August 16, 2022

Via Electronic Mail: rule-comments@sec.gov

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

Re: Proposed Rule: Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices
(Release No. 33-11068; 34-94985; IA-6034; IC-34594; File No. S7-17-22)

Dear Ms. Countryman:

LSTA appreciates the opportunity provided by the U.S. Securities and Exchange Commission ("**SEC**" or "**Commission**") to comment on its recently proposed rule, Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices, (hereinafter the "**Proposed Rule**").[1]

LSTA is a not-for-profit trade association that is made up of a broad and diverse membership involved in the origination, syndication, and trade of commercial loans. The 580-plus members of LSTA include commercial banks, investment banks, broker-dealers, hedge funds, mutual funds, insurance companies, fund managers, and other institutional lenders, as well as law firms, service providers and vendors.[2]

I. Support of the SEC's Stated Goals

LSTA supports the SEC's stated goals in proposing the new environmental, social, and governance ("**ESG**") disclosure requirements to promote "consistent, comparable, and reliable information among

[1] *See Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices*, Securities Act Release No. 11068, Exchange Act Release No. 94985, Investment Advisers Act Release No. 6034, Investment Company Act Release No. 34594 (May 25, 2022) [87 FR 36654 (June 17, 2022)]. The Commission is proposing to require, among other things, specific ESG disclosure obligations for registered investment advisers, registered funds and business development companies, among others. Such required disclosures would vary based on the extent to which an ESG (as hereinafter defined) strategy is followed and how the ESG strategy is pursued by such funds.

[2] LSTA undertakes a wide variety of activities to foster the development of policies and market practices designed to promote just and equitable marketplace principles and to encourage cooperation and coordination with firms facilitating transactions in loans. Since 1995, LSTA has developed standardized practices, procedures, and documentation to enhance market efficiency, transparency, and certainty. For more information, visit www.lsta.org.

investment products and advisers that claim to consider one or more ESG factors"[3] in order to address concerns that the current lack of consistent, comparable, and reliable information can create a risk of a mismatch between actual ESG considerations and investor expectations and that funds and advisory services may be marketed in a manner that exaggerates their ESG focus resulting in the practice known as "greenwashing". LSTA strongly agrees that such funds and advisers should be required to adhere to ESG policies that they disclose or affirmatively market, and that funds and advisers should disclose their material strategies and risks which in some cases will include ESG strategies and risks.

II. Executive Summary

As noted above, LSTA unequivocally supports the tenet that funds and registered investment advisers ("**RIAs**") are legally and ethically required to engage in responsible advertising when it comes to ESG. Funds and RIAs should not overstate or otherwise mislead investors on the impact of ESG considerations in their investment selection. However, apart from ESG labelled funds and strategies, there is a broad and evolving spectrum of ESG integration in investment selection. We recognize, as does the Commission, that it is critical that ESG considerations are not unduly given greater prominence than other aspects of the investment management process. To strike this balance LSTA urges the Commission to ensure that the final rules relating to the Proposed Rule (the "**Final Rule**"):

- Are predicated on the fund or RIA holding itself out as being an ESG fund or pursing an ESG strategy;
- Retain the traditional standard of materiality throughout its provisions; and
- Define what "ESG" is not.

The comments below identify several of the key aspects of the Proposed Rule which we view as being at odds with these principles, such as the requirement for all environmentally-focused funds to disclose greenhouse gas ("**GHG**") emissions and the proposed scope of the "Integration" and "Focused" categories. Indeed, these aspects of the Proposed Rule would be counterproductive to the SEC's stated goals as the proposed requirements would likely lead to misleading, immaterial and unreliable disclosures.

Furthermore, the Proposed Rule will impose significant costs and undue burdens on private companies, which are not within the Commission's regulatory authority. We question whether the SEC has satisfied its duties under the Administrative Procedure Act (the "**APA**") in this regard. Investors in private companies are as interested in obtaining reliable, consistent and comparable ESG information but are well aware of the resource constraints and steep learning curve that face many of the companies in whose debt they invest. Industry efforts are already underway to significantly improve the ESG information private companies share with credit investors that will address the stated objectives of the Proposed Rule without the attendant costs and burdens. LSTA has partnered with UN Principles for Responsible Investment ("**PRI**") and Alternative Credit Council ("**ACC**") to harmonize ESG data requests from investors and allow for private company borrowers to build the ESG competencies that will be needed going forward.[4] We highlight to the Commission that leaving

[3] *See* Proposed Rule at 7.

[4] Press release dated March 30, 2022, available at https://www.businesswire.com/news/home/20220330005590/en/Credit-Trade-Associations-Join-Forces-with-PRI-on-ESG-Credit-Harmonization.

this industry-led voluntary disclosure scheme undisturbed offers a specific alternative to the Proposed Rule's impact on private companies. We request that the Commission encourage the organic process that has taken hold in credit markets and adjust the scope of the final rulemaking to focus directly and indirectly only on entities the SEC has the authority to regulate under the Investment Company Act of 1940, as amended (the "**Investment Company Act**") and the Investment Advisers Act of 1940, as amended (the "**Advisers Act**" and, collectively, with the Investment Company Act, the "**Acts**").

III. Voluntary ESG Reporting For Private Companies is Developing and Should Not be Disrupted

While any fund or adviser that incorporates one or more ESG factors in its investment selection process is potentially in scope of the SEC's Proposed Rule, ESG considerations used by advisory firms that lend to private companies through a number of strategies, including mutual funds, exchange-traded funds, business development companies ("**BDCs**") and private funds, such as collateralized loan obligations ("**CLOs**") and other credit funds, and separately managed accounts ("**SMAs**") (collectively, "**Credit Investors**") in their investment decision-making generally relate to credit risk mitigation, rather than ESG principles or policies. For that reason, there has not been a similar level of proliferation of ESG funds and strategies in the credit markets as there have been in other pockets of finance, such as equities and public fixed income. Furthermore, LSTA believes that the SEC's proposed disclosure requirements relating to credit investments are unnecessary in light of current market-driven efforts. Credit Investors who desire ESG information are increasingly asking specific ESG-related questions of companies. For example, LSTA has developed an ESG Due Diligence Questionnaire ("**ESG DDQ**") for borrowers which is designed to solicit a baseline of ESG information and is currently used as a means of reporting and is applicable to companies across industries and in all stages of development with respect to ESG. The ESG DDQ has served as a crucial first step in regular ESG reporting to Credit Investors. There has been broad uptake in the completion of the ESG DDQ in credit transactions over the last 12 months, however, the high-level information reported reflects the undeveloped state of ESG among private companies.

Credit Investors are seeing the need for improvement in the quality of ESG information, particularly the need for quantitative and comparable information, and are actively working with their end investors/asset owners and companies to develop a market-based solution to address the stated goals of the Proposed Rule. These efforts take into account the resource limitations on borrowers and a realistic timeline for their development of ESG capabilities while still driving forward meaningful improvement.[5] These efforts are being led by LSTA's recent partnership with the PRI and the ACC to harmonize current disparate and competing ESG information requests. The project aims to align stakeholders to support material and consistent ESG data disclosure. The harmonized ESG reporting template will enable lenders to receive consistent data from corporate borrowers across the private and broadly syndicated credit markets. The move to a standard set of ESG reporting will bring efficiency to the reporting process of borrowers which in turn will promote more robust ESG reporting. In addition, leading global general partners and limited partners have also joined together to develop a standardized set of ESG metrics for comparative reporting through the ESG Data Convergence Initiative which seeks to create a critical mass of material, performance-based, comparable ESG data from portfolio companies. The ESG Data Convergence Initiative will further support the efforts described above.

[5] Given the resource constraints and education needed for these companies, the ability to have a sequenced, iterative approach is critical. This approach is executed more successfully in a voluntary disclosure context.

LSTA strongly urges the Commission to not disrupt these efforts with the Proposed Rule and allow the market to quickly develop practical solutions demanded by investors that will work within the evolving ESG landscape.

IV. LSTA Specific Comments to the Proposed Rule

A. Inclusion of BDCs in the Proposed Rule is Appropriate as Opposed to in the SEC's Recent Climate Proposal

We recognize and agree with commenters[6] that BDCs should not be included in the universe of registrants subject to the SEC's proposed rulemaking titled "The Enhancement and Standardization of Climate-Related Disclosures for Investors"[7] (the "**Climate Proposal**") as they are not operating companies but investing companies. The SEC requested public feedback on this very question in the Climate Proposal and LSTA hopes the SEC will exclude BDCs from its final Climate Proposal rulemaking. If BDCs are to be subject to rule-making in this area, LSTA believes it is more appropriate to include them in the scope of the Proposed Rule, which is specifically designed for investment companies.

We sincerely hope that the SEC takes the industry feedback to heart and exempts BDCs from the scope of the Climate Proposal. It is also important for the SEC to recognize that without such an exemption, in the event that both proposals are adopted, BDCs that are both registrants and subject to applicable provisions of the Investment Company Act would be burdened with two independent sets of climate reporting requirements which are not aligned.

Given the SEC's stated goal that both the Proposed Rule and the Climate Proposal are intended to provide investors reliable, comparable and decision-useful information on the companies in which they invest, there is significant cost and no value to BDCs being subject to one set of requirements as registrants and a separate set of requirements as investment companies. Further, since BDCs are not operating companies, the disclosures contemplated in the Proposed Rule are more appropriate and better achieve the SEC's stated goal, subject to the modifications described below.

B. LSTA Supports the Use of a Tiered Approach to ESG Disclosure But The Applicable Categories Must be Based on a Traditional Materiality Standard

In general, LSTA supports a tiered approach that requires different levels of disclosures based on the extent to which an ESG strategy is followed, how the ESG strategy is pursued, and the status of the fund or adviser. A tiered approach allows for ESG disclosures to be proportional to the importance of ESG in the investment selection process that will assist investors. We are concerned, however, that the Proposed Rule would require an adviser or a fund to provide detailed disclosures concerning the

[6] See (i) the letter from the Small Business Investor Alliance to the SEC, dated June 16, 2022 at 2, *available at* https://www.sec.gov/comments/s7-10-22/s71022-20131587-301953.pdf, (ii) the letter from the American Investment Council to the SEC, dated June 17, 2022 at 13, *available at* https://www.sec.gov/comments/s7-10-22/s71022-20132284-302816.pdf, and (iii) the letter from the Asset Management Group of the Securities Industry and Financial Markets Association to the SEC, dated June 17, 2022 at 18, *available at* https://www.sec.gov/comments/s7-10-22/s71022-20132939-303286.pdf.

[7] *See Enhancement and Standardization of Climate-Related Disclosures for Investors*, Release Nos. 33-11042; 34-94478 (Mar. 21, 2022), https://www.sec.gov/rules/proposed/2022/33-11042.pdf.

integration of ESG factors regardless of how minor the consideration may be or whether the adviser or fund promotes or follows an affirmative ESG-oriented strategy. The effect would create an undue emphasis on what may otherwise be an immaterial strategy. Such a result is contrary to the SEC's stated goal of reducing the risk of "greenwashing" by overemphasizing the consideration of ESG factors even where immaterial. Our comments in this section are intended to mitigate the risk of immaterial and irrelevant ESG disclosure by reviewing the categories through the lens of traditional materiality.

1. <u>"ESG Integration" Should be Removed from the Final Rule in its Entirety</u>

The Proposed Rule defines "ESG Integration" strategies as those that consider one or more ESG factors alongside non-ESG factors, such as macroeconomic trends or company-specific factors like a price-to-earnings ratio.[8] In describing such strategies, the Commission notes that ESG factors may be considered in the investment selection process but are generally not dispositive compared to other factors when selecting or excluding a particular investment.[9] Such proposed definition is so broad that it could pull in any fund or strategy where factors relating to E, S or G are relevant to credit analysis or other economic, financial or risk analysis, but are not considered as part of an affirmative ESG strategy or for the purpose of fulfilling ESG obligations. As currently proposed, additional disclosures of ESG Integration funds and strategies will overstate the emphasis of ESG in funds and strategies and result in overemphasis of ESG information in strategies where ESG is not pursued for its own sake. To avoid such overemphasis and the investor confusion that is likely to result, "ESG Integration" as a category of fund or strategy should be eliminated in its entirety from the Final Rule.

In the alternative, should the SEC significantly narrow the scope of "ESG Integration" and refocus the definition as set forth below, simple disclosures by ESG Integration funds may be of some interest to investors. If the category is not eliminated, LSTA recommends that "ESG Integration" should only cover funds that consider, or strategies where an adviser considers, ESG factors as part of an intentional ESG strategy or policy, considers ESG factors for a non-financial purpose or objective, or actively promotes the fund or strategy as integrating ESG factors in the investment decision making.[10] This narrowed scope would avoid immaterial and misleading disclosures.

2. <u>Use of a "Significant" and "Main" Standard for ESG-Focused Funds should be Replaced with a "Materiality" Standard</u>

The definition of "ESG-Focused" funds or strategies is overly broad and would not result in meaningful disclosures. The Proposed Rule defines "ESG-Focused" as funds or strategies that focus on one or more ESG factors by using them as a "significant or main consideration" in selecting investments or in engaging with portfolio companies.[11] This category explicitly includes any fund that (1) has a name including terms indicating that the fund's investment decisions incorporate one or more ESG Factors and (2) any fund whose advertisements or sales literature indicates that the fund's investment decisions

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[8] *See* Proposed Rule at 14.

[9] *Id*.

10 We note that "active" promotion must be given a carefully considered definition so that it does not cover circumstances, for example, where an adviser or fund is responding to institutional investors' questions such as responding to due diligence requests.

[11] *Id*. at 14-15.

incorporate one or more ESG factors by using them as a significant consideration in investment selection.[12] While the SEC helpfully clarifies that a mere mention of ESG considerations or a description of the relationship between ESG considerations and other considerations would not rise to this level, the terms "significant" and "main" are themselves different terms implying different degrees of consideration and are not terms defined in law.[13] The definitional ambiguities of these terms will create confusion and will present significant challenges to advisers and funds in their efforts to determine whether their ESG considerations rise to the level required to trigger the new disclosure requirements. The vagueness of the standard is further amplified by the fact that the definition will likely include funds or strategies that do not promote or market themselves to investors or clients as being ESG-Focused. In addition, this could result in over-disclosure by advisers and funds who are concerned that their determination of whether or not a strategy is "significant" will be second guessed after the fact. In light of this, LSTA requests the Commission to revise the definition of "ESG-Focused" to only include funds and strategies that use ESG factors as a material consideration in line with the well-understood "materiality" standard as codified in Supreme Court precedent and decades of SEC regulation. If the Final Rule is so revised, "ESG-Focused" funds would only include those funds and strategies that focus on one or more ESG factors by using them as a *material* consideration relating to an intentional ESG strategy or policy standard. The SEC should also then provide detailed guidance concerning how extensive an ESG factor must be in order to be considered "material".

3. Use of Screens Unrelated to an ESG Policy Should be Eliminated from the Scope of the "ESG Focused" Definition.

Under the proposed definition any funds that apply screens to include or exclude particular portfolio investments based on one or more ESG factors would be within the proposed definition of "ESG-Focused" strategies. The use of screens, particularly negative screens, is a common practice in investment management and are used to address factors that could be deemed "governance" or "social" but that are not part of an intentional ESG strategy. In some cases, this may be due to investor preferences, and in others, perhaps because of investment policies that the adviser has adopted at a firm level. Without any clarification around the scope of "ESG" or the motivation behind the screen, there is a significant risk that this category is overly broad as drafted. For instance, if certain investments are excluded largely on the basis of weak governance, it appears that such a screen could bring the strategy in the scope of the definition of "ESG-Focused" and require the fund to comply with the new prescriptive disclosures set forth in the Proposed Rule – despite the screen being used merely to execute a firms' credit views. In addition, indentures governing CLOs frequently include enumerated sectors in which the CLO manager is restricted from investing, and SMA clients often include in contracts, and private fund investors include in side letters with fund managers, a requirement that certain categories of investments be excluded (*e.g.*, tobacco), even where the manager is not purporting to provide an ESG-Focused strategy. These exclusions based on investor preferences should not impose ESG disclosure

[12] *Id*. at 34. Moreover, given the broad scope of the definition of "advertisement" under the Advisers Act many communications with institutional investors, such as due diligence questionnaires, may be considered "advertisements" but do not meet a standard of public disclosure, holding out, or what might constitute "marketing" in a more common parlance.

13 While Form ADV Part 2A Item 8.B requires disclosures relating to a "significant investment strategy or method of analysis" only "material risks involved" in those strategies must be disclosed and the release adopting the form indicates in note 74 that "a method of analysis or strategy [is] significant if more than a small portion of the adviser's client's assets are advised using the method or strategy." In Item 8.B there is a required disclosure of "significant or unusual risks" but the release adopting the form made clear this is included to cover risks that are not otherwise approved. Neither of these prior uses of significant" provide a useful standard that is easily applied to determine whether a strategy is "ESG-Focused". *See* Release No. IA-3060.

obligations on RIAs. If the disclosure requirements contemplated in the Proposed Rule are triggered just by the use of a negative screen, investors could be misled to believe that these screens relate to an intentional ESG policy and furthermore that the screens themselves are material to the investment selection process.

For the reasons stated above, the use of screens that are not attributable to stated ESG policies or goals or are included as a result of investor preference should not impose ESG disclosure obligations on a fund or adviser. For these reasons, the term "ESG-Focused" should be revised to exclude negative screens where the manager or fund does not promote those screens as part of an intentional ESG strategy.

C. The Final Rule Must Define What "ESG" is Not

The Commission proposes not to define the term "ESG" or any of its subparts (*i.e.*, "E," "S," or "G") for purposes of the new disclosure requirements noting that "ESG" is generally used 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.[14] While LSTA strongly agrees that static definitions would not be helpful due to the evolving nature of the ESG landscape, the lack of defined terms creates ambiguity and a risk of second guessing. In order to guard against such ambiguity, the Final Rule should clarify what is *not* considered ESG. Such exceptions from the definition should include any use of environmental, social and governance considerations in a fund's fundamental credit analysis because credit analyses are fundamentally an economic, financial or risk consideration that have long included factors that are now labeled ESG such as sound governance, physical and transition climate risks for certain industries, and workplace safety. The Final Rule should also clarify that a fund or adviser's compliance with applicable laws and regulations, including conventions, would not be considered "ESG" for purposes of these rules. Often funds and RIAs exclude certain investments in compliance with applicable sanctions and anti-money laundering rules. While these exclusions could be seen as relating to governance factors, such screens clearly should not classify a fund or adviser's strategy as ESG-Focused. Finally, BDCs are required to offer managerial assistance to portfolio companies, which is a statutory requirement and not driven by ESG engagement goals. Such engagement by a BDC could be considered related to ESG factors (particularly "G"), even when not part of an intentional ESG strategy or policy, and would cause the BDC to be pulled into the definition of an "ESG-Focused" fund – clearly an unintended result.

Rather than defining ESG (or any its subparts), the Final Rule should defer to an adviser or fund that makes a "good faith determination" concerning whether a particular factor is an ESG factor, and should allow (but not require) RIAs and funds to rely on established taxonomies, such as the EU Taxonomy, in making such good faith determinations. Funds and RIAs should not be penalized in relying on a good faith determination as to what constitutes ESG, particularly as the market continues to evolve.

D. GHG Emissions Disclosure Requirements Should be Limited to Climate-Focused or Carbon-Focused Funds

[14] *See* Proposed Rule at 10.

LSTA strongly believes that registered funds and BDCs that are not climate- or carbon-focused funds should be exempt from the additional disclosure requirements proposed for environmentally-focused funds (*e.g.*, the calculation of carbon footprint and weighted average carbon intensity ("**WACI**")). As highlighted throughout this letter, all disclosure requirements introduced by the Proposed Rule must be tied to a traditional "materiality" standard. It is as clear that GHG emissions data is material for a climate-focused fund as it is that GHG emissions data is likely immaterial for, *e.g.*, a fund focused on non-ozone depleting investments or investments in biodiversity protection. Limiting GHG emissions disclosures to climate- or carbon-focused funds also has the added benefit of better ensuring that the information being reported is of superior quality. In order to pursue a climate- or carbon-focused strategy, a fund must be confident that it will be able to readily obtain reliable data on its portfolio investments. Moreover, funds that are focused on climate or carbon strategies are more likely to have developed internal expertise to understand information on portfolio investments and calculate carbon-related metrics, such as those required under the Proposed Rule. Finally, the additional costs imposed by such a GHG emissions disclosure requirement in the Final Rule are likely low.

E. Mandatory Fund Disclosures on Private Companies Should Not be Required as They Are Inappropriate, Unduly Burdensome and Will Necessitate Reliance on Estimates

As explained above, we strongly encourage the Proposed Rule's requirement on funds to disclose GHG emissions data on its portfolio investments be limited to climate- or carbon-focused funds. However, if the SEC declines to limit the requirement as proposed, then we respectfully request that the Commission exclude registered funds and BDCs from reporting GHG emissions information on private company portfolio investments that do not themselves report GHG emissions information.

The Proposed Rule defines "portfolio company or portfolio investment" to include an investment in "(A) an issuer that is engaged in or operates a business or activity that generates GHG emissions…" and an entity that relies on section 3(c)(1) or 3(c)(7) "that invests in issuers described in paragraph (A) of this subsection…"[15] Registered funds and BDCs that invest in private operating companies, directly or through investments in private funds, such as CLOs, would need to include those investments for purposes of calculating that fund's carbon footprint and WACI. This is anything but a straightforward exercise. Little reliable GHG emissions data is reported by private companies and CLOs and credit funds that invest in private companies do not currently engage in carbon reporting. Likewise, the contracts underpinning their investments in private companies do not currently contemplate investee companies reporting GHG emissions to their investors. Looking forward, private funds will not have to report GHG emissions information on itself or its investments under the Proposed Rule or the Climate Proposal. Similarly, private companies do not have any direct obligations to disclose GHG emissions in the Climate Proposal.

The relationship between a fund required to report under the Proposed Rule and investee companies is that of lender and borrower. A private company looking for financing agrees, contractually and subject to confidentiality undertakings, to share its financial information to permit prospective lenders to assess its creditworthiness. This diligence process focuses on the borrower's ability to repay the loan and minimal information exists outside of this arrangement. The lender can request the borrower's Scope 1

[15] Proposed Instruction 1(d)(ix) to Item 24 of Form N-2.

and Scope 2 emissions, but there is no obligation on the borrower to provide it – indeed the borrower may be disinclined to provide it. These challenges are compounded where a fund is investing in a private fund which in turn invests in private companies. As an example, BDCs invest regularly in CLO notes. The CLO is managed by an RIA that agrees to report certain information to the CLO's investors as set forth in the relevant indenture. The Proposed Rule would require the BDC to look through the CLO to the underlying loans the CLO holds, however the BDC does not have a contractual relationship with the borrower, *because the BDC's investment is in the CLO*. The BDC is reliant on the CLO manager for access to any of the borrower's information. For the "look through" to function as proposed, a CLO manager has to agree to take on the responsibility of gathering Scope 1 and Scope 2 data on the borrowers in its portfolio and then share that information with the BDC. It is far from clear that the CLO manager would be successful in obtaining that information from the borrower, as described above, and given that, it is not clear whether a CLO manager would be willing to take on this responsibility. At a minimum, it will result in increased costs for the BDC which will be passed on to its investors.

For the reasons above, it is reasonable to assume that Credit Investors would be forced to largely rely on emissions estimates for its portfolio investments which would lead to investors receiving unreliable and incomparable information in direct odds with the SEC's stated objective. As we see, the Proposed Rule imposes an undue burden on the fund and introduces unneeded friction into the transaction. The costs are significant and, at best, only provides investors with incomplete, unreliable and incomparable information.

V. Cost-Benefit Analysis Indirectly Regulates, Underestimates Costs and Ignores a Reasonable Alternative for Private Companies

We question whether the SEC has satisfied its duties under APA given its failure to meaningfully consider the costs the Proposed Rule imposes on private companies. It appears that the SEC, pursuant to the Proposed Rule, is attempting to regulate indirectly what it is not authorized to regulate directly, at a significant cost to Credit Investors and private companies who are not regulated by the Acts. For example, the Commission includes GHG emissions reporting requirements for private company investments in the Proposed Rule, but this data is largely unavailable from private companies. Thus, funds and BDCs will be required to make good faith estimates for this entire asset class. Rather than face potential liability for their estimates, funds and BDCs will begin to demand costly and burdensome GHG reporting from the private companies or, worse, cause disincentive investments in private companies that are unable to provide this data. As the Supreme Court has explained, "reasonable regulation ordinarily requires paying attention to the advantages *and* the disadvantages of agency decisions."[16] Here, the SEC will face a heightened obligation, as it is statutorily required to consider whether its rules will "promote efficiency, competition, and capital formation."[17] These requirements "impose[] on the [Commission] an obligation to consider the economic implications of certain rules it proposes."[18] A failure to give "proper[]" consideration to the economic implications of its rules renders

[16] *Michigan v. EPA*, 576 U.S. 743, 753 (2015).

[17] 15 U.S.C. § 80b-2(c).

[18] *American Equity Inv. Life Ins. Co. v. SEC*, 613 F.3d 166, 178 (D.C. Cir. 2010) (considering 15 U.S.C. § 77b(b)).

the SEC's actions arbitrary and capricious, as many courts have concluded.[19] Furthermore, the APA obligates the SEC to give careful consideration to alternatives to any regulations the agency ultimately adopts.[20]

The SEC does not examine the significant costs and adverse impact on capital formation that the Proposed Rule would impose on credit market participants. While the Proposed Rule states that including private companies in GHG emissions reporting will cost more than excluding them[21], there is no recognition of these costs in the estimates the SEC provides. We describe a number of likely costs and market frictions relating to the GHG emissions reporting contemplated in the Proposed Rule– none of which appear to have been considered by the SEC.

1. Registered funds and BDCs will face significant compliance costs, including establishing new controls and processes, the need to hire additional third-party advisers as well as additional personnel with sufficient scientific and subject matter expertise to understand, track and make good faith estimates of GHG emissions numbers given the lack of reporting by private companies. These costs will ultimately be borne by investors.
2. There will be increased transaction costs in credit investing, for example, the increase in management fees a CLO manager would require if it were to take on the data collection and reporting responsibility the Proposed Rule contemplates for environmentally-focused funds. These costs will ultimately be borne by investors.
3. As noted above, registered funds and BDCs may choose not to invest in private companies, either directly or through private funds, like CLOs, that cannot provide them with the necessary information. Many of the smaller companies who turn to BDCs for financing do not have the ability to gather and report the information required by the Proposed Rule and also do not have access to public capital markets and, as such, it is unclear there is an alternative competitive source of capital. Companies would face lower access to capital and/or higher borrowing costs.
4. Alternatively, larger private companies who have additional financing options will likely choose to pursue an alternative source of capital from a lender that does not require such information. In this case, investment exposure in private companies will be less accessible to retail investors who rely on BDCs and registered funds for such access.

More generally, because the Proposed Rule covers funds and advisers that are not affirmatively pursuing ESG strategies but may consider ESG factors in some part, the cost-benefit analysis provided by the Commission vastly understates the costs of compliance to the industry, which will ultimately affect both the costs of and access to investments, particularly for retail investors. The cost burden is likely to be felt particularly by small and emerging advisers, which reduces diversity and in fact undermines the "S" and "G" portions of the stated goals of the Proposed Rule.

[19] *Id.*; *see also Business Roundtable v. SEC*, 647 F.3d 1144, 1148 (D.C. Cir. 2011); *Chamber of Commerce of U.S. v. SEC*, 412 F.3d 133, 144 (D.C. Cir. 2005).

[20] *See Laclede Gas Co. v. FERC*, 873 F.2d 1494, 1498 (D.C. Cir.1989) (failure to consider reasonable alternatives is arbitrary and capricious).

[21] Proposed Rule at 260.

In addition to the SEC's insufficient consideration of the costs the Proposed Rule would impose, the SEC has not properly considered reasonable alternatives that could further the SEC's objectives. As described above, there are concerted industry efforts to promote voluntary and robust disclosure on a range of ESG topics. These efforts will significantly improve the availability and comparability of ESG information on private companies – but these efforts will take time and will be most successful if left to develop organically and iteratively. A mandatory disclosure regime affecting private companies is ill-suited to their current capacity and the immature state of ESG reporting. Market-led efforts to support voluntary disclosure by private companies, however, are tailored to be cognizant of the resource constraints many private companies face. Given the robust efforts that credit market participants are making, which avoid the high costs and potential chilling effect of the Proposed Rule, any cost-benefit analysis would weigh against the Proposed Rule in this regard.

VI. Conclusion

LSTA appreciates the opportunity to provide input on the Proposed Rule and is committed to remaining engaged in the development of ESG-related disclosure requirements, an important issue to all financial market participants. LSTA appreciates the Commission's efforts to enhance the consistency, reliability, and comparability of ESG-related disclosures for investors. LSTA supports adoption of a Final Rule that provides material information to investors, but we believe that the current Proposed Rule requires significant refinement to achieve that goal.

We would be happy to discuss these comments and answer any questions. Please contact Tess Virmani at (212) 880-3006.

Sincerely,

Tess Virmani
Associate General Counsel, and
Executive Vice President- Public Policy, Head of ESG LSTA