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SEC Proposes New ESG Rules for Funds, Clearly Signaling Its Intent to Scrutinize ESG Claims

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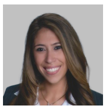

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The Securities and Exchange Commission (the "SEC") yesterday proposed amendments to rules and forms relating to ESG disclosures for investment advisors and investment companies. Specifically, the proposed changes seek to expand U.S. funds' disclosure requirements to clients and shareholders and to prevent misleading and deceptive claims relating to ESG qualifications.

The SEC's proposed rule explains that the intent of the proposed rules is to "create a consistent, comparable, and decision-useful regulatory framework for ESG advisory services and investment companies to inform and protect investors while facilitating further innovation in this evolving area of the asset management industry." The proposal would require disclosure regarding ESG strategies in fund prospectuses, annual reports, and adviser brochures. It would also require, in some cases, tabular ESG disclosure. Finally, it would require certain environmentally focused funds to disclose the greenhouse gas (GHG) emissions associated with their portfolio investments. A fact sheet released by the SEC can be found here.

Interestingly, the proposal categorizes ESG-focused funds into three different categories, and provides different disclosure requirements for each category:

1. *Integration Funds*. Funds that integrate ESG factors alongside non-ESG factors in investment decisions would be required to describe how ESG factors are incorporated into their investment process.

2. *ESG-Focused Funds*. Funds for which ESG factors are a significant or main consideration would be required to provide detailed disclosure, including a standardized ESG strategy overview table.

3. *Impact Funds*. A subset of ESG-Focused Funds that seek to achieve a particular ESG impact would be required to disclose how it measures progress on its objective.

This vote follows the SEC's announcement earlier this week that a major financial institution agreed to pay a $1.5 million penalty for misleading statements and omissions regarding its quality review of ESG factors in investment decisions. This settlement, taken together with yesterday's rule proposal and March's proposed climate disclosure rule, makes it apparent that the SEC is serious in its efforts to tackle so-called "greenwashing" and "social washing" concerns about ESG-related disclosures. As a result of this increased focus by the SEC, funds and other issuers should consult with counsel to ensure that their public statements and disclosures regarding ESG matters are not potentially misleading.

Yesterday's proposal will be published in the Federal Register for public comment. The comment period will remain open for 60 days after publication. The SEC's decision to allow for only 60 days to comment is notable because in recent weeks the SEC has faced public criticism and comment letters regarding the short comment periods on numerous recent rule proposals.

Please contact Cadwalader if you have questions about the application of the proposed rules.