NFIB

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July 14, 2022

The Honorable Gary Gensler, Chair
c/o Vanessa A. Countryman, Secretary
File No. S7-17-22, RIN 3235-AM96
Securities and Exchange Commission
100 F St. NE, Washington, DC 20549-1090

Dear Mr. Chairman:

RE: SEC Notice of Proposed Rulemaking titled "Enhanced Disclosures by Certain Investment Advisers and Investment Companies About Environmental, Social, and Governance Investment Practices," File No. S7-17-22, RIN 3235-AM96, 87 *Fed. Reg.* 36654 (June 17, 2022)

This letter presents comments of the National Federation of Independent Business (NFIB)[1] on the Securities and Exchange Commission (SEC) notice of proposed rulemaking titled "Enhanced Disclosures by Certain Investment Advisers and Investment Companies About Environmental, Social, and Governance Investment Practices" and published in the *Federal Register* of June 17, 2022. The SEC proposes to require registered investment advisers, registered investment companies, and certain other entities to "provide additional information regarding their environmental, social, and governance ('ESG') investment practices."[2]

While NFIB would prefer that the SEC withdrew the proposed rule as an unnecessary burden on a robust free market in capital, if the SEC nevertheless pursues the rule NFIB requests two changes to it. First, in the Preamble to the proposed rule, the SEC gives a number of informal assurances to small investment adviser businesses that they may exempt themselves from the scope of the rule by making no claims about addressing ESG objectives in their work. NFIB asks the SEC to convert those informal assurances in the Preamble into provisions in the binding rule. Secondly, to prevent legal challenges that the SEC rule denies due process of law because it uses the vague terms "environmental," "social," and "governance," NFIB recommends that the SEC define the three terms.

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[1] NFIB is an incorporated nonprofit association representing small and independent business members across America. NFIB protects and advances the ability of Americans to own, operate, and grow their businesses and ensures that governments of the United States and the fifty states hear the voice of small business as they formulate public policies.

[2] 87 *Fed. Reg.* 36654, col. 1.

1. Self-Exemption by Small Entity Investment Advisers

Congress has by law made clear the importance of taking careful account of the needs of small businesses in agency rulemaking.[3] The SEC should take careful account of the needs of small businesses in the field of investment advice in promulgating its final rule, both in light of that statutory policy and in light of the limited resources small businesses have in comparison to larger businesses for understanding and complying with complex regulations.

The SEC estimated that, as of December 2020, approximately 434 SEC-registered investment advisers qualify as "small entities" for purposes of the Regulatory Flexibility Act.[4] The SEC assures these SEC-registered small entity investment advisers that the proposed rule generally has no effect on them if they elect not to make claims about their ESG practices:

> *. . . [D]ue to the 'opt-in' nature of many of the requirements, small entities are already able to benefit from a simpler regulatory framework simply by not making claims about certain ESG goals for which additional disclosure is necessary in order to protect investors.*[5]

While an assurance in a Preamble provides a welcome indication of the intention of an agency proposing a rule, the law is not clear that the Preamble has any binding legal force.[6] Accordingly, NFIB recommends and requests that the SEC include in the final rule the following new section in title 17 of the Code of Federal Regulations:

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[3] In paragraph 2(a)(4) of the Regulatory Flexibility Act (RFA), Public Law 96-354, 5 U.S.C. 601 note, Congress declared that "the failure to recognize differences in the scale and resources of regulated entities has in numerous instances adversely affected competition in the marketplace, discouraged innovation and restricted improvements in productivity [.]" Congress also noted in paragraph 2(a)(6) of the RFA that "the practice of treating all regulated businesses, organizations, and governmental jurisdictions as equivalent may lead to inefficient use of regulatory agency resources, enforcement problems, and, in some cases, to actions inconsistent with the legislative intent of health, safety, environmental and economic welfare legislation [.]"

[4] 87 *Fed. Reg.* at 36741, col. 2. The SEC treats an investment adviser as a "small entity" if it "(1) has assets under management having a total value of less than $25 million; (2) did not have total assets of $5 million or more on the last day of the most recent fiscal year; and (3) does not control, is not controlled by, and is not under common control with another investment adviser that has assets under management of $25 million or more, or any person (other than a natural person) that had total assets of $5 million or more on the last day of its most recent fiscal year." 87 *Fed. Reg.* at 36741, col. 1 (footnote omitted). The SEC noted that other small entity investment advisers register with state securities authorities and not the SEC and therefore need not comply with the proposed rule. 87 *Fed. Reg.* at 36741, col. 2.

[5] 87 *Fed. Reg.* at 36743, col. 1.

[6] *St. Francis Medical Center v. Azar*, 894 F. 3d 290, 297 (D.C. Cir. 2018) ("Because the regulation itself is clear, we need not evaluate these mixed signals from the preamble, which itself lacks the force and effect of law."); *cf. AT&T Corp. v. Federal Communications Commission*, 967 F. 3d 840, 857 (D.C. Cir. 2020) ("The FCC contends that its explanatory statements, published in the Federal Register, should be treated as part of the binding regulation. It is mistaken. 'Publication in the Federal Register does not suggest that

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Subpart A of Part 240 in Chapter II of Title 17 of the Code of Federal Regulations is amended by inserting after section 240.0-13 the following new section:

§ 240.0-14 Exemption for Small Registered Investment Advisers From ESG Disclosure Requirements

(a) As used in this section:

(1) the term "Commission" means the Securities and Exchange Commission; and

(2) the term "small registered investment adviser" means an investment adviser (as defined in section 202(a)(11) of the Investment Advisers Act of 1940, 15 U.S.C. 80b-2(a)(11)) registered with the Commission that:

(A) has assets under management having a total value of less than $25 million;

(B) did not have total assets of $5 million or more on the last day of the most recent fiscal year; and

(C) does not control, is not controlled by, and is not under common control with another investment adviser that has assets under management of $25 million or more, or any person (other than a natural person) that had total assets of $5 million or more on the last day of its most recent fiscal year.

(b) A small registered investment adviser that makes no claim to its clients with respect to its environmental, social, or governance practices shall be exempt from any duty under any rules or orders of the Commission to make disclosures, by report, form, or otherwise, to its clients or the Commission concerning such practices.

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the matter published was meant to be a regulation, since the APA requires general statements of policy to be published as well.' *Brock v. Cathedral Bluffs Shale Oil Co.*, 796 F. 2d 533, 539 (D.C. Cir. 1986) (Scalia, J.) (citing 5 U.S.C. § 552(a)(1)(D)). Instead, the 'real dividing point' between the portions of a final rule with and without legal force is designation for 'publication in the Code of Federal Regulations.' *Id.* To be sure, we have reserved a possibility that statements in a preamble 'may in some unique cases constitute binding, final agency action susceptible to judicial review.' *NRDC v. EPA*, 559 F. 3d 561, 565 (D.C. Cir. 2009) (citing *Kennecott Utah Copper Corp. v. Dep't of Interior*, 88 F. 3d 1191, 1222-23 (D.C. Cir. 1996)). But 'this is not the norm' because '[a]gency statements "having general applicability and legal effect" are to be published in the Code of Federal Regulations.' *Id.* (quoting 44 U.S.C. § 1510(a)). And where, as here, there is a discrepancy between the preamble and the Code, it is the codified provisions that control." (emphasis added)).

2. Definitions of Key Terms "Environmental," "Social," and "Governance"

The SEC uses extensively, but does not define, the terms "Environmental," "Social," and "Governance" that lie at the heart of its proposed rule. The SEC provides nothing more than a list of synonyms for the acronym ESG in a footnote:

> *For the purposes of this release and the proposed rules, the Commission uses the term "ESG" to encompass terms such as "socially responsible investing," "sustainable," "green," "ethical," "impact," or "good governance" to the extent they describe environmental, social, and/or governance factors that may be considered when making an investment decision. These terms, however, are not defined in the Advisers Act, the Investment Company Act, or the rules or forms adopted thereunder.*[7]

The SEC's failure to define the key terms in its proposed rule was not accidental:

> *We are not proposing to define "ESG" or similar terms and, instead, we are proposing to require funds to disclose to investors (1) how they incorporate ESG factors into their investment selection processes and (2) how they incorporate ESG factors in their investment strategies. Is this approach appropriate? Should we seek to define "ESG" or any of its subparts in the forms? Should we provide a non-exhaustive list of examples of ESG factors in the forms? Should we define certain types of factors as being ESG but allow funds to add additional factors to that concept if they choose? Are there any other approaches that we should take in providing guidance to funds as to what constitutes ESG?*[8]

While the courts have upheld SEC rules using less-than-precise language as applied to the conduct of individuals who could not have been surprised that the language covered their conduct,[9] the courts cannot accept a complete failure to define the conduct prohibited or required in a rule.[10] The SEC must undertake the difficult, but essential,

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[7] 87 *Fed. Reg.* at 36656, col. 1, footnote 6.

[8] 87 *Fed. Reg.* at 36660, cols. 1-2.

[9] *Ialleggio v. SEC*, 185 F. 3d 867 (9th Cir. 1999) ("Although some conduct might not obviously depart from 'high standards of commercial honor,' cheating on his expense account in the mid-five figures plainly does. . . . Challenges to this rule on vagueness grounds have generally failed, where application of the rule to the particular misconduct 'cannot have come as a surprise.' ") (unpublished disposition, see 9th Cir. Rule 36-3).

[10] *Regency Air, LLC v. Dickson*, 3 F. 4th 1157, 1163 (9th Cir. 2021) ("For a regulation to survive a vagueness challenge, it 'must give a person of ordinary intelligence adequate notice of the conduct it proscribes.' " (citation omitted)); *United States v. Ancient Coin Collectors Guild*, 899 F. 3d 295, 321 (4th Cir. 2018) ("To provide notice that satisfies constitutional due process, a regulation 'must "give the person of ordinary intelligence a reasonable opportunity to know what is prohibited so that he may act accordingly." ' " (citation omitted)); and *Securities and Exchange Commission v. Panuwat*, 2022 WL 633306 (N.D. Cal. January 14, 2022) (" 'It is established that a law fails to meet the requirements of the

work of deciding what the SEC means when it uses the terms "Environmental," "Social," and "Governance."

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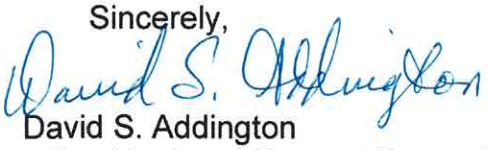
If the SEC pursues the proposed rule to require registered investment advisers and others to provide additional information regarding their environmental, social, and governance practices, NFIB asks the SEC to protect registered investment adviser small businesses as described above and to define the meaning of the key terms used in the rule.

Sincerely,



David S. Addington
Executive Vice President and General Counsel

Due Process Clause if it is so vague and standardless that it leaves the public uncertain as to the conduct it prohibits.' The same is true for regulations. 'In the absence of notice—for example, where the regulation is not sufficiently clear to warn a party about what is expected of it—an agency may not deprive a party of property by imposing civil or criminal liability.' To provide adequate notice, the law or regulation must 'give the person of ordinary intelligence a reasonable opportunity to know what is prohibited, so that he may act accordingly.' " (internal citations omitted)).