June 11, 2021

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

Re: Request for Comment on Climate Disclosure

Dear Ms. Countryman:

The American Securities Association[1] provides these comments in response to the request initiated by Securities and Exchange Commission (SEC) then-Acting Chair Lee regarding climate disclosure (Request).

New Information.

The SEC has indicated that its most urgent regulatory priority is to mandate climate and related environmental, social, and governance disclosures for public companies (collectively, ESG Disclosure). This effort seems to rest on a vocal "consensus" who support ESG Disclosure and argue government action is the only way forward. However, we wish to provide the SEC with some new research and other evidence which suggests that consensus support for mandated ESG Disclosure may not yet be settled.

The purpose of our submission is to catalogue a number of these recent studies, reports, news articles, and statements from policymakers to help inform the SEC as it moves forward on this complex issue set. We have broken out the information in Exhibit A into two categories: (1) ESG Investment Performance and (2) Costs of Climate and ESG Disclosure.

We have also set forth a few topics below that we believe the SEC should evaluate as it considers proposals to mandate prescriptive ESG Disclosure.

Questions to Consider.

[1] The ASA is a trade association that represents the retail and institutional capital markets interests of regional financial services firms who provide Main Street businesses with access to capital and advise hardworking Americans how to create and preserve wealth. The ASA's mission is to promote trust and confidence among investors, facilitate capital formation, and support efficient and competitively balanced capital markets. This mission advances financial independence, stimulates job creation, and increases prosperity. The ASA has a geographically diverse membership of almost one hundred members that spans every region of the United States.

- **The SEC's Mission:** How does the SEC prioritize the three prongs of its statutory mission to (1) protect investors, (2) maintain fair, orderly, and efficient markets, and (3) facilitate capital formation.[2] In this instance, it's not clear which investors the Commission seeks to protect, nor is it clear how increasing the cost of compliance for public companies will facilitate capital formation in the U.S.

- **Shareholder Priority:** The SEC should clearly set forth the legal authority it intends to rely on to place the interests of more vocal activist and institutional investors over those of less vocal retail investors on this issue. This is especially important given that numerous shareholder proposals mandating ESG Disclosure have repeatedly been voted down at company meetings over the last decade.

- **Wall Street or Retail Investors:** The SEC should consider who benefits from the creation of a complex and prescriptive ESG Disclosure framework. It appears that an entrenched professional class on Wall Street consisting of ESG standard-setters, ratings firms, well-heeled corporate attorneys, auditors, investment banks, asset managers, proxy advisors, and index providers stands ready to reap a massive monetary windfall from a government mandate of ESG Disclosure. This begs the question: should the SEC use ESG as the reason to adopt a policy that transfers money from the public companies owned by America's mom-and-pop investors directly to the Wall Street-industrial-complex? Retirees, working families, and those investing for a better future should have an answer to that question before a final rule comes up for a vote.

- **Investment Returns:** The SEC should include a discussion in its proposal describing how the returns of long-term retail investors may be impacted if: (1) the cost of public company compliance rises, (2) high-cost ESG products that underperform traditional investment vehicles become the market, or (3) an asset bubble created by ESG products inevitably pops.

- **Small Business Capital Formation:** We suggest the SEC consider delaying ESG Disclosure for small and emerging growth company issuers located in the United States. Taking this action would significantly reduce the cost burdens for those companies, and would not disincentivize capital formation. Imposing additional costs on these companies will only serve to further entrench the large and mega-cap companies in our markets who can easily absorb them. In this vein, we would also ask the SEC to think through the adoption of any policies that could tip the scales in favor of companies who many believe are using their market power to harm consumers and distort our political economy.[3]

[2] https://www.investor.gov/introduction-investing/investing-basics/role-sec
[3] Lynn, B (2020). *Liberty From All Masters*. St. Martin's Press; Lynn, B. (2011). *Cornered: The New Monopoly Capitalism and the Economics of Destruction*. Wiley 1st Edition; Hubbard, S. (2020). *Monopolies Suck, 7 Ways Big Corporations Rule Your Life and How to Take Back Control*. Simon & Schuster.

- **No China Exemption:** Communist China is the world's largest emitter of greenhouse gases, pays lip service to the Paris Agreement, and commits egregious "crimes against humanity" and genocide against its own people. Companies from this country must not be able to access our capital markets through index funds or other means unless they too must comply with U.S. disclosure mandate.

  We implore the SEC to make certain that every issuer, both foreign or domestic, and every foreign company included in an index offered by a fund issuer (i.e. ETF or otherwise) be explicitly subject to all U.S. ESG Disclosure mandates you will propose. Allowing Chinese Communist Party-controlled companies to continue to access our markets without adhering to our laws harms investors and working families, crowds out investment for American start-ups, and directly undermines the integrity of our capital markets.

Conclusion.

The ASA supports investor choice and access to a wide variety of investments, including ESG products. We also take the political issues surrounding the ESG Disclosure debate very seriously. As a result, we tried to raise some questions the SEC may not have previously thought about and introduce some new information into a discussion dominated by passionate opinions and conflicted market participants.

We stand ready to assist the Commission in any way we can.

Sincerely,

Christopher A. Iacovella
Chief Executive Officer
American Securities Association

EXHIBIT A

I. ESG Investment Performance.

"Many ESG Funds Are Just Expensive S&P 500 Indexes" (Bloomberg – May 7, 2021)

- *"Not all ESG ETFs and mutual funds are closet indexers, but true ESG funds generally come with higher fees and definitely come with more tracking error risk. Index funds give you cheap average performance. It's hard to save the world by being cheap and average."*

"ESG Outperformance Narrative is Flawed, New Research Shows" (Financial Times – May 2, 2021)

- *"The widely held belief that 'sustainable' investing delivers outperformance is a mirage and the above-market returns are actually driven by exposure to so-called style factors long known to boost investment returns…"*

"Beware ESG ratings, strategist warns – look past them to find the best stocks to buy" (CNBC – May 18, 2021)

- *"ESG refers to environmental, social and governance factors and has become a big area of focus for investors as they look to assess the sustainability of their portfolios. However, the huge amounts pumped into ESG funds in 2020 created a bubble in the sector, the [Bernstein] strategists argued, and the funds have "spectacularly underperformed" in 2021."*

"The World's Largest Pension Fund has Cooled on ESG. Should you?" (Shuli Ren, Bloomberg Opinion – May 5, 2021)

- *"But top officials of [Japan's $1.6 trillion Government Pension Investment Fund] have been talking up fiduciary duty lately. GPIF "can't sacrifice returns for the sake of buying environmental names or ESG names," a senior director at the fund's investment strategy department told Bloomberg News in April. At issue is poor performance. For instance, one of GPIF's earliest ESG picks was a thematic social index, which invests in domestic companies that hire and promote women. The MSCI Japan Empowering Women Index, the so-called Win index, has fared poorly against the benchmark Topix Index. Performance is all-important to GPIF: the fund is required to pursue a real investment return of 1.7% to support an aging Japan."*

"Honey, I Shrunk the ESG Alpha: Risk-Adjusting ESG Portfolio Returns" (Scientific Beta research report – April 2021)

- *"Recent strong performance of ESG strategies can be linked to an increase in investor attention. Flows into sustainable mutual funds show that attention to ESG has risen remarkably over the later period of our sample, from about 2013. We find that alpha estimated during low attention periods is up to four times lower than alpha during high attention periods. Therefore, studies that focus on the recent period tend to overestimate ESG returns. We conclude that claims of positive alpha in popular industry publications are not valid because the analysis underlying these claims is flawed. Omitting necessary risk adjustments and selecting a recent period with upward attention shifts enables the documenting of outperformance where in reality there is none."*

"Is ESG Intrinsically Inflationary?" (Financial Advisor Magazine – April 27, 2021)

- *"As its popularity continues to grow, some professional investors are warning that ESG (Environmental, Social and Governance) investing could be inflationary. Their argument is predicated on the expectation that complying with an expanding set of socially conscious mandates may be a worthy goal, but one that flies in the face of Milton Friedman's dictum that the only raison d'etre for corporations was to maximize profits for shareholders. It's perfectly understandable that investors will want to avoid companies reliant on child labor in foreign countries and with toxic environmental practices. But changing corporate behavior comes with a cost."*

"Valuing ESG: Doing Good or Sounding Good?" (Bradford Cornell (UCLA), Aswath Damodaran (NYU) – March 20, 2020)

- *"The ESG bandwagon may be gathering speed and getting companies and investors on board, but in our view, when all is said and done, a lot of money will have been spent, a few people (consultants, ESG experts, ESG measurers) will have benefitted, but companies will not be any more socially responsible than they were before ESG was invented. In our view, what is needed is an open, frank, and detailed national dialogue concerning ESG related public polices, particularly those related to climate change. Hopefully, that discussion will produce wise policies that will set the legal and regulatory framework in which corporations operate. With the proper framework in place, corporations can get back to focusing on maximizing shareholder wealth."*

"Socially Conscious ETFs Have Some Baffling Holes" (Yahoo Finance – January 27, 2020)

- *"Exchange-traded funds that cater to environmental, social and governance principles are being pitched as a way for investors to sleep with peace of mind, but they better be prepared to wake up with something less than dreamy returns.* ***Consider the iShares MSCI USA ESG Select Social Index Fund (SUSA), one of the oldest and largest ESG ETFs on the market. SUSA, which tracks the 100 stocks with the highest ESG ratings, has trailed the S&P 500 Index by 37 percentage points during the past 10 years****."*

"The ESG Performance Paradox" (Jordan Boslego, CFA Institute Blog – September 16, 2020)

- *"The argument that ESG factors lead to better long-term performance outcomes is much harder to prove than we might imagine. Academics have found a surprisingly low correlation between ESG ratings across providers. In other words, experts can't even agree on which firms have solid ESG credentials in the first place. Part of the problem is that the ESG umbrella encompasses so many different issues, whose salience is continually shifting."*

"ESG Didn't Immunize Stocks During the COVID-19 Crisis, But Investments in Intangible Assets Did." (Demers, Hendrikse, Joos, Lev – March 1, 2021)

- *"Environmental, social, and governance ("ESG") scores have been widely touted as indicators of share price resilience during the COVID-19 crisis. Contrary to this conventional wisdom, we present robust evidence that, once industry affiliation, market-based measures of risk, and accounting-based measures of performance, financial position, and intangibles investments have been controlled for, ESG offers no such positive explanatory power for returns during the COVID crisis. Specifically, ESG is insignificant in fully specified returns regressions for each of the Q1 2020 COVID market crisis period, and for the full COVID year of 2020. By contrast, a measure of the firm's stock of investments in internally generated intangible assets is an economically and statistically significant positive determinant of returns during each of the Q1 market implosion and full 2020 COVID year periods. Our results are robust to alternative measures of returns, as well as to using Refinitiv, Refinitiv II, and MSCI data to capture ESG performance. We conclude that ESG did not immunize stocks during the COVID-19 crisis, but that investments in intangible assets did."*

"Capitalism, Socialism, and ESG" (Rupert Darwall, Real Clear Foundation – May 2021)

- *"The corollary of the ESG thesis—that low-ESG-rated "sin stocks" are condemned to underperform the stock market—is decisively refuted by the data. When institutional investors "went underweight" by selling down their holdings in tobacco stocks, it made them cheaper for other investors to buy and make money, especially when they subsequently outperformed the market."*

- *"The profit opportunities that ESG creates for Wall Street, however, are clear. BlackRock charges 46 cents annually for every $100 invested in its iShares Global Clean Energy ETF and just 4 cents for its iShares fund linked to the S&P 500."*

"Where ESG Fails" (Porter, Serafeim, Kramer – October 2019)

- *"In many cases, ESG factors are not material to the performance of a particular business, nor do they highlight areas where the business has the greatest impact on society. The carbon footprint of a bank, for example, is not material to a bank's economic performance, nor would reducing its footprint materially affect global carbon emissions. In contrast, banks' issuance of subprime loans that customers were unable to repay had devastating social and financial consequences. Yet ESG reporting gave banks credit for the former and missed the latter altogether, in part because the voluntary and reputation-focused nature of sustainability reports tends to leave out bad news. Such broad and upbeat ESG reporting may make investors and consumers feel good by encouraging corporate window dressing, but it distracts from incentivizing and enabling companies to deliver greater social impact on the issues most central to their businesses."*

"ESG is All the Rage. Big Investors Can't Agree on Why" (Wall Street Journal – March 4, 2021)

- *"The theory is lovely: stocks with less exposure to new government restrictions on carbon emissions, biodiversity, water use or stronger labor standards should be more highly valued, as should companies that are better run. Flip it over, and investors should demand higher returns from riskier companies, to compensate for those risks, which means "bad" stocks should be cheaper. Unfortunately reality is messy. Even for a single factor, such as climate, it isn't clear how to pick winning stocks or sectors, because we can only guess at the mix of sticks and carrots governments will choose. Try to trade off E, S and G against each other and it becomes entirely subjective."*

"ESG Investing and Public Pensions: An Update" (Boston College Center for Retirement Research – October 2020)

- *"The results show a negative relationship between the rate of return and both state mandates and ESG policies, although only…It suggests that having a state mandate in place for a single year was associated with an annualized return that was nearly two basis points lower over the 18-year period. To put this finding in context, plans with state mandates have had them for an average of 10 years. So, the average annualized return for those with a state mandate would be 20 basis points lower than for those without a mandate."*

II. Costs of Climate and ESG Disclosures.

"Putting the Electric Cart before the Horse: Addressing Inevitable Costs of a New ESG Disclosure Regime" (Speech by Commissioner Elad Roisman – June 3, 2021)

- *"The costs are more obvious. Any new disclosure requirement causes companies to incur costs in obtaining and presenting the new information. Beyond the costs of collecting (and in some cases, calculating) and preparing the information for submission are the costs of increased liability for making such disclosures. None of these cost categories are necessarily unique to ESG disclosures. They may, however, be greater given both the potential scope and novelty of the "E" and certain "S" categories in particular. Also, to the extent that any new requirements call for information beyond our existing materiality standards, these costs could be even higher. The advantage of foreseeing costs is that we can do something to head them off—and I believe the SEC will have the obligation to do just that if the goal is to craft a proposal that gets ESG information into the hands of investors."*

"Rethinking Global ESG Metrics" (Statement from Commissioner Hester Peirce – April 14, 2021)

- *"The strength of our capital markets can be traced in part to our investor-focused disclosure rules and I worry about the implications a stakeholder-focused disclosure regime would have. Such a regime would likely expand the jurisdictional reach of the Commission, impose new costs on public companies, decrease the attractiveness of our capital markets, distort the allocation of capital, and undermine the role of shareholders in corporate governance."*

"Wall Street's Trillion-Dollar ESG Club Comes with Huge Tax Perks" (Bloomberg – April 23, 2021)

- *"In fact, pretty much everyone is. This month, JPMorgan Chase & Co. announced a pledge to finance and facilitate at least $2.5 trillion of sustainable and climate-friendly deals over the next decade, Bank of America set a target of $1.5 trillion, and Citigroup Inc. and Morgan Stanley said they would be mobilizing $1 trillion each. Meet Wall Street's new trillion-dollar ESG club. The banks created it, analysts say, to please regulators, impress shareholders and activists, do some good -- and cut their tax bills."*

June 3, 2021 letter from 22 members of Congress regarding the SEC's climate change initiative

- *"It is the SEC's job to look out for Main Street investors, not a cottage industry of standard setters and ratings firms that stand to benefit from further SEC regulation in this area."*

- *"There is no evidence that points to public companies being unaware or ignoring the fact that investors are demanding more information on climate change."*

- *"We are concerned that in the context of climate change disclosures, the SEC is currently on a course that will take it far afield of its statutory mission to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation."*

"A Response to Calls for SEC-Mandated ESG Disclosure" (Amanda Rose, Vanderbilt University – May 2021)

- *"The breadth of topics embraced by ESG, and the breadth of motivations spurring the ESG movement, has created a big tent that has undoubtedly served a purpose in terms of helping the various causes of those involved to gain momentum. But it has also created problems. For example, ESG performance ratings are inconsistent and difficult to decipher. Which of the myriad ESG issues are factored into a rating, how performance on those issues is measured, and the weight each issue is given are subjective, usually non-transparent determinations that vary across ratings providers. The breadth of ESG topics also makes studies that purport to show a positive link between ESG performance and financial performance difficult to interpret. There is no* a priori *reason to believe that a company's approach to climate change and a company's approach to diversity or any other ESG issue will have the same sort of impact on a company's financial performance; yet these studies often bundle ESG issues together to measure ESG performance or rely on ESG performance ratings that themselves bundle them together. They therefore leave unanswered which, if any, discrete corporate policies related to ESG actually impact financial performance."*

"Environmental, Social, and Governance Theory: Defusing a Major Threat to Shareholder Rights" (Richard Morrison, Competitive Enterprise Institute – May 2021)

- *"Despite the significant problems with inconsistent definitions and controversial policies, many proponents now suggest that ESG goals should be mandated by government policy. Recent legislation proposed by members of Congress, including Sen. Elizabeth Warren (D-MA), and regulatory proposals advanced by the current leadership of the Securities and Exchange Commission would require that U.S. corporations move from the longstanding legal presumption of shareholder primacy to one in which government agencies manage* *the priorities of business entities, but bear none of the cost for their mandates. This shift would constitute a major threat to the property, due process, and association rights of investors. However, there is another way. Many of the conflicts described above can be avoided if policy makers embrace a voluntary system of "benefit corporation" charters, augmented by private certification standards. Legally binding corporate charters that elevate other stakeholders above shareholders are available to those founders and board members who want to embrace them, as are the private, voluntary standards that publicly certify a similar balance of priorities. If the wave of enthusiasm for ESG investing is anywhere as significant and broad-based as its proponents claim, these non-coercive alternatives should be sufficient for the enlightened investors and managers of the 21st century to structure their commitments. Conversely, a legally mandatory process—in which detailed lists of rules for all firms are drawn up and enforced by the federal government—would be expensive, time-consuming, and afflicted by the same problems that beset most regulatory policy. Regulatory capture, privileging of incumbent firms, and negative effects on growth and innovation would likely all result from the policy making and enforcement processes. Moreover, flawed rules would become entrenched and become extremely difficult to change once regulated entities start spending money and making long-term compliance plans. This would achieve few of ESG advocates' progressive goals and leave dominant firms even more powerful than before."*

2011 Decision of U.S. Court of Appeals for the D.C. Circuit striking down the SEC's proxy access rule

- *"Under the APA, we will set aside agency action that is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law…" Indeed, the Commission has a unique obligation to consider the effect of a new rule upon "efficiency, competition, and capital formation," and its failure to "apprise itself—and hence the public and the Congress—of the economic consequences of a proposed regulation" makes promulgation of the rule arbitrary and capricious and not in accordance with law."*