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August 16, 2022

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

Re: *Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social and Governance Investment Practices (File No. S7-17-22)*

Dear Ms. Countryman:

We appreciate the opportunity to respond to the request for comments by the United States Securities and Exchange Commission (the "Commission") on its proposal to amend the rules and forms under the Investment Advisers Act of 1940 ("Advisers Act") and the Investment Company Act of 1940 ("Investment Company Act") to require additional information regarding environmental, social and governance ("ESG") investment practices.[1] The Capital Group Companies is one of the oldest asset managers in the United States. Through our investment management subsidiaries, we actively manage assets in various collective investment vehicles and institutional client separate accounts globally. The majority of these assets consist of the American Funds family of mutual funds, which are U.S. regulated investment companies managed by Capital Research and Management Company, distributed through financial intermediaries and held by individuals and institutions across different types of accounts.

We support the Commission's commitment to improve ESG-related disclosures by funds and advisers in the face of rising investor interest in ESG strategies. We also appreciate the

[1] *Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social and Governance Investment Practices*, Release No. IA-6034; IC-34594; File No. S7-17-22 (May 25, 2022), available at https://www.sec.gov/rules/proposed/2022/ia-6034.pdf (the "Proposed Rule").

Commission's efforts to accommodate the variety of approaches that asset managers take when incorporating ESG considerations into portfolio management and product design. That said, we agree with, and would amplify, the concerns raised by the Investment Company Institute ("ICI") and the Asset Management Group of the Securities Industry and Financial Markets Association ("SIFMA AMG") that certain elements of the Proposed Rule would undermine – rather than enhance – investor's understanding of ESG practices.

More specifically, we think the Proposed Rule's treatment of ESG integration and normal course activities such as engagement and proxy voting risks creating investor confusion. In addition, we think that incidental or de minimis screening implemented by funds based on E, S or G factors should not, without more, cause them to become subject to the requirements of ESG-Focused Funds. Our more detailed comments are below.

1. **ESG integration is helpful to investors. The Commission should preserve the ability of funds and advisers to discuss ESG integration in their marketing materials, subject to existing safeguards for fair and balanced and accurate disclosure.**

We believe that incorporating material ESG considerations into our investment process is fundamental to our role as an active manager. Considering ESG in the investment process is not merely about managing risks; examining material ESG risks *and* opportunities allows us to better identify investments that are set up to do well into the future, and in turn, contributes to successful long-term outcomes for our clients. In addition, as the Commission notes, there is increasing client expectation around the world to understand whether, and how, funds consider ESG risks and opportunities. As a result, we believe it is important for the Commission to preserve the ability of funds without a specific ESG investment objective or principal investment strategy to address ESG matters in their marketing materials.

The Proposed Rule would create three categories of funds: Integration, ESG-Focused and Impact. As proposed, Integration Funds are those that consider ESG risks and opportunities alongside other factors, and such ESG factors are generally "no more significant" than others in the investment selection process. Integration Funds would be permitted to "discuss the role of ESG factors in their advertisements or sales literature – including the relationship between ESG factors and other investment factors and that ESG factors might not be dispositive."[2] However, any fund that implies through its marketing materials that ESG factors are treated as a "significant or main consideration" of the fund would be deemed to be an ESG-Focused Fund subject to the attendant disclosure requirements under the Proposed Rule.[3]

It is unclear whether in practice this is a workable distinction. For example, an Integration Fund might convey in its advertisements that consideration of material E, S, and G factors – without an emphasis on any particular ESG risk or opportunity – is an "important" or "integral" part of its investment process. In addition, in the context of a specific investment decision by an Integration Fund, a particular E, S, or G risk or opportunity could warrant significant consideration given its materiality to the company's long-term profitability. Here, we note, as others have, that corporate governance-related considerations (i.e., the "G" in ESG) have long shaped investment convictions. In addition, an Integration Fund would consider "E" and "S" risks and opportunities to the extent material, and there may be circumstances where, based on their materiality, such factors are prioritized over other non-ESG factors.

In short, ESG risks and opportunities can and do, from time to time, constitute a significant consideration for Integration Funds. With this in mind, we would urge the Commission to clarify what it means for a fund to consider ESG factors as a "significant or main consideration" and to do so in a manner that allows room for Integration Funds to discuss their ESG practices in marketing materials without being deemed ESG-Focused Funds.

2. **The proposed disclosure requirements for Integration Funds would blur the line between funds that incorporate material ESG factors and those that seek to pursue an ESG strategy or objective.**

Rather than clarify, elements of the Proposed Rule would blur the distinction between Integration Funds and ESG-Focused Funds. For example, both would be required to disclose their ESG approach as a principal investment strategy in the summary section of the prospectus where funds are expected to include the most relevant and material disclosures.

[2] Proposed Rule at 34-35.
[3] Proposed Rule at 35.

The Proposed Rule would additionally require Integration Funds to describe in their statutory prospectus how GHG emissions of portfolio holdings are considered in the investment process.

We share the concerns raised by the ICI and SIFMA AMG that the above requirements would cause Integration Funds to overstate the role played by ESG considerations in the investment process in a way that is confusing to investors. What is more, in our view, ESG integration – unlike the strategies employed by ESG-Focused Funds – is not an investment strategy but rather an input or tool in the investment process.

For this reason, if the Commission mandates any disclosures relating to ESG integration, we believe it should be under Item 10 of Form N-1A as part of the fund's discussion of the investment adviser and its management of the fund rather than as a principal investment strategy under Item 4 or Item 9. Similarly, the disclosure requirement relating to GHG emissions would place outsized emphasis on the extent to which these are considered in the investment process. Funds that integrate ESG considerations broadly consider a number of different risks and opportunities when evaluating an investment, of which GHG emissions may be one, to the extent material to the business. The suggested disclosure of GHG emissions by Integration Funds could unhelpfully create investor expectations about the degree to which GHG emissions are being managed as part of an overall strategy or objective.

3. **The proposed definition and disclosure requirements of ESG-Focused Funds are overly broad, particularly with respect to proxy voting and engagement.**

The Proposed Rule's treatment of proxy voting and engagement is another way in which the line between Integration and ESG-Focused Funds is blurred. The Proposed Rule defines 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."[4] This category includes, among other things, funds for which proxy voting or engagement with issuers is a "significant means" of implementing

[4] Proposed Rule at 33.

the fund's ESG strategy. This would mean that "the [f]und, as applicable, regularly and proactively votes proxies or engages with issuers on ESG issues to advance one or more particular ESG goals the fund has identified in advance."[5]

We agree with the comments submitted by the ICI and SIFMA AMG that the above definition of ESG-Focused Funds is overly broad. More specifically, as it relates to proxy voting and engagement, we are concerned that funds would be deemed to be ESG-Focused Funds as a result of activities which we view to be part of our fiduciary responsibility to clients and additive to our process of ESG integration. In our view, this would likely create investor confusion.

The proxy voting process reflects our understanding of a company's business, its management and its relationship with shareholders over time. Proxy voting is integral to our investment process and our investment adviser entities do "regularly and proactively" vote proxies. Beyond proxy voting, we also engage with issuers as part of our normal course investing activities. We prioritize topics for engagement based on their materiality to our funds' investments. Though none of our funds in the U.S. have an "ESG strategy," our engagement goals may, from time to time, relate to E, S or G considerations, whether it be encouraging disclosure with respect to a particular issue, or seeking to better understand a company's approach to managing a particular ESG risk.

We further agree with the ICI and SIFMA AMG that the proposed ESG-Focused Fund disclosure requirements would be too granular to be helpful to investors. In particular, we believe disclosing the percentage of ESG voting matters a fund voted in furtherance of relevant ESG initiatives would not necessarily be an accurate reflection of how the fund carries out its ESG-related strategies. For example, a fund may vote against ESG proposals that are poorly formulated or overly prescriptive, do not relate to material issues, or that call for company action in an area where the company has already demonstrated meaningful progress. In other cases, the ESG voting matter at hand may be inconsistent with the fund's investment strategies or objective or otherwise conflict with the best interests of fund shareholders as determined by the investment adviser.

[5] Proposed Rule at 319.

As relates to engagement, the Proposed Rule would require granular disclosure in the statutory prospectus and annual report of engagement activities carried out on behalf of a fund, including specific objectives and KPIs. In our experience, engagement objectives, time horizons and KPIs are highly specific and evolve over time as companies achieve progress. We think the dynamic nature of engagements do not lend themselves to meaningful disclosure relating to these items in statutory prospectuses.

What is more, engagements tend to focus on complex issues against which companies generally do not – and are not necessarily expected to – make progress in a linear fashion. Requiring funds to annually report progress of their engagements could cause funds and advisers to set objectives and KPIs in the interest of producing better engagement “report cards” rather than driving substantive change in the interests of clients. Finally, the requirement to disclose the total number of ESG engagement meetings seems to suggest that quantity, rather than quality, is what matters. We are concerned the required disclosure would incentivize funds and advisers to unnecessarily increase the frequency of their engagements with companies.

Notwithstanding the foregoing, we appreciate that, to the extent an ESG-Focused Fund relies on proxy voting or engagement activities as a significant means of advancing its ESG strategy, additional disclosures regarding the same would be helpful to investors. To that end, we would be supportive of the Commission requiring such ESG-Focused Funds to provide in the fund’s annual report a narrative description of their proxy voting or engagement activities and how they advance the fund’s ESG strategy. We agree with SIFMA AMG that qualitative disclosure in this instance would better serve investors than the quantitative disclosures discussed above, which we believe would be less helpful and potentially misleading to investors.

We urge the Commission to carefully reconsider the scope of the ESG-Focused Fund category, especially as it relates to proxy voting and engagement. The breadth of this category would not only mandate ESG-related disclosures by funds that do not in fact have ESG strategies, but it is also likely to be problematic for retirement plan sponsors for whom consideration of ESG factors in fiduciary investment decision-making raises certain challenges under existing guidance by the U.S. Department of Labor. Generally, we agree with the ICI and SIFMA AMG that a more sensible approach would be to define an ESG-Focused Fund as a fund that discloses an ESG strategy – whether it be engagement or screening or otherwise – as a principal investment strategy in the summary prospectus.

4. **A fund that applies incidental or de minimis screening based ostensibly on one or more ESG factors should not, without more, be considered an ESG Focused Fund.**

Under the Proposed Rule, a fund that applies an inclusionary or exclusionary screen based on E, S or G factors by using them as a "significant or main consideration in selecting investments" would constitute an ESG-Focused Fund. Though, as noted above, the phrase "significant or main consideration" invites ambiguity, to the extent it is intended to imply a degree of materiality, we would agree this is a sensible classification. However, the Proposed Rule also states 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*."[6] This language suggests that funds with incidental screening based on E, S, or G factors would be required to disclose such screen as a principal investment strategy of the fund in the summary prospectus, even if the fund does not have an ESG strategy and the screen has a de minimis effect on the fund's investable universe. This would be an odd outcome, antithetical to the materiality-driven approach to disclosure under Form N-1A, and unhelpful in advancing the Commission's policy goal of reducing the risk of greenwashing.

The above language will sweep into the ESG-Focused Fund category many funds that are not considered ESG funds. A non-ESG fund may apply various incidental screening based on investment conviction that could be characterized as being informed by E, S, or G factors, given the broad scope of such matters. In our view, screening based on E, S or G factors should cause a fund to be an ESG-Focused Fund only if it has a material effect on the fund's investable universe (and, to that end, is stated as a principal investment strategy of the fund in the prospectus).

[6] Proposed Rule at 51 (emphasis added).

Regulatory authorities in certain other jurisdictions appear to be headed in a similar direction. For example, in Europe, while there is ongoing assessment regarding the definitions and scope of Article 8 funds that may lead to additional clarifications by the European Commission, broad market understanding based on guidance thus far is that basic sector-based exclusions (e.g., tobacco) alone will be insufficient for designation in the Article 8 fund category. In addition, the Monetary Authority of Singapore recently stated that funds that solely apply negative screening based on ESG factors will not be deemed to have an ESG focus.[7] Indeed, under the existing U.S. disclosure regime for registered funds, a negative strategy (e.g., a strategy not to invest in a particular type of security) is not deemed to be a principal investment strategy of the fund.[8] Requiring funds that employ negative screens (even if not de minimis in nature) to disclose such screens as a principal investment strategy calls that guidance into question and creates a differentiated approach for ESG screening that we do not believe is warranted.

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We thank the Commission for its consideration of our above comments. If you have any questions or would like to discuss the contents of this letter, please feel free to contact Clara Kang at [redacted].

Sincerely,

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Global Head of ESG
Capital Group

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[7] *Disclosure and Reporting Guidelines for Retail ESG Funds*. Circular No. CFC 02/2022 (July 28, 2022).
[8] See Form N-1A, Instruction 3 to Item 9.