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Commissioner Peirce's Speech on ESG Issues

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TO: ICI Members
Investment Company Directors
ESG Advisory Group
ESG Public Company Disclosure Working Group
SEC Rules Committee SUBJECTS: ESG RE: Commissioner Peirce's Speech on ESG Issues

Commissioner Peirce delivered remarks which include her views on issues related to environmental, social, and governance (ESG) matters as they pertain to asset managers, companies and governments. She noted, among other things, that "asset managers, companies, and governments are embracing ESG without considering the long-term consequences to, respectively, their clients, shareholders, and citizens."[1] Commissioner Peirce's remarks are summarized below.

The Ambiguity Surrounding ESG

Commissioner Peirce observed that "[n]o firm could identify—let alone evaluate—every issue that might fall under the elastic definition of ESG," and that the "fluctuating views on whether something garners ESG cheers or derision further complicates any analysis." She suggested that "ESG debates would be fewer if each ESG item once again could rise or fall on individual market participants' assessments of its link to long-term financial value at a particular company, not on its prominence in societal debates of the day and its consequent ESG label." She said that "ESG becomes most divisive when it mutates into short-hand for forcing companies to ditch long-term value maximization and cater to the current, loud demands of so-called 'stakeholders'—that amorphous collection of non-investors clamoring for a say in how all public companies operate and how their resources are spent," and offered that "[t]his version of ESG is political, not financial."

Commissioner Peirce stated that "[l]umping disparate items into a single ESG bucket creates an analytical muddle," and "[c]laims about the efficacy of corporate sustainability programs or the success of ESG investment strategies are suspect because something as imprecise as ESG cannot be studied with precision." She further observed that "ESG targets are also ambiguous" and "[o]btaining accurate and comparable data to assess whether an ESG objective has been met is difficult." She then noted that "[a]sset managers, companies, and governments, often at the prompting of interest groups with a clear stake in a particular issue, do things in the name of ESG that they otherwise could not get away with doing."

Asset Managers and ESG Ambiguity

Commissioner Peirce averred that "[a]sset managers sometimes have hidden behind ESG's ambiguity to justify behavior that may not align with their fiduciary duty." She stated that "[a]bsent a directive from or assent by its client to consider other factors, an asset manager should focus on financial returns," and that "ESG commitments can interfere with this singular focus." Commissioner Peirce said that "[a]sset managers are not serving investors well … when they make an unsupported claim of a causal connection to financial returns so they can consider an ESG factor that they want to consider for other reasons." After noting that "[a]sset managers of course do cater to investors who have objectives other than or in addition to maximizing financial returns," Commissioner Peirce said that "[a]sset managers should be able to serve this kind of investor as she wishes without dragging other investors unwittingly into supporting her non-financial causes."

She then stated that "[a]sset managers need to state clearly whether and how they will invest in, vote in, and engage with portfolio companies on behalf of their individual and fund clients … [t]hen investors can select an adviser or fund that accords with their objectives."

Companies and ESG Ambiguity

With respect to operating companies, Commissioner Peirce observed that "[c]ompanies sometimes have hidden behind ESG ambiguity to avoid accountability to shareholders" and sometimes "target ESG goals that are inconsistent with financial returns." She noted that companies "point to the interests of an expansive set of stakeholders to justify doing things, some of which may conflict with shareholder interests," and that "[c]atering to non-shareholder interests, which at bottom is what stakeholders represent, if not done to maximize long-term value, weakens board and management accountability and enhances management's discretion."

With respect to corporate ESG reporting, Commissioner Peirce noted that "emphasizing ESG reporting could harm financial reporting, about which investors care very deeply, by diverting corporate attention or normalizing the weaker standards and looser practices that are accepted by necessity in ESG reporting." She further noted that the "ESG processes that companies are integrating into everything they do today will impede their ability to react to changing market conditions."

Governments and ESG Ambiguity

Commissioner Peirce noted that "[g]overnments too have figured out how to hide behind ESG ambiguity for their own ends." She observed that "[r]equiring companies to consider ESG factors or even merely to collect and report data on ESG issues encourages boards and managers to devote resources to considering ESG matters and facilitates activist pressure by non-shareholder groups on companies to pursue ESG objectives" and that the "effect here is to provide the government with indirect control of corporate resource allocation decisions." She stated that "detailed ESG mandates have become a subtle mechanism for conforming corporate behavior to regulatory objectives and shifting capital flows."

In Commissioner Peirce's view, "[a]n investor-centric, principles-based disclosure regime rooted in the concept of financial materiality (as opposed to double materiality) provides investors with tailored, relevant information, rather than mechanical responses to a set of items prescribed for all companies." She stated that "[u]nder a principles-based approach, ESG items that factor meaningfully into value-maximizing decisions are reported in the same way other items are."

Commissioner Peirce cautioned that "[a]s the world unites in a mandatory ESG regime of unparalleled intricacy, global economic prosperity will suffer" as "[m]andated ESG metrics reflect the regulator's view of what should be important to decision-making." She suggested that because of the "direct and indirect costs, jurisdictions that have adopted stringent ESG mandates will find themselves competitively disadvantaged." She then said that she "care[s] about these developments because they affect many American companies," but also "because increasing the rules' reach will make it easier to fool people about the costs of an intense ESG regime on economic growth."

In respect of a single global disclosure framework, she noted that it "would ease compliance costs for companies that otherwise would be subject to multiple regimes, but it also would aggravate the problems created by such a mandatory ESG framework." She then cautioned that "[if] common a global framework guides companies world-over to prioritize things other than corporate value maximization, creates a convergence in global decisions about capital flows, and imposes a universal layer of rigidity on corporate and investor decision-making, markets will lose the heterogeneity and adaptability that they need to fund innovative solutions to new and intractable problems."

Conclusion

Commission Peirce suggested that in order to "free ourselves of the ESG constraint on economic growth … we can reject the highly prescriptive ESG frameworks that so many jurisdictions are imposing on companies today in favor of a return to a principles-based disclosure regime that does not isolate and elevate an issue simply because it bears the ESG label." She then noted that "we can insist that asset managers, corporations, and governments using other people's assets to further an ESG objective show the link to financial value of that particular ESG objective or explain clearly that obtaining the ESG objective comes at a financial cost."

Commissioner Peirce concluded by stating that "[w]e can solve the panoply of very serious problems we face," and the "best way to do so is to allow capital to flow in response to all of humanity's input, rather than in response to regulatory directives, even ones calling themselves ESG."

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Notes

[1] See Commissioner Hester M. Peirce, The Hitchhiker's Guide to ESG: Remarks at Annual US-Central and Eastern European Connection Weekend (June 29, 2024), available at https://www.sec.gov/newsroom/speeches-statements/peirce-remarks-esg-062924.