PRACTUS™

May 5, 2020

Via email: rule-comments@sec.gov

Vanessa Countryman, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-0609

Re: Request for Comments on Name Rule
File No. S7-04-20

Dear Ms. Countryman:

I am writing in reference to the Securities and Exchange Commission (the "Commission" or the "SEC") Release No. IC-33809; File No. S7-04-20, dated March 2, 2020 concerning the Request for Comment on Fund Names (the "Request") and the topics the Commission raised regarding the efficacy and possible amendment of the Commission's Rule 35d-1 (17 C.F.R §270.35d-1) (hereinafter referred to as the "Names Rule") promulgated under section 35(d) of the Investment Company Act of 1940 (15 U.S.C. 80a-34(d)) (the "1940 Act").

I am a partner at the law firm Practus, LLP. While Practus is a general practice law firm, a significant number of our lawyers represent investment advisers, fund sponsors, broker dealers and others who rely on us for advice regarding their obligations under the 1940 Act and its rules. We believe that the Names Rule continues to play a valuable role in the Commission's regulation of registered investment companies and should be improved to make it even more protective of investors.

Among other questions for which the Commission asked for comments were several related to the category of funds promoted as focused on "sustainable" and "socially-responsible" investment strategies. In its Request, the Commission sought comments on whether it makes sense to expand the Names Rule to give funds and their promoters better guidance regarding the proper use of words like "sustainable" or "ESG" (a common acronym used to refer to "environment, social, governance" investing styles). A wide variety of actors in the regulatory, industry and consulting community are working to agree upon a consistent set of principles that can better delineate the aims of ESG investing.[1] The Names Rule should expressly make funds that use names that refer to ESG-related strategies, such as "ESG", "Environmental", "Clean", "Impact", "Social" or "Sustainable", subject to the same "80-percent requirement" in Rule 35d-1 that now applies to funds that include geographic, asset-class and tax-related terms in their names.

[1] For example, Regulation (EU) 2019/2088 (*hereinafter* "Sustainable Finance Disclosure Regulation") seeks to harmonize European Union ESG disclosure standards for disclosures of different types of information complexity, granularity and consumer-friendliness.

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In our experience, advisers and investors rely on terms like "ESG" and "sustainable" as key indicators about the types of companies held in fund portfolios and the types of strategies fund managers employ, including the degree to which they engage in activism to improve performance. Advisers and investors are also seeking funds that are clear about the extent to which the funds pursue so-called "non-economic goals" in addition to traditional profit-maximization.

The Commission specifically has sought comment on whether the use of "ESG" should be reserved for funds who pursue all three objectives ("environment, social and governance") or whether those using ESG should at least explain which of the objectives are within their focus or strategy. In our view, use of the term "ESG" should be reserved for funds which have adopted and maintain an active strategy of choosing investments based on transparent and clear criteria that relate in a defensible way to achieving environmental and social goals. While governance plays a role in helping funds evaluate the extent to which management at the entities in which they invest have the tools they need monitor achievement of these goals, "governance" investing is a separate style that may or may not also overlap with "environmental" and "social" investing. The Commission should avoid crafting a change in the Names Rule that fails to reflect these distinctions. Nevertheless, we believe strongly that the Commission should encourage fund managers and advisors to explain their objectives and strategy more clearly and transparently.

We were pleased that this Release signals the Commission's willingness to address the challenge of ESG and "sustainable" and "socially-responsible" investing more broadly. With an update of the Names Rule, the Commission has an opportunity frame matters in ways that strengthen the ability of responsible fund sponsors to attract customers and reduce the freedom of competitors to promote funds that use these and similar catch-phrases to appeal to the same investors, but who lack a rigorous policy governing choice of investments or engagement with issuers of securities in their portfolios. Critics have rightly accused promoters of ESG and similar "corporate social responsibility" and "sustainability" language of selling a type of "green-wash"—an appealing salad of virtue-signaling PR words used without any rigor and lacking any enforcement measures to back them up. This is especially disturbing given that ESG investing is growing quickly and some observers predict that the style could command half of all assets under management in 2025.[2]

Nevertheless, we disagree with those who advocate that the Commission adopt rigid standards regarding use of ESG and related terms. There is considerable room for debate about what constitutes "environmental" and "social" investing. For example, "renewable" energy is often thought of as "environmental", yet there are critics of including wood-burning "biomass" projects under an "environmental" or "clean" banner given the clear trade-offs that are inherent in these technologies. Nuclear energy is also controversial and reasonable minds disagree on the appropriateness of nuclear energy in a portfolio of investments touted as "clean" or "environmental." The SEC is not an expert agency in environmental or energy matters, and therefore should resist calls by those who wish it to wade into these treacherous debates and issue one-size-fits-all rules.

[2] See report by Deloitte, "Advancing environmental, social, and governance investing**:** A holistic approach for investment management firms**"** February 20, 2020 at https://www2.deloitte.com/us/en/insights/industry/financial-services/esg-investing-performance.html. See, also "The Great Mirage: As ESG grows in popularity, so do suspicions that managers may be cashing in on the trend without really committing," CityWire, April 2020 at https://citywireusa.com/professional-buyer/ezine/esg-us-supplement-april-2020?p=2&utm_campaign=ESG-ezine&utm_source=pb-ESG-ezine&utm_medium=email&utm_content=2020-04-ESG-email

Rather, we think that the Commission should adopt a principles-based approach that promotes better self-governance. Self-governance or, better stated, "soft" governance models, do not have to be empty exercises in virtue signaling.[3] The credibility and effectiveness of voluntary "soft governance" can be enhanced by reference to principles that have been developed by third-party organizations or firms who state their criteria publicly and have transparent processes for adopting and amending these principles. Many of these entities also offer third-party audits of compliance as a service. Mandating disclosure of the results of these types of audits or reporting results through a third-party framework can increase the quality of information available to investors to monitor how their investments are performing and what portfolio decisions fund advisers are making that further investor goals. There is an abundant social science literature on self-governance, and there is broad consensus that private standards can increase information efficiency, help overcome collective action problems and the reluctance of private actors to provide public goods like better market information.

Under this type of approach, if a fund uses an "ESG-related" term in its name, it would need to adopt an 80% investment policy that meets several basic conditions:

1. Transparency – The investment policy should be clear about the fund's philosophy towards ESG investing and explain it in plain language in its disclosures. Among other things, the policy should specify what mix of screening methods the funds use, for example whether they are integrated, positive or negative.
2. Objective Criteria – The investment policy should either be grounded in objective criteria published by third-parties or the fund should explain to investors why it has chosen to adopt its own criteria without any reference to third-party standards, and explicitly describe the criteria.[4]
3. Independence—The fund should report its performance to a recognized self-governance initiative or commit to engaging an independent third-party to verify its performance against the fund's policy or explain in its disclosures why it is not using third-party reporting or verification.

The leading self-governance initiative in the investment industry is Principles of Responsible Investing ("PRI", see https://www.unpri.org/pri/an-introduction-to-responsible-investment/what-are-the-principles-for-responsible-investment) which is supported by the United Nations and whose voluntary principles have been adopted by hundreds of asset-owners and investment advisors. PRI essentially asks it members to commit to six principles, the first two of which are to "incorporate ESG issues into investment analysis and decision-making processes" and "be active owners and incorporate ESG issues into our ownership policies and practices." The third principle addresses the investment targets themselves, committing the members to "seek appropriate disclosure of ESG issues by the entities in which we invest."

[3] Self-governance refers broadly to arrangements where private parties make ex ante "credible commitments" to perform in ways that benefit the parties generally in circumstances where there are substantial ex post temptations to break the commitments, even when there is not an external agent to enforce the commitments. Self-governance requires that the members of the arrangement organize themselves, monitor each-others' behavior and impose sanctions on those who break their commitments. Such sanctions can be handed down in many ways, most often in real world self-governance situations by "naming and shaming" and exclusion from the group. See e.g. Ostrom et. al. (1992), "Covenants With and Without a Sword: Self-Governance is Possible," American Political Science Review, Vol.85, No. 2, p. 404-417.

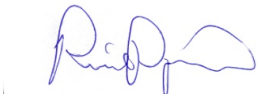
[4] In any changes to the Names Rule, the Commission should include among recognized third-party standards: (i) voluntary disclosure frameworks like PRI (see above); (ii) guidance frameworks such as GRI (see below) and the Sustainability Accounting Standards Board (SASB) or (ii) use of reports from private third-party aggregators of ESG metrics.

As to reporting standards that impact issuers, the Global Reporting Initiative ("GRI", see www.globalreporting.org) is prominent private initiative to promote better and more consistent reporting by issuers around environmental and sustainability goals. The GRI Sustainability Reporting Standards have been widely adopted by issuers who report emissions reductions, progress against human rights goals and other matters customarily included in sustainability reports. GRI has also been active in the capital market space, as a partner, along with PRI, in the Sustainable Stock Exchanges Initiative ("SSEI") that has been developed with the sponsorship of several United Nations agencies, and the UN Global Compact and PRI. The New York Stock Exchange and Nasdaq are members of SSEI. GRI's standards are developed in a transparent process that allows stakeholders and the general public to comment before the standards are adopted. This brief tour should make clear that there is a robust inter-connected eco-system of institutions that reflect industry and public input that could be strengthened by the right set of guidelines issued by the Commission under the Names Rule. Such an approach—disclosing the principles used to develop the investment strategy and explaining what third-parties were the source of such principles and/or standards incorporated in the strategy or why management has chosen not to rely on third-party principles and standards—would provide the right balance of flexibility and rigor. Finally, the Commission should consider creating a safe harbor on Names Rule compliance to any fund that also complies with the EU's Sustainable Finance Disclosure Regulation. High-quality disclosure around ESG and "sustainable" investing is a public good, and private governance systems can help overcome information and cost barriers that prevent private parties from generating and sharing efficient, actionable information with market participants. The Commission can also discourage free riding by requiring that fund managers explain why they have elected not to join any self-governance initiative or organization that requires adherence to independent reporting standards.

In summary the Commission should extend the Names Rule to better address ESG investing. The Commission should require that funds whose names indicate a commitment to ESG and "sustainable" styles adopt an 80-percent investment policy and disclose to investors the elements of the ESG evaluation system, the choices the funds have made, and explain why the specific standards and procedures were adopted and not others. The SEC should avoid proscribing particular standards or metrics in detail, because no "one-size-fits-all" approach will be right for all funds. Nevertheless the SEC could achieve better results for investors if it requires funds to commit in their disclosures to their own set of explicit standards and procedures, report on performance in a reliable and consistent fashion and either subject themselves to verifiable standards developed by independent third-parties or explain why third-party standards or verification are not useful to fund investors.

Thank you for the opportunity to comment on this important Request. If you would like additional information or I might be of assistance, please do not hesitate to contact me at the contact points indicated above.

Sincerely,



Richard P. Pasquier

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