



August 16, 2022

Vanessa Countryman, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-0609

VIA Electronic Filing

Re: Enhanced Disclosures by Certain Investment Advisers and Investment Companies About Environmental, Social, and Governance Investment Practices (File Number S7-17-22)

Dear Chair Gensler,

The Center for American Progress¹ (CAP) is pleased to submit its comments on the Securities and Exchange Commission’s (SEC or the Commission) proposed rule on “Enhanced Disclosures by Certain Investment Advisers and Investment Companies About Environmental, Social, and Governance Investment Practices” (the proposal or the proposed rule).² All page references are to the Federal Register version of the proposal.

As the Commission makes clear, the proposal is in line with the Commission’s authority and consistent with its practice over many decades. As markets have grown and investment funds and advisers have proliferated, the Commission has promulgated many rules requiring funds to provide investors with information about the fund’s fundamental characteristics and advisers to provide their clients with information about the strategies they use or recommend to their clients.³ The Commission has standardized several different types of disclosures so that investors can more easily compare funds and advisers.

The Commission has documented well the growth in ESG investing and associated efforts to establish frameworks for measuring ESG factors over the past couple of decades, as well as the increasing investor interest in ESG-related products, services, and data.⁴

¹ The Center for American Progress is an independent, nonpartisan policy institute that is dedicated to improving the lives of all Americans through bold, progressive ideas, as well as strong leadership and concerted action.

² Securities and Exchange Commission, “Enhanced Disclosures by Certain Investment Advisers and Investment Companies About Environmental, Social, and Governance Investment Practices,” 87 Fed. Reg. 36654, June 17, 2022.

³ Proposal at p.36655, including fn5.

⁴ Proposal at p.36656-36657.

Many aspects of the disclosure regime proposed, particularly the ESG-focused requirements, could have the salutary effect of discouraging so-called “greenwashing,” where funds or advisers may be making claims regarding their consideration of ESG-related issues that do not match their practices. The items to be disclosed on the table include basic information that investors should care about, such as the type of strategy used to select fund investments, and the methodologies and the source of the data used.

Clearly, Commission staff have carefully considered how disclosure in this area could help ensure that investment funds and advisers fulfill their fiduciary duties to investors and clients by providing reliable, consistent, and comparable information on the strategies they use to assess ESG factors. This rule is urgently needed, and we note below its strengths along with some suggestions where we believe it could be improved, including expanding basic ESG disclosure requirements to all investment funds and advisers and aligning disclosures of financed emissions with global practices. We believe the latter changes are essential to fulfillment of investment advisers’ fiduciary duties.

The Commission’s authority to regulate around fiduciary duty of investment advisers is a foundation of this proposed rule

It is critical to distinguish the Commission’s proposed disclosures for investment advisers, registered investment companies, and business development companies in this rule from its proposed climate disclosure rules for public companies. While the latter is soundly based in the Commission’s authority to regulate public company disclosures for the protection of investors and the public, the Commission’s authority in this rule has a separate and equally strong foundation. The Commission should make that clear in any guidance to accompany the final rule.

The SEC has express statutory authority to regulate fund managers and investment advisers with respect to fiduciary duties, including both requiring specific policies, procedures, and practices and requiring related disclosures.⁵ For example, the SEC relies on this authority to require advisers to disclose the factors they consider when selecting or recommending brokers for the execution of client transactions and evaluating the reasonableness of those brokers’ compensation.⁶

Firms that advise and direct the deployment of investor assets play an important role in protecting the interests of these investors, to whom they owe duties of care and loyalty. These advisors are stewards who make critical decisions about how and where to allocate capital, engage with company management, and vote on everything from boards of

⁵ U.S. Securities and Exchange Commission, “Laws and Rules: Investment Company Act of 1940,” available at <https://www.sec.gov/investment/laws-and-rules>. Common law also imposes fiduciary obligations on investment advisers toward their funds and customers, and the SEC can interpret investment advisers’ compliance with the duties of loyalty and care. See, e.g., SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 194 (1963) (“SEC v. Capital Gains”); Commission Interpretation Regarding Standard of Conduct for Investment Advisers, Advisers Act Release No. 5248 (June 5, 2019); Investment Adviser Codes of Ethics, Investment Advisers Act Release No. 2256 (July 2, 2004); Compliance Programs of Investment Companies and Investment Advisers, Investment Advisers Act Release No. 2204 (Dec. 17, 2003).

⁶ General Instructions, Part 2A of Form ADV: Firm Brochure, Item 12, available at <https://www.sec.gov/about/forms/formadv-part2.pdf>.

directors to major corporate strategies and actions. And they do this on behalf of investors.

Today, many investment advisers already consider climate change, worker treatment, and other ESG factors.⁷ But not all investment advisers are equally forward-leaning, and the scope and reliability of ESG integration and alignment vary widely across firms.⁸

The Commission must ensure that all investment advisers are transparent about their processes and procedures and help standardize disclosure in this area so that investors have a better understanding of what guides a particular investment adviser's decisions and can determine if those processes and procedures are consistent with their own goals and preferences. As will be discussed below, we are recommending that all investment advisers, registered investment companies, and business development companies be required to state whether they have specific processes and procedures for considering one or more ESG factors in their investment selections and advice or with respect to engagement and proxy voting. If not, they should say so. If so, they should describe those processes and procedures.

Further, we believe that the time has come for the Commission to require all registered investment companies and business development companies, whether operating in the public or private markets, to disclose the direct and indirect greenhouse gas emissions represented in their portfolios. As climate change worsens, GHG emissions are recognized around the world as one of the best indicators of climate risk to investments. Indeed, the disclosure of financed emissions by financial institutions, as well as some investment advisers and their funds, is happening globally, and methodologies for these disclosures are advancing rapidly.⁹ We believe that any investment adviser that is not aware of the GHG emissions represented in its portfolios is not satisfying its fiduciary duty to its investor clients. The need for GHG emissions information is urgent and essential to the protection of investors.

ESG Integration Fund requirements should be required for all funds

We applaud the Commission for its thoughtful and detailed work evidenced in the proposal to clarify what investment advisers, registered investment companies, and business development companies must disclose with respect to ESG-related investment selection, engagement activities, and proxy voting. This rule will begin the critical process of ensuring that advisers make appropriate disclosures so that investors have the

⁷ Tyler Gellasch, "Towards a Sustainable Economy: A Review of Comments to the SEC's Disclosure Effectiveness Concept Release" (Washington: Public Citizen, 2016), available at <https://www.citizen.org/sites/default/files/sustainableeconomyreport.pdf>; Amy Whyte, "More Institutions than Ever Are Considering ESG. Will They Follow Through?", Institutional Investor, October 6, 2020, available at <https://www.institutionalinvestor.com/article/b1npm5yq50b024/More-Institutions-Than-Ever-Are-Considering-ESG-Will-They-Follow-Through>.

⁸ Ibid.

⁹ See, e.g., Greenhouse Gas Protocol, "New Standard Developed to Help Financial Industry Measure and Report Emissions," available at <https://ghgprotocol.org/blog/new-standard-developed-help-financial-industry-measure-and-report-emissions>; and Partnership for Carbon Accounting Financials website, "Enabling financial institutions to assess and disclose greenhouse gas emissions of loans and investments," <https://carbonaccountingfinancials.com/>.

information they need to make investment decisions and can determine whether funds and advisers are aligned with their goals and preferences. This clarification is just in time, given the extraordinary increase in investor interest in ESG-related investment products and services.

We recommend some further refinements of the fund categorization framework in the proposal.

As referenced above, the focus by investors in capital markets on ESG-related factors is widespread and growing rapidly, especially as climate disasters become more widespread and corporate governance practices increasingly impact issuer operations, profitability, and legal risk. Given the implications for issuers in terms of managing operating, reputational, brand, and other risks, as well as taking advantage of opportunities, most issuers and, by extension, advisers and their funds, are paying attention to climate risk and other ESG factors.

Because of this broad understanding of the growing importance of ESG-related factors in the marketplace, it seems likely that the ESG Integration Fund category could cause confusion among investors who may think that a fund expressly identified as an ESG Integration Fund is somehow more ESG focused than a fund with no ESG designation. Moreover, the ability of ESG Integration Funds to discuss their consideration of ESG factors in their advertisements and marketing could result in the very greenwashing that the Commission seeks to eliminate in this and other proposed rules.¹⁰

Rather than having an ESG Integration Fund designation, the proposed rule is an appropriate and timely opportunity to clarify that investment advisers' fiduciary duties of care and loyalty necessitate disclosing whether and how they evaluate and incorporate ESG-related matters in their investment processes and procedures. Indeed, all registered investment companies and business development companies should make the disclosures that the proposed rule requires for ESG Integration Funds only.

In short, we believe the Commission can best protect investors by requiring all registered investment companies, business development companies, and advisers covered by the proposed rule to respond to the question (often asked by investors today): Do you have a strategy specifically aimed at one or more ESG factors in making investment selections or in engagement activities and proxy voting (as applicable)? All covered funds and advisers should be required to expressly respond to the question in the negative, if that is the case, or explain their policies and procedures for considering ESG-related factors, including identifying which ESG-related factors, if the response is in the affirmative.¹¹ The above requirement for all covered funds and advisers would then make more sense to investors next to the ESG-Focused and Impact funds. It would also simplify the framework, which would essentially have three categories (all funds, ESG-Focused, and Impact), instead of four (ESG Integration, ESG-Focused, Impact, and the rest).

¹⁰ Proposal at p.36664; Q15.

¹¹ We note that the proposal is limited to essentially "public" funds, including registered investment companies and business development companies. While not ideal policy, we recognize that the SEC may wish to similarly limit the proposed expansion to just those funds, rather than private, unregistered investment vehicles.

All of this said, if the Commission decides to retain the ESG Integration Fund category, we strongly urge it to prohibit ESG Integration Funds from using that label or discussing ESG in their advertising and marketing materials, as ESG considerations in such funds by definition carry no more weight than other considerations. Otherwise, if left as proposed, ESG Integration Funds will likely be gamed for greenwashing purposes.

The proposed rule's framework for disclosure relating to ESG-Focused and Impact Funds Would Be Very Helpful to Investors

The proposed rule's general approach of requiring brief but clear information in a table early in the prospectus for ESG-Focused and Impact funds, with a link or reference to more details later in the prospectus is highly appropriate and likely to be very helpful to investors.¹²

Details, such as identifying up front the ESG factor or factors a fund considers and specific information about strategies, disaggregated by ESG factor, should be welcome clarification. Even better are the disclosures in the second and third rows of the table, as they are likely to ensure that all funds provide a baseline of critical information that is consistent and comparable across funds. For example, descriptions of inclusionary versus exclusionary strategies should help shed light for investors on whether fossil fuel investments could be included and on what basis. Transparency around methodologies for investment selection and use of indexes or third-party frameworks, as well as engagement and proxy voting strategies, represents topline information that investors need to make decisions about whether a fund is appropriate for them.

Except for structure of the greenhouse gas emissions (GHG emissions) disclosure, which we discuss below, the disclosures in the annual report by registered investment companies and business development companies are also highly appropriate and, indeed, should already be part of these funds' periodic disclosures under current rules.

To protect U.S. investors, the Commission should require all investment funds to disclose their direct and indirect portfolio GHG emissions

As mentioned above, direct and indirect greenhouse gas emissions that companies are fully or partially responsible for is now widely recognized as essential information for all investors when making investment decisions. Its importance is confirmed by the fact that banks and other financial institutions have been leaders in developing methodologies and data for estimating their loan and investment asset portfolio emissions, which they view as a key element of assessing exposure to climate risk as the economic transition toward cleaner energy accelerates.

With the rapid transition to cleaner forms of energy and with financed emissions disclosure becoming a worldwide focus of financial institutions, it would be a dereliction of fiduciary duty for investment funds in U.S. markets not to estimate their portfolio emissions and disclose that information to investors. Importantly, that includes estimating the Scope 3 emissions of companies represented in their portfolios.

¹² Proposal at p.36662 et seq.

The data and methodologies for estimating Scope 1, 2, and 3 emissions in asset portfolios are developing rapidly.¹³ And, as growing numbers of financial institutions estimate these emissions, the data and methodologies will improve and the cost of making these estimates will decline. Moreover, the failure of investment funds—especially those that invest in companies in high-emission industries—to provide GHG financed emissions disclosures will put even sophisticated investors, not to mention the stability of the financial system, at risk.

Importantly, the underlying concern with respect to financed emissions disclosure is not just about greenwashing. It is fundamentally about risk—to investors and to the financial system and the economy. This is a type of risk that all fund advisers have a fiduciary duty to disclose to their investors. Indeed, limiting portfolio emissions disclosure to funds that are environmentally focused could invite a bifurcation of the market, in which risky assets are embedded in non-environmentally focused funds that need not make such disclosures. This is already happening.¹⁴

Where GHG emissions disclosure is required, we strongly support the proposed rule’s stance that those disclosures should not be reduced by purchased or generated offsets.¹⁵

We strongly disagree, however, with the proposed rule’s purported concern about double counting with respect to disclosure of Scope 3 financed emissions.¹⁶ As CAP has stated previously,¹⁷ unless the goal of Scope 3 emissions disclosure is to create a national or global inventory to account for each emission—which seems well outside the SEC’s authority or mandate—double counting is not a problem. Here, the goal is the help investors understand a company’s or fund’s climate risk exposure, and even partial responsibility for or connection to Scope 3 emissions, such as high-emission suppliers, contributes to that risk exposure.

Conclusion

The need for clarity from investment advisers and funds on whether and how they are considering climate risk and other ESG factors is urgent if all investors, even supposedly sophisticated ones who can invest directly in the private markets, are to be protected from otherwise hidden risks. The Commission should act on its authority to regulate fiduciary

¹³ See, e.g., “The Global GHG Accounting & Reporting Standard for the Financial Industry,” Partnership for Carbon Accounting Financials, November 18, 2020, p.48, available at <https://carbonaccountingfinancials.com/standard#the-global-ghg-accounting-and-reporting-standard-for-the-financial-industry>.

¹⁴ See, e.g., Yannic Rack, “Energy Firms Are Going ‘Green’ by Offloading Dirty Coal Plants,” Wired, February 23, 2022, available at <https://www.wired.com/story/europe-coal-plants-green/>; and Sam Meredith, “An energy transition loophole is allowing Big Oil to offload high-polluting assets to private buyers,” CNBC, May 19, 2022, available at <https://www.cnbc.com/2022/05/19/climate-how-big-oil-sells-off-polluting-assets-in-a-bid-to-look-green.html>.

¹⁵ Proposal at p.36679; Q96.

¹⁶ Proposal at p.36722.

¹⁷ Alexandra Thornton, “Why Companies Should Be Required To Disclose Their Scope 3 Emissions,” (Center for American Progress; Washington, DC), December 13, 2021, available at <https://www.americanprogress.org/article/why-companies-should-be-required-to-disclose-their-scope-3-emissions/>.

duty disclosures and quickly finalize this rule to clarify the ESG disclosures required of investment advisers and investment companies.

Sincerely,

Center for American Progress