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July 26, 2023

Ms. Vanessa A. 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:

The Investment Company Institute[1] is writing to supplement our views on the Securities and Exchange Commission's proposal to require enhanced Environmental, Social, and Governance (ESG) disclosures by certain advisers and investment companies.[2] In so doing, we recognize, and express support for, Chair Gensler's willingness to consider comments received after the close of

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[1] The Investment Company Institute (ICI) is the leading association representing regulated investment funds. ICI's mission is to strengthen the foundation of the asset management industry for the ultimate benefit of the long-term individual investor. ICI's members include mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and UCITS and similar funds offered to investors in other jurisdictions. Its members manage $30.1 trillion invested in funds registered under the US Investment Company Act of 1940, serving more than 100 million investors. Members manage an additional $8.8 trillion in regulated fund assets managed outside the United States. ICI also represents its investment adviser members in their capacity as managers of certain collective investment trusts (CITs) and retail separately managed accounts (SMAs). ICI has offices in Washington DC, Brussels, London, and Hong Kong and carries out its international work through ICI Global.

[2] *See* Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices, SEC Release No. IC-34594 (May 25, 2022), available at https://www.sec.gov/rules/proposed/2022/33-11068.pdf ("Proposing Release" or "Proposal"). We provided initial comments on several aspects of the Proposing Release in a letter submitted on August 16, 2022. *See* Letter from Eric J. Pan, President & CEO, ICI, and Annette M. Capretta, Associate General Counsel, ICI, to Vanessa A. Countryman, Secretary, SEC, dated August 16, 2022, available at https://www.sec.gov/comments/s7-17-22/s71722-20136279-307345.pdf ("2022 Letter"). We provided supplemental comments reiterating our concern with the prospect of requiring certain investment companies to disclose their carbon footprint and weighted average carbon intensity *before* public companies must disclose their greenhouse gas emissions (GHG) in a letter submitted on May 16, 2023. *See* Letter from Eric J. Pan, President & CEO, ICI, and Dorothy M. Donohue, Deputy General Counsel, Securities Regulation, ICI, to Vanessa A. Countryman, Secretary, SEC, dated May 16, 2023, available at https://www.sec.gov/comments/s7-17-22/s71722-190239-374582.pdf.

formal comment periods.[3] Given the Commission's volume and pace of rulemaking, it is particularly important for the public to have the ongoing opportunity to comment on proposed rulemakings.[4]

In our 2022 Letter, we offered support for the Commission's goal of promoting investor understanding of ESG funds and mitigating the risk of greenwashing. At the same time, we expressed concern that some of the Commission's disclosure requirements—particularly for "Integration Funds" and "ESG-Focused Funds" (as the Commission defines)—would increase, rather than mitigate, the risk of investor confusion.[5]

This letter provides additional information for the Commission to consider in formulating any final rule amendments. To further support our view that distinctly singling out "Integration Funds" is unnecessary, we describe how the Financial Industry Regulatory Authority's, or FINRA's, review of fund sales materials promotes consistency between a fund's prospectus and its marketing materials. We also describe a June 2023 Supreme Court decision which reinforces that the Commission compelling ESG disclosures raises constitutional concerns under the First Amendment to the U.S. Constitution.[6] Each issue is discussed in turn below.

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[3] *See* Testimony of Chair Gary Gensler Before the United States House of Representatives Committee on Financial Services, April 18, 2023, available at https://docs.house.gov/meetings/BA/BA00/20230418/115751/HHRG-118-BA00-Wstate-GenslerG-20230418.pdf ("With the closing of a formal comment period, staff begins its work to account for this important public input but continues to receive additional comments, which the Commission may consider. We greatly benefit from public input and consider adjustments that the staff, and ultimately the Commission, think are appropriate."); *id.*, available at https://archive.org/details/CSPAN2_20230419_080500_Securities__Exchange_Commissioner_Testifies_Before_House_Financial.../start/7800/end/7860 ("We often consider comments well beyond that period of time and continue to receive comments."). *See also* Market Data Infrastructure, SEC Release No. 34-90610 at 23 (Dec. 9, 2020), available at https://www.sec.gov/rules/final/2020/34-90610.pdf ("The Commission has considered all comment letters received to date, including comments that were submitted after the comment deadline had passed.").

[4] We, along with several other trade organizations, previously expressed concerns about "exceedingly short comment periods associated with numerous concurrent potentially interconnected rule propos[als] that touch on significant changes to the operational and regulatory regime applicable to financial firms." See Letter to SEC Chair Gensler from Alternative Credit Council (ACC); Alternative Investment Management Association (AIMA); American Bankers Association (ABA); American Council of Life Insurers (ACLI); American Investment Council (AIC); Banking Policy Institute (BPI); Bond Dealers of America (BDA); FIA Principal Traders Group (FIA PTG); Financial Services Forum (FSF); Institute of International Bankers (IIB); Institute for Portfolio Alternatives (IPA); Investment Adviser Association (IAA); Investment Company Institute (ICI); Loan Syndications and Trading Association (LSTA); Managed Funds Association (MFA); National Association of Corporate Treasurers (NACT); National Association of Investment Companies (NAIC); National Venture Capital Association (NVCA); Real Estate Roundtable (RER); Risk Management Association (RMA); Securities Industry and Financial Markets Association (SIFMA); Securities Industry and Financial Markets Association Asset Management Group (SIFMA AMG); Security Traders Association (STA); Small Business Investor Alliance (SBIA); and U.S. Chamber of Commerce (the Chamber) Center for Capital Markets (CCMC) (April 5, 2022), available at https://www.ici.org/system/files/2022-04/22-ici-letter-to-sec-chair-gensler.pdf.

[5] *See, e.g.*, 2022 Letter at 2, 5-10, 16-18.

[6] *See 303 Creative LLC v. Elenis*, No. 21-476, slip op. at 26 (U.S. June 30, 2023) ("Creative LLC").

I. Existing Regulatory Requirements Promote Effective ESG-Related Disclosure for "Integration Funds."

We support the Commission continually improving and modernizing fund disclosure and believe doing so is an effective approach to help enhance investor understanding of funds. As discussed in our 2022 Letter, however, the proposed definition of "Integration Fund" is overly broad and would capture most, if not all, funds.[7] "Integration Funds" would be forced to inappropriately single out ESG factors in disclosure, which would create the mistaken impression that the fund focuses more heavily on ESG as compared to other investment considerations. Doing so, ironically, would increase the risk of investor misunderstanding and potentially create the appearance of greenwashing.[8] For that reason, we recommended that the SEC abandon the "Integration Fund" category.[9]

We continue to believe that the SEC's current disclosure framework already supports effective disclosure for funds that integrate ESG factors.[10] We understand that, theoretically, one purpose that possibly could be served by categorizing and requiring particularized disclosure for funds that integrate ESG factors would be to assure consistency between disclosure in a fund's prospectus and its sales materials.[11] This letter describes FINRA regulations and review requirements that directly address this concern. We urge you to consider this information in formulating any final rule.

Much of the sales materials that funds use must be submitted to FINRA for review.[12] FINRA Rule 2210 requires funds to file certain retail communications[13] with FINRA within 10 business days of first use or publication. FINRA staff then reviews the filed materials for compliance with applicable FINRA rules, which require, among other things, that all communications be fair and balanced and not misleading.[14] Importantly, FINRA has prioritized review of any fund ESG-related communications with the public. The 2023 Report on FINRA's Examination and Risk Monitoring Program highlighted FINRA's focus on fund communications promoting ESG factors

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[7] 2022 Letter at 5-6. The definition of "Integration Fund" is discussed at *infra* notes 22-23 and accompanying text.

[8] *Id.* at 7.

[9] *Id.* at 21.

[10] Funds that integrate ESG factors into their investment process can provide disclosure regarding their integration of ESG factors consistent with the Commission's current layered disclosure framework, depending on the degree to which ESG factors are integrated into the investment process.

[11] We understand that a concern along these lines was a consideration in how the Proposing Release treats "Integration Funds."

[12] *See* FINRA Rule 2210.

[13] "Retail communication" is defined to mean any written (including electronic) communication that is distributed or made available to more than 25 retail investors within any 30 calendar-day period.

[14] *See* FINRA Rule 2210(d)(1).

and listed certain areas of examination and review focus.[15] We further understand from discussions with senior FINRA staff that they review ESG-related communications to ensure that the materials are consistent with fund prospectus disclosure and that there is sufficient balancing language and risk disclosure to satisfy FINRA requirements. This vigorous review system works well to ensure that funds are providing fair and balanced advertisements.

In sum, FINRA rules, accompanied by comprehensive, multifaceted staff review, serve to ensure that fund communications are clear and not misleading, ameliorating many of the concerns that prompted the SEC to propose a separate category for "Integration Funds" with distinct disclosure requirements.

II. Aspects of the Proposal Raise Serious First Amendment Concerns.

As the Supreme Court recently observed, businesses generally should be "free to think and speak as they wish, not as the government demands."[16] Thus, the government "may not compel a person to speak its own preferred messages."[17] As a rule, government efforts "to compel a person to speak its message when he would prefer to remain silent or to force an individual to include other ideas with his own speech that he would prefer not to include . . . offend[] the First Amendment just the same."[18] The fact that the compelled speech is commercial "makes [no] difference."[19] Speakers in business settings do not "shed their First Amendment protections by" speaking "with an expectation of compensation."[20]

Here, the Proposing Release compels investment companies to speak about their investment strategy and portfolio in a misleading way. For instance, the Proposing Release requires disclosure that risks misleading investors into thinking that most, if not all, funds operate as ESG funds. Because the First Amendment prohibits the government from compelling misleading speech, the Proposing Release, if adopted as proposed, cannot survive any level of scrutiny under the First Amendment.[21]

The Proposing Release defines "Integration Fund" to include any fund that "considers one or more ESG factors along with other, non-ESG factors in its investment decisions," which would sweep in most, if not all, funds.[22] Further, such "Integration Funds" would be required to

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[15] 2023 Report on FINRA's Examination and Risk Monitoring Program, FINRA at 41 (Jan. 2023), available at https://www.finra.org/sites/default/files/2023-01/2023-report-finras-examination-risk-monitoring-program.pdf.

[16] Creative LLC at 26.

[17] *Id.* at 8.

[18] *Id.* at 9.

[19] *Id.* at 16.

[20] *See id.* at 17.

[21] *See Nat'l Inst. of Fam. and Life Advoc. v. Becerra*, 138 S. Ct. 2361, 2372-73 (2018); *Video Software Dealers Ass'n v. Schwarzenegger*, 556 F.3d 950, 967 (9th Cir. 2009), *aff'd*, 564 U.S. 786 (2011).

[22] *See* Proposing Release at 26.

disclose how funds incorporate each ESG factor into their investment selection process.[23]

The Proposing Release likewise broadly defines "ESG-Focused Fund" and requires enhanced ESG disclosures from such funds.[24] As we stated in our 2022 letter:

> The proposed definition [of ESG-Focused Fund] is overly broad because, among things, it would include funds based solely on their engagement strategies. A common component of investment management is engagement with portfolio companies, and this activity is not limited to funds with ESG-related investing strategies. … [T]he governance practices of a company have been a long-standing area of consideration for fund managers as part of the investment selection process, and it also has been a long-standing area of focus in engagement activities. Depending on the Commission's intended meaning of "significant or main consideration"[with respect to ESG Focused Funds]—a new standard introduced in this proposal—we are concerned that a broad interpretation could inadvertently sweep in funds whose advisers are merely engaging with companies in the regular course.

These proposed mandates would create the false impression that nearly all, if not all, funds operate as ESG funds by forcing funds to more prominently disclose their consideration of ESG factors as compared to other investment criteria. On the one hand, the mandatory disclosures risk misleading investors into thinking that a fund prioritizes ESG criteria when it in fact does not—thus facilitating greenwashing. On the other hand, investors opposed to investments that rely on ESG criteria may wrongly think they have limited or no options in the marketplace.

For example, Integration Funds that consider greenhouse gas emissions of portfolio companies would be subject to enhanced disclosure that risks misleading investors into thinking the funds prioritize emission reduction over other investment considerations even when they do not. Such funds must describe how they consider the emissions of portfolio companies and describe the funds' methodology for doing so. The Proposing Release gives the following example:

> [A]n Integration Fund that considers GHG emissions might disclose that it considers the GHG emissions of portfolio companies within only certain "high emitting" market sectors, such as the energy sector. The fund in this example would also be required to describe the methodology it uses to determine which sectors would be considered "high emitting," as well as the sources of GHG emissions data the fund relied on as part of its investment selection process.[25]

The fund would be required to provide these enhanced disclosures even if the fund considers emissions for financial reasons. For example, a fund might consider the viability of investing in a certain industry long-term because of new environmental laws and regulations that make it more difficult to operate businesses in high-emitting sectors.

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[23] *See id.* at 26-29.

[24] *See id.* at 33-38.

[25] *Id.*

Additionally, the requirement that certain "ESG-Focused Funds" either estimate their portfolio's greenhouse gas emissions[26] or affirmatively state that they do not consider emissions as part of their investment strategy likewise risks investor confusion.[27] For example, because the Proposing Release would not require funds to use a particular estimation method, it risks introducing inconsistency and confusion about a portfolio's greenhouse gas emissions that could result in confusion among investors.[28] The Commission acknowledges as much:

> We recognize that the methodologies and assumptions underlying different good faith estimates of a company's GHG emissions data may impact the consistency of the data across different portfolio holdings of one fund as well as the comparability of funds with the same or similar portfolio holdings.[29]

On the Commission's own reasoning, requiring funds to estimate greenhouse gas emissions will worsen the very problem the Commission claims to be resolving, namely the current "lack of consistent, comparable, and decision-useful data" available to investors about funds' greenhouse gas emissions claims.[30] Instead, the requirement will introduce more inconsistent, incomparable, and potentially inaccurate data into the marketplace, further confusing investors.

Even if the greenhouse gas emission disclosures are not misleading, the disclosures are "unduly burdensome" and compel the disclosure of controversial information.[31] In conclusion, these new disclosure requirements impose a significant and unjustifiable burden on funds and fail to advance a substantial government interest.

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We urge you to consider our views as you work towards finalizing these rules and look forward to further dialogue with you on this important and timely matter. If you have any questions, or if we can be of assistance in any way, please contact either one of us.

Sincerely,

/s/ Eric J. Pan /s/ Dorothy M. Donohue

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[26] We use "greenhouse gas emissions" as shorthand for the Proposing Release's requirement that an "ESG-Focused Fund" that considers environmental factors in its investment strategy report both the carbon footprint and weighted average carbon density of the fund's portfolio. *Id.* at 88.

[27] *See id.* at 88-89.

[28] *See* 2022 Letter at 17-18.

[29] Proposing Release at 106.

[30] *Id.* at 87.

[31] *See Zauderer v. Off. of Disciplinary Couns.*, 471 U.S. 626, 651 (1985).

Eric J. Pan
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cc: Chair Gary Gensler
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