August 16, 2022

<u>Via email</u>

rule-comments@sec.gov

Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: <u>Comments on Proposed Rule - Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices - File Number S7-17-22</u>

Dear Ms. Countryman:

LTSE Services, Inc., appreciates this opportunity to provide comments and offer our support for the proposed rule entitled "Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices".[1] Although we believe the proposal represents a significant step toward eliminating "greenwashing", as well as materially deceptive and misleading business and investment practices among some funds and advisors, we would like to offer our suggestions for the Securities and Exchange Commission (SEC) to consider in formulating the final rule.

LTSE Services, Inc. is a data, analytics and advisory driven capital markets platform specifically designed for public companies and private companies planning to enter the public markets and an affiliate of The Long-Term Stock Exchange, Inc.

[1] *Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices*, Securities Exchange Act Release No. 94985 (May 25, 2022), 87 FR 36654 (June 17, 2022)[Enhanced Disclosures Rule].

(Exchange)[2]. We strive to help create a more sustainable world by encouraging public companies that join the LTSE ecosystem to integrate sustainability into long-term business models whose purpose is to generate significant long-term value for all of their respective stakeholders. In our view, the Environmental, Social and Governance (ESG) analysis is crucial for both companies and investors in understanding the risks and opportunities associated with the transition towards a more sustainable economy.

We support the requirements in the Enhanced Disclosures Rule to require the categorization of certain types of ESG strategies broadly and the requirement that funds and advisers subject to the proposed rule provide more specific disclosures in fund prospectuses, annual reports, and adviser brochures based on the ESG strategies pursued. We agree that Investors deserve "consistent, comparable and reliable information"[3] among investment products and advisors that claim to consider one or more ESG factors as part of their investment strategy. However, in achieving the objectives of the proposed rule, we urge the SEC to consider the underlying drivers of the rise of sustainable investing strategies in formulating the requirements of the final rule.

Fundamentally, investors have become critically aware of the social and environmental issues that plague society, including climate-change risks, biodiversity loss and rising social inequality which have demonstrated the need for a more sustainable form of capitalism. Funds, Investors, regulators and policymakers have all astutely highlighted that changes in capital market investment dynamics carry the potential to meaningfully affect asset prices and the world economy at a macro level. This acknowledgement has given rise to a movement supporting the transition toward a sustainable economy, while supporting long-term value creation.

We concur with the SEC regarding the design of the rule and its underlying purpose. However, we recommend that the SEC develop a "*Sustainability Taxonomy*", that establishes definitions and activities that can be categorized as sustainable economic activities. Similar to the EU Taxonomy[4], this would provide companies, funds, and policymakers with appropriate definitions for which economic activities can be considered environmentally sustainable. This enhancement to the regulatory framework, coupled with increased disclosure requirements related to funds and

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[2] The Exchange is an SEC-registered national securities exchange with a mission to serve companies and investors who share a long-term vision.
[3] See generally, Enhanced Disclosure Rule, 87 FR 36654 (June 17, 2022).
[4] See Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending regulation (EU) 2019/2088, Official Journal of the European Union, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32020R0852.

investment advisors, will help advance the underlying objective of sustainable investment strategies - namely to help shift capital towards its highest and greatest impact. Preserving and supporting the underpinning of these sustainable investment strategies simultaneously protects investors from greenwashing concerns.

In establishing a Sustainability Taxonomy, we believe this should be developed from the viewpoint of 'double materiality'. This provides the SEC with the opportunity to not only protect and enhance disclosures for shareholders, but also a broader group of stakeholders that are relevant to a given company's ecosystem. A careful, and methodical, implementation of a "Sustainability Taxonomy" is critical to establishing a framework that balances both shareholder and stakeholder protection. A "Sustainability Taxonomy" is a foundational element which moves society toward defining and achieving the protection of shareholders in their dual role as key stakeholders.

This rule, alongside the 'Names Proposal Rule'[5] , will go a long way to help create a consistent, comparable, and decision-useful regulatory framework and represents a significant step in helping investors, and those who provide advice to investors, make more informed choices regarding sustainable investing and better compare funds and investment strategies. It will also help substantially eliminate *the exaggeration of ESG and sustainability practices* by funds and advisers regarding the extent to which their investment products or services take into account ESG factors. In addition to our recommendation for a Sustainability Taxonomy, we would like to offer the following suggestions for the SEC to consider in formulating the final rule.

Additional specific disclosure requirements regarding ESG strategies in fund prospectuses, annual reports, and adviser brochures

As noted by the SEC in its proposing release related to the Enhanced Disclosures Rule, funds and registered advisers are currently subject to disclosure requirements concerning their investment strategies.[6] Funds must provide disclosures concerning material information on investment objectives, strategies, risks and governance, and management must provide a discussion of fund performance in the fund's shareholder report.[7] General disclosures about ESG-related investment strategies fall under these disclosure requirements, and failure to adhere to current disclosure requirements violates applicable SEC requirements[8], but there are no specific rules

[5] *Investment Company Names*, Securities Exchange Act Release No. 94981 (May 25, 2022), 87 FR 36594 (June 17, 2022) [hereinafter "Names Proposal"].
[6] See generally, Enhanced Disclosures Rule, 7 FR 36658 (June 17, 2022).
[7] Id.
[8] Id.

defining what a fund or adviser following an ESG strategy must disclose to investors[9]. However, as previously discussed, nuances and subjectivity in terminology and investment strategies create ambiguity and confusion, particularly for investors who seek to invest according to their values and/or achieve the best risk-adjusted returns. The SEC's response, as articulated in the proposed rule, is to require funds and advisers to disclose, with specificity, their ESG Investing approach. In theory, this requirement can help investors and clients understand the methodology the fund or adviser uses. This requirement can also assist investors in the comparison of a variety of approaches, such as the employment of an inclusionary or exclusionary screen, focus on a specific impact theme, or engagement with issuers to achieve ESG goals. The proposed rule seeks to ensure that these disclosures can be drawn out, with the goal of informing investors, by providing them with decision-useful information.

The Enhanced Disclosures Rule states *'funds that meet the proposed definition of 'Integration Fund' would provide more limited disclosures."* [10] The Enhanced Disclosures Rule provides that Integration Funds are required to summarize, in a few sentences, how the fund incorporates ESG factors into its investment selection process, including what ESG factors the fund considers. ESG analysis is a critical component of fundamental analysis, and data-permitting must be integrated into risk-models in order for investors to achieve superior risk-adjusted returns.[11] With this in mind, we believe that every fund that utilizes fundamental analysis, should be ESG integrated as failure to consider material ESG issues could be considered a breach of their fiduciary responsibility. We do not believe that any fund that uses fundamental analysis can completely and accurately articulate their ESG integration strategy in a short paragraph as recommended in this rule as investors require a level of transparency that allows them to identify those specific ESG components integrated into a fund's relevant risk-models. Therefore, we support this aspect of the proposed rule only if coupled with the Names Proposal requirement which states that ESG integration funds may not market themselves as 'ESG' in order to attract capital.[12] While we do not believe ESG integration Funds are"'greenwashing', we suggest that the SEC consider disclosure which requires that such funds disclose to investors that such funds' primary objectives is not to address the world's sustainability issues.

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[9] Id. See also ,In the Matter of Pax World Management Corp., Investment Advisers Act Release No. 2761 (July 30, 2008) (settled action) (alleging that despite investment restrictions disclosed in its prospectus, statement of additional information, and other published materials that it complied with certain socially responsible investing restrictions the fund purchased securities contrary to those representations and failed to follow its own policies and procedures requiring internal screening to ensure compliance with those restriction).
[10] Id. at 36660.
[11] Id. at 36661.
[12] Names Proposal, Securities Exchange Act Release No. 94981 (May 25, 2022), 87 FR 36594 (June 17, 2022).

The Enhanced Disclosure Rule states that “ESG-Focused” Funds, which would include, for example, funds that apply inclusionary or exclusionary screens, funds that focus on ESG-related engagement with the companies in which they invest, and funds that seek to achieve a particular ESG impact, would be required to provide more detailed information in a tabular format.[13] While we believe that this requirement, in theory, will help with decision making for underlying investors, in reviewing the recommended tabular approach for ESG-Focused Funds, we urge for the SEC to review ‘*seeks to achieve a specific impact*’ box within the template suggested because for the vast majority of ESG focused-funds, achieving impact is no more, or less, important than the other criteria provided. The nuance relates to ‘materiality’ and the respective fund’s approach to this concept. Funds that approach ESG from the concept of financial materiality may often seek to invest in companies with sustainable business models that are core to their investment thesis. As a result, this particular approach to materiality does not drive a fund to invest in companies addressing some of the world’s biggest problems and does not necessarily seek to make a specific impact. It is for this reason, we believe that the concept of “double materiality'' is foundational to the architecture of a “Sustainability Taxonomy” as it translates more directly into “ Impact”. We believe this distinction will help investors make more informed investment decisions. It will all support an approach toward the protection of all stakeholders, including shareholders.

Moreover, given the use of third-party ESG Ratings across all ESG strategies, we believe that ESG rating agencies should be brought under regulation. In doing so, we do not wish for the SEC to regulate opinion of this highly important and evolving field of finance, but, the materiality lens in ESG-ratings would be forced to be more consistent - namely from the viewpoint of double-materiality so as to help investors and in addressing the world’s most pressing problems and in turn redistribute capital to where it is most required.

The proposed rule also defines an “Impact Fund” as an ESG-Focused Fund that seeks to achieve a specific ESG impact or impacts.[14] An Impact Fund would be required to provide the proposed disclosures for all ESG-Focused Funds. Additionally, an Impact Fund must also include how it measures progress toward its stated impact; the time horizon used to measure that progress; and the relationship between the impact the fund is seeking to achieve and the fund’s financial returns. We commend the SEC for drawing this distinction, however, Impact Measurement is one of the most complex areas of sustainable investing. While a number of organizations such as the OECD and UN are working towards the development of accurate impact measurement

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[13] See generally, Enhanced Disclosures Rule, 7 FR 36662 (June 17, 2022).
[14] Id. at 36663.

tools, we recommend that the SEC implement a simple, but standardized, approach to impact measurement, until such initiatives are fully implemented.

Additional Disclosure Regarding Impacts and Proxy Voting or Engagements

Investment Stewardship, which includes both voting and engagement, is a key component of any investment strategy. We support requiring additional disclosure on these topics to help investors in ESG-Focused Funds understand how the fund's adviser engages with portfolio companies on ESG issues. We also support the layered disclosure approach related to this information. However, as noted in the proposed rule, if a fund that checks either the proxy voting or engagement box in the first row of the 'ESG Strategy Overview Table' indicating that proxy voting or engagement with issuers is a significant means of implementing its ESG strategy, we believe full details should be provided to investors rather than a brief narrative overview in the last row of the ESG Strategy Overview. We believe this requirement should apply whether 'significant' or 'not' given the influence funds have over companies and their ability to influence company behavior on key ESG issues. Additionally, we commend the SEC for their approach in requesting KPIs with respect to engagement, when coupled with holdings data, which will inform investors as to how central and/or important engagement is to a particular fund. Given the importance of proxy voting to any investment strategy, if a fund states that proxy voting is central to their ESG strategy, it only makes sense that for transparency purposes that their voting history on ESG issues must be made available for investors as well.

Generally requiring certain environmentally focused funds to disclose the Greenhouse Gas (GHG) emissions associated with their portfolio investments.

Finally, we commend the SEC for highlighting the current lack of consistent, comparable and decision-useful data to enable investors to make better informed investment decisions that are in line with their ESG investment goals, and assess any GHG-related claims a fund has made. [15] We note that the Enhanced Disclosure Rule would require an ESG-Focused Fund that considers environmental factors as part of its investment strategy to disclose the carbon footprint and the weighted average carbon intensity ("WACI") of the fund's portfolio in the MDFP or MD&A section of the fund's annual report, as applicable. [16] Having consistent GHG-related qualitative disclosures will enhance the ability of investors to make informed decisions with

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[15] Id. at 36655.

[16]Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices, Securities Exchange Act Release No. 94985 (May 25, 2022), 87 FR 36654 (June 17, 2022)[Enhanced Disclosures Rule].

regard to the carbon profile of a particular portfolio. This will ultimately enable environmentally focused investors to allocate capital toward decarbonized portfolios.

Since environmental and social issues are critically interconnected, we recommend for the SEC to ensure that all ESG-Focused Funds release quantitative and comparable GHG data. However, with respect to environmentally focused ESG-Focused Funds, by definition these funds invest in companies where the 'E' is material. Therefore, for these particular funds, we believe using Scope 1, 2 and 3 emissions data should be used when presenting the carbon profile of their respective funds. We would like to note that we believe that the SEC is correct in focusing on the carbon footprint and WACI, significant changes in an underlying company's market capitalization can be misrepresented with reviewing the WACI. Changes in market capitalization make it difficult to compare year-over-year performance.

Other metrics for the SEC to consider requiring the disclosure of by funds marketing themselves as ESG-Focused include the following '*Carbon Emissions to Value Invested*', normalized by fund assets under management. By normalizing Total Carbon Emissions, investors can compare portfolios of different sizes and still use a metric that is consistent with the GHG protocol. However, as discussed in more detail below, **funds must clarify for investors that the disclosure of these metrics by funds do not decarbonize the economy as a whole but represent investing in decarbonized portfolios**. It is important that disclosures made by funds make investors aware of this distinction between decarbonizing portfolios and the economy as it is often assumed that a portfolio with low WACI relative to a benchmark is helping solve the climate crisis. The reality is that this is not correct. In building on the SEC's proposal on disclosures related to climate-change[17], climate-change is an existential threat and one that also affects asset prices. In order to decarbonize the economy, a broad range of approaches and technologies is required, including but not limited to, energy efficiency, behavioral changes and electrification and a growth in renewable energy.

This dynamic can give rise to the fact that investments that might report high emissions, and ultimately be excluded from an ESG-Focused Fund, given the need to disclose the funds carbon metrics, could help the fund achieve an objective related to the environment generally or climate-change specifically. A prime example is investing in electric vehicles companies. As a result, the disclosures required by this

[17] See generally, the Enhancement and Standardization of Climate-Related Disclosures for Investors, Securities Exchange Act Release No. 94478 (March 21, 2022), 87 FR 21334 (April 11, 2022) [hereinafter "SEC Climate Disclosures Proposal"].

proposed rule will not be able to provide investors with consistent and comparable information related to impact of the fund's investment on the environment. This results from the important difference in decarbonized portfolios vs decarbonizing the economy, as mentioned above. However, in incentivizing investments into companies that can help facilitate the transition towards a more sustainable economy, we recommend that 'impact' funds be exempt from such reporting requirements. Alternatively, a simple and transparent approach towards impact reporting to be developed. In short, they should be required to describe the specific impact(s) they seek to achieve and summarize their progress on achieving those impacts that would move us toward a more sustainable economy and world. We believe such systemic issues can be articulated in a Sustainability Taxonomy.

Use of Carbon Offsets

Carbon offsetting has a powerful role to play in tackling the climate crisis. It is often a step in the journey to reach net zero and become climate positive. Carbon offsetting is an effective way for businesses to reduce their net carbon emissions. While it should not be used in place of a carbon reduction program, by emitting offsets, a fund runs the risk of not developing a powerful tool to tackle the climate crisis. By not including offsets, our concern is that companies could be disincentivized from trading these instruments and in turn in helping develop this important market that can be an effective tool to help decarbonize the economy.

While sometimes deemed controversial, carbon offsets operate on the theory that they are reducing carbon emissions. It is entirely possible for a fund to disclose such offsets separately, if it believed this information was helpful to investors, because funds are not restricted from providing additional information in the MDFP beyond what is permitted or required by SEC rules. As a result, we urge the SEC to make this disclosure requirement mandatory and require it to be prominently placed in the disclosure document.

Conclusion

We commend the SEC for its thoughtful consideration of issues related to disclosures by certain investment companies and advisors and its support for enhanced disclosures related to ESG and sustainability factors in fund disclosure documents, and adviser brochures, as applicable.

Investors clearly deserve clear and consistent information regarding investment funds and advisors that consider ESG factors and employ an ESG strategy in investment decisions, as well as voting of proxies on particular ESG-related voting matters and information concerning their ESG engagement meetings.

Given that the area of ESG and sustainable investments and investment strategies grew substantially over the past 20 years and continues to grow at an extremely rapid pace[18], *we* believe that SEC's Enhanced Disclosures Rule moves regulation closer to ensuring that investors get a clear and accurate picture of fund investment strategies and proxy voting practices so as to enable investors and clients to better compare ESG strategies of various managers and to ensure that their interests are better protected from "greenwashing" practice.

We urge the SEC to focus the Enhanced Disclosures Rule and the Names Proposal on an effort to incentivize investment funds to adapt investment criteria to focus companies on sustainable business practices and not just clarifying names and disclosure requirements. Enhanced disclosure related to the use of ESG or sustainability terminology alone will potentially address concerns of greenwashing, but with some adaptations, it may help towards the allocation of capital towards a more sustainable economy. The focus of regulation in this area should be on investment practices of investment funds and advisors, in order to encourage changes in business practices that will address the realities of the sustainability issues in the current global economy, and the steps that need to be taken to address such issues.

Thank you for your consideration. We appreciate the opportunity to comment on this Enhanced Disclosures Rule.

Please feel free to contact us with any questions or if we can provide any additional information.

Sincerely,

[18] U.S. sustainable investments increased from $639 billion in assets under management ("AUM") in 1995 to $17.1 trillion by 2020. The end of the last decade in particular saw extensive growth as the total U.S.-domiciled assets integrating ESG strategies grew from $12.0 trillion in 2018 to $17.1 trillion by 2020. This represented a 42% increase that brought the total amount of assets considering ESG strategies to 33%, or 1 in 3 dollars of total U.S. assets that are professionally managed. See, U.S. Sustainable Investing Forum, The Report on U.S. Sustainable and Impact Investing Trends (Nov. 16, 2020), available at: https://www.ussif.org/files/Trends/2020_Trends_Highlights_OnePager.pdf.

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