U.S. Chamber of Commerce

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August 12, 2022

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

Re: Proposed Rule, Securities and Exchange Commission; Enhanced Disclosures by Certain Investment Advisers and Investment Companies About Environmental, Social, and Governance Investment Practices (87 Fed. Reg. 36,654 - 36,761, June 17, 2022)

Dear Ms. Countryman:

The U.S. Chamber of Commerce's ("the Chamber") Center for Capital Markets Competitiveness ("CCMC") submits these comments in response to the proposed rule from the Securities and Exchange Commission ("Commission") entitled "Environmental, Social, and Governance Disclosures for Investment Advisers and Investment Companies" ("Proposal"). The Proposal would mandate extensive new requirements for funds and investment advisers regarding their use of environmental, social, and governance ("ESG") factors when developing investment strategies.

The Proposal states that "investors looking to participate in ESG investing face a lack of consistent, comparable and reliable information among investment products and advisers that claim to consider one or more ESG factors."[1] The Proposal further notes that a lack of standardized ESG disclosures "creates the risk that funds and advisers marketing [ESG] strategies may exaggerate their ESG practices or the extent to which their investment products or services take into account ESG factors."[2] This concern over "greenwashing" is cited as justification for new rules throughout the Proposal.

The Proposal establishes three categories of ESG funds and prescribes specific requirements for each: "Integration Funds" are funds that consider one more ESG factors alongside non-ESG factors when making investment decisions; "ESG-Focused Funds" focus on one or more ESG factors by using them as a "significant or main consideration" in choosing investments or engaging with portfolio companies; and "ESG Impact Funds" have a stated goal that seeks to achieve a specific ESG objective or objectives that generate

1 Securities and Exchange Commission, Release No. 33-11068; 34-94985; File No. S7-17-22 (May 25, 2022), p. 7, available at https://www.sec.gov/rules/proposed/2022/33-11068.pdf ("Proposal").
2 Proposal, p. 8.

specific ESG-related benefits. Depending on the type of fund, the Proposal contains a host of new mandates that encompass greenhouse gas ("GHG") emissions, fund proxy voting, and ongoing engagement with portfolio companies regarding ESG issues.

While the Commission may be concerned with issues such as "greenwashing," the Proposal misses the mark and, if made final, would create substantial new compliance costs for funds, investment advisers, and their clients while providing little benefit for investors. The overly prescriptive nature of the proposed mandates, reliance upon portfolio companies to provide certain information, and the heightened risk of liability for affected entities are serious and inherent flaws of the Proposal. The Chamber urges the Commission to re-consider the Proposal in its entirety and whether a simpler, more principles-based approach towards ESG disclosure – based upon current Commission authority - would be more effective.

The Chamber is also concerned over the Commission's process in releasing the Proposal. The comment period for the Proposal is unreasonably short and will inhibit the public's ability to provide informed feedback on a highly technical and consequential rulemaking. Further, the Proposal represents the latest iteration of the Commission's unprecedented regulatory agenda and is interrelated with other proposals the Commission has recently issued – notably the climate change disclosure proposal ("Climate Proposal"),[3] fund names proposal[4], and the Form N-PX proposal.[5] Regrettably, the Commission has failed to consider the cumulative impact of these proposals or how they would interact with each other if implemented.

In light of these concerns, the Chamber makes the following observations and recommendations regarding the Proposal:

I. **The volume of prescriptive and standardized disclosure that would be required by the Proposal will not provide decision-useful information to investors. The Commission should recognize its existing authorities and embrace a simpler and more principles-based approach to ESG disclosure.**

II. **The Commission currently retains the tools and authority to prohibit "greenwashing" or similar practices.**

III. **The proposed "Integration Fund" category would capture virtually every fund and make it difficult for investors to distinguish between funds' use of ESG criteria.**

IV. **The Proposal would create new opportunities for special interests to pressure some funds over immaterial social or political issues.**

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3 The Enhancement and Standardization of Climate-Related Disclosures for Investors (87 FR 21334)
4 Investment Company Names (87 FR 36594)
5 Enhanced Reporting of Proxy Votes by Registered Management Investment Companies; Reporting of Executive Compensation Votes by Institutional Investment Managers (86 FR 57478)

V. The Proposal would require funds to rely on portfolio companies to provide substantial information in order to comply, particularly as it relates to emissions. The Commission has also failed to consider how certain provisions of the Proposal are interrelated with other unfinished rulemakings.

VI. The Commission has not provided the public with a sufficient amount of time to comment on such a consequential proposed rulemaking.

Discussion

Over the last decade, the Chamber has been a leader in the conversation regarding ESG issues and the role that regulators should play in response to growing interest surrounding ESG disclosure and ESG investment products and services. The Chamber has issued several reports around ESG – including recommendations to companies on how to implement and manage ESG strategies – that discuss the lack of standardization in the definition of the term "ESG" and question the ever-increasing subset of topics that seem to apply under the "ESG umbrella."[6]

The Proposal estimates that over the last 25 years, the "U.S. sustainable investing universe" has grown to over $17 trillion in assets under management, including a fourfold increase over the last decade.[7] The Proposal cites a recent survey which found that 42% of institutional investors consider ESG factors when making investment decisions.[8] At the same time, what exactly constitutes "sustainable" or "ESG" investing remains subject to widespread interpretation. The individual "E," "S," and "G," components of ESG all can represent fundamentally different things. Accordingly, it is challenging for a regulator to standardize the use of "ESG" or other similar terms in regulation.

Under the Proposal, the Commission has chosen not to specifically define "ESG" or the particular issues that may fall under the ESG rubric. The Commission is right to avoid trying to define ESG as it would be impractical for a regulator to impose its definition on what is clearly a malleable term. It is paradoxical, however, that the Proposal mandates such granular and standardized disclosures surrounding a term and investing strategy that the Commission itself believes escapes clear definition. This would contribute to a host of compliance challenges for regulated entities who have differing methods for incorporating or considering certain ESG criteria into their investment processes.

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6 U.S. Chamber of Commerce, U.S. Chamber of Commerce Foundation "Project for Growth, Opportunity & Innovation: ESG Reporting Best Practices." Fall 2019. U.S. Chamber of Commerce, U.S. Chamber of Commerce Foundation, "Corporate Sustainability Reporting: Past, Present, Future." November 2018.
7 Proposal, p. 12.
8 Id.

The Chamber approaches the Proposal with a fundamental question: Would the Proposal demystify the world of ESG investing and provide investors with decision-useful information about how funds use E, S, or G factors, or would it result in a costly compliance exercise for funds and investment advisers without providing clear and useful information for investors regarding ESG? Even with the limited amount of time the Commission has given the public to review the Proposal, the answer, in our view, is unquestionably the latter.

The Commission must also keep in mind the interests and views of retail investors, whose savings are ultimately at risk in the markets and through funds or investment advisers. Noticeably, the Proposal says relatively little about retail investors. A recent poll conducted by the Financial Industry Regulatory Authority and the National Opinion Research Center ("NORC") found that more than half (54%) of survey respondents never or rarely considered environmental impacts when making investment decisions. And a quarter of respondents believed that ESG stood for "earnings, stock, growth." In our view, the Proposal would do little to nothing to provide these retail investors with a better understanding of what ESG is and how ESG factors could affect their investments.

Our observations and recommendations are discussed in further detail below.

The volume of prescriptive and standardized disclosure that would be required by the Proposal will not provide decision-useful information to investors. The Commission should recognize its existing authorities and embrace a simpler and more principles-based approach to ESG disclosure.

If adopted the Proposal would mandate that funds include expansive new disclosures in prospectuses, annual reports, and adviser brochures. The Commission's goal is to provide investors with "consistent, comparable, and reliable" information in order to "reduce the risk of exaggerated claims of the role of ESG factors in investing."[9]

The Chamber agrees that the growth in ESG-labeled or ESG-integrated funds warrants a closer look by regulators to ensure funds are not misleading investors with claims about their use of ESG (or any other factors). But the Proposal is predicated on the assumption that disclosures regarding a topic as nebulous as ESG can be neatly standardized and communicated to shareholders through uniform mandates.

This assumption neglects the actual ways in which many fund managers or investors use ESG criteria (or individual components of ESG) to make decisions or to incorporate the criteria within their investment due diligence. For example, certain funds may place particular emphasis on "E" factors, including GHG emissions, while others may emphasize core "G" issues rather than environmental or social matters. Yet both of these funds could be deemed "Integration Funds" and be required to disclose how certain E, S, or G issues are considered alongside "non-ESG" issues. This would not result in any type of

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9 Proposal, p. 18.

useful disclosure for investors and would likely create confusion over the extent to which "ESG" is incorporated into a fund's decision process.

Importantly, some funds which would be deemed Integration Funds under the Proposal already integrate E, S, or G, factors into their investments but may not necessarily label that process (or their products) as "ESG-friendly" or "ESG-focused." Moreover, integration of specific E, S, or G factors is often a firm-level process as opposed to a fund-level process. Requiring these disclosures in a fund's prospectus could mislead investors and create the perception that certain "ESG" criteria is prioritized over "non-ESG" criteria.

As Commissioner Peirce suggested, a better alternative for the Commission may be a simple requirement that all funds explain in a few sentences what their E, S, or G approach means *if that fund labels itself as some formulation of ESG.*[10] (emphasis added) The current Proposal, by contrast, is too broad and would create misperceptions for investors about the extent to which funds use ESG criteria or standards.

<u>The Commission currently retains the tools and authority to prohibit "greenwashing" or similar practices.</u>

Much of the justification for the Proposal stems from the Commission's concern over the practice of "greenwashing," which involves a fund or adviser making claims that a product or service is "green," "sustainable," or "ESG"-friendly based on false or misleading information. The Chamber agrees that greenwashing is a concern for investors and regulators.

However, since the Commission already has broad authority to crack down on greenwashing or similar practices, it should consider those authorities against the costs that would result from regulated entities having to comply with the Proposal. For example, the Proposal itself outlines many of the current authorities the Commission has to prevent greenwashing:

> In addition, current regulations seek to prevent false or misleading advertisements by advisers, including greenwashing, by prohibiting material misstatements and fraud. The provision at 17 CFR 275.204(4)-8 prohibits advisers to pooled investment vehicles from making false or misleading statements to existing or prospective investors in such pooled investment vehicles (e.g., investors in a registered investment company or private fund), the Marketing Rule prohibits an adviser from, directly or indirectly, distributing advertisements that contain any untrue statement of a material fact, or omitting to state a material fact necessary in order to make the statement made, in light of the circumstances under which it was made, not misleading. Therefore, it generally would be materially misleading for an

10 https://www.sec.gov/news/statement/peirce-statement-esg-052522

adviser materially to overstate in an advertisement the extent to which it utilizes or considers ESG factors in managing client portfolios.[11]

Additionally, last year the Commission announced the creation of a Climate and ESG Task Force within the Division of Enforcement. The Task Force has the responsibility of identifying "ESG-related misconduct" and uses "sophisticated data analysis to mine and assess information across registrants, to identify potential violations including material gaps or misstatements in issuers' disclosure of climate risks under existing rules, and disclosure and compliance issues relating to investment advisers' and funds' ESG strategies."[12] The Task Force has already announced its first enforcement action against an investment adviser for making misleading statements related to ESG.[13]

The Commission's Director of the Division of Enforcement also recently testified before the House Financial Services Committee regarding the Division's current work. During the hearing, the Director stated that the Commission's existing antifraud authority is "adequate" to address misleading or false advertisements an information provided by funds and advisers regarding ESG. Prior to adopting any final rule, the Commission should determine whether new mandates – and their associated costs – are justified given the existing regulatory authority already possessed by the Commission.[14]

The proposed "Integration Fund" category would capture virtually every fund and make it difficult for investors to distinguish between funds' use of ESG criteria.

The Proposal would define an Integration Fund as a fund "that considers one or more ESG factors along with 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."[15] The Chamber is concerned that this criteria effectively treats *every* fund as an integration fund.

By the Proposal's definition, any fund that actively considers or incorporates only "G" factors in its investment process would have to "provide a brief narrative of how it incorporates factors or provides an example to illustrate how it considers ESG factors with other factors."[16] Requiring funds to communicate through disclosure that their consideration of core governance issues are part of an overall "ESG strategy" would be fundamentally misleading and investors would be left to assume that the fund also incorporates "E" and "S" issues as part of its "ESG strategy." Funds would have to provide remedial disclosure that their focus on governance issues is a core part of their investment

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11 Proposal, p. 168.
12 https://www.sec.gov/spotlight/enforcement-task-force-focused-climate-esg-issues
13 https://www.sec.gov/news/press-release/2022-86
14 "Oversight of the SEC's Division of Enforcement" Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets (July 19, 2022).
15 Proposal, p. 26.
16 Proposal, p. 25.

process and should not be conflated with how other funds may incorporate broader "E" or "S" issues.

Additionally, the use of the word "determinative" in the proposed definition is troubling and at odds with how most active funds approach their investment process. Unless a fund uses specific ESG or other criteria to screen holdings (i.e., a fund that would likely be an ESG-Focused Fund under the Proposal), funds typically do not consider one factor alone as "determinative" over another when selecting portfolio investments. Funds would essentially have to assign rankings to certain factors that they consider when deciding investments – a practice that is antithetical to the way most funds have long operated.

At a minimum, the Chamber urges the Commission to exclude the concept and definition of Integration Funds altogether from any final rulemaking and to only focus on funds that label or market themselves as ESG funds.

The Proposal would create new opportunities for special interests to pressure some funds over immaterial social or political issues.

The Proposal requires ESG-Focused Funds for which proxy voting is a "significant means of implementing its ESG strategy" to disclose in their annual reports how the fund voted proxies on certain ESG-related voting matters. ESG-Focused Funds would further be required to disclose the portion of all ESG-related votes in which they voted "in furtherance of the initiative" and to cross reference their Form N-PX filing.

As part of this requirement, the Commission appears to be making an insinuation that funds should be voting in favor of any voting matter "involving ESG factors that the fund incorporates into its investment decisions." The Proposal does not contemplate whether certain ESG initiatives – including shareholder proposals – may include nonfinancial objectives or seek to achieve a goal through means that the fund does not support. If the Proposal is made final, funds would likely be in the position of having to provide remedial disclosure to explain certain votes, an outcome that could potentially confuse shareholders about a fund's voting policies and record.

These provisions would also likely expose funds to criticisms and campaigns by special interests that they are not doing "enough" to advance certain ESG initiatives. The Chamber registered similar concerns with regard to the Form N-PX proposal issued by the Commission in September of 2021.[17] We urge the SEC to drop any specific ESG-related proxy voting disclosures beyond what funds are currently required to disclose.

17 https://www.sec.gov/comments/s7-11-21/s71121-20109518-263914.pdf

The Proposal would require funds to rely on portfolio companies to provide substantial information in order to comply, particularly as it relates to emissions. The Commission has also failed to consider how certain provisions of the Proposal are interrelated with other unfinished rulemakings.

Under the Proposal, an ESG-Focused Fund that considers environmental factors as part of its investment strategy would be required to disclose the carbon footprint and weighted average carbon intensity ("WACI") of the fund's portfolio. These disclosures would be based upon the Scope 1 and Scope 2 emissions of the fund's portfolio companies. Further, a fund that is an "environmentally focused fund" would be required to disclose Scope 3 emissions of its portfolio companies. These provisions would largely follow the frameworks of the Task Force on Climate-Related Financial Disclosure ("TCFD") and the GHG Protocol.

As the Chamber stated in our recent comment letter on the Commission's Climate Disclosure Proposal, the Commission should not, in creating mandatory standards, rely on third-party frameworks such as TCFD and the GHG Protocol without undertaking a comprehensive analysis as to their appropriateness, and whether these voluntary frameworks should serve as the basis for mandated regulations. These third parties are not subject to the Administrative Procedure Act, and some have stated objectives that are outside the scope of the securities laws.

Funds would have to rely on portfolio companies to provide them with standardized data regarding emissions to comply. This information may not be available from a number of portfolio companies, particularly private companies that do not file reports with the SEC and are not listed on a national exchange. For example, a recent survey conducted in response to the SEC's climate change disclosure proposal found that 99% of public company suppliers do not regularly provide the types of emissions information that would be required to be collected under the Climate Disclosure Proposal.[18] Funds would face similar obstacles if this Proposal were to be implemented and would be left to make a "good faith" estimate about the level of portfolio company emissions. This approach would not result in useful disclosure for investors and undermines the Commission's stated goal of providing investors with "consistent, comparable, and reliable" information.

Providing emissions information would be especially difficult for business development companies (BDCs) given their statutory mandate and nature of their portfolio companies. BDCs are a specialty finance company that must invest 70% of their assets in "eligible assets" which typically consist of U.S.-based private businesses. These businesses would not be directly subject to the Climate Disclosure Proposal and therefore would not readily disclose information regarding emissions. The Commission must reassess its approach and must consider that compliance with the Proposal as drafted would be difficult – if not impossible – for funds and BDCs in many cases.

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18 https://www.sec.gov/comments/s7-10-22/s71022-20131426-301608.pdf

Moreover, given the interrelationships between the Proposal's emissions disclosure requirement and the Commission's Climate Disclosure Proposal, it is impossible for the public to submit informed comments regarding a fund's disclosure of GHG emissions prior to the finalization of the Climate Disclosure Proposal. At a minimum, if the Commission determines for this Proposal that emissions disclosure be included in a final rule, it should adopt a safe harbor for funds that allows them to make a good faith estimate and mitigates liability risk.

Scope 3 reporting should not be mandated at all, but instead remain voluntary for all funds. The Commission itself recognized the difficulties public companies would face in calculating Scope 3 emissions in the Climate Disclosure Proposal. The same would be true for funds that would be required to make estimations and projections that would ultimately be of little use for investors. We respectfully submit that disclosures of immaterial information or estimates would not be helpful to investors, would be outside the bounds of the SEC's authority, and should not be required.

The Commission has not provided the public with a sufficient amount of time to comment on such a consequential proposed rulemaking.

The Chamber and many other organizations have consistently registered our concerns over the unusually short comment periods the Commission has been providing to respond to the wide array of new and complex proposals. Most of these proposals are hundreds of pages in length and collectively ask thousands of questions on highly technical and complex matters. We urge the Commission to slow down the pace of its regulatory agenda and provide the public with more time to analyze rule proposals and provide informed feedback.

As many of the Commission's proposals are interconnected, it is more important that the Commission get regulation "right" and ensure that any new rules are justified, than it is to simply advance a high volume of divisive and controversial mandates. Although the Commission provided a 60-day comment period for this Proposal, it also requested comments by the same day on a related proposal on Investment Company Names. There is clear overlap in the two proposals, particularly regarding the provisions concerning integration funds and the need for additional disclosures that would include ESG-focused funds.

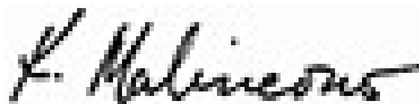
The Commission has also not conducted any kind of analysis to determine the cumulative impact of its regulatory agenda upon economic activity or capital formation. Regulated entities would have to divert substantial resources to comply with a host of new rules in a condensed time frame. The aggregate burden of coming into compliance with the Commission's fusillade of rulemaking would exhaust compliance department resources currently devoted to the identification and mitigation of actions that could harm investors. Given that the SEC is embarking on its most aggressive regulatory agenda in years, a more holistic examination of this agenda is warranted.

The Chamber provides these comments based upon our initial assessment of the Proposal and our best estimation for how it would work in practice. However, providing more time for commenters to consider and analyze the Proposal's mandates – particularly in their relation to other unfinished rulemakings – would improve the SEC's rulemaking process.

Conclusion

As explained throughout this letter, the Chamber is concerned that the Commission has not properly justified or considered the wide-ranging consequences of its expansive new proposed mandates for funds and investment advisers. We are also concerned that the Commission has once again sought to limit the public's deliberation and feedback on the rule, which weakens the Commission's rulemaking process and raises the likelihood of unintended consequences with any final rule. The Chamber urges the Commission to re-think the Proposal in its entirety along with its relation to other proposals prior to issuing a final rule.

Sincerely,



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