ESG Investing Guidance From The U.S. Securities And Exchange Commission

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The recent push for businesses to be run more sustainably shows no signs of cooling off as ESG investing continues to gain momentum. ESG investing (also known as socially responsible investing, impact investing, and sustainable investing) refers to investing that prioritizes favorable environmental, social, and governance (ESG) factors or outcomes.

ESG investing goes beyond a three-letter acronym to ask how a business serves all of its stakeholders: employees, customers, shareholders, communities, and the environment. As ESG investing becomes a stronger force in the market, investors are seeking assistance from law firms in navigating the confusing landscape of various standards and frameworks.

Everyone from the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC) to politicians and global organizations has stepped into the conversation to address the ESG investing surge and to provide much-needed guidance. Although there are currently no ESG-specific regulations or rules in the United States, there are many existing securities laws that apply to ESG investing and the SEC is responding with an all-agency approach. Recent actions by the agency include the creation of a Climate and ESG Task Force in the Division of Enforcement, a request for public comment on climate change disclosures, and the publication of an ESG risk alert by the Division of Examinations.

This blog post will focus on the SEC's ESG risk alert and provides guidance

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Commodity Futures Trading Commission (CFTC) on how clients and their compliance professionals can stay ahead of anticipated changes.

On April 9, 2021, the SEC's Division of Examinations (the Division) published its first risk alert detailing effective and deficient practices among investment advisers, registered investment companies, and private funds offering ESG investing strategies. In particular, the Division noted that its examinations would focus on portfolio management, performance advertising and marketing, and compliance programs, among other matters.

Generally, the guidance in the risk alert details effective and deficient compliance controls around ESG-related disclosures, marketing materials, and investment and proxy voting practices. In examining firms engaging in ESG investing, the Division detailed the following as effective practices:

- Clear and precise disclosures that were tailored to the firm's specific approach to ESG investing and that were aligned with the firm's actual practices (e.g., simple and clear disclosures regarding the firm's approach to ESG investing, ESG factors that could be considered alongside many other factors, and explanations regarding how investments were evaluated using goals established under global ESG frameworks)
- Detailed policies and procedures that addressed ESG investing, including specific documentation to be completed at various stages of the investment process (e.g., research, due diligence, selection, and monitoring)
- Knowledgeable compliance personnel who were integrated into the firm's ESG-related processes

The Division also described certain firm practices it believed were deficient based on its examinations regarding ESG investing:

- Portfolio management practices that were inconsistent with ESG approach disclosures
- Controls that were inadequate to maintain, monitor, and update clients' ESG-related investing guidelines, mandates, and restrictions
- Proxy voting that was inconsistent with stated ESG approaches
- Unsubstantiated or misleading claims regarding ESG approaches
- Inadequate controls to ensure consistency with firm practices and ESG-related disclosures and marketing
- Lack of policies and procedures addressing ESG investing analyses, decision-making processes, or compliance review and oversight
- Compliance programs that were less effective when compliance personnel had limited knowledge of ESG-investment analyses

The Division also stated that it will continue to review both internal and external documents to ensure that firms disclose their ESG standards and take care not to mislead investors. The SEC's guidance evidences the agency's increasing intent to play a significant role in the ESG space, and the agency is expected to further clarify its role later this month.

In the meantime, firms that engage in ESG investing should evaluate their current compliance controls in light of the compliance deficiencies outlined by the SEC, with particular focus on whether:

- their disclosures, marketing claims, and other public statements related to ESG investing are accurate and consistent with internal firm practices
- their approaches to ESG investing are implemented consistently throughout the firm
- their approaches to ESG investing are adequately addressed in the firm's policies and procedures
- their approaches to ESG investing are subject to appropriate oversight by compliance personnel
- they are adequately documenting and maintaining records relating to important stages of the ESG investing process