costs of past extreme heat events and examine the effectiveness of insurance at preventing losses related to extreme heat. As part of the study, the state's Department of Insurance will also look at heat risks that have historically been uninsured, identify barriers to use of insurance or other financing tools to fund or support heat risk mitigation or adaptation strategies and recommend how those barriers could be overcome.

U.S. Treasury Department proposes collection of homeowners' insurance data to address impact of climate change on insurance availability and affordability. On October 18, the Treasury's Federal Insurance Office ("FIO") issued a notice and request for comment proposing to collect homeowners' insurance underwriting data from over 200 property and casualty insurers. FIO's request relates to its mandate to analyze the potential impact of climate change on the affordability and availability of insurance, including the potential of major disruptions in the private insurance market due to climate-related disasters. The FIO proposes to collect data aggregated at the ZIP code level, which is a level of granularity at which no such data is publicly available. FIO expects that an insurer would need to complete between 100 and 350 hours of work to provide the data in response to this data call. Comments on FIO's proposal are due by December 17.

Connecticut Insurance Department issues guidance for Connecticut domestic insurers on managing financial risks for climate change. On September 15, the Connecticut Insurance Department ("CID") issued a bulletin setting forth its expectations for how Connecticut domestic insurers will manage financial risks of climate change. This bulletin is based in large part on some of the requirements in New York State Department of Financial Services' guidance on managing financial risks of climate change for New York domestic insurers, which was released in November of last year. Under the CID's bulletin, Connecticut domestic insurers are required to comply with the board governance requirements and to develop a specific plan for implementing the organizational structure requirements set forth in the CID's bulletin by no later than January 1, 2023.

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