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SEC Commissioner Uyeda Comments on ESG Investment Strategies

February 3, 2023

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Mark T. Uyeda, Commissioner at the U.S. Securities and Exchange Commission (SEC), **spoke** at the California '40 Acts Group on January 27 regarding various investment-related ESG issues.

Commissioner Uyeda offered his view that "ESG investing is complicated by three factors. First, the inability to objectively define 'ESG' or any of its components." As support for this concept, Commissioner Uyeda pointed to the, at-times, low correlation in ESG scores given to the same companies by different ESG ratings providers. The "impracticality of a universal 'ESG' definition," according to Commissioner Uyeda, "creates the potential for abuses that can drive assets to particular companies based on social or political agendas."

The second factor cited by the Commissioner is "the temptation to place the regulators' fingers on the scale in favor of specific ESG goals or objectives." Commissioner Uyeda cited the Department of Labor's (DOL) newly finalized rule on ESG investing as an example. The **rule**, which became effective on January 30, has been **challenged** by twenty-five Republican state attorneys general in Texas federal court. According to Commissioner Uyeda, there is a divergence between the final text of the rule – which he characterizes as providing "that an ERISA fiduciary's investment decision must be based on factors that the fiduciary reasonably determines are relevant to a risk and return analysis" – and the DOL's accompanying **press release**, which stated that the rule "remove[s] barriers to considering [ESG] factors in plan investments" and eliminates unnecessary restrictions on plan fiduciaries' "ability to weigh [ESG] factors when choosing investments, even when those factors would benefit plan participants financially." The Commissioner questioned the need for any ESG-specific rulemaking by the SEC given "existing requirements under the federal securities laws to disclose accurate

information about how client assets are invested" and the ability of the SEC under current rules to pursue greenwashing claims.

Finally, Commissioner Uyeda cited "the desire of certain asset managers to use client assets to pursue ESG-related goals without obtaining a mandate from clients." He cited a report from the minority staff of the U.S. Senate Banking Committee commenting on the investment stewardship activities of the three largest asset managers, and raised a concern about passive investment managers reporting on Schedule 13G notwithstanding that investment stewardship could be **viewed as inconsistent with passive investing**.

Taking the Temperature: Commissioner Uyeda's speech touched on many topics that frequently come up when there is a discussion about an asset managers' consideration of climate and other ESG issues in investment decision-making and proxy voting activity. In our view, from the perspective of financial institutions, these issues are best addressed through good governance and thorough disclosure consistent with applicable regulatory guidance. For instance, we have commented on difficulties involved in making sense of the ESG ratings landscape, including in part because of the type of concerns identified by the Commissioner. But to us the answer lies in greater granularity and disclosure because the divergence of approaches is reflective of: (1) the wide range of information to consider regarding a company's ESG profile; (2) the lack of consensus on how to assess that information; and (3) divergent views on what constitutes "good" and "beneficial" in the broader ESG market. By offering greater transparency regarding the inputs to their rankings and how those inputs are assessed and weighed, ESG ratings providers can offer consumers of that information a basis to make informed decisions as to how to effectively utilize **the ratings. Nonetheless, we** anticipate **continued regulatory initiatives and, in the U.S., politically-driven activity until a consensus emerges on an approach to ESG ratings. Commissioner Uyeda also commented on whether passive investment management is inconsistent with exercising stewardship principles in proxy voting. That issue was highlighted in connection with Vanguard's withdrawal from the Net Zero Asset Managers Initiative, where it cited as a reason its goal of providing clarity "about the role of index funds and about how we think about material risks, including climate-related risks," as we previously** reported**. Because passive investment strategies represent a large percentage of global assets under management, there would be significant implications for overall shareholder-company engagement if such managers were not able to engage with companies on climate and other potentially material issues.**