Summary Draft: Preliminary Recommendations of ESG Subcommittee for the AMAC

- Our recommendations apply broadly to products defined as ESG/sustainable/responsible investing
- These products are not significantly different from other products, with these exceptions
  - Less available public data to support these risk factors than many traditional products
  - Risk/return objectives that could reflect a longer time horizon than traditional products
  - Objectives that may fall outside risk/return objectives alone
- Overview of areas of our recommendations:
  - Issuer disclosure
  - Investment product disclosure
- Introductory statement of how these areas interrelate and our overall approach
  - We considered the full spectrum of action and in most case, recommend the encouragement of best practices, rather than a more prescriptive approach (brief summary of benefits and drawbacks of the ends of the spectrums we explored)
  - If standardized, consistent issuer disclosure were available, this could obviate the need for any additional practices in investment product disclosure, and would make performance attribution to ESG factors more consistent and reliable
  - Significant disclosure requirements already exist and we do not see the need to change the disclosure laws to improve the quality and comparability of ESG for investors
  - What we do recommend as needed is the adoption of standards for those disclosures; we propose that mandatory, rather than voluntary, standards may need to be established, as the current approach has not resulted in consistent, comparable, complete and meaningful disclosure
  - We do not recommend the highly prescriptive approach that is used, for example, in Europe, as that may result in the production of metrics that are not needed to assess an issuer’s material risks, and unnecessary cost
  - Instead, we prefer a focus on a limited number of material metrics, tailored by industry, overseen by an independent standard setting entity such as SASB, or other similar approaches based on frameworks such as TCFD and GRI
  - For this reason, we do recommend the encouragement of additional best practices in the ESG disclosures of investment products as necessary, but where these practices would be less important as issuer disclosure improves
  - In the absence of consistent issuer disclosure, we have no recommendations relating to performance measurement and attribution, but suggest that the topic be revisited if issuer disclosure improves significantly, as new best practices may emerge at that point

- ***Recommendations for issuer disclosure***

We recommend the SEC take steps to mandate the adoption of standards by which corporate issuers disclose material ESG risks. Those standards should:

- Be authoritative and binding, akin to generally accepted accounting principles (GAAP)
- Apply to disclosure of *material* ESG risks
- Guide issuers in evaluating whether an ESG risk is material, or could become so in the future
- Ensure disclosure of those material risks is:
    - Comprehensive: Addresses all material ESG risks
    - Meaningful: Conveys the issuer's exposure to each ESG risk
    - Comparable: Balances uniformity (to allow comparison across industries) and specificity (to allow comparison within industries)

We recommend the SEC consider the following approach to enhancing issuer disclosure of material ESG risks:

- Standard-setting:
    - Leverage third-party standard setters' frameworks for disclosure of material ESG risks, including quantitative backward- and qualitative forward-looking metrics and disclosures
        - Standards should be material, limited by industry, and provide clear guidance on relevant metrics; SASB's work currently meets these requirements, and other bodies may also do so in the future
    - Following appropriate study and deliberation, designate those third-party standards as authoritative and binding, putting them at parity with standards promulgated under GAAP
- Disclosure framework:
    - Embrace principles-based standards that mandate disclosure of material ESG risks
    - Encourage balanced approach that requires disclosure of focused list of material "core" ESG risks applicable to most issuers (such as climate risk), supplemented by disclosure of ESG risks pertinent to the issuer's business or industry
    - Apply disclosure requirements to all issuers, but consider tiering requirements as appropriate for smaller issuers
- Standardization:
    - Encourage third-party standard setters to prioritize development of:
        - Forward-looking disclosures, and backward-looking measures, of material ESG risks; analysis of various climate-change scenarios; discussion of efforts being undertaken to mitigate those material risks
        - Industry-specific disclosures on material climate-change risks, supported by highly refined industry classifications that promote comparability
- Presentation
    - Disclose material ESG risks in a manner consistent with the presentation of other financial disclosures, temporally aligning data with financial metrics, integrating ESG disclosure into statutorily required SEC filings and reports; making presentation machine-readable in a standard format and taxonomy

- ***Recommendations for investment product disclosure***
  - Existing rules already adequately guide disclosure and advertising
  - The Commission/Staff should recommend to the industry best practices for ESG disclosure to foster comparability
    - While not seeking a prescriptive approach, we note that products that give consumable, comparable disclosure will be more attractive to investors and professionals who provide research concerning investment products.
    - This incentive will help move products in a more consistent, comparable direction, at little cost, in a way that benefits investors
  - Align with taxonomy such as ICI
    - Inclusionary
    - Exclusionary
    - Impact
  - Clearly describe objectives of strategy that are not straightforward risk/return objectives
  - Prioritize the product's objectives and describe how the product goes about achieving its top objectives
  - In shareholder commentary continue to explain how the product achieved its top objectives and how these contributed to return
  - We further recommend to the Commission/Staff that it would be useful for all products, including these products, to describe how products holding equities carry out their ownership responsibilities
    - how they vote proxies
    - whether they engage management individually, and/or participate in collective engagement of management
    - whether they lead shareholder motions
    - how they carry out any other stewardship activities

- ***Observations regarding performance measurement***
  - There are a mix of research and assessments concerning how ESG factors affect performance, and a clear picture does not emerge
  - The SEC already requires certain fund performance disclosures and has recently proposed updates to those rules
  - A key component of the SEC's approach is to require benchmarking against a broad-market index and allow funds to determine whether the use of a secondary, more tailored index reflecting the fund's objective or strategy is appropriate
  - We believe this approach gives investors important performance information
  - We do not believe ESG should be treated differently than other fund objectives or strategies, with different or more stringent performance disclosure obligations

As the ESG market further develops and coheres, secondary benchmarking and other analyses may become valuable tools for investors as they have become for other investment strategies