August 16, 2022

Via Electronic Submission

Ms. Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Enhanced Disclosures by Certain Investment Advisers and Investment Companies About Environmental, Social, and Governance Investment Practices (SEC Rel. Nos. 33-11068; 34-94985; IA-6034; IC-34594; File No. S7-17-22)

Dear Ms. Countryman:

The Investment Adviser Association[1] (**IAA**) appreciates the opportunity to comment on the Commission's recent proposal to require registered investment advisers, certain advisers that are exempt from registration (collectively **investment advisers**), registered investment companies, and business development companies (collectively **funds**), to provide additional information regarding their environmental, social, and governance (**ESG**) investment practices.[2] Our comments in response to the Proposal build on the views expressed in our June 17, 2022, letter[3] in response to the Commission's Issuer ESG Proposal.[4]

Investment advisers have long considered material ESG factors as an integral part of prudent investment and risk management processes. They are also increasingly responding to

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[1] The IAA is the leading organization dedicated to advancing the interests of investment advisers. For more than 85 years, the IAA has been advocating for advisers before Congress and U.S. and global regulators, promoting best practices and providing education and resources to empower advisers to effectively serve their clients, the capital markets, and the U.S. economy. The IAA's member firms manage more than $35 trillion in assets for a wide variety of individual and institutional clients, including pension plans, trusts, mutual funds, private funds, endowments, foundations, and corporations. For more information, please visit www.investmentadviser.org.

[2] *Enhanced Disclosures by Certain Investment Advisers and Investment Companies About Environmental, Social, and Governance Investment Practices*, 87 Fed. Reg. 36654 (June 17, 2022), available at https://www.govinfo.gov/content/pkg/FR-2022-06-17/pdf/2022-11718.pdf (**Proposal**).

[3] *See* Letter from IAA General Counsel Gail C. Bernstein, *The Enhancement and Standardization of Climate-Related Disclosures for Investors* (June 17, 2022), available at https://investmentadviser.org/resources/comments-on-sec-proposal-to-enhance-and-standardize-climate-related-disclosures-for-investors/ (**IAA Response to the Issuer ESG Proposal**).

[4] *The Enhancement and Standardization of Climate-Related Disclosures for Investors*, 87 Fed. Reg. 21334 (Apr. 11, 2022), available at https://www.govinfo.gov/content/pkg/FR-2022-04-11/pdf/2022-06342.pdf (**Issuer ESG Proposal**).

investor demand for ESG-related investment services, funds, and data as investors continue to look to align their investment portfolios with their values and advance goals on issues such as sustainability and human capital. Investment advisers are thus increasingly developing and offering funds and strategies that consider ESG factors in their selection process.

The IAA strongly supports the view that investment advisers and funds should clearly articulate their investment strategies, including ESG and sustainable investment strategies, so that investors understand the investment adviser's or fund's philosophy and can make informed investment decisions. We believe that investment advisers and funds are already required to make these kinds of disclosures, whether related to ESG or otherwise. We nevertheless appreciate and are supportive of the Commission's desire to move forward with specific ESG disclosure requirements, including requirements designed to prevent greenwashing.

While we are generally supportive of the Proposal, we have concerns about its broad scope, which we believe could obscure rather than clarify salient information for investors. We are also concerned that the detail and specificity of information required to be disclosed could, paradoxically, be misleading in overemphasizing some factors over others. Further, certain aspects of the Proposal could disincentivize consideration of ESG factors in making investment and voting decisions. Including a materiality threshold for disclosures and flexibility or a safe harbor for good-faith determinations and estimations would ease many of our concerns. We offer these and other recommendations below that we believe would further the Commission's objectives, streamline and simplify the Proposal, and result in decision-useful disclosures for investors.

I. Executive Summary

We first make general recommendations to improve the Proposal and then offer several specific recommendations relating to: (A) Consideration of ESG Factors; (B) Impact Measurement Disclosures; (C) Greenhouse Gas (**GHG**) emissions disclosures; and (D) Marketing and Compliance Policies and Procedures.

General Recommendations

We recommend that any rule that the Commission adopts:

- Uses a materiality framework for disclosure.
- Avoids overemphasizing the role of ESG factors relative to other material factors.
- Balances the need for robust disclosures with the risk of information overload.
- Provides a safe harbor or makes clear that the rules will permit investment advisers and funds to make good faith determinations when disclosing ESG factors.

- Considers the purpose of the regulatory document when determining what information needs to be disclosed.

- Not be implemented until the later of 18 months from the effective date of a final rule on investment adviser and fund disclosure (**Final Rule**) or until the Commission has finalized and implemented the Issuer ESG Proposal (**Final Issuer ESG Rule**).

Specific Recommendations

A. Consideration of ESG Factors

We support the Commission's adoption of a rule that would require investment advisers and funds to disclose their consideration of ESG factors, subject to several recommended modifications. Specifically, we recommend that the Commission:

- Include a materiality standard in investment advisers' and funds' ESG factor disclosure obligations and, to prevent greenwashing, focus on how investment advisers and funds market themselves to the public.

- Remove the proposed requirements relating to private fund investment advisers or, in the alternative, preserve the confidentiality of their ESG strategy disclosures and require that they provide aggregate, rather than private fund-specific, disclosures.

- Not require disclosure of proprietary ESG investment methods and strategies.

- Require reporting of third-party ESG frameworks at the investment-adviser level rather than at the strategy level unless the framework is being used at the strategy level.

- Provide greater flexibility for investment advisers to provide ESG proxy voting information.

B. Impact Measurement Disclosures

We support the Commission's adoption of a rule that requires that investment advisers and funds disclose how they measure the impacts they seek to achieve with their ESG Impact strategies, subject to our recommendation that the Commission provide a safe harbor from liability or, in the alternative, at least allow flexibility for investment advisers and funds to provide impact measurements.

C. Greenhouse Gas Emissions Disclosure and Calculations

We support the Commission's adoption of a rule that requires funds to disclose the carbon footprint and weighted-average carbon intensity (**WACI**) of the fund's portfolio, subject to our recommendation that the Commission revise the fund GHG emissions disclosure and calculation requirements to exclude Scope 3 GHG emissions from the carbon footprint and

WACI reporting and provide a safe harbor for investment advisers and funds when reporting in good faith.

D. Marketing and Compliance Policies and Procedures

We support that the Commission is not proposing any new requirements related to marketing and compliance policies and instead reaffirming existing obligations under the compliance rules when investment advisers and funds consider ESG factors.

We discuss our recommendations below.

II. General Recommendations

A. The Commission should require disclosure only when information is material.

The Proposal would require an investment adviser to disclose, for each significant investment strategy or method of analysis it uses for which it considers *any* ESG factors, regardless of whether they are material, a description of and other detailed information about its consideration of those factors.[5] The Proposal would also require an investment adviser, if it has specific voting policies or procedures that include *one or more* ESG considerations when voting client securities, to describe which ESG factors it considers and how it considers them.[6] These proposed requirements do not include a materiality standard.

The Commission asks whether it should require investment advisers to make disclosures about an ESG factor "only if the adviser's strategy or method of analysis considers it to a material degree?"[7] We urge the Commission to answer this question in the affirmative. As it has done in other contexts,[8] the Commission should include a materiality standard for the

[5] 87 Fed. Reg. at 36757 (Proposed Form ADV Part 2A (**ADV 2A**) Item 8.D).

[6] *Id.* at 36761 (Proposed ADV 2A Item 17).

[7] *See id.* at 36695, Q. 175.

[8] *See, e.g., Commission Interpretation Regarding Standard of Conduct for Investment Advisers*, 84 Fed. Reg. 33669, 33675 and n. 55 (June 5, 2019) (**Fiduciary Interpretation**). Several ADV 2A items also require disclosure of information if it is material. For example: Item 2 requires an investment adviser to provide a summary of material changes and to update the ADV 2A only "whenever any information in the brochure becomes materially inaccurate"; Items 8.B and 8.C are intended to require disclosure only of material risks, not all risks; Item 9 provide that if a disciplinary event is immaterial, the investment adviser is not required to disclose it; Item 10 requires a description of material relationships or arrangements that the investment adviser (or any of its management persons) has with related financial industry participants and any material conflicts of interest that these relationships or arrangements create; Item 11 requires an investment adviser to describe the practice and discuss the related conflicts when an investment adviser or a related person invests clients in securities in which the investment adviser or a related person has a material financial interest; and Item 17 requires disclosure of certain financial information about an investment adviser when material to clients. The Commission also takes the view that it must show a misstatement or omission of a *material* fact when asserting violations of Section 206(4) of the Investment Advisers

consideration of ESG factors as part of a significant investment strategy or method of analysis as well as for consideration of ESG factors when voting client securities. We strongly believe that this would support the Commission's goal of improving "information available to investors by providing investors with an interest in ESG investing with key information that is material to their investment decisions."[9]

As fiduciaries, investment advisers have an ongoing obligation to inform their clients of any *material* information that could affect the advisory relationship.[10] Unless the Final Rule includes a materiality standard, however, investment advisers would be required to disclose immaterial information to investors that could be overwhelming and would not be decision-useful, could obscure material non-ESG-related disclosures, and may mislead investors by overemphasizing ESG factors relative to other more important factors.[11]

The Commission also asks how it should define materiality if it includes a materiality standard.[12] The IAA recommends that the Commission expressly confirm its previously stated view[13] that materiality for disclosure purposes under the securities laws is under the test articulated in the Supreme Court's *Basic v. Levinson* opinion.[14] Under this test, a fact is material "if there is a substantial likelihood that a reasonable investor would consider [it] important when making an investment or voting decision," considering "the total mix of information."[15]

Act of 1940 (**Advisers Act**) and Rule 206(4)-8 thereunder, and Section 34(b) of the Investment Company Act of 1940 (**Investment Company Act**). The Commission also proposes to use a materiality standard in other parts of the Proposal. For example, the Proposal would require an investment adviser "to describe any relationship or arrangement, that is material to the adviser's advisory business or to its clients, that the adviser or any of its management persons have with any related person that is an ESG consultant or other ESG service provider." 87 Fed. Reg. at 36889.

[9] 87 Fed. Reg. at 36755.

[10] *Fiduciary Interpretation*, 84 Fed. Reg. at 33675.

[11] The Commission recognizes the risk of overemphasis on some factors over other equally significant factors in its recent proposal on the Fund Names Rule. In that proposal, the Commission states that "[w]here a fund considers one or more ESG factors alongside other, non-ESG factors in its investment decisions but ESG factors are generally no more significant than other factors in the investment selection process, such that those ESG factors may not be determinative in deciding to include or exclude any particular investment in the portfolio, including ESG terminology in the fund's name would mislead investors by suggesting that the ESG factors play a more prominent role." *Investment Company Names*, 87 Fed. Reg. 36594 (June 17, 2022), available at https://www.govinfo.gov/content/pkg/FR-2022-06-17/pdf/2022-11742.pdf.

[12] 87 Fed. Reg. at 36695, Q. 175.

[13] *Amendments to Form ADV*, 75 Fed. Reg. 49233, 49237 (citing *SEC v. Steadman*, 967 F.2d 636, 643 (D.C. Cir. 1992) ("The standard of materiality under the Advisers Act is whether there is a substantial likelihood that a reasonable investor (here, client) would have considered the information important … This is a facts and circumstances test, requiring an assessment of the 'total mix of information.'").

[14] *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988). This recommendation aligns with our recommendation in the IAA Response to the Issuer ESG Proposal.

[15] *TSC Industries v. Northway, Inc.*, 426 U.S. 438, 445, 449 (1976).

The Commission has previously stated that because "materiality depends on the factual situation, which may vary with each situation, [the Commission] do[es] not believe that it is appropriate to specifically define or provide any bright line tests for what is and is not material."[16] We agree that the Commission should also not try to create a bright-line test for materiality in the context of ESG disclosures. Materiality can be a dynamic concept, depending on facts and circumstances, and involving judgment. For example, there is currently no commonly agreed methodology to assess or measure how ESG risks and opportunities may affect future financial position and performance. Similarly, sustainability topics that an investment adviser once considered immaterial for disclosure can become material, based on its analysis.

B. The Commission should avoid overemphasizing the role of ESG factors.

The Proposal represents a shift in investment adviser disclosure requirements that may hinder the Commission's ability to meet its objectives of assisting investors to make more informed investment decisions and preventing greenwashing.[17] The disclosure requirements as proposed may not only skew investor perception but also inadvertently have the effect of greenwashing because even if an investment adviser or fund does not consider ESG factors to be material or does not market its funds and strategies as "ESG," these requirements could effectively force investment advisers and funds to highlight ESG factors more prominently than other factors.

This concern is particularly heightened for ESG Integration strategies and funds, where there could be other material non-ESG factors that the investment adviser or fund incorporates into its investment strategy. Although the investment adviser or fund would need to provide salient information about these other material factors as well, they would not be required – and, as discussed in the next section, it would not make sense for them – to disclose these other non-ESG factors at such a granular level. Accordingly, we urge the Commission to consider the risks from overemphasis on ESG factors as it assesses the amount and specificity of disclosure it will require.

C. The Commission should balance the need for robust disclosures with the risk of information overload.

In addition to the risk that overemphasizing ESG factors may potentially mislead investors, the amount of information and level of specificity that would be required by the extensive list of potential additional disclosure items in Form ADV may result in information overload. We are also concerned that investment advisers may feel compelled to make more

[16] *Amendments to Form ADV, supra* note 13 at 49237.

[17] The Commission is concerned that the "lack of specific disclosure requirements tailored to ESG investing creates the risk that funds and [investment] advisers marketing such strategies may exaggerate their ESG practices or the extent to which their investment products or services take into account ESG factors. With respect to environmental and sustainability factors, this practice often is referred to as 'greenwashing.'" 87 Fed. Reg. at 36655.

granular Form ADV disclosures with respect to other, non-ESG factors that are material factors for fear that their disclosures will otherwise not be balanced, thereby risking even greater information overload. The Final Rule should strike the right balance between helping investors understand a potential investment and not burdening investors with having to sift through too much information or information that is ultimately not decision-useful.

The Commission has previously recognized that disclosing too much information can confuse investors and obscure the truly important information. It has stated that an "overload for investors . . . can result from disclosure of information that is not required, is immaterial, and does not promote understanding," and that "unnecessary duplicative disclosure . . . can tend to overwhelm readers and act as an obstacle to identifying and understanding material matters."[18] In the context of the ADV 2A, the Commission has stated that disclosure to clients should be "succinct and readable," and that investment advisers that "choose to disclose more than is required by the [ADV 2A] (and their fiduciary obligations) will create lengthier brochures than those that take a more focused approach."[19] Fund disclosures must also be presented in a "clear, concise and understandable manner."[20]

While this concern is amplified by the lack of a materiality standard for disclosure of ESG factors, it exists even with respect to information that is material. We agree that all material information that could affect the advisory relationship must be disclosed. However, the level of detail in the disclosure should not prevent it from being clear, focused, and understandable. Thus, in addition to adding a materiality standard and calling for a level of detail that does not overwhelm investors, the Commission should encourage investment advisers to use a layered approach to disclosure that would present information in a manner that emphasizes, within the universe of material information that is disclosed, the information and analysis that would be most important to a reasonable investor.[21] This presentation would assist investors in identifying more readily the most important information.

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[18] *See Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations*, 68 Fed. Reg. 75056 (Dec. 29, 2003), available at https://www.govinfo.gov/content/pkg/FR-2003-12-29/pdf/03-31802.pdf#page=11.

[19] *Amendments to Form ADV, supra* note 13 at 49233.

[20] Investment Company Act Rule 421.

[21] The Proposal contemplates layered disclosure for funds, and we recommend a layered approach for investment adviser disclosure as well.

D. The Commission should provide a safe harbor or make clear that it will permit investment advisers and funds to make good faith determinations about required ESG disclosures.

The IAA generally supports the Commission's decision not to define ESG or similar terms.[22] However, because definitions are not included in the Proposal, investment advisers and funds will need to make subjective judgments about a particular factor's potential status as ESG-related, which may create a higher level of ambiguity and a risk of second-guessing by the Commission and its staff on the nature and substance of ESG disclosures.[23]

The IAA recommends that the Commission provide a safe harbor or otherwise make clear that it will permit investment advisers and funds to make good-faith determinations of whether an investment strategy considers ESG factors, as those factors are defined by the investment adviser or fund.

E. The Commission should consider the purpose and objectives of the regulatory document when determining what information needs to be disclosed.

The IAA believes that the Commission should align required disclosures with the purpose and objectives of the regulatory document in which they are required to be disclosed.

The Form ADV Part 1A (**ADV 1A**) requires information about the investment adviser's business, ownership, clients, employees, business practices, affiliations, and any disciplinary events of the investment adviser or its employees. ADV 1A is used for regulatory purposes and the information it collects is that which the Commission's examination staff has identified as important for the Commission's examination program and other regulatory functions.[24]

While an investment adviser's responses to ADV 1A are available to the public through the Commission's website,[25] they are not delivered directly to clients or prospective clients, and

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[22] What is currently called ESG investing is relatively new – it was only 18 years ago that the United Nations (UN) study "Who Cares Wins" helped coin the ESG label. UN, *Who Cares Wins: Connecting Financial Markets to a Changing World* (2004), available at https://www.unepfi.org/fileadmin/events/2004/stocks/who_cares_wins_global_compact_2004.pdf.

[23] For example, some IAA members do not consider faith-based investing as an ESG factor. Therefore, they would respond that they do not consider ESG factors in their investment strategies. Another example is whether ESG factors would include real estate investment strategies that focus on investments in particular parts of the country given the possible social implications? Also, would strategies that consider certain governance aspects, such as executive compensation ratios and history of legal compliance, be included in considering ESG factors?

[24] ADV 1A disclosures are designed to improve the depth and quality of information that the Commission collects on investment advisers, facilitate risk monitoring initiatives, and assist Commission staff in its risk-based examination program. *See Form ADV and Investment Advisers Act Rules*, 81 Fed. Reg. 60418 (Sept. 1, 2016), available at https://www.govinfo.gov/content/pkg/FR-2016-09-01/pdf/2016-20832.pdf.

[25] SEC, Investment Adviser Public Disclosure, https://adviserinfo.sec.gov/.

they are not necessarily written in a manner designed to be meaningful to clients or prospective clients – rather, they are largely a series of "check-the-box" responses.

The ADV 2A, on the other hand, requires investment advisers to prepare narrative brochures that include plain English disclosures of the investment adviser's business practices, fees, conflicts of interest, and disciplinary information. The ADV 2A disclosures are aimed at and delivered to clients and prospective clients.

The Commission should bear these differences in mind as it considers new disclosures for investment advisers. As discussed more fully below and to improve the usefulness of the Form ADV disclosures, we believe that certain proposed disclosure Items in the ADV 1A and ADV 2A should be limited or revised.

F. The Commission should not implement an ESG rule for investment advisers and funds until the later of 18 months following the effective date of the Final Rule or until the Commission has finalized and implemented the Issuer ESG Proposal.

As we stated in the IAA Response to the Issuer ESG Proposal, the IAA appreciates that the Commission proposed to address climate-related information provided by public issuers prior to proposing a rule for disclosure by investment advisers or funds.[26] We again urge the Commission not to implement any rule related to disclosure of ESG factors for investment advisers and funds until after the Commission has finalized and implemented the ESG Issuer Proposal.[27] As discussed below, we also request that the Commission provide an 18-month transition period after the effective date of the Final Rule, if adopted, to give funds and investment advisers sufficient time to comply with the new ESG disclosure requirements. Accordingly, we ask that the compliance date of the Final Rule be the later of 18 months following its effective date or after the Commission has finalized and implemented the Final Issuer ESG Rule.

The Commission has stated that one purpose of the Proposal is to "create a consistent, comparable, and decision-useful regulatory framework for ESG advisory services and investment companies to inform and protect investors while facilitating further innovation in this evolving area of the asset management industry."[28] While investment advisers and funds already make meaningful ESG-related disclosures to investors, a Final Issuer ESG Rule would improve the quality and reliability of information provided by public issuers and ESG rating providers – two of the primary sources of climate-related risk information for investment advisers and funds

[26] *See* IAA Response to the Issuer ESG Proposal, *supra* note 3.

[27] The IAA recognizes that there is a proposed staggered implementation process under the Issuer ESG Proposal related to the size of the issuer and the type of data required to be disclosed. We believe that the implementation of the Final Rule could begin after the first implementation date of the Final Issuer ESG Rule, when investment advisers and funds will have an initial consistent and standardized set of information on which to rely.

[28] 87 Fed. Reg. at 36654.

– and reduce reliance on estimated data. It would also help investment advisers and funds satisfy any more granular disclosure requirements in a Final Rule.[29]

Investment advisers and funds engage in rigorous due-diligence efforts to obtain ESG-related information, integrate that information into their investment decision-making and proxy voting processes, and make meaningful disclosure to investors. Investment advisers and funds currently encounter substantial difficulties when attempting to assess public issuers' climate-related financial risks. The disclosures that public issuers make today regarding climate-related financial risk are very often insufficient and boilerplate.[30] Even when public issuers do provide substantive information, they do not do so in a standardized, consistent format.[31] Investment advisers and funds must scour public issuers' websites, investor presentations, and Commission filings looking for it, and must then interpret the unique format and terms each public issuer uses.[32] Smaller investment advisers and funds are disproportionately impacted, typically having fewer resources and leverage to devote to obtaining ESG-related information, including having less access to issuer personnel.

A Final Issuer ESG Rule would compel public issuers to disclose material climate-related financial risk information, GHG emissions data, targets and goals disclosure, and other material climate-related data to the market, thereby creating a standardized base of climate-related data for use in investment decisions and proxy voting, as well as to help investment advisers and funds comply with the new disclosure requirements in the Proposal. We believe that by sequencing the rules appropriately, the Commission can also greatly reduce the costs of implementing the Proposal, especially for smaller advisers and funds.

The need for sequencing is clear with respect to disclosures related to GHG emissions. If a Final Rule is implemented prior to implementation of a Final Issuer ESG Rule's GHG emissions disclosure requirements (or if these requirements for issuers are not ultimately adopted), many funds would likely need to rely on estimates for their GHG emissions reporting

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[29] Improved quality of issuer information will improve investment adviser and fund disclosures. For example, for both the carbon footprint and WACI measures, the Proposal does not permit a fund to reduce the GHG emissions associated with a portfolio company as a result of the company's use of purchased or generated carbon offsets. This calculation will be more difficult without a Final Issuer ESG Rule that requires disclosure of how public issuers use carbon offsets and renewable energy credits.

[30] 87 Fed. Reg. at 21339 ("[T]he disclosures in registrants' Forms 10-K frequently contain general, boilerplate discussions that provide limited information as to the registrants' assessment of their climate-related risks or their impact on the companies' business.").

[31] *Id.* ("The inclusion of climate-related disclosures in SEC filings should increase the consistency, comparability, and reliability of climate-related information for investors. The placement of climate-related information in different locations can make it difficult for investors to find comparable climate-related disclosures.")

[32] For example, an investment adviser could directly input climate-related risk disclosures into its proprietary rating system. However, because the current state of disclosure is inconsistent from public issuer to public issuer, an investment adviser would need to rely on data cleaning and estimation practices to normalize the metrics and fill in the gaps. Consistency of disclosures is likely to improve the overall accuracy of the investment adviser's underlying ratings.

requirements. Under the Proposal, funds that are "environmentally-focused" would be required to report the carbon footprint and WACI of their portfolios. Specifically, funds "would be required to obtain the information necessary to calculate a portfolio company's enterprise value and the portfolio company's total revenue from the company's most recent [regulatory report] filed with the Commission . . . containing such information."[33] The Commission recognizes that this information "would be the most reliable source of [GHG emissions] information,"[34] and acknowledges that "not all of the companies in which an environmentally focused fund may invest will currently provide the GHG information necessary for the fund to calculate the proposed financed emissions disclosures."[35] We do not believe that it makes sense to include the fund-disclosure requirement if a Final Issuer ESG Rule is not in place first.[36]

III. Specific Recommendations

A. Consideration of ESG Factors

The proposed amendments to ADV 1A would collect census-like information about the ESG-related advisory services provided to separately managed account (**SMA**) clients and reported private funds in a check-the-box (Yes or No) format. In each case, an adviser would have to identify whether it uses an ESG Integration, ESG-Focused, or ESG Impact strategy (as defined by the Commission) in providing services to its SMA or private fund clients and which factors it considers (Environmental, Social, and/or Governance). The proposed reporting requirements are designed to capture this information separately for each private fund, and in the aggregate for all SMA clients of the investment adviser. An investment adviser also would be required to report the name of any third-party ESG framework it follows, as well as whether the investment adviser or any of its related persons is an ESG consultant or other ESG service provider.

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[33] 87 Fed. Reg. at 36680.

[34] *Id.*

[35] 87 Fed. Reg. at 36681.

[36] The EU's adoption and compliance timelines of its ESG rules, which have presented substantial challenges for fund and asset managers, should serve as a cautionary tale. For example, under the Sustainable Finance Disclosure Regulation (**SFDR**), which takes effect in a staggered manner, investment advisers and funds must disclose how they address sustainability risks in their investment decisions as well as any adverse impacts on the environment and will need to provide support for sustainability claims made about their products. *See* European Commission, *SFDR* (Nov. 27, 2019), available at https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019R2088&from=EN. However, these disclosures must be made before companies are required to provide the underlying information, because the disclosure requirements for companies under the Corporate Sustainability Reporting Directive (**CSRD**) will not be adopted until later this year. *See* European Commission, *CSRD* (Apr. 21, 2021), available at https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52021PC0189&from=EN. Investment advisers and funds have had difficulty complying with SFDR without a standardized base of ESG data, which would be created by CSRD and that would compel public issuers to disclose ESG and other material non-financial data to the market.

Investment advisers would be required to disclose significant investment strategies or methods of analysis in ADV 2A, Item 8, for each strategy or method of analysis for which an adviser considers *any* ESG factor. The investment adviser would be required to provide a description of each ESG factor it considers and how it incorporates those factors in the advice it provides to clients, including clients that are private funds.

For each strategy or method of analysis required to be disclosed, an investment adviser must also include an explanation of whether the strategy is ESG Integration, ESG-Focused, or ESG Impact, and provide several other specified detailed disclosures.

An investment adviser must also describe, by strategy or method of analysis, any criteria or methodology used to evaluate, select, or exclude investments and how it uses these criteria or methodologies. The disclosure must address the investment adviser's use of any internal or third-party methodologies or frameworks, scoring or rating providers, inclusionary or exclusionary screens, or ESG indexes.

Investment advisers also would be required to describe any securities voting policies and procedures that include *any* ESG considerations, and any material arrangement with a related person ESG consultant or ESG service provider.

The Proposal also includes amendments to fund registration statement forms that would apply to open-end funds (including ETFs) and closed-end funds (including business development companies) that meet the proposed definitions of ESG Integration, ESG-Focused, or ESG Impact. As noted above,[37] the Proposal calls for a layered disclosure approach for funds. Under this approach, which we support, certain information would be included earlier in a fund's prospectus and more detailed information would be included further back in the prospectus, so that a fund does not overemphasize the role of ESG factors in investment selection decisions, and thereby potentially mislead investors.

1. Form ADV disclosures

a. Materiality standard for proposed Form ADV disclosures.

As discussed above, we urge the Commission to include a materiality standard for disclosure of consideration of ESG factors to minimize the risk of confusing or even misleading investors to believe that ESG factors are more important than other, material, factors used by the investment adviser or fund.

We therefore recommend that the Commission revise the language of the proposed disclosure requirement in Item 5(K)(5) of ADV 1A to:

[37] *See supra* note 21.

> (5) Do you consider any Environmental, Social or Governance ("E," "S," or "G," and collectively, "ESG") factors in a material way (i) as part of one or more significant investment strategies or methods of analysis in the advisory services you provide to your separately managed account clients, including in your selection of other investment advisers if applicable, and/or (ii) as part of your advisory services when requested by your separately managed account clients?

To provide consistency and ensure that investors are receiving salient and not extraneous information, we recommend that the Commission conform the proposed disclosures in ADV 2A to the revised language we have provided above.

b. ESG Integration Strategy

The Proposal defines an ESG Integration strategy as one that "considers one or more ESG factors alongside other, non-ESG factors in investment decisions such as macroeconomic trends or company-specific factors like a price-to-earnings ratio. In such strategies, ESG factors may be considered in the investment selection process but are generally not dispositive compared to other factors when selecting or excluding a particular investment."[38] The Proposal would require investment advisers to disclose whether they consider one or more ESG factors in SMA or private fund strategies alongside other, non-ESG factors in their investment advice, and also disclose that such ESG factors are generally no more significant than other factors in advising their clients with respect to investments, such that ESG factors may not be determinative in providing advice with respect to any particular investment.

We are concerned that this definition is so broad as to capture virtually any investment adviser that considers the governance of an issuer, or other factors that are integral to fundamental investment analysis, even when the investment adviser does not consider or in any way market itself as engaging in ESG investing. This concern is exacerbated by the absence of a materiality standard in the definition. Indeed, in the absence of further guidance from the Commission, it is not clear whether the incorporation of *any* ESG factor would trigger the ESG Integration definition and disclosure requirement or if some higher standard instead would apply.

However, a materiality standard, without more, would still likely lead to a vastly over-inclusive definition because, for example, the Proposal may not adequately contemplate the governance portion of ESG. Even with a materiality standard, it would seem likely that an investment adviser that answers "no" to having "ESG-Focused" or "ESG Impact" strategies would virtually always answer "yes" to ESG Integration, as governance tends to be a fundamental component of traditional investment analysis. This data point may therefore be relatively meaningless to both the Commission and investors. It also may confuse the issue of which firms are truly incorporating material components of "E" and "S" as opposed to others

[38] 87 Fed. Reg. at 36657.

that are simply including governance as a standard consideration.[39] In our view, this disclosure also would do little to minimize greenwashing and, paradoxically, may actually facilitate greenwashing.

For these reasons, we suggest that the Commission exclude the ESG Integration category altogether. If the Commission decides to retain the category, we believe that a better approach would be to require an investment adviser to disclose an ESG Integration strategy only to the extent that the investment adviser holds itself out or otherwise markets itself as providing ESG investment strategies. Disclosure could be meaningful in such circumstances because the investment adviser would need to explain how its investment strategies are ESG strategies.

We recommend that the Commission revise the language of the proposed disclosure requirement in ADV 1A Item 5(K)(6)(a) to:

> (6)(a) Do you ~~consider~~ <u>market yourself to the public as incorporating</u> one or more ESG factors <u>as a material component in your investment advice</u> ~~alongside other, non-ESG factors in your investment advice, but such ESG factors are generally no more significant than other factors in advising your clients with respect to investments, such that ESG factors may not be determinative in providing advice with respect to any particular investment~~ (“integration”)?

c. ESG-Focused Strategy

The Proposal would require investment advisers to disclose whether they focus on ESG factors by using them as a significant or main consideration in advising clients with respect to investments or in the investment advisers’ engagement strategy with the companies in which their clients invest.[40] Consistent with our comments above, we recommend that investment advisers would only check the box if the factors are a material component of the investment strategy.

We also believe that to be an ESG-Focused strategy, ESG factors need not just be used in a material way or as a significant consideration, but must be *more* significant than other factors, or used as a main consideration. We thus recommend that the Commission revise the language of the proposed disclosure requirement in ADV 1A Item 5(K)(6)(b) to:

> (6)(b) Do you focus on material ESG factors by using them as a <u>more</u> significant <u>factor than other factors</u> or <u>as a</u> main consideration in advising your clients with respect to investments

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[39] To the extent investment advisers consider specific governance factors as a material part of their investment strategy, they would need to disclose this in the ADV 2A.

[40] 87 Fed. Reg. at 36757 (Proposed ADV 1A Item 5(K)(6)(b)).

> or in your engagement strategy with the companies in which your separately managed account clients invest (ESG "focused")?

d. ESG Impact Strategy

The Proposal would require investment advisers, if they employ an ESG-Focused strategy, to disclose whether they seek to achieve a specific ESG impact or impacts.[41]

The Commission has provided different descriptions of what would constitute an ESG impact strategy. The Proposal first defines an ESG Impact strategy as a strategy that has a "stated goal that seeks to achieve a specific ESG impact or impacts that generate specific ESG-related benefits,"[42] but it subsequently states that an ESG Impact strategy is a strategy that "seek[s] to achieve a specific ESG impact or impact."[43] We suggest that the Commission be consistent in its description and clarify that, to constitute an ESG Impact strategy, a strategy must "have a stated goal that seeks to achieve a specific impact." In our view, having a stated goal provides greater clarity than a statement that a goal is being sought.

We thus recommend that the Commission revise the language of the proposed disclosure requirement in Item 5(K)(6)(c) to:

> (6)(c) If you answered "Yes" to (6)(b), do you ~~seek~~ <u>have a stated goal that seeks</u> to achieve a specific ESG impact or impacts? (ESG "impact")?

2. Treatment of private funds

The Proposal would require an investment adviser to identify in the ADV 1A whether it uses an ESG Integration, ESG-Focused, or ESG Impact strategy in providing services to its private fund clients and which factors it considers (E, S, and/or G). The Proposal represents a significant shift in private fund adviser disclosure requirements that we do not believe is warranted and we recommend that the Commission remove these requirements.

Currently, the ADV 1A requires investment advisers to disclose information related to the private funds they advise. This disclosure is limited to the formation and operation of the private fund (name, type of private fund, ownership of the private fund, services provided to the private fund, and service providers (administrator, marketer, auditor, prime broker, custodian)). The Commission has not previously required investment advisers to private funds to disclose any information related to investment strategies or trading methodologies in the ADV 1A, nor should it do so. To the extent that these strategies are required to be disclosed, they are disclosed on

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[41] *Id.* at 36757 (Proposed ADV 1A Item 5(K)(6)(c)) and 87 Fed. Reg. at 36760 (Proposed ADV 1A Schedule D Section 7.B.(1)(A)(29)(b)(3)).

[42] *Id.* at 36657.

[43] *Id.* at 36757.

Form PF, which is kept confidential pursuant to Section 204(b) of the Advisers Act and the rules thereunder. We believe that requiring disclosure in the ADV 1A, a publicly available document, would be counter to Congress' intent to keep this information confidential.

We also believe that the proposed disclosure requirements relating to private fund strategies would be inconsistent with the Commission's view that private funds may not be marketed to the public except under very limited circumstances.[44]

Nor do we believe that it is necessary for private funds to make the proposed disclosures to help investors understand the funds' investment strategies. Private fund clients receive extensive fund information in multiple private fund offering documents including the private placement memorandum. When this information is disclosed, it is generally disclosed to sophisticated parties under a non-disclosure agreement and is not meant for public distribution. As noted below, we believe that this information would be proprietary and competitively sensitive, and that its disclosure could economically harm investment advisers without a commensurate benefit to investors. We urge the Commission to reconsider this aspect of the Proposal.

If the Commission nonetheless includes ESG disclosure requirements related to private funds, the IAA recommends that (i) the Commission maintain the confidentiality of these disclosures, (ii) the proposed ADV 1A Items relating to these disclosures be aligned with our recommendations above,[45] and (iii) instead of imposing reporting requirements on each private

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[44] Securities Act Rules 506(b) and (c). Most offerings in the United States by private funds are made pursuant to the Rule 506(b) exemption from registration. Issuers relying on this exemption are prohibited from using any form of general solicitation or general advertising to market the fund interests. Rule 506(c) establishes an additional exemption, which differs from Rule 506(b) in that general solicitation and general advertising are permitted, so long as (i) all purchasers are "accredited investors" (up to 35 nonaccredited investors can purchase securities in an offering under Rule 506(b)); and (ii) reasonable steps are taken by issuers to verify that the purchasers are accredited investors. *See also* SEC, *Private Fund*, available at https://www.sec.gov/education/capitalraising/building-blocks/private-fund ("A private fund cannot publicly offer its securities.").

[45] If the Commission proceeds, we recommend that it revise the language of the proposed disclosure requirement in Schedule D Section 7.B.(1)(A)(29)(a) of ADV 1A to:

> (29)(a) Do you consider any ESG factors <u>in a material way</u> as part of one or more significant investment strategies or methods of analysis in the advisory services you provide to this private fund?

We likewise recommend that the Commission revise the language of the proposed disclosure requirement for private fund advisers in ADV 1A Schedule D Section 7.B.(1)(A)(29)(b)(1) to:

> (29)(b)(1) Do you ~~consider~~ <u>market yourself to private fund investors as incorporating</u> one or more ESG factors <u>as a material component in your investment advice</u> ~~alongside other, non-ESG factors in your investment advice, but such ESG factors are generally no more significant than other factors in advising the fund with respect to investments, such that ESG factors may not be determinative in providing advice with respect to any particular investment~~ ("integration")?

fund, the Commission require disclosure in the aggregate for all private fund clients of the investment adviser, similar to the proposed reporting requirements for SMAs.[46]

With respect to confidential treatment, the Commission could treat this as nonpublic information, similar to how the Chief Compliance Officer information is currently treated and similar to the treatment of information filed on Form PF.[47] As noted above, under Section 204(b)(10) of the Advisers Act, as adopted by the Dodd-Frank Act, the Commission is expressly limited from disclosing publicly an investment adviser's "proprietary information" in Form PF filings. In adopting Form PF, the Commission recognized the importance of protecting this information, determining not to adopt certain questions on Form ADV in response to commenter concerns that "they would result in the public disclosure of competitively sensitive or proprietary information."[48]

For the same reasons, the IAA also recommends that the Commission not require the private-fund-related ESG disclosure proposed in amended Item 8 unless it is only *aggregate* private fund ESG strategy disclosures. We believe that this would align with the Commission's layered disclosure approach where investors would receive summary information concerning an investment adviser's private fund ESG strategies and then would receive additional information through the fund's offering documents that are provided only to investors to which investment advisers to private funds may market their funds and that are permitted to invest in those specific strategies.

In addition, we recommend that the Commission revise the language of the proposed disclosure requirement for private fund advisers in ADV 1A Schedule D Section 7.B.(1)(A)(29)(b)(2) to:

> (29)(b)(2) Do you focus on material ESG factors by using them as a more significant factor than other factors or as a main consideration in advising the fund with respect to investments or in your engagement strategy with the companies in which the fund invests (ESG "focused")?

Finally, we recommend that the Commission revise the language of the proposed disclosure requirement for private fund advisers in Schedule D Section 7.B.(1)(A)(29)(b)(3) to:

> (29)(b)(3) If you answered "Yes" to 29(b)(2), do you ~~seek~~ have a stated goal that seeks to achieve a specific ESG impact or impacts (ESG "impact")?

[46] Each Schedule D is for each private fund, so we suggest putting the aggregate disclosure in a new Item 7C.

[47] Form PF was adopted in 2011 as required by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. Pub. L. 111-203, 124 Stat. 1376 (2010).

[48] *Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF*, 76 Fed. Reg. 71128, 71145 (Nov. 16, 2011), available at https://www.govinfo.gov/content/pkg/FR-2011-11-16/pdf/2011-28549.pdf. "Proprietary information" includes sensitive, non-public information regarding the investment or trading strategies of the adviser, analytical or research methodologies, trading data, computer hardware or software containing intellectual property, and any additional information the Commission considers proprietary. 15 U.S.C. § 80b-4(b)(10)(b) (2021). The Commission has affirmed this view in its recently proposed amendments to Form PF.

3. Fund disclosures

a. Materiality standard and ESG Integration funds

The Proposal requires a fund, if *any* ESG factors are part of the principal investment strategies, to briefly summarize in the summary prospectus how the fund incorporates these factors into the investment selection process, including what factors are considered. Further, the fund would need to describe in the statutory prospectus how the fund incorporates ESG factors into the investment selection process, including the ESG factor(s) considered, and if the fund considers the GHG emissions of its portfolio investments as part of its investment selection process, describe how it considers such information (including a description of the methodology the fund uses for this purpose).[49]

Consistent with the concerns we note above related to required Form ADV disclosures, the IAA recommends that the Commission require funds to disclose their consideration of ESG factors or GHG emissions in the statutory prospectus only when they are a material component of the fund's investment strategy. We also recommend similar treatment of an ESG Integration fund[50] to what we have recommended for investment advisers above, *i.e.*, that an ESG Integration fund is a fund that markets itself as considering material ESG factors, but those factors have no more significance than other factors. We provide suggestions below on how the Commission can address potential confusion between an ESG Integration fund and an ESG-Focused fund.

b. ESG-Focused and ESG Impact funds

The Proposal requires an ESG-Focused fund to disclose information in a standardized tabular format in the summary prospectus (**ESG Strategy Overview table**) that is organized into three broad categories: an overview of the fund's strategy with a "check-the-box" feature; how the fund incorporates E, S, and/or G factors in its investment decisions; and how the fund votes proxies and/or engages with companies about E, S, and/or G issues.[51] Further, the fund would need to describe in the statutory prospectus how it incorporates ESG factors into its investment process, including information related to several distinct items.[52]

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[49] 87 Fed. Reg. at 36661.

[50] An "ESG Integration Fund" is a fund that considers one or more ESG factors alongside other, non-ESG factors in its investment decisions, but those ESG factors are generally no more significant than other factors in the investment selection process, such that ESG factors may not be determinative in deciding to include or exclude any particular investment in the portfolio. *Id.* at 36660.

[51] An "ESG-Focused Fund" is a fund that focuses on one or more ESG factors by using them as a significant or main consideration in selecting investments or in its engagement strategy with the companies in which it invests. *Id.* at 36662. ESG Impact funds are considered a subset of ESG-Focused funds under the Proposal. As such, ESG Impact funds would be subject to the same prospectus disclosure requirements as ESG-Focused funds but would have additional disclosure requirements as well.

[52] *Id.* at 36662-64.

The ESG-Focused fund would also need to disclose in its annual report[53] information related to where proxy voting is a "significant" means of implementing the ESG strategy by disclosing the percentage of ESG proxy voting-related matters where the fund voted in favor of the initiative and providing a cross-reference to the fund's full proxy voting record filed on Form N-PX. Where engagement other than through proxy voting is a "significant" means of implementing the ESG strategy, the fund would be required to disclose its progress in certain specified ways. Where an ESG-focused fund considers environmental factors as part of its investment strategy, it would need to disclose certain GHG emissions metrics for the fund's portfolio (carbon footprint and WACI), unless the fund affirmatively states in the "ESG Strategy Overview" section of its tabular presentation that it does not consider GHG emissions as part of its investment strategy.[54]

The IAA supports the Commission's use of a tabular format for disclosure in the summary prospectus, which is intended to provide investors with a "clear, comparable, and succinct summary of the salient features" of an ESG-Focused fund's implementation of ESG factors.[55] We also support the Commission's layered approach to ESG-related disclosures. Specifically, while ESG-Focused funds would be required to complete each row of the table with a brief disclosure, more detailed disclosure would be required later in the prospectus.

While we are generally supportive, we have the following two concerns related to the scope and clarity of the required disclosures.

First, the line between an ESG Integration fund and an ESG-Focused fund is not clear. The Proposal states that mentioning ESG factors in an advertisement or marketing materials – but not as a "significant or main consideration" – would not cause a fund to be an ESG-focused fund (absent other factors).[56] The Commission does not elaborate on what types of statements could be viewed as portraying that ESG factors are a "significant or main consideration" in a fund's investment or engagement strategy. Accordingly, it is not clear to what extent an ESG Integration fund could discuss ESG factors without causing the fund to be viewed as an ESG-Focused fund.[57] The Commission notes that the "significant or main" aspect of the proposed definition of an ESG-Focused fund "would permit Integration Funds to discuss the role of ESG factors in their advertisements or sales literature – including the relationship between ESG factors and other investment factors and that ESG factors might not be dispositive – while

[53] 17 C.F.R. § 270.30a-1 (2021).

[54] *Id.* at 36663-64.

[55] *Id.* at 36663.

[56] *Id.*

[57] For the reasons discussed above in connection with ESG Integration strategies, we believe that a fund should only be considered to be an ESG Integration fund if it markets itself as considering ESG factors in a material way.

deterring marketing materials that imply that ESG factors are a significant or the main consideration of a fund."[58]

In addition to aligning its approach to ESG Integration funds with our recommendations for ESG Integration strategies (*i.e.*, include a materiality standard and a marketing to the public requirement), we also recommend that the Commission revise the proposed ESG-Focused fund-related language to state that mentioning ESG factors in an advertisement or marketing materials would not cause a fund to be an ESG-Focused fund unless the advertisements reflect that ESG factors are <u>more</u> significant than other non-ESG factors or are <u>a main</u> consideration of the fund. We believe that these changes will eliminate the confusion between when a fund is an ESG Integration fund and when it is an ESG-Focused fund.

Second, the implications of applying a limited exclusionary screen, without more, are not clear. The Proposal indicates that a fund would still be viewed as using an exclusionary screen even if its exclusionary policy applies to less than 100% of the portfolio. In addition, if the screen applies to less than 100% of the fund's portfolio, excluding cash and cash equivalents held for cash management, the fund would be required to (i) state the percentage of the portfolio to which the screen applies, in terms of the fund's net asset value, and (ii) explain briefly why the screen does not apply to the entire portfolio.[59]

We recommend that the Commission clarify that applying a limited exclusionary screen should not by itself cause a fund to be considered an ESG-Focused fund – instead, the screen must be more significant than other factors or a main component of the fund's investment strategy in order for the fund to be considered an ESG-Focused fund.

4. The Commission should not require investment advisers to disclose proprietary, competitively sensitive ESG investment methods and strategies.

The IAA is concerned that the proposed disclosure requirements, specifically those related to internal methodologies and third-party criteria, may reveal proprietary and competitively sensitive confidential, non-public information regarding an investment adviser's investment processes or trading strategies, analytical or research methodologies, trading data, and/or computer hardware or software containing intellectual property.[60] As noted above, we believe disclosure of this information could economically harm investment advisers, their clients, and investors, and potentially damage market integrity by raising risks for frontrunning and other

[58] 87 Fed. Reg. at 36662.

[59] *Id.* at 36665.

[60] The Commission cites this concern in the Proposal. *Id.* at 36695, Q. 183 ("Would any of our proposed disclosures reveal non-public information regarding an adviser's SMA strategy and/or a private fund's trading strategies, analytical or research methodologies, trading data, and/or computer hardware or software containing intellectual property?").

manipulative conduct. We urge the Commission to remove these specific disclosure items from Item 8.D of ADV 2A.

We note that many investment advisers use proprietary internal methodologies in their ESG investment strategies. For example, an investment adviser, instead of screening out specific sectors, may develop a proprietary research engine to rank and rate public issuers against their peers. An investment adviser also may use a proprietary software system that combines the different perspectives and approaches of several external data providers to integrate ESG factors into its investment process for active and passive portfolios. In addition, the qualitative analysis and company engagement of an active manager, in conjunction with its proprietary scoring methods, would be highly sensitive information, that, if publicly disclosed, could lead to competitive harm.

We also understand that many investment advisers use ESG research providers that have their own proprietary ESG methodologies and ratings frameworks and restrict investment advisers from disclosing these providers' proprietary information. These research firms have invested their financial and intellectual capital in the development of proprietary rating frameworks and their models have become a source of competitive differentiation.[61] Investment advisers may be prohibited from providing this information without the consent of these third parties and could face legal liability if they do so.

The IAA requests that the Commission allow investment advisers to maintain the confidentiality of proprietary investment strategies as well as the names of third-party research providers and their proprietary information in their response to proposed Item 8 in ADV 2A. This information is not necessary to be included to inform prospective and current clients. Investment advisers typically address with prospective and current clients the methodologies employed for a specific strategy prior to entering into an advisory relationship or engaging in that strategy on behalf of the client. Additionally, the investment objectives and guidelines for a client account are discussed and agreed upon by the client, or its representatives, which often may include its legal counsel and other relevant third parties, prior to execution of an investment advisory agreement. A client's investment objectives and guidelines and an investment adviser's strategies continue to be addressed with the client on an ongoing basis.

As an alternative to proposed Item 8.D, we recommend that the Commission allow investment advisers to provide a summary of any proprietary investment strategy and state that more detailed information will be provided on a one-on-one basis when appropriate or when requested by the client. We believe that, to the extent the Commission believes that it is essential that it obtain information about an investment adviser's proprietary methodologies, it can also

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[61] *See, e.g.*, Truvalue Labs, *ESG Research in the Information Age: AI, Unstructured Data and the Future of ESG Investing* (2019), available at https://cdn2.hubspot.net/hubfs/4137330/White%20Papers/WP_ESGResearch_InfoAge.pdf?__hssc=16054825.1.1578655262760&__hstc=16054825.bac067346c4aadc8a5c43f15f7d0ae07.1578655262760.1578655262760.1578655262760.1&__hsfp=1603390744&hsCtaTracking=60c937d4--47dd-4a22-bdfc-2d575f9cd566%7C1a3c1c13-d812--4521--811b-e5f05cf1f141.

supplementally request[62] this information from investment advisers under Advisers Act Section 204(a), where the information can be submitted with a confidential treatment request.[63]

5. The Commission should generally require reporting of third-party ESG frameworks at the investment-adviser level only.

The IAA agrees with the Commission that an investment adviser should disclose whether it uses third-party framework(s) and that the investment adviser can include a hyperlink to any such framework. Because third-party frameworks are generally firm-wide and process-driven, however, we believe that requiring disclosure of the third-party framework criteria for each ESG strategy would in most circumstances be duplicative and would not provide additional benefits for investors.

For example, the United Nations Principles for Responsible Investment (**UNPRI**) requires investment adviser signatories to "incorporate ESG issues into investment analysis and decision-making processes."[64] This responsibility covers an investment adviser's process broadly and applies at the investment-adviser level, not the strategy level. The Net Zero Asset Managers Initiative (**NZAMI**) requires investment adviser signatories to "[i]mplement a stewardship and engagement strategy, with a clear escalation and voting policy, that is consistent with our ambition for all assets under management to achieve net zero emissions by 2050 or sooner."[65] This responsibility covers an investment adviser's total assets under management.

While many third-party framework disclosures are generally not appropriate at the strategy level, there may be circumstances where they would be appropriate. For example, investment advisers may use the United Nations Sustainable Development Goals (**UN SDG**)[66] holistically as part of their corporate governance framework. However, investment advisers also may engage in thematic and impact investing that focuses on one or more of the UN SDGs' 17 categories. For instance, an investment adviser's strategy that states a goal to have an impact on climate change could incorporate only goal 7, "Affordable and Clean Energy," and goal 13, "Climate Action."

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[62] This would be similar to how the Commission requests supplemental information from public issuers under Securities Act Rule 418.

[63] SEC Rules of Practice, Rule 190.

[64] UNPRI, *What are the Principles for Responsible Investment?*, available at https://www.unpri.org/about-us/what-are-the-principles-for-responsible-investment.

[65] NZAMI, *The Net Zero Asset Managers Commitment*, available at https://www.netzeroassetmanagers.org/commitment/.

[66] UN, *The Sustainable Development Agenda*, available at https://www.un.org/sustainabledevelopment/development-agenda/ ("The UN SDGs are a universal call to action to end poverty, protect the planet and improve the lives and prospects of everyone, everywhere. The 17 Goals were adopted by all UN Member States in 2015, as part of the 2030 Agenda for Sustainable Development which set out a 15-year plan to achieve the Goals.").

Where the third-party framework is being used at the investment-adviser level, we recommend that the investment adviser be required to provide an overview of the framework and how the investment adviser uses it in its decision-making process, and hyperlink to the framework. In a circumstance where the third-party framework is being used at the strategy level, we believe it would be appropriate for the Commission to require disclosure at the strategy level.

6. The Commission should provide greater flexibility for investment advisers to provide proxy voting information.

The IAA agrees that investment advisers should provide clear disclosures relating to their proxy voting policies. Proposed amendments to Item 17 of ADV 2A require investment advisers that consider one or more ESG factors when voting client securities to describe which ESG factors they consider and how they consider them. Consistent with our recommendations above, investment advisers should not be required to describe which ESG factors they consider and how when voting proxies, unless the factors are a material component of the proxy voting decision-making process.

Many investment advisers also use the services of third-party proxy advisory firms – such as Institutional Shareholder Services (**ISS**) and Glass Lewis – to make recommendations to them on how to vote and help them administratively cast their votes. Proxy advisory firms also provide specific guidelines on their recommendations relating to ESG issues.[67] These guidelines and recommendations are drawn from the proprietary databases maintained by third-party proxy advisory firms, which contain ESG information that these firms have collected from various sources.

For investment advisers that look to a third-party proxy advisory firm's ESG voting policy[68] to inform its voting decisions, instead of the proposed disclosure of specific voting policies, the IAA recommends that the Commission allow those investment advisers to provide an overview of the proxy advisory firm's ESG policy and hyperlink to the policy in the ADV 2A. The Commission should also allow investment advisers to use this same process for bespoke or custom proxy voting policies, which are discussed more fully below. We believe this layered approach would be more user friendly for investors.

The IAA also agrees that investment advisers should describe how clients can direct the investment advisers' vote and how an investment adviser addresses conflicts between the investment adviser and the client. We request that the Commission confirm explicitly that

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[67] Proxy advisory firms typically provide research and voting recommendations, executive compensation data and analytics, support in helping their clients engage with the company on relevant issues, other consulting services, and an online platform in which the firm's clients can register their voting choices (which the firm then relays to each company).

[68] The IAA would differentiate investment advisers that use proxy advisory firms to provide substantive voting information and those that use proxy advisory firms operationally to vote their proxies (the investment adviser provides the policy, and the proxy advisory firm handles the mechanics of voting).

investment advisers would not be required to disclose custom or bespoke proxy voting policies created for specific clients. Proxy voting advice that reflects a client's custom policy is proprietary to that client and may be indicative of a proprietary investment approach. It may also reflect confidential information about the client and its investment process.

B. The Commission should provide a safe harbor from liability or, in the alternative, at least allow flexibility for investment advisers and funds to provide impact measurements.

The IAA agrees that investment advisers should provide an overview of the impact(s) that they state they are seeking to achieve with any ESG impact strategy or methodology. We appreciate that impact measurement can be an effective tool in addressing the Commission's concerns about greenwashing. However, it is unclear under the Proposal how investment advisers can measure and disclose how they are progressing towards the stated impact. For example, the impact sought by an investment adviser could occur but there could be several factors that contribute to that result and it may be difficult if not impossible for the investment adviser to tease out separately each cause and effect.[69] Because of these challenges, an investment adviser could provide stated impact objectives that are so vague as to be meaningless or so specific that the investment adviser will not be able to adapt to changing conditions that may be needed as part of the dynamic investment management process. Additionally, some ESG Impact strategies may have goals that are more aspirational and measuring progress towards those goals may require a greater amount of estimation. These strategies would likely not be conducive to the prescribed disclosure items.

Moreover, there is currently no consensus on how to measure impact generated by an investment adviser's investments – on the contrary, there are several methodologies.[70] Measuring impact may also differ among ESG factors. For example, while defined standards exist for measuring certain environmental impacts, such as GHG emissions,[71] there are no objective standards or consensus at this time for reporting social outcomes or quantifying social impact.

The impact sought by an ESG Impact fund raises similar questions. For example, "a fund that invests with the goal of seeking current income while also furthering the fund's disclosed goal of financing the construction of affordable housing units would be an [ESG] Impact Fund"

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[69] *See* Group of Eight (**G8**) (now Group of Seven (**G7**)), Social Impact Investment Taskforce, *Measuring Impact* (Sept. 2014), available at https://gsgii.org/wp-content/uploads/2017/07/Measuring-Impact-WG-paper-FINAL.pdf ("Impact" has a fluid definition, often varying across different investments and sometimes difficult or impossible to measure). One example would be a strategy with a stated goal of combatting Amazon deforestation. The amount of deforestation may increase, but the strategy may have saved 20,000 acres from deforestation.

[70] *See* Ivy So and Alina Staskevicius, *Measuring the "Impact" in Impact Investing*, Harvard Business School (2015), available at http://www.hbs.edu/socialenterprise/Documents/MeasuringImpact.pdf (for example, methodologies include, but are not limited to, expected return, theory of change, mission alignment, and experimental).

[71] CO_2-equivalent emissions are a good example. They can be measured, and in a single number they convey the impact created by a range of greenhouse gases. Further, once measured, these emissions can be monetized in the form of a carbon price, which enables comparison across public issuers.

under the Proposal.[72] However, it may not be possible for the fund to measure accurately its impact as opposed, for example, to the impact of factors such as tax breaks, zoning changes, a decrease in demand for housing, and even the weather on improvements to construction of affordable housing. It is unclear from the Proposal how the fund should measure impact in these circumstances.

The specificity of the proposed progress measurements and milestones disclosures would also raise liability risk for investment advisers and funds because of the challenges discussed above. This may disincentivize firms from engaging in impact strategies. The IAA thus recommends that the Commission include a safe harbor for impact measurements for investment advisers and funds that would provide that impact measurements would be deemed not to be fraudulent unless it is shown that the measurements were made without a reasonable basis or were constructed other than in good faith. If the Commission declines to provide a safe harbor, then at a minimum it should provide flexibility for investment advisers and funds to provide impact measurements that may include estimates and assumptions as long as they are properly disclosed.

C. The Commission should revise its fund GHG disclosure and calculation requirements for ESG-Focused funds that consider environmental factors as part of their investment strategies.

1. Disclosure that a fund does not consider GHG emissions

The IAA appreciates the Commission's view that not all ESG-Focused funds that consider environmental factors as part of their investment strategies consider the GHG emissions of the issuers in which they invest. A fund would not be required to disclose its GHG emissions metrics if it affirmatively states in the ESG Strategy Overview table in the summary prospectus that it does *not* consider public issuers' GHG emissions as part of its investment strategy. This means that a fund that considers GHG emissions in *any* way, even if it is not a material consideration, would need to make GHG emissions-related disclosures.

The IAA believes that these disclosures could confuse and even mislead investors by creating the inaccurate impression that the fund is focused on GHG reduction when its primary focus is on other environmental considerations, and GHG emissions may not even be a material consideration for the fund.

We recommend that the Commission not require these disclosures unless the consideration of GHG emissions is a material component of the fund's strategy. We also recommend that ESG-Focused funds that consider environmental factors not be required to affirmatively disclose that they do not consider GHG emissions as part of the fund's strategy as this may mislead investors to determine that the fund is not environmentally focused or is less environmentally focused than funds that do not make this affirmative statement.

[72] 87 Fed. Reg. at 36662.

2. Scopes 1, 2, and 3 GHG emissions

The Proposal would also require an ESG-Focused fund that considers environmental factors as part of its investment strategy to disclose the carbon footprint and WACI of the fund's portfolio in its annual report.[73] The IAA appreciates that the Commission is proposing a layered approach to this disclosure, requiring a fund to disclose GHG metrics data in the annual report along with a brief summary of the sources of the data and the amount of estimated GHG emissions used, while providing more detailed information regarding the fund's process and methodology for calculating and estimating GHG metrics on Form N-CSR[74] for investors and other industry participants that wish to access this additional information.[75]

Both methodologies would require that Scopes 1 and 2 GHG[76] emissions be included in the emissions calculation but would not require Scope 3 emissions calculations. Scope 3 emissions data would be required under the carbon footprint metric only if it is reported by a portfolio company. Scope 3 emissions would be disclosed separately from Scopes 1 and 2 emissions and by sector. Funds would not be required to estimate Scope 3 emissions.[77]

We believe it is premature at this point to require disclosure of Scope 3 GHG emissions, even when a portfolio company voluntarily reports this data and do not believe that the Commission should require this disclosure. As we discussed in the IAA Response to the Issuer ESG Proposal,[78] Scope 3 GHG emissions information still suffers from significant data gaps and the absence of agreed-upon measurement methodologies. Unlike Scopes 1 and 2 GHG emissions information, Scope 3 GHG emissions information has not been broadly required or adopted, in part because of the challenges associated with collecting it.[79] Therefore, there are strong

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[73] *Id.* at 36676. *See also Implementing the Recommendations of the Task Force on Climate-related Financial Disclosures* (Oct. 2021), available at https://www.fsb.org/wp-content/uploads/P141021-4.pdf (defining the WACI metric as a portfolio's exposure to carbon-intensive companies).

[74] Form N-CSR is a document that funds must file with the Commission within 10 days of disseminating annual and semiannual reports to shareholders.

[75] 87 Fed. Reg. at 36682.

[76] We support the Commission's leveraging the GHG Protocol. The Environmental Protection Agency (**EPA**) also uses the concept of scopes and refers to the GHG Protocol when providing guidance to registrants regarding their GHG emissions inventories, so the data compiled for the EPA's own GHG emissions reporting program can be used in partial fulfillment of a registrant's GHG emissions disclosure obligations and reduce the reporting obligation for registrants. *See* EPA, *Greenhouse Gas Reporting Program*, available at https://www.epa.gov/ghgreporting.

[77] Because Scopes 1 and 2 GHG emissions for a vertically integrated company, *i.e.*, a company that controls multiple stages of its production process and supply chain to minimize or eliminate the need for outside entities, are Scope 3 GHG emissions for a non-vertically integrated company, we believe the Proposal creates an incentive for funds to invest in non-vertically integrated companies.

[78] *See* IAA Response to the Issuer ESG Proposal, *supra* note 3.

[79] Scope 3 involves emissions outside of the control of a registrant in the value chain and requires engagement with unrelated third parties.

limitations to Scope 3 GHG emissions data reliability currently reported by companies under voluntary standards and frameworks.[80]

If the Commission nevertheless requires Scope 3 GHG emissions disclosure, we recommend, for the reasons we discuss in the IAA Response to the Issuer ESG Proposal, that the Commission not allow funds to provide their own categories of upstream or downstream activities and instead require funds to use the GHG Protocol categories of upstream and downstream activities.

3. Complexity of the GHG emissions calculations

The IAA is also concerned that the complexity[81] of the calculations is likely to result in less accurate information being reported and could serve as a disincentive for funds to consider GHG emissions. An illustrative, but certainly not the only, example is that the Proposal requires a fund – let's call it "Fund A" – that invests in other funds or private funds ("Funds B and C") to take into account the GHG emissions of the portfolio companies in which Funds B and C invest. This is intended to avoid a situation in which Fund A invests in portfolio companies through Funds B and C without Fund A's reflecting the associated emissions in its GHG metrics.[82] Not only does this create exceedingly complicated data collection and reporting requirements in general, but we are particularly concerned that an environmentally-focused fund-of-funds – Fund A – will have difficulty satisfying these disclosure requirements if Funds B and C are not required to (or otherwise do not) report the data or report the data inaccurately or inconsistently. Given the complexity of the proposed disclosure requirements, it would be easy to see how a fund, acting in good faith, would make inadvertent errors.

If Funds B and C were themselves environmentally focused funds required to report their carbon footprint and WACI, then it would be easier for Fund A to determine the GHG emissions associated with its investment for purposes of calculating its carbon footprint and WACI, because, as the Proposal notes, it could take its pro rata share of Funds B's and C's GHG emissions. If, however, Funds B and C are not required to disclose that information, then Fund A, according to the Proposal, "could" look through its investment in Funds B and C to determine its pro rata share of the emissions of the portfolio holdings of Funds B and C. This "look-through" requirement, assuming it could be reliably done, would impose a substantial, and in our view, unnecessary, burden on Fund A, much of which would likely be borne by Fund A's investors.

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[80] Examples include lack of high-quality primary GHG emissions data (companies may rely on creating secondary data based on industry averages, environmentally extended input-output data, or other methodologies – this use of secondary data will result in less accurate emissions reporting) and complexity and inconsistency of calculation methodologies (companies in the same sector using different methodologies would create an inconsistent message to stakeholders such as investors).

[81] The Proposal includes more than 20 pages of discussion related solely to the calculation of a fund's carbon footprint and WACI.

[82] 87 Fed. Reg. at 36680.

Because of the complexity of the calculations and the high likelihood of error, the IAA recommends that the Commission include a safe harbor for fund carbon footprint and WACI calculations similar to the safe harbor it has proposed for public issuer Scope 3 GHG emissions reporting in the Issuer ESG Proposal.[83] The safe harbor would provide that the carbon footprint and WACI calculations would be deemed not to be fraudulent unless it is shown that the calculations were made without a reasonable basis or were calculated other than in good faith.

D. Marketing and Compliance Policies and Procedures

The IAA supports the Commission's not proposing any new, specific marketing and compliance policies and instead reaffirming existing obligations under the compliance rules when investment advisers and funds incorporate ESG factors as a significant investment strategy or method of analysis in the advisory services they provide. As the Commission notes, different strategies will require different levels and types of compliance policies and procedures. As noted previously, we strongly support the view that investment advisers should clearly articulate their investment strategies, including sustainable and ESG investment strategies.

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We appreciate the Commission's consideration of our comments on this important Proposal. Please do not hesitate to contact the undersigned at (202) 293-4222 if we can be of further assistance.

Respectfully Submitted,

/s/ Gail C. Bernstein

Gail C. Bernstein
General Counsel

/s/ William A. Nelson

William A. Nelson
Associate General Counsel

cc: The Honorable Gary Gensler, Chair
The Honorable Hester M. Peirce, Commissioner
The Honorable Caroline A. Crenshaw, Commissioner
The Honorable Mark T. Uyeda, Commissioner
The Honorable Jaime Lizárraga, Commissioner
William A. Birdthistle, Director, Division of Investment Management

[83] *Issuer ESG Proposal*, *supra* note 4 at 21391.