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DIVISION OF ECONOMIC JUSTICE
INVESTOR PROTECTION BUREAU

August 16, 2022

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

RE: Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices, Release No. IA-6034; IC-34594; File No. S7-17-22

Dear Secretary Countryman:

On behalf of the undersigned Attorneys General, we submit this letter in response to the Securities and Exchange Commission's ("SEC") proposed rule, titled *Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social and Governance Investment Practices*, Release No. IA-6034 (the "Proposed Rule"). We write in support of the Proposed Rule and agree in particular that investors need consistent, comparable, and reliable information on Environmental, Social, and Governance ("ESG")-based investment products and strategies. We also write to provide general comments in support of further clarification of the Proposed Rule.

I. Investment Companies and Investment Advisers Play a Pivotal Role in the Investment Choices Available to U.S. Investors.

The significance of investment companies to U.S. investors is unquestionable. Industry statistics reflect that as of the end of 2020, U.S. financial services firms offered over 16,000 different registered investment companies to investors, including over 9,000 mutual funds, 2,200 exchange-traded funds ("ETFs"), 4,300 Unit Investment Trusts ("UITs"), and nearly 500 closed-end funds.¹ These funds held combined assets at that time in excess of \$29.7 trillion, with mutual

¹ See Inv. Co. Inst., *2021 Inv. Co. Factbook: A Review of Trends & Activities in the Inv. Co. Indus.* 40 (2021), https://www.ici.org/system/files/2021-05/2021_factbook.pdf (noting that while the overall number of investment companies declined slightly from 2019, total numbers have increased overall since 2005 with the number of ETFs continuing to rise).

funds (nearly \$23.9 trillion) and ETFs (nearly \$5.4 trillion) holding the vast majority.² U.S. households are the largest group of investors in these vehicles, with registered investment companies managing 23% of household financial assets, a figure that has steadily grown over the last three decades as U.S. workers have increasingly placed money into defined contribution retirement plans and individual retirement accounts.³ Adding to that significance are the more than 37,000 private funds available to accredited and qualified investors as of the end of 2020,⁴ managed by over 3,300 investment advisers and holding over \$17 trillion in gross assets.⁵ Likewise, as the SEC noted in its economic analysis of the Proposed Rule, the more than 10,000 investment adviser firms who managed over \$40 trillion for separately managed account (“SMA”) clients during that time period serve yet another large role to the U.S. investing public.⁶

II. The Growing Prevalence of ESG Investments, Combined with the Lack of Disclosure and Potential for Fraud, Necessitate Enhanced Disclosures.

Against this backdrop, the last decade has seen a proliferation of firms offering funds and strategies that claim to implement ESG factors in response to increased demand from retail and institutional investors, including in our respective states.⁷ The number of funds available to U.S. investors that advertise ESG as a significant consideration has more than doubled in the last five years,⁸ and U.S. mutual fund and ETF assets labeled as “ESG” increased 33% in 2021 alone, to

² *Id.* at 41.

³ *Id.* at 43. These statistics also show that the portion of defined contribution retirement plan assets held in mutual funds has increased from 43% to 59% over the last 20 years. *Id.* at 44.

⁴ Amendments in 2020 to the “accredited investor” definition made it easier for more individuals to invest in private funds. The amendments preserved the \$200,000 annual income or \$1 million net worth requirements originally set in 1982, but now also allow individuals who do not meet these wealth thresholds to invest based on having sufficient “knowledge and expertise.” See 17 C.F.R. 230.501(a)(5), (6), (10), (11); see also Accredited Inv. Definition, 85 Fed. Reg. 64234 (Oct. 9, 2020); Taylor Tepper, *SEC Rule Change Gives More People Access to Riskier Inv.*, Forbes (Aug. 27, 2020), <https://www.forbes.com/sites/advisor/2020/08/27/sec-definition-change-accredited-investor/?sh=5fc92a6b1543>.

⁵ SEC Div. of Inv. Mgmt. Analytics Office, *Priv. Fund Stats., Fourth Calendar Quarter 2021* (Jul. 19, 2022), <https://www.sec.gov/divisions/investment/private-funds-statistics/private-funds-statistics-2021-q4.pdf>.

⁶ Enhanced Disclosures by Certain Inv. Advisers & Inv. Cos. About Env’t, Soc., & Governance Inv. Practices, 87 Fed. Reg. 36654, 36700 (proposed June 17, 2022); see also Ted Godbout, *SMA’s Finding a Receptive Audience*, Nat’l Assoc. of Plan Advisors (July 6, 2021), <https://www.napa-net.org/news-info/daily-news/smas-finding-receptive-audience>, (reporting that advisors anticipated increased use of separate accounts by 19% and ETFs by 18% going into 2022).

⁷ See Glob. Sustainable Inv. Alliance, *Glob. Sustainable Inv. Review 2020* 5, 10, 12-13 (2021) <http://www.gsi-alliance.org/wp-content/uploads/2021/08/GSIR-20201.pdf> (defining “sustainable investing” as including approaches that consider ESG factors in portfolio selection and management, and reporting a 33% growth in sustainable investing assets in the U.S. from 2014-2016, a 38% growth from 2016-2018, and a 42% growth from 2018-2020, and reporting the global institutional share of sustainable investing assets at 75% as of 2020); Greg Iacurci, *Money Inv. in ESG Funds More than Doubles in a Year*, CNBC.com (Feb. 11, 2021), <https://www.cnbc.com/2021/02/11/sustainable-investment-funds-more-than-doubled-in-2020.html> (reporting U.S. investors had access to nearly 400 sustainable funds in 2020, representing a 30% increase from the previous year).

⁸ John Hale, *SEC Proposes New Rules for Sustainable Funds Aimed at Standardizing ESG Disclosures*, Morningstar (May 27, 2022), <https://www.morningstar.com/articles/1096343/sec-proposes-new-rules-for-sustainable-funds-aimed-at-standardizing-esg-disclosures>; Christopher Davis, *After Two-Year Surge in Demand, ESG Fund Assets Still*

\$400 billion.⁹ This momentum is only expected to continue in the near future, with global ESG assets estimated to grow from \$35 trillion to \$50 trillion by 2025.¹⁰

Industry ESG offerings are evolving to meet increased demand with no clear framework for disclosure of the scope and extent to which the funds and advisers utilize ESG considerations in investment strategies. To protect investors, this industry requires, foremost, a regulatory regime for funds and advisers that mandates comprehensive, consistent, and meaningful disclosures to help investors better evaluate products and services.¹¹ Currently, the amount of information provided to investors varies across funds and advisers. Without the disclosure requirements advanced in the Proposed Rule, individuals who want to invest according to their values must navigate through inconsistent, ambiguous, and often misleading statements used to promote various ESG strategies, or, worse, they must endure outright fraud. Recent examples of “greenwashing” include funds that claim to pursue “low carbon” or “clean energy” as the environmental benefits or targeted impacts of their strategies, despite not meeting recognized standards for addressing climate change.¹² Other existing funds experiencing asset loss have repurposed or rebranded themselves as “ESG-oriented,” claiming significant correlations between their original strategy and an ESG-based one.¹³ Without adequate disclosure or context, investors may be unable to determine whether a fund’s strategy maintains a genuine link to ESG or is merely rebranding as a sales tactic. As long as investors seek opportunities to make ESG-conscious investments—a trend not expected to dissipate any time soon¹⁴—these practices

Have Room to Run, ISS Insights (March 30, 2022), <https://insights.issgovernance.com/posts/after-two-year-surge-in-demand-esg-fund-assets-still-have-room-to-run/> (hereinafter “*ESG Fund Assets Still Have Room to Run*”).

⁹ See Lauren Foster, *ESG Fund Assets Soared in 2021. They Still Have Room to Run*, Barron’s (March 30, 2022), <https://www.barrons.com/articles/esg-fund-assets-soared-in-2021-they-still-have-room-to-run-51648590122>.

¹⁰ Saijel Kishan, *ESG by the Numbers: Sustainable Inv. Set Records in 2021*, Bloomberg (February 3, 2022), <https://www.bloomberg.com/news/articles/2022-02-03/esg-by-the-numbers-sustainable-investing-set-records-in-2021>; see also, Iacurci, *Money Invested in ESG Funds More Than Doubles in a Year*, *supra* note 7.

¹¹ Davis, *ESG Fund Assets Still Have Room to Run*, *supra* note 8 (noting that surging ESG sales are attracting new competitors to the industry, forcing funds to find new ways to satisfy investor preferences to appeal to their ability to make change).

¹² See Amy Gunia, *Thinking of Inv. in a Green Fund? Many Don't Live Up to Their Promises, A New Report Claims*, Time (Sept. 20, 2021), <https://time.com/6095472/green-esg-investment-funds-greenwashing/> (citing an InfluenceMap report finding that more than half of the funds analyzed that marketed using ESG climate key words “[fell] short of the vision laid out in the Paris Agreement”).

¹³ See Debbie Carlson, *An ESG Makeover Gives Funds a Second Chance to Score*, Barron’s (June 2, 2022), <https://www.barrons.com/articles/an-esg-makeover-gives-funds-a-second-chance-to-score-51654155003>; Dave Michaels, *SEC Is Investigating Goldman Sachs Over ESG Funds*, Wall St. J. (June 10, 2022), <https://www.wsj.com/articles/sec-is-investigating-goldman-sachs-over-esg-funds-sources-say-11654895917> (hereinafter “*SEC Is Investigating Goldman*”) (noting that while Goldman renamed its “Blue Chip Fund” as the “U.S. Equity ESG Fund,” the fund’s top three holdings have remained the same); Silla Brush, *One Fund, Three Names & Lots of Questions for ESG*, Bloomberg (July 25, 2022), <https://www.bloomberg.com/news/articles/2022-07-25/how-blackrock-rebranded-one-sustainable-mutual-fund> (reporting on one fund rebranded twice in six years as an “ESG” and “sustainable” investment, and that at least 65 US funds were rebranded as “sustainable” since 2019).

¹⁴ Steve Wendel, Samantha Lamas, *Who Cares About ESG Inv.?* Morningstar (May 3, 2019), <https://www.morningstar.com/articles/926921/who-cares-about-esg-investing> (citing survey statistics showing that

threaten to exploit their efforts to align their investments with their principles and potentially undermine their financial security. Moreover, given the higher costs often associated with investing in ESG funds, giving investors access to better information is all the more necessary and appropriate.¹⁵

This conduct has triggered regulatory enforcement and other remedial actions against firms who deceive investors with illegitimate claims that participating in their funds will yield ESG benefits.¹⁶ But merely initiating enforcement actions after investors have been harmed is insufficient. The risks that a retail investor faces in a rapidly-shifting environment necessitates steps like the Proposed Rule to exact more thorough and uniform disclosures of funds' and firms' ESG profiles, and quantifiable benchmarks for their progress.¹⁷ Investors need this transparent, consistent, and easily comparable information, and they need it now. For these reasons, the undersigned Attorneys General strongly support the Proposed Rule's enhanced disclosure requirements.

III. The Enhanced Disclosures Under the Proposed Rule Will Provide Numerous Benefits to Investors.

By requiring investment companies and investment advisers to disclose the identified information in the contemplated manner, the Proposed Rule will significantly benefit investors. First, the proposed “layered approach” to disclosure provides information in doses to investors, rather than inundating them upfront with data that lacks sufficient context for understanding. The summary, for example, would give retail investors the opportunity to understand a fund's ESG strategy conceptually and then better understand the enhanced detail and specifics disclosed in the statutory prospectus. The Proposed Rule also prescribes different levels of disclosure for each fund based on the degree to which the fund's strategy investment is tied to ESG considerations. This approach strikes a proper balance between the level of disclosure required for ESG

“respondents representing 72% of the adult population in the United States expressed at least a moderate interest in sustainable investing,” and that interest is “generally unrelated to age or gender”).

¹⁵ See Morningstar, *2020 U.S. Fund Fee Study* (Aug. 2021), <https://www.morningstar.com/lp/annual-us-fund-fee-study> (observing that investors in sustainable funds pay a higher asset-weighted average expense ratio from their traditional peers).

¹⁶ See Press Release, SEC, *SEC Charges BNY Mellon Inv. Adviser for Misstatements & Omissions Concerning ESG Considerations* (May 23, 2022), <https://www.sec.gov/news/press-release/2022-86>; *SEC Is Investigating Goldman, supra* note 13; Patricia Kowsmann, *U.S. Auths. Probing Deutsche Bank's DWS Over Sustainability Claims*, Wall St. J. (Aug. 25, 2021), <https://www.wsj.com/articles/u-s-authorities-probing-deutsche-banks-dws-over-sustainability-claims-11629923018>; Frances Schwartzkopff, Saijel Kishan, *ESG Funds Managing \$1 Trillion Are Stripped of Sustainable Tag by Morningstar*, Bloomberg (Feb. 10, 2022), <https://www.bloomberg.com/news/articles/2022-02-10/funds-managing-1-trillion-stripped-of-esg-tag-by-morningstar> (reporting that the tags were removed from funds that claimed to, but did not actually integrate ESG factors in the investment process in a “determinative way for their investment selection”).

¹⁷ See OICU-IOSCO, *Env't, Soc. & Governance (ESG) Ratings & Data Prods. Providers Consultation Rep.* 7-8 (July 2021), <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD690.pdf> (highlighting that the relatively new practice of ESG reporting by companies makes it difficult for investors to assess ESG performance and risk based on standardized criteria).

“Integration Funds,” for whom considered ESG factors are non-determinative, and “Focused Funds” and “Impact Funds” for whom ESG factors are a significant or driving determination.

The Proposed Rule also effectively aims to minimize greenwashing, first, by requiring ESG Focused Funds and Impact Funds to disclose how they incorporate ESG factors into their investment decisions, and second—and more importantly—by requiring Impact Funds to disclose how they measure progress and what key performance indicators they rely on. This information, combined with the proposed disclosure enhancements in Impact Fund annual reports, is crucial to investors’ ability to evaluate the fund’s claims. Investors will be more readily able to determine after any given reporting period whether a fund is on track with respect to its ESG goal, or whether to place their respective investment elsewhere. This is particularly true for investors whose primary investment objective is achieving the targeted impact, rather than a return on their investment. In the case of environmental ESG-Focused Funds, the SEC’s prescribed formulas for disclosing aggregate GHG emissions constitute consistent and uniform means for these funds to disclose their carbon footprint metrics, making for easier and better comparability between funds. And the Proposed Rule’s requirement for funds and advisers to disclose affiliations with ESG providers is an effective means of disincentivizing potential conflicts of interest between funds and advisers and affiliated ESG service providers, as well as providing investors with critical information for their investment decision-making.

In addition, the Proposed Rule stands to improve legitimacy among ESG investment companies and investment advisers. Funds that carry an ESG moniker but are not prepared to provide any detail or disclose any methodology about how they consider ESG factors in making investment determinations will be forced to cease characterizing themselves in that way. And non-ESG funds attempting to adopt an ESG posture for reasons unrelated to any social impact (e.g., higher fees, loss of asset inflows, high investment correlation) similarly will be faced with the choice to either provide the level of detail sufficient for them to proceed as an ESG fund or stop presenting themselves as one.

Finally, the Proposed Rule’s requirements for enhanced disclosure on Form ADV and Form N-CEN should result in investors receiving material ESG strategy, affiliation, and voting information that is necessary to their decision-making and long overdue for them to receive. For firms that previously provided this disclosure, the Proposed Rule effectively just reorganizes the sequencing of that information and consolidates it for investors. These requirements should not be particularly onerous for an investment adviser to satisfy, and the end result should prove to be a better balance of information-sharing between investment adviser firms, who have access to and control this information, and investors who need it to make better informed decisions.¹⁸ Moreover, firms that have not been robust in vetting and disclosing their ESG investment offerings for SMA clients will be forced to reexamine whether they want to truly commit by

¹⁸ See Henry Tricks, *A Broken Sys. Needs Urgent Repairs*, *The Economist* (July 1, 2022), <https://www.economist.com/special-report/2022/07/21/a-broken-system-needs-urgent-repairs> (noting that between charging higher fees and amorphous standards of compliance, investment advisers have turned ESG investing to their advantage).

giving the level of disclosure called for under the Proposed Rule, or instead to leave the ESG field to those firms that will.

IV. Additional Clarifications in Response to SEC’s Request for Comment

To advance the SEC’s intent to give greater transparency to individuals participating in ESG investing, we believe the following clarifications to the Proposed Rule would be consistent and appropriate with its provisions and purpose. First, in inquiring whether the proposed definition of “Integration Fund” is sufficiently clear, the SEC asks whether “funds that do not currently consider themselves to integrate ESG factors [] would fall under this definition and be required to provide disclosures.”¹⁹ As an initial step to limit overinclusion, we believe the final rule should allow funds that do not adopt any type of ESG moniker to affirmatively disclose early in their prospectuses and annual filings, in sections clearly delineated for actual and prospective investors, that they do not consider ESG factors in their investment decision making. Any fund that provides this clear and upfront disclosure will have affirmatively put investors on notice that they are not an ESG fund and thus will not have an obligation to provide further ESG disclosures mandated under any final rule.

Second, an ESG Integration Fund or ESG-Focused Fund’s statements regarding the extent to which it considers ESG in its decision-making may be expressed as forward-looking statements. The SEC should expressly state in the final rule whether, and to what extent, any federal safe harbors for forward-looking statements would apply to the proposed required ESG disclosures. This specificity will be important to investors, and to funds, and investment advisers issuing those statements to ensure that sufficient caution is used in making and relying on them.

Finally, in response to the SEC’s question regarding the format of Form ADV disclosure,²⁰ we note that most investment advisers, large and small, are required to register either with the SEC or with one or more states using Form ADV. This includes smaller, ESG-focused firms who might manage a handful of impact funds, or who might offer a select few strategies for a small number of clients. The Proposed Rule’s addition of sub-Item 8.D to Form ADV would require an investment adviser to describe ESG factors and their methods of analysis for each such strategy. In the case of a small, ESG-focused firm, this may essentially require duplicative information already disclosed in response to Item 8’s sub-items A-C. The SEC should therefore clarify how firms who already are required to provide this information currently in response to Form ADV Item 8 should provide the enhanced information in a manner that avoids unnecessary duplication and limits investor confusion.

V. Conclusion

We appreciate the opportunity to comment on this important proposal. For all of the reasons discussed above, we support the Proposed Rule and encourage the SEC to adopt it, along with the recommended clarifications.

¹⁹ See 87 Fed. Reg. at 36661 (request for comment question three).

²⁰ See 87 Fed. Reg. at 36689 (request for comment question 135).

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Sincerely,



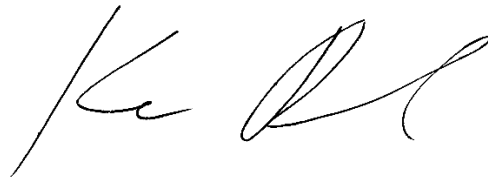
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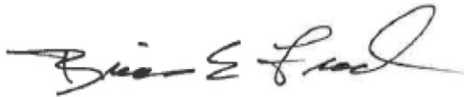
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