Invested in America

August 16, 2022

Submitted electronically via SEC.gov
Vanessa Countryman, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

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

Dear Ms. Countryman:

On behalf of our member firms and their customers, the Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to comment on the Commission's proposal[2] to enhance disclosures by certain investment advisers and funds about their environmental, social and governance ("ESG") investment practices (the "Proposal").

SIFMA lauds the Commission for its attempt to provide investors in ESG investment products with clear, accurate and comparable information, and supports the Commission's decision to focus on using disclosures to clarify the role ESG factors play in managers' investment decisions instead of mandating a single definition of "ESG."

We note that SIFMA Asset Management Group of SIFMA ("SIFMA AMG") has filed a letter detailing various possible improvements to the Proposal. In addition to the items raised in that letter, SIFMA believes certain provisions of the Proposal should be modified to maintain the goals of the Proposal while limiting unintended or undue consequences. We submit the following

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[1] SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry's nearly 1 million employees, we advocate for legislation, regulation and business policy, affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry-coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org. SIFMA appreciates the assistance of George B. Raine, James D. McGinnis, Jennifer Choi and Colton Canton of Ropes & Gray LLP in the preparation of this response.
[2] Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices Release No. IA-6034, 87 Fed. Reg. 36654 (proposed May 25, 2022), available at https://www.sec.gov/rules/proposed/2022/ia-6034.pdf [hereinafter the "Proposal" or "Proposing Release"].

suggested revisions and alternative approaches to portions of the rule for the Commission's consideration.

Additionally, SIFMA notes that the Proposal is one of numerous, interconnected rule changes proposed by the Commission, including new climate-related reporting rules for public companies,[3] amendments to Form N-PX[4] and changes to Rule 35d-1.[5] Many of these rules have concurrent implementation periods, placing a significant burden on regulated parties attempting to keep pace with a rapidly changing regulatory landscape. SIFMA believes that the implementation period for the Proposal should be lengthened considering the volume, speed and complexity of the numerous regulatory changes proposed by the Commission.[6]

1. SIFMA supports the Commission's decision not to provide a single definition of "ESG."

SIFMA supports the Commission's decision to focus on ensuring investment advisers and fund managers provide full and fair disclosures of what they consider "ESG" factors instead of dictating a single definition of what constitutes "ESG." As sponsors to wrap programs and distributors of funds and investment products, SIFMA members are familiar with a wide range of different investment products offered by a variety of fund managers. SIFMA believes that ESG investment products are part of a dynamic sector where industry standards continue to solidify. Clients seek to fulfill a variety of ESG-related goals. Dictating a single definition of what qualifies as an ESG product may make it difficult for wrap program sponsors and distributors to provide investors with information on products and services that fulfill the full range of investors' needs. Broker-dealers whose customers seek ESG-focused investments, for example, should be able to recommend to investors, consistent with their obligations under Regulation Best Interest, the full range of products available without the compliance burden of determining for any given product whether the factors each product considers falls under a particularized SEC-set definition of "ESG." The Commission's current emphasis on ensuring investors understand what each manager conceives of as an "ESG" issue and how those issues are incorporated into the manager's products maintains appropriate flexibility while providing a framework and regulatory guideposts to the market for ESG products.

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[3] The Enhancement and Standardization of Climate-Related Disclosures for Investors, Release Nos. 33-11042, 34-94478 Fed. Reg. 21334 (proposed March 21, 2022).

[4] Enhanced Reporting of Proxy Votes by Registered Management Investment Companies; Reporting of Executive Compensation Votes by Institutional Investment Managers, Release Nos. 34-03169, IC-34389 Fed. Reg. 57478 (proposed Sept. 29, 2021).

[5] Investment Company Names, Release Nos. 33-11067, 34-94981, IC-34593 Fed. Reg. 36594 (proposed May 25, 2022).

[6] Additionally, SIFMA appreciates that the Commission has included a 60-day comment period for this rulemaking. *See* Proposing Release, *supra* note 2, at 1. SIFMA continues to believe that, consistent with federal guidance on rulemaking procedure, the public should be provided a minimum of 90 days to comment on rule proposals. *See* Joint Comment Letter from SIFMA & SIFMA AMG on the "Importance of Appropriate Length of Comment Periods" (Apr. 5, 2022), https://www.sifma.org/resources/submissions/importance-of-appropriate-length-of-comment-periods.

2. The Proposal's Form ADV amendments should be narrowed so that advisers' disclosures about their incorporation of ESG factors and disclosures regarding certain affiliates' activities are not unduly prominent compared to their disclosures about other important investment strategies.

- *SIFMA supports limiting the Form ADV brochure disclosures that the Proposal mandates for advisers that implement ESG integration strategies and increasing the compliance period for all disclosure requirements.*

The Proposal implements several new disclosures for advisers in their annual Form ADV filings. These include a requirement that each adviser describes each "ESG factor or factors it considers for each significant investment strategy or method of analysis for which the adviser considers any ESG factors."[7] The description of how an adviser uses these strategies would include "an explanation of whether and how the adviser employs integration and/or ESG-focused strategies, and if ESG-focused, whether and how the adviser also employs ESG impact strategies."[8]

For the reasons laid out in SIFMA AMG's letter, SIFMA is concerned that these disclosures will be required of too many advisers who do not intend to present themselves as managing or providing access to ESG products and that, in some cases, the required disclosures will call for a potentially misleadingly high level of disclosure. In particular, the Proposal's requirement that advisers describe each ESG factor they consider for any integration strategy could obligate some advisers who integrate ESG factors into all of their investments to provide laundry lists of those ESG factors for dozens or hundreds of individual strategies.

The Commission should narrow the level of detail required for disclosures about integration strategies and adopt a layered disclosure approach. Advisers who employ integration strategies should be able to fulfill their disclosure obligations by relying on existing ESG-related policies or disclosure documents and should not need to repeat that information in their disclosure brochures.

- *SIFMA requests the Commission consider limiting the information it mandates advisers provide regarding third-party ESG services and enhancing protections for advisers disclosing the methodologies and processes of third parties whose adherence to those methodologies they cannot control.*

SIFMA further believes the Proposal may require advisers subject to the rule to provide too much information about the policies, practices and methodologies of third parties. The Proposal would mandate that, for any "significant strategy" an adviser employs, that the advisers disclose any "third-party criterion or methodology" used to evaluate investments based on ESG factors, including "an explanation of how the adviser evaluates the quality of relevant third-party data." Similarly, advisers would need to disclose the use of any "inclusionary or exclusionary" screens including "an explanation of the factors the screen applies" and the "name and description" of any ESG-related index the fund tracks, including "how the index utilizes ESG factors in determining its constituents."[9]

[7] Proposing Release at 130.
[8] *Id.*
[9] *Id.* at 132.

SIFMA believes it may not be practicable for advisers to disclose this level of detail about third-party methodologies and practices. Furthermore, advisers and distributors are concerned that, absent additional clarification, investment advisers could be subject to unreasonable compliance obligations relating to ensuring that third parties (particularly third parties that are not registered or required to be registered as investment advisers and thus are not subject to the Commission's jurisdiction regarding compliance policies, procedures or disclosures) continually operate in a manner consistent with each adviser's disclosures. Advisers may not have access to sufficiently detailed information about the composition and weighting of indexes managed by third parties to fulfill these disclosure obligations. Securing this level of disclosure may prove especially challenging because the methodologies used to create ESG indexes, rank investments and operate ESG screens will often be proprietary and/or the third party will not be subject to the same rules and regulations as the adviser. Third-party service providers are likely to be justifiably wary of providing details about the operations of their services in freely available regulatory documents when charging for those methods is core to the providers' business models.

SIFMA therefore proposes that the new Form ADV disclosures should require explanation of the methodology used to rank or screen investments, or to track a particular index, only when such tools are developed and employed internally by an adviser or are provided by a third party that is also an adviser. Otherwise, advisers should be required to provide high-level information regarding their ESG service providers' methodologies. Requiring further disclosures from advisers would be ineffective, as they are likely to have access to little if any additional information beyond what the provider publicly discloses. Additionally, pointing investors to the third party's own descriptions would properly contextualize the source of the advisers' scoring, indexing or screening methods and notify investors that the adviser is not the primary entity applying those methods.

Finally, to ensure advisers are not subject to compliance duties they do not have the practical ability to implement, the Proposal should provide a safe harbor for disclosures based on a third party's representations about that third party's methods and practices. The Commission could encourage more fulsome disclosure from advisers by confirming that an adviser or distributor has no duty to verify the accuracy of a third party's description of their own methodologies or to ensure that a particular third-party provider's descriptions of their methodology for ranking or screening investments based on ESG criteria, or for tracking an index, reflect the actual practice of that provider.

- *SIFMA recommends the Commission change the disclosures required of wrap fee program sponsors implementing ESG integration strategies in the same manner as described above for other advisers and reduce the information advisers must provide about the practices and methods of third-party portfolio managers.*

SIFMA is particularly concerned with the application of new disclosure rules to wrap program sponsors. Similar to the above requirements for disclosure in advisers' Form ADV brochures, providers of wrap fee products and services would disclose how they "incorporate ESG factors in the selection of portfolio managers for the wrap fee clients" and in their wrap fee programs generally.[10] Specifically, a sponsor's wrap fee brochures would need to include "a description of

[10] *See id.* at 141.

what ESG factors they consider, and how they incorporate the factors under each program" and a description of any ESG factors used "when selecting, reviewing, or recommending portfolio managers within the wrap fee programs they sponsor."[11] If the sponsor is also the program's portfolio manager, it must make the same Form ADV ESG disclosures discussed above in its wrap fee brochure.[12]

As part of its explanation of how the wrap fee sponsor considers ESG factors, the sponsor must: (1) describe any "criteria or methodology" the sponsor uses to "assess portfolio managers' application" of ESG factors in their investing activities; (2) explain whether the sponsor or a third party "reviews" the portfolio manager's application of relevant ESG factors and (3) specifically state if an adviser or a third party does *not* review the manager's application of ESG factors and whether and/or why such an assessment "may not be calculated, compiled, assessed, or presented on a uniform and consistent basis."[13]

SIFMA believes that these disclosures may present a significant regulatory burden for wrap fee sponsors without providing commensurate benefits to investors. Currently, Form ADV requires wrap fee program sponsors to "[d]escribe the services, including the types of portfolio management services, provided under each program."[14] Many managers – especially those who offer several wrap fee programs – often provide high level descriptions of their portfolio management programs that do not discuss any particular factors weighed by the portfolio manager.[15] SIFMA is concerned that the extensive disclosures envisioned by the Proposal would result in many advisers providing a misleading amount of extra detail for their ESG considerations compared to other factors of greater or equal import in their investment processes. For example, requiring an adviser to specifically disclose that it does not review the manager's application of ESG factors misleads investors by implying that such a review is required by rule. A wrap program sponsor that chooses to apply a robust, yet consistent, review process to all investment strategies could be required to misstate in its disclosures that its process is not "presented on a uniform or consistent basis."

Similarly, wrap fee program sponsors typically provide only a limited set of disclosures about a third-party adviser's use of different investment strategies because such information is included in the third-party advisers' own brochure, which is also provided to the wrap fee client. Under the Proposal, however, these sponsors would likely need to duplicate the third-party adviser's ESG strategies as part of their description of the "criteria or methodology" the sponsor uses to "assess [the] portfolio manager's application" of ESG factors in their investments. Because sponsors would have to make these disclosures if they integrate ESG factors into their selection of a portfolio manager at all, their wrap fee brochures would provide far more information on an

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[11] *Id.* at 142.
[12] *See id.* at 145.
[13] *Id.* at 144.
[14] Form ADV Part 2A, Appendix 1.
[15] *See, e.g.*, LPL Financial LLC, Manager Access Select Program Brochure, available at https://files.adviserinfo.sec.gov/IAPD/Content/Common/crd_iapd_Brochure.aspx?BRCHR_VRSN_ID=775852 (describing wrap fee programs as providing "ongoing discretionary investment advice regarding the investment and reinvestment of account assets in accordance with the investment objective, restrictions and guidelines set forth in the Application or in other agreed-upon written instructions" without discussing factors involved in investment selection.)

adviser's ESG strategies than it would on, for instance, the role of fundamentals analysis or other investment strategies, even if those strategies were far more influential in an adviser's investment processes than ESG factors.

In addition to possibly misleading investors, these disclosures would present a significant regulatory burden to wrap fee program sponsors while providing benefits to investors that are, at best, dubious. Advisers would likely need to harmonize their "description of what ESG factors they consider, and how they incorporate the factors" with a third-party portfolio manager's description of their own use of ESG factors – information investors already have from the third-party portfolio manager's own brochure. These duplicative disclosures could be required for dozens of wrap free programs an adviser might sponsor, presenting a high risk of error and investor confusion.

SIFMA proposes that the Commission make two changes to its proposal for ESG disclosures in wrap fee programs. First, Item 4 of Form ADV Part 2A should require a description of the ESG factors an adviser considers when (1) the adviser directly manages the wrap fee program and (2) the adviser also employs an ESG-focused or ESG impact strategy in the wrap fee program. If an adviser simply offers an investment strategy managed by a third-party portfolio manager, Form ADV Part 2A should explain that a discussion of the ESG factors the portfolio manager considers can be found in the portfolio manager's own Form ADV and provide the location of that discussion.

- *SIFMA supports limiting the disclosures that the Proposal mandates for advisers that conduct business activities as ESG providers or that have related persons that are ESG providers.*

The Proposal would require that advisers disclose and provide information about their own or certain affiliates' business activities as ESG service providers.[16] This requirement as proposed would likely require unnecessary disclosure of business activities that do not relate to the adviser's advisory services to its clients, which could confuse and mislead clients or prospective investors. SIFMA is concerned that the proposed disclosures may reveal non-public information regarding a firm's non-advisory services such as proprietary research, analytical data and/or computer hardware or software containing intellectual property. SIFMA proposes that the amendments be limited and tailored to require disclosure only if the adviser provides its ESG provider services to its own advisory clients or in its advisory business to a material extent. Similarly, if an adviser has a related person that provides ESG provider services, the adviser should only be required to disclose the related person's ESG-related activities if the adviser actually uses the services of the related person ESG provider.

3. The Proposal's methods for calculating a fund's contribution to its issuer's GHG emissions should be refined because the current method is likely to overstate the extent of such contributions.

- *The Commission should reconsider mandating that advisers calculate their GHG emissions statistics using the full notional value of any derivatives exposure the fund has to a portfolio company.*

[16] *See* Proposing Release at 133–34; *see also id.* at 163–65.

The Proposal institutes significant new disclosure requirements for funds that incorporate environmental factors into their investment analyses, which SIFMA believes will impose high costs on affected parties while providing data of limited use to investors in some cases. In addition to concerns regarding the GHG emissions raised in SIFMA AMG's comment letter, to the extent the Commission forges ahead with the Proposal in its current form, SIFMA urges the Commission to reexamine the methods it uses to calculate the necessary GHG emissions disclosures with respect to the inclusion of derivatives within the calculations. In particular, SIFMA takes issue with the Proposal's deeming a fund to have functionally made an equity investment in a company equal to the full notional amount of any derivatives exposure that fund has to that company.

Requiring funds to report the notional value of their derivatives exposure overstates the fund's actual contribution to the issuer's carbon emissions. This is because a fund's derivative exposure to a portfolio company does not finance the activities of the portfolio company directly. Mandating funds calculate their contributions to their issuers' GHG emissions using the notional value of their derivative exposure to those issuers is therefore almost certain to lead to systematic overestimates of the contribution of a given fund to the financing of any particular GHG emissions, undermining the Commission's goal of providing investors with accurate and decision-useful information.

SIFMA recommends that the Commission exclude the value of derivatives held in portfolio companies from estimates of portfolio companies' GHG emissions by giving funds the option of not treating investments in derivatives as investments in a "portfolio company" for the purposes of the rulemaking. Under this suggestion, a fund would not count its derivative exposure as equity in a company for purposes of calculating GHG emissions, nor would the value of those derivatives be counted as part of the net asset value of the fund for purposes of its GHG emissions disclosures. Many funds would therefore have little incentive to shift their investments to derivatives without providing GHG emissions disclosure, and the Commission would not imply that a funds derivative exposure is contributing significant financing to carbon producing activities.

If the Commission continues to believe that inclusion of investments in derivatives is important for the purposes of GHG emissions disclosure, in keeping with the flexible framework of the rest of the rule, the Commission could permit funds to determine when to use the notional or market value of their derivatives to calculate their GHG emission disclosures. This would minimize potential overstatements of fund investments in underlying portfolio company holdings, as often the notional value can far exceed the actual economic exposure to an underlying company, which in many cases is a fairer approximation of holding an equity interest in that company. To ensure accuracy in disclosures, the fund could be required to state in plain language whether their GHG emissions numbers are based upon the notional or market value of the derivatives in question, allowing investors to draw informed conclusions about the implications of those numbers.

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SIFMA appreciates the Commission's efforts to improve investors' access to information in the evolving ESG landscape and for opportunity to suggest improvements to the Proposal. SIFMA and its members would welcome any further questions or opportunities to discuss the Commission's ESG policies. Please do not hesitate to contact Melissa MacGregor (mmacgregor@sifma.org) or our counsel George B. Raine (george.raine@ropesgray.com) and James D. McGinnis (james.mcginnis@ropesgray.com) at Ropes & Gray LLP.

Sincerely,

Melissa MacGregor

Melissa MacGregor
Managing Director & Associate General Counsel

cc: The Hon. Gary Gensler, Chair, U.S. Securities and Exchange Commission
The Hon. Hester M. Peirce, Commissioner, U.S. Securities and Exchange Commission
The Hon. Caroline A. Crenshaw, Commissioner, U.S. Securities and Exchange Commission
The Hon. Mark T. Uyeda, Commissioner, U.S. Securities and Exchange Commission
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