CFA Institute

1401 New York Ave. NW
Suite 330
Washington, DC
20005-2269 USA

+1 (202) 908 4520 tel
+1 (202) 908 4538 fax
info@cfainstitute.org
www.cfainstitute.org

August 16, 2022

Ms. Vanessa A. Countryman, Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090
rule-comments@sec.gov
Reference: File Number S7-17-22

Re: Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices

Dear Secretary Countryman,

CFA Institute hereby submits this comment letter to the Securities and Exchange Commission ("SEC" or "Commission") in response to its published notice of proposed rules for Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices (the "Proposed Rules" or "Proposing Release.")

CFA Institute[1] is the global association of investment professionals with more than 81,000 U.S.-based members who function as chief investment officers, investment advisers, and portfolio managers on the buy side of the market; as brokers, investment bankers, and financial analysts on the sell side; and as consultants, chief financial officers, regulators, and academics elsewhere in the financial markets. Our membership is bound by a common commitment to the CFA Institute Code of Ethics and Standards of Professional Conduct that requires all members and candidates to "place their clients' interests before their employer's or their own interests."[2] CFA Institute speaks on behalf of its members and advocates for investor protection and market integrity before standard setters, regulatory authorities, and legislative bodies worldwide.

The Proposed Rules set forth an extensive new set of disclosure requirements for investment companies and business development companies registered under the Investment Company Act of 1940 and for registered investment advisors subject to the Investment Advisers Act of 1940. The Proposed Rules call for amendments to a range of existing disclosure forms, including a registered investment company's summary and statutory prospectuses and annual reports. For registered investment advisers, Form ADV Parts 1 and 2 would also be modified in an effort to

---

[1] CFA Institute membership includes investment analysts, advisers, portfolios managers, and other investment professionals in more than 160 markets, with more than 190,000 holding the Chartered Financial Analyst (CFA®) designation.
[2] CFA Institute Code of Ethics and Standards of Professional Conduct: https://www.cfainstitute.org/-/media/documents/code/code-ethics-standards/code-of-ethics-standards-professional-conduct.pdf

1401 New York Ave. NW
Suite 330
Washington, DC
20005-2269 USA

+1 (202) 908 4520 tel
+1 (202) 908 4538 fax
info@cfainstitute.org
www.cfainstitute.org

require more consistent and comparable details concerning if and how such managers consider environmental, social, and governance factors in the investment decision making process.

We appreciate the Commission's efforts to improve the quality and consistency of ESG related disclosures from investment firms, given the absence of a common reporting framework. More importantly, we strongly support the need for action to address what many observe as rampant "greenwashing" in the marketplace. Some investment firms are aggressively marketing ESG products and their "green" investment prowess to meet growing demand from an entire generation of investors seeking exposure to ESG-focused strategies. Put simply, these managers need to substantiate their consideration of ESG factors by providing concrete and specific disclosures that reflect actual ESG considerations.

We believe that industry standards play an important role, alongside regulation, in shaping industry practices. Having recognized that investors, asset managers, and advisers could all benefit from standardized product-level ESG disclosures, CFA Institute developed the Global ESG Disclosure Standards for Investment Products. We believe these standards can be a useful model for regulators, and we encourage the Commission to utilize them in their development of regulatory requirements.

EXECUTIVE SUMMARY

Fund Categories

We agree that it is useful to distinguish between different types of funds for the purpose of determining the scope of enhanced ESG disclosure requirements. However, we believe that the distinction between Integration Funds and ESG-Focused Funds should be based on the significance of ESG factors in a fund's name, advertisements, and sales literature rather than on consideration of ESG factors in investment decisions. Enhanced ESG disclosure requirements should apply only to those funds that hold themselves out as having an ESG focus or claim that ESG factors are a significant or main consideration in investment decisions. We believe that limiting enhanced ESG disclosure requirements to ESG-Focused Funds would more precisely target greenwashing, solve a number of practical difficulties in the Proposed Rules, and be more effective from a cost-benefit standpoint.

Fund Disclosures

CFA Institute fully supports the objective of having more consistent and accurate disclosures by fund managers and fund companies to prevent "greenwashing" of products and services that are labeled and/or marketed as ESG products. For our purposes, we consider greenwashing to be a situation in which disclosures or advertising materials intentionally or inadvertently mislead investors about the ESG approaches used in an investment product, the ESG characteristics of an investment product, or the degree of influence that an investment product has on ESG issues.

CFA Institute

1401 New York Ave. NW
Suite 330
Washington, DC
20005-2269 USA

+1 (202) 908 4520 tel
+1 (202) 908 4538 fax
info@cfainstitute.org
www.cfainstitute.org

We agree that an ESG-Focused Fund should make summary-level disclosures and detailed-level disclosures, as well as discuss in annual reports the attainment of, or progress toward, any targets or goals that are part of the fund's ESG strategy. We also agree that an Impact Fund should disclose its environmental and/or social objectives along with key information about those objectives, and discuss in annual reports attainment of, or progress toward, those objectives. For some disclosure requirements, however, we disagree with the proposed scope, wording, or disclosure mechanism, but in these cases, we offer our ideas about how to improve them.

We encourage the Commission to reconsider the current approach to disclosures, where they are required to be in different documents, in different locations. For example, an open-end ESG-Focused Impact Fund would be required to include information about its use of ESG factors in:

- Item 2 of the prospectus
- Item 4 of the prospectus
- Item 9 of the prospectus
- Management discussion of fund performance in the Annual Report
- Form N-CEN

To best meet the goal of providing improved information to help investors make more informed choices regarding ESG investing and better compare funds, we believe that a more helpful approach would be to require all ESG-related disclosures to be within a single ESG-specific document.

Adviser Disclosures

We support increased adviser disclosures to address the issue of greenwashing and misleading sales practices. The disclosures in the case of Form ADV limit themselves to generalities versus specifics, which we think is appropriate, especially when reflecting on the reality that the Adviser may be managing a range of funds and other portfolios – some of which do and some of which do not consider ESG factors. We encourage the Commission to be concise in its objectives for enhanced ESG reporting to mitigate greenwashing, most specifically for those featuring ESG-focused strategies.

As noted above for funds, the Proposed Rules may potentially capture thousands of advisers that have been active, fundamental managers for many years and who have routinely factored climate risks, social exposures, and corporate governance matters, as a matter of business as usual. Advisers that neither market nor otherwise emphasize ESG factors are unlikely to participate in greenwashing. We recommend a similar approach to ESG disclosures for advisers as with funds. Advisers that market and feature consideration of ESG factors should be required to include a new ESG appendix to Form ADV, which includes all ESG-Focused principal strategies and serves as the single detailed description of ESG activities/strategies.

CFA Institute Private Sector Standards

CFA Institute

1401 New York Ave. NW
Suite 330
Washington, DC
20005-2269 USA

+1 (202) 908 4520 tel
+1 (202) 908 4538 fax
info@cfainstitute.org
www.cfainstitute.org

CFA Institute has developed private sector standards that establish the disclosures that funds and strategies should make about their use of ESG approaches. We encourage and welcome the Commission's reference to and use of the concepts offered in these best practice standards.

DETAILED COMMENTS

CFA Institute Private Sector Standards

On 1 November 2021, CFA Institute issued the Global ESG Disclosure Standards for Investment Products3 ("Standards" or "ESG Disclosure Standards"), the first global voluntary standards for disclosing how an investment product considers ESG factors in its objectives, investment process, and/or stewardship activities. These Standards are designed to facilitate the fair representation and full disclosure of the ESG approaches used in an investment product so that investors can better understand, evaluate, and compare investment products that incorporate one or more ESG approaches—regardless of how the investment product is named or categorized. Our ESG Disclosure Standards require the disclosure of key information that is decision-useful to investors and reasonable for investment managers to provide. These disclosure requirements cover the full universe of ESG approaches that are currently in practice as well as sources and types of ESG information used in the investment product. These Standards are universal in that they can be applied to all types of investment vehicles, all asset classes, all ESG approaches, and in all markets. In June 2022, CFA Institute issued a technical handbook to accompany the Standards. The Handbook[4] provides explanation and interpretation of the provisions in the Standards as well as additional sample disclosures.

The ESG Disclosure Standards were developed through a transparent, collaborative, and rigorous standard setting process. This three-year process included working with volunteer investment professionals who have deep knowledge and expertise in designing, marketing, and evaluating funds that incorporate ESG considerations; analysis and incorporation of over 160 comment letters; consultation with over 25 associations, regulators, and industry associations; and research of over 125 ESG-related codes, standards, regulations, frameworks, and due diligence questionnaires. Again, we encourage the Commission's reference to and use of the concepts offered in these best practice standards.

Fund Categories

Integration Funds

[3] See https://www.cfainstitute.org/-/media/documents/ESG-standards/Global-ESG-Disclosure-Standards-for-Investment-Products.pdf

[4] See Global-ESG-Disclosure-Standards-for-Investment-Products-Handbook.pdf (cfainstitute.org)

CFA Institute

1401 New York Ave. NW
Suite 330
Washington, DC
20005-2269 USA

+1 (202) 908 4520 tel
+1 (202) 908 4538 fax
info@cfainstitute.org
www.cfainstitute.org

The Proposed Rules define an Integration Fund as "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."

We do not believe this category is needed because we do not believe that Integration Funds should be required to make enhanced ESG disclosures. In our view, it would be appropriate to limit enhanced ESG disclosure requirements to ESG-Focused Funds and not create any new disclosure requirements for Integration Funds.

Under the proposed definition, most actively-managed funds with a fundamental analysis strategy would be categorized as an Integration Fund. Arguably, these funds and their managers have long included ESG factors as part of their investment process. For example, corporate governance considerations have been considered by fundamental active managers for decades.

Integration Funds consider ESG factors alongside many other factors within a mosaic of information. Current regulation does not require disclosure about any specific factors that are considered in a fund's investment decisions, and we believe ESG factors should be treated no differently in the context of an Integration Fund. Singling out ESG factors for enhanced disclosures would give investors the impression that ESG factors in an Integration Fund are more important than they typically are, and new disclosures may lead investors to believe there has been a change in the strategy when in fact no change has taken place.

We believe the risk of an investor being misled about a fund's consideration of ESG factors is low for an Integration Fund provided the fund does not indicate, through its name, advertisements, sales literature, or regulatory disclosures, that ESG factors are a significant or main consideration in its investment decisions. Investors are becoming increasingly aware of ESG risks, and many investors are interested in how funds are considering and managing these risks. Most funds have already responded to this need by discussing their consideration of ESG factors in their marketing materials and/or regulatory disclosures. We believe this is appropriate and that funds should continue to be allowed to discuss their consideration of ESG factors in an accurate and proportionate manner. If, however, a fund indicates, through its name, advertisements, sales literature, or regulatory disclosures, that ESG factors are a significant or main consideration in its investment decisions, then we believe the fund should be categorized as an ESG-Focused Fund and be subject to enhanced ESG disclosure requirements.

ESG-Focused Funds

The Proposed Rules define an ESG-Focused Fund as "a Fund that focuses on one or more ESG factors by using them as a significant or main consideration (1) in selecting investments or (2) in its engagement strategy with the companies in which it invests. An ESG-Focused Fund includes (i) any fund that has a name including terms indicating that the Fund's investment decisions incorporate one or more ESG factors; and (ii) any Fund whose advertisements, as defined

CFA Institute

1401 New York Ave. NW
Suite 330
Washington, DC
20005-2269 USA

+1 (202) 908 4520 tel
+1 (202) 908 4538 fax
info@cfainstitute.org
www.cfainstitute.org

pursuant to rule 482 under the Securities Act of 1933 [17 CFR 230.482], or sales literature, as defined pursuant to rule 34b-1 under the Investment Company Act of 1940 [17 CFR 270.34b-1], indicate that the Fund's investment decisions incorporate one or more ESG factors by using them as a significant or main consideration in selecting investments."

We agree that any fund whose name, advertisements, or sales literature indicate that ESG factors are a main or significant consideration in its investment decisions should be categorized as an ESG-Focused Fund. It is these funds for which the risk of greenwashing is most acute. We offer several suggestions to improve this definition so that there is greater consistency across funds.

We recommend modifying the definition of ESG-Focused Fund so that the determination is based solely on how the fund is marketed. To determine the significance of ESG factors on investment decisions or engagement would require some sort of attribution analysis, and the tools to perform an accurate analysis do not yet exist. Also, , it would require definitive criteria as to what constitutes a significant or main consideration. The Proposed Rules contemplate this problem and propose that "funds that apply an inclusionary or exclusionary screen would be considered an ESG-Focused Fund regardless of how extensive or narrow the screen is," while asking, "should we prescribe how extensive an inclusionary or exclusionary screen must be in order for a fund applying the screen to be an ESG-Focused Fund under our proposed amendments?" We will work through this question to show the difficulties of attempting to establish definitive criteria.

We believe that the use of inclusionary or exclusionary ESG screening criteria alone is too blunt of a test to determine whether a fund is an ESG-Focused Fund and that this "bright line" test is inconsistent with the concept of significance embedded in the proposed definition of ESG-Focused Funds. The following examples highlight the problem of categorizing a fund as an ESG-Focused Fund without considering the extent of the screening criteria's effect. First, consider a fund that has an investment policy that prohibits equity investments in companies with a dual-class share structure based on the belief that this structure does not sufficiently protect the rights of the fund's investors. Under the Proposed Rules, this fund, assuming it does not hold itself out as an ESG-Focused Fund, would still be categorized as an ESG-Focused Fund.

Second, consider a fund that has an objective to track an index while excluding companies that produce certain types of products. Assume the criteria are chosen such that very few companies are excluded. This fund would be categorized as an ESG-Focused Fund, and it may even hold itself out as an ESG-Focused Fund. However, it would have a portfolio that is virtually identical to a fund that tracks the same broader index (e.g., the S&P 500), that has no exclusions, and that would not be categorized as an ESG-Focused Fund. These examples do not pose a problem with respect to disclosures. Investors would be provided with information about ESG screening criteria that would likely inform their fund selection decision. The difficulty is that the marketplace would adopt the definition of ESG-Focused Funds and use it as a categorization tool but, as shown in the examples above, the categorization may not reflect the typical investor's expectations about the nature of an ESG-Focused Fund. That is, the typical investor will not realize that the categorization proposed by the SEC was only intended to drive an enhanced set of disclosures.

On the other hand, we believe it would be difficult to prescribe how extensive an inclusionary or exclusionary ESG screen must be for a fund to be categorized as an ESG-Focused Fund. The extent of inclusion or exclusion is somewhat subjective, and it is difficult to justify choosing one particular point on the spectrum that triggers enhanced ESG disclosures. Furthermore, there are difficulties in measuring the extent of exclusion or inclusion. One challenge is that many funds do not have well-defined investment universes. Another difficulty is deciding whether the extent of ESG inclusion or exclusion would be measured before or after the application of other non-ESG screening criteria.

We believe that the best way to distinguish an ESG-Focused Fund is to base the determination solely on whether the fund holds itself out as an ESG-Focused Fund. This approach is objective and can be applied consistently. This change can be easily accomplished in the Proposed Rules by deleting the first part of the definition that reads, "a Fund that focuses on one or more ESG factors by using them as a significant or main consideration (1) in selecting investments or (2) in its engagement strategy with the companies in which it invests," and retaining the latter elements that address the fund's name and marketing materials.

We generally agree with the second part of the definition that reads, "(i) any fund that has a name including terms indicating that the Fund's investment decisions incorporate one or more ESG factors; and (ii) any Fund whose advertisements, as defined pursuant to rule 482 under the Securities Act of 1933 [17 CFR 230.482], or sales literature, as defined pursuant to rule 34b-1 under the Investment Company Act of 1940 [17 CFR 270.34b-1], indicate that the Fund's investment decisions incorporate one or more ESG factors by using them as a significant or main consideration in selecting investments." We offer several recommendations for improving this part of the definition.

First, we believe it would be difficult, in some cases, to determine if a term used in a fund's name indicates that the fund's investment decisions incorporate one or more ESG factors. For example, consider the XYZ Renewable Energy Fund that invests solely in companies that manufacture, install, and operate renewable power equipment. It is not clear from the name alone whether this fund incorporates ESG factors as a main consideration or it is simply focused on a specific sub-industry (in this case, Renewable Electricity, GICS Code 5510502). To overcome this problem, we recommend modifying the definition such that the determination is not made solely on the term in the name but also considers how the fund defines the term. This recommendation assumes that the changes to the Names Rule are enacted as proposed and a fund will be required to include, in its prospectus, "definitions of the terms used in its name." With this change, the XYZ Renewable Energy Fund would have the opportunity to explain that its use of the term "Renewable Energy" is to communicate that it is focused on a particular industry and, assuming its marketing materials do not indicate that ESG factors are significant consideration in investment decisions, would avoid being automatically classified as an ESG-Focused Fund.

Second, we recommend replacing "selecting investments" with "investment decisions" or "investment process" so that the definition does not apply only to investment selection and instead captures the entire investment management process, including proxy voting and engagement. For example, the rule might read as follows, "(ii) any Fund whose advertisements, as defined pursuant to rule 482 under the Securities Act of 1933 [17 CFR 230.482], or sales literature, as defined pursuant to rule 34b-1 under the Investment Company Act of 1940 [17 CFR 270.34b-1], indicate *that ESG factors are a significant or main consideration in investment decisions*."

As a final matter in this section, we raise two questions for the Commission's consideration.

First, could a fund's investors be harmed if a fund does not indicate in its name, advertisements, or sales literature that ESG factors are a significant or main consideration in investment decisions when ESG factors are a significant or main consideration? If we assume the fund is pursuing its stated objectives and is following its policies and procedures, we do not believe this poses any harm to the fund's investors. There are many types of factors that might be a significant or main consideration in investment decisions. Funds do not currently disclose a full list of such factors, and this does not seem to pose any difficulties. Thus, we reiterate our view that a fund that does not hold itself out as an ESG-Focused Fund, even if ESG factors are a significant or main consideration in its investment decisions, should not be subject to additional disclosures.

Second, would basing the determination of an ESG-Focused Fund solely on its name, advertisements, and sales literature, and not on the significance of the ESG factors in selecting investments or the engagement strategy, enable greenwashing? We think it does not, based on our definition of greenwashing. Some individuals, however, use the term "greenwashing" when a fund does not meet their personal expectations for what an ESG/responsible/sustainable fund should do or look like—even if the fund has clearly disclosed its ESG objectives and policies and is following them. These critics may argue that the definition for an ESG-Focused Fund must ensure that funds in that category meet a minimum standard. The problem, however, is finding a standard that investors, asset owners, and regulators can agree on. We believe a more practical approach is to 1) allow funds to decide if, how, and to what extent ESG factors are incorporated in investment decisions, 2) allow funds to decide if they will make the incorporation of ESG factors a significant element in the marketing of the fund, 3) trigger enhanced ESG disclosures when a fund's name, advertisements, or sales literature indicate ESG factors are a significant or main consideration, and then 4) allow investors decide in which funds they wish to invest.

Impact Funds

The Proposed Rules define an Impact Fund as "an ESG-Focused Fund that seeks to achieve a specific ESG impact or impacts." We agree that an Impact Fund should disclose the same information as an ESG-Focused Fund as well as additional information related to its impact objectives. Thus, it is appropriate to define Impact Funds such that these disclosure requirements are triggered.

CFA Institute

1401 New York Ave. NW
Suite 330
Washington, DC
20005-2269 USA

+1 (202) 908 4520 tel
+1 (202) 908 4538 fax
info@cfainstitute.org
www.cfainstitute.org

Risks of Categorization

Even if the proposed categories are intended to serve only as a mechanism to trigger different disclosure requirements, we believe they will be used more broadly in the marketplace in the same way that Articles 6, 8, and 9 were intended to trigger different disclosure requirements but became a broader classification framework in the EU market. Outside the context of the Proposed Rules, the proposed definitions could lead to additional confusion in the marketplace. For example, the term Integration Fund could be easily confused with the term ESG Integration, which is currently understood as one ESG approach that may be combined with other ESG approaches, such as screening, in an overall investment strategy.[5] We can imagine a fund manager trying to explain that they employ ESG Integration within an ESG-Focused Fund but that the fund itself is not an Integration Fund. Similarly, the term Impact Fund could easily be confused with Impact Investments, which is defined by the Global Impact Investing Network (GIIN) as "investments made with the intention to generate positive, measurable social and environmental impact alongside a financial return."[6] There are several aspects of the GIIN definition that are not included in the proposed definition of an Impact Fund, and we believe this would invite debate as to whether these aspects are necessary for impact investing. Additionally, the marketplace generally views ESG-Focused Funds and Impact Funds as distinct types of funds. Thus, the SEC may create additional confusion by characterizing Impact Funds as a subset of ESG-Focused Funds.

To avoid the risks described above, we urge the Commission to consider not using meaningful category names or avoiding naming conventions altogether. It is possible, for example, to refer to different types of funds as "Type 1, Type 2, and Type 3." This approach might still result in the classifications being used broadly in the market but at least it would avoid potential confusion with existing terms and definitions. Alternatively, it is possible to avoid naming conventions altogether by simply referring to a rule number—e.g., "If the Fund meets all the criteria listed under [cite rule number], disclose…"

Fund Disclosures

Integration Funds

<u>Form N-1A, Item 4. Risk/Return Summary: Investments, Risks, and Performance, (a) Principal Investment Strategies of the Fund</u>

The Proposed Rules require an Integration Fund to "summarize in a few sentences how the Fund incorporates ESG factors into the investment selection process, including what ESG factors the

[5] "ESG integration: The process of including ESG factors in investment analysis and decisions to better manage risks and improve returns. It is often used in combination with screening and thematic investing." —PRI, "Reporting Framework Glossary," 2021.
[6] See https://thegiin.org/

CFA Institute

1401 New York Ave. NW
Suite 330
Washington, DC
20005-2269 USA

+1 (202) 908 4520 tel
+1 (202) 908 4538 fax
info@cfainstitute.org
www.cfainstitute.org

Fund considers." As stated previously, we recommend excluding Integration Funds from the Proposed Rules. However, if our recommendation is not accepted, we agree that an Integration Fund should be required to summarize in a few sentences how the Fund incorporates ESG factors into the investment process but should not be required to disclose a listing of ESG factors the Fund considers. We believe that it is not feasible to require an Integration Fund to disclose a full and complete list of all the particular ESG factors that it considers. The core philosophy behind ESG Integration is to identify, research, and analyze the particular ESG factors that are material to an investment decision, and it is impossible to state precisely what those factors will be for all investment decisions. In addition, such factors are likely to vary by industry and asset class, as well as over time.

<u>Form N1-A, Item 9. Investment Objectives, Principal Investment Strategies, Related Risks, and Disclosure of Portfolio Holdings, (b) Implementation of Investment Objectives</u>

The Proposed Rules require an Integration Fund to "describe how the Fund incorporates ESG factors into its investment selection process, including: (a) The ESG factors that the Fund considers, and (b) If the Fund considers the GHG emissions of its portfolio holdings as an ESG factor in its investment selection process, describe how the Fund considers the GHG emissions of its portfolio holdings, including a description of the methodology the Fund uses for this purpose." We do not believe that Integration Funds should be required to make detailed-level disclosures about how the Fund incorporates ESG factors into its investment selection process and the ESG factors that the Fund considers because the emphasis of ESG factors over other factors could mislead investors about the significance of ESG factors. Furthermore, in our view, it is not appropriate to require Integration Funds to make specific disclosures about GHG emissions because if an Integration Fund considers GHG emissions, such consideration is by definition not more significant than other factors and the resulting disclosures would place too much emphasis on GHG emissions, which may mislead investors to believe that ESG factors play a bigger role in the fund than they do.

ESG-Focused Funds

To best meet the goal of providing improved information to help investors make more informed choices regarding ESG investing and better compare funds, we believe that a more helpful approach would be to require all ESG-related disclosures to be made in one location, e.g., within an ESG-specific document. While we do not have strong views regarding the particulars for how this is accomplished, we do believe that it would be more efficient for funds, and easier for investors to understand, if enhanced ESG disclosures were made in one location. However, if this recommendation is not accepted, we offer our ideas below about how to improve the proposed disclosure requirements if they are integrated into existing items in Form N-1A.

<u>Form N-1A, Item 4. Risk/Return Summary: Investments, Risks, and Performance, (a) Principal Investment Strategies of the Fund</u>

CFA Institute

1401 New York Ave. NW
Suite 330
Washington, DC
20005-2269 USA

+1 (202) 908 4520 tel
+1 (202) 908 4538 fax
info@cfainstitute.org
www.cfainstitute.org

Tabular Format

The Proposed Rules require ESG-Focused Funds to disclose an overview of the Fund's ESG Strategy, how the Fund incorporates ESG factors in its investment decisions, and how the Fund votes proxies and/or engages with companies about ESG issues in a tabular format.

The tabular format proposed by the Commission would generally aid investors' comprehension of the Fund's ESG strategy. However, presenting the ESG strategy in a table may overemphasize the ESG-related elements of the Fund's principal investment strategies and de-emphasize other principal investment strategies that are described in narrative form. We should not assume that ESG-related elements are always more important than other elements of principal investment strategies (e.g., earnings estimates) or always deserve more attention. By definition, all "principal" investment strategies are important.

Overview of the Fund's ESG Strategy

Instruction 4 under Item 4(a)(2)(ii)(B) requires an ESG-Focused Fund to "provide a concise description in a few sentences of the ESG factor or factors that are the focus of the Fund's strategy." We agree that it is appropriate to require an ESG-Focused Fund to disclose this information.

Moreover, Instruction 4 requires an ESG-Focused Fund to present a list of "common ESG strategies in a 'check the box' style and indicate with a check mark or other feature all that apply." We believe it is appropriate for an ESG-Focused Fund to disclose a summary of the ESG strategies that it employs, but struggle with a checkbox format. To achieve consistency across funds and be useful to investors, we encourage the Commission to better define each of the checkbox items. To be sure, previous efforts to clearly and concisely define ESG strategies, by CFA Institute and others, have proven difficult. A simpler and more evergreen approach would be to require a summary description of the ESG strategies employed and to provide guidance that promotes consistency across funds. The guidance could provide recommendations for describing ESG strategies and identify terms that should be used or avoided. We offer additional suggestions for a checkbox approach in Appendix A.

How the Fund Incorporates ESG Factors in its Investment Decisions

In our view, the instructions for how the Fund incorporates ESG factors in its investment decisions (Instructions 5-7) will result in lengthy disclosures, rather than the brief disclosures that the Commission seeks. We recommend integrating Instructions 5-7 with Instruction 2 for Item 9(b)(2) because Instructions 5-7 seek a level of detail that is more appropriately presented under Item 9(b)(2). This should be straightforward because there is significant overlap in the disclosure requirements embedded in these two sets of instructions. We recommend replacing Instructions 5-7 with a single instruction that is consistent with the level of detail sought by Instructions 4 and 8. In other words, we recommend simply requiring funds to provide a concise description of how the fund incorporates ESG factors in its investment decisions.

1401 New York Ave. NW
Suite 330
Washington, DC
20005-2269 USA

+1 (202) 908 4520 tel
+1 (202) 908 4538 fax
info@cfainstitute.org
www.cfainstitute.org

How the Fund votes proxies and/or engages with companies about ESG issues

Instruction 8 under Item 4(a)(2)(ii)(B) requires an ESG-Focused Fund to 1) describe briefly how the Fund engages or expects to engage with issuers on ESG issues (whether by voting proxies or otherwise), 2) state whether it has specific or supplemental policies and procedures that include one or more ESG considerations in voting proxies and, if so, state which considerations, 3) if the Fund seeks to engage other than through shareholder voting, such as through meetings with or advocacy to management, the Fund must provide an overview of the objectives it seeks to achieve with the engagement strategy, and 4) if the Fund does not engage or expect to engage with issuers on ESG issues (whether by voting proxies or otherwise), the Fund must provide that disclosure. We believe it is appropriate to require an ESG-Focused Fund to disclose this information.

<u>Form N-1A, Item 9. Investment Objectives, Principal Investment Strategies, Related Risks, and Disclosure of Portfolio Holdings, (b) Implementation of Investment Objectives</u>

Indexes

Currently, Item 9(b)(2) of Form N-1A requires a fund to "explain in general terms how the Fund's adviser decides which securities to buy and sell." The Proposed Rules add an instruction to Item 9(b)(2) that requires ESG-Focused Funds to "describe how the Fund incorporates ESG factors into its investment process, including: (a) The index methodology for any index the fund tracks, including any criteria or methodologies for selecting or excluding components of the index that are based on ESG factors."

We believe that it is appropriate to require an ESG-Focused Fund that tracks an ESG index to disclose the significant ESG characteristics of the index. However, instruction 2(a) for Item 9(b)(2) could be construed to mean a fund must disclose the index methodology in its entirety. Such a disclosure would not be feasible or practical for funds to make and would not be easily comprehended by investors. We believe Instruction 5(c) for Item 4(a)(2)(ii)(B) of Form N-1A specifies the appropriate level of detail, and we recommend using this instruction as the instruction under Item 9(b)(2).

Internal Methodologies

The Proposed Rules add an instruction to Item 9(b)(2) that requires ESG-Focused Funds to "describe how the Fund incorporates ESG factors into its investment process, including: (b) Any internal methodology used and how that methodology incorporates ESG factors." We do not support requiring funds to disclose the detailed workings of their proprietary internal methodologies; rather they should disclose an overview of how the fund uses an internal methodology, as is required by Instruction 5(b) under Item 4(a)(2)(ii)(B). This is a reasonable level of detail for funds to disclose and would provide the appropriate level of detail to enable

CFA Institute

1401 New York Ave. NW
Suite 330
Washington, DC
20005-2269 USA

+1 (202) 908 4520 tel
+1 (202) 908 4538 fax
info@cfainstitute.org
www.cfainstitute.org

investors to understand this information. We recommend that the first part of Instruction 5(b) under Item 4(a)(2)(ii)(B) be moved under Item 9(b)(2) and replace Instruction 2(b).

We also recommend that in the Adopting Release, the Commission include guidance about the appropriate level of detail expected in an overview, and to provide this guidance for the different types of internal methodologies that are commonly used. Consider, for example, a fund that uses an internal scoring system. The Commission might provide guidance that explains that, an overview of an internal scoring system is expected to describe the inputs and outputs of the scoring systems as well as how the scores are used in investment decisions. Consider another example in which a fund systematically considers what it deems to be financially material ESG factors in its financial analysis. We encourage the Commission to provide guidance that explains that an overview of this internal methodology must include how financial materiality is determined and how the fund incorporates financially material ESG factors into its financial analysis.

Third-Party Rating Systems

The Proposed Rules add an instruction to Item 9(b)(2) that requires ESG-Focused Funds to "describe how the Fund incorporates ESG factors into its investment process, including: (c) The scoring or ratings system of any third-party data provider, such as a scoring or ratings provider, used by the Fund or other third-party provider of ESG-related data about companies, including how the Fund evaluates the quality of such data." The details of third-party scoring or ratings system are invariably proprietary. It would be appropriate to require an ESG-Focused Fund to disclose an overview of a third-party scoring or rating system, as is required by Instruction 5(b) under Item 4(a)(2)(ii)(B). An overview would include information that is publicly disclosed by the third party. We recommend that the second part of Instruction 5(b) under Item 4(a)(2)(ii)(B) be moved under Item 9(b)(2) and replace Instruction 2(c).

We believe it is appropriate to require an ESG-Focused Fund to include information about how the Fund evaluates the quality of third-party ESG data, scores, and ratings. We recognize that there are inherent risks in using third-party ESG data, scores, and ratings because they are not as standardized, reliable, or consistently available as other types or data, scores, and ratings – e.g., financial statement data, market data, and credit ratings. However, we do not believe these risks are so great as to be characterized as principal investment risks and disclosed under Item 9(c).

ESG Screening Criteria

The Proposed Rules add an instruction to Item 9(b)(2) that requires ESG-Focused Funds to "describe how the Fund incorporates ESG factors into its investment process, including: (d) The factors applied by any inclusionary or exclusionary screen, including any quantitative thresholds or qualitative factors used to determine a company's industry classification or whether a company is engaged in a particular activity." We believe it is appropriate for an ESG-Focused Fund to disclose this information.

1401 New York Ave. NW
Suite 330
Washington, DC
20005-2269 USA

+1 (202) 908 4520 tel
+1 (202) 908 4538 fax
info@cfainstitute.org
www.cfainstitute.org

It is important, however, to make a distinction between discretionary and non-discretionary screening criteria. Discretionary criteria are criteria that are used to help identify investment opportunities but are not required to be met to make an investment. For example, consider a fund that has 30 screening criteria and typically only investments that meet at least 20 of the 30 screening criteria are prioritized for due diligence, but this fund has no rule preventing an investment that meets less than 20 of the criteria, and no single criterion is a "deal breaker." In our opinion, it would be more accurate to characterize this sort of discretionary criteria as part of "fundamental research" rather than "screening." This distinction is important because discretionary criteria are proprietary, and funds should not be required to disclose the proprietary elements of their investment process. Also, disclosure of criteria that *may* be applied is not helpful to investors. On the other hand, it is very helpful for investors to understand, and feasible for fund advisers to disclose, non-discretionary screening criteria because non-discretionary screening criteria are part of the fund's design.

To reinforce an earlier comment, we believe Instruction 5(a) under Item 4(a)(2)(ii)(B) should be moved under Item 9(b)(2). Instruction 5(a) requires an ESG-Focused Fund to "If applicable, state what exceptions apply to the inclusionary or exclusionary screen. In addition, state the percentage of the portfolio, in terms of net asset value, to which the screen is applied, if less than 100%, excluding cash and cash equivalents held for cash management, and explain briefly why the screen applies to less than 100% of the portfolio." We believe it is appropriate, and helpful to investors, to require an ESG-Focused Fund to state what exceptions apply to a screen, but it may not be feasible or practical in all cases for a fund to state the extent of exception in terms of percentages of a portfolio. For example, consider a fund that invests in equity and fixed income and that applies ESG screening criteria only to equity investments. If the relative proportion of assets in each asset class varies significantly, it would not be meaningful to state the exclusion as a percentage of the portfolio.

In addition, Instruction 5(a) under Item 4(a)(2)(ii)(B) states that "Information must be provided with respect to each applicable common ESG strategy (e.g., inclusionary and exclusionary screens) in a disaggregated manner if more than one applies." We agree that it would be helpful to investors if information about each ESG strategy employed by a fund was presented in a disaggregated manner.

Third-Party ESG Frameworks

The Proposed Rules add an instruction to Item 9(b)(2) that requires ESG-Focused Funds to "describe how the Fund incorporates ESG factors into its investment process, including: (e) A description of any third-party ESG frameworks that the Fund follows as part of its investment process and how the framework applies to the Fund." We generally agree with this requirement but recommend changing the word "follows" to "uses." Funds do not always "follow" such frameworks. For example, funds typically do not "follow" the principles of the UN Global Compact; they typically use companies' adherence to principles of the UN Global Compact as screening criteria. We recommend that Instruction 6 under Item 4(a)(2)(ii)(B) be moved under Item 9(b)(2) and combined with Instruction 2(e).

1401 New York Ave. NW
Suite 330
Washington, DC
20005-2269 USA

+1 (202) 908 4520 tel
+1 (202) 908 4538 fax
info@cfainstitute.org
www.cfainstitute.org

Engagement

The Proposed Rules add an instruction to Item 9(b)(2) that requires ESG-Focused Funds to "describe how the Fund incorporates ESG factors into its investment process, including: (f) With regard to engagement, whether by voting proxies or otherwise, a description of specific objectives of such engagement, including the Fund's time horizon for progressing on such objectives and any key performance indicators that the Fund uses to analyze or measure of the effectiveness of such engagement." We believe it is appropriate to require an ESG-Focused Fund to disclose this information. Instruction 8 under Item 4(a)(2)(ii)(B) requires an overview of the objectives the Fund seeks to achieve with its engagement strategy *only if the Fund seeks to engage other than through shareholder voting, such as through meetings with or advocacy to management*. For clarity and consistency, we recommend that Instruction 2(f) have the same conditional clause.

Additional Instructions for Portfolio-Level Targets and Constraints

It is common for funds to have one or more portfolio-level targets or constraints that are related to ESG considerations (e.g., a 20% minimum allocation to green bonds, a 10% maximum allocation to fossil fuels, a weighted-average carbon intensity that is 50% less than the Fund's benchmark). We believe that it is appropriate to require an ESG-Focused Fund to disclose key information about portfolio-level targets or constraints and that specific instructions related to this ESG strategy would promote transparency and comparison. If an ESG-Focused Fund has a target to allocate a certain percentage of the fund's assets to investments with predetermined ESG characteristics, we recommend that it be required to disclose a) the specific ESG characteristics of the investments for which there is an allocation target; and b) the allocation target value or range. If an ESG-Focused Fund has a target for one or more aggregate ESG characteristics, we recommend it be required to disclose a) the ESG characteristic(s) that is evaluated; b) how the ESG characteristic(s) is measured; c) the target value or range for the ESG characteristic(s); d) how the target ESG characteristic(s) is expected to be attained; and, e) the risks that could significantly hinder the attainment of the target ESG characteristic(s).

<u>Form N-1A, Item 27. Financial Statements, (b) Annual Report</u>

The Proposed Rules require ESG-Focused Funds for which proxy voting is a significant means of implementing their ESG strategy to disclose in the annual report the percentage of ESG voting matters during the period for which the fund voted in furtherance of the initiative. We agree that if a fund uses proxy voting as a significant means of implementing its ESG strategy that it is appropriate to require the fund to disclose information about its voting record. We believe, however, that the proposed metric—i.e., the percentage of ESG voting matters during the reporting period for which the Fund voted in furtherance of the initiative—will likely not be as useful or comparable as some might imagine because the percentage of ESG voting matters supported is a blunt measure that does not reflect the variety of considerations that go into proxy votes. As a result, we do not support this metric.

CFA Institute

1401 New York Ave. NW
Suite 330
Washington, DC
20005-2269 USA

+1 (202) 908 4520 tel
+1 (202) 908 4538 fax
info@cfainstitute.org
www.cfainstitute.org

The Proposed Rules require ESG-Focused Funds that use ESG engagement as a significant means of implementing its ESG strategy to disclose in the annual report the fund's progress on key performance indicators. If an ESG-Focused Fund uses ESG engagement as a significant means of implementing its ESG strategy, we agree that it is appropriate to require the fund to disclose information about the fund's progress on any key performance indicators. However, we do not agree that ESG-Focused Funds should be required to report specifically on the number or percentage of issuers with which the Fund held ESG engagement meetings and total number of ESG engagement meetings. This is not an informative metric and it is susceptible to significant manipulation.

The Proposed Rules would require ESG-Focused Funds that consider environmental factors, except for those funds that affirmatively state in the "ESG Strategy Overview" table that they do not consider the greenhouse gases ("GHG") emissions of the portfolio companies in which they invest, to disclose the Carbon Footprint and Weighted Average Carbon Intensity of the portfolio. We appreciate that some investors wish to have standardized GHG information that can be compared across funds, but we believe the current quality of data that is available for GHG calculations will not allow for accurate, meaningful metrics, and could potentially cause more harm than good. Until global, high-quality reporting standards on GHG are in place for both public and private companies in the fund portfolio, it is difficult to expect funds to accurately model and report such information.

Instead of specifying particular topics and metrics, such as percentage of voting matters supported, number or percentage of engagements, and aggregate GHG metrics, we recommend taking a broader approach. Specifically, we recommend requiring ESG-Focused Funds to discuss in their annual reports (or within the separate ESG-specific document) progress toward, or attainment of, any ESG-related objectives, goals, and/or targets disclosed within the principal investment strategies of the fund, including any supporting key performance indicators and other metrics.

Impact Funds

Form N-1A, Item 2. Risk/Return Summary: Investment Objectives/Goals

The Proposed Rules add an instruction to Item 2 that requires an Impact Fund to disclose "the ESG impact that the Fund seeks to generate with its investments." We agree that it is appropriate to require an Impact Fund to disclose the ESG impact that it seeks to generate with its investments, and also agree that this disclosure should be made as part of Item 2 alongside the Fund's investment objectives or goals.

Form N-1A, Item 4. Risk/Return Summary: Investments, Risks, and Performance, (a) Principal Investment Strategies of the Fund

Instruction 7 under Item 4(a)(2)(ii)(B) would requires an Impact Fund to disclose "an overview of the impact(s) the Fund is seeking to achieve and how the Fund is seeking to achieve the impact(s). The overview must include (i) how the Fund measures progress toward the specific impact, including the key performance indicators the Fund analyzes, (ii) the time horizon the Fund uses to analyze progress, and (iii) the relationship between the impact the Fund is seeking to achieve and financial return(s). State that the Fund reports annually on its progress in achieving the impact(s) in the Fund's annual report to shareholders." We agree it is appropriate for an Impact Fund to disclose this information.

We recommend that the Commission add a new instruction under Item 4(a)(2)(ii)(B) for an Impact Fund to disclose an overview of how it expects to attain its environmental and/or social objectives through its investment decisions. A fund's overview would briefly discuss how it plans to allocate its capital in pursuit of its impact objective. For example, the overview could be:

> The Fund seeks to invest its capital in enterprises that provide sustainable solutions for forestry products, soft commodity production, and smallholder agricultural practices. As a supplier of capital to companies that may be otherwise unable to obtain funding, the Fund contributes to the mitigation of biodiversity loss in South America.

Furthermore, we recommend Instruction 8 under Item 4(a)(2)(ii)(B) be modified to require an Impact Fund to disclose an overview of how it expects to attain its environmental and/or social objectives through its engagement strategy. A fund's overview would briefly discuss how it plans to use proxy voting or other engagement activities to achieve its impact objective. A sample disclosure here may be:

> We vote our proxies and undertake engagement efforts for all portfolio companies. Proxy voting may support either the Fund's financial objective or its impact objective. When we vote in support of the Fund's impact objective, we prioritize certain environmental and social issues, including issues relating to climate change mitigation efforts, transparency in reporting of environmental and social metrics, and linking executive pay to certain ESG metrics.

Form N-1A, Item 9. Investment Objectives, Principal Investment Strategies, Related Risks, and Disclosure of Portfolio Holdings, (b) Implementation of Investment Objectives

We recommend adding a requirement for an Impact Fund to disclose a detailed description of how it expects to attain its environmental and/or social objectives through its investment decisions and its engagement strategy. This description should include the proportion of the portfolio committed to attaining the environmental or social objectives; the risks that could significantly hinder the attainment of the impact objectives, should they occur; and the process for assessing, addressing, monitoring, and managing potential negative social and environmental impacts that may occur in the course of attaining the Fund's objectives. For example, a disclosure here could be:

> At least 80% of the Fund's assets will be invested in opportunities that are expected to allow the Fund to attain its objectives to (1) achieve an equity market rate of return over a long-

term investment horizon, and (2) actively engage with portfolio companies to encourage them to reduce their greenhouse gas (GHG) emissions to levels consistent with a 1.5 degree Celsius warming limit, by 2030, in alignment with targets set by the Paris Agreement.

The Fund's Sustainability Team monitors investee's impacts on biodiversity, water, waste, and human rights to ensure GHG emissions targets are not attained through a negative impact on other key ESG issues. There is a risk that a company in which the Fund invests subsequently generates an adverse social or environmental impact or event. In these instances, the Fund's Sustainability Team, in conjunction with the Fund's portfolio managers, determines whether to sell the security or whether to engage with the company in an attempt to mitigate the adverse consequences.

There is a risk that our engagement efforts will not achieve the engagement goals set for a company. A company may choose not to respond to our engagement efforts, or the company may experience a change in economic circumstances or a change in management that affects its ability or willingness to address GHG emissions reductions. In addition, there is a risk that we made an error in our emissions target and that the GHG emissions goal for a company or companies is not feasible.

Form N-1A, Item 27. Financial Statements, (b) Annual Report

The Proposed Rules require an Impact Fund to summarize briefly the Fund's progress on achieving the impacts described in response to Instruction 7 of Item 4(a)(2) in both qualitative and quantitative terms during the reporting period, and the key factors that materially affected the Fund's ability to achieve the impact(s)." We agree it is appropriate to require an Impact Fund to report this information in its annual report.

Adviser Disclosures

Form ADV Item 8

The Proposed Rules would require an adviser to provide a description of the ESG factor or factors it considers for each significant investment strategy or method of analysis for which the adviser considers any ESG factors in Item 8 of Form ADV. This would require an explanation of whether and how the adviser incorporates a particular ESG factor, and/or a combination of factors.

We agree that it is useful to distinguish between different types of strategies that consider ESG factors for the purpose of determining the scope of enhanced ESG disclosure requirements. However, similar to our comments with respect to funds, we believe that the Commission should make the distinction between Integration Strategies and ESG-Focused Strategies based on the significance of ESG factors in a strategy's name, advertisements, and sales literature rather than on routine consideration of ESG factors in investment decisions. To us, enhanced ESG

1401 New York Ave. NW
Suite 330
Washington, DC
20005-2269 USA

+1 (202) 908 4520 tel
+1 (202) 908 4538 fax
info@cfainstitute.org
www.cfainstitute.org

disclosure requirements should apply only to those strategies that hold themselves out as having an ESG focus or claim that ESG factors are a significant or main consideration in investment decisions. If the Commission limits enhanced ESG disclosure requirements to ESG-Focused Strategies, then it would more precisely target greenwashing, solve a number of practical difficulties in the Proposed Rules, and be more effective from a cost-benefit standpoint.

As proposed, an adviser that uses an ESG integration strategy would be required to disclose whether and how it considers ESG factors alongside other non-ESG factors for each significant investment strategy. We believe that disclosing this level of detail about ESG integration within a significant investment strategy description would overstate the importance of ESG factors. When an adviser uses only ESG integration, and ESG integration is not a significant or main consideration in investment decisions, disclosure should be limited to the required description of the methods of analysis and should not be included within any significant investment strategy description. If our recommendation to remove Integration Strategies from the scope of the final rule is accepted, we recommend taking this same approach, and limiting voluntary disclosures about the use of ESG integration to the description of the methods of analysis, to ensure that the use of ESG integration is not overemphasized.

We support the Commission's view that an adviser that uses one or more ESG factors as a significant or main consideration and promotes this fact in its name, advertisements, or sales literature should be required to make more detailed disclosures about the use of these ESG factors for its significant investment strategies. However, we believe that the level of detail required in the Commission's proposed rule will result in lengthy, even boilerplate, disclosures that will overemphasize the role of ESG factors relative to other factors. For ESG-Focused Strategies, we recommend instead:

- requiring advisers to summarize, in a few sentences within the investment strategy description in item 8, how the strategy incorporates ESG factors into investment decisions, including which ESG factors the strategy considers. This level of detail would align with the summary description of ESG factors included in Form N-1A, Item 4.

- requiring advisers to prepare an ESG appendix to the brochure, which would include all ESG-Focused Strategies and include the detailed disclosures proposed to be included in Item 8 of Part 2A of Form ADV. Investors who are interested in the details about an adviser's consideration of ESG factors could be alerted to the existence of the additional ESG-related disclosures in the ESG appendix for a specific investment strategy through a reference within the applicable strategy descriptions that refers the reader to the ESG appendix for additional information about the adviser's consideration of ESG factors.

We believe that this approach would be most helpful to investors who are reviewing a variety of strategies, either within a single adviser or across advisers.

The Proposed Rules include a series of disclosures about various ESG considerations that are generally consistent with the proposed disclosure requirements for pooled funds. We have

1401 New York Ave. NW
Suite 330
Washington, DC
20005-2269 USA

+1 (202) 908 4520 tel
+1 (202) 908 4538 fax
info@cfainstitute.org
www.cfainstitute.org

provided detailed comments on these disclosures for pooled funds, and our comments also apply to Form ADV disclosures, where applicable. For example, we have the same concerns about requiring disclosures about third-party scoring systems and index descriptions.

Wrap Fee Brochure

Under the Proposed Rules, wrap fee sponsors that consider ESG factors when selecting, reviewing, or recommending portfolio managers within the wrap fee programs they sponsor, must describe the ESG factors they consider and how they consider them. The Proposed Rules include three disclosures that must be part of this disclosure requirement.

First, we believe that the procedures contemplated by these disclosures presume a detailed level of ongoing oversight of the underlying portfolio managers by the sponsor that is not consistent with current market practice. In our view, the proposed required disclosures are not appropriate because they are not aligned with the type of oversight activities undertaken by most wrap fee sponsors.

Second, we agree that wrap fee clients should receive similar ESG-related information as non-wrap fee clients. While we appreciate that some wrap fee clients may wish to know how a sponsor selects and monitors underlying portfolio managers, clients are most interested in the details of the strategy they are considering and not how the sponsor came to include the portfolio manager as a possible investment option. Therefore, we believe that the information about an ESG strategy that would be most helpful to clients would come from the underlying portfolio manager. In most wrap fee programs, where the wrap fee client selects the underlying portfolio manager, the portfolio manager is also required to provide its Form ADV to the wrap fee client. Because the sponsor has the primary relationship with the wrap fee client, we recommend requiring the sponsor to provide, or cause to be provided, the same information required to be disclosed in Form ADV Item 8 to wrap fee clients. Wrap fee sponsors could obtain this information from the underlying portfolio managers and provide this information directly to wrap fee clients, or sponsors could instead place reliance on the underlying portfolio manager to provide this information. In either case, distributing this information to wrap fee clients should be the responsibility of the wrap fee sponsor.

Finally, we also recommend deleting the three proposed disclosure requirements for wrap fee sponsors because the current required disclosures for oversight and monitoring of underlying portfolio managers suffice.

CONCLUSION

We believe that the options presented in the Commission's proposal on Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices provide thoughtful choices and mechanisms for addressing existing gaps and omissions in the quality of disclosures associated with ESG investment

1401 New York Ave. NW
Suite 330
Washington, DC
20005-2269 USA

+1 (202) 908 4520 tel
+1 (202) 908 4538 fax
info@cfainstitute.org
www.cfainstitute.org

products and services. The proliferation of these products and their susceptibility to zealous sales practices is a substantial concern for investor protection and market integrity. Indeed, the danger of these being mis-sold to a concerned public, worried about climate change, is very real.

CFA Institute appreciates the opportunity to offer our views on these important matters. For questions about this comment letter, please contact [redacted] or [redacted]

Sincerely,

Paul P. Andrews

Paul P. Andrews
Managing Director
Research, Advocacy and Standards
CFA Institute

cc:
Commissioner Gary Gensler
Commissioner Hester Peirce
Commissioner Caroline Crenshaw
Commissioner Mark Uyeda
Commissioner Jaime Lizárraga
SEC Office of the Investor Advocate

APPENDIX A – CHECKLIST OF ESG APPROACHES

Based on our development of the Global ESG Disclosure Standards for Investment Products, we believe that the seven approaches we describe below are a complete set of ESG approaches currently employed by investment advisers. The checklist in the Proposed Rules omits several of these approaches, and we recommend adding them. New ESG approaches may be developed in the future and, therefore, the checklist should contain an "other" checkbox. If the seven ESG approaches described below are included in the checklist, a fund would rarely, if ever, need to use the "other" checkbox, at least at the present time.

With respect to checkbox labelling, we acknowledge the value of brevity but believe that much of the confusion in the marketplace is the result of too much brevity and too much reliance on poorly-defined industry jargon. As a result, we recommend that checkbox labels be sufficiently descriptive, precise, and avoid jargon and terms that investors may not be familiar with or understand. We have applied these principles to our list of ESG approaches below.

- Systematically considers financially material ESG information in investment decisions.
- Tracks an ESG index and/or uses an ESG index as an investment universe.
- Systematically applies ESG criteria to exclude certain investments and/or to determine if an investment is eligible for inclusion in the fund's portfolio.
- Sets allocation targets and/or constraints based on the ESG characteristics of investments.
- Sets targets and/or constraints for fund-level ESG characteristics.
- Considers ESG issues when exercising the rights and position associated with the ownership, management, and oversight of the fund's assets.
- Has an intention to generate positive, measurable social and environmental impact alongside a financial return.

Systematically considers financially material ESG information in investment decisions

The checklist in the Proposed Rules does not contain this ESG approach. Many market participants refer to this approach as "ESG Integration," but we do not believe that is a self-explanatory term, especially for retail investors. Accordingly, we recommend including this ESG approach in the checklist because 1) it is a common ESG approach, and 2) while it is often true that the consideration of material ESG information is generally not more significant than other factors, it is possible that financially material ESG information is a significant or main consideration.

Tracks an ESG index and/or uses an ESG index as an investment universe

The checklist in the Proposed Rules contains a box that is labelled, "Tracks an index." In our view, this description is too narrow and could be interpreted to apply only to index funds. While we agree that passively-managed funds often "import" their ESG characteristics from the indexes that they track, it is also possible for actively-managed funds to "import" ESG characteristics

CFA Institute

1401 New York Ave. NW
Suite 330
Washington, DC
20005-2269 USA

+1 (202) 908 4520 tel
+1 (202) 908 4538 fax
info@cfainstitute.org
www.cfainstitute.org

from indexes that are used as investment universes. Consider an actively-managed fund that uses an ESG index as its investment universe but does not apply any ESG screening criteria. Assume the index methodology applies exclusionary ESG criteria. Because the fund does not technically "track an index" or "apply exclusionary screens," this fund could avoid checking both the index box and the exclusionary screening box. Furthermore, this fund might even argue that it is not an ESG-Focused Fund. The additional language that we propose above would help close this loophole.

Systematically applies ESG criteria to exclude certain investments and/or to determine if an investment is eligible for inclusion in the fund's portfolio

The checklist in the Proposed Rules has a checkbox for "Applies an inclusionary screen" and a checkbox for "Applies an exclusionary screen." There is significant debate about whether an inclusionary screen is any different from an exclusionary screen and, if so, how they differ.

From a purely logical perspective, there is no difference whatsoever between an inclusionary screen and an exclusionary screen. It is always possible to rewrite exclusionary screening criteria as inclusionary screening criteria, and vice versa. The choice to state a criterion as inclusionary or exclusionary is often simply a matter of clarity and convention. For example, it is more direct to say, "the fund excludes violators of the UN Global Compact," than it is to say, "any company that has not violated the UN Global Compact is eligible for investment." We suspect, however, that often the choice to state a criterion as inclusionary or exclusionary is also driven by marketing considerations.

The Commission's definition of inclusionary screens includes, by way of example in its discussion on page 44, relative ESG screening criteria and, in doing so, implies that all relative screening criteria is inclusionary. However, there are occasions when relative screening criteria is exclusionary. For example, some funds exclude issuers in the bottom 20% of the industry or sector.

While not mentioned in the Proposed Rules, there is one other way that some market participants seek to distinguish inclusionary and exclusionary screens—by trying to make a distinction about the type of characteristic that is screened. Some ESG screening criteria are based on the products and services offered by a company; some are based on the presence, absence, or nature of a company's policies; and some are based on the practices, activities, or outcomes of a company's operations. Some will argue that "negative screening," which is often used interchangeably with "exclusionary screening," should only apply to ESG screening criteria that are based on products and services (e.g., tobacco, pornography, oil & gas.) This overly narrow definition is not consistent with the word "negative," which is quite broad in its meaning, and it is inconsistent with industry practice since many funds exclude companies on the basis of policies, practices, and outcomes. A better name for this type of screen would be a "controversial product/services" screen.

CFA Institute

1401 New York Ave. NW
Suite 330
Washington, DC
20005-2269 USA

+1 (202) 908 4520 tel
+1 (202) 908 4538 fax
info@cfainstitute.org
www.cfainstitute.org

Rather than aim to parse the differences between exclusionary screens and inclusionary screens, which are often nuanced and contextual, we believe there would be greater consistency in the use of the checklist if the two screening checkboxes were combined into one.

Sets allocation targets and/or constraints based on the ESG characteristics of investments

The checklist in the Proposed Rules does not contain this ESG approach. We encourage the Commission to include it because it is a common ESG approach. An example of an allocation target may be: The Fund aims to invest at least 25% of the market value of its fixed-income holdings in labeled green bonds and Certified Climate Bonds. An example of an allocation constraint may be: The Fund will not invest more than 10% of its market value in companies that extract fossil fuels.

Sets targets and/or constraints for fund-level ESG characteristics

The checklist in the Proposed Rules does not contain this ESG approach. We believe it should be included however, because it is a common ESG approach. An example of a target for fund-level ESG characteristics may be: The Fund seeks to maintain a weighted average carbon intensity (WACI) target that is at least 50% lower than the WACI of its benchmark.

Considers ESG issues when exercising the rights and position associated with the ownership, management, and oversight of the fund's assets

The checklist in the Proposed Rules has a checkbox for Proxy Voting and a checkbox for Engagement. These two items do not cover the full universe of ownership-related actions in which a fund might engage, though we acknowledge these are by far the two most prevalent. Thus, we recommend combining the two checkboxes and using more generic language for the checkbox label.

Has an intention to generate positive, measurable social and environmental impact alongside a financial return

The Proposed Rules have a checkbox for "Seeks to achieve a specific impact." We believe the wording of the checkbox label should be more consistent with our recommended definition of an Impact Fund.