



Long-Awaited ESG Rules in the US

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On May 25, 2022, in a long-awaited move, the U.S. Securities and Exchange Commission (“SEC”) issued a pair of rule proposals related to the use of environmental, social and governance (“ESG”) investment practices by open-end and closed-end registered investment companies, as well as by business development companies (“BDCs,” and collectively, “funds”). The SEC’s stated goals with these proposals are to increase transparency and confidence in funds that consider ESG factors as part of their investment process, given the recent and ongoing dramatic growth in investor interest in ESG investing. The SEC believes that investors looking to participate in ESG investing currently face a lack of consistent, comparable and reliable information among funds that claim to consider one or more ESG factors.

The first proposal seeks to create a robust disclosure and reporting framework for funds regarding their ESG investment practices. To effectuate this goal, the proposal would make a number of amendments to the registration and reporting forms utilized by funds in their securities offerings and ongoing periodic reporting. While the SEC does not generally prescribe specific disclosures for particular investment strategies, the SEC believes that ESG strategies and disclosures differ materially in certain respects that necessitate specific requirements and mandatory content standards to assist investors in making more informed investment decisions.

The second proposal would amend Rule 35d-1 (the so-called “Names Rule”) under the Investment Company Act of 1940, as amended (the “Investment Company Act”), to, among other things, add new requirements for funds that consider ESG factors in connection with their investment practices. The SEC believes that the Names Rule, which has not been amended since its adoption over 20 years ago, has not kept pace with industry developments and product evolution. Additionally, the SEC emphasized that competitive pressures may incentivize asset managers to include words in a fund’s name as a way to attract investor assets—for example, terms related to ESG. Further, the SEC expressed concern that the current Names Rule may permit funds to depart, over time, from the investment focus suggested by their name. Importantly, the proposed amendments to the Names Rule also would have significant implications for non-ESG funds, especially for those funds that may invest in more illiquid assets (including funds of private funds), and would mark a significant change, as the rule does not currently apply to commonly used fund names that focus on investment strategies instead of particular investments, such as “growth” or “income” funds.

Each proposal was approved by the SEC in a 3-1 vote along party lines, with Commissioner Peirce dissenting. The proposals will remain open for public comment for 60 days after their publication in the Federal Register.

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