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SEC Exams to Include ESG Focus in 2023

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On February 7, the Division of Examinations of the U.S. Securities and Exchange Commission (SEC) **announced** the publication of its **2023 examination priorities**, which include a focus on ESG-related advisory services and fund offerings.

In its press release, the SEC stated that “the Division will continue its focus on ESG-related advisory services and fund offerings, including whether funds are operating in the manner set forth in their disclosures. In addition, the Division will assess whether ESG products are appropriately labeled and whether recommendations of such products for retail investors are made in the investors’ best interests.”

Under the heading of notable new and significant focus areas and a subheading “Environmental, Social, and Governance (ESG) Investing,” the Division states: “[registered investment advisors] and registered funds are competing for the rising investor demand for ESG-related investments and strategies that incorporate certain ESG criteria, and, thus are increasingly offering and evaluating investments that employ such strategies and investments. Therefore, the Division will continue its focus on ESG-related advisory services and fund offerings, including whether the funds are operating in the manner set forth in their disclosures. In addition, the Division will assess whether ESG products are appropriately labeled and whether recommendations of such products for retail investors are made in investors’ best interest.” The Division added that the “priorities reflect the Division’s assessment of certain risks, issues, and policy matters arising from market and regulatory developments, information gathered from examinations, and other sources, including tips, complaints, and referrals, and coordination with other Divisions and Offices at the SEC as well as other regulators. While the Division will allocate significant resources to the examination issues described herein, it will also conduct examinations focused on and devote resources to new or emerging risks, products and services, market events, and investor concerns.”

SEC Chair Gary Gensler commented that “[i]n a time of growing markets, evolving technologies, and new forms of risk, our Division of Examinations continues to protect

investors," with Division of Examinations' Director Richard R. Best stating that the "priorities reflect the changing landscape and associated risks in the securities market and are the product of a risk-based approach to examination selection that balances our resources across a diverse registrant base. We will emphasize compliance with new SEC rules applicable to investment advisers and investment companies as well as continue our focus on emerging issues and rules aimed at protecting retail investors."

Taking the Temperature: There is nothing particularly surprising in the Division's announcement given the SEC's overall attention to ESG-related issues within its investor protection purview. To name a few, the SEC announced its proposed climate-related disclosure rule in March 2022. The SEC's final rule is expected to be issued in April 2023. Before that, the SEC established a task force focused on climate and ESG issues in March 2021. But the Commission is divided on the appropriate way to address ESG considerations in financial services. Notwithstanding its proposed climate rule and ESG task force, SEC Commissioners Uyeda and Peirce have expressed the view held by some lawmakers who take the position that disclosure rules specifically targeting climate and other ESG subjects are unnecessary and will impose an excessive regulatory burden on corporations. The disagreement within the SEC mirrors the debate occurring in the U.S. more broadly. For instance, Democratic members of Congress have established a sustainable investment caucus whereas certain Republican members of Congress have launched various inquiries or initiatives targeting financial organizations deemed excessively concerned with ESG issues. As we have commented, however, those in the latter camp arguably are missing the point: whether or not the SEC climate rule survives as proposed, or in modified form, or even if it is invalidated via court challenges (an outcome we think unlikely), companies need to consider and report on material risks, developments and opportunities, whether arising from climate issues, social impact movements, or other forces. Likewise, asset managers need to consider those same issues when making investment decisions as well as reporting on the sustainability characteristics of their investment portfolios – issues that have put them at the forefront of calling for greater issuer disclosure on ESG-related matters.