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PRIVATE EQUITY FIRMS FACING INCREASED SCRUTINY IN FALSE CLAIMS ACT LITIGATION

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This is Part Two of a three-part article addressing the surprisingly wide-ranging scope of potential liability of private equity funds for the obligations of portfolio companies. As we discussed in Part One (which appeared in the July 2020 issue of *Wall Street Lawyer*), the source of risk is not traditional common-law alter ego or veil piercing doctrines (though the legal analysis can in part draw on these doctrines) but rather is regulatory in nature. Part One examined the risk in the context of the federal WARN Act. In this Part Two, the focus is the False Claims Act.

False Claims Act Background

The False Claims Act ("FCA") is the federal government's primary statute for combating fraud against government programs. It imposes liability on one who, among other things, knowingly presents or causes to be presented false or fraudulent claims to government programs. In this context, "knowingly" is defined broadly to include acting with deliberate ignorance or reckless disregard as to the truth or falsity of the claim. Specific intent to defraud is not required. The statute also imposes liability on one who knowingly retains an overpayment received from a government program or avoids a liability owed to the government.

The FCA imposes significant liability. The statute provides for treble damages plus penalties of approximately $11,000-$23,000 for each false claim or false statement used to get a false claim paid.

Most FCA cases are filed by whistleblowers, referred to as "relators." Under the *qui tam* provisions of the FCA, a relator can file suit on behalf of the United States. The relator files the Complaint under seal, without serving or otherwise informing the defendant. While the case is sealed, the Department of Justice ("DOJ") has an opportunity to investigate the relator's allegations to decide whether to intervene in the lawsuit. The DOJ will typically serve document subpoenas upon the

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defendant and possibly others, which the DOJ frequently follows with requests for voluntary witness interviews. The FCA also permits the DOJ to compel witnesses to provide deposition testimony and allows it to serve written interrogatories. In some cases, the DOJ will employ more surreptitious investigative techniques, such as having a cooperating witness secretly record conversations.

After it completes its investigation, the DOJ will decide whether to intervene in the *qui tam* suit. If the DOJ decides the case merits intervention, it will take the lead in prosecuting the case. If the government intervenes, the relator is entitled to receive 15%-25% of the government's eventual recovery, whether from a settlement or a verdict after trial. Alternatively, if the DOJ declines to intervene, the relator can continue to litigate the case on behalf of the government and is entitled to receive 25%-30% of any eventual recovery. Regardless of the intervention decision, the relator is also entitled to attorney's fees in case in the event that either the relator or the government prevails.

Where there has not been a prior public disclosure of the allegations of fraud, anyone can file suit as a relator—an employee, former employee, competitor, supplier, customer or even a total stranger. If there has been a public disclosure of the allegations, such as in a newspaper article or in a Congressional hearing or agency audit, the relator must come forward with information over and above what has been publicly disclosed.

According to DOJ statistics, between 2010 and 2019, relators filed a total of 6,650 *qui tam* lawsuits, with 634 filed in 2019. The great majority of the government's recoveries come from cases originally filed by relators. Between 2010 and 2019, the government recovered a total of $37.9 billion in FCA cases of which $29 billion originated from cases filed by relators. During that same period, relators received rewards totaling nearly $4.9 billion.

Most *qui tam* lawsuits allege fraud against Medicare, Medicaid and other federal health care programs (including 449 of the 634 *qui tam* suits filed in 2019), and most of the government's FCA recoveries are due to health care cases. Between 2010 and 2019, $25.4 billion of the government's $37.9 billion total FCA recovery came from health care cases.

Many states and municipalities have enacted False Claims Acts that parallel the federal law, including similar provisions allowing relators to file *qui tam* lawsuits and receive a portion of any recovery.

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Recent FCA Cases Against Private Equity Funds and Sponsors

Two recent cases illustrate the potential FCA liability facing private equity funds and sponsors. In each case, the court held that an FCA Complaint sufficiently alleged that the private equity investor could be liable for causing its portfolio company to submit false claims to federal health programs. One case has concluded with a substantial settlement and the other case remains active.

***United States ex rel. Carmen Medrano v. Diabetic Care RX, LLC:* Private Equity Sponsor Settles after Court Finds that the Government's Complaint Adequately Alleged the Firm's Role in the Alleged Misconduct.**

In February 2018, in *United States ex rel. Carmen Medrano v. Diabetic Care RX, LLC*, 2018 WL 6978633 (S.D. Fla. 2018), the United States intervened in a *qui tam* action brought by two relators alleging fraud on the part of a compounding pharmacy. In its Intervention Complaint, the United States alleged that the compounding pharmacy, two of its executives, and Riordan, Lewis & Haden, Inc. ("RLH"), a private equity sponsor that managed private equity funds that owned a majority of the compounding pharmacy, were all liable under the FCA. This has been widely reported as the first time that the government had intervened in a *qui tam* action against a private equity firm.

The government alleged that the compounding pharmacy paid illegal kickbacks in the form of excessive commissions paid to marketing companies to recruit Tricare beneficiaries to receive prescriptions for various compounded pain creams, scar creams, and vitamins, without regard to the patients' actual medical needs. In addition, the government alleged that the pharmacy and the marketing companies paid kickbacks to telemedicine doctors to prescribe the creams and vitamins for patients that they had not actually seen, and that the entities routinely paid for or waived patient copayments in violation of the federal Anti-Kickback Statute ("AKS").

The government alleged that two RLH partners served as directors of the pharmacy and approved the decision to use independent contractors, despite knowing that outside counsel had advised that paying commissions to independent contractors (rather than to an employed sales force) posed risk under the AKS. Further, the government alleged that RLH periodically eased the pharmacy's cash flow problems by providing cash from the private equity investors to fund the alleged illegal commission payments that were due to the marketers. Finally, the government alleged that RLH and its appointed board members failed to ensure that the portfolio company implemented an effective compliance program, failed to establish a compliance committee, and failed to appoint a qualified chief compliance officer.

In a Report and Recommendation on a motion to dismiss, a Magistrate Judge agreed with the government that its Complaint sufficiently alleged RLH's involvement in the pharmacy's scheme to pay alleged unlawful commissions to marketers:

> The Complaint does . . . adequately allege RLH's knowledge that [the compounding pharmacy] submitted false claims to TRICARE under the marketing kickback scheme. . . . [T]he Complaint alleges that RLH was advised by counsel that paying commissions to marketers could violate the AKS and that compliance with the AKS was a material requirement for reimbursement from TRICARE. The Complaint also alleges that RLH: (i) approved of [the pharmacy's] decision to use marketers to generate referrals; (ii) knew that TRICARE was the source of the majority of [the pharmacy's] revenue; (iii) received monthly financial statements, which reported the monthly compounding revenue and the commission paid to the Marketers; and (iv) RLH funded $2 million in commissions to the Marketers in January 2015.[1]

The Magistrate Judge, however, opined that the Complaint did not allege sufficient facts for RLH to be liable for the pharmacy's alleged scheme of waiving patient copayments. The Magistrate Judge wrote that "[a]s to this scheme, the only allegations against RLH are that [one of the RLH partners on the pharmacy board] sent [the pharmacy CEO] OIG Guidelines advising that routine copayment waivers could violate the AKS. But the Complaint is devoid of allegations that RLH was aware that [the pharmacy] was routinely paying patients' copayments, or doing so without verification of financial need."

Subsequently, in September 2019, RLH and the compounding pharmacy agreed to pay $21,050,000 to settle the FCA claims against them. In its press release[2] announcing the settlement, the DOJ stated that "RLH, the private equity firm that managed [the compounding pharmacy] on behalf of its investors, allegedly knew of and agreed to the plan to pay outside marketers to generate the prescriptions and financed the kickback payments to the marketers."

***United States ex rel. Martino-Fleming v. South Bay Mental Health Center, Inc.*: Court Denies Private Equity Fund's Motion to Dismiss and Holds that the State's Complaint Adequately Alleged Involvement of the Firm in the Alleged Misconduct.**

In *United States ex rel. Martino-Fleming v. South Bay Mental Health Center, Inc.*, 2018 WL 4539684 (D. Mass. 2018), a former employee of a chain of mental health centers filed a *qui tam* action under the federal and Massachusetts False Claims Acts, alleging that the mental health centers used unlicensed and unsupervised personnel to provide services to patients, in violation of state Medicaid rules. The Commonwealth of Massachusetts intervened in the Massachusetts FCA claims, but the United States declined to intervene. In its intervention Complaint, the Commonwealth named as defendants: (i) the mental health center chain; (ii) its former CEO; (iii) a private equity fund and its sponsor ("H.I.G."); (iv) an investment vehicle ("C.I.S.") that was formed by the H.I.G. fund to acquire the mental health center chain and whose majority owner is the H.I.G. fund; and (v) an individual who served as the CEO and Board Chair of C.I.S.

Massachusetts alleged that C.I.S. and the H.I.G. fund and sponsor became aware via pre-acquisition due diligence that the mental health centers were using unlicensed and inadequately supervised personnel. It further alleged that after the acquisition, the Director of Clinical Services of the mental health chain informed multiple C.I.S. executives that the mental health centers were using unlicensed and unsupervised personnel, and that the problem increased as the private equity owners pressed for growth in the business. Subsequently, "tiger teams" formed by the mental health chain investigated and reported to the C.I.S. Board on the licensure and supervision problems, and recommended to the C.I.S. Board that the mental health centers hire a "substantial number" of "qualified supervisors" in order to satisfy Massachusetts regulations.

According to the Complaint, the C.I.S. Board took no action to ensure the portfolio company corrected the staffing problems and considered the tiger teams to be an "enormous waste of time." In addition, Massachusetts alleged that the C.I.S. Board was "heavily involved in the operational decisions of [the mental health centers], including approving contracts, strategic planning, budgeting, and earnings issues." Finally, Massachusetts alleged that the H.I.G. defendants knew of these compliance issues because certain H.I.G. executives learned about them by serving on the Board of C.I.S.

The C.I.S. and H.I.G. defendants moved to dismiss. They argued that the Complaint alleged merely that they had failed to stop the portfolio company from violating Massachusetts regulations, but not that they actually caused the portfolio company to commit the violations. In support, they cited cases holding that mere knowledge that another is submitting false claims to the government is not enough to give rise to FCA liability. Despite this case law, the District Court denied the motion to dismiss and held that the Complaint adequately alleged that the C.I.S. and H.I.G. defendants caused the mental health centers to submit false claims:

> Here, the Relator alleges that she and the Tiger Teams expressly informed the CEO and Board[] of C.I.S. . . . that the supervision of clinical workers violated state regulations and recommended that a substantial number of licensed supervisors be hired to fix the problem, and that the recommendation was rejected. The allegation that C.I.S. and [the CEO of C.I.S.] knowingly ratified the prior policy of submitting false claims by rejecting recommendations to bring [the mental health chain] into regulatory compliance constitutes sufficient participation in the claims process to trigger FCA liability.
>
> Because it is alleged that H.I.G. members and principals formed a majority of the C.I.S. and [mental health chain] Boards, and were directly involved in the operations of [the mental health chain], the motion to dismiss the H.I.G. entities is also denied. A parent may be liable for the submission of false claims by a subsidiary where the parent had direct involvement in the claims process.[3]

This case is currently pending.

Lessons for Private Equity Firms

The recent success in FCA litigation against private equity funds and sponsors is likely to encourage additional efforts. We understand that the government is currently investigating sealed *qui tam* lawsuits filed against portfolio companies and the private equity funds that have ownership interests in them. Private equity sponsors may wish to consider a number of measures to reduce potential FCA risks for their funds and themselves.

Portfolio Company Compliance Programs. Private equity funds and their sponsors should ensure that portfolio companies implement effective compliance programs to address specific risk areas for their industry. A portfolio company should appoint a compliance officer, adopt compliance-related policies and procedures, conduct structured compliance training and education for employees and contractors, conduct regular compliance auditing and monitoring, and establish a Board Compliance Committee. In the case of portfolio companies in the health care field, the Office of Inspector General of the U.S. Department of Health and Human Services ("OIG") has issued multiple guidance documents outlining and elaborating upon the elements of an effective compliance program. Likewise, the OIG has issued compliance guidance for members of Boards of Directors of health care companies.

Responding Decisively to Compliance Concerns. When executives of a private equity fund or sponsor are put on notice of a compliance concern involving a portfolio company, they should ensure that the portfolio company takes appropriate action. The government and relators will seek to impute knowledge they gain from their role on the portfolio company's board to the private equity fund or sponsor, and especially so in the case of a majority-owned investment. As a result, private equity representatives on portfolio company boards will wish to ensure that identified compliance issues are properly investigated and that the portfolio company implement any necessary remedial action.

Pre-Investment Regulatory Due Diligence. Private equity funds should ensure that they have conducted adequate regulatory due diligence before making an investment in a target company. This will enable the private equity fund to ensure that compliance issues are remediated prior to acquisition or are at least addressed with an appropriate plan of correction. In many cases, as a condition of closing, private equity investors require the business being acquired to self-disclose violations of law to the government and adopt internal controls to prevent continuation of the noncompliance. In the health care field, this may mean making a disclosure to the OIG under its Self-Disclosure Protocol or a disclosure to the Centers for Medicare and Medicaid Services under that agency's Stark Law Disclosure Protocol. Of course, private equity funds should also seek appropriate representations and warranties from the seller, as well as customary, and, if needed, special indemnifications and escrows, related to compliance issues (and should consider purchasing representation and warranty insurance). These contractual protections, however, may not be effective at limiting exposure for similar actions continuing post-closing, especially where the private equity fund and/or sponsor is made aware of the issue.

Educate Private Equity Principals, Members, Directors and Employees that Increased Involvement in a Portfolio Company's Operations Increases Liability Risk. A private equity fund can and should play a valuable role in improving a portfolio company's operations and may want its principals, members, directors and/or employees to play an active role on the portfolio company's board. There are many good business reasons for doing so, including the business expertise that the private equity investors bring. However, participating in the portfolio company's day-to-day operations increases the risk that the private equity fund or sponsor will be liable under the FCA if their involvement touches on regulatory and compliance issues. Private equity principals, members, directors and employees who serve on portfolio company boards should receive education regarding how their participation and knowledge can potentially be imputed to the private equity fund and/or sponsor for purposes of FCA liability.

Conclusion

The FCA risks facing private equity funds and sponsors are not only economic but also reputational. FCA reputational harm may undermine efforts to raise funds from current and future investors, particularly for private equity funds that rely on endowments and/or public pension fund investors, as these investors can be quite sensitive to corporate and social responsibility qualifications. Being in the national press as a defendant in a Medicare or Medicaid fraud case, or having settled an FCA lawsuit, can potentially complicate securing investment from a teachers' or other public employees' pension fund. Potential acquisition targets may also be wary of a private equity fund investor and its sponsor embroiled in FCA investigations or litigation.

Although private equity funds do not themselves submit claims to the government, they can still be liable under the FCA for "causing" their portfolio companies to submit false or fraudulent claims. It is predictable that the government and private relators will seek to broadly expand the concept of "causing" a portfolio company to submit false claims, such that there could be risk whenever employees or directors of a private equity fund and/or sponsor come to learn of uncorrected regulatory noncompliance by a portfolio company. Private equity funds and sponsors would be well-advised to educate their employees, executives, principals and directors on liability risks under the FCA, the financial incentives for whistleblowers to file *qui tam* suits, and measures that private equity funds and sponsors can adopt to reduce their potential exposure to economic and reputational harms.

ENDNOTES:

[1] *United States ex rel. Carmen Medrano v. Diabetic Care RX, LLC*, 2018 WL 6978633, at *11 (S.D. Fla. 2018).

[2] https://www.justice.gov/opa/pr/compounding-pharmacy-two-its-executives-and-private-equity-firm-agree-pay-2136-million.

[3] *United States ex rel. Martino-Fleming v. South Bay Mental Health Center, Inc.*, 2018 WL 4539684, at *4-5 (D. Mass. 2018).

SEC PASSES INDEPENDENT PROXY ADVISORY FIRM REGULATIONS

By Michael Verrechia and Paul Schulman

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On July 22, 2020 the Securities and Exchange Commission passed a set of rules regulating the independent proxy advisory firms, a space currently dominated by ISS and Glass Lewis. This article will not rehash the lengthy (10 year-plus) and hotly-debated process, including ISS filing a lawsuit against the SEC in the fall of 2019, that led to the adoption of these new regulations. We will focus instead on the key provisions of the rules that affect our clients and the practical impact they will have on proxy solicitation campaigns going forward.

In the current proxy voting landscape, a vast majority of institutional investors make their own voting decisions and use the proxy advisors' recommendations solely as a resource; however there are a number of major shareholders, including large quantitative hedge funds, passive investors and private wealth managers that have no internal proxy voting resource and rely on an automatic vote. This process, commonly referred to as the "robo-vote," allows an institution to automatically follow a proxy advisor's recommendation, which nullifies the need to engage with an issuer or spend any time weighing the pros and cons of a particular vote. The SEC expressed its opinion that these firms are improperly outsourcing their fiduciary responsibilities to a third-party.

For companies with significant institutional share ownership, this block of robo-voted shares can be outcome determinative and often puts the proxy advisor in the position of being the de facto largest shareholder.

No Preview

Unfortunately for issuers, the SEC did not mandate that the proxy advisory firms provide all companies with a draft of the report prior to its publication. The ability to preview the reports was clearly the most desired outcome for issuers, allowing them to provide additional information and perspectives to the proxy advisors or correct any material errors, all in order to flip adverse vote recommendations. A number of S&P 500 clients, who have long had the benefit of receiving draft ISS reports, have been successful in either getting ISS to change its recommendation prior to publication or given a second opportunity to provide disclosure, or perspective, into the report's narrative. Smaller companies are still left having to wait until after the ISS report is released to be able to react to the analyses and recommendations.

The disadvantage to smaller companies is two-fold. First, the bar for ISS to issue a revised report, either with a vote recommendation change or clarifying language is seemingly higher than it is when attempting to affect such changes during the preview period; and second, there are always a number of firms that utilize robo-voting but then do not flip when a revised recommendation is released.

A New Pathway For Company Response

The new rules provide a more direct path for companies to furnish institutions with a counter to an ISS or Glass Lewis recommendation.

Issuers have always had the ability to file additional solicitation material to counter a proxy advisor's recommendation and to take their case directly to shareholders through engagement. However, the effectiveness of this effort can be adversely impacted by the fact that many institutions robo-vote as soon as ISS publishes its report and are unlikely to read or be swayed by these supplemental filings or to engage with the company.

What the new rules provide to address this are the following:

i.) the proxy advisors must allow issuers the ability to provide a response to dispute a recommendation;

ii.) the proxy advisors must notify their clients of any such company response; and

iii.) discourage shareholders from robo-voting, and instead consider both the proxy advisor recommendation and company response.

Impact of the Rules From a Proxy Solicitor's Perspective

As most companies know from experience, proxy returns trickle in at the beginning of the solicitation period, mostly from retail shareholders, and it's only after the proxy advisor recommendation (usually two to three weeks ahead of the meeting) that initial institutional voting comes in. The first wave usually occurs within 24 hours of the ISS report and is made up not only of the robo-votes, but other clients of ISS that have given ISS the authority to vote on their behalf using a customized voting policy that is often fairly consistent with the ISS policy.

Understanding which holders are typically included in this block of votes, a proxy solicitor can identify these firms and determine the appropriate course of action for company's engagement efforts. If the proxy advisors maintain the standard timing of releasing their reports, and institutions delay their voting instructions by a week or more, the timeframe that companies have in which to engage with shareholders is significantly shortened.

Institutions that contract Glass Lewis to vote on their behalf come in much closer to the meeting, typically two to three days prior.

Many of the firms that outsource their voting to one of the proxy advisors do not have the internal resources, capability or desire to make an independent decision. Requiring them to now do so results in additional costs of compliance, research and staffing. For a quantitative-driven hedge fund who may have hundreds, if not thousands, of positions, the result may be a decision that the cost of voting outweighs the benefit and we may see less vote participation. The proxy disclosure of one of these firms reads as follows:

> "The Firm has established a two-tiered policy for voting proxies. . . . the firm will generally rely on the recommendations of its proxy adviser, Institutional Shareholder Services, Inc. ("ISS"). (If ISS does not have a recommendation, the Firm generally will abstain from voting.) For the . . . Funds, which are traded pursuant to a high turnover strategy, the Firm will abstain from voting proxies, as it has concluded that under ordinary circumstances the voting of proxies for these Funds would not be in the best interests of its clients because (a) it would divert resources away from the implementation of its trading strategy and (b) given the Funds' high rate of turnover, it is unlikely that securities held on a particular record date would remain in the portfolio on the date of the vote."

What impact, if any, these new regulations have on advisory firm recommendations and policies remains to be seen.

Proxy Solicitation Rules

The SEC has also redefined the terms "solicit" and "solicitation" of Rule 14a-1 to include the proxy voting advice given by the advisory firms will generally be considered a solicitation and subject to the proxy rules. Importantly the amended rule will include exemptions if certain conditions are met. In short the exemptions that must be satisfied include: disclosure of conflicts of interest, advisory reports are to be made available before or at the same time reports are made available to advisory firm clients, and the institutional clients of the advisory firms can expect to be aware of written statements from the advisory firms, re: issuers, in a timely manner before a shareholder meeting.

The disclosure of conflicts of interest is a drastic departure from the current standards as advisory firms offer consulting services to issuers regarding proposals that the advisory firms will be making future voting recommendations on.

Proposed Increase of 13F Threshold

Separately on July 10, 2020, the SEC proposed increasing the reporting threshold for a Form 13F from $100 million AUM to $3.5 billion AUM. The reporting threshold of Form 13Fs has not been changed since 1975 when Congress adopted the requirements.

Per the SEC, the intended purpose of the increase is to lessen the reporting burden on smaller investment managers. The change in the threshold is a response to the growth of the equity markets as the requirements were initially put in place to monitor large institutional investors. This new threshold, according to the SEC, would cover disclosure for greater than 90% of the dollar value of holdings currently reported but relieving almost 90% of current filers that are smaller managers.

The SEC has opened a 60-day comment period and SEC Commissioner Allison Herren Lee is an early dissenter and voted against the proposal. The effects of this, if enacted, would be wide reaching as companies would have significantly decreased transparency in their own shareholders. The ability of issuers to proactively engage with their shareholder base would be impacted greatly. Smaller investment managers would have an advantage over larger firms, who would continue to file Form 13Fs, in discreetly acquiring an equity stake in an issuer. It would also allow activist shareholders, most of whom fall below the $3.5 billion AUM threshold, to accumulate significant positions up to 4.9% with absolutely no notice to the company or other shareholders.

ESCAPE TO THE PHILIPPINES

By Paul Marrinan

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On July13, 2020, the SEC[1]and CFTC[2] charged a little-known but surprisingly well-funded company known as Abra, legal name Plutus Financial Inc., and a related Philippines firm, for offering unregistered security-based swaps. Something that is probably not surprising when you learn that Abra's core business is digital assets or cryptocurrency. What may be surprising is how the company has offshored many of its operations to the Philippines to avoid strict regulations in the U.S.

For anyone unfamiliar with the Philippines, it is important to know that overseas remittances formed 10.2% of the country's GDP in 2018[3] and that over 65% of the domestic population, of 109 million people, is unbanked.[4] The SEC/CFTC charge shines a light on this app and similar crypto-based offerings that are well resourced but under the radar for many reasons, costing the Mountain View, CA-based company $300,000 in fines. Abra is an interesting case study based on the structure of its offering. The Californian team has outsourced many risk-related activities to other service providers, while also avoiding strict regulation by accessing an off-shore environment via Plutus Technologies Philippines Corporation. They cannot be accused of being unregulated. However, they do raise the questions about whether they are being regulated appropriately in the Philippines, and what effect that may have for their business back in the U.S.

In the Philippines, Tambunting Pawnshops[5] and 7-Eleven stores across the country can be used to buy cryptocurrency using cash. Abra claims to provide access to over 150 countries[6] and 85 cryptocurrencies,[7] with intentions to expand this in the future. However, the regulatory environment in the Philippines, and Abra's apparent use of regulatory loopholes, raises concerns that the platform may be used for illegal activity such as money laundering ("ML") and terrorist financing ("TF"). Recent developments, such as the Wirecard scandal,[8] have highlighted the possible role of Filipino agents[9] in facilitating multi-billion-dollar cryptocurrency scams.

Abra's business model does provide benefit in the Philippines through crypto-enabled international remittances to reduce costs and improve efficiency for their users. Unfortunately, the regulatory structures in the Philippines appear to be unsuited to the mixed-use approach being applied by Abra. Tambunting pawnshops are regulated by Bangko Sentral Ng Pilipinas (BSP). 7-Elevens use the services of Electronic Commerce Payments ("ECPay") Inc. as a money service bureau ("MSB") excluding electronic money issuers ("EMI"), also regulated by BSP, and the Abra application is regulated by the Philippines SEC as Plutus Technologies Philippines Corporation, d/b/a Abra International. The Philippines regulatory structure breaks down registration requirements to constituent industries, with all crypto exchanges being required to register with BSP as a Remittance and Transfer Company ("RTC") with Virtual Currency exchange services.[10] Recent reports show 16 cryptocurrency exchanges have been approved by BSP, with the notable absence of Abra and its various registered business names, or their custody provider Bittrex, a registered Money Service Bureau in the U.S. with the exception of New York State.

Abra's escape to the Philippines may appear insignificant from a U.S. perspective, but it is important to consider that the size of the Filipino remittance industry alone would place the diaspora in the top 100 global economies by GDP, just behind Cameroon and Bahrain.[11] Across the South-East Asian ("SEA") island national, Tambunting has become a major source of financial assistance amongst Filipinos.[12] In a country where remittances from abroad are key to the national economy, Tambunting's services are a vital part of the Filipino society. However, from a Know-Your-Customer ("KYC") perspective, Tambunting tellers are subject to more lenient controls than are standard in more developed economies. According to their website, customers only require one form of identification for any Tambunting transaction,[13] and many of these forms of ID do not include a photograph, can be forged easily, or are not automatically verifiable.

The Asia/Pacific Group ("APG") Mutual Evaluation Report ("MER") on the Philippines discusses a number of cases where remittances have been used to launder funds for organized crime and terrorist activity.[14] Combine this with the presence of terrorist groups across the country, and the use of cryptocurrency to layer money laundering transactions, and Abra is not just avoiding U.S. regulation for ease of business purposes. The company is inadvertently creating a platform that circumvents the checks and balances that are recommended by the Financial Action Task Force ("FATF")[15] which raises the risk of unforeseen consequences linked to terrorist activity and organized crime.

Crypto Remittances and Regulation

It is worth noting that Tambunting is a respected regulated pawnshop business in the Philippines. The network of pawnshops provides access to digital assets on both Coins.ph and Abra via ECPay. However, the regulation of pawnshops and MSBs like ECPay in the Philippines is anomalous to the regulation of virtual asset exchanges in the country.

In most countries, Abra onboarding can be done using a customer's bank account or credit card. In the Philippines, cash onboarding can be done via Tambunting, using Abra Tellers,[16] and through the 7-Eleven chain of stores, via CLIQQ kiosks.[17] ECPay is the company that operates these CLIQQ kiosks that allow for the onboarding of up to 100,000 Philippine Pesos ("PHP") per day, which is around USD $2,000—approximately 62% of the average income in the Mindanao region.

While Abra does run KYC on accounts looking to use a bank account or credit card, the same requirements do not appear to apply to Filipino accounts that only use cash on a single transaction basis.[18] The anti-fraud solution which Abra has integrated, Simplex,[19] is designed for credit and debit card transactions only.[20] The remittance integration, inBestGo, is a Guatemalan-based service which is designed for the Guatemalan market.[21]

Although Coins.ph[22] receives similar services from Tambunting and CLIQQ, Coins.ph differs from Abra as it is registered as a RTC with virtual currency exchange services, under the name Betur Inc.[23] By outsourcing their custody solution to Bittrex,[24] Abra creates an ambiguity around the service which they are providing to their clients.[25] Like many legal contracts, when being compared to "smart-contracts," this ambiguity is a feature rather than a flaw in the Abra service.[26] By partnering with some businesses which are regulated by BSP and by registering Plutus Technologies Philippines Corporation with the Filipino SEC, the company appears to be meeting their regulatory responsibilities. Closer analysis of the U.S.-based company that is registered with FinCEN as an MSB,[27] which is necessary to operate as a cryptocurrency exchange across the United States, indicates that their Philippines-based affiliate is not registered under the equivalent category as an RTC in the Philippines. This is further complicated by the fact that the majority of operations appear to still be running through their California base.

The Philippines MER[28] shows that the infrastructure for investigating ML/TF is not very effective in combating the illicit movement of money. This is surprising considering the relatively high level of education[29] in the country and overall size of the Filipino economy.[30] Unfortunately, the controversial new Anti-Terrorism Act 2020 does little to address terrorist financing in the Philippines beyond removing some oversight measures, such as the requirement for court orders by the Anti-Money Laundering Council ("AMLC").[31] These circumstances combine to make the region an ideal target for money launderers, terrorist financiers, corrupt abuses of power, and, ironically, foreign direct investment, as a favorable infrastructure for such activities is present, *i.e.*, educated work force, weak regulatory structure, international network of diaspora, relatively large economy, and a lack of legislative oversight of government.

Why Is This More Than Just a Regulatory Risk?

The Philippine Institute for Peace, Violence and Terrorism Research ("PIPVTR") has found evidence that Islamic State ("IS")-linked terror groups in the Philippines are using cryptocurrency to launder funds.[32] This money was used to fund the activities of terror networks in the Mindanao region. The report also highlights the use of private remittances to fund the Marawi siege. Allegations of another pro-IS group in Indonesia that considered using bitcoin for fundraising have also surfaced, but eventually the proposal was considered too complicated.[33] A concern that is catered for by removing technical barriers to entry, this represents the start of a move by terror groups across the SEA Region away from their traditionally-trusted networks of cash smugglers.[34] The shift towards cryptocurrency means that the abuse of regulatory loopholes may disproportionately impact developing communities.

As mentioned earlier, the Philippines has been targeted as a filter hub for scam companies like

Wirecard (registered as an EMI with BSP)[35] looking to avoid attention. While Filipino law enforcement agencies have demonstrated the ability to address fraud through suspicious transaction reports ("STRs"), these agencies currently lack the infrastructure to investigate complex cryptocurrency schemes across their broad diaspora. This is especially difficult where more than half the population are not engaged with the traditional financial system. Even applications like Abra that include transaction monitoring to some degree are not capable of deterring illicit activity on their platform effectively.

Abra is an example of a fintech application which is well-funded[36] but under-supervised: something that is a constant challenge for regulators that are confined by limited budgets and the limits of their jurisdictions. Financing FinTech for the Philippines market is not an inherently bad activity, but removing the guardrails of regulation can often have unforeseen consequences beyond a company's bottom line. By providing an efficient onboarding service to cryptocurrency, the application carelessly reduces the barrier to entry for financiers of terror and money launderers to use cryptocurrency to obfuscate money flows as cash remittances. Based on the level of remittances already flowing through the Filipino economy, the Tambunting and 7-Eleven off-ramps are susceptible to abuse by bad actors. Especially as it is unclear that crypto-related transnational transfers are recorded by BSP statistics. The SEC/CFTC settlement has placed a target on Abra's standards of compliance. By offshoring a significant portion of their operations to the Philippines, and not registering as an RTC for virtual assets in that jurisdiction, there are additional warning signs which may lead to violations under the USA Patriot Act, 2001.[37] Abra is not likely to be actively involved in illicit activity, but this still was not a defense for BitInstant's CEO, Charlie Shrem, during the Silk Road takedown back in 2014.[38]

Operating in a grey area, avoiding direct regulation and oversight, increases the risk of money laundering and terrorist financing across the Philippines, and other jurisdictions where the app is operating. While the necessity for AML/CFT regulation and compliance in the U.S. is debated within the crypto community, the purpose of these regulations is to control the flow of funds to bad actors in vulnerable parts of the world. Where even small amounts can disproportionately impact society. While Abra has paid its fine to the SEC and CFTC, it is unclear that the company has taken appropriate action to avoid future sanctions, which should be of greatest concern to its investors going forward. Their silence on the topic is surprising, considering Bill Barhydt's regular newsletter and weekly Ask-Me-Anything ("AMA") on YouTube. Compliance is not an interesting talking point, but failure to acknowledge the SEC/CFTC warning is yet another red flag.

ENDNOTES:

[1] https://www.sec.gov/litigation/admin/2020/33-10801.pdf. The SEC has fined $150,000 for unregistered security-based swaps.

[2] https://www.cftc.gov/media/4191/enfplutosfinancialorder071320/download. The CFTC sanctioned Abra for offering digital asset-based swaps for illegal off-exchange trading and registration violations.

[3] https://data.worldbank.org/indicator/BX.TRF.PWKR.DT.GD.ZS?locations=PH. Personal remittances received as % of GDP in the Philippines.

[4] https://databank.worldbank.org/reports.aspx?source=1228. World Bank statistics show that only 34.5% of Filipinos 15+ hold an account.

[5] https://tambunting.ph/Main?profile. Tambunting is a Filipino institution created by a Chinese immigrant over 100 years ago, which has become synonymous with financial assistance in the Philippines.

[6] https://www.abra.com/. The application claims to be available in 150+ countries.

[7] https://support.abra.com/hc/en-us/articles/360001777311-What-Cryptocurrencies-does-Abra-support-. List of 85 cryptocurrencies as of June 26, 2020.

[8](McCrum & Stefania, 2019). https://www.ft.com/content/cd12395e-4fb7-11e9-b401-8d9ef1626294. Reports have shown how Filipino shell companies

were being used by Wirecard.

[9](Ghosh, 2020) https://www.businessinsider.com/philippines-wirecard-2-billion-lawyer-framed-2020-6. Mark Tolentino is a Filipino lawyer who has been linked to the Wirecard scandal that claims he is a victim of identity theft.

[10] http://www.bsp.gov.ph/banking/MSB.pdf. List of Remittance and Transfer Companies ("RTC") with Virtual Currency ("VC") Exchange Services, as of June 30, 2020.

[11] https://www.worldometers.info/gdp/gdp-by-country/. GDP by country statistics.

[12](Estrella, 2017) https://remit.com.au/tambunting-pawnshop-the-first-of-its-kind/. Tambunting is identified as a mainstream channel for remittances in the Philippines.

[13] https://www.tambunting.ph/Main?ID. Forms of ID accepted.

[14] http://www.fatf-gafi.org/media/fatf/documents/reports/mer-fsrb/APG-Mutual-Evaluation-Report-Philippines.pdf. Remittances have been linked to a range of criminal activity in the Philippines, including terrorism, drug trafficking, sex trafficking, and even bank robbery, see case study in section 10.7.

[15] https://www.fatf-gafi.org/media/fatf/documents/reports/Guidance-RBA-Virtual-Currencies.pdf. FATF guidance for a risk-based approach to virtual currencies.

[16] https://support.abra.com/hc/en-us/articles/115003984788-Where-can-I-find-Abra-Tellers-Philippines. Abra Tellers are currently only available in the Philippines.

[17] https://support.abra.com/hc/en-us/articles/360034493251-How-do-I-deposit-into-my-wallet-using-EC-Pay-CLiQQ-kiosk-Philippines. CLIQQ kiosks are used to pay bills and top up credit on certain accounts.

[18] https://support.abra.com/hc/en-us/articles/360018568971-Abra-s-Verification-Process. Abra only requires KYC if a customer wishes to fund their account with a bank account or credit card.

[19] https://www.simplex.com/. Simplex is an EU licensed Fintech company focused on crypto purchases with credit cards.

[20] https://support.abra.com/hc/en-us/articles/360007264791-Why-do-I-have-to-provide-additional-documents-to-Simplex-.Simplex is used as part of Abra's KYC process.

[21] https://inbestgo.com/forms/registros/. InBestGo's registration form, which is required for using the Guatemalan banking system.

[22] https://coins.ph. Coins.ph is one of the largest virtual asset exchanges in the Philippines.

[23] http://www.bsp.gov.ph/banking/MSB.pdf. Despite the similarities between Coins.ph and Abra, Plutus Technologies, Abra, and its partner companies are conspicuous in their absence from this list.

[24] https://support.abra.com/hc/en-us/articles/360040834752-Native-Coin-Migration. Abra uses Bittrex as its global custodian.

[25] https://www.youtube.com/watch?v=dNhcq7RkVtE. During a regular AMA, Abra CEO Bill Barhydt clarifies that Abra does not provide crypto custody, because they outsource this part of their solution to a "qualified custodian."

[26]"Smart contracts: terminology, technical limitations and real world complexity," by Eliza Mik, in Law, Innovation & Technology, Vol. 9, Issue 2, pp. 269-300, 2017.

[27] https://www.fincen.gov/fcn/financial_institutions/msb/msbstateselector.html. Plutus Financial Inc., d/b/a Abra, can be found FinCEN's MSB registration portal.

[28] http://www.fatf-gafi.org/media/fatf/documents/reports/mer-fsrb/APG-Mutual-Evaluation-Report-Philippines.pdf. The APG MER provides an in-depth look at the state of the Philippines financial regulation infrastructure.

[29] http://uis.unesco.org/en/country/ph. The Philippines has the highest literacy rate in the South East Asia region at 98.2%.

[30] https://tradingeconomics.com/philippines/gdp. The Philippines' GDP was estimated to be USD $376.8 billion in 2019.

[31] https://thecorpusjuris.com/legislative/republic-acts/ra-no-11479.php. Republic Act 11479, also known as the Anti-Terrorism Act 2020 has been widely criticized for the potential for overreach that it provides to the government.

[32](Fabe, 2020.) https://pipvtr.org/2020/05/20/terrorism-financing-continues-unabated-during-the-covid-19-pandemic/. Reports indicate greater use of cryptocurrency to fund terrorist activity in Mindanao.

[33](Arianti& Yeo Yaoren, 2020.) https://thediplomat.com/2020/06/how-terrorists-use-cryptocurrency-in-southeast-asia/. The use of cryptocurrency for terrorist

fund-raising in Indonesia and the Philippines.

[34]Terrorism Financing Regional Risk Assessment 2016—South East Asia and Australia, produced by the Australian government, see pg. 16 discussing key features of TF in the region.

[35] http://www.bsp.gov.ph/banking/emi_.pdf. Wirecard e-Money Philippines is still registered as an electronic money issuer.

[36] https://www.coindesk.com/sec-cftc-hit-crypto-app-abra-with-300k-in-penalties-over-illegal-swaps. Coindesk has identified over $50 million in funding to date, including between $350,000 and $1 million in PPP bailout loans.

[37] https://www.congress.gov/107/plaws/publ56/PLAW-107publ56.pdf. Uniting and strengthening America by providing appropriate tools required to intercept and obstruct terrorism (USA Patriot Act) Act of 2001.

[38] https://www.coindesk.com/bitinstant-ceo-charlie-shrem-arrested-silk-road-bitcoin-bust.

EU TAXONOMY REGULATION COMES INTO FORCE

By Mehran Massih and Jason Pratt

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On June 22, 2020, the European Union so-called "Taxonomy Regulation"[1]—touted as the world's "first ever green list"—was published in the EU Official Journal after the final stage of its approval by the European Parliament. This paved the way for the Regulation to come into effect on July 12. The green framework the Regulation establishes will evolve over time well beyond this date and, in practice, may influence financial disclosure practices beyond the European Union, including in the United States.

The Regulation is one part of the European Commission's multi-faceted package of reforms relating to sustainable finance, which in turn is a component of the EU's more ambitious "Green Deal."[2] The Taxonomy Regulation is a significant milestone among these measures because it establishes an EU-wide classification system—in effect, a glossary or "taxonomy"—for determining whether an economic activity is environmentally sustainable for purposes of investment. It purports to provide businesses and investors with a common language to identify which economic activities can be considered "green."

The Taxonomy Regulation amends the "Disclosure Regulation"[3]—which is also part of the EU's sustainable finance reform package—to require new sustainability-related pre-contractual and period reporting disclosures from financial market participants offering EU-regulated financial products, including managers of UCITS funds, alternative investment funds, insurance-based investment products, securitisation, venture capital and private equity funds, and pension products and pension schemes. The disclosures will be mandatory in respect of certain products or offerings that invest in an economic activity that contributes to an environmental objective and (a) have sustainable investment as their objective or (b) promote environmental or social characteristics of the investment. Broadly, the financial market participant offering the relevant product will be required to state: how and to what extent they have used the Taxonomy in determining the sustainability of the underlying investments; to what environmental objective(s) the investments contribute; and the proportion of underlying investments that are Taxonomy-aligned as a percentage of the investment, fund, or portfolio.

Pre-contractual and periodic reporting disclosures in respect of all other financial products must carry a disclaimer that the investment does not take into account the EU criteria for environmentally sustainable investments.

The Taxonomy Regulation also introduces new sustainability-related disclosure obligations for "large public-interest entities" that are already required to publish a non-financial statement under the EU Non-Financial Reporting Directive.[4] This category generally includes EU-listed companies, banks, or insurance companies with more than 500 employees that meet specified balance sheet or turnover thresholds. These entities will be required to disclose in their non-financial statements, such as their annual reports or sustainability reports, how and to what extent their activities are associated with Taxonomy-aligned activities in terms of their proportion of turnover, capex, and, if relevant, opex.

Despite the prescribed scope of the Taxonomy Regulation, the mere fact that a pan-European package of "green" criteria has been published for the first time in a rulemaking instrument will likely give the Taxonomy a much larger life. At least for the time being, the Taxonomy is likely to become the go-to reference point for sustainability criteria in any investment or financing context, potentially regardless of jurisdiction. Given the lack of any equivalent rulemaking in the United States, financial market participants in the U.S. could start to refer to the Taxonomy as a benchmark in so-called "green" offerings and financial products.

What Activities Are "Green"?

In substance, the Taxonomy Regulation is the culmination of final recommendations made in March 2020 by a Technical Expert Group on Sustainable Finance or TEG, a body the European Commission established to further a number of initiatives under the EU action plan on sustainable finance. The Regulation recognizes six broad "environmental objectives":

- Climate change mitigation.
- Climate change adaptation.
- Sustainable use and protection of water and marine resources.
- Transition to a circular economy (*i.e.,* waste prevention, reuse and recycling).
- Pollution prevention and control.
- Protection and restoration of biodiversity and ecosystems.

An economic activity is deemed to be environmentally sustainable if it:

- Contributes substantially to one or more of these environmental objectives, or directly enables other activities to make a substantial contribution to one or more of them.
- Does not significantly harm any other environmental objective.
- Complies with applicable technical screening criteria, which mostly have yet to be developed and are forthcoming pursuant to delegated regulatory authority.
- Complies with certain minimum safeguards (*e.g.,* OECD Guidelines on Multinational Enterprises and the UN Guiding Principles on Business and Human Rights).

The technical screening criteria are the centrepiece of fleshing out the specifics and will be developed in stages. So far, the TEG has developed technical screening criteria for 70 activities in eight economic sectors contributing to climate change mitigation and 68 activities contributing to climate change adaptation. The sectors covered so far include the following:

- Agriculture, forestry, and fishing.
- Manufacturing.
- Electricity, gas, steam and air conditioning supply.

- Water, sewerage, waste, and remediation.
- Transportation and storage.
- Information and communication technologies.
- Construction and real estate.

These criteria are the "flesh and bones" of the Taxonomy—the glossary element that is bound to be referred to repeatedly. The TEG's work so far on these criteria provides the basis for a delegated act that the European Commission intends to adopt by the end of 2020. The TEG's criteria are very much a work in progress, however, and it is possible additional activities will be included as substantially contributing to climate change mitigation or adaptation in the Commission's delegated act. In addition, the Taxonomy Regulation requires the Commission to review regularly the criteria it adopts in line with scientific and technological developments.

As for the other four environmental objectives, the Taxonomy Regulation requires the European Commission to establish technical screening criteria for these objectives by the end of 2021.

"Enabling" and "Transitioning" Activities

Importantly, the Taxonomy Regulation deems economic activities that directly "enable" the six environmental objectives to be environmentally sustainable, as long as they (a) do not lead to a "lock-in" in assets that undermine long-term environmental goals, and (b) have a substantial positive environmental impact based on life-cycle considerations. Enabling activities cover the provision of products or services that make a substantial contribution to activities deemed environmentally sustainable based on their own performance. Examples would include manufacture of low-carbon technologies or their key components, equipment or machinery, information and communications technology for climate change mitigation, and professional, scientific, and technical activities for climate change adaptation.

In addition, TEG recognized that, although some economic activities will not currently meet the Taxonomy's technical screening criteria, the financing or costs of improvement measures can be considered Taxonomy-aligned if they are part of a "transition" plan to meet the criteria over a defined time period.

Future Steps

The Taxonomy will evolve over time as the Commission's delegated acts bring more detail to each of the broad requirements outlined above. One of the key next steps will be the development of additional regulatory technical standards to flesh out the "do no significant harm" principle to an activity being Taxonomy aligned, and its related disclosure requirements. Moreover, as part of its action plan on sustainable finance, the Commission intends further down the line to propose an EU "eco-labelling" scheme for financial products and an EU green bond standard, both of which will rely heavily on the criteria established by the Taxonomy. These are only two of the initiatives planned in a robust EU rulemaking space that is likely to pave the way for similar requirements elsewhere.

ENDNOTES:

[1]Regulation (EU) 2020/852.

[2]The European Green Deal is an overarching framework of actions the European Commission presented in December 2019 to transform the European economy. A key component is a legal commitment for the EU to achieve climate neutrality by 2050. Other core components are strategies on supplying clean and secure energy, biodiversity, zero pollution, a circular economy, and sustainable food production.

[3]Regulation (EU) 2019/2088 on Sustainability-Related Disclosures in the Financial Services Sector.

[4]Directive 2014/95/EU, amending Directive 2013/34/EU.

ESG (AND WHAT IT MEANS TO YOU AND ME)

By Elad L. Roisman

Elad Roisman is a Commissioner at the Securities and Exchange Commission. The following is edited and adapted from his keynote speech, given at the Society for Corporate Governance National Conference, on July 7, 2020. He noted as a preface that his views and remarks were his own and did not necessarily represent those of the SEC or other SEC Commissioners.

I want to use this opportunity to provide a brief update on the proxy reform rulemakings, which the Commission proposed last November. While I cannot give you any details on the substance, I can say that the completion of those rulemakings is a priority for me and for Chairman [Jay] Clayton. The staff on the SEC's rulemaking teams has remained focused throughout these past few months digesting the comments we received on both proposals and drafting recommendations for the Commission to finalize each of them. I look forward to considering those recommendations, and I hope we also move forward in pursuing efforts to improve our "proxy plumbing" infrastructure. I continue to think through ways to address the inherent problems with the current framework, and I always welcome new suggestions.

Full Disclosure: My Thoughts on ESG

Today, I would like primarily to talk about another area that I know is front-of-mind for a lot of people in this room: "ESG." This is a broad subject with a wide variety of implications, including many that go well beyond the scope of the Commission's authority. I could not possibly address all aspects of my thinking on it in one speech, so I will focus on two particular areas: (1) calls for mandated ESG disclosure for public companies, and (2) ESG disclosure by asset managers.

First, let me level-set: In my experience, there is not consensus on what, exactly, "ESG" means. I often wondered how the three concepts of environmental, social, and governance matters got lumped together. When I looked into it, I saw that it was relatively recently that socially responsible investors, focusing on "E" and "S" issues, rebranded to add "governance" to the mix, a component that had research tying it to firm value.[1] In my mind, corporate governance stands by itself and rarely has a direct relationship to environmental or social issues. Best practices in corporate governance are usually the result of many years of private ordering experimentation and experience. Also, governance reform focuses on the company itself and what is best for its optimal operation as well as its shareholders. The same is not necessarily true of "E" or "S." Those matters tend to be more society, or stakeholder, focused. For example: How is the company "doing its part" to combat climate change or address global and political matters?

An obvious problem with mandating ESG disclosure is that the issues under this enormous umbrella of a term are usually subjective and constantly evolving based on current events. Because of this evolution, requiring prescriptive disclosure would be difficult. Who is in a position to codify a list of environmental or social issues for the foreseeable future?[2] Presumably, that list would change as society changes and as companies change. If the SEC had tried to codify a list just 10 years ago, I think it would look different than any list we would make today or 10 years from now.

I understand that many of you in attendance who work at public companies face pressure to disclose or act on ESG-related issues. I read about and have heard directly from activists, large investors, company advisors, politicians, and others who have demanded certain actions or information from your companies. I hear about the various ESG rating firms who send time-intensive surveys and assign scores to your businesses based on metrics that wildly differ from each other. I also know that you spend a meaningful amount of your time responding to that demand. Many public companies voluntarily provide some form of corporate social responsibility or sustainability reports to investors—by voluntarily, I mean companies are not required to do so by the SEC or other government mandate. I am happy to see this sort of private ordering take place. It is important to realize and acknowledge that companies provide information and act without the government telling them to do so for many different reasons, including because their customers, employees, and others motivate them to do so. Sometimes, a company may deem certain ESG information material, such that it is disclosed in SEC filings. Other times, the company does not believe it rises to the level of materiality, and thus it is not included in SEC filings.

As a Commissioner, I too have felt increasing pressure from advocacy groups, politicians, and some investor groups to support rules that explicitly require public companies to disclose a wide range of ESG information in their SEC filings. In fact, the SEC's Investor Advisory Committee ("IAC") recently recommended that the SEC amend the reporting requirements to include ESG factors.[3] I appreciate the time and consideration our IAC members put into their recommendations. I would note that these are recommendations, not mandates, and they are meant to aid me and my fellow commissioners who have been appointed to make policy decisions for the agency.[4]

Everyone, Stop Grandstanding

In my experience, some advocates try to make ESG an issue of morality or politics. I have heard ESG policy proponents portrayed in varying lights, ranging from responsible stewards steeped in science to thinly veiled political operatives pushing their own agenda. Opponents of prescriptive ESG policies are also portrayed in varying lights from responsible stewards skeptical of allowing changing mores to dictate investment strategy to uneducated and morally inferior denialists. It is too easy to fall into the trap of categorizing people in ways that obviate the need to address the substance and merits of ESG issues. But, this makes policy discussions turn personal and almost always less productive. Also, increasingly, there has been a desire from some quarters to conflate greater societal debates about environmental regulation and social policies with public company disclosure requirements. However, I believe it is important to differentiate these policy areas, as they involve different policy-makers and different goals. Only by acknowledging this broader context of how we often confront ESG topics, will we be able to have more objective and productive policy discussions.

ESG Mandates: When Securities Laws Get Personal

I have given the matter of SEC-mandated ESG disclosure a lot of thought, and I have serious reservations about imposing prescriptive requirements in this area. In my experience, and based on the many discussions I have had on the topic, this type of mandated disclosure is often fraught with subjectivity and agendas that are often unrelated to "investor welfare." In other words, I have seen too many people appear to blur their personal views on environmental and social issues with how they believe the federal securities laws should operate to regulate the actions of others. Normally I keep my personal life out of my speeches, but in this case it seems illustrative to reference the fact that I personally have strong convictions on certain ESG matters. For example, I believe that human behavior, including through business operations, has an impact on our environment and we should think about what we can do to reduce pollution and conserve our great natural resources for future generations. I organize my actions in my personal life around this and other beliefs.

I believe it is important that I distinguish such beliefs and actions in my personal life from those that drive me as an SEC Commissioner and regulator. I was appointed to this position to support the mission of the SEC—protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation.[5]

This agency oversees and enforces the federal securities laws, which have a relatively narrow scope, even if the effects are sometimes broad. These two items, scope of authority and effect of actions, should not be confused. In particular, we should be aware of the effects of our actions, and we should not try to expand our authority in order to amplify those effects. Let me be specific. If I were to use the securities laws to pursue my own environmental and social vision for the world, I would be subordinating the SEC's mission to my personally held objectives. In other words, I would be acting outside the scope of my responsibility and authority. Imagine the unintended consequences that could flow from such an abuse of power.

(Justice) Marshall Law: Materiality

Materiality is the touchstone of our public company disclosure regime. Public companies must disclose material information to their investors, a standard that has been defined by the Supreme Court and followed for decades.[6] I am a proponent of the SEC's principles-based materiality standard now more than ever. As a result of the COVID-19 pandemic and the shutdown of the economy that followed, America's public companies faced a crisis that few could have predicted. In SEC filings made before this past March, I am not aware of any company that provided risk factor disclosure regarding the risks associated with the spread of coronavirus. Since March, companies in different industries, and even within the same industry, have faced unique challenges and their disclosure evidences this.

Our principles-based framework requires disclosure of all material information (including with respect to environmental factors),[7] but it allows each individual company to tailor that information so that it is useful to their investors. This benefits investors because it highlights for them what they need to know to make informed decisions. In addition, important information is not lost in a sea of inapplicable information. For the avoidance of doubt, ESG issues can be material to companies and necessitate disclosure. In fact, I can think of many scenarios where it would be. For instance, if a company decided to take a public stance on a certain social or political issue, there may be a risk that it could lose a substantial percentage of its customers who disagree with that stance, resulting in a material adverse financial effect. That may be a risk the company is willing to take, but it may also have to disclose that to investors.

Now, imagine if I wanted to use the SEC disclosure rules as a tool to encourage public companies to behave in a way that I believe is best for society. Perhaps I could require public companies to disclose things beyond what a reasonable investor would consider important in making an investment or voting decision. There are some situations in which Congress has actually required the SEC to do that, and it has not turned out well.[8] In fact, I believe that some of the rules effectuated pursuant to such mandates are the hardest to rationalize from the standpoint of the SEC's mission.

Recently, the SEC proposed—for the third time—a congressionally mandated rulemaking that would require resource extraction issuers to disclose payments made to a foreign government or the U.S. federal government for the purpose of the commercial development of oil, natural gas, or minerals.[9] While the Commission takes its statutory requirements seriously, I cannot plausibly say the rulemaking is central to the SEC's tripartite mission to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation. As one Senator who co-sponsored the provision requiring this rulemaking stated, this rule will "help empower citizens to hold their governments to account for the decisions made by their governments in the management of valuable oil, gas, and mineral resources and revenues."[10] Now, I am sure that members of Congress as well as those who work at the State Department and other agencies tasked with responding to corruption and violence in other countries are keenly aware of certain behavior and problems in those countries. And I hope they are thinking through ways to prevent and stop it. But I don't see myself as having special expertise in those matters, and I can't help but worry: If we adopt this rule and it indirectly forces companies to cease business operations in certain countries, will we have achieved the net benefit Congress was hoping for? Or, rather, will people in these communities lose their only available employment option?[11] What type of mandated disclosure will help solve that problem? The point I am trying to make is that securities law regulators are not best equipped to understand (much less address) all of the potential negative effects that may result from us approaching these issues through mandated disclosures under the securities law framework.

So Sue Me!

One thing that ESG disclosure proponents rarely mention is the liability that our public companies face for the disclosure they provide in SEC filings.[12] U.S. public companies face greater litigation risk than companies listed in almost every other jurisdiction. U.S. public companies are not only subject to enforcement by the SEC and other federal agencies as well as state authorities for material misstatements and omissions, they also must draft disclosure with the awareness that the law provides a private right of action for misstatements and omissions in SEC filings. These companies are on the hook—to a lot of different people—for everything they do (or do not) disclose in their filings. That seems like good incentive to me to disclose material information, ESG or otherwise. And let me be clear: a board of directors has a fiduciary duty to the shareholders of the company. If certain information that happens to fall in any of the ESG categories is material to that company, the company needs to disclose it. We expect management and the board to do that, and we will come after them when they don't.

These are my thoughts on the matter of prescriptive ESG public company disclosure.

Actually, We May Need More ESG Disclosure. . .

There is one area where I do believe the SEC would be well within its authority to elicit more ESG disclosure because I believe it is material to investors. That is in our regulation of asset managers—whom many of you may think of as your biggest shareholders. These are entities that own, on behalf of retail investors, stakes in many public companies. Many asset managers have asked the SEC to impose specific ESG disclosure requirements on such companies or asked companies directly for particular ESG information. Additionally, more and more asset managers are asserting that ESG metrics are driving their investment decisions, and, in fact, they will be using their ownership and voting power to effectuate changes in the companies they own (on behalf of investors).

I do not discount or ignore these calls for additional ESG information, but they raise questions in my mind about what the asset managers are doing with that information. How are they using it to improve returns for their investors? What analysis have they done to show it provides alpha? Or, is this a virtue signaling tactic to market themselves to particular potential clients, who have expressed a preference for environmentally or socially-focused portfolios? Are they backing up their claims in their own SEC disclosures, such as Form ADV filings or the prospectuses of the funds they offer?

In recent years, asset managers have proliferated in their creation of investment products labeled as "ESG," "Green," or "Sustainable."[13] There appears to be increasing demand for products of this description. Yet, there is no universal definition for any of these terms, and such products' investment philosophies and holdings can differ widely. I do not mean to imply that the SEC should define one method of integrating environmental or social factors into how an asset manager devises an investment product. In fact, I think it is beneficial for retail investors to have a wide array of choice and for such funds to compete with one another. But, I do think that retail investors who want "green" or "sustainable" products deserve more clarity and information about the choices they have.

One risk I worry about here is the extent to which retail investors understand that some of these funds may be prioritizing environmental or social goals above the fund's economic returns. To me, it seems likely that a significant portion of those who invest in ESG funds want to "do well" while "doing good"—seems like a win/win. But, some of these funds invest and vote proxies primarily to achieve some environmental or social good, possibly at the expense of investment returns. This is less of a win/win, especially if a fund's disclosure is not transparent on this point. Do asset managers believe this is the appropriate tradeoff for their investors, and how are they evaluating their own performance in this regard? Do retail investors know if they are leaving money on the table?[14]

Another risk that concerns me is "greenwashing"—asset managers conveying a false impression to retail investors that a given product is environmentally friendly. As an example, I recently saw a "green bond fund" that advertised an impressive annual environmental impact: avoiding millions of metric tons of CO2 emissions; reducing air pollutants by hundreds of metric tons; and generating hundreds of millions of mega-watts of renewable energy. When I read the fine print description of how these numbers were calculated, a footnote caught my eye. It said something along the lines of given the difficulty of attributing the impact of each bond in the fund's portfolio (which ranged from a hundredth of a percent to less than a few percent), the data regarding emissions, air pollutants, and renewable energy reflected the total impact generated by the project, program, or issuer rather than the fund's share alone. In other words, in the marketing materials of this "green" fund, the asset manager was taking credit for all the environmental accomplishments of every project it had invested in, even though it had capitalized (at best) only a small fraction of each one.

When an asset manager markets a fund as having an ESG strategy, it has an obligation to disclose material information about that fund to investors and potential investors. Additionally, it would make sense to me that asset managers who want to use these terms to name their funds or advertise their products should be required to explain to investors what they mean.[15] For example, how do the terms "ESG," "green," and "sustainable" relate to a fund's objectives, constraints, strategies, and the characteristics of its holdings? Are "E," "S," and "G" weighted the same when selecting portfolio companies? Does the fund intend to subordinate the goal of achieving economic returns to non-pecuniary goals, and, if so, to what extent?[16]

Only by seeing this type of information for every so-called "ESG" or "sustainable" fund can retail investors have enough information to compare different funds, understand any trade-offs they may be making, and decide which one suits their personal objectives. The SEC's examination teams would also be able to evaluate these types of funds for compliance purposes, as they do with other funds. Whether you are supportive of, opposed to, or neutral to ESG-focused investing strategies, I think many would be interested in such disclosures and whether these asset managers' actions match their rhetoric.

Conclusion

Thank you all for listening. I hope this helps you better understand my thinking regarding my role—as an SEC Commissioner—in requiring new and prescriptive ESG disclosure. In discharging my responsibilities as an SEC Commissioner, I often remind myself that the SEC is not a merit regulator and that my personal convictions matter only so far as they support the SEC's mission. If you would like to share your thoughts on anything I have said today, I would love to get your perspective. As I used to say: My office door is always open. Though, presently, you cannot literally take me up on the offer to visit, I do hope you will reach out to schedule a call to tell me your thoughts. Such discussions provide me with additional insights and lead me to rethink or refine my views.

ENDNOTES:

[1]*See* Max Matthew Schanzenbach and Robert H. Sitkoff, Reconciling Fiduciary Duty and Social Conscience: The Law and Economics of ESG Investing by a Trustee (Feb. 1, 2020). 72 Stanford Law Review 381 (2020); Northwestern Law & Econ Research Paper No. 18-22; Harvard Public Law Working Paper No. 19-50, *available at* https://ssrn.com/abstract=3244665 or http://dx.doi.org/10.2139/ssrn.3244665.

[2]The European Commission (a legislative body, unlike the SEC) has taken legislative action to require disclosure on such issues and is expected to pass more in the near future. *See* "Financing the green transition: The European Green Deal Investment Plan and Just Transition Mechanism" (Jan. 14, 2020), *available at* https://ec.europa.eu/commission/presscorner/detail/en/ip_20_17 and "Sustainable finance: TEG final report on the EU taxonomy" (Mar. 9, 2020), *available at* https://ec.europa.eu/knowledge4policy/publication/sustainable-finance-teg-final-report-eu-taxonomy_en. In addition, the United Kingdom's Financial Conduct Authority has proposed rules that would require certain U.K. issuers to provide enhanced climate change disclosures consistent with the recommendations of the Financial Stability Board's Task Force on Climate-related Financial Disclosures. *See* "Proposals to enhance climate-related disclosures by listed issuers and clarification of existing disclosure obligations" (Mar. 2020), *available at* https://www.fca.org.uk/publication/consultation/cp20-3.pdf.

[3]*See* "Recommendation of the Investor-as-Owner Subcommittee on ESG Disclosure" (May 14, 2020), *available at* https://www.sec.gov/spotlight/investor-advisory-committee-2012/recommendation-of-the-investor-as-owner-subcommittee-on-esg-disclosure.pdf.

[4]I have increasingly found that many people equate the work of the SEC's advisory committees with the work of the SEC's own staff, believing that advisory committee recommendations have the regulatory force of being from the agency. This is not accurate. The committees are advisory only, and their recommendations are as well.

[5]5 U.S.C.A. § 3331 (2015). Specifically, the oath requires that each Commissioner say the following: "I, [name], do solemnly swear (or affirm) that I will support and defend the Constitution of the United States against all enemies, foreign and domestic; that I will bear true faith and allegiance to the same; that I take this obligation freely, without any mental reservation or purpose of evasion; and that I will well and *faithfully discharge the duties of the office on which I am about to enter*. So help me God." (emphasis added).

[6]*TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 96 S. Ct. 2126, 48 L. Ed. 2d 757, Fed. Sec. L. Rep. (CCH) P 95615 (1976).

[7]*See* Commission Guidance Regarding Disclosure Related to Climate Change, Release No. 33-9106 (Feb. 8, 2010), *available at* https://www.sec.gov/rules/interp/2010/33-9106.pdf.

[8]For instance, Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") amended the Securities and Exchange Act of 1934 (the "Exchange Act") and directed the Commission to issue rules requiring certain companies to disclose their use of "conflict minerals" if those minerals are "necessary to the functionality or production of a product" manufactured by those companies. The SEC adopted rules pursuant to Section 1502 of the Dodd-Frank Act in 2012. In 2015, the U.S. Court of Appeals for the District of Columbia Circuit reaffirmed its prior holding that Section 13(p)(1) of the Exchange Act and SEC Rule 13p-1 "violate the First Amendment to the extent the statute and rule require regulated entities to report to the Commission and to state on their website that any of their products have 'not been found to be "DRC conflict free."' " *National Ass'n of Manufacturers v. S.E.C.*, 800 F.3d 518, 530, 43 Media L. Rep. (BNA) 3216, Fed. Sec. L. Rep. (CCH) P 98600 (D.C. Cir. 2015). In 2017, the U.S. District Court for the District of Columbia entered final judgment in the case and remanded to the Commission. *National Association of Manufacturers v. United States Securities and Exchange Commission*, Fed. Sec. L. Rep. (CCH) P 99678, 2017 WL 3503370 (D.D.C. 2017). In addition, Section 1504 of the Dodd-Frank Act added Section 13(q) to the Exchange Act to require certain companies to disclose certain resource extraction payments. The Commission first adopted the rules to implement the statute in 2012, but the rules were vacated by the U.S. District Court for the District of Columbia less than one year later. *American Petroleum Institute v. S.E.C.*, 953 F. Supp. 2d 5, Fed. Sec. L. Rep. (CCH) P 97545 (D.D.C. 2013). The Commission adopted a

revised version of Rule 13q-1 and amendments to Form S-D in 2016. Less than one year later, the revised rules were disapproved by a joint resolution of Congress pursuant to the Congressional Review Act. H.R.J. Res. 41, 115th Cong. (2017) (enacted). 5 U.S.C.A. 801 et seq. *See also* discussion *infra*.

[9]Disclosure of Payments by Resource Extraction Issuers, Release No. 34-87783 (Dec. 19, 2019), *available at* https://www.sec.gov/rules/proposed/2019/34-87783.pdf.

[10]*See* 156 Cong. Rec. S3816 (daily ed. May 17, 2010).

[11]*See* "How a well-intentioned U.S. law left Congolese miners jobless," Sudarsan Raghavan, The Washington Post (Nov. 30, 2014), *available at* https://www.washingtonpost.com/world/africa/how-a-well-intentioned-us-law-left-congolese-miners-jobless/2014/11/30/14b5924e-69d3-11e4-9fb4-a622dae742a2_story.html.

[12]Another important thing to note is that, with respect to disclosure requirements, the SEC primarily deals with public companies (which make up only a subset of companies). In order to make the greatest impact and create a level playing field, Congress or other federal agencies with direct oversight responsibility should deal with the "E" and the "S" issues directly, rather than having the SEC try to require information from only a subset of companies.

[13]*See, e.g.*, Request for Comments on Fund Names, Release No. IC-33809 (Mar. 2, 2020), *available at* https://www.sec.gov/rules/other/2020/ic-33809.pdf (the "Names RFC"). Note 23 references EDGAR data showing the number of ESG funds has increased over 300% in the last two decades.

[14]The SEC's Asset Management Advisory Committee has formed a subcommittee focusing on ESG-focused investment products and disclosures. Their most recent presentation is available here: https://www.sec.gov/files/ESGSubcommitteeUpdate_0.pdf.

[15]*See* Names RFC, supra note 14. I am sure that the feedback we received will be informative, and I hope the Commission can set forth clearer parameters around how investment products, such as "ESG" mutual funds and ETFs, are named.

[16]The Department of Labor recently proposed a rule that would require plan fiduciaries to select investments and investment courses of action based solely on financial considerations relevant to the risk adjusted economic value of a particular investment. *See* Employee Benefits Security Administration, Department of Labor, "Financial Factors in Selecting Plan Investments" (June 30, 2020), *available at* https://www.govinfo.gov/content/pkg/FR-2020-06-30/pdf/2020-13705.pdf.

SEC/SRO UPDATE: FINANCIAL REGULATORS MODIFY VOLCKER RULE; SEC CHARGES MICROCAP FRAUD SCHEME PARTICIPANTS ATTEMPTING TO CAPITALIZE ON THE COVID-19 PANDEMIC; SEC PROPOSES AMENDMENTS TO UPDATE FORM 13F FOR INSTITUTIONAL INVESTMENT MANAGERS; SEC AND JUSTICE DEPARTMENT'S ANTITRUST DIVISION SIGN HISTORIC MEMORANDUM OF UNDERSTANDING

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Financial Regulators Modify Volcker Rule

On June 25, the Securities and Exchange Commission ("SEC"), along with four other federal regulatory agencies, finalized a rule modifying the Volcker Rule's prohibition on banking entities investing in or sponsoring hedge funds or private equity funds—known as "covered funds."[1]

The Volcker Rule generally prohibits banking entities from engaging in proprietary trading and from acquiring or retaining ownership interests in, sponsoring, or having certain relationships with a hedge fund or private equity fund.

The final rule, which is similar to the proposed rule released in January,[2] modifies three areas of the Volcker Rule by:

- Streamlining the covered funds portion of rule;
- Addressing the extraterritorial treatment of certain foreign funds; and
- Permitting banking entities to offer financial services and engage in other activities that do not raise concerns that the Volcker Rule was intended to address.

The final rule will be effective October 1.

SEC Charges Microcap Fraud Scheme Participants Attempting to Capitalize on the COVID-19 Pandemic

On June 11, the SEC filed an emergency action and obtained an asset freeze against five individuals and six offshore entities for an alleged fraudulent scheme that generated more than $25 million from illegal sales of multiple microcap companies' stock, including four that were the subject of recent SEC trading suspension orders: Sandy Steele Unlimited Inc., WOD Retail Solutions Inc., Bioscience Neutraceuticals, Inc., and Rivex Technology Corp.[3]

The SEC's complaint alleges that from at least January 2018 to the present, two key persons and others, enabled corporate control persons that were unknown to the public to conceal their identities while dumping their company's stock into the market for purchase by unsuspecting investors. The complaint alleges that these illegal stock sales were often boosted by promotional campaigns that, in some instances, included false and misleading information designed to fraudulently capitalize on the COVID-19 pandemic. For example, the alleged promotions included claims that Sandy Steele could produce medical quality facemasks and that WOD Retail had automated kiosks for retailers to use in response to the COVID-19 pandemic. The complaint also charges some other participants with fraudulently dumping shares of Sandy Steele.

The SEC's complaint charged various participants with violating the antifraud and registration provisions of the federal securities laws. The SEC seeks permanent injunctions, conduct based injunctions, disgorgement of allegedly ill-gotten gains plus interest, civil penalties, and penny stock bars. Parallel criminal charges were also brought against one of the key individuals.

SEC Proposes Amendments to Update Form 13F for Institutional Investment Managers

On July 10, the SEC announced proposed amendments to Form 13F to update the reporting threshold for institutional investment managers (the "Proposal").[4]

Form 13F was originally adopted pursuant to a 1975 statutory directive designed to provide the SEC with data from larger managers about their investment activities and holdings, so that their influence and impact could be considered in maintaining fair and orderly securities markets. At the time Form 13F was adopted, the threshold for filing was $100 million. The Proposal would raise the reporting threshold from $100 million to $3.5 billion, which reflects proportionally the same market value of U.S. equities that $100 million represented in 1975. According to the press release, the Proposal would provide relief to smaller investment advisers currently required to File Form 13F, while retaining data on over 90% of the dollar value of the securities currently reported on Form 13F.

In addition to raising the reporting threshold, the Proposal would also require SEC staff to review the Form 13F reporting threshold every five years and recommend appropriate adjustments (if any) to the SEC. The Proposal would also eliminate the ability of managers to omit certain small positions, which would increase the overall holdings information reported by larger managers.

The comment period for the Proposal will be open until September 29, 2020.

SEC and Justice Department's Antitrust Division Sign Historic Memorandum of Understanding

On June 22, the SEC announced that the SEC and the Antitrust Division of the Department of Justice (the "DOJ") signed an interagency memorandum of understanding (the "MOU") to "foster cooperation and communication between the agencies with the aim of enhancing competition in the securities industry."[5]

In addition to provisions that would facilitate communication and cooperation between the SEC and the DOJ's Antitrust Division, the MOU establishes a framework for the agencies to continue regular discussions and review law enforcement and regulatory matters affecting competition in the securities industry, including provisions to establish periodic meetings among the respective agencies' officials. The MOU also provides for the exchange of information and expertise the agencies believe to be potentially relevant and useful to their oversight and enforcement responsibilities.

ENDNOTES:

[1] *See* SEC Press Rel. No. 2020-143 (June 25, 2020), *available at* https://www.sec.gov/news/press-release/2020-143; *see also* https://www.sec.gov/rules/final/2020/bhca-9.pdf (final rule).

[2] *See* SEC Rel. No. BHCA-8 (Jan. 30, 2020), *available at* https://www.sec.gov/rules/proposed/2020/bhca-8.pdf (proposed rule).

[3] *See* SEC Press Rel. No. 2020-131 (June 11, 2020), *available at* https://www.sec.gov/news/press-release/2020-131.

[4] *See* SEC Press Rel. No. 2020-152 (July 10, 2020), *available at* https://www.sec.gov/news/press-release/2020-152; *see also* https://www.sec.gov/rules/proposed/2020/34-89290.pdf (proposed rule).

[5] *See* SEC Press Rel. No. 2020-140 (June 22, 2020), *available at* https://www.sec.gov/news/press-release/2020-140.

FROM THE EDITOR

An ESL Debate Takes Shape

In a recent speech (reprinted elsewhere in this issue), SEC Commissioner Elad Roisman expressed skepticism about some SEC-mandated ESG disclosure. "I have serious reservations about imposing prescriptive requirements in this area," he said in July. "This type of mandated disclosure is often fraught with subjectivity . . . I have seen too many people appear to blur their personal views on environmental and social issues with how they believe the federal securities laws should operate to regulate the actions of others."

Roisman added he believes it's unclear as to "what, exactly, ESG means. I often wondered how the three concepts of environmental, social, and governance matters got lumped together . . . it was relatively recently that socially responsible investors, focusing on 'E' and 'S' issues, rebranded to add 'governance' to the mix, a component that had research tying it to firm value." For Roisman, "corporate governance stands by itself and rarely has a direct relationship to environmental or social issues. Its best practices . . . are usually the result of many years of private ordering experimentation and experience. Also, governance reform focuses on the company itself and what is best for its optimal operation as well as its shareholders. The same is not necessarily true of 'E' or 's.' Those matters tend to be more society, or stakeholder, focused."

Thus, he argued, "an obvious problem with mandating ESG disclosure is that the issues under this enormous umbrella of a term are usually subjective and constantly evolving based on current events." He wondered if some asset managers used ESG as a virtue-signaling tactic to present themselves in a favorable light to investors.

Roisman's speech indicates a possibly-growing divide among SEC Commissioners as to ESG disclosure. While Roisman appears to be positioning himself along the more skeptical end of the spectrum, Commissioner Allison Lee has advocated for greater climate risk disclosure for companies. "We must not only seek to prevent false or misleading disclosure, but also to ensure that investors receive the material information that they need to pursue their investment goals, either on their own or through their investment advisers," she said in March, criticizing the SEC's Disclosure Effectiveness Initiative for failing to sufficiently require disclosure of climate-change-related risks.

The debate comes as asset managers push for improvements in ESG disclosure and reporting standards. A Government Accountability Office report released in July noted that "most institutional investors interviewed (12 of 14) said they seek information on ESG issues to better understand risks that could affect company financial performance over time. These investors . . . use ESG disclosures to monitor companies' management of ESG risks, inform their vote at shareholder meetings, or make stock purchasing decisions. Most . . . noted that they seek additional ESG disclosures to address gaps and inconsistencies in companies' disclosures that limit their usefulness." Yet Roisman's public reservations may indicate that a regulatory ESG consensus could prove difficult to achieve in the near future.

Chris O'Leary, Managing Editor

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