Floyd Advisory

A Year in Review:
2023 SEC Climate and ESG Task Force Activity

CONTENTS

Introduction and Our Objective

We are pleased to present you with our report *A Year in Review: 2023 SEC Climate and ESG Task Force Activity*.

This report serves to summarize the 2023 activity of the U.S. Securities and Exchange Commission's ("SEC" or "Commission") Climate and Environmental, Social, and Governance ("ESG") Task Force ("ESG Task Force"). By analyzing ESG Task Force updates and over 150 SEC press releases issued throughout the year, we categorized the types of ESG-related enforcement actions and resulting securities laws violations observed to help demonstrate the ESG Task Force's key areas of focus.

As an independent consulting firm with financial and accounting expertise, we are committed to contributing thought leadership and relevant research regarding financial reporting matters that will assist our clients in today's fast-paced and demanding market. This report is just one example of how we continue to fulfill this commitment.

We welcome your comments and feedback, especially requests for any additional analysis you would find helpful.

Floyd Advisory
FEBRUARY 2024

Executive Summary

- The SEC requires issuers to maintain and regularly evaluate the effectiveness of disclosure controls and procedures.[1]
- Our analysis identified four primary types of ESG-related enforcement actions, all associated with misleading or insufficient disclosures concerning the following:
  - ***Category A***: ESG Investment Products (e.g., investment advisers' or funds' green energy strategies).
  - ***Category B***: Environmental Incident or Compliance (e.g., oil spill or oil rig safety compliance).
  - ***Category C***: Products or Services that Claim to Benefit Society (e.g., health insurance).
  - ***Category D***: Products or Services that Claim to Benefit the Environment (e.g., electric vehicles).
- The data suggests that the ESG Task Force has been most focused on Category D, specifically misleading or insufficient disclosures to investors related to products or services that claim to benefit the environment.
- We also analyzed the different types of securities laws violations charged in the ESG-related enforcement actions. The results suggest that the ESG Task Force has prioritized (i) violations related to Actively Traded Securities under the Securities Exchange Act of 1934, and more specifically, (ii) financial reporting disclosure violations identified within SEC filings, such as Forms 10-K and 10-Q.
- We identified instances where the observed financial reporting disclosure violation directly or tangentially related to a misstatement recorded to an issuer's balance sheet or income statement.

Background: Formation of the ESG Task Force in March 2021

On March 4, 2021, the SEC's Division of Enforcement announced the formation of the ESG Task Force.[2] The 22-member task force was commissioned to develop initiatives to proactively identify ESG-related misconduct and to respond to tips, referrals, and whistleblower complaints on ESG-related issues. More specifically, the ESG Task Force is responsible for:[3]

i. "identify[ing] any material gaps or misstatements in issuers' disclosure of climate risks under existing rules; and
ii. analyz[ing] disclosure and compliance issues relating to investment advisers' and funds' ESG strategies."

In a separate statement released by the SEC that same day, titled "Enhancing Focus on the SEC's Enhanced Climate Change Efforts," the Commission asserted the following:[4]

> *"Our Division of Enforcement will continue to identify, investigate, and bring actions against those who violate our laws and rules. Some of those violators might be public companies or advisers whose climate- or ESG-related statements are false or misleading,* ***but such actions would not be based on any new standard; we have always pursued violations of our antifraud provisions****." [Emphasis Added]*

"Climate risks and sustainability are critical issues for the investing public and our capital markets. The task force announced today will play an important role in enhancing and coordinating the efforts of the Division of Enforcement, the Office of the Whistleblower, and other parts of the agency to bolster the efforts of the Commission as a whole on these vital matters."

**Allison Herren Lee,
Former Acting Chair of the SEC
March 4, 2021
SEC Announces Enforcement Task Force Focused on Climate and ESG Issues**

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[1] The Securities Exchange Act of 1934; Rule 13a-15.
[2] SEC.gov | SEC Announces Enforcement Task Force Focused on Climate and ESG Issues
[3] *Ibid*.
[4] SEC.gov | Enhancing Focus on the SEC's Enhanced Climate Change Efforts

ESG Task Force Update in April 2023

The SEC issued an ESG Task Force update on April 11, 2023, titled "Enforcement Task Force Focused on Climate and ESG Issues" ("ESG Task Force Update").[5] The ESG Task Force Update announced the following regarding the ESG Task Force's activity, consistent with the SEC's announcement of the ESG Task Force's formation on March 4, 2021:[6]

> *"The Climate and ESG Task Force is coordinating the effective use of Division resources, including through the use of sophisticated data analysis to mine and assess information across registrants, to identify potential violations including* ***material gaps or misstatements in issuers' disclosure of climate risks under existing rules, and disclosure and compliance issues relating to investment advisers' and funds' ESG strategies****." [Emphasis Added]*

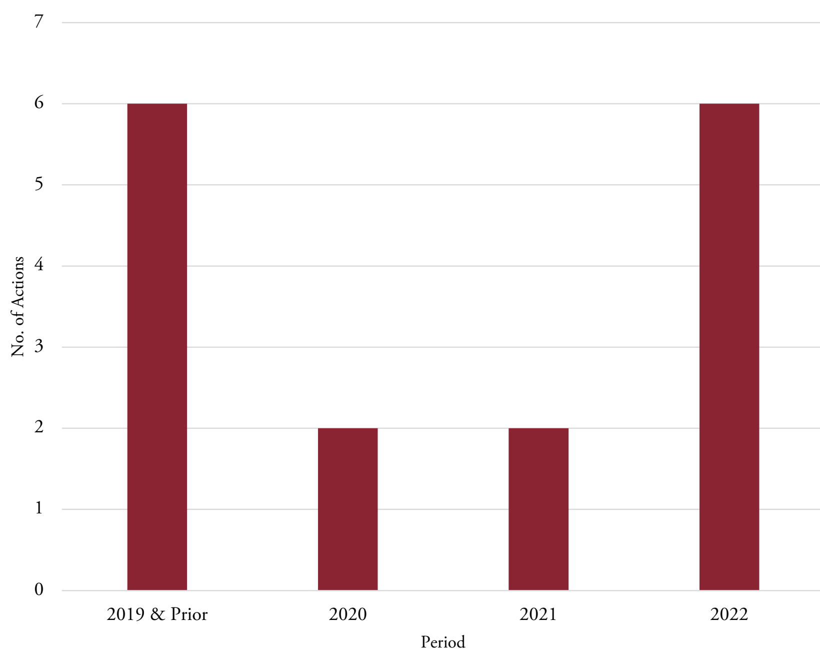
"Today, investors increasingly want to understand the climate risks of the companies whose stock they own or might buy. Large and small investors, representing literally tens of trillions of dollars, are looking for this information to determine whether to invest, sell, or make a voting decision one way or another."

Gary Gensler,
Chair of the SEC
July 28, 2021
Prepared Remarks Before the Principles for Responsible Investment "Climate and Global Financial Markets" Webinar

The ESG Task Force Update also highlighted a list of 16 "examples of enforcement actions related to ESG issues or statements," which specifically included a "non-exhaustive" list of ESG-related enforcement actions filed to date ("Highlighted Actions").

The Highlighted Actions were dated from 2008 to 2022. The graph below provides a breakdown of the Highlighted Actions by period:

Summary Breakdown of the Highlighted Actions (Cases Filed by Year)



Notably, 9 of the 16 Highlighted Actions were filed before the formation of the ESG Task Force on March 4, 2021.[7]

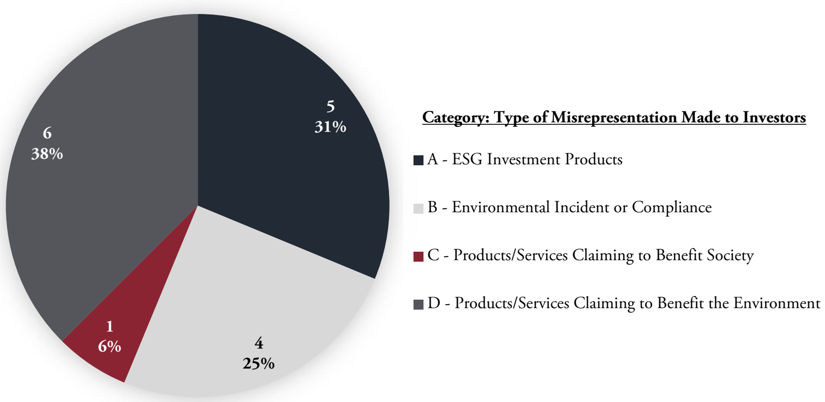
[5] SEC.gov | Enforcement Task Force Focused on Climate and ESG Issues
[6] *Ibid.*
[7] One of the two Highlighted Actions in 2021 was filed on March 3, 2021 (i.e., one day before the formation of the ESG Task Force).

Categorization of the ESG-Related Enforcement Actions

To further understand the ESG Task Force's efforts and areas of focus to date, we first analyzed the 16 Highlighted Actions. For each Highlighted Action, our team reviewed the (a) press release and (b) complaint or cease-and-desist order to categorize the types of ESG-related issues and misrepresentations that were made to investors. We established the following four categories and summarized our observations in the chart below:

	ESG-Related Issue (By Type of Misrepresentation Made to Investors)
A	***ESG Investment Products***: Disclosure and compliance issues related to investment advisers' and funds' ESG strategies.
B	***Environmental Incident or Compliance***: Materially false, misleading, or insufficient disclosures re: an environmental incident or compliance with environmental regulations (e.g., oil spill or oil rig safety compliance).
C	***Products or Services that Claim to Benefit Society***: Materially false, misleading, or insufficient disclosures re: products or services that claim to benefit society (e.g., health insurance).
D	***Products or Services that Claim to Benefit the Environment***: Materially false, misleading, or insufficient disclosures re: products or services that claim to benefit the environment (e.g., electric vehicles).

Highlighted Actions by ESG-Related Issue



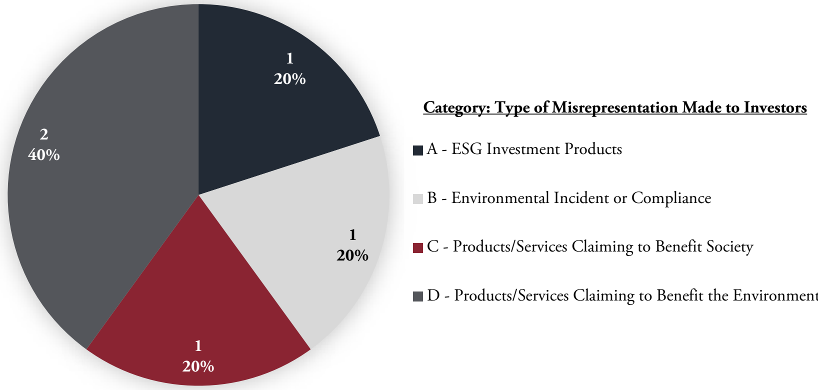
Because the latest Highlighted Action was filed in November 2022, we expanded our analysis by reviewing over 150 SEC press releases that announced an enforcement action through December 2023.[8] We identified an additional five enforcement actions ("2023 Actions") that fell into one of the four categories, which are summarized in the following chart:

"'ESG' also encompasses a wide variety of investments and strategies. Some funds screen out certain industries. Others specifically include certain industries. Others may claim to have a particular impact on an issue. Some may track board votes or make assertions about the greenhouse gas emissions, labor practices, or water sustainability of their underlying assets. Some funds involve human judgments. Others might track an outside index. Needless to say, there's a wide range here."

Gary Gensler,
Chair of the SEC
May 25, 2022
Statement on ESG Disclosures Proposal

[8] Press releases highlight recent actions taken by the SEC and other newsworthy information and do not capture a complete population of enforcement actions initiated in a given year. For example, approximately 780 enforcement actions were filed by the SEC for the fiscal year ended September 30, 2023. Our analysis took a higher-level approach and focused on 2023 enforcement actions that were announced in SEC press releases. As such, in our review of press releases from January 1, 2023 through December 31, 2023, we identified approximately 150 enforcement actions.

2023 Actions by ESG-Related Issue



> "Whether advertising how they incorporate ESG factors into investment recommendations or making any other representation that is material to investors, investment advisers must ensure that their actions conform to their words. Here, DWS advertised that ESG was in its 'DNA,' but, as the SEC's order finds, its investment professionals failed to follow the ESG investment processes that it marketed."
>
> Sanjay Wadhwa, Deputy Director of the SEC's Division of Enforcement
> September 25, 2023
> Deutsche Bank Subsidiary DWS to Pay $25 Million for Anti-Money Laundering Violations and Misstatements Regarding ESG Investments

The results show that Category D (Products/Services Claiming to Benefit the Environment) was the most prevalent type of ESG-related misrepresentation across the Highlighted Actions and 2023 Actions. This was followed by Category A (ESG Investment Products), Category B (Environmental Incident or Compliance), and Category C (Products/Services Claiming to Benefit Society), respectively.

While our categorical breakdown is analytically useful, a closer look at examples of specific cases for each category provides a clearer understanding of the ESG Task Force's areas of focus:

Category A) ESG Investment Products

We identified six Category A issues from the population of Highlighted Actions and 2023 Actions, the second most observed type of ESG-related misrepresentation made to investors. This category includes disclosure and compliance issues related to investment advisers' and funds' ESG strategies. An example of an enforcement action within this category is summarized below:

- ***September 25, 2023:*** [9] ***The SEC charged registered investment adviser DWS Investment Management America Inc. (DIMA or DWS), a subsidiary of Deutsche Bank AG, in an enforcement action concerning misstatements regarding its ESG investment process.*** The SEC's order found that DIMA made materially misleading statements about its controls for incorporating ESG factors into research and investment recommendations for ESG-integrated products, including certain actively managed mutual funds and separately managed accounts. The order found that DIMA marketed itself as a leader in ESG that adhered to specific policies for integrating ESG considerations into its investments; however, from August 2018 until late 2021, DIMA failed to adequately implement certain provisions of its global ESG integration policy as it had led clients and investors to believe it would. The order found that DIMA also failed to adopt and implement policies and procedures reasonably designed to ensure that its public statements about the ESG-integrated products were accurate. Without admitting or denying the SEC's findings, DIMA agreed to a cease-and-desist order and a $6 million penalty in the AML action; and to a cease-and-desist order, censure, and a $19 million penalty in the ESG misstatements action.

[9] https://www.sec.gov/news/press-release/2023-194

Category B) Environmental Incident or Compliance

We identified five Category B issues from the population of Highlighted Actions and 2023 Actions, the third most observed type of ESG-related misrepresentation made to investors. This category includes materially false, misleading, or insufficient disclosures related to an environmental incident or compliance with federal environmental regulations (e.g., oil spill or oil rig safety compliance). An example of an enforcement action within this category is summarized below:

- ***April 28, 2022:[10] The SEC charged Vale S.A., a publicly traded Brazilian mining company and one of the world's largest iron ore producers, with making false and misleading claims about the safety of its dams prior to the January 2019 collapse of its Brumadinho dam. The collapse killed 270 people, caused immeasurable environmental and social harm, and led to a loss of more than $4 billion in Vale's market capitalization.*** More specifically, beginning in 2016, Vale was alleged to have manipulated multiple dam safety audits, obtained fraudulent stability certificates, and fraudulently disclosed that the Brumadinho dam was safe in multiple public disclosures. The complaint further alleged that Vale knew the Brumadinho dam did not meet internationally recognized standards for dam safety, but nonetheless used sustainability reports, presentations, ESG webinars, and its SEC filings to fraudulently convince investors otherwise. Vale S.A. paid $55.9 million to settle the lawsuit, which included $25 million in civil penalties, and $30.9 million in prejudgment interest.[11]

Category C) Products or Services that Claim to Benefit Society

We identified two Category C issues from the population of Highlighted Actions and 2023 Actions, the least observed type of ESG-related misrepresentation made to investors. This category includes materially false, misleading, or insufficient disclosures related to products or services that claim to benefit society (e.g., health insurance). An example of an enforcement action within this category is summarized below:

- ***July 20, 2022:[12] The SEC charged Health Insurance Innovations (HII) and its former CEO for concealing extensive consumer complaints about short-term and limited health insurance products HII offered.*** From March 2017 through March 2020, HII and its former CEO allegedly made false representations to its investors about its high compliance standards and customer satisfaction, despite tracking tens of thousands of dissatisfied consumers who complained that HII's distributors made misrepresentations to sell the health insurance products, charged consumers for products they did not authorize, and failed to cancel plans upon consumers' requests. The order found that the products provided minimal health benefits, did not cover pre-existing conditions, prescriptions, and hospital care, and were not considered qualifying health coverage under the Affordable Care Act, leaving many consumers with unpaid medical bills when they sought treatment. HII paid $11 million, and the former CEO paid over $1 million in civil penalties, disgorgement, and interest.

Category D) Products or Services that Claim to Benefit the Environment

We identified eight Category D issues from the population of Highlighted Actions and 2023 Actions, the most observed type of ESG-related misrepresentation made to investors. This category includes materially false, misleading, or insufficient disclosures related to products or services that claim to benefit the environment (e.g., electric vehicles). An example of an enforcement action within this category is summarized below:

"Our action against Vale illustrates the interplay between the company's sustainability reports and its obligations under the federal securities laws. The terms of today's settlement, if approved by the court, will levy a significant financial penalty against Vale and demonstrate that public companies can and should be held accountable for material misrepresentations in their ESG-related disclosures, just as they would for any other material misrepresentations."

Mark Cave,
Associate Director of the SEC's Division of Enforcement
March 28, 2023
Brazilian Mining Company to Pay $55.9 Million to Settle Charges Related to Misleading Disclosures Prior to Deadly Dam Collapse

10 https://www.sec.gov/news/press-release/2022-72
11 https://www.sec.gov/news/press-release/2023-63
12 https://www.sec.gov/news/press-release/2022-126

- ***September 26, 2023:*[13] *The SEC announced charges against a New York-based manufacturer of hydrogen fuel cell electric vehicles ("FCEVs") and two former executives for their roles in a fraudulent scheme to mislead investors.*** According to the SEC's original complaint, the company misrepresented business dealings by creating the false impression of significant future sales transactions of FCEVs. The complaint alleges that Hyzon also falsely stated that it had delivered its first FCEV in July 2021, even going as far as posting a misleading video of the vehicle purportedly running on hydrogen, when the vehicle was not equipped to operate on hydrogen power. The complaint further alleges that Hyzon later falsely reported that it sold 87 FCEVs in 2021, when in fact it had not sold any vehicles that year. The company, former CEO, and former managing director consented to pay $25 million, $100,000, and $200,000 in civil penalties, respectively.

Categorization of Securities Laws Violations Charged in ESG-Related Enforcement Actions

"Fund managers focusing on ESG generally examine criteria within the environmental, social, and/or governance categories to analyze and select securities … The *environmental* component might focus on a company's impact on the environment—for example, its energy use or pollution output. It also might focus on the risks and opportunities associated with the impacts of climate change on the company, its business and its industry."

February 26, 2021
Environmental, Social and Governance (ESG) Funds – Investor Bulletin

(continued on pg. 7)

For each Highlighted Action and 2023 Action, we also analyzed the securities laws violations charged in the respective complaint or cease-and-desist order. We then classified each violation into one of three general categories, and further into one of eleven more specific categories, with each set of categorizations describing the type of violation charged by the SEC. The categories are presented below:

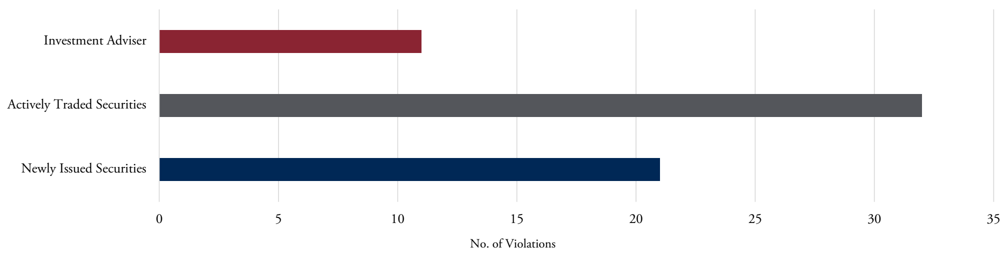
	Securities Laws Violations (By Type of Violation)
	***Guidance for Investment Advisers:*[14]**
A	*Failure to Follow Internal Compliance Program*
B	*Misleading Representations*
	***Guidance for Actively Traded Securities:*[15]**
C	*Acting as an Unregistered Broker-Dealer*
D	*Insufficient Books and Records to Support Transactions Recorded in Accordance with GAAP*
E	*ICFR Failure and/or Circumvention*
F	*Fraud or Deceit in the Purchase or Sale of Securities*
G	*Material Misrepresentations or Misleading Omissions in Reports Filed with the SEC*
H	*Failure to File Reports*
I	*Violation of Securities Laws by Means of Another Person*
	***Guidance for Newly Issued Securities:*[16]**
J	*Sale of Unregistered Securities*
K	*Fraud or Deceit in the Offer or Sale of Securities*

[13] https://www.sec.gov/news/press-release/2023-200
[14] Violations of the Investment Advisers Act of 1940 and the Investment Company Act of 1940.
[15] Violations of the Securities Exchange Act of 1934.
[16] Violations of the Securities Act of 1933.

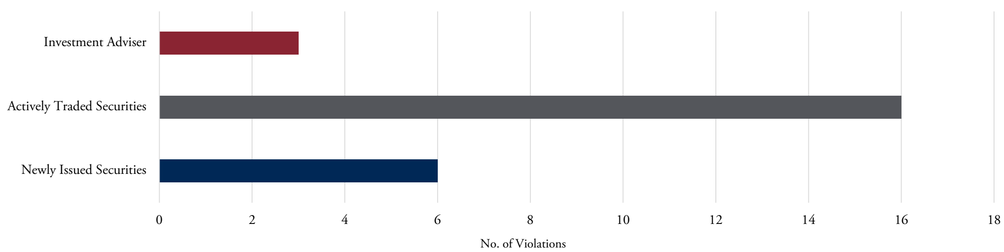
As demonstrated in the graphs below, we quantified the number of instances where each violation type (at a summary-level and detail-level) appeared across the relevant complaints and cease-and-desist orders.

We start with our summary-level observations presented in the graphs below:

Highlighted Actions: Violations by Type (Summary-Level)



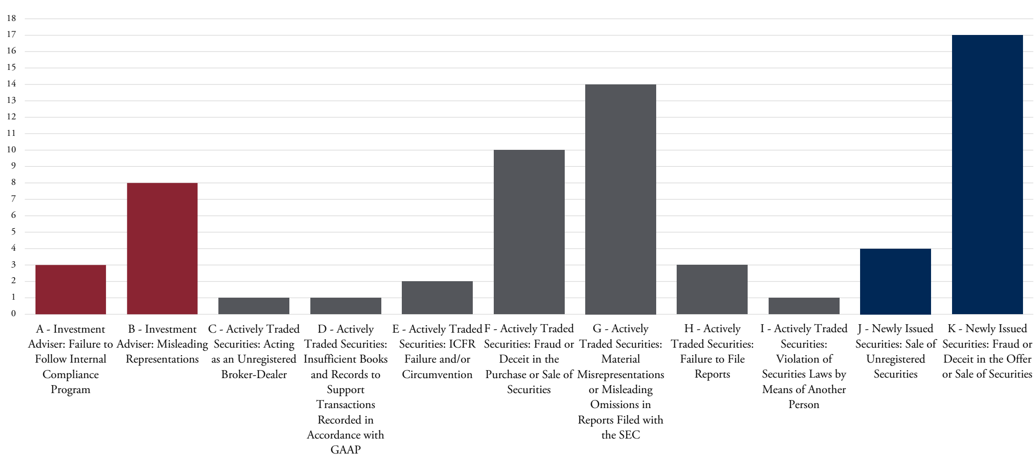
2023 Actions: Violations by Type (Summary-Level)



The results are consistent across both sets of actions, whereby violations related to Actively Traded Securities (i.e., violations of the Securities Exchange Act of 1934) were most prevalent. This suggests that the ESG Task Force may have prioritized financial reporting disclosure violations identified within SEC filings, such as Forms 10-K and Form 10-Q.

Digging deeper into the data, our detail-level observations support this suggestion that the ESG Task Force appears to have prioritized financial reporting disclosure violations. See the graphs below:

Highlighted Actions: Violations by Type (Detail-Level)

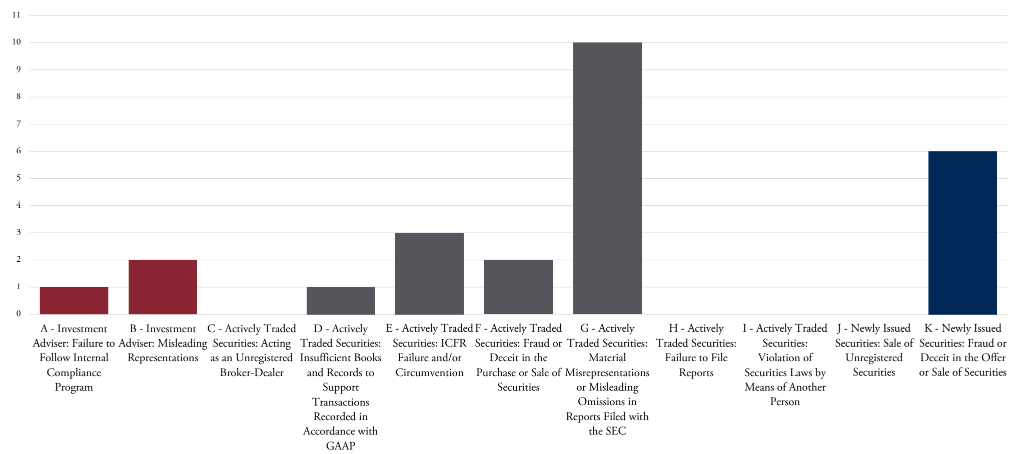


"… The *social* component might focus on the company's relationship with people and society—for example, issues that impact diversity and inclusion, human rights, specific faith-based issues, the health and safety of employees, customers, and consumers locally and/or globally, or whether the company invests in its community, as well as how such issues are addressed by other companies in a supply chain."

February 26, 2021
Environmental, Social and Governance (ESG) Funds – Investor Bulletin

(continued on pg. 8)

2023 Actions: Violations by Type (Detail-Level)



We observed that financial reporting disclosure issues were represented by Type D (Insufficient Books and Records to Support Transactions Recorded in Accordance with GAAP), Type E (ICFR Failure and/or Circumvention), and Type G (Material Misrepresentations or Misleading Omissions in Reports Filed with the SEC) violations. These financial reporting disclosure violations were captured by nine enforcement actions, in which the disclosure violation was committed on either Forms 10-K, 10-Q, 20-F, or 6-K filings.

In addition, we identified certain financial statement impacts and accounting considerations that were directly or tangentially related to financial reporting disclosure violations. We highlighted certain examples below:

- ***Hyzon Motors Inc. (September 2023)***[17]
  Disclosure Violation: The company reported in its financial statements filed with the SEC that it sold 82 FCEVs to Chinese customers in the fourth quarter of 2021. This statement was false and misleading.
  Financial Statement Issue: The company failed to accurately report revenue in its financial statements. When corrected as part of a restatement, the company's revenues fluctuated more than 85% in multiple quarters and the year ended 2021.

- ***Compass Minerals International Inc. (September 2022)***[18]
  Disclosure Violation: In its 10-K, the company made certain materially false misrepresentations concerning the production capacity levels of its mines.
  Financial Statement Issue: Certain accounting misstatements were noted as the company's inventory accounting methodology did not comply with Generally Accepted Accounting Principles (GAAP).

> **"... The *governance* component might focus on issues such as how the company is run—for example, transparency and reporting, ethics, compliance, shareholder rights, and the composition and role of the board of directors."**
>
> **February 26, 2021 Environmental, Social and Governance (ESG) Funds – Investor Bulletin**

[17] https://www.sec.gov/news/press-release/2023-200
[18] https://www.sec.gov/news/press-release/2022-171

- ***Vale S.A. (April 2022)***[19]
  Disclosure Violation: Vale's public statements, including in SEC periodic filings on Forms 20-F and 6-K in 2017 and 2019, sustainability reports issued in 2017 and 2018, and a December 2018 ESG webinar, touted the stability declarations and reassured investors that its dams were stable and safe. However, the company secured each of the stability declarations for the Brumadinho dam through fraud and deceptive acts. Therefore, these statements were materially false and misleading. The Brazilian dam collapsed in January 2019, killing 270 people.
  Accounting Consideration: Although not specifically asserted in the complaint, ASC 450-20 under GAAP requires companies to record and disclose contingent liabilities if (i) it is probable that an obligation has occurred, and (ii) the amount of the obligation can be reasonably estimated.

Concluding Thoughts

Rule 13a-15 of the Securities Exchange Act of 1934 requires issuers to maintain and regularly evaluate the effectiveness of disclosure controls. With the creation of the ESG Task Force, the SEC has increased its focus on disclosure violations concerning products or services that claim to benefit the environment (as well as other ESG-related issues), while at the same time focusing on financial reporting disclosure violations committed in forms filed with the SEC.

In recent years, the SEC has proposed several new climate and ESG-related disclosure rules, primarily focused on the risks and impacts of climate change and greenhouse gases. However, these proposed rules are non-final and have yet to be effectuated as new securities laws.

We hope you found our analyses and related observations insightful and welcome your comments and feedback. We will continue to monitor the activity of the ESG Task Force and provide future updates.

[19] https://www.sec.gov/news/press-release/2022-72

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ABOUT Floyd Advisory
Floyd Advisory is a consulting firm providing financial and accounting expertise in areas of SEC reporting, transaction advisory, investigations and compliance, litigation services, as well as business strategy and valuation.

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