Speech

Keynote Speech at the Society for Corporate Governance National Conference

Commissioner Elad L. Roisman

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Introduction

Good afternoon, everyone. Thank you, Keir [Gumbs], for the kind introduction, and thank you to the Society for Corporate Governance for the invitation to speak today. I had been looking forward to seeing everyone in Colorado this week but, of course, life for all of us has changed since we made those plans. Given how hectic I presume the last few months have been for you, I want you to know how much I appreciate that you are taking the time to call in and listen to me speak.

I would like to begin by taking a moment to remember Marty Dunn. He was an incredible lawyer and an even better person. He helped train countless lawyers and was a big figure in the lives of so many in our Division of Corporation Finance and in the securities world. He has left a lasting legacy and my thoughts go out to his family.

Before I continue, I must note that my views and remarks are my own and do not necessarily represent those of the Securities and Exchange Commission ("SEC") or the other SEC Commissioners.

Proxy Update

I want to use this opportunity to provide a brief update on the proxy reform rulemakings, which the Commission proposed last November. While I cannot give you any details on the substance, I can say that the completion of those rulemakings is a priority for me and for Chairman Clayton. The staff on the SEC's rulemaking teams has remained focused throughout these past few months digesting the comments we received on both proposals and drafting recommendations for the Commission to finalize each of them. I look forward to considering those recommendations, and I hope we also move forward in pursuing efforts to improve our "proxy plumbing" infrastructure. I continue to think through ways to address the inherent problems with the current framework, and I always welcome new suggestions.

Full Disclosure: My Thoughts on ESG

Today, I would like primarily to talk about another area that I know is front-of-mind for a lot of people in this room: "ESG." This is a broad subject with a wide variety of implications, including many that go well beyond the scope of the Commission's authority. I could not possibly address all aspects of my thinking on it in one speech, so I will focus on two particular areas: (1) calls for mandated ESG disclosure for public companies, and (2) ESG disclosure by asset managers.

ESG (and What It Means to You and Me)

First, let me level-set: In my experience, there is not consensus on what, exactly, "ESG" means. I often wondered how the three concepts of environmental, social, and governance matters got lumped together. When I looked into it, I saw that it was relatively recently that socially responsible investors, focusing on "E" and "S" issues, rebranded to add "governance" to the mix, a component that had research tying it to firm value.[1] In my mind, corporate governance stands by itself and rarely has a direct relationship to environmental or social issues. Best practices in corporate governance are usually the result of many years of private ordering experimentation and experience. Also, governance reform focuses on the company itself and what is best for its optimal operation as well as its shareholders. The same is not necessarily true of "E" or "S." Those matters tend to be more society, or stakeholder, focused. For example: How is the company "doing its part" to combat climate change or address global and political matters?

An obvious problem with mandating ESG disclosure is that the issues under this enormous umbrella of a term are usually subjective and constantly evolving based on current events. Because of this evolution, requiring prescriptive disclosure would be difficult. Who is in a position to codify a list of environmental or social issues for the foreseeable future?[2] Presumably, that list would change as society changes and as companies change. If the SEC had tried to codify a list just ten years ago, I think it would look different than any list we would make today or ten years from now.

I understand that many of you in attendance who work at public companies face pressure to disclose or act on ESG-related issues. I read about and have heard directly from activists, large investors, company advisors, politicians, and others who have demanded certain actions or information from your companies. I hear about the various ESG rating firms who send time-intensive surveys and assign scores to your businesses based on metrics that wildly differ from each other. I also know that you spend a meaningful amount of your time responding to that demand. Many public companies voluntarily provide some form of corporate social responsibility or sustainability reports to investors—by voluntarily, I mean companies are not required to do so by the SEC or other government mandate. I am happy to see this sort of private ordering take place. It is important to realize and acknowledge that companies provide information and act *without the government telling them to do so* for many different reasons, including because their customers, employees, and others motivate them to do so. Sometimes, a company may deem certain ESG information material, such that it is disclosed in SEC filings. Other times, the company does not believe it rises to the level of materiality, and thus it is not included in SEC filings.

As a Commissioner, I too have felt increasing pressure from advocacy groups, politicians, and some investor groups to support rules that explicitly require public companies to disclose a wide range of ESG information in their SEC filings. In fact, the SEC's Investor Advisory Committee ("IAC") recently recommended that the SEC amend the reporting requirements to include ESG factors.[3] I appreciate the time and consideration our IAC members put into their recommendations. I would note that these are *recommendations*, not mandates, and they are meant to aid me and my fellow commissioners who have been appointed to make policy decisions for the agency.[4]

Everyone, Stop Grandstanding

In my experience, some advocates try to make ESG an issue of morality or politics. I have heard ESG policy proponents portrayed in varying lights, ranging from responsible stewards steeped in science to thinly veiled political operatives pushing their own agenda. Opponents of prescriptive ESG policies are also portrayed in varying lights from responsible stewards skeptical of allowing changing mores to dictate investment strategy to uneducated and morally inferior denialists. It is too easy to fall into the trap of categorizing people in ways that obviate the need to address the substance and merits of ESG issues. But, this makes policy discussions turn personal and almost always less productive. Also, increasingly, there has been a desire from some quarters to conflate greater societal debates about environmental regulation and social policies with public company disclosure requirements. However, I believe it is important to differentiate these policy areas, as they involve different policy-makers and different goals. Only by acknowledging this broader context of how we often confront ESG topics, will we be able to have more objective and productive policy discussions.

ESG Mandates: When Securities Laws Get Personal

I have given the matter of SEC-mandated ESG disclosure a lot of thought, and I have serious reservations about imposing prescriptive requirements in this area. In my experience, and based on the many discussions I have had on the topic, this type of mandated disclosure is often fraught with subjectivity and agendas that are often unrelated to "investor welfare." In other words, I have seen too many people appear to blur their personal views on environmental and social issues with how they believe the federal securities laws should operate to regulate the actions of others. Normally I keep my personal life out of my speeches, but in this case it seems illustrative to reference the fact that I *personally* have strong convictions on certain ESG matters. For example, I believe that human behavior, including through business operations, has an impact on our environment and we should think about what we can do to reduce pollution and conserve our great natural resources for future generations. I organize my actions in my personal life around this and other beliefs.

I believe it is important that I distinguish such beliefs and actions in my personal life from those that drive me as an SEC Commissioner and regulator. I was appointed to this position to support the mission of the SEC—protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation.[5] This agency oversees and enforces the federal securities laws, which have a relatively narrow scope, even if the effects are sometimes broad. These two items, scope of authority and effect of actions, should not be confused. In particular, we should be aware of the effects of our actions, and we should not try to expand our authority in order to amplify those effects. Let me be specific. If I were to use the securities laws to pursue my own environmental and social vision for the world, I would be subordinating the SEC's mission to my personally held objectives. In other words, I would be acting *outside* the scope of my responsibility and authority. Imagine the unintended consequences that could flow from such an abuse of power.

(Justice) Marshall Law: Materiality

Materiality is the touchstone of our public company disclosure regime. Public companies must disclose material information to their investors, a standard that has been defined by the Supreme Court and followed for decades.[6] I am a proponent of the SEC's principles-based materiality standard now more than ever. As a result of the Covid-19 pandemic and the shutdown of the economy that followed, America's public companies faced a crisis that few could have predicted. In SEC filings made before this past March, I am not aware of any company that provided risk factor disclosure regarding the risks associated with the spread of coronavirus. Since March, companies in different industries, and even within the same industry, have faced unique challenges and their disclosure evidences this.

Our principles-based framework *requires* disclosure of all material information (including with respect to environmental factors),[7] but it *allows* each individual company to tailor that information so that it is useful to their investors. This benefits investors because it highlights for them what they need to know to make informed decisions. In addition, important information is not lost in a sea of inapplicable information. For the avoidance of doubt, ESG issues can be material to companies and necessitate disclosure. In fact, I can think of many scenarios where it would be. For instance, if a company decided to take a public stance on a certain social or political issue, there may be a risk that it could lose a substantial percentage of its customers who disagree with that stance, resulting in a material adverse financial effect. That may be a risk the company is willing to take, but it may also have to disclose that to investors.

Now, imagine if I wanted to use the SEC disclosure rules as a tool to encourage public companies to behave in a way that *I believe* is best for society. Perhaps I could require public companies to disclose things *beyond* what a reasonable investor would consider important in making an investment or voting decision. There are some situations in which Congress has actually required the SEC to do that, and it has not turned out well.[8] In fact, I believe that some of the rules effectuated pursuant to such mandates are the hardest to rationalize from the standpoint of the SEC's mission.

Recently, the SEC proposed—for the third time—a congressionally mandated rulemaking that would require resource extraction issuers to disclose payments made to a foreign government or the U.S. federal government for

the purpose of the commercial development of oil, natural gas, or minerals.[9] While the Commission takes its statutory requirements seriously, I cannot plausibly say the rulemaking is central to the SEC's tripartite mission to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation. As one Senator who co-sponsored the provision requiring this rulemaking stated, this rule will "help empower citizens to hold their governments to account for the decisions made by their governments in the management of valuable oil, gas, and mineral resources and revenues."[10] Now, I am sure that members of Congress as well as those who work at the State Department and other agencies tasked with responding to corruption and violence in other countries are keenly aware of certain behavior and problems in those countries. And I hope they are thinking through ways to prevent and stop it. But I don't see myself as having special expertise in those matters, and I can't help but worry: If we adopt this rule and it indirectly forces companies to cease business operations in certain countries, will we have achieved the net benefit Congress was hoping for? Or, rather, will people in these communities lose their only available employment option?[11] What type of mandated disclosure will help solve that problem? The point I am trying to make is that securities law regulators are not best equipped to understand (much less address) all of the potential negative effects that may result from us approaching these issues through mandated disclosures under the securities law framework.

So Sue Me!

One thing that ESG disclosure proponents rarely mention is the liability that our public companies face for the disclosure they provide in SEC filings.[12] U.S. public companies face greater litigation risk than companies listed in almost every other jurisdiction. U.S. public companies are not only subject to enforcement by the SEC and other federal agencies as well as state authorities for material misstatements and omissions, they also must draft disclosure with the awareness that the law provides a private right of action for misstatements and omissions in SEC filings. These companies are on the hook—to a lot of different people—for everything they do (or do not) disclose in their filings. That seems like good incentive to me to disclose material information, ESG or otherwise. And let me be clear: a board of directors has a fiduciary duty to the shareholders of the company. If certain information that happens to fall in any of the ESG categories is material to that company, the company needs to disclose it. We expect management and the board to do that, and we will come after them when they don't.

These are my thoughts on the matter of prescriptive ESG public company disclosure.

Actually, We May Need More ESG Disclosure…

There is one area where I do believe the SEC would be well within its authority to elicit more ESG disclosure because I believe it is material to investors. That is in our regulation of asset managers—whom many of you may think of as your biggest shareholders. These are entities that own, on behalf of retail investors, stakes in many public companies. Many asset managers have asked the SEC to impose specific ESG disclosure requirements on such companies or asked companies directly for particular ESG information. Additionally, more and more asset managers are asserting that ESG metrics are driving their investment decisions, and, in fact, they will be using their ownership and voting power to effectuate changes in the companies they own (on behalf of investors).

I do not discount or ignore these calls for additional ESG information, but they raise questions in my mind about what the asset managers are doing with that information. How are they using it to improve returns for their investors? What analysis have they done to show it provides alpha? Or, is this a virtue signaling tactic to market themselves to particular potential clients, who have expressed a preference for environmentally or socially-focused portfolios? Are they backing up their claims in their own SEC disclosures, such as Form ADV filings or the prospectuses of the funds they offer?

In recent years, asset managers have proliferated in their creation of investment products labeled as "ESG," "Green," or "Sustainable."[13] There appears to be increasing demand for products of this description. Yet, there is no universal definition for any of these terms, and such products' investment philosophies and holdings can differ widely. I do not mean to imply that the SEC should define one method of integrating environmental or social factors into how an asset manager devises an investment product. In fact, I think it is beneficial for retail investors to have

a wide array of choice and for such funds to compete with one another. But, I do think that retail investors who want "green" or "sustainable" products deserve more clarity and information about the choices they have.

One risk I worry about here is the extent to which retail investors understand that some of these funds may be *prioritizing* environmental or social goals above the fund's economic returns. To me, it seems likely that a significant portion of those who invest in ESG funds want to "do well" while "doing good"—seems like a win/win. But, some of these funds invest and vote proxies primarily to achieve some environmental or social good, possibly *at the expense of* investment returns. This is less of a win/win, especially if a fund's disclosure is not transparent on this point. Do asset managers believe this is the appropriate tradeoff for their investors, and how are they evaluating their own performance in this regard? Do retail investors know if they are leaving money on the table? [14]

Another risk that concerns me is "greenwashing"—asset managers conveying a false impression to retail investors that a given product is environmentally friendly. As an example, I recently saw a "green bond fund" that advertised an impressive annual environmental impact: avoiding millions of metric tons of CO2 emissions; reducing air pollutants by hundreds of metric tons; and generating hundreds of millions of mega-watts of renewable energy. When I read the fine print description of how these numbers were calculated, a footnote caught my eye. It said something along the lines of given the difficulty of attributing the impact of each bond in the fund's portfolio (which ranged from a hundredth of a percent to less than a few percent), the data regarding emissions, air pollutants, and renewable energy reflected the *total* impact generated by the project, program, or issuer rather than the fund's share alone. In other words, in the marketing materials of this "green" fund, the asset manager was taking credit for all the environmental accomplishments of every project it had invested in, even though it had capitalized (at best) only a small fraction of each one.

When an asset manager markets a fund as having an ESG strategy, it has an obligation to disclose material information about that fund to investors and potential investors. Additionally, it would make sense to me that asset managers who want to use these terms to name their funds or advertise their products should be required to explain to investors what they mean.[15] For example, how do the terms "ESG," "green," and "sustainable" relate to a fund's objectives, constraints, strategies, and the characteristics of its holdings? Are "E," "S," and "G" weighted the same when selecting portfolio companies? Does the fund intend to subordinate the goal of achieving economic returns to non-pecuniary goals, and, if so, to what extent?[16]

Only by seeing this type of information for every so-called "ESG" or "sustainable" fund can retail investors have enough information to compare different funds, understand any trade-offs they may be making, and decide which one suits their personal objectives. The SEC's examination teams would also be able to evaluate these types of funds for compliance purposes, as they do with other funds. Whether you are supportive of, opposed to, or neutral to ESG-focused investing strategies, I think many would be interested in such disclosures and whether these asset managers' actions match their rhetoric.

Conclusion

Thank you all for listening. I hope this helps you better understand my thinking regarding my role—as an SEC Commissioner—in requiring new and prescriptive ESG disclosure. In discharging my responsibilities as an SEC Commissioner, I often remind myself that the SEC is not a merit regulator and that my personal convictions matter only so far as they support the SEC's mission. If you would like to share your thoughts on anything I have said today, I would love to get your perspective. As I used to say: My office door is always open. Though, presently, you cannot literally take me up on the offer to visit, I do hope you will reach out to schedule a call to tell me your thoughts. Such discussions provide me with additional insights and lead me to rethink or refine my views. Thank you again for your time today. I look forward now to taking any questions you may have. Keir, I will turn it back over to you.

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[1] *See* Schanzenbach, Max Matthew and Sitkoff, Robert H., Reconciling Fiduciary Duty and Social Conscience: The Law and Economics of ESG Investing by a Trustee (Feb. 1, 2020). 72 Stanford Law Review 381 (2020); Northwestern Law & Econ Research Paper No. 18-22; Harvard Public Law Working Paper No. 19-50, *available at* https://ssrn.com/abstract=3244665 or http://dx.doi.org/10.2139/ssrn.3244665.

[2] The European Commission (a legislative body, unlike the SEC) has taken legislative action to require disclosure on such issues and is expected to pass more in the near future. *See* "Financing the green transition: The European Green Deal Investment Plan and Just Transition Mechanism" (Jan. 14, 2020), *available at* https://ec.europa.eu/commission/presscorner/detail/en/ip_20_17 and "Sustainable finance: TEG final report on the EU taxonomy" (Mar. 9, 2020), *available at* https://ec.europa.eu/knowledge4policy/publication/sustainable-finance-teg-final-report-eu-taxonomy_en. In addition, the United Kingdom's Financial Conduct Authority has proposed rules that would require certain U.K. issuers to provide enhanced climate change disclosures consistent with the recommendations of the Financial Stability Board's Task Force on Climate-related Financial Disclosures. *See* "Proposals to enhance climate-related disclosures by listed issuers and clarification of existing disclosure obligations" (Mar. 2020), *available at* https://www.fca.org.uk/publication/consultation/cp20-3.pdf.

[3] *See* "Recommendation of the Investor-as-Owner Subcommittee on ESG Disclosure" (May 14, 2020), *available at* https://www.sec.gov/spotlight/investor-advisory-committee-2012/recommendation-of-the-investor-as-owner-subcommittee-on-esg-disclosure.pdf.

[4] I have increasingly found that many people equate the work of the SEC's advisory committees with the work of the SEC's own staff, believing that advisory committee recommendations have the regulatory force of being from the agency. This is not accurate. The committees are advisory only, and their recommendations are as well.

[5] 5 U.S.C. § 3331 (2015). Specifically, the oath requires that each Commissioner say the following: "I, [name], do solemnly swear (or affirm) that I will support and defend the Constitution of the United States against all enemies, foreign and domestic; that I will bear true faith and allegiance to the same; that I take this obligation freely, without any mental reservation or purpose of evasion; and that I will well and faithfully *discharge the duties of the office on which I am about to enter*. So help me God." (emphasis added)

[6] *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 (1976).

[7] *See* Commission Guidance Regarding Disclosure Related to Climate Change, Release No. 33-9106 (Feb. 8, 2010), *available at* https://www.sec.gov/rules/interp/2010/33-9106.pdf.

[8] For instance, Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") amended the Securities and Exchange Act of 1934 (the "Exchange Act") and directed the Commission to issue rules requiring certain companies to disclose their use of "conflict minerals" if those minerals are "necessary to the functionality or production of a product" manufactured by those companies. The SEC adopted rules pursuant to Section 1502 of the Dodd-Frank Act in 2012. In 2015, the U.S. Court of Appeals for the District of Columbia Circuit reaffirmed its prior holding that Section 13(p)(1) of the Exchange Act and SEC Rule 13p-1 "violate the First Amendment to the extent the statute and rule require regulated entities to report to the Commission and to state on their website that any of their products have 'not been found to be "DRC conflict free."'" *Nat'l Ass'n of Mfrs., et al. v. SEC*, 800 F.3d 518, 530 (D.C. Cir 2015). In 2017, the U.S. District Court for the District of Columbia entered final judgment in the case and remanded to the Commission. *Nat'l Ass'n of Mfrs., et al. v. SEC*, No. 13-CF-000635 (D.D.C. Apr. 3, 2017). In addition, Section 1504 of the Dodd-Frank Act added Section 13(q) to the Exchange Act to require certain companies to disclose certain resource extraction payments. The Commission first adopted the rules to implement the statute in 2012, but the rules were vacated by the U.S. District Court for the District of Columbia less than one year later. *API v. SEC*, 953 F. Supp. 2d 5 (D.D.C. July 2, 2013). The Commission adopted a revised version of Rule 13q-1 and amendments to Form S-D in 2016. Less than one year later, the revised rules were disapproved by a joint resolution of Congress pursuant to the Congressional Review Act. H.R.J. Res. 41, 115th Cong. (2017) (enacted). 5 U.S.C. 801 et seq. *See also* discussion *infra*.

[9] Disclosure of Payments by Resource Extraction Issuers, Release No. 34-87783 (Dec. 19, 2019), *available at* https://www.sec.gov/rules/proposed/2019/34-87783.pdf.

[10] *See* 156 Cong. Rec. S3816 (daily ed. May 17, 2010).

[11] *See* "How a well-intentioned U.S. law left Congolese miners jobless" by Sudarsan Raghavan of The Washington Post (Nov. 30, 2014), *available at* https://www.washingtonpost.com/world/africa/how-a-well-intentioned-us-law-left-congolese-miners-jobless/2014/11/30/14b5924e-69d3-11e4-9fb4-a622dae742a2_story.html.

[12] Another important thing to note is that, with respect to disclosure requirements, the SEC primarily deals with public companies (which make up only a subset of companies). In order to make the greatest impact and create a level playing field, Congress or other federal agencies with direct oversight responsibility should deal with the "E" and the "S" issues directly, rather than having the SEC try to require information from only a subset of companies.

[13] *See*, *e.g.*, Request for Comments on Fund Names, Release No. IC–33809 (Mar. 2, 2020), *available at* https://www.sec.gov/rules/other/2020/ic-33809.pdf (the "Names RFC"). Note 23 references EDGAR data showing the number of ESG funds has increased over 300% in the last two decades.

[14] The SEC's Asset Management Advisory Committee has formed a subcommittee focusing on ESG-focused investment products and disclosures. Their most recent presentation is available here: https://www.sec.gov/files/ESGSubcommitteeUpdate_0.pdf.

[15] *See* Names RFC, *supra* note 14. I am sure that the feedback we received will be informative, and I hope the Commission can set forth clearer parameters around how investment products, such as "ESG" mutual funds and ETFs, are named.

[16] The Department of Labor recently proposed a rule that would require plan fiduciaries to select investments and investment courses of action based solely on financial considerations relevant to the risk adjusted economic value of a particular investment. *See* Employee Benefits Security Administration, Department of Labor, "Financial Factors in Selecting Plan Investments" (June 30, 2020), *available at* https://www.govinfo.gov/content/pkg/FR-2020-06-30/pdf/2020-13705.pdf.