



MUTUAL FUND DIRECTORS FORUM

The FORUM for FUND INDEPENDENT DIRECTORS

August 16, 2022

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

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

Dear Ms. Countryman:

The Mutual Fund Directors Forum (“the Forum”)¹ welcomes the opportunity to comment on the Commission’s recent rule proposals regarding disclosures by investment advisers and investment companies with respect to their use of environmental, social and governance-related (“ESG”) factors in their investment activities.² Given the increasing importance of ESG to many investors, we welcome the Commission’s efforts to provide greater clarity in this area. However, as we discuss in more detail below, we have concerns about the manner in which the Commission is proposing to improve and clarify disclosure in this area.

The Forum is an independent, non-profit organization for investment company independent directors and is dedicated to improving mutual fund governance by promoting the development of concerned and well-informed independent directors. Through education and other services, the Forum provides its members with opportunities to share ideas, experiences and information concerning critical issues facing investment company independent directors and also serves as an independent vehicle through which Forum members can express their views on matters of concern.

¹ The Forum’s current membership includes over 1000 independent directors, representing 145 mutual fund groups. Each member group selects a representative to serve on the Forum’s Steering Committee. This comment letter has been reviewed by the Steering Committee and approved by the Forum’s Board of Directors, although it does not necessarily represent the views of all members in every respect.

² See Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices, Release No. 33-11068; 34-94985; IA-6034; IC-34594; File Nos. S7-17-22, 87 Fed. Reg. 36654 (June 17, 2022) (*hereinafter* “Proposing Release”).

We agree with the Commission that ESG plays an increasingly important role in the investment decisions of many fund investors. Irrespective of the view one takes on the role that corporations should play in achieving environmental and social goals and in altering their own internal corporate governance – and there is little doubt that individual fund investors have widely differing views on these issues – we believe that funds should provide investors with clear disclosure on whether and how they rely on ESG factors in their investment processes. Clear disclosure based on materiality enables investors to make informed decisions regarding the funds in which they choose to invest and, to the extent they wish, choose funds whose ESG practices are aligned with their own views.

More specifically, given the central role that directors play in overseeing their funds' disclosure processes (and their funds' adherence to what they disclose about their investment strategies), directors have a keen interest both in the quality of ESG disclosure and how the SEC chooses to regulate that disclosure. Indeed, we agree with the Commission that a fund's disclosure about its ESG practices has the potential to be misleading if it inaccurately describes or otherwise overstates the manner in which a fund's adviser relies on ESG factors or the importance that it places on them as part of the investment process. This is especially true given the increased focus that many fund investors are placing on funds' ESG practices. Currently, funds that use ESG investment strategies to a material degree disclose those strategies in their prospectuses. Therefore, while the Commission's proposals may represent a step forward in responding to some investors' increasing desire for ESG-related funds, we believe that the proposed approach should be modified to be more responsive to the needs of investors.

1. Structure of ESG Disclosure

It is not surprising that the Commission's Proposing Release focuses both on preventing "greenwashing" while at the same time attempting to improve the comparability and clarity of ESG-based disclosure. Certainly, greenwashing should not be ignored. However, as recent enforcement actions demonstrate, the Commission has ample ability to investigate and, if necessary, take action in cases of greenwashing. More importantly, to the extent that greenwashing is a broad problem, focusing any regulatory efforts in this area on improving the accuracy and clarity of disclosure should address the problem. We therefore believe that the Commission's proposal would be best served by focusing its efforts on delineating what constitutes meaningful and clear disclosure about a fund's ESG-oriented investment strategy (and the investment and other results achieved from the employment of that strategy).

While we believe that the Proposing Release has the potential to improve ESG-related disclosure, we are concerned about the Commission's heavy reliance on the distinction between ESG Integration Funds and ESG Focused Funds. Specifically, we do not believe that approaching disclosure in a bifurcated manner is likely to achieve the Commission's aims. Rather, it may result in investor confusion and has the potential to limit the ability of fund advisers to further develop strategies and otherwise innovate in the ESG space. Furthermore, we are concerned that the categories may be overly broad, inadvertently requiring funds to overstate the extent to which they use ESG factors in their investment process.

Generally, we support the disclosure structure that the SEC is proposing for ESG Integration Funds for those funds that use ESG factors as part of their principal investment strategies.³ The layered approach proposed by the Commission, in which a fund’s ESG strategy is described succinctly in the summary section of the prospectus and then in more detail in the statutory prospectus, has the potential to create accessible and understandable disclosure about how a fund incorporates ESG factors into its investment strategy while also providing more detailed information to those investors desiring it. More importantly, clear disclosure of this type, made in plain English, will enable individual investors to better distinguish how different funds employ ESG-related considerations in implementing their investment strategies.

We are concerned, however, that the tabular approach proposed for ESG Focused Funds is unlikely to be effective. Instead, we encourage the SEC to rely on the same approach it proposes for ESG Integration Funds. We see at least two issues. First, a table that requires funds to characterize how they employ ESG-related factors by selecting among a few different categories risks giving a veneer of comparability to funds that are, in fact, quite different. Even for funds that the Proposing Release would characterize as ESG Focused, we believe the manner in which the adviser employs ESG can be described succinctly and accurately to investors. This is true whether the adviser uses inclusionary or exclusionary screens, uses an ESG-informed scoring system, engages in proxy activism, or takes another approach altogether. Clear and concise disclosure of a fund’s actual strategy, rather than a forced categorization of it, will better enable fund investors to understand the differences between various funds. Second, we are also concerned that a bifurcated approach to disclosure will limit the ongoing innovation in and response to investor needs that has characterized the ESG sector to date. Forcing funds into boxes – and potentially forcing them to identify as an ESG Integration or Focused Fund – creates incentives towards uniformity in each of these categories rather than creating incentives to innovate and to be responsive to the needs of investors.

2. Proposed GHG Disclosure

We also have fundamental concerns about the Commission’s proposed requirement that a subset of ESG funds provide detailed disclosure about the greenhouse gas (“GHG”) emissions of the companies in which they invest. There has not been a demonstrated need from the investor community for this level of disclosure and it may overwhelm investors with too much data, counter to other pending proposals by the Commission that are designed to streamline the information provided to investors.⁴ As drafted, the Proposing Release is overly inclusive as all funds that focus

³ The proposed rule would limit the additional disclosure for Integration Funds to a fund that “considers ESG factors as part of its principal investment strategies.” Proposed Form N-1A, Item 4(a)(2)(ii). In the text of the Proposing Release, the description of the funds to which this additional disclosure would apply is somewhat more ambiguous. *See* Proposing Release at 25-26 (referring to funds that “incorporate[] ESG factors into [the] investment selection process” without noting whether this occurs as part of a principal investment strategy). We believe that the Commission should limit application of the proposed rule to funds that incorporate ESG factors as part of a principal investment strategy, and that doing so will address the potential for overinclusion that the Commission raises in Requests for Comment 3 and 4. *See id.* at 29-30.

⁴ *See* 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, Release Nos. 33-10814; 34-89478; IC-33963; File No. S7-09-20, 85 Fed. Reg. 70716 (November 5, 2020).

on the “E” in ESG, unless they affirmatively state that they do not consider issuers’ GHG emissions as part of their investment strategy, would be required to provide GHG emissions disclosure. Additionally, the costs associated with the proposed disclosure requirements and the difficulty of locating accurate emissions data from certain companies outweighs the predicted benefit. Further, the Proposing Release puts the onus on the investor to review the process by which the fund analyzes the emissions data it receives, which will vary fund by fund. The Commission’s goal should be to simplify ESG disclosure, not to create additional hurdles and costs for investors.

Second, while access to data and other climate-related measures has expanded in some respects, there is not a consistent, standardized framework to report GHG emissions, let alone assurances that the information received is complete and accurate. Similarly, advisers are likely to face data gaps and varying audit standards. The Proposing Release relies on data that would only be widely available upon the effectiveness of the currently proposed rule “The Enhancement and Standardization of Climate-Related Disclosures for Investors.”⁵ Additionally, an investment fund may also encounter a “non-reporting portfolio company” and be forced to cobble together third-party data that attempts to represent what the non-reporting entity’s GHG emissions may total, a potentially costly and unreliable calculation.

Finally, the inevitable cost of implementing the rule as proposed will likely shift to investors, many of whom have not demanded this level of emissions data. As we state above, investors are better served through clear and concise disclosure of a fund’s ESG strategy and execution in the prospectus, rather than tables of data and analysis covering potentially hundreds of issuers. We believe this approach better suits the Commission’s goal to provide clarity to investors on ESG-related investment products.

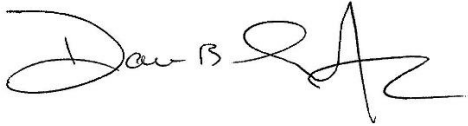
Conclusion

While we agree that ESG is an increasingly important area of focus for fund directors and that greenwashing should not be ignored, we believe the Commission’s efforts would be best focused on delineating what constitutes meaningful and clear disclosure rather than focusing on categorizing different types of ESG funds. The layered approach outlined for ESG Integrated Funds would help investors appreciate a particular fund’s approach to ESG for any fund that uses ESG as a principal part of its investment strategy. We believe that such an approach would allow advisers to more accurately describe the process that they follow with respect to ESG at a particular fund and therefore help investors understand any differences between funds. Further, we have fundamental concerns about the proposed disclosure regarding GHG emissions of the companies in which certain ESG funds invest. The disclosure is likely to overwhelm investors with information that would be costly to collect, if it is available at all. Those costs are likely to be passed through to investors who have not widely demanded this level of detailed information. Instead, we believe the Commission should focus on clear and concise disclosure about a fund’s ESG strategy.

⁵ See The Enhancement and Standardization of Climate-Related Disclosures for Investors, Release Nos. 33-11061; 34-94867; File No. S7-10-22, 87 Fed. Reg. 21334 (April 11, 2022).

We would welcome the opportunity to discuss these comments in further detail. Please feel free to contact David Smith, the Forum's General Counsel, at david.smith@mfd.org or 202-507-4491 or Carolyn McPhillips, the Forum's President, at carolyn.mcphillips@mfd.org or 202-507-4493.

Sincerely,

A handwritten signature in black ink that reads "David B. Smith, Jr." followed by a stylized flourish.

David B. Smith, Jr.
Executive Vice President & General Counsel