

## **INVESTOR PROTECTION TO SOCIETAL PROTECTION? WITH PROPOSED AMENDMENTS AND RECENT PROBE, SEC TAKES CONCRETE STEPS TO INCREASE ESG-RELATED DISCLOSURES BY PUBLIC COMPANIES AND INVESTMENT MANAGERS**

On September 29, 2021, the U.S. Securities and Exchange Commission ("SEC") proposed [amendments](#) to Form N-PX under the Investment Company Act of 1940, as amended, to increase the amount of information that mutual funds, exchange-traded funds, closed-end funds and certain other registered investment companies must report about their proxy voting practices. The proposed rules also require certain investment managers to annually report how they voted proxies regarding executive compensation and other matters on Form N-PX. Managers would be required to categorize each proxy voting matter from a specified list of categories and subcategories, including compensation, corporate governance, the environment, diversity, and human rights or human capital.

The proposed amendments are part of a broader SEC initiative to mandate more granular, specific disclosures on environmental, social, and governance ("ESG") concerns by public companies and other securities industry participants. The SEC has justified its increased focus on ESG disclosure, in part, by emphasizing the policy view that [investors](#) are increasingly focused on and demanding more ESG-related information when formulating investment decisions. This focus on providing investors with ESG information that they may subjectively desire appears to reflect a shift in the SEC's more traditional view that public disclosure should focus on more objective data and be predicated on the company's business operations or an investment company's underlying investments. The SEC's recently announced investigation into Activision for failing to disclose sexual harassment and other allegations of corporate misconduct may also be instructive

in understanding the kinds of ESG-related actions the SEC intends to pursue moving forward.

## **Recent Developments in Human Capital Management Disclosure**

Efforts by the SEC to address investors' concerns relating to ESG disclosure have increased in the past few years. In August of 2020, the SEC [adopted](#) amendments to Regulation S-K requiring "as a disclosure topic, a description of the registrant's human capital resources to the extent such disclosures would be material to an understanding of the registrant's business." Such a description could contain "any human capital measures or objectives that the registrant focuses on in managing the business" as well as various "measures or objectives that address the attraction, development, and retention of personnel" and that are listed by the SEC as "non-exclusive examples of subjects that may be material, depending on the nature of the registrant's business and workforce." What was deemed material for these human capital disclosures was largely determined by public companies with a specific focus on human capital issues that the company believed could have a material impact on its business.

SEC Commissioners Lee and Crenshaw dissented from the Regulation S-K amendments because they believed that they did not go far enough in requiring more granular, quantitative disclosures by all companies, regardless of the nature of their business and workforce. Lee in particular [argued](#) that "generalized materiality determinations will not provide the kind of consistent, comparable ESG or climate data that investors seek." This criticism is similar to arguments about public company environmental disclosures, which claim that although the SEC passed guidance pertaining to climate change disclosures in 2010, over the years, "materiality principles alone have not provided investors with high-quality, decision-useful climate disclosure."

While Commissioners Lee and Crenshaw were unable to convince then-SEC Chair Jay Clayton to require more specific disclosures in 2020, Clayton's successor, SEC Chair Gary Gensler, is very focused on creating a detailed human capital management disclosure regime for public companies. Gensler [stated](#) in a June 2021 speech at London City Week and again reiterated on [Twitter](#) later in August of 2021 that he wanted SEC staff to generate new, more specific recommendations pertaining to human capital disclosures. These recommendations could include, for example, requiring companies to report on a "number of metrics, such as workforce turnover, skills and development training, compensation, benefits, workforce demographics including diversity, and health and safety." In contrast to the Regulation S-K disclosure amendments adopted under then-Chair Clayton, Gensler's reporting mandates appear designed to move away from allowing companies to ascertain what information is "material" enough to their business operations to be disclosed, and to instead require companies to disclose whatever information the SEC determines is "material" to their investors.

## **The SEC's Probe into Activision**

The SEC's new focus on ESG issues can be illustrated by its recent probe into Activision Blizzard, Inc., which the video game company [confirmed](#) on September

21, 2021. The SEC's investigation comes on the heels of a turbulent summer, with the company facing a class action and scrutiny by multiple other governmental bodies such as the California Department of Fair Employment and Housing ("DFEH"), the Equal Employment Opportunity Commission ("EEOC"), and the National Labor Relations Board ("NLRB"). While Activision recently [settled](#) with the EEOC on September 27 for \$18 million dollars, the other investigations and class action are still ongoing.

At the core of these investigations are questions about Activision's employment practices in relation to accusations "of sexual misconduct and workplace discrimination." The California DFEH, in particular, [alleges](#) that Activision "fostered a sexist culture and paid women less than men despite women doing substantially similar work, assigned women to lower level jobs and promoted them at slower rates than men, and fired or forced women to quit at higher frequencies than men." Additionally, Activision has been accused of having an environment in which "women were subjected to constant sexual harassment, including groping, comments and advances," and it is also alleged that the company's upper levels of management and human resources department knew of this behavior and "failed to take reasonable steps to prevent the unlawful conduct, [] instead retaliat[ing] against women who complained." Shareholders involved in the [class action](#) target much of the same behavior, alleging that the "company made 'false and misleading statements' between August 4, 2016, and July 27, 2021, in SEC filings that failed to disclose the company was actually a hostile workplace for women and minorities, that numerous complaints had been made to its HR department over the years, and that DFEH had launched an investigation as a result."

The SEC's investigation seems focused on similar issues. The SEC's subpoena [demands](#) "minutes from Activision board meetings since 2019, personnel files of six former employees and separation agreements the company has reached this year with staffers." Additionally, the SEC is asking for communications between senior executives and Activision's CEO, Bobby Kotick, pertaining to "complaints of sexual harassment or discrimination by Activision employees or contractors." These requests focus generally on more recent documents, but future requests may dredge up older documents if the SEC broadens the scope of its investigation. The purpose of the SEC's requests appears to be two-fold: first, a concern that Activision and its executives did not adequately share allegations of sexual assault and workplace discrimination with investors; and second, that the disclosures should have been shared at an earlier time with both investors and other groups.

Many questions about Activision's duty to disclose its internal sexual assault and workplace discrimination issues remain. For example, the SEC's human capital reporting requirement did not take effect until November 2020 and allowed companies to determine the "materiality" of an event based on its potential to impact the company's business. Regardless of the ultimate outcome, the mere existence of an SEC investigation can pose significant financial and reputational risks to a public company. Moreover, the SEC's recently proposed amendments to Form N-PX identify a wide array of potentially confusing categories and sub-categories of information that investment managers must report on – presumably because the SEC believes that these categories are of material interest to investors. SEC examiners, the plaintiffs' bar, or other regulators may interpret this

to mean that each category and sub-category of information identified in the proposed amendments can serve as the basis for a lawsuit and/or enforcement action alleging a failure to disclose such information deemed subjectively material to certain investors.

## **New Terms and Definitional Confusion**

The SEC's proposed ESG proxy reporting categories and sub-categories raise a number of definitional questions that both investment managers and public companies must contend with. The list of reportable ESG categories and sub-categories include:

- **Environment or climate** – with the following subcategories: greenhouse gas (GHG) emissions, transition planning or reporting, biodiversity or ecosystem risk, chemical footprint, renewable energy or energy efficiency, water issues, waste or pollution, deforestation or land use, say-on-climate, environmental justice, or other environment or climate matters.
- **Human rights or human capital/workforce** – with the following subcategories: workforce-related mandatory arbitration, supply chain exposure to human rights risks, outsourcing or offshoring, workplace sexual harassment, or other human rights or human capital/workforce matters.
- **Diversity, equity, and inclusion** – with the following subcategories: board diversity, pay gap, or other diversity, equity, and inclusion matters.
- **Political activities** – with the following subcategories: lobbying, political contributions, or other political activity matters.
- **Other social** – with the following subcategories: data privacy, responsible tax policies, charitable contributions, consumer protection, or other social matters.

While some of the topics above (e.g., GHG emissions) are generally understood and/or are defined by sustainability reporting standards organizations (e.g., the GRI Standards Glossary), other sub-categories may not be well understood. For example, the new "Environmental or Climate" category includes reporting on "water issues" and "environmental justice." The SEC does not define these terms in its proposing release and the meanings are likely unclear to public companies, investment managers, and even the investors intended to benefit from the new disclosures. Thus, we expect industry participants to push the SEC to provide clear definitions of each new term in Form N-PX and to align its definitions with those used by international standards organizations. It also will be important for the SEC to align the definitions of each new terms in Form N-PX with the definitions used in any other ESG-related reporting requirements that the SEC proposes in the coming years. Any disconnect in terminology could make it difficult for investment managers to correctly classify ESG-related issues when completing Form N-PX.

## What Industry Participants Can Do Now to Mitigate Risk

While the exact parameters are yet to be defined, the trend toward increasing the breadth and depth of ESG-related disclosure will continue at least throughout the current administration. Thus, although the area is in flux, companies should prepare now for new disclosure requirements on a wide array of topics pertaining to ESG, consider participating in the SEC notice-and-comment process for the proposed rule individually or through industry bodies, and begin managing the risks associated with the SEC's evolving views on ESG. For example:

- What has your company disclosed in the past that it believes is material? Is there information in light of the proposed amendments and the Activision probe that should have been shared with investors?
- Relatedly, do you have a mechanism or system through which you could efficiently gather information pertaining to the categories of information outlined in the SEC's proposed amendments to Form N-PX?
- Given the number of categories outlined in the proposed rules, and a lack of more specific definitions, have you internally discussed how broadly to define these categories and sub-categories of information and what information you would include?
- Which function within your company is charged with the responsibility for monitoring these areas, and is the relevant governance structure appropriate for the upcoming changes?
- Has your Board discussed ways to improve the reporting of ESG-related issues in case of future requests by regulators?
- Have you considered, or spoken with industry trade groups about, commenting on the proposed Form N-PX amendments and its vague terminology in particular?
- If you are an investment adviser to an ESG-focused fund or an adviser that takes ESG-related issues into consideration when making investments, have you conducted an in-depth assessment of your compliance practices in preparation for inevitable questions about them from SEC examiners? For more information on Clifford Chance's mock SEC ESG examination and presentation offerings please [Click Here](#).

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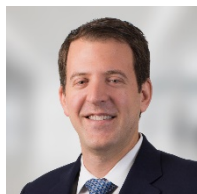
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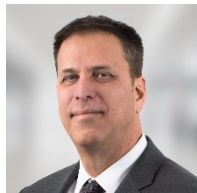
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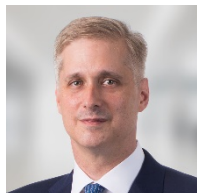
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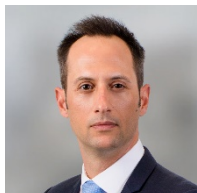


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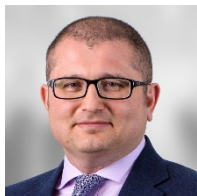
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