Latest Developments in Governance, Stewardship and Sustainability

September 2023

The SEC Adopts Enhancements to the 'Names Rule'

On September 20, 2023, the Securities and Exchange Commission (SEC) adopted rule enhancements to the Investment Company Act "Names Rule". These enhancements aim to provide additional safeguards for investors and prevent the use of misleading or deceptive names for investment funds. A fund's name is significant because it often serves as the initial piece of information that investors encounter. The amendments to the Names Rule will include the following key provisions:

1. Requiring a broader set of funds to adopt an 80 percent investment policy, such as those with names implying a particular investment focus (e.g., "growth" or "value");*
2. Requiring funds to regularly assess how their portfolio assets align with the 80 percent investment policy, conducting such reviews at least on a quarterly basis;
3. Prohibiting unlisted registered closed-end funds or business development companies from changing their 80% investment policy without first obtaining shareholder approval, barring exceptional circumstances;**
4. Enhancing the prospectus disclosure requirements related to terminology used in fund names. This includes requiring that any terms used in the fund's name that suggest an investment focus be consistent with those terms' plain English meaning or established industry use; and
5. Adding more reporting and disclosure requirements for funds regarding compliance with names-related regulatory requirements (e.g., to define the terms used in its fund name and disclose the criteria the fund applies to select the investments that the term describes).

Funds with net assets of $1 billion or more will have 24 months to comply with the amendments, while those with net assets of less than $1 billion will have 30 months to comply.

* If the name of a fund subject to the Names Rule suggests a focus on a specific type/theme of investment, then at least 80% of its assets must be in such investments.

**Exceptions may apply in the following cases: (a) a fund manager engages in a tender or repurchase offer prior to changing their 80% investment policy, (b) that offer is not oversubscribed, and (c) the fund purchases the shares at their net asset value.

The ESAs' Report on the Sustainable Finance Disclosure Regulation (SFDR) Unveils Good and Bad Examples from Published Principal Adverse Impact (PAI) Disclosures

On September 28, 2023, the European Supervisory Authorities (ESAs) jointly released a report on the extent of voluntary disclosure of principal adverse impacts (PAI) under the Sustainable Finance Disclosure Regulation (SFDR). This report included their assessment of PAI disclosures and provided indications of good and bad PAI disclosures.

Examples of disclosures classified as good included::

1. A complete statement on due diligence and transparency policies;
2. Incorporation of sufficient details/ relevant information; and
3. Indication of when more information will be provided.

In contrast, disclosures regarded as 'bad', fell short for the following reasons:

1. Inclusion of a statement on disclosure of due diligence that was not detailed/substantiated;
2. [FMPs] only deciding to consider PAIs at group level but not on an individual basis;
3. Not providing clear rationales for why FMPs do not consider PAI when they do not, and lack of information as to whether and when they intend to consider such adverse impacts;
4. Referring to unclear procedures and lack of legal clarity to calculate PAI impact;
5. Confusing PAI statement with integration of sustainability risks by disclosing information about policies on the integration of sustainability risks in their investment decision-making process;
6. Not complying because they do not have a website; and
7. Providing different information for professional and retail investors.

Overall, the ESAs found improvement in terms of the visibility of these disclosures on the disclosing entities' websites and easier access to them compared to last year. However, the ESAs flagged two major areas for improvement: explanation of non-consideration of PAIs; and disclosures on the degree of alignment with the Paris Agreement.

PRI Releases a New Evaluation Tool and DDQ to Assist Investors in Assessing Manager Stewardship for Sustainability

On September 21, 2023, the Principles for Responsible Investment (PRI) released an Evaluation Tool along with a Due Diligence Questionnaire (DDQ). These resources are designed to assist investors (and their investment consultants where relevant) in understanding, evaluating and comparing how managers use stewardship to address sustainability issues (e.g., human rights, climate change and biodiversity). Both the tool and DDQ can be used in tandem or independently and are meant to complement any other tools and standards that may be used.