

MEMO# 34170

June 2, 2022

SEC Proposes Enhanced Investment Adviser and Fund Disclosures about ESG Investment Practices

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TO: ICI Members
Investment Company Directors
Chief Compliance Officer Committee
Closed-End Investment Company Committee
Disclosure Working Group
ESG Advisory Group
ESG Fund Disclosure Working Group
ESG Public Company Disclosure Working Group
ESG Task Force
SEC Rules Committee SUBJECTS: Closed-End Funds
Compliance
Disclosure
ESG
Investment Advisers RE: SEC Proposes Enhanced Investment Adviser and Fund Disclosures about ESG Investment Practices

On May 25, 2022, the US Securities and Exchange Commission voted 3-1 to propose enhanced disclosures by certain investment advisers and investment companies about environmental, social, and governance (ESG) investment practices.[\[1\]](#) The Commission also proposed amendments to the fund names rule, which is summarized in a separate memorandum.[\[2\]](#) Comments are due 60 days after publication of the Proposing Release in the Federal Register, and ICI will submit a comment letter.

The proposal would require registered investment companies and business development companies (BDCs), registered investment advisers, and certain advisers that are exempt from registration to provide additional information regarding their ESG practices.

The Proposing Release acknowledges that the Commission has not generally prescribed specific disclosures for particular investment strategies but states that ESG strategies differ in certain respects that the Commission believes necessitate specific requirements and mandatory content to assist investors in understanding the fundamental characteristics of

an ESG fund or an adviser's ESG strategy in order to make a more informed investment decision.

The proposed new requirements are summarized below.

Proposed Fund Disclosure Requirements

Fund Categories

Category

Definition

Integration Fund

A fund that considers one or more ESG factors alongside 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.[\[3\]](#)

ESG-Focused Fund

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.

An ESG-Focused Fund includes (i) any fund that has a name including terms indicating that the Fund's investment decisions incorporate one or more ESG factors; and (ii) any fund whose advertisements indicate that the fund's investment decisions incorporate one or more ESG factors by using them as a significant or main consideration in selecting investments.[\[4\]](#)

Impact Fund (Sub-set of ESG-Focused Funds)

An ESG-Focused Fund that seeks to achieve a specific ESG impact or impacts.[\[5\]](#)

Registration Statement Disclosures

The proposal would require summary information in the summary section of the prospectus or early part of the prospectus and more details in the statutory prospectus or later part of the prospectus.[\[6\]](#)

Integration Funds

An Integration Fund would be required to summarize in a few sentences how it incorporates ESG factors into its investment process, including what ESG factors it considers, in the summary prospectus, and to provide a more detailed description in the statutory prospectus.

If the Integrated Fund considers the greenhouse gas (GHG) emissions of its portfolio holdings as an ESG factor in its investment selection process, it would be required to also describe in the statutory prospectus how it considers the GHG emissions of its portfolio holdings, including a description of the methodology it uses for this purpose.[\[7\]](#)

The Proposing Release states that some investors have expressed particular demand for information on the ways in which funds consider GHG emissions as a factor in the investment selection process, which can create an incentive for funds to overstate the extent to which portfolio company emissions play a role in the fund's strategy and therefore warrants specific disclosure requirements regarding the process for integrating this data.[\[8\]](#)

ESG-Focused Funds

An ESG-Focused Fund would be required to provide key information about its consideration of ESG factors in a tabular format - an ESG Strategy Overview table - in the fund's prospectus.[\[9\]](#)

The Proposing Release states that requiring all ESG-Focused Funds to provide concise disclosure, in the same format and same location in the prospectus, is designed to provide investors a clear, comparable, and succinct summary of the salient features of a fund's implementation of ESG factors. It states that this information would help an investor determine if a given ESG-Focused Fund's approach aligns with the investor's goals.[\[10\]](#)

To facilitate a layered disclosure approach, the amendments would require an ESG-Focused Fund to complete each row of the ESG Strategy Overview table with the brief disclosure required by that row—and only the information required by the relevant form instructions—with lengthier disclosure or other available information required elsewhere in the prospectus.[\[11\]](#)

In the first row (Overview of the Fund's [ESG] strategy), an ESG-Focused Fund would be required to provide a concise description in a few sentences of the factor or factors that are the focus of the fund's strategy, followed by a "check the box" list of common ESG strategies, with checked boxes indicating the strategies followed by the fund.[\[12\]](#) The listed strategies would be:

- Tracks an index
- Applies an inclusionary screen
- Applies an exclusionary screen
- Seeks to achieve a specific impact
- Proxy voting[\[13\]](#)
- Engagement with issuers[\[14\]](#)
- Other

In the second row (How the Fund incorporates [ESG] factors in its investment decisions), an ESG-Focused Fund would be required to summarize how it incorporates ESG factors into its process for evaluating, selecting, or excluding investments. The fund would provide specific information, in a disaggregated manner, with respect to each of the common ESG strategies identified.

If the fund applies an inclusionary or exclusionary screen, it would be required to explain the factors the screen applies, any exceptions to the screen, and the percentage of the portfolio, in terms of net asset value, to which the screen applies, if less than 100%. In the more detailed description later in the prospectus, the fund also would be required to

disclose the quantitative thresholds or qualitative factors used to determine a company's industry classification or whether a company is engaged in a particular activity.

If the fund uses an internal methodology, a third-party data provider, or a combination of both, the fund would be required to provide an overview of them in the ESG Strategy Overview table and more detailed descriptions later in the prospectus. If the fund tracks an index, the summary would identify the index and briefly describe the index and how it utilizes ESG factors in determining its constituents and the more detailed description later in the prospectus would include any criteria or methodologies for selecting or excluding components of the index. The fund also would be required to provide an overview of any third-party frameworks that it follows in the investment process in the ESG Strategy Overview table and a more detailed description later in the prospectus.

An Impact Fund would be required to provide an overview of the impacts the fund is seeking to achieve and how the fund is seeking to achieve the impact(s). The overview would include (i) how the fund measures progress toward the specific impact, including the key performance indicators (KPIs) the fund analyzes, (ii) the time horizon the fund uses to analyze progress, and (iii) the relationship between the impact the fund is seeking to achieve and financial return(s). The fund also would be required to state that the fund reports annually on its progress in achieving the impact in its annual report.

A fund would be required to fill out the third row (How the Fund votes proxies and/or engages with companies about [ESG] issues), regardless of whether the proxy voting or engagement boxes are checked. The fund would describe briefly how it engages or expects to engage with issuers on ESG issues. It would be required to state whether it has specific or supplemental policies and procedures that include one or more ESG considerations in voting proxies and, if so, which considerations.

If the Fund seeks to engage other than through shareholder voting, such as through meetings with or advocacy to management, it would be required to provide an overview of the objectives it seeks to achieve with the engagement strategy. If the fund does not engage or expect to engage with issuers on ESG issues, it would be required to provide that disclosure in the row. In the more detailed description later in the prospectus, the fund would be required to describe the specific objectives of such engagement, including its time horizon for progressing on such objectives and any KPIs that the fund uses to analyze or measure of the effectiveness of such engagement.

Annual Report Disclosures

The proposed annual report disclosures would be included in the management's discussion of fund performance (MDFP).[\[15\]](#) Some of the required disclosures are dependent on how the fund describes its strategy in Form N-CEN, whose proposed amendments are described below.

Impact Funds

An Impact Fund would be required to summarize briefly the fund's progress on achieving its impacts in both qualitative and quantitative terms and discuss the key factors that materially affected the fund's ability to achieve the impact(s).

Proxy Voting and Engagement

An ESG-Focused Fund that indicates that it uses proxy voting as a significant means of implementing its ESG strategy would be required to disclose the percentage of ESG voting matters for which the fund voted in furtherance of the initiative and cross reference to its most recent complete voting record filed on Form N-PX.

An ESG-Focused Fund that indicates that it uses ESG engagement as a significant means of implementing its ESG strategy would be required to discuss the fund's progress on any KPIs and disclose the number or percentage of issuers with which the fund held ESG engagement meetings and the total number of ESG engagement meetings.[\[16\]](#)

GHG Emissions

An ESG-Focused Fund that indicates on Form N-CEN that it considers environmental factors, except if it affirmatively states in the ESG Strategy Overview table that it does not consider the GHG emissions of portfolio companies, would be required to disclose the following aggregated GHG emissions metrics of the portfolio for the reporting period: (1) carbon footprint and (2) weighted average carbon intensity (WACI).[\[17\]](#)

The proposal indicates a hierarchy of sources of portfolio company emissions data that a fund must use, depending on its availability. A fund would be required to use the Scope 1, Scope 2, and Scope 3 emissions in a portfolio company's regulatory report if available. If this information is not reported in a regulatory report, then the fund would be required to use the information made publicly available by the portfolio company. If the portfolio company does not report or otherwise publicly provide its Scope 1 and 2 emissions, then a fund would be required to use a good faith estimate of the portfolio company's Scope 1 and 2 emissions. The fund would be required to discuss briefly how it calculates the estimates, including the sources of data for determining the estimates, and the percentage of the fund's aggregated GHG emissions for which it used estimates.

If a fund obtains exposure to a portfolio company by entering into a derivatives instrument, the derivatives instrument would be treated as an equivalent position in the securities of the portfolio company that are referenced in the derivatives instrument.

A fund would be required to disclose Scope 3 emissions to the extent Scope 3 emissions are publicly available, using the carbon footprint methodology (and not WACI). The fund would be required to disclose the Scope 3 emissions separately for each industry sector in which the fund invests.

Inline XBRL Data Tagging

The proposal would require funds to tag their ESG disclosures using Inline XBRL. The Commission states that this would allow investors and other market participants, such as data aggregators to use automated analytical tools to extract information sought wherever it may be located within a filing.

Form N-CEN

The proposal would amend Form N-CEN to collect census-type information regarding the funds that incorporate ESG factors and the ESG-related service providers they use in a structured data language. One amendment would apply to all index funds and would require them to provide the full name and legal entity identifier (LEI), if any, or provide and describe other identifying number of the index.[\[18\]](#)

A fund would indicate if it is an Integration Fund or an ESG-Focused Fund.

An ESG-Focused Fund would be required to:

- indicate which of the E, S, and G factors it considers;
- indicate the strategies it follows (using the same common strategies as in the ESG Strategy Overview table);
- provide the full name and LEI of any ESG consultant(s) or other ESG service providers whose ESG information or scores the fund considers; and
- provide the name of any third-party ESG frameworks the fund follows.

Investment Adviser Disclosures

Form ADV Part 2A (Adviser Brochure)

The Commission proposes new disclosure requirements for the adviser brochure to provide advisory clients and prospective clients with useful and comparable information to help them better evaluate the ESG-related services of advisers that offer them and the variety of ways advisers currently approach ESG investing.

The proposal would require an adviser to provide a description of the ESG factor or factors it considers for each significant investment strategy or method of analysis for which the adviser considers any ESG factors. The new disclosure item would require an explanation of whether and how the adviser incorporates a particular ESG factor (E, S, or G) and/or a combination of factors. In addition, similar to funds, the proposed disclosure would include an explanation of whether and how the adviser employs integration and/or ESG-focused strategies, and if ESG-focused, whether and how the adviser also employs ESG impact strategies.[\[19\]](#)

If the adviser has authority to vote client securities and has specific voting policies and procedures to include one or more ESG considerations, it would be required to describe which ESG factors it considers and whether clients can direct the adviser's vote in a particular solicitation.

The proposal also would require the adviser to describe any relationship or arrangement that is material to the adviser's advisory business or its clients that the adviser or any of its management persons have with any related person that is an ESG consultant or other ESG service provider.

Form ADV Part 1A Reporting

The Commission proposes amendments to Form ADV Part 1A to collect information about an adviser's uses of ESG factors in its advisory business and expand the information collected about services provided to separately managed account (SMA) clients and reported private funds.[\[20\]](#)

The adviser would be required to indicate whether it considers any E, S, or G factors as part of one or more significant investment strategies or methods of analysis in the advisory services provided to SMA clients or private funds and the strategy (i.e., integration, ESG-focused, impact). In addition, the adviser would be required to name any third-party framework followed in connection with its advisory service to SMA clients and whether they conduct other business activities as an ESG provider or have related persons that are ESG providers.

Compliance

Compliance Policies and Procedures and Marketing

The Proposing Release includes commentary by the Commission reaffirming existing obligations under the compliance rules when advisers and funds incorporate ESG factors.^[21] The Commission stated that, as with all disclosures, advisers' and funds' compliance policies and procedures should address the accuracy of ESG-disclosures made to clients, investors and regulators. It stated that they should also address portfolio management processes to help ensure portfolios are managed consistently with the ESG-related investment objectives disclosed by the adviser and/or fund. The Commission provided examples of effective ESG-related disclosure, policies, procedures and practices. The Commission also observed, in connection with marketing practices, that it generally would be materially misleading for an adviser materially to overstate in an advertisement the extent to which it utilizes or considers ESG factors in managing client portfolios.

Compliance Dates

The Commission proposes the following compliance dates for the proposed new requirements:

- Prospectus disclosure requirements of Forms N-1A and N-2; disclosure requirements for UITs on Form N-8B2; regulatory reporting on Form N-CEN, and regulatory reporting on Form ADV Parts 1 and 2: One year following the effective date of any adoption, which would be sixty days after the date of publication in the Federal Register.
- Annual Reports and Form N-CSR: 18 months following the effective date, which would be sixty days after the date of publication in the Federal Register.

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endnotes

^[1] SEC, Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices, Release No. IA-6034; IC-34594 (May 25, 2022), available at <https://www.sec.gov/rules/proposed/2022/ia-6034.pdf> (Proposing Release). The SEC also issued a press release, available at <https://www.sec.gov/news/press-release/2022-92>, and a fact sheet, available at <https://www.sec.gov/files/ia-6034-fact-sheet.pdf>, which summarize the proposal. Chair Gensler and Commissioners Crenshaw and Lee voted for the proposal and Commissioner Peirce voted against it. Their statements are available as follows: Chair Gensler (<https://www.sec.gov/news/statement/gensler-statement-esg-disclosures-proposal-052522>), Commissioner Peirce (<https://www.sec.gov/news/statement/peirce-statement-esg-052522>), and Commissioner Crenshaw (<https://www.sec.gov/news/statement/crenshaw-statement-esg-investment-practices-052522>).

[2] See ICI Memorandum No. 34168 (Jun. 1, 2022), available at <https://www.ici.org/memo34168>; see also SEC, Investment Company Names, Release No. IC-34593 (May 25, 2022), available at <https://www.sec.gov/rules/proposed/2022/ic-34593.pdf>.

[3] See Proposed Item 4(a)(2)(i)(A) of Form N-1A and Proposed Item 8.(2)(e)(1)(A) of Form N-2.

[4] See Proposed Item 4(a)(2)(i)(B) of Form N-1A and Proposed Item 8.(2)(e)(1)(B) of Form N-2. The Proposing Release states that this requirement is to help ensure that any fund that markets itself as ESG provides sufficient information to investors to support the claim. See Proposing Release at 33.

[5] See Proposed Item 4(a)(2)(i)(C) of Form N-1A and Proposed Item 8.(2)(e)(1)(C) of Form N-2. The Proposing Release provides an example of an Impact Fund as one that invests with the goal of seeking to advance the availability of clean water by investing in industrial water treatment and conservation portfolio companies. See Proposing Release at 35.

[6] Open-end funds would provide the summary information in the summary section of the fund's prospectus, while closed-end funds would disclose the information as part of the prospectus's general description of the fund. The more detailed descriptions would be included in an open-end fund's statutory prospectus and later in a closed-end fund's prospectus. See Proposing Release at 26-27. The proposal would not require the same level of detail by UITs. Rather, any UIT with portfolio securities selected based on one or more ESG factors would be required to explain how the factors were used to select the portfolio securities. See Proposing Release at 67-68.

[7] See Proposed Instruction 1(b) of Item 9(b)(2) of Form N-1A; see also Proposed Instruction 9.(a)(2) of Item 8 of Form N-2.

[8] See Proposing Release at 28.

[9] An open-end fund would be required to provide the disclosure at the beginning of its risk/return summary, while a closed-end fund would provide the table at the beginning of the discussion of the fund's organization and operation. See Proposed Item 4(a)(2)(ii)(B) of Form N-1A and Proposed Item 8.(2)(B) of Form N-2.

[10] See Proposing Release at 37.

[11] In an electronic version of the prospectus, the fund also would be required to provide hyperlinks in the table to the related, more detailed disclosure later in the prospectus.

[12] See Proposed Item 4(a)(2)(ii)(B) of Form N-1A and Proposed Item 8.(2)(e)(2)(B) of Form N-2.

[13] The fund would only check the box for proxy voting or engagement with issuers if it is a significant means of implementing the fund's ESG strategy, meaning that the fund, as applicable, regularly and proactively votes proxies or engages with issuers on ESG issues to advance one or more particular goals the fund has identified in advance. See Proposed Instruction 4 of Proposed Item 4(a)(2)(ii)(B) of Form N-1A and Proposed Instruction 4 of Proposed Item 8.(2)(e)(2)(B) of Form N-2.

[14] See id.

[15] See Proposed Item 27 of Form N-1A and Proposed Instruction 4(g) of Item 24 of Form N-2. For BDCs, the proposed disclosure would be included in the management discussion and analysis (MD&A) in the fund's annual report on Form 10-K. See Proposing Release at 70-71 and Proposed Instruction 10 of Item 24 of Form N-2.

[16] An ESG engagement meeting is defined as a substantive discussion with management of an issuer advocating for one or more specific ESG goals to be accomplished over a given time period, where progress that is made toward meeting such goal is measurable, that is part of an ongoing dialogue with the issuer regarding this goal.

[17] See Proposed Item 27(b)(7)(i)(E) of Form N-1A and Proposed Instruction 4.g(1)(E) to Item 24 of Form N-2. Funds required to disclose aggregate GHG emissions also would be required to provide descriptions of any assumptions and methodologies it applied in calculating the portfolio's GHG emissions, any limitations associated with the fund's assumptions and methodologies, and explanations of any good faith estimates of GHG emissions in Form N-CSR. See Proposed Item 7 of Form N-CSR.

[18] See Proposed Item C.3.b.i. of Form N-CEN.

[19] An adviser that considers different ESG factors for different strategies would be required to include the proposed disclosures for each strategy.

[20] The Commission is focusing on the collection of this information with respect to SMA clients and private funds because registered funds and BDCs would report similar ESG-related information, including on Form N-CEN and in the fund prospectuses.

[21] See Proposing Release at 165-68.