

MEMO# 34854

February 1, 2023

SEC Commissioner Uyeda's Speech on Issues Related to Asset Managers' Use of ESG Investment Strategies

[34854]

February 1, 2023

TO: ICI Members
Investment Company Directors
ESG Advisory Group
ESG Public Company Disclosure Working Group
SEC Rules Committee SUBJECTS: ESG RE: SEC Commissioner Uyeda's Speech on Issues Related to Asset Managers' Use of ESG Investment Strategies

Commissioner Uyeda delivered remarks which include his views on issues related to asset managers' use of environmental, social, and governance (ESG) investment strategies. He noted, among other things, that "regulatory issues presented by ESG investing are nothing new," and that "[a] straightforward regulatory approach would treat ESG investing like any other investment strategy and apply this well-established framework, rather than impose a specific ESG regulation."[\[1\]](#) Commissioner Uyeda's remarks are summarized below.

The Growth of ESG Investing

Commissioner Uyeda, in discussing the growth of ESG investing and citing statistics regarding the growth in fee revenue from ESG-themed funds, observed that "ESG products typically charge higher fees than more 'plain vanilla' products," and that a "skeptic might believe that some ESG products are merely offered in order to extract higher management fees."

The Fiduciary Duty of Investment Advisers

Commissioner Uyeda discussed the fiduciary duty owed by an investment adviser to its clients and noted that "an adviser can only pursue an ESG investment strategy if the client expresses a desire to pursue such a strategy after receiving full and fair disclosure regarding the salient features of the strategy, including the strategy's risk and return profile." He noted that "ESG investing is complicated by three factors. First, the inability to objectively define "ESG" or any of its components. Second, the temptation to place the regulators' fingers on the scale in favor of specific ESG goals or objectives. And third, the

desire of certain asset managers to use client assets to pursue ESG-related goals without obtaining a mandate from clients."

The Definition of "ESG"

Commissioner Uyeda observed that "[r]egulators, industry participants, and investors have struggled to define 'ESG.'" He further indicated that "[s]ince stakeholders have different views as to what constitutes a desirable social or political outcome, success in categorizing investments as 'good' or 'bad' from an ESG perspective can be elusive." He cited a study which "showed that two large ESG rating firms agreed on their ESG ratings only 18% of the time." He then noted that given the existing regulatory framework, under which "an adviser is required to provide full and fair disclosure about what it means when it uses [the] term [ESG]... it is not clear why additional rulemaking is needed in this area."

Attempts by Regulators to Favor ESG Investing

Commissioner Uyeda expressed "significant concerns that the goal of establishing ESG rating standards goes far beyond preventing 'greenwashing.'" He indicated his view that "[b]ecause ESG ratings may be divorced from matters of financial materiality, they can reflect a particular political or social agenda." He discussed the U.S. Department of Labor's adoption in 2020 of a rule that "set forth clear standards for ERISA fiduciaries in selecting and monitoring investments for employee sponsored benefit plans" and subsequent language changes which "seem[ed] merely to create confusion as to why ESG factors - and not any other type of investment factor - are singled out as being permissible for consideration."

In discussing three proposed rules from the U.S. Securities and Exchange Commission which "attempt to address ESG issues," Commissioner Uyeda asked whether "these unique, highly-prescriptive disclosure requirements specifically targeted at ESG investment strategies [are] needed?" In specific reference to the SEC proposal regarding disclosure by corporate issuers, he noted that he was "concerned that the proposal would cast aside the Commission's time-honored approach to securities regulation, which requires issuers to disclose information that is material to an investment decision from an economic standpoint."

Activism by Asset Managers

Commissioner Uyeda observed that "some asset managers have been walking a fine line between hewing to their fiduciary duties to their clients and furthering social and political goals that may be unrelated to the interests of their clients." He said that it is "unclear why asset managers that engage in 'investment stewardship' have been filing beneficial ownership reports on Schedule 13G, which can only be used if the manager does not hold securities with the purpose or effect of changing or influencing the control of the issuer of the securities." He noted that "[t]hese asset managers may indeed have a control purpose when engaging in investment stewardship campaigns that seek to remove board members or impose operational changes" and suggested that "perhaps they should be reporting on Schedule 13D."

He then concluded his remarks by noting that "the existing regulatory framework is well suited to guide the conduct of investment advisers. Any emerging regulations should be careful not to tip the scale in favor of any particular political or social cause, and adherence to the established framework of focusing on financial materiality will continue to serve

investors well."

Joshua Weinberg
Associate General Counsel, Securities Regulation

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.