PRI Principles for Responsible Investment

CONSULTATION RESPONSE

SECURITIES AND EXCHANGE COMMISSION FILE NO. S7-17-22: ENHANCED DISCLOSURES BY CERTAIN INVESTMENT ADVISERS AND INVESTMENT COMPANIES ABOUT ENVIRONMENTAL, SOCIAL, AND GOVERNANCE INVESTMENT PRACTICES

16 August 2022

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To inform this response, the following investor groups have been consulted: PRI Global Policy Reference Group. This consultation is not an endorsement or acknowledgement of the views expressed in this response.

INTRODUCTION

The Principles for Responsible Investment (PRI) is the world's leading initiative on responsible investment. The PRI has now over 5,000 signatories (pension funds, insurers, investment managers and service providers) to the PRI's six principles with approximately USD$121 trillion in assets under management.[1]

The PRI supports its international network of signatories in implementing the Principles. As long-term investors acting in the best interests of their beneficiaries and clients, our signatories work to understand the contribution that environmental, social and governance (ESG) factors make to investment performance, the role that investment plays in broader financial markets and the impact that those investments have on the environment and society as a whole.

The PRI works to achieve this sustainable global financial system by encouraging adoption of the Principles and collaboration on their implementation; by fostering good governance, integrity and accountability; and by addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation. The PRI develops policy analysis and recommendations based on signatory views and evidence-based policy research.

The PRI welcomes the opportunity to respond to the SEC's proposed rulemaking on enhanced ESG-related disclosures for investment advisers and investment companies.

[1] Principles for Responsible Investment, *Signatory Directory* (July 2022), available at https://www.unpri.org/signatories/signatory-resources/signatory-directory.

ABOUT THIS CONSULTATION

This document responds to the US Securities and Exchange Commission’s (“SEC” or “The Commission”) File No. S7-17-22: Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices (“Proposal” or “Proposed Rule”). The Commission seeks input from market participants on proposed rules that would require registered investment companies and business development companies (“funds”), as well as registered investment advisers (“advisers”), to disclose information about their incorporation of ESG factors.

As an investor-focused organization, the PRI’s response is grounded in the perspective of a reasonable investor and evidence-based policy research. The PRI seeks to provide insight to the Commission on disclosures from funds and advisers that will provide relevant ESG-related information to investors.

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SUMMARY OF THE PRI'S POSITION

The PRI supports the Proposed Rule and the Securities and Exchange Commission's efforts to improve adviser and fund disclosure as it relates to environmental, social and governance issues. Principle 6 of our Principles for Responsible Investment calls on signatories to report their activities and progress towards implementing the Principles, and the PRI believes transparency and accountability are necessary features for a sustainable financial system.[2]

The PRI has previously outlined ESG-related disclosure best-practices for investors, including via our Toolkit for Sustainable Investment Policy and Regulation, produced in partnership with the World Bank Group.[3] Investor ESG regulations can remove barriers to action, creating positive duties for investors to integrate ESG issues into their investment practices and processes.

The PRI supports efforts to reduce greenwashing and ensure savers and investors are confident in the services advertised and provided by investment and fund managers. Research shows that investors are increasingly looking to select funds and investment products that match their ESG-related investment goals. However, a recent survey of individual investors conducted by Morgan Stanley reported that 71% of investors cited concerns about authenticity and greenwashing as a significant barrier to including sustainable investing in their portfolio.[4] Another recent survey reported that while 65% of investors rate ESG as important or very important for their investment decisions, only 37% are confident their portfolio is aligned to their values.[5]

To ensure transparency and provide investors the information needed to make informed decisions, fund level disclosure should reflect investment practices and align with marketing materials.

The PRI supports the following aspects of the Proposal:

- Disclosure of ESG-related practices and considerations by funds and advisers to better inform investors and help align fund selection with investor ESG-related goals.
- Disclosure of proxy voting activities, aligned with recommended amendments to Form N-PX proposed by the PRI.[6]
- Disclosure of GHG emissions metrics to provide investors with standardized and comparable information.
- Efforts to align disclosure requirements with global policy developments including those under review by the UK's Financial Conduct Authority (FCA) and the EU's Sustainable Finance Disclosure Regulation (SFDR).
- Efforts to ensure marketing materials accurately reflect various levels of consideration of ESG.
- Alignment with the proposed amendments to the Fund Names rule, requiring a fund to disclose "ESG Focused Fund" disclosures if the fund name includes terms related to ESG or sustainability.

[2] *What are the Principles for Responsible Investment*, available at https://www.unpri.org/about-us/what-are-the-principles-for-responsible-investment.

[3] Principles for Responsible Investment and the World Bank Group, *How Policy Makers can Implement Reforms for a Sustainable Financial System*, available at https://www.unpri.org/download?ac=12247.

[4] Morgan Stanley, *Sustainable Signals: Individual Investors and the COVID-19 Pandemic* (2021), available at 2021-Sustainable_Signals_Individual_Investor.pdf (morganstanley.com), p. 8.

[5] Capital Preferences, *ESG is Personal: 2021/22 Study of Preferences and Advisory Practices* (2022), available at 2https://www.capitalpreferences.com/wp-content/uploads/2022/06/2022-ESG-Preferences-Study-Capital-Preferences-Confidential.pdf, p. 5.

[6] Principles for Responsible Investment, *Consultation Response Securities and Exchange Commission: Request for Comment on Enhanced Reporting of Proxy Votes by Registered Management Investment Companies; Reporting of Executive Compensation Votes by Institutional Investment Managers; File Number S7-11-21* (December 2021), available at https://dwtyzx6upklss.cloudfront.net/Uploads/w/v/c/priconsultation_formnpx_442144.pdf.

KEY RECOMMENDATIONS

The PRI supports ESG-related disclosure requirements that allow for evolution of ESG practices to better understand and align with investor and market goals. We propose the following amendments to the proposal:

- **Ensure all disclosures present information on practices, as stand-alone metrics may not provide the relevant context necessary for investors.**
- **Eliminate the proposed "ESG Integration" category and require all funds to disclose the proposed information**.
- **Clarify the terms "significant or main consideration" used throughout the proposal.**
- **Expand consideration of "environmental factors" and require all funds to disclose if, and if so, how, they consider GHG emissions and climate change as part of investment practice.**
- **Require all funds to disclose if they consider the impacts of their investment decisions and if so, how.** This disclosure will better reflect market realities that all investments, and all funds, have impacts. It will also make clear the distinction between considering ESG factors for risk/return, or also for broader benefits and impacts.
- **Only categorize funds using engagement and proxy voting on ESG-related issues as ESG-Focused Funds if these strategies are a "significant or main consideration".** This would more closely reflect market practice aligned with fiduciary duty requirements.
- **Revise the disclosure requirement for engagement metrics to capture engagement outputs rather than inputs**; including effectiveness, effort and efficiency.
- **Revise Impact Funds to be "Impact-Focused Funds" and limit these funds to those where impact is a "significant or main consideration" of the fund.**
- **Ensure required disclosures of Impact Funds reflect that not all impact goals can be easily quantified,** such as human rights-related goals.
- **Make all disclosure of "third-party ESG frameworks" "as appropriate" or only when a "significant or main consideration" and only in order to provide context on a specific strategy, goal or relevant use case.**
- **Look to lessons learned from the EU's Sustainable Finance Disclosure Regulation (SFDR) and work with the EU, the UK's Financial Conduct Authority (FCA) and others to build a harmonized global system of investor and product disclosure.**

DETAILED RESPONSE

In order to most effectively address greenwashing, any disclosure requirements should, at minimum, present a description of actions taken in relation to any claims of ESG consideration, as stand-alone statements of “considering ESG” may not present useful information to investors. In order to best address greenwashing and advance ESG considerations, the Commission should consider the design of each disclosure to ensure the average investor is able to understand what that disclosure means in practice, as standalone KPIs can be interpreted in various ways by investors.[7]

SIGNATORY FEEDBACK

To better inform our response to the Commission, we held more than two dozen meetings with PRI signatories and requested input on our response. Broadly, the signatories engaged support the Commission’s Proposed Rule and efforts to address greenwashing and ensure all market participants are doing as they say. However, signatories also generally agreed that overly prescriptive or unclear disclosure requirements could disincentivize further ESG integration and consideration by adding liability and costs—especially if those added costs lead to higher fees on "ESG funds" compared to other funds.

Specifically, concerns were raised that setting too prescriptive disclosures would disincentivize ESG considerations or require managers to conform their considerations and uses of ESG to those of the Commission, and that creation of categories that do not match market practice could add to confusion for both managers and investors.

For example, signatories stated that a lack of clarity in the difference between an ESG Integration Fund and an ESG Focused Fund could encourage managers to undersell, or otherwise curtail, their ESG-related activities in an effort to manage risk.

Signatories also expressed concern that the added disclosures could present additional liability for them with their interactions with the Commission. For example, a manager expressed they have numerous funds that all perform ESG integration, however, in various ways using different methods and underlying data to reflect the goals of each fund. Concerns were raised that Commission examiners could misconstrue ESG integration and view one fund as “appropriately” integrating ESG, yet view another fund deviating from the firm’s, or other firm, “standard” or “known” practices. The signatory stated it would be safer to do the bare minimum required by fiduciary duty.

GLOBAL ALIGNMENT

The PRI supports global alignment of disclosure standards[8] and encourages the Commission to work closely with other regulators to align regulatory regimes, share lessons learned and best practice, avoid market fragmentation and support a better global understanding of the shift toward responsible investment.

Financial markets are increasingly interconnected, with asset owners and managers working across jurisdictions. The number of investment related ESG reporting requirements on asset owners and investment managers, both mandatory and voluntary, is rising.[9] Divergence among jurisdictions is concerning for investors, especially those that operate in multiple jurisdictions or rely on reporting from investment managers in different jurisdictions. In the Institute of International Finance (IIF) - European Banking Federation Global Climate Finance Survey of 70 financial institutions,[5] 65% of institutions reported that “green” regulatory market fragmentation was a major obstacle and would

[7] Principles for Responsible Investment, *Review of Trends in ESG Reporting Requirements for Investors* (August 2022), available at https://www.unpri.org/download?ac=16705.
[8] Principles for Responsible Investment, *Leading Financial Market Participants Call for Stronger Alignment of Regulatory and Standard Setting Efforts around Sustainability Disclosure*, available at https://www.unpri.org/download?ac=16342.
[9] Principles for Responsible Investment, *Review of trends in ESG Reporting Requirements for Investors* (August 2022), available at https://www.unpri.org/download?ac=16705.

have a material impact on the market for sustainable finance. Investment managers may face substantial costs as well as practical challenges, such as reconciling data from different sources and complying with divergent requirements in multiple jurisdictions.

The SEC's proposed ESG-related disclosures share commonalities with other national actions being taken to better manage fund and product ESG disclosure and greenwashing.[10] For example, the United Kingdom's Financial Conduct Authority (FCA) is currently developing Sustainability Disclosure Requirements and Investment Labels.[11] This disclosure and labeling standard is being developed on a similar timeline to the SEC's efforts and considering similar categorization of ESG or sustainability-related funds. Similarly, Articles 8 and 9 of SFDR offer categorization of funds with sustainable characteristics or with sustainable investment objectives, respectively. We encourage the Commission to work closely with other regulators in order to collectively improve these regulatory systems.

CONSIDERATION OF FUND CATEGORIZATION

The finalized rule should provide market participants with as much clarity as possible on the proposed categories and whether they can and should be understood as sustainability or ESG-related labels or not. We caution the Commission that market participants may view the Proposed Rule as a labeling—and thus, a marketing—regime and urge the Commission to consider this likelihood and potential impacts when finalizing the Proposal.

The PRI's position as a global organization provides us with a unique perspective on investor disclosure regimes in other jurisdictions. In the European Union, for example, conversations with signatories following the implementation of SFDR have revealed confusion surrounding the categorization of funds according to Article 8 (funds promoting environmental or social characteristics) and Article 9 (funds with sustainable investment as its objective) of the regulation. The wide variation in practices within these disclosure categories (particularly Article 8) can make it difficult for investors to discern the actual sustainability performance of the funds and underlying investments, as these categories do not guarantee standards for investment practice or sustainability performance. Other stakeholders in the sustainable investment space have pointed to this problem. For example, Eurosif highlights that:

> *Following the logic of a disclosure-based framework, the product categories in SFDR have a broad scope. They were deliberately left broad to capture as wide a range of products as possible. This is positive when viewed from the perspective of transparency as it ensures disclosures are applied to a wide segment of the market. However, significant risks emerge when a framework designed solely for transparency and disclosure starts being used to classify products.*[12]

Research by Morningstar has shown the wide variety of fund strategies categorized as Article 8 funds. In their review of the initial implementation of SFDR, Morningstar found that "asset managers have taken different interpretations of the definitions, some opting for a softer approach than others. This has resulted in an unexpectedly high number and broad range of products labelled Article 8 and Article 9." Morningstar further highlights that Article 8 funds include a variety of strategies utilized,

[10] Regulatory developments include guidance from the Australian Securities & Investments Commission on How to avoid greenwashing https://asic.gov.au/regulatory-resources/financial-services/how-to-avoid-greenwashing-when-offering-or-promoting-sustainability-related-products/, the Monetary Authority of Singapore's Disclosure and Reporting Guidelines for Retail ESG Funds https://www.mas.gov.sg/regulation/circulars/cfc-02-2022---disclosure-and-reporting-guidelines-for-retail-esg-funds, the Japanese Financial Services Agency's report on Enhancing Asset Management Business 2022 includes reporting guidance on pages 47-49 https://www.fsa.go.jp/en/news/2022/20220527/20220527_4.pdf, and recent guidance in Hong Kong on ESG disclosures in Financial Markets https://www.seyfarth.com/news-insights/further-guidance-on-enhanced-esg-disclosures-in-hong-kong-financial-markets.html#:~:text=The%202021%20Circular%20also%20requires,ESG%20data%2C%20or%20applicable%20assumptions.

[11] Financial Conduct Authority, *Sustainability Disclosure Requirements (SDR) and Investment Labels (*November 2021), available at https://www.fca.org.uk/publication/discussion/dp21-4.pdf.

[12] Eurosif, *EU Sustainable Finance & SFDR: Making the Framework fit for Purpose* (June 2022), available at https://www.eurosif.org/wp-content/uploads/2022/06/Eurosif-Report-June-22-SFDR-Policy-Recommendations.pdf.

from exclusion-only strategies to comprehensive thematic approaches.[13] While the fact that there are a variety of ESG strategies represented in Article 8 and 9 funds is not in itself a problem, it does become problematic when market participants are not able to—or do not feel it necessary to—easily distinguish between funds.

In response to these issues, the European Commission has proposed to develop minimum sustainability criteria for funds that fall under Article 8 of SFDR.[14] Since the first round of product disclosures under SFDR will be due in 2023, it is difficult to draw further conclusions on the appropriateness and effectiveness of the disclosures required and how they relate to market expectations and interpretations.

[13] Morningstar, SFDR: *Four Months After Its Introduction Article 8 and 9 Funds in Review*, available at https://www.morningstar.co.uk/uk/news/214207/sfdr-four-months-on.aspx, p. 25.

[14] European Commission, *Strategy for Financing the Transition to a Sustainable Economy,* available at https://ec.europa.eu/info/publications/210706-sustainable-finance-strategy_en.

ANSWERS TO SPECIFIC QUESTIONS

INTEGRATION FUNDS

Question 2: Should these disclosure requirements apply to registered open-end funds, registered closed-end funds, and BDCs, as proposed? Are there other substantive disclosure requirements that should differ based on the type of fund? Should our proposed disclosure requirements apply to insurance company separate accounts registered as management investment companies?

All registered investment companies, and related investment vehicles, should be required to disclose what is proposed for "ESG Integration Funds" with PRI's recommended amendments to those disclosures.

Question 3: Is the proposed definition of an Integration Fund appropriate and clear? Are there other alternative definitions we should consider? For example, is the aspect of the definition specifying that ESG factors "may not be determinative in deciding to include or exclude any particular investment in the portfolio" sufficiently clear? Would it be clearer to provide that ESG factors are "not necessarily" determinative, or would that imply a greater role of ESG factors than may be the case for many integration funds? Is the proposed definition over- or underinclusive? For example, are there funds that do not currently consider themselves to integrate ESG factors but would fall under this definition and be required to provide disclosures? Conversely, are there funds that do not meet the proposed definition that do consider themselves to integrate ESG factors?

The PRI recommends the commission eliminate the proposed ESG Integration Fund category as it could potentially limit growth of ESG incorporation across the investment industry. Instead, the PRI recommends requiring all funds to disclose the items in the ESG Integration category. We also recommend requiring all funds to disclose if they consider GHG emissions and/or climate change, and impacts, and if so, how.[15] Should a fund not consider ESG factors, GHG emissions/climate change or impacts in their investment decision-making, those respective decisions should be disclosed to potential investors, as these are an increasingly material considerations for investors choosing between funds and advisers.

Following 15 years of research including legal analysis by Freshfields Bruckhaus Deringer,[16] the PRI and partners concluded that considering ESG is a core part of fiduciary duties.[17] Many ESG factors are in fact financially material and therefore should be taken into account.[18] While the weight of consideration should be comparable to their level of risk and return, incorporation of ESG-related factors in investment practices and decision-making should be a part of every fund manager's work, at least in order to determine the appropriate level of consideration.

[15] See response to Question 92 for our complete recommendation on this point.

[16] Freshfields Bruckhaus Deringer, *A Legal Framework for Impact: Sustainability Impact in Investor Decision-Making*, available at https://www.unpri.org/download?ac=13902.

[17] Principles for Responsible Investment and UNEP Finance Initiative, *Fiduciary in the 21st Century*, available at https://www.unpri.org/download?ac=9792.

[18] Eccles, R., Ioannou, I. and Serafeim, G., *The Impact of Corporate Sustainability on Organizational Processes and Performance', Management Science* (2014), Vol. 60, Issue 11, pp. 2835–2857, available at: https://doi.org/10.1287/mnsc.2014.1984. University of Oxford and Arabesque Partners, *From the Stockholder to the Stakeholder: How Sustainability Can Drive Financial Outperformance* (March 2015), available at https://arabesque.com/research/From_the_stockholder_to_the_stakeholder_web.pdf. Khan, M., Serafeim, G. and Yoon, A. *Corporate Sustainability: First Evidence on Materiality* (2016), The Accounting Review, Vol. 91, Issue 6, pp. 1697–1724, available at http://www.aaajournals.org/doi/abs/10.2308/accr-51383. Nguyen-Taylor, K. and Martindale, M., *Financial Performance of ESG Integration in US Investing* (2018), available at: https://www.unpri.org/download?ac=4218. Subramanian et al*., ESG Part II: A Deeper Dive* (2017), available at: https://www.bofaml.com/en-us/content/esg-investing-research-report.html. McKinsey Quarterly, *Five Ways that ESG creates value* (November 2019), available at https://www.mckinsey.com/~/media/McKinsey/Business%20Functions/Strategy%20and%20Corporate%20Finance/Our%20Insights/Five%20ways%20that%20ESG%20creates%20value/Five-ways-that-ESG-creates-value.ashx.

As all funds, including those that may not consider themselves ESG Integration, should consider ESG factors as part of their fiduciary duties and financial risk management, all funds would currently fall under the proposed Integration category.[19] However, the creation of a categorical name, rather than a simple addition—or clarification—of disclosure requirements, establishes the contradictory understanding that some funds may not need to consider ESG factors at all.

A distinct category for managers considering ESG factors in a significant way has the possibility of showing an implied restriction that funds that do not integrate ESG in the way described by the Proposal do not fall into the "Integration" category and therefore cannot consider ESG factors. This distinction could also be interpreted as a narrowing of fiduciary duties; that consideration of ESG factors is a specific, additional activity undertaken by only certain investors.

By requiring all funds to "summarize in a few sentences how the fund incorporates ESG factors into its investment selection process, including what (if any) ESG factors the fund considers", the SEC would eliminate the impression that ESG factors are somehow different to other investment relevant factors and instead signal that considering ESG factors is a fundamental part of financial risk management.

The view that all funds should consider investment relevant ESG factors, and therefore be subject to the disclosure under the ESG Integration category, matches market trends. For example, the CFA Institute's position on ESG Integration clearly states that it "encourages all investment professionals to consider material ESG factors, where relevant, as an important part of the analytical and investment decision-making process, regardless of investment style, asset class, or investment approach."[20] Similarly, Blackrock recently stated in a white paper that, "while 'integration' is sometimes used to describe a specific ESG strategy or style of investing, this can be confusing, as integration of material ESG factors is increasingly part of mainstream investment and reflects considerations that are reflected across all portfolios".[21]

Some signatories expressed to the PRI that the required disclosures for Integration Funds may encourage them to overstate the relative consideration they give to ESG factors, compared to other factors. However, this assumes that ESG-related risks will remain at a consistent level, where, in fact, the relative risk and weight of these factors is all but guaranteed to grow over time and an increasing level of consideration is appropriate.

Market participants that do not consider ESG factors in their investment practice can be at risk of ignoring material issues, and thus violating their fiduciary duties. As such, the Commission should rather consider the risk to beneficiaries of funds ignoring or of funds automatically treating ESG information as immaterial without conducting the appropriate assessment. These practices could be undertaken out of bias or ignorance. However, the Commission, in potentially over-regulating those integrating ESG factors, risks stymieing efforts of market participants to fulfil their fiduciary duty by working to improve their understanding of ESG factor implications for their beneficiaries and long-term risk-adjusted performance of their funds.

The Commission should make clear that the intention of the proposal is not to restrict or in any way narrow consideration of ESG factors to a certain segment of market participants. ESG-related factors have implications for all funds and all asset classes, and a regulatory regime that discourages ESG consideration or classifies it as separate duties would be detrimental to financial markets, society and the economy. Rather, all funds and advisers should have a process in place to systematically

[19] Principles for Responsible Investment, *Consultation Response FCA: Sustainability Disclosure Requirements and Investment Labels* (January 2022), available at priresponsefcaconsultationonsdrandinvestmentlabels07jan2022_574155.pdf (dwtyzx6upklss.cloudfront.net).

[20] CFA Institute, *Positions on Environmental, Social and Governance Considerations*, available at https://www.cfainstitute.org/-/media/documents/article/position-paper/cfa-institute-position-statement-esg.ashx.

[21] Blackrock, *Towards a Common Language for Sustainable Investing* (January 2020), available at https://www.blackrock.com/corporate/literature/whitepaper/viewpoint-towards-a-common-language-for-sustainable-investing-january-2020.pdf, p. 11.

consider ESG-related factors and disclose how they do so. Such disclosure would allow the Commission and the market to compare those disclosures with marketing materials to ensure funds and advisers are not overstating their ESG-related activities.

Question 5: Should we, as proposed, require an Integration Fund to provide a brief description of how the fund incorporates any ESG factors into its investment selection process, including what ESG factors the fund incorporates? Should we require a fund to include example(s)? Should we require a specific type of example? What additional disclosure about an Integration Fund would be helpful for an investor?

The PRI supports the disclosure requirement of how funds incorporate any ESG factors into their investment selection process for all funds, including what ESG factors the fund incorporates. This would provide investors with a baseline understanding of the fund's strategy and actions related to ESG factors. We similarly support the limited disclosure requirement in fund summary prospectus to match consideration of ESG levels, as well as increased disclosure in statutory prospectus. Practices around ESG integration vary between funds. Requiring substantive disclosure of ESG consideration and related practices in the statutory prospectus of a fund can significantly reduce the ability of funds to "greenwash" as these documents are filed with the Commission and subject to Exchange Act rules barring material misstatement. Requiring all funds to provide basic ESG-related disclosure in statutory prospectus also allows for easy comparison with related marketing materials.

The ESG Integration Fund category could potentially increase greenwashing, by allowing funds with limited ESG considerations to disclose minimal information to the Commission, yet market their fund, appropriately, as an "ESG Integration Fund". While institutional investors may be able to distinguish the difference, many retail investors may take this "categorization" as determinative as they do a fund's name. While the Commission did not design this rule to produce public labels, as we have seen with the EU's SFDR, the market has interpreted similar categorizations as such and the UK's FCA is designing a similar categorization to serve as a labeling regime, specifically.[22] We believe the creation of an ESG Integration Fund category could be used in the same way, providing a mark of approval for funds with vastly different levels of ESG integration that could easily be misinterpreted by investors.

The Commission should also require all funds to disclose if and how they consider the impact of their investment decisions beyond their immediate investment goals. The PRI's foundational report *A Legal Framework for Impact*, commissioned in partnership with the UNEP FI and the Generation Foundation, and authored by Freshfields Bruckhaus Deringer argues that "all business enterprises have sustainability impacts, positive or negative. An enterprise has a positive sustainability impact where it does something that advances an overarching sustainability outcome. This can include steps to eliminate activities that make those overarching outcomes less likely."[23] Requiring disclosure of impacts from all funds further clarifies that impact is not limited to "ESG" but relevant for all investment decisions and all funds.

Furthermore, requiring disclosure of if impacts are considered, and how, would eliminate the ability of funds and advisers to imply—through marketing materials or otherwise—that they are considering impacts of their funds beyond the standard risk/return analysis that is a baseline for ESG integration.

Requiring this disclosure would be in line with a wider trend to move towards reporting sustainability impacts,[24] such as the EU's SFDR regulation which requires disclosure of whether funds consider or not the adverse impacts of their investment decisions (under Article 7). Market analysis suggests that

[22] Morningstar, *SFDR Article 8 and Article 9 Funds: 2021 in Review* (February 2022), available at https://assets.contentstack.io/v3/assets/blt4eb669caa7dc65b2/bltd0f4649e9dbfcd1f/620292b71586404a56476df2/SFDR_Article_8_and_Article_9_Funds_2021_in_Review.pdf.

[23] Freshfields Bruckhaus Deringer, *A Legal Framework for Impact: Sustainability Impact in Investor Decision-Making*, available at https://www.unpri.org/download?ac=13902 , p. 24.

[24] Principles for Responsible Investment, *Review of Trends in ESG Reporting Requirements for Investors* (August 2022), available at https://www.unpri.org/download?ac=16705&adredir=1.

a considerable portion of funds (almost 20%) reporting under SFDR do already consider adverse impacts in their investment decisions.[25] Reports continue to cite that younger investors are actively seeking to make positive impacts with their investments[26] and interpret "ESG scores" or related criteria as providing information on a fund or product's broader impact on society, the environment or economic sustainability. For example, in a survey of individual investors in 2021, 73% of millennial investors made changes to their investment portfolios, or plan to do so in the next 12 months, in response to social justice issues.[27] Fund disclosure about whether and how funds consider the impact of their investment decision can provide clarity to those investors and better align disclosures with growing market demands and investor expectations.[28]

Question 6: Should we, as proposed, require an Integration Fund that considers the GHG emissions of its portfolio holdings as an ESG factor in its investment selection process, to disclose how it considers the GHG emissions of its portfolio holdings? Should the description, as proposed, include a description of the methodology such a fund uses for this purpose? Would investors find this narrative disclosure useful to make better informed investment decisions? Should we require Integration Funds to disclose quantitative information or other GHG metrics, in addition to or in lieu of, the narrative disclosure? If so, what type of quantitative information of GHG metrics should be disclosed? For instance, should we require Integration Funds that consider GHG emissions as a part of their investment selection process to disclose the same standardized GHG metrics we are requiring of certain ESG-Focused Funds? Would such quantitative data be useful to investors?

The PRI supports the requirement for funds that consider GHG emissions to disclose how it considers the GHG emissions of its portfolio holdings. However, the PRI recommends that the Commission eliminate the Integration Fund category and require this disclosure for all funds (See responses to Question 4 and Question 92). If a fund does not consider GHG emissions, then it can simply state that. This disclosure would be in line with requirements of the EU's SFDR.

We recommend replacing the term "methodology" with one that provides more flexibility for fund disclosure, such as "consideration" "process," "investment activity," or "investment thesis."[29] The term "methodology" could be interpreted to mean that the only way for a fund to consider GHG emissions is by calculating emissions numerically. However, there are many ways that funds consider GHG emissions without calculating emissions for portfolio companies (See response to Question 87).

[25] Morningstar, *SFDR Article 8 and Article 9 Funds: Q2 2022 in Review*, available at https://www.morningstar.com/en-uk/lp/sfdr-article8-article9, p. 30.
[26] Responsible Investment Association, *Millennials, Women and the Future of Responsible Investing* (April 2016), available at https://www.riacanada.ca/research/millennials-women-and-the-future-of-responsible-investing/, Bauer, Tobias Ruof, Paul Smeets, *Get Real! Individuals Prefer More Sustainable Investments*, The Review of Financial Studies, Volume 34, Issue 8, August 2021, Pages 3976–4043, available at https://doi.org/10.1093/rfs/hhab037.
[27] Morgan Stanley, *Sustainable Signals: Individual Investors and the COVID-19 Pandemic* (2021), available at https://www.morganstanley.com/assets/pdfs/2021-Sustainable_Signals_Individual_Investor.pdf, p. 8.
[28] Principles for Responsible Investment, *Review of Trends in ESG Reporting Requirements for Investors* (August 2022), available at https://www.unpri.org/download?ac=16705&adredir=1.
[29] Proposed Rule at p. 321.

ESG-FOCUSED FUNDS

Question 13: Should we, as proposed, define an ESG-Focused Fund as a fund that focuses on one or more ESG factors by using them as a significant or main consideration in selecting its investment or its engagement strategy with issuers of its investments?

The PRI supports the proposed additional disclosure for "ESG-Focused Funds" and recommends the Commission clarify the terms "significant or main consideration"[30] used throughout the proposal.

Under the Proposed Rule, an ESG-Focused Fund is defined as a fund "that focuses on one or more ESG factors by using them as a significant or main consideration (1) in selecting investments or (2) in its engagement strategy with the companies in which it invests." "Significant or main consideration" is not defined under the Proposal. The lack of definition could create confusion among market participants in practice, especially when it comes to funds that utilize strategies from the proposed Strategy Overview table,[31] but do not know whether the extent they do so would qualify as a "significant or main consideration".

For example, the Proposal states that ESG-Focused Funds would include those that "track an ESG-focused index or that apply a screen […] has a policy of voting its proxies and engaging with the management of its portfolio companies to encourage ESG practices or outcomes." However, a significant number of funds utilize basic screens—such as screening out tobacco or firearms companies. The proposed disclosure requirements for these types of screens may not be appropriate, as this may not be a key part of any strategy but a straight-forward decision that does not otherwise impact the fund strategy or decision-making. Required enhanced disclosure for all screens could disincentivize funds from setting these policies in order to avoid publishing an ESG-related disclosure that is sparse for information.

Question 14: As discussed above, a fund that applies a screen to include or exclude investments based on ESG factors would meet the proposed definition of an ESG-Focused Fund. Should our definition of an ESG-Focused Fund specifically reference a fund that follows an ESG-related index or a screen based on ESG factors to include or exclude investments? Should our definition take into account whether a fund's use of an ESG-related index or screen is to promote ESG goals? Should the reference to engagement be a means of identifying Impact Funds, rather than ESG-Focused Funds generally?

As discussed above, the use or consideration of a screen should not automatically categorize a fund as ESG-Focused or Impact, as that screen may not be a "significant or main consideration" of the fund. Inconsistent or unclear categorization of funds risks disincentivizing basic ESG considerations or actions; minimizing the work of other funds that hold ESG considerations as a significant or main consideration; and confusing investors by having vastly different funds within the same category.

Similarly, a reference to engagement should not be a means of identifying Focused or Impact Funds. PRI reporting data shows that 86% of PRI signatories use engagement to manage ESG issues.[32] Automatically categorizing all funds using engagement as a way to manage ESG issues as Focused Funds would falsely imply this is a "significant or main consideration" and similarly for Impact Funds would falsely imply that these funds have impact goals as a primary focus of the fund. Instead, the *purpose* of the engagement strategy should be a determining factor for categorizing funds. For some investors, engagement serves the goal of protecting against material risks, while others may utilize engagement to achieve an impact goal. Further, the "significance" of engagement as a part of

[30] Proposed Rule at p. 316.
[31] Proposed Rule at p. 318.
[32] Principles for Responsible Investment, *Do PRI Signatory Investors Walk the Talk?* (January 2021), available at https://www.unpri.org/pri-blog/do-pri-signatory-investors-walk-the-talk/7026.article.

any strategy can differ from a low number of engagements where ESG was a low priority, to a core strategy and purpose of the fund. This significance should be a key determination for inclusion in this category.

Automatically categorizing funds that engage with companies based on ESG topics as Focused or Impact Funds may have unintended consequences by presenting ESG engagement as somehow additional, or different than engagement on other issues. The additional reporting burden could deter funds from using engagement on ESG topics as a strategy all together, thereby disincentivizing engagement on ESG issues as an important risk management tool.

Question 15: Should we include the proposed elements in the definition of ESG-Focused Fund related to the use of ESG-related names or advertising or other materials? In particular, does the proposed definition provide appropriate flexibility to allow an Integration Fund to describe its integration process accurately in advertising or other materials, while assuring that funds that market themselves as having an ESG focus provide sufficient information to support such claim?

The PRI supports the idea that funds' advertisements and sales literature should influence the required disclosure and could lead to categorization as a Focused or Impact Fund.

Under the Proposed Rule, ESG Focused Funds include funds "whose advertisements, as defined pursuant to rule 482 under the Securities Act of 1933 [17 CFR 230.482], or sales literature, as defined pursuant to rule 34b-1 under the Investment Company Act of 1940 [17 CFR 270.34b-1], indicate that the Fund's investment decisions incorporate one or more ESG factors by using them as a significant or main consideration in selecting investments."

However, the Proposed Rule is not clear regarding what kind of language signals "significant or main consideration". For example, in the discussion section of the Proposal the Commission states that "any fund that markets itself, whether through its name or marketing materials as having an ESG focus, would be required to provide the proposed ESG Strategy Overview Table discussed below".[33] Further, it highlights that "a fund's use of advertisements or sales literature that mention ESG factors, but not as a "significant or main consideration" in the fund's investment or engagement strategy, would not alone cause the fund to be an ESG-Focused Fund. This aspect of the proposed definition of an ESG-Focused Fund would permit Integration Funds to discuss the role of ESG factors in their advertisements or sales literature—including the relationship between ESG factors and other investment factors and that ESG factors might not be dispositive—while deterring marketing materials that imply that ESG factors are a significant or the main consideration of a fund."[34]

This explanation of when an Integration Fund is allowed to market its consideration of ESG factors, without automatically being categorized as a Focused Fund, depends on the interpretation of "significant or main consideration". While it might be clear that an Integration Fund cannot state that ESG factors play a significant or main consideration in its investment processes, there are a variety of other phrases that could be used in marketing materials. It is not clear how one would determine whether these phrases imply an "ESG Focus" or "significant or main consideration" compared to a fund manager describing their integration process in detail as an important feature of the fund. The lack of definition could easily translate into confusion for retail investors seeking specific funds, and fund managers or advisers downplaying their ESG consideration practices for fear of misstatement.

The PRI encourages the SEC to provide clarity on the terms "significant or main consideration," and to provide further information on what kind of language implies an ESG focus versus ESG integration in advertisements and sales literature.

[33] Proposal at p. 34.
[34] Proposal at p. 34-45.

In general, further clarity on language in advertisements and sales literature that may be permissible and/or appropriate is needed. In the European Union, for example, lack of clarity around these issues has caused market confusion, and the European Securities and Markets Authority (ESMA) has seen it necessary to publish guidance on the matter to provide clarity.[35] To avoid similar confusion, the SEC should clarify these issues in the final rule.

Question 22: Should we, as proposed, permit a fund to replace the term "ESG" in the ESG Strategy Overview table with another term or phrase that more accurately describes the ESG factors that the fund considers? Should a fund be required to replace ESG with a different term in certain circumstances, such as when it focuses on a particular issue or set of issues?

Question 23: Should we allow flexibility in how funds label each row in the table beyond the flexibility provided regarding the term ESG and the pronouns used?

No, while the same information would be in the same place across all forms, retail investors may not understand this change and assume the disclosures are different.

ESG incorporation is an evolving practice and "ESG" is only one part of responsible investment.[36] As practice evolves over time, the Commission will need to adapt this form and related terms to reflect a shift to considerations beyond the ESG moniker, such as sustainability.

Question 49: We are proposing that a fund disclose any third-party ESG frameworks it follows. Is the level of detail about that third-party ESG framework appropriate? Should we limit the scope of what is reported about the third-party ESG framework? If so, how? Is there other information about the third-party ESG framework that should be disclosed? If so, what types of information should be disclosed? Is there additional information about how the fund follows the third-party ESG framework that would be helpful?

The PRI supports the intent of the Commission's proposal requiring disclosure of third-party ESG frameworks being utilized, however, as drafted the proposal will not produce the desired information and may, in fact, increase greenwashing.

Along with other similar disclosures, the Proposal would require an ESG-Focused Fund to provide in its summary prospectus "an overview of any third-party ESG frameworks that the Fund follows as part of its investment process."[37] The fund would also be required to provide a "description of any third-party ESG frameworks that the Fund follows as part of its investment process and how the framework applies to the Fund."[38]

We would caution the Commission that a general statement of "considering"[39] a framework does not provide useful information to the market on specific practices and could increase greenwashing by allowing general claims to act as proxies for information on related practices.

To prevent mischaracterization or confusion, the Commission should ensure any disclosure of frameworks/standards/targets are provided alongside and used in order to provide context, details, or goals that significantly influence practices. As such, we recommend that the Commission make the following changes for all similar disclosures for both funds and advisers:

1. Clarify the Commission's definition of "third-party ESG frameworks";
2. Clarify the terms "following" and "consider";

[3535] European Securities and Markets Authority, Supervisory Briefing: *Sustainability Risks and Disclosures in the Area of Investment Management* (May 2022), available at https://www.esma.europa.eu/sites/default/files/library/esma34-45-1427_supervisory_briefing_on_sustainability_risks_and_disclosures.pdf.

[36] Principles for Responsible Investment, *What is Responsible Investment*, available at https://www.unpri.org/an-introduction-to-responsible-investment/what-is-responsible-investment/4780.article.

[37] Proposed rule at p. 335.

[38] Proposed rule at p. 322.

[39] Proposal at p. 49.

3. Expand the list of examples provided by the Commission to reflect the full scope of its understanding of "third-party ESG frameworks";
4. Only require and/or allow disclosure of a framework if it is considered appropriate or a “significant or main consideration” of a fund’s or adviser’s strategy, activities or goals;
5. Only require and/or allow disclosure of a framework alongside an explanation of how, in practice, the fund/adviser follows/considers that framework.

These changes would allow funds and advisers to utilize their consideration of “frameworks” and similar third-party guidance in order to provide context and detail on their ESG-related practices.

As drafted, the proposed disclosure would allow funds and advisers to mislead investors by improperly suggesting that they are “following” “frameworks” as proxies for actions taken in alignment with these broad frameworks.

A third-party framework or standard for a fund is only relevant if the fund were to claim that it engages in a certain practice in a manner that is consistent with or pursuant to some specific requirement of the framework or standard. However, as standalone disclosures, a claim of “following” or “considering” a framework could allow for misrepresentation, add to investor confusion and could, in practice, promote greenwashing.

The current use of the terms “following” or “consider” are too broad to prove useful for investors. For example, one of the most common frameworks is the Paris Climate Agreement. However, an investor claim to “consider” the Paris Agreement is a meaningless statement unless that is paired with formalized targets and an implementation plan to hold global temperature rise well below two degrees Celsius.

By naming a framework as being followed, broadly, the summary prospectus could be interpreted as endorsing, following, or even being endorsed by, the framework’s entire body of work. Determining the details of what “following” means would be left to the investor, requiring them to proactively seek out additional information in the full prospectus in order to understand what the fund means by this in practice.

Utilizing an example provided in the Proposal, the UN Sustainable Development Goals consist of 17 high-level goals and 169 targets, such as

> *Goal 4: Ensure inclusive and equitable quality education and promote lifelong learning opportunities for all*.

Should an investor read in a summary prospectus that a fund “seeks to support the UN SDGs” through its investments, there may be additional information in the fund prospectus, but should an investor not choose to find the detailed summary, there is no “right” or “standard” way for an investor to interpret that one-line summary.

The UN SDG website cites 1325 publications in some way associated with the SDGs, including actions one can take in order to support the goals.[40] Within those publications, there are thousands of details and recommendations, which may be "followed” and “considered” by firms in widely divergent ways.

The Commission should require disclosure of third-party ESG frameworks for funds only when this information provides clarity on specific ESG-related claims made by the funds. The Commission should amend the disclosure of third-party ESG frameworks to require disclosure of any relevant third-party frameworks only when actually used by a fund to direct, measure, or benchmark performance of, its strategy in a way that is a “significant or main consideration” of the fund. The identification of third-party ESG frameworks would be misleading unless it is essentially used to clarify or explain the fund’s practices and other disclosures.

[40] United Nations Department of Economic and Social Affairs, *Do you know all 17 SDGs?* (August 15, 2022), available at https://sdgs.un.org/goals.

The Commission should clarify the definition of "third-party ESG framework" and we recommend providing additional examples such as: The TCFD Recommendations; The Paris Climate Agreement; The OECD Guidelines for Multinational Enterprises, including guidance on Responsible Business Conduct for Institutional Investors. Still, many of these frameworks are set out in multi-part analyses, and a statement of "following" or "considering" can prove meaningless unless paired with an explanation of concrete uses for these frameworks in order to set or achieve measurable goals.

We request the Commission remove the PRI from its list of example "third-party ESG frameworks" at this time.

While we do not oppose disclosures requiring PRI signatories to state their relationship to the PRI, we do not believe the Proposal's characterization of the PRI is accurate, and, if finalized as drafted, the Proposal would create confusion and significant additional liability for the PRI and our signatories.

The PRI is a membership-based initiative driven by six "aspirational principles" to which signatories commit (as opposed to specific practices). Our members include approximately 5,000 global signatories, including asset owners, asset managers and service providers, with diverse investment strategies and circumstances. The PRI purposefully maintains a large, diverse signatory base in order to assist all investors, asset owners and service providers who are interested in improving their responsible investment practices, regardless of where they are on that journey. Our work ranges from assisting investors in understanding the basic principles of ESG integration, to providing resources to assist asset owners to engage their managers on responsible investment, to providing tools and organizing peers to actively work to achieve net zero targets for investment portfolios.

Over our 15 years, the PRI has released hundreds of documents, covering thousands of pages of materials outlining issues for asset managers and owners and chronicling market and regulatory developments around the world. Notably, there is not a single PRI "standard" which a fund could be "compliant" with or not. The PRI does operate a reporting framework for signatories to help them understand their responsible investment activities year-over-year. However, the PRI has not set out standards within this framework that demarcates achievement of a specific goal as achieving or not achieving "responsible investment". Specifically, the reporting framework does not ask for fund-level disclosure.

The PRI is not a fund-level initiative and the SEC's consideration of a fund's relationship to the PRI would be outside the bounds of PRI's scope. Funds themselves are not permitted to become PRI signatories. Yet the Proposal's focus is at the fund-level.

Signatories to the PRI are expected to have a "responsible investment policy, setting out the firm's overall approach and/or formalized guidelines on E, S and G factors that cover more than 50% of AUM." Therefore, if a fund adviser/manager is a signatory to the PRI, that does not guarantee that any assets within any specific fund are included within a parent organization's responsible investment policy. Further, it is also possible that only a portion of a fund's assets fall under a parent organizations' responsible investment policy, and that portion may change regularly.

The PRI, in its annual Reporting Framework for members asks signatories to disclose ESG-related activities at the enterprise level, not at fund level. The PRI does not, in any direct way, consider any individual fund's relationship to the Principles.

The proposal would also suggest that firms that are not members of the PRI – and with whom we have no relationship – could self-identify as "following" the PRI or the publicly available principles and reporting framework.

The disclosure of "third-party ESG frameworks" as proposed necessitates higher levels of scrutiny by the public and the Commission and creates additional liability and risks for PRI signatories' inclusion of ESG considerations than those who are not members.

Despite the fact that the PRI does not articulate any investment framework or standards for individual funds (unlike some other third parties), the proposal would expressly require PRI signatories to make heightened disclosures (and face heightened regulatory and civil liability).

Requiring PRI signatories to disclose their participation in a way that is not necessarily representative of their practices, or those of any specific fund, creates additional liability on those signatories, especially if the required disclosure encourages them to conform their consideration of ESG with the Commission's separate understanding of what "following" PRI's principles or being a PRI signatory means.

By inaccurately suggesting that the PRI articulates an investment framework for funds through the use of its name in the Proposal, the Proposal would in effect be imposing a higher standard of disclosure for PRI signatories than other regulated organizations. This additional regulation implies that PRI signatory investment practices are in some way additional to those market participants that are not PRI signatories—when, in fact, fiduciary duty would require that all investors consider ESG factors to determine their relevance.

Should the Commission require PRI signatories to disclose their relationship to the PRI, the Commission should also require disclosure of any trade association or other paid membership organizations that funds and advisers maintain, as these memberships can also relate to investment strategy and adviser and fund practices.

The Commission should ensure its use of the terms "framework" and "standard"[41] are clear and consistent. These terms appear to be used interchangeably in the proposal yet have different purposes, activities and subscribers. For an example of a "framework," the Nordic Investment Bank's Responsible Investment Framework explains it has utilized the PRI's six principles as impetus to lay out its own proposed practices to implement its responsible investment policy.[42] Meanwhile a "standard," in fact, sets a level of attainment or quality necessary in order to be defined as meeting that threshold. For example, the International Organization for Standardization (ISO) has a set of standards that "contribute to" the SDGs, which details how organizations can achieve specific contributions to the SDGs.[7]

The Commission should resolve inconsistencies in its various disclosures related to "third-party ESG frameworks".

For example, the narrative discussion of the proposal states: "... the fund would provide *an overview of those standards in the row, with the more detailed description of any applicable ESG framework and how it applies to the fund later in the prospectus*." The proposal then states, "In these cases, requiring a fund to disclose that the fund's investments will follow such a framework would help an investor understand how the fund considers such ESG frameworks in its investment strategy. For example, under the proposed amendments, a fund might disclose in its ESG Strategy Overview table that the fund's investment objective is to seek long-term capital appreciation while also contributing to positive societal impact aligned to the UN SDGs by limiting the fund's investments to companies that contribute to at least one of those goals. The fund would then be required to disclose later in its prospectus more information about any UN SDG goal on which the fund focuses and how the fund determines that a portfolio company contributes to that goal."

However, the initial description of this disclosure is not to require the fund's consideration of the framework, i.e. how it uses the framework to set targets, goals or otherwise influence its investment strategy and thesis. Instead, the description only requires disclosure of "*an overview of those standards*" in the summary prospectus, with information on "how the framework applies to the Fund" disclosed elsewhere. These are two different disclosures with different information and purposes.

Within the proposed rule text itself, there is a similar discrepancy. Proposed amendments to Form N-1A would require the appropriate fund to disclose "A description of any third-party ESG frameworks that the Fund follows as part of its investment process and how the framework applies to the Fund."[43]

[41] Proposed Rule at p. 48.
[42] Nordic Investment Bank, *NIB Launches Responsible Investment Framework* (May 2022), available at https://www.nib.int/releases/nib-launches-responsible-investment-framework.
[43] Proposed Rule at p. 322.

However, the proposed amendments to Form N-2 would require a different disclosure: “As applicable, provide an overview of any third-party ESG frameworks that the Fund follows as part of its investment process.” The original definition is then added in the “Supplemental ESG Disclosure” section as a separate required disclosure.

Further, in the proposed amendments to Part 2 of Form ADV, the Commission has proposed in a note: “If you utilize or follow a third-party ESG framework, criterion, or index, you may include a hyperlink to any such framework, criterion, or index in your response to this Item.” While this may be useful for an index, we struggle to determine what on our own website should be the appropriate landing page for the link. Similarly, what about the Sustainable Development Goals? And, of course, no link may be representative of any specific practice, actions taken, or goals set by the specific fund making a disclosure.

The proposal does seek to utilize consideration of third-party frameworks in order to describe a specific practice in Part 2A Appendix 1 of Form ADV: Wrap Fee Program Brochure, Item 6. Portfolio Manager Selection and Evaluation, A.4.(i) requires “a description of any criteria or methodology you use to assess portfolio managers’ applications of the relevant ESG factors into their portfolio management, including any industry or other standards for presenting the achievement of ESG impacts and/or third-party ESG frameworks, and any internal criteria or methodology.” This consideration of third-party ESG frameworks is presented in a way that could provide context for investors, especially if paired with detailed disclosure of how frameworks or standards are utilized or considered. **Should the Commission wish to require disclosure of “third-party ESG frameworks”, we generally recommend this use case for disclosure of frameworks as well as flexibility for managers to disclose this information “as appropriate” or only if a “significant or main consideration”, to reflect the level of use and influence frameworks may have on their activities.**

PROXY VOTING/ ENGAGEMENT WITH COMPANIES

Question 58: Should we, as proposed, provide separate check boxes for proxy voting and engagement? Should we, as proposed, include both proxy voting and engagement in the row "How the Fund votes proxies and/or engages with companies about [ESG] issues?" How commonly do funds voting proxies as a significant means of implementing their ESG strategy also use engagement as a significant means of implementing their ESG strategy, or vice versa? Do funds engage with issuers in ways other than through voting proxies and meeting with management that we should address in the disclosure rules? What are those other ways? Should we require disclosure about those other ways of engaging with issuers? What would that disclosure include?

Filing shareholder proposals constitutes an additional means of engagement that investors have with issuers and ought to be considered for inclusion in the disclosure requirements. A disclosure requirement asking funds to disclose shareholder proposals they lead-filed and co-filed would provide investors with useful information.

Question 77: Should we, as proposed, require any fund that indicates that it uses proxy voting as a significant means of implementing its ESG strategy to disclose the percentage of voting matters during the reporting period for which the fund voted in furtherance of the initiative? Should we permit the fund to limit this disclosure to voting matters involving the ESG factors the fund incorporates into its investment decisions, as proposed? Would investors and other market participants find this information helpful? Is there any additional information regarding their proxy voting that we should require funds to provide?

The PRI supports the proxy voting disclosure requirements. Increasing the availability and accessibility of proxy voting data for investors in a consistent and comparable manner helps to protect investors and maintain fair, orderly and efficient markets. Increased transparency on how funds are voting on issues, particularly issues of human capital management, climate change and executive compensation, provides investors with the ability to gain insight into how funds are participating in the proxy voting process and adds to the mix of information investors use to make investment decisions.

Further, integrating ESG factors is a necessary part of the investment process, as it is critical for the promotion of long-term shareholder value.[44] Principle 2 of PRI's Principles states signatories will seek to be "active owners" that "incorporate ESG issues into our ownership policies and practices."[45] Similarly, Principle 6 states that PRI signatories will "report on our activities and progress towards implementing the Principles".

We support having a summary of fund's voting practices in the prospectus, but the Commission should consider if these disclosures would be duplicative given recent proposed amendments to Form N-PX. The PRI supported the SEC's proposed changes to form N-PX, establishing categories that include "ESG," which would make the interpretation of a Fund's detailed voting history more easily understandable to an investor.[46] We encourage the SEC to finalize the Proposed Rule, along with adding the categories recommended in the PRI's comment letter. These changes to form N-PX would make funds' proxy voting disclosure related to ESG more comparable and standardized.

[44] Principles for Responsible Investment, *How ESG Engagement Creates Value for Investors and Companies* (2018), available at https://www.unpri.org/download?ac=4637.
[45] Principles for Responsible Investment, *What are the Principles for Responsible Investment?*, available at https://www.unpri.org/pri/what-are-the-principles-for-responsible-investment.
[46] Principles for Responsible Investment, *Consultation Response Securities and Exchange Commission: Enhanced Reporting of Proxy Votes by Registered Management Investment Companies; Reporting of Executive Compensation Votes by Institutional Investment Managers*; File Number s7-11-21 (December 2021), available at https://dwtyzx6upklss.cloudfront.net/Uploads/w/v/c/priconsultation_formnpx_442144.pdf.

Question 79: Should funds be required to provide a narrative explanation of how they cast their proxy votes on ESG matters, either instead of or in addition to statistics on ESG matters? If we required a narrative, what elements should a fund be required to include?

Funds should be allowed to supplement their proxy voting disclosure with a narrative explanation. A narrative explanation of proxy voting related to ESG matters can be useful, in particular in the following circumstances:

- When the votes cast appear to be a departure from the fund's proxy voting principles or published proxy voting policy. The PRI encourages its signatories to adopt and publish proxy voting principles, which are high-level statements which explain the investor's position on ESG issues and how they vote to effect progress on those issues. Signatories should, where possible, support all resolutions which, if successful, would be consistent with their voting principles and oppose only resolutions whose effect would be contrary to these principles.[47] If a fund's vote is contrary to its proxy voting principles, a narrative explanation explaining this decision is useful.
- If the fund's proxy voting principles or voting policy is not public, a narrative description on how they vote on ESG matters is helpful.
- Explanation of significant votes related to ESG, in line with the European Union's Shareholder Rights Directive II.

Question 81: Should we, as proposed, require disclosure of the number or percentage of issuers with which the fund engaged and total number of ESG engagement meetings, as we propose to define that term? Would this information be useful to investors? Instead of, or in addition to, ESG engagement meetings, are there other metrics that we could require to be disclosed in relation to a fund's engagement strategy? Should we require funds to provide additional context to this information beyond the number or percentage of issuers with which the fund engaged and number of engagement meetings?

No, the PRI does not support the proposed engagement metrics. The PRI encourages the Commission to move towards results-oriented reporting metrics.[48] While the PRI supports fund disclosure related to engagement, the proposed metrics highlight inputs, rather than engagement outcomes, and therefore may incentivize quantity over quality when it comes to engagement meetings. The PRI believes that investors should focus on areas where they can have the most impact, even if this leads to engagement with a lower proportion of their portfolio. Engagement and proxy voting activities should not be standalone objectives. Dialogue without clear purpose, preparation and consistency of messaging can be more detrimental than no action at all. A 'quantity over quality' approach fails to generate value for clients and beneficiaries and dilutes the influence of more informed investors.[49] An increase in quantity of meetings, as is incentivized by these two metrics, could be harmful to the market and potentially hinder progress on ESG issues.

More effective KPIs would be ones that measure:

- **Effectiveness** (highlighting whether desired outcomes were achieved)
- **Effort** (was the investor acting alone or part of a collaboration, did the investor escalate the engagement)

[47] Principles for Responsible Investment, *Making Voting Count*, available at https://www.unpri.org/download?ac=12730, p. 5.
[48] Principles for Responsible Investment, *Review of Trends in ESG Reporting Requirements for Investors* (August 2022), available at https://www.unpri.org/download?ac=16705.
[49] More information about the PRI's view on these issues is available at Principles for Responsible Investment, *Consultation Response FRC: proposed Revision to the UK Stewardship Code* (March 2019), available at https://d8g8t13e9vf2o.cloudfront.net/Uploads/q/a/k/stewardshipcodeconsultationpriresponse_40740.pdf.

- **Efficiency** (a ratio that encompasses a measure of time or number of meetings to achieving measurable outcomes)

The Commission should consider how to encourage more informative disclosure of the outcomes of engagements rather than the inputs. In our view, effective stewardship does not involve maximizing the number of shareholder votes exercised and issuer engagement meetings held. Beyond exploring metrics that better capture effectiveness, effort, and efficiency, the Commission could consider requiring a narrative description of agreements with issuers on items proposed by the investor via engagement.

Question 86: As proposed, the form would require funds to report statistics regarding the number of ESG engagements meetings across their entire portfolio, irrespective of the ESG goal of the meeting; should we instead require funds to break down their engagement statistics based on category? Would this provide helpful detail for an investor seeking to assess a fund’s engagement on a particular topic? Would the breadth of potential categories make it difficult to convey the overall extent of a fund’s engagement? Are there particular categories of engagement where investors would find it useful for ESG engagement meeting statistics to be presented separately? Would subcategorizing the statistics in this fashion present any challenges, such as administrative burden for funds or complexity in determining the particular category into which an ESG engagement meeting falls?

See response to Question 81.

We do not recommend the Commission require disclosure of ESG engagement meetings as the primary metric. The PRI believes that requiring disclosure of ESG engagement meetings would create incentives to prioritize quantity over quality with potential harms to the market. However, if engagements are quantified, there should also be the option to provide reasoning on how an engagement was categorized. In some instances, there may be double counting or ambiguity regarding the category an engagement fits into, since investors often engage with companies on multiple issues at once. When this occurs, investors should have the ability, and be encouraged, to make this clear.

GHG EMISSIONS DISCLOSURE

Question 87: Should we, as proposed, require environmentally focused funds to disclose their GHG emissions? Would such disclosure help investors interested in investing in such funds select a fund that is appropriate for them? To what extent would requiring GHG metrics reporting help prevent greenwashing?

The PRI supports the GHG emissions disclosure requirements in the Proposed Rule. The proposed metrics will provide investors with a starting point for comparing environmentally focused funds. **However, since there are additional metrics and approaches used by funds related to climate and GHG emissions, we recommend also requiring complementary narrative disclosure of a fund manager's process for integrating GHG emissions and climate change considerations into its investment activity**. The SEC may, for example, ask funds to disclose *"Investment goals set and actions taken in order to achieve theory of change / investment thesis related to climate and GHG emissions".* Narrative disclosure of this kind will allow fund managers to convey their particular perspective on climate as an investment risk and the specific approach that they have taken to addressing it. Currently, a wide range of constructive approaches coexist in the marketplace and SEC should encourage broader understanding of all these approaches through narrative disclosure.

Currently, some fund processes to consider GHG emissions involve fund wide GHG emissions measurement and disclosure; others may calculate and disclose other quantitative metrics such as Implied Temperature Rise or Climate Value at Risk; some may calculate multiple such metrics for internal purposes but choose not to disclose them; and others may not calculate any of these metrics at all, instead researching companies' approach to climate issues and engaging them on this topic. There is a widespread consensus in the field that quantitative metrics for the measurement of portfolio risk are still developing; that each of these measures provides different information; and that each can produce different results depending on methodological choices. Given this reality, narrative disclosure is extremely important to provide a holistic sense of a portfolio manager's perspective on the management of climate risk and opportunity.

It is worth noting that several PRI signatories expressed concerns about how their fund strategies centered around engagement would fit within the proposed GHG emission disclosure requirements. Some investors are prioritizing engagement with large holdings in high-emitting sectors without such a portfolio-wide GHG emissions calculation. Examples of engagement focused climate action include, in 2022, Christian Brothers' Investment Services' majority vote result for a shareholder resolution at Exxon[50] requesting the quantification of climate risk in the company's audited financial statements, as well as Mercy Investment Services' request to Chevron[51] (ultimately supported by that company's board) to assess the efficacy of its efforts to reduce methane emissions.

Question 90: Are there any potential unintended effects in requiring GHG emissions reporting? For example, are there investments that might report high emissions that could nonetheless help the fund achieve an investment objective related to the environment generally or climate change specifically, such as the GHG emissions generated from investments in the construction of windmills or electric cars? If so, would our proposed approach to limit GHG reporting to environmentally focused funds that do not affirmatively state that they do not consider GHG emissions of the issuers in which they invest help alleviate potential unintended effects of the GHG emissions reporting requirement? Rather than our proposed approach to limit the scope of funds subject to the GHG reporting requirement, should we instead require these funds to report alternative metrics that they consider in making investment decisions?

[50] CBIS, *Majority of Exxonmobil Shareholders Reaffirm Need for Company to Account for Climate Risk*, available at https://cbisonline.com/us/wp-content/uploads/sites/2/2022/05/2022-XOM-Resolution-CBIS-PR-05.27.22.pdf.

[51] HIS Markit, *Chevron Shareholders Push for Accountability on Methane Reductions*, available at https://cleanenergynews.ihsmarkit.com/research-analysis/chevron-shareholders-push-for-accountability-on-methane-reduct.html.

The PRI is supportive of the standardized GHG emissions reporting requirements, which will enhance comparability between funds. The Commission should further consider its categorization of “environmentally focused” funds to make clear which ESG-Focused Funds would fall into this separate category and be subject to this additional disclosure.

Funds should also be encouraged to disclose additional metrics they utilize related to climate and GHG emissions, to reflect that current market practices are still developing. For example, in late 2021, the UK’s Climate Financial Risk Forum, a working group involving many of that country’s leading financial institutions, published a guide to climate risk metrics.[52] It noted that “a wide range of climate-related metrics are currently in use by financial institutions for differing purposes” and that “carbon-related metrics do not necessarily translate into financial impacts.” It further noted that improved metrics in this area are “an important area for future development.” After extensive review of current practice and consideration of possible metrics to recommend to the financial industry, the Forum chose to provide an “illustrative dashboard” of fifteen potentially useful climate metrics. It advised, however, that “the nascent and evolving nature of climate metrics [...] lends itself to a principle-based approach” at the current time. In addition, observers of the industry, including the well-regarded team led by academic Julia Bingler at ETH Zurich, have also pointed out that climate metrics are currently evolving and should be continually reviewed in order to improve their usefulness.[53]

Similarly, the Commission should consider encouraging benchmark disclosures or attribution analysis, where appropriate, in order to provide context for investors on the quantitative metrics provided. Benchmarks allow easier comparisons across funds and provide investors with valuable context that makes metrics comprehensible. For most investors who have not themselves conducted GHG emissions calculations on portfolios, this metric will be difficult to understand in isolation.

Question 92: In addition to requiring environmentally focused funds to disclose their GHG emissions, should we also require Integration Funds that state that they use GHG metrics in their integration or investment process, or Integration Funds that consider environmental factors generally, to disclose their GHG emissions? Alternatively, should we require all ESG funds, regardless of their focus on E, S or G, to disclose these metrics? Alternatively, should we require all funds, regardless of whether they are ESG funds, to disclose their GHG emissions? Are investors in funds that do not involve ESG factors nonetheless interested in the GHG emissions associated with the funds’ portfolios?

We recommend the Commission amend its references to “environmental factors”[54] to appropriately consider the scope of the climate crisis, and require all funds to disclose if, and how so, they consider GHG emissions and climate change as part of their investment practice. The proposal only references GHG emissions in relation to “environmental factors” yet this is a limited understanding of a broad category of ESG activity. It is true that historically, GHG emissions/climate change was seen as one "environmental factor" among others. As the severity of global heating has become more pronounced, however, investors seeking to address it have come to understand climate change as deeply interwoven with other environmental factors (such as deforestation and biodiversity, as forests that provide habitat for endangered species also function as carbon sinks). To speak about a fund's consideration of environmental issues in 2022, therefore, presumably includes any considerations of climate change. If climate change is considered part of “environmental factors” then all funds and advisers should be actively considering these factors in their investment decision-making. **The threats posed by climate change touch all sectors and economies[55] and as such it is reasonable, given the state of the climate emergency, to ask all funds to disclose whether**

[52] Climate Financial Risk Forum, *Climate Financial Risk Forum Guide: Climate Data and Metrics* (October 2021), available at https://www.fca.org.uk/publication/corporate/climate-financial-risk-forum-guide-2021-data-metrics.pdf.

[53] Julia Anna Bingler and Chiara Colesanti Senni, *Taming the Green Swan: How to Improve -Related Financial Risk Assessments*, available at https://doi.org/10.3929/ethz-b-000428321.

[54] Proposed Rule at p. 324.

[55] As of 11 August 2022, Germany is estimating that a current drought may cause up to €80 billion in economic losses. Bloomberg, *Historic Drought Threatens to Cripple European Trade* (10 August 2022), available at https://www.bloomberg.com/news/features/2022-08-10/europe-s-low-water-levels-threaten-rhine-river-hit-80b-trade-lifeline.

and if so, how, environmental factors/issues (including climate change and GHG emissions) are incorporated into their investment approach.

Question 93: Should we, as proposed, require funds to disclose the Scope 1 and Scope 2 GHG emissions of their portfolio holdings using the carbon footprint and the WACI metrics? Do these metrics provide investors with useful information about the emissions associated with the fund's portfolio?

Portfolio emissions and WACI, while potentially useful, are not the only metrics commonly used to estimate the effect of a portfolio on global heating.

One often-noted limitation of WACI is that it is backward-looking, relying on disclosures for past periods. Thus, it may give an inaccurate picture of the impact that investee companies are likely to have on climate going forward, particularly if many portfolio companies are in the process of changing their business models. For this reason, another widely used metric is Implied Temperature Rise (ITR),[56] a metric intended to show the likely rise in average global temperatures compared to pre-industrial levels that would result if all investment activity in the market mirrored the approach taken in a particular portfolio. Another limitation of WACI is that it does not provide information about the impact of climate risk on the portfolio itself. While it shows the rate at which companies are emitting carbon, in the absence of a price on carbon, this does not simply translate to a cost for the emitting company. Thus, the estimation of the impact of carbon emissions on the value of a portfolio is a complex and necessarily speculative matter which must consider factors other than the emissions alone. Using a variety of methodologies, some investors address this issue by calculating a climate-related Value at Risk,[57] a metric intended to assess the potential for climate-related losses to a portfolio.

In its most recent publication on metrics, targets, and transition plans, the Task Force for Climate-Related Financial Disclosures encourages the use of other metrics, including the proportion of assets exposed to physical and transition risks, an internal carbon price, and the percentage of assets invested in line with climate opportunities.[58] It also notes that some investors may find it useful to measure portfolio alignment by the number of investee companies with net-zero targets, or to assess divergence from a benchmark as regards future climate impact. These are all varied attempts to assess the same questions of 1) the portfolio's likelihood of being affected by climate change, and 2) the potential for the fund's investment activity to have a positive or negative effect on the real economy and our global climate.

Part of the challenge facing investors and regulators is that each of these metrics can be calculated in a variety of ways, with no single methodology yet dominant. For example, WACI can involve carbon emissions scaled by enterprise value, revenues, market capitalization, or unit of production, producing different results in each case. Arguments can be made for the relevance of each approach. Calculations of Implied Temperature Rise and Climate Value at Risk can vary depending on the scenarios being used regarding the future development of the economy, as well as assumptions being made about future actions by corporate issuers on the basis of their statements today.

Moreover, just as results can vary across different calculation methods for the same metric, the overall impression of the same portfolio's climate related performance can vary significantly across the different metrics. For example, in certain cases WACI calculations may give a different impression of whether a firm is leading or lagging the market than one derived from ITR. This is in part because the former provides a backward-looking snapshot of the most recently reported emissions associated with investee companies, while ITR relies on estimates of companies' future actions in the context of

[56] Net Zero Knowledge Hub, Your Net-Zero Strategy, *Taking Your Portfolio's Temperature*, available at https://www.net-zero-hub.com/net-zero-strategy/taking-your-portfolios-temperature/.

[57] Task Force on Climate-Related Financial Disclosures, *Forward-Looking Financial Sector Metrics Consultation* (October 2020), available at https://www.fsb.org/wp-content/uploads/P291020-4.pdf.

[58] Task Force on Climate-related Financial Disclosures, *Guidance on Metrics, Targets, and Transition Plans* (October 2021), available at https://assets.bbhub.io/company/sites/60/2021/07/2021-Metrics_Targets_Guidance-1.pdf.

particular projected scenarios. ITR calculations may also, depending on the methodology, make assumptions about carbon budgets at the sector or geographic level that intersect in counter-intuitive ways with WACI calculations made at the company level. For all these reasons, as the TCFD noted in its 2020 consultation on forward looking metrics,[59] many investors calculate multiple climate metrics as inputs to capital allocation decisions, and therefore should be encouraged to disclose any additional metrics they utilize, alongside narrative disclosure that provides context on the investment approach taken.

In sum, while the PRI supports the proposed GHG emissions disclosure metrics, we also note that currently multiple metrics are used as investigative tools that can help an investor raise questions about a portfolio while crafting an approach to climate change. Funds should therefore be encouraged to report on which metrics they have calculated and why.

Continued efforts to improve portfolio-level metrics also display the importance of the underlying data available. Without comprehensive climate-related disclosure from issuers of both public and private securities, portfolio managers will continue to lack the consistent, comparable data necessary to provide the most accurate assessments possible. As such, the PRI recommends the Commission finalize *The Enhancement and Standardization of Climate-Related Disclosures for Investors*[60] as soon as possible. This data is vitally important to the successful implementation of this Proposed Rule.

[59] Task Force on Climate-Related Financial Disclosures, *Forward-Looking Financial Sector Metrics Consultation* (October 2020), available at https://www.fsb.org/wp-content/uploads/P291020-4.pdf.
[60] Principles for Responsible Investment (17 June 2022), available at https://dwtyzx6upklss.cloudfront.net/Uploads/x/d/z/pricomment_secclimaterelateddisclosures_423012.pdf.

IMPACT FUNDS

Question 52: Are Impact Funds appropriately considered a subset of ESG-Focused Funds, or are they sufficiently distinct that they need a separate set of disclosure requirements in the prospectus beyond the specific proposed instruction for Impact Funds? Should we require additional disclosures for Impact Funds beyond what we have proposed? Is there any disclosure about an Impact Fund we have proposed that the Commission should not adopt?

The PRI recommends the Commission rename Impact Funds to "Impact-Focused Funds" and redefine these funds to only include those funds where efforts to achieve specific impact is a "significant or main consideration". We also recommend adding a separate reporting requirement for all funds, asking whether, and if so, how they consider impact in their investment processes. These two changes would recognize the fact that all funds have impact and should be able to consider the impacts of their investments without immediately being classified as an Impact Fund.

Impact Funds are not necessarily a subset of ESG-Focused Funds, as all funds do, objectively, have impacts beyond provision of capital to companies. The definition of impact provided in the Proposal has the potential to stymie efforts to consider impacts across the investment industry by creating the impression that any fund or adviser that considers impacts must have impact as an "ESG focus" as well. This could especially slow efforts to consider and mitigate negative impacts, for example, which is increasingly demanded by retail investors.

The PRI's *Legal Framework for Impact* report shows clearly that significant material ESG considerations fall within use cases where an investor or fund seeks to achieve impacts in order to improve financial performance or manage financial risks ("instrumental IFSI") – considering ESG factors (such as systemic risks) that are not traditional but still fall within risk/return assessments and are material to the fund's financial performance. Such a fund would be in contrast to some types of funds traditionally described as 'impact investing' funds, which prioritize achieving impacts as ends in themselves. There are also levels of impact consideration that may or may not include specific impact goals or targets.

For example, an "Integration Fund" may avoid investing in high-carbon emitting companies for pure risk/return reasons, while also secondarily understanding that not investing in these companies reduces the fund's financing of environmentally harmful activities. The fund could also believe that not financing environmentally harmful activities promotes a sustainable economy, which in turn can help its long-term success. While this fund is considering its impact, and perhaps it is one part of its investment strategy, it is not necessarily a "significant or main consideration." This fund would not be considered an "Impact-Focused Fund" and should not be considered an "Impact Fund".

The Commission should clarify how financial risk/return goals related to ESG fit within ESG-Focused or Impact Funds. The Global Impact Investment Network (GIIN) states, "impact investments are investments made with the intention to generate positive, measurable social and environmental impact alongside a financial return".[61] As such, the Commission could consider Impact Funds as those attempting to achieve a specific goal or target i.e. funds with a "theory of change" or which "seek to contribute" to a goal. These differ from funds looking to mitigate their impact. For example, a decision of whether to invest in a mid-stream oil & gas company may take the emissions impact into account as one consideration, but that consideration may be no more determinative than others, or, may not be a "significant or main consideration."

In order to clearly establish a distinction between ESG consideration for risk assessment compared to that seeking or expecting to have an impact or benefit, the Commission should further clarify appropriate language in marketing and advertising materials that references impacts, or related terms,

[61] Global Impact Investing Network, *What You Need to Know About Impact Investing* (2022), available at https://thegiin.org/impact-investing/need-to-know/

and what language would subject a fund to the “Impact Fund” disclosure requirements. The SEC should provide clarity on this distinction and on what kind of language in marketing materials triggers Impact Fund disclosure requirements. A required disclosure of impact considerations by all funds and advisers would allow a fund/adviser to share their considerations and their level of influence. This disclosure could then inform, and be compared to, related marketing materials to ensure accuracy and prevent overstatement.

Question 53: Should we, as proposed, require an Impact Fund disclose the relationship between the impact the Fund is seeking to achieve and financial return(s)? Should we require this disclosure of all ESG-Focused Funds?

No, this disclosure risks promoting the misconception that “impact funds”, or anyone considering impact of investment decisions, is doing so at the expense of market-rate returns. This presumption is wrong. Very few funds sacrifice market-rate returns in order to direct a specific impact, and those that do would be required to display this in the fund prospectus already.

The PRI’s *Legal Framework for Impact* report identifies that significant investment actions for the purpose of sustainability impact fall within “instrumental” impact and therefore do not sacrifice market-rate returns—even potentially making these funds more resilient to sudden shocks and increasing long-term returns, as shown by the latest academic research[62]—while having a positive impact on sustainability goals. These instrumental activities fall immediately within the fiduciary duties of investment advisers as they generate market-rate returns for beneficiaries today while contributing to a stable, productive financial system for the future as well.

Rather than pose this question within the rule, the SEC should clarify via guidance, if it feels necessary to do so, that any fund not seeking market-rate return for any reason must disclose that in the summary prospectus.

Question 55: Should we require, as proposed, an Impact Fund to describe the fund’s time horizon for progressing on its impact objectives and any key performance indicators that the fund uses to analyze or measure the effectiveness of its engagement?

Yes, Impact Funds should be required to disclose any key performance indicators, or targets, but the Commission should amend the Proposal to reflect that specific time horizons are not always applicable. Research has shown that two thirds of individual investors would like to receive information about the impact and societal benefits of their investments alongside financial reports, which highlights a clear need for this information.[63]

The concept of target setting is well established among impact funds and often aligned with broader societal goals in reference to international norms and agreements. Examples include the International Bill of Rights or the UN Sustainable Development Goals. The SEC should recognize the complexity of target setting, namely that:

> *The nature of targets can vary. For example, GHG emission measurement for the mitigation of climate change lends itself to quantitative target-setting against scientifically quantified thresholds and allocations. By contrast, human rights targets tend to be qualitative and process-based, aimed at reducing the risk of future instances occurring, e.g. ‘when applicable, to prevent, mitigate and remedy instances of adverse human rights impacts when they arise or could arise’.*[64]

Some impact goals are more process oriented and reactive. These are often related to human rights impact goals, for example:

[62] See Footnote 27.

[63] Morgan Stanley, *Sustainable Signals: Individual Investors and the COVID-19 Pandemic* (2021), available at https://www.morganstanley.com/assets/pdfs/2021-Sustainable_Signals_Individual_Investor.pdf, p. 9.

[64] Impact Management Platform (May 26, 2022), *Set Targets*, available at https://impactmanagementplatform.org/actions/investment-and-finance/set-targets/.

- Funds engage companies in conflict and high-risk geographies to ensure that they have proper human rights risk management and stakeholder engagement plans in place (this will be of heightened importance when the risk landscape changes due to new situations of conflict);
- Funds engage companies in sectors known for low wages to ensure that the companies have strategies in place to ensure the provision of a living wage for all employees and contractors (this can evolve into quantitative targets over time, measuring percentage of workforce receiving living wages)

As a result, the concept of time horizons is not always applicable. The SEC should consider these nuances and allow funds flexibility in disclosing their targets and progress over time.

Question 72: Should we, as proposed, require the annual report disclosure for Impact Funds to be in both qualitative and quantitative terms? Are there burdens or other issues related to this requirement? Would this result in more comparable information across funds? Are there impacts that commenters do not believe can be conveyed effectively in quantitative terms? Should we allow, but not require, an Impact Fund to provide a qualitative discussion and quantitative information? Should we instead only require Impact Funds to provide a qualitative discussion of its progress? Alternatively, should we require Impact Funds to provide their progress only in quantitative terms?

We support the inclusion of both quantitative and qualitative reporting requirements where appropriate but advise against requiring quantitative disclosure where such metrics may be unavailable or not used by the fund. Assessing impact often centers on the following concepts:

- Concept of contribution: “a credible narrative, or thesis, which describes how the actions of the investor will help achieve the [impact] goal or how the outcome would not have occurred without the investor’s involvement.” “This reference to a ‘credible’ narrative reflects the point made above: it will rarely be possible to attribute the occurrence of a particular sustainability outcome to a single activity or measure the precise difference that the activities of a single investor have made to that outcome. Because of that, the emphasis may often need to be on the basis for and quality of the investor’s explanation for the difference it has made.”

- Concept of additionality: “outcomes are assessed against the situation that would have prevailed without the relevant intervention (a ‘counterfactual’) to establish whether there has been an increase in the quantity or quality of the positive sustainability outputs of a given enterprise.”[65]

While it is possible to report on both of these concepts in quantitative terms, the role of narrative disclosure is important in order to fully explain progress made.

[65] Freshfields Bruckhaus Deringer, *A Legal Framework for Impact: Sustainability Impact in Investor Decision-Making*, available at https://www.unpri.org/download?ac=13902 p. 44-45.

ADVISER BROCHURE (FORM ADV PART 2A)

Question 136: Is there other information about the consideration of ESG factors when providing investment advice that advisers should be required to include in their brochures?

The PRI generally supports the proposed disclosures in Form ADV. It is important for investors to understand how advisers consider ESG factors in relation to their other investment activities, including any particular focus or specified goals.

The Commission should further consider if any of the recommended disclosures are duplicative to current requirements or are already included in current requirements and can be clarified through guidance documents.

Question 140: We have proposed terms for ESG "integration", ESG-"focused" and ESG "impact" under our Form ADV proposal, which are generally similar to the corresponding definitions we are proposing for funds. Is this appropriate?

These terms are generally appropriate for explanation of adviser strategies and consideration. The Commission should further clarify the distinction between these types of strategies in a similar manner to the PRI's recommendations for fund disclosure, including as it relates to marketing materials. However, as adviser disclosure describes the use of a general strategy – rather than a specific strategy being executed for a fund or product – the issue with "Integration" terminology as explained for funds is not necessarily applicable.

Question 143: Should we, as proposed and similar to the proposed requirements for funds, specifically require an adviser to disclose additional information regarding impacts for any significant strategy that is an ESG impact strategy? Should we modify the application of this proposed requirement to advisers? For example, should advisers include the key performance indicators used to measure progress given that advisers do not have a disclosure that corresponds to the MDFP, where we are proposing to require specific disclosures by Impact Funds on their progress?

As with fund-level disclosure, advisers should disclose any impact strategies they employ and the goals they seek to achieve, including any KPIs or frameworks used in order to provide detail necessary for a reasonable investor to understand the adviser's actions. This recommendation is consistent with our view that specific KPIs or references to frameworks should be utilized to provide context of manager or adviser practices, and always alongside narrative disclosure.

Question 144: Should we create an additional, separate disclosure requirement for an adviser's significant strategy for which the adviser primarily uses shareholder engagement, as opposed to portfolio management, to implement its ESG-focus? Do advisers engage with portfolio companies on ESG issues in other ways that we have not proposed to address, but should specifically address, in the brochure?

The PRI supports disclosure that presents investors with information on the adviser's significant strategies and primary activities to enact those strategies, as well as any goals set. The Commission should consider whether disclosure of an adviser's main strategy, in the case that strategy is engagement, is not already required via other disclosures and therefore a separate disclosure requirement would be duplicative.

Question 151: Should we additionally require all advisers that consider ESG factors as part of their significant strategies to state that the consideration of ESG factors may lead to the adviser selecting or recommending an investment that may not generate the same level of returns as investments where the adviser does not consider ESG factors? Or, should advisers be required to describe the applicable risks in their own words?

No, the Commission should refrain from requiring this disclosure as it mischaracterizes the vast majority of ESG-related considerations and strategies. Most investors incorporating ESG factors in investment decision-making and as significant or main considerations or strategies are seeking market-rate returns or better and view ESG considerations as additive. The addition of a question as proposed would presume that consideration of ESG factors is not in line with market rate returns and require advisers to convince investors that it is. Advisers should be provided the ability to present their strategies and any significant risks in their own words.

REGULATORY REPORTING ON FORM N-CEN AND ADV PART 1A

Question 162: Should funds be required to report the proposed census-type information regarding their incorporation of ESG factors into their investment strategy on Form N-CEN? Would this information be helpful to investors and other market participants? How would investors and other market participants use this information?

The PRI recommends removing the required disclosure of any third party ESG frameworks being “followed” as this required disclosure is confusing to managers and does not provide any decision-useful information to the Commission because of the countless ways this required disclosure can be interpreted by management.

Question 180: As proposed, should we require all advisers to report whether the adviser follows any third-party ESG framework(s), and if so, to report the name of each framework? Are there ways to enhance the information provided? For example, should we allow advisers to report this information only if they follow such frameworks to a certain extent? If so, how should we set such threshold for reporting? Should we also require advisers report this information as it relates specifically to their SMA clients and/or reported private funds, or, as proposed, should we require advisers to provide this information as it relates to any part of their advisory business (without specifying which part)?

Required disclosure of third-party ESG frameworks being followed or considered should, at minimum, be paired with the appropriate narrative disclosure of related practices or goals. As proposed, the Commission’s consideration of “third-party ESG frameworks” is unclear and requires additional examples across the range of frameworks considered as well as the Commission’s definition of frameworks and "considering/following".

The Commission should not set a specific threshold, but instead allow these disclosures to be “as applicable” or only if that framework is a “significant or main consideration” of their practices to allow managers to determine if their consideration of these frameworks is an informative disclosure.

Disclaimer

The PRI has experience of public policy on sustainable finance policies and responsible investment across multiple markets and stands ready to further support the work of SEC to improve ESG disclosure and issuer accountability in the United States.

Any questions or comments can be sent to policy@unpri.org.