ESG Remains a Priority: SEC Asset Management Advisory Committee Adopts ESG Disclosure Recommendations

July 22, 2021

On July 7, the Securities and Exchange Commission (SEC) Asset Management Advisory Committee (the Committee) adopted recommendations developed by the Environmental, Social and Governance (ESG) Subcommittee related to ESG disclosure by registered issuers (the Recommendations). The Recommendations are intended to improve the available information and disclosure used by issuers, including business development companies (BDCs), closed-end funds (CEFs) and mutual funds, to describe ESG investing.

The Recommendations direct the SEC to issue guidance that will facilitate meaningful, consistent and comparable ESG disclosure from issuers. Notably, the Recommendations do not contemplate changes to the regulatory framework that would specifically require ESG disclosure or metrics, but instead provide guidance and best practices around how issuers should incorporate ESG disclosure in a manner that will allow investors to make better-informed investment decisions.

Background

The Recommendations follow a number of previous SEC initiatives that approach ESG from a variety of angles.

For example, on March 3, the SEC Division of Examinations identified ESG issues as a 2021 exam priority for investment advisers. Also, on March 4, the SEC announced the creation of a Climate and ESG task force under the purview of the SEC Division of Enforcement that will, among other things, "analyze disclosure and compliance issues relating to investment advisers' and funds' ESG strategies."[1] On April 9, the Division of Examinations published an ESG Risk Alert, describing areas it intends to focus on in examinations of investment advisers' and funds' ESG products and services.[2]

SEC Chairman Gary Gensler has spoken publicly about his intent to focus on ESG-related issues. On May 6, at a House Financial Services Committee hearing, Chairman Gensler indicated that the SEC is looking to propose rules on ESG reporting by public companies after gathering feedback over the course of the summer from investors and others. On June 23, at London City Week, Chairman Gensler reiterated his focus on ESG topics and emphasized the importance of disclosure, stating that "investors increasingly want to understand the climate risks of issuers" and "investors representing literally tens of trillions of dollars of assets under management are looking for consistent, comparable, decision-useful information to determine whether to invest, sell, or make a proxy vote

[1] "ESG is in the (SEC) House: SEC Exams, Enforcement and Regulations are Coming" (March 8, 2021) https://katten.com/esg-is-in-the-sec-house-sec-exams-enforcement-and-regulations-are-coming.

[2] "ESG Issues Become Leading Concern for SEC and CFTC: SEC Warns Investment Advisers and Funds About ESG Disclosures" (April 27, 2021), https://katten.com/esg-issues-become-leading-concern-for-sec-and-cftc-sec-warns-investment-advisers-and-funds-about-esg-disclosures.

one way or another."[3] The SEC received hundreds of comment letters in connection with a public comment period on potential ESG and climate change regulations that concluded on June 13.

ESG Subcommittee Recommendations

The ESG Subcommittee provided the following recommendations at the July 7 meeting:

The SEC should:

- take steps to foster meaningful, consistent and comparable disclosure of material ESG matters by issuers;
- in furtherance of the above, encourage issuers to adopt a framework for disclosing material ESG matters and to provide an explanation if no disclosure framework is adopted;
- initiate a study of third-party ESG disclosure frameworks for the disclosure of material ESG matters to assess whether the frameworks could play a more authoritative role in the future;
- suggest best practices to enhance ESG investment product disclosure, and provide a clear description of each product's strategy and investment priorities, including description of non-financial objectives such as environmental impact or adherence to religious requirements. In doing so, the SEC should consider adopting terminology that aligns with the taxonomy developed by the Investment Company Institute ESG Working Group;[4] and
- suggest best practices for investment products to describe each product's planned approach to share ownership activities in the Statement of Additional Information, and any notable recent ownership activities other than proxy voting activity reported in Form N-PX.

In discussing its rationale for the Recommendations, the Committee emphasized its view that there is a pressing need for the SEC to implement a process for enhancing the quality, consistency and comparability of ESG disclosures. This would allow investors to access relevant information and improve the likelihood that disclosure will be consistent and comparable across issuers making investments in similar businesses or industries.

The Committee recommended that the SEC specifically consider the value that investors now ascribe to ESG topics. The Committee discussed the significance of ESG through three different lenses: (1) the impact of ESG on investment performance; (2) market interest; and (3) the volume of global regulatory activity and standards. From these perspectives, the Committee observed that "market participants, regulators, and standard setters view material ESG matters to play a role in capital formation, capital allocation and risk/return expectations."

However, the Committee did note that it may be premature for the SEC to broadly implement specific mandated disclosure of material ESG matters through a rulemaking process. Instead, once consistent and comparable ESG metrics are able to achieve widespread market adoption and acceptance, the SEC can revisit the topic and consider whether to provide more specific, codified guidance.

The Committee concluded by recommending a general suggested best practice that ESG investment products specifically describe their objectives, how they prioritize those objectives, and the risk/return profile of their objectives, which will allow investors to make a sufficiently informed investment decision.

SEC Commissioner Reactions

Chairman Gensler delivered remarks at the July 7 meeting and strongly supported the Recommendations.[5] He identified a specific concern that funds focusing on ESG investing are using a "huge range" of terms and criteria to

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[3] SEC Chairman Gary Gensler, "Prepared Remarks at London City Week" (June 23, 2021), https://www.sec.gov/news/speech/gensler-speech-london-city-week-062321.

[4] ICI Webinar Materials, "New Common Terminology for ESG Fund Investing Strategies" (August 11, 2020), https://www.ici.org/system/files/attachments/pdf/20_webinar_ici_esg_primer_0811_slides.pdf.

[5] SEC Chairman Gary Gensler, "Prepared Remarks Before the Asset Management Advisory Committee" (July 7, 2021), https://www.sec.gov/news/public-statement/gensler-amac-2021-07-07.

describe sustainability-related investment strategies, and noted that he thinks "investors should be able to drill down to see what is under the hood of these funds." In that regard, he has asked the Staff to take a holistic look at investment product naming conventions, including with respect to Rule 35d-1 under the Investment Company Act of 1940, applicable to BDCs, CEFs and mutual funds, which provides guidance and criteria surrounding "materially deceptive and misleading" fund names.

SEC Commissioner Caroline Crenshaw also provided support of the Recommendations in her remarks, noting that "investors are using ESG-related metrics to make investment decisions and to allocate capital more than ever," and that it is the role of the SEC to "ensure that ESG-related disclosures are consistent, comparable, high-quality, and decision-useful."[6]

SEC Commissioner Hester Pierce reiterated her ongoing concerns with implementing any type of objective standard around ESG reporting, noting that "[f]inancial reporting lends itself to concrete, objective, comparable metrics. ESG standard-setting, by contrast, as the draft recommendation acknowledges, is a much more fluid project that covers a wide range of issues, many of which are not objectively quantifiable and comparable across issuers."[7]

SEC Commissioner Allison Lee raised a separate concern that the Recommendations do not go far enough, and that a "best practice" or "guidance" approach is unlikely to achieve the Committee's goal to provide investors with "consistent, comparable and reliable information" with respect to ESG disclosure.[8]

Conclusion

The Advisory Committee unanimously adopted the Recommendations. The Recommendations, together with other recent statements by Chairman Gensler and the SEC Staff, signal that the SEC intends to maintain its focus on ESG and related disclosure topics and may issue additional ESG disclosure guidance in the near future. BDCs, CEFs, mutual funds and other issuers may consider preparing for this new guidance by developing and/or updating disclosure controls and procedures or other compliance policies to specifically contemplate ESG-related topics.

6 SEC Commissioner Caroline Crenshaw, "Remarks at Asset Management Advisory Committee" (July 7, 2021), https://www.sec.gov/news/public-statement/crenshaw-amac-remarks-070721.

7 SEC Commissioner Hester M. Peirce, "Remarks Before the Asset Management Advisory Committee" (July 7, 2021), https://www.sec.gov/news/public-statement/peirce-amac-remarks-070721.

8 Commissioner Lee's remarks have not yet been posted as of the date of this Client Alert.

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