
MAY 27, 2022

SEC Proposes Amendments to Form ADV Regarding Investment Advisers' ESG Practices

On May 25, 2022, the SEC proposed amendments to Form ADV (“Proposed Amendments”) (available [here](#))¹ which would require investment advisers, including private fund² advisers, to provide additional information regarding their incorporation of environmental, social and governance (“ESG”) factors in their investment strategies. According to the proposing release, the Proposed Amendments are designed to promote consistent, comparable and decision-useful information for investors. While the Proposed Amendments do not define “ESG” or similar terms, they do seek to categorize certain types of ESG strategies broadly and would require advisers to provide specific disclosures based on the ESG strategies they pursue. In addition, the proposing release provides staff observations and offers guidance to advisers regarding compliance practices relating to ESG investing. Comments on the Proposed Amendments are due 60 days after their publication in the Federal Register.

Key Takeaways

Increased investor demand for ESG products, the expansion of various approaches to ESG investing by advisory clients, the increased number of ESG products offered and a lack of standardized ESG terminology present a number of compliance risks for advisers. Correspondingly, recent SEC Risk Alerts³ and enforcement activity confirm that the SEC and its staff remain focused on whether advisers' disclosures and marketing materials related to ESG investing are accurate and consistent with internal practices. The proposing release notes that SEC staff have observed a range of compliance practices that, in their view, do not appear to address effectively advisers' incorporation of ESG factors into their advisory services. In light of these observations, advisers that incorporate ESG factors into their investment strategies and practices, including for private funds, may wish to consider reviewing their obligations under the Compliance Rule⁴ and Marketing Rule.⁵ Specifically, advisers may consider reviewing the accuracy of their ESG-related disclosures made to investors, prospective investors and regulators and whether their compliance policies and procedures are consistent with such disclosures. Advisers may also consider reviewing their portfolio management processes to ensure that their portfolios are managed consistently with any ESG-related investment objectives disclosed by the adviser and/or its private fund(s). Similarly, the proposing release notes that under the Marketing

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Rule, it “generally would be materially misleading for an adviser materially to overstate in [its marketing materials] the extent to which it utilizes or considers ESG factors in managing client portfolios.”

Proposed Amendments to Form ADV

The following table summarizes certain of the Proposed Amendments particularly relevant to advisers to private equity, credit and hedge funds, as well as separately managed accounts.⁶

Item	Required Disclosure
Part 1A	The Proposed Amendments would require both SEC-registered advisers and exempt reporting advisers⁷ to report census-type information to the SEC on Part 1A about their use of ESG factors in their advisory business, including their use of ESG providers (e.g., ESG index providers, ESG scoring providers).
Item 5.K. Separately Managed Accounts⁸	Whether the adviser considers any ESG factors as part of one or more significant investment strategies or methods of analysis (“significant strategies”) in the advisory services it provides to separately managed account clients and, if so, which factors it considers and the type(s) of ESG-related strategy(ies) it employs: namely, “integration” strategies where one or more ESG factors is considered alongside other, non-ESG factors; “ESG-focused” strategies that consider one or more ESG factors; and/or “ESG impact” strategies that are designed to achieve a certain ESG goal (as well as certain information required by the corresponding sections of Schedule D).
Item 5.M. Third-Party ESG Framework(s) <i>(new item)</i>	Whether the adviser follows any third-party ESG framework(s) in connection with its advisory services and, if so, the name of the framework (e.g., the United Nations Principles for Responsible Investment).
Items 6. Other Business Activities and 7. Financial Industry Affiliations and Private Fund Reporting⁹	Whether the adviser conducts other business activities as an ESG provider or has related persons that are ESG consultants or other ESG service providers (as well as certain information required by the corresponding sections of Schedule D).
Schedule D; Section 7.B.(1)	Whether the adviser considers any ESG factors as part of one or more significant strategies in the advisory services it provides to private funds and, if so, which factors it considers and the type(s) of ESG-related strategy(ies) it employs: integration, ESG-focused and/or ESG impact strategy.
Part 2A / “Brochure”	The Proposed Amendments would require all SEC-registered advisers to provide information about advisers’ use of ESG factors in narrative format in their brochure, which must be filed with the SEC and delivered to clients and prospective clients.
Item 8.D. Methods of Analysis, Investment Strategies and Risk of Loss¹⁰ <i>(new sub-item)</i>	For each significant strategy for which the adviser considers any ESG factor(s), a description of: <ul style="list-style-type: none"> ▪ the ESG factor(s) the adviser considers and how the adviser incorporates a particular ESG factor(s) when providing investment advice; ▪ whether and how the adviser incorporates E, S or G factors, or a combination of ESG factors; ▪ whether and how the adviser employs integration, ESG-focused and/or ESG impact strategies; and ▪ any criteria or methodology the adviser uses to evaluate, select or exclude investments, including any internal methodology, third-party criterion or methodology, inclusionary or exclusionary screen and/or index.

Item	Required Disclosure
Item 10.C. Other Financial Industry Activities and Affiliations	A description of any relationship or arrangement, that is material to the adviser's advisory business or to its clients, that the adviser or any of its management persons have with any related person that is an ESG consultant or other ESG service provider, including the identity of such related person ESG provider and any material conflicts of interest related thereto.
Item 17. Voting Client Securities	If the adviser has specific voting policies or procedures that include one or more ESG considerations when voting client securities, a description of the ESG factors it considers and how it considers them.

Compliance Date

If adopted, advisers would have one year after the effective date of the amendments to Form ADV (60 days after the date of publication in the Federal Register) to comply with the ESG disclosure requirements.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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¹ The Proposed Amendments were included in a package of ESG-related proposals predominantly aimed at registered investment companies and business development companies.

² A “private fund” is an issuer that would be an investment company as defined in Section 3 of the Investment Company Act of 1940, as amended, but for Section 3(c)(1) or 3(c)(7) of that Act.

³ See [SEC Risk Alert: The Division of Examinations' Review of ESG Investing](#) (Apr. 9, 2021).

⁴ Rule 206(4)-7 under the Investment Advisers Act of 1940, as amended (the “Advisers Act”).

⁵ Rule 206(4)-1 under the Advisers Act.

⁶ For purposes of reporting on Form ADV, advisory accounts other than those that are pooled investment vehicles (i.e., registered investment companies, business development companies and private funds) are considered to be separately managed accounts. See Form ADV Part 1A Item 5.K(1) (describing separately managed account clients).

⁷ Form ADV defines an “exempt reporting adviser” as an investment adviser that qualifies for the exemption from registration under Section 203(l) of the Advisers Act because it is an adviser solely to one or more venture capital funds, or under Rule 203(m)-1 of the Advisers Act because it is an adviser solely to private funds and has assets under management in the United States of less than \$150 million.

⁸ Proposed amendments to Item 5.K. would be applicable to advisers registered or required to be registered with the SEC.

⁹ Proposed amendments to Items 6 and 7 and Section 7.B.(1) of Schedule D would be applicable to SEC-registered investment advisers and exempt reporting advisers.

¹⁰ The proposing release notes that clients seeking advisory services tailored to their ESG investing goals would refer to an adviser’s disclosures under the brochure’s current Item 4.C. to assess whether and how an adviser tailors its advisory services to the individual needs of clients, and whether clients may impose restrictions on investing in certain securities or types of securities. The SEC asks for comments as to whether they should propose additional amendments to specify that all advisers that tailor their advisory services based on the ESG preferences of clients must describe the tailoring as part of Item 4.