Simpson Thacher

Memorandum

Tracking the SEC's Climate and ESG Task Force

April 26, 2023

On March 28, 2023, the SEC's Climate and ESG Task Force announced a $55.9 million settlement against Brazilian mining company Vale S.A.–the largest and most significant settlement obtained by the Task Force since its formation two-plus years ago. Here's what we've learned about the Task Force's activities so far, and what companies should be watching for.

Aligning with the growing importance of ESG concerns to investors, and coinciding with increased investor appetite for ESG-related investment portfolios, the SEC created the Climate and ESG Task Force (the "Task Force") within the Division of Enforcement on March 4, 2021. At the time, the SEC announced that the Task Force would develop initiatives to actively identify ESG-related misconduct, focusing on matters such as identifying material misstatements or gaps in issuer disclosure of climate risks under existing rules, and pursuing tips and whistleblower complaints on ESG-related issues–bolstering the efforts of the SEC as a whole in addressing climate risk and other ESG-related topics. SEC Chair Gary Gensler also noted that the Task Force would focus on truth in advertising in fund disclosures when using terms like "green" and "sustainable."

While the launch of the Task Force generated buzz, based on publicly-issued press releases, the number of matters in which it had a significant role has been quite limited. As to why the activity of the Task Force, while important, has been lighter touch than anticipated, it may simply be a function of the rise of competing priorities at the SEC, most notably the allocation of significant enforcement resources to crypto-related investigations.

Below, we detail the four significant actions and settlements that have been primarily attributed to the Task Force. Our analysis of these actions indicates the following key points:

- Environmental disasters have spurred the Task Force's publicized actions against issuer companies thus far. These high-profile cases have focused on companies with significant, known environmental and social risks.
- For issuers, the Task Force has thus far focused to a greater degree on ESG-related statements made outside of SEC-filed documents, as opposed to within them. That may be because company filings are generally subject to a level of review and scrutiny that ESG reports or similar publications and communications as to ESG performance are not–but should be, given the potential consequences (both from the perspective of regulatory and litigation risk).

- Large investment companies have been targeted by the Task Force for "truth in advertising" claims like the ones forecasted by Chair Gensler–issues that the SEC's proposed rule on investment naming[1] is meant to target as well.
- Other recent enforcement actions brought by the SEC without substantial Task Force involvement indicate a keen focus on matters like workplace harassment and discrimination, and related lapses in governance controls in place at companies–an ESG issue to be sure, whether addressed by the Task Force or otherwise.
- Collectively, the Task Force's public actions highlight the critical need for proper governance, including procedures and controls addressing ESG issues. Decisions and disclosures around ESG metrics and statistics should be treated like financial metrics and statistics: they should flow through the proper decision-making channels, be subject to closely-followed procedures and policies, rely on objectively verifiable data, and be pressure-tested by corporate boards to avoid embellishment or mischaracterizations.

Summary of Task Force Actions to Date

Company:	**Vale S.A.**
Date:	SEC Complaint filed April 28, 2022; Settled March 28, 2023
Result:	Settlement: $55.9 million ($25 million civil penalty, $30.9 million disgorgement and prejudgment interest)
Primary securities law issue:	False and misleading disclosure
Underlying ESG concern:	Community and employee safety; environmental contamination

DESCRIPTION[2]

Brazilian mining company Vale S.A's Brumadinho dam, constructed to hold potentially toxic byproducts from the company's mining operations, collapsed in January 2019. The disaster resulted in 270 deaths and the release of 12 million cubic tons of mining waste with downstream effects on the local community and economy. Vale was required to pay $7 billion in compensation to victims by the Brazilian state of Minas Gerais, but the SEC also alleged securities violations by virtue of the company's allegedly materially false and misleading statements about the safety and stability of its dams.

The SEC's complaint pointed to statements made by Vale in its 20-F and 6-K filings, as well as in its sustainability reports and more broadly. Those reports, which were referenced in the company's SEC filings (but not themselves filed with the SEC), described safety audits that the SEC alleged had been fraudulently obtained. The SEC's complaint also detailed allegedly false public statements made by the company's CEO in a magazine article about

[1] SEC rule, proposed May 25, 2022, available here.

[2] Based on the SEC's settlement announcement and complaint. The company did not admit or deny the findings of the order.

the safety of its dams, and other information provided on the company's website about its ESG efforts, claiming that Vale's misstatements were material to investors.

TAKEAWAY

Statements made in ESG or sustainability reports and published (voluntarily) on a company's website are not immune from Task Force scrutiny. Companies face pressure to furnish increasing amounts of information to investors and other stakeholders regarding their ESG efforts. It's not uncommon to see a 75 or 100-page ESG report on a company's website–in addition to growing disclosure about ESG efforts, targets, and achievements in proxy statements and sometimes in annual 10-K or 20-F reports. To date, issuers have tended to examine statements made in their SEC filings more carefully than other voluntary reports, in part because of the executive certification requirements applied to them. In the Vale action, however, the SEC went to great lengths to show that companies won't be off the hook for statements made in voluntary reports. In a press release, SEC Associate Director Mark Cave emphasized the point: "Our action against Vale illustrates the interplay between the company's sustainability reports and its obligations under the federal securities laws... [P]ublic companies can and should be held accountable for material misrepresentations in their ESG-related disclosures, just as they would for any other material misrepresentations."

Company:	**Goldman Sachs Asset Management**
Date:	Charged and settled November 22, 2022
Result:	$4 million settlement
Primary securities law issue:	Policies and procedures failures
Underlying ESG concern:	ESG-qualified investment offerings

DESCRIPTION[3]

From 2017, Goldman Sachs Asset Management ("GSAM") offered two mutual funds and a separately managed account strategy marketed as ESG investments. Prospectuses set out a two-step process for selecting and monitoring securities included in the fund: first, screening securities issued by companies in industries, including casinos, distillers, tobacco producers and arms manufacturers; and second, applying a proprietary ESG analysis (including a proprietary ESG questionnaire and materiality matrix). The SEC's order stated that GSAM failed to adopt written policies and procedures governing how ESG factors were evaluated as part of the investment process until sometime after the products were introduced. In addition, the SEC stated that once written policies were adopted, the policies were not consistently applied, that the procedures were not followed, that staff did not receive sufficient training, and that teams used alternative processes than those described in offering documents.

[3] Based on the SEC's settlement announcement and order. The company did not admit or deny the findings of the order.

During the period in question, GSAM shared information about these policies and procedures with third parties, including intermediaries and its board of trustees. The SEC order noted that GSAM violated Section 206(4) of the Investment Advisers Act of 1940 and Rule 206(4)-7, requiring a registered investment adviser to adopt and implement written compliance policies and procedures reasonably designed to prevent violations of the Advisers Act and the rules thereunder.

TAKEAWAY

The "G" in ESG–governance–is a critical component to offering ESG investment products. ESG as a method for measuring company performance has, in the United States, generally arisen through market practice rather than an agreed-upon set of rules or definitions. Determining what qualifies as an ESG factor, which factors matter most, and how to compare or evaluate corporate practices has presented companies and investors with a significant challenge. (This is part of why a number of third parties now offer bespoke ESG ratings products[4] and data, analytics and research solutions as companies look for more effective ways to identify, quantify and calculate a number of difficult-to-measure inputs.) Here, rather than assert a disclosure-based violation, the settlement was grounded in perceived shortcomings in policies and procedures, underscoring the SEC's ability to bring what are, in effect, strict liability cases against registered entities active in the ESG space.

Because ESG-related inputs can vary widely, the SEC is sensitive to issues of greenwashing in investment offerings: attracting ESG-focused investors while not ensuring that the product offered is held to a consistent standard. In a press release, Andrew Dean, Co-Chief of the SEC's Asset Management Unit, said, "Today's action reinforces that investment advisers must develop and adhere to their policies and procedures over their investment processes, including ESG research, to ensure investors receive the advisory services they would expect to receive from an ESG investment." Having appropriate governance practices in place is crucial to support a company's labeling as one component of managing overall ESG-related risks–in particular as labeling relates to investment products and strategies, but also more broadly as companies weigh the types of statements and characterizations they are willing to make on ESG-related topics.

[4] *See, e.g.*, Bloomberg, Moody's, MSCI, Refinitiv and S&P.

Company:	**Compass Minerals International, Inc.**
Date:	Charged and settled September 23, 2022
Result:	$12 million settlement (part of which relates to an ESG concern)
Primary securities law issue:	Deficient disclosure controls and procedures
Underlying ESG concern:	Environmental contamination

DESCRIPTION[5]

In September 2022, the SEC announced a settlement with Compass Minerals International, Inc., a mineral production company, for alleged disclosure violations that resulted from a "deficient disclosure process." One charge focused on failure to disclose potential financial risks arising from contamination of a river in Brazil, with excessive discharges of mercury attributed to deficient disclosure controls and procedures. Starting in 2017, a subsidiary of mineral production company Compass Minerals International, Inc., allegedly began discharging excessive amounts of mercury into the Botafogo River in Pernambuco, Brazil. The facility allegedly covered up the misconduct by submitting inaccurate test reports to Brazilian environmental authorities. In its order, the SEC stated that the mercury contamination and following cover-up could have resulted in regulatory penalties, suspension of the facility's operating permit or third party liability. Without adequate disclosure controls and procedures in place, according to the SEC, the company failed to analyze these risks for disclosure.

The SEC's order stated that the Company violated its Rule 13a-15 obligations relating to maintenance of disclosure controls and procedures. The SEC noted remedial efforts undertaken by the company, including creating a new chief accounting officer, developing new internal controls and procedures regarding disclosure, creating a board-chartered disclosure committee, and adding to its board several new directors with industry experience in finance and accounting as well as safety and sustainability.

TAKEAWAY

Environmental contamination and associated disclosure (or lack thereof) can present a hook for the Task Force. ESG concerns in the Compass matter were secondary to material misstatements in the company's earnings calls and other shareholder communication, as well as in its Form 10-K. But while ESG wasn't the primary driver of the action, the Task Force used the mercury contamination as a means to build claims of disclosure failures, again looking to controls and procedures–rather than disclosure-based violations–that may be lacking as they relate to oversight of ESG-related matters.

[5] Description based on the SEC's settlement announcement and order. The settlement also covered material misstatements relating to the company's salt production capabilities and costs associated with technology upgrades. The company did not admit or deny the findings of the order.

Company:	**BNY Mellon Investment Advisor, Inc.**
Date:	Charged and settled May 23, 2022
Result:	$1.5 million settlement
Primary securities law issue:	Misstatements and omissions about ESG considerations
Underlying ESG concern:	ESG-qualified investment offerings

DESCRIPTION[6]

From July 2018 to September 2021, BNY Mellon Investment Adviser, Inc. ("BNYMIA") allegedly indicated to investors that all investments in certain of its mutual funds had undergone an ESG quality review as part of the investment process. While this was true for some funds, others included investments that had not received any such review.

The SEC charged BNYMIA with violating Section 206(2) of the Advisers Act, which prohibits an investment adviser from engaging in fraud or deceit but ultimately sounds in negligence; Section 206(4), which prohibits false and misleading statements to investors or prospective investors; and Section 34(b) of the Investment Company Act, which makes it unlawful for any person to make an untrue statement of material fact in filed documents. In its order, the SEC noted remedial efforts by BNYMIA, including revising certain disclosure language and the modification of relevant processes, policies and procedures.

TAKEAWAY

Acknowledging advances in competing efforts by regulators and standards boards to develop non-financial reporting standards, investment advisers need to clearly incorporate (and follow) appropriate procedures into their investment practices. Adam S. Aderton, former Co-Chief of the SEC's Asset Management Unit and a former member of the Task Force, stated: "Investors are increasingly focused on ESG considerations when making investment decisions. As this action illustrates, the Commission will hold investment advisers accountable when they do not accurately describe their incorporation of ESG factors into their investment selection process."

Conclusion

While the Task Force has not brought the flurry of enforcement actions that may have been anticipated at its announcement, it has reinforced the message that when it comes to ESG, governance–including having appropriate policies in place, executing proper oversight, and generally ensuring that any investor-facing language accurately describes the processes and actions in place at a company–is a critical area of focus.

[6] Based on the SEC's settlement announcement and order. The company did not admit or deny the findings of the order.

For further information regarding this memorandum, please contact one of the following authors:

NEW YORK CITY

Marc P. Berger
+1-212-455-2197
marc.berger@stblaw.com

Leah Malone
+1-212-455-3560
leah.malone@stblaw.com

Michael J. Osnato, Jr.
+1-212-455-3252
michael.osnato@stblaw.com

PALO ALTO

Stephen P. Blake
+1-650-251-5153
sblake@stblaw.com

WASHINGTON, D.C.

Emily B. Holland
+1-202-636-5987
emily.holland@stblaw.com