INVESTMENT COMPANY INSTITUTE®
Washington, DC ▪ Brussels ▪ London ▪ Hong Kong ▪ www.ici.org

August 16, 2022

Ms. Vanessa A. Countryman
Secretary
US 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 (ICI)[1] is writing to provide our views on the Securities and Exchange Commission's proposal to require registered investment advisers, registered investment companies, and business development companies, to provide additional disclosure regarding their environmental, social, and governance (ESG) investment practices.[2]

Investors have been showing increasing interest in ESG investing, and the fund industry is responding to this interest by, among other things, creating new funds that explicitly tailor their investments to specific ESG criteria.[3] Although such funds make up a relatively small proportion

---

[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. Its 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 Europe, Asia and other jurisdictions. Its members manage total assets of $28.1 trillion in the United States, serving more than 100 million investors, and an additional $9.3 trillion in assets outside the United States. 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* (May 25, 2022) (Proposing Release), available at https://www.sec.gov/rules/proposed/2022/33-11068.pdf.

For simplicity, we refer to registered investment companies as funds and business development companies as BDCs throughout this letter.

[3] For example, in the first half of 2022, 67 new funds that invest according to ESG criteria were launched, representing 19% of all new funds during that time (see Figure 6 in the Appendix). See also the Appendix for background on the fund industry and trends in funds that invest according to ESG criteria.

of the registered fund industry, they represent an important and growing component.[4] It is appropriate for the Commission to evaluate its current regulations and related disclosure requirements applicable to these funds and whether modifications are warranted.[5]

We support the fundamental goals of the Commission's proposal: to mitigate the risk of greenwashing and promote investor understanding of ESG funds. We also support certain key aspects of the proposal, such as facilitating the ability of investors and the marketplace to distinguish between "ESG" funds and "non-ESG" funds and promoting the comparability of key information about ESG-related investing strategies.[6]

Despite our endorsement of the Commission's goals, we cannot support many parts of the proposal. The proposal is overly complex and prescriptive and unnecessarily departs from the SEC's time-honored approach to disclosure requirements. The result is that some new disclosure requirements could unintentionally increase, rather than mitigate, the risk of investor confusion. In addition, the prescriptive requirements would impose costly burdens on funds without appreciable benefit to fund investors. We, therefore, offer our recommendations for modifications to the proposal that we believe would better achieve the Commission's goals without the negative consequences or the unnecessary burdens and costs.

## Executive Summary

ICI supports the goals of the proposal to mitigate the risk of greenwashing and promote investor understanding of fund ESG investing. The proposed new disclosure requirements, however, are overly complex and prescriptive, increase the risk of investor confusion, and impose unnecessary

---

[4] Funds that invest according to ESG criteria made up just 1.6% of all mutual fund and ETF total net assets and 8.0 percent of the number of funds in June 2022. See Figures 3, 4, and 5 in the Appendix.

[5] The Commission states its views regarding why specific ESG disclosure requirements are needed in the Proposing Release at 17–22, and we wish to address one of the potential reasons it provides. The Commission suggests that investors are potentially paying higher fees for sustainable strategies, citing in support a *Wall Street Journal* article. See Proposing Release, *supra* n. 2, at 18 and n. 31.

In ICI's view, this suggestion is misleading. The average expense ratio that investors incurred for investing in actively managed equity mutual funds that invest according to ESG criteria—measured as the asset-weighted average expense ratio—was 0.77% in 2021, a bit above the asset-weighted average of 0.68% investors incurred for investing in other actively managed equity mutual funds.

This modest difference arises primarily because ESG criteria funds tend to be smaller than non–ESG criteria funds. In 2021, for instance, the average size of actively managed ESG criteria equity mutual funds was $1.0 billion, compared to $3.1 billion for other (i.e., non–ESG criteria) actively managed equity mutual funds. This is significant because smaller funds, irrespective of their investment objectives, tend to have higher expense ratios than larger funds simply because of economies of scale. See ICI, *2022 Investment Company Fact Book*, *available at* https://www.icifactbook.org/pdf/2022_factbook.pdf, at 106 (ICI Fact Book).

[6] We also support the Commission's determination to not define "ESG" or other similar terms. See Proposing Release, *supra* n. 2, at 24-25 (Question 1).

burdens and costs on funds. We recommend the following modifications to better achieve the goals of the proposal without the negative consequences or unnecessary burdens and costs.

- Revise the definition of ESG-Focused Fund to be more consistent with the current disclosure framework and current practices;
- Require enhanced disclosure only of ESG-Focused Funds, and not Integration Funds;
- Require less-prescriptive prospectus disclosure requirements for ESG-Focused Funds;
- Revise Impact Fund disclosure requirements to better reflect the current disclosure framework and impact investing practices;
- Eliminate annual shareholder report disclosures regarding proxy voting and engagement;
- Right-size the scope of funds subject to aggregated GHG emissions reporting and limit fund reporting to data in portfolio companies' regulatory reports;
- Revise adviser disclosure obligations to eliminate unnecessary details; and
- Extend the compliance period for the new disclosure requirements to three years.

We discuss in Section 1 our concerns with the proposed fund disclosure requirements and provide in Section 2 our recommended modifications to the proposal to address these concerns. We also provide comments on the proposed requirements for adviser disclosure (Section 3) and the Commission's cost-benefit analysis and proposed compliance dates (Section 4). Finally, in the Appendix, we provide background and data on trends in the fund industry, including with respect to funds that invest according to ESG criteria.

## Key Considerations

Our recommended modifications are based on the following views regarding effective fund disclosure for the benefit of investors:

1. *The current disclosure framework supports effective disclosure.* The current disclosure framework, which requires funds to disclose their investment objectives, principal investment strategies, and principal investment risks, is the product of years of thoughtful work, including periodic reexamination, by the Commission, sometimes based on investor focus groups, that provides useful information to investors in a layered format.[7] The disclosure

[7] See, e.g., *Registration Form Used by Open-End Management Investment Companies*, Investment Company Act Release No. 23064 (Mar. 13, 1998), *available at* https://www.sec.gov/rules/final/33-7512r.htm ("Through focus groups and written comments on the initiatives, investors have confirmed that they concur strongly with the Commission's view that fund disclosure documents will be useful only if they communicate information effectively.") and Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies, Investment Company Act Release No. 28584 (Jan. 13, 2009), *available at*

framework is supported by the antifraud provisions of the federal securities laws, which provide the Commission with an enforcement tool to address material misrepresentations, including in connection with ESG investing practices.[8] Funds rely on this well-established framework to describe to investors their ESG-related objectives and strategies. Any new disclosure requirements should be consistent with, and built upon, this long-standing framework.

2. *Any prescribed disclosures for particular investment strategies should be modest and narrowly tailored.* The Commission acknowledges that it has not generally prescribed specific disclosures for particular investment strategies.[9] The complexity of the proposal illustrates the challenges with prescribing specific disclosures for particular investment strategies. For example, some of the proposed disclosure requirements could give the incorrect and potentially misleading impression to investors that ESG factors are more important than other factors that are integrated into a fund's investment process.

3. *Narrative discussion, rather than granular, quantitative data, can in many cases be more informative for investors.* Requiring funds to disclose specific quantitative metrics that are not pertinent to a fund's investment objectives and principal investment strategies could lead to investor confusion and the dangerous illusion of certainty; whereas a narrative discussion can provide context and explanation that would promote investor understanding.

4. *Disclosure obligations imposed on funds should follow appropriate regulatory sequencing.* Funds should not be required to report data in a regulatory filing that is dependent on portfolio companies' data *unless the portfolio companies are already required to report the data and make such data available.* In the context of US public companies, the Commission should *first* require US public companies to report the data, which, in turn, funds would use to compute and report fund-level data. That is a necessary precedent to imposing a reporting obligation on funds. Further, the Commission must not place on funds liability for information it requires funds to report that is derived from (or dependent on) information reported by a portfolio company that is greater than the portfolio company's liability for providing that information in the first instance.

---

https://www.sec.gov/rules/final/2009/33-8998fr.pdf (which took into account investors' preferences as reflected in focus group interviews and a telephone survey) (Summary Prospectus Adopting Release); see also Tailored Shareholder Reports, Treatment of Annual Prospectus Updates for Existing Investors, and Improved Fee and Risk Disclosure for Mutual Funds and Exchange-Traded Funds; Fee Information in Investment Company Advertisements, Investment Company Act Release No. 33963 (Aug. 5, 2020), *available at* https://www.sec.gov/rules/proposed/2020/33-10814.pdf (pending Commission proposal).

[8] See Section 206(4) of the Investment Advisers Act of 1940 and Rule 10b-5 under the Securities Exchange Act of 1934; see also FINRA Rule 2210(d) and MSRB Rule G-40.

[9] See Proposing Release, *supra* n. 2, at 17.

## Comments on the Proposal

## Section 1: Complex and Prescriptive Nature of Proposed Fund Disclosure Requirements

The proposed fund disclosure requirements are overly complex and prescriptive, increase the risk of investor confusion, and impose unnecessary burdens and costs on funds. The proposal defines certain categories of funds for the purpose of mandating specific disclosure obligations for each fund category. The proposed definitions, however, are not appropriately tailored to the intended purpose of the mandated disclosures and, thus, can produce unintended consequences.

### 1.1 Integration Funds

The Commission proposes to require a fund that falls within the definition of "Integration Fund" to include specific ESG-related disclosures in its prospectus. The breadth of the proposed definition combined with the new disclosure requirements means that this new disclosure obligation could be imposed on most, if not all, funds. In addition, by mandating that these funds elevate the role of ESG factors (and possibly GHG emissions) in disclosures relating to their investment analysis, above other factors a fund may consider, the proposed new disclosure requirements could even increase the risk of investor confusion and the appearance of greenwashing.

For these and other reasons, we recommend that the proposal be modified so as not to mandate new disclosure requirements for Integration Funds. As a corollary, the Commission should eliminate the definition of Integration Fund. We discuss these recommendations in Section 2.2 below.

#### 1.1.1 Proposed Definition of Integration Funds Could Apply to Most Funds

The Commission's proposed definition of an Integration Fund is 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.

Most, if not all, funds likely "consider" one or more ESG factors in their investment process and, thus, could fall within this definition.[10] Take, for example, the case with respect to the

[10] The Commission estimates that 80% of all open-end funds will incur burdens associated with the proposed Integration Fund disclosure. It expects a majority of funds may incur some burdens to determine whether the

governance factor. Long before ESG investing became a trend, funds evaluated the governance aspects of portfolio companies, such as board composition and terms and senior management succession planning.[11] In addition, a fund might consider a variety of material factors, such as geo-political risks for a global company, climate-related risks for a company with significant operations in a coastal area, and employee benefits that might affect the ability of a company to attract talent. Any of these factors might be considered "ESG" factors even in cases where a fund considers them from a financial perspective and does not market itself or consider itself an "ESG" fund and, thus, any of these funds could be considered Integration Funds under the Commission's proposed definition.

In addition, the proposed definition does not address the extent to which a fund integrates ESG factors into the investment process. For example, a fund's adviser may consider one or more ESG factors when deciding to buy or sell one particular investment and may not consider such factors with respect to other investments. It is unclear whether this fund would be an Integration Fund under the proposed definition and, thus, required to include the enhanced disclosure in its prospectus. This clearly would not be a reasonable outcome.

### 1.1.2 Proposed Prospectus Disclosure for Integration Funds Could Increase, Rather than Mitigate, the Risk of Investor Confusion

The breadth of the proposed definition for Integration Fund combined with the proposed new disclosure obligations would likely confuse investors rather than enhance their understanding.

The proposal would add new instructions to the current disclosure requirement (in Item 9(b)(2) of Form N-1A) that a fund explain in general terms how the fund's adviser decides which securities to buy and sell.[12] The proposed instruction states that if the fund is an Integration Fund, it must describe how the fund incorporates ESG factors into its investment selection process, including the ESG factors that the fund considers.

At the same time, Proposed Item 4(a)(2)(ii)(A) of Form N-1A (principal investment strategies item) would require an Integration Fund that "considers ESG factors as part of its *principal investment strategies*" to summarize in a few sentences in the summary prospectus how it

---

proposed disclosure requirements would apply to their investment strategies. See Proposing Release, *supra* n. 2, at 266–67 (Note 6 to Table 2: Form N-1A PRA Estimates).

[11] The Commission seems to acknowledge the potential breadth of the proposed definition because of funds' consideration of governance factors in its questions in the Proposing Release, asking whether funds might be considered Integration Funds because of their "long-standing considerations of governance factors in their investment selection processes." See Proposing Release, *supra* n. 2, at 30 (Question 4).

[12] See Proposed Instructions to Item 9(b)(2) of Form N-1A.

incorporates ESG factors into the investment selection process, including what ESG factors the fund considers.[13]

The Commission requiring an Integration Fund to do so can be read to imply that the fund considering ESG factors as part of its *principal investment strategies* is a necessary precedent to provide the disclosure called for by the *principal investment strategies* item. The Commission's proposed approach, however, is not clear and demonstrates the challenges of trying to "prescribe specific disclosures for particular investment strategies."[14] For this and other reasons, we recommend that the Commission not mandate disclosure requirements for an Integration Fund (and, thus not define the term), as discussed in Section 2.2.

In addition, if the fund considers the GHG emissions of its portfolio holdings as an ESG factor in its investment selection process, the fund would be required to describe how it considers the GHG emissions of its portfolio holdings, including a description of the methodology the fund uses for this purpose.

For most funds, the consideration of an ESG factor, such as governance, may be a relatively small component of their research in relation to other factors, and the significance of any ESG-related factor could vary across portfolio companies and over time. Other factors, such as growth and profitability measures, valuation metrics, economic sector exposures, and earnings and volatility metrics, may be equally or more important inputs to the investment process. Yet, the Commission is proposing to elevate ESG factors above any others for mandated specific disclosures, even though, under its proposed definition of Integration Fund, ESG factors are "no more significant than other factors in the investment selection process" and are not "determinative in deciding to include or exclude any particular investment." Accordingly, a mandated heightened focus on ESG factors in a fund's summary prospectuses could mislead and confuse investors regarding the relative importance of those factors. Similarly, a mandated heightened focus on GHG emissions in the statutory prospectus could give the appearance of greenwashing.

In addition, the Commission provides a questionable policy basis for singling out GHG emissions—above all other factors a fund might consider—for mandated disclosure by an

---

[13] See also Proposed Item 4(a)(2)(ii)(A) of Form N-1A and Proposed Item 8.2.e(2)(A) of Form N-2. For simplicity, we refer to the proposed disclosures under Item 4 of Form N-1A as "summary prospectus" disclosures and the proposed disclosures under Item 9 of Form N-1A as "statutory prospectus" disclosures. Closed-end funds do not have a summary section in their prospectuses but the proposed disclosure requirements use principles of layered disclosure by requiring certain items to appear earlier in the prospectus. The proposed Form N-2 disclosures track those of the proposed Form N-1A disclosures, and our comments regarding the Form N-1A disclosures also apply to the proposed Form N-2 disclosures.

[14] See Proposing Release, *supra* n. 2, at 17. The Proposing Release's description of the requirement suggests that a fund that falls within the definition of Integration Fund would be required to provide these additional disclosures.

Integration Fund. Such a focus on a climate-related disclosure could give investors the misleading impression that GHG emissions is a more important consideration than other factors, when that may not be the case. The Commission justifies the GHG emissions disclosure requirement on the assertion that "some investors have expressed particular demand" for it[15] and that the Commission is concerned that funds may "overstate the extent to which portfolio company emissions play a role in a fund's strategy."[16] The Commission's way of addressing this concern, however, is to *mandate* disclosure about GHG emissions by all Integration Funds that consider them, regardless of the extent of that consideration. In some cases, the mandated disclosure could lead to the very practice the Commission is seeking to curtail: overstating the role of GHG emissions in a fund's investment process. In other words, the existence of an Integration Fund category with required specific disclosures about GHG emissions, regardless of the substance of that disclosure, could incorrectly elevate the importance of GHG emissions in an investor's mind.

### 1.2 ESG-Focused Funds

The proposal would require enhanced disclosures by ESG-Focused Funds in prospectuses and specific reporting obligations in annual reports, in certain circumstances. We support aspects of the proposed new requirements that would facilitate the ability of investors and the marketplace to identify those funds that are ESG-Focused Funds and promote comparability of key information about an ESG-Focused Fund's principal ESG strategies. The proposed disclosure requirements, however, include unnecessarily broad and prescriptive provisions that could increase the risk of investor confusion and the burdens and costs to funds.

For these and other reasons, we recommend modifying the definition of ESG-Focused Fund and the disclosure requirements with a more straightforward and less prescriptive approach, which we discuss in Sections 2.1 and 2.3 below.

#### 1.2.1 Proposed Definition of ESG-Focused Funds Is Overly Broad

The proposal 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.

---

[15] As noted above, the fund industry has responded to investor interest in ESG investing by, among other things, creating new funds that explicitly tailor their investments to specific ESG criteria, which generally are ESG-Focused Funds, not Integration Funds.

[16] See Proposing Release, *supra* n. 2, at 28.

> 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 … or sales literature … 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.

The proposed definition 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. As previously noted, the 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"—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. Most funds would have to, at a minimum, monitor and evaluate whether their engagement activities could technically pull them into the category of ESG-Focused Funds, and, thus, impose a significant burden on most funds. Moreover, many of those funds could inadvertently be swept into the ESG-Focused Funds category based on the proposed definition, which would not only be unnecessarily burdensome and costly to those funds, but it could unintentionally create the wrong impression for investors that the fund's principal investment strategies focus on ESG factors in the selection of investments when that is not the case. We highly doubt this was the Commission's intent.

We also question basing the definition of ESG-Focused Fund on a fund's engagement strategies when the proposed disclosure requirements for ESG-Focused Funds are related to how a fund's adviser decides which securities to buy and sell.[17] A fund's engagement strategies may support investment selection but may not themselves be decisive in determining the selection.

In addition, many funds have a long history of excluding certain industries from their portfolios—sometimes based on a fund adviser's firm wide exclusion policy—without any intention of being regarded as an "ESG" fund. For example, an adviser might exclude tobacco companies or weapons manufacturers from all of its investments, but that does not mean each of

[17] Item 9(b)(2) of Form N-1A requires a fund to "Explain in general terms how the Fund's adviser decides which securities to buy and sell (e.g., for an equity fund, discuss, if applicable, whether the Fund emphasizes value or growth or blends the two approaches)." The proposal would add instructions to Item 9(b)(2) for disclosures by any fund that meets the definition of Integration Fund or ESG-Focused Fund under proposed Item 4(a)(2)(i).

the funds it manages is intended to be regarded as an "ESG" fund. We are concerned that these funds could incorrectly be swept into the new disclosure obligations for ESG-Focused Funds.

### 1.2.2 Proposed ESG-Focused Funds Disclosure Requirements are Overly Prescriptive

By definition, the summary prospectus is not the appropriate place for the detailed disclosures the Commission proposes. In addition, the proposed statutory prospectus items are unnecessarily prescriptive.

#### 1.2.2.1 Summary Prospectus: Proposed ESG Strategy Overview Table is Inconsistent with the Goal of a Summary Prospectus

An important element of the Commission's proposed new disclosure obligations for ESG-Focused Funds is the inclusion of an ESG Strategy Overview table in an ESG-Focused Fund's summary prospectus. Requiring ESG-Focused Funds to highlight in their summary prospectuses that they are an "ESG" fund can help investors and the marketplace more easily identify "ESG" funds. For this reason, we support the inclusion of an overview section in an ESG-Focused Fund's prospectus, subject to our suggested modifications to the definition and disclosure requirements of an ESG-Focused Fund, which we discuss in Sections 2.1 and 2.3 below.

We object, however, to the proposed extensive and prescriptive elements of the ESG Strategy Overview table, which are inconsistent with the purposes of summary prospectus disclosure. The foundation of the summary prospectus "is the provision to all investors of streamlined and user-friendly information that is key to an investment decision."[18] The Commission has previously stated that it intends the information in a summary prospectus to be presented succinctly (in three or four pages), and the Commission staff has criticized and discouraged disclosures that include long, complex, and detailed descriptions of principal investment strategies and risks.[19] Yet, the proposed three rows of detailed disclosures would require lengthy discussion in the summary section of the prospectus and, as such, would be inconsistent with goal of the summary prospectus.

Although we generally support requiring ESG-Focused Funds to provide key information about the ESG factors that are a focus of its principal investment strategies and its principal ESG strategies, as suggested in the first row of the proposed ESG Strategy Overview table, the "check-the-box" method for communicating information about the ESG strategies may detract from, rather than enhance, investor understanding of these strategies. As proposed, a fund would check the box for certain of the strategies, regardless of the degree to which the strategy is used,

---

[18] See Summary Prospectus Adopting Release, *supra* n. 7.

[19] See IM Guidance Update, *Guidance Regarding Mutual Fund Enhanced Disclosure* (Jun. 2014), available at https://www.sec.gov/investment/im-guidance-2014-08.pdf.

and would check the box for proxy voting and engagement "if it is a significant means of implementing the fund's ESG strategy."[20]

The simplistic check-the-box approach might give investors a false sense of comparability among funds that use a particular implementation strategy to varying degrees. We also question how helpful the check-the-box approach would be for investors as many funds may end up checking most of the boxes, including "other," because they participate to some degree in most of the listed investment and engagement strategies.

Including proxy voting and engagement among the list of common ESG-related strategies also could be confusing, when all funds vote proxies and many fund advisers engage with companies regarding a variety of matters that are not necessarily ESG-related. In addition, as noted above, the proposed disclosure requirements relate to how a fund's adviser decides which securities to buy and sell, and proxy voting and engagement strategies do not necessarily fit within this disclosure item.

In addition, using two different standards for checking an item invites complexity and confusion. It would give investors the inaccurate impression that a fund's basis for checking the box for one strategy is the same as it is for another.

The proposed disclosures for the second and third rows of the ESG Strategy Overview table would require details and granularity that are inconsistent with the goal of "streamlined and user-friendly information that is key to an investment decision." In the second row, an ESG-Focused Fund would be required to summarize how it "incorporates ESG factors into its investment process for evaluating, selecting, or excluding investments."[21] A fund would be required to provide the details with respect to *each* applicable common ESG strategy in a disaggregated manner,[22] and funds may use multiple rows or other text features to provide this disclosure.

The details required under the proposed disclosure requirements include:

- the percentage of the portfolio to which an inclusionary or exclusionary screen is applied, if less than 100%, and why the screen applies to less than 100% of the portfolio;
- how the fund uses an internal methodology, third-party data provider, such as a scoring or ratings provider, or a combination of both; and

---

[20] See Proposed Instruction 4 to Proposed Item 4(a)(ii)(B) of Form N-1A and Proposed Instruction 4 to Proposed 8.2.e(2)(B) of Form N-2.

[21] See Proposed Instructions 5 and 6 to Proposed Item 4(a)(ii)(B) of Form N-1A and Proposed Instructions 5 and 6 to Proposed 8.2.e(2)(B) of Form N-2.

[22] Id.

- the name of any index the fund tracks and a brief description of the index and how the index utilizes ESG factors in determining its constituents.

The third row of the ESG Strategy Overview table would require a brief description of how an ESG-Focused Fund engages or expects to engage with issuers on ESG issues (whether by voting proxies or otherwise).[23] An ESG-Focused Fund would be required to disclose this information, even if proxy voting or engagement is not a "significant means of implementing the fund's ESG strategy."[24] Among other things, an ESG-Focused Fund would be required to disclose whether it has specific or supplemental policies and procedures that include one or more ESG considerations in voting proxies and, if it seeks to engage other than through shareholder voting, such as through meetings with or advocacy to management, it must provide an overview of the objectives it seeks to achieve with the engagement strategy.

Such granular information in every ESG-Focused Fund's summary prospectus clearly would defeat the purpose of highlighting for investors key information about the fund.

To address these concerns, we recommend that ESG-Focused Funds only provide information proposed for the first row of the ESG Strategy Overview table, with some modifications, as we discuss in Section 2.3 below.

**1.2.2.2 Statutory Prospectus: Proposed Disclosures Are Too Detailed and Prescriptive**

The current disclosure requirements for the statutory prospectus require a fund to explain in *general* terms how the fund's adviser decides which securities to buy and sell.[25] The Commission proposes instructions for this item that would require disclosure that goes well beyond an explanation in general terms and would inappropriately burden funds.

For example, the proposal would require a fund to disclose the index methodology for any index the fund tracks, including any criteria or methodologies for selecting or excluding components of the index that are based on ESG factors. This disclosure obligation would inappropriately put the burden on funds to include in their own regulatory filings information about a third party's methodologies. Depending on the contractual arrangements with the third party, such added disclosure also could increase the costs of that service.[26] Moreover, including information from a

---

[23] See Proposed Instruction 8 to Proposed Item 4(a)(ii)(B) of Form N-1A and Proposed Instruction 8 to Proposed 8.2.e(2)(B) of Form N-2.

[24] *Id*.

[25] See Item 9(b)(2) of Form N-1A.

[26] Fund complexes' current contractual arrangements with index providers may not contemplate inclusion of this type of index information in the fund prospectus. In cases where contracts are not sufficiently expansive, the parties may need to amend them, and the fees that fund complexes pay may very well increase as a result. See ICI, *Indexes and How Funds and Advisers Use Them: A Primer* (Jan. 2021), *available at*

third party could inappropriately subject an ESG-Focused Fund to private litigation risk related to the accuracy of the third party's information.[27]

In addition, the proposed requirement to disclose any internal methodology the fund adviser uses and how that methodology incorporates ESG factors could raise concerns about disclosing proprietary information about the fund adviser's investment process.

The proposed requirement to disclose the scoring or ratings system of any third-party data provider, such as a scoring or ratings provider, used by the fund, including how the fund evaluates the quality of such data, is unnecessarily granular and focuses inexplicably on ESG-related data providers, above all other data providers. Funds may use a wide variety of sources for data and information to support their investment research and processes. The proposed disclosure requirements would suggest that ESG-related data providers play a larger role than they do, potentially misleading investors.

To address these concerns, we recommend that the proposed requirements for summary prospectus disclosure instead be required for statutory prospectuses, with some modifications, as discussed in Section 2.3 below.

### 1.2.3 Proposed ESG-Focused Funds Annual Shareholder Report Requirements are Overly Prescriptive

The proposed requirement that, in certain circumstances, an ESG-Focused Fund disclose quantitative data regarding proxy voting and engagement would produce overly granular details that would not necessarily enhance investor understanding of an ESG-Focused Fund's proxy voting and engagement activities and would impose significant burdens and costs on funds. In addition, the proposed scope of funds that would be subject to the GHG emissions reporting requirement is overly broad, and the proposed requirement that a fund report aggregated GHG emissions with respect to its entire portfolio, regardless of the availability of the data from

---

https://www.ici.org/system/files/attachments/pdf/21_ppr_index_primer.pdf (discussing arrangements with index providers, which can be similar to other types of third-party service providers used by a fund).

[27] We raise similar concerns about the Commission's proposed requirements for index funds in our letter on the Commission's Investment Company Names Proposal, Investment Company Act Release No. 34593 (May 25, 2022), *available at* https://www.sec.gov/rules/proposed/2022/ic-34593.pdf (Names Rule Proposal). See also Letter from Eric J. Pan, President & CEO, and Susan Olson, General Counsel, ICI to Vanessa A. Countryman, Secretary, SEC, regarding Investment Company Names (File No. S7-16-22) (Aug. 16, 2022) (ICI Names Rule Comment Letter) (warning against proposed guidance that could upend the concept of passive management and urging the Commission to recognize that index funds and their investment advisers do not have control over the index methodologies of third-party index providers and (other than in the case of custom indices) generally have no input as to how an index is constructed).

portfolio companies, would impose an inappropriate burden on funds and not produce consistent, comparable or reliable metrics for the benefit of fund investors.

For these and other reasons, we recommend eliminating the proposed annual report disclosure requirements relating to proxy voting and engagement and to require only those funds with a principal investment strategy that focuses on investing in line with GHG emissions reduction to report aggregated GHG emissions and only based on portfolio companies that make the necessary underlying data available in their regulatory reports. We discuss these recommendations in Sections 2.5 and 2.6 below.

### 1.2.3.1 Proxy Voting and Engagement

The Commission proposes requiring an ESG-Focused Fund that "indicates that it uses proxy voting as a significant means of implementing its ESG strategy"[28] to disclose the percentage of ESG voting matters for which the fund voted in furtherance of the initiative (the fund may limit this disclosure to voting matters involving ESG factors the fund incorporates in its investment decisions); and include a cross reference to its most recent complete voting record filed on Form N-PX.

The percentage of ESG voting matters for which a fund voted in furtherance of an initiative would not be particularly informative for an investor. Funds typically vote on shareholder proposals in addition to management proposals. Because management proposals that address governance matters might technically be considered "ESG voting matters," many voting matters might be considered ESG voting matters, and the metrics may not be that informative.[29]

In addition, the Commission's determination to mandate disclosure of this metric suggests a viewpoint that the percentage of ESG voting matters supported by a fund would reflect the extent to which the fund adheres to its ESG-related strategies, when that is not the case. For example, some shareholder proposals may not be well formulated or practicable or consistent with a fund's investment strategies and objectives. In many such cases, it would be consistent with a fund adviser's fiduciary duty and pursuit of the fund's objectives to vote against the shareholder proposals. As a result, the proposed reporting of this metric could result in confusing and potentially misleading information. In addition, the compliance burdens associated with identifying and tracking which proposals constitute an "ESG voting matter" would be unnecessarily burdensome.

Similarly, the proposal would require an ESG-Focused Fund that indicates that it uses ESG engagement as a significant means of implementing its ESG strategy to provide certain metrics

---

[28] The ESG-Focused Fund would indicate this in response to Proposed Item C.3(j)(iii) on Form N-CEN. See Proposed Item 27(b)(7)(i)(C) and Proposed Instruction 4.g(1)(D) to Item 24 of Form N-2.

[29] For additional background on fund proxy voting practices, see ICI Fact Book, *supra* n. 5, at 38. In 2020, funds cast more than 7.6 million votes on management and shareholder proposals, with each fund voting, on average, on about 1,500 separate proxy proposals.

regarding engagement activities, including the number or percentage of issuers with which the fund held ESG engagement meetings and the total number of ESG engagement meetings. The Commission proposes to define an engagement meeting 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."[30]

The proposed definition reflects a misguided view, however, that an engagement meeting necessarily involves advocacy regarding a specific goal, when these meetings (which could span years) generally provide fund advisers an opportunity to listen to company management and to understand if the company is moving towards, for example, better overall governance. Therefore, it is difficult to assign or credit a specific outcome to a specific meeting.

Like the proposed metrics relating to proxy voting, the proposed metrics relating to engagement activities suggest a Commission viewpoint that the *number* of engagement meetings, rather than, say, the quality of engagement, is an appropriate basis for measuring the value of this activity. Such a metric might give investors the incorrect impression that a large number of short engagement meetings would reflect more committed or effective engagement than fewer, but more substantive, meetings. Moreover, the compliance burdens associated with supporting this disclosure would be substantial as it would require tracking of meetings at the fund level, when engagements generally occur at the adviser level, and fund positions in a particular issuer can vary over time.[31] The Proposing Release's description of the compliance process needed to support this disclosure illustrates this: it suggests that compliance policies and procedures include a requirement that employees memorialize discussion of ESG issues by creating and preserving meeting agendas and contemporaneous notes. It also indicates that funds would need to distinguish meetings that are "engagement meetings" and those that are merely "meet and greet" meetings—a process, as the Commission acknowledges, that involves a "level of subjectivity."[32]

As discussed in Section 2.5 below, we recommend that these disclosure requirements be eliminated from any final form amendments and that funds continue to rely on the current annual report disclosure requirements to provide relevant information about their proxy voting and engagement activities. Alternatively, if the Commission determines to require disclosure on these

---

[30] See Proposed Item 27 (b)(7)(i)(D) of Form N-1A and Proposed Item 24.g(1)(D) of Form N-2. We assume that the reference to "measurable" progress in the proposed definition of "engagement meeting" refers to the progress of the portfolio company with respect to the goal, and not a measurement of a fund's contribution through proxy voting or engagement, which would not be appropriate or feasible, given the multitude of factors that may prompt a company to make a change.

[31] These reporting requirements would be particularly challenging for fund complexes that have funds with different fiscal years and funds with multiple sub-advisers.

[32] See Proposing Release, *supra* n. 2, at 82-83.

subjects, it should require it in a narrative form, rather than the quantitative metrics that convey limited and potentially misleading or confusing information.

**1.2.3.2 GHG Emissions**

Under the proposal, any ESG-Focused Fund that considers environmental factors[33] (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 carbon footprint and weighted average carbon intensity (WACI) of the portfolio for the reporting period. The fund would be required to use a hierarchy of data sources from which to calculate the metrics: regulatory reports, information publicly provided by the portfolio company, and, if such information is unavailable, a "good faith estimate" of the portfolio company's emissions. In addition, if a portfolio company reports its Scope 3 emissions in a regulatory report or provides it publicly, then an ESG-Focused Fund that considers environmental factors also would be required to report separately the carbon footprint metric based on the Scope 3 data.[34]

The scope of funds subject to the GHG emissions reporting obligation is overly broad because it could capture funds that do not have a principal investment strategy that focuses on investments in line with GHG emissions reduction. For example, an ESG-Focused Fund that considers environmental factors, in addition to social and governance factors, and also considers GHG emissions for some of its holdings, such as fossil fuel companies, would be required to report the aggregated GHG emissions data for *all* of its holdings, even if the fund does not have a principal investment strategy focused on investing in line with GHG emissions reduction. As a result, the fund would be required to track and report data in an annual report that is not tied to its actual investment strategies.

In addition, requiring reporting of aggregated GHG emission data for such a broad group of funds could give investors the incorrect impression that these metrics provide the primary means for evaluating how "green" a fund is, when that is not the case. For example, a fund might have an investment strategy to invest in companies with strong transition plans to reduce GHG emissions. Because those companies' GHG emissions might be relatively high today, that fund's aggregated GHG emissions might be high relative to those of other funds that, for example, invest primarily in sectors with naturally lower GHG emissions. The fund's aggregated GHG emissions, rather than its strategy to allocate capital to companies transitioning to lower GHG

[33] Under the proposal, an ESG-Focused Fund that indicates that it considers environmental factors in response to Item C.3(j)(ii) on Form N-CEN, is subject to the GHG emissions reporting requirement, except if it affirmatively states in the ESG Strategy Overview table that it does not consider the GHG emissions of portfolio companies in which it invests.

[34] ESG-Focused Funds that focus on environmental factors would be required to disclose Scope 3 emissions separately for each industry sector in which the fund invests, as well as the percentage of the fund's net asset value invested in each industry sector. See Proposed Instruction 1(c) to Proposed Item 27(b)(7)(i)(E) and Proposed Instruction1(c) of Proposed Item 24.g(1)(E) of Form N-2.

emissions, might end up being the barometer investors use to evaluate its "greenness." Other examples include funds investing in green bonds, where the issuer may be a company from a sector or industry with relatively higher GHG emissions, and funds investing in companies offering products, such as electric vehicle batteries, that have relatively higher GHG emission profiles as they ramp up operations.

The proposed reporting requirements also would put funds in the untenable position of having to report metrics in a regulatory report that are dependent on data from portfolio companies when portfolio companies are not obligated to report their own emissions data in a regulatory report. This reporting obligation could inappropriately subject an ESG-Focused Fund to private litigation risk related to the accuracy of the aggregated GHG emissions that would necessarily be dependent on third-party sources.

The reporting requirements also could produce metrics that are not consistent, comparable or particularly informative. For example, under the Commission's proposal to require public companies to report GHG emissions information, a company could choose its method for calculating its Scope 2 emissions for purchased electricity (e.g., location-based, market-based, or another method).[35] In addition, a portfolio company that does not report Scopes 1 and 2 GHG emissions information in a regulatory report but provides it publicly may use different methodologies for Scope 1 and 2 metrics. For example, under the Commission's proposed disclosure requirements for public companies, the company would not be permitted to include carbon offsets in its calculations whereas some portfolio companies that are not subject to the Commission's public company disclosure requirements might include offsets.[36]

Finally, and importantly, any good faith estimates by a fund of a portfolio company's Scopes 1 and 2 GHG emissions would be based on assumptions and methodologies that could differ significantly from those of another fund. As a result, differences between one fund's WACI and another fund's WACI may be based more on differences in assumptions and methodologies than the climate-related exposures. Accordingly, mandating the disclosure of aggregated GHG emissions data with respect to a fund's entire portfolio holdings would not necessarily enhance investors' understanding of the climate-related exposures of a fund's portfolio.[37]

---

[35] See *The Enhancement and Standardization of Climate-Related Disclosures for Investors*, Release No. 33-11042 (Mar. 21, 2022), *available at* https://www.sec.gov/rules/proposed/2022/33-11042.pdf, at 195 (stating that a company "could use either [the location-based or market-based method], both methods, a combination, or another method as long as it identifies the method used and its source.").

[36] See *id*. at 469 ("When disclosing a registrant's Scopes 1, 2, and 3 emissions, exclude the impact of any purchased or generated offsets.").

[37] Indeed, under the proposal, a fund would be required to discuss briefly how it calculates good faith estimates, including the sources of data for determining such estimates and the percent of the fund's aggregated GHG emissions for which the fund used estimates, which would be an added layer of complex information investors would have to evaluate to interpret GHG metrics reporting. See Proposed Instruction 1(d)(xi)(C) of Proposed Item 27(b)(7)E) of Form N-1A and Proposed Instruction 1(d)(xi)(C) of Proposed Item 24.g(E) of Form N-2.

Nor would mandating that ESG-Focused Funds that consider environmental factors report Scope 3–based carbon footprint data enhance investor understanding. As we stated in our comment letter on the SEC's proposal for climate-related disclosures by public companies, there are significant data gaps and an absence of agreed-upon methodologies for companies to measure Scope 3 GHG emissions.[38] These deficiencies seriously undermine the ability of most companies to report consistent, comparable, and verifiably reliable Scope 3 emissions data. Moreover, under the Commission's climate proposal, public companies would be able to report Scope 3 emissions in ranges. The varied methodologies that companies would use to report Scope 3 emissions and the ability to report in ranges would render any aggregated Scope 3 metrics reported by a fund based on such underlying data essentially fraught with uncertainty and vagueness that begs the question of whether the information is useful and reliable for investor purposes.

### 1.3 Impact Funds

The proposal imposes additional disclosure obligations on a sub-set of ESG-Focused Funds—Impact Funds. The proposal would define an Impact Fund as "an ESG-Focused Fund that seeks to achieve a specific ESG impact or impacts" and require any fund that meets this definition to disclose as part of its investment objective "the ESG impact that the Fund seeks to generate with its investments." [39] It also would require an Impact Fund to provide an overview in the summary prospectus "of the impact(s) the Fund is seeking to achieve and how the Fund is seeking to achieve the impact(s)" and summarize briefly in its annual report "the Fund's progress on achieving the impacts."[40]

We agree with the intent behind the Commission's proposed enhanced disclosures for Impact Funds – that is, that a fund that seeks to generate a measurable impact should explain that strategy and report on its progress. We disagree with two aspects of the proposal, however. First, the proposal would require funds that fall within a Commission-dictated definition of Impact Funds to include an impact objective in the formal investment objective of the fund, when we believe that the fund, and not the Commission or the staff, is best positioned to articulate its investment objective to promote investor understanding. Second, the proposed disclosure and reporting requirements seem to assume that a fund would measure progress at an aggregated portfolio level when funds generally measure progress of individual investments. Many funds have a strategy to invest in companies that aim to create positive impacts but do not themselves, as a fund, seek specific sustainable outcomes. This reflects the essential nature of funds as a

---

[38] See Letter Eric J. Pan, President & CEO, and Dorothy M. Donohue, Deputy General Counsel, ICI to Vanessa Countryman, Secretary, SEC (Jun. 16, 2022), *available at* https://www.ici.org/system/files/2022-06/22-ici-cl-sec-climate-proposal.pdf (ICI Public Company Climate Disclosure Comment Letter).

[39] See Proposed Instruction to Item 2 and Proposed Item 4(a)(2)(i)(C) of Form N-1A and Proposed Item 8.2.e(1)(C) and Proposed Instruction 10 to Item 8.2.e(2)(B) of Form N-2.

[40] See Instruction 7 to Item 4(a)(2)(ii)(B) and Proposed Item 27(b)(7)(i)(B) of Form N-1A and Proposed Instruction 7 to Item 8.2.e(2)(B) and Instruction 4.g(1)(B) of Form N-2.

vehicle to invest in other companies, and the Commission should permit funds to determine whether their strategies and reporting are based on measuring progress at the aggregated portfolio level or individual security level.

To address these concerns, we recommend, as discussed in Section 2.4, that a fund, rather than the Commission, determine whether to include an impact objective as part of the investment objective and that the disclosure requirements be modified to reflect that an Impact Fund may measure and report impact-related information based individual investments, rather than in an aggregated manner.

**Section 2: ICI's Recommended Modifications to Proposed Fund Disclosure Requirements**

To better achieve the policy goals of the proposal and address the concerns raised in Section 1, we recommend the modified approach described in Sections 2.1 through 2.6 below.[41] Because our recommendations are based on a revised definition of ESG-Focused Fund, we begin with that recommendation.

**2.1 Revise the Definition of ESG-Focused Fund to Be More Consistent with the Current Disclosure Framework and Current Practices**

We recommend that the disclosure requirements be reframed so that a fund determines whether it is an ESG-Focused Fund based on its stated principal investment strategies.[42] Under this approach, *if* the fund's stated principal investment strategies indicate that it is an ESG-Focused Fund, *then* it would be subject to enhanced disclosure requirements that would promote investor understanding. The fund is best positioned to determine whether and how its principal investment strategies have an ESG focus.

---

[41] The proposed new disclosure requirements would apply to open-end funds (including ETFs) and closed-end funds (including BDCs). Our recommended modifications likewise apply to ETFs and BDCs. As we stated in response to the Commission's proposed climate-related disclosure requirements for public companies, this proposal, rather than the public company proposal, is the more appropriate vehicle for addressing disclosures by ETFs that are registered only under the Securities Act of 1933 and BDCs. See ICI Public Company Disclosure Comment Letter, *supra* n. 39, at 30 (recommending that ETFs that are registered only under the Securities Act and BDCs be excluded from that proposal).

The proposal would require funds to tag their ESG disclosures using Inline XBRL and to report certain information in Form N-CEN. We do not object to these aspects of the proposal except that they should conform with our recommended modifications. The Commission should confirm that any information required in Form N-CEN can be updated on an annual basis.

[42] As we previously noted, it is not clear what the Commission intended to require. We believe our recommended approach would lead to more clarity. As discussed in Section 2.2, we recommend that the Commission not define or mandate specific disclosure for Integration Funds.

This approach would address the concerns that the proposed definitions could sweep in a broader group of funds than intended, subjecting them to new disclosure obligations that could mislead or confuse investors. It also would be more consistent with the current disclosure framework, under which each fund, and not the Commission or Commission staff, determines how best to inform investors of its investment objectives and principal investment strategies and to base its disclosures on that determination.

Accordingly, we recommend that the definition of ESG-Focused Fund be modified to be a fund whose stated principal investment strategies focus on one or more ESG factors in the selection of investments. Under this recommended approach, a fund whose stated principal investment strategies focus on one or more ESG factors in the selection of investments would then be required to provide key information in a section in its summary prospectus and to provide certain enhanced disclosures in the statutory prospectus. We discuss in Section 2.3 our recommended modifications for these disclosures.

The inclusion of an ESG Strategy Overview section in the prospectus would signal to investors and the marketplace that the fund is an "ESG" fund.[43] All other funds, including a fund that merely integrates ESG factors into its traditional investment process, would not include an ESG Strategy Overview section in its summary prospectus. Accordingly, this approach would help investors to distinguish those funds that are "ESG" funds.

Although we agree with the concept in the proposed ESG-Focused Funds definition that suggests any fund that is not an ESG-Focused Fund should not suggest through its name or in its advertisements or sales literature that it is an ESG-Focused Fund, we do not believe it is necessary for purposes of prospectus disclosure to define an ESG-Focused Fund by these criteria.[44] Rather, we believe that the most straightforward and consistent disclosure approach is to treat a fund as an ESG-Focused Fund based on its stated principal investment strategies.

---

[43] To classify funds that invest according to ESG criteria, ICI examines the prospectuses of funds using the same approach that it does for other categories across all funds. See ICI Fact Book, *supra* n. 5, at 41-42. In particular, ICI looks for language indicating that a fund places an important and explicit emphasis on environmental, social, or governance criteria to achieve certain goals. Morningstar likewise classifies funds according to prospectus disclosure, and they define sustainable investments as those "focusing on sustainability; impact; or environmental, social, and governance, or ESG; factors in its prospectus or other regulatory filings." See *Morningstar Sustainable Attributes, available at* https://advisor.morningstar.com/Enterprise/VTC/Sustainable_Attributes_Definitions_July2020.pdf.

[44] See ICI Names Rule Comment Letter, *supra* n. 27 (stating that we do not support expanding the scope of the Names Rule to encompass ESG-related terms). Moreover, the proposed definition of ESG-Focused Funds should be based on the fund's stated principal investment strategies, and not the composition of its portfolio.

**2.2 Require Enhanced Disclosure Only of ESG-Focused Funds, and Not Integration Funds**

As discussed in Section 1, the proposed mandated disclosures for Integration Funds (under the proposed broad definition) could potentially mislead or confuse investors regarding the relative importance of ESG factors. Rather than adjust the definition or the disclosure obligations, we recommend that the Commission eliminate any enhanced disclosure obligations for Integration Funds. With the elimination of any disclosure obligations regarding Integration Funds, there would be no need to define this term.

The goal of enhancing investor understanding of ESG-Focused Funds can be achieved through the inclusion of an ESG Strategy Overview section in the prospectus of ESG-Focused Funds. This would signal to investors that these funds are "ESG" funds and enhanced disclosures for these funds would facilitate investor understanding of ESG-Focused Funds' principal ESG strategies.

Funds that integrate ESG factors into their investment process may 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. For example, some funds may mention the integration of ESG factors in the prospectus while others may discuss it in the statement of additional information. A fund also may discuss its use of the ESG integration tool in advertisements or sales literature where it is consistent with the fund's registration statement disclosures. This disclosure approach is no different with respect to other investment tools a fund might use in its investment process. The well-understood disclosure framework guides the appropriate disclosure based on each fund's circumstances.

In addition, any disclosure by a non-ESG Focused Fund about its integration of ESG factors should not raise concerns of investor confusion because that fund would not include an ESG Strategy Overview section in its prospectus and, thus, would not be identified as an "ESG" fund. A non-ESG Focused Fund also could not describe itself as an ESG-Focused Fund in advertisements or sales literature, nor could it include a term in its name that suggests that it is an ESG-Focused Fund.[45]

If the Commission nevertheless determines to define Integration Fund and impose new disclosure obligations on this category of funds, it should not dictate where in the registration statement the disclosure should be included.[46] Rather, it should permit an Integration Fund to

---

[45] The Commission proposed to consider the names of "integration funds" as materially deceptive or misleading if the name indicates that the fund's investment decisions incorporate one or more ESG factors. See Names Rule Proposal, *supra* n. 27.

[46] In the definition of Integration Fund, we recommend that the word "considers" be replaced with the phrase "discloses that it incorporates" and the words "investment decisions" be replaced with "investment process" to better

determine how best to present its use of ESG integration to promote investor understanding. If the Commission determines to mandate the location of the disclosure, it should require it to appear in the fund's statement of additional information and not in the prospectus. Most importantly, it should *not* mandate that funds include ESG integration disclosure in a summary prospectus, which, depending on the fund's circumstances, could give ESG integration undue prominence and, thus, increase the risk of investor confusion, rather than promote investor understanding.

If the Commission is concerned that a fund's discussion of ESG integration in its prospectus (or its marketing materials) might cause investors to view it as an "ESG" fund, it could require any fund that expressly states in its prospectus that it considers one or more ESG factors to provide a disclaimer that explains that the ESG factors it considers are not necessarily determinative of any investment decision.

**2.3 Require Less-Prescriptive Prospectus Disclosure Requirements for ESG-Focused Funds**

We support requiring an ESG-Focused Fund (as we recommend defining it) to provide key information about the ESG-related focus of its principal investment strategies in the summary prospectus and an overview of how it incorporates ESG factors into its investment decisions in the statutory prospectus.[47]

Thus, we recommend that an ESG-Focused Fund provide the information required in the proposed first row of the ESG Strategy Overview table, with some modifications. We agree that an ESG-Focused Fund should provide a concise description in a few sentences of the ESG factor or factors that are the focus of the fund's principal investment strategies. We recommend that, rather than checking a box for communicating the ESG strategies used by the fund, an ESG-Focused Fund explain the principal ESG strategies that it uses in a few sentences. We believe this narrative approach would better promote investor understanding of the strategies and avoid the potential confusion associated with the proposed check-the-box approach, as we discussed in Section 1.[48]

In addition, an ESG-Focused Fund should be required to provide a narrative only about a strategy that is a *principal* ESG strategy. This approach would convey more useful information to

---

reflect that the definition should capture only those funds that disclose their use of ESG integration as an investment tool.

[47] Our recommended modifications to the ESG-Focused Fund disclosure requirements would also apply to an Impact Fund, which the Commission is treating as a subset of ESG-Focused Funds.

[48] If the Commission determines to retain the check-the-box approach for indicating the ESG strategies that an ESG-Focused Fund uses, then we recommend that the list of ESG strategies be adjusted by eliminating proxy voting and engagement for the reasons discussed above and that an ESG-Focused Fund should check the box only for those strategies that are *principal* ESG strategies.

investors than a requirement that an ESG-Focused Fund provide a narrative about *any* ESG strategy it uses, regardless of the extent of its use of that strategy. It also could help more appropriately address the circumstance where advisers apply exclusionary screens across all funds, which may not be a fund's principal ESG strategy. Under our recommended approach, only funds that use an exclusionary screen as a principal ESG strategy would be required to provide related narrative disclosure.

We recommend eliminating the other two rows of the ESG Strategy Overview table as they would require disclosure of overly detailed information inconsistent with the purpose of a summary prospectus, as we discussed in Section 1. With the elimination of the two rows, leaving the one row of information, the ESG Strategy Overview information does not need to be in a table, which would avoid any costs associated with the table format. Rather, we recommend that the ESG Strategy Overview be provided in a standard location in the summary prospectus to promote comparability among ESG-Focused Funds, for the benefit of investors.[49]

We recommend that the statutory prospectus disclosures be modified to require an overview of the identified principal ESG strategies, rather than the details proposed. For example, we recommend that an ESG-Focused Fund that tracks an index identify the index and provide information about how to find more information about the index but the fund should not be required to disclose the index methodology, including any criteria or methodologies for selecting or excluding components of the index that are based on ESG factors. A fund also should not be required to name the third-party ratings or data providers that it uses or how it evaluates the quality of the data.[50] A fund may explain in general terms any internal methodology used and how that methodology incorporates ESG factors but should not be required to disclose proprietary information about the fund manager's investment process.

---

[49] If the Commission determines to retain the second row of the ESG Strategy Overview table, we recommend that the proposed disclosures be reduced significantly so that an ESG-Focused Fund provides an overview of how it incorporates ESG factors into its investment decisions but is not directed to provide the detailed items in the proposed instructions and also is not required to provide the information with respect to each ESG strategy in a disaggregated manner. If the Commission determines to retain the third row of the ESG Strategy Overview table, we recommend that an ESG-Focused Fund be required to provide an overview of its proxy voting and/or engagement strategies only if they are principal ESG strategies.

[50] If the Commission determines to require ESG-Focused Funds to disclose information about third-party ratings or data providers, an ESG-Focused Fund should only be required to provide the information for a third-party source upon which it relies *exclusively* to determine which investments qualify to be excluded from, or included in, the fund's portfolio.

## 2.4 Revise Impact Fund Disclosure Requirements to Better Reflect the Current Disclosure Framework and Impact Investing Practices

We agree with the intent behind the Commission's proposed enhanced disclosures for Impact Funds—that is, that a fund that seeks to generate a measurable impact should explain that strategy and report on its progress. As we previously noted, however, we disagree with the proposed requirement that funds that fall within a Commission-dictated definition of Impact Funds be required include an impact objective in the investment objective of the fund and believe that the proposed disclosure and reporting requirements should clarify that a fund may measure progress through individual investments, rather than at an aggregated portfolio level.

### 2.4.1 Impact Funds Should Have the Option to Determine Their Own Investment Objective

In discussing this part of the proposal with members, we considered how best to calibrate the definition of Impact Fund to distinguish for investors how these funds differ from other ESG-Focused Funds. One approach we considered was to define an Impact Fund as "a fund whose stated investment objective indicates that it seeks to achieve a specific ESG impact or impacts." The second approach we considered was to define an Impact Fund as "a fund whose stated principal investment strategies or investment objectives indicate that it seeks to generate positive, measurable, reportable social and/or environmental impact alongside a financial return." Under the latter approach, the Impact Fund would not be required to include an impact objective as part of its investment objective. The extent to which a fund seeks a measurable social and/or environmental impact and its relationship to financial objectives can vary, and the fund is best positioned, and can most accurately determine for itself, whether to include an impact objective as part of its investment objective.

While we do not support the Commission's proposed approach we were unable to reach consensus on a revised definition of Impact Fund. We found that there really is more than one reasoned approach that would effectively inform investors about such a fund's investment approach. This is an instance where a "one-size-fits-all" approach is neither workable nor the ideal way to promote investor understanding or global consistency. For example, the first approach would allow funds to more directly declare themselves to be an "Impact Fund" by including an impact objective as part of the investment objective. It would be a bright line, distinguishing Impact Funds from other types of ESG-Focused Funds. The second approach reflects an emerging global consensus regarding what constitutes an impact investing strategy.[51]

---

[51] See ICI, *Funds' Use of ESG Integration and Sustainable Investing Strategies: An Introduction Sustainable Investing Strategies Paper* (Jul. 2020), *available at* https://www.ici.org/doc-server/pdf%3A20_ppr_esg_integration.pdf, at 7 ("Funds with this type of investment approach seek to generate positive, measurable, reportable social and environmental impact alongside a financial return."); see also Global

While the first approach would likely include a smaller group of funds, the second approach would likely subject a larger group of funds to any new disclosure requirements. But the second approach also could be overinclusive or at least raise questions as to whether a fund truly falls within the Impact Funds category. In that case, defining Impact Funds as those that expressly indicate in their principal investment strategies that they seek a "measurable impact" would place more flexible guardrails around which funds qualify as Impact Funds. This approach recognizes that this type of investing style still is developing and may lead to enhanced investor understanding and global consistency in the long run.

Regardless of how Impact Fund is defined, however, we recommend modifications to the disclosure requirements of an Impact Fund, which we discuss below.

### 2.4.2 The Commission Should Clarify That Any Measurement and Reporting of Progress Does Not Have to be Aggregated at the Fund Level

The proposal would require an Impact Fund to include in the ESG Strategy Overview table of the summary prospectus how it measures progress toward a specific impact, the time horizon it uses to analyze progress, and the relationship between the impact the fund is seeking to achieve and financial returns. It also would be required to summarize briefly in the annual report the fund's progress on achieving the impact in both qualitative and quantitative terms during the reporting period and the key factors that materially affected the fund's ability to achieve the impact(s).

We recommend that the proposed disclosure requirements for the summary prospectus be shifted to the statutory prospectus and that those disclosure requirements be revised to require a fund to provide an overview of the impact(s) the fund is seeking "to generate" (rather than, as proposed, "seeking to achieve") and how the fund measures progress toward "an impact" (rather than, as proposed, "the specific impact").

As discussed above, it is imperative for the Commission to acknowledge and clarify that the prospectus disclosures and annual reporting may reflect the fund's measurement of investment-level impacts and not an aggregated portfolio-level impact. Our recommended approach recognizes that an Impact Fund does not necessarily seek to generate an impact relating to one theme that could be rolled up and measured on an aggregated level. Rather, many Impact Funds

---

Impact Investing Network at https://thegiin.org/impact-investing/need-to-know/#what-is-impact-investing ("Impact investments are investments made with the intention to generate positive, measurable social and environmental impact alongside a financial return.") and *Morningstar Sustainable Attributes, Framework and Definitions for "Sustainable Investment" and "Employs Exclusions" Attributes* (Jul. 31, 2020), available at https://advisor.morningstar.com/Enterprise/VTC/Sustainable_Attributes_Definitions_July2020.pdf ("These are strategies that seek to make a measurable impact alongside financial return on specific issue areas through their investments. Impact funds are often focused on specific themes or use the 17 U.N. Sustainable Development Goals as a framework for evaluating the overall impact of the portfolio.")

focus on multiple themes, such as some or all of the 17 United Nations Sustainable Development Goals.

For similar reasons, we recommend that the Commission clarify that an Impact Fund's annual report disclosures may discuss the fund's progress on "generating" (rather than, as proposed, "achieving") impacts, which can be described in connection with individual investments, and not necessarily at an aggregated portfolio level. In addition, the Commission should clarify that an Impact Fund is not obligated to describe progress in quantitative terms, which is not necessarily feasible with respect to certain investment themes. To do this, the Commission should, at a minimum, revise the disclosure requirement to indicate that an Impact Fund may describe its progress in "qualitative and/or quantitative terms" (rather than, as proposed, "both qualitative and quantitative terms").

### 2.5 Eliminate Required Annual Shareholder Report Disclosures Regarding Proxy Voting and Engagement

We recommend that the proposed requirement that an ESG-Focused Fund disclose specific and quantitative information about its proxy voting and engagement activities be eliminated from any final amendments. The current regulatory requirements provide a sound basis for effective disclosure regarding these activities. If a fund's proxy voting or engagement activities materially affected the fund's performance during the most recently completed fiscal year, the fund will discuss those activities in the annual report.[52]

Moreover, investors interested in complete vote-by-vote information on proxy voting can access it in a fund's Form N-PX. The Commission has proposed to modernize Form N-PX and make information reported on the form more accessible to investors—a component of the proposal that we support.[53]

If the Commission nevertheless determines to require certain ESG-Focused Funds to disclose information about their proxy voting and/or engagement activities, it should require a narrative discussion about how proxy voting and/or engagement activity reflects the fund's ESG strategies,

---

[52] See Item 27(b)(7)(i) of Form N-1A and Instruction 1.g(1) of Item 24 of Form N-2.

[53] See *Enhanced Reporting of Proxy Votes by Registered Management Investment Companies; Reporting of Executive Compensation Votes by Institutional Investment Managers*, Investment Company Act Release No. 34389 (Sep. 29, 2021) *available at* https://www.sec.gov/rules/proposed/2021/34-93169.pdf and Letter from Susan Olson, General Counsel, and Sarah A. Bessin, Associate General Counsel, ICI to Vanessa Countryman, Secretary, SEC regarding *Enhanced Reporting of Proxy Votes by Registered Management Investment Companies; Reporting of Executive Compensation Votes by Institutional Investment Managers* (File No. S7-11-21) (Dec. 14, 2021), available at https://www.ici.org/system/files/2021-12/proxyltr.pdf (supporting requiring funds to use XML tagging in their reports).

rather than the proposed quantitative data, which, as we previously discussed, could confuse investors, rather than enhance their understanding of these activities.

### 2.6 Right-size the Scope of Funds Subject to Aggregated GHG Emissions Reporting and Limit Fund Reporting to Data in Portfolio Companies' Regulatory Reports

We recommend several modifications to the proposal that certain ESG-Focused Funds report aggregated GHG emissions in their annual reports.[54]

First, it is essential that funds be provided a safe harbor from liability for reporting metrics that are necessarily dependent on third-party data. Given the novel and untested nature of the underlying data, a fund should be protected from potential liability relating to the accuracy or reliability of the aggregated GHG emissions data when that accuracy and reliability depends on data supplied by a third party.[55] The safe harbor should be available, regardless of whether the GHG emissions data of the portfolio company is in its regulatory report, is made publicly available by the company, or is based on the fund's good faith estimate.[56] Just as the Commission proposed providing public companies with a safe harbor for reporting scope 3 GHG emissions, it should provide a safe harbor to funds.

Second, the scope of funds subject to GHG emissions reporting obligations should be narrowed to ESG-Focused Funds with a principal investment strategy that focuses on investing in line with GHG emissions reduction. This would more appropriately link an obligation to report to GHG emissions information in the section of the annual report about a fund's performance to the fund's principal investment strategies.

Third, to address concerns regarding the inconsistency and unreliability of portfolio company data, discussed in Section 1, a fund should only be required to report carbon footprint and WACI metrics based on the Scope 1 and Scope 2 GHG emissions reported by a portfolio company in a

---

[54] As previously noted, any GHG emissions disclosures by BDCs should be subject to the fund-related disclosure requirements, and not the public company disclosure requirements. See n. 41, *supra*.

[55] Because the proposed GHG emissions metrics would be included in a fund's annual shareholder report filed on Form N-CSR, they would be subject to certification by the principal executive officer and principal financial officer. See Item 13 of Form N-CSR.

[56] At a bare minimum, the Commission should apply to funds liability for reporting information that is dependent on public company disclosure of GHG emissions that is commensurate with the liability it applies to public companies' disclosure of that information. For example, in our Public Company Climate Disclosure Comment Letter, we supported the Commission requiring public companies to disclose Scopes 1 and 2 emissions on an aggregated basis and additionally on a disaggregated basis for any particular constituent GHG that is material to the company in a regulatory filing. We also more generally recommended that the Commission adopt a "furnish and file" approach. Disclosure that is furnished, but not filed in Form 10-K is not subject to strict liability under Section 18 of the Exchange Act, disclosure controls or procedures, or certifications. See ICI Public Company Climate Disclosure Comment Letter, *supra* n. 38.

regulatory report. This would include reporting by US public companies if the Commission adopts new rules requiring US public companies to report Scope 1 and Scope 2 GHG emissions.[57] It also could include non-US companies that report the data in a regulatory report of its own jurisdiction if the methodologies used to report the Scope 1 and Scope 2 GHG emissions data is the same as that required by the Commission for US public companies.[58]

For many funds, this limitation means that the aggregated GHG emissions they report would be with respect to a portion of the fund's portfolio. To provide context for the reported aggregated GHG emissions, we recommend that the fund also report the percentage of its portfolio covered by the aggregated metric. In addition, for the metric to be at all meaningful, we recommend that a fund be required to report the aggregated GHG emissions data only if it can do so with respect to a minimum threshold percentage of the portfolio, such as 50%.[59] For example, for certain funds, such as fixed-income funds, GHG emissions data may not be available for a substantial portion of the fund's portfolio holdings. In the fund-of-funds context, following this general approach, the fund of funds should only be required to report aggregated metrics based on GHG emissions data reported by the underlying funds in regulatory reports, such as an ESG-Focused Fund subject to this reporting requirement.[60]

We also recommend that an ESG-Focused Fund be permitted to include a narrative explanation of the reported GHG emissions data to put it into context. As previously noted, the single GHG emissions metric could give an investor the misleading impression that it represents the best barometer for evaluating an ESG-Focused Fund's strategy. In the examples previously given of a company transitioning to lower GHG emissions, issuers of green bonds, and a manufacturer of electric vehicle batteries, an ESG-Focused Fund should be able to put into context the GHG emissions contributions of those investments to the fund's aggregated GHG emissions metrics, for the benefit of investors.

---

[57] Reporting by US public companies of Scopes 1 and 2 GHG emissions in either a filed or furnished report that is required by the Commission should constitute a "regulatory report" for purposes of this fund disclosure requirement.

[58] In our comment letter on the proposed climate-related disclosure requirements for public companies, we urged the Commission to move forward and prioritize work with the International Standards Setting Board and other jurisdictions towards developing common global baseline standards in order to mitigate fragmentation and provide investors with useful and generally consistent disclosure. See ICI Public Company Climate Disclosure Comment Letter, *supra* n. 38.

[59] The proposed carbon footprint would be normalized for fund size by dividing the aggregated GHG emissions by the fund's net asset value. Under our recommendation, the fund would normalize aggregated GHG emissions for purposes of calculating carbon footprint by dividing the aggregated GHG emissions by the asset value attributable to those portfolio companies that report Scopes 1 and 2 GHG emissions in their regulatory reports.

[60] The Commission's proposed approach that, where an underlying fund does not report the data, the fund look through and determine the Scopes 1 and 2 data of the portfolio companies of the investee fund would be exceedingly burdensome, especially if it required the fund to make good faith estimates of the data of a portfolio company of an underlying fund.

Fourth, because of the inconsistent and unreliable nature of Scope 3 emissions data, funds should not be required to disclose the proposed Scope 3 GHG emissions carbon footprint data by industry sector, even if public companies are required to report Scope 3 GHG emissions data in their regulatory reports.

Fifth, the requirement to treat derivatives as an equivalent position in the securities of the portfolio company that are referenced in the derivatives instrument is premature and should be omitted from the proposed GHG metrics calculations.[61] There are no standardized, globally-accepted methodologies for calculating GHG emissions associated with the many and varied types of derivative instruments. The absence of any standardized methodology will require funds to make their own assumptions about how to include the GHG emissions of the portfolio company referenced in the derivatives instrument and the resulting notional GHGs (i.e., the hypothetical GHGs attributed to the derivatives contract) will vary from fund to fund and create emissions metrics that are not comparable.[62] We recommend that the Commission work with standard setters to address methodologies for calculating GHGs attributable to investments in derivatives. Notional GHGs associated with investments in derivatives should be incorporated into the proposed GHG emissions metrics only after development of standardized, globally accepted methodologies.

Finally, our recommendations are premised on the adoption by the Commission of new GHG emissions disclosure requirements for public companies. If the Commission does not adopt the disclosure requirements or if they are overturned or suspended by a court in a legal proceeding, then any requirement that funds be required to report aggregated GHG emissions data based on US public company data must likewise be eliminated or suspended.

**Section 3: Proposed Adviser Disclosure Requirements**

The Commission proposes requiring advisers to disclose their ESG-related services and strategies.[63] We support requiring advisers to provide high-level, rather than detailed,

---

[61] See Proposed Instruction (d)(xiii) to Item 27(b)(7)(i)(E) of Form N-1A and Proposed Instruction 1(d)(xiii) to Item 24.4.g of Form N-2 ("If a Fund obtains exposure to a portfolio company by entering into a derivatives instrument, the derivatives instrument will be treated as an equivalent position in the securities of the portfolio company that are referenced in the derivatives instrument.").

[62] For example, should the equivalent position in a portfolio company referenced in a call option be delta-adjusted? As another example, how, if at all, should the market capitalization of a portfolio company be adjusted for outstanding derivatives contracts when calculating carbon footprint? Consider a situation where Fund A owns 60% of the market capitalization of Portfolio Company X and Fund B owns 40%. Further, assume that Fund C enters into a total return swap on Company X with a notional amount equal to 30% of Company X's market capitalization. Absent adjustments this scenario would seemingly cause the GHG emissions attributed to Company X on an aggregated basis to be over reported by 30%.

[63] See Proposing Release, *supra* n. 2, at 127–148 and 154–165 and proposed amendments to Form ADV.

information. The proposed requirements to provide extensive and granular information regarding each significant investment strategy, could unfortunately lead to increasing, rather than mitigating, the risk of investor confusion. Current brochure disclosure regarding non-ESG investing strategies is less detailed. This imbalance may cause investors to misinterpret ESG-related disclosure as indicating a greater focus on ESG than actually exists, merely because of its outsized length. This risk is heightened for an adviser that considers ESG as one factor among many in making its investment decisions. This is especially the case because the proposal would require these disclosures for *each* ESG strategy the adviser utilizes.[64] The brochure is intended to be a document that describes the adviser's overall business and should not include details about individual, unique strategies. In addition, the prescriptive requirements would impose costly burdens on advisers.

Moreover, because many fund advisers draw from their fund disclosures to provide parallel information in the Form ADV disclosures (i.e. to the extent disclosure also is appropriate for non-fund clients), we urge the Commission to ensure that the Form ADV disclosure requirements are no more prescriptive than fund disclosure requirements and use similar terms to facilitate that parallel disclosure. To ensure consistency in the disclosures, the Commission also should modify the disclosure requirements with respect to separate accounts to conform to the modifications we recommend for fund disclosures.

**Section 4: Economic Analysis and Compliance Costs and Dates**

**4.1 The Commission Significantly Underestimates the Costs of Complying with the Proposal**

The Commission's economic analysis for this proposal does not provide compelling evidence of the need for the proposed extensive and prescriptive disclosure and reporting requirements. As we have noted, many of the proposed provisions would not enhance investor understanding but could, instead, increase the risk of investor confusion. Thus, the benefits of many of the proposed requirements have not been demonstrated.

Yet the costs would be substantial. The Commission's cost analysis substantially underestimates the costs to each fund and to the fund industry of this proposal, including failing to account for key costs funds would incur. The Commission estimates that 80% of funds filing on Form N-1A would incur the burdens proposed for Integration Fund disclosure and 755 funds would incur the burdens associated with the ESG-Focused Funds disclosure.[65] It estimates that a fund falling within the Integration Fund category would incur an initial internal burden of 3 hours and an

---

[64] In this regard, the Commission should confirm that an adviser would not be obligated to provide separate disclosure for each ESG-Focused Fund it advises.

[65] See Proposing Release, *supra* n. 2, at 267.

annual burden of 2 hours and a fund falling within the ESG-Focused Fund category would incur an initial internal burden of 18 hours and an annual burden of 12 hours.[66] Because Form N-1A sets forth the disclosure requirements for both prospectuses and annual reports, we assume these estimates are intended to include the number of hours the Commission expects it will take to implement the new disclosure requirements for both disclosure documents, which may require distinct resources to prepare (e.g., accounting personnel may be more involved in preparing and certifying the proposed GHG metric disclosures that would appear in shareholder reports).

The Commission woefully underestimates the number of hours and resources funds would expend to comply with the new disclosure requirements. The Commission suggests that all that would be required for the prospectus disclosure requirements is for attorneys and compliance professionals to "review and familiarize themselves" with the new requirements, fund managers to review their current investment strategies and practices to gather any information needed for the proposed disclosures, and attorneys to review disclosures to ensure they satisfy the new requirements.[67] With respect to the proposed new annual report disclosure requirements for certain ESG-Focused Funds, the Commission simply indicates that these funds would need to "gather their records on these issues, review and evaluate them in accordance with their stated goals or key performance indicators, and prepare disclosures in the report."[68]

This cost analysis falls short in several ways. The descriptions understate the extensive analysis, consultation, and discussions that would be required to implement the new requirements and the ongoing oversight and compliance for those funds that are subject to the additional disclosure. Our members consistently cite one-time compliance costs (e.g., legal costs, preparation of new policies and procedures, creation of internal controls and ongoing testing, and staff training), increased technology expenditures, increased use of third-party vendors, development of appropriate oversight programs, and increased staffing needs as the primary drivers of the overall cost of implementing a new or revised process in response to a new regulatory mandate.

Additionally, the Commission ignores the opportunity costs associated with funds' efforts to comply with the proposed new disclosure requirements, including the diversion of resources that may otherwise be focused on, for example, bolstering portfolio and risk management capabilities, improving customer service, and product innovation.

Furthermore, the Commission's economic analysis either overlooks or does not comprehensively evaluate certain other major costs of complying with the proposal including the following:

---

[66] Id.

[67] Id. at 213.

[68] Id. at 221.

- Cost to obtain necessary data from external sources/vendors,
- Cost related to disclosure updates to shareholders,[69]
- Cost associated with updating policies and procedures and training,
- Cost of engaging outside counsel and other specialists to assist with evaluating current disclosures and drafting new or updated disclosures,
- Cost of developing estimates of necessary data for, calculating, and reporting aggregated GHG emissions data,
- Cost, which may include increased fees, for adding disclosures about third-parties,
- Cost of oversight of the overall program including, for some ESG-Focused Funds, evaluating, developing a tracking mechanism, and tracking ESG voting matters and engagement meetings, and
- Cost associated with updating recordkeeping processes, procedures, and systems to demonstrate compliance with the proposal.

The far-reaching changes that are proposed would have considerable negative economic impacts on the fund industry and its shareholders by increasing costs. Fund shareholders ultimately would bear much of the monetary burden associated with the proposal because compliance costs are fund expenses, which generally shareholders bear. The Commission is required to conduct a cost benefit analysis and, doing so is particularly critical for a proposal like this, where significant costs will be borne by fund shareholders if the new disclosure requirements are adopted as proposed.

The Commission itself observed that many of the benefits and costs discussed within the economic analysis are difficult to quantify[70] and, as noted above, the Commission's economic analysis failed to fully consider the magnitude and complexity of the system enhancements and many other ancillary costs required to comply with the proposed amendments. Therefore, we do not believe that the Commission has provided a compelling cost benefit analysis which demonstrates that the benefits of the proposal outweigh the costs.

The Commission therefore must conduct a more detailed cost assessment that better reflects funds' obligations before moving forward on this regulatory initiative. We further believe that

---

[69] The economic analysis does not address the significant costs a fund would incur if it were required to mail a supplement to existing shareholders. As discussed, *infra*, we recommend that the Commission permit funds to provide their new disclosures in their annual updates.

[70] Proposing Release, *supra* n. 2, at 171.

our recommended modifications would better achieve the Commission's goals without the negative consequences and unnecessary burdens and costs of the proposal.

### 4.2 The Commission Should Extend the Compliance Dates

The Commission proposes the compliance dates of one year for prospectus disclosure requirements and 18 months for annual report requirements.[71]

We urge the Commission to extend the compliance period for the new disclosure and reporting requirements to three years.[72] We also recommend that the Commission allow funds to provide their new disclosures in their annual updates to their registration statements.[73]

The proposal would require many funds to make significant changes to their disclosure. For example, if the Commission's proposed requirement that ESG-Focused Funds include an ESG Strategy Overview table with three rows of extensive disclosure in their summary prospectuses, fund complexes would need to incorporate the new table and new disclosure items in their summary prospectuses. Even if the Commission adopted the more streamlined prospectus disclosure requirements that we have recommended, ESG-Focused Funds would still need to incorporate a new section in its summary prospectus. In addition, if the proposed annual report requirements are adopted, ESG-Focused Funds would be required to develop policies and procedures for tracking and calculating the proposed metrics.

---

[71] See Proposing Release, *supra* n. 2, at 168–170. Specifically, the Commission proposes a compliance date of one year following the effective date of any adoption, which would be sixty days after the date of publication in the Federal Register, for the following 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. It proposes a compliance date of 18 months following the effective date of any adoption for annual reports and Form N-CSR.

[72] Regarding UITs, we recommend that the Commission clarify that any new disclosure requirements be applicable only to UITs deposited *after* the compliance date and that UIT sponsors not be required to amend prospectus disclosure for UITs already deposited. Given a UIT's fixed and transparent portfolio, it certainly would be confusing for an existing investor to receive a prospectus reflecting revisions to the investment methodology. The Commission's economic analysis assumes this approach, stating that "UITs would incur one-time direct compliance costs at inception" (i.e., UITs deposited after the compliance date). See Proposing Release, *supra* n. 2, at 215-217. Moreover, this approach would be consistent with the Commission's proposed approach in the Investment Company Names Proposal, in which the proposed amendments would primarily apply only to UITs deposited after the effective date. See Names Rule Proposal, *supra* n. 27, at 202 (proposing to provide certain exemptions to UITs deposited prior to the effective date of any final rule). We also recommend that any additional new disclosure requirements be required only in Form S-6 and not in both Form S-6 and Form N-8B-2. Because Form S-6 is the retail-facing prospectus, Form N-8B-2 is only provided to the Commission and not to investors, and Form N-8B-2 is generally not amended as new UIT series are deposited, amending Form N-8B-2 would provide negligible benefit.

[73] To accomplish this, the Commission should make clear that a fund would not be required to amend its prospectus and transmit to shareholders at the compliance date. Rather, the fund should be able to reflect the new disclosures in its next annual update following the compliance date.

Fund complexes would need ample time to implement, and test, the changes before they can confidently incorporate them into the disclosure preparation workflow. They also would need to dedicate significant time, effort, and expense to modifying websites and developing disclosure templates.

In addition, the Commission's proposal would create new categories of funds and would require considerable investor and intermediary education.

The Commission should not underestimate the significance of the changes the proposal contemplates and the complexities associated with implementing the requirements of this proposal simultaneously with those of other, complex proposals.[74]

* * * *

[74] The Commission requested public comment on three regulatory actions, each of which, if finalized, will significantly affect fund operations. In addition to this proposal, the Commission has proposed amendments to the Names Rule and has sought comment on whether information providers might meet the definition of "investment adviser." See Investment Company Names Proposal, *supra* n. 27 and *Request for Comment on Certain Information Providers Acting as Investment Advisers*, Investment Company Act Release No. 42618 (Jun. 15, 2022), *available at* https://www.sec.gov/rules/other/2022/ia-6050.pdf. Comments are due to the Commission on each of these on the same day, August 16. We are concerned that the Commission simply does not seem to be taking into account that the pace and complexity of the Commission's simultaneous rulemaking may ultimately harm, rather than benefit, fund investors. We expressed extreme concern with this approach to rulemaking earlier this year. In April, ICI, along with several other trade associations, submitted a letter to Chair Gensler pointing out that aside from the sheer volume of rulemaking items, the Commission simultaneously was tackling issues that could result in significant shifts in industry operations and practices. The letter also pointed out that "exceedingly short comment periods associated with numerous concurrent potentially interconnected rule proposals that touch on significant changes to the operational and regulatory regime applicable to financial firms could result in rules that hurt investors, damage the financial system, implicate the Commission's obligations under the [Administrative Procedure Act] and internal rulemaking guidelines, and ultimately violate the Commission's tripartite mission." 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.

We appreciate the opportunity to provide feedback on the proposal and look forward to further dialogue with you on this important matter. If you have any questions, or if we can be of assistance in any way, please contact us at eric.pan@ici.org or acapretta@ici.org, or Dorothy Donohue, Deputy General Counsel, Securities Regulation, at ddonohue@ici.org.

Sincerely,

/s/ Eric J. Pan

Eric J. Pan
President & CEO

/s/ Annette M. Capretta

Annette M. Capretta
Associate General Counsel

cc: Chair Gary Gensler
Commissioner Hester M. Peirce
Commissioner Caroline A. Crenshaw
Commissioner Mark T. Uyeda
Commissioner Jaime Lizárraga

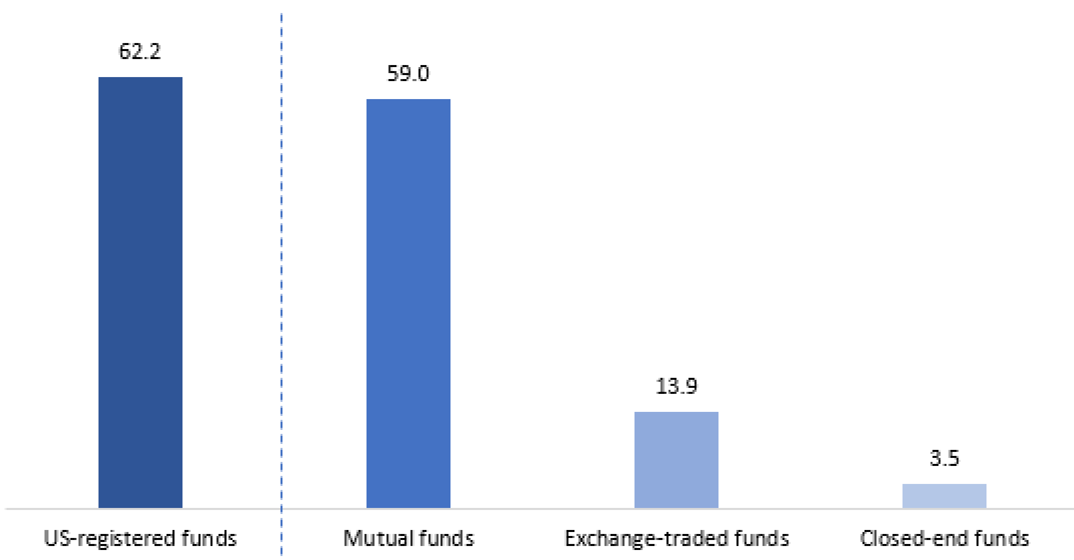
William Birdthistle, Director
Division of Investment Management

# Appendix

## Background on the Fund Industry

In 2021, nearly half (47.9%) of US households owned shares of mutual funds or other US-registered investment companies—including ETFs and closed-end funds—representing an estimated 62.2 million households and 108.1 million investors. Mutual funds were the most common type of investment company owned, with 59.0 million US households, or 45.4%, owning mutual funds in 2021 (Figure 1). In 2021, 13.9 million US households, or about 11%, owned ETFs, and 3.5 million households reported closed-end fund ownership.

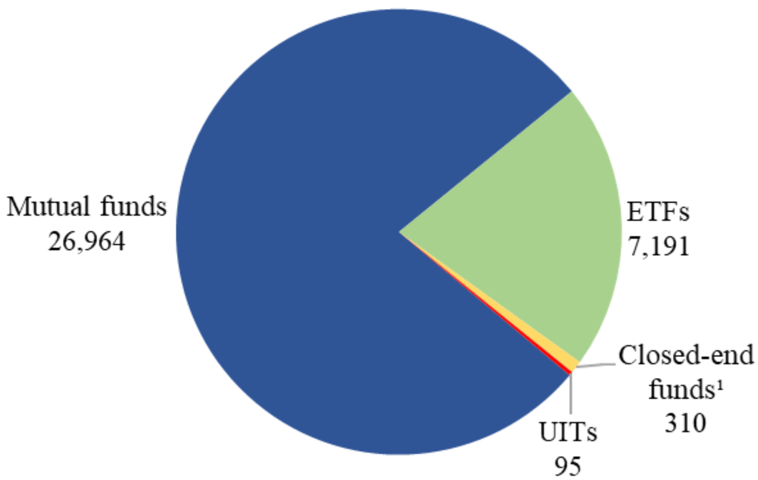
**Figure 1**
**More Than 62 Million US Households Invest in US-Registered Funds**
Millions of US households owning mutual funds, ETFs, or closed-end funds, 2021




Note: Households may own more than one type of fund.
Source: Investment Company Institute Annual Mutual Fund Shareholder Tracking Survey

At year-end 2021, mutual funds had total net assets of nearly $27 trillion, ETFs had net assets of $7.2 trillion, closed-end funds had total assets of $310 billion, and UITs had net assets of $95 billion (Figure 2).

**Figure 2**
**Investment Company Total Net Assets by Type**
Billions of dollars, year-end 2021

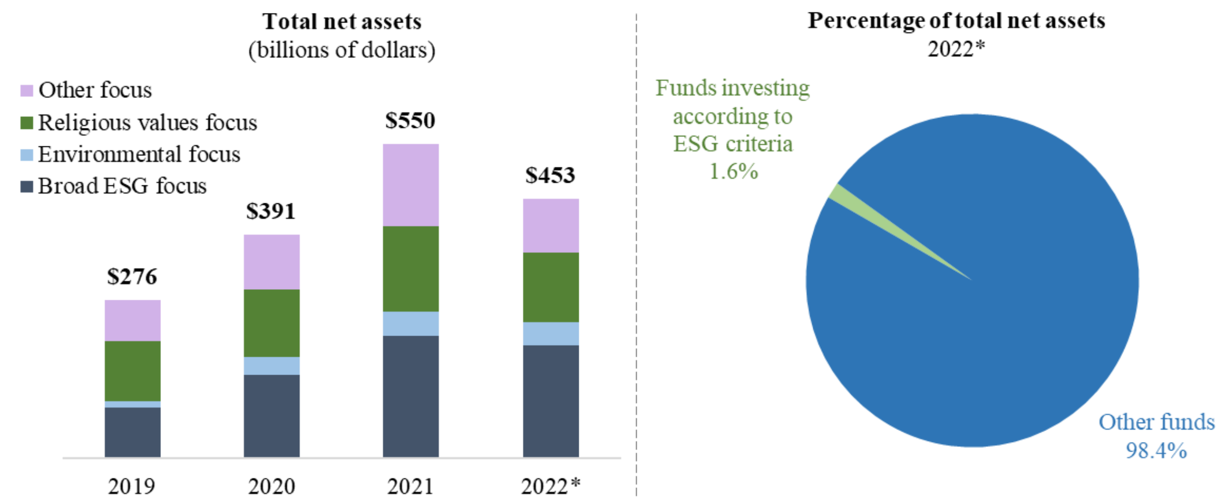



**Total investment company assets: $34.6 trillion[2]**

[1] Closed-end fund data include preferred share classes.
[2] Total investment company assets include mutual fund holdings of closed-end funds and ETFs.
Source: Investment Company Institute

ICI's Research Department examines the prospectuses of funds to classify those that invest according to ESG criteria, reviewing for language indicating that a fund places an important and explicit emphasis on environmental, social, or governance criteria to achieve certain goals. Following this approach, as of June 2022, 818 mutual funds and ETFs, with assets of $453 billion were classified generally as investing according to exclusionary, inclusionary, or impact investing ESG criteria.[75] Those funds represent 1.6% of US mutual fund and ETF total net assets, with environmentally focused funds representing less than 0.15% of mutual fund and ETF total net assets (Figure 3).[76]

**Figure 3**
**Total Net Assets of Funds That Invest According to ESG Criteria and Their Share of Total Fund Assets**
Year-end*




*Data for 2022 are as of June 30.
Note: Data include mutual funds and ETFs. Data include mutual funds that invest primarily in other mutual funds and ETFs that invest primarily in other ETFs.
Source: Investment Company Institute

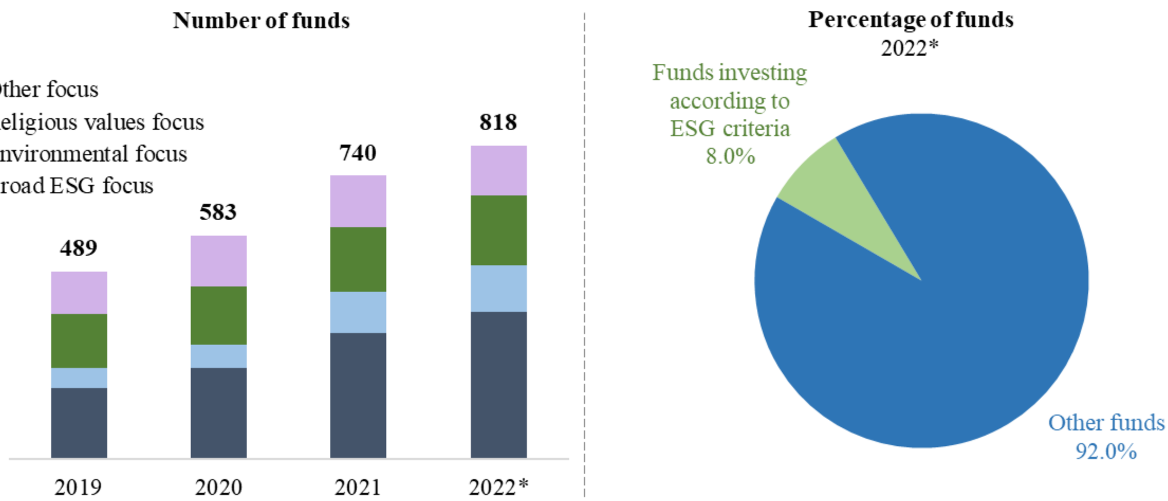
[75] See ICI Fact Book, *supra* n. 5, at 42. See also ICI, *Funds' Use of ESG Integration and Sustainable Investing Strategies: An Introduction* (July 2020), available at www.ici.org/system/files/attachments/20_ppr_esg_integration.pdf and ICI, *ESG and Funds: Frequently Asked Questions* (February 2022), available at www.ici.org/system/files/2022-02/22-esg-faqs.pdf.

[76] See ICI Fact Book, *supra* n. 5.

**Figure 4**

**Number of Funds That Invest According to ESG Criteria and Their Share of the Total Number of Funds**

Year-end*




*Data for 2022 are as of June 30.

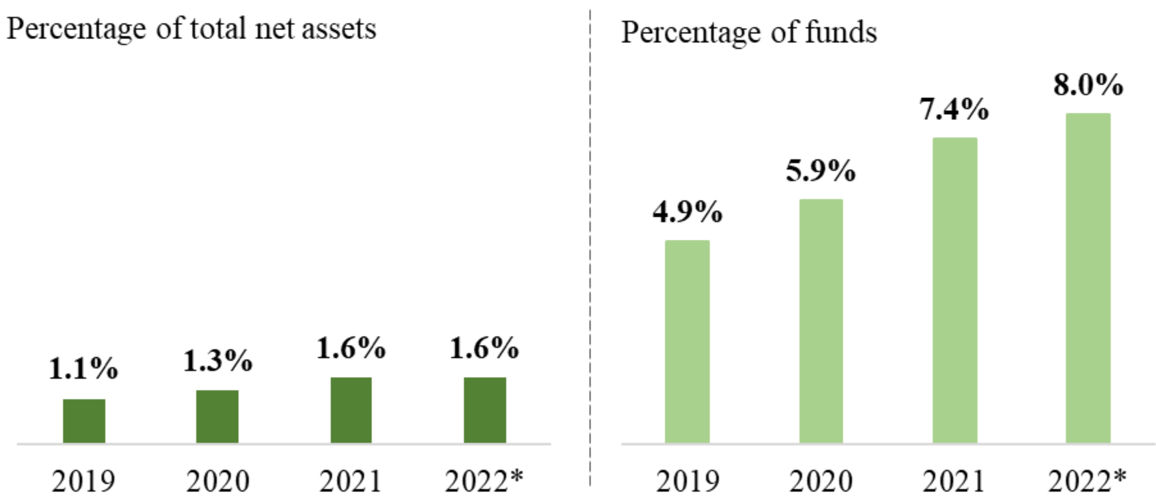
Note: Data include mutual funds and ETFs. Data include mutual funds that invest primarily in other mutual funds and ETFs that invest primarily in other ETFs.

Source: Investment Company Institute

**Figure 5**

**Funds That Invest According to ESG Criteria Represented 8% of the Total Number of Funds at the End of June 2022**

Year-end*




*Data for 2022 are as of June 30,

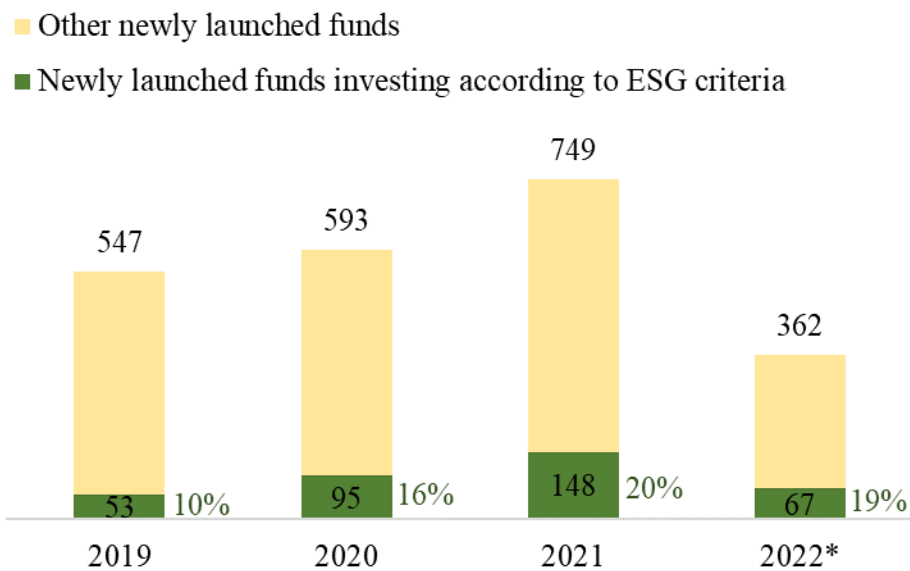
Note: Data include mutual funds and ETFs. Data include mutual funds that invest primarily in other mutual funds and ETFs that invest primarily in other ETFs.

Source: Investment Company Institute

**Figure 6**

**Funds That Invest According to ESG Criteria Were 19% of All Newly Launched Funds in the First Half of 2022**

Annual*




*Data for 2022 are as of June 30.

Note: Data include mutual funds and ETFs. Data include mutual funds that invest primarily in other mutual funds and ETFs that invest primarily in other ETFs.

Source: Investment Company Institute