

## SEC proposes new rules for funds with ESG characteristics

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The Securities and Exchange Commission has proposed a set of new rules for funds in an effort to promote clarity and transparency for the growing environmental, social, and governance market.

The proposed rules and form amendments are designed to create a consistent, comparable, and decision-useful regulatory framework for ESG advisory services and investment companies to inform and protect investors while facilitating transparency. The scope would apply to certain registered investment advisers, advisers exempt from registration, registered investment companies, and business development companies.

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### Providing additional information on ESG investment practices

The first set of amendments to rules under the Investment Advisers Act of 1940 and the Investment Company Act of 1940 seeks to oblige both open-end funds (including ETFs) and closed-end funds (including BDCs) that incorporate one or more environmental, social, and governance (ESG) factors into their investment selection process, to provide additional information regarding ESG investment practices.

At present, disclosure requirements for funds and registered advisers are concentrated around investment strategies. Funds must provide disclosures concerning material information on investment objectives, strategies, risks, and governance, while management must provide a discussion of fund performance in the fund's shareholder report. General disclosures about ESG-related investment strategies fall under these requirements, however, there are no specific requirements about what a fund or adviser following an ESG strategy must include in its

disclosures.

## **Preventing greenwashing in funds marketing**

The second set of rules aims to amend Rule 35d-1 (the so-called Names Rule) under the Investment Company Act of 1940, to expand scope and apply such rule to **any fund name** with terms, suggesting that the fund focuses in investments that have, or investments whose issuers have, particular characteristics. This would also include fund names with ESG and similar terminology. In practise, a fund's 80% investment policy would have to be aligned with ESG criteria in order to be able to use such terminology in its name. In addition, the Securities and Exchange Commission (SEC) is proposing that funds' prospectus disclosures would need to define the terms used in its name, including the criteria the fund uses to select the investments that the term describes. This enhancement is aimed towards the prevention of greenwashing in fund names.

Both proposals aim to help investors, and those who provide advice to investors, make more informed choices regarding ESG investing and better compare funds and investment strategies. The proposed amendments create a framework for disclosures regarding a fund or adviser's ESG-related strategies and hope to enhance the quantitative data for environmentally focused fund strategies.

## **A proposed new fund taxonomy**

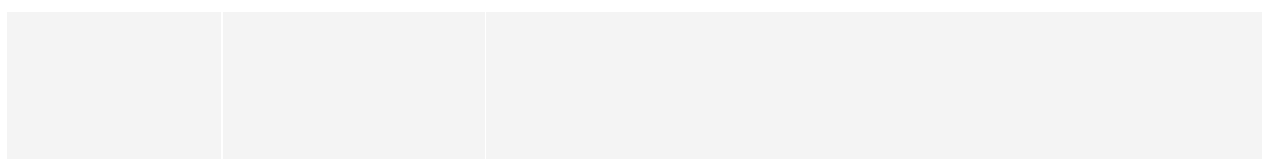
The proposed ESG-related disclosure and reporting requirements for registered funds focus on prospectuses, annual shareholder reports, and Form N-CEN. The specific disclosures and level of detail required would depend on the extent to which a fund considers ESG factors in its investment processes.

To facilitate this framework, the SEC proposed a new fund taxonomy consisting of three categories of ESG funds, each with accompanying disclosure requirements:

In addition, a fund for which proxy voting or other engagement with issuers is a significant means of implementing its strategy should also disclose information regarding how it voted proxies relating to portfolio securities on particular ESG-related voting matters and information regarding its ESG engagement meetings.

Specific disclosure requirements regarding ESG strategies would need to be made to investors in fund registration statements, the management discussion of fund performance in fund annual reports, and adviser brochures.

The proposal was subject to comment for 60 days from their publication in the Federal Register, and the rules are still subject to change.



Describe how  
the fund  
incorporates

For each  
strategy,  
describe how  
ESG factors  
are  
incorporated.  
Explain  
whether and  
how ESG  
factors are

ESG factors into its investment selection process. Funds consider GHG emissions as a factor must describe the methodology.

considered alongside other non-ESG factors. Describe any criteria or methodology used to evaluate, select, or exclude investments based on the consideration of ESG factors (for example, screens).

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|  | <p>Disclose proxy voting information (if proxy voting is important to the fund's strategy). Engagement policy and</p> | <p>Describe how the fund incorporates ESG into its investment selection process, including:</p> | <p>For each strategy, describe how ESG factors are incorporated, and which factors are considered. Explain whether and how the strategy focuses on</p> |
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|  | <p>engagement results (if it is a significant part of the fund's strategy).</p> |  | <p>one or more ESG factors.</p> |
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| <p>Disclose proxy voting information (if proxy voting is important to the fund's strategy).<br/>Engagement policy and engagement results (if it is a significant</p> | <p>Provide key information about the consideration of ESG factors, disclosed in a standardised form.<br/>Describe how the fund will achieve its ESG objectives.<br/>Disclose:</p> | <p>Same as ESG Fund, plus an overview of the impact(s)</p> |
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part of the fund's strategy). If the fund considers environmental factors, disclose GHG emissions of the portfolio.

the adviser seeks to achieve and the methods used to achieve them.

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