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Missouri Court Enjoins Missouri's Anti-ESG Rules for Financial Advisers

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A federal district court in Missouri recently enjoined 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 permanent injunction issued in *Securities Industry and Financial Markets Association v. Ashcroft*, No. 23-cv-4154 (W.D. Mo. Aug. 14, 2024), vindicates a noteworthy response from the securities industry to the anti-ESG backlash that has emerged in some states in the past few years and has politicized investment decisionmaking.

Background

In June 2023, the Missouri Securities Division adopted two rules (the "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 obtain signatures from Missouri investors on consent forms before incorporating a "social objective" or other "nonfinancial objective" into any discretionary investment decision or any advice or solicitation to buy or sell a security. The mandatory language includes an acknowledgment that such advice will result in investments or recommendations not solely focused on maximizing financial return.

The Rules define some key terms:

- "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 criteria that is [*sic*] 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 the mandated "written acknowledgment and consent" from their clients either when the relationship is established or before effecting discretionary trading or providing advice.

The Securities Industry and Financial Markets Association ("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 make and keep records different from 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.'"

The court denied Missouri's motion to dismiss in January 2024. And it now has granted summary judgment for SIFMA and issued a statewide injunction against the Rules.

The Court's Decision

The court held that SIFMA had shown actual success on the merits of its four challenges to the Rules.

First, the Rules are preempted by NSMIA, which contains express preemption provisions.

- The broker-dealer rule is expressly preempted because "it requires broker-dealers to make and keep record[s] that differ from – and are in addition to – federal requirements." It also imposes a signature requirement not mandated by federal

law.

- The investment-adviser rule is preempted because it applies to "qualifying investment adviser representatives of federally covered investment advisers" and "impermissibly imposes new and different State regulatory obligations that are not required by federal law," including "compliance obligations for advisory firms."

Second, the Rules are preempted by ERISA, which also contains an express preemption provision.

- The Rules "interfere with ERISA by restricting what investments may be recommended or selected, and by mandating disclosure and recordkeeping requirements not required by ERISA."
- The court acknowledged that ERISA's broad preemptive scope is limited by a savings clause, which preserves "any law of any State which regulates . . . [securities]." But the savings clause does not shield the Rules because they pose an "obstacle" to ERISA's "comprehensive remedial scheme" in that a Department of Labor ERISA regulation "authorizes the exact fiduciary activities that Defendants seek to curtail." That regulation "specifically permit[s] fiduciaries to consider social or nonfinancial objectives in certain circumstances."

Third, the Rules violate the First Amendment to the U.S. Constitution.

- The court recognized that the Constitution affords "lesser protection to commercial speech" and imposes "a lower level of scrutiny to laws that compel disclosures . . . of purely factual and uncontroversial information about the terms under which . . . services will be available." But lower-level scrutiny did not apply here because "the written consent requirement does not consist of only 'purely factual . . . information.'" Rather, it requires customers to "'acknowledge and understand that incorporating a social objective or other nonfinancial [objective] . . . *will result* in investments and recommendations/advice that are *not* solely focused on maximizing a financial return for me or my account.'" The court found such a compelled statement both "not purely factual" and "misleading."
- Moreover, "the speech compelled by the Rules is not uncontroversial." The defendant Secretary of State had published an article titled "Opinion: It's Time to Rein In ESG," and his "statements discussing political priorities are not uncontroversial and may be considered in determining the appropriate level of scrutiny to be applied."
- The Rules could not survive a higher level of "intermediate scrutiny" because "they are more extensive than necessary to further the government's interest." "To the extent the Rules were intended to prevent fraud and deceit, the written content [*sic*

] requirement is not narrowly tailored." And "to the extent the Rules were geared toward addressing a policy debate, Defendants had a less coercive method of publicizing their views on 'social' investing."

Fourth, the Rules are "unconstitutionally vague." They do not adequately define "nonfinancial objective" and do not provide any guidance on the meaning of "maximization of financial return." "Taken at face value, this phrase plausibly could be read to refer to those investment strategies that provide the highest potential returns on the amounts invested, even when such strategies are the riskiest."

Having found SIFMA's success on the merits, the court then concluded that SIFMA had established the other criteria for a permanent injunction:

- SIFMA had established irreparable harm by showing a violation of its First Amendment rights;
- The Rules' preemption by federal law and the violation of SIFMA's constitutional rights outweighed any interest that defendants might have in the Rules; and
- "The public has a compelling interest in protecting First Amendment rights."

The court therefore granted summary judgment for SIFMA and issued the permanent injunction.

Implications

The *SIFMA* decision is yet another round 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, others have fought to exclude those considerations from financial decisionmaking.

The *SIFMA* ruling focuses on the compliance and speech 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 and investors even in some "red" states have complained that anti-ESG edicts have hampered their ability to use their best judgment to generate financial returns. For example, an Oklahoma court recently enjoined enforcement of an Oklahoma statute blocking government retirement systems from investing in companies or funds that allegedly boycott energy companies for not meeting environmental standards beyond those prescribed by federal and state law. However, 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 politicians' appetite for further attempts at regulation and political point-scoring.

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