

SEC proposal on ESG disclosure

*Specific requirements for Investment
Advisers and Investment Companies*



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1 Introduction and executive summary

The Need for Specific ESG Disclosure Requirements

In May 2022 the SEC published a proposal on new rules on the enhanced disclosures by certain investment advisers and investment companies about ESG investment practices

1 Background



Currently there are **no specific requirements** about what a fund or adviser following an ESG strategy must include in its disclosures. This situation generates a number of risks for market participants, such as:

- **Risk of exaggerated labels**, labeling themselves as “ESG,” “green,” or “sustainable” in an effort to attract investors or clients, when the ESG-related features of their investment strategies may be limited.
- **Inconsistency of information** concerning how ESG factors are considered in their investment strategies to investors, other market participants, and the Commission.

2 Overview of the Proposals



Funds

- **Minimum disclosure requirements** for ESG-Focused Funds, including GHG emissions.
- **Streamlined disclosure** for **Integration Funds** that consider ESG factors, among others.
- Funds to tag their ESG disclosures using the **Inline XBRL¹** structured data language.

Advisers

- **Adviser brochure** (Form ADV Part 2A) is **amended** to include information about **ESG-related disclosures from registered investment advisers** that consider ESG factors as part of their advisory businesses (several elements in common with the requirements proposed for registered funds).

- Require certain ESG reporting on **Forms NCEN and ADV Part 1A**, which are XML-structured forms.
- **Address the accuracy** of ESG-disclosures made to clients, investors and regulators and portfolio management process

3 Next steps



- Final publication (uncertain, the consultation period finished on 16 July 2022).
- Adoption, following the effective date of publication:
 - **One year** for the following elements: i) some proposed disclosure requirements in prospectuses and for UITs; ii) the proposed regulatory reporting on Form N-CEN, and iii) the proposed disclosure requirements and regulatory reporting on Form ADV Parts 1 and 2.
 - **18 months** for the proposed disclosures in the report to shareholders.



2

Fund Disclosure

Integration Funds, ESG-Focused Funds and UITs

The proposed rules would require the three different types of registered funds to disclose to investors how they incorporate ESG factors into their investment selection processes and in their investment strategies

1

Integration Fund disclosure

Summarize description of:

- **how the fund incorporates ESG factors** into its investment selection process.
- **what ESG factors** the fund considers

Where applicable, **how funds consider GHG emissions** (methodology)

2

ESG-Focused Fund disclosure

- Key information about their consideration of ESG factors in a **tabular format**¹
- **Engagement** with issuers on ESG issues (proxy voting and others)
- **GHG emissions metrics:** weighted average carbon intensity (WACI)² and carbon footprint³
- **Specific for Impact Funds:**
 - how the progress towards the stated impact is measured, the time horizon used and the impact - financial returns relationships.
 - Progress (qualitative and quantitative) and key factors on achieving the impact.

3

Unit Investment Trusts disclosure

- UIT with portfolio securities selected based on one or more ESG factors would have to explain **how those factors were used to select those securities.**
- **Not required:**
 - Differentiate disclosure based on whether a UIT's selection process was an integration model or an "ESG-focused" model and
 - Disclosure of engagement with portfolio companies.

How to disclose?

All these ESG disclosures shall be tagged using the Inline eXtensible Business Reporting Language ("Inline XBRL")



(1) See the Table [in Annex 1](#); (2) Portfolio's exposure to carbon-intensive companies, expressed in tons of carbon dioxide equivalents (CO2e) per million dollars of the portfolio company's revenue.; (3) The total carbon emissions associated with the fund's portfolio, normalized by the fund's net asset value and expressed in tons of CO2e per million dollars invested in the fund.

* Definition of each type of fund in [annex 2](#)

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Adviser Brochure Content of the brochure

Advisers registered with the Commission must deliver a brochure and one or more brochure supplements to each of their clients or prospective clients, which advisers may use to help them with their disclosure obligations as fiduciaries

1

Description of the ESG factor for each significant investment strategy or method of analysis



- Provide a **description of the ESG factor**;
- **Disclose to clients** how these factors are **incorporated when providing advice**;
- Explain **whether** and **how** the adviser incorporates a **particular ESG factor** (E, S, or G) and/or a combination of factors;
- Explain **whether** and **how** the adviser **employs integration** and/or ESG-focused **strategies**;
- If there are considered different ESG factors for different strategies should be included the **proposed disclosures for each strategy**

2

Criteria or a methodology to evaluate, select, or exclude investments based on the consideration of ESG



- **Non-exclusive list of criteria and methodologies** to evaluate investments is provided:
 - An **internal methodology**, a third-party criterion or methodology such as a scoring provider or framework, or a combination of both;
 - An **inclusionary** or **exclusionary screen**;
 - An **index**, including the name of the index and a description of the index and how the index utilizes ESG factors.

3

Description of any relationship or arrangement



- Describe any **relationship or arrangement**, that is **material** to the adviser's advisory business or to its clients, that the adviser or any of its management persons have with any related person that is an ESG consultant or other ESG service provider.

4

When voting client securities, include a description of which ESG factors they consider and how



- Have specific **voting policies** or **procedures** that include one or more ESG considerations when voting client securities to include in their brochures a description of which ESG factors an adviser considers and how they consider them.
- If an adviser has **different voting policies** and procedures for strategies that address ESG-related matters, or for different clients or different ESG-related strategies, the adviser generally should describe those differences.

4 Regulatory reporting on Form N-CEN and Form ADV

ESG related amendments

The SEC proposes to amend these forms for registered funds and advisers respectively, to collect census-type information about funds' and advisers' uses of ESG factors



Form N-CEN

Annual report filed with the Commission by **all registered investment companies**, other than face-amount certificate companies.



This information would **complement** the proposed tailored narrative disclosure included in the fund prospectus and annual report.



Form ADV

Uniform form used by **investment advisers** to register with both the SEC and state securities authorities.



These proposed amendments would expand the information collected about the advisory services provided to separately management account clients and reported private funds.

Disclosure requirements proposed:

A fund would be required to **indicate whether or not it incorporates ESG factors** and, if it does incorporate ESG factors, to report:

- the type of **ESG strategy** it employs
- the **ESG factor(s)** it considers
- if applicable, whether it considers **ESG factors as part of its proxy voting policies** and procedures
- provide the **legal name and legal entity identifier ("LEI")**, if any, or provide and describe other identifying number of each such ESG provider and whether the ESG provider is an affiliated person of the Fund.
- whether the fund follows any **third-party ESG frameworks**.

Disclosure requirements proposed:

1 Form ADV: Part 1A (Brochure)



- SEC proposes to **require ESG-related disclosures** from advisers that consider ESG factors as part of their advisory businesses, including when making investment recommendations or decisions and when voting client securities.
- SEC plans amendments to collect information about an **adviser's considerations of ESG factors** in its advisory business.

2 Form ADV: Part 2A (Wrap fee program brochure)



SEC propose disclosures about a wrap fee program sponsor's use of **ESG factors**, tailored to wrap fee programs.



This information will be collected using the structured **XML-based data**, languages in which those Forms are currently submitted, thus providing the Commission and investors with consistent, usable, and comparable data.

5 Compliance Policies and Procedures and Marketing

Address the accuracy of ESG-disclosures

Funds are required to adopt compliance policies to address the accuracy of their disclosure measures, which would be subjected to fixed dates and will have to fulfill some marketing requirements



Compliance policies

Compliance policies and procedures must address the **accuracy of disclosures made to clients, investors and regulators**, as well as **portfolio management processes**, including consistency of portfolios with investment objectives and disclosures by the adviser and/or fund.

ESG strategies, including integration, ESG-focused and impact strategies, will necessarily require **different levels and types of compliance policies** and procedures.

If a registered fund discloses to investors that it adheres to a particular **global ESG framework**, its policies and procedures should include controls that help to ensure client portfolios are managed in accordance with that framework.

If an adviser uses **ESG-related positive and/or negative screens** on client portfolios, the adviser should maintain adequate controls to monitor, implement, and update those screens.

The aim is to **prevent false or misleading advertisements** by advisers, including greenwashing, by prohibiting material misstatements and fraud.



Marketing rule

Advisers are not allowed to distribute, directly or indirectly, **advertisements that contain any untrue statement** of a material fact, or omitte o state a material fact necessary in order to make the statement made, in the light of the circumstances under which it was made, not misleading.

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Why MS

Key aspects and differential value

At MS we know the sector and we are specialists in both Sustainability and Regulatory Reporting, with knowledge of best practices in different industries and geographies, mobilising a team with extensive experience in the field

ESG

- ✓ **50+ projects** developed in the field of **Sustainability**, focusing on diagnosis and development of information models supporting management and regulatory reporting, development of models, strategic plans, adaptation to regulatory requirements, etc
- ✓ **Exhaustive knowledge of ESG regulation**, with a **Regulatory Observatory** specialising in sustainability requirements, including regulatory exercises (e.g. Pillar 3 ESG, stress tests).
- ✓ **R&D team specialised** in the definition and implementation of **climate risk measurement solutions** in different fields (physical risk, transition risk, portfolio alignment) used as accelerators in different projects.
- ✓ **Reference consultant for the World Bank**, maintaining a partnership through the IFC-Green Banking Academy in internal training and training for financial institutions in Climate Change Risk Management.
- ✓ Member of the **Social Impact Chair of internationally renowned universities** to promote training and development of social impact measurement methodologies.

Data Governance & Regulatory Reporting

- ✓ **100+ Data Transformation and Data Governance projects** in different industries (banking, insurance, energy, Telco, Retail, ...), considering the architecture, quality, data governance, etc. fronts.
- ✓ **Multidisciplinary team** with relevant experience in Regulatory Reporting and **Governance and Quality** projects.
- ✓ Capacity for **technical and functional challenge** through in-depth knowledge of **data management**.
- ✓ Our value proposition relies on a **specialist, cutting-edge R&D** team with centres of excellence in the field of modelling.
- ✓ **Independent view of any supplier**, collaborating with leading suppliers in these areas.



General capabilities of Management Solutions

- ✓ **Leadership in business consultancy** with a presence in **+40 countries**, through **+31 offices**, which gives us a global vision at world level, fundamental in this field.
- ✓ Proven **commitment and delivery capacity** (agile but high-value deliverables) and compliance with committed deadlines.
- ✓ **Unique partnership** model which facilitates our **benchmarking capability**.

A₁ ESG Strategy Overview table - Instructions for filling in it

General Instructions:

- Complete **each row** with the brief disclosure required by that row—and only the information required by the relevant form instructions—with **lengthier disclosure** or other available information required elsewhere in the prospectus.
- In an **electronic version** of the prospectus, that is, a prospectus posted on the fund’s website, electronically delivered to an investor, or filed on EDGAR with the Commission, the fund also would be required to provide hyperlinks in the table to the related, more detailed disclosure later in the prospectus to help investors easily access the information.

<p>Overview of the fund’s ESG strategy</p>	<p>Concise description in a few sentences of the factor or factors that are the focus of the fund’s strategy. These allow an investor immediately to identify the ESG strategies a fund employs.</p> <p>The Fund engages in the following to implement in (ESG) strategy:</p> <ul style="list-style-type: none"> <input type="checkbox"/> Tracks an index <input type="checkbox"/> Applies an inclusionary screen <input type="checkbox"/> Applies an exclusionary screen <input type="checkbox"/> Seeks to achieve a specific impact <input type="checkbox"/> Proxy voting <input type="checkbox"/> Engagement with issuers <input type="checkbox"/> Other → <p>An ESG-Focused Fund would not be required to check any of the boxes if none of the common ESG strategies applied to the fund, and instead, would check the “other” box</p>
<p>How the Fund incorporates [ESG] factors in its investment decisions</p>	<ul style="list-style-type: none"> • Specific information, in a disaggregated manner, with respect to each of the common ESG strategies applicable to the fund as identified by the “check the box” disclosure (Use of multiple rows in the table or other text features are permitted) • If the fund uses an internal methodology, a third-party data provider, or a combination of both, in evaluating, selecting, or excluding investments, the fund’s disclosure in this row must describe how the fund uses the methodology, third-party data provider, or combination of both, as applicable. • If the fund tracks an index, the summary must identify the index and briefly describe the index and how it utilizes ESG factors in determining its constituents. • Overview of any third-party ESG frameworks that the fund follows as part of its investment process. • Specific for IF: Overview of the impact(s) the fund is seeking to achieve, and how the fund is seeking to achieve the impact(s)
<p>How the Fund votes proxies and/or engages with companies about [ESG] issues</p>	<ul style="list-style-type: none"> • These additional disclosure helps investors in ESG-Focused Funds understand how the fund’s adviser engages with portfolio companies on ESG issues. • A fund that checks either the proxy voting or engagement box in the first row of this table, would be required to provide here a brief narrative overview of how the fund engages with portfolio companies on ESG issues (e.g overview of the fund’s voting of proxies and meetings with management). • A fund that does not check the proxy voting box or the engagement box in the first row would disclose that neither proxy voting nor engagement with issuers is a significant means of implementing its investment strategy.

A₂ Definitions

Proposed Integration Fund disclosure

A fund that **considers one or more ESG factors** along with others in its investment decisions, which are generally **no more significant** than the other factors.

Proposed ESG-Focused Fund disclosure

A fund that **focuses on one or more ESG factors** by using them as a **significant or main consideration** in selecting investments or in its engagement strategy with the companies in which it invests¹. This includes:

- **Impact Funds (IF):** which seek to achieve a specific ESG impact or impacts.
 - Funds that has a **policy of voting its proxies** and engaging with the management of its portfolio companies to encourage ESG practices.
-

Proposed Unit Investment Trusts (UITs) disclosure

Unmanaged investment company that invests the money that it raises from investors in a generally fixed portfolio of stocks, bonds, or other securities





International
One Firm



Multiscope
Team



Best Practice
Know-How



Proven
Experience



Maximum
Commitment



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