Consumer Federation of America

Aug. 16, 2022

Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: File No: S7-17-22: Environmental, Social, and Governance Disclosures for Investment Advisers and Investment Companies

Dear Secretary Countryman:

On behalf of the Consumer Federation of America (CFA),[1] I am writing in strong support for the above-captioned proposal to require investment companies and investment advisers to provide additional specific disclosures regarding how they incorporate Environmental, Social, and Governance (ESG) considerations into their investing practices.[2] By requiring funds and advisers to provide more detailed explanations about their ESG investing practices to investors in fund registration statements, fund annual reports, and adviser brochures, this proposal would ensure that investors have more meaningful information on which to make investment decisions. This more comprehensive and detailed information would help investors identify more readily funds and advisers that consider ESG factors, understand and differentiate how different funds and advisers consider ESG factors, and make more informed investment decisions that better reflect their preferences, objectives, and expectations. We urge the Commission to adopt this proposal with our suggested modifications without undue delay.

1. **The increased demand for ESG funds and advisory services, variations in ESG investing practices, and the lack of clarity and detail about how asset managers approach ESG investing, taken together, increase the risk that ESG investments will not match investors' preferences, objectives, and expectations.**

The popularity of ESG investing has increased dramatically in recent years. While estimates vary, it is undeniable that there has been explosive growth in the number and diversity of ESG fund and advisory offerings, the flows into ESG-oriented funds and advisory services,

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[1] The Consumer Federation of America is a non-profit association of more than 250 consumer groups that was established in 1968 to advance the consumer interest through research, advocacy, and education.
[2] Proposed Rule, Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices, Release No. IA-6034; IC-34594 (May 25, 2022), https://bit.ly/3QFUmkv [hereafter "Proposing Release" or "Proposal" or "Proposed Rule"].

and the resulting total assets under management invested in ESG-oriented strategies.[3] This growing demand for ESG investments is shared by retail and institutional investors alike.[4]

In the ESG investing marketplace, in recent years and to a certain degree, a generally shared understanding among investors and other market participants has developed regarding what ESG investing means. But, a continuing and essential hallmark of that marketplace, too, is a necessary level of flexibility in what constitutes and/or qualifies as ESG investing. Indeed, and as discussed in more detail below, the umbrella term "ESG" broadly applies to numerous subcategories of narrower investment considerations. As such, there remains a range of preferences among investors and approaches taken by asset managers to reflect ESG-oriented objectives and expectations. As a result, the ESG asset management market is incredibly diverse, with different funds and advisers approaching ESG investing in myriad ways.[5] For example, some integrate ESG criteria alongside other non-ESG factors, while others engage in more focused ESG investing, such as screening companies based on an inclusionary or exclusionary framework. Still others approach ESG as a corporate governance strategy, using shareholders' voices to affect changes to policies and practices within the companies they own.

In addition, some ESG asset managers focus on or weigh different ESG factors more heavily than others. For example, while one portfolio might include securities selected from each of the three (E, S, and G) categories, another might include securities selected from just one or two of the categories. Similarly, one portfolio might weigh environmental factors more heavily than social or governance factors, while another might weigh governance factors more heavily than environmental and social factors.

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[3] *See* U.S. Securities & Exchange Commission, Asset Management Advisory Committee, *Recommendations for ESG* (July 7, 2021), https://bit.ly/3PqoHCn ("ESG investing has grown significantly in recent years; according to the ICI, "socially conscious" registered investment products grew from 376 products/$254 billion in assets under management ("AUM") at the end of 2017 to 1,102 products/$1.682 trillion in AUM by the end of June, 2020."); *see also* Morningstar, *Sustainable Funds U.S. Landscape Report, 2021: Another year of broken records*, at 1-2 (January 31, 2022), https://bit.ly/3JZevj9 (According to the report, "[t]he number of sustainable open-end and exchange-traded funds available to U.S. investors increased to 534 in 2021, up 36% from 2020[;]" "[s]ustainable funds attracted a record $69.2 billion in net flows in 2021, a 35% increase over the previous record set in 2020[;]" "[a]ssets in sustainable funds landed at a record $357 billion at the end of 2021, more than 4 times the total three years ago[;]" and "[o]ver the past year, funds have launched that target everything from LGBTQ+ rights and affordable housing to sea decarbonization and clean cryptocurrency mining.").

[4] J.P. Morgan, *ESG Outlook 2022: The Future of ESG Investing* (January 2, 2022), https://bit.ly/3JXwlmF ("The shift to sustainable investing is so powerful because it's being driven by demand from the bottom up. Quite simply, investors – from individual savers through to large institutions – are directing an ever-increasing proportion of their portfolios towards sustainable strategies as they look to use their capital to help create a more sustainable world."); *see also* Globe Scan, *Retail Investors Show Strong and Growing Interest in ESG* (December 14, 2021), https://bit.ly/3AnQQ8Y ("Half of American retail investors (51%) now say ESG has influenced their investments, up 25 points compared to 2003."). *But see* FINRA Investor Education Foundation, *Investors Say They Can Change the World, If They Only Knew How: Six Things to Know about ESG and Retail Investors* (March 2022), https://bit.ly/3w4RFkA; *and* Business Wire, *ESG Investing Reaches Critical Mass* (April 22, 2022), https://bwnews.pr/3zXoYah (Graphic: "Financial professionals and investors aren't always on the same page about ESG").

[5] *See, e.g.,* State Street Global Advisors, *Understanding & Comparing ESG Terminology* (2018), https://bit.ly/3du1qSP ("According to a survey of 475 institutional investors . . . , more than half of institutions that have adopted environmental, social and governance (ESG) investing cite a lack of clarity over ESG terminology. At the heart of the challenge is that the terms used to describe the various ESG strategies are not universally defined and can mean different things to different investors.").

Even within each ESG category, it is not uncommon for different funds and advisers to focus on different themes or goals. For example, one environmentally focused fund might invest in "green" companies that are developing innovative solutions designed to reduce or mitigate various effects of climate change, while another might invest in companies that produce energy from solar, wind, and other renewable sources, while still another might invest in companies that agree to reduce greenhouse emissions. Similarly, one socially focused fund might invest in companies with diverse and inclusive workplaces, while another might invest in companies that are committed to complying with certain labor practices, while still another might invest in companies that exhibit particularly strong or socially active corporate cultures. Likewise, one governance focused fund might invest in companies that are committed to corporate transparency, while another might invest in companies that are dedicated to making changes to their board composition, while still another might invest in companies that are committed to making changes to their executive compensation structures. The potential variety of approaches are seemingly unlimited, and indeed, many of these examples entail significant overlap between one another and are employed differently across the various categories of ESG investing.

Moreover, different asset managers may take varying approaches when defining their ESG criteria. They may also have different methodologies of measuring and analyzing whether companies meet their particular ESG criteria. Accordingly, asset managers may exercise broad discretion and include qualitative judgment into this process. ESG asset managers may also use data from third party providers, including "scoring" or "rating" information to help them determine whether to invest in specific companies. Third party service providers may also take varying approaches when defining their ESG criteria and selecting and implementing their methodologies, which also may include making subjective determinations.

The examples discussed above are just a few of the myriad ways different funds and advisers may approach ESG investing. Importantly, all of them may be perfectly acceptable approaches to ESG investing—indeed the diversity of offerings may benefit investors by providing them a range of investment approaches that have the potential to match their preferences, goals, and expectations. However, in order for investors to make informed investing decisions that accurately reflect their preferences, objectives, and expectations, it is critical that investors understand how each ESG product or advisory service incorporates ESG considerations into their respective investing practices.[6]

Unfortunately, and for several reasons, it can be exceedingly difficult for investors to undertake this kind of assessment. For one, current fund and advisory disclosures are often vague and lacking sufficient detail about how asset managers approach ESG investing. As a result, these disclosures often do not provide the detailed information that investors need to make

[6] For example, an SEC Investor Alert cautions investors who may be considering purchasing ESG funds that, "You should read the fund's disclosure documents closely to be sure you understand what the fund is—and is not—invested in, and how its ESG orientation may affect its risk." The Alert then poses a list of questions investors should ask when determining if an ESG fund is right for them. Unfortunately, the answers to those questions may not be clear from the fund's disclosure documents. *See* U.S. Securities & Exchange Commission, Investor Alerts and Bulletins, Environmental, Social and Governance (ESG) Funds, February 26, 2021, https://bit.ly/3QMeEZG.

informed investment decisions.[7] Compounding these difficulties for investors, different funds and advisers often approach disclosures of their practices differently, including disclosing their practices in different ways and places. This can make it difficult for investors to find decision-useful information, if it exists at all, and to understand, compare, and differentiate between different offerings in order to identify the offerings that represent the best match for them.

Recent reviews of fund prospectuses highlight the lack of clarity and detail about how ESG funds are incorporating ESG factors. For example, researchers at the University of California at San Diego who examined fund prospectuses through natural language processing recently found that prospectuses ultimately proved ineffective as a tool to distinguish different ESG funds.[8] Among other issues, the researchers found that some funds lacked precise language, didn't clearly state their investment style, and vaguely stated that ESG characteristics would be different in the view of each investor. In other words, prospectuses did not provide investors with the ESG-related information they needed to make informed decisions that reflect their preferences, objectives, and expectations

Similarly, analysis by Morningstar has noted that hundreds of non-ESG funds have added language to their prospectuses suggesting that they are considering potential ESG factors in their portfolios, yet they are doing so without providing sufficient clarity about how they are incorporating ESG factors into their process.[9] According to Jon Hale, Morningstar's global head of sustainability research, "These funds are not being repurposed into ESG funds, but they have added language to the prospectus to say they are considering it, and then they sort of leave it at that," in an interview with *InvestmentNews*. "If anything further is included, it might be a caveat that explains ESG doesn't necessarily drive all the investment decisions," Hale observed.[10] Here again, this kind of disclosure does not promote informed investment decision making.

Likewise, our own limited review of fund prospectuses found some ESG fund prospectuses to be lacking clarity and detail about how funds incorporate ESG factors into their investing processes. This included prospectus language stating, among other things, that:

- the fund adviser's ESG factor evaluation is generally qualitative and subjective, without saying what that means in practice;
- the fund seeks to optimize ESG exposure, without saying how it would do so or what that would entail;
- the fund exhibits positive ESG characteristics, without defining those or describing how the fund would assess them;

[7] *See, e.g.*, U.S. Securities & Exchange Commission, Division of Examinations, Risk Alert, The Division of Examinations' Review of ESG Investing, April 9, 2021, https://bit.ly/3w1S2ft ("This rapid growth in demand, increasing number of ESG products and services, and lack of standardized and precise ESG definitions present certain risks. For instance, the variability and imprecision of industry ESG definitions and terms can create confusion among investors if investment advisers and funds have not clearly and consistently articulated how they define ESG and how they use ESG-related terms, especially when offering products or services to retail investors.").
[8] Min Yi Li, Qianchen Zheng, Hao-Che Hsu, and Yin Zhu, *Identify "Greenwashing" Funds using NLP in Firms' Prospectuses*, https://bit.ly/3Qrj7B8.
[9] Jeff Benjamin, *Hundreds of Conventional Funds Add "ESG" to Prospectus Just in Case*, INVESTMENTNEWS, August 1, 2019, https://bit.ly/3pkEHLD.
[10] *Id.*

- the fund's selection criteria might not apply to all securities in the fund's portfolio, without stating why it doesn't apply to all securities or to what securities it does apply;
- the fund invests in securities that meet the adviser's sustainability criteria at the time of investment, without saying what that criteria is or how the adviser evaluates whether securities meet that criteria;
- the fund invests based on a proprietary ESG issuer rating process, without describing what the process entails; and
- the fund's adviser will use its internally developed ESG scores to identify companies that, in their view, demonstrate sound or improving ESG practices, without saying what that means in practice.

These disclosures would not enable an investor to understand how the fund incorporates ESG into its investing process or compare that process with other funds.

Moreover, the increased demand for ESG funds and advisory services, coupled with the lack of a specific disclosure framework for how funds and advisers incorporate ESG considerations into their investing practice, creates skewed incentives for funds and advisers and additional risks for investors. Chief among them is the potential for greenwashing, which heightens the risk that investors will be misled about the features and risks of the products or services that are marketed and sold to investors.[11] George Serafeim, a professor at Harvard Business School and one of the world's leading experts in sustainable finance, has warned that, "There are now stronger incentives for asset managers to greenwash."[12] Serafeim continued, "ESG cannot be just a marketing tool to attract capital. Right now there is a false sense of security or satisfaction if an investor buys an ESG product that might not be what the investor thinks it is."[13]

Indeed, recent research suggests that greenwashing is occurring with some prevalence in the fund market. In *Defining Greenwashing*, Ariadna Dumitrescu, Javier Gil-Bazo, and Feng Zhou proposed a definition for greenwashing that considers whether a mutual fund claims in its prospectus to invest according to ESG criteria and evaluates the truthfulness of the fund's claim based on the sustainability scores of the securities held in the fund's portfolio and on the fund's proven commitment to ESG investment through its voting record.[14] Using this definition, the authors concluded that 23.8% of funds that claim to invest according to ESG principles neither hold securities with above average or high ratings nor vote in support of more than 70% of firms'

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[11] *See, e.g.*, IOSCO, *Recommendations on Sustainability-Related Practices, Policies, Procedures and Disclosure in Asset Management* (Nov. 2021), https://bit.ly/3CgDXz5. ("The term "greenwashing" refers to the practice of misrepresenting sustainability-related practices or the sustainability-related features of investment products. In the 'race to promote their green credentials,' some asset managers may misleadingly label products as sustainable without meaningful changes in the underlying investment strategies or shareholder practices.").
[12] Eshe Nelson, *Sustainable Investing Risks Becoming a Victim of Its Own Success*, QUARTZ, December 13, 2018, https://bit.ly/2yT4kfQ; *see also* Tom Eckett, *FCA Called to Step in on 'Shameful' Industry Greenwashing*, ETF STREAM, November 5, 2019, https://bit.ly/3fJBNu3.
[13] Eshe Nelson, *Sustainable Investing Risks Becoming a Victim of Its Own Success*.
[14] Ariadna Dumitrescu, Javier Gil-Bazo, and Feng Zhou, *Defining Greenwashing* (May 2, 2022), https://bit.ly/3zZNk33.

ESG initiatives.[15] In terms of assets under management, the authors found that greenwashers account for 30.2% of all assets in ESG funds.[16] Additionally, the authors found that retail investors do not discriminate between true ESG funds and greenwashers.[17] These findings support the need for requiring ESG funds and advisers to provide more detailed disclosures about their ESG investing practices to investors, particularly those products and advisory services that are being marketed and sold to retail investors.

The increased demand for ESG funds and advisory services, coupled with the lack of a specific disclosure framework for how funds and advisers incorporate ESG considerations into their investing practices, is also likely to incentivize funds and advisers to use vague, aspirational disclosures that provide little meaningful information on which to make an informed investment decision. Such disclosures may also obscure funds' and advisers' actual investing practices. This could lead even well-intended asset managers to fall short of their claims. Further, the use of vague, aspirational disclosures makes it more challenging and time consuming for investors, if they're even able, to cut through the jargon, make sense of the information, and effectively compare different offerings.

In addition, these skewed incentives are likely to foster and perpetuate dynamics of reverse competition, where funds and advisers compete for assets based on marketing prowess rather than the quality and cost of their products and services. These dynamics are likely to make it even more difficult for investors to differentiate between products and to impede the development of this market. It is also likely to put those funds and advisers who are engaging in ESG activities in earnest (as compared to those that are not), including by providing detailed and comprehensive disclosures about their practices, at a competitive disadvantage relative to those that are not.

These shortcomings under the current market and regulatory environment underscore the need for the Commission to require funds and advisers to provide investors with enhanced disclosures about their ESG investing practices so as to ensure that investors have the information they need to make informed decisions when selecting ESG funds and advisory services.

2. **This proposed rule would provide investors with the information they need to make informed decisions when selecting ESG funds and advisory services.**

By requiring funds and advisers to provide more detailed explanations about their ESG investing practices to investors in fund registration statements, fund annual reports, and adviser brochures, this proposal would ensure that investors have more meaningful information on which to make investment decisions. This more comprehensive and detailed information would help investors more readily identify funds and advisers that consider ESG factors, would help them understand, differentiate, and compare how different funds and advisers consider ESG factors, and overall, would enable investors to make more informed investment decisions that better reflect their preferences, objectives, and expectations. These disclosures would also reduce the

[15] *Id.*, at 3-4.
[16] *Id.*, at 4.
[17] *Id.*, at 5.

potential for funds and advisers to engage in greenwashing or provide vague, aspirational disclosures that provide scant meaningful information on which to make an informed investment decision. In so doing, these disclosures would help to promote competition on terms that benefit investors.

The various aspects of the proposal are discussed below.

A. Proposed Fund Prospectus Disclosures

The proposal would require open-end funds (including ETFs) and closed-end funds (including BDCs) that consider one or more ESG factors to provide more detailed information about the fund's implementation of ESG factors in the fund's principal investment strategies. The level of detail required by this enhanced disclosure would depend on the extent to which a fund considers ESG factors in its investment process such that funds that incorporate ESG factors more extensively into their investment process would be required to provide more detailed ESG-related information. The proposal also sets out a layered approach to disclosure so as to highlight key information for investors early on in the prospectus and provide more details later on. We support this framework, as it will help to ensure that investors are provided the most salient and digestible information up front, followed by and undergirded with additional, more detailed information that they can review if they so choose. We view the proposed framework as being superior to one that would instead provide investors with excessive information in one place, as that would carry the potential to overwhelm investors and could ultimately impede decision making.

Toward these ends, the proposal would require different degrees and types of disclosure across two main types of ESG funds. ESG Integration funds, funds that consider one or more ESG factors alongside other, non-ESG factors such that ESG factors are not dispositive, would provide more limited disclosures relative to ESG-Focused Funds, funds in which ESG is a significant or main consideration in selecting investments or in their engagement strategy with the companies in which they invest.[18] This taxonomy is generally consistent with how funds invest and characterize their investing practices. It is also generally consistent with the taxonomy that the Investment Company Institute's (ICI's) ESG Working Group has articulated, including in its white paper, *Funds' Use of ESG Integration and Sustainable Investing Strategies: An Introduction*.[19]

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[18] Impact Funds would be a type of ESG-Focused Fund with a stated goal of pursuing a specific impact. These funds would have to provide additional disclosure to clarify the impact the fund is seeking to achieve as well as to allow investors to evaluate the fund's progress in achieving that impact.

[19] *See* ICI, *Funds' Use of ESG Integration and Sustainable Investing Strategies: An Introduction*, at 4, 5, and 7 (July 2020), https://bit.ly/3PqdPod (ICI uses the terminology "Sustainable," rather than "ESG-Focused," but it is clear from the description that Sustainable encompasses the same concept as ESG-Focused. The report states, "Fund managers may incorporate, or integrate, ESG considerations into their investment process along with other material factors and analysis[;] . . . Sustainable investing strategies are distinct from ESG integration in that they use ESG analysis as a significant part of the fund's investment thesis to respond to investors' objectives and accomplish sustainability-related outcomes while seeking financial returns." The report also notes that sustainable investing includes exclusionary, inclusionary, and impact investing. The report also states that "Funds with this type of investment approach [impact funds] seek to generate positive, measurable, reportable social and environmental impact alongside a financial return. Measurement, management, and reporting of impact is a defining feature of impact investing.").

Under the proposal, ESG Integration Funds would be required to summarize in a few sentences how the fund incorporates ESG factors into its investment selection process, including what ESG factors the fund considers. In contrast, ESG-Focused Funds would be required to provide more detailed information than Integration Funds. This information would be presented in an ESG Strategy Overview table in the same location of each fund's prospectus. This table would require information to be provided in a standard order and consistent manner, across ESG-Focused Funds. First, an ESG-Focused Fund would be required to disclose how the fund implements its strategy, including whether the fund:

- tracks an index;
- applies an inclusionary screen;
- applies an exclusionary screen;
- seeks to achieve a specific impact;
- engages in proxy voting;
- engages with issuers; or
- by other means.

In addition, an ESG-Focused Funds would be required to explain how it incorporates ESG factors into its investment decisions and how it votes proxies and/or engages with companies about ESG issues. We agree that requiring all ESG-Focused Funds to provide this concise disclosure, in the same format and same location in the prospectus, would provide investors a clear, comparable, and succinct summary of the key features of a fund's implementation of ESG factors. Investors could use this information to compare and contrast different ESG-Focused Funds' approaches quickly and easily. This in turn would help them choose the funds that best align with their preferences, objectives, and expectations.

When completing the ESG Strategy Overview table, the proposed rules would require ESG-Focused Funds that apply inclusionary or exclusionary screens to explain briefly the factors the screen applies as well as to state the percentage of the portfolio, in terms of net asset value, to which the screen is applied and explain briefly why the screen applies to less than 100% of the fund's portfolio (excluding cash and cash equivalents held for cash management), if applicable. We believe these proposed requirements would provide concrete information to investors about what kinds of investments the fund includes or excludes in its portfolio and the share of the fund that is affected by this screening. This information would help investors assess the fund's selection criteria and how that criteria is being applied in practice, which in turn would help address the risk that funds might provide vague statements about their selection criteria, including that the criteria may not apply to all securities.

In addition, if an ESG-Focused Fund commits to any third-party framework, the proposal would require the fund to disclose what third-party framework the fund follows and how the framework applies to the fund's investments. This information would help investors better understand how the fund's commitment to the third-party framework is reflected in its portfolio, which would help investors identify funds that reflect investors' ESG investment objectives. It would also address the risk that funds may state that they commit to a third-party framework without providing details about what that means in practice.

Moreover, if an ESG-Focused Fund tracks an index, the proposal would require the fund to describe the index and how the index utilizes ESG factors in determining its constituents. This information is particularly relevant, given the increasing popularity of index investing and the fact that an index's selection criteria ultimately affects management decisions and capital allocations.[20] In addition, if an ESG-Focused Fund uses an internal methodology or an ESG provider in evaluating, selecting, or excluding investments, the proposal would require the fund to provide an overview of how it incorporates ESG factors into its process for evaluating, selecting, or excluding investments. As with the index-related information, this information would help investors understand and evaluate the fund's investment selection criteria.

The proposal would also require an ESG-Focused Fund that engages with issuers to provide qualitatively an overview of how it engages or expects to engage with its portfolio companies on ESG issues, including through the fund's voting of proxies and meetings with management. This information would help investors who are interested in issuer engagement strategies to better understand how funds employ such strategies, compare funds with different and similar engagement strategies, and identify those funds that best reflect their engagement preferences, objectives, and expectations.

In addition, if a fund is an Impact Fund, a type of ESG-Focused Fund with a stated goal of pursuing a specific impact, the proposal would require the fund to describe what impact(s) it seeks to achieve, how it will achieve the impact(s), how the fund measures progress, what key performance indicators are analyzed, what time horizon is used to analyze progress, and the relationship between the impact and financial returns. This information would help investors who are interested in particular impact strategies to better understand different funds' impact strategies, compare funds with different and similar impact strategies, and identify those funds that best reflect their impact preferences, objectives, and expectations.

For the reasons discussed above, we believe the proposed approach distinguishing Integration Funds from ESG-Focused Funds and requiring different degrees and types of disclosure across these two main types of ESG funds would help to provide important, decision-useful information to investors in a format they can understand. This information would better enable investors to compare and contrast different fund offerings and promote competition within the fund industry based on quality and cost.

However, we urge the Commission to make one important modification to these prospectus disclosures so as to better distinguish Integration Funds from ESG-Focused Funds for investors. Specifically, ESG Integration Funds should be required to state explicitly in their summaries that they are not ESG-Focused Funds and that therefore ESG considerations are not significant or main considerations in selecting investments or in their engagement strategies with the companies in which they invest. Investors need to be told explicitly what an ESG Integration Fund is, and just as importantly, what it is not. This information would help investors understand this critical distinction between Integration Funds and ESG-Focused Funds within the four corners of funds' prospectuses. Without this kind of disclosure, an investor who reads an ESG-

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[20] *See* Adriana Z. Robertson, *Passive in Name Only, Delegated Management and "Index" Investing*, at 13 (June 2019), https://bit.ly/3AlhtLE ("[D]espite the central role indices play in modern financial markets, little is known about how they go about selecting which securities to include or exclude.").

Integration Fund's prospectus might be under the false impression that an ESG-Integration Fund is the only type of ESG fund available, when they may actually prefer an ESG-Focused Fund.

B. Proposed Fund Annual Reports

In addition to the proposed amendments to fund prospectuses, the proposal would require certain ESG-Focused Funds to provide additional ESG-related information in their annual reports. Specifically, Impact Funds would be required to discuss the fund's progress on achieving its ESG-related impacts in both qualitative and quantitative terms during the reporting period, and the key factors that materially affected the fund's ability to achieve the desired impact. Additionally, funds for which proxy voting is a significant means of implementing their ESG strategy would be required to disclose certain information regarding how the fund voted proxies relating to portfolio securities on ESG issues during the reporting period. Funds for which engagement with issuers on ESG issues through means other than proxy voting as a significant means of implementing their ESG strategy would also be required to disclose certain information about their engagement practices. Finally, the proposal would also require environmentally focused funds to disclose the aggregated greenhouse gas ("GHG") emissions of the portfolio.

We generally support these aspects of the proposal. Whereas fund prospectuses are used primarily by new investors who are in the market to purchase funds, funds' annual reports can provide new and existing investors with useful information that helps them monitor funds' activities. In this case, ESG-related information in fund annual reports could help investors monitor funds' progress toward their ESG-related objectives. This information would help to ensure that investors have the information they need to determine whether a fund's ESG-related activities reflect their preferences, objectives, and expectations—not only when investors purchase these funds but also so long as they hold them.

In particular, we support the proposed requirement for environmentally focused funds to disclose the aggregated greenhouse gas ("GHG") emissions of their portfolio. Specifically, environmentally focused funds that consider issuers' GHG emissions as part of their investment strategy would be required to disclose their carbon footprint and the Weighted Average Carbon Intensity ("WACI") of their portfolio. Requiring this subset of funds to report these quantitative metrics on a consistent basis would enable investors to compare different funds' GHG-related investing practices and make more informed investment decisions, as well as limit funds' incentive to exaggerate or make vague, unsubstantiated claims regarding their GHG-related investing practices. Supplementing this information, the proposal would require environmentally focused funds to disclose the Scope 3 emissions of their portfolio companies, to the extent that Scope 3 emissions data is reported by the fund's portfolio companies. Scope 3 emissions would be disclosed separately for each industry sector in which the fund invests. We believe separating out Scope 3 emissions from Scopes 1 and 2 is appropriate, given the limited information and reliability of data regarding Scope 3 emissions currently available. Still, Scope 3 emissions data are important information that investors in environmentally focused funds would likely want to consider, particularly as the information becomes more comprehensive and reliable over time.

We also support the proposed inclusion of derivatives in calculating GHG metrics. If the calculation did not include derivatives, it could create an incentive for funds that want to gain exposure to high-emitting companies but don't want that exposure to affect their GHG emissions statistics to use derivatives in order to hide that exposure for purposes of these disclosures.[21] Such evasion would be inconsistent with the purposes underlying these disclosures and would lead to less accurate, less reliable information being provided to investors.

However, we do not think the proposed disclosure requirements for ESG-related engagement activities, as would be required of funds for which engagement is a significant means of implementing their ESG strategy, would likely elicit particularly enhanced or decision-useful information for investors, or foster more meaningful interactions between funds and issuers. Specifically, the proposal would require these funds to disclose the number or percentage of issuers with whom the fund held ESG engagement meetings during the reporting period related to ESG issues, as well as the total number of ESG engagements. However, as the Proposing Release recognizes, by focusing on the number of meetings, there is serious risk that these disclosures could encourage funds to focus on the quantity of meetings, rather than the quality.[22] We do not believe investors would benefit from such superficial metrics. Instead, by focusing on these metrics, the disclosures could actually discourage funds from pursuing other, potentially more meaningful engagement strategies and practices, practices that could better reflect investors' preferences, objectives, and expectations.

C. Inline XBRL Data Tagging

The proposal would require funds to submit all proposed ESG-related registration statements and fund annual reports filed with the Commission in a structured, machine-readable data language. As in other contexts, we strongly support the expanded use of machine-readable disclosures, as they would allow investors, researchers, and other third party analysts to efficiently access, aggregate, search, sort, and analyze the information provided in these disclosures. More efficient, high-quality analysis of this information would benefit investor decision making and, in turn, investor outcomes. In this case, the availability of machine-readable disclosures would make it more likely that investors make investment decisions relating to ESG-related funds that better reflect their preferences, objectives, and expectations.

D. Proposed Adviser Disclosures

The proposal would also require registered investment advisers that consider ESG factors as part of their advisory businesses to include ESG-related disclosures in their Form ADV brochures that largely parallel the information that funds would provide, as discussed above, as well as information about how their ESG practices affect the advisory relationship. These

[21] *See* CFA, *Comment Letter Re: Investment Company Names* (August 16, 2022) [to be published on the Commission's website] (Describing that there is evidence, for example, that funds use derivatives to evade the Commission's Investment Company Names Rule).

[22] *See* Proposing Release, at 82-83 ("We recognize that funds may be incentivized to report a higher number or percentage of engagements, and this may result in funds construing the term "ESG engagement meeting" differently. . . . We recognize that, unlike the proposed disclosure requirements relating to a fund's proxy voting, the level of subjectivity involved in determining whether a discussion meets the definition of an ESG engagement meeting could diminish the comparability across funds of the statistics reported pursuant to this instruction.").

disclosures would help provide prospective and current clients with information that helps them understand how advisers consider ESG when making investment decisions, compare different advisers' practices, and select an adviser whose practices best reflect their preferences, objectives, and expectations.

Conclusion

By requiring funds and advisers to provide more detailed explanations about their ESG investing practices to investors in funds' registration statements, funds' annual reports, and advisers' brochures, this proposal would provide investors with more meaningful information on which to make investment decisions. This in turn will help investors make more informed investment decisions that better reflect their preferences, objectives, and expectations.

For the reasons discussed above, we urge the Commission to adopt this proposal with our suggested modifications without undue delay.

Respectfully submitted,

Dylan Bruce
Financial Services Counsel