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Missouri Court Denies Dismissal of SIFMA Challenge to Missouri's Anti-ESG Rules for Financial Advisers

Corporate Defense and Disputes on **January 8, 2024**

A federal district court in Missouri recently denied a motion to dismiss the Securities Industry and Financial Markets Association's ("SIFMA's") challenge to Missouri Securities Division rules that require financial firms and professionals to obtain clients' signatures on state-prescribed documents before providing advice that "incorporates a social or nonfinancial objective." The decision – *Securities Industry and Financial Markets Association v. Ashcroft* – upholds a noteworthy response from the securities industry to the anti-ESG backlash that has emerged in the past few years and has politicized investment decisionmaking.

Background

In June 2023, the Missouri Securities Division adopted two rules applicable to broker-dealers, investment advisers, and their agents and representatives (the "Affected Persons"). The rules deem Affected Persons to engage in dishonest or unethical business practices in Missouri if those persons do not disclose to clients or prospective clients that the Affected Person "incorporates a social objective or other nonfinancial objective" into any discretionary investment decision or any advice or solicitation to buy or sell a security.

- "Incorporat[ing] a social objective" means considering "socially responsible criteria in the investment or commitment of client funds for the purpose of seeking to obtain an effect other than the maximization of financial return to the client."
- "Socially responsible criteria" are "any criterion that is intended to further, or is branded, advertised, or otherwise publicly described by" the Affected Person as furthering "international, domestic, or industry agreements relating to environmental or social goals," "corporate governance structures based on social characteristics," or "social or environmental goals."
- "Nonfinancial objective" means "the material fact to consider criteria in the investment or commitment of client funds for the purpose of seeking to obtain an

effect other than the maximization of financial return to the client."

The rules require Affected Persons to obtain "written acknowledgment and consent" from their clients either when the relationship is established or before effecting discretionary trading or providing advice.

SIFMA challenged the rules on four grounds:

- The rules are preempted by the National Securities Markets Improvement Act of 1996 ("NSMIA") to the extent they apply to federally covered investment advisers and representatives because they require those Affected Persons to incur costs and undertake duties beyond those mandated by federal law.
- The rules are preempted by the Employee Retirement Income Security Act to the extent they apply to ERISA plan assets.
- The rules violate the First Amendment's protection against compelled speech because they "require Affected Persons to issue state-scripted documents and to secure written consents conforming to the state's prescribed language related to a controversial matter of public debate."
- The rules are unconstitutionally vague because they "fall far short of providing regulated persons with the ability to ascertain with certainty what strategies or securities include 'social' or 'nonfinancial objectives.'"

Missouri moved to dismiss, contending that SIFMA lacked standing to sue and that the Complaint failed to state a claim in any event. The court denied the motion in all respects.

The Court's Decision

The court first held that SIFMA had standing to sue. Although its members are federally covered investment advisers, which are excluded from the Missouri rules, SIFMA sufficiently alleged for pleading purposes that the investment-adviser rule imposes compliance costs on SIFMA members who have investment-adviser representatives in Missouri and that SIFMA could sue on their behalf.

Turning to the merits, the court concluded that SIFMA had adequately alleged that the Missouri rules are preempted by NSMIA.

- SIFMA pled that the investment-adviser rule regulates SIFMA's members through their representatives in Missouri and that the scope of regulation goes beyond the

licensing, registering, or qualifying of investment advisers – the three areas of regulation that NSMIA allows. Regulating "what investment adviser representatives must disclose to their clients" is "distinct from the areas of state regulation permitted by NSMIA."

- Similarly, SIFMA alleged that the broker-dealer rule "requires [SIFMA's] members to obtain and preserve consent forms, which is 'making and keeping records'" beyond what NSMIA requires.
- In addition, SIFMA alleged that the Missouri rules "indirectly impose merit-based conditions on the sale of securities" by erecting "an extra hurdle before certain covered securities can be offered to Missouri investors, based on the substantive characteristics of those securities."

The court next held that SIFMA had adequately alleged preemption under ERISA.

- SIFMA sufficiently alleged that the rules "relate to" ERISA because they "regulate broker-dealers and investment advisers who are otherwise regulated by ERISA when managing employee retirement funds" and because they would "impact the administration of ERISA plans by requiring advisers to obtain and preserve consent forms not otherwise required by ERISA."
- The court acknowledged that ERISA's broad preemptive scope is limited by a savings clause, under which ERISA "shall not 'be construed to exempt or relieve any person from any law of any State which regulates . . . [securities].'" But the court concluded that, even if the Missouri rules are deemed to regulate securities, SIFMA had adequately pled that they "interfere with ERISA's 'comprehensive remedial scheme,' exempting it from the Savings Clause because 'a state law seek[s] to provide relief for what [is], in substance, alleged breaches of ERISA's fiduciary duties – including accusations that an ERISA fiduciary gave an ERISA plan [holder] inadequate investment advice[.]'"

The court further ruled that SIFMA had adequately pled a violation of the First Amendment.

- The court recognized that the Constitution affords "'lesser protection to commercial speech'" and imposes "'a lower level of scrutiny [on] laws that compel disclosures . . . of purely factual and uncontroversial information about the terms under which . . . services will be available.'" But SIFMA sufficiently alleged that lower-level scrutiny did not apply here because "'[t]he state is requiring securities firms to tell their clients that consideration of social or nonfinancial objectives will inherently jeopardize financial returns[,] which . . . is not purely factual,' as environmental, social, and governance objectives are not predictors of profitability and can serve

as a ‘tiebreaker’ between two otherwise equivalent securities.” Moreover, SIFMA alleged that “the speech is controversial ‘because the Rules’ required scripts express only one side of a debate over the merits of social objectives’ [when] investing.”

- SIFMA also adequately pled that the Missouri rules could not survive a higher level of “intermediate scrutiny” because “there are ‘less coercive method[s] of publicizing [Defendants’] views about social investing,’ which Defendants do not contest.”

Finally, the court agreed that SIFMA had adequately alleged that the Missouri rules are “unconstitutionally vague.” The rules define a nonfinancial objective as considering “criteria in the investment or commitment of customer funds for the purpose of seeking to obtain an effect other than the maximization of financial return to the customer.” The court agreed that “‘consider’ could be applied to routine investment advice and there is no guidance as to how consider is defined, or what extent of consideration qualifies under the Rules.”

Implications

The Missouri decision is yet another skirmish in the culture wars’ efforts to address and influence investing. While some financial firms and governmental entities have sought to promote ESG considerations as relevant investment criteria (whether for financial reasons, nonfinancial reasons, or both), others have fought to exclude those considerations from financial decisionmaking.

The *SIFMA* ruling, which is only a pleading-stage decision, focuses on the compliance burdens that a state may or may not impose on investment advisers and broker-dealers. It does not take sides on the substantive and perhaps politicized issue of the extent (if any) to which financial professionals can or should consider “social or other nonfinancial objectives” (to use Missouri’s phrase) in investment decisionmaking.

But the case does illustrate how governmental efforts to restrict those considerations can interfere with financial professionals' ability to do their jobs as they see fit. Indeed, financial professionals even in some "red" states have complained that anti-ESG edicts have hampered their ability to use their best judgment to generate financial returns. But if rules such as Missouri's are adopted at least in part for political motives, rulings such as the *SIFMA* decision might not have much impact on some states' appetite for further attempts at regulation and political point-scoring.

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