



Environmental, Social, and Governance (ESG)

The SEC Point of View

Special Report

August 2022



ENVIRONMENTAL, SOCIAL, AND GOVERNANCE THE SEC POINT OF VIEW

IN THIS SPECIAL REPORT

Jump right to matters of:

- [Climate-Related Disclosures](#)
- [Human Capital Management](#)
- [Diversity, Equity, and Inclusion](#)
- [ESG Investing](#)
- [Cybersecurity](#)



Trends in SEC Comment Letters

This Special Report addresses current trends in SEC comment letters regarding environmental, social, and governance (ESG) matters.

The SEC is expected to increase the level of disclosures required of public companies in the near future and has already sent—and continues to send—comment letters to registrants on a number of ESG-related topics.

Key takeaways:

- There is increased focus on ESG disclosures
- Materiality is not an easy concept when it comes to ESG
- Consistency and authenticity are critical for ESG storytelling
- There are some required ESG disclosures, but a consistent standard of specificity is lacking
- The SEC has already proposed several requirements for certain ESG topics, seeking to build upon and enhance existing guidance and rulemaking
- The SEC review and comment letter process can help registrants avoid potential ESG reporting pitfalls

Overview

Environmental, social, and governance (ESG) reporting has been a topic of discussion for several years, but recently became a business and market imperative for many industries. Unlike the European Union (EU) with its ESG regulatory disclosure regime for corporates and investments, there is no such regime in the United States (US), adding to the challenges of ESG reporting. US regulatory progress is, nevertheless, underway as investors, customers, employees, and other concerned parties demand transparency in the absence of a disclosure framework, making it important for corporate management and boards of directors to understand that a lack of transparency and accountability could leave registrants vulnerable to major financial, operational, and reputational risks. A key to this regulatory progress is efforts by the Securities and Exchange Commission (SEC).

In late March 2022, the SEC announced its 2022 examination priorities, noting that ESG is among its “significant focus areas.” Also in late March, the SEC proposed long-awaited climate-risk disclosure rules—an important step in the direction of more clarity for registrants, investors, and other capital-market stakeholders around information increasingly being used to guide investment decisions. A number of other efforts have shone a light on the SEC’s commitment to the ESG imperative, ranging from the creation of the Climate and ESG Task Force and the well-publicized pro-ESG disclosure position by SEC Chairperson Gary Gensler, to interpretive guidance, more rulemaking, and enforcement actions. A common theme across all of these efforts involves encouraging registrants to report on their performance in relation to ESG metrics through proactive compliance and enhanced disclosures tailored to their business as a way to better manage risks and address threats before they crop up.

To help simplify the challenges associated with ESG reporting and better equip registrants to tell a credible story about their risk management and approach to long-term viability, this Special Report includes extracts from SEC comment letters together with a discussion of registrant responses that offer a better understanding of what the SEC expects when it comes to the level of ESG disclosures. In fact, it allows registrants to see how their peers are addressing SEC inquiries about the five ESG topics referenced above that are, and appear poised to remain, in the spotlight. Before delving into these comment letter trends, however, the Special Report preliminarily discusses the recent ESG-friendly shift in the SEC’s approach towards registrants’ requests to exclude shareholder proposals relating to environmental and social (E&S) matters, as well as materiality in the ESG space, both of which inform the SEC review and comment letter process.

Simplifying the ESG Reporting Challenge

SEC Shift in Line With E&S Shareholder Engagement

In November 2021, the SEC’s Division of Corporation Finance published Staff Legal Bulletin (SLB) 14L, raising the burden for registrants seeking to exclude E&S shareholder proposals from proxy statements. Previously, SEC Staff allowed a registrant to exclude such a proposal if the registrant established that the proposal lacked social or ethical significance for its business. Now, a registrant is expected to establish that the proposal does not “raise ... issues with a broad societal impact” because Staff no longer focus on determining the connection between a policy issue and the registrant, but rather on the social policy

significance of the issue. By way of example, proposals raising human capital management (HCM) issues with a broad societal impact would not be subject to exclusion simply because the shareholder proponent did not establish that the HCM issue was significant to the registrant.

The SLB also suggests that proposals asking registrants to report in line with “well-established national or international frameworks” may not necessarily be excluded on grounds of micromanagement as in the past, the idea being that these frameworks may be topics that shareholders are well-equipped to evaluate. Though the SEC has not defined these frameworks, it appears to be deferring to the Global Reporting Initiative (GRI), Task Force on Climate-Related Financial Disclosures (TCFD), Sustainability Accounting Standards Board (SASB), and other sustainability reporting frameworks.

This guidance is likely to result in more and more E&S-related shareholder proposals being voted on at registrants’ shareholder meetings and finding their way into filing disclosures under the SEC’s watchful eye. As for governance-related proposals, the SLB is not expected to shift the SEC’s approach, which generally has been to view them as already having broad societal impact that raise important policy issues for companies.

Understanding What Is Material to Stakeholders

In making assessments regarding what is material to an understanding of business operations, it is good practice for registrants to begin by identifying relevant stakeholders and the factors that matter most to them. In the ESG space, for example:

- Investors are interested in risk factors expected to affect the bottom line, as well as the expected level of impact.
- Customers want innovative products and services that both satisfy their needs and align with their ESG values.
- Regulators expect companies to implement and follow best practices for ESG reporting.
- Suppliers and other business partners are interested in strategic relationships free from major financial, operational, and reputational risks.
- Employees want to work for companies that are not only financially sound, but also ESG-aware.

Management can then evaluate which topics matter most relative to the business model. By way of illustration, the table below references various ESG metrics set forth by the SASB. Depending upon a registrant’s industry, lines of business, production processes, and regions of operation, certain topics will be more impactful to the materiality determination. Hence why SEC Staff look for disclosures that are tailored to risks posed to a registrant’s business and operations during the review and comment letter process.

ESG SPECIAL REPORT – THE SEC POINT OF VIEW

Environment	Social Capital	Human Capital	Business Model & Innovation	Leadership & Governance
<ul style="list-style-type: none"> -Greenhouse Gas (GHG) Emissions -Air Quality -Energy Management -Water & Wastewater Management -Waste & Hazardous Materials Management -Ecological Impacts 	<ul style="list-style-type: none"> -Human Rights & Community Relations -Customer Privacy -Data Security -Access & Affordability -Product Quality & Safety -Customer Welfare -Selling Practices & Product Labeling 	<ul style="list-style-type: none"> -Labor Practices -Employee Health & Safety -Employee Engagement, Diversity & Inclusion 	<ul style="list-style-type: none"> -Product Design & Lifecycle Management -Business Model Resilience -Supply Chain Management -Materials Sourcing & Efficiency -Physical Impacts of Climate Change 	<ul style="list-style-type: none"> -Business Ethics -Competitive Behavior -Management of the Legal & Regulatory Environment -Critical Incident Risk Management -Systemic Risk Management

ESG Comment Letter Trends

Below are climate-related, HCM, diversity, equity, and inclusion (DEI), ESG investing, and cybersecurity disclosures that were the subject of SEC comments. Each case highlights the disclosure(s) under scrutiny, SEC comments made in light of existing interpretive guidance and/or rulemaking, and the registrant’s response. Moreover, in each case, SEC Staff did not raise issue with the response.

Climate-Related Disclosures

Disclosure expectations

The SEC wants registrants to align their climate-change disclosures with Interpretive Release No. 33-9106, *Commission Guidance Regarding Disclosure Related to Climate Change*, issued in February 2010, to help guide disclosures pertaining to (1) the impact of pending or existing climate-change-related legislation, regulations, and international accords; (2) indirect consequences of regulation or business trends (e.g., increased demand for goods that result in lower emissions than competing products, increased competition to develop innovative new products); and (3) physical impacts of climate change. The SEC is looking for detailed disclosure about these matters in, among other filings, registrants’:

- Securities Exchange Act (Exchange Act) periodic reports on Forms 10-K, 10-Q, and 20-F (in, e.g., sections on risk factors, management’s discussion and analysis of financial condition and results of operations (MD&A), description of business, legal proceedings, and notes to financial statements, as applicable).

- Exchange Act current reports on Forms 8-K (in, e.g., sections on results of operations and financial condition, other events) and 6-K (in, e.g., sections on changes in business, financial condition and results of operations, legal proceedings).
- Exchange Act registration statements on Form 10 (in, e.g., sections on risk factors, business, legal proceedings, financial information).
- Securities Act registration statements on Forms S-1, S-3, S-4, SF-3, F-1, F-3, and F-4 (in, e.g., sections on risk factors, MD&A, description of business, legal proceedings, and financial information, as applicable).
- Regulation A Forms 1-A, 1-K, and 1-SA (in, e.g., sections on risk factors, business, and MD&A, as applicable).

Building upon this 2010 guidance, the proposed climate-risk disclosure rules published in late March 2022 in Proposed Rulemaking Release No. 33-11042 are expected to be finalized as early as this October and can help issuers more efficiently and effectively disclose climate-related risks in registration statements and periodic reports, such as GHG emissions (which would be subject to assurance for accelerated and large accelerated filers and for certain emissions) and certain climate-related financial statement metrics and related disclosures in notes to audited financial statements.

Also, in the spirit of clarity, the Division of Corporation Finance published *Sample Letter to Companies Regarding Climate Change Disclosures* in September 2021 to shed light on some of the sample comments that it may issue to registrants regarding their climate-related disclosures or the absence thereof. These comments relate to (1) discrepancies between SEC filings and corporate social responsibility (CSR) reports, (2) risk factors (e.g., policy and regulatory changes, market trends and other transition risks related to climate change that may affect business), and (3) MD&A (e.g., quantification of material increased compliance costs related to climate change and business impact of purchase or sale of carbon credits or offsets).

Managing these disclosure expectations can help registrants avoid SEC enforcement actions similar to the one brought against Vale S.A. In that action, the SEC alleged that the company misrepresented its “commitment to sustainability,” as well as certain other material matters, thereby highlighting its heightened scrutiny of alleged misstatements about registrants’ ESG credentials.

Disclosures under scrutiny

Citigroup Commercial Mortgage Securities Inc. (Form SF-3 filed February 14, 2022)

- **Original Disclosure:** The “Risk Factors” section covering pages 58 through 172.
- **SEC Comments (Form UPLOAD filed March 11, 2022):** “To the extent that you believe investors in these asset-backed securities may be impacted by climate-related events, including, but not limited to, existing or pending legislation or regulation that relates to climate change, please consider revising your disclosure to describe these specific risks. See the Commission’s Guidance

Regarding Disclosure Related to Climate Change, Interpretive Release No. 33-9106 (Feb. 8, 2010).”

- **Registrant Response (Form SF-3/A filed April 8, 2022, page 102):** Added a new risk factor titled “Climate Change May Lead to an Increase in the Frequency of Natural Disasters and Extreme Weather Conditions in Certain States in Which the Mortgaged Properties are Located, Which May Adversely Affect the Value of the Affected Mortgaged Properties and the Ability of the Borrowers to Make Payments on the Related Mortgage Loans,” as follows: “There have been concerns that climate change has led to, and may increasingly lead to, an increase in the frequency of natural disasters and extreme weather conditions, ... with certain states bearing a greater risk of the adverse effects of climate change. If material, such events may result in physical damage to or destruction of certain mortgaged properties. Further, the borrowers financial condition or results of operations at affected mortgaged properties may be adversely affected. Should the impact of climate change be perceived as chronic, there may be a decrease in demand for mortgaged properties located in the affected areas, which could adversely affect real estate values, as well as an increase in insurance costs and a reduction in coverage availability. In addition, changes in federal and state legislation and regulation on climate change could result in increased required capital expenditures to improve the energy efficiency of the borrowers’ existing mortgaged properties or to protect them from the consequence of climate change. The foregoing effects of climate change could increase the frequency and severity of losses on mortgage loans secured by mortgaged properties located in the affected states.”

Stanley Black & Decker, Inc. (Form 10-K filed February 18, 2021)

- **SEC Comments (Form UPLOAD filed September 30, 2021):** “We note your statement in your CSR report that your commitment to environmental sustainability remains core to the way you operate, particularly with regard to climate, waste and water. We also note that you provided more expansive disclosure in your CSR report than you provided in your SEC filings. Please advise us what consideration you gave to providing the same type of climate-related disclosure in your SEC filings as you provided in your CSR report.”
- **Registrant Response (Form CORRESP filed November 10, 2021):** “The ... Disclosure and Reporting Committee ... considers the Company’s strategy, operations, legal and compliance risk, among other areas, in the context of the Company’s business, operating results and financial condition, against the applicable disclosure requirements under the U.S. securities laws and regulations to determine if all SEC and U.S. GAAP requirements have been properly disclosed. Based on the importance of the Company’s social responsibility to its overall strategy, the Company previously expanded its disclosures within the ‘Business’ section in its Form 10-K for the fiscal year ended January 2, 2021 ... The Company has not identified any matters discussed in its CSR report that would materially impact, either quantitatively or qualitatively, the Company’s business, capital expenditures, results of operations, financial condition and competitive position that required disclosure in its Form 10-K for the fiscal year ended January 2, 2021. Much of the information in the CSR report is provided by the Company on a voluntary basis in order to provide transparency to a broad group of stakeholders. We are aware that increased public awareness and concern regarding environmental risks, including global climate change, may result in more international,

regional and/or federal requirements or industry standards to reduce or mitigate global warming and other environmental risks. At present, there continues to be a lack of consistent climate legislation, and as a result, we do not believe that there is any material existing climate legislation that is likely to have a material impact on the Company. The Company will continue to monitor climate change as well as climate legislation and regulation enacted to determine if there are material impacts, either quantitatively or qualitatively, to the Company's business, capital expenditures, results of operations, financial condition and competitive position that would require disclosure in its SEC filings."

General Dynamics Corporation (Form 10-K filed February 9, 2021)

- **SEC Comments (Form UPLOAD filed October 25, 2021):** "Your response to prior comment 3, which states that you have not identified any material indirect consequences of climate-related regulation or business trends, appears to be conclusory without providing sufficient supporting detail. Please provide us with additional information explaining how you assessed the indirect consequences of climate-related regulation or business trends for your defense segments and your Aerospace segment ..."
- **Registrant Response (Form CORRESP filed November 5, 2021):** "General Dynamics assesses the indirect consequences of climate-related regulation or business trends through its comprehensive risk-management program, which encompasses all of our segments. The risk management program seeks to identify current and future threats to revenue and earnings (which would include an assessment of all of the individual items noted in the Staff's prior comment, including (a) decreased demand for goods or services that produce significant greenhouse gas emissions or are related to carbon-based energy sources; (b) increased demand for goods that result in lower emissions than competing products; (c) increased competition to develop innovative new products that result in lower emissions; and (d) any anticipated reputational risks resulting from operations or products that produce material greenhouse gas emissions). Under our risk management program, the Board oversees management's identification and prioritization of risk, focusing on the most significant risks facing the company that could have a substantive financial or strategic impact. Senior management is responsible for day-to-day risk management and conducts a thorough assessment through internal management processes and controls. The Chief Executive Officer and senior management team provide the Board with a dedicated and comprehensive assessment of material risks at least twice per year, and the Board is briefed throughout the year as needed on specific risks facing the company. In our process, upstream, downstream and operational risks are also assessed for potential financial or strategic impact holistically across the company, taking into account the totality of the circumstances, including quantitative analyses of potential financial and operational impact as well as qualitative factors such as compliance with laws, pending regulations and the potential effect on our reputation. Management reviews each risk and opportunity and determines the appropriate path forward."

Human Capital Management

Disclosure expectations

Effective November 2020, the SEC adopted some amendments to modernize corporate reporting in Final Rulemaking Release No. 33-10825, *Modernization of Regulation S-K Items 101, 103, and 105*, by adding ESG disclosure topic HCM to companies' descriptions of business in their periodic reports on Form 10-K, Exchange Act registration statements on Form 10, and Securities Act registration statements on Forms S-1 and S-4. The disclosure is expected to include a description of a registrant's human capital resources, including any measures or objectives that management focuses on in overseeing the business. Though the SEC identified ones addressing the attraction, development, and retention of personnel as noteworthy examples, it did not require the disclosure of these matters, instead recommending that each registrant disclose details tailored to its business and circumstances.

Also, the SEC indicated in its Spring 2022 regulatory agenda that proposed rules seeking to enhance registrant disclosures regarding HCM could be released as early as October 2022.

Disclosures under scrutiny

Lionheart Acquisition Corporation II, now known as MSP Recovery, Inc. (Form S-4 filed November 10, 2021)

- **Original Disclosure:** The following "Human Capital" provision on page 150: "As of June 30, 2021, we had approximately 80 employees and none of our employees are covered by labor unions. We believe that the relationships we have with our employees are positive."
- **SEC Comments (Form UPLOAD filed December 10, 2021):** "Please provide the information required by Item 101(c)(2)(ii) of Regulation S-K."
- **Registrant Response (Form S-4/A filed December 23, 2021, page 151):** Expanded upon disclosure as follows: "Our employees and culture are critical components to our success and growth as a company. As of September 30, 2021, we had approximately 90 employees. None of our employees are covered by collective bargaining agreements or represented by a labor union. We believe that the relationships we have with our employees are positive. In addition, we employ specialized contract or part-time employees on a temporary basis, which include highly trained IT personnel, accountants, statisticians, physicians, data analysts and attorneys to maximize the recovery of claims. We have historically been able to transition many of these top performers from contract or part-time to full time employment. We strive to attract, develop and retain the best talent by providing competitive pay and benefits, continuous growth and development, and a diverse and inclusive workplace. Our human capital resource objectives include not only acquiring the best talent but also motivating those that drive our business forward. We aim to achieve these objectives using generous compensation programs and offering a one-of-a-kind employee experience. To better develop and incentivize our employees, we regularly provide employee feedback and

recognition. We have an annual bonus program, and we regularly utilize spot bonuses in order to continue to drive our employees to find opportunities and innovate our business.”

Alight, Inc. (Form S-1 Draft Registration Statement filed February 16, 2021)

- **Original Disclosure:** The following “Employees and Culture” provision on page 244: “As of December 31, 2020, we had approximately 15,000 employees globally. We consider our relationship with our employees to be good. Approximately 2,500 of those employees are represented by labor organizations or works councils in the following countries: Austria, Brazil, Denmark, France, Germany, Italy, Luxembourg, The Netherlands, Poland, Spain, Sweden, and the United Kingdom.”
- **SEC Comments (Form UPLOAD filed March 17, 2021):** “Please amend your disclosure to provide a more detailed discussion of your human capital resources, including any human capital measures or objectives upon which you focus in managing your business. For example, describe any measures or objectives that address the development, attraction, and retention of personnel. See Item 101(c)(2)(ii) of Regulation S-K.”
- **Registrant Response (Form S-1 filed March 29, 2021, page 268):** Expanded upon disclosure by renaming the provision “Colleagues and Culture” and adding, “Our people-first culture is underpinned by our core values at Alight which include People Matter, Be Real, Excellence Every Day, Think Forward and Act Now. People are our most important and valued asset and we are proud of our colleague engagement. We continue to invest and grow our Inclusion and Diversity function through a variety of initiatives and multiple colleague-led communities, connecting colleagues across regions and diversity to inspire change across our organization. We champion civic and community engagement through paid time-off for our people and locally advertised volunteering opportunities. Our approach to Reward supports our Pay for Performance philosophy. Our compensation package includes salary, performance-led incentive programs and long-term incentives that align colleague and shareholder interests as well as rewarding our people. We provide competitive benefit packages in the countries in which we operate, which may include a variety of benefits such as life and health insurance, paid time off, paid parental leave, financial planning, and a retirement savings plan. Alight measures the effectiveness of its people-first culture through quarterly engagement surveys, pulse surveys, attrition data, diversity data and regularly soliciting feedback from across the organization. Our focus areas include colleague growth, recognition, connection, belonging and wellbeing. We continue to be recognized for our engagement efforts, including having received the Great Place to Work certification in three consecutive years.”

Diversity, Equity, and Inclusion

Disclosure expectations

DEI often overlaps with HCM discussed above, as it embraces policies and programs aimed at increasing diverse representation on boards of directors (“boards”), amongst executives, and within the workforce in general. On the board diversity front, effective February 2010, the SEC adopted a rule requiring registrants

to disclose in their proxy statements whether a nominating committee has a policy regarding the consideration of diversity in identifying director nominees and if so, how the policy is implemented and how the nominating committee or the board assesses the effectiveness of the policy. As the rule did not mandate any disclosure regarding board demographics, the SEC sought to help fill this gap when in 2019, it issued two Compliance & Disclosure Interpretations on Regulation S-K (Questions 116.11 and 133.13), clarifying that if a board considers an individual nominee's self-identified diversity characteristics (e.g., race, gender, ethnicity, religion, nationality, disability, sexual orientation or cultural background), the SEC expects proxy disclosures to identify these characteristics, together with the manner in which they were considered.

Note that in August 2021, the SEC issued Release No. 34-92590, adopting two NASDAQ rules intended to build upon the foregoing. One requires a NASDAQ-listed registrant to disclose in a proxy statement (or in an annual report on Form 10-K or 20-F if no proxy statement) how board members voluntarily self-identified regarding gender, pre-defined race and ethnicity categories, and LGBTQ+ status, in the form of a standardized matrix, by the later of August 8, 2022 and the date that it files a proxy statement for its 2022 annual shareholders' meeting (or annual report, as applicable). The other requires a Nasdaq-listed registrant to either have at least two diverse board members or explain in its proxy statement why it does not, with phased-in compliance ranging between 2023 and 2026 based upon a registrant's listing tier.

Also, the SEC indicated in its Spring 2022 regulatory agenda that proposed rules seeking to further enhance registrant disclosures about the diversity of board members and nominees could be released as early as October 2022.

As for executive and workforce diversity, the SEC encourages registrants to recruit, promote, and retain diverse talent at all levels of the organization (see earlier section on HCM).

Disclosures under scrutiny

Investment Managers Series Trust II (Form N-14 filed December 17, 2021)

Original Disclosure: The following provision under "Proxy Voting Policy" on page 31: "The Board has adopted Proxy Voting Policies and Procedures (the 'Trust Policies') on behalf of the Trust, which delegates the responsibility for voting the Fund's proxies to the Sub-Advisor, as applicable, subject to the Board's continuing oversight. The Trust Policies require that the Sub-Advisor vote proxies received in a manner consistent with the best interests of the Fund. The Trust Policies also require the Sub-Advisor to present to the Board, at least annually, the Sub-Advisor's Proxy Voting Policies and Procedures ('Sub-Advisor's Policies') and a record of each proxy voted by the Sub-Advisor on behalf of the Fund, including a report on the resolution of all proxies identified by the Sub-Advisor as involving a conflict of interest. See Appendix B for the Sub-Advisor's Proxy Policies and Procedures and the Trust Policies. The Trust Policies and Sub-Advisor's Policies are intended to serve as guidelines and to further the economic value of each security held by the Fund. The Trust's CCO will review the Trust Policies and the Sub-Advisor Policies annually. Each proxy will be considered individually, taking into account the relevant circumstances at the time of each vote. If a proxy proposal raises a material conflict between the Sub-Advisor's interests and the Fund's interests, the Sub-Advisor will resolve the conflict by following the policy guidelines or the recommendation of an independent third party. The Fund is required to annually file Form N-PX, which lists the Fund's complete proxy voting record for the 12-month period ended June 30 of each

year. Once filed, the Fund’s proxy voting record will be available without charge, upon request, by calling toll-free 1-833-AXS-ALTS (1-833-297-2587) and on the SEC’s web site at www.sec.gov.”

- **SEC Oral Comments Provided on December 29, 2021:** “[P]lease disclose how the Fund will approach ESG issues when voting proxies or explain why it is not required.”
- **Registrant Response (Form N-14/A filed February 1, 2022, page B-30):** Added the following to the “Proxy Voting Policy” section: “The Sub-Advisor’s environmental, social and governance (‘ESG’) process extends to its proxy voting practices in that it will utilize recommendations from Glass Lewis and data available from ISS ESG and other sources to assess the likely impact of proposals on the ESG indicators that underpin the Index, and will vote against proposals that are likely to lower scores on any of those indicators, while supporting proposals that are likely to increase scores. In addition to considering the effects of a proposal on the indicators that make up the Fund’s Index, the Sub-Advisor may also consider effects that are in keeping with the principles of the Index, even if they are not specifically measured. For example, the Sub-Advisor will likely vote in favor of proposals that increase diversity on the Board of Directors or in senior leadership and against proposals that would allow the gap between executive pay and pay for low-level employees to grow too large.”

Plum Acquisition Corp. I (Form S-1 filed February 19, 2021)

- **Original Disclosure:** The following provision under “Summary” on page 3: “We also are undertaking a ‘2 and 20 pledge,’ where we will commit to donating 2% of our retained promote to DEI related causes mutually agreed upon with the partner company that we acquire. We also commit to filling at least 20% of Plum Acquisition Corp.’s board seats with diverse candidates with notable ability to add value to our acquired asset. We believe that our DEI strategy, along with our 2 and 20 pledge, will be highly appealing to market-leading companies across all sectors that prioritize attracting and retaining the best talent and standing out for thought leadership in the market.”
- **SEC Comments (Form UPLOAD filed March 1, 2021):** “Refer to your disclosure regarding your 2 and 20 pledge on page 3. Please revise to clarify what you mean when you state that you will donate 2% of your 'retained promote' to DEI related causes. Please also clarify how you intend to measure whether you have filled 20% of your board seats with 'diverse candidates with notable ability to add value to our acquired asset' and whether your current board meets that threshold.”
- **Registrant Response (Form S-1/A filed March 3, 2021, page 3):** Expanded upon disclosure by adding, “Our sponsor intend to donate interests in our sponsor equivalent to an aggregate of 105,000 founder shares to DEI related causes following the consummation of our initial business combination. We also commit to filling at least 20% of our board seats with candidates who bring gender, racial and/or ethnic diversity. We currently exceed this threshold with 60% diverse board members.”

J.P. Morgan Access Multi-Strategy Fund, LLC (Form PRE 14A filed August 3, 2021)

- **Original Disclosure:** “The Governance Committee also considered the overall diversity of the Board’s composition. The Governance Committee believes the Board generally benefits from diversity of background, experience and views among its members, and considers this a factor in evaluating the composition of the Board. In considering potential nominees, the Committee values diversity based on gender, race, ethnicity and other attributes. The Governance Committee has adopted a policy on diversity ...”
- **SEC Oral Comments Provided on August 9, 2021:** “Under ‘Proposal 1: Election of Directors/Trustees – Nomination Process’ it is disclosed that the Governance Committee has adopted a policy on diversity. Please provide the information regarding the Governance Committee’s diversity policy as required by Item 407(c)(2)(vi) of Reg S-K as referenced by Item 22(b)(15)(ii)(A) of Schedule 14A.”
- **Registrant Response (Form CORRESP filed August 18, 2021):** “The Governance Committee has adopted a formal policy on diversity which states that the Committee recognizes that diverse viewpoints, skill sets, backgrounds and experiences strengthen the performance of the Board and its committees as decision-making and oversight bodies serving the best interests of the Funds and their shareholders and values the diverse attributes of individual Directors/Trustees and the overall Board. In accordance with Item 407(c)(2)(vi) of Reg S-K, the Nomination Process section describes the Governance Committee’s process for identifying and evaluating nominees for trustees/directors, including how the Committee (and the Board) considers diversity and implements its policy on diversity. As disclosed in the Nomination Process section, the Governance Committee considered the overall diversity of the Board’s composition that would result from the election of the Nominees if approved by shareholders. The Nomination Process section also discloses that the Governance Committee believes the Board generally benefits from diversity of background, experience and views among its members, and considers this a factor in evaluating the composition of the Board. In considering potential nominees, the Committee values diversity based on gender, race, ethnicity and other attributes. In light of the Staff comment, however, the following sentence will be added immediately following the sentence in indicating that the Governance Committee has adopted a policy on diversity: ‘The Governance Committee expects to assess the effectiveness of the policy as part of the annual self-assessment process of the Board.’”

ESG Investing**Disclosure expectations**

The SEC’s Division of Examinations monitors Investment Advisers Act and Investment Company Act forms to see whether investment advisers, registered investment companies, and private funds engaged in ESG investing are:

- Accurately disclosing their ESG investing approaches and adopting and implementing policies, procedures, and practices designed to prevent violations of the federal securities laws (e.g., Investment Company Act Rule 35d-1 requiring a registered investment company with a name

suggesting that the company focuses on a particular type of investment to invest at least 80% of its assets in that type of investment (“Names Rule”).

- Aligning proxy voting with their ESG-related disclosures and mandates.
- Avoiding greenwashing by not overstating or misrepresenting the ESG factors considered or incorporated into portfolio selection, such as in their performance advertising and marketing.

A Risk Alert on ESG investing issued by the Division of Examinations in April 2021 focused on ESG-related advisory services and investment products and highlighted the need for SEC involvement in this area. In fact, the SEC proposed two pieces of rulemaking in late May 2022, seeking to improve upon the Names Rule and other disclosures for funds and investment advisers that market themselves as having an ESG focus (i.e., Proposed Rulemaking Release Nos. 33-11067 and 33-11068), both of which are expected to be finalized as early as this October.

Two registrants that recently became the subject of SEC enforcement actions for not accurately representing ESG investments are (1) Bank of New York Mellon Corporation, whose subsidiary agreed to pay a \$1.5 million settlement for allegedly representing or implying that “ESG quality reviews were part of the ... investment research process” for all investments in the funds, when that was not the case, and (2) Wahed Invest, LLC, who agreed to pay a penalty of \$300,000 for allegedly failing to adopt and implement written policies and procedures addressing how it would ensure compliance with Islamic, or Shari’ah, law despite having marketed itself as providing such advisory services. Moreover, The Goldman Sachs Group, Inc. and Deutsche Bank AG are currently under investigation over claims of greenwashing. These enforcement actions and probes underscore the importance of ramping up ESG disclosures, as doing so can help registrants avoid material gaps and misstatements therein.

Disclosures under scrutiny

William Blair Funds (Post-Effective Amendment to Form N-1A filed December 9, 2021)

- **Original Disclosure:** “The Adviser’s assessment of current and prospective portfolio holdings typically integrates an analysis of applicable environmental, social and governance (collectively, ‘ESG’) factors.”
- **SEC Oral Comments Provided on January 27, 2022:** “Please consider (i) revising the ... disclosure ... to provide examples of the ESG factors utilized and (ii) inserting an ESG-related risk factor if appropriate in light of the Fund’s intended investment strategy.”
- **Registrant Response (Form CORRESP filed February 15, 2022):** “The Registrant believes that the current disclosure regarding consideration of ESG factors is appropriately included in response to the Form N-1A requirement to summarize ‘how the Fund’s adviser decides which securities to buy and sell’ in accordance with Item 9(b)(2) of Form N-1A. As indicated in the Fund’s Prospectus, ‘ESG factors are considered based on criteria developed by the Fund’s investment team, and they are integrated with other relevant factors to provide a holistic assessment of companies. The

Adviser seeks to ensure that the investment team is fully aware of companies' ESG risks and opportunities by integrating ESG factors into the investment process in a systematic manner. The emphasis on ESG factors depends on the importance of these factors to the relevant industry and the unique circumstances of each company.' The Registrant believes the disclosure, including the level of detail, is appropriate as drafted ... [and] respectfully notes that the Fund does not hold itself out as an ESG-focused fund ... Accordingly, the Registrant does not believe it is appropriate to overemphasize the ESG-related factors that the Adviser and its investment team consider relative to other factors considered as part of its investment process."

Managed Portfolio Series (Post-Effective Amendment to Form N-1A filed September 30, 2021)

- **SEC Oral Comments Provided on December 17, 2021:** "With a view to the Fund's name, please provide more detail, including any data or study, to support the inference that diverse company leadership leads to workforce diversity."
- **Registrant Response (Form CORRESP filed December 17, 2021):** In connection with its fund V-Shares U.S. Diversity ETF, "[t]he Trust responds by supplementally providing various articles and research papers demonstrating that a company's prioritizing diversity of leadership can reasonably be considered as an effective indicator of the likelihood that an organization will prioritize diversity in how it conducts business, staffs its workforce, and serves the communities and constituents to whom it provides its products and/or services. General diversity among an organization's workforce is a matter that is effectively promoted and implemented down the ranks of the company from the top, with the goal being to achieve effective diversity and inclusion at the whole workforce level[.]"

Northern Lights Fund Trust IV (Post-Effective Amendment to Form N-1A filed September 1, 2021)

- **SEC Oral Comments Provided on October 18, 2021:** "The Staff notes that the Fund's proposed name is based on its selection of sub-advisors. The Staff believes the name is misleading because the name suggests to prospective investors that 'Diversity Equity & Inclusion' refers to the portfolio companies held by the Fund. Please change the name to match the Fund's investment strategy, for example, 'Sterling Capital Mid-to-Large Cap Equity Fund,' or, alternatively, adopt an 80% test with respect to securities that reflect a 'Diversity, Equity & Inclusion' investment strategy."
- **Registrant Response (Form CORRESP filed November 5, 2021):** "The Registrant has revised the name of the Fund to be 'Sterling Capital Diverse Multi- Manager Active ETF'. The addition of 'Multi-Manager' and the placement of 'Diverse' before 'Multi-Manager' clearly indicate that the Fund utilizes diverse managers to actively select securities for the Fund's portfolio. At its core, the Fund will employ highly professional and talented businesses that are majority diverse-owned and/or controlled, which can be only fully recognized by prospective investors if 'Diverse Multi-Manager' is in the Fund's name. The name avoids potential investor confusion because 'Diverse' modifies 'Multi-Manager'. To further guard against any potential investor confusion, the Fund's investment objective will continue to state that 'Diverse Multi-Manager' refers to the sub-advisors managing the Fund. In addition, ... the Registrant has moved this disclosure in the principal investment

strategy section so that it appears sooner and more prominently in the Fund’s Prospectus. The Registrant further notes that the proposed Fund name will comply with Rule 35d-1 under the 1940 Act because 80% or more of the Fund’s assets will be invested in mid-to-large cap equity securities and the term ‘diverse’ connotes neither a particular investment type nor an investment in particular industry.”

Cybersecurity

Disclosure expectations

The SEC wants registrants to align their cybersecurity disclosures with Interpretive Release No. 33-10459, *Commission Statement and Guidance on Public Company Cybersecurity Disclosures*, issued in February 2018. The crux of the guidance is that the SEC is looking for detailed disclosure about cybersecurity risks and incidents in, among other filings, registrants’:

- Forms 10-K, 10-Q, and 20-F (in, e.g., sections on risk factors, MD&A, description of business, legal proceedings, and notes to financial statements, as applicable).
- Forms 8-K (in, e.g., sections on results of operations and financial condition, other events) and 6-K (in, e.g., sections on changes in business, financial condition and results of operations, legal proceedings).
- Forms 10 (in, e.g., sections on risk factors, business, legal proceedings, financial information).
- Forms S-1, S-3, S-4, F-1, F-3, and F-4 (in, e.g., sections on risk factors, MD&A, description of business, legal proceedings, and financial information, as applicable).
- Registration Statements on Forms N-1A (in, e.g., sections on risk disclosure, business, legal proceedings, financial information).

Some of these sought-after disclosures include: (1) risks associated with cybersecurity and cybersecurity incidents that make investments in securities speculative or risky (e.g., existing or pending laws and regulations that may affect the requirements that registrants are subject to relating to cybersecurity and associated costs); (2) nature of board of director’s role in overseeing the management of cybersecurity risk; (3) extent to which cybersecurity affects products, services, and relationships; (4) cybersecurity-related legal proceedings; and (5) cybersecurity incidents and resultant risks that affect financial statements.

In early February 2022, the SEC proposed rules aimed at enhancing cybersecurity preparedness for investment advisers and investment companies (i.e., Proposed Rulemaking Release No. 33-11028) and in early March 2022, proposed rules seeking to enhance and standardize disclosures by public companies regarding incident reporting, cybersecurity risk management, strategy, and governance (i.e., Proposed Rulemaking Release No. 33-11038), both of which are expected to be finalized as early as April 2023.

Disclosures under scrutiny

Redwood Enhanced Income Corp. (Form 10 filed April 1, 2022)

- **Original Disclosure:** The “Risk Factors” section covering pages 35 through 56.
- **SEC Comments (Form UPLOAD filed May 13, 2022):** “Please add disclosure regarding cybersecurity risks.”
- **Registrant Response (Form 10-12G/A filed May 26, 2022, page 52):** Added the following risk factor under the heading “The Company is subject to risks associated with communications and information systems”: “The Company depends on the communications and information systems of the Adviser and its affiliates as well as certain third-party service providers. As these systems became more important to the Company’s business, the risks posed to these communications and information systems have continued to increase. Any failure or interruption in these systems could cause disruptions in the Company’s activities. In addition, these systems are subject to potential attacks, including through adverse events that threaten the confidentiality, integrity or availability of the Company’s information resources. These attacks, which may include cyber incidents, may involve a third party gaining unauthorized access to the Company’s communications or information systems for purposes of misappropriating assets, stealing confidential information related to the Company’s operations or portfolio companies, corrupting data or causing operational disruption. Any such attack could result in disruption to the Company’s business, misstated or unreliable financial data, liability for stolen assets or information, increased cybersecurity protection and insurance costs, litigation and damage to the Company’s business relationships, any of which could have a material adverse effect on the Company’s business, financial condition and results of operations.”

ProShares Trust (Post-Effective Amendment to Form N-1A filed December 28, 2021)

- **Original Disclosure:** “Metaverse Companies Risk” disclosure on page 5.
- **SEC Oral Comments:** “Consider whether data privacy risk, cyber crime activities and the lack of legislation and enforcement tools should be added in the risk disclosure.”
- **Registrant Response (Post-Effective Amendment to Form N-1A filed March 14, 2022, page 5):** Expanded upon disclosure by adding, “These companies may be significantly affected by service disruptions caused by hardware or software failures and by cybersecurity attacks. They may also be impacted by privacy concerns and laws, evolving internet regulation and other foreign or domestic regulations that may limit or otherwise affect their operations. There is no guarantee that the products or services produced by companies in Metaverse-related businesses will be successful.”

Yoshitsu Co., Ltd. (Form F-1 filed August 27, 2021)

- **Original Disclosure:** The “Risk Factors” section covering pages 7 through 25.

- **SEC Comments (Form UPLOAD filed September 16, 2021):** “In light of the significance of online sales in China to your business and recent events indicating greater oversight by the Cyberspace Administration of China over data security, please revise your disclosure to explain how this oversight impacts your business and to what extent you believe that you are compliant with the regulations or policies that have been issued by the CAC to date.”
- **Registrant Response (Form CORRESP filed October 1, 2021):** “We respectfully advise the Staff that we believe the regulations and policies that have been issued by the Cyberspace Administration of China (the ‘CAC’) to date do not apply to us ... and therefore have no material impact on our business as of the date of this response letter.”

The company explained that “[o]n April 27, 2020, the CAC, along with 11 other authorities, promulgated the Cybersecurity Review Measures, effective on June 1, 2020, ... applicable to ‘critical information infrastructure operators’ (‘CIIO’) who purchase network products and services in China. On July 10, 2021, the CAC released a revised draft for comments of the Cybersecurity Review Measures ..., which expanded the scope of review to include data processors who engage in data processing activities that affect or may affect national security of China.” The company further explained that it has “entrusted the operations of all of [its] online stores ... to third-party Chinese e-commerce marketplace operators (the ‘Entrusted Third Parties’)” and that “[c]onsumer purchase data and personal information generated by these online stores are collected, used, managed, and stored in China by the Entrusted Third Parties” such that they “only receive necessary information ... in order ... to complete orders for these online stores ... [They] do not save or use such information once the orders are fulfilled.”

Conclusion

It is apparent given the nature of SEC comments that ESG disclosures ought to be detailed enough to enable investors and other stakeholders to evaluate material risks. Though the SEC has undoubtedly issued certain ESG reporting requirements, as well as a good amount of explanatory guidance, what is lacking when it comes to ESG disclosures is a consistent standard of specificity. As we await more clarity—which appears to be on the horizon—reviewing registrants’ responses to SEC inquiries about ESG disclosures can help ease ESG reporting challenges by providing insight into SEC expectations and peer behavior.

For information on the accounting consequences of ESG matters, refer to our Thomson Reuters® [Special Report](#) titled *Environmental, Social, and Governance – How ESG Affects Accounting Now*.