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Submitted Electronically

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Ms. Vanessa Countryman, Secretary
U.S. Securities and Exchange Commission
100 F Street NE
Washington, D.C. 20549-1090

RE: Release No. 33-11068; 34-94985; IA-6034; IC-34594; File No. S7-17-22; RIN 3235-AM96
Proposed Rule: Enhanced Disclosures by Certain Investment Advisers and Investment Companies About Environmental, Social, and Governance Investment Practices

Ladies and Gentlemen:

Morningstar welcomes the opportunity to comment on the Enhanced Disclosures by Certain Investment Advisers and Investment Companies About Environmental, Social, and Governance Investment Practices, or Proposed Rule, recently published by the Securities and Exchange Commission, SEC, or Commission.[1] Morningstar is a leading provider of independent investment research and has a long history of advocating for transparency in global markets.

Morningstar brings a unique perspective to the questions posed in the Proposed Rule. As the world's largest provider of mutual fund data and ratings, Morningstar has a long history of advocating for transparency in global financial markets. Morningstar's mission is to empower investor success. Morningstar evaluates how funds perform along a variety of environmental, social, and governance, or ESG, factors. We evaluate funds based on their ESG disclosures in regulatory filings, through data on fund manager stewardship activities like proxy voting, and based on their underlying holdings using Sustainalytics's company-level ESG Ratings that are aggregated up to the fund. Because we offer an extensive line of products for individual investors, professional financial advisors, and institutional clients, we have a broad view on the Proposed Rule and the possible effects of a future final rule for investors.

This letter contains: 1) a summary of our views and 2) detailed answers to selected questions posed in the Proposed Rule, attached as Appendix A.

Executive Summary

Morningstar appreciates the Commission's intention to enhance and standardize the disclosure of ESG investment practices by investment advisers and companies. ESG has increasingly become material for many companies within various industries and, as such, disclosures in this area are financially material and a key aspect of investor decision-making. Investors have made known their interest in ESG as well. In one 2020 survey, 42% of institutional investors said they consider ESG factors in their investment

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[1] SEC. 2022. Enhanced Disclosures by Certain Investment Advisers and Investment Companies About Environmental, Social, and Governance Investment Practices. https://www.federalregister.gov/documents/2022/06/17/2022-11718/enhanced-disclosures-by-certain-investment-advisers-and-investment-companies-about-environmental (Proposed Rule).

decision.[2] Another survey of professional selectors and institutional investors showed that "75% and 77% respectively believe that the consideration of ESG factors is integral to investment decision-making."[3]

To further facilitate the Commission's goals in the area of fund ESG disclosures, we submit the following comments and suggestions:

1) Morningstar supports fund ESG data that is consistent, complete, and comparable. As such, funds should report data in a structured format and be subject to certain minimum standards and formats standardized across funds.
    - Morningstar believes funds can and should be encouraged to provide additional ESG metrics on a voluntary basis, provided that these funds report the minimum required metrics.
2) Morningstar believes that the Commission should eliminate the ESG-Integration category altogether.
    - Disclosing that a fund considers ESG is not informative for investors. The category would include too many funds using too little ESG to be meaningful.
3) If the Commission keeps the ESG-Integration category, Morningstar believes that "ESG-Integration" is a misleading name and recommends that the Commission rename this category "ESG Consideration."
    - "ESG-Integration" implies a more substantial commitment to ESG than is warranted; ESG-Focused and Impact Funds commonly use the term "ESG integration" to describe their broad-based incorporation of ESG factors and the central role they play in their investment strategies.
    - The label "ESG-Integration" can contribute to greenwashing by making funds appear more committed to ESG factors than they are.
4) Morningstar sees ESG-Focused Funds as on a continuum with more nuance than the SEC's current framework permits.
    - The proposed framework does not cover funds that are limiting ESG Risks, Seeking ESG Opportunities, or Targeting Sustainability Themes.
    - Morningstar views impact as part of the continuum.
    - Tracking an index is a means of attaining ESG goals that funds should separately disclose.
5) Morningstar supports the Commission requiring funds to report data in a structured format and subjecting them to certain minimum standards and formats comparable across funds. We recommend consistency in reporting and disclosures around methodology be the principles underlying all requirements.
    - We recommend that the Commission encourage disclosure of alternative metrics when these metrics are relevant to the fund's investment strategy.
    - Morningstar recognizes that not all data for underlying investments is available to funds, consistency in reporting and disclosure around methodology is the principle that is important.
6) We support the Commission's proposed requirements around proxy and engagement and believe the Commission could make this framework more flexible to accommodate a range of fund active ownership approaches.

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[2] Whyte, Amy. October 6, 2020. "More Institutions than Ever are Considering ESG. Will they Follow Through?" Institutional Investor. https://www.institutionalinvestor.com/article/b1npm5yq50b024/More-Institutions-Than-Ever-Are-Considering-ESG-Will-They-Follow-Through.

[3] Proposed Rule, P. 36657.

- We support funds providing separate reporting for proxies and engagement.
- Proxy disclosures should be sufficiently flexible to accommodate the differences in ESG priorities and considerations across funds.
- We recommend flexible engagement disclosures that account for a variety of engagement approaches.
- We agree that the Commission should require funds to amend their prospectuses to include voting and engagement information, but not in a way that could limit fund practices from evolving.

I. Morningstar believes that the Commission should eliminate the ESG-Integration category altogether.

Morningstar recommends that the Commission eliminate the ESG-Integration category for disclosure purposes because, as proposed, it would encompass too many funds to be helpful to investors and impose an unnecessary burden of disclosure on funds. At most, these funds should disclose simply that ESG is a supporting consideration, but mandating further disclosure is not beneficial. Disclosure may even be harmful, as it could mislead investors by indicating that a fund has a more significant commitment to sustainable investing than it has. Under the Proposed Rule, greenwashing may worsen, as funds that do not necessarily consider themselves to "integrate" ESG factors may nonetheless be required to disclose such considerations as if they do. To avoid these risks, Morningstar recommends that the Commission eliminate the ESG-Integration category.

Morningstar tracked the growth of funds that mention ESG in their prospectuses beginning in 2016 when we found the first such instance. By 2019, close to 600 funds (not counting ESG-Focused and Impact Funds) included some mention of ESG in their prospectus. We subsequently stopped tracking this data because these funds became too numerous for the metric to be helpful to investors. To estimate the current frequency, we analyzed the most recent summary prospectuses for US open-end mutual funds and Exchange-Traded Funds, or ETFs, that would not meet the ESG-Focused or Impact Fund criteria. Of about 2,600 active equity open-end funds that would **not** meet the ESG-Focused or Impact Fund criteria, almost 17% use the term "ESG" in their summary prospectuses. We used the summary prospectus for this analysis because each document only covers one fund, removing the possibility of false positives due to ESG-Focused or Impact Funds being described in the same statutory prospectus, with more potentially detailing their use of ESG factors only in the statutory prospectus.

Morningstar has found that some asset managers include a blanket statement about ESG in all their funds' prospectuses. For example, every fund prospectus for one large asset manager includes the following language:

> The Firm integrates environmental, social, and governance (ESG) factors into its investment research process when applicable. While ESG matters vary widely, we generally consider ESG to mean: Environmental or "E" matters, such as climate change, resource depletion, waste, pollution, or deforestation; Social or "S" matters, such as companies' relationships with their employees and suppliers, including labor standards, diversity, and human rights issues; and Governance or "G" matters, such as shareholder rights, bribery and corruption, executive pay, and board composition. We focus on the ESG factors we consider most likely to have a material impact on the performance of the holdings in the fund's portfolio.

From this statement alone, this asset manager would have to disclose as an ESG-Integration Fund. As these blanket statements grow more common in fund prospectuses, the ESG-Integration category will be far too large to be helpful for investors trying to ascertain a fund's level of commitment to ESG.

Since 2020, Morningstar's manager research analysts have been assessing the ESG commitment level of many of the asset managers and mutual funds under coverage. They have found that virtually every asset manager collects ESG information and has hired ESG analysts to make ESG information and expertise available to the portfolio managers running their investment strategies and mutual funds. However, the degree to which mutual funds use ESG information varies widely. Most think of ESG as part of the mosaic of information possibly considered in evaluating investments. Sometimes an ESG evaluation affects an investment decision in a meaningful way—but most often, it does not.

In other words, a very large number of funds can be said to be using ESG in some manner to inform their investment decisions, even if only on occasion. It is unnecessary to require all these so-called Integration Funds to detail their approach to incorporating ESG information when it is neither central nor a structured aspect of the fund. On the one hand, it could discourage some asset managers from continuing to incorporate ESG at all; on the other hand, it could mislead investors into thinking that virtually all mutual funds are "ESG" funds in some manner.

By definition, funds that use ESG in a non-central way use a combination of other investment factors, at least some of which are central to the strategy. Yet the Commission has not singled out other commonly used investment factors for additional disclosure, such as valuation, earnings per share, earnings quality, and momentum, even though these factors may be more central to the strategy than are ESG factors. This problem further highlights how the disclosure requirements for Integration Funds, as proposed, may mislead investors and place an undue burden on funds. Morningstar accordingly recommends that the Commission remove the proposed Integration Fund category, limiting ESG disclosure requirements to ESG-Focused, including Impact, Funds.

II. Morningstar believes that "ESG-Integration" is a misleading name and recommends that this category, if kept, should be renamed to "ESG Consideration."

Morningstar believes that "ESG-Integration" is a misleading label for funds that do not use ESG as a "significant" or "main" consideration, but only as one consideration among many.[4] The label is problematic because "ESG-Integration" implies a more substantial commitment to ESG than is warranted; ESG-Focused and Impact Funds commonly use the term "ESG integration" to describe their broad-based incorporation of ESG factors and the central role they play in their investment strategies. The label "ESG-Integration" can also contribute to greenwashing by making funds appear more committed to ESG factors than they are. If the Commission decides to keep this category, we recommend they rename it "ESG Consideration."

"ESG integration" is a key component of ESG investing (or "sustainable" investing or "responsible" investing) in general. The Principles for Responsible Investing, or PRI, defines it as "the explicit and systematic inclusion of ESG issues in investment analysis and investment decisions."[5] According to this definition, most ESG-Focused Funds and Impact Funds use "ESG integration" as part of their investment processes and generally do so in a more comprehensive way than do the funds in the group the Commission defines in its proposal as "ESG-Integration."

[4] Proposed Rule, P. 36747.

[5] PRI. April 25, 2018. "What is ESG Integration?" https://www.unpri.org/fixed-income/what-is-esg-integration/3052.article (PRI article).

If the Commission wishes to create a label for funds for which ESG factors play an insignificant role—one factor amongst many which is relevant to the investment decision in an unstructured, ad hoc manner—"ESG Consideration Fund" is more accurate. In the 2019 Sustainable Funds U.S. Landscape Report, Morningstar defined ESG Consideration funds as "[f]unds that consider ESG alongside many other factors."[6] ESG Consideration funds "incorporate ESG without orienting their entire investment process and outcomes around it." For such funds, "ESG criteria may or may not play a role in the selection of any specific security, and ESG considerations generally do not come into play at the portfolio-construction stage."[7] ESG Consideration funds "are best thought of as funds that simply consider ESG information relevant to a more complete investment analysis."[8]

By contrast, in the same report, Morningstar defined "ESG Integration" funds as those "that broadly integrate ESG criteria throughout their investment processes. They exhibit higher levels of commitment to sustainable investing than ESG consideration funds—in many cases, much higher. The typical ESG integration fund's portfolio tilts toward companies its managers believe are addressing material sustainability challenges in ways that will make them better investments, and away from companies that are not."[9] The difference in definitions across the Morningstar report illustrates the confusion likely to follow any final rule that defines "ESG Integration Funds" in the manner the Commission proposes. To avoid confusion, Morningstar recommends that the category of funds defined in the proposal as "ESG-Integration," if retained, should be renamed "ESG Consideration."

If the Commission does retain the ESG-Integration category in some form, hopefully under another name, we recommend that this category of funds be required to disclose carbon emissions metrics like the ESG-Focused Funds. In imposing such a requirement, the Commission will help investors by forcing funds to not simply give lip service to ESG, but provide data when environmental considerations are in play. Such information will help investors distinguish which funds do more or less along this dimension and will reduce the instances of greenwashing. Ultimately, once the climate issuer proposal is fully implemented, we believe that sufficient public company data will be available such that the Commission could revisit disclosure requirements, making ESG disclosures uniform for all funds, in line with regulatory trends in other jurisdictions.

III. Morningstar sees ESG-Focused Funds as on a continuum with more nuance than the SEC's proposed framework permits.

Morningstar sees sustainable funds as on a continuum rather than in bright-line categories. We have defined sustainable investing as investing that seeks "to deliver competitive financial results, while also driving positive environmental, social, and corporate governance outcomes,"[10] and sustainable funds as funds that "hold [themselves] out to be a sustainable investment."[11] "The prospectus' Principal Investment Strategies section should contain enough detail to leave no doubt that ESG concerns figure *prominently* in the investment process."[12] We believe that our definition of sustainable funds is broadly aligned with the Commission's definition of an ESG-Focused Fund, which the Commission defines as "a fund that focuses on one or more ESG factors by using them as a *significant or main* consideration (1) in

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[6] Morningstar. February 2019. "Sustainable Funds U.S. Landscape Report." P. 2. (2019 Landscape).
[7] 2019 Landscape, P. 10.
[8] 2019 Landscape, P. 11.
[9] 2019 Landscape, P. 12.
[10] Morningstar. December 2, 2021. "The Morningstar Sustainable-Investing Framework." P. 2. https://assets.contentstack.io/v3/assets/blt4eb669caa7dc65b2/blt978916061960d126/61b3a77ef6b339160b825de3/SI_Framework_120221.pdf (2021 Framework).
[11] Morningstar. January 2022. "Sustainable Funds U.S. Landscape Report." P. 3 (2021 Landscape).
[12] 2021 Landscape, P. 3.

selecting investments or (2) in its engagement strategy with the companies in which it invests."[13] These funds fall on a continuum as described in our sustainability framework.[14]

Rather than adopting the "ESG-Focused Fund" category, with Impact Funds as a subset, as proposed, Morningstar supports the use of a continuum framework with impact as one end of the continuum. "Impact" is more accurately thought of as an approach some ESG-Focused Funds use rather than as a defining characteristic that distinguishes two types of funds. To some extent, all sustainable funds are concerned about the broader impact of their investments on people and planet. Some propose to assess that impact in an explicit way as part of their overall approach. The difference between such funds and other ESG-Focused Funds is one of degree, not kind. Thus, "Assess Impact" should be a choice that is included in the Overview of the Fund's ESG Strategy checkbox, rather than a separate sub-category. This disclosure will make it much easier for more Funds to disclose how they assess impact without forcing them, in essence, to declare themselves to be "Impact Funds."

Many of the SEC's proposed disclosures would fit into a continuum, but the current disclosures as described in the Commission's chart[15] as shown in Exhibit 1, would put too many types of funds in the "Other" category. We suggest a continuum with disclosures showing where a fund is on this continuum to better help investors assess the ESG characteristics and strategy of a fund.

[13] Proposed Rule, P. 36662.

[14] 2021 Framework, P. 4. In other work, Morningstar modeled the pricing of ESG risk in equity securities. See Idzorek, T.M. & Kaplan, P.D. 2021. "A World of ESG Views and Preferences." P. 8.

[15] Proposed Rule, P. 36663.

Exhibit 1: Proposed [ESG] Strategy Overview Disclosures

Overview of the Fund's [ESG] strategy	
	The Fund engages in the following to implement its [ESG] Strategy (check all that apply): ☐ Tracks an index ☐ Applies an inclusionary screen ☐ Applies an exclusionary screen ☐ Seeks to achieve a specific impact ☐ Proxy voting ☐ Engagement with issuers ☐ Other
How the Fund incorporates [ESG] factors in its investment decisions	
How the Fund votes proxies and/or engages with companies about [ESG] issues	

A continuum that distinguishes between funds that only avoid negative ESG outcomes and those that advance positive ESG outcomes provides investors with a more-nuanced understanding of how exactly funds consider ESG factors in their investment decisions and engagement. Such a framework better captures a fund's investment motivations and approaches, improving investors' clarity.

Morningstar premises its continuum framework on its definition of "sustainable investing." Importantly, sustainable investors and the funds in which they invest vary tremendously. While some investors prioritize investment outcomes over societal outcomes, others may prefer to maximize the positive impact of their investments. Most will prefer both. By using one category to capture all funds that significantly consider ESG factors, the Proposed Rule construes these funds as monolithic, leading to investor confusion and incongruity between expectations and outcomes. Instead, we recommend that the Commission take a more-nuanced approach to improve clarity and better accommodate investors' varied approaches to sustainable investing.

Morningstar's continuum of ESG approaches is outlined in Exhibit 2.

Exhibit 2: Morningstar's ESG Framework

In addition, we see "tracking an index" as a separate aspect of ESG funds that can serve any of the goals outlined in the continuum shown above. For instance, the Commission notes that an index can use "any criteria or methodologies for selecting or excluding components of the index that are based on ESG factors."[16] These criteria or methodologies, which the SEC would require funds to describe in the proposed disclosure, align with the other categories for disclosure.

The ESG-Focused Fund category encompasses six distinct groups of funds, as shown above, and we explain each in greater detail. These categories are also laid out in our Sustainable-Investing Framework: funds that Apply Exclusions, funds that Limit ESG Risk, funds that Seek ESG Opportunities, funds that Practice Active Ownership, funds that Target Sustainability Themes, and funds that Assess Impact.[17] The type of funds on Morningstar's sustainable-investing continuum represent a broad range of approaches to using ESG factors to inform investment decisions. We recommend the Commission include all these approaches in the "Overview of the Fund's ESG Strategy" checklist:

- Funds that **Apply Exclusions** exclude issuers based on certain products/services, an industry, or certain corporate behaviors, like major controversies. This category aligns with the SEC's "applies an exclusionary/inclusionary screen" categories of the proposed framework.
- Funds that **Limit ESG Risk** use ESG information, usually in the form of ESG ratings of companies, to assess material ESG risks as part of the overall assessment of risk. This category is missing from the SEC's framework.
- Funds that **Seek ESG Opportunities** use ESG information to identify companies that are sustainability leaders, often by industry or sector, or to identify improving companies, or those that are using sustainability to establish or enhance a competitive advantage. This approach includes what is sometimes called "ESG Best-in-Class" or "Positive Screening" based on ESG ratings. This category is also not encompassed by the SEC's framework. However, both the "limiting risks" and "seeking opportunities" categories could align with funds that track an index for which ESG information plays a central role in index construction.
- Funds that **Practice Active Ownership** seek positive ESG outcomes via active ownership activities, primarily made possible because asset managers are shareholders in public companies. These activities may include: engaging directly with companies on ESG issues, proposing ESG-related shareholder resolutions, supporting ESG issues through proxy voting, participating in ESG-related investor coalitions, or advocating for public policy measures that address sustainability concerns. This category aligns with the SEC's "proxy voting" and "engagement with issuers" categories of the proposed framework.
- Funds that **Target Sustainability Themes** identify investments that stand to benefit from the long-

[16] Proposed Rule, P. 36666.
[17] 2021 Framework.

term trend toward greater sustainability in the way we live and work. Such themes may include environmentally related themes like renewable energy, clean technology, and clean water, or those related to social themes, such as gender equity, managing population growth, or health and well-being. This category is not encompassed by the SEC's framework.

- Funds that **Assess Impact** integrate impact assessments into security selection and portfolio construction. Fixed-income managers, for example, may consider a bond's use of proceeds, focusing on bonds that finance projects to benefit people and the planet. Equity managers may consider whether a company's products/services/behaviors support or detract from the United Nation's Sustainable Development Goals, which many investors and companies are using as an impact framework. At the portfolio level, investors may assess the overall impact of their portfolio holdings in relation to a goal or benchmark. This category aligns with the SEC's "seeks to achieve a specific impact" category of the proposed framework.

While some ESG-Focused Funds may use only one of these approaches, most use more than one, and some use all of them. Thus, it is appropriate to include the entire list in the "Overview of the Fund's ESG Strategy" checkbox. "Tracks an ESG index" is also important to include for investors to easily determine whether the ESG-Focused Fund is passively or actively managed. The box should include a space for the fund to name the index it tracks. Morningstar's suggested disclosures are provided in Exhibit 3 below.

Exhibit 3: Morningstar's Suggested [ESG] Strategy Overview Disclosures

<table>
<tr><td rowspan="2">Overview of the Fund's [ESG] strategy</td><td></td></tr>
<tr><td>The Fund engages in the following to implement its [ESG] Strategy (check all that apply):
☐ Applies exclusionary screens
☐ Uses ESG information to help assess risk
☐ Uses ESG information to identify investment opportunities
☐ Practices Active Ownership to pursue ESG objectives
☐ Targets sustainability themes
☐ Tracks an index
○ Name of index: ________________________
☐ Other</td></tr>
<tr><td>How the Fund incorporates [ESG] factors in its investment decisions</td><td></td></tr>
<tr><td>How the Fund votes proxies and/or engages with companies about [ESG] issues</td><td></td></tr>
</table>

Each box that is checked should be accompanied by a brief explanation in the Summary Prospectus and a more-detailed explanation in the Statutory Prospectus.

We support the Commission's proposed requirement for a fund to disclose whether and how it: tracks an index, applies an inclusionary/exclusionary screen, seeks to achieve a specific impact, uses proxy voting, and engages with issuers, as shown in Exhibit 1. These strategies encompass much of what Morningstar includes in our sustainable investing continuum. However, we believe that the disclosures need to be enhanced to incorporate these additional manifestations of ESG investing, as shown in Exhibit 3.

The Proposed Rule neglects many important elements of ESG strategy. Specifically, key elements of Limit ESG Risk, Seek ESG Opportunities, and Target Sustainability Themes are unaccounted for under the current disclosure requirements. For example, if a fund limits ESG risk, its assessment of ESG information entails more than just applying an inclusionary/exclusionary screen; under the Proposed Rule, such a fund would only check the boxes relating to screens that may represent only a small part of how a fund limits ESG risk. The same would be true for funds that Seek ESG Opportunities. Additionally, funds that Practice Active Ownership generally seek positive ESG outcomes but may not reach the disclosure threshold proposed by the Commission: "seeks to achieve a specific impact." The same also applies to funds that Target Sustainability Themes. Meanwhile, funds that track an ESG index will have varying implications about a fund's level of ESG consideration since it depends on how the index itself considers ESG factors.

As proposed, the disclosure requirements for ESG-Focused Funds will not capture a significant amount of information relating to a fund's ESG strategy that would benefit investors. Furthermore, when certain elements of ESG strategy are not covered by the rule, perverse incentives for asset managers may result: They may, for example, exaggerate the extent to which they seek to achieve a specific impact, and, consequently, exacerbate the risk of greenwashing, a substantial threat to investor protection.

By incorporating this continuum view to disclosure requirements for ESG-Focused and Impact Funds, the Commission would better capture the broad range of ESG strategies that funds use and allow investors to better differentiate among various types of funds that use ESG factors to inform investment decisions.

IV. Morningstar supports requiring funds to report data in a structured format and be subject to certain minimum standards and formats comparable across funds.

Morningstar recommends that consistency in reporting and disclosure of methodology be the principle underlying all requirements, recognizing that not all data for underlying investments is available to funds. We believe funds can and should be encouraged to provide additional ESG metrics on a voluntary basis, provided that these funds report the minimum required metrics. We support the Commission in subscribing a minimum standard for reporting. Technical suggestions on how to make disclosures more consistent and comparable can be found in Appendix A in our answers to questions 22-35 and 73-76.

Morningstar generally supports the SEC's proposed fund metrics reporting requirement for Greenhouse Gas, or GHG, emissions. We believe funds should disclose GHG emissions data whenever relevant and available. When such data is unavailable, we recommend that the Commission encourage disclosure of alternative metrics and require a narrative summary explaining the fund's assumptions and methodology around whatever GHG emissions data or estimates the fund has.

Appreciating the urgency of addressing global climate change and the proportionate investor demand for sustainable investment options, we support the Commission's proposal to require environmentally focused funds to disclose their GHG emissions. We agree that this disclosure requirement should be limited to those environmentally focused funds that do not affirmatively state that they do not consider GHG emissions of the issuers in which they invest as part of their ESG strategy. To require disclosure from all ESG-Focused Funds, even those that state they do not consider GHG emissions, would be burdensome, as some may focus on the S and the G, and these disclosures would not be helpful to investors.

Morningstar recommends alignment with available frameworks, namely the Task Force on Climate-Related Financial Disclosures, or TCFD, and the Partnership for Carbon Accounting Financials, or PCAF. We support the Commission's provisions in line with these frameworks, including requiring funds to use the carbon footprint and Weighted Average Carbon Intensity, or WACI, metrics to disclose Scopes 1, 2, and 3 GHG emissions of their portfolio holdings. We recommend separate disclosure of Scope 1, Scope 2, and Scope 3 emissions since these may vary by industry.[18] This data may vary significantly across industries; by requiring funds to disclose Scopes 1, 2, and 3 emissions data separately, funds will gain better insights into emissions at the industry level.

In cases where Scope 1 and Scope 2 data are unavailable, Morningstar supports the Commission's proposal to require these funds to use a good-faith estimate. However, funds will need actionable and comprehensive guidance from the Commission on how to obtain this information. Where regulatory reports or estimates for underlying investments are available, the funds should use this data. If such information is unavailable, funds should not be forced to compute estimates for underlying investments, for example, private companies, but they should disclose what proportion of the portfolio is affected by such gaps in data. Thus, we further recommend that funds disclose the percentage of the portfolio estimated, as another signal of quality and to avoid greenwashing.

Morningstar generally supports the Commission's proposal to allow funds to rely on the underlying fund's disclosed GHG emissions data. We ask that the Commission consider requiring reporting funds to require underlying funds to obtain reasonable assurance. Some additional compliance time may be needed to meet such a requirement, but such a requirement would improve the accuracy of GHG emissions data.

We believe Impact Funds should make disclosures in addition to those already required in the Proposed Rule commensurate with the impacts they are seeking to make. Specifically, if relevant to their goals, we recommend that Impact Funds be required to disclose additional metrics related to the environmental and social ramifications of investment decisions. The Sustainability Accounting Standards Board, or SASB, specifically references impact metrics such as water quality, water and electricity affordability, and access (for example, utilities), or the value chain percentage of water sourced from regions with high water stress (for example, nonalcoholic beverages).[19] We expect land use and water rights to become increasingly prevalent topics and recommend that the Commission consider requiring additional disclosure in these areas for Impact Funds making investments in these areas.

We recognize that in some cases funds may not have all the above information available to disclose. Funds could be required to disclose only when they have the information from their underlying portfolio companies. For instance, Morningstar supports the Commission's proposal to require funds to disclose and aggregate portfolio companies' Scope 3 emissions when a portfolio company publicly reports that information. Otherwise, funds should not have to make such disclosures.

As discussed previously, we recommend that the Commission eliminate the Integration Fund category from the Proposed Rule, consequentially relieving those funds of GHG emissions disclosure requirements. For reasons already discussed, we find these disclosures may be misleading and, therefore, unhelpful to investors.

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[18] Proposed Rule, P. 36682.

[19] SASB. September 2020. "SASB Implementation Supplement: Greenhouse Gas Emissions and SASB Standards." https://www.sasb.org/wp-content/uploads/2020/10/GHG-Emmissions-100520.pdf (SASB).

V. We support the Commission's proposed requirements around proxy and engagement and believe this framework could be more flexible to accommodate a range of fund approaches.

While Morningstar agrees that the Commission should have funds provide information on proxies and engagement, we have recommendations on how the Commission can do this in a less prescriptive and more helpful way.

a. We support reporting proxy and engagement separately.

Morningstar supports the Commission's proposal to provide separate check boxes for proxy voting and engagement. Proxies and engagement are connected yet distinct categories, and to combine them would limit the information available. We recommend that the proxy and engagement disclosures include a narrative to accommodate an explanation of how the fund integrates the two.

b. Proxy disclosures should be flexible to accommodate the differences in ESG priorities and considerations across funds.

Morningstar supports the proposal to require advisers to report whether they consider ESG factors as part of the adviser's proxy voting policies and procedures. These considerations are likely where the fund's voting and engagement practices and activities are set and executed and are therefore very relevant to understanding a fund's use of proxy voting and engagement in furtherance of its ESG investing approach.

Morningstar recommends that the Commission require funds to provide a narrative explanation of how they cast their proxy votes on ESG matters and statistics on how they voted on ESG matters. The proxy disclosures should explain whether the fund applies proxy voting guidelines in executing its ESG voting strategy, ESG voting criteria, and whether ESG considerations were utilized across all proxy ballots and voting or only selected items. A brief explanation of how ESG screens and security selection criteria affect proxy voting could also provide helpful context for proxy voting.

In addition, Morningstar supports the Commission's proposal that funds that use proxy voting as a significant means of implementing their ESG strategy disclose the percentage of ESG-related voting matters during the reporting period for which the fund voted in furtherance of the initiative. We recommend that these funds also be required to explain the method they apply to derive this metric because the computations can be complex and distinct across funds. Any framework for this disclosure should be flexible to accommodate the differences in ESG priorities, considerations linked to the fund's broad active ownership strategy, and the specific features of the portfolio.

Morningstar encourages the Commission to require funds to point investors to their full vote record in the relevant N-PX filing as proposed, particularly as the Commission amends Form N-PX to be more helpful to investors. We have provided our comments separately to Form N-PX.[20]

c. We recommend flexible engagement disclosures that account for a variety of engagement approaches.

[20] Morningstar. January 4, 2021. "Comment letter to the SEC on Tailored Shareholder Reports, Treatment of Annual Prospectus Updates for Existing Investors, and Improved Fee and Risk Disclosure for Mutual Funds and Exchange-Traded Funds; Fee Information in Investment Company Advertisements." https://www.sec.gov/comments/s7-09-20/s70920-8204205-227382.pdf.

Engagements, which Morningstar defines as two-way communication between the fund and the issuer, should be a separate disclosure from proxies. The engagement disclosure should help identify holdings subject to ESG engagements, the ESG themes addressed in engagements, and a qualitative assessment of engagement progress, but without imposing too rigid a framework on exactly how to report this information.

Funds should also disclose whether a fund engages on ESG issues directly or whether the fund's adviser/asset manager undertakes ESG-focused engagements on its behalf. In many respects, centralizing engagement activities across a group of funds makes sense because of the leverage and scale this affords. If the fund parent/adviser conducts ESG engagements, the fund should disclose information that explains whether the fund manager provides input/participates in the ESG engagements, references the asset manager/adviser's engagement priorities statement and report, and details the ESG themes addressed in engagements.

Morningstar supports the Commission's proposal to require funds that use engagement with issuers as a significant means of implementing their ESG strategy to disclose in their annual report progress on any key performance indicators of such engagement. Morningstar recommends that funds have flexibility in how they write these disclosures to accommodate the nuances across funds.

Engagement happens beyond votes and meetings. For example, asset managers often write letters requesting disclosure on ESG issues. Companies may respond in writing rather than at a meeting, meaning required disclosures that specify "meeting with management" will not capture this activity. Thus, the Commission may want to consider requiring disclosure of engagement activities more generally than engagement meetings per se.

While Morningstar supports the disclosure of the number or percentage of issuers with whom the fund held ESG engagement meetings during the reporting period related to one or more ESG issues, and the total number of ESG engagement meetings, we recognize the limitations of these metrics as further explained in our answers to questions 77 and 78. If an ESG-Focused Fund seeks to engage with issuers on ESG matters other than through voting proxies, such as through meetings with or advocacy to management, the fund should be encouraged, but not required, to disclose the objectives in general terms. Required disclosure may become limiting for a fund as its relationships with issuers evolve.

d. We agree that the Commission should require funds to amend their prospectuses to include voting and engagement information, but not in a way that could limit funds from addressing emerging issues.

Morningstar supports the Commission's proposal to require funds that use engagement with issuers as a significant means of implementing their ESG strategy to amend their prospectus by checking the appropriate box in the ESG Strategy Overview Table. This table should identify specific methods the funds use to influence issues and require a brief narrative overview of how the fund engages with portfolio companies on ESG.

Morningstar also supports that a fund be required to identify in its prospectus any specific or supplemental proxy voting policies and procedures that include significant ESG consideration for companies in their investment portfolio. However, this disclosure should not require a fund to state which ESG considerations those policies and procedures address. ESG considerations and priorities change over time. Requiring such specific disclosures limits a fund's evolving goals.

Conclusion

In summary, we support the Commission's goals of requiring funds to disclose more information about ESG investment practices. This information is increasingly a core investment theme for a growing number of investors. A broader level of ESG disclosure will become more and more imperative to maximize transparency and empower investor success. We have summarized our views above and answer some specific questions from the Proposed Rule in Appendix A.

Morningstar thanks the Commission for the opportunity to comment on the Proposed Rule. We would be pleased to engage with the Commission on an ongoing basis, leveraging our global organization of experts operating in multiple jurisdictions. Should you wish to discuss these and other comments, please do not hesitate to contact either of us as indicated below:

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<u>Appendix A: Selected Responses to SEC Questions on Enhanced Disclosures by Certain Investment Advisers and Investment Companies About Environmental, Social, and Governance Investment Practices</u>

A. Proposed Fund Disclosures to Investors

1. Proposed Prospectus ESG Disclosure Enhancements

1. We are not proposing to define "ESG" or similar terms and, instead, we are proposing to require funds to disclose to investors (1) how they incorporate ESG factors into their investment selection processes and (2) how they incorporate ESG factors in their investment strategies. Is this approach appropriate? Should we seek to define "ESG" or any of its subparts in the forms? Should we provide a non-exhaustive list of examples of ESG factors in the forms? Should we define certain types of factors as being ESG but allow funds to add additional factors to that concept if they choose? Are there any other approaches that we should take in providing guidance to funds as to what constitutes ESG?

Morningstar agrees with the Commission's decision to not propose a definition of "ESG." There is no set definition of what specific issues ESG includes, as these issues may change over time and different issues may be more material in some industries than in others. The Commission must not inadvertently imply that ESG is more defined than it actually is.

The difference between how investors "incorporate ESG factors into their investment selection processes" and how they "incorporate ESG factors in their investment strategies" is not clear. However, we support the Commission simply requiring funds to disclose what they mean by ESG and how they use it.

2. Should these disclosure requirements apply to registered open-end funds, registered closed-end funds, and BDCs, as proposed? Are there other substantive disclosure requirements that should differ based on the type of fund? Should our proposed disclosure requirements apply to insurance company separate accounts registered as management investment companies?

Morningstar recommends that the ESG disclosure requirements apply to insurance company separate accounts registered as management investment companies.

a) Proposed Integration Fund Disclosure

3. Is the proposed definition of an Integration Fund appropriate and clear? Are there other alternative definitions we should consider? For example, is the aspect of the definition specifying that ESG factors "may not be determinative in deciding to include or exclude any particular investment in the portfolio" sufficiently clear? Would it be clearer to provide that ESG factors are "not necessarily" determinative, or would that imply a greater role of ESG factors than may be the case for many integration funds? Is the proposed definition over- or under- inclusive? For example, are there funds that do not currently consider themselves to integrate ESG factors but would fall under this definition and be required to provide disclosures? Conversely, are there funds that do not meet the proposed definition that do consider themselves to integrate ESG factors?

The proposed definition of Integration Fund is generally clear. However, the use of the term "Integration Fund" is not. The term implies a more substantial commitment to ESG than is warranted. Furthermore, "ESG integration" is commonly used by ESG-Focused and Impact Funds to describe their broad-based incorporation of ESG factors and the central role they play in these strategies. The PRI defines "ESG integration" as "the explicit and systematic inclusion of ESG issues in investment analysis and investment decisions."[21] Based on that definition, most ESG-Focused Funds and Impact Funds also use "ESG integration" as part of their investment processes and generally do so in a more comprehensive way than do the funds in the group the SEC is trying to define here. The name "Integration Fund" is therefore misleading both to investors and funds. Many funds would be confused as to whether they would be required to make disclosures, and, in doing so, their disclosures could be seen as greenwashing.

Morningstar recommends that the Commission rename the Integration Fund category or eliminate it from the Proposed Rule altogether. If the Commission wishes to label funds for which ESG factors play a supporting role in the investment process, "ESG Consideration Fund" is a more accurate label. Morningstar has defined "ESG Consideration Funds" as "[f]unds that consider ESG alongside many other factors."[22] ESG Consideration Funds "incorporate ESG without orienting their entire investment process and outcomes around it."[23] For such funds, "ESG criteria may or may not play a role in the selection of any specific security, and ESG considerations generally do not come into play at the portfolio-construction stage."[24] ESG Consideration Funds "are best thought of as funds that simply consider ESG information as relevant to a more complete investment analysis."[25] This definition closely aligns with what the SEC has proposed to call "Integration Funds." Morningstar believes that using the name "ESG Consideration Funds" will make those funds' commitment to ESG more clear.

Alternatively, Morningstar finds compelling reasons to abandon the category altogether. As proposed, the category would encompass too many funds to be useful to investors and impose an unnecessary burden of disclosure on funds. At most, these funds should disclose simply that ESG is a supporting consideration, but mandating further disclosure is not beneficial. Disclosure may even be harmful, as it could mislead investors by indicating that a fund has a greater commitment to sustainable investing than it actually has. Under the Proposed Rule, greenwashing may worsen, as funds that do not necessarily consider themselves to "integrate" ESG factors may nonetheless be required to disclose such considerations as if they do. To avoid these risks, Morningstar recommends eliminating the ESG-Integration category.

> **4. Will funds that engage in fundamental-oriented analysis, *i.e.*, funds that analyze a portfolio company's value by examining related economic and financial factors about their portfolio companies generally, consider themselves to be Integration Funds? Should such funds be Integration Funds because of their long-standing considerations of governance factors in their investment selection processes? For ESG disclosure requirements, should there be an Integration Fund category, as proposed, or should we limit disclosure requirements to ESG-Focused Funds? Alternatively, should there be additional categories of funds other than Integration Funds, ESG-Focused Funds, and Impact Funds, as proposed?**

Many funds do now use ESG information as part of their process, but few would consider labeling themselves as "Integration Funds" because they do not integrate ESG as thoroughly as ESG-Focused Funds do. These funds want to avoid being accused of greenwashing, but the Proposed Rule would force many of them to, in essence, call themselves "ESG-Integration Funds," which could open them up to charges of greenwashing. This result is the opposite of what the Commission intends, and a large reason why Morningstar recommends instead using the name "ESG Consideration Funds" or eliminating the category altogether.

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[21] PRI article.
[22] 2019 Landscape, P. 2.
[23] 2019 Landscape, P. 10.
[24] 2019 Landscape, P. 11.
[25] 2019 Landscape, P. 11.

Such funds should not be considered Integration Funds simply because of their long-standing considerations of governance factors in their investment selection processes. While some "G" issues are general governance best practices issues, others include how well the board oversees a firm's sustainability or ESG efforts and board diversity. Use of these factors alone is not enough to warrant status as an Integration Fund.

Morningstar believes that the Commission should limit disclosure to ESG-Focused and Impact Funds. The broad purpose of the Proposed Rule seems to be to distinguish between funds for which ESG plays a central role, and all other funds, including those in which ESG plays a supporting role. Some investors may be interested to know that an otherwise conventional fund considers ESG, but such a minimal level of ESG consideration does not warrant a disclosure requirement. Many such funds indicate today in their prospectuses that they use ESG, while also clarifying that it is one consideration among many. Morningstar finds, therefore, that the Integration Funds category should be eliminated, or, at the very least, renamed "ESG Consideration."

Morningstar also sees opportunities for additional categories, however. In our Sustainable Investing Framework, we include Sustainability-Themed funds, which could fall outside the proposed confines of ESG-Focused and Impact Funds. A Sustainability-Themed Fund, like one focused on renewable energy, for example, may not use broader ESG assessments nor have specific impact goals.

> **5. Should we, as proposed, require an Integration Fund to provide a brief description of how the fund incorporates any ESG factors into its investment selection process, including what ESG factors the fund incorporates? Should we require a fund to include example(s)? Should we require a specific type of example? What additional disclosure about an Integration Fund would be helpful for an investor? Where should that additional disclosure be located?**

Recent trends in data gathered by Morningstar indicate that the number of funds that would qualify as an Integration Fund has grown enormously. Morningstar tracked the growth of funds that mention ESG in their prospectuses beginning in 2016, when we found the first such instance. By 2019, close to 600 funds (not counting ESG-Focused and Impact Funds) included some mention of ESG in their prospectus. We subsequently stopped tracking this data because these funds became too numerous for the metric to be helpful to investors.

To estimate the current frequency, we analyzed the most recent summary prospectuses for U.S. open-end mutual funds and ETFs that would not meet the ESG-Focused or Impact Fund criteria. We used the summary prospectus for this analysis because each document only covers one fund, removing the possibility of false positives due to ESG-Focused or Impact Funds being described in the same statutory prospectus. We find that 9% of the funds examined, or 750 funds that are not ESG-Focused or Impact Funds, use the term "ESG" in their summary prospectus, with more potentially detailing their use of ESG factors only in the statutory prospectus. When we narrow the universe to active equity open-end funds that would not meet the ESG-Focused or Impact Fund criteria, almost 17%, or 2,600 funds, use the term "ESG" in their summary prospectuses.

Morningstar believes that imposing disclosure requirements on Integration Funds will affect an enormous proportion of existing funds, perhaps more than the Commission anticipates. For this reason, among others, Morningstar supports the elimination of the Integration Fund category.

Morningstar supports requiring these funds to provide a brief statement in the Summary Prospectus describing how the fund considers relevant E, S, and G factors alongside other factors. For these funds, ESG may inform some investment decisions but is generally not determinative. They could then provide a more-detailed statement in the Statutory Prospectus, as proposed.

> **6. Should we, as proposed, require an Integration Fund that considers the GHG emissions of its portfolio holdings as an ESG factor in its investment selection process, to disclose how it considers the GHG emissions of its portfolio holdings? Should the description, as proposed, include a description of the methodology such a fund uses for this purpose? Would investors find this narrative disclosure useful to make better informed investment decisions? Should we require Integration Funds to disclose quantitative information or other GHG metrics, in addition to or in lieu of, the narrative disclosure? If so, what type of quantitative information of GHG metrics should be disclosed? For instance, should we require Integration Funds that consider GHG emissions as a part of their investment selection process to disclose the same standardized GHG metrics we are requiring of certain ESG-Focused Funds? Would such quantitative data be useful to investors?**

Most Integration Funds will simply indicate that they consider material ESG factors, which vary from industry to industry. For some industries, carbon emissions are material, but the fund may use a Carbon Risk Rating to assess this risk rather than a measure of GHG emissions. Morningstar believes that the proposed disclosure requirements for Integration Funds go too far. If an Integration Fund has real GHG standards it is applying across its investments, then it probably should be in the ESG-Focused category.

If the commission keeps the ESG-Integration category, which we recommend renaming, Morningstar believes that it is helpful to require Integration Funds that consider GHG emissions to disclose the same standardized GHG metrics as ESG-Focused Funds.

> **7. Should Integration Funds provide the tabular disclosure we are proposing for ESG-Focused Funds, as discussed below? Would that disclosure overemphasize the role ESG factors play in an Integration Fund's portfolio or, conversely, would investors find the disclosure informative?**

As we have stated previously, if the Commission keeps the Integration Fund category, these funds should have the same disclosures as ESG-Focused Funds. In the future, once the climate issuer proposal is fully implemented, we believe the Commission could require the same disclosures of all funds, moving towards the uniformity in other jurisdictions.

> **9. We are proposing to require an Integration Fund to provide a brief disclosure in the summary section of an open-end fund's prospectus and in the general description of the fund for a closed-end fund. The brevity of this disclosure is designed to avoid giving investors the impression that Integration Funds incorporate ESG factors more than they actually do as a result of lengthy ESG disclosure. Is it feasible for funds to meet the elements of the proposed disclosure requirement with a brief description or example? If not, should we modify any aspects of the disclosure requirements to promote brevity? Should we impose a word limit or use another method to ensure brevity, beyond including the general requirement that the disclosure be brief? Are there other ways to ensure balanced disclosure that would not overemphasize the role of ESG factors while also fostering meaningful disclosure about ESG factors? Conversely, should we delete the requirement that the disclosures be brief?**

Morningstar believes that if the Commission renames the Integration Fund group and requires them to make disclosures, brevity is important and necessary, and we would support the proposal to require the disclosure to be brief. At the same time, disclosures should be standardized for all funds required to make them. The balance the Commission is striking is to disincentivize overstating the ESG case, or greenwashing. If disclosures are required to be brief, the Commission should provide guidance on what brevity means.

10. A fund is permitted to add a statement of its investment objectives, a brief description of its operations, or any additional information on its front cover page. That other information may include a text or design feature. Should we address a fund's use of a text or design feature on its front cover page? For example, should we provide that it would be materially deceptive and misleading for an Integration Fund to use a text or design feature on its front cover page that implies a focus on one or more ESG factors? Should we place limitations on the ability of an Integration Fund to use a text or design feature on its front cover page to indicate that the fund's investment decisions incorporate one or more ESG factors on the basis that such features might be misleading? Conversely, are there other formatting requirements that would help improve the salience and prominence, such as font size and bolding, that we should address?

While we are not aware of the current extent of this problem, Morningstar would support efforts by the Commission to address a fund's use of materially misleading and deceptive text or design on its front cover page.

11. Should we, as proposed, require an Integration Fund to provide a more detailed description of how the fund incorporates ESG factors into its investment selection process in an open-end fund's statutory prospectus or later in a closed-end fund's statutory prospectus? Would investors find this information useful for understanding the ESG integration process? Would this information overemphasize the extent to which an Integration Fund considers ESG factors in its investment selection process? Would the layered disclosure format that we are proposing be appropriate for Integration Funds? Should all or more information about the fund's ESG integration process be in the summary section of the prospectus? Conversely, should we require Integration Funds to put most or all of the information about their ESG integration process in the statutory prospectus (or, for closed-end funds, later in the prospectus), as proposed?

If the Commission retains the Integration Fund category and corresponding disclosure requirements, Morningstar supports brevity in the Summary Prospectus and giving the fund the opportunity to elaborate in the Statutory Prospectus. We do not think that greater detail should be required.

Morningstar believes that the use of the term "Integration Fund" will itself overemphasize the extent to which these funds consider ESG factors. The requirement that these funds make any disclosure could risk overstating their ESG case to investors. However, if the Commission requires these funds to disclose, the layered format—brevity in Summary Prospectus with more detail in the Statutory Prospectus—is appropriate. In general, the disclosures should be in the same format as ESG-Focused Funds and would be expected to be more concise.

b) Proposed ESG-Focused Fund Prospectus Disclosure

12. Are there additional distinctions that the disclosure rules should make besides the proposed distinctions between Integration Funds and ESG-Focused Funds, as proposed, for the level of detail required in prospectus disclosures?

Morningstar believes that the basic distinction between supporting role and leading role for ESG factors is appropriate.

13. Should we, as proposed, define an ESG-Focused Fund as a fund that focuses on one or more ESG factors by using them as a significant or main consideration in selecting its investment or its engagement strategy with issuers of its investments?

Generally, the Commission's definition of "ESG-Focused Fund," as proposed, is clear and appropriate, although the definition of "ESG factors" might be confusing. We understand "ESG-Focused Funds" as those that use one or more "approaches" to ESG and these approaches are the central defining feature of the fund's process. Approaches include exclusions, ESG integration, thematic investments, impact, and engagement, among others.

14. As discussed above, a fund that applies a screen to include or exclude investments based on ESG factors would meet the proposed definition of an ESG-Focused Fund. Should our definition of an ESG-Focused Fund specifically reference a fund that follows an ESG-related index or a screen based on ESG factors to include or exclude investments? Should our definition take into account whether a fund's use of an ESG-related index or screen is to promote ESG goals? Should the reference to engagement be a means of identifying Impact Funds, rather than ESG-Focused Funds generally?

Morningstar recommends that the Commission make clear that most index funds that follow ESG indexes should be defined as ESG-Focused Funds. When a fund tracks an index, it is simply using the index as a means to achieve another ESG-Focused strategy—for example, applying a screen or seeking a specific impact.

Engagement can certainly be impactful, such that it can be identified with Impact Funds. However, if an ESG-Focused Fund claims ESG factors play a central role in its engagement process but does not posit that it is seeking impact outcomes, Morningstar does not believe it should be considered an "Impact Fund" under the proposal.

22. Should we, as proposed, permit a fund to replace the term "ESG" in the ESG Strategy Overview table with another term or phrase that more accurately describes the ESG factors that the fund considers? Should a fund be required to replace ESG with a different term in certain circumstances, such as when it focuses on a particular issue or set of issues? Should we mandate that funds choose from a list of alternative terms to improve comparability, and, if so, what terms should those be?

Morningstar suggests not allowing funds to rename the table. Having a table consistently called "ESG Strategy Overview" would provide clarity and make data collection easier. We also think the Commission should not mandate that funds choose from a list of alternative terms to improve comparability. Since funds can employ more than one ESG strategy or target multiple issues, deciding and then requiring providers to choose from a list of terms instead of ESG could add unnecessary inconsistency.

23. Should we allow flexibility in how funds label each row in the table beyond the flexibility provided regarding the term ESG and the pronouns used?

Morningstar recommends keeping the table as consistent as possible for collection purposes. Flexibility should be allowed across funds, but the order of the content within the table should remain consistent and the content of each section should remain generally the same. For example, replacing "How the fund incorporates ESG factors in its investment decision" could be called "ESG factors incorporation," but moving this section to the top of the table, or giving it a different meaning could pose a challenge for data collection and comparability.

25. Should we, as proposed, require an ESG-Focused Fund to provide a concise description in a few sentences of the ESG factor or factors that are the focus of the fund's strategy? Is beginning the table with an overview helpful? Would it give investors a way to quickly discern the particular ESG-focus of the fund?

Morningstar supports the Commission in requiring ESG-Focused Funds to provide a concise description of the ESG factor or factors that are the focus of the fund's strategy. Having a text description is helpful, as the nature of how ESG is defined continues to evolve.

26. Should we, as proposed, require funds to include the types of common ESG strategies in a "check box" format? Is this format useful to an investor so that the investor can quickly and easily understand the fund's ESG strategy and compare it with the ESG strategies used by other funds? Alternatively, as opposed to listing all the strategies and checking the ones that apply, should funds list only the ESG strategies that apply to them?

Morningstar supports requiring funds to include the types of common ESG strategies in a "check box" format. From an investor perspective, it is helpful to see what other common strategies are not applicable.

27. Should the instructions include definitions or descriptions for each common strategy on the list, or are they sufficiently self-explanatory?

Morningstar recommends that the Commission provide definitions, even if the definition is basic. For example, "Proxy Voting" on its own could be confused with just voting, whereas what is intended with this disclosure is voting with an ESG focus. We have also seen at least one example where a fund manager said the fund applied exclusions, but the fund strategy was primarily Treasury bonds and inflation-linked derivatives, so by nature, the strategy already excluded corporate securities. Another example was a fund manager who said the fund was an "impact fund" because the asset management firm itself was women/minority-owned—which does not automatically make all of its funds "impact" funds. These examples are more extreme than the average and are not necessarily representative of funds, but still highlight why definitions should be provided.

28. Would there be instances where a fund might face ambiguity as to whether a strategy on the list accurately describes a technique the fund utilizes? For example, are there instances where it might be ambiguous whether a fund applies an inclusionary or exclusionary screen? If so, is there alternative disclosure a fund should provide?

Morningstar believes the existing three "open text" fields and the "other" option will address the potential for ambiguity. Definitions for the strategies on the list can mitigate a lack of clarity as well; such clarity would have helped in the example in our answer to Question 27 where a fund might think it employs exclusions because its portfolio strategy already excludes all types of corporate-issued holdings even though this exclusion is not based on ESG criteria.

34. Is the information that we are proposing to require an ESG-Focused Fund to disclose about how the fund incorporates ESG factors into its investment process for evaluating, selecting, and excluding investments appropriate and sufficiently clear?

The proposed disclosures are appropriate and clear.

35. Should we specifically require, as proposed, an ESG-Focused Fund to disclose in the ESG Overview Table whether it seeks to select or exclude issuers that engage in certain activities, or whether the fund seeks to select or exclude issuers from particular industries?

Morningstar supports the Commission's proposal to request ESG-Focused Funds to disclose in the ESG Overview Table whether they seek to select or exclude issuers that engage in certain activities, or whether the fund seeks to select or exclude issuers from particular industries.

Overview of the fund's ESG strategy

(3) Proxy voting or engagement with companies

58. Should we, as proposed, provide separate check boxes for proxy voting and engagement? Should we, as proposed, include both proxy voting and engagement in the row "How the Fund votes proxies and/or engages with companies about [ESG] issues?" How commonly do funds voting proxies as a significant means of implementing their ESG strategy also use engagement as a significant means of implementing their ESG strategy, or vice versa? Do funds engage with issuers in ways other than through voting proxies and meeting with management that we should address in the disclosure rules? What are those other ways? Should we require disclosure about those other ways of engaging with issuers? What would that disclosure include?

Morningstar generally supports the Commission's proposal to provide separate check boxes for proxy voting and engagement; though they can overlap, funds should disclose them separately.

However, while separate disclosure of a fund's proxy voting strategy and corporate engagement strategy would be preferable, proxy voting and engagement decisions are taken at the parent level rather than at the individual fund level, making the Proposed Disclosure format challenging for some.

Funds do engage with issuers in ways other than voting proxies and corporate engagement. For example, asset managers often write letters requesting disclosure on E&S issues, and companies may respond in writing rather than at a meeting. Required disclosures that specify "meeting with management" might not capture this activity.

59. As proposed, any fund for which proxy voting or engagement with issuers is a significant means of implementing the Fund's ESG strategy would indicate it pursues the applicable strategy by checking the box for proxy voting or engagement (or both, as applicable). Should this be the case, even for a fund that uses investment selection as the primary method for achieving its ESG goal? Is the proposed requirement that proxy voting or engagement with issuers be a "significant" means of implementing the fund's ESG strategy clear? Should we provide additional guidance on what constitutes a "significant" means of implementing a fund's ESG strategy? Should we provide that a fund's proxy voting would only be a "significant" means of implementing the fund's ESG strategy if the fund engages in activity beyond simply exercising its right to vote, for example by developing or proposing initiatives directly? Should we provide for additional requirements in order for a fund to check the applicable box indicating that it uses proxy voting or engagement with issuers to implement its ESG strategy?

Morningstar supports the Commission's proposal that funds for which proxy voting or engagement with issuers is a significant means of implementing the Fund's ESG strategy would indicate that they pursue the applicable strategy by checking the box for proxy voting or engagement. Funds that use investment selection as the primary method for achieving their ESG goals should still be required to indicate they pursue the applicable strategy by checking the appropriate check box if proxy and/or engagement is a significant part of the strategy. If a fund includes an investment due to ESG criteria, an investor could expect to see proxy voting and engagement policies to address when companies are off-track with such targets. However, some funds may only pursue their objectives through engagement and proxy, not investment (such as index funds), or some may choose to only pursue their goals through investment and not use engagement or proxy. The check boxes help investors get the complete picture of the fund's strategies.

Morningstar believes the definition of "significant" is straightforward and may not need defining, but some examples could be helpful.

The Commission should not provide that a fund's proxy voting would only be a "significant" means of implementing its ESG strategy if it engages in activity beyond simply exercising its right to vote. A fund that "simply exercised its right to vote" but—to advance its ESG objectives—frequently voted against management resolutions and/or supported shareholder resolutions it did not "develop or propose" would also fit the definition of "significant means." Thus, significant should be understood in a flexible manner to accommodate a range of approaches.

> **60. Should we, as proposed, require an ESG-Focused Fund that does not expect to vote proxies or engage with issuers to provide such disclosure in the ESG Strategy Overview table? If a fund does not expect to vote proxies or engage with its issuers, should it be required to affirmatively state this fact, as proposed, or would it instead be appropriate to require a different disclosure, such as a statement that the row is "not applicable?" Would such disclosure help an investor understand how a fund does or does not engage with issuers to implement its ESG strategy? Are there circumstances in which an ESG-Focused Fund's disclosure of its proxy voting or engagement practices could result in the fund making decisions that are not in the fund's best interest? Should we provide an exception from this disclosure for ESG-Focused Funds that do not expect to invest in voting securities, or would describing such strategy provide investors with helpful information? Should we require an ESG-Focused Fund that does not expect to invest in voting securities to affirmatively disclose this fact to investors in the ESG Strategy Overview table? Are there other ways in which funds that invest in non-voting securities engage with issuers and, if so, should we modify the proposed requirement to explicitly refer to such practices as being relevant disclosure for purposes of this item?**

Morningstar supports the Commission's proposal to require ESG-Focused Funds that do not expect to vote proxies or engage with issuers to disclose that in the ESG Strategy Overview table. The Commission requiring a statement that the row is "not applicable" would be appropriate. A "not applicable" option is useful for funds that do not have the option of voting (for example, fixed income, real estate, or direct infrastructure funds). Such disclosure will help an investor understand how a fund does or does not engage with issuers to implement its ESG strategy.

> **61. Is there additional information that should be disclosed in the statutory prospectus about the ESG-Focused Fund's specific or supplemental proxy voting policies regarding how it votes on ESG issues? For example, should we require a fund to provide a narrative description of its specific or supplemental proxy voting policies regarding how it votes on ESG issues? Can those policies be described briefly in a way that is understandable to investors? What other disclosure would help an investor understand how the fund votes proxies on ESG issues?**

Morningstar believes that funds should disclose additional information in the statutory prospectus about the ESG-Focused Fund's specific or supplemental proxy voting policies regarding how it votes on ESG issues, particularly where the fund's policies differ from those of the parent. The fund may briefly describe those policies in a way that is understandable to investors, based on broad principles tied to the overall investment strategy. Links to the parent-level voting and engagement policies would be useful here.

b) ESG Impact Disclosures

73. Instead of requiring an Impact Fund to disclose its progress towards achieving its specific impact in the annual report as proposed, should we instead require it to be disclosed in another regulatory document such as the fund's prospectus, or Forms N-CEN, N-CSR, or N-PORT? Should we allow the fund to omit the disclosure in its annual report or other regulatory document if the fund provides the information on its website? If so, should the regulatory documents provide a link to the website?

The disclosure should be provided in the annual report.

76. Should we require all ESG-Focused Funds and/or Integration Funds to provide MDFP or MD&A disclosure regarding how effectively they implemented their ESG strategies? For example, do ESG-Focused Funds that primarily use an inclusionary or exclusionary screen track any key performance indicators to analyze the effectiveness of the screen in furthering the ESG issues that are relevant to fund? Do Integration Funds track any key performance indicators? Would this disclosure of such key performance indicators be helpful to investors? Would it lead to potential for investors to be misled through overemphasis of ESG factors relative to such funds' actual level of consideration of such factors?

This information is not relevant from a data-collection perspective. Morningstar recommends not requiring ESG-Focused Funds and/or Integration Funds to provide Management Discussion of Fund Performance, or MDFP, or Management Discussion and Analysis, or MD&A, disclosure.

b) ESG Proxy Voting Disclosure

77. Should we, as proposed, require any fund that indicates that it uses proxy voting as a significant means of implementing its ESG strategy to disclose the percentage of voting matters during the reporting period for which the fund voted in furtherance of the initiative? Should we permit the fund to limit this disclosure to voting matters involving the ESG factors the fund incorporates into its investment decisions, as proposed? Would investors and other market participants find this information helpful? Is there any additional information regarding their proxy voting that we should require funds to provide?

Morningstar supports the Commission's proposal to require any fund that indicates that it uses proxy voting as a significant means of implementing its ESG strategy to disclose the percentage of voting matters during the reporting period for which the fund voted in furtherance of the initiative. This is essential information for investors to evaluate whether the fund is implementing the intended ESG strategy. The Commission should also permit the fund to limit this disclosure to voting matters involving the ESG factors the fund incorporates into its investment decisions, as proposed. This disclosure also helps companies understand what asset managers seek regarding ESG issues.

78. Are there any complexities with calculating the aggregate percentage of fund votes in furtherance of an ESG voting matter? For example, to what extent would there be ambiguity as to whether a voting matter involves the ESG factors the fund incorporates into its investment decisions? Are there cases in which it may be unclear whether or not a shareholder proposal that relates to an ESG factor a fund incorporates into its investment decisions advances the particular ESG goal? Could there be situations in which a shareholder proposal may be related to a particular ESG factor the fund incorporates into its investment decisions but the fund nonetheless votes against the proposal, for instance because it believes the proposal would not be a constructive way to address the particular ESG matter? Would funds that wish to provide additional context in these or similar situations be able to do so effectively and concisely within the MDFP or MD&A disclosure?

A shareholder proposal may relate to a particular ESG factor the fund incorporates into its investment decisions, even when the fund nonetheless votes against the proposal. Many asset managers of funds that wish to provide additional context in these or similar situations publicize brief vote rationales where they have not supported management resolutions or shareholder resolutions on ESG matters. We believe there is no reason why these explanations cannot be included in the MDFP or MD&A for key votes. As a best practice example, United Kingdom Stewardship Code 2020, or UKSC, Principle 12 allows rationale disclosures for "some or all voting decisions".[26] This could avoid disclosure overload in the MDFP/MD&A.

79. Should funds be required to provide a narrative explanation of how they cast their proxy votes on ESG matters, either instead of or in addition to statistics on ESG matters? If we required a narrative, what elements should a fund be required to include?

The Commission should require funds to provide a narrative explanation of how they cast their proxy votes on ESG matters in addition to statistics on ESG matters. Morningstar recommends including ESG goals being supported by the fund's voting activity, common factors in goal-relevant resolutions for which the fund voted, and common factors among goal-relevant resolutions the fund voted against in the narrative. Suitable wording will often already exist in the parent's proxy voting policy, so this disclosure should not be a heavy lift for many ESG-focused managers.

80. Should we, as proposed, require funds to provide cross-references to the more detailed disclosure regarding the fund's full proxy voting record on Form N-PX? Should we also require funds to cross reference their ESG proxy voting policies and procedures?

Morningstar supports the Commission's proposal to require funds to provide cross-references to the more detailed disclosure regarding the fund's full proxy voting record on Form N-PX. The Commission should also require funds to cross reference their ESG proxy voting policies and procedures.

c) ESG Engagement Disclosure

81. Should we, as proposed, require disclosure of the number or percentage of issuers with which the fund engaged and total number of ESG engagement meetings, as we propose to define that term? Would this information be useful to investors? Instead of, or in addition to, ESG engagement meetings, are there other metrics that we could require to be disclosed in relation to a fund's engagement strategy? Should we require funds to provide additional

[26] The Financial Reporting Council Limited. 2020. "The UK Stewardship Code 2020." P. 22. https://www.frc.org.uk/getattachment/5aae591d-d9d3-4cf4-814a-d14e156a1d87/Stewardship-Code_Final2.pdf (UKSC).

context to this information beyond the number or percentage of issuers with which the fund engaged and number of engagement meetings?

The proposed definition of ESG engagement meetings may be limiting. For instance, a private letter to all issuers in a fund's portfolio should count as an ESG engagement if such letter requests action or disclosure about a specific and measurable ESG issue that affected the entire fund portfolio. The Commission should adopt a broader definition of engagement to capture all such engagement activity.

While the disclosure of the number or percentage of issuers with which the fund engaged and the total number of ESG engagement meetings would be useful for investors, the SEC notes the increased incentive to report a high number. The Commission must strike a balance between a definition of engagement activity (which is probably a better reporting tool than engagement meetings) that is precise enough to avoid gaming but sufficiently flexible to accommodate fund managers' different approaches.

If the Commission does require concrete statistics about engagements, we see several limitations. Whether the percentage of the number of issuers or rather presented as a proportion of the portfolio is more informative remains unclear. One statistic would almost necessitate the disclosure of the other for a balanced view. Further, funds may engage with companies in the fund's investment universe that they do not currently own (i.e., are considering purchasing). The Commission's definition of engagement should be more holistic and allow funds to present all this information if relevant to their ESG strategy. The Commission could require that if funds choose to present certain statistics—for example, the percentage of issuers in their portfolio with whom they engage—they must also report the proportion of the portfolio that such issuers represent, so that investors are presented a more-holistic picture of the significance of the engagement.

84. Is it possible that funds will construe the term "ESG engagement meeting" more liberally than investors, resulting in a higher reported number than if the definition of ESG engagement meeting were more narrow? Should we provide additional guidance on the definition of ESG engagement meeting or require additional policies and procedures, recordkeeping, or disclosure in order to assist in making funds' approaches to what constitutes an ESG engagement meeting more consistent between funds and more consistent with investors' expectations? For example, should we require funds to develop written documentation regarding their engagement objectives, performance indicators to measure progress, monitoring and evaluation of ESG engagement meetings, or development of relationships with issuers? How do funds currently set and track their ESG engagement objectives? Is the requirement that progress toward an ESG goal be "measurable" sufficiently clear? Should we provide additional guidance or context regarding the definition of "measurable" as used in this instruction? Are there certain ESG goals where progress is not measurable where it would be appropriate for funds to be required to describe their engagement strategy?

Funds are likely to construe the term "ESG engagement meeting" more liberally than investors, resulting in a higher reported number than if the definition of ESG engagement meeting were narrower. If the Commission requires asset managers to report on something indicated to be favorable, they will report more than what may be strictly justified.[27] A key question for the Commission to consider is whether only

[27] Official Journal of the European Union. November 27, 2019. "REGULATION (EU) 2019/2088 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 27 November 2019 on sustainability-related disclosures in the financial services sector." Article 8 & 9.
https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32019R2088&qid=1658865994032&from=EN.

counting meetings is evidence of quality interaction. As the proposal indicates, not all meetings are of the same value, even if they are consistently defined.

Morningstar believes that requiring documentation on engagement objectives and performance indicators may be preferable to applying a narrower definition. We recommend that the Commission refer to the reporting expectations for engagement laid out in Principle 11 of the UKSC.[28] Indeed, some international fund managers already report in line with UKSC's principles. We recommend that the Commission refer to the Financial Reporting Council's, or FRC, report on Effective Stewardship Reporting, which contains valuable examples of existing practice.[29]

The Commission should provide additional guidance and/or context regarding the definition of "measurable" as used in the Commission's definition of "ESG engagement meeting."[30] We note that the Commission also uses the term "measurable" in its definition of "impact strategies;" we are supportive of the two definitions being identical.[31]

Progress may not be measurable for some specific ESG goals. If a fund discloses a goal that is not measurable, Morningstar recommends that the Commission require the fund to explain why it is not measurable and to describe the engagement strategy.

> **86. As proposed, the form would require funds to report statistics regarding the number of ESG engagements meetings across their entire portfolio, irrespective of the ESG goal of the meeting; should we instead require funds to break down their engagement statistics based on category? Would this provide helpful detail for an investor seeking to assess a fund's engagement on a particular topic? Would the breadth of potential categories make it difficult to convey the overall extent of a fund's engagement? Are there particular categories of engagement where investors would find it useful for ESG engagement meeting statistics to be presented separately? Would subcategorizing the statistics in this fashion present any challenges, such as administrative burden for funds or complexity in determining the particular category into which an ESG engagement meeting falls?**

Morningstar supports the Commission's proposal to require separation of E&S from G engagements. Without this separation, a fund could report a high number of ESG engagement meetings based purely on routine compensation and board composition matters.

d) GHG Emissions Metrics Disclosure

(3) Proposed fund metrics reporting requirement

> **87. Should we, as proposed, require environmentally focused funds to disclose their GHG emissions? Would such disclosure help investors interested in investing in such funds select a fund that is appropriate for them? To what extent would requiring GHG metrics reporting help prevent greenwashing?**

Morningstar supports the Commission's proposal to require environmentally focused funds to disclose their GHG emissions. GHG emissions represent a definite signal that the company is conscious of ESG-

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[28] UKSC, P. 20.
[29] FRC. November 2021. "Effective Stewardship Reporting: Examples from 2021 and expectations for 2022." P. 58-66. https://www.frc.org.uk/getattachment/42122e31-bc04-47ca-ad8c-23157e56c9a5/FRC-Effective-Stewardship-Reporting-Review_November-2021.pdf.
[30] Proposed Rule, P. 36674.
[31] Proposed Rule, P. 36657.

related issues. GHG metrics and targets (including disclosed tracking of updates) will provide transparency and mitigate risks of greenwashing.

> **88. Should we, as proposed, limit the GHG emissions reporting requirements to environmentally focused funds that do not affirmatively state that they do not consider GHG emissions of the issuers in which they invest as part of their ESG strategy? Should the GHG emissions reporting requirement be limited to fund strategies where the fund's adviser considers GHG emissions information in executing the fund's strategy? If so, would this approach achieve this goal? Are there other environmentally focused funds that should not be subject to the GHG emissions reporting requirements? Alternatively, should we propose modified or different GHG emissions reporting requirements for certain environmentally focused funds, such as funds that focus on investing in carbon capture technology?**

Morningstar supports the Commission's proposal to limit the GHG emissions reporting requirements to environmentally focused funds that do not affirmatively state that they do not consider GHG emissions of the issuers in which they invest as part of their ESG strategy. This approach should successfully capture all funds for which the fund's adviser considers GHG emissions information in executing the fund's strategy. A fund can include a disclosure saying they are not considering GHG emissions if this statement is in fact true and GHG emissions are irrelevant to their investment strategy, minimizing any compliance burden to those for whom the emissions are relevant. Requiring emissions reporting from funds that state they do not consider GHG emissions is unnecessarily burdensome and such disclosures would be unhelpful to investors.

> **89. Do commenters agree that, with respect to BDCs that are environmentally focused funds, the GHG emission disclosure we are proposing in this release would complement the GHG disclosure proposed in the Climate Disclosure Proposing Release if both proposals were adopted? Conversely, should a BDC only be required to disclose the GHG emissions disclosure proposed in this release or only provide the disclosure proposed in the Climate Disclosure Proposing Release?**

Morningstar believes that it is not necessary for the Commission to require business development companies, or BDCs, that are environmentally focused funds to disclose the same information in two sets of standardized SEC documentation, if the Climate Disclosure Proposing Release is adopted. If BDCs were to aggregate information from their portfolio companies and present information for the BDC as a whole, such information could be beneficial for investors.

> **90. Are there any potential unintended effects in requiring GHG emissions reporting? For example, are there investments that might report high emissions that could nonetheless help the fund achieve an investment objective related to the environment generally or climate change specifically, such as the GHG emissions generated from investments in the construction of windmills or electric cars? If so, would our proposed approach to limit GHG reporting to environmentally focused funds that do not affirmatively state that they do not consider GHG emissions of the issuers in which they invest help alleviate potential unintended effects of the GHG emissions reporting requirement? Rather than our proposed approach to limit the scope of funds subject to the GHG reporting requirement, should we instead require these funds to report alternative metrics that they consider in making investment decisions?**

Morningstar believes that the proposed disclosures allow funds flexibility in describing their ESG strategy. If a fund is focused on climate transition, such as construction of windmills, and not GHG emissions, it can say so in its narrative disclosures. It is also welcome to disclose alternative metrics that could be helpful to investors and the Commission could encourage the use of such metrics. For instance, nature-based initiatives such as the Taskforce on Nature-related Financial Disclosures or equivalent measures, could be used on a voluntary basis.

91. Are there alternative metrics that funds focused on climate change consider in making investment decisions that we should require funds to report alongside or instead of the proposed GHG emission metrics?

Morningstar recommends that Impact Funds disclose additional metrics related to the environmental and social ramifications of investment decisions. The SASB specifically references impact metrics such as water quality, water and electricity affordability, and access (for example, utilities) or the value chain percentage of water sourced from regions with high water stress (for example, nonalcoholic beverages).[32] We expect land use and water rights to become increasingly prevalent topics.

92. In addition to requiring environmentally focused funds to disclose their GHG emissions, should we also require Integration Funds that state that they use GHG metrics in their integration or investment process, or Integration Funds that consider environmental factors generally, to disclose their GHG emissions? Alternatively, should we require all ESG funds, regardless of their focus on E, S or G, to disclose these metrics? Alternatively, should we require all funds, regardless of whether they are ESG funds, to disclose their GHG emissions? Are investors in funds that do not involve ESG factors nonetheless interested in the GHG emissions associated with the funds' portfolios?

As indicated in our previous answers, Morningstar recommends that the Commission eliminate the Integration Fund category from the Proposed Rule, excusing them from disclosing GHG emissions or whether they use GHG metrics, especially since it would not be feasible for them to determine GHG emissions data given their limited focus on this factor. They should only disclose if this category is kept.

93. Should we, as proposed, require funds to disclose the Scope 1 and Scope 2 GHG emissions of their portfolio holdings using the carbon footprint and the WACI metrics? Do these metrics provide investors with useful information about the emissions associated with the fund's portfolio? Are we correct in our understanding that investors would benefit from seeing both metrics to appreciate the climate impact of the fund's investment decision as well as the fund's exposure to transition risks? Alternatively, should we require only one of these metrics to be disclosed? What are the costs associated with requiring the disclosure of a portfolio's Scope 1 and Scope 2 emissions?

Morningstar supports the Commission's proposal for funds to use the carbon footprint and WACI metrics to disclose Scopes 1 and 2 GHG emissions of their portfolio holdings. We generally recommend alignment with the TCFD and PCAF; both the carbon footprint and the WACI metrics are consistent with the emissions metrics suggested by both the TCFD and PCAF.

94. Should we require funds to disclose other metrics? Rather than requiring funds to disclose carbon footprint and WACI, should we allow funds to use any reasonable methodology to calculate the GHG emissions associated with their portfolios and provide an explanation of their methodology?

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[32] SASB.

We believe that all funds should report the same metrics. If funds wish to report additional metrics, they could do so on a voluntary basis. The Sustainable Finance Disclosure Regulation, or SFDR, uses a similar framework to the TCFD, so Morningstar supports the Commission in also allowing funds to use methodologies compatible with the SFDR, for example, the GHG Intensity of Investee Companies.[33] We encourage the Commission to produce a list of approved methodologies in order to ensure standardization and comparability of data. The minimum required disclosures, however, should be in the same format and computed based on the same methodology for all funds.

> **95. The carbon footprint and WACI metrics we are proposing are generally consistent with the metrics recommended by the PCAF Standard and the TCFD. Are there alternative calculation methodologies that we should require funds to use? For example, should we require funds to disclose the carbon emissions of the portfolio as a whole? For example, would investors benefit from seeing the fund's carbon footprint not normalized for the size of the fund, to focus investors on the absolute level of GHG emissions associated with fund portfolios?**

The carbon footprint and WACI metrics as proposed by the Commission are generally consistent with the metrics recommended by the PCAF Standard and the TCFD. Both absolute emissions and emissions intensity (as proposed by PCAF) are important. Any additional metrics, as explained above in our answer to Question 94, should be voluntary.

> **96. Should we, as proposed, require funds to calculate their GHG emissions without including a provision permitting a fund to give effect to any purchased or generated carbon offsets? Alternatively, should we allow funds to provide GHG emissions net of such carbon offsets in lieu of an absolute presentation?**

Morningstar recommends that the Commission require funds to disclose total emissions; the Commission could also give credit to offsets, but only upon separate disclosure of offsets (not a netting without disclosure) and allow users to understand the credibility and integrity of the offsets (for example, assumptions about the permanence of the carbon offset). The fund's process for monitoring offsets and mitigating risks of reduced impact on emissions reductions (such as forest land exposure to wildfires) would be useful as well. On the other hand, if the Commission prefers to exclude disclosure of offsets, Morningstar would not object.

> **97. Should we, as proposed, require funds to combine the Scope 1 and Scope 2 emissions of their portfolios? Alternatively, should we require funds to report separately their portfolio Scope 1 emissions from their portfolio Scope 2 emissions?**

Morningstar recommends that the Commission require funds to report Scope 1 and Scope 2 emissions separately, especially as these may vary significantly across industries. Such a requirement will give funds better insights into emissions at the subindustry level.

> **100. If an environmentally focused fund invests in a portfolio company with a holding company structure, should the fund's carbon footprint and WACI include the consolidated emissions of all subsidiaries owned by that holding company as Scope 2 emissions, or should the calculations include solely the Scope 1 and 2 emissions of the holding company? Are**

[33] This metric is the weighted average Scope 1, Scope 2 and Scope 3 carbon emissions intensity normalized by sales. (Unit: tons of CO2e/EUR million of sales). European Commission. 2021. "Sustainability-related disclosure in the financial services sector." https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance/sustainability-related-disclosure-financial-services-sector_en.

there alternative approaches to account for the holding company's control over the emissions of its subsidiaries?

Morningstar recommends that an environmentally focused fund invested in a portfolio company with a holding company structure should include in its carbon footprint and WACI the consolidated emissions of all subsidiaries owned by that holding company as Scope 1 and 2 emissions disclosed separately if that information is available to the fund.

101. Should we, as proposed, require the disclosure of portfolio companies' Scope 3 emissions to the extent they are publicly reported by a portfolio company? Should we require funds to estimate these Scope 3 emissions when they are not reported? How burdensome would this be for funds? Would the estimated Scope 3 emissions be reliable?

Morningstar supports the Commission's proposal to require funds to disclose and aggregate portfolio companies' Scope 3 emissions when a portfolio company publicly reports that information. Funds should not have to make such disclosures otherwise because fund estimates of Scope 3 emissions for their portfolio companies would not be easily comparable to those provided through regulatory reporting.

103. Should we, as proposed, require the disclosure of portfolio companies' Scope 3 emissions separately for each industry sector in which the fund invests? Is "industry sector" the appropriate category for the portfolio companies' Scope 3 emissions? Alternatively, should we permit or require funds to use the same reasonably identifiable category for portfolio company Scope 3 emissions that they use to depict the portfolio holdings of the fund in the graphical representation of holdings section of the annual report? Alternatively, should we require the disclosure of a single metric for all these portfolio companies' Scope 3 emissions?

Morningstar believes that the disclosure of portfolio companies' Scope 3 emissions separately for each industry sector in which the fund invests would be helpful as long as they are able to obtain this information. We support the Commission's use of the term "industry sector," though we recommend that the Commission offer a definition in a glossary to ensure consistency. Morningstar recommends that the Commission use industry classifications such as those used by SASB, the European Union Taxonomy, or the North American Industry Classification System.

104. Should we, as proposed, require the calculation of Scope 1 and Scope 2 emissions separately from Scope 3 emissions? Alternatively, should we require funds to disclose all three emission types as a single metric?

Morningstar supports the Commission's proposal to require separate disclosure of Scope 1, Scope 2, and Scope 3 emissions, as these may vary by industry.

108. Should we prescribe how the fund must determine the GHG emissions associated with its investments in a fund or private fund? If the underlying fund or private fund discloses the GHG emissions of its portfolio, should funds be allowed to rely on the underlying fund's disclosed GHG emissions data as proposed? Alternatively, should the fund be required to look through its investment in the underlying fund regardless of whether such underlying fund discloses its GHG emissions?

Morningstar generally supports the Commission's proposal to allow funds to rely on the underlying fund's disclosed GHG emissions data. We ask that the Commission also consider requiring reporting funds to require underlying funds to obtain reasonable assurance. Some additional compliance time may be needed to meet such a requirement, but such a requirement would improve the accuracy of GHG emissions data.

> **113. Should we, as proposed, require funds to obtain all the information necessary to calculate a portfolio company's enterprise value from their most recent regulatory report? Would this approach ease the burdens and costs associated with complying with the proposal? Would it enhance the comparability of the information across funds with similar investments? Alternatively, should we require funds to obtain more recent data, if such information is voluntarily provided by the portfolio company?**

Morningstar supports the SEC proposal to require funds to obtain all the information necessary to calculate a portfolio company's enterprise value from their most recent regulatory report.

> **116. Should we, as proposed, require all necessary data related to the fund to be provided as of the fund's most recently completed fiscal year and all necessary data related to the portfolio company as of the date of the relevant regulatory report filed by the portfolio company containing the necessary information? Would the inconsistency in the "as of" dates of the data used in the calculation of GHG metrics affect the quality of the fund's GHG emissions disclosure?**

Morningstar supports the requirement to use the "as of" dates as proposed.

> **117. If a portfolio company reports its total revenue in currency other than U.S. dollars, should we, as proposed, require a fund to convert the reported revenue to U.S. dollars using the exchange rate as of the date of the portfolio company's regulatory report? What are the costs associated with such a requirement? Should we instead allow a fund to use the exchange rate as of the fund's most recently completed fiscal year or, alternatively, the current exchange rate?**

Morningstar supports the Commission's proposal to require a fund to represent reported revenue in U.S. dollars. This conversion should already be part of a portfolio company's standard operations to track performance. We recommend the Commission enforce the use of standard accounting guidelines for exchange rates. Typically exchange rates are applied at period-end, but some may choose an average rate; Morningstar is agnostic in this regard as to which methodology is used.

> **120. Should we, as proposed, require that a fund use the Scope 1, Scope 2, and Scope 3 emissions of a portfolio company from the company's most recent regulatory report if the report includes that information? Would this approach ease the burdens and costs associated with complying with the proposal to the extent portfolio companies include the relevant GHG information in their regulatory reports? Would it enhance the comparability of the information across funds with similar investments? Are we correct in our understanding that data provided in a regulatory report filed with the Commission is always more reliable than information disclosed on portfolio company website and GHG emissions estimates generated by an ESG provider? Alternatively, should we require funds to seek to obtain more recent data from the portfolio company? What are the costs and burdens associated with such an alternative approach?**

Morningstar supports the Commission's proposal to require that a fund use the Scope 1, Scope 2, and Scope 3 emissions of a portfolio company from the company's most recent regulatory report if the report includes that information. A reported figure is generally more accurate than an estimate.

121. For portfolio companies that do not report or otherwise provide their Scope 1 and Scope 2 emissions ("non-reporting portfolio companies"), should we, as proposed, require funds to use a good faith estimate of the portfolio companies' Scope 1 and Scope 2 emissions? Should we provide additional guidance on performing these calculations?

Morningstar recommends that the Commission provide additional stringent guidance on performing calculations of portfolio companies' estimated Scope 1 and Scope 2 emissions. We also recommend that funds disclose the percentage of the portfolio that is estimated, as another signal of quality and to avoid greenwashing.

124. Rather than requiring a fund to estimate a non-reporting company's GHG emissions, should we exclude non-reporting companies from a fund's GHG emission calculations? If so, should we also limit a fund's ability to invest in non- reporting companies? For example, should we limit a fund's ability to invest in non-reporting companies to 20% of a fund's net asset value?

Morningstar does not take a firm position on whether the Commission exclude non-reporting companies from a fund's GHG emission calculations until methodologies are in place to obtain estimates of their emissions, with the understanding that this transition may take a few years to happen. Importantly, funds should disclose what part of their portfolio is not reported.

125. Should we, as proposed, require a fund to briefly discuss in the MDFP or MD&A how the fund estimates any GHG emissions, including the sources of data for determining such estimates, and the percentage of the fund's aggregated GHG emissions for which the fund used estimates rather than reported emissions? Is it clear to funds what this description should include? Is there any additional guidance that we should provide? For example, if a fund bases its estimate on information provided by an ESG service provider, is there any additional information that we should explicitly require regarding these service providers? Would this additional information be helpful to investors in understanding how a fund calculates its GHG emissions?

Morningstar supports the Commission's proposal to require a fund to discuss how it estimates any GHG emissions and the percentage of the fund's aggregated GHG emissions for which the fund used estimates as described above. We believe that disclosure of the percentage of estimates is especially critical. We recommend the Commission require funds to validate these disclosures with a third-party provider, and further recommend that funds disclose the name of the validating entity or assurance company in order to ascertain quality. We believe that monitoring these validating entities is essential (via a regulatory oversight body).

126. Should we, as proposed, require a fund to narratively explain on Form N-CSR the methodologies and assumptions it applied when calculating any good faith estimates of a portfolio company's GHG emissions? Is it clear to funds what this description should include? For funds that base their estimates on information provided by ESG service providers, would the funds be able to describe the underlying methodologies and assumptions used by these service providers?

If a fund provides estimates, Morningstar believes that such estimates should be explained on Form N-CSR, in the manner and format most consistent with SEC practices. We recommend that the Commission further define what such a description should include.

127. Is our layered approach to the disclosure of GHG emissions appropriate? Should we require a fund to state, in the shareholder report, that additional information regarding the underlying assumptions and methodologies is available on Form N- CSR? Would investors be sufficiently familiar with Form N-CSR to understand the cross reference? Would funds be able to provide a hyperlink or other more specific reference even though the fund may not have filed its report on Form N- CSR at the time it delivers the shareholder report? Alternatively, should we require a fund to summarize briefly the underlying methodologies and assumptions, including any limitations of the methodology, in the shareholder report?

Morningstar recommends that the Commission require a fund to summarize its underlying methodologies and assumptions, cross-referencing other SEC documentation as needed.

(4) Inline XBRL Data Tagging

128. Should any of the proposed disclosure items be excepted from the proposed Inline XBRL requirement? What would be the effects on data quality and usability to investors and other data users with excepting such disclosure items from the requirement to submit data in Inline XBRL?

Morningstar believes that no proposed disclosure items should be excepted from the proposed eXtensible Business Reporting Language, or Inline XBRL, requirements. Data is most helpful to investors when it is complete.

129. Should we require or permit funds to use a different structured data language to tag the proposed disclosures? If so, what structured data language should we require or permit, and why?

The Commission should not require issuers to use a different structured data language to tag the proposed disclosures. We view Inline XBRL as an appropriate markup language to use for the disclosures of this data.