August 16, 2022

VIA ELECTRONIC SUBMISSION
Ms. Vanessa Countryman
Secretary
Securities and Exchange Commission
100 F St. NE
Washington, D.C. 20549

Re: Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices (SEC Release Nos. IA-6034; IC-34594; File No. S7-17-22) (May 25, 2022).

Dear Ms. Countryman,

The American Investment Council (the "AIC") appreciates the opportunity to submit this letter to the Securities and Exchange Commission (the "Commission") on the proposed rules seeking to enhance disclosure by certain investment advisers and investment companies about environmental, social, and governance investment practices (the "Proposal") pursuant to the Investment Advisers Act of 1940, as amended (the "Advisers Act") and the Investment Company Act of 1940, as amended (the "Investment Company Act").[1]

The AIC is an advocacy, communications, and research organization established to advance access to capital, job creation, retirement security, innovation, and economic growth by promoting responsible long-term investment. In this effort, the AIC develops, analyzes, and distributes information about the private equity and private credit industries and their contributions to the U.S. and global economy. Established in 2007, and formerly known as the Private Equity Growth Capital Council, the AIC is based in Washington, D.C. The AIC's members are the world's leading private equity and private credit firms, united by their commitment to growing and strengthening the businesses in which they invest.[2]

The AIC commends the SEC's efforts to bring clarity to products that market environmental, social, and governance ("ESG") strategies in the asset management industry. Our members recognize the continued importance of ESG-related investment strategies to the market and, as a direct response, our members provide investors and clients with critical exposure to a variety of ESG-related mandates. For example, private equity and private credit are major

1 Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices; 87 Fed. Reg. 36,654 (Jun. 17, 2022). All citations to the Proposal will refer to the Federal Register page, unless otherwise indicated.
2 For further information about the AIC and its members, please visit our website at http://www.investmentcouncil.org.

sources of investment for sustainable energy companies and green jobs nationwide. Many private funds[3] are at the forefront of investing in clean energy technologies and financing the clean energy transition. In fact, private equity firms have invested almost $150 billion in clean technology and sponsored more than 1,000 U.S. clean technology companies over the past decade.[4] In 2021, private equity investment in clean technology surged to over $27 billion, up from roughly $20 billion in 2020.[5] Clean technology spans a range of energy solutions, including renewables such as solar and wind, and other alternatives such as hydrogen and hydroelectric. Private equity also has invested almost $100 billion in environmental service companies that are designed to address a variety of sustainability issues such as turning waste into bioproducts.[6] The capital provided by private equity and private credit funds plays a critical role in addressing this capital need and mitigating the growing effects of climate change, and will continue to do so for years to come.

Private capital in ESG-related strategies has increased, and will continue to increase, in large part as a response to investor demand. We appreciate that there is growing potential for ESG-related investment opportunities, and that investors and clients need consistent and reliable information to make investment decisions. However, we believe a targeted regulatory approach is critical to ensuring that investors and clients receive the information necessary to make informed investment decisions, and to clearly distinguish between traditional investment products, ESG-focused products, and impact investing products. We believe the Commission's approach raises some significant concerns, particularly with respect to experienced investors in tailored products such as private funds. We encourage the Commission to consider that an overinclusive and overly broad approach is likely to result in unintended consequences that do not further the Commission's goals. These potential unintended consequences include limited investor choice and the proliferation of repetitive, boilerplate disclosure that will not provide meaningful information to, or will even confuse, clients and investors. As discussed in more detail below, we believe the Commission should narrow the Proposal to avoid these unintended consequences, particularly when it comes to sophisticated market participants that are already accustomed to specific, strategy-focused disclosure.

I. Overview

This letter primarily focuses on the application of the Proposal to investment advisers to private funds and institutional clients; however, we believe many of the points in this letter apply equally to registered investment companies and business development companies.

As a preliminary matter, the AIC believes that the Proposal should not apply to investment advisers to private funds and institutional clients. As discussed in more detail below, grouping an adviser's strategies into one or more of three proposed categories will not enhance available disclosures and, due to the ambiguous nature of the proposed categories, will often

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3 For purposes of this letter, we generally use the term "private fund" to encompass private equity funds, private credit funds, and other private investment vehicles.

4 The American Investment Council, *Investing in a Cleaner World* (April 2022), at 3. https://www.investmentcouncil.org/wp-content/uploads/2022/05/2022-aic-sustainability-report.pdf.

5 *Id.*

6 *Id.*

mislead clients and investors into believing that a product is pursuing an ESG strategy when that is not in fact the case. This will cause regulation-imposed greenwashing, which is precisely what the Proposal seeks to avoid.

Specifically, the Commission should reconsider the Proposal's application to advisers to private funds and institutional clients for a number of reasons. First, the existing regulatory framework provides adequate protections and sufficient disclosures, which are already tailored for sophisticated clients and investors and, under this existing framework, advisers customarily provide individualized reporting relating to ESG matters if requested by an investor or a client. Second, the Proposal's application to private funds is premature and impracticable. Third, the concepts of "E," "S," and "G," which are understandably not defined given their fluidity, will cause unnecessary confusion with respect to private funds and institutional accounts. The impracticality of defining these terms only reinforces our view that the Commission should reconsider the Proposal. If the Commission pursues the Proposal, the AIC proposes that any final rule take into account the recommendations set out below, including with respect to the removal of the concept of "integration" strategies and limiting the rule's application to advisers that hold themselves out as pursuing an ESG strategy. We believe that these recommendations will increase the clarity of disclosure mandated under the Proposal and further the Commission's goal of reducing the risk of greenwashing.

To the extent a final rule will apply to investment advisers to private funds and institutional clients, the concept of an "integration" strategy should be removed as it is overinclusive and will capture products that are not promoted as following any ESG strategy. The definition of "ESG-focused" should be narrowed to clearly apply to strategies that are marketed or promoted as considering specific "E" or "S" – and not "G" – factors as a material component of the strategy's investment objective.[7] And, finally, while we agree that it would be prudent to require certain disclosures regarding impact strategies, we believe the Commission should more closely align the definition of "impact" to the prevailing market standard, thus reflecting investor and client expectations.

The Commission's approach under any final rule should recognize that any adviser that does not hold itself out as pursuing a strategy that principally considers ESG would de facto not be engaging in "greenwashing" and is not a contributor to the inconsistencies regarding ESG disclosures that the Commission is trying to address with the Proposal.[8] Thus, in any final rule, the Commission should adopt as a principle that disclosure requirements should only apply to those investment advisers that pursue a strategy that is affirmatively marketed or promoted as considering specific "E" or "S" factors as a material component of a client's investment objective.

Further, we ask the Commission to explicitly acknowledge in any final rule release that an investment adviser's ESG strategy at the enterprise level is independent from and not necessarily relevant to each client's ESG strategy. The Commission should state in any final rule

[7] As noted in more detail below, we believe that good governance is a ubiquitous factor in investment decisions and thus the "G" factor in ESG should not be the sole determining factor with respect to a product's classification under any final rule.

[8] Proposal at 36,655.

release that an investment adviser's proprietary ESG strategy would not necessarily result in disclosure requirements under any final rule adopted pursuant to the Proposal. We also ask that the Commission draw necessary distinctions between any final rules regarding investment advisers' ESG disclosure obligations and any final rules regarding climate disclosures required of public companies.

Finally, we ask that the Commission extend the compliance period to at least two years.

II. Discussion

a) ***The Proposal should not apply to investment advisers with respect to private funds and institutional clients.***

The AIC appreciates the Commission's concern regarding reliable and comparable disclosures on ESG aspects of the investment process. We and our members recognize that disclosure practices can differ significantly across investment advisers. We note, however, that these practices are rapidly evolving and converging, as the industry works to make comparable, consistent, and reliable ESG data more widely available.[9] Our view is that the Proposal should not apply to investment advisers[10] to private funds and institutional clients because: (1) the existing regulatory framework already addresses the Commission's concerns; (2) the Proposal is impracticable and premature; and (3) the expansive nature of the terms "E," "S," and "G" renders them difficult to apply to products that are already tailored to the needs of sophisticated clients and investors.

1. <u>The existing regulatory framework already addresses the Commission's concerns</u>.

The Commission identifies "greenwashing" and conduct inconsistent with disclosure as ongoing concerns that necessitate the Proposal.[11] However, the Commission does not explain how the existing regulatory framework fails to address these concerns nor does the Commission explain why additional regulation of investment advisers in this regard is required.

Pursuant to judicial and Commission interpretations under the Advisers Act, all investment advisers are subject to an affirmative, unwaivable fiduciary duty that requires advisers to serve the best interests of their clients. This fiduciary duty includes a duty of loyalty that requires an adviser to make full and fair disclosure of all material facts and all material

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9 For example, over 100 institutional investors and investment advisers, representing $8.7 trillion in AUM, have joined the ESG Data Convergence Initiative. This initiative, launched in September 2021, seeks to standardize ESG metrics and provide a mechanism for comparative reporting in the private markets. The group plans to meet annually to assess the prior year's data and to refine and build on the initial metrics. *See* Institutional Limited Partners Association, *ESG Data Convergence Initiative*, https://ilpa.org/ilpa_esg_roadmap/esg_data_convergence_project/ (last accessed August 8, 2022).

10 Except for our stating that we believe many of the points in this letter apply equally to registered investment companies and business development companies, this comment letter does not discuss the application of the Proposal to registered investment companies and business development companies. We understand that other commenters will likely focus on those aspects of the Proposal.

11 Proposal at 36,655.

conflicts of interest regarding the advisory relationship.[12] Thus, investment advisers must in effect disclose all information that will materially affect clients and investors. This would include the effect of ESG-related investment decisions, to the extent these factors are material. In line with this, under existing securities laws, a registered investment adviser is already required to disclose material risks with respect to each investor's decision to invest in each offered vehicle. In addition, each registered investment adviser must publicly disclose in its Form ADV the material risks involved with respect to each significant investment strategy or method of analysis it uses.[13] Increasingly, governing documents of private funds and institutional accounts also require ongoing disclosure and reporting with respect to ESG matters.

In fact, the Commission acknowledges in the Proposal that the conduct the Proposal is designed to regulate is *already* subject to existing requirements. These requirements are designed to broadly achieve the same level of investor protection. For example, the Proposal explains that an investment adviser must already make material disclosures to investors in private funds under the Advisers Act, as required under Rule 206(4)-8, and that an investment adviser may not mislead investors or clients in investment adviser advertisements, pursuant to Rule 206(4)-1.[14] The Commission also acknowledges that an investment adviser's compliance program must seek to ensure that its conduct is consistent with disclosure as a part of its compliance program and its obligations under Rule 206(4)-7.[15] And, further, the Commission continues to use its existing enforcement authority to bring and settle charges related to ESG disclosure and practices against investment advisers that do not comply with the above requirements.[16]

The existing regulatory framework thus provides the Commission and its staff with the tools necessary to police investment advisers' ESG practices and operates as intended. This existing framework should continue to serve as the rubric applicable to investment advisers. This is particularly true for investment advisers to non-retail clients such as private funds and institutional clients. Private fund investors and institutional clients are sophisticated parties that have the resources to engage in highly negotiated transactions involving tailored products.[17] Whether in response to specific requests, or as part of standard marketing materials, investment advisers commonly provide information to investors regarding their ESG practices. The information they provide is meaningful precisely because it is tailored to the relevant product's specific strategy and investment process, or is provided specifically in response to a request from an investor or client. As discussed in more detail below, mechanistically grouping an adviser's

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[12] *See* Commission Interpretation Regarding Standard of Conduct for Investment Advisers, 84 Fed. Reg. 33,669 (July 12, 2019) ("Fiduciary Interpretation").

[13] *See* FORM ADV (Paper Version); Uniform Application for Investment Adviser Registration; PART 2: Uniform Requirements for the Investment Adviser Brochure and Brochure Supplements; https://www.sec.gov/about/forms/formadv-part2.pdf.

[14] Proposal at 36,697.

[15] Proposal at 36,696.

[16] In the Matter of BNY Mellon Inv. Adviser, Inc., Investment Adviser Release No. 6032 (May 23, 2022) (finding that BNY Mellon Investment Adviser, Inc. violated Sections 206(2) and 206(4) of the Advisers Act and Rules 206(4)-7 and 206(4)-8 under the Advisers Act, and Section 34(b) of the Investment Company Act).

[17] *See* Fiduciary Interpretation, comparing retail investors and institutional clients; *see also* Staff Bulletin: Standards of Conduct for Broker-Dealers and Investment Advisers Conflicts of Interest, Securities and Exchange Commission (https://www.sec.gov/tm/iabd-staff-bulletin-conflicts-interest).

strategy into one of three proposed categories will not enhance available disclosures and, due to the broad nature of the proposed categories, will likely mislead clients and investors into believing that they are investing in a product pursuing an ESG strategy with the unintended result of regulation-imposed greenwashing.[18] Nor will the proposed required disclosures provide for meaningful comparability as the brochure is, by Commission design, a disclosure document not intended to capture the detailed information provided to private fund investors in offering and other-related documents.[19]

2. *The Proposal's application to investment advisers is impracticable and premature.*

The Proposal to require a box checking and provide standardized disclosure with respect to three broad categories will not provide investors or clients with any more meaningful disclosure than they already receive because advisers already provide disclosure that is typically tailored to client and investor needs and is consistent with an adviser's fiduciary duty to disclose all material facts relating to the advisory relationship. Instead, in light of the uncertainty in the definitions of the three strategies the Commission proposes and the inherent confusion relating to E, S, and G factors, the Proposal's approach will undoubtedly result in inconsistent implementation (thereby thwarting any potential for consistent disclosure) and increased costs for investment advisers, clients, and investors.

To illustrate some of the difficulties the Proposal could create, consider that an investment adviser may use its investment discretion to determine that a potential portfolio company's use of renewable energy sources is dispositive with respect to one investment opportunity for a private fund client, but the adviser may determine that the same "ESG" factor is not dispositive with respect to another investment decision for the same private fund client for other reasons. In that case, the classification of the private fund's strategy under the Proposal's rubric is unclear and arbitrary. A single ESG-related decision may not be material to an entire product's strategy. Further, reasonable people may differ on the correct classification under the Proposal in this scenario. An adviser's choice to classify the strategy as "integration," "ESG-focused," or neither will be misleading in light of the likely inconsistencies that will develop in the market if a final rule is adopted as proposed in the Proposal.

This Proposal is also premature. The Commission has only recently proposed rules regarding climate disclosures for public companies.[20] Neither the Commission nor industry participants have thus had the opportunity to truly assess the merits of agency-mandated

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[18] This risk is further pronounced by the broad nature of the term "integration" strategy, which will function as a "catch all" for most advisers' strategies and potentially lead investors and clients to believe that a product follows an ESG-related strategy when in actuality, it may not. We discuss this feature of the Proposal further, below.

[19] The Commission has previously noted that "…the brochure may not be the best place for a multi-strategy adviser to disclose risks associated with all of its methods of analysis or strategies. Disclosure of that information likely would lengthen the brochure unnecessarily given that different clients will be pursuing different strategies, each of which poses specific and different risks." Amendments to Form ADV, 75 Fed. Reg 49233, 49239 (August 12, 2010).

[20] The Enhancement and Standardization of Climate-Related Disclosures for Investors, 87 Fed. Reg. 21,334 (April 11, 2022), (the "Issuer Proposal").

disclosure in the narrower climate context, much less the broader ESG context. The Commission should therefore consider first adopting and implementing the Issuer Proposal. This would permit the Commission and market participants to accumulate reportable data provided pursuant to any final rule adopted under the Issuer Proposal, so that the Commission may determine the type of consistent and comparable ESG data that should be disclosed by investment advisers, and so that market participants may have access to the necessary data.

Individual investment advisers and industry coalitions have spent years (and in some cases, over a decade) developing proprietary ESG metrics. Similarly, advisers are in the process of developing relevant ESG disclosure that responds to specific investor demands in compliance with existing requirements under the Advisers Act and the rules promulgated thereunder.[21] The Commission should allow the industry to reach a higher degree of consensus and develop comparable metrics on an industry-wide basis that respond to investor and client needs. The Commission could then evaluate whether the market practice addresses the Commission's concerns before proposing ESG disclosure that, as with this Proposal, is not likely to result in any more meaningful disclosure to investors or clients. The Proposal could unduly hamper these industry efforts and fuel market confusion by forcing advisers to classify their products into categories that will not align with how that product is otherwise promoted by an investment adviser.

The Proposal raises the question of whether all strategies of a signatory to the United Nations Principles for Responsible Investing ("PRI") would need to be categorized as ESG-Focused given the breadth of that definition.[22] PRI's Principle 2 states that signatories will "be active owners and incorporate ESG issues into our ownership policies and practices." The Proposal will thus raise a number of ambiguous questions with respect to PRI alone. For example, is PRI compliance sufficient to be "engagement" for purposes of the Proposal's definition of "ESG Focused?" And, is data gathering alone sufficient to constitute "engagement?" The Commission should restructure its Proposal to avoid these difficult questions by focusing on how an investment adviser markets itself, rather than focusing on an adviser's operational practices. And, the Commission should provide additional clarity to avoid disincentivizing advisers from voluntarily adopting higher, third-party designed, standards with respect to their operations to ensure that their products are not inadvertently classified as ESG-Focused.

Finally, the Commission should confirm that the proposed amendments to Form ADV apply solely with respect to investment decisions made in connection with investment advisory services provided to clients and that the required disclosure would be client specific.[23] In particular, the Commission should clarify that broad, adviser-level statements or commitments at

[21] For example, over 100 institutional investors and investment advisers, representing $8.7 trillion in AUM, have joined the ESG Data Convergence Initiative. This initiative, launched in September 2021, seeks to standardize ESG metrics and provide a mechanism for comparative reporting for the private market industry. The group plans to meet annually to assess the prior year's data and to refine and build on the initial metrics. *See*, *supra*, footnote 4.

[22] Proposal at 36,667 (Question 31).

[23] E.g., The proposed amendments to Item 8 require disclosures of certain ESG considerations an adviser makes "when formulating investment advice or managing assets." Proposal at 36,687.

the enterprise level with respect to an investment adviser's day-to-day business should not be interpreted as client marketing or necessarily relevant to a particular fund's investment objective that would implicate the rule or cause any product to be classified in one of the proposed categories under the Proposal when they otherwise would not.

3. *The expansive nature of the terms "E," "S," and "G" renders them difficult to apply to products that are already tailored to the needs of sophisticated clients and investors*.

The terms "Environmental," "Social," and "Governance," which would be challenging to define at this point, will cause confusion among investor, clients, and investment advisers, whether undefined or defined. The Commission should consider only subjecting investment advisers to the requirements applicable to impact funds because "E," "S," and "G" are contextual and evolving terms that will lead to inconsistent results. Over time, it is likely that the meaning of these terms will evolve as markets and social and political views change. As discussed above, determining whether investment decisions relate to "E," "S," or "G" factors is inherently complicated. For example, a compliance professional at an investment adviser could reasonably ask whether an investment by a fund in a portfolio company that produces solar panels means, de facto, that the fund's adviser adopts some form of an ESG strategy, thus requiring Form ADV disclosures under one of the three categories. Seeking to define the terms would have no reasonable chance of success given, among other factors, the breadth of those terms. As noted below, the Commission should also adopt a good-faith categorization safe harbor in acknowledgment that reasonable minds may differ on categorization of strategies.

Further, the "G" for governance should be removed from the Proposal altogether. If not removed, the Commission should take great care to narrowly define "G" such that it is useful to investors and clients. All investment decisions generally require some consideration of "governance," irrespective of whether the adviser making the decision pursues any form of an ESG strategy. Indeed, governance is a key attribute in determining an investment's likelihood of success. Poorly run businesses will have lower returns, and bring other risks, such as reputational risks. Including such considerations in ESG strategies risks misleading investors into believing that an advisory client pursues an ESG strategy when it in fact does not and as noted above, may lead to claims of greenwashing.

Indeed, the European Union's Sustainable Finance Disclosure Regulation ("EU SFDR") recognizes the ubiquity of good governance as a factor in investment decisions. For example, EU SFDR treats good governance as a prerequisite of Article 8 funds (which are similar to the Commission's proposed ESG-focused funds) and Article 9 funds (which are similar to the Commission's proposed impact funds), rather than as a distinct component of a strategy.[24] Products that market only good governance as a strategy would not be able to elect Article 8 or

[24] *See,* European Commission, *Annex to the Commission Decision on the adoption of the answers to be provided to questions submitted by the European Supervisory Authorities pursuant to Article 16b(5) of the founding Regulations of the European Supervisory Authorities in the period from 1 January 2021 to 30 January 2021*, https://www.eiopa.europa.eu/sites/default/files/joint-committee/c_2022_3051_f1_annex_en_v3_p1_1930070.pdf (last accessed August 11, 2022), clarifying that an Article 8 or Article 9 product would be in breach of the regulation if it invested in companies lacking good governance.

Article 9 without an "E" or "S."[25] The Commission should take a similar approach and clarify that considerations relating to governance alone would not determine a fund's classification as ESG-focused or ESG impact.

b) ***To the extent the final rule will apply to investment advisers to private funds and institutional clients, it should, at most, require disclosure regarding ESG-focused and ESG impact strategies that are marketed as such.***

As stated above, we believe the Proposal should not apply to investment advisers to private funds and institutional clients in light of the existing regulatory framework and the difficulties associated with applying the "E," "S," and "G" standards to investment advisers. However, assuming the Commission moves forward with a Proposal that applies broadly to investment advisers to private funds and institutional clients, the Commission should revise the Proposal such that the final rule: (1) does not include the concept of an "integration" strategy; (2) narrows the definition of an "ESG-focused" strategy to align with an adviser's marketing of the strategy; (3) narrows the definition of "impact" strategy to conform to market practice; (4) clarifies the rule's application to an investment adviser's enterprise-level ESG initiatives; and (5) includes certain safe harbors with respect to Form ADV disclosure.

1. *<u>Disclosure requirements regarding "integration" strategies should be removed from the final rule</u>.*

What constitutes an "impact" strategy is generally understood,[26] but the definitions of "integration" and "ESG-focused" will in practice capture strategies that do not hold themselves out to clients or investors as materially pursuing ESG priorities. This will be confusing to investors and the terms "integration" and "ESG-focused" will be difficult to distinguish from one another.

In particular, any notion of an "integration" strategy should be removed from the final rule because it is overly broad, will cause confusion, and will not practically operate to provide any meaningful disclosure to clients or investors. The Commission asserts that its amendments to Form ADV "would help clients and prospective clients better understand how... advisers consider ESG factors when formulating investment advice and providing investment recommendations, and any corresponding risks or conflicts of interest."[27] As explained in more detail below, the Proposal's definition of "integration" simply does not advance this goal.

In the Proposal, the SEC notes that "[a]n Integration Fund, for this purpose, would be a fund that considers one or more ESG factors along with other, non-ESG factors in its investment decisions, but those ESG factors are generally no more significant than other factors in the

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[25] EU SFDR defines an Article 8 fund as a fund "which promotes, among other characteristics, environmental or social characteristics, or a combination of those characteristics, provided that the companies in which the investments are made follow good governance practices," and an Article 9 fund as fund that "has sustainable investment as its objective." Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability□related disclosures in the financial services sector, O.J.L. 317.

[26] We discuss common understandings of "impact" strategies below.

[27] Proposal at 36,687.

investment selection process, such that ESG factors may not be determinative in deciding to include or exclude any particular investment in the portfolio."[28] Based on this explanation, how an investment adviser could "consider" ESG is unclear, if such a factor may never be "determinative." Indeed, all strategies are likely to qualify, at a minimum, as integration strategies under this definition. Arguably, almost every adviser considers some environmental, social, or governance factors in diligencing investments, and, based on the circumstances, could consider such a factor determinative.[29] For example, funds may consider not only the risk of direct costs resulting from poor ESG outcomes to a portfolio, but also consider reputational risks, regulatory risks, or systemic risks in their investment decisions.[30] A diligent adviser to a fund that is not pursuing or marketing an ESG strategy may well take into account environmental issues such as fuel efficiency, water scarcity, or the risk of environmental remediation liabilities; social factors such as labor practices, human rights issues, health and safety, and data privacy issues; and governance factors such as board composition, fraud risk, and issues of bribery and corruption. Investors and clients expect this level of diligence regardless of an adviser's stated ESG-specific goals and would not characterize a strategy as having any specialized interest in ESG if an investment adviser were to routinely consider these and similar factors in connection with investment opportunities. Imposing the label of "ESG integration" on these ordinary course considerations not only creates needless regulatory burdens but also risks confusing investors about the ESG posture of a fund. And consequently, the "catch all" nature of this category will render it, and any related disclosure, at best largely meaningless to investors and clients, and at worst, misleading.

The Proposal also incorrectly assumes that an adviser will be able to predict whether it will "consider" ESG factors with respect to portfolio investments in advance of knowing the relevant facts with respect to an investment decision. In certain cases, we believe the adviser would be required to consider any fact that could affect the client's investment performance under the adviser's existing fiduciary obligations. This peculiarity, resulting from the broad definition of "integration" strategy, may cause investment advisers to consider classifying all non-ESG focused and non-ESG impact products as "integration" products, simply so that the adviser may preserve its ability to exercise judgment that it arguably *must already* exercise in line with its fiduciary duty. To the extent the SEC maintains an "ESG integration" category, we would suggest the SEC clarify that advisers only need to update the relevant disclosures annually and that they do not need to provide updates as their ESG approach evolves over the course of a year.

2. <u>The Commission should re-define the term "ESG-focused."</u>

The difficulty in assessing whether a client follows an "integration" strategy is further complicated by the lack of clarity in the definition of "ESG-focused."[31] The Commission should narrow the definition of "ESG-focused" to a strategy that markets or is promoted as considering

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28 Proposal at 36,660.

29 *See, e.g.*, CFA Institute, *Environmental, Social, and Governance Issues in Investing* (October 2015), at 1.3, https://www.cfainstitute.org/-/media/documents/article/position-paper/esg-issues-in-investing-a-guide-for-investment-professionals.pdf.

30 *Id.*

31 We discuss impact strategies in more detail below.

specific "E" or "S" factors as a material component to the strategy's investment objective. This approach would be consistent EU SFDR's definition of an Article 8 fund, which is defined as a fund "which promotes, among other characteristics, environmental or social characteristics, or a combination of those characteristics, provided that the companies in which the investments are made follow good governance practices." [32]

Narrowing the definition in this way will align any final rule with investors' perceptions about ESG and will offer protection to those investors in the form of standardized disclosure. Without these changes, many advisers that do not hold out or market their products as ESG-focused will nonetheless fall into this category under the Proposal. In particular, investment advisers with traditional private equity strategies customarily use risk-based screening, which may include factors that appear to be "E-," "S-," or "G-"aligned but in fact are not intended to give the strategy an E, S, or G slant. Under the Proposal, however, these advisers would be forced into an ESG-focused category, even if the adviser, and importantly the client or investors, do not view the strategy as having any discernable E, S, or G goals. This is yet another example that demonstrates the potential confusion that the Proposal could cause as drafted. The final rule's categories should thus closely consider (1) how the adviser markets the relevant product and (2) whether achieving certain ESG-specific goals is material to the product's strategy.

Further, narrowing the definition of ESG-focused to only those strategies that are marketed or promoted as considering specific "E" or "S" factors as a material component of the strategy's investment objective also addresses the myriad issues that arise if the SEC were to base the ESG-focused categories on an adviser's "engagement strategy with the companies in which its clients invest." Engagement with portfolio companies is a common aspect of portfolio management and operations and should not be conflated with a strategy that is specifically marketed as seeking to achieve a fund's investment objective through engagement with issuers on specific ESG issues. Advisers should have the flexibility to engage with portfolio investments in ways that are most reflective of their approach and that can deliver the returns that investors desire. Any final rule should permit advisers to determine whether the quantity and quality of "E" or "S" engagement (whether through meetings with portfolio companies, or otherwise) is material to a private fund or client's strategy and market the product accordingly. Moreover, any final rule should provide that merely exercising the right to vote proxies would not constitute a "significant" means of implementing an ESG strategy and would not result in a strategy being deemed "ESG-focused."

3. *The final rule's definition of "impact" strategy should more closely align with investor expectations.*

We agree that impact strategies create risks and challenges that do not necessarily exist in other strategies. If an investment adviser does hold itself out as pursuing a strategy with an investment objective specifically designed to achieve enumerated environmental or social goals,

[32] Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector, O.J.L. 317. We ask that the Commission consider the likely confusion that will be created in the market through the introduction of an ESG-related regulatory regime that is inconsistent with existing regimes such as SFDR.

the Commission's concerns about marketing and "greenwashing" would certainly be implicated. We thus support the Commission's view that additional disclosure with respect to impact strategies would benefit investors and, accordingly, impact strategies warrant distinct categorization. For these reasons, we also support proposed disclosure around the expected effect of impact strategies on financial outcomes.

We would, however, encourage the Commission to reconsider the definition of "impact" to clarify that it is a distinct strategy, not one that is a subset of an "ESG-focused" strategy, particularly because while ESG-related strategies generally are not concessionary, impact strategies may be concessionary in certain cases. We believe impact is an important feature for any Form ADV disclosure required of investment advisers and will provide clients and investors with a clear picture of a particular product's investment objective. Investors need to understand that an advisory mandate operated with an "impact" strategy systematically prioritizes non-financial metrics that achieve some environmental, social, or related change. In comparison to an "ESG-focused" strategy, investment advisers market impact strategies to investors under a completely different framework, using impact metrics. By contrast, as discussed above, we would define "ESG-focused" strategies as those that are marketed or promoted by an adviser as considering specific "E" or "S" factors as a material component of the strategy's investment objective.[33] As the definition of "impact" currently stands in the Proposal, many private funds that do not hold themselves out as impact funds will meet the Commission's definition of "impact" fund and thus cause confusion for investors.

We would therefore encourage the Commission to consider existing industry definitions of impact investing to inform the final rule's definition of "impact" strategy and limit the final rule's definition to those strategies that select investments based on the investment's perceived ability to achieve or generate a measurable external environmental or social impact. By way of example, the Global Impact Investing Network explains that "[i]mpact investments are investments made with the intention to generate positive, measurable social and environmental impact alongside a financial return. Impact investments can be made in both emerging and developed markets, and target a range of returns from below market to market rate, depending on investors' strategic goals."[34] Similarly, the Operating Principles for Impact Management define "impact investing" as "investing into companies and organizations with the intent to contribute to measurable positive social or environmental impact alongside financial returns."[35]

The current definition of "impact" could arguably capture advisers that seek to engage with investments to achieve a particular improvement in an investment's own internal ESG performance metrics. This is not aligned with how the market thinks of impact strategies.

[33] This approach would largely be consistent with EU SFDR, which defines an Article 9 fund as "a Fund that has sustainable investment as its objective or a reduction in carbon emissions as its objective." We ask that the Commission consider that introducing another regulatory regime with respect to ESG funds that is inconsistent with existing mainstream regimes (such as EU SFDR) is likely to cause confusion and compliance challenges by advisers operating in the US and EU.

[34] Global Impact Investing Network, *What is Impact Investing*, https://thegiin.org/impact-investing/need-to-know/#what-is-impact-investing (last accessed August 7, 2022).

[35] Operating Principles for Impact Management, *Invest for Impact*, https://www.impactprinciples.org/ (last accessed August 7, 2022).

Impact should be clearly defined to refer to a fund's investment objective so as not to pick up post-investment ESG initiatives at the portfolio company level. Advisers commonly address ESG-adjacent factors for improvements at the portfolio investment level as a part of value-creation efforts, without taking into account the effect on ESG metrics. For example, an adviser may pursue an initiative to reduce energy consumption and water intake at the investment to lower production costs, may seek to improve diversity and inclusion efforts to improve employee satisfaction and reduce turnover, and could implement internal governance structures within the company to reduce the risk of fraud or mismanagement. In this example, these initiatives would be part of the adviser's overall value-add proposition, even if the adviser did not intend to pursue any explicit ESG-related goals or initiatives.

4. The Commission should confirm that firm-wide ESG commitments are not necessarily captured by this Proposal and the relevant categorizations should be based solely on how a particular fund or strategy is marketed.

Many investment advisers have established ESG policies, initiatives or commitments that are designed to address the firm's ESG practices, which can be separate and distinct from a registrant's investment strategy ESG practices. It would be misleading to investors if the existence of these policies, initiatives, or commitments or other ESG statements made at the enterprise level were necessarily viewed as applying to all clients of a firm and therefore triggered specific categorizations of all of those investment activities under the Proposal.

The Commission should confirm that the proposed amendments to Form ADV apply solely with respect to the specific investment objectives and investment decisions made in connection with investment advisory services provided to clients and that the required disclosure would be client-specific.[36] In particular, the Commission should clarify that broad, firm or adviser-level statements or commitments made with respect to an investment adviser's enterprise should not be interpreted as client marketing or necessarily relevant to a particular strategy's ESG investment objective or cause any strategy to be classified under one of the proposed categories in the Proposal when it otherwise would not. The adviser should be the one to determine how a policy, initiative or commitment will apply to a particular strategy and then craft appropriate tailored marketing materials and classify the strategy under the Proposal accordingly. For example, as flagged above, a firm's signatory status as a PRI signatory should not necessarily affect the categorization of a firm's funds or strategies under the Proposal. Instead, the relevant fund or adviser would need to analyze whether it views its signatory status as a material component of the fund or strategy's investment objective such that it was appropriate to market itself that way and claim the ESG-focused classification.

We note that making this point clear would also help delineate between certain disclosures required under the Issuer Proposal and this Proposal. Relevant firm-level climate goals made by publicly listed asset managers may still be captured by the Issuer Proposal, while client-level ESG goals relating to the investment objectives of a particular fund or strategy would be captured by this Proposal as appropriate.

[36] E.g., The proposed amendments to Item 8 require disclosures of certain ESG considerations an adviser makes "when formulating investment advice or managing assets."

5. *The Commission should consider certain safe harbors with respect to Form ADV disclosure*.

As discussed above, we believe the final rule may result in somewhat inconsistent classifications of otherwise similar products. In light of these difficulties, the Commission should consider two safe harbors with respect to the classification of private fund and institutional client account strategies. First, the Commission should adopt an explicit exemption from Form ADV disclosure requirements with respect to each private fund and institutional client for which an adviser does not prioritize ESG factors in the investment process. Second, an adviser's good faith attempt to classify its clients appropriately on Form ADV should benefit from a safe harbor.

c) ***Specific suggestions regarding the proposed amendments to Form ADV.***

As discussed in more detail above, we do not believe the categorization of strategies as "integration" or "ESG-focused" will bring value to investors in private funds or to institutional clients. If the Commission adopts these categories as proposed, we would encourage the Commission to reconsider the proposed changes to Part 1A and Part 2A of the Form ADV.

As discussed above, we believe a "check-the-box" approach to investment strategies in the ESG context is overly simplistic. Given the lack of clarity in the definitions of "integration," "ESG-focused," and "impact," our view is that ensuing data collection is likely to present inaccurate information to the Commission.

Further, the amount of disclosure required in Form ADV Part 1, Item 7B (with respect to fund-by-fund disclosure) and Part 2A under the Proposal is disproportionate to the purported problem, particularly because under the existing regulatory framework, an investment adviser is already required to disclose material risks to clients and investors. In this regard, the requirement that the Form ADV Part 1 include fund-by-fund disclosure with respect to ESG strategy in Item 7B is unnecessary and inconsistent with the disclosures required with respect to each client that is a separately managed account.

Furthermore, the proposed disclosure requirements are overly broad and will not result in an accurate portrayal of an investment adviser's business. Investment advisers are not monolithic; many investment advisers operate varying strategies across multiple clients. The Proposal's disclosure requirements in Part 2A of the Form ADV clearly suggest a "kitchen sink" approach to ESG in that they effectively require a heavily weighted discussion of every significant "integration," "ESG-focused," and "impact" strategy that an investment adviser may operate. Thus, with these proposed instructions to Item 8 of Form ADV Part 2A, an adviser that operates a proportionally small ESG strategy will appear to be heavily oriented towards ESG.

The proposed amendments to Form ADV will also require disclosures regarding "ESG consultant" or "ESG service provider" businesses that the adviser either operates or is affiliated with. The need for this disclosure is not supported by the concerns that the Commission raises in the release. In addition, these terms are vague and will be confusing if adopted as proposed. The Commission should define these terms in any final rule.

Finally, while we do not object to the general disclosure of third-party frameworks, we note that sponsors that instead use proprietary frameworks should be permitted to make general reference to these without revealing confidential or competitively sensitive information.

d) ***Considerations affecting registered advisers that are public companies.***

The Commission should also clarify that granular ESG disclosure mandated under any final rule adopted under the Proposal would not, by itself, give rise to any additional reporting obligations under any final public company climate rule adopted pursuant to the Issuer Proposal. Investment advisers that are public companies will be subject to heightened disclosure requirements when a final rule under each of the Proposal and the Issuer Proposal is adopted. We ask that the Commission closely consider the effect of the public company climate proposal on publicly listed investment advisers and provide explicit guidance on the interplay of the two rules when both apply to a given entity. Further, the Commission should clarify that an investment adviser's public reporting regarding climate change under the Issuer Proposal will not necessarily overlap with a client's "strategy" as contemplated in the Proposal. For example, if an adviser that is controlled by a public company discloses in its Form ADV that it pursues certain climate goals for a particular strategy, the public company should not be viewed as pursuing the same climate goal and should not be required to make related disclosures in periodic reporting, offering materials, or other SEC disclosures.

e) ***Compliance dates: the transition period should be extended to at least two years.***

In our view, the transition period for the final rule should be at least two years. The Commission asks whether different funds should have different transition periods.[37] The transition period for all strategies should be extended to two years so investment advisers have sufficient time to classify all of their strategies within the scope of the final rule. Assessing the practical implications of any final rule and implementing compliance and reporting policies will be both a costly and time-consuming process. As discussed above, the private funds industry has separately made great strides in developing consistent ESG reporting, but this has taken a significant amount of time and effort. Adapting to any final rule will therefore be complex. The Commission should extend the implementation period to allow the industry to thoughtfully consider, and to adapt to, these novel requirements and develop fair and accurate disclosure.

New market entrants and smaller fund sponsors, which are more likely to be women- or minority-owned[38] than larger private fund advisers often lack the resources and back-office infrastructure to respond as quickly to additional regulations as larger, established private fund advisers. These groups will therefore be disproportionately impacted by a shorter transition period.

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[37] Proposal at 36,697 (Question 190, asking whether Integration Funds and ESG-Focused Funds should be subject to the same compliance period).

[38] Minority- and women-owned businesses represent a fraction of the asset management industry, and therefore can be expected to constitute a greater percentage of new entrants to the market. *See, e.g.*, Securities and Exchange Commission Asset Management Advisory Committee - Subcommittee on Diversity and Inclusion - Recommendations for Consideration by the AMAC on July 7, 2021, https://www.sec.gov/files/amac-recommendations-di-subcommittee-070721.pdf.

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The AIC appreciates the ability to highlight its views on these issues and would be pleased to answer any questions that you might have concerning our views.

Respectfully submitted,

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