



**Via email: rule-comments@sec.gov**

Brent Fields  
Secretary  
Securities and Exchange Commission  
100 F St. NE  
Washington, DC 20549-1090

**Re: Request for Comment on Names Rule  
File No. S7-04-20**

---

Dear Mr. Fields:

The University of Miami School of Law Investor Rights Clinic ("IRC") appreciates the opportunity to comment on the efficacy of 17 CFR 270.35d-1 (the "Names Rule"). The IRC primarily assists unsophisticated investors and seniors who have suffered financial losses in their savings. The vast majority of our clients are unable to understand a prospectus, for example, and, thus, are unlikely to understand where to seek information about a fund's composition and associated risks.

The SEC is requesting comment on potential standards for the names of funds, such as registered investment companies and business development companies. The SEC understands that investors may make decisions based on what a fund's name communicates. The names of these companies have the potential to mislead investors as to the contents of a fund where they are not sufficiently regulated. There have been several changes and evolutions in the market since the adoption of the Names Rule in 2001; accordingly, the SEC is looking to update the rule with solutions to the new challenges that it presents in the request for comment.

## **I. Overview**

The SEC recognized the importance of fund names in 2001 when the Commission enacted Rule 35-d1, also known as the "Names Rule." In adopting the Names Rule, the SEC also highlighted the legislature's concern about misleading fund names, stating, "Congress has recognized, however, the name of an investment company may communicate a great deal to an investor." Since its adoption, the Names Rule has been an important shield for investors from deceptive funds and bad actors in the securities marketplace.

The average IRC client is unsophisticated. They do not know to understand a prospectus and make the necessary inquiries about the assets within a fund. Instead, they may rely on the name of the fund to accurately represent its contents. Unsophisticated investors are particularly vulnerable to misleading fund names—they rely on funds' names to determine its strategies and risks, or to understand the recommendation of an advisor. Accordingly, we suggest that the SEC consider standards for the environmental, social, and corporate governance ("ESG") label.

Additionally, we suggest that index funds must ensure that the name of the index complies with the Names Rule if the index fund uses the index name in the name of the fund.

## II. Application of the Names Rule to ESG Investment Mandates

ESG factors have increasingly aligned with the values of investors.<sup>1</sup> Individual investors often do not want to feel that they are, for example, contributing to a company that is minimally compliant with environment regulations or a company that has poor working conditions. Investors may feel that companies that have efficient and sustainable environmental practices or that have a particular commitment to their employees are lower-risk or have especially great potential. This is especially true with respect to corporate governance, as poor internal controls have the potential to be detrimental to investors. Currently, there is some uncertainty as to whether companies that use the ESG designation operate in a manner consistent with its standards. Until accepted standards are established for ESG funds, the SEC should consider disallowing the label to avoid misleading investors. However, to the extent that funds will continue to use the ESG label, the SEC should consider adopting preliminary standards to determine compliance with ESG factors.

The Names Rule applies to ESG investment mandates: 80 percent of the assets in a fund must meet set criteria to qualify for the mandate. We suggest that the standard be that investments must meet the standard for being either environmentally sustainable, socially conscious, or have strong internal controls in its governance to carry the ESG label.

To meet the standard of environmental sustainability, we suggest, for example, that the companies the fund invests in be required to have a sustainability policy, follow the Sustainability Accounting Standards Board's standards<sup>2</sup>, follow the Global Reporting Initiative standards<sup>3</sup> (GRI), and/or have a chief sustainability officer. The object would be to have company meet one or more standards that demonstrate its commitment to an environmental cause, which may be unique to its geography or industry, such as climate change, air or water pollution, sustainable energy, or recycling.

<sup>1</sup> See Alyce Lomax & John Rotonti, *What is ESG Investing?*, MOTLEY FOOL (Feb., 25 2020, 8:27 PM), <https://www.fool.com/investing/what-is-esg-investing.aspx>; CFA Institute, *ESG Investing and Analysis*, CFA INST., <https://www.cfainstitute.org/en/research/esg-investing>.

<sup>2</sup> The Sustainability Accounting Standards Board establishes sustainability accounting standards across various industries and may be utilized by companies listed on a national exchange in their filings to the SEC, which disclose material information relating to sustainability. Practical Law Corporate & Securities, *ESG Disclosures & Sustainability Reporting Frameworks*, THOMPSON REUTERS: PRAC. L. (last updated Nov. 8, 2018). The standards help companies to assess which information is financially material and, thus, which issues are most important to investors. *Materiality Map: Why is Financial Materiality Important?* SASB, <https://www.sasb/standards-overview/materialitymap>.

<sup>3</sup> GSI sets out standards that may be used by companies to report "their impacts on the economy, the environment, and society." GSSB, GRI 412: HUM. RTS. ASSESSMENT 2016 (outlines one of seventy-seven standards). Companies may register a Sustainability Report in the GRI database. Practical Law Corporate & Securities, *ESG Disclosures & Sustainability Reporting Frameworks*, THOMPSON REUTERS: PRAC. L. (last updated Nov. 8, 2018).

Socially conscious organizations should implement policies and programs to create a culture of, for example, diversity, or commitment to labor standards. To meet the socially conscious standard, we suggest requiring that a company, at minimum, have adopted a code of ethics. Section 406 of the Sarbanes–Oxley Act requires public companies to disclose to shareholders whether they have adopted a code of ethics for senior managers. The company could also meet the social conscious standard through means such as adhering to the International Standard Organization<sup>4</sup> (“ISO”) Standard 26000, which guides socially responsible behavior.

Lastly, a company may meet the ESG standard by utilizing best practices in their corporate compliance. Because there is no one-size-fits-all approach to governance and internal controls, the SEC may consider adopting criteria based on best practices within specific industries. Strong corporate governance practices may include, for example, Say on Pay that aligns executive compensation with the value created by sustainable policies<sup>5</sup> and employee training programs that educate employees, at all levels, on their responsibilities as they relate to compliance with laws and regulations, as well as with the company’s internal policies.

### **III. Index-Based Funds Should Ensure that the Securities Underlying the Index Comply with the Names Rule Regarding the Name of the Index**

The securities market has seen an explosion in index-based funds. In just under 20 years, the number of index-based funds has quintupled.<sup>6</sup> As these securities have promulgated, more and more investors are incorporating these index-based funds into their own personal portfolios. Oftentimes, investors, especially unsophisticated investors, rely on the names of investment products to help inform their decisions and achieve their investment goals.

Index-based funds appear to satisfy the Names Rule simply if the index-based fund uses the name of the index it is tracking and includes the securities underlying the index in the fund regardless of whether the name of the index accurately describes its underlying securities. However, the name of the index does not have to comply with the Names Rule because indices are not subject to the Names Rule. Indices escape the reach of the Names Rule due to the fact they are not investment companies and cannot be directly invested into by investors. By comparison, funds who use an original name for their fund must ensure the securities of the fund comply with the regulations outlined in the Names Rule.

By way of example, if there was a “Green Energy Index” which included oil and gas companies in the Index, a “Green Energy Index Fund” could be created with the same securities

<sup>4</sup> “Clarif[ies] what social responsibility is, helps businesses and organizations translate principles into effective actions and shares best practices... globally.” *ISO 26000: Social Responsibility*, ISO, <https://www.iso.org/iso-26000-social-responsibility.html>; Practical Law Corporate & Securities, *ESG Disclosures & Sustainability Reporting Frameworks*, THOMPSON REUTERS: PRAC. L. (last updated Nov. 8, 2018).

<sup>5</sup> TRENDS IN EXECUTIVE COMPENSATION, DELOITTE, 1, 4 (2019), <https://www2.deloitte.com/content/dam/Deloitte/ch/Documents/audit/deloitte-ch-en-on-the-boards-agenda-trends-in-executives-compensation-sept-19.pdf>.

<sup>6</sup> SEC, REQUEST FOR COMMENTS ON FUND NAMES, 1, 8 n.22 (2020).

as those tracked by the Index. Under current rules, the index-based fund managers do not have to perform any further due diligence to ensure the securities underlying the index conform to the name of the index. This could lead to a scenario where an investor interested in expanding his portfolio into the green energy space could be misled by the name of “Green Energy Index Fund.” By comparison, if a fund manager was to start a novel “Green Energy Fund,” the fund manager would have to perform due diligence to ensure the securities underlying the Fund complied with the requirements of the Names Rule.

In light of the recent and rapid growth of index-based funds, we propose that index-based funds should ensure the securities underlying the index comply with the Names Rule if they are going to use the name of the index in the name of their index-based fund. This change would ensure that investors are not being misled and that fund managers are performing proper due diligence regarding their funds regardless of the type of fund being managed.

First, there seems to be no reason why index-based funds could not perform the due diligence needed to ensure the securities underlying the index comply with the Names Rule. All the management of the fund must do is look at the securities of the index and ensure that the securities fall within the restrictions imposed by the Names Rule. The management of an index-based fund would be better equipped to perform due diligence on the composition of the index rather than outside investors, especially unsophisticated investors. If the index-based fund does not meet the Names Rule, the management of the fund can still track the fund, it simply must not include the name of the index in the name of the fund. The name of the index it is tracking could simply be placed in the prospectus and other offering materials of the fund.

In addition, by requiring that the securities underpinning the index match the name of the index, according to the Names Rule, when a fund uses an index name in its name, it will ensure that investors will not be misled when investing in index-backed funds. Because the name of indices sometimes do not accurately represent the securities of the indices, investors who rely on the name of index-based funds, especially unsophisticated investors, can be deceived into investing into a fund that does not match their investment goals or objectives. By ensuring the name of an index-based fund properly portrays the underlying securities of the index, all investors can invest with more confidence and make a better-informed decision on their investments.

Finally, by mandating that index names follow the Names Rule if found in the name of an index-based fund, it will also disincentivize bad actors from purposefully creating indices that have no correlation to their name and then create index-based funds based on the poorly-named index. Financial ETFs around the globe are starting to create their own indices—so called “self-indices.” In the words of one Canadian banker, “[t]he biggest pro...would be an adaptive methodology where you can *establish the rules based on your own criteria*.”<sup>7</sup> In April 2017, Fidelity released two self-indexed ETFs in Europe.<sup>8</sup> Because of the index-based fund loophole, a bad actor could simply self-index its own created index and may mislead investors as to the

<sup>7</sup> Gail Moss, *Will ETF issuers create their own indices?*, INV. & PENSIONS EUR. (Nov. 2017), <https://www.ipe.com/will-etf-issuers-create-their-own-indices/10021552.article> (emphasis added).

<sup>8</sup> *Id.*

underlying assets of the fund. Altering the rule regarding index-based funds would prevent this type of financial deceit from occurring.

Until the SEC addresses the Names Rule index-based fund loophole, investors will be uninformed and could be relying on potentially misleading information when transacting in index-based securities. Further, applying the Names Rule to the securities underpinning indexes when the index name is used in the fund will ensure that index-based fund managers perform the proper due diligence with level of detail other fund managers must already do.

#### **IV. Conclusion**

We thank the SEC for the opportunity to comment on this proposal. The IRC is committed to protect investors, especially unsophisticated investors, from all types of securities misrepresentations, including those which may mislead investors interested in ESGs and index-based funds. While we respect and understand the balance the SEC must take between security sellers and buyers, we urge the SEC to amend or create rules which level the playing field for all entities involved in the securities industry. The fairer a securities market is, the more trust the public will have in investing their hard-earned money into that market.

Respectfully Submitted,

/s/Cole Baldecchi

Cole Baldecchi  
*Student Legal Intern*

/s/Savannah Padgett

Savannah Padgett  
*Student Legal Intern*