Securities Regulation Daily Wrap Up, TOP STORY—Require ESG disclosures for asset managers, not issuers, urges Roisman, (Jul. 8, 2020)

Securities Regulation Daily Wrap Up

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By Lene Powell, J.D.

Retail investors interested in "green" or "sustainable" funds deserve detailed information from asset managers, but issuers should not be subject to prescriptive disclosure requirements, said the commissioner.

In recent remarks, SEC Commissioner Elad Roisman cautioned against imposing new mandates for public companies to disclose specific environmental, social, and governance (ESG) information. In Roisman's view, such requirements would be problematic because ESG issues are subjective and ill-defined, and securities regulators are not well equipped to understand negative effects that may flow from prescriptive disclosure requirements. However, Roisman does believe that asset managers who market funds as having an ESG strategy are obliged to explain what a fund means by terms like "green" and "sustainable" and whether they are prioritizing non-pecuniary goals over economic returns.

Roisman's remarks were delivered at the Society for Corporate Governance National Conference.

Issuers should focus on material disclosures. Roisman said he understands that public companies are facing pressure to disclose or act on ESG-related issues. As an SEC commissioner, he himself has felt increasing pressure from advocacy groups, politicians, and some investor groups to support rules to explicitly require public companies to disclose ESG information in SEC filings. Roisman observed that the SEC Investor Advisory Committee recently recommended by a 14-4 vote that the SEC amend the reporting requirements to include ESG factors.

Roisman pushed back against imposing any new disclosure requirements, however. He made the following arguments:

- The term ESG is an "enormous umbrella," and issues are usually subjective and constantly evolving based on current events. In Roisman's view, corporate governance issues rarely have a direct relationship to environmental or social issues.
- The securities laws already require disclosure of material information to investors. The SEC's mission is to oversee and enforces the federal securities laws, which have a relatively narrow scope, even if the effects are sometimes broad.
- Many public companies already voluntarily provide some form of corporate social responsibility or sustainability reports to investors.
- Areas where Congress has required the SEC to use disclosure rules as a tool to encourage public companies to behave in beneficial ways have "not turned out well." For example, SEC rules that require disclosure of payments by resource extraction issuers to governments may indirectly force companies to stop business operations in certain countries. In turn, this could result in people in those countries losing their only available employment.
- Public companies face lawsuits for information they do or do not disclose in SEC filings.

Asset managers should be clear about ESG goals. Although Roisman was hesitant about the idea of imposing ESG disclosure requirements for issuers, he believes that retail investors who want "green" or "sustainable" products deserve more clarity and information about investment offerings by asset managers.

Roisman has several concerns about the use of ESG factors asset managers in investment decisions and marketing:

- Some asset managers, instead of using ESG information to improve returns to investors, may be using it more as a "virtue signaling tactic" to attract investors. Roisman believes that asset managers that market ESG should be required to state what they mean by ESG terms and explain how they relate to a fund’s objectives, constraints, strategies, and the characteristics of its holdings.
- Some asset managers may be prioritizing environmental or social goals above the fund’s economic returns, and retail investors may not fully understand this. In Roisman’s view, asset managers should be required to explain if an ESG fund intends to subordinate the goal of achieving economic returns to non-pecuniary goals, and, if so, to what extent.
- Some asset managers might be "greenwashing," or conveying a false impression to retail investors that a given product is environmentally friendly, when it is not. For example, marketing materials for one "green" bond fund that Roisman examined took credit for all the environmental accomplishments of every project the fund had invested in, even though it had capitalized (at best) only a small fraction of each one.

Roisman said that requiring ESG funds to disclose detailed information would allow retail investors to compare different information and understand trade-offs. This information would also be useful to SEC examination teams in evaluating fund compliance.

"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," said Roisman.

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