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STATE OF HAWAI'I
EMPLOYEES' RETIREMENT SYSTEM

August 16, 2022

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

Re: S7-17-22 Environmental, Social, and Governance Disclosures for Investment Advisers and Investment Companies

Aloha nō e Secretary Countryman:

We are writing to you on behalf of the State of Hawai'i Employees' Retirement System (Hawai'i ERS), which manages $22 billion in assets for retirement benefits on behalf of ~140,000 members, or ~10% of the State's population.

Hawai'i ERS supports the intent of the Proposed Rule in providing a consistent regulatory framework for Environmental, Social, and Governance (ESG) disclosures which will facilitate the ability of investors to make meaningful comparisons across investments. We support the disclosure of ESG factors at both the fund and adviser levels because specific qualitative reporting and quantitative metrics play a key role in investment decision-making. This Proposed Rule is within the SEC's mandate to protect investors, to maintain fair, orderly, and efficient markets, and to facilitate capital formation.

Hawai'i ERS has a fiduciary duty to act in the best interests of its retirees, which includes mitigating macroeconomic market risks, and working to maximize the rate of return over the long term. ESG issues have financial impacts on investment returns[1]. The assessment of ESG issues is a key component of fiduciary duty because the incorporation of these issues is now an investment norm, these issues are financially material, and regulatory frameworks across the globe are requiring this incorporation[2]. Companies unprepared for the physical and regulatory risks of climate change face operational challenges, property loss, and fines. Companies with poor human rights and governance practices are vulnerable to lawsuits. The incorporation of ESG factors can not only mitigate risk but can also drive value creation[3] - for example, screening, one type of ESG implementation, can increase the risk-adjusted returns of a portfolio relative to its conventional benchmark[4]. The Inflation Reduction Act of 2022 allocates over $369B to support the mitigation of climate change, creating additional investment

[1] *https://arabesque.com/research/From_the_stockholder_to_the_stakeholder_web.pdf*
[2] *https://www.unpri.org/download?ac=9792.*
[3] *https://www.mckinsey.com/~/media/McKinsey/Business%20Functions/Strategy%20and%20Corporate%20Finance/Our%20Insights/Five%20ways%20that%20ESG%20creates%20value/Five-ways-that-ESG-creates-value.ashx*
[4] *https://www-tandfonline-com.eres.library.manoa.hawaii.edu/doi/pdf/10.1080/10971475.2020.1857063*

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opportunities in this space. Standardized reporting, provided in the same format, located in the same places, and aligned with existing frameworks, will create the transparency needed by investors such as Hawai'i ERS to accurately price ESG-related risks and opportunities, and better diversify portfolios.

In addition, Hawai'i ERS is an attached agency of the State and must act in compliance with State law. Hawai'i law asserts that "the State shall expand strategies and mechanisms to reduce greenhouse gas (GHG) through the reduction of energy use, adoption of renewable energy, and control of air pollution among all agencies…"[5]. Additionally, ERS has the obligation, as a State agency, to consider the impact of investment plans, decisions, and strategies on the State's ability to achieve net-zero emissions by 2045 while maintaining our primary purpose of generating returns for our retirees[6]. Consistent and standard ESG disclosures would allow the ERS to assess the ESG investment risks and opportunities that affect financial returns while also fulfilling this obligation of reviewing and considering GHG impacts.

Comments:

- **Standardization**: We appreciate the SEC's focus on global alignment given our global investment universe, and support building on existing frameworks and aligning with international standards, such as the alignment of GHG metrics with the PCAF (Partnership for Carbon Accounting Financials) Standard, the TCFD (Task Force on Climate-Related Financial Disclosures) and the GHG Protocol.
- **Simplify Categorization**: Hawai'i ERS agrees with the UN PRI that the reporting required under the Integration category should be applied as a baseline to all funds, and that the Integration category itself should be removed, as most funds already consider ESG to some degree. Beyond that, the level of disclosure required should depend on the extent to which a fund considers ESG in its investment process. Hawai'i ERS also supports the UN PRI's suggestion that Impact funds should be renamed Impact-Focused funds, as most funds consider impact to some degree.
- **Prevent Greenwashing**: Requiring funds to provide an example of incorporation of ESG factors or other ESG strategy would be helpful to investor understanding of methodology. There is no need to be prescriptive. Simply, any mention of a framework should include an example of application. ESG-Focused funds (including Impact-Focused funds) should disclose the relationship between the impact the Fund is seeking to achieve and financial returns. Progress should be reported annually with a focus on outputs rather than inputs.
- **Provide Flexibility**: The SEC should provide a high-level definition of key terms and concepts such as ESG, engagement, and greenwashing, along with non-exhaustive lists of examples, but allow funds flexibility in addressing additional ESG factors and strategies. Standardization is needed to reduce subjectivity and increase comparability. Having said that, ESG is a quickly evolving area of the industry, and simple minimum disclosures with built in flexibility for additional detail is key. The SEC will need to revisit this rule as new strategies and metrics are developed.
- **GHG Disclosures**: Hawai'i ERS would prefer for all funds, regardless of whether they are ESG funds, to disclose their GHG emissions. Not all our investments focus on ESG factors, but we are nonetheless interested in measuring GHG emissions across investments due to the State's codified commitments to reduce GHG emissions. Quantitative metrics allow investors to evaluate the effectiveness of a strategy through tracking year-over-year change and allow for meaningful comparison across funds as well as aggregation at a portfolio level.
    - Understanding that funds are developing various GHG metrics, the SEC should allow full flexibility for funds to provide additional metrics beyond carbon footprint and WACI.
    - A data hierarchy for sources of GHG emissions information would aid standardization.

[5] *http://www.capitol.hawaii.gov/session2017/bills/SB559_CD1_.htm*
[6] *https://www.capitol.hawaii.gov/hrscurrent/Vol04_Ch0201-0257/HRS0225P/HRS_0225P-0005.htm*

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- A company's use of purchased or generated carbon offsets should not reduce the GHG emissions associated with a portfolio company but can be disclosed separately. This allows for transparency into the absolute level of real-world emissions.
    - Carbon footprint and WACI should include the consolidated emissions of all subsidiaries owned by holding company
    - In calculating WACI, if a company reports zero revenue in a given year, the denominator should be 1.
    - Metrics in relation to additional types of GHG such as methane would be helpful.
- **Adviser-level disclosures**: We support disclosures of ESG-related activities across the entire business of investment advisers, as that would aid in investors' understanding of conflicts of interest. Standardized questions in relation to best practices such as annual review of compliance policies and procedures are also welcome.
- **Derivatives**: We agree that derivatives should be treated as an equivalent position in the cash market securities.

Ua mau ke ea o ka ʻāina i ka pono. We appreciate the effort the SEC has put into this Proposed Rule, and we support its adoption.

Sincerely,

Thomas Williams
Executive Director

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