Consumer Federation of America

May 12, 2020

Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: File Number S7-04-20
Request for Comments on Fund Names

Dear Ms. Countryman,

We are writing on behalf of the Consumer Federation of America (CFA)[1] to respond to the Commission's request for comments on the appropriate framework for addressing misleading fund names.[2] Retail investors routinely use funds (registered investment companies) to save for retirement, college, or other important savings goals. Many retail investors rely on fund names to help determine a fund's investments, strategies, and risks. Indeed, fund names are often the first piece of information about a fund that investors receive. And in some cases, in the selection of a target date fund for example, the fund name may be the primary or only piece of information the investor considers when making a purchase decision. As a result, a fund's name can have a substantial influence on an investor's purchasing decisions.

To the extent that investors purchase funds based on their names and the funds' names don't match the way they invest, investors can be misled or deceived. This can result in investor harm if those funds do not meet the investor's needs, goals, or expectations or expose them to unexpected risks. Indeed, when investors justifiably rely on funds' names as an indication of how the funds will invest, and those funds operate in a manner that is inconsistent with what their names suggest, it can impose real costs on investors.

The Names Rule, promulgated in 2001, was intended to protect against these risks by requiring funds with a name that suggests a particular investment emphasis to invest in a manner consistent with its name while leaving funds broad latitude to choose names that create no such expectation. As the Commission noted at the time, "The need for investment companies to invest

[1] Consumer Federation of America is a nonprofit association of more than 250 national, state, and local consumer groups that was established in 1968 to advance the consumer interest through research, advocacy, and education.
[2] Investment Company Act No. Release 33809 (March 2, 2020) [85 FR 13221] (March 6, 2020)], https://bit.ly/3cp6mmI.

in a manner consistent with their names is particularly important to retirement plan and other investors who place great emphasis on allocating their investment company holdings in well-defined types of investments, such as stocks, bonds, and money market instruments."[3] Unfortunately, there are significant gaps and loopholes in the rule that do not ensure that funds invest in a manner that is consistent with their names in all circumstances. As a result, investors continue to be at risk of being misled or deceived by fund names and suffering harm as a result. We therefore welcome the Commission's recognition of the importance of assessing the effectiveness of the existing rule in prohibiting funds from using names that are materially deceptive or misleading and considering whether there are alternatives that address these concerns. The goal of that reconsideration should be to protect investors more effectively.

We believe the Commission should both close the gaps and loopholes in the existing Names Rule and expand its application to cover all instances in which fund names create the reasonable expectation that the funds will invest in a certain way. This is necessary to ensure that funds do not adopt names that create that reasonable expectation without operating in a manner that is consistent with that expectation. Moreover, because many investors do not read detailed disclosures and the most vulnerable investors are most likely to rely on fund names in making their investment decisions, the Names Rule should not allow disclosure, particularly disclosures buried deep in a prospectus, to "cure" a misleading or deceptive name.

I. Funds understand that the names they choose have a significant influence on investors' purchase practices.

At the outset, it's important to recognize that funds are not required to adopt names that describe their investment objective, strategy, or policies. Rather, they are free to choose whatever names they'd like, so long as those names are not misleading and deceptive. However, if a fund chooses to adopt a name that suggests a particular investment objective, strategy, or policy, it is critical that the fund's investment objective, strategy, or policy reflect that name. By definition, to allow otherwise would be to allow funds to engage in misleading and deceptive behavior.

Funds clearly understand both how important fund names can be in communicating and advertising to investors and that fund names can influence investor decisions. Accordingly, funds are very careful to choose names that are appealing to investors. Ben Carlson, a portfolio manager at Ritholtz Wealth Management and market commentator stated, for example, "Wall Street's team of marketers and salespeople know that investors look at the names of the funds when making their investment choices. And when they don't like how the fund's name is currently working, they can always change it."[4] They do this, according to Carlson, "to drum up interest."[5]

Indeed, research suggests that when funds make name changes, it often has the intended effect of increasing flows to those funds. Research by Michael Cooper, Hyseyin Gulen, and P. Raghavendra Rau found, for example, that the year after a fund changed its name to reflect a hot style, the fund experienced an average cumulative abnormal flow of 28 percent, with no

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[3] Investment Company Act Release No. 24828 (Jan. 17, 2001) [66 FR 8509 (Feb. 1, 2001)] ("Names Rule Adopting Release"), https://bit.ly/3bsipy4.
[4] Ben Carlson, *What's In a (Mutual Fund's) Name?,* A WEALTH OF COMMON SENSE, March 10, 2015, https://bit.ly/3dxE2hY.
[5] *Id*.

improvement in performance.[6] While this research is dated, more recent research suggests that fund name changes continue to positively affect flows.

In this more recent research, Susanne Espenlaub, Imtiaz ul Haq, and Arif Khurshed examined 'superficial' name changes, those that are not warranted by changes in a fund's investment strategy or holdings, a merger or acquisition, or a change in the fund manager.[7] The researchers found that such name changes constituted a majority (approximately 60%) of all the name changes in their sample period. Because superficial name changes contain absolutely no information reflecting a change in the future potential earnings of the fund, according to the researchers, they did not expect that investors would react to such changes. However, in contrast to their expectations, they found that not only do such name changes attract significantly positive abnormal flows, but also that these are not significantly different from those of fundamental, non-superficial name changes. The researchers also found no evidence that performance improved after such name changes or that fees decreased. Instead, the researchers found that investors tended to lose out due to lower returns to name-change funds as a group.

Thus, fund names and name changes have the potential to affect investor interest and fund flows. Given these incentives for funds to adopt names that maximize their potential attraction, this creates the risk that funds may use names that are deceptive and misleading, to investors' detriment. Indeed, the Names Rule was adopted in response to strengthen the Commission's hand in combating such abuses. In order to ensure the rule continues to protect investors against these risks, improvements to the rule are needed.

II. Significant gaps and loopholes in the Names Rule fail to ensure that funds invest in a manner that is consistent with their name in all circumstances. As a result, investors continue to be at risk of being misled or deceived by fund names and suffering harm as a result.

Section 35(d) of the Investment Company Act, as amended by the National Securities Markets Improvement Act of 1996, prohibits a registered investment company from using a name that the Commission finds by rule to be materially deceptive or misleading. Section 35(d) reflects Congress' concern that funds' use of misleading or deceptive names was not adequately being addressed by the Commission and, as a result, investors weren't being adequately protected. The Senate Committee Report, for example, suggested that Congress believed that investor protection merited a new, streamlined approach whereby the Commission could nimbly exercise its broad authority to protect against the risk that funds would choose names that mislead or deceive investors.[8]

Pursuant to this congressional directive, the Commission promulgated rule 35d-1 ("the Names Rule") in 2001. In the adopting release, the Commission appeared to reflect an understanding that Congress was concerned investors weren't being sufficiently protected against potentially misleading and deceptive names and that additional regulation was needed in this area

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[6] Michael J. Cooper, Huseyin Gulen, and P. Raghavendra Rau, *Changing names with style: Mutual fund name changes and their effects on fund flows*, THE JOURNAL OF FINANCE, November 10, 2005, https://bit.ly/2WpyHUb.

[7] Susanne Espenlaub, Imtiaz ul Haq, and Arif Khurshed, *It's all in the name: Mutual Fund Name Changes after SEC Rule 35d-1*, JOURNAL OF BANKING & FINANCE, ELSEVIER, vol. 84(C), 123-134 (2017), https://bit.ly/2YY67ey.

[8] *See* S. Rep. No. 293, 104th Cong., 2d Sess. 8-9 (1996), https://bit.ly/3cskRWG.

to protect investors. The Release stated, "[I]n adopting amended section 35(d), Congress reaffirmed its concern that investors may focus on an investment company's name to determine the company's investments and risks, and recognized that investor protection would be improved by giving the Commission rulemaking authority to address potentially misleading investment company names."[9]

Unfortunately, despite Congress' clear concern that investors weren't being sufficiently protected against potentially misleading and deceptive names and the broad authority that it granted to the Commission to address these concerns, the existing Names Rule has significant gaps and loopholes that allow funds to use misleading and deceptive names, to investors' detriment. It therefore fails to fulfill what Congress intended, falling far short of ensuring that funds that choose to adopt names that imply they invest in a particular manner actually invest in a manner that is consistent with their name.

First, the existing Names Rule, which requires a fund to invest at least 80% of its assets in the type of investment suggested by its name, covers only a narrow slice of the fund market. The rule applies only if a fund's name suggests that the fund focuses its investments in a particular type of investment (e.g., the ABC Stock Fund, XYZ Bond Fund, or QRS U.S. Government Fund), industry (e.g., the ABC Utilities Fund or XYZ Health Care Fund), or particular country or geographic region (e.g., the ABC Japan Fund or XYZ Latin America Fund). The Names Rule does not, however, apply to fund names that imply something about the fund's investment objective, strategy, or policies. For example, it does not apply if a fund's name suggests it uses a value or growth strategy. As a result, a fund could have "value" in its name and could invest primarily in growth stocks or vice versa.[10] We do not see how allowing a fund to use a name that implies it follows one investment strategy when it actually follows a very different strategy is any less deceptive or misleading than the types of names that are prohibited by the rule. On the contrary, investment strategies of this type are among the factors unsophisticated investors are least likely to be able to assess independently.

In addition, the rule doesn't apply to target date fund names. This is particularly problematic given the dramatic growth in target date fund assets in the last 20 years, which in part is due to the fact that they are often used as the default investment alternative in 401(k)s and other retirement plans. It is also particularly problematic because target date funds are specifically marketed as simple solutions for financially unsophisticated investors who don't have the time, resources, or ability to evaluate investments, including the funds' underlying investments, in order to determine whether the funds are appropriate for them.[11] For these reasons, target date funds are among the funds whose names retail investors, including retirement savers, are most likely to rely on in making a fund selection. Specifically, these target date fund investors are likely to rely on the fund name, based on the target date, as a shorthand indicator of what fund they should invest in.

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[9] Investment Company Act Release No. 24828 (Jan. 17, 2001) [66 FR 8509 (Feb. 1, 2001)], https://bit.ly/3bsipy4.

[10] Jane Longueville, *Style drift: Are your mutual funds true to their name?,* THRIVENT, April 02, 2020, https://bit.ly/3dCW6Y3 (finding that "not all funds stay true to their name, which can play havoc with the asset allocation strategy of an investor's portfolio.").

[11] *See, e.g.*, Catherine Brock, *A Shocking Number of Retirement Savers Are Confused About Target-Date Funds*, MOTLEY FOOL, March 21, 2020, https://bit.ly/2zsQOjg.

The Commission has previously recognized these concerns. In 2010, the Commission proposed, but never finalized, rules to require a target date retirement fund that includes the target date in its name to disclose the fund's asset allocation at the target date immediately adjacent to the first use of the fund's name in marketing materials.[12] The release stated that "target date fund names are designed to be significant to investors when selecting a fund."[13] The Commission continued, "Target date fund names generally include a year, such as 2010. The year is intended as the approximate year of an investor's retirement, and an investor may use the date contained in the name to identify a fund that appears to meet his or her retirement needs. This naming convention, however, may contribute to investor misunderstanding of target date funds. Investors may not understand, from the name, the significance of the target date in the fund's management or the nature of the glide path up to and after that date. For example, investors may expect that at the target date, most, if not all, of their fund's assets will be invested conservatively to provide a pool of assets for retirement needs. They also may mistakenly assume that funds that all have the same date in their name are managed according to a uniform asset allocation strategy."[14]

The Commission discussed how target date fund performance during the 2008-2009 financial crisis highlighted the risks that investors could face with regard to these funds. For example, many target date funds that were close to reaching their target date suffered significant losses in 2008, and there was a wide variation in returns among target date funds with the same target date.[15] The Commission reasoned that the 2010 target date fund names and advertising proposal was intended to "convey information about the allocation of the fund's assets at the target date and reduce the potential for names that include a target date to contribute to investor misunderstanding of target date funds. For example, if a target date fund remains significantly invested in equity securities at the target date, the proposed disclosure would help to reduce or eliminate incorrect investor expectations that the fund's assets will be invested in a more conservative manner at that time."[16]

Unfortunately, however, that proposal suffered from serious deficiencies, as outlined in a recommendation of the SEC Investor Advisory Committee,[17] and was never finalized. As a result, target date fund investors are still at risk of being misled where there is a mismatch between target date fund names and their investment strategies. For example, a target date fund could bill itself as a 2020 fund, clearly suggesting that it is appropriate for an investor who plans on retiring in 2020. While it would be most appropriate for that fund to have shifted its focus from investing for growth to investing for income given the short time horizon until retirement, and it would be reasonable for an investor to expect that the fund's investments are tailored to that purpose based

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[12] Investment Company Advertising: Target Date Retirement Fund Names and Marketing, Investment Company Act Release No. 339126 (June 16, 2010) [75 FR 35,921–22 (June 23, 2010)], https://bit.ly/2YUk8ty.

[13] *Id*. (citing Karrie McMillan, General Counsel, Investment Company Institute, at Target Date Fund Joint Hearing (June 18, 2009) https://bit.ly/35RRydK, at 6-7 (stating that the expected retirement date that is used in target date fund names is a point in time to which investors easily can relate.).

[14] *Id*.

[15] *Id*. ("Investment losses for funds with a target date of 2010 averaged nearly 24% in 2008, ranging between approximately 9% and 41%....By contrast, in 2009, returns for 2010 target date funds ranged between approximately 7% and 31%, with an average return of approximately 22%.").

[16] *Id*.

[17] Recommendation of the Investor Advisory Committee, Target Date Mutual Funds (Adopted April 11, 2013), https://bit.ly/2Lkpiqz.

on the fund's name, a 2020 target date fund could have a substantial amount of equity risk that is not consistent with that objective. An investor who invested in the 2020 fund based on their reasonable expectation that the fund would match the short time horizon until retirement could be exposed to substantial risk that is inconsistent with those expectations and needs. We discuss how this could best be addressed in the next section of this letter.

In addition, the existing Names Rule doesn't apply at all times. First, the 80% investment requirement applies only at the time when a fund invests its assets (i.e., the date of the fund's purchase of those assets). Thus, a fund that begins by complying with the rule could experience drift at certain times to an entirely different composition that does not comply with the 80% requirement. While future investments would have to be made in a manner to bring the company into compliance with the 80% requirement, the fund would not have to affirmatively make changes after it has fallen out of compliance to ensure that it comes back into compliance in a timely manner. As a result, investors who purchase the fund during what could be an extended period of non-compliance could be misled by the fund name.

For example, a fund could originally be marketed as a small cap fund and comply with the rule by investing 80% of its assets in small cap companies. However, over time, many of the small cap companies could grow to be mid- and large-cap companies, changing the composition of the fund and its exposure. Through drift, these funds may no longer reflect their name, and an investor who makes asset allocation decisions to invest in these funds based on their names and the reasonable expectations these funds create would be misled. These investors' desired asset allocation would be impacted as well. Investors who already have exposure to large cap companies and are looking to diversify their exposure into smaller companies would instead be magnifying their exposure to large companies by investing in these funds.[18]

Second, the existing Names Rule applies only during "normal circumstances." The adopting release stated that this provision was intended to provide "flexibility" to permit funds to take "temporary defensive positions" to avoid losses in response to adverse market, economic, political, or other conditions, or to otherwise depart from the 80% investment requirement in other limited, appropriate circumstances, particularly in the case of unusually large cash inflows or redemptions. However, as an extreme example, this effectively allows a fund to call itself a stock fund while holding a 100% cash position for a potentially significant amount of time. This result would defeat investors' reasonable expectation that a stock fund would be invested substantially if not exclusively in stock. In order to accurately reflect their name and not mislead investors, we think the Commission should significantly narrow this exception, as we discuss in the next section of this letter.

Next, the existing Names Rule allows single-state tax exempt funds to use names that mislead or deceive investors about what they are investing in. Specifically, a single-state tax exempt fund can invest substantially in securities issued by another municipality, despite the fact that investors would reasonably expect that a fund with a state's name would invest primarily, if not exclusively, in that state's securities. Disturbingly, this activity is permissible as long as the fund discloses in its prospectus that it is investing in this manner, despite the fact that investors

[18] *See, e.g.*, David Randall, *Analysis: What's in your small-cap fund? Try Boeing or Pfizer*, REUTERS, August 2, 2013, https://reut.rs/2WHVLwg.

may not read or understand such a prospectus disclosure, in part, because such disclosures are nonsensical, as illustrated below.

Recent experience illustrates how several single-state tax exempt funds invested substantially in securities issued by another municipality and suffered as a result. As reported in a November 2015 article in *Institutional Investor*, the Oppenheimer Rochester Maryland Municipal Fund and the Oppenheimer Rochester Virginia Municipal Fund held 42.7% and 37.5% of their respective portfolios in Puerto Rican government debt in September 2015, nearly two months after the commonwealth defaulted on interest rate payments.[19] Despite the fact that the names of these funds strongly suggest that the funds invest primarily or exclusively in Maryland and Virginia municipal securities, respectively, this activity by the funds was permissible. Investors who reasonably expected, based on the funds' names, that they would invest according to that mandate, were misled or deceived.[20] And to the extent the fund's investments were not consistent with their needs or goals -- exposing them to significantly more risk in this case and suffering the losses associated with those risks -- they were harmed.

Even more egregious, the existing rule allows a single state tax-exempt fund to invest 100% of its securities in another municipality's securities. According to the rule, a single state tax-exempt fund can include a security of an issuer located outside of the named state in the 80% basket if the security pays interest that is exempt from both federal income tax and the tax of the named state, provided that the fund discloses in its prospectus that it may invest in tax-exempt securities of issuers located outside of the named state. Thus, there is nothing stopping a Maryland fund from investing 0% in Maryland securities and 100% in Puerto Rican securities. According to the Oppenheimer Rochester Virginia's prospectus, for example, securities issued by Puerto Rico "are considered to be 'Virginia municipal securities' for purposes of this prospectus."[21] This is simply nonsensical.

In trying to justify allowing this charade, the Commission explained that, "Investors are generally more interested in the tax-exempt nature of an issuer's distributions than the issuer's location."[22] First, the Commission has no basis for this statement. Second, it appears that funds view things differently. They are likely to receive some benefit from being closely associated with a particular state and using its name. Otherwise, they would simply choose a different state's name. And a state whose securities may not be appealing to investors because the state is having financial difficulties, for example, may have an incentive to use another state's name to attract investment in its fund, thereby increasing investment in its own securities. This tactic would clearly be misleading and deceptive to investors, who would reasonably expect the fund to invest in the securities of the state suggested by the fund's name. Yet the Commission's approach would appear to allow this deceit.

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[19] Richard Teitelbaum, *Oppenheimer's Tax-Free Puerto Rican Muni Bond Junket*, INSTITUTIONAL INVESTOR, November 5, 2015, https://bit.ly/3cqmGU1.

[20] *Id*. The funds were apparently allowed to do this because they disclosed that they would be investing in securities issued by other municipalities. For example, according to Institutional Investor, the prospectus for the Oppenheimer Rochester Virginia fund stated: "The Fund also invests in the obligations of the governments of U.S. territories, commonwealths and possessions such as Puerto Rico, the U.S. Virgin Islands, Guam, or the Northern Mariana Islands to the extent such obligations are exempt from state income taxes. These investments also are considered to be 'Virginia municipal securities' for purposes of this prospectus."

[21] *Id*.

[22] Investment Company Act Release No. 24828 (Jan. 17, 2001) [66 FR 8509 (Feb. 1, 2001)], https://bit.ly/3bsipy4.

We see no legitimate reason why a fund that uses a state's name should be allowed to engage in any of this misleading and deceptive behavior. If a fund can't invest at least 80% of its securities in in-state securities at all times, it shouldn't be allowed to use the name of that state. After all, if the real purpose, as the Commission suggests, is to signal the tax-exempt nature of the distributions, funds are free to use names that reflect that fact without falsely associating their fund with a particular locale.

III. The Commission should close the gaps and loopholes in the existing Names Rule. It should also expand the rule's application to cover all instances in which funds don't operate in ways that are consistent with the names they adopt or the way they hold themselves out.

As discussed above, the Names Rule applies narrowly to specific types of securities and, even where it does apply, there are exceptions that further narrow the rule's reach. We believe this leaves too much room for funds to adopt misleading and deceptive names and to otherwise hold out in ways that are potentially misleading to investors. We therefore urge the Commission to close those gaps and loopholes to better protect investors from misleading or deceptive fund names. Specifically, the Names Rule should cover not just securities that a fund invests in, but also ways in which a fund suggests that it complies with a particular investment objective, strategy, or policy. In addition, the rule should apply to target date fund names. Finally, the exception for taking a defensive position during market disruptions should be narrowed substantially. We also encourage the Commission to capture more broadly instances in which fund names or other ways they hold out, including through the indexes that they track and the tickers that they use, reasonably suggest something about how they invest.

We recognize that applying the Names Rule to fund names that reflect certain investment strategies or policies, including target date strategies, raises issues that cannot readily be addressed through the kind of bright-line 80% asset test included in the existing rule. For example, it is reasonable to expect that different fund managers would adopt somewhat different approaches to various investment strategies, such as "growth" or "value" investing. However, it is equally reasonable to expect that those strategies would fall within certain norms. The same holds true for target date funds, where funds should have the flexibility to adopt somewhat different approaches, but within certain industry norms. While we support continuing to apply the 80% rule to securities, we believe the Commission will need to adopt a different framework from the existing requirement to apply the rule to investment strategies and policies.

In developing such a framework, we think the Commission should establish the principle that a fund should be required to invest in a manner that is consistent with industry norms, such that a reasonable investor would conclude that the fund invests consistent with the one implied by its name. To the extent a fund invests in a way that would lead a reasonable investor to conclude that the fund does not invest in a manner consistent with its name, that should be a violation of the rule. This is consistent with the approach the Commission outlined in its 2001 adopting release, when it stated that a fund name "may be materially deceptive and misleading even if the investment company meets the 80% requirement" and that the rule is not intended to provide a safe harbor. Moreover, it tracks the standard that the Commission stated would guide its consideration of whether a particular name is misleading. Unfortunately, it doesn't appear that that standard has

been meaningfully applied since the Names Rule was originally promulgated. Nonetheless, we think it's a sensible principle to apply going forward, and we urge the Commission to do so.

Second, while we recognize that there may be some benefit to giving funds leeway during extreme market disruptions, any such flexibility should be extremely limited in scope, both with regard to the amount and the time that they can diverge.[23] The sole purpose in setting those limitations should be to avoid having the fund engage in panicked buying and selling during extreme market disruptions. After all, many investors rely on asset allocation strategies to meet their needs and goals. If they choose funds to implement that strategy whose names reflect their concentration in a specific asset class, they could have their asset allocation strategies disrupted if those funds diverge from their stated asset class focus during periods of adverse market or economic conditions. Funds that desire greater flexibility to move in and out of a particular asset class during market disruptions can obtain that flexibility simply by not choosing a name that reflects adherence to a particular investing style.

Finally, in the request for comment, the Commission highlights several particular fund practices that it seeks feedback on. First, the request highlights how some funds are increasingly using derivatives and other instruments in order to gain exposure to certain asset classes. The existing Names Rule allows a fund to include a derivative (or other synthetic instrument) in the 80% basket if it has economic characteristics similar to the securities included in that basket. We believe the Commission needs to limit this approach.

Even where they have economic characteristics that are similar to certain securities, derivatives also have other characteristics that may pose different or additional risks to the fund's portfolio and its investors. For example, while a fund may use a total return swap to gain synthetic exposure to a particular equity index, doing so would also create exposure to leverage risk, counterparty credit risk, interest rate risk, swap risk, model risk, management risk, operational risk, and legal risk. These are risks that the fund would not similarly be exposed to if it had invested directly in the constituents of the particular equity index. Using total return swaps could also add to the fund's borrowing costs, which could be substantial and not reflected in the fund's expense ratio. Clearly, it would be misleading for a fund that invests exclusively in total return swaps to name itself a stock fund. No reasonable investor who understands the differences between total return swaps and stocks would believe such a fund was a stock fund. By the same logic, allowing a fund to use derivatives as a substitute for the securities they are gaining exposure to while using a name that suggests that it is gaining direct exposure to those securities would allow misleading or deceptive behavior. We think the rule should reflect this concern and prohibit such activity.

Similarly, to the extent a fund gains significant exposure through a derivative to a particular asset and uses a name that reflects having exposure to a different asset, that would also be misleading or deceptive. This scenario is likely to occur if the market value of the derivative is relatively small but the potential exposure is significant.

The request also highlights how the number of funds with investment mandates that include criteria that require some degree of qualitative assessment or judgment of certain characteristics (such as funds that include one or more environmental, social, and governance-

[23] The divergence should be a de minimis amount and persist no longer than days or weeks, not months.

oriented assessments ("ESG") or judgments in their investment mandates) is growing. The request asks whether funds' use of these parameters, including the term "ESG," should be covered by the Names Rule. We agree that a fund's use of the term "ESG" clearly suggests that it invests according to certain environmental, social, and governance criteria and mandates. To the extent that a fund uses such a label but invests in a manner that no reasonable investor would conclude is consistent with those criteria and mandates, that should be a violation.

We share the Commission's concern that in our competitive fund market, asset managers have an incentive to use fund names that are more likely to attract assets. To the extent that ESG attracts investor interest, funds would have an incentive to use that label irrespective of how they actually invest. For example, George Serafeim, a professor at Harvard Business School and one of the world's leading experts in sustainable finance, has warned that, "There are now stronger incentives for asset managers to greenwash."[24] Serafeim continued, "ESG cannot be just a marketing tool to attract capital. Right now there is a false sense of security or satisfaction if an investor buys an ESG product that might not be what the investor thinks it is."[25] We share this concern.

Part of the problem, according to Professor Serafeim, is that the ESG investment industry is developing in "a very messy way."[26] This is because there is a lack of generally accepted standards on how to measure, analyze, and communicate what constitutes ESG investing. As the request points out, not all ESG funds are the same and there are a range of views on how funds might best meet their ESG criteria and mandates. For example, some may view ESG as one component in an integrated framework of determining whether to invest in certain companies, while others may screen companies based on an inclusionary or exclusionary framework. Still others may view ESG as a corporate governance strategy to use the fund's shareholder voice to change policies and practices within the companies they own. All of these may be perfectly acceptable approaches to ESG investing.

Given the fact that there are a range of views and no commonly accepted understandings of what ESG is, we think it is premature to restrict the use of ESG where a fund genuinely is seeking to comply with its ESG criteria and mandates. The market hasn't developed and the Commission hasn't studied this issue sufficiently to take action in this area. We therefore encourage the Commission to study the development of this market and survey investors on their views of this topic, which will help inform potential future Commission action. Ultimately, its goal should be to protect against misleading and deceptive practices without restricting appropriate uses of the term or imposing a one-size-fits-all approach to ESG investing.

As a first step in the fund names context, however, funds should be required to clearly and prominently explain what they mean by the use of labels such as ESG. One potential approach might be to model such a disclosure after the Commission's proposed target date fund name and advertising rule, which would have required target date funds that include a target date in their name to disclose the fund's asset allocation at the target date immediately adjacent to the first use

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[24] Eshe Nelson, *Sustainable investing risks becoming a victim of its own success*, QUARTZ, December 13, 2018, https://bit.ly/2yT4kfQ; *See also* Tom Eckett, *FCA called to step in on 'shameful' industry greenwashing*, ETF STREAM, November 5, 2019, https://bit.ly/3fJBNu3.
[25] *Id*.
[26] *Id*.

of the fund's name in marketing materials. This would provide helpful disclosures to investors about their investment policies and practices. We also think that funds that use the ESG or similar label should be required to clearly disclose how the fund invests consistent with ESG criteria and mandates. To the extent it invests according to one mandate but not another, for example, it should make that clear as well.

IV. The Commission must not allow a fund to "cure" a misleading or deceptive name through disclosure.

While disclosure can certainly play an important role in clarifying what fund names mean in the context of a fund's particular investment objective, strategy, or policy, disclosure must not be used as a way of "curing" a misleading or deceptive name, particularly if it is buried in a prospectus. Such disclosures are unlikely to be read or understood by many investors, as the Commission's own past research has shown. Moreover, those investors most likely to rely on fund names in choosing an investment are also probably least likely to actually read the fund prospectus. Even for investors who do review the fund prospectus, disclosure alone is unlikely to be sufficient to counteract the effect of a misleading fund name. This is especially true if the disclosures are nonsensical. The above example, whereby a fund is allowed to state that Puerto Rican securities "are considered to be 'Virginia municipal securities' for purposes of this prospectus," is a prime example of the type of disclosure that should be prohibited. Such meaningless disclosure doesn't clarify anything; rather, it serves to perpetuate a deception on investors.

Conclusion

Investors continue to be at risk of being deceived or misled by fund names that suggest the fund invests one way but invests another. Investors risk suffering harm as a result of this potential misleading or deceptive activity if, as a result, they choose funds that are inappropriate to their investment needs, goals, or risk tolerance. We appreciate the Commission's efforts to assess the effectiveness of the existing Names Rule in prohibiting funds from using names that are materially deceptive or misleading, and we urge the Commission to propose changes designed to better protect investors by covering a broader range of deceptive names and closing gaps and loopholes in the existing rule.

Respectfully submitted,

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