Published on *The National Law Review* https://natlawreview.com

SEC’s Division of Examinations Issues Risk Alert on ESG Investing

Article By:

John S. Marten

Nathaniel Segal

Jacob C. Tiedt

John M. Sanders

On April 9, 2021, the SEC’s Division of Examinations (formerly the Office of Compliance Inspections and Examinations) issued a risk alert highlighting the staff’s observations from recent examinations of investment advisers, registered investment companies and private funds offering **environmental, social and governance (ESG) products** and services. In light of the increased investor demand for ESG products and services and the variability of ESG definitions and terms, the risk alert elaborates on the focus of future examinations, as well as on deficiencies and best practices observed in past examinations.

The staff stated that future examinations of firms engaging in ESG investing will focus on, among other things, the following:

- The firm’s policies, procedures and practices related to ESG investing and the use of ESG-related terminology, including the processes for ensuring that the selection of investments and proxy voting are consistent with ESG disclosures and marketing materials;
- The firm’s regulatory filings, websites, reports to any sponsors of global ESG frameworks the firm has committed to follow, client presentations, responses to due diligence questionnaires, requests for proposals and client/investor-facing documents; and
- The firm’s compliance policies and procedures and their implementation, as well as compliance oversight and the review of ESG investing practices and disclosures.

The staff found the following deficiencies in its examinations of firms engaging in ESG investing:

- Portfolio management practices that were inconsistent with ESG disclosures;

- Inadequate controls regarding ESG-related investing guidelines, mandates and restrictions;
- Proxy voting that was inconsistent with stated ESG approaches;
- Unsubstantiated or misleading claims regarding ESG approaches;
- Inadequate controls to ensure consistency between actual firm practices and ESG-related disclosures and marketing;
- Lack of policies and procedures addressing ESG investing analyses, decision-making processes or compliance review and oversight; and
- Compliance personnel with limited knowledge of ESG-investment analyses, resulting in less effective compliance programs.

In contrast to such deficiencies, the staff observed the following effective practices related to ESG investing:

- Clear and precise disclosure that has been tailored to the firm’s specific approach to ESG investing and that is aligned with the firm’s actual practices;
- Detailed policies and procedures that address ESG investing, including specific documentation to be completed at various stages of the investment process; an
- Knowledgeable compliance personnel who are integrated into the firm’s ESG-related processes.

In light of these observations, the staff advised firms to review their disclosures and other public statements to ensure that they are consistent with the firm’s practices, to ensure the consistent application of ESG investing principles throughout the firm and that these principles are adequately addressed in the firm’s compliance program, and to document and maintain records relating to the ESG investing process.

The risk alert is available here.

National Law Review, Volume XI, Number 152