GLOBAL AFFAIRS
ASSOCIATES

May 5, 2020

The Honorable Jay Clayton, Chairman
Vanessa A. Countryman, Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

*Via Electronic Submission*

**Re: File No. S7-04-20 - Request for Comments on Funds Names**

Dear Chairman Clayton and Secretary Countryman:

Global Affairs Associates, LLC submits the following comments in response to the Securities and Exchange Commission's request for comments on fund names published in the federal register on March 2, 2020 (85 FR 13221).

Global Affairs Associates, LLC is a Houston, Texas sustainability consulting firm that helps clients make business-appropriate decisions about sustainability, including issues of ESG transparency. We are well-versed in the research linking certain ESG practices and disclosures to economic value. Our clients are typically publicly traded companies. Our mission is to empower companies to realize the economic value in social and environmental performance and transparency.

Like financial transparency, ESG transparency helps markets price risk properly. Because ESG transparency is fundamental for investors to properly evaluate risk and efficiently allocate capital, we share the SEC's concerns about the possible inappropriate use and abuse of the terms "ESG", "Sustainability", "impact", et al., as they relate to fund names. When linked to verifiable practices and data, ESG transparency can aptly indicate a fund's value and risk profile to markets. When used inappropriately or opaquely, claims of ESG credentials may obscure risks, and undermine the trend which, on the whole, advances market efficiency.

**Context from SEC**

This Request for Comments is lengthy. We focus on a narrow set of the questions which we felt comfortable responding to based on our knowledge of the topics and our experience. The questions are referenced by page number below. All text in blue is drawn from the Request for Comments.

The Names Rule generally requires that if a fund's name suggests a particular type of investment (e.g., ABC Stock Fund, the XYZ Bond Fund, or the QRS U.S. Government Fund), industry (e.g., the ABC Utilities Fund or the XYZ Health Care Fund), or geographic focus (e.g., the ABC Japan Fund or XYZ Latin America Fund), the fund must invest at least 80 percent of its assets in the type of investment, industry, country, or geographic region suggested by its name. (p. 6)

These funds often include these parameters in the fund name. The staff has observed that some funds appear to treat terms such as "ESG" as an investment strategy (to which the Names Rule does not apply) and accordingly do not impose an 80 percent investment policy, while others appear to treat "ESG" as a type of investment (which is subject to the Names Rule). (p. 9)

Based on EDGAR data, approximately 65 funds (excluding unit investment trusts) included the terms "ESG", "Clean", "Environmental", "Impact", "Responsible", "Social", or "Sustainable" in their names as of December 31, 2007. The number of funds increased to 291 as of December 31, 2019. (p. 9 Footnote)

**Questions from SEC**

*Should the Names Rule apply to terms such as "ESG" or "sustainable" that reflect certain qualitative characteristics of an investment? (p. 14-15)*

Yes, we believe that the SEC should update the Names Rule to apply to terms such as "ESG" or "sustainable," regardless of whether funds consider themselves investment policies or strategies.

> The Names Rule generally requires that if a fund's name suggests a particular type of investment (e.g., ABC Stock Fund, the XYZ Bond Fund, or the QRS U.S. Government Fund), industry (e.g., the ABC Utilities Fund or the XYZ Health Care Fund), or geographic focus (e.g., the ABC Japan Fund or XYZ Latin America Fund), the fund must invest at least 80 percent of its assets in the type of investment, industry, country, or geographic region suggested by its name. (p. 6)

ESG refers to a wide spectrum of environmental, social, and corporate governance considerations that may impact a company's ability to execute its business strategy and create value over the long term.[1] Any investment making claims of ESG or sustainability should be required to invest at least 80 percent of its assets per the ESG investment strategy, policy or objective suggested by its name, and be required to make additional disclosures as to the particular qualitative and/or quantitative characteristics of its investments (more on this below). The reason for this is that "ESG" as a concept is so broad that additional clarification is necessary for investors to make appropriate decisions.

A helpful method for clarification could begin with clearly defining where the investment falls on the Responsible Investment Continuum: Exclusionary Screening, ESG Integration, Thematic Exposure, or Impact Investing. Broadly speaking, we mean:

[1] ESG Glossary, Global Affairs Associates, LLC, December 2019

1. **Exclusionary Screening** - those excluding a specific industry or product (e.g., weapons manufacturers or fossil fuels)
2. **ESG Integration** - Investments are screened based on a predefined set of ESG criteria. The criteria should be clearly defined and disclosed.
3. **Thematic Exposure** - based on a unifying impact theme, such as gender diversity or low carbon energy
4. **Impact Investing** - while less likely to show up in public markets, these investments seek a specific environmental or social return alongside a financial return (e.g., an increase in vaccination rates)

One could argue that Thematic Exposure behaves more like investment strategy, while exclusionary screening and ESG integration behave more like investment policies. However, in order to effectively execute a thematic exposure investment, policies are also necessary. For example, how could one correctly assemble a gender diversity portfolio or low carbon portfolio based on existing SEC disclosure requirements that do not address these issues? These require voluntary disclosure from companies, and thus require a clearly defined investment policy for screening. Therefore, the Names Rule should indeed apply to any fund claiming space on the Responsible Investment Continuum.

More generally, the broad and pliable nature of the terms "ESG" and "Sustainable" means that there are a variety of qualitative and quantitative characteristics that could be considered. This is what leads to the confusion and potential abuses of such terms. It is precisely because of the broad and pliable nature of such terms that the Names Rule could be a useful tool for driving clarity and transparency for investors.

At the very least, any investment making such a claim in their name should clearly state in the prospectus,

5. which aspect(s) of "ESG" they are focused on
6. their specific definition of the term used, ideally referencing a standard definition
7. the specific criteria screened for.

*Are investors relying on these terms as indications of the types of assets in which a fund invests or does not invest (e.g., investing only in companies that are carbon neutral, or not investing in oil and gas companies or companies that provide substantial services to oil and gas companies)? (pp. 14-15)*

a. *Or are investors relying on these terms as indications of a strategy (e.g., investing with the objective of bringing value-enhancing governance, asset allocation or other changes to the operations of the underlying companies)?*
b. *Or are investors relying on these terms as indications that the funds' objectives include non-economic objectives?*

c. *Or are investor perceptions mixed among these alternatives or otherwise indeterminate? If investor perceptions are mixed or indeterminate, should the Names Rule impose specific requirements on when a particular investment may be characterized as ESG or sustainable and, if so, what should those requirements be?*

It is our understanding, generally speaking, that at best, investor perceptions are mixed among those alternatives, and in some cases they are indeterminate. Please see our previous answer for a discussion of the Responsible Investment Continuum and an answer to item C.

*Should there be other limits on a fund's ability to characterize its investments as ESG or sustainable? For example, ESG (environment, social, and governance) relates to three broad factors: must a fund select investments that satisfy all three factors to use the "ESG" term? (p. 15)*

Yes, there should be other limits on a fund's ability to characterize its investments as ESG or sustainable. The very use of ESG can be problematic because it means everything--and therefore can mean nothing. Currently, the term "ESG investing" is often used interchangeably with "Responsible Investing." Yet a more nuanced approach could support clarity. Funds should demonstrate which aspect of ESG they are focused on, articulate where they fall on the Responsible Investment Continuum, and how they justify their claim.

- **Exclusionary** screened funds should <u>not</u> use the term "ESG" because they are not adhering to any ESG criteria but rather negative screening. Rather, in general, they should refer to what's excluded, i.e., "Alcohol Free."
- **ESG Integration.** When referring to the ESG integration approach, meaning the inclusion of ESG criteria for screening, the fund should transparently communicate their clearly defined set of ESG criteria and how the portfolio companies are evaluated regularly against those criteria.
- **Thematic exposure**. Such portfolios may have an easier time avoiding confusion already because their nature is an active focus on a certain E, S, or G theme. They should focus on their theme and avoid the term "ESG" because a company's inclusion based on theme does not mean they meet any other form of ESG criteria. For example, take a theoretical company that meets the criteria of a "Clean Energy" fund because they produce solar panel parts. Yet the company scores low on ISS[2] governance criteria and has high exposure to unmitigated labor risks where they operate abroad. They may meet the theme, but are not necessarily required to meet any other criteria. (If a fund does begin implementing ESG criteria alongside the theme, it could communicate that clearly).
- **Impact investing**. Again, this is more common in private markets, but for argument's sake the term ESG would also be too broad and confusing for this type of investment. Rather, the pro-active impact

[2] Institutional Shareholder Services

sought should be communicated. For example, for an investment focused on poverty alleviation could refer to the UN Sustainable Development Goals (SDGs) to communicate its impact area.

**Responsible Investment Continuum: Recommendations for Naming**

| | Description | Recommendation |
|---|---|---|
| Exclusionary | Do not adhere to ESG criteria but rather negative screening | Fund should generally refer to what's excluded, i.e., "Alcohol-free" |
| ESG integration | Inclusion of ESG criteria for screening | Fund should transparently communicate their clearly defined set of ESG criteria and how the portfolio companies are evaluated regularly against those criteria |
| Thematic exposure | Such portfolios may have an easier time avoiding confusion already because their nature is an active focus on a certain E, S, or G theme | Fund should focus on their theme and avoid the term "ESG" because a company's inclusion based on theme does not mean they meet any other form of ESG criteria |
| Impact investing | More common in private markets. The term ESG would also be too broad and confusing for this type of investment. | The impact pro-actively sought should be communicated |



In an effort to provide some additional clarity on the use of the terms, we will share our understanding of the evolution of the "ESG" term in this section.

**Corporate Social Responsibility (CSR)**

While the term "corporate social responsibility (CSR)" has been around since Howard Bowen coined it in 1953, the rubber met the road on CSR transparency with the founding of the Global Reporting Initiative (GRI) in 1997. CSR became the term of choice to embody the idea that corporations have a responsibility to society in addition to a responsibility to their shareholders. This movement was a societal response to many unfortunate incidents of corporate disregard for externalities caused by their operations and/or business models. At the UN Sustainable Investment Conference in 2018, Tom Mohin, Chief Executive of GRI, said succinctly that CSR reporting was "born of activism." Many corporate initiatives that resulted from the CSR movement were related to philanthropic giving, employee volunteering and matching funds, and human rights. Examples of joint civic-corporate initiatives resulting from the CSR movement include the Voluntary Principles on Security and Human Rights, founded in 2000, the Extractive Industries Transparency Initiative in 2003, and the UN Guiding Principles on Business and Human Rights, developed from 2005-2011. Notably, CSR also popularized the concept of stakeholder engagement.

**CSR to Sustainability**

In the 2010's, the term "sustainability" began to eclipse "corporate social responsibility/CSR" as the most popular buzzword. "Sustainability" has many definitions and uses, but modern sustainability in this context is typically rooted in the Brundtland Commission's definition of "sustainable development", published in *Our Common Future* in 1987:

> Sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs.

Two important global agreements also happened in 2015 that recognized the growing global risks related to climate change and the need to look holistically at human development. Through the Paris Agreement, parties agreed to reduce greenhouse gas emissions to limit the average global temperature rise to 2 degrees Celsius. Second, the issuance of the UN Sustainable Development Goals (SDGs), the next iteration of the Millennium Development Goals (MDGs), outlined a universal call to action to achieve the 2030 Agenda For Sustainable Development. The 17 ambitious goals, such as ending poverty and hunger, are to be achieved by 2030.

In a world far more connected than ever before, the proliferation of CSR and sustainability as serious concepts in investment and business hit a tipping point in the past decade, albeit at different paces in different regions. But with the activist and non-governmental origins of both CSR and sustainability, we believe the investment community needed something more technical and comprehensive as a catch-all phrase. Hence, the coining of environmental/social/governance, or ESG. As we at Global Affairs Associates like to say, "ESG is everything that's not on your balance sheet."

Of course, corporate governance is not new. Companies have to disclose their risks on their 10-K; the Sarbanes-Oxley Act of 2002 placed governance issues into mainstream financial discussions if they were not already present. Environmental and social concerns are not new either. But the laser-sharp focus from the international business community on climate change as a prominent, disruptive global risk has made those concerns more concrete.

The changing nature of global risk as outlined in the World Economic Forum's annual Global Risks Report demonstrates the seriousness of environmental risks to the global economy. The recommendations of the powerful Task Force on Climate-Related Financial Disclosure (TCFD), a Task Force of the Financial Stability Board, has made it clear that asset owners and managers must take the risks and opportunities seriously. In addition, two additional major trends have also impacted ESG's meteoric rise: a growing body of research demonstrating the financial materiality of certain, industry-specific ESG factors to company success; and a change in consumer preferences as Millennials come of age demanding more transparency and E&S performance from their portfolios.

This is a very lengthy way to say that a best-case scenario would be a use of these terms that reflects a deep understanding of the complex global issues driving their use, and linked to clearly defined criteria and goals, depending on their place in the Responsible Investment Continuum.

*Are there particular terms used in fund names that are especially prone to mislead investors? (p. 16)*

ESG is especially broad; it stands for quite literally anything and everything that is not on the balance sheet. We need to move to a place in which people understand ESG is <u>not</u> the latest iteration of CSR or sustainability, but rather is <u>anything</u> about a business that is not on the balance sheet, that can impact the business' success or impact its stakeholders, positively or negatively. As discussed above, the use of ESG unless backed by clearly defined criteria can be problematic. A move toward specificity in terminology would help this problem. See our Responsible Investment Continuum recommendation chart above.

*Are there alternative ways in which fund names should be regulated or addressed that would more effectively protect investors? For example, through hyperlinks or other technology, should funds be required to connect their names to a more detailed discussion of the fund's investment strategy in a manner that is immediately accessible to investors in a variety of contexts? (p. 17)*

Yes, absolutely; in addition to the Names Rule, such methods would be extremely helpful to provide the detail. It would allow investors to have immediate access to the details, while providing additional incentive for Names Rule compliance. In addition, from the corporate perspective, companies that wish to participate in ESG-related funds would have more clarity as to how they are being evaluated and chosen.

*Are there approaches other jurisdictions or other regulated industries use that may work well for U.S. investors? Would a principles-based approach be better? If so, what should the principles be? (p. 17)*

Other jurisdictions' approaches to naming standards reflect differing policy goals, but there are also active efforts to move toward convergence. For example, the EU taxonomy standards aim to create a common language for sustainability, and are primarily focused on "strengthening the transparency of companies on their environmental, social and governance (ESG) policies." In the EU case, "Taxonomy is a classification tool, essentially a list of economic activities and performance thresholds." For example, "It specifies what level of environmental performance a service or product should have if it is going to contribute to Europe's environmental objectives." Such economic performance should make a contribution to one of the six environmental objectives set by the EU: climate change mitigation, climate change adaptation, sustainable and protection of water and marine resources, transition to a circular economy, pollution prevention and control, and protection and restoration of biodiversity and ecosystems. While the EU's set of policy objectives is unique, the beauty of the EU taxonomy is that it has policy objectives as guidance, providing a level of clarity and distillation of priorities.

Another example is that China and Hong Kong have implemented policies which require more transparent ESG reporting frameworks for "green" or "ESG" funds. The China Securities Regulatory Commission, "has introduced new requirements that, by 2020, will mandate all listed companies and bond issuers to disclose ESG risks using China's own sustainability reporting standards." Hong Kong has implemented "enhanced product-level disclosure requirements for any retail fund with a green/ESG focus evident in its name." China's and Hong Kong's policies promote implementation of their own reporting standards. Canada also has a set of 'green taxonomy' which is unique to the country, taking regional characteristics into consideration.

Convergence in taxonomy is an important global goal, however. Several joint initiatives exist, such as the effort between the China Green Finance Committee (CGFC) and the European Investment Bank to map and compare green bond standards.[3] (See appendix for additional resources.)

In summary, thank you for the opportunity to comment. We are available should you wish to discuss further.

Sincerely,

Amanda Hsieh

Kaitlyn Allen
President & CEO

Amanda Hsieh
COO

[3] https://www.eib.org/en/press/all/2017-311-joint-white-paper-by-china-green-finance-committee-and-eib-set-to-strengthen-international-green-bond-market

**Appendix: Additional Resources**

We have included additional resources that you may find helpful here.

1. Harvard Law - Towards a Common Language for Sustainable Investing
    a. "Investment product naming conventions. This aspect of taxonomy focuses on helping to bring clarity to common investment product names. For example, what is meant by "impact", "ESG" and similar terms, and thematically, what is meant by labels such as "low carbon", "ethical", "socially responsible" and the like when applied to investment products? Are there guidelines or useful metrics that can allow asset owners to better understand these products and strategies?"
    https://corpgov.law.harvard.edu/2020/01/22/towards-a-common-language-for-sustainable-investing/
2. ESG naming and taxonomy initiatives
    a. "establishing a clear and detailed EU classification system – or taxonomy – for sustainable activities. This will create a common language for all actors in the financial system"
    "strengthening the transparency of companies on their environmental, social and governance (ESG) policies. The Commission will evaluate the current reporting requirements for issuers to make sure they provide the right information to investors"
    https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance_en
    b. EU Sustainable Finance Taxonomy
    "The EU taxonomy is a tool to help investors understand whether an economic activity is environmentally sustainable, and to navigate the transition to a low-carbon economy. Setting a common language between investors, issuers, project promoters and policy makers, it helps investors to assess whether investments are meeting robust environmental standards and are consistent with high-level policy commitments such as the Paris Agreement on Climate Change."
    https://www.unpri.org/sustainable-markets/eu-sustainable-finance-taxonomy
    c. EU taxonomy final report: 2020 starts a decade of action on climate change
    "Taxonomy is a classification tool, essentially a list of economic activities and performance thresholds. It specifies what level of environmental performance a service or product should have if it is going to contribute to Europe's environmental objectives."

"The taxonomy also matters because it's underpinned by regulation. The list of economic activities and performance thresholds will be issued as part of the explicit legal requirements from the European Commission by the end of 2020."
https://www.unpri.org/eu-taxonomy-final-report-2020-starts-a-decade-of-action-on-climate-change/5547.article

d. "In Asia Pacific, regulators and stock exchanges are increasingly focused on how to achieve a common approach to sustainable finance terminology. A common theme has been a sharp regulatory focus on issuer disclosure, with the key jurisdictions either imposing or promoting voluntary compliance with ESG reporting frameworks."
https://corpgov.law.harvard.edu/2020/01/22/towards-a-common-language-for-sustainable-investing/

e. "China was the pioneer and leads the region on this front: in August 2016, China issued the 'Guidelines for Establishing the Green Financial System', a comprehensive policy framework to aggressively promote green finance, including the need for increased ESG transparency. Since then, the China Securities Regulatory Commission (CSRC) has introduced new requirements that, by 2020, will mandate all listed companies and bond issuers to disclose ESG risks using China's own sustainability reporting standards. At the same time, China is placing clear policy emphasis to move towards harmonization of green standards both domestically and internationally. In November 2017, the China Green Finance Committee (CGFC) and the European Investment Bank jointly published a white paper which mapped and compared green bond standards, paving the way for convergence in taxonomy. In December 2017, China and the UK jointly launched a 3-year initiative for a group of financial institutions to pilot TCFD reporting."
https://corpgov.law.harvard.edu/2020/01/22/towards-a-common-language-for-sustainable-investing/

f. "In April 2019, the Hong Kong Securities and Futures Commission (SFC) issued enhanced product-level disclosure requirements for any retail fund with a green/ESG focus evident in its name, and in May 2019 the Hong Kong Stock Exchange conducted a consultation on proposed higher issuer reporting standards, including certain mandatory ESG disclosures. These followed the SFC publication of a 'Strategic Framework for Green Finance' in 2018, under which a key priority is to increase disclosure on climate risks."
https://corpgov.law.harvard.edu/2020/01/22/towards-a-common-language-for-sustainable-investing/

g. "The Singapore Exchange has implemented a comply-or-explain model for sustainability reporting, covering the primary components: material ESG factors, policies, practices and performance, targets, sustainability reporting framework, and board statements. The Monetary Authority of Singapore will publish a consultation paper in 2020 on a new set of

Environmental Risk Management guidelines to set standards on governance, risk management and disclosure across the banking, insurance and asset management sectors."
https://corpgov.law.harvard.edu/2020/01/22/towards-a-common-language-for-sustainable-investing/

h. Redefining ESG: A green taxonomy for Canada?
"The report, written by the Expert Panel on Sustainable Finance, concluded that the Canadian economy would benefit from a green taxonomy, but only if it incorporates features that are unique to the country. A taxonomy would enable investment managers to put pressure on Canadian companies that have poor ESG track records, with the aim of elevating their ESG profiles."
https://www.refinitiv.com/perspectives/future-of-investing-trading/redefining-esg-a-green-taxonomy-for-canada/

3. Examples of popular ESG funds and what types of companies are included
https://www.bloomberg.com/graphics/2018-ten-funds-with-a-conscience/
    a. Calvert Equity (CSIEX)
        i. Fund top holdings:
        Alphabet, Visa, Microsoft Corp, Danaher Corp, Thermo Fisher Scientific, Ecolab, Mastercard, Intercontinental Exchange, Linde PLC, and Zoetis
        https://www.bloomberg.com/quote/CSIEX:US
    b. Putnam Sustainable Leaders (PNOPX)
        i. Fund top holdings:
        Microsoft Corp, Apple, Visa, Amazon.com, Bank of America Corp, Danaher Corp, BlackRock, Adobe, Fidelity National Information, and Hilton Worldwide Holdings
        https://www.bloomberg.com/quote/PNOPX:US
    c. Calvert U.S. Large Cap Core Responsible Index (CSXAX)
        i. Fund top holdings:
        Apple, Microsoft Corp, Amazon.com, Alphabet, JP Morgan Chase & Co, Visa, Procter & Gamble Co / The, Bank of America Corp, Mastercard, and Intel Corp
        https://www.bloomberg.com/quote/CSXAX:US
    d. Neuberger Berman Sustainable Equity (NBSRX)
        i. Fund top holdings:
        Microsoft Corp, Intercontinental Exchange, Texas Instruments, Alphabet, Stanley Black & Decker, Comcast Corp, JP Morgan Chase & Co, Becton Dickinson and Co, Cigna Corp, and Medtronic PLC
        https://www.bloomberg.com/quote/NBSRX:US