In brief

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SEC proposals on fund and adviser ESG disclosures and fund names

At a glance

The SEC has proposed enhanced disclosures for funds and investment advisers that consider ESG factors and expanded naming guidance for registered funds.

What happened?

On May 25, the SEC proposed two rules impacting funds and advisers. One proposes enhanced disclosure requirements for funds and investment advisers that market themselves as having an ESG focus. The other would expand applicability of the SEC's "Names Rule" to funds that focus on a particular investment characteristic, such as ESG or growth.

Proposal to enhance ESG disclosures of certain funds and advisers

The SEC proposed enhanced disclosures for funds (registered investment companies (RICs) and business development companies (BDCs)) and investment advisers (registered investment advisers and certain advisers exempt from registration) that consider ESG factors in their portfolios. The proposal identifies three types of funds with tiered disclosure requirements.

- Integration funds - Funds that integrate ESG factors with non-ESG factors in investment decisions would be required to describe how they do so.
- ESG-focused funds - Funds that significantly or primarily consider ESG factors in investment decisions would be required to provide detailed disclosure about their ESG strategy, including a standardized ESG strategy overview table.
- Impact funds - A subset of ESG-focused funds that seek to achieve a particular ESG impact would be required to quantitatively disclose how they measure progress toward their objectives.

The disclosures for certain ESG-focused funds would include the percentage of ESG-related proxy matters supported by the fund as well as information regarding ESG engagement meetings. Impact funds would also need to disclose key metrics on the fund's ESG goals and related progress. Greenhouse gas (GHG) emissions would generally be required to be disclosed for ESG-focused funds that consider environmental factors in their investment strategies. Disclosures would include specified scope 1 and 2 GHG emissions metrics of the portfolio as well as scope 3 emissions if they are reported by the portfolio companies.[1] Scope 3 financed emissions would be reported separately from scope 1 and 2 financed emissions and separately for each industry sector in which the fund invests.

The proposed disclosures would be in the fund prospectus and in the management's discussion of fund performance section of fund annual reports. Advisers that consider ESG factors would be required to make similar disclosures in their brochures and Form ADV filings with the SEC.

For more details about the proposed disclosure requirements, refer to the SEC's proposed rule or fact sheet.

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[1] For more information on greenhouse gas emissions, listen to our podcasts, Getting smarter on GHG emissions: Scope 1 and Scope 2 and Getting smarter on GHG emissions: Scope 3.

Proposal to amend the Names Rule

The SEC proposed amendments to its rule 35d-1 under the Investment Company Act of 1940, commonly referred to as the "Names Rule." Currently, the Names Rule requires a RIC or BDC to invest at least 80% of its assets in the *type* of investment, or in investments in the industry, country, or geographic region, suggested by its name. The proposal would expand the existing 80% requirement to apply to any fund name with terms suggesting that the fund's focus is in investments with *particular characteristics*. Examples include fund names with the terms "growth," "value," or any term that suggests the fund meets certain ESG criteria, such as "sustainable" or "green."

Integration funds would not be permitted to use ESG terms in their names; the proposal states that doing so would be materially deceptive and misleading. A fund would be permitted to temporarily depart from the 80% investment requirement only in certain specified circumstances (e.g., market fluctuations or other circumstances where the temporary departure is not caused by the fund's purchase or sale of a security or the fund's entering into or exiting an investment). However, the fund would have to return to compliance with the 80% investment requirement as soon as reasonably practicable, with compliance required in most cases within 30 days.

The proposal also includes information on how to calculate the 80% concentration, including how to value investments in derivatives, and requires additional recordkeeping on compliance with the Names Rule.

For more details about the proposed disclosure requirements, refer to the SEC's proposed rule or fact sheet.

Why is this important?

These proposals would standardize naming and disclosure requirements for funds that consider ESG factors in their investment allocations in an effort to provide more decision-useful information to investors.

What's next?

Public comments on each of the proposals will be due 60 days after they are published in the Federal Register. Each rule would be effective after a one-year transition period following the date the final rule is posted in the Federal Register.

Funds and advisers should begin to prepare by first determining their current and future strategic level of focus on ESG factors. With this understanding, they should assess the policies, procedures, and data underlying their ESG investments and consider whether there is a need to enhance governance and compliance oversight. In addition, funds and advisers impacted will need information from the companies in which they invest, which may be private and not otherwise subject to SEC rules. It is best to begin discussion now on timing and availability of information. Lastly, advisers to RICs and BDCs should consider how the proposed amendments to the Names Rule would impact the names of their funds and investment policies.

We will also release a podcast that summarizes the proposals. Look for it at viewpoint.pwc.com or wherever you get your podcasts.

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