Securities Regulation Daily Wrap Up, TOP STORY—Gensler, senate Republicans spar over crypto regulation, ESG, (Sept. 14, 2021)

Securities Regulation Daily Wrap Up

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Chair Gensler maintained that the SEC has broad authority to regulate digital assets, while Republicans said they prefer a "light touch" on crypto regulation and urged the SEC to avoid "regulation by enforcement."

SEC Chair Gary Gensler testified before the Senate Banking Committee on a broad array of topics, including the SEC's role in regulating cryptocurrencies and whether it should mandate certain disclosures related to environmental, social, and governance (ESG) issues, particularly those related to climate risk and social issues.

Cryptocurrency. Echoing a sentiment he has expressed in the past, Gensler said that large parts of the field of crypto assets are "sitting astride of" regulatory frameworks that protect investors. Comparing it to the Wild West, Gensler advised that there is currently not enough being done to protect investors in crypto finance, issuance, trading, or lending. Gensler noted that he has asked the SEC staff to work along two tracks when it comes to approaching how the SEC regulates cryptocurrency: (1) how to work with other financial regulators under current authorities to best bring investor protection to crypto markets; and (2) determine what gaps exist that it might fill with the assistance of Congress. Gensler added that the SEC is not only working with the CFTC (which he formerly chaired) in areas of relevant or overlapping jurisdiction, but also other financial regulators, including the Fed, the Treasury Department, and the Office of the Comptroller of the Currency.

The committee's ranking member, Sen. Pat Toomey (R-Pa) was critical of what he perceived as the lack of clarity regarding SEC's cryptocurrency policy. He heralded crypto and blockchain as very promising technologies, but noted that the SEC has identified under the *Howey* test for investment contracts some cryptocurrencies that are securities and some that are not. Toomey expressed his frustration at the lack of public guidance about how the SEC makes the determination that a cryptocurrency or token is a security or not.

Toomey acknowledged that the SEC staff will provide feedback and analysis privately to parties who seek it out but wondered why this analysis has to be private. Why wait to make the SEC's views known until it "swoops in" with an enforcement action, Toomey asked, in some cases, years after the product was launched. This amounts to regulation by enforcement, which Toomey fears can stifle domestic innovation. Toomey's views are similar to those of SEC Commissioner Hester Peirce, who has also bemoaned the lack of SEC clarity on how to determine whether a certain digital asset is a security.

Gensler replied that under both the *Howey* and *Reves* tests, the SEC has a lot of latitude to determine whether these cryptocurrencies or tokens come under the purview of the Commission. He added that Congress could provide legislative direction in this area, but for now, under *Howey* and *Reves*, the SEC is working with a very broad definition of what a security is.

Senator Steve Daines (R-Mont) also expressed his concern about the SEC's posture towards crypto and blockchain, believing that the SEC should provide a "lighter touch" towards regulation. He echoed Sen. Toomey's concern about the lack of clarity for market participants who instead must rely on vague statement and remarks. However, Sen. Elizabeth Warren (D-Mass) voiced her support for Gensler's concern about protecting investors in the crypto market, noting that even in the previous week, some prominent cryptocurrencies fell drastically in value and some crypto exchanges experiences outages that would not let investors make withdrawals or trades

Climate risks and ESG disclosure. Gensler also spoke about the Commission's recent initiatives that are exploring ways for investors to receive consistent, comparable, and decision-useful disclosures, particularly

regarding climate risk, human capital, and cybersecurity. In addition to then-Acting Chair Allison Herren Lee's request for comments on the SEC's approach to climate-related disclosures, Gensler said that he has directed the staff to develop proposals for the Commission's consideration of these potential disclosures

Democrats seemed receptive to the SEC mandating disclosures regarding ESG matters, with a particular focus on climate change. Senator John Tester (D-Mont) noted the impact of extreme weather events on the lives of Americans and the economy. "It's not going away, and it is getting worse," he proclaimed. He inquired of Gensler how he views the role of the SEC as a regulator in this area. Gensler replied that investors want more disclosure about climate risk. While most companies do disclose climate risks in one way or another, the role of the SEC should be to help make the disclosures useful to investors by being consistent and comparable. Senator Tina Smith (D-Minn) agreed with Gensler that climate risk disclosure is not currently presented in a way that is very useful to investors. According to Smith, climate risk is not a social issue; it is a systemic risk that needs to be disclosed in a thoughtful way.

Responding to a question from Sen. Catherine Cortez Masto (D-Nev), Gensler also noted that there has been an increase in funds that market themselves as "green," "sustainable," or similar descriptors. The SEC should be able to look at the metrics of these kind of funds to see if they are actually investing in such products or companies, Gensler said

Some Republicans on the committee took issue with what they saw as the SEC trying to impose its views on social issues on corporations as out of line with the agency's mandate. In his opening statement as ranking member, Sen. Toomey reiterated his concern expressed during Gensler's confirmation hearing that the SEC might be used to "advance a liberal political agenda, such as combatting global warming and advancing so-called social justice" and using the SEC's regulatory authority to pursue disclosures that are not financially material to the reporting company. Toomey singled out global warming and human capital disclosures such as the racial and gender makeup of boards as areas where he believes the SEC has strayed from its mandate

Agreeing with his colleague, Sen. John Kennedy (R-La) pointedly asked Gensler sarcastically regarding the companies the SEC regulates, "Do you consider yourself to be their daddy?" When Gensler responded no, Kennedy continued, asking, "Why do you impose your personal preferences about social issues and cultural issues on companies?" Gensler denied that he was doing that. If investors want disclosures about climate risk or other issues, it is the role of the SEC to put out a release for notice and comment and perform an economic analysis to see what investors are saying, Gensler explained.

Democrats on the committee were more receptive to greater disclosure of social and governance issues. Senator Tester noted that the SEC is currently prohibited under an appropriations rider from mandating that companies disclose political spending, specifically bringing up companies that said they would not make campaign contributions to members of Congress who opposed certifying the results of the 2020 presidential election, many of which backed off on that promise. According to Sen. Tester, while a million dollar contribution may not seem material to a multi-billion-dollar company, it is definitely material to the campaign receiving the donation.

Other committee members voiced support for the SEC's initiative on improving human capital disclosures. Senator Mark Warner (D-Va), who has sponsored human capital legislation, the Workforce Investment Disclosure Act, called out companies who say their greatest asset is their workforce, yet there is virtually no reporting on human capital by these companies. Investors want to know about employee retention and what kinds of skills and training employees receive, he said. Warner also encouraged Gensler and the SEC to go beyond human capital and consider the whole realm of ESG reporting.

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