Securities Regulation Daily Wrap Up, ESG NEWS—State attorneys general oppose trading in Natural Asset Companies, (Jan. 12, 2024)

Securities Regulation Daily Wrap Up

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Utah's attorney general called NACs "a brutish vehicle to accomplish an activist political agenda."

Comments are in on a proposed rule change that would allow Natural Asset Companies to trade on the NYSE. The proposal describes NACs as corporations whose primary purpose is to manage, maintain, restore, and grow the value of natural assets. While some commenters, including Deutsche Bank and the World Wildlife Fund, support the development, 25 state attorneys general wrote to oppose this "new front in the effort to promote ESG policies at the expense of economic growth."

Background. Last September, the New York Stock Exchange filed a proposal to change its rules to adopt a new listing standard to allow NACs. This type of company was conceived by Intrinsic Exchange Group, which maintains a NAC Reporting Framework and advises on their formation. IEG would receive a share of revenues generated by the NYSE from the listing and trading of NACs.

According to IEG, natural asset owners—including governments, private landowners, farmers, ranchers, and corporations seeking to improve the sustainability of their supply chain—can form NACs to "generate a market return that appeals both to investors focused on socially responsible, impact, or sustainable opportunities and those with broader investment mandates."

The NYSE posits that "[d]espite a recognition that nature is immensely valuable, that value generally has not been included in the financial system." NACs "will capture the intrinsic and productive value of nature," allowing investors "efficient, pure-play exposure to nature and climate." IEG says that investors could include institutional investors, family offices, multilateral development banks, and retail investors.

Governance structure. According to IEG, NACs are designed to capture the full value of natural assets, which may include the value from their non-use. The NAC Reporting Framework builds on the U.N. System of Environmental and Economic Accounting - Ecosystem Accounting Framework to enable a NAC to prepare an Ecological Performance Report alongside a traditional financial statement.

A NAC's corporate charter must state that the purpose of the company is to actively manage, maintain, restore, and grow the value of natural assets and their production of ecosystem services, with the objective of maximizing ecological performance. NAC funds must be used primarily to meet the company's responsibilities with respect to the natural assets, although funds may be used to support community well-being as long as this does not harm the natural assets. The NAC must be prohibited from engaging directly in unsustainable extractive activities or using funds to finance such activities.

It is contemplated that NACs will be governed as other traditional listed companies, with several additional requirements. NACs must adopt an environmental and social policy, a biodiversity policy committing to achieving no net loss, a human rights policy, and an equitable benefit sharing policy.

Support for proposal. In a short letter of support, Deutsche Bank Securities said that the current public company reporting framework limits the options for disclosing the value of owning, maintaining, and enhancing natural assets. The only ways landowners can recognize asset value tend to be "impactful," such as developing or extracting the land, even if doing so generates less value than was provided by the intact ecosystem. Deutsche also notes that the established system of financial reporting does not fully capture the economic impact of natural disasters.

World Wildlife Fund wrote that a financial mechanism to measure and disclose the value of natural capital is necessary to create financial incentives for its protection. The proposal takes lessons from past shortcomings by including clear guidance on permitted and prohibited activities, public disclosure requirements, and transparent requirements for sharing benefits with local communities.

AG opposition. On the other hand, 25 state attorneys general oppose the rule change. Their letter charges that the proposed rule change violates the Exchange Act and the Major Questions Doctrine and exceeds the SEC's statutory authority. Additionally, the proposal is "just plain bad policy" that would allow private entities—including foreign actors—to lock up public lands in perpetuity.

The AGs maintain that the purpose of the NAC proposal is to finance an unlawful rule proposed by the Bureau of Land Management. This rule would authorize BLM to grant conservation leases for public lands but does not describe where the money for these leases would come from. "The BLM rule authorizes BLM to issue leases that limit public lands to no use or to only extremely limited uses. The NYSE's proposed rule change in turn provides the mechanism by which companies can obtain the funding necessary to pay for those money-losing leases," the AGs write.

The NYSE proposal exceeds the SEC's authority by regulating matters beyond the scope of the Exchange Act, the AGs continue, and by doing the opposite of protecting investors and the public interest. The Exchange Act does not authorize a new class of security aimed at environmental rather than economic ends, but the SEC and NYSE are attempting "to implement a radical environmental agenda through the rulemaking process (and outside the legislative process)."

Finally, the AGs object to the proposal as bad policy. Unlike federal and state governments, the private entities that create NACs will be beholden to private interests. The proposal would enable foreign actors to obtain perpetual control over public lands, raising national security concerns. The AGs also see an inevitable bubble forming—and eventually damaging the economy when it bursts—due to the trading of shares that are not underpinned by any economic value.

The letter is signed by the Attorneys General for the States of Utah, Kansas, Alabama, Alaska, Arkansas, Florida, Idaho, Indiana, Iowa, Kentucky, Louisiana, Mississippi, Missouri, Montana, Nebraska, New Hampshire, North Dakota, Ohio, Oklahoma, South Carolina, Tennessee, Texas, Virginia, West Virginia, and Wyoming.

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