THE
INVESTMENT
ASSOCIATION

16th August 2022

Vanessa Countryman
Secretary, Securities and Exchange Commission
100 F St, NE
Washington DC 20549-1090
USA
Via email: rule-comments@sec.gov

Dear Ms Countryman:

Re: Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices Release IA-6034, 87 F.R. 36654 (June 17, 2022) File No S7-17-22 ("ESG Proposal")

Introduction

1. The Investment Association ("IA") is pleased to provide its views and recommendations to the U.S. Securities and Exchange Commission ("SEC") on the ESG Proposal. We are a UK-based trade association representing investment firms that manage £9.4trn ($12.8trn) in assets from the UK. Almost 50 per cent of the £9.4trn is managed by member firms that are U.S. controlled or headquartered. We have a particular interest in regulatory initiatives that affect cross-border investment as well as industry-relevant innovations including the development of responsible investment frameworks. Our member firms invest widely in the U.S. economy, across different asset classes including equity, fixed income infrastructure, and other financial instruments (e.g. futures, forwards, options and swaps). UK based investment managers manage more than $670bn in U.S. listed equities and provide support for businesses in every U.S. state. Our members manage approximately $1.2trn on behalf of North American clients from the UK. U.S. investors see the benefits of the UK's role as a global investment management center, with its strong pedigree in portfolio management. In addition, the UK is establishing a reputation as a center of responsible and sustainable investment management: 49% of UK AUM is managed according to ESG integration, a quarter of assets are subject to exclusions and the percentage of AUM in sustainability focused strategies doubled in 2020 to 2.6%.

2. The ESG proposals from the SEC are of significant interest to investment managers across the globe and could have an important impact on current and future product offerings, as well as compliance oversight. We therefore ask the Commission to consider the cross-border implications of the proposals, including measures to ensure global regulatory coherence in the development of ESG and disclosure policy. Any regulatory position taken by the SEC needs to consider similar approaches taken by other governments and regulators to help ensure a consistent, comparable,

well-reasoned and proportionate response to critical ESG disclosure and investment-related activities. Ultimately, this will ensure that clients and savers around the world have the necessary, consistent, and comparable information they need to make informed decisions about global ESG products.

3. UK investment managers play a significant role in providing all forms of responsible investment to investors including stewardship and ESG integration through to impact investing. Responsible and sustainable investment strategies are available to investors through separately managed accounts ("SMAs"), funds, private funds and non-discretionary (advisory) services. The UK's experience is that this is entirely consistent with the objective to generate sustainable value for investors over their investment time horizons.

4. There is considerable consumer interest in ESG and responsible investment– and a keen need for regulatory clarity to improve consumer confidence in responsible and sustainable investment products. Our funds data shows that responsible investment funds attracted $22bn in sales from UK retail investors in 2021, representing over a third (37%) of all UK investor fund sales. Funds under management (FUM)[1] in responsible investment grew by 62% in 2021, compared with a rise of 11% for industry FUM overall. This growth reflects healthy sales in 2021, but most importantly, a growing interest from investors in ESG funds. Even in the challenging market conditions in 2022, sales of responsible investment funds to UK investors have been resilient in the first half of the year at $6.4 billion, contrasting with high outflows from the wider funds market of $14.4 billion.

5. There is a clear international mandate to bring about more clarity and choice for the consumer. Building trust and confidence in the market is crucial, and the SEC's efforts in this space are welcome. Savers and investors want to see and understand the impact of their investments on the world around them and have confidence that when they invest in a responsible and sustainable investment product, the product objectives are clear and match their preferences and expectations. This goes to the role of investment managers to bring clarity and consistency to the way the industry describes these products to clients and to make it easier for all savers to understand the opportunities available to them.

6. In the UK, at the end of 2019, the IA launched the IA Responsible Investment Framework – the first ever industry-agreed Responsible Investment Framework with supplementary definitions to bring clarity, consistency and choice for the consumer. The Framework does not represent a standard or a label in and of itself. However, it is a major collective step forward. The IA is building on this framework by working with members, clients, policy makers, regulators, and all relevant market participants on further signposting of responsible investment products and promoting awareness about the role that investment management can play in bringing about a sustainable world.

[1] The IA distinguishes between assets under management (AUM) and funds under management (FUM). AUM is collected on a UK-managed basis and represents the total value of assets managed from the UK for both UK and overseas investors. FUM refers to the total value of assets invested in collective investment schemes, such as unit trusts and open-ended investment companies (OEICS), known in the UK as authorised investment funds, and is collected on a UK-investor basis.

The Critical Need for Global Regulatory Coherence

7. The UK-based investment management industry is global in nature and has been a strong proponent of international coordination and the global regulatory coherence of sustainable finance rules.

8. Fragmented approaches across different jurisdictions – including gold-plating at a national level – runs the risk of not treating clients consistently and fairly. For example, different regulatory requirements will impact the investable universe of certain clients more heavily than others. Different or even divergent standards would prevent the sustainable investment market reaching the scale and liquidity needed to achieve policymakers' goals. This is a critical issue, we have raised as part of the work on the development of the UK Sustainability Disclosure Requirements ("SDR"), classification and labels for investment funds.

9. In this context, the regular correspondence and productive relationship between the Financial Conduct Authority ("FCA") and the SEC is welcome, as is the wider Treasury-led dialogue, the U.S.-UK Financial Regulatory Working Group. Cooperation and coordination between the U.S. and the UK in international regulatory forums is also valuable as it helps to set the baselines from where national regulators start. This is the case with the International Sustainability Standards Board ("ISSB") as it develops a global baseline for corporate reporting on sustainability, noting the importance of interoperability of reporting across different jurisdictions. The IA is ready to provide industry input at all these levels and encourages all jurisdictions to incorporate the ISSB reporting standards into their regulatory reporting requirements.

The IA's Proposed Approach

10. As part of our deep engagement with the work currently on-going in the UK on a possible SDR, classifications and labels for investment funds, we have developed a view on the key principles that need to be taken into consideration to make any sustainability disclosure requirements, disclosures, classifications and labels a success:

    Simple and adaptable – a label system and associated disclosure needs to be simple and comprehensible to investors, advisers and other market participants. It needs to be adaptable in recognition that work continues to develop clear quantitative methodologies to determine a sustainable asset, for example the ongoing development of the EU/UK taxonomies.

    Supported by appropriate data and methodologies – a system that is appropriately supported by credible data and methodologies to show how funds are delivering minimizes the opportunity for greenwashing.

    Future-proofed – any regulatory approach must be flexible, easily administered across international boundaries, non-political and designed to help ensure that the system is future-proofed for the evolution of the fund universe and the broader regulatory environment.

Clarity, investor protection and enforcement – the final rulemaking must be clear in scope and application, setting specific expectations.

We urge the SEC to take these principles into account as it sets the final rules.

Specific Comments on the Commission's Proposals

11. We provided evidence to the U.S. Department of Labor ("DOL") on its 2020 proposal to try to treat ESG exclusively as a specific asset class rather than as an integral part of the investment process. The concern expressed then was that many of the issues the DOL wanted to separate out as ESG were key parts of the investment management process and corresponded to financial factors, the exclusion of which would have material consequences for the generation of returns for investors. We continue to advocate this approach.

12. In principle, the SEC's tiered approach to disclosures, depending on the extent to which a fund considers ESG factors in its investment process, is welcome. As is the approach to disclosures for investment advisers considering E, S or G, or ESG or a combination thereof, for the SMAs for which it exercises discretion or gives investment advice. Investors need to see the alignment between stated ambition, disclosure and delivery. There is a distinction between ESG focused funds and impact investing, for example, between a firm seeking a financial return by investing with a specific sustainability criterion and a fund with a clear intention to seek financial return and to deliver demonstrable change through asset allocation and stewardship i.e. create an 'ESG impact'.

13. When examining the tiers, the proposal's definition of "integration funds" as a new regulatory category is currently too broad and capable of capturing funds within the regime that are not intentionally focused on sustainability. As noted before, integrating ESG risks should be part of the investment decision making process. Accordingly, we would recommend that the SEC either remove the integration fund label entirely, or, avoid both defining and mandating disclosure requirements for integration funds.

14. The IA supports the approach of only using labels as positive identifiers for funds and therefore aligns with the SEC categories ESG focused funds and ESG impact funds.

15. In order to determine whether an ESG focused fund aligns with an investor's goal the SEC has proposed that ESG focused funds provide 'concise disclosure, in the same format and same location in the prospectus, is designed to provide investors a clear, comparable, and succinct summary of the salient features of a fund's implementation of ESG factors. Whilst we are supportive of this principle, we have some concerns that the volume of required disclosures by ESG focused funds, will mean that the important and material information that investors require to make informed decisions is lost amongst other disclosures.

16. The SEC proposed rule, states that "*funds for which engagement with issuers, either by proxy voting or otherwise, is a significant means of implementing their ESG strategy check the appropriate box in the first row of the ESG Strategy Overview Table".*

There is a risk that the proposed 'tick box' approach does not encourage funds to disclose meaningful information such as their approach to engagement, proxy voting and the measurable outcomes that the fund is seeking to achieve from the engagements. The SEC should provide a clear definition on what is meant by "significant" in order to promote consistent and comparable reporting.

Funds that purport to take ESG factors into consideration when making investing decisions should describe how their approach to engagement and voting supports their investment strategy and objectives, similarly these funds should outline in their fund documentation how it leads to specific outcomes aligned with such objectives for the fund.

We would suggest that proxy voting and engagement should be a minimum expectation across all activities and should be part of all sustainable fund strategies, rather than being a distinguishing factor for some sustainable funds. We agree that the fund should set out how their proxy voting and engagement activities help to deliver the fund's investment objective but would be cautious about suggesting that they should form an ESG strategy on their own. More broadly, we agree that funds should utilize existing powers through the role that they play as stewards, allocating, managing and overseeing capital to create long-term value for clients.

We would further note that engagement and voting are primarily carried out at the firm rather than product level and are not limited to ESG- focused funds. Firms aggregate the entire firm's holdings to maximize the influence investors can have, seeking to maintain and enhance the long-term value of the asset for the benefit of end-savers, focusing on the material risks and opportunities for the asset.

17. The IA is opposed to the possibility of a third-party marketer or third-party rater being the main determinator of whether a fund is integrated, ESG-focused, or impact. These third-party service providers are not subject to regulation or broader oversight, which results in lack of transparency and accountability. In addition, there are concerns around providing information on the use of third-party data providers, such as scoring or methodologies. This information is often subject to (price-sensitive) licensing agreements. We consider how third-party ratings are used rather than what providers are used as more useful information.

18. The proposals appear to place a significant emphasis on disclosing particular metrics, particularly greenhouse gas emissions, which we believe is not desirable and fails to recognize that ESG funds cover a range of sustainable investment strategies encompassing more than just carbon emissions, for example diversity and inclusion and biodiversity and natural capital loss. Disclosures should be based on the strategy of the fund and how it is being implemented.

19. In relation to coverage – we understand that SEC registered investment advisers must comply with the requirements, but we would appreciate clarification as to how Private Fund Advisers are caught by the scope of the rulemaking.

20. We also want to highlight that as part of our work on UK SDR, classifications and labels, together with other market participants in the UK, the IA are working on defining impact investing for public

markets, aligning our proposal with the June draft guidance from the Global Impact Investing Network. The continuing evolution of data, transparency and definitions across ESG fields such as this will be a challenge posed to industry and regulators alike, consideration of which needs to be a part of any rulemaking.

21. A key consideration going forward should also be the compatibility and interoperability with proposed regimes in other jurisdictions. As SIFMA noted in its 17 June evidence on climate disclosures, the rules should, "expressly allow all registrants to comply with ISSB standards and non-U.S. reporting regimes recognized as substantially equivalent by the Commission in order to maximize the consistency and usefulness of climate disclosures to investors."

Naming proposal

22. The IA welcome the objective of the naming proposal to ensure end investors are getting a clear view of what they're buying and what investments they are being exposed to. Fund naming and marketing rules should be aligned to labels in order to ensure consistency. Only if products that have an ESG label should be allowed to use ESG in the fund name and be marketed as responsible or sustainable investment products. However, we have some concerns to the extension of the Rule as proposed to include fund names suggesting investment in instruments or issuers with "particular characteristics". There are no globally agreed definitions of ESG terminology, which makes the need for continuous assessment of the construction of the portfolio burdensome. It could have the unintended consequence of leading to high turnover within the portfolios and would not be in the best interests of the end investor.

Final Comments & Next Steps

23. Labels, classification frameworks and related disclosures have been used within the funds market for a significant period of time. The IA and our members are supportive of effective disclosure rules and recognize that more work needs to be done by the investment management industry to communicate often complex sustainable investment approaches to consumers in a clear and consistent way. We are therefore supportive of the important work of the SEC and other regulators around the world to bring clarity and consistency in the markets for ESG investment products, including appropriate disclosures.

24. In particular, we would advocate for the appropriate sequencing of sustainability and ESG disclosure obligations throughout the investment chain. To provide decision-useful disclosures to help consumers make informed choices in line with their investment objectives, investment managers need high quality, meaningful and comparable disclosures from investee companies. These companies are the ultimate source of the data and information needed by investment managers. The experience in other jurisdictions of inappropriate sequencing of legislation has led to delays in implementation and an undue regulatory burden for investment managers.

25. Working together and learning from each other is one of the most important principles in sustainable finance. The final rulemaking must reflect clear, consistent global standards, not just U.S.-centric views. ESG reaches across international boundaries and non-U.S. firms and clients that are caught by the final rulemaking would have to comply with multiple standards, which ultimately

runs the risk of not treating clients consistently and fairly. In this regard, we recommend that the SEC adopt an approach that permits non-U.S. firms caught by the rulemaking to use relevant approved jurisdictions' home-country standards – an approach taken by the SEC in other contexts.

26. Education should be promoted to all market participants, including policy makers, industry and investors given the fluid nature of sustainable investing; this remains a dynamic and developing market and everyone involved is building up capabilities and expertise. We welcome the opportunity to brief and discuss our industry-led Responsible Investment Framework and supplementary definitions with the SEC; how the ESG Proposals affect international investors; and the challenges and opportunities for investors in the responsible investment space in the coming years.

27. The IA is deeply engaged with all sustainable finance rules developments in the UK including extensive work on the UK's proposed Sustainability Disclosure Requirements (SDR) incorporating proprietary consumer research on the FCA's proposed sustainable investment labels to test how retail clients understood and responded to ESG fund labels. We would very much welcome an opportunity to discuss this with the Commissioners and the SEC Staff.

28. Finally, and in the context of the rapid evolution of investment strategies and customer expectations in this space and in the coming years, the SEC should also acknowledge that the classification, labels and associated rules on disclosure will need to be reviewed regularly to ensure that they continue to meet consumer needs.

We hope you find our comments helpful. If you have any questions, please contact Sally Springer at investments.capitalmarkets@theia.org or contact Richard Normington at GlobalMarkets@theia.org.

Thank you for your kind consideration.

Sincerely yours,

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