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SEC Proposes ESG Disclosure Requirements for Investment Advisers and Investment Companies

The SEC proposals track EU requirements in certain respects, but differences in content and scope could leave advisory firms with increasingly complex compliance challenges.

Key Points:

- The proposal on ESG disclosures for investment advisers and registered investment companies would introduce requirements for advisers and registered funds that consider ESG factors in their investment processes to disclose more about those factors' role in investment decisions.
- The Names Rule proposal would extend the 80% investment policy requirement to registered funds with names that suggest the fund focuses on investments/issuers with particular ESG characteristics.
- Together, the proposals make the United States just the latest in a series of jurisdictions to establish sustainability disclosure regimes for investment products, increasing global compliance challenges.

On May 25, 2022, the US Securities and Exchange Commission (the SEC or the Commission) proposed rules that would require registered and exempt investment advisers (Advisers) as well as registered investment companies (Registered Funds) to provide standardized environmental, social, and governance (ESG) disclosures to their investors and the Commission (referred to herein as the ESG disclosures proposal). The SEC also proposed amendments to Rule 35d-1 (the Names Rule), which governs naming conventions for Registered Funds (referred to herein as the Names Rule proposal). The proposed rules, if adopted as proposed, would require information on the ESG factors that Advisers and Registered Funds consider in making investment decisions, as well as how those factors are used in the investment process.

Executive Summary

The ESG disclosures proposal would establish ESG-related disclosure requirements for Advisers and Registered Funds concomitant with the role ESG plays in the investment strategies of such regulated entities. For Advisers and Registered Funds that treat ESG factors similar to other investment considerations, the requirements would be brief. However, for Registered Funds that are focused on ESG or particular impacts, the disclosures would require prospectus disclosures and (in some cases)

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annual report disclosures to describe how the consideration of ESG factors is put into effect in Registered Funds' strategies. This includes particular greenhouse gas (GHG) metrics from any ESG-Focused Funds (as defined below) that consider environmental factors. Additionally, the proposed amendments to the Names Rule would expand the scope of the current 80% investment policy requirement to apply to any Registered Fund name that includes terms that suggest the fund focuses on investments that have, or whose issuers have, particular characteristics, as well as enhance related disclosure, reporting, and record-keeping requirements.

The proposed US ESG disclosures are arriving hot on the heels of EU regulatory reforms that came into effect in 2021 to help provide investors with clarity on the ESG characteristics of financial products under the Sustainable Finance Disclosure Regulation (EU SFDR) and amendments coming into effect for investment advisers in August 2022 under the Markets in Financial Instruments Directive (MiFID). The US proposals are also running parallel to a regulatory agenda for ESG disclosures for financial products in the UK and other jurisdictions, though the regimes do not all share the same approach to methodology or content. As such, careful analysis of the different regimes may be necessary to determine how different jurisdictions' requirements align or diverge.

Advisory firms can start to prepare for the impacts of these proposals by: (1) assessing their current ESG posture relative to the proposals and (2) comparing regime requirements if they are looking to fundraise across multiple jurisdictions.

The Commission's proposing releases include approximately 200 specific comment requests on the ESG disclosures proposal and approximately 100 specific comment requests on the Names Rule proposal. Comments are due no later than 60 days after the proposing releases are published in the Federal Register, which we do not expect for at least a couple of weeks.

ESG Disclosure Requirements for Advisers

The disclosure requirements applicable to Advisers are generally similar to those that would be imposed on Registered Funds. The majority of such requirements would apply only to registered investment advisers, except for certain Form ADV Part 1A disclosure requirements described below.

Under the proposed rules, registered investment advisers would be required to add the following disclosures to their ADV Part 2A brochures if they consider ESG factors in connection with any significant investment strategy or method of analysis:

- a description of the ESG factor(s) considered and how they are incorporated into the adviser's investment recommendations;
- an explanation of whether and how the adviser employs ESG integration, ESG-focused strategies, or ESG impact strategies (definitions in keeping with how such Registered Funds are described below);
- if applicable, a description of any ESG criteria or methodology used in investment evaluation or selection;
- a description of any relationship or arrangement material to an adviser's business or clients that the adviser or its management persons have with any related person that is an ESG consultant or ESG service provider;

- for advisers with specific voting policies or procedures that include one or more ESG considerations, a description of those factors and how they are considered in voting client securities; and

- for advisers sponsoring wrap fee programs, an explanation of whether they review, or whether a third party reviews, portfolio mangers' application of relevant ESG factors and the nature of such review, or an affirmative statement that no such review occurs and an explanation of any limitations on calculation, assessment, or presentation of ESG factors as a result.

In general, if an adviser employs different ESG factors, criteria, etc. for different strategies, then those would have to be described separately.

Both registered and exempt advisers would also be required to disclose certain ESG-related information on Form ADV Part 1A. Registered advisers would be required to disclose their use of ESG factors and any third-party ESG frameworks used in connection with their advisory services. Both registered and exempt advisers would be required to provide information on whether they conduct other business activities as ESG service providers/consultants or have any related persons that are third-party ESG service providers/consultants.

ESG Disclosure Requirements for Registered Funds

The proposed rules would implement disclosure requirements for Registered Funds based on the centrality of ESG to a Registered Fund's investment strategy. Any Registered Funds except unit investment trusts (UITs), which are discussed below, that consider ESG factors in the investment process would be classified as either an "Integration Fund" or an "ESG-Focused Fund."

- **Integration Funds** are defined as Registered Funds that consider ESG factors in their investment selections but in which ESG factors are "generally no more significant than other factors in the investment selection process, such that ESG factors may not be determinative in deciding to include or exclude any particular investment in the portfolio."

- **ESG-Focused Funds** are defined as Registered Funds that have one or more ESG factors as a significant or main consideration in (1) investment selection or (2) engagement with the Registered Fund's portfolio companies. This would include any Registered Fund that markets itself (whether through its name or marketing materials) as having an ESG focus.

If an ESG-Focused Fund also focuses on achieving a specific impact (e.g., improving water quality, supporting affordable housing, etc.), then it would also be considered an "Impact Fund" and would be subject to additional requirements specific to Impact Funds.

Disclosures would be required in two main places: (1) a Registered Fund's prospectus and (2) its annual reporting, including on Form N-CEN as appropriate. Registered Funds would submit this information with Inline XBRL tags, consistent with existing requirements for such tagging.

Prospectus Requirements

The disclosures required in a Registered Fund's prospectus are meant to provide investors with a concise overview of the role ESG factors play in the Registered Fund's investment strategy.

Prospectus Requirements for Integration Funds

The proposed rules would require an Integration Fund to describe “in a few sentences” the ESG factors that the fund considers and incorporates them into its investment strategy. This disclosure is meant to be in addition to the information that Registered Funds are required to provide in the prospectus about their investments, risks, and performance. However, the Commission explicitly states that the ESG factors description is not meant to be extensive because the Commission does not want disclosures to overemphasize the role ESG factors play in such funds’ investment selection process.

Prospectus Requirements for ESG-Focused Funds

The proposed rules would require ESG-Focused Funds to provide more detailed disclosures on the use of ESG factors than is required of Integration Funds. The Commission has developed an “ESG Strategy Overview Table” that these funds would need to include with concise responses toward the front of their prospectus, with more detailed disclosures provided later in the body of the prospectus.

The ESG Strategy Overview Table consists of three main sections:

1. **Overview of the Registered Fund’s ESG strategy** — A concise description (in a few sentences) of the factor(s) that are the focus of the Registered Fund’s strategy. This section also includes a list of common ESG strategies; the Registered Fund would be required to indicate whether it uses any of the strategies by checking the appropriate boxes, with the exception of the proxy/engagement boxes. For those strategies, Registered Funds would only need to check the box if such voting or engagement were a “significant means” of implementing their strategy.

2. **How the Registered Fund Incorporates ESG factors in its Investment Decisions** — An overview of the Registered Fund’s strategy for incorporating ESG factors, including specific information for each strategy that the Registered Fund indicated it uses in the overview section (except for proxy/engagement, which is the subject of the third section). For example, Registered Funds using inclusionary or exclusionary screens would be required to identify the factors applied by the screen, any exceptions, the percentage of the portfolio to which the screen applies, as well as an explanation if that applicable percentage is less than 100%. Similarly, Registered Funds that indicate that they track an ESG index would be required to identify the index and briefly describe it and how it uses ESG factors.

   For virtually all of these items, the Commission indicates that more detailed descriptions are warranted later in the prospectus. The Commission gives an example of a Registered Fund with the objective of contributing to positive societal impact aligned to the UN Sustainable Development Goals (SDGs). In the table, the Registered Fund might state that it pursues this objective “by limiting the fund’s investments to companies that contribute to at least one of those goals.” But the Commission indicates that such a Registered Fund should “disclose later in its prospectus more information about any UN SDG goal on which the fund focuses and how the fund determines that a portfolio company contributes to that goal.”

3. **How the Registered Fund Votes Proxies and/or Engages with Portfolio Companies about ESG issues** — Registered Funds that indicate proxy voting or company engagement as a significant means of implementing their ESG strategy would be required to provide a brief narrative overview of how the Registered Fund engages with portfolio companies on ESG issues. The Registered Fund would also be required to identify whether it has specific or supplemental voting policies or procedures that include one or more ESG considerations for

portfolio companies and, if so, state what ESG considerations they address. If a Registered Fund engages with portfolio companies beyond voting proxies, then it would be required to disclose an overview of the objectives of the engagement strategy. If the Registered Fund does not engage or expect to engage with issuers on ESG issues beyond its approach to voting proxies, it would be required to affirmatively state so.

Similarly, Registered Funds that do not indicate proxy voting or company engagement as a significant part of their ESG strategy would still be required to include this section and affirmatively state so.

Additional Prospectus Requirements for Impact Funds

As noted above, the proposed rules consider Impact Funds a subset of ESG-Focused Funds. As such, Impact Funds would be required to provide the disclosures discussed above in addition to certain information specific to Impact Funds.

The main additions are to the “How the Fund Incorporates ESG factors in its Investment Decisions” section of the required table. In addition to the ESG-Focused Fund disclosures, an Impact Fund would also have to provide an overview of the impact(s) the fund is seeking to achieve and how it is seeking to achieve such impact(s). Specifically, the overview would have to include:

- how the fund measures progress toward the specific impact (including pertinent key performance indicators (KPIs) that the fund analyzes);
- the time horizon the fund uses to analyze progress; and
- the relationship between the impact(s) the fund is seeking to achieve and financial return(s).

Impact Funds would also be required to disclose the ESG impact(s) they are seeking to generate with their investments in the discussion of the Registered Funds’ investment objective.

The US regime is similar in approach to the EU equivalent: both align the buckets of ESG objectives and outcomes that Advisers must opine on with the characteristics that Registered Funds must report on. However, specific ESG disclosures are mandated only for Registered Funds under the SEC’s proposed rules, which differs from the EU approach which captures financial products more broadly.

Annual Report Requirements

The Commission has not proposed any specific annual report requirements for Integration Funds. However, the obligations that would be imposed on ESG-Focused Funds (including Impact Funds) could be substantial. There are three main categories of requirements that may apply to Registered Funds’ annual reports.

1. *Requirements for Impact Funds*

Impact Funds would be required to discuss their progress in achieving their stated impact objective(s) and would have to do so in both quantitative and qualitative terms. This qualitative aspect may include how certain concepts (such as “green”) are defined and how they contribute to the impact objective(s). Impact Funds would also be required to summarize the key factors that materially affect their ability to achieve the stated impact objective(s).

2. *Requirements for Firms Where Proxies/Engagement Forms a Significant Part of the Investment Strategy*

ESG-Focused Funds that check the boxes for proxy voting or company engagement in the ESG Strategy Overview Table in their prospectus would be required to provide annual disclosures on ESG aspects of their proxy voting and engagement activities.

Registered Funds that identify proxy voting as a significant part of their strategy would be required to disclose the percentage of ESG-related voting matters during the reporting period for which the Registered Fund voted to advance the initiative. However, this disclosure may be limited to voting matters involving ESG factors that the Registered Fund incorporates into its investment decisions. Registered Funds would also be required to provide a cross-reference to their most recent complete proxy voting record filed on Form N-PX.

Registered Funds that identify company engagement as a significant part of their strategy would be required to disclose the number or percentage of issuers that the Registered Fund held ESG engagement meetings with during the reporting period, as well as the total number of such ESG engagement meetings. The Commission defines an "ESG engagement meeting" as "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 a goal is measurable, that is part of an ongoing dialogue with management regarding this goal."

The SEC discusses at length what is not an "ESG engagement meeting" for purposes of this disclosure. For example, the Commission notes that high-level discussions of a topic, letters sent to multiple issuers, and general announcements do not constitute engagement. However, beyond this, the SEC explicitly recommends that Registered Funds memorialize discussions of ESG issues via agendas or minutes of discussions in order to corroborate any sessions that a Registered Fund might report as an ESG engagement meeting.

3. *Funds Incorporating Environmental Considerations*

ESG-Focused Funds that consider environmental factors as part of their investment strategy would be required to disclose detailed information regarding the GHG emissions characteristics of their portfolios. This is the case even for Registered Funds that are not explicitly focused on climate; the only exception is if a Registered Fund affirmatively states in its ESG Strategy Overview Table that it does not consider GHG emissions as part of its investment strategy.

The required GHG disclosures consist of two metrics: a Registered Fund's carbon footprint and weighted average carbon intensity. These metrics are meant to reflect a Registered Fund's absolute emissions and emissions intensity, respectively.

Registered Funds subject to this requirement would be required to provide these metrics based on portfolio companies' Scope 1 and Scope 2 emissions, regardless of whether the companies publish such information. For any portfolio companies without publicly available information, the proposed rule allows Registered Funds to use a "good faith estimate" of their emissions. However, Registered Funds would also be required to disclose the percentage of aggregate portfolio GHG emissions calculated using such estimates and provide a brief description of the calculation methodology, including data sources used. This recognizes the transitional nature of the ESG journey and echoes market practice in Europe, which relies heavily on proxy data and the use of third-party ESG data companies. As a result, market practice

in Europe often requires enhanced diligence on the data sources used to stress test alignment with the metrics assumed by the regulatory framework.

Providing Scope 3 emissions would also be required, broken out by industry sector, to the extent portfolio companies report this information. However, there is no requirement for Registered Funds to estimate Scope 3 emissions of portfolio companies if that data is not available. In contrast, the EU SFDR requires companies to take into account Scope 3 emissions as part of the application of the principal adverse impact indicators for financial market participants offering products that make sustainable investments.

The ESG disclosures proposal provides detailed information on how Registered Funds are supposed to calculate the required metrics. Registered Funds would also be required to disclose assumptions, methodologies, and any limitations associated with the same for these calculations on Form N-CSR.

Unit Investment Trust Requirements

UITs need not provide the same degree of disclosure as other Registered Funds. Instead, the proposed rules generally only require UITs with securities selected based on one or more ESG factors to explain how those factors were used to select the portfolio securities.

Form N-CEN Requirements

The proposed rules would add a new item to Form N-CEN that would require Registered Funds to provide information about ESG strategies and processes. A Registered Fund that indicates that it incorporates ESG factors would be required to report, among other things:

- the type of strategy employed (integration, ESG-focus, or ESG impact);
- the ESG factor(s) considered; and
- the method(s) the Registered Fund uses to implement its ESG strategy.

Such Registered Funds would also be required to disclose whether they considered ESG-related information or ESG scores from ESG service providers and, if so, provide the legal name and legal entity identifier (or another identifying number) of each such provider.

The Form N-CEN requirements would also require Registered Funds to disclose whether they follow any third-party ESG frameworks in their investment strategies and, if so, provide the full name of such frameworks.

Proposed Amendments to the Names Rule

Adopted in 2001 under the Investment Company Act of 1940, the current Names Rule prohibits Registered Funds from using “materially deceptive or misleading” names.[1] Specifically, the Names Rule requires a registered investment company or business development company (BDC) with a name that suggests it focuses on (1) a particular type of investment, (2) investments in a particular industry, or (3) a particular country or geographic region, or suggests certain tax treatment, to invest at least 80% of its assets in the investments, or in investments in the industry or geographic region, suggested by its name (the 80% investment policy requirement or the 80% requirement).

The proposed amendments to the Names Rule would broaden the scope of the 80% investment policy requirement to apply to any Registered Fund name with terms that suggest the Registered Fund focuses on investments that have, or investments whose issuers have, particular characteristics. This expanded

requirement would include, for instance, Registered Fund names that indicate that the Registered Fund's investment decisions incorporate one or more ESG factors. ESG terms that would trigger the 80% investment policy requirement — if they describe ESG factors that may be considered when making an investment decision — include, for example, "ESG," "sustainable," "green," "socially responsible," "ethical," "impact," or "good governance." The proposed requirement would also include Registered Fund names with terms such as "growth" or "value," which, under the current rule, are considered investment strategies and therefore do not fall under the scope of the 80% requirement. Depending on the context, the proposed requirement would also apply to other Registered Fund names that may not currently trigger the 80% requirement, such as names that include the terms "global," "international," "income," or "international term (or similar) bond."

Other proposed amendments to the Names Rule include:

- limits on the circumstances and amount of time a Registered Fund would be able to depart from its 80% investment policy requirement — in most cases, the time limit to return to compliance with the 80% requirement would be 30 consecutive days;
- a requirement that a Registered Fund generally use a derivatives instrument's notional amount, rather than its market value, when determining its compliance with the 80% investment policy requirement;
- specifying that a Registered Fund would be able to include a derivatives instrument in its 80% basket if it provided investment exposure to one or more market risk factors associated with the investments suggested by the fund's name;
- a requirement that a BDC or a registered closed-end fund that is (1) not listed on a national securities exchange and (2) subject to the 80% investment policy requirement, would have to make its 80% investment policy a fundamental policy, meaning that changes to its 80% investment policy would necessitate shareholder approval;
- specifying that a Registered Fund name may be materially deceptive or misleading even if the fund complies with the 80% requirement; i.e., compliance with the Names Rule's 80% requirement does not create a safe harbor for Registered Fund names;
- a requirement that a Registered Fund would have to define the terms used in its name, as well as delineate the criteria the fund uses to select the investments that the term describes, in its prospectus;
- a requirement that the terms used in a Registered Fund's name that suggest an investment focus or that the fund is tax-exempt be consistent with those terms' plain English meanings or established industry use;
- specifying that the names of Integration Funds would be considered materially deceptive or misleading if the names indicate that the Integration Funds' investment decisions incorporate one or more ESG factors;
- a requirement to maintain written records documenting either compliance with the 80% requirement or analysis that the requirement does not apply to the Registered Fund;

- certain exceptions for UITs, unless a UIT has already adopted, or needed to adopt, an 80% investment policy under the current rule;
- new reporting items on Form N-PORT regarding (1) a Registered Fund's name rule compliance and (2) a requirement for a Registered Fund subject to the 80% investment policy requirement to indicate whether each of its portfolio investments are included in the fund's 80% basket;
- a requirement to not only notify shareholders upon a change in a Registered Fund's 80% investment policy, but also a change to a fund's name that accompanies such policy change; and
- an update to the notice requirement to address Registered Funds that use electronic delivery methods to provide information to shareholders.

These proposed amendments to the Names Rule follow the Commission's request for comments on the rule in March 2020.[2] The Names Rule has not been amended since its adoption in 2001.

A Review of Global Trends

Both the SEC proposals and the EU SFDR aim to articulate the role of ESG in financial/investment products. The regimes share similar framing structures, but the content requirements and scope of coverage are generally different. For example, the EU SFDR applies to financial advisers and "financial market participants," which form a considerably larger set of entities than that covered in the SEC proposals, notably including private equity, private credit, venture capital, and other alternative investment funds that are not captured by the SEC proposals. And while the Advisers Act portions of the proposal would apply to a private fund's sponsor, the requirements are essentially limited to advisory strategy disclosures rather than fund or portfolio-level disclosures. In contrast, the EU SFDR prescribes both entity-level disclosures and three sets of product-level disclosures (pre-contractual, periodic, and website) for financial market participants.

Within the proposed SEC and EU SFDR disclosure requirements themselves, certain disclosures have at least thematic similarity, such as the requirement to discuss the degree to which any ESG impact was achieved by investment products with such objectives. However, the approach to metrics is quite different. For example, Scope 3 emissions must be taken into consideration under the EU SFDR as part of the application of the principal adverse impact indicators for financial products that make sustainable investments. In fact, the EU SFDR assumes many more metrics and provides more detailed guardrails on what may generally be deemed "sustainable" than under the SEC's proposed rules.

This divergence is due, at least in part, to the establishment of the EU Taxonomy. The EU Taxonomy establishes technical screening criteria for economic activities to be considered environmentally sustainable,[3] which informs how financial market participants complete certain disclosures under the EU SFDR. In essence, the EU set a threshold for environmental sustainability under various environmental objectives, which investors then use to disclose the degree to which their portfolio is in alignment. Without a similar taxonomy in the US, the SEC proposal instead mandates disclosure of certain metrics, currently limited to climate, and allows investors to decide whether they are sufficiently aligned with sustainability/ climate objectives. The differences in regulatory methodology between the regimes create distinct compliance challenges.

Globally, several other sustainability disclosure regimes, including taxonomies of varying scopes, either have been published or are in development.[4] However, the extent to which these regimes will apply to financial products broadly or will be paired with similar structural ESG disclosures (such as required by

the EU SFDR and the SEC's proposed rules) is uncertain. One notable trend has been the adoption of the EU SFDR regime in the US when fund sponsors view the EU as a key market to attract investment. Careful analysis will be necessary to ensure that the Commission's proposed disclosure standard can sit alongside the EU SFDR and EU Taxonomy equivalents (and ultimately alongside any other such disclosure regimes in other jurisdictions) and present a clear and non-conflicting picture for investors.

The growing number of regulatory frameworks governing ESG disclosures, including taxonomies and their equivalents, creates a complex and fragmented environment for affected advisory firms to navigate. Differences in scope of applicability, sustainability objectives covered, and technical criteria and methodologies may mean that advisers and their advised products have to collect varying information, or at least analyze information differently, to comply with different regimes. This fragmentation can frustrate efforts to raise capital globally.

There are at least some efforts toward international harmonization. In 2019, a host of jurisdictions established the International Platform on Sustainable Finance (IPSF) to "stimulate investment" and "coordinat[e] efforts on initiatives and approaches to environmentally sustainable finance, while respecting national and regional contexts."[5] The IPSF, which has grown to include over half the world's population and economy but notably does not yet include the US, has adopted several principles and recommendations to improve comparability and interoperability of regimes. And several working groups have been established to work toward alignment, particularly between the frameworks in effect in the EU and China.[6] However, at this stage, regulated entities are still left with little option but to analyze compliance with each regime individually.

Commissioner Peirce's Objections

The sole objection to the proposed rules came from SEC Commissioner Hester M. Peirce. With respect to the proposed amendments to the Names Rule, Commissioner Peirce stated that the amendments would "create more fog than they dissipate." Commissioner Peirce argued that applying the 80% requirement to "vague" terms such as "ESG," "growth," and "value" is unworkable and would require subjective judgments from the industry and the Commission. Commissioner Peirce also objected to the strict 30-day limit on departures from the 80% requirement, stating that such an inflexible limit could induce managers to make undesirable investments or even shut down in times of market stress. Finally, she argued that the proposed one-year implementation period is too short.

Regarding her objection to the ESG disclosures proposal, Commissioner Peirce acknowledged "a legitimate concern about the practice of greenwashing by investment advisers and investment companies." Nonetheless, she said that a new rule "should not be a high priority" because the SEC can already institute enforcement actions when advisers say "one thing about ESG and [do] another."

Commissioner Peirce stated that she would have supported a rule that simply required relevant regulated entities to answer the following three questions:

1. If you offer products or services you label as some formulation of "E," "S," or "G," what does the label mean with respect to each such product or service?

2. What do you do to make your product or service line up with E, S, or G, as you have defined it for that product or service?

3. For each such product or service, what — if any — is the cost to investors, including in terms of forgone financial returns of pursuing E, S, or G objectives alongside of or instead of financial objectives?

In objecting to the proposed rules, Commissioner Peirce criticized the Commission's attempt to require disclosures of GHG metrics from certain Registered Funds. Specifically, she noted that if the SEC adopts the climate-risk disclosure rule for public companies, then "some data will be available, albeit not reliable. [But] [i]f portfolio companies do not provide disclosures, the proposal would require the fund to cobble data together as best it can," which, in Commissioner Peirce's view, would undermine the Commission's goal of creating consistency and comparability.

How Advisory Firms Can Start Preparing

While the SEC's final rules may differ from the proposed rules, affected firms should start preparing now to (1) comply with the new requirements and (2) navigate the complex landscape of global ESG regulations that have yet to converge. While specifics will vary, below are two steps that fund sponsors can take to better position themselves in advance of the final rules.

1. Assess existing ESG posture and ESG reporting

Advisory firms are in different places with regard to ESG. Some industry participants have already adopted ESG-related policies and receive and report ESG-related information in line with investor expectations. Regardless, the first step is for Advisers and Registered Funds within scope of the SEC proposals to understand (1) what they currently know (which includes what they may have previously disclosed), (2) how they know it (and, if applicable, why they have disclosed it), and (3) whether they have the degree of certainty needed to disclose this information in an SEC filing.

From there, affected regulated entities will need to analyze how their current information compares against the requirements in the SEC's proposed rules. This analysis should ideally be at a technical level to capitalize on potential overlap. For example, BDCs are regulated as Registered Funds under the proposed rules and are also explicitly subject to the SEC's public company climate-risk proposal. Climate-focused BDCs should thus pay particular attention to how disclosures under the two regimes may coordinate, looking not only for areas where duplicative efforts may be avoided, but also for areas where distinctions between the requirements may need nuanced explanation to prevent the appearance of conflicting disclosures.

This analysis is particularly important for advisory firms and funds that are already required to provide information for other jurisdictions, such as under the EU SFDR. Technical comparison may reveal opportunities to avoid reduplication of efforts; however, to the extent that there are methodological differences in the regimes' technical specifications, regulated entities may need to collect information and report on the same topic in different ways to satisfy both sets of requirements.

2. For funds seeking investors in multiple jurisdictions, compare requirements to streamline compliance efforts

Funds should organize disclosure needs by jurisdiction to track the particular information they will need to disclose and identify thematic features of the disclosures they will need to provide. Such organization can help funds and their sponsors assess whether the requirements in different jurisdictions are sufficiently similar to require only a single form of data and/or disclosure or whether the requirements will necessitate stand-alone documentation, reporting or collection of data on ESG factors.

If you have questions about this Client Alert, please contact one of the authors listed below or the Latham lawyer with whom you normally consult:

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Endnotes

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[1] 17 C.F.R. § 270.35d-1.

[2] See Request for Comments on Fund Names, Investment Company Act Release No. 33809 (March 2, 2020).

[3] The delegated acts establishing the technical screening criteria for alignment with the EU Taxonomy have not yet been released for all of the environmental objectives presently covered, nor are any social objectives presently covered by the EU Taxonomy. However, work on these topics is ongoing.

[4] For example, China has released a revised "Green Bond Endorsed Projects Catalogue" that organizes activities by environmental goal. (See here) The United Kingdom and Singapore have established expert groups to advise on developing taxonomies, with an eye to being leaders in their respective financial hubs. (See here and here) And several countries (such as South Africa, Georgia, and Chile) are looking to develop taxonomies that take into account their unique domestic circumstances. (See here, here, and here).

[5] https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/191018-international-platform-sustainable-finance-press-release_en.pdf

[6] https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/211104-ipsf-common-ground-taxonomy-instruction-report-2021_en.pdf