August 16th, 2022

Ms. Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street NE
Washington DC 20549

Re: Environmental, Social, and Governance Disclosures for Investment Advisers and Investment Companies (Release Nos. 33-11068, 34-94985, IA-6034, IC-34594; File No. S7-17-22)

Dear Ms. Countryman:

The Small Business Investor Alliance (SBIA) submits these comments in response to the proposed rule issued by the Securities and Exchange Commission (SEC) regarding new environmental, social, and governance (ESG) disclosure mandates for funds and investment advisers. ("Proposal") The SBIA has several concerns regarding the Proposal, including its impact upon business development companies (BDCs) and their investors along with the portfolio companies of both BDCs and private funds.

The SBIA is the leading national association that develops, supports, and advocates on behalf of policies that benefit providers of capital to small and mid-size American businesses. SBIA's membership includes BDCs, private equity investment funds, as well as the institutional investors that invest in those funds. SBIA's public policy goals are focused on maintaining a robust, healthy, and competitive market for small business investing in America.

<u>Background</u>

As investor interest surrounding ESG has grown, regulators should ensure that disclosures surrounding ESG or similar issues are accurate and do not mislead investors. However, in our view the Proposal would implement a costly and expansive regulatory framework for ESG while doing little to prevent harmful practices.

In particular, the Proposal purports to establish "consistent, comparable, and reliable" information for investors with regard to ESG investing by funds and investment advisers. The Proposal states that investors are currently subject to a "risk that a fund or adviser's actual consideration of ESG does not match [their] expectations, particularly given that funds and advisers implement ESG

strategies in a variety of ways."[1] The Proposal further states that the SEC is seeking to prevent the practice of "greenwashing," which involves funds or investment advisers making misleading or untruthful claims about their approaches to ESG or "sustainable" investing.

The SEC's efforts to crack down on "greenwashing" and other harmful practices is understandable, but the SEC currently has regulatory and enforcement authority to take action against regulated entities that make misleading disclosures. We urge the SEC to recognize and – if necessary – refine its existing authority rather than impose sweeping regulatory mandates on funds and advisers.

Our views and observations on the Proposal are discussed in further detail below.

I. <u>The Proposal would place costly new rules on BDCs and their shareholders and require that BDCs rely on their portfolio companies to provide certain information in order to comply.</u>

The Proposal would require that funds – including BDCs – that incorporate one or more ESG factors into their investment process provide greater disclosure regarding their use of ESG factors in selecting portfolio companies. The low threshold of "one or more" ESG factors effectively treats every fund as an "ESG" fund, even if the fund or BDC does not label itself explicitly as "ESG-friendly" or as being guided by ESG criteria. This will lead to situations where BDCs and funds that may have historically focused on a number of core governance ("G") issues are required to explain that focus as part of the fund's "ESG strategy." This will mislead investors to believe that a fund or BDC is an ESG-focused fund when, in reality, it may not consider "E" or "S" issues extensively in its investment process.

Even more concerning, other aspects of the Proposal would require BDCs that are deemed "ESG-Focused" or "environmentally focused" funds to rely on their portfolio companies to provide them with information related to greenhouse emissions (GHG). BDCs are a specialty finance vehicle and are mandated by law to invest 70 percent of their assets in "eligible portfolio companies" which typically consist of U.S.-based private businesses. The securities of these businesses are not publicly listed and, therefore, would not be subject to any kind of requirement that their GHG data be publicly disclosed.

The Proposal would put many BDCs in the impossible position of having to collect information that may not exist, and then aggregate that information into their SEC filings. Funds and BDCs that are unable to verify the accuracy of GHG information would have to make a "good faith" estimate regarding portfolio emissions, but that good faith estimate would not benefit from a safe harbor from liability under the Proposal.

The SBIA registered similar concerns in our earlier letter to the SEC regarding the March 2022 climate change disclosure proposal.[2] It is worth noting that the SEC is proposing BDCs to be subject to *both* the climate change disclosure rule as well as many provisions of the Proposal. The SEC's assertion in the Proposal that these two rules would "complement" each other in the context of BDCs does not consider the indirect mandates that would be placed on BDC portfolio

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[1] Proposal at 8

[2] https://www.sec.gov/comments/s7-10-22/s71022-20131587-301953.pdf

companies.[3] The SEC has also not considered at all what the cumulative costs of these two proposals would be on BDCs and their investors, a significant shortcoming of its economic analysis for the Proposal.

As the SBIA previously recommended, BDCs should be exempted altogether from the climate change disclosure rule, and we believe that the Proposal should, at a minimum, be narrowed to only apply to funds that explicitly label or market themselves as "ESG" vehicles.

II. The proposed mandates for investment advisers would similarly impose substantial compliance burdens on advisers and private funds and fail to provide decision-useful information for investors.

The Proposal would also require that investment advisers to SEC-reported private funds disclose "whether it employs in its management of that private fund an ESG-integration or ESG-focused approach, and if ESG-focused, whether it also employs an ESG-impact approach. It would also report whether it incorporates one or more E, S, and/or G factors, and which factors."[4] The Proposal also prescribes related to use of third-party frameworks and any potential business activities an adviser is engaged in, such as being an ESG provider.

Similar with our concerns over BDCs, the requirement to provide extensive reporting based on "one or more" E, S, or G factors is unnecessary and potentially misleading. These requirements effectively consider all "ESG" factors as the same and of equal interest to investors, even if an adviser focuses solely on a small number of considerations that the SEC determines fall under the ESG umbrella.

Commissioner Peirce also noted in her dissenting statement on the Proposal that the term "ESG" may become stale as new terms or classifications begin being used:

> "E, S, and G cannot be adequately defined, nor will they be, should the proposal eventually find its way into the Code of Federal Regulations. All you will learn from the proposed definitions is that "E" stands for environmental, "S" stands for social, and "G" for governance, but I suspect that you already knew that. The cool kids already have moved on to "*E*ESG"—*Employees*, Environmental, Social, and Governance. We better amend that proposal before it goes out the door lest a fund or adviser that prioritizes human capital issues despairs of being able legally to offer an ESG fund. Our refusal to define ESG is, of course, wholly understandable. Can you imagine an issue that would *not* fit within the ambit of at least one of those letters, based on someone's reading? Take, for example, the recent suggestion by some analysts that investments in defense stocks be added to the European Union's Social Taxonomy. Imagine trying to conjure up a definition that not only met the universe of current understanding, but was flexible enough to grow to meet the hour-by-hour expansion of just what makes up E, S, and G."[5]

The SBIA echoes these concerns and believes that the SEC should use its existing tools and regulations to protect investors from greenwashing. Indeed, the Proposal lays out some of the existing authorities the SEC has to prevent greenwashing or similar practices:

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[3] Proposal at 89

[4] Proposal at 157-158

[5] [SEC.gov | Statement on Environmental, Social, and Governance Disclosures for Investment Advisers and Investment Companies]

In addition, current regulations seek to prevent false or misleading advertisements by advisers, including greenwashing, by prohibiting material misstatements and fraud. The provision at 17 CFR 275.204(4)-8 prohibits advisers to pooled investment vehicles from making false or misleading statements to existing or prospective investors in such pooled investment vehicles (e.g., investors in a registered investment company or private fund), the Marketing Rule prohibits an adviser from, directly or indirectly, distributing advertisements that contain any untrue statement of a material fact, or omitting to state a material fact necessary in order to make the statement made, in light of the circumstances under which it was made, not misleading. Therefore, it generally would be materially misleading for an adviser materially to overstate in an advertisement the extent to which it utilizes or considers ESG factors in managing client portfolios. For example, if an adviser advertisement asserts that it applies a negative screen to oil and gas stocks in client portfolios, but it fails to apply such a screen in practice it would be materially misleading. Similarly, it generally would be materially misleading if an adviser stated in its marketing materials that it has substantially contributed to the development of specific governance practices, or reduction in carbon emissions, at is portfolio company, if the adviser's actual roles in the development or reduction in emissions were limited or inconsequential.[6]

Conclusion

The SBIA urges the SEC to re-consider the need for additional and prescriptive mandates regarding the use of E, S, or G factors by funds, BDCs, and investment advisers. The current Proposal, in our view, is unjustified and would create substantial costs for investors with little benefits in return. We look forward to continuing the conversation with the SEC on this issue and being a resource for commissioners and staff.

Sincerely,

Brett Palmer
President
Small Business Investor Alliance

[6] Proposal at 168