The Forum for Sustainable and Responsible Investment

August 16, 2022

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

RE: Environmental, Social and Governance Disclosures for Investment Advisers and Investment Companies (File No. S7-17-22)

Dear Ms. Countryman:

On behalf of US SIF: The Forum for Sustainable and Responsible Investment, I appreciate the opportunity to provide this comment letter in response to the Notice of Proposed Rulemaking (the "Release"), "Environmental, Social and Governance Disclosures for Investment Advisers and Investment Companies" (File No. S7-17-22) (the "Proposal"). US SIF supports the Securities and Exchange Commission's (the "SEC's") effort to bring more clarity to fund disclosures. Our organization has a long history of encouraging greater transparency by fund managers and promoting best practices by funds that consider environmental, social and governance ("ESG") factors. Some aspects of the Proposal, however, do not align with real-world fund investment approaches or investor informational needs and are likely to generate higher compliance costs than those reflected in the Release and diminish expected benefits from the disclosures. Accordingly, this letter includes some recommendations to strengthen the proposal.

US SIF is the leading voice advancing sustainable investing across all asset classes. Our mission is to rapidly shift investment practices toward sustainability, focusing on long-term investments that can generate positive social and environmental impacts. Our members, which include investment management and advisory firms, mutual fund companies, asset owners, research firms, financial planners, advisors and broker-dealers, represent more than $5 trillion in assets under management or advisement. US SIF members incorporate ESG criteria into their investment decisions and take their responsibilities as shareowners seriously, including voting proxies and engaging with companies.

Sustainable investing assets account for $17.1 trillion—or 1 in 3 dollars—of the total US assets under professional management, according to US SIF's 2020 Trends Report.[1] A 2019 survey of

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[1] US SIF Foundation, "Report on US Sustainable and Impact Investing Trends 2020," at 9 (hereinafter, "2020 Trends Report").

individual investors with $100,000 or more in investable assets conducted by Morgan Stanley's Institute for Sustainable Investing found that 95% of millennial respondents were interested in sustainable investing.[2]

US SIF and our hundreds of members believe that ESG factors are financially material information, on par with other data considered in analyzing investments. Sustainable investing does not require a trade-off with returns, and there is evidence that considering ESG factors can boost investment performance, especially during market disruptions.[3] A study by a division of the ESG research firm ISS found that, among US companies with a market capitalization above $250 million, ESG performance was related to higher EVA [economic value added] margin, EVA spread, and return on invested capital between 2013 and 2019.[4] It also found that shares of companies with high ESG performance tend to outperform, without any increase in risk.[5]

Two meta-analyses have also shown a strong association between ESG performance and corporate financial performance. A study published in The Journal of Sustainable Finance & Investment analyzed 2,200 individual studies and reported that 90 percent found a non-negative relationship between ESG considerations and corporate financial performance, with a clear majority showing a positive relationship that was stable over time.[6] Another study by Oxford University and Arabesque Partners found that 88 percent of reviewed studies reported that "companies with robust sustainability practices demonstrate better operational performance, which ultimately translates into cashflows," and "80 percent of the reviewed studies demonstrate that prudent sustainability practices have a positive influence on investment performance."[7]

Considering ESG factors can help manage risk and avoid corporate scandals. Volkswagen's cheating on vehicle emissions testing in 2015 and BP's 2010 oil spill in the Gulf of Mexico are two high-profile examples of how mismanagement of sustainability issues can have financially material consequences. A company's ESG performance reflects the quality of its management, providing a window into an investment variable that is otherwise difficult to evaluate.

Overview

The press release on this Proposal states that "ESG encompasses a wide variety of investments and strategies." The term ESG investing is relatively new and increasingly viewed as not being the right rubric to capture the range of sustainable investing strategies. In fact, the term ESG more correctly refers to the data points used in sustainable investment strategies, not the

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[2] https://www.morganstanley.com/content/dam/msdotcom/infographics/sustainable-investing/Sustainable_Signals_Individual_Investor_White_Paper_Final.pdf, at 4.

[3] E.g., https://www.adecesg.com/resources/faq/what-is-esg-investing/

[4] https://www.issgovernance.com/file/publications/ISS_EVA_ESG_Matters.pdf, at 5.

[5] https://www.issgovernance.com/file/publications/ISS_EVA_ESG_Matters.pdf, at 10-11.

[6] https://www.tandfonline.com/doi/full/10.1080/20430795.2015.1118917

[7] https://arabesque.com/research/From_the_stockholder_to_the_stakeholder_web.pdf, at 8.

actual investments and strategies themselves. Thus, US SIF strongly recommends that the SEC use the term ESG only to refer to the environmental, social and governance factors. This will also assist end investors who may likely not understand the term ESG but do largely understand what is referenced by the term "sustainable."

The Proposal divides funds into three categories: Integration Funds ("Integration Funds"), which consider "one or more ESG factors alongside other, non-ESG factors in [their] investment decisions" but the ESG factors are "generally no more significant than other factors;" ESG-Focused Funds ("Focused Funds"), defined as funds that focus on "one or more ESG factors by using them as a significant or main consideration (1) in selecting investments or (2) in [their] engagement strategy" with portfolio companies; and Impact Funds ("Impact Funds"), which are ESG-Focused Funds that seek to "achieve a specific ESG impact or impacts."

The category into which a fund places itself determines the disclosures it would have to make according to the Proposal. Integration Funds would be required, in a few sentences, to summarize how they incorporate ESG factors into the investment process, including which ESG factors they consider. Focused Funds would have much more extensive obligations. They would be required to identify in the ESG Strategy Overview summary table which ESG strategies it follows, such as screening, reliance on third-party data and ratings, and use of an index, as well as provide brief descriptions of how ESG factors are incorporated and how they vote proxies and/or engage with companies. The Proposal would require Focused Funds to provide more detailed information about relevant strategies later in the prospectus, as well as greenhouse gas (GHG) emissions metrics if a Focused Fund considers environmental factors. Impact Funds would have to disclose still more extensive information, including the impact(s) it is pursuing, how it seeks to achieve the impact(s), how it measures impact, and the time horizon over which impact is measured and tracked.

US SIF agrees with the Commission's assertion in the Release that greater transparency around funds' consideration of ESG factors would enable investors to "make more informed choices regarding ESG investing and better compare funds and investment strategies." In a 2015 report, US SIF found that only half of a small sample of investment managers that incorporated ESG factors disclosed the ESG criteria they considered across all asset classes.[8] To prevent greenwashing and investor confusion, the report recommended that managers disclose the ESG criteria they apply and indicate whether their use of ESG factors is systematic or ad hoc.[9] US SIF has continued to push these best practices in multiple reports since then. More recently, the 2020 *Trends Report* found that institutions that incorporate ESG factors did not disclose their specific ESG criteria for over 41% of assets under management or advisement.[10] Thus, ample room exists for improvement.

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[8] https://www.ussif.org/files/Publications/UnlockingESGIntegration.pdf, at 4

[9] https://www.ussif.org/files/Publications/UnlockingESGIntegration.pdf, at 4-5.

[10] 2020 Trends Report, at p.17.

US SIF appreciates the layered disclosure approach, in which summary information is presented in the ESG Strategy Overview table in the front of the prospectus and elaborated upon later. This would allow investors to quickly and easily identify funds that are of interest (or not). Some investors might not go any further, but those who wish to know more can find those details. The Commission's checklist of ESG strategies in the ESG Strategy Overview table aligns closely with US SIF's own description of sustainable investment strategies.[11] And the Proposal appropriately recognizes that proxy voting and engagement can be key tools for funds to communicate with portfolio companies about ESG matters and that investors would benefit from additional information about these stewardship activities.

Areas to Strengthen

Fund Categories (Recommendation: remove)

Sustainable investing strategies do not always fit neatly into "Integration" or "ESG Focused/Impact" silos.[12] The Proposal's division of funds into three categories does not reflect how fund managers incorporate ESG factors in investment and stewardship decision-making, which could increase compliance costs. For example, the Praxis Growth Index Fund[13] "seeks to reflect the performance of the U.S. large capitalization growth equities market. It aims to invest in "companies aligned with the Stewardship Investing Core Values" and uses ESG integration techniques. Fund rating firm Morningstar has characterized ESG oriented funds as approaches

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[11] Sustainable investors generally focus on at least one of two broad strategies. One is incorporating ESG criteria into investment research, analysis, decision-making and portfolio construction across a range of asset classes. A second is filing shareholder resolutions at publicly traded companies and practicing other forms of investor engagement across asset classes.

ESG Integration: The systematic and explicit inclusion of ESG risks and opportunities into the process of financial analysis, which can include adjusting estimated future cash flows or modeled discount rates based upon evaluation of ESG-related risks and opportunities and identifying and measuring the impact of off-balance sheet ESG-related assets and liabilities.
• Positive/Best-in-Class: Investment in sectors, companies or projects selected for positive ESG performance relative to industry peers. This strategy also includes avoiding companies that do not meet certain ESG performance thresholds.
• Negative/Exclusionary Screening: The exclusion from a fund or plan of certain sectors or companies involved in activities deemed unsustainable or controversial.
• Impact Investing: Investment in companies, organizations and funds with the explicit intention to generate positive social and environmental impact alongside a financial return, which can range from below market to market rate.
• Sustainability Themed Investing: Thematic portfolio construction around specific ESG areas, such as gender-lens investing, clean technology, sustainable food and agriculture, renewable energy, or place-based investing.

ESG incorporation strategies are not mutually exclusive, and money managers may employ more than one within their investment products. US SIF definitions of sustainable investment strategies can be found in the 2020 Trends Report, at 14.
[12] Ibid.
[13] We note that the SEC has also not defined terms like "Growth" used to describe non-ESG fund strategies.

on a continuum and noted that, in practice, sustainable investors often combine approaches. [14] The inconsistency between the discrete categories used in the Proposal and funds' own approaches would create difficulty for funds seeking to determine which compliance regime applies to them, which in turn would impose compliance costs that are higher than contemplated by the Release. We also anticipate that many funds that would be covered in ESG focused funds are seeking specific outcomes or impacts. Thus, having a separate category of impact funds as a subset of ESG focused funds could be duplicative. The data that investors likely want to be disclosed are the ESG criteria being used in the construction of the fund and whether this data is being used to help create better investment results (i.e. risk and opportunity assessments) or whether ESG data is being used to achieve broader social impact or both.

Additionally, the varied Disclosure obligations could create some unintended consequences such as an incentive for funds to choose to classify themselves as Integration Funds, in order to have lower disclosure obligations. The Release acknowledges this possibility but asserts that the benefit of using the categories outweighs the disadvantages, including the potential for misclassification. To the extent funds that should classify themselves as Focused Funds instead place themselves in the Integration Fund category, in order to lessen their reporting obligations, the transparency benefits touted in the Release would be impaired.

Further, we don't believe that a fund designed to track a non-ESG index whose only ESG strategy is engagement on ESG issues, thus qualifying it as a Focused Fund, should face a much more substantial disclosure obligation than a fund that falls into the Integration Fund category. Integration-type approaches account for the largest proportion of the growth in ESG assets. We believe that funds following an integration strategy may present a higher risk of exaggerated claims due to the less specific nature of the strategy, making robust disclosure even more important.

Differences in the disclosures required of Integration and Focused Funds also deprive investors of comparable information with which to compare funds that fall into different categories with one another. At least some investors would likely want to obtain information about both Integration and Focused Funds in order to compare approaches as well as funds. For example, an investor might wish to select a labor-friendly investment approach but not be certain how prominent a role she wants human capital considerations to play; comparable information about all funds that consider factors related to human capital would assist her in deciding on a strategic approach and a specific fund.

Greenhouse Gas Reporting (Recommendation: make disclosures consistent)

While in principle, we support the Proposal's provisions on GHG emissions metrics, the SEC has not made a case for why this is the only ESG metric required in this proposal and thus, it seems like an outlier as presented. The SEC should provide the rationale for this as well as whether

[14] https://www.morningstar.com/articles/1058990/the-morningstar-sustainable-investing-framework

there would be future efforts to add additional E, S or G metrics. Additionally, the proposed requirement that Focused Funds, but not Integration Funds, disclose the Proposal's standardized GHG emissions metrics likewise limits investors' ability to compare funds across categories on this important dimension. The 2020 *Trends Report* found that "[c]limate change is the most important specific ESG issue considered by money managers in asset-weighted terms."[15] The $4.2 trillion in AUM disclosing reliance on climate-related factors represented a 39% increase from 2018.[16] Investors' inability to evaluate the GHG performance of both Integration and Focused Funds limits the utility of the disclosures to investors.

Requiring the same disclosure from all funds that consider ESG factors falls within the scope of the Proposal and would not require a re-proposal. This approach was identified as a "Reasonable Alternative" in the Release's Economic Analysis. We believe that the SEC's major concern about this approach—that it risks overstating the role of ESG factors in funds whose investment processes are not ESG-driven—is exaggerated and can be addressed by requiring language regarding the relative roles of ESG and non-ESG factors. As well, Questions 6 and 7 of the Release seek comment on requiring Integration Funds that consider GHG emissions to disclose the Proposal's standardized GHG metrics and requiring Integration Funds to make the same tabular disclosures proposed for Focused Funds.

Disclosure of Internal Methodologies (Recommendation: remove)

For Focused Funds, the Proposal would mandate disclosure of any internal methodology used to evaluate, select or exclude investments. The Release reasons that such disclosure is necessary to provide investors with "detailed information to help determine whether the fund's process for analyzing investments aligns with the ESG-related priorities of the investor." A Focused Fund would be required to describe the internal methodology in detail and explain how it incorporates ESG factors.

In our view, requiring disclosure of outside data, ratings, and indexes used in the investment process provides investors with useful information without competitively harming funds. Funds' internal methodologies stand on a different footing. Those methodologies are valuable fund assets and are the product of substantial research, analysis, and judgment. Disclosing them publicly would compromise funds' ability to compete, ultimately reducing investor choice. Funds would have little incentive to expend resources developing proprietary methodologies if their value will quickly be diminished through public disclosure. Accordingly, we urge the SEC not to retain this requirement in the final rule.[17]

Stewardship Activities (Recommendation: use qualitative disclosure)

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[15] 2020 Trends Report, at 18.
[16] 2020 Trends Report, at 21.
[17] See Release Questions 43 ("Should we, as proposed, require funds to disclose in the ESG Strategy Overview Table an overview of their use of . . . internal methodologies? Are there any competitive concerns with disclosing internal methodologies?") and 44 ("Should we, as proposed, require funds to disclose more detailed information later in the prospectus about . . . the fund's internal methodologies?").

The Proposal would require Focused Funds to indicate in the ESG Strategy Overview summary table whether proxy voting and/or engagement with issuers are among the significant avenues used to implement its ESG strategy and, if they are, to provide a brief narrative overview regarding such engagement. Focused Funds checking the engagement box in the table would be required to disclose in its annual report the number or percentage of issuers with which it held ESG engagement meetings during the reporting period."

The Proposal's emphasis on company meetings ignores the range of stewardship activities a Focus Fund may undertake.[18] If a company is open to the possibility of changing its ESG disclosures or policies, a letter or meeting might achieve the fund's goal. However, some companies might not agree to meet or make any changes until after a shareholder proposal has been submitted or voted on by shareholders. "Vote no" campaigns against directors or other management proposals are a form of escalation that funds might employ to communicate dissatisfaction with particular policies or company behavior—for instance, votes against compensation committee members can register disagreement with decisions about executive pay. At portfolio companies with persistent problems or those in which board shortcomings are causing or amplifying sustainability concerns, a fund might nominate candidates for election to a portfolio company board, as investment firm Engine No. 1 did successfully at ExxonMobil in 2021, citing concerns related to ExxonMobil's lack of a "credible strategy to create value" in a rapidly decarbonizing world.[19]

Presenting only company meeting data risks overemphasizing the importance of such meetings and potentially misleading investors about the relative robustness of funds' stewardship programs. In addition, many smaller firms are not able to get meetings, whereas the largest asset managers often have greater access to company management, further emphasizing the inappropriateness of this sole metric. Meetings are not the only quantifiable metric related to stewardship.[20] Funds could disclose the number of shareholder proposals they filed each year, the number of those proposals on which settlements were reached, the substance of such settlements, the support obtained on proposals that went to a vote, and any changes made by portfolio companies following the shareholder meeting. In that regard, it is worth noting that companies sometimes implement part or all of the requests made in a shareholder proposal without meeting with the proponent. Likewise, funds could disclose participation in vote no campaigns and proxy contests and any resulting ESG improvements. Information on the number and outcomes of informal approaches to companies such as letters would also be useful to investors.

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[18] See Release Question 58 ("Do funds engage with issuers in ways other than through voting proxies and meeting with management that we should address in the disclosure rules? What are those other ways?")

[19] https://engine1.com/transforming/articles/exxon-mobil-one-year-later

[20] See Release Question 81 ("Instead of, or in addition to, ESG engagement meetings, are there other metrics that we could require to be disclosed in relation to a fund's engagement strategy?"). For a discussion of engagement reporting frameworks, see https://croataninstitute.org/wp-content/uploads/2021/05/IE2_Report.pdf, at 24-35.

Qualitative disclosures on stewardship would round out the picture for investors. Each fund's mix of activities differs: Some rely primarily on private approaches, as noted in the Release, while others prefer to pursue more public and formal tactics. A narrative explanation of a fund's stewardship philosophy and its process would provide context for quantitative disclosures and allow the fund to explain how it targets issues and portfolio companies, evaluates effectiveness, and determines when escalation is appropriate. This section would provide an opportunity for a fund to describe the extent of its participation in multi-investor and multi-stakeholder initiatives, which can magnify an investor's influence, and in any public policy advocacy on ESG issues.

Investment Adviser Regulation (Recommendation: remove)

Registered Investment Advisers are currently required to disclose in Form ADV Part 2A, Item 8, the investment strategies and methods of analysis the adviser uses when formulating investment advice or managing assets and the material risks associated with each strategy or method.[21] The Proposal would add a new sub-item mandating disclosure of ESG factor(s) considered for each significant investment strategy or method of investment analysis for which ESG factors are considered.

We believe that the current requirement should be read to encompass the disclosure proposed in the Proposal. In a Risk Alert from last year, the Division of Examinations stated that its Staff would "continue to examine [investment advisers] to evaluate whether they are accurately disclosing their ESG investing approaches and have adopted and implemented policies, procedures, and practices that accord with their ESG-related disclosures."[22] The Risk Alert made it clear that ESG-related strategies should be disclosed just as non-ESG strategies are: "The Division's interest in the accuracy and adequacy of disclosures provided by advisers and funds offering clients ESG investment strategies is the same as it would be for advisers and funds offering any other type of investment strategy." The Risk Alert indicates, then, that additional regulation is not necessary; if the Staff determines that disclosures are uneven or insufficiently detailed, informal guidance may be useful.

In addition, we believe requiring advisors to include additional ESG disclosures will deter some advisors from offering sustainable offerings to their clients.

Recommendations

To ensure that the final rule provides investors with information that they can use to fully evaluate funds that consider ESG factors without imposing overly burdensome fund compliance costs, we recommend the following changes:

[21] See https://www.sec.gov/about/forms/formadv-part2.pdf
[22] https://www.sec.gov/files/esg-risk-alert.pdf

The SEC should require all funds that consider ESG factors to disclose the same information to investors. Investors should be able to compare funds across ESG approaches. Eliminating the Proposal's fund categories would mitigate fund compliance costs associated with determining which category the fund must comply with, avoid investor confusion stemming from unequal disclosure across fund categories, **and eliminate the incentive for funds to place themselves in the Integration Fund category to take advantage of its minimal disclosure obligations.**

The disclosure requirements applicable to all funds that consider ESG factors should retain the Proposal's layered approach and should include:

- An overview of fund ESG strategy, including whether a fund uses ESG integration, best in class, positive/negative screens, thematic and/or stewardship activities
- How the fund incorporates ESG criteria into investment decision making and a description of those criteria
- The use of third-party data, scoring, or ratings (but not a description of internal methodologies)
- The use of an index and how the index uses ESG criteria
- The impact objective(s) of the fund, if any
- How the fund engages with portfolio companies, including proxy voting policies and voting data relevant to the fund's focus issue(s) as well as the information described in the "Stewardship Activities" section of this comment
- The standardized GHG metrics, as defined in the Proposal, if the fund considers climate-related factors.

The SEC should eliminate the Proposal's provisions applicable to registered investment advisers: The Staff should provide guidance clarifying the applicability of current rules to ESG strategies and methods of analysis and the specific information necessary to comply fully with those rules if disclosure shortcomings are identified.

Thank you for considering these comments. Please let us know if we can provide any more information or answer any questions.

Sincerely,

Lisa Woll
CEO