

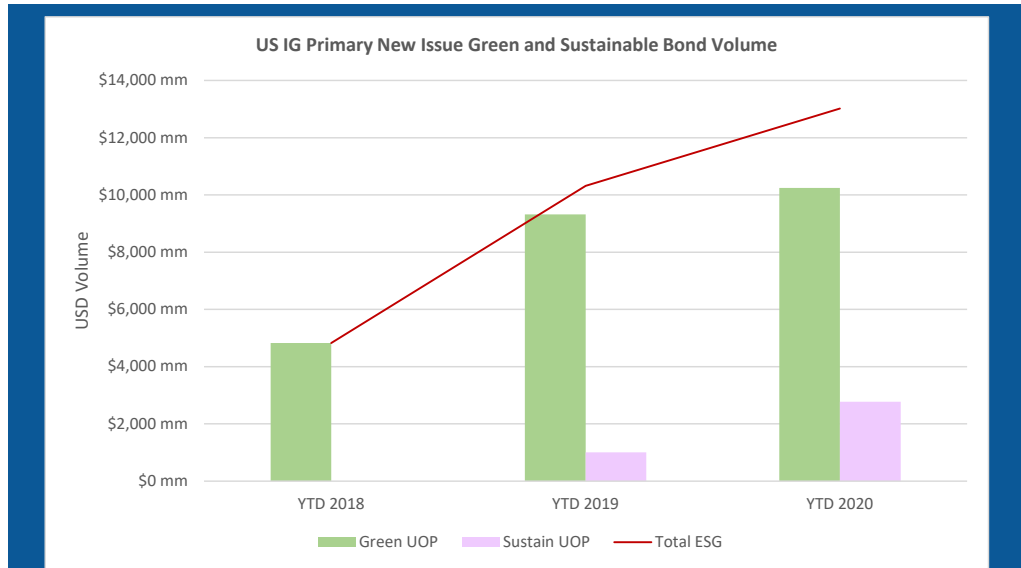
Academy ESG

Late June and July 2020 have brought forth two recent developments relating to Sustainable Investment/ESG policy that we think are critical in revealing what regulators could be planning for ESG funds and asset managers. Away from regulations, here are some themes we are tracking as a firm:

- ◆ There has been increased interest in Sustainability/ESG across the market, and with it, a demand for minority-owned businesses and diverse suppliers.
- ◆ There has been an increased focus on the diligence of Diversity & Inclusion enterprises, and Academy Securities is equipped for that scrutiny, being hyper-compliant in maintaining its Department of Veteran Affairs SDVOSB and MBE-Hispanics certification, as well as a commitment to its veteran hiring social mission.
- ◆ As Sustainable Investing practices and ESG continue to evolve, the Academy team aims to be a resource on this front by helping our clients and partners navigate not just ESG topics, but implementing a Diversity & Inclusion strategy which is core to most corporate governance objectives.

ESG & ERISA

A major ESG policy related development came out of the Department of Labor in late June when it proposed a new investment duties rule to update and provide clarity around ESG investing. The Department's updated policy included new text that, under ERISA, would require plans to invest on relevant financial considerations, prohibit fiduciaries from subordinating the interests of plan participants to non-pecuniary goals,



ESG & Cap Markets: Year to Date total US IG ESG Instrument volume continues to exceed 2019 by over 30%. This month Kimco Realty came to market with a \$500mm green bond offering that was reported to be over 6x oversubscribed, allowing it to up size the deal to \$500mm from \$300mm.

and requirements on selecting investment alternatives for plans that support one or more ESG objectives in their mandates or fund names.

While the proposal clearly acknowledges ESG factors in some instances as pecuniary, it seems like a slight back pedal from the overall tone of the DOL's Interpretive Bulletin 2015-01, when they stated *"The IB also acknowledges that in some cases ESG factors may have a direct relationship to the economic and financial value of the plan's investment. In such instances, the ESG issues are not merely collateral considerations or tiebreakers, but rather are proper components of the fiduciary's primary analysis of the economic merits of competing investment choices."* Still, even in 2015-01, the Department makes it clear that a fiduciary may not accept lower expected returns or take on greater risks in order to secure collateral benefits.

The Department of Labor's newly proposed rule under ERISA (it is also an enforcer of the law, a responsibility it shares with the Department of Treasury) is important because ERISA sets the standards for who must be covered, vesting, funding, and plan trustee and fiduciary responsibilities across pension, welfare, and health plans. This encompasses more than \$7.6 trillion in assets!

It remains to be determined what impact this proposal may or may not have on Sustainable Investment/ESG, but it no doubt adds another layer of scrutiny to anything claiming such a title. This is a theme that seems to be carrying over.

SEC Commissioner Discusses ESG & Disclosure

The second development, or update, on what we might expect as far as guidance on the Sustainable Investment/ESG policy came from SEC Commissioner Elad Roisman.

Speaking independently, the Commissioner, in response to recent requests made to his office relating to ESG, gave some thoughtful remarks on the subject, reinforcing the organization's principles-based framework approach—which does include climate change—and the emphasis of materiality as the cornerstone for financial disclosure.

He also recognized that there are material ESG concerns that should be reported, especially those related to governance, but prescriptive disclosures requiring all components of an ever-evolving ESG criteria would be difficult. The commissioner also expressed concerns in regards to the SEC being used as an entity to make public companies do what the SEC or Congress feels is right, citing conflict mineral disclosure under Dodd-Frank, and the legal hurdles it failed to clear, as an example.

One point he was extremely adamant about was ESG, asset managers, and fund labels. This was one area that he felt needed more reporting and transparency.

Greenwashing, and funds claiming more responsibility for key performance indicators around Sustainability, like CO2 mitigation, was one concern. His other concern was funds which invest and vote proxies to achieve environmental or social goals at the risk of financial expense to investors—especially if a fund is not transparent on such a point.

Where Regulators Could Be Headed with ESG

Given the language within the Department of Labor's recent proposed rules, and the SEC Commissioner's speech, we think any future action on the regulatory front will likely focus the attention on asset managers and funds claiming to be Sustainable/ESG.

Both developments dovetail with the SEC's examination letters to asset managers and funds in late 2019 and early 2020 where they targeted ESG funds, with the March 2020 SEC request for comment on a rule seeking to eliminate misleading fund names.

We think that the scrutiny, while perhaps initially challenging for ESG disclosure, will only further show the value behind a material-based Sustainability/ESG investment approach. The Sustainability Accounting Standard Boards—of which this author is a member—is one organization that recognizes materiality and is positioned well as a leader in the space. Many organizations use SASB's industry/sector specific standards for assessing and conveying material exposure to various ESG issues. Their philosophy, in many ways, aims to address the concerns of materiality the Commissioner mentioned in his speech.

It is clear that the conversation on Sustainability & ESG is far from over and there is more wood to chop, as further critique and analysis on its benefit continue ♦

Further Resources

- ◆ [Department of Labor Proposed Rule June 23rd](#)
- ◆ [Addressing ESG Factors Under ERISA from UNPRI](#)
- ◆ [Fact Sheet Department of Labor IB 2015-01](#)
- ◆ [SEC Guidelines on Climate Change and disclosure](#)
- ◆ [SEC Requests Comment on Fund Names Rule; Seeks to Eliminate Misleading Fund Names](#)
- ◆ [ESG Funds Draw Scrutiny](#)
- ◆ [SEC Commissioner Elad Roisman Speech](#)

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