

SEC Proposes Rules Relating to Registered Funds' ESG Investments

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Introduction

On May 25, 2022, the SEC proposed two rules relating to Environmental, Social, and Governance (“ESG”) practices by registered funds and investment advisers: (1) one titled “Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices” (the “Proposed ESG Rule”)¹ and (2) one titled “Investment Company Names” (the “Proposed Names Rule”)² (collectively, the “Proposed Rules”). Comments on the Proposed Rules will be due on August 16, 2022.

The Proposed Names Rule would expand on the current requirements for funds registered under the Investment Company Act of 1940 as amended (the “40 Act”) and business development companies (“BDCs”)³ (but not private funds) to invest at least 80% of their assets in accordance with the suggested investment focus of the fund’s name. The Proposed ESG Rule seeks to categorize certain types of ESG strategies broadly and would create additional disclosure requirements in registered fund and BDC prospectuses and annual reports, and in Form ADV for investment advisers registered under the Investment Advisers Act of 1940, as amended (the “Advisers Act”) and exempt reporting advisers that offer investors products that consider ESG factors in their investment processes.

These Proposed Rules appear intended to address potential “greenwashing,” a practice in which an investment adviser, for example, overstates or misrepresents the “E” (or environmental) factors considered or incorporated into the adviser’s portfolio selection, such as in the adviser’s performance advertising and marketing. Notably, the Proposed Rules follow the SEC’s separate March 2022 proposal on climate-related disclosure for

¹ Securities & Exchange Commission, “Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices,” 87 Fed. Reg. 36654 (2022).

² See Securities & Exchange Commission, “Investment Company Names,” 87 Fed. Reg. 36594 (2022).

³ For purposes of this alert, unless otherwise indicated, we use the term “registered funds” or “funds” to refer to both investment companies registered under the 40 Act and to BDCs.

companies with reporting obligations pursuant to Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934, as amended (the “’34 Act”) and companies filing a registration statement under the Exchange Act or the Securities Act of 1933, as amended (“Proposed Climate Disclosure Rule”);⁴ the Proposed Climate Disclosure Rule and the Proposed Rules are indicative of the SEC’s increasing and heightened focus on climate-related issues. This Debevoise In-Depth discusses the key provisions of each of the Proposed Rules; other regulatory, examination, and enforcement developments; policy considerations with respect to the Proposed Rules; and suggested next steps for registered funds and advisers.

In this Debevoise In-Depth, we focus on the applicability of the Proposed Rules to registered funds and business development companies, and to investment advisers to such entities. For a discussion of how the Proposed ESG Rule applies to private fund advisers, see our previous Debevoise In-Depth titled, “[Applicability of the SEC’s Proposed ESG Rules to Private Fund Advisers](#).”⁵

Key Provisions of the Proposed ESG Rule

General Observations

The SEC noted in the Proposed ESG Rule’s preamble that the rule is intended to “create a consistent, comparable, and decision-useful regulatory framework for ESG advisory services and investment companies to inform and protect investors while facilitating further innovation in this evolving area of the asset management industry.”⁶ Specifically, the Proposed ESG Rule is designed to help clarify what the SEC believes to be current confusion surrounding ESG products. Of note, the Proposed ESG Rule does not define “ESG” or similar terms,⁷ instead requiring registered funds and advisers to disclose the ESG factors considered and how they are considered.⁸

⁴ 87 FR 21334 (2022). For the Debevoise In-Depth discussing the Proposed Climate Disclosure Rule, see Debevoise In-Depth, “An In-Depth Review of the SEC Proposed Climate Change Disclosure Rule” (Apr. 25, 2022), available at <https://www.debevoise.com/insights/publications/2022/04/sec-issues-long-awaited-proposed-climate-change>.

⁵ Debevoise In-Depth, “Applicability of the SEC’s Proposed ESG Rules to Private Fund Advisers” (Jun. 15, 2022), available at <https://www.debevoise.com/insights/publications/2022/06/applicability-of-the-secs-proposed-esg-rules-to>.

⁶ 87 Fed. Reg. 36654.

⁷ 87 Fed. Reg. 36660, ¶ 1.

⁸ The Proposed ESG Rule does not apply to private funds, although some provisions of the Proposed ESG Rule may affect registered investment advisers and advisers exempt from registration that advise private funds. See Debevoise In-Depth, “Applicability of the SEC’s Proposed ESG Rules to Private Fund Advisers” (Jun. 15, 2022), *supra* note 5.

Classification of ESG Funds

The Proposed ESG Rule classifies ESG funds into two broad categories, which would divide registered funds based on the extent to which ESG factors are considered in their investment selection processes. As described below, the proposal classifies the funds as: (1) “integration funds”; and (2) “ESG-focused funds.” The Proposed ESG Rule also would create a third category, “impact funds,” which would be a subset of ESG-focused funds.

- **Integration Funds.** Integration funds are defined as considering one or more ESG factors alongside other, non-ESG factors, where ESG factors would generally be no more significant than the other factors in selecting or excluding particular investments.⁹ An example of an integration fund would be one that selects investments “because those investments met other criteria applied by the fund’s adviser (e.g., investments selected on the basis of macroeconomic trends or company-specific factors like a price-to-earnings ratio).”¹⁰
- **ESG-Focused Funds.** Unlike integration funds, ESG-focused funds focus on one or more ESG factors by using them as a significant or main consideration in selecting investments or in their engagement strategies with portfolio companies.¹¹ The SEC did not provide guidance on how to assess “significance” in categorizing strategies. However, the SEC noted that ESG-focused funds would include funds that have names and/or distribute advertisements or sales literature¹² suggesting that the fund meets the SEC’s definition. Examples of ESG-focused funds include those that track ESG-focused indices, apply a screen to include or exclude investments based on ESG factors, or have policies of proxy voting or engaging with management of portfolio companies to encourage ESG practices.¹³
- **Impact Funds.** Impact funds, which are a subset of ESG-focused funds, would seek to achieve specific ESG impacts or impacts that generate specific ESG-related benefits.¹⁴ ESG impact funds incorporate ESG factors into the fund’s investment strategy more than ESG integration or other ESG-focused funds. Examples of ESG impact funds include those that invest in portfolio companies in order to further the

⁹ 87 Fed. Reg. 36657; Proposed 17 CFR 274 (Form N-1A (Items 4(a)(2)(i)(a), 8.2.e.(1)(A))), 87 Fed. Reg. 36746-751.

¹⁰ 87 Fed. Reg. 36660.

¹¹ Proposed 17 CFR 274 (Form N-1A (Item 4(a)(2)(i)(B)), Form N-2 (Item 8.2.e.(1)(B))), 87 Fed. Reg. 36746-755.

¹² The term “advertisements” is defined in Rule 482 under the Securities Act of 1933, and the term “sales literature” is defined in Rule 34b-1 of the Investment Company Act of 1940 (‘40 Act). See 17 CFR 230.482, 270.34b-1.

¹³ 87 Fed. Reg. 36662.

¹⁴ Proposed 17 CFR 274 (Form N-1A (Item 4(a)(2)(i)(C)), Form N-2 (Item 8.2.e.(1)(C))), 87 Fed. Reg. 36746-755.

funds' disclosed ESG goals, such as the construction of affordable housing units or improvement of the availability of clean water.¹⁵

The Proposed ESG Rule includes a variety of disclosure requirements for investment advisers and funds, which vary based on the extent to which funds and advisers consider ESG factors.¹⁶ In other words, impact funds would be subject to the most requirements, while integration funds would be subject to the fewest.

The SEC requests comment on a variety of issues related to their proposed classification of funds, including whether their overall approach to not define "ESG" or related terms, but rather to require funds to disclose how they are incorporating ESG factors into their investment selection process and strategies, is appropriate.¹⁷ The SEC also asks whether they should define certain types of factors as being ESG, but allow funds to add additional factors to that concept if they choose. The SEC further requests comment on whether there are any other approaches that the SEC should take in providing guidance to funds as to what constitutes ESG.¹⁸ With respect to the reach of these disclosure requirements, the SEC is seeking comments on whether the Proposed ESG Rule should apply to registered open-end funds, registered closed-end funds, and BDCs (as proposed), and whether there are other substantive disclosure requirements that should differ based on the type of fund.¹⁹

Rules and Forms Amended

The Proposed ESG Rule would amend rules and forms required under each of the Advisers Act, 40 Act, and 34 Act. Specifically, the Proposed ESG Rule would amend:

- Disclosure requirements in prospectuses on Forms N-1A (the initial registration statement and annual shareholder report for open-end funds),²⁰ N-2 (the initial registration statement and annual shareholder report for closed-end funds),²¹ and N-CSR (which provides additional information following a fund's annual and semiannual shareholder reports required under Section 30 of the '40 Act and Sections 13(a) and 15(d) of the '34 Act);²²

¹⁵ 87 Fed. Reg. 36663.

¹⁶ 87 Fed. Reg. 36659.

¹⁷ 87 Fed. Reg. 36660, ¶ 1.

¹⁸ *Id.*

¹⁹ *Id.*, ¶ 2.

²⁰ Securities & Exchange Commission, "Form N-1A," Form, available at <https://www.sec.gov/files/formn-1a.pdf>.

²¹ Securities & Exchange Commission, "Form N-2," Form, available at <https://www.sec.gov/files/formn-2.pdf>.

²² Securities & Exchange Commission, "Form N-CSR," Form, available at <https://www.sec.gov/files/formn-csr.pdf>.

- Disclosure requirements for Unit Investment Trusts (“UITs”) on Forms N-8B-2 (the registration form for UITs)²³ and S-6 (for UIT securities registrations);²⁴
- Regulatory reporting requirements on Form N-CEN (the census-level annual report for registered funds);²⁵ and
- Disclosure requirements on Form ADV (the uniform form used by investment advisers to register with both the SEC and state securities authorities).²⁶

These forms must be submitted in XBRL format in accordance with Regulation S-T.²⁷

Compliance Dates

Most disclosures that would be required under the Proposed ESG Rule, if finalized, would take effect 12 months after the Proposed ESG Rule is adopted, although the Form N-CSR disclosures would not be required until 18 months after adoption.²⁸

Disclosure	Effective 12 Months After Adoption	Effective 18 Months After Adoption
Form N-1A and N-2	x	
Forms N-8B2 and S-6 for UITs	x	
Form N-CEN	x	
Form ADV	x	
Form N-CSR		x

Registered Funds

For registered funds, the Proposed ESG Rule would add additional ESG disclosure requirements in (1) the prospectus (Forms N-1A and N-2, as applicable), (2) the annual shareholder report (Forms N-1A, N-2, 10-K, N-CSR, and N-PX, as applicable), and (3) the annual census-level report (Form N-CEN).

²³ Securities & Exchange Commission, “Form N-8B-2,” Form, available at <https://www.sec.gov/files/formn-8b-2.pdf>.

²⁴ Securities & Exchange Commission, “Form S-6,” Form, available at <https://www.sec.gov/files/forms-6.pdf>.

²⁵ Securities & Exchange Commission, “Form N-CEN,” Form, available at <https://www.sec.gov/files/formn-cen.pdf>.

²⁶ Securities & Exchange Commission, “Form ADV (Paper Version) Part 1A,” Form, available at <https://www.sec.gov/about/forms/formadv-part1a.pdf>; Securities & Exchange Commission, “Form ADV (Paper Version) Part 2: Uniform Requirements for the Investment Adviser Brochure and Brochure Supplements,” Form, available at <https://www.sec.gov/about/forms/formadv-part2.pdf>.

²⁷ 87 Fed. Reg. 36685-686; Proposed 17 CFR 232.405, 87 Fed. Reg. 36744.

²⁸ 87 Fed. Reg. 36697.

Prospectus ESG Disclosure Amendments (Forms N-1A and N-2)

Under the Proposed ESG Rule, all registered funds that reference or utilize ESG factors would be required to disclose information regarding their investment processes in their prospectuses in the fund's principal investment strategies section.²⁹ Because the information required to fully understand a fund's ESG methodology could lead to large amounts of disclosure, the Proposed ESG Rule's disclosure requirement is structured in a "layered format"; key information would be disclosed in the summary section of the prospectus, while the additional information would be provided later on in the disclosure.³⁰

Integration Funds. Integration funds would first be required to summarize in a few sentences how the funds incorporate ESG factors into the investment selection process, including what ESG factors the funds consider.³¹ An integration fund would then expand on this concise information by providing a more detailed description of how the fund incorporates ESG factors into its investment selection process.³² Moreover, if an integration fund considers the Greenhouse Gas ("GHG") emissions of its portfolio holdings as an ESG factor in the fund's investment process, the Proposed Rule would require the fund to describe that process, including a description of the methodology that the fund uses.³³ For open-end funds, the additional information would be located outside of the summary prospectus, and, for closed-end funds, this information would be later in the prospectus.³⁴

ESG-Focused Funds. At a broad level, an ESG-focused fund would be required to provide key information in an "ESG Strategy Overview" table in the fund's prospectus.³⁵

²⁹ 87 Fed. Reg. 36659; Proposed 17 CFR 274 (Form N-1A (Amended Items 4, 9), Form N-2 (Item 2, Amended Item 8)), 87 Fed. Reg. 36746-755.

³⁰ 87 Fed. Reg. 36660.

³¹ 87 Fed. Reg. 36660; Proposed 17 CFR 274 (Form N-1A (Item 4(a)(2)(ii)(A)), Form N-2 (Item 8.(2)(e)(2)(A))), 87 Fed. Reg. 36746-755. Open-end funds would provide this information in the summary section of the fund's prospectus, while closed-end funds, which do not use summary prospectuses, would disclose the information as part of the prospectus's general description of the fund. 87 Fed. Reg. 36660. Note that, in the Proposed ESG Rule's preamble, the SEC acknowledged that requiring Integration Funds to provide more disclosure in the summary prospectus, for open-end funds, or, in the general description, for closed-end funds, could potentially overemphasize the role ESG factors play in the funds' investment selection process, and thus confuse investors. *See id.*

³² *See* 87 Fed. Reg. 36660-661; Proposed 17 CFR 274 (Form N-1A (Instruction 1(a) to Item 9(b)(2)), Form N-2 (Item 8.2.e(2)(B))), 87 Fed. Reg. 36746-755.

³³ 87 Fed. Reg. 36661; Proposed 17 CFR 274, (Form N-1A (Instruction 1(b) to Item 9(b)(2)), Form N-2 (Instruction 9.a(2) to Item 8.2.e(2)(B))), 87 Fed. Reg. 36746-755.

³⁴ 87 Fed. Reg. 36661.

³⁵ 87 Fed. Reg. 36661; Proposed 17 CFR 274 (Form N-1A (Instruction 1 to Item 4(a)(2)(ii)(B)), Form N-2 (Instruction 1 to Item 8.2.e(2)(B))), 87 Fed. Reg. 36746-755 (providing that the ESG Strategy Overview table would come before the risk/return summary (for open-end funds) or discussion of the fund's organization and operation (for closed-end funds), and disclosure in the table need not be repeated in the narrative disclosure

The information provided in the table is intended to be brief and to only include the information required by the relevant form instructions.³⁶

[ESG] Strategy Overview

<p>Overview of the Fund's [ESG] strategy</p>	<p>The Fund engages in the following to implement its [ESG] Strategy:</p> <ul style="list-style-type: none"> <input type="checkbox"/> Tracks an index <input type="checkbox"/> Applies an inclusionary screen <input type="checkbox"/> Applies an exclusionary screen <input type="checkbox"/> Seeks to achieve a specific impact <input type="checkbox"/> Proxy voting <input type="checkbox"/> Engagement with issuers <input type="checkbox"/> Other
<p>How the Fund incorporates [ESG] factors in its investment decisions</p>	
<p>How the Fund votes proxies and/or engages with companies about [ESG] issues</p>	

To complement the brief descriptions provided in the ESG Strategy Overview table, ESG-focused funds would be required to provide lengthier disclosures later in the prospectus regarding the following information:

- **Overview of the Fund's ESG Strategy (First Row).** In the first row of the table, the Proposed ESG Rule would require an ESG-focused fund to provide a concise description of the factor or factors that are the focus of the fund's strategy.³⁷ The fund also would check a box for any of the strategies that it utilizes (e.g., tracking an index, inclusionary/exclusionary screens, etc.).³⁸

that will follow the table in the risk/return summary of discussion of the fund's organization and operation). Note that, though the Proposed ESG Rule proposes consistent titles in the rows of the table, funds may use alternative titles to "ESG" (e.g., "sustainable") if the titles would more accurately describe the fund's ESG focus. See 87 Fed. Reg. 36663-664, n. 60; Proposed 17 CFR 274 (Form N-1A (Instruction 2 to Item 9(b)(2)), Form N-2 (Instruction 9.b to Item 8.2.e.(2)(B))), 87 Fed. Reg. 36746-755. In the preamble, the SEC notes that its goal in creating the table was to provide a clear, concise, and comparable summary of a fund's key ESG features that will help investors determine if a fund's approach aligns with its objectives. 87 Fed. Reg. 36664.

³⁶ 87 Fed. Reg. 36663-664.

³⁷ 87 Fed. Reg. 36664; Proposed 17 CFR 274 (Form N-1A (Instruction 4 to Item 4(a)(2)(ii)(B)), Form N-2 (Instruction 4 to Item 8.2.e.(2)(B))), 87 Fed. Reg. 36746-755.

³⁸ 87 Fed. Reg. 36664. The SEC's objective in creating this first row is to "help investors quickly compare different funds' area of focus and approaches to ESG investing and to provide context for the more specific disclosure in the rows that follow." 87 Fed. Reg. 36665.

- **How the Fund Incorporates ESG Factors in Its Investment Decisions (Second Row).** In the second row, the Proposed ESG Rule would require an ESG-focused fund to summarize how it incorporates ESG factors into its process for evaluating, selecting, or excluding investments, including with respect to the items listed below.³⁹ Later in the prospectus, funds would be required to supplement this information along with more detailed information regarding the strategies checked in the first row.⁴⁰
 - *Inclusionary or Exclusionary Screens.* If the fund applies an inclusionary or exclusionary screen, the fund would briefly explain the factors that the screen applies, such as particular industries or business activities it seeks to include or exclude, and, if applicable, what exceptions apply to the screen.⁴¹ In addition, the fund would be required to state the percentage of the portfolio, in terms of net asset value (“NAV”), to which the screen applies.⁴² Later in the prospectus, a fund applying a screen would disclose any quantitative thresholds or qualitative factors used to determine a company’s industry classification or whether a company is engaged in a particular activity.⁴³
 - *Internal Methodologies or Third-party Data Providers.* If the fund uses an internal methodology, a third-party data provider, or a combination of both in its investment process, the fund would disclose how it uses the methodology, third-party data provider, or combination of both, as applicable.⁴⁴ As with the other

³⁹ 87 Fed. Reg. 36664; Proposed 17 CFR 274 (Form N-1A (Instruction 5 to Item 4(a)(2)(ii)(B)), Form N-2 (Instruction 5 to Item 8.2.e.(2)(B))), 87 Fed. Reg. 36746-755.

⁴⁰ Open-end funds would provide this additional information in response to Form N-1A’s Item 9 (description of the fund’s investment objectives, principal investment strategies, related risks, and portfolio holdings), as revised by the Proposed ESG Rule. Closed-end funds would provide the additional information in response to Form N-2’s Item 8 (description of the fund, including its investment objectives and policies, as well as other matters), as revised by the Proposed ESG Rule. See Proposed 17 CFR 274 (Form N-1A (Instruction 2 to Item 9(b)(2)), Form N-2 (Instruction 9 to Item 8.2.e.(2)(B))), 87 Fed. Reg. 36746-755.

⁴¹ 87 Fed. Reg. 36665; Proposed 17 CFR 274 (Form N-1A (Instruction 4 to Item 4(a)(2)(ii)(B)), Form N-2 (Instruction 5 to Item 8.2.e.(2)(B))), 87 Fed. Reg. 36746-755.

⁴² 87 Fed. Reg. 36665. This requirement would only apply if the screen applies to less than 100% of the fund (excluding cash and cash equivalents held for cash management); the fund would also be required to explain briefly why the screen applies to less than 100% of the portfolio. Proposed 17 CFR 274 (Form N-1A (Instruction 5(a) to Item 8.2.e.(2)(B))), 87 Fed. Reg. 36746-751.

⁴³ 87 Fed. Reg. 36666; Proposed 17 CFR 274 (Form N-1A (Item 9(b)(2)(d)), Form N-2 (Instruction 9(b)(4) to Item 8.2.e.(2)(B))), 87 Fed. Reg. 36746-755.

⁴⁴ 87 Fed. Reg. 36666. The SEC believes that this information would be helpful to investors because different advisers or third-party data providers can disagree on how companies fare on various ESG factors; as a result, funds that have similar ESG strategies could, in reality, have different, sometimes contradictory, views on a particular investment. Id.

disclosures required in this table, additional information regarding an investment methodology would be provided later in the prospectus.⁴⁵

- *Tracking an Index.* If the fund tracks an index, the summary would identify the index and briefly describe the index and how it utilizes ESG factors in determining its constituents.⁴⁶ Later in the prospectus, the fund would also provide the index's methodology, including any criteria or methodologies for selecting or excluding components of the index that are based on ESG factors.⁴⁷
- *Third-Party ESG Frameworks.* If the fund follows a third-party framework, such as the United Nations Sustainable Development Goals or the Task Force on Climate-Related Financial Disclosures ("TCFD"), the fund would provide a brief overview of the framework in the table.⁴⁸ The fund would include a more detailed description later in the prospectus.⁴⁹
- *Additional Requirements for Impact Funds:* Impact funds would also include descriptions of the impact(s) that the fund is seeking to achieve, and how the fund is seeking to achieve those impact(s). Specifically, the overview must include "(i) how the fund measures progress toward the specific impact, including the key performance indicators the fund analyzes, (ii) the time horizon the fund uses to analyze progress, and (iii) the relationship between the impact the fund is seeking to achieve and financial return(s)."⁵⁰
- **How the Fund Votes Proxies and/or Engages with Companies about ESG Issues (Third Row).** For funds in which proxy voting or engagement with portfolio companies is a "significant" means of implementing their ESG strategies, the third row of the table would include a brief narrative overview of how the fund engages in proxy voting or with portfolio companies on ESG issues.⁵¹ The fund would

⁴⁵ 87 Fed. Reg. 36666; Proposed 17 CFR 274 (Form N-1A (Amended Instruction 2 to Item 9(b)(2)), Form N-2 (Instruction 9(b) to Item 8.2.e.(2)(B))), 87 Fed. Reg. 36746-755.

⁴⁶ 87 Fed. Reg. 36666; Proposed 17 CFR 274 (Form N-1A (Instruction 5(c) to Item 4(a)(2)(ii)(B)), Form N-2 (Instruction 5(c) to Item 8.2.e.(2)(B))), 87 Fed. Reg. 36746-755.

⁴⁷ 87 Fed. Reg. 36666; Proposed 17 CFR 274 (Form N-1A (Instruction 5(a) to Proposed Item 4(a)(2)(ii)(B)), Form N-2 (Instruction 9(b)(1) to Item 8.2.e.(2)(B))), 87 Fed. Reg. 36746-755.

⁴⁸ 87 Fed. Reg. 36666; Proposed 17 CFR 274 (Form N-1A (Instruction 5(a) to Item 4(a)(2)(ii)(B), Instruction 2(a) to Amended Item 9(b)(2)), Form N-2 (Instruction 9(b)(1) to Item 8.2.e.(2)(B))), 87 Fed. Reg. 36746-755.

⁴⁹ 87 Fed. Reg. 36666; Proposed 17 CFR 274 (Form N-1A (Instruction 2(e) to Item 9(b)(2)), Form N-2 (Instruction 9(b)(5) to Item 8.2.e.(2)(B))), 87 Fed. Reg. 36746-755.

⁵⁰ 87 Fed. Reg. 36668; Proposed 17 CFR 274 (Form N-1A (Instruction 7 to Item 4(a)(2)(ii)(B)), Form N-2 (Instruction 7 to Item 8.2.e.(2)(B))), 87 Fed. Reg. 36746-755.

⁵¹ 87 Fed. Reg. 36669; Proposed 17 CFR 274 (Form N-1A (Instructions 4 and 8, Item 4(a)(2)(ii)(B)), Form N-2 (Instructions 4 and 8 to Item 8.e.(2)(B))), 87 Fed. Reg. 36746-755. In the Proposed ESG Rule's preamble, the SEC explained that, unlike with the other ESG strategies listed in the table, the additional requirement for the

supplement this overview later in the prospectus.⁵² If the fund engages with portfolio companies on ESG matters in ways other than through voting proxies (e.g., through meetings with management), the fund would be required to disclose an overview of the objectives it seeks to achieve with its engagement.⁵³ If a fund does not engage on particular ESG issues, it should disclose that in the overview table, and, even if a fund does not check the box in the first row of the table (i.e., engagement is not a significant way the fund implements its ESG strategy), the fund must still fill out this row of the table and disclose this fact. In the more detailed disclosures later in the prospectus, the fund would be required to disclose “specific information on the objectives it seeks to achieve with its engagement strategy, including the fund’s time horizon for progressing on such objectives and any key performance indicators that the [f]und uses to analyze or measure the effectiveness of such engagement.”⁵⁴

The SEC requests comments on all aspects of its proposed disclosures. Notably, with respect to its proposed integration fund disclosure requirements, the SEC asked whether its proposed definition of an integration fund is appropriate and clear,⁵⁵ whether the SEC should (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,⁵⁶ and whether, alternatively, integration funds should also be required to complete the tabular disclosure that the SEC proposes for ESG-focused funds.⁵⁷ The SEC also asks whether it is feasible for funds to meet the elements of the proposed disclosure requirement with a brief description or example, and if not, whether any aspects of the proposal, including the requirement that disclosures be brief, should be modified.⁵⁸

For the proposed ESG-focused fund prospectus disclosure requirements, the SEC requests comments on many aspects of its proposal, including: whether the proposed level of disclosure and the division of that disclosure between the summary section of the prospectus and the statutory prospectus (i.e., Items 4 and 9 of Form N-1A) is appropriate,⁵⁹ whether the SEC should modify its proposed definition of ESG-focused

fund to make proxy voting or other engagement a “significant” portion of its strategy results in this disclosure item being more limited. *Id.*, 87 Fed. Reg. 36669-670.

⁵² 87 Fed. Reg. 36670; Proposed 17 CFR 274 (Form N-1A (Instruction 2(f) to Item 9(b)(2)), Form N-2 (Instruction 9.b.(6) to Item 8.2.e.(2)(B)), 87 Fed. Reg. 36746-755.

⁵³ 87 Fed. Reg. 36670; Proposed 17 CFR 274 (Form N-1A (Instructions 4 and 8, Item 4(a)(2)(ii)(B)), Form N-2 (Instructions 4 and 8 to Item 8.2.e.(2)(B)), 87 Fed. Reg. 36746-755.

⁵⁴ 87 Fed. Reg. 36670; Proposed 17 CFR 274 (Form N-1A (Instruction 2(f) to Item 9(b)(2)), Form N-2 (Instruction 9(b)(6) to Item 8.2.e.(2)(B))), 87 Fed. Reg. 36746-755.

⁵⁵ 87 Fed. Reg. 36661, ¶ 3.

⁵⁶ 87 Fed. Reg. 36661, ¶ 6.

⁵⁷ 87 Fed. Reg. 36661-662, ¶ 7.

⁵⁸ 87 Fed. Reg. 36662, ¶ 9.

⁵⁹ 87 Fed. Reg. 36667, ¶ 33.

funds,⁶⁰ and whether the approach proposed for closed-end funds is appropriate, or if the SEC should consider any alternatives.⁶¹

The SEC also asks several questions about the proposed “ESG Strategy Overview” table, including if the instructions and descriptions for the common strategies in the table are sufficiently self-explanatory⁶² and whether there are any strategies not on the list that should be included (or any that are currently on the proposed list that should be excluded).⁶³ Additionally, the SEC requests comment on whether the agency should (as proposed) limit the disclosure in the “ESG Strategy Overview” table to the information required by the instructions (or permit, but not require, other information to be included in the table as well).⁶⁴ The SEC also seeks feedback on whether there are any competitive concerns with requiring funds to disclose internal methodologies, and if so, if there are alternatives that would mitigate those concerns and still achieve the goal of helping investors.⁶⁵ Relatedly, the SEC requests comment on whether there are any licensing or other issues that a fund would have to address if the SEC were to require a fund to disclose information concerning a third-party data provider, index, or any third-party ESG framework.⁶⁶

Regarding the proposed framework for impact funds, the SEC requests comment on whether impact funds are appropriately considered a subset of ESG-focused funds, as proposed, or if impact funds are sufficiently distinct that they need a separate set of disclosure requirements;⁶⁷ whether the SEC should require additional disclosures for impact funds beyond what is currently proposed;⁶⁸ and whether any particular proposed disclosures should not be adopted.⁶⁹

Fund Annual Report ESG Disclosures (Forms N-1A, N-2, 10-K, N-CSR, N-PX)

The Proposed ESG Rule would also require additional ESG-related disclosures in fund annual reports for (1) impact funds, (2) ESG-focused funds, (3) funds that engage with portfolio companies through means other than proxy voting, and (4) funds that consider environmental factors, which must disclose GHG emissions metrics. For registered funds, the proposed disclosure would be included in the management’s discussion of fund performance (“MDFP”) section of the fund’s annual shareholder

⁶⁰ 87 Fed. Reg. 36664, ¶ 13.

⁶¹ 87 Fed. Reg. 36664, ¶ 20.

⁶² 87 Fed. Reg. 36665, ¶ 27.

⁶³ 87 Fed. Reg. 36665, ¶ 29.

⁶⁴ 87 Fed. Reg. 36664, ¶ 18.

⁶⁵ 87 Fed. Reg. 36667, ¶ 43.

⁶⁶ 87 Fed. Reg. 36668, ¶ 50.

⁶⁷ 87 Fed. Reg. 36669, ¶ 52.

⁶⁸ Id.

⁶⁹ Id.

report.⁷⁰ For BDCs, the disclosure would be included in the Management Discussion and Analysis (“MD&A”) section of Form 10-K.⁷¹

- **Impact Funds.** The Proposed ESG Rule would require an impact fund to discuss the fund’s progress on achieving its impact in both qualitative and quantitative terms during the reporting period, as well as the key factors that materially affected the fund’s ability to achieve its impact.⁷²
- **ESG-Focused Funds.** ESG-focused funds (including, but not limited to, impact funds) for which proxy voting is a significant means of implementing their ESG strategy would be required to disclose certain information regarding how the fund voted proxies relating to portfolio securities on ESG issues during the reporting period.⁷³ Specifically, funds would be required to disclose “the percentage of ESG-related voting matters during the reporting period for which the Fund voted in furtherance of the initiative.”⁷⁴ These funds also would be required to refer investors to the fund’s full voting record filed on Form N-PX.⁷⁵
- **ESG Engagement Disclosure.** Funds for which engagement with issuers through means other than proxy voting is a significant means of implementing their ESG strategy would be required to disclose in their annual fund reports progress on any key performance indicators of such engagement.⁷⁶ In particular, funds must disclose the number or percentage of issuers with whom the fund held ESG engagement meetings⁷⁷ during the reporting period related to one or more ESG issues and the total number of ESG engagement meetings.⁷⁸

⁷⁰ 87 Fed. Reg. 36672; Proposed 17 CFR 274 (Form N-1A (Amended Item 27), Form N-2 (Instruction 4.(g) to Item 24)), 87 Fed. Reg. 36746-755.

⁷¹ 87 Fed. Reg. 36672; Proposed 17 CFR 274 (Form N-2 (Instruction 10 to Item 24)), 87 Fed. Reg. 36751-755.

⁷² 87 Fed. Reg. 36672; Proposed 17 CFR 274 (Form N-1A (Item 27(b)(7)(i)(B))), Form N-2 (Instruction 4.(g)(1)(B) to Item 24)), 87 Fed. Reg. 36746-755.

⁷³ 87 Fed. Reg. 36672; Proposed 17 CFR 274 (Form N-1A (Item 27(b)(7)(i)(C))), Form N-2 (Instruction 4.(g)(1)(C) to Item 24)), 87 Fed. Reg. 36746-755.

⁷⁴ 87 Fed. Reg. 36673.

⁷⁵ Id. Note that this requirement would not apply to BDCs because they do not file reports on Form N-PX. 87 Fed. Reg. 36674, n. 110. The SEC noted in the preamble that this combination will “allow an investor immediately to see the extent to which the fund was voting in favor of relevant ESG initiatives, while directing investors to the more detailed disclosure of the fund’s voting record filed on Form N-PX for investors interested in that more detailed information.” Id., 87 Fed. Reg. 36674.

⁷⁶ 87 Fed. Reg. 36674; Proposed 17 CFR 274 (Form N-1A (Item 27(b)(7)(i)(D))), Form N-2 (Instruction 4.(g)(1)(D) to Item 24)), 87 Fed. Reg. 36746-755.

⁷⁷ In this context, the SEC defines an “ESG engagement meeting” to mean a “substantive discussion with management of an issuer advocating for one or more specific ESG goals to be accomplished over a given time period, where progress that is made toward meeting such goal is measurable, that is part of an ongoing dialogue with management regarding this goal.” 87 Fed. Reg. 36674. While the SEC recognizes that there is a level of subjectivity present in deciding whether a discussion qualifies as an “ESG engagement meeting” that could

- **GHG Emissions Metrics Disclosures.**⁷⁹ Notably, while the Proposed ESG Rule includes information on emissions reporting frameworks such as the TCFD and ultimately does not adopt one in particular,⁸⁰ it would still require an ESG-focused fund that considers environmental factors in their investment strategies to disclose the carbon footprint and the weighted average carbon intensity (“WACI”) of the fund’s portfolio in the MDFP or MD&A section of the fund’s annual report, as applicable.⁸¹ A fund’s WACI measures that fund’s exposure to carbon-intensive companies; in other words, WACI allows an investor to see, in quantitative terms, the portfolio companies’ carbon intensity (i.e., the portfolio companies’ GHG emissions relative to their revenue), rather than the companies’ absolute GHG emissions.⁸² The proposed metrics for WACI and carbon footprint disclosures are consistent with those of the TCFD, as well as the Partnership for Carbon Accounting Financials (“PCAF”) standards.⁸³
- The GHG emissions metrics disclosure requirement would apply to ESG-focused funds that indicate that they consider environmental factors in response to Item C.3(j)(ii) on Form N-CEN, unless these funds affirmatively state that they do not consider issuers’ GHG emissions as part of their investment strategy in the “ESG Strategy Overview” table of the fund’s prospectus.⁸⁴ Moreover, the Proposed ESG Rule would require integration funds that consider GHG emissions to disclose additional information about how the fund considers GHG emissions,

diminish the comparability across funds, the agency ultimately decided that it is important to provide this information for investors to allow them to evaluate the efficacy of their fund’s engagement activities and to provide some basis for comparison among funds. 87 Fed. Reg. 36675.

⁷⁸ The SEC believes that disclosure of this information will allow investors to evaluate critically the disclosure of funds whose ESG strategy involves engagement other than, or in addition to, proxy voting in order to reduce the potential for exaggerated claims of engagement, as well as to allow investors to understand better whether these funds are accomplishing their objectives. See 87 Fed. Reg. 36674.

⁷⁹ Note that funds may need to comply with the GHG emissions metrics disclosures under the Proposed ESG Rule, if finalized, in addition to the Proposed Climate Disclosure Rule. See 87 FR 21334 (2022).

⁸⁰ See Proposed ESG Rule, 87 Fed. Reg. 36681 (“We are not proposing to require that funds use a particular estimation method. We understand there are different approaches to estimating a portfolio company’s GHG emissions that funds could use when calculating their WACI or carbon footprint under the proposal.”).

⁸¹ 87 Fed. Reg. 36673, Proposed (Form N-1A (Item 27(b)(7)(i)(E)), Form N-2 (Instruction 4.(g)(1)(E) to Item 24)), 87 Fed. Reg. 36746-755. Funds that do not consider environmental factors do not have to disclose this information. Id.

⁸² 87 Fed. Reg. 36678.

⁸³ Id.

⁸⁴ Id. Because not all ESG-focused funds that consider environmental factors specifically consider the GHG emissions of the issuers in which they invest, funds would not be required to disclose their GHG emissions metrics if they affirmatively state in the “ESG Strategy Overview” table in the fund prospectus that they do not consider issuers’ GHG emissions as part of their investment strategies. See 87 Fed. Reg. 36676, n. 126.

including the methodology and data sources that the fund may use as part of its consideration of GHG emissions.⁸⁵

- The Proposed ESG Rule would also amend Form N-CSR by imposing additional requirements on funds, including requiring the fund to report: (i) additional information pertaining to any assumptions and procedures used to calculate the portfolio's GHG emissions, (ii) any limitations regarding said procedures and assumptions, and (iii) explanations of any good faith appraisal of GHG emissions necessary to be submitted under this rule.⁸⁶ Recognizing the potential for disclosure of this information to become unwieldy and cumbersome, the SEC is again proposing a layered approach, which would require the disclosure of GHG metrics data in the annual report accompanied by a brief summary of the sources of data and the amount of estimated GHG emissions used, while also requiring the fund to provide more detailed information regarding its processes and methodology for calculating and estimating GHG metrics.⁸⁷
- We note that, of the many disclosures in the Proposed ESG Rule, the GHG disclosures may be the most significant and challenging disclosure to implement for many funds.

The SEC requests comment on all aspects of the proposed amendments to fund annual reports, including: whether the agency should, as proposed, require environmentally focused funds to disclose their GHG emissions⁸⁸ and whether the GHG reporting requirements should be limited to: (1) environmentally focused funds that do not affirmatively state that they do not consider GHG emissions of the issuers in which they invest as part of their ESG strategy (as proposed) or (2) to funds with strategies in which the fund's adviser considers GHG emissions information in executing the fund's strategy.⁸⁹ Similarly, the SEC asks whether there would be any potential unintended consequences in requiring GHG emissions reporting.⁹⁰

⁸⁵ 87 Fed. Reg. 36660. The SEC explains in the Proposed ESG Rule's preamble that a confluence of factors—including particular investor demand on how funds consider GHG emissions, an increasing acceptance and convergence around GHG emissions metrics, and the potential for integration funds to vary substantially in how they utilize GHG emissions data in their investment process—led them to conclude that requiring integration funds to disclose portfolio company GHG emissions would facilitate comparability between funds and investors' overall comprehension. *Id.*

⁸⁶ 87 Fed. Reg. 36681-682; Proposed 17 CFR 274 (Form N-CSR (Item 7), Form N-2 (Instruction 10 to Item 24)), 87 Fed. Reg. 36751-756.

⁸⁷ 87 Fed. Reg. 36682; Proposed 17 CFR 274 (Form N-CSR (Item 7), Form N-2 (Instruction 10 to Item 24)), 87 Fed. Reg. 36751-756.

⁸⁸ 87 Fed. Reg. 36682, ¶ 87.

⁸⁹ *Id.*, ¶ 88.

⁹⁰ *Id.*, ¶ 90.

Notably, with respect to the specific GHG emissions metrics required in the Proposed ESG Rule, the SEC asks: (1) whether the agency should (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; (2) what are the costs associated with disclosing Scope 1 and 2 emissions;⁹¹ (3) whether the agency should require the disclosure of portfolio companies' Scope 3 emissions to the extent they are publicly reported by a portfolio company; and (4) whether the agency should require funds to estimate these Scope 3 emissions when they are not reported (as well as how burdensome would this requirement be for funds).⁹²

Annual Census-Level Report (Form N-CEN)

The Proposed ESG Rule would amend Form N-CEN by creating a new category of funds (funds that incorporate ESG factors) in Item C.3 (Additional Questions for Management Investment Companies: Type of Fund).⁹³ These amendments would collect census-level information on funds that consider ESG factors and/or use ESG-related service providers.⁹⁴ Funds would disclose whether they are integration funds or ESG-focused funds and, for ESG-focused funds, whether they are impact funds. Funds are also asked whether they consider environmental, social, and/or governance factors; which of the common ESG strategies listed in the ESG Strategy Overview Table in the annual report the funds employ (if any); whether the funds consider ESG information from ESG consultants or service providers, and, if so, the identifying information of such providers and whether the providers are affiliated with the funds; and whether the funds follow any third-party ESG frameworks and, if so, which ones.⁹⁵

Some issues on which the SEC requested comment include: (1) whether each aspect of the proposed modifications to Form N-CEN would be appropriate, including whether the SEC should modify the guidelines for when an ESG fund would be required to disclose it follows a third-party framework;⁹⁶ (2) whether the agency should require funds to report the name of the ESG provider (if applicable), as proposed;⁹⁷ and (3) if funds should be required to report whether an ESG provider is an affiliated person of the

⁹¹ 87 Fed. Reg. 36683, ¶ 93.

⁹² Id., ¶ 101.

⁹³ Proposed 17 CFR 274 (Form N-CEN (Item C.3(j))), 87 Fed. Reg. 36755-756. The Proposed ESG Rule would also request identifying information for index funds, including the Legal Entity Identifier (LEI) information. Id., Proposed 17 CFR 274 (Form N-CEN (Item C.3(b))), 87 Fed. Reg. 36755-756.

⁹⁴ 87 Fed. Reg. 36692.

⁹⁵ 87 Fed. Reg. 366756.

⁹⁶ 87 Fed. Reg. 36693, ¶ 171.

⁹⁷ Id., ¶ 167.

fund, as proposed.⁹⁸ The SEC also asked whether there are other types of conflicts of interest about which the agency should require funds to report.⁹⁹

Unit Investment Trusts

The Proposed ESG Rule would require any UIT with portfolio securities selected based on one or more ESG factors to “briefly describe” in Form N-8B-2 how those factors were used to select the portfolio securities.¹⁰⁰ Notably, the requirements for UITs are far less extensive than for other types of funds. As the SEC notes in the rule’s preamble, “[i]n contrast to the amendments that [the SEC] [is] proposing for other types of funds, the level of detail required by the proposed amendment reflects the unmanaged nature of UITs.”¹⁰¹

The SEC requests comment on whether the ESG disclosure requirement should apply to UITs, as proposed,¹⁰² and whether there are elements of the proposed disclosure requirements for other types of funds that should be required of UITs as well.¹⁰³ In addition, the SEC asks whether the ESG disclosure requirements for UITs should address proxy voting¹⁰⁴ and/or engagement.¹⁰⁵

Investment Advisers

Forms Amended

The Proposed ESG Rule also includes revisions to Form ADV Parts 1A¹⁰⁶ and 2A¹⁰⁷ that would affect investment advisers. These proposed revisions would require additional disclosure of advisers’ consideration and use of ESG factors.

⁹⁸ Id., ¶ 168.

⁹⁹ Id.

¹⁰⁰ Proposed 17 CFR 274 (Form N-8B-2 (Instruction 2 to Item 11)), 87 Fed. Reg. 36755. Unit Investment Trusts (“UITs”) are registered funds organized under a trust indenture or similar instrument that issue redeemable securities, each of which represents an undivided interest in a unit of specified securities. 15 U.S.C. 80a-4(2). According to public filings with the SEC, as of October 26, 2021, there were 35 UITs registered on Form S-6 that incorporated an ESG strategy. See 87 Fed. Reg. 36671, n. 95. We note that the ESG Proposed Rule does not include any changes to Form S-6 except for conforming changes with respect to the rule’s XBRL requirement. See Proposed Form S-6 (Instruction 5), 87 Fed. Reg. 36746.

¹⁰¹ 87 Fed. Reg. 36671.

¹⁰² Id., ¶ 62.

¹⁰³ Id., ¶ 64.

¹⁰⁴ Id., ¶ 66.

¹⁰⁵ 87 Fed. Reg. 36672, ¶ 67.

¹⁰⁶ Proposed 17 CFR 274 (Form ADV, Part 1A), 87 Fed. Reg. 36757-36761. See also Securities & Exchange Commission, “Form ADV (Paper Version) PART 1A,” Form, available at <https://www.sec.gov/about/forms/formadv-part1a.pdf>.

¹⁰⁷ Proposed 17 CFR 274 (Form ADV, Part 2A), 87 Fed. Reg. 36761. See also Securities & Exchange Commission, “Form ADV (Paper Version) PART 2: Uniform Requirements for the Investment Adviser Brochure and Brochure Supplements,” Form, available at <https://www.sec.gov/about/forms/formadv-part2.pdf>.

As with the provisions of the Proposed ESG Rule relating to registered funds, the SEC proposes three categories of “ESG” strategies” with respect to an adviser’s funds and separately managed accounts (“SMAs”) for purposes of the Proposed ESG Rule: (1) an “integration” strategy, which considers ESG factors but does not place greater significance on such factors than non-ESG factors; (2) an “ESG-focused” strategy, which uses ESG factors as significant or main considerations; and (3) an “ESG impact” strategy, a subset of “ESG-focused” strategy, which seeks to achieve a specific ESG impact. The SEC noted in the preamble to the Proposed ESG Rule that the definitions applicable to strategies are similar to those for funds.¹⁰⁸

Form ADV Part 1A

The Proposed ESG Rule would add new and amended questions to Part 1A of Form ADV (a “check-the-box” list of questions relating to investment advisers’ business, ownership, clients and other topics) relating to separately managed account clients and private funds, third-party ESG frameworks, and the use of affiliated and unaffiliated ESG consultants or other ESG service providers.

ESG Disclosures for Separately Managed Account Clients and Private Fund

Advisers. In Item 5.K (Separately Managed Account Clients) and Section 7.B.(1) of Schedule D (Private Fund Reporting), the Proposed ESG Rule would add new questions about how advisers use ESG factors in the advisory services that they provide to SMA clients or in managing private funds, as applicable.

Advisers would be required to disclose, for each SMA client or private fund managed, as applicable:

- whether they consider any ESG factors as one or more significant investment strategies or methods of analysis in: (A) the advisory services provided to SMA clients, including in the selection of other investment advisers if applicable, and/or as part of advisory services when requested by SMA clients (Item 5.K) and (B) the advisory services provided to private funds (Section 7.B.(1) of Schedule D);
- if yes, whether they use an integration, ESG-focused, and/or ESG impact approach; and
- which environmental, social or governance factors are considered.¹⁰⁹

¹⁰⁸ 87 Fed. Reg. 36687, n. 194.

¹⁰⁹ 87 Fed. Reg. 36757, 36759-36760.

Third-Party ESG Frameworks. The Proposed ESG Rule would add a new Item 5.M, which includes a disclosure of whether the adviser follows any third-party ESG frameworks in connection with its advisory services and, if so, which frameworks.¹¹⁰

Use of ESG Consultants or Other ESG Service Providers. The Proposed ESG Rule would add new disclosures of whether advisers use the services of ESG consultants or service providers, such as ESG index or scoring providers, in Items 6.A (Other Business Activities) and 7.A (Financial Industry Affiliations), as well as Sections 6.A and 7.A of Schedule D.¹¹¹ Notably, however, the Proposed ESG Rule does not include a definition of the term “ESG consultant” or “ESG service provider.”

The SEC requests comment regarding whether each aspect of its proposed approach is appropriate. Examples of questions asked by the SEC include whether: (1) advisers should be required to indicate whether they consider E, S or G factors, as proposed, or, alternatively, only select an ESG factor if the advisor’s strategy or method of analysis considers the factor to a material degree;¹¹² (2) additional information should be required (e.g., disclosures of advisers’ use of indices, use of inclusionary/exclusionary screens, or issuer engagement) or certain proposed information should not be required with respect to private funds;¹¹³ (3) advisers should be required to report the full name and LEI of ESG providers used for their SMA clients and private funds (currently not proposed), and, if so, whether this should only be limited to providers that the advisor relies on to a material extent;¹¹⁴ (4) advisers should disclose whether they consider ESG factors as part of the adviser’s proxy voting policies and procedures (as proposed for registered funds but not currently proposed for advisers);¹¹⁵ (5) any proposed disclosures would reveal non-public information regarding private funds’ trading strategies or other proprietary information;¹¹⁶ (6) both registered advisers and exempt reporting advisers should be required to complete the proposed new questions in Section 7.B.(1) of Schedule D about their reported private funds;¹¹⁷ and (7) in lieu of the proposed amendments to Items 6 and 7, advisers should only be required to disclose the proposed information if the adviser actually uses the services of the related person ESG provider (or provides its ESG provider services to its own advisory clients) to a material extent.¹¹⁸

¹¹⁰ 87 Fed. Reg. 36758.

¹¹¹ 87 Fed. Reg. 36758-36759.

¹¹² 87 Fed. Reg. 36695, ¶ 175.

¹¹³ *Id.*, ¶¶ 176–177.

¹¹⁴ *Id.*, ¶ 181.

¹¹⁵ *Id.*, ¶ 182.

¹¹⁶ *Id.*, ¶ 183.

¹¹⁷ *Id.*, ¶ 184.

¹¹⁸ 87 Fed. Reg. 36696, ¶ 186.

Form ADV Part 2A (the Adviser Brochure)

The Proposed Rule also would add new and amended instructions to Part 2 of Form ADV¹¹⁹ relating to methods of analysis, investment strategies, and risk of loss (Item 8), financial industry activities and affiliations (Item 10), and voting client securities (Item 17).

Methods of Analysis, Investment Strategies, and Risk of Loss. The Proposed ESG Rule would add a new instruction to Item 8.D, which would require disclosure of each significant investment strategy or method of analysis for which the adviser considers ESG factors.¹²⁰ The adviser would be required to describe the ESG factor(s) considered and how the factors are incorporated when advising clients with respect to investments, including whether and how the adviser uses integration or ESG-focused (including ESG impact) strategies. In the Proposing Release, the SEC provides what could serve as a “model” disclosure of these factors.¹²¹

For advisers that use criteria or methodologies for evaluating, selecting or excluding investments, the advisers must describe those criteria and/or methodologies, including a description of whether and how the adviser uses: an internal methodology, a third-party criterion or methodology (e.g., scoring provider or framework) or a combination of both; an inclusionary or exclusionary screen; and/or an index. We note that Item 8.B currently requires advisers to explain the material risks involved with each of its significant strategies, which the SEC believes include material risks associated with ESG investing.¹²²

Other Financial Industry Activities and Affiliations. The Proposed ESG Rule would amend Item 10.C. to require a description of any material relationships with ESG consultants or ESG providers.¹²³

Voting Client Securities. For advisers that have specific voting policies or procedures that include ESG considerations, the Proposed ESG Rule would amend Item 17.A. to include a description of which ESG factors are considered and how they are considered.¹²⁴

The SEC requests comment regarding whether each aspect of its proposed approach is appropriate. Of note, the SEC asks whether: (1) the proposed terms for “ESG

¹¹⁹ Part 2 of Form ADV has instructions for the mandatory narrative brochures that disclose the adviser’s business practices, fees and other information.

¹²⁰ 87 Fed. Reg. 36761.

¹²¹ 87 Fed. Reg. 36687-36688.

¹²² 87 Fed. Reg. 36689, ¶ 139.

¹²³ 87 Fed. Reg. 36761.

¹²⁴ Id.

integration,” “ESG-focused” and “ESG impact” are sufficiently clear;¹²⁵ (2) there should be an additional, separate disclosure requirement for advisers that primarily use shareholder engagement (as opposed to portfolio management) to implement their ESG priorities (which is not currently proposed);¹²⁶ (3) as proposed, advisers should be required to disclose any relationships or arrangements with related person ESG providers that are “material” to the adviser’s business or clients;¹²⁷ and (4) advisers that do not consider ESG factors when voting client securities are required to expressly disclose this fact (which is not currently proposed).¹²⁸

Wrap Fee Disclosures. The Proposed ESG Rule also would amend the disclosure requirements for advisers that sponsor wrap fee programs, by specifying certain ESG-related disclosures that must be included in the required wrap fee program brochure provided to clients.¹²⁹ Specifically, the proposed amendments would alter Items 4.A (Services, Fees and Compensation), 6.A(4) (Portfolio Manager Selection and Evaluation), and 6.C (Portfolio Manager Selection and Evaluation) of the wrap fee program brochure requirements.

The Proposed ESG Rule would amend Item 4.A to include a description of any ESG factors considered, and how the adviser incorporates these factors under each program.¹³⁰ For advisers that do consider ESG factors when selecting, reviewing or recommending portfolio managers, the Proposed ESG Rule would add a new Item 6.A.(4), which would include a description of the ESG factors considered and how they are considered.¹³¹ This description must describe: (1) any criteria or methodology used to assess portfolio managers’ application of the relevant ESG factors, (2) an explanation of whether the adviser or a third-party reviews portfolio managers’ applications of the relevant ESG factors; and (3), if applicable, an explanation that neither the adviser nor a third party assesses portfolio managers’ application of the relevant ESG factors.¹³²

The SEC requests comment regarding whether each aspect of its proposed approach is appropriate.¹³³ Of note, the SEC asked whether wrap fee program participants should

¹²⁵ 87 Fed. Reg. 36689, ¶¶ 140–141.

¹²⁶ Id., ¶ 144.

¹²⁷ 87 Fed. Reg. 36690, ¶ 152.

¹²⁸ Id., ¶ 155.

¹²⁹ Advisers that sponsor wrap fee programs must provide brochures that state any fees an individual may pay in addition to the wrap fee, as well as the scenarios under which one may need to pay them.

¹³⁰ 87 Fed. Reg. 36761.

¹³¹ Id.

¹³² Id.

¹³³ 87 Fed. Reg. 36691-36692, ¶¶ 156-161.

receive similar ESG-related information as advisory clients that do not participate in such programs.¹³⁴

Guidance on Compliance Policy Reviews and Misleading Statements. The Proposed Rule's preamble also provides guidance relating to compliance, procedures and marketing, although it does not create or amend existing rules to incorporate such guidance. The guidance tracks substantially the SEC's recent ESG risk alert issued in April 2021¹³⁵ and provides helpful model language for advisers to consider as part of any amendments to their compliance policies and procedures.

In the preamble, the SEC reminds advisers to annually review the adequacy and effectiveness of their compliance policies and procedures consistent with Rule 206(4)-(7) under the Advisers Act. With respect to ESG, advisers' compliance policies and procedures should address the accuracy of ESG-disclosures and ESG-related investment objectives in portfolio management processes.¹³⁶

The SEC also reminds advisers of their obligations pursuant to Rule 206(4)-(8) under the Advisers Act (prohibiting advisers to pooled investment vehicles from making false or misleading statements to existing or prospective investors) and the Marketing Rule (prohibiting advisers from distributing advertisements that contain any untrue statement of a material fact or material omissions), including with respect to ESG representations.¹³⁷ Examples of materially misleading actions cited in the preamble include (1) overstating in an advertisement the extent to which ESG factors are considered in managing client portfolios and (2) overstating an adviser's contribution to the development of specific governance practices (e.g., reduction in carbon emissions, at its portfolio company).¹³⁸

Key Provisions of the Proposed Names Rule

General Observations

The SEC noted in the Proposed Names Rule's preamble that the rule is intended to further address potentially deceptive or misleading registered fund names, especially in the growing ESG funds space, as well as in response to other recent developments. According to the SEC, names are an important marketing tool for funds, and investors

¹³⁴ 87 Fed. Reg. 36691, ¶ 156.

¹³⁵ Securities & Exchange Commission, "The Division of Examinations' Review of ESG Investing," Risk Alert (Apr. 9, 2021), available at <https://www.sec.gov/files/esg-risk-alert.pdf>.

¹³⁶ 87 Fed. Reg. 36696-36697.

¹³⁷ 87 Fed. Reg. 36697.

¹³⁸ Id.

often rely heavily on the names of funds in making investment decisions.¹³⁹ We note that the Proposed Names Rule would not apply to private fund names.

Regulations and Forms Modified

The Proposed Names Rule would expand the scope of Rule 35d-1 under the '40 Act, a rule originally adopted in 2001 to prohibit “materially deceptive and misleading” registered fund names.¹⁴⁰ Currently, under Rule 35d-1, if a fund’s name suggests investment in a particular type of investment or investments, investments in a particular industry or industries or “in certain countries or geographic regions,” at least 80% of the fund’s assets must be invested in accordance with the suggested focus of its name (“80% Investment Policy Requirement” and “80% Investment Policy”).¹⁴¹ Under the Proposed Names Rule, the SEC seeks to broaden the scope of Rule 35d-1 to apply to fund names that “suggest an investment focus,” such as names including terms suggesting that the fund focuses in investments that have, or whose issuers have, particular characteristics, among other changes. The proposed changes to Rule 35d-1 would apply to all registered funds, although there is a limited exception for UITs.¹⁴²

Additionally, the Proposed Names Rule would add disclosure and reporting requirements to the prospectuses of open-end funds, closed-end funds, and UITs, as well as to Form N-PORT (the monthly reporting form for registered funds other than money market funds and small business investment companies).¹⁴³

Compliance Date

If finalized, all aspects of the Proposed Names Rule would take effect one year after adoption. The SEC plans to withdraw some previous no-action letters and other staff

¹³⁹ 87 Fed. Reg. 36595.

¹⁴⁰ 17 CFR 270.35d-1; 15 U.S.C. § 80a-34(d).

¹⁴¹ Id. Note that the current Rule 35d-1 also covers fund names suggesting guarantee or approval by the U.S. government and those suggesting tax exempt status. Id. The SEC previously published a request for comment regarding several aspects of Rule 35d-1, including non-ESG issues, in 2020 (during the previous administration). This previous request for comment sought feedback from the public regarding how to best prevent funds from using deceptive and misleading investment names, including alternatives to Rule 35d-1; whether the Rule 35d-1 should be applied to ESG funds; whether the 80% threshold is appropriate; whether notice requirements should be modified; and how Rule 35d-1 should address the use of derivatives by funds. See 85 Fed. Reg. 13221 (2020).

¹⁴² The Proposed Names Rule does not apply to UITs that made initial deposit of securities prior to the final rule amendments’ effective date, unless the UIT had already adopted a fundamental policy under the Proposed Names Rule or was required to adopt such a policy at the time of initial deposit. See Proposed 17 CFR 270.35d-1(f), 87 Fed. Reg. 36594.

¹⁴³ Securities & Exchange Commission, “Form N-PORT,” Form, available at <https://www.sec.gov/files/formn-port.pdf>.

statements relating to Rule 35d-1 upon the Proposed Names Rule's adoption; additionally, interested parties may request that additional guidance be withdrawn.¹⁴⁴

Updates to the 80% Investment Policy Requirement

To update the 80% Investment Policy Requirement, the Proposed Names Rule would add and amend provisions relating to: (1) names "suggesting an investment focus" (a new category of funds that would be covered under Rule 35d-1), (2) calculations of the "80% basket" under the 80% Investment Policy Requirement, (3) temporary departures from the 80% Investment Requirement, (4) fundamental policy and notice requirements, (5) recordkeeping requirements, and (6) the lack of a safe harbor under Rule 35d-1 for compliance with the 80% Investment Rule. This Debevoise In-Depth focuses on the Proposed Names Rule's amendments that would affect funds with names suggesting an investment focus, although we note that many of the proposed changes would also expand the requirements for funds with names suggesting tax exempt status.¹⁴⁵

Names Suggesting an Investment Focus

The Proposed Names Rule would add a new category of potentially deceptive or misleading fund names subject to the 80% Investment Policy Requirement: "names suggesting an investment focus." This new category would encompass the existing categories covered by the current version of Rule 35d-1 (*i.e.*, names suggesting that the fund focuses its investments in particular types of investments or industries, and in particular countries or geographic regions). Additionally, the new category would include fund names suggesting "investments that have, or whose issuers have, particular characteristics (*e.g.*, a name with terms such as "growth" or "value," or terms indicating that the fund's investment decisions incorporate one or more ESG factors").¹⁴⁶

In the preamble of the Proposed Names Rule, the SEC clarified that examples of names that may suggest a particular investment focus include "growth," "value," "sustainable,"

¹⁴⁴ 87 Fed. Reg. 36621. Guidance that the SEC may consider withdrawing include a FAQ regarding Rule 35d-1, a letter to the Investment Company Institute in 2003 regarding the rule, and a November 2013 guidance update. See Securities & Exchange Commission, "Division of Investment Management, Frequently Asked Questions about Rule 35d-1(Investment Company Names)," FAQ (Dec. 04, 2021), available at <https://www.sec.gov/divisions/investment/guidance/rule35d-1faq.htm>; Securities & Exchange Commission, Division of Investment Management, "Division of Investment Management: Letter to Investment Company Institute," Letter (Oct. 17, 2003), available at <https://www.sec.gov/divisions/investment/guidance/tyl101703.htm>; Securities & Exchange Commission, Division of Investment Management, "IM: Guidance Update," Update (Nov. 2013), available at <https://www.sec.gov/divisions/investment/guidance/im-guidance-2013-12.pdf>.

¹⁴⁵ Proposed 17 CFR 270.35d-1(a)(3), 87 Fed. Reg. 36649. Note that the Proposed Names Rule would also continue to cover fund names suggesting guarantee or approval by the U.S. government. See Proposed 17 CFR 270.35d-1(a)(1), 87 Fed. Reg. 36649.

¹⁴⁶ Proposed 17 CFR 270.35d-1(a)(2), 87 Fed. Reg. 36649.

“global,” “international,” “income,” and “intermediate term (or similar) bond.” Names that reference the characteristics of the fund’s overall portfolio (e.g., the fund is “balanced”), or particular investment techniques that do not suggest a focus in a particular type of investment (e.g., “long/short”; “real return”), would be less likely to suggest an investment focus.¹⁴⁷ As with the Proposed ESG Disclosure Rule, the SEC declined to propose definitions of the terms “environmental,” “social,” or “governance,”¹⁴⁸ although the SEC did clarify in the preamble of the Proposed Names Rule that, for the purposes of the proposal, “the term ‘ESG’ encompasses terms such as “socially responsible investing,’ ‘sustainable,’ ‘green,’ ‘ethical,’ ‘impact,’ or ‘good governance’ to the extent they describe environmental, social, and/or governance factors that may be considered when making an investment decision.”¹⁴⁹

The Proposed Names Rule also contains the following important clarifications:

- While funds are generally afforded flexibility to use reasonable definitions of the fund’s name, any terms used that suggests a particular investment must be consistent with those terms’ “plain English meaning or established industry use,¹⁵⁰ and
- The use of ESG terms in an integration fund’s name suggesting that the fund’s investment decisions incorporate one or more ESG factors would be “materially deceptive and misleading.”¹⁵¹ Because integration funds, by definition, do not consider ESG factors to a greater extent than non-ESG factors in their investment selection process, the use of ESG terms in these funds’ names would suggest an improperly inflated significance of ESG considerations in the fund’s strategy.¹⁵²

The SEC requests comment on whether its proposed approach toward funds with names suggesting investment focuses, including ESG funds, is appropriate.¹⁵³ With respect to ESG fund names, the SEC also asks several questions, including whether the 80% Investment Policy Requirement should apply to ESG-related funds at all,¹⁵⁴ and

¹⁴⁷ 87 Fed. Reg. 36599-36600.

¹⁴⁸ Proposed 17 CFR 270.35d-1(g)(4), 87 Fed. Reg. 36650.

¹⁴⁹ 87 Fed. Reg. 36598, n. 32.

¹⁵⁰ Proposed 17 CFR 270.35d-1(a)(2)(iii), 87 Fed. Reg. 36649. Note that this “plain English” requirement also applies to fund names suggesting tax exempt status. *Id.*, Proposed 17 CFR 270.35d-1(a)(3)(ii), 87 Fed. Reg. 36649.

¹⁵¹ Proposed 17 CFR 270.35d-1(d), 87 Fed. Reg. 36650. Note that, although the SEC does not define “integration fund” in the Proposed Names Rule, the description used in the Proposed Names Rule matches the definition of “integration fund” used in the Proposed ESG Disclosure Rule. *Id.*

¹⁵² For example, if a fund name includes the word “sustainable,” but other non-sustainability considerations are driving investment selections, then such a fund name would be misleading. 87 Fed. Reg. 36613-36614.

¹⁵³ 87 Fed. Reg. 36600, ¶ 1; 87 Fed. Reg. 36614, ¶ 63.

¹⁵⁴ 87 Fed. Reg. 36601, ¶ 4.

whether, alternatively, integration funds should be able to use ESG terms, as long as the funds identify themselves as integration funds.¹⁵⁵ Additionally, the SEC asks whether the use of ESG terminology should be further limited or correspond to a certain investment focus.¹⁵⁶

Calculations of the “80% Basket”

In the preamble to the Proposed Names Rule, the SEC provides guidance with respect to calculating the “80% basket” for the purposes of the 80% Investment Policy Requirement, although the SEC notes that the calculations may be “context-specific.”¹⁵⁷

For example, if a fund’s name suggests an investment focus that has multiple elements, the fund’s 80% basket must include investments that address all of the elements in the name (e.g., the “ABC Wind and Solar Power Fund” should have both wind and solar investments).¹⁵⁸ Additionally, the SEC notes in the preamble of the Proposed Names Rule that a fund of funds, or other acquiring fund, could include the entire value of its investment in an appropriate acquired fund when calculating the 80% basket (e.g., the “XYZ Industrials Fund” could count the entire value of its investment in “ABC Automotive Fund” in its 80% basket, provided that the “ABC Automotive Fund” has an 80% Investment Policy in an industrial sector or subsector).¹⁵⁹

The Proposed Names Rule also includes provisions regarding the calculation of the 80% basket for funds with derivatives investments.¹⁶⁰ Funds may include in the basket any derivative that provides investment exposure to investments suggested by the fund’s name or provides investment exposure to one or more of the market risk factors associated with investments suggested by the fund’s name.¹⁶¹ For the purposes of calculating the 80% basket, the derivatives investment exposure would be measured in notional value, not market value.¹⁶² In the preamble, the SEC provides substantial guidance regarding these calculations.

¹⁵⁵ 87 Fed. Reg. 36614, ¶ 64.

¹⁵⁶ 87 Fed. Reg. 36615, ¶ 65.

¹⁵⁷ Note that the Proposed Names Rule would define the term “80% basket,” which is currently not defined in Rule 35d-1, to mean “investments that are invested in accordance with the investment focus that the fund’s name suggests” in accordance with the Proposed Names Rule. See Proposed 17 CFR 270.35d-1(g)(1), 87 Fed. Reg. 36650.

¹⁵⁸ 87 Fed. Reg. 36600.

¹⁵⁹ Id.

¹⁶⁰ The Proposed Names Rule defines a derivatives instrument as “any swap, security-based swap, futures contract, forward contract, option, any combination of the foregoing, or any similar instrument.” See Proposed 17 CFR 270.35d-1(g)(3), 87 Fed. Reg. 36650.

¹⁶¹ Proposed 17 CFR 270.35d-1(b)(2), 87 Fed. Reg. 36649.

¹⁶² Proposed 17 CFR 270.35d-1(g)(2), 87 Fed. Reg. 36650.

Some issues on which the SEC requests comment include its approach to calculating the “80% basket” on the fund’s assets, including whether additional guidance would be helpful for funds to reasonably determine which investments qualify for their 80% basket, whether reasonable alternatives should be considered, and if specific requirements should be adopted with regards to the portion of funds excluded from the 80% basket.¹⁶³ The SEC also asked whether its approach to derivatives calculations is appropriate or whether the agency should consider reasonable alternatives.¹⁶⁴

Temporary Departures from the 80% Investment Requirement

According to the current Rule 35d-1, a fund’s investment policy must apply “under normal circumstances” and “at the time a fund invests its assets,” but does not include any additional specifications.¹⁶⁵ The Proposed Names Rule would therefore specify the circumstances in which funds are allowed to depart temporarily from the 80% requirement. Firms may temporarily depart from the requirement: (1) in response to market fluctuations that cause the fund’s temporary departure from compliance; (2) to address unusually large cash inflows or unusually large redemptions; (3) to take a position in cash and cash equivalents or government securities to avoid a loss in response to adverse market, economic, political, or other conditions; or (4) to reposition or liquidate a fund’s assets in connection with a reorganization, to launch the fund, or when notice of a change in the fund’s 80% Investment Policy has been provided to fund shareholders at least 60 days before the change.¹⁶⁶

The proposal requires funds that drift away from the 80% Investment Policy Requirement to bring their investments back into compliance “as soon as reasonably practicable.” In most circumstances, the maximum duration of departure would be 30 days, other than in the case of a fund launch¹⁶⁷ (180 consecutive days) or reorganization (no proposed time frame). By stipulating the nature and scope of temporary departures from the 80% Investment Policy Requirement, the proposed amendment seeks to ensure that funds stay within investor expectations and reduce the possibility for investors to be materially misled or deceived.¹⁶⁸

The SEC asked several questions on whether its approach towards temporary departures was appropriate. Of note, the SEC asked whether exceptions for market fluctuations, unusually large cash flows, and temporary defensive positions should be limited to 30

¹⁶³ 87 Fed. Reg. 36600-36602, ¶¶ 1-15.

¹⁶⁴ 87 Fed. Reg. 36608-36609, ¶¶ 32-43.

¹⁶⁵ 17 CFR 270.35d-1(a)-(b).

¹⁶⁶ Proposed 17 CFR 270.35d-1(b)(1)(i)-(iv), 87 Fed. Reg. 36649. See also 87 Fed. Reg. 36602.

¹⁶⁷ The Proposed Names Rule would define “launch” as “a period, not to exceed 180 consecutive days, starting from the date the fund commences operations.” Proposed 17 CFR 270.35d-1(g)(7), 87 Fed. Reg. 36650.

¹⁶⁸ 87 Fed. Reg. 36602.

days (as proposed),¹⁶⁹ whether the proposed 30-day time limit is appropriate (or whether the board should instead approve, or be notified of, departures from the time period past 30 days),¹⁷⁰ and whether the time limit raised compliance concerns for funds.¹⁷¹

Fundamental Policy and Notice Requirements

To use a name suggesting an investment focus, closed-end funds and BDCs would be required to adopt fundamental policies¹⁷² that reflect the 80% Investment Policy Requirement;¹⁷³ other funds, such as open-end funds and ETFs, may continue to either adopt fundamental policies or provide at least 60 days prior notice of a change in investment policy that complies with the requirements.¹⁷⁴

Although the Proposed Names Rule would generally retain the character of the notice requirement,¹⁷⁵ it would further specify that notices must include:

- the fund's fundamental policy that was adopted under the Proposed Names Rule,
- the nature of the change to the policy,
- the fund's old and new names, and
- the effective date of any policy and/or name changes.¹⁷⁶

The SEC requests comment on whether the 80% investment requirement should be expanded to other types of funds and whether the proposed rule is less applicable to

¹⁶⁹ 87 Fed. Reg. 36604, ¶ 17.

¹⁷⁰ 87 Fed. Reg. 36604-36605, ¶ 24.

¹⁷¹ 87 Fed. Reg. 36605, ¶ 25.

¹⁷² For open-end and closed-end funds, the Proposed Names Rule would use the definition of fundamental policy under Section 8(b)(3) of the '40 Act (law regarding registration statements). For BDCs, the term "fundamental policy" would be defined under the Proposed Names Rule as a policy that is "changeable only if authorized by the vote of a majority of the outstanding voting securities of the fund." See Proposed 17 CFR 270.35d-1(g)(6), 87 Fed. Reg. 36650. The term "fundamental policy" was not previously defined in Rule 35d-1.

¹⁷³ Currently, closed-end funds may also provide at least 60 days prior notice of a change in investment policy that complies with the requirements. See 17 CFR 270.35d-1(2)(ii), (3)(ii). This option would no longer be allowed under the Proposed Names Rule. The SEC noted in the preamble that, since closed-end funds and BDC investors have limited exit options, the Proposed Names Rule would help ensure that investors could vote on changes in investment policy. See 87 Fed. Reg. 36609-36610.

¹⁷⁴ Proposed 17 CFR 270.35d-1(a)(2)(ii), 87 Fed. Reg. 36649.

¹⁷⁵ Notices provided in accordance with the Proposed Names Rule must be provided in plain English separately from other documents and contain a "prominent statement" of the notice, as required under the current Rule 35d-1. See Proposed 17 CFR 270.35d-1(e)(1)-(2), 87 Fed. Reg. 36650. However, the Proposed Names Rule would update this notice requirement to account for electronic delivery and other industry-wide changes. See Proposed 17 CFR 270.35d-1(e)(1)-(2)(ii), 87 Fed. Reg. 36650.

¹⁷⁶ Proposed 17 CFR 270.35d-1(e)(3), 87 Fed. Reg. 36650.

some unlisted closed-end funds and BDCs.¹⁷⁷ With respect to the notice requirement, the SEC requests comment on whether it is appropriate to require notices to describe a change to the fund's name, whether the 60-day notice period is sufficient and appropriate, and whether funds should be afforded greater flexibility to ensure shareholders are alerted about changes to a fund's investment policy.¹⁷⁸

Recordkeeping

The Proposed Rule would add additional recordkeeping requirements for all funds.

Funds that are not required to adopt an 80% Investment Policy, including funds that do not have names suggesting investment focuses, must create a written record of the fund's analysis that a fundamental policy is not required. This record must be maintained in an easily accessible place for a period not less than six years after the fund's last use of its name.¹⁷⁹

Funds that are required to adopt an 80% Investment Policy, including funds that have names that suggest investment focuses, must create a written record of compliance and maintain such records for a period of at least six years after the creation of the records.¹⁸⁰ Such records must include:

- the fund's record of which investments are included in the fund's 80% basket and the basis for including each such investment in the fund's 80% basket,
- the value of the fund's 80% basket as a percentage of the total value of the fund's assets,
- for temporary departures discussed earlier in this Debevoise In-Depth: the reasons for the departure and the dates of the departures, and
- any notices sent regarding changes in the fund's investment policy under the Proposed Names Rule.¹⁸¹

The SEC requests comments on whether the proposed recordkeeping requirement is appropriate, and whether there are additional types of records that should be required for funds that must adopt an 80% investment policy.¹⁸²

¹⁷⁷ 87 Fed. Reg. 36610, ¶¶ 45-46.

¹⁷⁸ 87 Fed. Reg. 36616-36617, ¶¶ 66-73.

¹⁷⁹ Proposed 17 CFR 270.35d-1(b)(3), 87 Fed. Reg. 36649-36650.

¹⁸⁰ Id.

¹⁸¹ Id.

¹⁸² 87 Fed. Reg. 36619, ¶¶ 84-85.

No Safe Harbor for Compliance with the 80% Investment Policy

The Proposed Names Rule would caution that a fund name may still be “materially deceptive or misleading,” and in violation of Rule 35d-1, even if the fund adopts a fundamental policy in accordance with the 80% Investment Policy; in other words, there is no safe harbor.¹⁸³ For example, a “fossil fuel-free” fund could comply with the 80% Investment Policy Requirement, but still have a deceptive fund name if a substantial portion of the remaining 20% of investments are invested in fossil fuel issuers.¹⁸⁴

The SEC requests comments on whether it should more explicitly codify the lack of safe harbor in connection with compliance with the 80% Investment Policy,¹⁸⁵ and whether, alternatively, the SEC should require certain funds to invest a greater percentage of their assets in the investments suggested by the fund’s name.¹⁸⁶

Disclosure Requirements

The Proposed Rule would add disclosure and reporting requirements, including in fund prospectuses for open-end funds (Form N-1A),¹⁸⁷ closed-end funds (Form N-2),¹⁸⁸ and UITs (Form N-8B-2),¹⁸⁹ as well as on Form N-PORT. Notably, there are no additional reporting changes for money market funds or BDCs.¹⁹⁰

Prospectus Disclosure Defining Terms Used in Fund Name

For open-end funds, closed-end funds, and UITs, the proposal would require a fund to disclose in its prospectus the definition of the terms used in the fund name, including any word or phrase used in the fund’s name, other than any trade name of the fund or its adviser, related to the fund’s investment focus or strategy. This disclosure would also include the specific criteria the fund uses to select the investments that the term describes, if any.¹⁹¹

Additionally, the Proposed Names Rule would amend Item 4 of Form N-1A (Investments, Risks, and Performance) to require a fund to summarize how the fund intends to achieve its investment objectives identified in Item 9(b) (Implementation of Investment Objectives), as well as any policy to concentrate in securities of issuers in a

¹⁸³ Proposed 17 CFR 270.35d-1(c), 87 Fed. Reg. 36650.

¹⁸⁴ 87 Fed. Reg. 36610.

¹⁸⁵ 87 Fed. Reg. 36611, ¶ 49.

¹⁸⁶ Id., ¶ 51.

¹⁸⁷ Securities & Exchange Commission, “Form N-1A,” available at <https://www.sec.gov/files/formn-1a.pdf>.

¹⁸⁸ Securities & Exchange Commission, “Form N-2,” available at <https://www.sec.gov/files/formn-2.pdf>.

¹⁸⁹ Securities & Exchange Commission, “Form N-8B-2,” available at <https://www.sec.gov/files/formn-8b-2.pdf>.

¹⁹⁰ As with the Proposed ESG Funds Rule, these forms must be filed in accordance with Rule 405 of Regulation S-T. See Proposed 17 CFR 232.405, 87 Fed. Reg. 36647.

¹⁹¹ Proposed 17 CFR 274 (Form N-1A (Instruction to Amended Item 4(a)(1)), Form N-2 (Instruction 2 to Item 8), Form N-8B-2 (Instruction 2 to Section II.11)), 87 Fed. Reg. 36650-36651.

particular industry or group of industries.¹⁹² Closed-end funds would receive an additional instruction on Item 8 of Form N-2 (General Description of the Registrant), which would (1) define “concentration” (for the purposes of the item) as 25% or more of the value of the Registrant’s total assets invested or proposed to be invested in a particular industry or group of industries, and (2) note that the fund’s policy on concentration should not be inconsistent with the registrant’s name.¹⁹³ Finally, UITs would be required to “briefly describe the kind or type of securities comprising the unit of specified securities in which security holders have interest” on Form N-8B-2.¹⁹⁴

Though the current Rule 35d-1 requires funds suggesting investment in particular countries or geographic areas to make prospectus disclosures about the terms used in the fund’s names and specific criteria to select investments, the Proposed Names Rule proposes an expansion of this requirement as a way to codify an already common practice among funds subject to the 80% investment policy.¹⁹⁵ As with the Proposed Names Rule’s other changes to Rule 35d-1, funds must use terms that are consistent with the plain English meaning or established industry use.¹⁹⁶

The SEC requests comment on several issues, including whether the proposed new instructions in fund registration forms are appropriate and clear, as well as whether it would be helpful and appropriate to revise the instructions that a fund use reasonable definitions of the terms used in its name, among other questions.¹⁹⁷

Form N-PORT Reports

The Proposed Names Rule adds new items for funds required to comply with the 80% Investment Policy Requirement. In a new Item B.9, funds with names suggesting an investment focus must disclose: (1) the value of the fund’s 80% basket and (2) the number of days that the value of the fund’s 80% basket fell below 80% of the value of the fund’s assets during the reporting period.¹⁹⁸ If a fund is required to adopt a policy as a fund with names suggesting an investment focus, the fund must answer a “yes or no” question on whether the investment is included in the fund’s 80% basket.¹⁹⁹

¹⁹² Proposed 17 CFR 274 (Form N-1A (Amended Item 4(a)(1))), 87 Fed. Reg. 36650.

¹⁹³ Proposed 17 CFR 274 (Form N-2 (Instruction 1 to Item 8)), 87 Fed. Reg. 36651.

¹⁹⁴ Proposed 17 CFR 274 (Form N-8B-2 (Section II.11)), 87 Fed. Reg. 36651. Note that this would be limited to only issuers that derived more than 15% of their gross revenues from the business of a broker, dealer, underwriter, or investment adviser during the most recent fiscal year. See Proposed 17 CFR 274 (Form N-8B-2 (Instruction 1 to Section II.11)), 87 Fed. Reg. 36651.

¹⁹⁵ 87 Fed. Reg. 36611-36612.

¹⁹⁶ 87 Fed. Reg. 36613.

¹⁹⁷ 87 Fed. Reg. 36613, ¶¶ 58-59.

¹⁹⁸ Proposed 17 CFR 274 (Proposed Form N-PORT (Item B.9)), 87 Fed. Reg. 36651. Note that this change would also affect funds with names suggesting tax-exempt status.

¹⁹⁹ *Id.*

The SEC requests comments on whether the proposed requirement that funds report whether each portfolio investment is included in the fund's 80% basket is appropriate and if the proposed requirement should be modified in any way.²⁰⁰ Further, the SEC requests comments on whether there is any reason why the information that a fund would report in response to the proposed requirement should not be made public, as the proposed requirement would make said information public.²⁰¹

Other Regulatory, Examination, and Enforcement Activity

Prior SEC Rulemaking and Guidance on Climate and ESG Issues

Over the past year, the SEC has proposed several changes that would significantly alter how issuers disclose key ESG-related information. In addition to the Proposed ESG Rule and the Proposed Fund Names Rule, the SEC proposed climate-related disclosure requirements for registrants, including public companies, in its Proposed Climate Disclosure Rule, released in March 2022.²⁰²

The Proposed Climate Disclosure Rule seeks to provide investors with “consistent, comparable, and decision-useful information” by adding disclosure requirements to Regulation S-K (which primarily governs qualitative disclosures), and Regulation S-X (which governs financial statements). In general, these disclosures would address various climate-related risks to the registrant's business, operations, and financial condition, including disclosure of a registrant's greenhouse gas emissions. The Proposed Climate Disclosure rule draws heavily from two sources: (1) the TCFD, which has developed a climate-related reporting framework that is familiar to many registrants and investors, and (2) the Greenhouse Gas Protocol, which the SEC identifies as the leading accounting and reporting standard for GHG emissions.²⁰³ The proposal is amongst the lengthiest and most impactful changes in the SEC's history. In the short time since it has been proposed, it has garnered significant attention across the political and business spheres, and it is expected to face legal challenges²⁰⁴

²⁰⁰ 87 Fed. Reg. 36618, ¶ 81.

²⁰¹ 87 Fed. Reg. 36619, ¶ 83.

²⁰² 87 FR 21334 (2022). For the Debevoise In-Depth discussing the Proposed Climate Disclosure Rule, see Debevoise In-Depth, “An In-Depth Review of the SEC Proposed Climate Change Disclosure Rule” (Apr. 25, 2022), available at <https://www.debevoise.com/insights/publications/2022/04/sec-issues-long-awaited-proposed-climate-change>.

²⁰³ Id.

²⁰⁴ See Wall Street Journal, Paul Kiernan, “SEC Floats Mandatory Disclosure of Climate-Change Risks, Emissions” (March 21, 2022), available at https://www.wsj.com/articles/sec-to-float-mandatory-disclosure-of-climate-change-risks-emissions-11647874814?mod=Searchresults_pos13&page=3.

The SEC previously provided guidance on climate disclosures in 2010 through its “Commission Guidance Regarding Disclosure Related to Climate Change,” which provided initial clarification about how the SEC’s existing disclosure requirements under Regulation S-K apply to climate change matters.²⁰⁵ Over a decade later, in March 2021, the SEC requested public input on issues relating to climate change disclosures,²⁰⁶ which informed the rulemaking process for the Proposed Climate Disclosure Rule.

In addition, in September 2021, the SEC sent requests for additional climate and ESG information to a number of public companies,²⁰⁷ while simultaneously releasing a “Sample Letter to Companies Regarding Climate Change Disclosures,” which served as an example of a potential request for information from the agency to public companies regarding their climate-related disclosure or the absence of such disclosure.²⁰⁸

Recent ESG-Related Examination and Enforcement Activity

In addition to contributing to the Proposed ESG Rule, the SEC’s Division of Examinations regularly reviews filings and disclosures of registered investment advisers and registered funds. The Division also conducts examinations of these registrants to ensure, among other requirements, that registrant disclosures are complete and accurate; as part of these exams, the division reviews investment advisers’ and companies’ offers, recommendations, and advertisements of ESG products. In April 2021, the Division released a risk alert on ESG investing, which reported deficiencies relating to registered investment advisers’ and funds’ portfolio management practices, performance advertising and marketing, and compliance programs regarding their ESG investment strategies and products.²⁰⁹ The following year, the SEC’s 2022 published Examinations Priorities document listed ESG investing by advisers and funds as one of the agency’s priority examination areas,²¹⁰ and stated that the SEC intends to especially scrutinize

²⁰⁵ See Securities & Exchange Commission, “Commission Guidance Regarding Disclosure Related to Climate Change” (Feb. 8, 2010), available at <https://www.sec.gov/rules/interp/2010/33-9106.pdf>; the 2010 guidance was subsequently reiterated in a January 2020 statement by then-SEC Chairman Jay Clayton. See Securities & Exchange Commission, Jay Clayton, “Statement on Proposed Amendments to Modernize and Enhance Financial Disclosures ; Other Ongoing Disclosure Modernization Initiatives ; Impact of the Coronavirus ; Environmental and Climate-Related Disclosure” Statement, (Jan. 30, 2020), available at <https://www.sec.gov/news/public-statement/clayton-mda-2020-01-30>.

²⁰⁶ Securities & Exchange Commission, Allison Lee, “Public Input Welcomed on Climate Change Disclosures,” Speech (Mar. 15, 2021), available at <https://www.sec.gov/news/public-statement/lee-climate-change-disclosures>. This initiative, along with 2010 guidance informed the Proposed Rule.

²⁰⁷ See Kiernan, supra note 204.

²⁰⁸ Securities & Exchange Commission, “Sample Letter to Companies Regarding Climate Change Disclosures,” Sample Letter (Sep. 22, 2021), available at <https://www.sec.gov/corpfin/sample-letter-climate-change-disclosures>.

²⁰⁹ Securities & Exchange Commission, “The Division of Examinations’ Review of ESG Investing,” Risk Alert (Apr. 9, 2021), available at <https://www.sec.gov/files/esg-risk-alert.pdf>.

²¹⁰ Securities & Exchange Commission, “SEC Division of Examinations Announces 2022 Examination Priorities,” Press Release (Mar. 30, 2022), available at <https://www.sec.gov/news/press-release/2022-57>.

potential “greenwashing.” Notably, 2022 is the first year that ESG investing received a standalone section in the SEC’s Examination Priorities document, again indicating that the SEC is paying close attention to ESG-related investment products and strategies.

As further evidence of the SEC’s focus on ESG matters, the SEC’s Division of Enforcement formed the Climate and ESG Task Force in March 2021.²¹¹ In May 2022, the SEC charged a large investment adviser for alleged misstatements and omissions regarding the purported ESG considerations of some of the adviser’s funds.²¹² Additionally, in February 2022, the SEC settled an action against a robo-advisory firm for allegedly failing to adopt and implement written policies and procedures on how it would ensure compliance on an ongoing basis with its faith-based investment strategy, among other conduct.²¹³

These recent developments suggest a heightened focus on ESG in examination and enforcement activities in tandem with the rulemaking process for the new ESG-related rules.

Other Climate-Related Actions from U.S. Financial Regulators and International Organizations

In recent years, other U.S. financial regulators besides the SEC have also taken action relating to climate change. Some examples are below.

- In October 2021, the Financial Stability Oversight Council (“FSOC”) released a “Report on Climate-Related Financial Risk” (“FSOC Climate Report”).²¹⁴ The FSOC Climate Report (1) reviews current efforts by member institutions to incorporate climate-related financial risk into their regulatory and supervisory activities, (2) highlights associated data and methodological challenges, (3) discusses the role of disclosure, (4) addresses implications of these risks on financial stability, and (5) issues recommendations for itself, its members, and other regulatory bodies. The FSOC Climate Report also emphasizes the need for member agencies to develop

²¹¹ Securities & Exchange Commission, “SEC Announces Enforcement Task Force Focused on Climate and ESG Issues,” Press Release (Mar. 4, 2021), available at <https://www.sec.gov/news/press-release/2021-42>.

²¹² Namely, the investment adviser allegedly represented or implied in various statements that all investments in funds that the adviser sub-advised had undergone an ESG quality review, even though that was not always true. Securities & Exchange Commission, “SEC Charges BNY Mellon Investment Advisers for Misstatements and Omissions Concerning ESG Considerations,” Press Release (May 23, 2022), available at <https://www.sec.gov/news/press-release/2022-86>.

²¹³ In the Matter of Wahed, LLC, Investment Advisers Act Release No. 5959 (Feb. 10, 2022), available at <https://www.sec.gov/litigation/admin/2022/ia-5959.pdf>.

²¹⁴ See Debevoise In Depth, “FSOC and Federal Banking Agencies Move on Climate Change” (Oct. 26, 2021), available at <https://www.debevoise.com/insights/publications/2021/10/fsoc-and-federal-banking-agencies-move-on>.

“scenario analysis” tools to measure and predict risks across financial institutions arising from climate change.

- Also in October 2021, the Board of Governors of the Federal Reserve (“Federal Reserve”) announced that it was developing scenario analyses to model potential financial risks associated with climate change and to assess the resilience of both individual financial institutions as well as the financial system overall. Federal Reserve Governor Lael Brainard stated that she believes that scenario analysis “will be helpful to provide supervisory guidance for large banking institutions in their efforts to appropriately measure, monitor, and manage material climate-related risks, following the lead of a number of other countries.”²¹⁵
- On December 16, 2021, the Office of the Comptroller of the Currency (“OCC”) released for public comment its draft principles for the management of climate-related financial risk by OCC-supervised banking organizations with more than \$100 billion in total consolidated assets (“OCC Principles”).²¹⁶ The OCC Principles are intended to “provide a high-level framework” for climate risk management, and cover several areas, including corporate governance, policies and procedures, scenario analysis, and data reporting. Like the FSOC Climate Report, the OCC Principles also cover scenario analysis. The comment period for the OCC Principles closed in February 2022, and, later this year, the OCC is expected to issue more detailed guidance.²¹⁷
- On March 29, 2022, the Federal Deposit Insurance Corporation (“FDIC”) released its own set of climate principles, which are substantively similar to the OCC Principles.²¹⁸ Like the OCC Principles, the FDIC Principles also provide a framework for climate risk management for financial institutions with more than \$100 billion in

²¹⁵ Board of Governors of the Federal Reserve System, Lael Brainard, “Building Climate Scenario Analysis on the Foundations of Economic Research,” Speech (Oct. 7, 2021), available at <https://www.federalreserve.gov/newsevents/speech/brainard20211007a.htm>.

²¹⁶ See Debevoise In Depth, “OCC and Basel Committee Issue Separate Proposed Principles for the Management of Climate-Related Financial Risks,” Jan. 5, 2022, available at <https://www.debevoise.com/insights/publications/2022/01/occ-and-basel-committee-issue-separate>.

²¹⁷ Office of the Comptroller of the Currency, “Risk Management: Principles for Climate-Related Financial Risk Management for Large Banks; Request for Feedback,” OCC Bulletin, December 16, 2021, available at <https://www.occ.gov/news-issuances/bulletins/2021/bulletin-2021-62.html>.

²¹⁸ See Debevoise In Depth, “The FDIC, Following the OCC Last December, Issues Draft Principles for Climate-Related Financial Risk Management” (Apr. 6, 2022), available at <https://www.debevoise.com/insights/publications/2022/04/the-fdic-following-the-occ-last-december-issues>.

total consolidated assets, and both Principles cover the same topics.²¹⁹ The comment period for the FDIC Principles closed on June 3, 2022.²²⁰

Policy Considerations

The Proposed Rules both passed by a 3-1 vote, with Chair Gary Gensler and Commissioners Allison Herren Lee and Caroline Crenshaw voting in favor, with Commissioner Hester Peirce, the sole Republican commissioner, voting against.

We note that, on balance, and as compared to the Proposed Climate Disclosure Rule, the Proposed Rules are more measured in their introduction of new regulatory standards, and they contain some helpful guidance as to compliance.

Proposed ESG Rule

In general, commissioners supporting the Proposed ESG Rule positioned it as an opportunity to reduce greenwashing, improve information availability, and increase the reliability of disclosures in an industry perceived to be jargon-loaded and often unclear. In his statement supporting the Proposed ESG Rule, Chair Gensler explained that the term “ESG” encompasses a wide variety of investments and strategies, and that it “can be very difficult to understand what some funds mean when they say they’re an ESG fund.”²²¹ Therefore, investors should “have consistent and comparable disclosures about asset managers’ ESG strategies so they can understand what data underlies funds’ claims and choose the right investments for them.”²²² Relatedly, Commissioner Crenshaw noted that the rule is neutral with respect to the benefits or risks of ESG investing; instead, the SEC is interested in “in the reliability and sufficiency of adviser and fund disclosures to investors and in providing a consistent and coherent framework in which investors can make informed investment decisions.”²²³ Despite some critics’ concerns of regulatory overreach, Commissioner Lee stated her view that the Proposed ESG Rule

²¹⁹ The FDIC Principles differ from the OCC Principles only with respect to a few minor details in the introduction and requests for comment.

²²⁰ Federal Deposit Insurance Corporation, “Statement of Principles for Climate-Related Financial Risk Management for Large Financial Institutions” (Apr. 4, 2022), available at <https://www.fdic.gov/news/board-matters/2022/2022-03-29-notational-fr.pdf>.

²²¹ See e.g., Securities & Exchange Commission, Gary Gensler, “Statement on ESG Disclosures Proposal” (May 25, 2022), available at <https://www.sec.gov/news/statement/gensler-statement-esg-disclosures-proposal-052522>.

²²² *Id.*

²²³ Securities & Exchange Commission, Caroline Crenshaw, “Statement on Proposed Rule Requiring Enhanced Disclosure by Certain Investment Advisers and Investment Companies on ESG Investment Practices” (May 25, 2022), available at <https://www.sec.gov/news/statement/crenshaw-statement-esg-investment-practices-052522> (“In proposing today’s rule, the Commission is not weighing in on the advisability of ESG investing, or second-guessing the investment strategies of managers and funds. Rather, the proposal seeks to align investor expectations with manager practices through disclosure.”).

actually “goes to the heart of” the SEC’s mission, “which is to protect investors by promoting transparency and accountability around investment decision-making.”²²⁴

On the other hand, Commissioner Peirce strongly dissented from the Proposed Rule, saying she has “little faith” that the proposal will lead to more efficient capital allocation or greater investor wealth accumulation.²²⁵ Unlike Commissioner Crenshaw—who stated the proposal was ESG-neutral—Commission Peirce believes the rule is predicated on the assumption “today’s investor is driven by concern for environmental, social, and governance matters, not an anachronistic desire to earn returns on her hard-earned money.”²²⁶ Despite the focus on ESG investors, she highlights that the proposal “avoids explicitly defining E, S, and G, yet implicitly uses disclosure requirements to induce substantive changes in funds’ and advisers’ ESG practices.” While she criticizes the proposal’s ambiguity in some places, she also claims that the specific metrics required under the Proposed Rule regarding GHG Emissions disclosures are also problematic in their own right given the consistent lack of availability of the underlying data.

The mixed reaction to the Proposed ESG Rule carries over to the public realm as well. While some trade associations have supported the SEC’s efforts to combat greenwashing and misleading fund names,²²⁷ others have criticized the rule, calling it “unworkable.”²²⁸ Other potential concerns are that aspects of the Proposed ESG Rule, especially those relating to GHG emissions, may increase regulatory compliance costs for funds and advisers, which could, in turn, discourage funds from seeking ESG-related investments.²²⁹

²²⁴ Securities & Exchange Commission, Allison Herren Lee, “It’s Not Easy Being Green: Bringing Transparency and Accountability to Sustainable Investing” (May 25, 2022), available at <https://www.sec.gov/news/statement/lee-statement-esg-052522>; see also Securities & Exchange Commission, Caroline Crenshaw, “Statement on Proposed Rule Requiring Enhanced Disclosure by Certain Investment Advisers and Investment Companies on ESG Investment Practices,” supra note 223.

²²⁵ Securities & Exchange Commission, Hester Peirce, “Statement on Environmental, Social, and Governance Disclosures for Investment Advisers and Investment Companies” (May 25, 2022), available at <https://www.sec.gov/news/statement/peirce-statement-esg-052522>.

²²⁶ *Id.*

²²⁷ See, e.g., Wall Street Journal, Paul Kiernan, “SEC Proposes More Disclosure Requirements for ESG Funds” (May 25, 2022), available at <https://www.wsj.com/articles/sec-to-propose-more-disclosure-requirements-for-esg-funds-11653498000> (quoting a statement from the American Securities Association, a lobbying group that represents regional brokerage and financial services firms, stating that the group “supports efforts by the SEC to stop misleading and deceptive marketing gimmicks surrounding ESG funds”).

²²⁸ Bloomberg, Lydia Beyoud and Saijel Kishan, “SEC Plan for Funds to Track Pollution Is ‘Unworkable,’ ICI Says” (May 26, 2022), available at <https://www.bloomberg.com/news/articles/2022-05-26/sec-s-esg-rule-proposal-criticized-by-key-fund-group#xj4y7vzkg>.

²²⁹ See, e.g., Law360, Al Barbarino, “SEC’s ESG Fund Plan Called ‘Very Weird,’ Too Prescriptive” (Jun. 06, 2022), available at <https://www.law360.com/articles/1499922/sec-s-esg-fund-plan-called-very-weird-too-prescriptive>.

Proposed Fund Names Rule

All three Commissioners who voted in favor of the proposal mentioned in their statements that the goal of the Proposed Fund Names Rule is to align fund names with investors' reasonable expectations based on those names,²³⁰ as "gaps in the current [Rule 35d-1] may undermine investor protection."²³¹ They also emphasized the timeliness of the proposed changes, given the dramatic changes to the fund industry since Rule 35d-1 was adopted in 2001, including the proliferation of ESG-labeled funds.²³²

Again, in contrast to the other three Commissioners, Commissioner Peirce did not support the proposal, outlining four main objections in her statement, specifically that: (1) the application of the 80% rule to names suggests that a fund that focuses on investments with "particular characteristics" (*i.e.*, ESG funds), will rely on subjective judgments; (2) the proposed amendments would "unduly constrain advisers' ability to make decisions that are best for the funds they manage"; (3) the "outright prohibition" on integration funds' ability to use ESG-related terms in their names could result in substantive changes in the way some funds are managed; and finally, (4) the proposed one-year implementation period is too short given the quantity of funds that may have to make adjustments to their portfolios or change their names.²³³

Like the Proposed ESG Rule, the Proposed Names Rule received comments both in support of and against it,²³⁴ although the majority of the attention appears to be focused on the Proposed ESG Rule, which would likely have a large impact, if adopted.

²³⁰ See, e.g., Securities & Exchange Commission, Allison Herren Lee, "What's in a Name? Aligning Fund Names with Investor Expectations" (May 25, 2022), available at <https://www.sec.gov/news/statement/lee-names-rule-statement-052522> ("Fund names, as with any type of branding, provide a critical means by which sponsors market their funds and convey information to investors, and today's proposal recognizes that investors may often rely on fund names in deciding where to invest their savings.").

²³¹ Securities & Exchange Commission, Gary Gensler, "Statement on Proposed Updates to Names Rule" (May 25, 2022), available at <https://www.sec.gov/news/statement/gensler-statement-proposed-updates-names-rule-052522>.

²³² See, e.g., Securities & Exchange Commission, Caroline Crenshaw, "A Rose By Any Other Name: Statement on Proposed Amendments to the Names Rule" (May 25, 2022), available at <https://www.sec.gov/news/statement/crenshaw-statement-names-rule-052522> ("The amount of money in registered investment companies has tripled; ETFs, alternative strategy funds, and indexed products have become commonplace in the portfolios of everyday investors; ESG and sustainable investing has taken a prominence previously unseen; and thematic investing, such as by reference to block chain or cybersecurity is growing.").

²³³ Securities & Exchange Commission, Hester Peirce, "Statement on Investment Company Names" (May 25, 2022), available at <https://www.sec.gov/news/statement/peirce-fund-names-statement-052522>.

²³⁴ See, e.g., Financial Times, Patrick Temple-West and Stefania Palma, "SEC prepares to crack down on misleading ESG investment claims" (May 25, 2022), available at <https://www.ft.com/content/6fefdb2c-f72e-4e52-b95b-c0727aeb1a94>.

Suggested Next Steps for Registered Funds and Advisers

In addition to submitting to the SEC comment letters regarding the Proposed Rules, registered funds and advisers should consider a number of actions to support compliance with the new disclosure rules and decrease potential enforcement risk. The Proposed Rules, as well as other recent SEC actions, suggest that the agency is increasing regulatory scrutiny and enforcement activity regarding ESG matters.

Accordingly, we recommend that funds and advisers evaluate their current ESG disclosures for precision and consistency. To prevent allegations of greenwashing, funds and advisers should ensure that their ESG disclosures, as well as any other public materials and statements relating to ESG, are clear, accurate and tailored to advisers' specific business practices and investment strategies. Funds and advisers may wish to consider updating compliance policies and processes to specifically address the detailed requirements of the Proposed Rules, and, in the future, advisers may wish to exercise caution when deciding whether to market their funds as ESG funds or use names that may suggest ESG focuses.

We also recommend that funds and advisers allocate sufficient resources to ensure they remain apprised of substantial regulatory developments, including anticipated revisions to the Proposed Rules. Advisers' management and compliance personnel should be well informed on the registrants' specific ESG and climate-related actions. Finally, advisers may wish to engage with accounting firms, outside counsel and other third parties for purposes of training their teams, as operative ESG, climate governance and regulatory compliance necessitates a multifaceted, coordinated effort.

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Please do not hesitate to contact us with any questions.

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