Managed Funds Association
The Voice of the Global Alternative Investment Industry
Washington, D.C. | New York | Brussels

August 15, 2022

Via Electronic Mail: **rule-comments@sec.gov**

Ms. Vanessa Countryman
Secretary
United States Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Re: Request for Public Comment — Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices [File No. S7-17-22]

Dear Ms. Countryman:

Managed Funds Association ("**MFA**")[1] appreciates the opportunity to represent the views of the alternative investment industry in response to the United States Securities and Exchange Commission's (the "**Commission**" or "**SEC**") request for public comments on its recent proposal, *Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices* (file no. S7-17-22) (the "**Proposal**").[2]

MFA is supportive of the Commission's efforts to promote reliable, accurate, and decision-useful environmental, social, and governance ("**ESG**") related disclosures to inform investors in ESG funds about relevant advisers' approaches to ESG issues in connection with their investment decisions. However, MFA is concerned that the Proposal will in fact have the opposite effect because ESG considerations often arise because of related financial impacts. In the absence of clear guidance in the Proposal on how to differentiate between ESG factors that are being considered for their ESG implications from ESG factors that are being considered for their financial implications, we are concerned that many, if not all, investment strategies could arguably be deemed to be at least "ESG Integration" strategies, if not "ESG Focused" or "ESG Impact" strategies. This would include all manner of strategies that are not marketed to investors as ESG products and have the unintended consequence of "greenwashing" the entire private funds

[1] MFA represents the global hedge fund and alternative asset management industry and its investors by advocating for regulatory, tax, and other public policies that foster efficient, transparent, and fair capital markets. MFA's more than 150 member firms collectively manage nearly $2.6 trillion across a diverse group of investment strategies. Member firms help pension plans, university endowments, charitable foundations, and other institutional investors to diversify their investments, manage risk, and generate attractive returns over time. MFA has a global presence and is active in Washington, Brussels, London, and Asia.

[2] See Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices, Securities Act Release No. 11068, Exchange Act Release No. 94985, Investment Advisers Act Release No. 6034, Investment Company Act Release No. 34594 (May 25, 2022) [87 FR 36654 (June 17, 2022)] (the "**Proposing Release**").

industry. Labeling essentially all funds as some type of ESG fund would make investors' comparisons among strategies and funds more, rather than less, difficult. In addition, because the Proposal is not limited to true ESG strategies and funds, it understates the costs of compliance by several orders of magnitude and creates significant burdens, especially for smaller and newly-formed advisers, without achieving (and, rather, perhaps undermining) its stated purposes or benefits of providing reliable ESG information to investors. Finally, the Proposal creates a harmful disincentive for advisers from considering ESG factors in their investment decision-making more broadly. This will likely limit the ESG approaches and strategies available to investors and hamper the efforts of private fund advisers to participate in the evolution of ESG-related approaches to investing.

MFA membership includes private fund advisers that employ a wide spectrum of investment strategies and take various approaches to ESG issues. With no formal definition of "ESG," and with approaches to ESG issues varying widely among investors, a disclosure framework that is overly broad, relies upon vaguely defined distinctions among investment strategies, and oversimplifies the diverse universe of private fund strategies into three categories would be unreliable and difficult to apply. Therefore, MFA urges the Commission to consider the following recommendations as it adopts any final rules related to the Proposal (the "**Final Rules**").

MFA recommends:

(a) Implementing a "good faith" standard in respect of advisers determining how to classify their strategies under the Final Rules.

(b) Revising the definition of "ESG Focused" strategies in the Final Rules to:

   (i) exclude strategies that employ screens unless such strategies are promoted and marketed to investors as strategies designed to achieve a non-financial ESG objective; and

   (ii) include only those strategies that are promoted and marketed to investors as using ESG factors as a "primary" affirmative consideration in the investment decision-making process to achieve a non-financial ESG objective. Alternatively, the Commission should implement a "materiality" standard and provide practical guidance on how extensive the consideration of non-financial ESG factors must be in an investment strategy before such strategy is deemed to be an "ESG Focused" strategy.

(c) Removing "ESG Integration" strategies from the scope of the Final Rules altogether. Alternatively, the Commission should limit such category to cover only those strategies where the adviser uses, and actively promotes and markets such strategy as using, ESG factors in the investment decision-making process to achieve a non-financial ESG objective (in which case, any strategies that merely consider ESG factors in the investment decision-making process to the extent they are deemed financially material will be excluded).

(d) For purposes of the Final Rules' new Form ADV disclosure requirements related to ESG investing:

(i) adopting a "materiality" standard, as opposed to a "significant" standard, and providing practical guidance on what constitutes a "material strategy" as applied throughout the Final Rules; and

(ii) applying a "materiality" standard so that implementing an ESG strategy for an immaterial number of clients, investments or amount of assets under management (or as an immaterial part of a larger portfolio strategy) would not trigger a disclosure requirement for the adviser's entire business.[3]

(e) Although the Proposal does not impose greenhouse gas ("**GHG**") emissions disclosures by private fund advisers, from a market perspective MFA urges that the Commission permit the netting of GHG emissions associated with a security underlying a short position against the GHG emissions associated with a security underlying a long position for purposes of calculating the carbon footprint and weighted average carbon intensity ("**WACI**") disclosed by a registered fund or business development company in its annual report.

(f) Sequencing the effectiveness of the Final Rules to follow the SEC's recent Proposed Public Company Climate-Related Disclosure Rules if they are adopted (as defined below).

I. INTRODUCTION

We are supportive of the Commission's general efforts to promote "reliable information among investment products and advisers that claim to consider one or more ESG factors,"[4] particularly in light of the ongoing innovative and evolving nature of ESG investing. At the same time, we believe that prescribing specific disclosures relating to ESG represents a significant departure from the existing SEC disclosure framework with respect to the use of any particular investment strategy or approach. Requiring an adviser to provide extensive disclosures concerning how it integrates ESG factors—no matter how incidental the consideration may be or whether the adviser considers those factors as part of a strategy that is marketed to investors as affirmatively seeking ESG-oriented outcomes—will result in undue emphasis on an otherwise immaterial strategy (or aspect thereof). This is likely to lead to greater investor confusion and frustration as the term "ESG" becomes overused and hollow. We believe this result would be contrary to the Commission's stated goal of reducing the risk of "greenwashing" by creating a misleading impression of the importance of ESG factors to an adviser's strategy, fund, or investment process.

In addition to being a departure from the existing disclosure framework, we believe the new requirements set forth in the Proposal are unnecessary, given: (i) the existing requirements under Section 206 of the Investment Advisers Act of 1940, as amended (the "**Advisers Act**"),

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3 For example, the proposed Item K(6) of Form ADV Part 1A will only create confusion if an adviser has a single client and/or strategy for which ESG factors may be considered, and is required to "select all that apply." An accurate response can convey a misimpression that all portfolios include ESG considerations.

4 *See* Proposing Release, *supra* footnote 2, at 7.

provide the Commission with the regulatory tools necessary to address potential "greenwashing" and to oversee compliance with ESG policies identified or promoted by private fund advisers and funds, and (ii) the type of sophisticated investors investing in private funds have the ability to contract for additional specific disclosures and reporting based on their particular needs and preferences (and, in fact, regularly seek such additional information concerning ESG strategies, execution and performance through their own due diligence processes). As such, MFA is concerned that without any commensurate benefit to investors and the private funds market more generally, the burdens and costs imposed by the Proposal will limit the ESG approaches and strategies available to investors by discouraging innovation with respect to ESG investing.[5]

As discussed, MFA membership includes private fund advisers that employ a wide spectrum of investment strategies and take various approaches to ESG issues. Consequently, we are aware and supportive of the need for accurate and decision-useful ESG-related disclosures to inform investors in ESG Funds about advisers' approaches to ESG issues in making investment decisions. However, in attempting to limit greenwashing of private fund adviser strategies that are marketed to investors as ESG products, the Proposal will have the opposite effect insofar as its broad and vaguely defined categories would require most, if not all, all private fund adviser strategies to self-identify as an "ESG Integration," "ESG Focused," or "ESG Impact" strategy. The Proposal would make it difficult or perhaps impossible to differentiate between ESG factors that are being considered for their ESG implications from ESG factors that are being considered for their financial implications. Some of our members view ESG as a primary focus of an investment strategy and/or manage assets on behalf of investors that are particularly attentive to non-financial ESG factors, while others view ESG considerations merely as financial or other factors—and sometimes immaterial ones—in their investment decision-making process. Therefore, a disclosure framework that uses vaguely defined distinctions among investment strategies will be difficult to apply and unreliable. The Proposal departs from the existing Form ADV disclosure framework by introducing new and ambiguous terms and three new categories of ESG strategies that suffer from both a material lack of clarity and over-inclusiveness, which in turn will frustrate the Commission's goals.

MFA's members are most directly concerned with the Commission's proposal to amend Form ADV Part 1A (for both registered investment advisers and exempt reporting advisers) and Part 2A (for registered investment advisers), set forth on pages 353-361 of the Proposing Release. Investors in private funds and many managed accounts covered by these rules are not retail investors, but sophisticated institutional investors. The new disclosures set forth in the Proposal would vary based on the nature of the products offered by the adviser (*i.e.*, managed accounts or private funds), whether the adviser considers ESG factors in connection with any "significant" strategy, and how the ESG strategy is pursued. While the Proposal covers other topics, this letter

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5 The Commission significantly underestimates the costs imposed under the Proposal by several orders of magnitude. *See* Proposing Release, *supra* footnote 2, at n.448. ("Based on the results of the PRA analysis, the annual direct paperwork cost burdens attributable to information collection requirements in the proposed amendments to both Form ADV Part 2A and Part 1A would be approximately $912.75 per RIA, $83.85 per ERA, and $55.90 per private fund advised."); *see also id*. at 280 (indicating that the burden to update all Form ADV disclosures will be just 0.4 hours). In addition to being harmful to investors who will ultimately bear, directly or indirectly, any increased costs imposed by the Proposal, there are valid concerns about the ability of smaller private fund advisers to be able to cover any such increase in costs.

focuses on the proposed amendments under the Advisers Act. As discussed above, we are concerned both that the Proposal fails to create benefits to the private funds market and investors commensurate with its burdens and that the Proposal is not well designed to achieve its stated purposes.

Accordingly, MFA submits several recommendations to assist the Commission in better identifying and addressing ESG disclosures within the private funds market and aligning the burdens of any new disclosure framework with the practical benefits for investors.

II. MFA COMMENTS

a. The Commission should consider implementing a "good faith" standard in respect of advisers determining how to classify their strategies under the Final Rules.

In the Proposal, the Commission notes that "ESG" is generally used to encompass 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.[6] The Commission proposes not to define the term "ESG" or any of its subparts (*i.e.*, "E," "S," or "G") for purposes of the new Form ADV disclosure requirements.[7]

Determinations of what constitutes "E," "S," or "G" can be inherently subjective, value-laden and contingent on the then-current context; therefore, MFA believes it is appropriate for the Commission to refrain from defining such terms.

Given the indefinite nature of what constitutes "E," "S," and/or "G," MFA also urges the Commission to consider implementing a "good faith determination" standard in connection with an adviser's application of those terms for purposes of the new Form ADV disclosures requirements. Advisers should not be second-guessed when they make a good faith determination as to whether a particular strategy integrates or will integrate ESG factors.

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6 *See* Proposing Release, *supra* footnote 2, at n.6.

7 *Id*. at 129 ("Similar to our proposal for registered funds, we are not proposing to define "ESG" or similar terms.").

b. The Commission should revise the definition of "ESG Focused" strategies in the Final Rules to (i) exclude strategies that employ screens unless such strategies are promoted and marketed to investors as strategies designed to achieve a non-financial ESG objective and (ii) include only those strategies that are promoted and marketed to investors as using ESG factors as a "primary" affirmative consideration in the investment decision-making process to achieve a non-financial ESG objective. Alternatively with respect to the latter recommendation, implement a "materiality" standard and provide practical guidance on how extensive the consideration of non-financial ESG factors must be in an investment strategy before such strategy is deemed to be an "ESG Focused" strategy.

In the Proposal, the Commission proposes new Form ADV disclosures requirements for private fund advisers or funds employing "ESG Focused" strategies.[8] The Commission proposes to define "ESG Focused" strategies as those that focus on one or more ESG factors by using such factors as a "significant or main consideration" in selecting investments or in engaging with portfolio companies.[9] The Proposal identifies examples of strategies that would fall into the definition of "ESG Focused" strategies, including those that apply screens to include or exclude particular portfolio investments.[10]

"Significant or main" are not terms defined in law and each of those words have different meanings,[11] and thus their application will cause substantial confusion.[12] The vagueness of the standard is compounded by the fact that the definition could pull in strategies even where the adviser does not pursue a strategy, or actively promote and market such strategies, to investors as being based on consideration of ESG factors to achieve non-financial ESG-related objectives.

The inclusion of all investment strategies that apply screens within the scope of "ESG Focused" strategies misjudges the "significance" of screens. Screens are common in strategies that

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8 *Id*. at 127-165.

9 *Id*. at 14-15.

10 *Id*.

11 The term "significant" has been defined as "sufficiently great or important to be worthy of attention; noteworthy; consequential, influential." OED ONLINE, Oxford University Press (June 2022), www.oed.com/view/Entry/179569 (last visited July 14, 2022). The term "main" has been defined as "chief or principal in permanent relation to others of the same kind or group." OED ONLINE, Oxford University Press (June 2022), www.oed.com/view/Entry/112518 (last visited July 14, 2022).

12 Although advisers have long been required to disclose risk factors for any "significant" strategy under Item 8.B of Part 2 of Form ADV, the context for the Proposal's use of such threshold is different (i.e. whether a factor is significant to a strategy) and will lead to confusion. *See* 275.204-3 and Amendments to Form ADV, Investment Advisers Act Release No. 3060 at text accompanying n.74 (July 28, 2010) [75 FR 49233 (Aug. 12, 2010)] (describing significant investment strategies or methods of analysis in the context of a Form ADV brochure Item about risk disclosure as providing a threshold for disclosure that "captures those methods of analysis or strategies that will be relevant to most clients"); *but see id*. at n.74 (stating "we would view a method of analysis or strategy as significant if more than a small portion of the adviser's clients' assets are advised using the method or strategy").

do not pursue non-financial ESG-related objectives.[13] The request also creates the risk of pulling the SMA strategy into the scope of the SEC's proposed definition of "ESG-Focused" strategies even though neither the client nor the adviser considers such SMA strategy as being focused on ESG and even though the investments screened into the SMA portfolio do not reflect the non-financial application of ESG factors.[14]

Accordingly, MFA urges the Commission to revise the definition of "ESG Focused" in two ways. First, the Commission should apply a "primary consideration" standard, rather than a "significant or main consideration" standard, and apply such standard only to strategies that are promoted and marketed to investors as ESG products. Alternatively, the Commission should adopt the SEC's historic "materiality" standard and provide practical guidance on applying such standard for purposes of the new Form ADV disclosure requirements. Second, the Commission should revise the definition of "ESG Focused" so that it will not capture strategies merely because a screen is employed. As an alternative to removing screens as a defining element of "ESG-Focused" strategies, we request that the Commission clarify that not every screen (whether affirmative or negative) will necessarily be a "significant" factor for a strategy and that not every screened strategy is an "ESG-Focused" strategy.

c. The Commission should remove "ESG Integration" strategies from the scope of the Final Rules altogether. Alternatively, the Commission should limit such category to cover only those strategies where the adviser uses, and actively promotes and markets such strategy as using, ESG factors in the investment decision-making process to achieve a non-financial ESG objective.

In the Proposal, the Commission proposes new Form ADV disclosures requirements for private fund advisers or funds employing "ESG Integration" strategies.[15] The Commission proposes to define "ESG Integration" strategies as those that consider one or more ESG factors alongside non-ESG factors in investment decisions, such as macroeconomic trends or company-specific factors like a price-to-earnings ratio.[16] In describing such strategies, the Commission notes

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[13] By way of example, if a separately managed account ("**SMA**") client requests the adviser to screen out tobacco from a strategy that otherwise invests in all U.S. industrial sectors, but does not otherwise request any consideration of non-financial ESG factors in the investment strategy of such SMA, the SMA strategy would presumably fall within the SEC's proposed definition of "ESG Focused" strategies. Such a screen would exclude just one industry (GIC 302030) from a strategy within a broad investable universe, and it may not be "significant" for the SMA's achievement of investment returns and in some cases may be entirely irrelevant (*e.g.* a government pension plan may be required to prohibit tobacco holdings in a fund that invests in media and telecom). Moreover, the client's request for excluding tobacco-related investments may have been made for non-ESG reasons (e.g., the client has sufficient tobacco exposure through other holdings).

[14] The Commission likely did not intend for the definition of "ESG-Focused" strategies to capture such a wide array of strategies. When attempting to estimate the number of ESG-Focused Funds and ESG Impact Funds in the Proposing Release, the Commission looked at fund names as a proxy for the fund's investment strategy (which is a much narrower criterion than looking at all funds that implement an ESG-related screen). *See* Proposing Release, *supra* footnote 2, at 175.

[15] *Id.* at 127-165.

[16] *Id.* at 14.

that ESG factors may be considered in the investment selection process but are generally not dispositive compared to other factors when selecting or excluding a particular investment.[17]

We appreciate the Commission's interest in ensuring that investors receive adequate investment disclosures. We are concerned, however, that under the Commission's broad "ESG Integration" definition, many if not most strategies employed by advisers will fall into this category. As a result, more likely than not, an adviser will need to provide extensive disclosures concerning how it integrates ESG factors—no matter how incidental the consideration typically is or whether the adviser considers those factors as part of a strategy that is marketed to investors as affirmatively pursuing ESG-oriented outcomes. Such requirement is likely to result in undue emphasis on an otherwise immaterial strategy or aspect thereof, and lead to greater investor confusion and frustration as the term and categorization "ESG" becomes overused and hollow. We believe this result would be contrary to the Commission's stated goal of reducing the risk of "greenwashing" by inadvertently creating a misleading impression of the importance of ESG factors to an adviser's strategy, fund, or investment process.

We believe the Proposal's definition of "ESG Integration" strategies is overly broad in ways that the Commission may not have intended and is likely to result in over-disclosure by advisers who generally consider ESG factors only to the extent they are financially material, and would create an undue emphasis on what might otherwise be an immaterial use of "E," "S" or "G" strategies or factors. The goal should not be to convert essentially all funds into some type of ESG fund but to ensure that advisers and funds that tell investors they pursue an ESG strategy do in fact pursue such a strategy and adequately explain both that strategy and its risks, requirements that are already established under the Advisers Act. For these reasons, MFA requests that the Commission remove the new "ESG Integration" category from the Final Rules or, if such category is more narrowly defined, at least eliminate the detailed proposed Form ADV disclosure requirements for private fund advisers or funds employing such strategies.

Given the undefined nature of ESG,[18] the Proposal appears to encompass the use of factors that advisers consider in the normal course that have nothing to do with achieving non-financial ESG outcomes, thereby inadvertently bringing too many advisers into the new disclosure requirements. For example, if an adviser considers a portfolio company's rate of employee retention and/or employment practices as part of its investment decision-making process, would the Commission deem such adviser as employing an "ESG Integration" strategy? Similarly, if an adviser votes a proxy in favor of a controversial merger, would the Commission deem the "governance" outcome of a successful transaction as turning the merger arbitrage strategy into an "ESG Integration" strategy? If an adviser has a policy of not investing in companies with a history of material legal violations or active investigations by criminal authorities or regulators, and such policy reflects a financial assessment that such events are likely to impact a portfolio company's value, would the Commission nonetheless deem the adviser to have an "ESG Integration" strategy

[17] *Id*.

[18] *See supra* Section II.a.

subject to the new disclosure requirements? Failing to distinguish between financial and non-financial use of ESG factors creates confusion and makes the Proposal overbroad.

MFA is concerned that the increased burden and compliance costs of the new Form ADV disclosures requirements for "ESG Integration" strategies may incentivize private fund advisers and funds to explicitly disclaim the consideration of any and all ESG factors in their investment decision-making processes. The Proposal, which contemplates many novel and detailed disclosures, would require private fund advisers and funds to establish new systems, controls and processes and possibly prompt them to engage new external third-party advisors. Given the breadth and over inclusiveness of the Proposal in its current form, we are concerned that the burden in adviser time and external expense will outweigh the benefits of ESG disclosure compliance to the adviser and its clients. This would, in turn, create a disincentive for advisers to embrace factors that could be deemed "E," "S" or "G," and could also limit investor choice and service (*e.g.*, by incentivizing advisers to refuse to accommodate client requests). MFA recommends that the Commission remove "ESG Integration" from the scope of the proposed disclosure requirements altogether in order to preserve the discretion of advisers to consider all financially material factors without being burdened with an overbroad disclosure rule being triggered.

As an alternative to removing the new Form ADV disclosures requirements for private fund advisers or funds employing "ESG Integration" strategies from the Final Rules, MFA recommends that the Commission limit such category to cover only those strategies where the adviser uses, and actively promotes and markets such strategy as using, ESG factors in the investment decision-making process to achieve a non-financial ESG objective. In such event, the definition of "ESG Integration" should explicitly exclude any strategies that merely consider ESG factors in the investment decision-making process to the extent they are deemed financially material. It should also exclude strategies that the adviser does not actively promote and market as an ESG product. Additionally, the Final Rules should provide practical guidance on scenarios that would not pull a given strategy into the definition of "ESG Integration" strategies. This guidance should address instances where an adviser:

(i) responds to investor questions and/or provides due diligence or other similar information to investors concerning its ESG policies and practices but does not otherwise actively promote and market its strategies to investors as using ESG factors in the investment decision-making process to achieve a non-financial ESG objective;

(ii) considers ESG factors for their financial impacts alone, and not for their non-financial impacts; or

(iii) employs negative screens.

Accordingly, MFA recommends that the Commission remove "ESG Integration" strategies from the scope of the Final Rules altogether. Alternatively, the Commission should limit such category to only those strategies that an adviser actively promotes and markets to investors as using ESG factors in the investment decision-making process in order to pursue a non-financial ESG objective. As discussed above, requiring an adviser to provide extensive disclosures concerning how it integrates ESG factors, even if use of such factors is incidental to the overall deployment of the strategy, could result in undue emphasis on an otherwise immaterial aspect of the strategy. This overemphasis would be contrary to the Commission's stated goal of reducing the risk of "greenwashing" by inadvertently creating a misleading impression of the importance of ESG factors.

d. For purposes of the Final Rules' new Form ADV disclosure requirements related to ESG investing, the Commission should: (i) consider using a "materiality" standard, as opposed to a "significant" standard, and provide practical guidance on what constitutes a "material strategy" as applied throughout the Final Rules; and (ii) apply a "materiality" standard so that implementing an ESG strategy for an immaterial number of clients, investments or amount of assets under management (or as an immaterial part of a larger portfolio strategy) would not trigger a disclosure requirement for the adviser's entire business.

The Proposal provides for new Form ADV disclosure requirements designed to collect information about an adviser's use of ESG factors related to advisory services to SMAs and private funds. The Proposal would require an adviser to disclose whether it considers ESG factors "as part of one or more significant strategies" in the advisory services it provides.[19] The Commission believes that "these disclosures would allow clients and prospective clients to compare the ways different advisers consider ESG factors in their significant investment strategies."[20]

Although the Commission has stated that "[f]or these purposes, [it] would view a method of analysis or strategy as *significant* if more than a small portion of the adviser's clients' assets are advised using the method or strategy,"[21] it is unclear what a "small portion" means and whether small is measured with respect to all the adviser's clients' assets collectively. These definitional ambiguities will present significant challenges to advisers in attempting to determine whether their considerations of ESG factors rises to the level required to trigger the new Form ADV disclosure requirements. In addition, this could result in over-disclosure by advisers who are concerned that their determination of whether or not a strategy is "significant" will be second guessed after the fact. Importantly, over-disclosure would undermine the stated goals of the Proposal by causing advisers who cannot ascertain whether their use is "significant" to generate verbiage merely for regulatory compliance. To the extent that investors mistake the volume of disclosure for the intensity of an adviser's consideration of ESG, the Proposal could prove problematic.

MFA urges the Commission to consider using a "material strategy" standard (that is consistent with the SEC's historical materiality threshold), as opposed to a "significant strategy" standard, for purposes of the new Form ADV disclosure requirements related to ESG investing and to provide practical guidance on what constitutes a "material strategy" as applied throughout the Final Rules. MFA also urges the Commission to apply a "materiality" standard so that implementing an ESG strategy for an immaterial number of clients, investments or amount of

19 *See* Proposing Release, *supra* footnote 2, at 157.

20 *Id*. at 130.

21 *Amendments to Form ADV*, Investment Advisers Act Release No. 3060, at n.74 (July 28, 2010) [75 FR 49233 (Aug. 12, 2010)] (emphasis added).

assets under management (or as an immaterial part of a larger portfolio strategy) would not trigger a disclosure requirement for the adviser's entire business.

While requiring disclosures unqualified by materiality is not unprecedented,[22] we are concerned that the sheer number of unqualified disclosures will create significant investor confusion and impose excessive costs on private fund advisers to comply. Accordingly, MFA believes that qualifying the new Form ADV disclosure requirements to the extent that any ESG investing is a "material strategy" of a private fund adviser or fund—as well as clarifying that an immaterial volume or number of ESG trades within a broader investment strategy that is not promoted and marketed as an ESG strategy—will reduce the confusion and frustration for investors, while accomplishing the Commission's goals, and ease the compliance burden on advisers.

e. Although the Proposal does not impose GHG emissions disclosures on private fund advisers, from a market perspective MFA urges that the Commission permit the netting of GHG emissions associated with a security underlying a short position against the GHG emissions associated with a security underlying a long position for purposes of calculating the WACI disclosed by a registered fund or business development company in its annual report.

Although the disclosure of GHG emissions is not called for by the Proposal's Form ADV amendments, MFA wishes to offer an observation about the calculation of investors' GHG emissions.[23] To the extent a registered fund engages in a short sale of a security, the Proposal does not permit the registered fund to subtract the GHG emissions associated with the security from the GHG emissions of the fund's portfolio for purposes of calculating the fund's carbon footprint or WACI disclosed in its annual report.[24] The Commission reasoned that "[a] short sale would allow the fund to profit from a decline in value of the security, but would not reduce the extent of the fund's financed emissions and may not offset the transition risk expressed by the fund's WACI."[25]

While the methodology set forth by the Commission in the Proposal for calculating carbon footprint or WACI does not directly impact advisers of private funds (*i.e.*, funds not registered as investment companies under the Investment Company Act of 1940),[26] MFA membership believes that short selling can contribute to increasing the cost of capital for high-emissions companies and can serve as a tool to incentivize corporate management to take ESG factors into consideration. A

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22 *See* 17 CFR § 229.104(a)-(b); *see also* 17 CFR § 229.402.

23 For funds that consider environmental factors as part of their investment strategy and are registered as investment companies under the Investment Company Act of 1940, the Proposal requires such funds to disclose the carbon footprint and WACI of its portfolio in their annual report. *See* Proposing Release, *supra* footnote 2, at 88. The Commission noted that "[c]arbon footprint is the total carbon emissions associated with the fund's portfolio, divided by the fund's market net asset value and expressed in tons of CO2e per million dollars invested in the fund, while WACI is the fund's exposure to carbon-intensive companies, expressed in tons of CO2e per million dollars of the portfolio company's total revenue." *Id*. at n.389.

24 *Id.* at 98.

25 *Id.* at 99.

26 It should be noted, however, that many MFA members are private fund advisers which also provide advisory services to funds that are registered as investment companies under the Investment Company Act of 1940.

recent report published by MFA, in conjunction with Copenhagen Economics, provides quantitative evidence in support of this position.[27] The report introduced an equity demand model which shows that short sales have the potential to change the supply demand balance for individual stocks and then estimated the effect of short sales on the allocation of capital.[28] It then quantified how the climate transition could have a differential effect on various sectors and how short selling allows investors to hedge that risk.[29] In particular, the report shows that short positions have the potential to reduce capital investment in the most emissions-heavy publicly traded companies by 3-8% (or $50-$140 billion).[30] To realize the full potential of short selling as an ESG tool, we urge the Commission to not require treatment of short positions the same as long positions when evaluating the carbon footprint or WACI associated with a registered fund's portfolio. Requiring the same treatment would limit investor choice and investment opportunities by discouraging advisers from offering certain types of ESG strategies.

Accordingly, MFA recommends that the Commission permit GHG emissions associated with a security underlying a short position to be netted against the GHG emissions associated with a security underlying a long position for purposes of calculating the carbon footprint and WACI that is disclosed in a registered fund's annual report.

f. The effectiveness of the Final Rules should be sequenced to follow the SEC's recent Proposed Public Company Climate-Related Disclosure Rules (if adopted).

The new disclosure and reporting requirements set forth in the Proposal will be highly dependent on advisers and funds receiving robust disclosures from domestic and foreign registrants on various ESG factors. For instance, an adviser to an Impact Fund would be required to make certain disclosures concerning measuring progress towards the stated impact, and the ability to measure progress is tied to the availability and accuracy of more robust disclosures from the portfolio companies in which it invests. On March 21, 2022, the Commission issued proposed rules that would require domestic and foreign issuers to include extensive climate-related information in their registration statements and periodic reports (the "**Proposed Public Company Climate-Related Disclosures Rules**").[31]

MFA members are investors in issuers and are acutely aware of the need for accurate and decision-useful climate-related disclosures that will facilitate their ability to make informed and financially responsible investment decisions on behalf of the investors they serve. If the Commission ultimately proceeds to adopt the recently Proposed Public Company Climate-Related Disclosure Rules, MFA believes that it is too early to subject funds and advisers to the Proposal's

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27 MFA, *The Use of Short Selling to Achieve ESG Goals* (June 2022), *available at* https://www.managedfunds.org/wp-content/uploads/2022/06/ESG-Short-Selling-White-Paper_Final.pdf.

28 *Id*.

29 *Id*.

30 *Id*.

31 *The Enhancement and Standardization of Climate-Related Disclosures for Investors*, Securities Act Release No. 11042, Exchange Act Release No. 94478 (proposed May 9, 2022).

prescriptive disclosure requirements before they are able to analyze the final Proposed Public Company Climate-Relate Disclosure Rules.

In addition, to the extent the Commission proceeds with both rules, it should allow sufficient time for public company disclosures to develop in response to such new rules before the new prescriptive disclosures requirements set forth in the Proposal take effect with Final Rules. This sequencing will allow issuers, investors, and other market participants to adequately digest the new disclosures available. It will also permit advisers and funds to design appropriate processes and procedures based on new issuer disclosures and ESG-related data.

The failure to allow for this type of sequencing would place an undue burden on advisers and funds and could cause confusion amongst various market participants, which would hinder the Commission's objectives in proposing both of these Rules. Accordingly, MFA recommends that the effectiveness of the Final Rules be sequenced to follow the SEC's Proposed Public Company Climate-Related Disclosure Rules if they are adopted.

III. CONCLUSION

We are supportive of the Commission's general efforts to promote "reliable information among investment products and advisers that claim to consider one or more ESG factors,"[32] particularly in light of the ongoing innovative and evolving nature of ESG investing. However, the Proposal's prescriptive approach for specific ESG disclosures is a problematic and material departure from the existing SEC disclosure framework. Requiring an adviser to provide extensive disclosures concerning how it integrates ESG factors—no matter how incidental the use of such factors may be or whether the adviser considers those factors as part of a strategy that is marketed to investors as affirmatively pursuing ESG outcomes—could result in undue emphasis on an otherwise immaterial aspect of the strategy, which would be contrary to the Commission's stated goal of reducing the risk of "greenwashing" by creating a misleading impression of the importance of ESG factors. In addition, we believe the new requirements set forth in the Proposal are unnecessary, given: (i) the existing requirements under Section 206 of the Advisers Act, which are already being used to address potential "greenwashing" and to oversee compliance with ESG policies, and (ii) the type of sophisticated investors investing in private funds regularly seek additional specific disclosures and reporting based on their particular needs and preferences. For these reasons, MFA urges that the Commission consider the recommendations set forth in this letter as it proceeds with adoption of any Final Rules.

[32] *See* Proposing Release, *supra* footnote 2, at 7.

We appreciate the opportunity to provide comments, and please do not hesitate to contact David Lourie, Vice President & Senior Counsel or the undersigned at (202) 730-2600.

Respectfully Submitted,

/s/ Jennifer W. Han

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Chief Counsel & Head of Global Regulatory Affairs

cc: The Honorable Gary Gensler, Chair
The Honorable Hester M. Peirce, Commissioner
The Honorable Caroline A. Crenshaw, Commissioner
The Honorable Mark T. Uyeda, Commissioner
The Honorable Jaime Lizárraga, Commissioner