Submitted via email: rule-comments@sec.gov

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Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Environmental, Social, and Governance Disclosures for Investment Advisers and Investment Companies, File No. S7-17-22; Investment Company Names, File No. S7-16-22.

Institutional Shareholder Services Inc. (ISS) appreciates the opportunity to provide comments on the proposed rule on Environmental, Social, and Governance (ESG) Disclosures for Investment Advisers and Investment Companies ("ESG Disclosures Proposal") and the proposed rule on Investment Company Names ("Names Rule Proposal," and with the ESG Disclosures Proposal, the "Proposals"), published by the Securities and Exchange Commission (SEC or Commission).[1]

Founded in 1985, ISS is a leading provider of corporate governance and sustainable investing solutions, market intelligence and fund services, and events and editorial content for institutional investors and corporations. ISS ESG, the responsible investment arm of ISS, provides institutional investors with comprehensive data, analytics, and advisory services to help them understand, measure, and manage ESG-related risks and opportunities to achieve their investment objectives. ISS' comments represent our views in our capacity as a service provider to institutional investors, and as a key participant in the corporate governance and responsible investment industries, and not necessarily the views of our clients.

Given the substantial growth in sustainable investing over recent years and investor appetite for ESG information, the Commission's continuing assessment of whether existing rules and regulation sufficiently address this market development is appropriate. ISS welcomes the Commission's focus on providing greater clarity around ESG products and services by revisiting the fund "Names Rule" and funds' and advisers' related disclosure obligations. We support the Commission's objective to ensure that funds' investment activities are consistent with their marketed names and claims and to facilitate consistent disclosure by funds and advisers of their ESG practices. To this end, we also support the Commission's use of existing oversight authority to ensure compliance with already existing disclosure obligations.

[1] *See* Environmental, Social, and Governance Disclosures for Investment Advisers and Investment Companies, Securities Act Release No. 11,068, Exchange Act Release No. 94,985, 87 Fed. Reg. 36, 654 (May 25, 2022), https://www.federalregister.gov/documents/2022/04/11/2022-06342/the-enhancement-and-standardization-of- climate-related-disclosures-for-investors; *See also* Investment Company Names, Securities Act Release No. 11,067, Exchange Act Release No. 94,981, 87 Fed. Reg. 36, 594 (May 25, 2022), https://www.federalregister.gov/documents/2022/06/17/2022-11742/investment-company-names

In our view, the Proposals have the potential to provide clarity for the benefit of retail and institutional investors and equally for investment funds and advisers aspiring to enhance the industry's credibility and foster investor trust. We believe that a central policy challenge before the Commission is how to elicit meaningful disclosure and ensure that fund communication accurately reflects the way in which the investment process actually takes place. We appreciate the Commission's decision to let the market define "ESG investing" and related terms at a granular level and to take steps to at a high level formalize ESG terminology around which many market participants have coalesced.

As the Commission considers whether or how to finalize the Proposals, we would encourage it to ensure that the final rules not single out ESG funds and ESG investment practices of investment managers for unique scrutiny relative to other types of funds or investment practices. While the proliferation of ESG-related terms is at the fore of the current public policy discussion, consideration of material E, S, and G factors is not new to financial analysis. In particular, consideration of "G" factors is a well-established and routine part of investors' risk/return analysis. In that sense, a regulatory framework that is consistent across all funds and investment strategies is important. Below, we comment on select issues in the Proposals and offer our general observations, with the goal of encouraging a clear and practical approach to designing a consistent, comparable, and decision-useful regulatory framework for ESG (and all) fund and advisory services.

ESG Terminology Standards and Fund Classification.

In the ESG Disclosures Proposal, the Commission proposes to require additional disclosures from funds and advisers that consider ESG factors. Specifically, the Commission proposes to classify ESG funds into three categories - ESG integration funds, ESG-focused funds, and ESG impact funds (described as a subset of ESG-focused funds) - based on how central ESG factors are to their strategy, and then proposes layered disclosure in funds' and advisers' prospectuses and annual reports pegged to those three categories. The Commission proposes that investment advisers considering ESG factors generally make similar disclosures in their brochures and report certain other ESG information annually.

ISS agrees that the use of clear and consistent investment terminology supported by relevant disclosures is essential to help investors make informed investment decisions in accordance with their investment goals. While we generally believe that the Commission's existing fund rules are robust and already equally extend to ESG funds, we recognize that investors and the market would benefit from greater clarity regarding key ESG-related terms and consistent disclosure of their application across all products incorporating ESG factors. We agree that the Commission has a role to play in helping to standardize commonly used ESG terminology.

ISS generally views the promotion of a common ESG terminology framework as distinct from a fund classification framework and believes that the benefits of consistent sustainable finance-related terms and definitions go beyond investment products. We do not have a view on whether an ESG fund classification is needed in the U.S. market at this time, but we broadly agree that an ESG terminology framework, such as those developed by the Investment Company Institute (ICI) or the Institute of International Finance (IIF),[2] provide a sound basis for a consistent and comparable cataloguing of the various types of ESG strategies used in fund management.

[2] *See* Investment Company Institute (ICI), "Funds' Use of ESG Integration and Sustainable Investing Strategies: An Introduction" (Jul. 2020), https://www.ici.org/system/files/attachments/20_ppr_esg_integration.pdf; *See also* Institute of International Finance (IIF) Sustainable Finance Working Group Report, "The Case for Simplifying Sustainable Investment Terminology" (Oct. 2019), https://www.iif.com/Portals/0/Files/content/Regulatory/IIF%20SFWG%20-%20Growing%20Sustainable%20Finance.pdf

A baseline set of terms to describe ESG investing strategies encourages a common understanding amongst investors and other stakeholders, including policymakers, and would drive convergence around standard ESG characteristics. To this end, the Commission's proposal to catalogue ESG investing strategies and terminology and related disclosures in the ESG Strategy Overview table is welcome. The table provides disclosure across "evergreen" ESG term categories (e.g., exclusionary or inclusionary screens, seeks to achieve a specific impact, proxy voting, tracks an index, engagement with issuers) while providing flexibility for funds that may use more than one ESG strategy to explain in narrative form their investment selection and management processes.

We highlight a few areas of the Proposals that merit greater attention or where more flexibility would be additive to achieving the Commission's goals:

- We view comparability of ESG funds as a primary benefit of disclosure, especially for retail investors, and its greatest challenge. ESG funds do not naturally self-categorize into discernible ESG fund buckets in large part because ESG factors often intertwine, making the array of ESG funds more analogous to a continuum. In our experience, this makes classification of ESG funds very challenging. We would expect that delineating between ESG integration and ESG-focused funds would raise similar comparability hurdles to distinguishing between Article 8 and Article 9 products under the EU's Sustainable Finance Disclosures Regulation (SFDR). We also foresee a scenario where it would be helpful to discern along the sub-continuum of ESG-focused funds, as we have seen with Article 8 funds.

- An overarching challenge with fund classification, as the EU SFDR experience has arguably illustrated, is that even when fund classification is intended to be a disclosure and transparency framework, the classification nonetheless runs the risk of becoming a de-facto product labelling regime.

- Regarding the proposed ESG integration fund category, we would support the Commission's decision to eliminate this category altogether. While "integration" of ESG factors can be viewed as a specific ESG strategy, we generally see integration of material ESG factors as increasingly part of fundamental investment analysis. The incorporation of material factors – whether ESG or non-ESG - into the investment process enhances investment decision-making by expanding the universe of factors in the search for alpha. Because ESG-factor integration is becoming more and more common, we believe ESG integration as its own fund category would soon become outdated.

- If the Commission is committed to introducing an ESG fund classification, we would encourage the Commission to limit the classification to a few categories that are not overly prescriptive so as to accommodate the future development of new sub-categories. Such an approach would encourage further creation of a suite of sustainable product options to meet investors' diverse and evolving needs.

ESG Reporting of Portfolio Companies.

Corporate issuer disclosure is an important first "building block" to achieving consistent and comparable fund disclosure. As it stands today, however, investors and their investment managers are still faced with a lack of comprehensive, reliable, and comparable corporate ESG data. This is particularly true for smaller cap listed equities, other asset classes, and those in emerging markets. ISS supports the Commission taking active steps to address these data gaps and we are hopeful that the sustainability-related reporting standards being developed by the IFRS International Sustainability Standard Board will materialize into a "global baseline."[3]

Ideally, work on product-level ESG disclosure would sequentially follow efforts across jurisdictions to standardize sustainability disclosure for corporate issuers. We recognize, however, that it will take time for the disclosure requirements and reporting standards to come online and that clarity regarding ESG practices of investment managers and the marketing of ESG funds is necessary now. Accordingly, we believe that fund and investment manager disclosure rules need to explicitly acknowledge the developing regulatory environment and be flexible enough to accommodate instances where primary source data is limited.

We welcome a phased approach to requiring fund or manager use of specific metrics, with the goal of baseline transparency of metrics used by an investment manager to achieve a fund objective. We appreciate the Commission's acknowledgment that disclosure of data on some asset classes presents coverage issues and may not lead to reliable or consistent data, even if fund reporting is mandatory – at worse, this could be misleading; at best, it presents a comparability problem. For example, although there is increasingly industry consensus on how to calculate weighted-average carbon intensity ("WACI") for equity products, a consensus view on how to calculate WACI for fixed income and multi-asset products does not yet exist. Similarly, we appreciate the Commission's recognition that for funds required to report Scope 3 emissions under the ESG Disclosures Proposal, the ability to fulfill such a requirement is limited to the extent the data is reported by a fund's portfolio companies.

To be clear, ISS agrees that investment managers who rely on ESG metrics to meet their investment objectives and claims should provide quantitative and, where impracticable, narrative disclosure on those metrics to enable investors to evaluate the relevant claims. To the degree the investment manager is reliant on external data sourcing, we believe it would be appropriate for the Commission to consider providing a safe harbor from liability for fund disclosure of, for example, GHG emissions data in line with the safe harbors proposed to be afforded to corporate issuers under the SEC's climate-related disclosure proposal.[4]

Given the continuous development of ESG metrics and methodological approaches, we believe the Commission should not preclude investment managers from using any particular methodological approach. Whether internal to an investment manager or developed by a service provider, we believe investment managers should have the flexibility to use their own good faith estimates even when, for example, a portfolio company publicly provides its GHG emissions data. With respect to transparency of methodologies, whether those developed by the investment manager or their service provider, we note that the need for transparency needs to be carefully balanced to facilitate clarity while fostering an innovative and competitive marketplace. This is especially relevant given the fast-evolving ESG data market, where competitive differentiation fosters innovation and ESG product variety.

[3] *See* Letter from Institutional Shareholder Services to ISSB (Jul. 29, 2022), https://www.ifrs.org/content/dam/ifrs/project/climate-related-disclosures/exposure-draft-comment-letters/i/institutional-shareholder-services--iss--643d9d90-e77f-429c-9ea5-b1e631bcb1fe/iss-comment- letter-ifrs-s1-and-s2-eds.pdf. *See also* Letter from Institutional Shareholder Services to Vanessa A. Countryman, Secretary, U.S. Securities and Exchange Commission (Jun. 22, 2020), https://www.sec.gov/comments/s7-10-22/s71022-20132703-303196.pdf.
[4] *See* The Enhancement and Standardization of Climate-Related Disclosures for Investors, Securities Act Release No. 11,042, Exchange Act Release No. 94,478, 87 Fed. Reg. 21,334 (Mar. 21, 2022), https://www.federalregister.gov/documents/2022/04/11/2022-06342/the-enhancement-and-standardization-of- climate-related-disclosures-for-investors

Measuring Investment Stewardship Practices and Engagement Metrics.

In the ESG Disclosures Proposal, the Commission proposes to require funds for which engagement with issuers on ESG issues through means other than proxy voting is a significant part of implementing their ESG strategy to disclose key performance indicators for engagement practices. Specifically, the Commission proposes to require funds to disclose the number or percentage of issuers with whom they held ESG engagement meetings related to one or more ESG issues, the total number of ESG engagement meetings, and the progress on any objectives of such engagement.

ISS is skeptical that the granular focus on the number of meetings as a key performance indicator would be useful to investors and questions whether the metric would further the Commission's goal of enabling investors to more comprehensively and efficiently evaluate how funds implement and accomplish their ESG strategies. Quite the opposite, we believe that this particular proposed requirement could inadvertently lead to very specific but misleading information by incentivizing quantity-over-quality disclosure as to the nature and/or results of a fund's ESG engagement strategy.

In general, ISS agrees that investors would benefit from more holistic disclosure of material information about investment managers' and funds' investment stewardship practices, given that shareholder engagement (and proxy voting) is generally conducted at the fund manager level, not at the fund level. Where engagement is core to the active ownership strategy – whether an ESG strategy or not – we support disclosure that is meaningful in both quantitative and qualitative ways and that clearly articulates the scope and limits of an engagement strategy.

With respect to manager-level and fund-level disclosure, we highlight a few areas for the Commission's consideration:

- *Defining engagement*. When an investment manager engages with an issuer of corporate securities, the investment manager should define the objective(s) of initiating engagement. These objectives can run the gamut of obtaining general information to inform the investment manager's voting decisions; communicating the manager's perspective on a specific matter; or, advocating with the issuer on a particular requested change, such as an ESG-related goal directly connected to a fund's objective.

  In considering requiring disclosure of a fund's engagement practices, the Commission should distinguish between general engagement with an issuer that is routine (e.g., continuous dialogue, meetings to gather background) or focuses on specific research purposes (e.g., understanding how a company is managing ESG risk) from action-oriented engagement that is more in-depth, intensive, and directly connected to a fund's objective. Disclosure of the latter would be more appropriate and pertinent, as it is more likely to provide investors with meaningful and material information about their investments and a manager's engagement strategy and progress towards engagement goal(s).

- *Engagement philosophy*. In our experience, investment managers generally already make available to their clients and publicly their engagement philosophies and proxy voting policies. Some managers engage with a number of portfolio companies on broad themes or in connection with a company controversy; others may prefer a company-specific approach, where engagement can help mitigate or eliminate an identified performance risk; some managers may opt for a combined approach.

- *Tracking engagement*. Measuring engagement, particularly the ratio of input to output, is already challenging but standardizing a set of key metrics around engagement practices would erect even more practical challenges. We do recognize that investors and investment managers alike are interested in finding ways to effectively measure engagement. While market participants work to coalesce around the best metrics, narrative disclosure of a fund's stewardship philosophy, approach, and activities is a practical, workable, and still helpful alternative. Such disclosure could help explain how a fund manager exercises their fiduciary responsibility, including in line with a specific fund engagement strategy, and empower investors to make informed investment decisions. The narrative disclosure could extend to an overview of a manager's team structure; defining and measuring engagement "milestones;" defining and tracking collaborative engagement and "snapshot metrics," like quality of meetings and intensity of engagement approach; and criteria for escalation to proxy voting.

To be clear, it is our view that if a fund uses engagement as a principal investment strategy, the fund should disclose the identified goal(s) and relevant criteria; how engagement is defined and integrated into their investment selection process; and the criteria and monitoring process, including the timeline, used to assess the success of the engagement strategy. For example, if a portfolio manager has an environmentally-driven engagement strategy and chooses to invest in companies with poor environmental practices (broadly speaking, companies poorly managing environmental risks that could negatively affect the companies' risk/return profiles), the fund should make clear the criteria used to define "poor" and select portfolio companies, articulate the engagement goal(s) and engagement timeline, and explain the criteria and monitoring process used to determine an "improvement" in a company's environmental practices (i.e. define strategy success).

With respect to proxy voting, we support the proposed requirement that funds provide cross-references to the more detailed disclosure regarding their full proxy voting record on Form N-PX.[5] It would also be helpful to cross reference funds' ESG proxy voting policies and procedures. Such connections could help investors to more readily access and more efficiently analyze funds' engagement and proxy voting information.

Expanding the Scope of the 80% Investment Policy Requirement.

In the Names Rule Proposal, the Commission proposes, among other things, to modernize the 80 percent investment policy requirement by applying it to fund names with terms such as "growth" or "value" and those indicating that a fund's investment decisions incorporate one or more ESG factors. Simply put, the Commission is proposing to expand the current scope of the 80% rule to cover "investment strategies." The Commission explains that distinguishing whether a term connotes a "strategy" versus a "type of investment" raises interpretive issues, where the distinction may be one without a difference; that the two are not always mutually exclusive; and that the proposed approach errs on the side of investor protection by seeking to eliminate the current exclusion of "strategy" funds from the Names Rule.

ISS agrees that a fund's name is an important marketing tool that can have a significant impact on investors' decisions when selecting investments. We also agree with the Commission that looking at the fund name alone would amount to insufficient investor due diligence. In the absence of a unified ESG terminology and relying on a fund name alone, it is very challenging for investors to understand a fund's use or interpretation of ESG terms, much less its ESG bona fides. We would therefore strongly encourage the Commission to stress in investor education and bulletins that looking beyond the ESG fund name to the fund prospectus is not only necessary but critical.

[5] *See* Letter from Lorraine Kelly, Head of Governance Solutions, ISS to Vanessa A. Countryman, Secretary, SEC (Dec. 14, 2021), https://www.sec.gov/comments/s7-11-21/s71121-20109580-263952.pdf

In general, we question whether applying the Names Rule to ESG-branded funds would provide investors with the desired clarity and wonder if it would exacerbate rather than resolve interpretive issues. Investors are not monolithic in seeking ESG products and given the range of ESG approaches and the evolving interpretation of material ESG factors, a fund name would likely not convey enough material information to meaningfully inform an investor. Such complexity lends ESG-branded funds more naturally to disclosure through a fund prospectus where the description of the strategy gives investors more complete information than the Names Rule alone would allow.
Rather than tying a term such as ESG in a fund's name to a particular investment or strategy, we would support the Commission requiring ESG funds to clearly and prominently disclose in their prospectuses how their investment strategies and methodologies define and substantiate the use of ESG-related terms as marketed. We note that this approach would still subject ESG funds to the general prohibition on misleading names under Section 35(d) of the Investment Company Act.

Global Sustainable Finance Regulation.

One facet unique to ESG investing relative to other types of investing is that in some markets sustainable finance regulation is central to advancing a larger policy objective of channeling capital towards sustainable activities and ultimately a net zero economy. At their governments' direction, some securities regulators are introducing extensive sustainability-related reporting requirements of the asset management industry at the investment product, portfolio, and entity levels. The scope and ambition of such regulation diverges significantly market to market, increasing the exposure of U.S. investors, investment managers, and regulators to risks associated with a globally fragmented policy approach, such as:

- Regulatory arbitrage and supervisory challenges for securities regulators stemming from the co-existence of different ESG classification frameworks across jurisdictions. This could result in scenarios where the same fund may be considered an ESG fund in one jurisdiction but not another, leading to confusion and potentially contributing to allegations of greenwashing;

- Regulatory fragmentation placing U.S. investors at an informational disadvantage relative to their global counterparts, who are more likely to have ready access to granular and extensive investment manager and product disclosure; and

- Regulatory fragmentation that increases compliance for U.S. asset managers operating globally at the cost of product innovation (e.g., where there is no U.S. equivalent category recognizing Article 8 or Article 9 SFDR funds developed by U.S. firms or equivalent reciprocation in the reverse, should the Commission adopt an ESG fund classification).

In this regard, ISS would support coordination between the SEC and other securities regulators and organizations such as the International Organization of Securities Commissions (IOSCO) regarding overlapping regulatory and supervisory approaches. We would also support continuing collaboration with the industry to advance market-led efforts that may address or altogether pre-empt fragmentation concerns.

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ISS thanks the Commission for considering our comments and welcomes the opportunity to discuss this matter further.

Respectfully,

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