Committee on Banking, Housing, and Urban Affairs
Oversight of the U.S. Securities and Exchange Commission
September 14, 2021

Questions for The Honorable Gary Gensler, Chair, U.S. Securities and Exchange Commission, from Senator Tim Scott:

1) **Environmental, Social, and Governance (ESG) based investing is the form of investing by which investment decisions are made based on a firm's environmental impact, its relationship with various communities and social agendas, and management culture. From 1995 through 2018, the number of assets in funds with ESG criteria increased from $0.6 trillion to $12 trillion, an increase of 2,000 percent. More than half of all public pension funds are now invested with ESG criteria.**

   I was concerned to learn that a recent study by the Center for Retirement Research at Boston College found that state mandates and ESG investing policies reduce annual returns by 70 to 90 basis points. As SEC Chairman, you have clearly telegraphed the Commission's intention develop and implement mandatory climate risk investment disclosure by the end of 2021.

   a. **Based on the findings of the Boston College study cited above, would you agree that by making climate risk disclosures mandatory the SEC will be prioritizing a political agenda over financial returns for Americans saving for retirement**?

Full and fair disclosure promotes efficiency, transparency, and competition in our markets, and is crucial to informed investment decision-making. It allows investors to decide what risks they wish to take.

From time to time the SEC freshens up our disclosure regimes to reflect investor demands. Today, investors in our markets increasingly want to understand the climate risks of the companies whose stock they own or might buy. Thus, I have asked SEC staff to develop a proposal for climate risk disclosure requirements - to provide consistent, comparable, and decision-useful disclosures - for the Commission's consideration.

In the asset management space, many funds these days brand themselves as "green," "sustainable," "low-carbon," and so on. I've directed staff to review current practices and consider recommendations about whether fund managers should disclose the criteria and underlying data they use to market themselves as such.

2) **In the same Boston College study, one main factor that researchers cited as contributing to lower returns for funds with ESG criteria were the increased fees associated with ESG disclosures and investing. ESG disclosures and investing requires a tremendous amount of research and trading, research and trading which is often provided by a cadre of Wall Street banks, consultants, asset managers, and advisory firms. I fear that ESG investing may simply be another form of active trading aimed at bolstering Wall Street's bottom line.**

a. Rather than lining the pockets of Wall Street traders and banks through high ESG investment fees and expenses, wouldn't most Americans be better served putting their money into broad market index funds or other instruments with very low or no management fees?

All registered funds, including ESG-focused funds, are required to provide clear and robust disclosure of their fees and expenses in their registration statements. This information allows investors to compare fees and expenses across funds and make informed investment decisions. Earlier this year, the SEC's Office of Investor Education and Advocacy issued an Investor Bulletin providing investors with information about ESG funds. The bulletin encourages investors to ask questions before investing in ESG funds and carefully read all of the fund's available information. When selecting an investment product, investors should make sure they understand the fees and expenses they will pay for a fund. The bulletin also reminds investors that they should compare the fees and expenses of an ESG fund to other available investment options.

3) Digital assets are a new and exciting technological development that holds the potential to transform not just the finance industry, but also energy, logistics, art, and so many others. I know you have a background and understand the potential of this emerging technology sector.

As policymakers, we must ensure the United States remains a leader in the world for technology and financial innovation. Despite this, I noted that there are no proposed rulemakings on the SEC's most recent Unified Agenda related to digital assets. For these reasons, I'm perplexed by several of your recent recent public announcements and actions taken by the SEC regarding crypto regulation.

a. Rather than releasing clear and transparent rules of the road for the industry, does the SEC plan to regulate via enforcement and one-off private staff guidance to stakeholders?

I support innovative developments in our capital markets. Before starting at the SEC, I had the honor of researching, writing, and teaching about the intersection of finance and technology at the Massachusetts Institute of Technology. In that work, I came to believe that, though there was a lot of hype masquerading as reality in the crypto field, Satoshi Nakamoto's innovation is real. Further, it has been and could continue to be a catalyst for change in the fields of finance and money.

While I'm technology-neutral, I am anything but public policy-neutral. As new technologies come along, we need to be sure we're achieving our core public policy goals. In finance, that's about protecting investors and consumers, guarding against illicit activity, and ensuring financial stability.

I also believe that innovation should not be used to circumvent the important investor and market protections that are at the heart of the SEC's mission — protecting investors, maintaining fair,

orderly, and efficient markets, and facilitating capital formation. Innovation in our capital markets has been ongoing over many decades and such innovation facilitates new and effective ways to invest, trade, and raise capital. As innovation in financial products and markets further develops, we will continue to foster that development while assuring compliance with the federal securities laws.

4) **As we discussed during the hearing, over the last decade technological advancements and innovation have spurred competition among retail brokers, lowering costs and barriers to entry for retail investors. This has resulted in a younger and more diverse group of Americans reaping the benefits of stock ownership – many of them for the first time.**

   The existing rules regulating the markets have worked well to both foster and keep up with the pace of innovation and competition in the marketplace. I remain concerned that the SEC may move prematurely, and without sufficient analysis or stakeholder input, to pursue proposals that would raise costs and curb retail investor access to the markets.

   a. **Can you please provide additional details regarding the areas of regulation or market structure that, as SEC Chairman, you are encouraging the Commission to re-examine in an effort to ensure that the rules of the road are keeping pace with marketplace innovation?**

We can't take our leadership in capital markets for granted. New financial technologies continue to change the face of finance for investors and issuers. More retail investors than ever are accessing our markets. Other countries are developing deep, competitive capital markets as well. Because of rapidly changing technology and business models, I think the SEC needs to look for opportunities to freshen up our rules related to market structure to continue to maintain markets that are the envy in the world.

Ultimately, promoting fair, orderly, and efficient markets can help reduce the cost of capital for issuers and increase the rate of returns for investors across each of the markets the SEC oversees – Treasury markets, corporate bonds, municipal bonds, mortgage and other asset back securities, equity markets, and security based swaps amongst others. This helps contribute to economic growth and is a competitive advantage for our nation.

I recently addressed your core question – how we might re-examine regulation of market structure to ensure keeping pace with innovation – at a talk to the Securities Industry Financial Market Association.[17]

5) **During our conversation at this hearing, one of the issues we both strongly agreed upon was the importance of small business and entrepreneurship in empowering Americans to accumulate wealth and achieve long-term financial stability. In some**

[17] https://www.sec.gov/news/speech/gensler-sifma-110221

of your previous appearances before Congress the issue of business development companies, or BDCs, have been discussed. As you're probably well aware, there's been longstanding bipartisan support to reform the rules that apply to BDCs so they can deploy more capital to small and businesses throughout the country and provide the opportunity for them to grow.

One of these issues that's arisen is known as acquired fund fees and expenses, or AFFE. Essentially, AFFEs require a misleading disclosure about the actual cost of investing in BDCs and basically "double counts" investor expense. This creates an unintended consequence of harming both investors and small businesses by closing the door to increased investment.

This effectively discourages investment into American small businesses. For example, after this rule was implemented, we saw a decline in the number of BDCs available to invest it, resulting in a massive decline in investment and as such a decline in small business growth.

This has harmed both BDC investors and their portfolio companies and has had a negative economic effect in areas that have a large BDC presence, like South Carolina.

Please answer the following with specificity:

a. **We know that BDCs play a vital role in providing opportunities for investors to help encourage small business growth. What can you tell us about the SEC's agenda to remove disincentives to invest in BDCs at this point?**

b. **Last year the SEC proposed a rulemaking that would have provided at least a partial fix for the AFFE problem, however there is bipartisan support for the SEC to go further and ensure that BDCs can be re-included in indices. What is the SEC's plan for finalizing this proposal and is your goal to facilitate institutional investment in BDCs?**

The Commission has an outstanding proposal addressing AFFE, among a number of other disclosure topics. Specifically, the proposal would permit funds, including BDCs that make limited investments in other funds to disclose AFFE in a footnote to the fee table and fee summary, rather than as a fee table line item. Comments on the proposal have been mixed, with some supporting and others opposing the proposed changes. The staff is reviewing the comments received, and I look forward to engaging with the team and my fellow Commissioners on this topic.