MEMO# 33635

June 30, 2021

SEC Commissioner Lee Speech on Directors' Duties Regarding ESG

[33635]

June 30, 2021

TO: ICI Members
ICI Global Members
ESG Advisory Group
ESG Task Force
SEC Rules Committee SUBJECTS: Disclosure
ESG
Fund Governance RE: SEC Commissioner Lee Speech on Directors' Duties Regarding ESG

Commissioner Lee recently provided her views on how boards of directors should navigate ESG-related issues that are "fundamental to the success and sustainability of companies, financial markets, and our economy."[1] She noted that "while many companies report that they oversee ESG at the board level, some analysis suggests they may lack specific sustainability mandates and do not demonstrate board-management engagement on ESG. In addition, there are some indicators that reported board expertise on ESG may be ill-defined and still lacking."

Commissioner Lee also noted that a focus on ESG issues is sometimes labeled "woke washing"[2] or woke policymaking and recommended considering:

> whether public pledges on ESG issues are actually backed up by corporate action. That's part of my message today - that substantive consideration of ESG should be meaningfully integrated into board oversight. And why I've previously suggested that our disclosure regime should provide investors with adequate information to test public pledges like these.

The Commissioner Lee's remarks are summarized further below.

Understanding ESG and Board Obligations

Commissioner Lee states that boards increasingly have oversight obligations related to climate and ESG risks, pointing out that,

> Under the federal securities laws, the board plays a critical and mandatory role in the existing corporate disclosure process. This increasingly requires directors to think about and consider the impact of climate change and other ESG matters on the financial statements and other corporate disclosures. Because matters such as climate change may bear on the valuation of assets, inventory, supply chain, and future cash flows, board oversight of audits increasingly necessitates engagement on those issues.

She also pointed to fiduciary duties of loyalty and care and that a board must be well informed when making corporate decisions, including decisions that relate to long-term business strategies, and "a board may well need to ensure it has relevant information related to the climate and ESG-related risks and opportunities its company faces." In addition,

directors may need to investigate "red flags" that suggest harm to the corporation, which "may require directors to do a deeper dive on climate change and other ESG issues as the regulatory landscape evolves."

Commissioner Lee observed that "[a]ll of this suggests that climate change and other ESG matters should be regular and robust topics for the board, whether at meetings of the full board or in key committees? ."

Mitigating ESG Risks and Maximizing ESG Opportunities

Commissioner Lee also pointed out that there is a rising expectation that boards will play a key role in managing physical risk, transition risk, regulatory risk, reputational risk, and human capital risk. She then outlined three "key steps for boards that seek to maximize ESG opportunities" including enhancing board diversity, increasing board expertise,[3] and inspiring management success.[4]

Dorothy M. Donohue
Deputy General Counsel - Securities Regulation

endnotes

[1] Commissioner Allison Herren Lee, Keynote Address at the 2021 Society for Corporate Governance National Conference, Climate, ESG and the Board of Directors: You Cannot Change the Wind But You Can Adjust Your Sails (June 28, 2021), available at https://www.sec.gov/news/speech/lee-climate-esg-board-of-directors.

[2] Woke-washing refers to a company providing the appearance of social consciousness that is not supported by its activities.

[3] Commissioner Lee explained that these efforts could include integrating ESG considerations into the nominating processes to recruit directors that will bring ESG expertise to the board; training and education to enhance board members' expertise on ESG matters; and engaging with outside experts to advise boards.

[4] She explained that executive compensation is a powerful tool for achieving strategic company goals and that it works for specific goals or targets a company may set in addition to corporate financial goals.
