Blogs
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Asset Management ADVocate

No Summer Slump on ESG at the SEC: Board Duties, Exams, Rulemaking and Skepticism

This post catches up on the ESG front at the SEC following the appointment of Gary Gensler as Chairman. The switch from a Chairman appointed by President Trump to one appointed by President Biden may add momentum to the SEC's ESG proposals.

Board ESG Duties

Commissioner Allison Herren Lee, speaking in late June, thanked public companies for the thousands of letters submitted in response to the request for comment on climate change disclosures and called on their boards of directors to dig deeper on ESG. While her remarks were directed at public company boards, they also provide important insights for the boards of mutual funds, ETFs and other registered investment companies. This year's annual proxy season revealed unprecedented support for climate-related proposals generally and for racial equity, political spending and other ESG shareholder proposals. Certainly the widely-reported successful taking of board seats at Exxon Mobil by activist investors surprised many. Commissioner Lee sees these developments as placing "ever greater responsibility" on boards "to integrate climate and ESG into their decision-making, risk management, compensation, and corporate transparency initiatives." Regardless of their stance on regulatory involvement in climate and ESG disclosures, Commissioner Herren Lee said, in keeping with their fiduciary duties and the federal securities laws, boards:

- are increasingly responsible for the "identification, assessment, decision-making, and disclosure" of ESG risks;
- may need to investigate ESG "red flags" and "climate change and other ESG issues as the regulatory landscape evolves;"
- should "proactively seek to integrate climate and ESG into their decision-making" to mitigate risk; and
- must ensure that corporate "public pledges on ESG issues are actually backed up by corporate action."

She added that boards might also seek to enhance their diversity, increase their level of climate and ESG risk expertise, and inspire management by tying executive compensation to ESG metrics.

ESG Exams, Rulemaking

The SEC staff's ESG-oriented examinations of funds and advisers are ongoing. As evidenced in information request letters that we've obtained, the staff is asking for data on firms':

- internal definition of ESG and socially responsible investing ("SRI") and ESG/SRI strategies and the criteria considered, including internal and third-party scoring systems;
- written policies and procedures relating to ESG/SRI practices;
- adherence to any ESG/SRI standard or framework, such as the UNPRI;
- marketing materials and performance reporting that discuss ESG/SRI matters, and related documentation;
- any ESG/SRI-related client complaints; and
- ESG/SRI-related activist activities, including shareholder proposal submissions.

At the same time, the SEC's annual regulatory agenda, includes:

- disclosure relating to climate risk and human capital;
- ESG investment fund rules; and
- enhancing shareholder democracy.

Speaking in late June, Chairman Gary Gensler noted that he was struck by the intensity of the call for enhanced ESG disclosures in comment letters submitted to the SEC. He reported that staff was considering "the ways that funds are marketing themselves to investors as sustainable, green, and 'ESG,' and what factors undergird those claims." Chairman Gensler also emphasized the staff's work towards mandatory human capital disclosures alongside climate disclosures. Metrics for public companies, Gensler said, could include "workforce turnover, skills and development training, compensation, benefits, workforce demographics including diversity, and health and safety."

Skeptical Commissioners

In her June speech, Commissioner Herren Lee asserted that the only open debate about the financial significance of ESG metrics is "when, not if, these issues are material." In stark contrast, Commissioner Hester Pierce, who has long questioned the need for specific ESG disclosures and regulation, issued a public statement in early July urging the International Financial Reporting Standards Foundation "not to wade into sustainability standard-setting." Doing so, she said, would "improperly equate sustainability standards with financial reporting standards" and pose the risk of misleading investors because "sustainability standard-setting is an inherently more subjective, less precise, less focused, more open-ended activity than financial accounting standard-setting." Similarly, Commissioner Elad Roisman has questioned whether the SEC can "make ESG rules that are sustainable." Speaking in late June, Commissioner Roisman emphasized the SEC's challenges of "keeping focused on materiality" in ESG rulemaking and acquiring and maintaining "the expertise to develop and oversee a disclosure regime that includes specifically 'E' and 'S' information."

Conclusion

During these dog days of summer in Washington, the SEC is not alone in its focus on ESG regulatory issues. Staff at the DOL are implementing an executive order instructing the DOL "to protect the life savings and pensions of United States workers and families from the threats of climate-related financial risk," a far cry from implementing the unenforced Trump-era ESG rules for ERISA fiduciaries. On Capitol Hill, legislators have before them a bill that would clearly permit ERISA fiduciaries to consider ESG factors in managing retirement plans. Still, the SEC is perhaps most active in the ESG regulatory space these days. In our next post we'll cover the recommendations of the SEC's Asset Management Advisory Sub-Committee on Diversity and Inclusion.

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