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August 16, 2022

Ms. Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

Re: *Investment Company Names (File No. S7-16-22)*

Dear Ms. Countryman:

The Investment Company Institute[1] is writing to provide our views on the Securities and Exchange Commission's proposal to amend Rule 35d-1 under the Investment Company Act of 1940 ("1940 Act") (generally, "Names Rule").[2] The ICI appreciates the Commission's efforts to improve and clarify the Names Rule; however, as discussed herein, we have significant concerns with certain aspects of the proposed amendments. We believe the changes risk producing investor confusion and are not well suited to furthering the Commission's goals of improving and clarifying the requirements of the Names Rule for the benefit of investors. Instead, the proposed amendments introduce new interpretative issues along with substantial and unnecessary complexity, burden, and cost without commensurate benefits. In 2020, when the Commission sought information on the Names Rule, the ICI and others agreed the rule had been largely effective but observed that there were areas that would benefit from improvement. [3] This

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[1] The Investment Company Institute ("ICI") is the leading association representing regulated investment funds. ICI's mission is to strengthen the foundation of the asset management industry for the ultimate benefit of the long-term individual investor. Its members include mutual funds, exchange-traded funds ("ETFs"), closed-end funds, and unit investment trusts ("UITs") in the United States, and UCITS and similar funds offered to investors in Europe, Asia and other jurisdictions. Its members manage total assets of $28.1 trillion in the United States, serving more than 100 million investors, and an additional $9.3 trillion in assets outside the United States. ICI has offices in Washington, DC, Brussels, London, and Hong Kong and carries out its international work through ICI Global.

[2] *See* Investment Company Names, SEC Release No. IC-34593 (May 25, 2022), available at https://www.sec.gov/rules/proposed/2022/ic-34593.pdf ("Release").

[3] *See, e.g.,* Letter from Susan Olson, General Counsel, ICI, to Vanessa Countryman, Secretary, SEC, (May 5, 2020), ("2020 ICI Letter"); Letter from Peter Germaine, Chief Legal Officer, Federated Hermes, Inc, to Vanessa Countryman, Secretary, SEC, (May 6, 2020); Letter from Elizabeth Lance, Vice President and Legal Counsel, and Brian R. Poole, Vice President and Senior Legal Counsel, T. Rowe Price to Vanessa A. Countryman, Secretary, SEC (May 21, 2020); and Letter from Jeffrey Kupor, Head of Legal, Americas, Invesco to Vanessa A. Countryman, Secretary, SEC (May 5, 2020) available at https://www.sec.gov/comments/s7-04-20/s70420.htm. *But see* Letter

proposal however, sets forth vast, fundamental changes – sweeping in numerous funds[4] never covered before under expansive yet vague criteria, changing the operation of the rule for all funds and imposing significant new compliance and reporting requirements. We believe a more targeted approach, such as that outlined in our 2020 recommendations, would be more effective and efficient in serving the Commission's goals and the interests of fund investors.

The ICI's recommended approach recognizes that the name of a fund is a tool for communicating with investors; yet, it also recognizes that investors should not place undue reliance on a fund's name.[5] Logically, a fund's name – given reasonable limits in length – can only be a starting point for investors and must be read in conjunction with other important, more detailed, information about a fund's investment objectives and strategies, fees and expenses, performance and other matters of importance to investors. *Investors would be well served if the Commission prioritized communicating this key message.*

The Commission currently is considering two other disclosure proposals: one revamping the shareholder report and prospectus disclosure and a second requiring funds and investment advisers to provide additional information regarding their environmental, social, and governance ("ESG") practices.[6] Either or both of these proposals should be used as a vehicle for educating investors on how best to contextualize a fund's name.

In contrast, the proposed Names Rule amendments risk overemphasizing and driving too much attention to a fund's name – resulting in, at one end of the spectrum, longer, more complex,

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from Micah Hauptman, Financial Services Counsel, and Barbara Roper, Director of Investor Protection, Consumer Federation of America to Vanessa A. Countryman, Secretary, SEC, (May 12, 2020), available at https://www.sec.gov/comments/s7-04-20/s70420.htm.

[4]As used in this letter, the term "fund" refers to registered investment companies and business development companies ("BDCs").

[5] 2020 ICI Letter. *See also* Investment Company Names, SEC Release No. IC-24828 (Jan. 17, 2001), available at https://www.sec.gov/rules/final/ic-24828.htm ("Adopting Release").

[6] 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, SEC Release No. IC-33963 (August 5, 2020) ("Prospectus and Shareholder Report Proposal"), available at https://www.sec.gov/rules/proposed/2020/33-10814.pdf; and Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices, SEC Release No. IC-34594 (May 25, 2022) ("ESG Proposal"), available at https://www.sec.gov/rules/proposed/2022/33-11068.pdf. The Commission also is seeking information on information providers, including index providers, and the Investment Advisers Act of 1940 and the 1940 Act. Request for Comment on Certain Information Providers Acting as Investment Advisers, SEC Release Nos. IA–6050; IC-34618 (June 15, 2022), available at www.sec.gov/rules/other/2022/ia-6050.pdf ("Information Providers RFI").

names or, at the other end of the spectrum, more general, less informative, names. Either outcome is not beneficial for investors.

In sum, the Commission should encourage investors to continue to focus beyond the name and should not overemphasize the importance of, or seek to force too much detail into, a name.[7]

We also believe that the Commission should take a more reasoned and calibrated approach to improving fund disclosure. In 2020, the Commission proposed wholesale changes to the content and delivery requirements associated with both fund prospectuses and fund shareholder reports. The Commission has targeted October 2022 for final rules and rule amendments.[8] In May 2022, the Commission proposed requiring funds to provide additional information regarding their ESG investment practices. The comment period for the ESG Proposal closes on the same day as the comment period for the Names Rule proposal. The Commission should evaluate the effect of these disclosure proposals *before* discerning how best to change the Names Rule for the benefit of investors.[9] Sequencing, and the interaction, of regulatory actions is important and must inform the Commission as it makes significant and costly changes to fund disclosure. Chair Gensler himself said that he wants to follow this principle:

> I'm often asked to prioritize the remaining items on our rulemaking agenda. When will we vote on what? At their core, those questions are more about sequencing than prioritization. … The process is intentionally flexible; it's about getting proposals right, based upon the economic analysis and our legal authorities, and learning from public feedback.[10]

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[7] The Commission doing so is at odds with recent Commission statements and academic research. For example, the Commission pointed out in the 2020 Disclosure Release that "[a]cademic research similarly suggests that, due to limits on an individual's ability to absorb and process information, investors may be more likely to understand and effectively use concise disclosure that is well-organized and focused on key information." See 2020 Disclosure Release at 370.

[8] *See* "SEC Announces Spring Regulatory Agenda" ("Spring Regulatory Agenda") (June 22, 2022), available at https://www.sec.gov/news/press-release/2022-l12.

[9] We expect that the Commission would have to re-propose any amendments to the Names Rule in light of those developments and our extreme concerns with the proposal.

[10] *See* SEC Chair Gary Gensler, "Dynamic Regulation for a Dynamic Society" (Jan. 19, 2022), available at https://www.sec.gov/news/speech/gensler-dynamic-regulation-20220119. The Commission requested public comment on three regulatory actions, each of which, if finalized, will significantly affect fund operations. In addition to the Names Rule, the Commission proposed ESG rules for funds and advisers and requested comment on whether

Further, surveys of mutual fund-owning households consistently indicate that the overwhelming majority of investors look beyond a fund's name when making investment decisions. The surveys show that a fund's performance and fees rank as the two most important factors to investors.[11] Neither of these features is, or should be, implicated by a fund's name. Eighty-nine percent of mutual fund-owning households consider a fund's investment objective, and 90% consider the risk level of a fund's investments when deciding whether to invest in a mutual fund.[12] Given this, it is clear that the Commission should avoid taking regulatory action to that will tip the balance or encourage investors to expect a name to tell them all that they need to know about a fund before making an investment decision.

Yet the Commission seems to be taking this approach, and in so doing, acting in a manner diametrically opposed to the policy underpinnings of Section 35(d) of the 1940 Act and Rule 35d-1. The Release correctly states that:

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information providers might meet the definition of "investment adviser." Comments are due to the Commission on each of these on the same day, August 16.

We are concerned that the Commission simply does not seem to be taking into account that the pace and complexity of the Commission's simultaneous rulemaking ultimately may harm, rather than benefit, fund investors. We expressed extreme concern with this approach to rulemaking earlier this year. In April, the ICI, along with several other trade associations, submitted a letter to Chair Gensler pointing out that aside from the sheer volume of rulemaking items, the Commission simultaneously was tackling issues that could result in significant shifts in industry operations and practices. The letter also pointed out that "exceedingly short comment periods associated with numerous concurrent potentially interconnected rule proposals that touch on significant changes to the operational and regulatory regime applicable to financial firms could result in rules that hurt investors, damage the financial system, implicate the Commission's obligations under the [Administrative Procedure Act] and internal rulemaking guidelines, and ultimately violate the Commission's tripartite mission." Letter to SEC Chair Gensler from Alternative Credit Council (ACC); Alternative Investment Management Association (AIMA); American Bankers Association (ABA); American Council of Life Insurers (ACLI); American Investment Council (AIC); Banking Policy Institute (BPI); Bond Dealers of America (BDA); FIA Principal Traders Group (FIA PTG); Financial Services Forum (FSF); Institute of International Bankers (IIB); Institute for Portfolio Alternatives (IPA); Investment Adviser Association (IAA); Investment Company Institute (ICI); Loan Syndications and Trading Association (LSTA); Managed Funds Association (MFA); National Association of Corporate Treasurers (NACT); National Association of Investment Companies (NAIC); National Venture Capital Association (NVCA); Real Estate Roundtable (RER); Risk Management Association (RMA); Securities Industry and Financial Markets Association (SIFMA); Securities Industry and Financial Markets Association Asset Management Group (SIFMA AMG); Security Traders Association (STA); Small Business Investor Alliance (SBIA); and U.S. Chamber of Commerce (the Chamber) Center for Capital Markets (CCMC) (April 5, 2022), available at https://www.ici.org/system/files/2022-04/22-ici-letter-to-sec-chair-gensler.pdf.

[11] *See* 2022 ICI Factbook, Ch. 7 at 132, available at https://www.icifactbook.org/pdf/2022_factbook_ch7.pdf.

[12] *See id.*

> Congress provided the Commission with rulemaking authority to address materially deceptive or misleading fund names, recognizing the concern that investors may rely inordinately on a fund's name to determine its investments and risks. The [current] names rule, in turn, helps ensure that a fund's name does not misrepresent the fund's investments and risks.[13]

But the Release then states that:

> Consequently, the rule helps to ensure that investors' assets in funds are invested in accordance with their reasonable expectations based on the fund's name.[14]

By viewing a fund's name through this lens, the Commission seems to be going beyond Section 35(d)'s grant of authority to define what constitutes a "materially deceptive or misleading" fund name and instead claiming authority to craft rule amendments that serve to allow an investor to make an investment decision solely based on the fund name. There is a significant difference between a name based on investors' reasonable expectations and a name that is materially deceptive or misleading.[15] We are concerned that the Commission seems to be proposing a regulatory system that promotes, rather than discourages, investors placing "inordinate" reliance on a fund's name. Such an approach would not be consistent with the authority granted to the SEC under Section 35(d).

If the Commission's actions successfully shift a potential investor's focus in this manner, it certainly would be a step backwards for investor understanding and inconsistent with how investors and the investment professionals they hire evaluate investment options today. Our research shows that, in 2021, 79% of households who owned mutual funds outside their employer-sponsored retirement plans purchased their funds with the help of an investment

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[13] Release at 6.

[14] *Id.*

[15] *See Brody v. Transitional Hospitals Corp.*, 280 F.3d 997, 1006 (9th Cir. 2002) ("Often, a statement will not mislead even if it is incomplete or does not include all relevant facts. . . . No matter how detailed and accurate disclosure statements are, there are likely to be additional details that could have been disclosed but were not. To be actionable under the securities laws, an omission must be misleading; in other words, it must affirmatively create an impression of a state of affairs that differs in a material way from the one that actually exists.").

professional,[16] who are subject to standards of conduct that require them to look deeper than a fund's name when making a recommendation to a client.[17]

Even if the Commission's actions do not change investor behavior, this data makes clear that any possible investor protection benefits of the Commission's proposed amendments to the Names Rule would be very limited. Simultaneously, as further discussed, the complexity and costs of complying with the proposal, if adopted, also would be extremely significant, borne by funds and their investors, and have not been adequately examined in the Release.[18]

## I. Expansion of the Scope of the Names Rule

### *A. The Scope of the Names Rule Should Not Be Expanded to Include Terms Suggesting a Fund Focuses in Investments That Have "Particular Characteristics"*

The ICI strongly opposes the proposed expansion of the universe of types of investments and strategies implicated by the Names Rule to include names suggesting investments with particular "characteristics." In the more than two decades since it was adopted, the Names Rule has proven to be an effective, workable framework for ensuring that funds' portfolios reflect the types of investments indicated in their names. The objective, quantifiable nature of the 80% investment policy requirement has enabled the development of a widely used framework that helps align fund investments with investor expectations in a meaningful way. Indeed, the success of the existing Names Rule framework is evidenced by the general lack of enforcement proceedings or investor lawsuits against funds or their advisers alleging the use of misleading names.

The Commission too seems to have recognized that overreliance on fund names is a low-risk area. Each year, the Commission's Division of Examinations issues priorities for the coming year, and our review of the priorities for the past four years revealed that fund names were not included as a priority area.[19]

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[16] 2022 ICI Factbook, Ch. 7 at l24.

[17] *See* Regulation Best Interest: The Broker-Dealer Standard of Conduct, SEC Release No. 34-86031 (June 5, 2019), available at https://www.sec.gov/rules/final/2019/34-86031.pdf; Commission Interpretation Regarding Standard of Conduct for Investment Advisers Release No. IA-5248 (June 5, 2019), available at https://www.sec.gov/rules/interp/2019/ia-5248.pdf.

[18] *See infra* Section XI.

[19] *See, e.g.*, Securities and Exchange Commission, 2022 Examination Priorities, available at https://www.sec.gov/files/2022-exam-priorities.pdf. We found one reference to compliance with the Names Rule in

Further, we support the Commission's current work to improve and modernize fund disclosure (with rule proposals totaling well over 1,000 pages) and believe such work is a more effective approach to help improve investor understanding of funds. Indeed, the Commission proposed wholesale changes to the content and delivery requirements associated with both fund prospectuses and fund shareholder reports in 2020 and the recent ESG Fund Proposal would require "Integration" funds, "ESG-Focused" funds and "Impact" funds to provide enhanced disclosure to investors.[20] Although we believe that certain aspects of both of these proposals are overly prescriptive, they both seem to reflect an understanding that investors should, and do, read more than a fund's name as part of the investment decision-making process. [21]

We also believe proper sequencing of rule changes is critical to maintain an effective and efficient regulatory framework, which is important for investor protection. Here the proper sequence would be for the Commission to finalize the two outstanding disclosure proposals (appropriately modified to reflect public comments) and evaluate their effect on investor understanding of funds. Then, and only then, would the Commission be in a position to evaluate the costs and benefits associated with making comprehensive changes to the Names Rule. In the future, the Commission then should seek comment on any changes to the Names Rule when the public has experience with the changes from the disclosure proposals.

The proposed amendments to the Names Rule would represent a drastic expansion of the 80% investment policy requirement to cover any names suggesting that a fund focuses on investments that have, or whose issuers have, particular "characteristics"— a nebulous term that is not

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the Division of Examinations "2021 Observations from the Registered Investment Companies Examinations." There, without any additional detail, the staff merely stated that they had observed that some funds and their advisers had "inadequate policies and procedures" for "monitoring portfolios for compliance with the 80% rule." We agree that monitoring is appropriate but it does not serve as a valid basis for the scope of the Proposal, particularly the amendments to Form N-PORT, discussed *infra*.

[20] *See* ESG Proposal. The ESG Proposal defines an "ESG-Focused Fund" as "a [f]und that focuses on one or more ESG factors by using them as a significant or main consideration (1) in selecting investments or (2) in its engagement strategy with the companies in which it invests. An ESG-Focused Fund includes (i) any fund that has a name including terms indicating that the [f]und's investment decisions incorporate one or more ESG factors; and (ii) any [f]und whose [advertisements or sales literature] indicate that the [f]und's investment decisions incorporate one or more ESG factors by using them as a significant or main consideration in selecting investments." The ESG Proposal defines an "Impact Fund" as an ESG-Focused Fund that seeks to achieve a specific ESG impact or impacts."

[21] *See* Letter from Eric J. Pan, President & CEO and Annette Capretta, Associate General Counsel, Investment Company Institute to Vanessa A. Countryman, Secretary, Securities and Exchange Commission, Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices (August 16, 2022) ("ESG Letter").

defined in the proposed amendments nor in the Release except by reference to a short list of examples.[22] Specifically, the proposed amendments state that this expanded standard would encompass, among other terms, "growth," "value," and "terms indicating that a fund's investment decisions incorporate one or more ESG factors." To this short list, the Release adds a handful of additional terms, including "income," "global," "international," and "intermediate term (or similar) bond."[23]

In contrast to the categories currently covered by the Names Rule, these terms are inherently subjective and not necessarily readily reducible to quantitative, asset-based tests. Historically, the Names Rule requirements did not cover such investment strategies. As a result, expansion of the Names Rule to encompass these terms would introduce unnecessary complexity, subject funds and their advisers to the compliance risks associated with a vague legal standard, and lead to confusing and inconsistent application of the 80% investment policy requirement across the fund industry. Further, we do not believe that the Commission has articulated or demonstrated a compelling justification for expanding the 80% investment policy requirement to encompass such terms.[24] Again, we point to the Commission's current and ongoing efforts to improve and enhance fund disclosure. Driving such detail and information into a name makes little sense in the context of the Commission's work on fund disclosure.

We believe that the amendments, if they are adopted as proposed, would raise considerable interpretive issues both as to: (i) whether a particular term suggests a focus on investments with particular characteristics; and (ii) where a fund has adopted an 80% investment policy tied to particular characteristics, whether a given investment is consistent with that policy.

First, beyond the short handful of terms identified in the Release (*e.g.*, the aforementioned "growth," "value" and "income"), there is considerable uncertainty as to precisely what terms would be deemed to suggest a focus in investments that have, or whose issuers have, particular characteristics.[25] The Release helpfully clarifies that the 80% investment policy requirements

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[22] Release at 198.

[23] *Id.* at 24.

[24] *See supra* note 19.

[25] To cite just a few examples, it is unclear whether any of the following terms would be viewed as suggesting a focus on investments that have particular characteristics for purposes of the proposed amendments: "focused," "managed," "disciplined," "dynamic," "plus," "quality," "tactical," "aggressive," "conservative," "dividend," "defensive" and "volatility."

would not apply to terms that describe "characteristics of a fund's portfolio as a whole."[26] In this regard, the Release observes that duration (which measures a portfolio's sensitivity to changes in interest rates) describes characteristics of a fund's overall portfolio.[27] However, as further discussed below, the Release also indicates that similar terms historically recognized as connoting characteristics of a fund's overall portfolio (such as "intermediate term bond") would implicate the Names Rule under the proposed amendments. As this disparate treatment of similar concepts illustrates, funds would face considerable uncertainty in evaluating whether a term indicates characteristics of individual portfolio investments or of the fund's portfolio as a whole.[28]

Similarly, the Release clarifies that terms that suggest a particular result or outcome do not suggest a focus on investments that have particular characteristics.[29] The Release cites "real return" as a term that "suggests a possible result to be achieved" and that, therefore, would not implicate the Names Rule under the proposed amendments. However, depending on the context in which they are used, certain terms—such as "growth," "income," "global" or "sustainable"—could refer either to a particular portfolio investment or to the overall outcome that the fund seeks to achieve. For example, a fund called the "XYZ Diversified Growth Fund" could use the term "growth" in its name to signal that it seeks capital appreciation or long term growth of the net asset value of the fund and not to focus on investments in "growth" companies. Likewise, the term "income" may refer to characteristics of a particular security or it can describe an overall outcome that a fund seeks to achieve, which the fund may pursue through a range of different portfolio strategies or techniques and investments, including, among others, fixed income securities,[30] income-producing equity securities and various forms of derivatives.[31] Rather than categorically resolving this potential ambiguity by either requiring a fund to adopt an 80% investment policy that may not be consistent with the fund's intended purpose or objective or to

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[26] Release at 24.

[27] *Id.*

[28] We do not recommend that the Commission begin to prescriptively develop a dictionary for terminology.

[29] Release at 25.

[30] In contrast to "income," use of the term "fixed income" in a fund's name would suggest investment in a particular type of security and would therefore implicate the current Names Rule.

[31] Further complicating the proposed inclusion of the term "income" in the scope of the Names Rule is the fact that a single instrument may be used either for the purpose of producing income or for another purpose. For example, a fund could enter into an interest rate swap in order to generate income or to hedge interest rate exposure in the fund's portfolio.

change its name,[32] the amended rule needs to acknowledge this nuance and recognize that such terms, by their nature, are not properly addressed through the adoption of an 80% investment policy or, at least, would not be within the scope of the Names Rule to the extent that they refer to the possible result to be achieved by the fund.[33] Moreover, this approach of mandating one meaning of a term over another is flatly inconsistent with the Commission's grant of authority in Section 35(d) of the 1940 Act to define names that are materially deceptive or misleading. Terms that could refer to either a particular investment or the portfolio as a whole are *per se* not misleading or deceptive because they do not create an affirmative impression in one way or another.[34] Rather than taking this approach, the Commission should instead acknowledge that disclosure in a fund's prospectus can communicate to investors the relationship between a fund's name and its investment strategies, and Section 35(d) of the 1940 Act will continue to prohibit a fund from adopting a name that is materially deceptive or misleading in light of the fund's investment strategies.[35]

Second, even where the Commission has explicitly identified a term as being within the scope of the proposed amended rule, the proposed "particular characteristics" standard introduces considerable subjectivity and uncertainty and invites inconsistent application and *ex post facto* second-guessing. "Growth" and "value," for example, are fluid concepts that may be subject to qualitative judgments based on criteria that can be subjective and vary over time. In this regard, we observe that a single issuer may, under a reasonable definition (such as by reference to widely recognized indices), simultaneously qualify as both a growth and a value company (for example, the issuer may be included in both the growth and value indices published by a single index provider), may transition from one category to another (a phenomenon that would present additional problems in light of the proposed continuous testing regime, as discussed below)[36] or may be treated differently by different index providers.

In Section XI, we describe how this is reflected in the classification of growth or value stocks by widely recognized index providers. Figure 3 provides the criteria used by these index providers

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[32] *See* Release at 24, n. 49 ("To the extent that a term used in a fund name could reasonably be understood to describe the characteristics of the portfolio as well as, or alternatively, the characteristics of the component portfolio investments . . . we believe such a name would suggest an investment focus under the proposed amendments.").

[33] *See* Release at 25.

[34] *See Brody v. Transitional Hospitals Corp.*, *supra* note 15.

[35] See ESG Letter at Section 2.1 (recommending that the Commission permit funds with stated principal investment strategies that indicate that the fund is an ESG-Focused fund be subject to enhanced disclosure requirements).

[36] Please see our discussion below in Section III regarding the proposed amendments' continuous testing regime.

for growth and value. There are differences in criteria and number of criteria, along with differences in weighting and time periods that are applied by the providers. As we note in that section, index providers may simultaneously categorize the same security as both a growth and value stock. Figure 4 shows the overlap in company stocks between major growth and value indices. Accordingly, there are reasonable variations in definitions for what securities are "growth" or "value." Many funds, like index providers, have definitions with varying criteria that investment personnel use to analyze companies and to categorize them as "growth" or "value" companies.

Requiring a fund with this type of subjective definition for a term to have an 80% investment policy does not provide much useful information to an investor, because whether an investment would comply with the 80% investment policy hinges on reasoned evaluations and determinations of investment personnel, including portfolio managers. Multi-manager funds, subadvised funds and funds of funds will encounter additional complexities given that the expert analysis applied by individual portfolio managers rightly may differ from one another. At the same time, investors, their advisers and other intermediaries have access to many useful sources of information about the fund and its investment policies and strategies, such as the fund's prospectus, annual and semi-annual shareholder reports, quarterly portfolio holdings, and included within these sources is information on the fund's performance standing alone and compared to market indices.

The proposed amendments also present significant interpretive challenges with respect to funds that pursue thematic investment strategies. Examples of thematic investment strategies include focusing on concepts such as infrastructure, blockchain technology, biotechnology or electric and automated vehicles. In some instances, a thematic strategy may capture the entire value chain associated with a particular theme, spanning a wide range of industries and geographies. Such thematic strategies are often difficult to reduce to a coherent 80% investment policy requirement based on particular characteristics because their investments may vary widely in terms of industries, capitalization ranges, revenue sources, asset classes and other key characteristics. Funds that focus on investments in specific sectors may face similar issues when defining characteristics of the companies in the sector in which they seek to invest, or as the characteristics of these companies change over time.

The Release provides that a fund may define its 80% investment policy "in a reasonable way" and acknowledges that there may be numerous valid "reasonable" formulations for a particular

name.[37] In this regard, the Release indicates that, with respect to a name suggesting an investment focus in a particular industry, the Commission would view as a reasonable definition any securities issued by companies that derive more than 50% of their revenue or income from, or own significant assets in, the industry.[38] While such a definition could be administrable in the case of names that align with well-defined industries and companies that clearly disclose the specific sources of their revenue, a fund whose name indicates a thematic investment strategy may have difficulty demonstrating compliance with such a test and may be forced to exclude companies that are consistent with the fund's investment theme. For example, such a test could prevent investors from gaining exposure to existing, established companies that are expanding into a new, innovative sector of the market and which may not distinguish such revenue streams from those associated with their core business lines. Restricting funds' ability to gain such exposure ignores the fact that many successful companies have significant business lines across multiple themes and industries and risks harming investors by depriving them of exposure to companies that could be leading innovators in such investment themes and industries. According to the Release, the Commission does not believe that the use of "text analytics" or "natural language process" is appropriate to evaluate whether a company is sufficiently tied to a particular "theme."[39] Rather than reducing interpretive issues, the inclusion of these strategies into an 80% policy only adds difficult and new interpretive issues for investors, funds and Commission staff.

Additionally, the proposed expansion of the 80% investment policy requirement would significantly increase funds' compliance burdens and divert resources from other important compliance matters.[40] Developing and applying compliance testing aimed at capturing subjective characteristics, including cases where they may vary between funds and portfolio managers, would be highly challenging and time consuming and would require redirecting portfolio managers' focus and attention from implementing a fund's investment strategies and seeking to maximize returns for investors. Development of a scalable compliance monitoring system generally requires the use of reference data supplied by third-party data providers (*i.e.*, to tag various characteristics of a fund's investments), and it is our understanding that such data providers do not currently support the expanded set of terms that would be included under the proposed amendments. Furthermore, given the highly subjective nature of these terms, even if data providers were to offer such services in the future, evaluating investments would continue to

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[37] Release at 26 to 27.

[38] *Id.* at 27.

[39] *See id.*

[40] *See infra* Section XI.

require considerable portfolio manager or investment staff intervention. This means there will likely be more manual processes required for the system which increases the risk of errors. This substantial increase in compliance costs and burdens and added complexity, as well as the heightened compliance risk imposed by the proposed amendments, is unwarranted in view of the limited investor protection benefits of the proposal and the lack of evidence supporting the need for such substantial and fundamental changes. The Commission also has not addressed how its pending fund disclosure proposals could address some of the goals of its Names Rule proposal.

We also have concerns that this proposed expansion of the 80% investment policy requirement could encourage the broader use of more generic fund names that will have the effect of conveying less information to investors. The proposed amendments also could incentivize the adoption of longer, more complex names that seek to capture the full range of investments reflected in a fund's investment strategy. As names grow longer and more complex, there is the risk people will inevitably refer to them by shorter names, thereby undermining the Commission's goals. As a result, the proposed changes do not seem well suited to achieving the Commission's goals or benefiting fund investors.

This proposed expansion also could have an anti-competitive impact on the fund industry by encouraging homogenization and chilling creative and innovative strategies in actively managed funds, while also limiting the range of acceptable indices that a passively managed fund may track. Ultimately, such a trend could result in investors having fewer choices. The Commission must avoid this consequence.

Rather than requiring the adoption of 80% investment policies tied to terms in fund names that are highly subjective, not straightforwardly reducible to measurable characteristics, and/or require significant portfolio management judgment in their implementation, the Commission should recognize, as it did when it initially adopted the Names Rule, that an "investment company's name, like any other single piece of information about an investment, cannot tell the whole story about the investment company."[41] For funds with such names, investment strategy and risk disclosures are the appropriate forum for communicating nuanced strategy characteristics to investors, rather than the Commission's proposed one-size-fits-all approach of an 80% investment policy. In this regard, we note that investors who wish to obtain information about a fund and its holdings have at their fingertips access to more information than at any time in history. In addition to a fund's summary prospectus—a key document in informing investor expectations—investors have ready access to information available through funds' websites and

[41] Adopting Release at Section I.

through third-party channels, such as retirement and brokerage platforms. We believe the Names Rule in its current form is effective *because* of, and not in spite of, the fact that its 80% investment policy requirement applies to a more discrete set of terms that are capable of being objectively classified. The proposed amendments, if adopted, would instead establish a more complex, subjective version of the Names Rule that would lead to inconsistent application, high compliance burdens and the potential for the Commission staff substituting its judgment for that of funds' portfolio management professionals. We strongly urge the Commission to retain the current approach for the 80% investment policy requirement.

If our recommendation to maintain the existing scope of the Names Rule is not accepted, we respectfully submit, as an alternative, that the Commission (i) more narrowly tailor the proposed expanded coverage of terms that suggest an investment focus to exclude terms that reasonably may be defined subjectively—such as "growth" and "value"—that do not readily reduce to concrete, measurable characteristics, and for which evaluations, opinions and views reasonably may vary and (ii) recognize that certain terms (such as "growth," "income" and "sustainable") may refer *either* to characteristics of a fund's individual investments or to the intended result of the portfolio as a whole and, accordingly, not categorically include such terms in the scope of the 80% investment policy requirement. Investors understand that funds' portfolio managers regularly make well-informed quantitative and qualitative judgments about how to pursue a strategy and whether securities align with these sorts of strategy-focused terms in fund names and entrust them to do so in seeking to achieve results consistent with a fund's investment strategy. This process is subject to oversight and supervision by the adviser and, ultimately, the fund's board.[42]

For the foregoing reasons, we urge the Commission not to expand the scope of terms subject to the Names Rule to encompass names suggesting a fund focuses on investments that have, or whose issuers have, particular characteristics.

### *B. "Global" and "International" Should Continue To Be Outside the Scope of the Names Rule*

The Release stated that the proposed expansion of the 80% investment policy requirement under the Names Rule would encompass the terms "global" and "international."[43] While the

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[42] In this regard, we note that fund boards have been entrusted to oversee compliance with a number of Commission rules, including, among others, Rules 2a-5, 18f-4 and 22e-4 under the 1940 Act.

[43] Release at 24-25.

Commission historically has not required a fund using one of those terms in its name to adopt an 80% investment policy for such terms, the Commission's disclosure review staff has historically commented on the use of "global" and "international" in a Fund's name and required funds to adopt certain investment policies tied to those terms.[44]

While a fund could consider an 80% investment policy using what has historically been endorsed by the staff, in the context of the term "global," neither this endorsed approach nor any other that we can conceive of could be formulated as an 80% investment policy as required by the text of the proposed amendments to the Names Rule. This is because the term "global" applies to the overall fund portfolio rather than a characteristic of a particular investment. Put differently, we are not aware of any investment that could reasonably be viewed as other than potentially eligible for inclusion in the historical interpretation of "global" and, as such, the term "global" cannot sensibly fit into a framework, like the 80% investment philosophy, premised on an asset-based test applied to individual investments.[45]

This limitation on applicability is in no way limited to the term "global," but illustrates the broader and critical point that while an 80% investment policy is a workable solution in the context of some terms (*e.g.*, those terms covered under the existing Names Rule), there are other applications (such as the terms "global" and "international") in which it plainly does not work. Accordingly, the inclusion of these terms in the scope of the Names Rule will continue to result in interpretive issues and these terms should not be included in the scope of the rule.

### *C. Short-, Intermediate-, and Long-Term (or Similar) Terms used in Bond Fund Names Should Not Implicate the Names Rule*

The proposal would reflect a change in the treatment of short-, intermediate-, and long-term bond funds under the Names Rule.[46] The staff of the Division of Investment Management has taken the position that the Names Rule does not require an 80% investment policy for funds whose names include "intermediate-term" or similar names because, as the staff recognized, "intermediate term bond" or similar terms are meant to be a characteristic of the portfolio as a

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[44] In the case of funds using the term "global," such policies have included, for example, investing at least 40% of a fund's assets *(or the fund's overall portfolio)* in issuers domiciled in countries outside the United States or investing in issuers domiciled in at least three countries, including the United States.

[45] We note that inclusion of the term "global" in the scope of the Names Rule is also incompatible with the proposed reporting requirements on Form N-PORT because a fund could not meaningfully characterize individual securities as either satisfying or not satisfying any reasonable definition of the term "global."

[46] Release at 24.

whole.[47] In light of this, the staff has historically required such funds to have an appropriate dollar-weighted average maturity, measured at the portfolio level, rather than employing an 80% investment policy for each portfolio investment.[48] We believe that this approach appropriately reflects the experience and investment exposure that a typical investor seeks to obtain by investing in such funds.

We acknowledge the technical distinction between duration (which is the measurement of certain characteristics of a portfolio of assets) and maturity (which describes the remaining term of a particular debt instrument and is one component of calculating a portfolio's duration). We believe, however, that investors interpret references to maturity in a fund's name to refer generally to the average time to maturity of the fund's overall portfolio and rely on the expertise of investment advisers to construct a portfolio reflecting the indicated maturity profile in pursuit of achieving the fund's investment objectives in a manner consistent with its investment strategies and policies.

This approach aligns with the time-tested position articulated by the staff in 2001 and, consequently, reflected in the experience of shareholders over the past 21 years. Requiring these funds to adopt an 80% investment policy would necessitate significant changes in the portfolios of certain funds without any measurable benefit or improvement in clarity for investors. In light of this, we believe that the status quo treatment of funds with such names is consistent with investor expectations and not misleading. Accordingly, we oppose the proposal to include these terms in the scope of the Names Rule.

### *D. Prospectus Definition of Terms in Fund Names*

The Release includes a proposed amendment to funds' registration statement forms that would require each fund that is required to adopt and implement an 80% investment policy to include disclosure in its prospectus that defines the terms used in its name, including the specific criteria the fund uses to select the investments that the term describes, if any. The Release notes that funds would have the flexibility to use reasonable definitions of the terms that their names use but could not change the meaning of the terms to be inconsistent with their plain English meaning or established industry use. Although we do not object to this disclosure requirement, which is consistent with our overall view that a fund's investment strategy is critical to an

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[47] Frequently Asked Questions about Rule 35d-1 (Investment Company Names) at Questions l1 and l2.

[48] *Id.*

investor's understanding of a fund, we are concerned about the risk of second-guessing by Commission staff of the choice of definitions.

## II. Temporary Departures from the 80% Investment Requirement

### *A. Proposed Standard Is Unnecessarily Prescriptive and Risks Harming Funds and Investors*

The proposed amendments would permit a fund to deviate from its 80% investment policy only in certain enumerated circumstances and would require a fund to return to compliance with its 80% investment policy as soon as reasonably practicable and, in any event, within 30 days, with certain specified exceptions.[49] This represents a completely new approach that is a significant and highly disruptive departure from the current Names Rule framework, which (1) requires a fund to comply with its 80% investment policy "under normal circumstances"[50] and (2) measures compliance using a time-of-acquisition test.[51] For the reasons discussed below, we believe the Commission should not alter the "under normal circumstances" standard, nor should it replace the "at the time of investment" compliance standard.[52] We remind the Commission that all funds remain subject at all times to Section 35(d)'s prohibition on materially deceptive or misleading names. We observed in 2020 that there was no need to duplicate these ongoing protections by applying the standard differently.[53]

The approach established by the existing Names Rule is effective, provides appropriate and reasonable flexibility for funds and their advisers, is consistent with other 1940 Act tests that measure fund holdings, and is considerably far less costly to administer than the proposed amendments. A continuous testing regime, along with the 30 day limit, would harm shareholders by forcing funds to sell securities at undesirable prices and inappropriate times (*e.g.*, in declining markets under a rigid timeline). Such transactions could generate unwanted capital gains, increase transaction costs, reduce diversification and impose longer-term negative consequences for a portfolio. In certain cases, such as when a small cap stock performs so well that it "graduates" from the small cap category to the mid cap category, a fund could be forced to

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[49] Release at 33-34.

[50] Rule 35d-1.

[51] Release at 38-39.

[52] The ICI recommended that the Commission retain the "time of investment" standard in 2020, warning of risks from a change in the long-time standard which is also used for other regulatory requirements. ICI 2020 Letter at 6-7.

[53] *Id.*

abruptly sell its highest-performing holdings, even in a case where the portfolio managers believe the stock is likely to continue to appreciate. In this regard, funds (and their shareholders) would effectively be penalized for successful security selection. The Commission rightly recognized this concern when originally adopting the Names Rule, acknowledging that funds should not be required to "sell portfolio holdings that have increased in value" in order to reattain compliance with their 80% investment policies.[54] Further, certain index funds could experience a drastic increase in transaction costs due to the need for more frequent rebalancing (*e.g.*, an index fund that currently rebalances its portfolio annually arguably could effectively be required to rebalance much more frequently to comply with the proposed amendments). In Section XI, we describe variations in the frequency of rebalancing by index providers. We also assessed the number and index weight of the securities dropped—sometimes more than 20%—during rebalancings of the Russell Growth 2000 Index between 2019 and 2022 (Figure 5).

Forced sales would also likely arise in the context of severe market dislocations. The proposed amendments permit deviations in response to market fluctuations or to take a position in cash or cash equivalents or government securities to avoid losses in response to adverse market, economic, political or other conditions.[55] We understand that funds generally could take temporary defensive positions not inconsistent with a fund's principal investment strategies. In each of these cases, however, the fund is required to return to compliance as soon as reasonably practicable and in any case within 30 days. In reality, market dislocations are, by their nature, unpredictable in their timing and severity, and the length of such a dislocation is unknowable until it has passed, and certainly can last longer than 30 days.

The existing framework inherently recognizes that periods of extreme market conditions and other situations require thoughtful stewardship rather than prescriptive forced selling that could serve to exacerbate volatility and be detrimental to the best interests of the fund and its shareholders. Indeed, under certain market conditions, many funds with similar 80% investment policies could be forced to act simultaneously, which could exacerbate price volatility. Such forced sales could serve to further intensify the market conditions that prompted the issue in the first instance. Such forced sales could also expose funds to the danger that other investors may be able to anticipate a fund's need to sell securities by analyzing publicly available holdings data

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[54] Adopting Release at note 32.

[55] Release at 33-34. The Release also permits a fund to temporarily depart from its 80% investment policy to address unusually large redemptions, which could accompany market turbulence.

and opportunistically taking advantage of funds required to engage in such prescribed forced sales.

The existing time of investment standard is consistent with other portfolio compliance tests under the 1940 Act. The diversification and industry concentration provisions in Section 5, the anti-pyramiding provisions of Section 12(d)(1) and the limitations on investments in securities-related issuers in Section 12(d)(3) are all measured on a time-of-acquisition basis.[56] This type of approach for the Names Rule appropriately balances compliance objectives with deference to the expertise of investment advisers (whom shareholders have entrusted with investment discretion) to safely navigate a fund back into compliance in a deliberate manner that best protects the fund and its shareholders.

The imposition of an ongoing compliance test would also represent a paradigmatic shift in the Commission's approach to disclosure rules. Historically, disclosure rules such as the Names Rule have been designed to ensure that a fund's disclosure accurately reflects its investments and activities. Consistent with other provisions of the federal securities laws, the Names Rule is premised on the principle that a fund's investment strategy (*i.e.*, in what the fund invests and how the fund does so) informs the disclosure of its strategy and risks. The proposed amendments would turn this premise on its head, enabling a new rule to instead drive investment strategy by requiring a fund to divest securities based on the rule's fixed timeline when the portfolio manager otherwise would have more carefully evaluated holding or selling the securities, including considering what actions are consistent with the fund's investment strategy and what the portfolio manager believes to be the most appropriate for the fund. The Commission's proposed paradigm creates tension between adherence to an inflexible Names Rule, a fund's disclosure and an investment adviser's fiduciary duty. We also are very concerned that such a rigid approach could result in confusion for investors and managers when strategies are intended to specifically include management discretion to address market changes and events.

The Commission's proposed approach would impose significant burdens on funds and fund sponsors that are not justified by any apparent benefit. The Release claims that the proposed amendments would address the problem of funds "drifting" away from their 80% investment policies, which the Commission suggests occurs with the current "under normal circumstances" and "time of investment" framework.[57] However, the Release also acknowledges that funds are

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[56] Similarly, the leverage limitations in Section 18 of the 1940 Act are measured at the time a senior security is issued by a fund.

[57] Release at 14-15.

already limited in their ability to "drift" under the existing Names Rule's requirement that "future investments must be made in a manner that will bring the [f]und into compliance" if the fund is out of compliance with its 80% investment policy. The current Names Rule framework, along with other requirements, thus already provides an effective check on a fund's ability to deviate from its 80% investment policy. Indeed, a fund that trades portfolio investments on a daily basis is *de facto* already subject to a continuous testing regime, insofar as it cannot make an investment if doing so would cause it to be further out of compliance with its 80% investment policy. Under this framework, funds are required to evaluate their holdings prior to each trade. In contrast, the proposed amendments would require funds to test their portfolios each day, regardless of the fund's trading activity, to test for any passive breaches of the fund's 80% investment policy. Such a requirement would impose substantial burdens on funds, their sponsors and their administrators. Such ongoing testing however would be far more challenging in the case of certain of the highly subjective terms that the proposed amendments would absorb into the scope of the Names Rule, given that such terms, as discussed above, are not readily quantifiable. In some cases, relevant information on whether a particular investment satisfies a fund's 80% investment policy on a daily or ongoing basis would not be available at such a frequency, thus further frustrating efforts to effectively characterize investments. For example, this challenge could be more pronounced in the context of ESG investments.

### *B. Deviations from an 80% Investment Policy and Communication to Fund Boards*

We urge the Commission to retain the Names Rule's existing "under normal circumstances" and "time of investment" standards. However, should the Commission decide to amend the existing standards, there are alternatives that would be less harmful to funds and their investors and less burdensome than those proposed by the Commission. For instance, a fund that falls out of compliance with its 80% investment policy for more than 60 days could be required to notify its board. Fund directors are regularly relied upon, under a variety of 1940 Act provisions and the rules thereunder, to provide oversight and to serve as an independent check on a fund's management. Indeed adopting this approach would be similar to other rules under the 1940 Act.

### *C. Shareholders Should Have the Choice of Selecting Funds with Greater Portfolio Management Flexibility*

We believe the proposal prevents investors from having access to funds that both (i) are actively managed in ways that enable them to weather prolonged crises or market disruptions through adjustments to their portfolios and (ii) have names that meaningfully reflect the funds' investments (*i.e.*, names subject to an 80% investment policy). For example, the proposal would flatly prohibit a fund having "small-cap" in its name from having a strategy that provides

management with flexibility to invest significantly in other securities or cash during significant market dislocations or crises or during times when the portfolio managers are not able to find sufficient attractive investment opportunities, which could not be achieved through any type or amount of disclosure. This risks reducing investor choice and unduly limiting active managers' flexibility.

If the proposal is not otherwise revised, there must be an alternative to address this problem. For example, the Commission could endorse the use of certain terms in a fund's name that would signal to investors that the fund is permitted to depart from its 80% investment policy in a manner consistent with the current Names Rule's "under normal circumstances" standard. This would provide investors with the valuable option to choose the level of discretion they wish to assign to a fund's manager. Such fund names could, for example, include the word "managed" (*e.g.*, the "Managed Large-Cap Growth Fund").[58]

### *D. If the Commission Adopts A Continuous Testing Standard, Circumstances Giving Rise to Acceptable Departures Should Be Expanded*

With respect to the proposed approach to limit departures from a fund's 80% investment policy to scenarios explicitly provided for in the proposed amendments, we believe the Commission should retain a principles-based approach, as it is impossible to predict with certainty every circumstance in which a temporary departure from a fund's 80% investment policy would be appropriate, and a fund's inability to respond in the fund's best interest to such unforeseeable circumstances could harm the fund and its shareholders. At the very least, the proposed amendments should contemplate greater flexibility for managers to adjust a fund's portfolio holdings in response to times of crisis or market stress. Under a principles-based approach, a manager could exercise its reasonable judgment in determining whether circumstances warrant deviation from a fund's 80% investment policy, and a fund's disclosure could clearly communicate that possibility to shareholders.

If the Commission ultimately chooses to adopt a prescriptive list of permissible circumstances under which a fund may deviate from its 80% investment policy, despite our recommendation to the contrary, the Commission should expand the scope of acceptable temporary departures to include, at a minimum: (i) the repositioning of fund assets in connection with changes of sub-advisers and/or portfolio managers; (ii) during the period leading up to a material strategy

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[58] *See also* Commissioner Hester Peirce, *Statement on Investment Company Names*, (May 25, 2022), available at https://www.sec.gov/news/statement/peirce-fund-names-statement-052522.

change; (iii) in connection with the addition or removal of a co-subadviser; and (iv) in the case of closed-end funds, the purchase and sale of investment types that by nature require more time to acquire or dispose of (*e.g.*, securities acquired in private placement transactions and investments in private funds). In addition, if it adopts the proposed ongoing compliance approach, the Commission should expand the scope of the prong that would permit a fund to take a position in cash and cash equivalents or government securities to avoid losses in response to adverse market, economic, political or other conditions by permitting a fund to invest in other types of instruments beyond those enumerated in the proposal (*e.g.*, consistent with the fund's investment policies and strategies).

## III. Considerations Regarding Derivatives

### *A. Permit Funds to Value Derivatives Using Exposure Metrics and Methods Other than Notional Value*

The proposed amendments would require funds to value derivatives instruments using their notional amounts, with certain adjustments, to determine compliance with the Names Rule.[59] The Commission acknowledges that the "value" of a derivatives instrument as defined in the 1940 Act, which is generally the market value or fair value of securities, "may bear no relation to the investment exposure created by the derivatives instrument."[60] While the ICI generally supports the proposed use of notional value for purposes of the Names Rule with certain adjustments, the notional value of certain derivatives instruments similarly may not accurately represent the exposure a fund obtains through such instruments and may lead to skewed compliance results.

We note that there can be varying methods used to calculate derivatives exposure, and that the appropriate measure can differ depending on the fund's purpose for holding a derivatives instrument. For example, a fund may view a notional exposure measure as more appropriate when it invests in a derivatives instrument to gain investment exposure to an underlying asset, whereas the same fund may view market value or another value as more appropriate when it is using a derivatives instrument as a hedge. The compliance result of the requirement to value all derivatives instruments using the instrument's notional amount could be particularly odd where a fund would have more than 80% of its net assets in investments suggested by the fund's name and should seemingly meet the 80% test but, due to the potentially outsized impact of applying

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[59] Release at 48.

[60] *Id*. at 49.

the derivatives instrument's notional amount to the Names Rule compliance test, the fund would fail as a result of a derivatives instrument used to hedge assets in the 20% basket and where the derivative instrument's potential impact on the fund's performance would be minimal.

To address these concerns and consistent with our response to the Commission's 2020 request for comments on the Names Rule,[61] ICI strongly recommends that funds be permitted to test each derivatives instrument type consistent with a reasonable exposure metric and method that best measures the economic exposure the derivatives instrument obtains synthetically, which may or may not represent the notional value of the derivatives instrument. Providing funds with the necessary flexibility to determine the measure that most accurately captures their derivatives exposures, rather than mandating notional value testing for all derivatives, would be more workable from an operational standpoint and would more closely align fund names with their true economic exposure.

The Commission previously has recognized that valuation of derivatives through metrics other than notional value may be appropriate in certain compliance contexts. In 2011, for example, the Commission sought information on whether funds test for compliance with concentration requirements by considering "current market value or the notional amount of a derivative (or some other measure)."[62] In addition, in the Release, the Commission asks whether it should permit, "rather than require as proposed, a fund to use notional amounts of derivatives instruments for purposes of determining the fund's compliance with its 80% investment policy."[63] We believe these examples reflect the Commission's understanding that a one-size-fits-all approach with requiring notional value testing across all derivatives instrument types may not align a fund's compliance testing with the economic impact of a fund's derivatives exposure. Such alignment is particularly significant in the context of the Names Rule and preventing the use of misleading or deceptive fund names.

Rather than mandating notional value for all derivatives instruments, or other specific valuation methods on an instrument-by-instrument basis (which could become impractical as the universe of derivatives products expands and evolves), the Commission should permit funds to test each type of derivative for Names Rule purposes using a reasonable exposure metric and method that fully reflects the economic exposure the fund obtains through the use of such derivatives

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[61] *See* 2020 ICI Letter.

[62] *See* Use of Derivatives by Investment Companies under the Investment Company Act of 1940, SEC Release No. IC-29776 (Aug. 31, 2011), available at www.sec.gov/rules/concept/2011/ic-29776.pdf.

[63] Release at 62.

instrument, as long as the fund consistently applies the metric and method and discloses whether notional value, market value or another metric is used for these purposes. This approach would be reasonable and would further the aim of the proposed amendments to "allow funds to use names that may more effectively communicate their investments and risks to investors and reduce the risk that a fund may use derivatives to invest in a manner inconsistent with the investment focus suggested by the fund's name."[64] Required disclosures would allow the Commission staff to assess whether funds' practices are reasonable and confirm that a fund applies the selected measure on a consistent basis within the fund's portfolio.

### *B. Permit but do not Require Adjustments for the Notional Value Calculation*

The proposed amendments would require a fund, in calculating notional amounts for Names Rule purposes, to convert interest rate derivatives to their 10-year bond equivalents and to delta adjust the notional amounts of options contracts (the "Proposed Notional Adjustments").[65] The ICI generally supports the proposed ability for a fund to make adjustments to the notional value of certain derivatives instruments, but strongly urges the Commission to make such adjustments permissive (not mandatory).

Funds should be permitted, but not required, to make the Proposed Notional Adjustments in calculating notional amounts, which would be consistent with the adjustments permitted under Rule 18f-4 under the 1940 Act for calculating a fund's "derivatives exposure."[66] The Release and the Adopting Release for Rule 18f-4[67] both indicate that the Proposed Notional Adjustments are designed to ensure that the notional amounts of a fund's derivatives "better represent a fund's exposure to interest rate changes" and "provide for a more tailored notional amount that better reflects the exposure that an option creates to the underlying reference asset."[68] The Release also notes that the proposed approach would "best reflect the fund's investment exposure" and "help

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[64] *Id.* at 49.

[65] *Id.* at 51-52.

[66] *Id.* at 77.

[67] Use of Derivatives by Registered Investment Companies and Business Development Companies, Investment Company Act Release No. IC-34078 (Oct. 28, 2020) ("Rule 18f-4 Release"), available at www.sec.gov/rules/final/2020/ic-34084.pdf.

[68] *Id.* at 152 and 156.

ensure that the investment focus a fund's name communicates is not materially deceptive or misleading."[69]

However, while some fund groups have implemented the use of the Proposed Notional Adjustments for purposes of Rule 18f-4, other fund groups have not found that it is necessary to do so because their funds are either well-above or well-below the 10% threshold applicable to funds relying on the limited derivatives user exception, thereby allowing such funds to avoid the costs and operational challenges associated with implementing the practices. For example, many funds rely on third-party systems to track and monitor investments and compliance with related investment guidelines, policies, and applicable regulatory requirements. These funds would need to implement significant and costly changes to such systems to implement the Proposed Notional Adjustments. Accordingly, the proposed approach presents technological and operational challenges and would create significant costs for funds that have not implemented the Proposed Notional Adjustments in connection with Rule 18f-4, which could be particularly impactful for smaller fund groups and smaller funds and their shareholders.

We also note that a fund still would be subject to the codification in the Names Rule of the Commission position that compliance with the Names Rule is not a safe harbor from Section 35(d)'s prohibition on funds' use of materially deceptive or misleading names (as discussed in more detail in Section V below), which would serve to ensure that the Commission's goal underlying the required Proposed Notional Adjustments is met.

### *C. Funds Should Be Able to Consider All Derivatives that Provide Exposure to Relevant Market Risk Factors*

The proposed amendments would permit a fund to include in its 80% basket a derivatives instrument that provides investment exposure to one or more of the market risk factors associated with the investments suggested by the fund's name.[70] In the Release, the Commission notes interest rate risk, credit spread risk, and foreign currency risk as examples of such market risk factors, and highlights the specific examples of currency derivatives used to hedge foreign currency risk and interest rate derivatives used to hedge interest rate risk and/or manage duration.[71]

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[69] Release at 52.

[70] *Id.* at 55.

[71] *Id*.

We appreciate the Commission's recognition "that, in addition to using derivatives as direct substitutes for cash market investments, some funds use derivatives instruments to hedge exposures or to obtain exposure to market risk factors associated with the fund's investments."[72] While ICI generally supports this proposed ability for a fund to include additional types of derivatives instruments in the 80% basket, the Commission should acknowledge in adopting the Names Rule that it should permit funds to consider all derivatives that provide exposure to such risk factors associated with investments suggested by a fund name when testing Names Rule compliance.

Absent such guidance, funds that use derivatives instruments that complement the fund's strategy, but that do not provide investment exposure to the enumerated market risk factors in the Release, might face significant interpretive challenges in determining whether a particular derivatives instrument can be included in its 80% basket, and the proposed approach also could invite the potential for "second-guessing" by the Commission's examination staff if a fund includes in its 80% basket derivatives instruments that are not of the types specifically enumerated in the Names Rule or the Release.

### *D. Broaden Excluded Closed-Out Positions to Include Those with Different Counterparties*

The Release suggests that a fund would eliminate from the Names Rule test "derivatives that were closed out with the same counterparty and result in no credit or market exposure to the fund," and asks whether the Names Rule should address these positions.[73] We believe that the Commission should permit funds to exclude all closed-out derivatives positions from Names Rule compliance testing and that the Names Rule should explicitly permit such exclusion.

Although the suggested approach reflects the types of closed-out derivatives funds can disregard for calculating derivatives exposure under Rule 18f-4, we strongly disagree with limiting closed-out positions to those with the same counterparty for purposes of Names Rule compliance. The Commission should permit funds to treat a broader set of transactions as eliminating market exposure, and exclude relevant offsetting derivatives positions regardless of whether they are closed out with the same counterparty or are the same instrument type. Limiting excluded closed-out derivatives positions to those with the same counterparty would be economically inefficient for funds. Under the suggested approach, a fund might be forced to choose between the derivatives counterparty that offers the best pricing terms and credit risk at the time or the

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[72] *Id.*

[73] *Id.* at 60.

one that it engaged in the original derivatives transaction with; and might forfeit the opportunity to obtain more favorable terms from another counterparty at the time it seeks to enter into an offsetting position.

Restricting closed-out positions to derivatives closed out with the same counterparty also is not necessary to serve the policy concerns underlying Section 35 and Rule 35d-1. The policy concerns underlying Section 18 and the Rule 18f-4 restriction on offsetting positions across different counterparties (*i.e.*, the risk that one fund counterparty might default while the other position remains outstanding, and the potential for a fund to have a large volume of open derivatives positions subject to their own margin and other requirements with various counterparties) do not apply for purposes of the Names Rule. The Names Rule primarily is focused on the investment exposures suggested by a fund's name aligning with those from the fund's investments and addressing fund names that might mislead investors. If "ABC Equity" fund is using equity derivatives to achieve equity investment exposure, it is irrelevant whether its net exposure results from closed-out positions with the same counterparty or from offsetting positions with different counterparties. A fund may achieve the exact same changes to its investment exposures through derivatives closed out with the same counterparty as it does through offsetting derivatives transactions with different counterparties, and the identity of the counterparty should not be a determining factor for purposes of this aspect of the Names Rule. We believe this is a reasonable approach and would align funds' real-world practices with respect to offsetting derivatives transactions with Names Rule compliance.

If the Commission does not permit funds to exclude all offsetting derivatives positions for Names Rule purposes, we believe the Commission should at least provide guidance that funds may treat all centrally cleared derivatives transactions as positions with the same counterparty for purposes of determining closed-out positions.

### *E. Permit Funds to Include Physical Short Sales and Short Positions in Their 80% Baskets and Address Physical Short Sales*

The Release states that a fund would be required to take into account the notional value of short positions in derivatives for purposes of determining compliance with its 80% test and asks whether this treatment is appropriate.[74] It also seeks comment on whether the Names Rule should

[74] Release at 63-64.

address the consideration and valuation of physical short sales for purposes of Names Rule compliance.[75]

The Commission should adopt a flexible approach to permit, but not require, funds to include physical short sales and short derivatives positions in their 80% baskets. Funds should be allowed to include in their 80% baskets the absolute value (however measured) of a short sale or short position in a derivatives instrument if the investment provides short investment exposure to the investments suggested by the fund's name or to the market risk factors discussed herein, whether or not the fund's name includes specific terminology suggesting the use of short sales or short positions. Long and short positions both can be used to obtain exposures suggested by a fund's name, and this approach would be consistent with the proposed approach of including derivatives instruments that provide investment exposure to a market risk factor associated with a fund's name. Accompanied by appropriate disclosures, it would not be necessary for a fund's name to indicate the use of short positions to avoid misleading investors. We note that, currently, many funds do count such short exposures in their 80% baskets for purposes of Names Rule compliance testing, regardless of whether the fund's name includes specific terminology suggestive of the use of short positions.

We also recommend that the Commission address the valuation of physical short sales for Names Rule purposes. Many types of funds engage in physical short sales with regular frequency and such funds and their investors would benefit from guidance from the Commission on how such instruments should be treated under the Names Rule. Consistent with our prior comments, we believe that funds should be permitted to use the absolute notional amount or the absolute market value of the asset sold short under a physical short sale for purposes of valuing such transaction for Names Rule compliance. In addition, a fund should be permitted to look through to the components of its open short sale positions to offset their investment exposure (*i.e.*, the fund should be able to close-out all or part of a short sale position) for purposes of compliance with its 80% policy. The current lack of clarity with respect to physical short sales in the Names Rule and the Release will result in confusion and likely disparate practices.

### *F. Expand the Cash and Cash Equivalents Concept*

The proposed amendments would require funds to deduct cash and cash equivalents up to the notional amounts of the fund's derivatives instruments from a fund's assets when computing

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[75] *Id.*

compliance with the Names Rule (*i.e.,* the denominator in the 80% calculation).[76] The proposed approach is designed to remove from the calculation cash and cash equivalents, which do not themselves provide market exposure, where they effectively function as low risk collateral for the derivatives instruments whose notional amounts already are included in the denominator and to eliminate "double counting" the fund's exposure.[77] While we generally agree with this approach, we strongly urge the Commission to allow funds to reduce the value of their assets by excluding assets other than cash and "cash equivalents"[78] as detailed further below.

The proposed exclusion for cash and cash equivalents is unnecessarily limited and disregards the various types of liquid investments funds utilize for cash management purposes similar to how they might utilize cash and cash equivalents. Funds that engage in derivatives-focused strategies often hold a broader array of different types of assets that also effectively function as low-risk collateral for derivatives instruments, which funds hold instead of cash. These instruments can generate a limited amount of returns and reduce bank exposure, but generally are not held to obtain market exposure.

Funds should be permitted to reduce the value of their assets by excluding not just cash and cash equivalents, but also any assets that are posted as collateral under derivatives instruments and the following other asset types, including : other U.S. government securities such as U.S. Treasury securities with under five years to maturity and comparable non-U.S. government securities permitted to be posted as margin under CFTC and prudential regulators' margin requirements, investment-grade corporate bonds with under three years to maturity, short-term bond fund shares, interests in other short-term investment funds, and repurchase agreements on cash equivalents or any of the foregoing types of instruments. These assets also could include other types of securities or assets that also effectively function as low-risk collateral for derivatives instruments held in a fund's portfolio that provide exposure to the fund's investment focus.

### *G. Clarify that Derivatives Valuation Methods Under the Names Rule May Be Different than for Other 1940 Act Requirements*

To provide greater clarity to funds and investors in an increasingly complex regulatory environment, the Commission must clearly acknowledge in any adopting release that funds may

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[76] *Id.* 53-54.

[77] *Id.*

[78] *See id.* at n. 86 (noting that the Commission commonly considers "cash equivalents" to include "Treasury bills, agency securities, bank deposits, commercial paper and shares of money market funds.")

value derivatives instruments under Rule 35d-1 differently than they would when assessing compliance with other 1940 Act requirements, including for diversification purposes and portfolio concentration policies. Any guidance should emphasize that any prescribed valuation methods for Names Rule purposes does not impact any valuation methods permitted under U.S. GAAP or other methods utilized to value derivatives for other purposes under applicable rules and that the adopted valuation method is limited to Names Rule compliance purposes only. This acknowledgement would provide needed clarity to funds and help ensure that they maintain compliance with all other 1940 Act requirements.

## IV. Effect of Compliance with 80% Investment Policy and Absence of a Safe Harbor

The proposed amendments codify Commission guidance that a fund's name may be materially deceptive and misleading even if the fund adopts, and is in compliance with, its 80% investment policy—in other words, that compliance with the Names Rule is not a safe harbor from Section 35(d)'s prohibition on funds' use of materially deceptive or misleading names.[79] We do not oppose the codification of this longstanding Commission position in the text of the Names Rule.

Certain statements in the Release, however, raise significant concerns. These include statements relating to a fund holding investments that are "antithetical" to its investment focus and a fund that "invests in a way such that the source of a substantial portion of the fund's risk or returns is different from that which an investor reasonably would expect based on the fund's name."[80] The Release also contains highly problematic statements regarding index funds. These statements introduce vague new standards. We are deeply concerned that unless the Commission rescinds the guidance or offers considerably better clarity, these statements could be interpreted overbroadly by the Commission's staff or others.

### *A. Release's Guidance Concerning Index Funds Would Force a Drastic Expansion of the Nature of Investment Advisers' Required Oversight of Index Providers*

In the Release, the Commission stated that even though an index fund may be appropriately invested in its disclosed index, the "underlying index may have components that are contradictory to the index's name" and that under such circumstances, the fund's name may be

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[79] Release at 69. The Commission stated in the Adopting Release that "the 80% investment requirement is not intended to create a safe harbor for investment company names" and that "[a] name may be materially deceptive or misleading even if the investment company meets the 80% requirement."

[80] *Id*.

materially deceptive or misleading.[81] The proposed amendments and related guidance could impose on a fund's investment adviser an unwarranted and inappropriate degree of oversight or supervision of index providers. We remind the Commission that it is seeking information related to index providers and the Investment Advisers Act of 1940 and the 1940 Act and that it has announced its intention to issue a proposal in the last quarter of 2022.[82] As formulated in the Release, this treatment could potentially extend not only to funds that contain the term "index" in their names, but also to any funds that have adopted 80% investment policies that are defined by reference to an index. As a general matter, index funds' 80% investment policies are premised on the funds holding instruments that are included in the reference index. Fund sponsors, of course, conduct initial and ongoing periodic due diligence on index providers. On a day-to-day basis, however, index funds rely upon the index provider to construct the index—a fact that is clearly disclosed to and understood by investors. As such, we believe that there is greater risk of investors being misled by an index fund deviating from investing in the named index's constituents than would be caused by any potential misalignment between the index's name and its constituents.

The treatment of index funds expressed in the Release would impose significant increased burdens on investment advisers, including considerable costs, and would drastically transform the existing dynamic between investment advisers to index funds and the providers of the funds' indices. Investment advisers are engaged to provide portfolio management. The Release's guidance could be interpreted to impose on advisers an obligation to closely and continuously scrutinize the operations of index providers. Indeed, the implications of this guidance could upend the concept of passive management—an investment adviser constantly applying its own judgment to evaluate whether an index's constituent holdings are consistent with the index's themes might no longer be viewed as engaging in passive management. The Commission should recognize that index funds and their investment advisers do not have control over the application of index methodologies of third-party index providers. Although the Commission's concerns may be focused on custom indices and not on conventional indices, the Commission made no such distinction in the Release. Further, we note that even in the case of custom and affiliated indexes,

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[81] *Id.* 70.

[82] The Commission is currently gathering public input on index providers and others. *See* Letter from Susan M. Olson, General Counsel to Vanessa A. Countryman, Secretary, Securities and Exchange Commission, Request for Comment on Certain Information Providers Acting as Investment Advisers (August 16, 2022). The Commission's regulatory agenda includes a proposed rulemaking on third-party service providers for October. SEC Announces Spring 2022 Regulatory Agenda (June 22, 2022), available at https://www.sec.gov/news/press-release/2022-112.

there is critical separation between the operations of the fund adviser and the index provider.[83] In all cases, investment advisers would continue to be expected to engage in initial and periodic ongoing due diligence of index providers and index methodologies to confirm, among other areas of importance, that those methodologies are consistent with a fund's name.

This treatment could also result in increased tracking error to the extent a fund would be required under the proposed amendments and guidance to modify its investments because an index no longer has 80% of its constituents with characteristics that are consistent with its index methodology. The requirement also may place a fund in the untenable position where it would need to choose between following its replication/sampling strategy or violating the Names Rule and its 80% investment policy.

This treatment could also be interpreted to indicate that a fund has a materially deceptive name during a period prior to a rebalancing of the index if more than 20% of the assets making up the index are to be replaced in the rebalancing.[84] For example, market movement may cause index constituents to move above or below index capitalization requirements, to drop below liquidity requirements or to no longer meet revenue, dividend distribution or other index inclusion requirements. Typically, index methodologies require such securities to be removed from the index at the next rebalancing or reconstitution as set forth in the index methodology. It may be impossible for an adviser to determine the moment when more than 20% of an index no longer meets the criteria for initial inclusion in the index or is "contradictory" to the index's name (where, for example, the necessary information is not readily available), and shareholders should not expect that an adviser will be continually monitoring the components of an index and making decisions on its own as to whether the index continues to meet the 80% test. Further, to the extent an index provider announces changes to its index composition in advance of a rebalancing that would involve more than 20% of assets represented by the index, it is unclear whether a fund with an 80% investment policy that tracks that index would be deemed to be out of compliance

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[83] While an investment adviser typically would identify specific features, *e.g.*, screens, exclusion lists or weightings, that it wants the custom index to apply, the index provider would be responsible for finalizing and memorializing the methodology, as well as for the ongoing administration of the custom index. *See, e.g.*, *Indexes and How Funds and Advisers Use Them: A Primer* (January 2021), ICI, at 8-10, available at www.ici.org/doc-server/pdf%3A21_ppr_index_primer.pdf.

[84] This interpretation would be somewhat contradictory to a statement in the Release that such a rebalancing could result in a justified temporary departure from a fund's 80% investment policy that would need to be addressed as soon as reasonably practicable, but in no event longer than 30 days. Release at 40.

with the Names Rule from the time of that announcement until the actual rebalancing takes place.

Moreover, shareholders of a fund with an 80% investment policy tied to an index should rightfully expect that the fund will, under normal circumstances, invest at least 80% of its assets in the components of the index, regardless of whether the components of the index will be substantially different upon the next rebalancing of the index.[85] Shareholders who have chosen to invest in an index fund should expect that the fund will seek to perform like the index, rather than performing like what the index "will likely" or "should" be. In fact, investing in the components of the index arguably is the *only* way for a fund to invest in a manner consistent with its name. Indeed, doing otherwise potentially would be materially misleading.

For the foregoing reasons, we strongly oppose the Commission adopting the guidance expressed in the Release concerning the Names Rule's treatment of index funds. Alternatively, we propose the Commission provide guidance to the effect that if an index has an index construction methodology that is consistent with its name, an index fund that complies with its 80% investment policy tied to the index meets the Names Rule requirements and does not otherwise have a materially misleading name. An index fund should not have to perform a daily compliance test with respect to whether an underlying index has components that could be perceived to be, or to have become, contradictory to the index's name. The Commission should also make clear that as long as an index rebalances at least once per year, an index fund tracking that index would not be expected to deviate from the index should characteristics of a particular issuer included in the index change during the period between rebalances (*e.g.*, in the case of a small cap issuer that becomes a mid-cap issuer between rebalances).[86]

### *B. Release's Guidance on "Antithetical" Investments*

We are concerned that the proposal's guidance concerning "antithetical" investments is overbroad, poses significant risks of second-guessing and should not be adopted or must be adopted in a narrower and clearer form. In the Release, the Commission stated that a fund's name

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[85] *See* Release at 152 (stating, "investors in an index fund may expect the fund to be invested at or near 100% in the named index given that these investors would likely be purchasing the fund to obtain exposure to that index.").

[86] *See infra* Section XI (describing index rebalancing).

could be materially deceptive or misleading if the fund makes substantial investments that are antithetical to its investment focus.[87]

This ambiguous concept could, in practice, replace the Names Rule's 80% standard with a 100% standard given the uncertainty as to which investments might, in hindsight, be viewed as antithetical to a fund's name. One of the examples cited in the Release illustrates this ambiguity. The Release states that "a fund's name could be materially deceptive or misleading for purposes of section 35(d) if the fund invests in a way such that the source of a substantial portion of the fund's risk or returns is different from that which an investor reasonably would expect based on the fund's name, regardless of the fund's compliance with the requirements of the names rule (*e.g.*, a short-term bond fund using the 20% basket to invest in highly volatile equity securities that introduce significant volatility into a fund that investors would expect to have lower levels of volatility associated with short-term bonds)."[88] The Release provides no insight as to how a fund's adviser would determine whether particular equity securities would be "highly volatile," what level of exposure to these securities would be viewed as introducing "significant volatility" into a fund, or how to gauge investor expectations regarding the fund's volatility.

Evaluating whether an investment is antithetical to a fund's name, is highly subjective and may involve value judgments, thus exposing funds to second-guessing. Consequently, in certain cases, a fund's adviser could be compelled to conservatively apply the fund's 80% investment policy to 100% of the fund's investments out of concern that the investments included in the fund's 80% basket would be viewed by the Commission staff as antithetical to the fund's name. If the Commission does adopt a form of the antithetical investments guidance in any final amendments, it must clearly define the contours of what it would view as misleading under this framework and make clear that an investment that is merely inconsistent with a fund's 80% investment policy would not rise to the level of being antithetical.[89]

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[87] Release at 69.

[88] *Id.* at 69-70.

[89] For example, the Commission should clarify that it would not be misleading for a fund with an 80% investment policy to invest in large cap equities to invest up to 20% of its assets in small cap equities or for a fund with an 80% investment policy to invest in equities generally to invest up to 20% of its assets in bonds or other fixed income instruments, provided that such investments are not inconsistent with the fund's disclosure concerning its investment strategy and associated risks.

## V. Proposed New N-PORT Requirements are Overly Burdensome and Costly, While Providing No Apparent Benefit to Investors

Under the proposed amendments, funds would be subject to several new reporting requirements on Form N-PORT.[90] These include reporting as to whether an individual portfolio investment is included in a fund's 80% basket, the total value of a fund's 80% basket (as a percentage of the fund's total assets), and the number of days during the reporting period that the fund was not in compliance with its 80% investment policy.[91]

We oppose the proposal for funds to report, with respect to every portfolio investment, whether such investment is included in the fund's 80% basket. It is not clear what benefit is gained in requiring classification of 100% of a fund's portfolio investments when only 80% or more are required to satisfy its 80% investment policy. These proposed reporting requirements would be extremely burdensome and would impose considerable compliance costs.[92] In this regard, we believe the Commission's economic analysis is drastically understated, particularly as it relates to implementation. Funds already provide a lot of information and data to the public and, even more to the Commission, on which it can readily run its own analyses to determine if there are issues for follow-up by the Commission staff.

In recent years, new regulations have compelled many funds to engage third-party service providers to assist with, for example, the liquidity rule- and derivatives rule-related monitoring and reporting requirements at significant cost. If adopted, the proposed amendments to Form N-PORT requirements could compel funds also to engage a Names Rule vendor to manage the reporting. The proposed changes could also require funds to obtain supplemental and perhaps specially tailored data on their portfolio investments from a third-party data vendor and may require upgrades to advisers' post-trade compliance systems to enable them to perform the required daily testing as well as the mapping of the data to the N-PORT files. For example, the calculation methodology for the 80% basket will need to be specially programmed for derivatives. These requirements would severely tax advisers' compliance and operations resources. Moreover, the use by funds of third-party data or compliance systems would risk homogenization of the definitions of certain terms that now are reasonably defined in different ways, such as "growth" or "value." This could decrease the variety of options available to

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[90] Release at 95-96, 100.

[91] *Id.*

[92] Further, as noted above, it is unclear how certain terms (such as "global") could be applied at the level of individual portfolio investments.

potential fund investors and place practical limitations on creativity, product innovation and the ability of portfolio managers of active strategies to make determinations regarding which investments are best suited to achieve a fund's intended results.

We do not believe that the requirement that funds subject to an 80% investment policy classify each portfolio investment serves any meaningful public policy objective. Additionally, as a consequence of the substantial burden the proposed reporting requirements would place on funds, we believe it would disincentivize the use of names that are descriptive for investors.

As an alternative to the expansive additional reporting requirements in the proposed amendments, the ICI would support narrower reporting requirements that balance providing useful information to shareholders while limiting the excessive costs associated with the proposal. In this regard, it would be reasonable to require a fund to indicate (on Form N-PORT or another appropriate filing, such as Form N-CEN) whether the fund is subject to an 80% investment policy. Such a disclosure approach would give investors clear notice that a fund is subject to an 80% investment policy when reviewing the fund's portfolio holdings.

We fail to see any benefit to investors for a mandated security-by-security designation, particularly given the subjective nature that would underpin many of these designations and the fact that, at least, and in many cases considerably more than, 80% of holdings would be designated as in the basket.

We strongly oppose the proposed amendments' requirement that funds publicly report the number of days in which a fund was not in compliance with its 80% investment policy. If the Commission proceeds, it must align its approach with that of analogous reporting requirements under the Commission's liquidity and derivatives rules, which are not made publicly available.[93] We believe that presenting this to investors publicly on Form N-PORT, devoid of context and explanation as to the cause or effect of the deviation, would not communicate meaningful information to investors and risks unnecessary confusion and concern.

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[93] *See* Use of Derivatives by Registered Investment Companies and Business Development Companies, Release No. IC-34084 (October 28, 2020); Investment Company Liquidity Disclosure, Release No. IC-33142 (June 28, 2018).

## VI. Recordkeeping

The Commission proposes to introduce numerous new recordkeeping requirements as part of the proposed amendments to the Names Rule.[94] The proposal would require funds to maintain written records relating to: (i) which portfolio investments are included in a fund's 80% basket and the basis for including each investment in the basket; (ii) the value of a fund's 80% basket as a percentage of the fund's assets; (iii) the dates of any deviations from a fund's 80% investment policy together with documented reasons for such deviations; and (iv) any notices sent to shareholders under the Names Rule.[95]

ICI strongly opposes the requirement that funds maintain records documenting each investment included in the fund's 80% bucket and the basis for its inclusion. Such a requirement would impose significant burdens on funds' compliance and portfolio management personnel and, at a minimum, distract and, at worst, reduce their capacity to focus on other important aspects of fund compliance and portfolio management with little apparent benefit to funds and their shareholders. This requirement would also significantly increase compliance costs, particularly if coupled with the Commission's proposed expansion of the scope of the names rule to include funds whose names indicate thematic and similar types of investment strategies and often will not be susceptible to objective, quantifiable tests. The compliance burden of applying an 80% investment policy to such strategies would only be compounded by a requirement to maintain written records substantiating the inclusion of each investment in a fund's 80% bucket on a daily basis. While the Release seeks to justify this requirement by reference to the Commission's ability to better evaluate whether a fund is complying with its 80% investment policy, it cites no data suggesting that funds are not already broadly complying with their policies. As noted, there will be many interpretive issues and thus increasing second-guessing.[96]

The proposed amendments would also require funds that do *not* adopt an 80% investment policy to maintain a written record documenting the basis for concluding that the fund's name does not require adoption of such a policy.[97] Such a requirement, in effect, extends the scope of the Names Rule to touch every single fund, regardless of its name. This implies a presumption that a fund is subject to the Names Rule unless it can demonstrate otherwise. Such an approach is out of

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[94] Release at 103-104, 106-107.

[95] *Id.* 103-104.

[96] Additionally, the Release does not provide any guidance on how such a recordkeeping requirement would apply to index funds and the underlying index constituents.

[97] Release at 106-107.

character with the federal securities laws, which generally do not require a person to take affirmative actions in connection with laws and rules that do not apply to them.

## VII. ESG-Related Considerations

As described earlier, contemporaneously with proposing amendments to the Names Rule, the Commission published the ESG Proposal, which would require funds and investment advisers to provide additional information regarding their ESG investment practices. That proposal, if adopted, will, among other things, create three distinct categories of investment strategies: "Integration," "ESG-Focused" and "Impact" and introduce detailed requirements regarding funds' use of ESG factors, including enhanced, unique disclosure.

While we do not agree with the entirety of the Commission's ESG Proposal, we support its fundamental goals: to mitigate the risk of greenwashing and promote investor understanding of ESG funds. We also support certain key aspects of the proposal, such as facilitating the ability of investors and the marketplace to distinguish between "ESG" funds and "non-ESG" funds and promoting the comparability of key information about ESG-related investing strategies. We believe that the ESG Proposal is better suited than the Names Proposal to improve investor understanding of ESG funds and for addressing concerns such as greenwashing.

Also as previously described, in 2020, the Commission published a disclosure proposal for funds that would completely overhaul both the content and delivery requirements associated with prospectuses and shareholder reports. The Commission has indicated that it intends to finalize this proposal in October.[98] Although we believe that certain aspects of this proposal are overly prescriptive, it correctly reflects an understanding that investors should, and do, consider more than a fund's name as part of the investment decision-making process. We recommend that the Commission proceed *first* with finalizing these disclosure proposals (amended as appropriate to reflect public comments) and evaluating their effect on investor understanding before also proceeding with such fundamental changes to the Names Rule.

Consistent with our views on the proposed expansion of the 80% investment policy to include terms suggesting investments with particular characteristics, we do not support expanding the scope of the Names Rule to encompass ESG-related terms.[99]

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[98] *See* Spring Regulatory Agenda.

[99] We also note that the Commission states in the ESG Proposal that "[w]here a fund considers one or more ESG factors alongside other, non-ESG factors in its investment decisions but ESG factors are generally no more

The Release provides guidance on the application of an 80% investment policy to a fund name that suggests an investment focus that has multiple elements.[100] The examples presented in the Release represent scenarios where a fund is a "Wind and Solar Power" fund or an "Environmental, Social, and Governance" fund.[101] If the Commission chooses to adopt the proposed expansion of the Names Rule to encompass ESG-related terms, the Commission should provide additional clarity regarding the requirements for funds with multiple terms in their names, both for ESG-related terms and other terms that would be subject to the rule. Additionally, the Commission should confirm explicitly that it will consider the overall context in which terms are used and recognize that certain terms are intended to be (and, indeed, are) read together in certain contexts or may not be solely used for ESG investment strategies. For example, "Sustainable Growth" could reasonably be read as an investment focus consisting of one (investing in companies that are sustainable in the environmental sense of the term) or two elements (*i.e.*, growth that is sustainable (or "maintainable") over time) and "Impact" could be a non-ESG term (for example, there are cases in which a non-ESG Focused Fund can make a measurable impact in ways that do not relate to environmental, social or governance objectives).

## VIII. Unlisted Closed-End Funds and BDCs

The Commission proposes to require unlisted closed-end funds and BDCs that are required to adopt an 80% investment policy to make such a policy a fundamental policy.[102] We believe the Commission should not adopt such a requirement because it will significantly impede a fund's ability to make strategy changes that the fund and its board deem to be in the best interest of the fund and its shareholders.

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significant than other factors in the investment selection process, such that those ESG factors may not be determinative in deciding to include or exclude any particular investment in the portfolio, including ESG terminology in the fund's name would mislead investors by suggesting that the ESG factors play a more prominent role." ESG Proposal at 81. Thus, the Commission can achieve the aim of establishing that the use of ESG terms by non-ESG-Focused funds as misleading without needing to address ESG terms in the context of an expanded Names Rule.

As the proposals advance, the Commission should take care to harmonize any common definitions and concepts among proposals. For example, the definition of an integration fund in any final Names Rule should be consistent with how it is defined in any final ESG-related fund disclosure rule.

[100] Release at 25.

[101] *Id*.

[102] *Id.* 65-66.

The Release states that such a requirement would be appropriate because unlisted closed-end funds and BDCs are relatively illiquid, and, therefore, their shareholders are not able to effectively object to an upcoming change in policy by redeeming or selling their shares within the notice period in the event that they disagree with an investment strategy change.[103] We believe that the Commission's proposed rule is overly broad and should not be adopted or should be limited so as to provide a mechanism for unlisted closed-end funds and BDCs to continue to maintain non-fundamental 80% investment policies. For example, the Commission could provide an exemption for funds that provide a redemption opportunity to all shareholders, in accordance with applicable Commission rules, within a notice period. Alternatively, for funds that offer regular repurchases or tender offers, such funds should be permitted to set a notice period for a proposed 80% investment policy change that is lengthy enough for any investors who wish to redeem their investments to do so prior to the change in policy. For example, the Commission could permit such a fund to change its 80% investment policy after offering a repurchase or tender offer and demonstrating that all investors who wished to participate were able to do so.

## IX. Unit Investment Trusts

The Commission proposes applying all provisions of the proposed Names Rule to unit investment trusts ("UITs") deposited after the proposal's effective date.[104] The Commission requests comment on whether UITs should be excepted from any provisions of the Names Rule and, if so, how the Commission would ensure that UIT investors are protected. While we support the Commission partially exempting UITs deposited prior to any final rule's effective date, we recommend that any final rule require that the Names Rule only apply at the time of initial deposit and not on an ongoing basis.[105] The essential nature of a UIT is to maintain a fixed and

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[103] *Id.* at 66-67.

[104] *Id.* at 109.

[105] Our recommendation is with respect to non-exchange traded UITs holding a fixed portfolio of securities and does not encompass UITs structured as ETFs or separate accounts that are UITs offering variable insurance contracts. Operationally, UITs hold a basket of fixed income or equity securities and seek to maintain that portfolio over a specified term. UITs holding fixed income securities generally issue all their shares on the initial date of deposit and do not create additional shares. UITs holding equity securities also issue shares on the initial date of deposit, but generally create additional UIT shares to sell as purchase orders come in by buying a pro rata slice of the UIT portfolio securities, to the extent practicable, and depositing them into the trust in exchange for additional UIT shares to sell. The UIT sponsor decides how long a UIT continues to create shares, but 90 days is a common offering period. This means that 90 days after the initial date of deposit, no new shares of the UIT will be created (except if created as part of a dividend reinvestment plan). Because there are long periods where UITs will not be buying securities, in particular UITs holding fixed income securities, the only way to come into compliance with an 80% policy due to market fluctuations would be to sell securities. Such sales would not only be prevented by the terms of

transparent portfolio of securities for a specified term, regardless of how market movements impact the weighting of those securities. UITs are marketed as a pro rata slice of a portfolio of securities over a specified term and UIT offering materials, such as the prospectus, generally state that security weightings will change during the life of the UIT due to market fluctuations and other potential market events. UIT investors, therefore, would expect that any applicable 80% test would be measured at the time of deposit because that was when the portfolio securities were selected.

Additionally, requiring UITs to sell securities to maintain compliance with the Names Rule creates potential legal issues for UITs.[106] UITs— by law and contract— are limited with regards to why they may sell a security, when they may sell a security, and the weighting of additional securities purchased.[107] If a UIT were to no longer comply with its 80% investment policy after the initial date of deposit solely due to market fluctuations, the proposed Names Rule would require the UIT sponsor to come back into compliance with the 80% policy within 30 days. Such a requirement would put the UIT sponsor in an untenable position whereby the sponsor must either (i) comply with the Names Rule and sell out of a portfolio position or change the weighting of securities purchased, potentially in violation of the disclosure in the UIT prospectus and terms of the trust indenture, or (ii) violate the Names Rule to maintain compliance with the requirements of the UIT's prospectus and trust indenture. To avoid this result, the Commission has historically created carve-outs for UITs in rules that are premised on ongoing portfolio management and there must be a similar carve-out here.[108]

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a UIT's trust indenture, but such sales would actively go against an investor's choice to be exposed to a basket of securities over a set term.

[106] We note that although UITs are currently subject to the Names Rule, the current Names Rule is an acquisition test and does not require a UIT to sell securities if its portfolio no longer satisfies the 80% policy due to market fluctuations. While the preference would be for the Names Rule to only apply as of the initial date of deposit, it is the proposed amendments to the Names Rule potentially requiring a UIT to sell securities that creates a potential legal quagmire for UITs.

[107] *See* PaineWebber Equity Trusts No Action Letter (pub. avail. July 19, 1993) (Incoming Letter) ("A [UIT] is not 'managed' by the Sponsor or the Trustee; rather, their activities are governed solely by the provisions of the applicable Indenture. Currently, each Indenture pursuant to which a [UIT] is organized provides that the Sponsor may direct the Trustee to sell or liquidate Equity Securities in a [UIT] only under eight specified circumstances."). Further, certain UITs are structured as grantor trusts under the internal revenue code and must make security purchases pro rata if making additional deposits 90 days after the UIT's initial date of deposit.

[108] *See, e.g.*, Rule 22e-4 under the 1940 Act (noting that for UITs, liquidity determinations are made as of or prior to the initial date of deposit, whereas other investment companies have ongoing portfolio management responsibilities).

We believe that applying the 80% test on the initial date of deposit coupled with a UIT's fixed and transparent portfolio, the elements of which are also configured as of the initial date of deposit, prevents any potential concerns that the Names Rule seeks to address. Requiring sponsors to maintain the 80% policy after the initial date of deposit would not only be inapposite to investors' expectations, but could create investor harm as the investor would no longer be able to be exposed to a selection of securities, weighted as of the initial date of deposit, over a set period of time. Because investors would expect to be exposed to market fluctuations as they affect the selected portfolio of securities deposited in a UIT, we also believe that the proposed notification for departures from an 80% test would be of minimal benefit to unitholders.[109]

Finally, we note that while the Commission proposes certain exceptions for UITs deposited prior to the effective date of any adopted Names Rule amendments, we request that providing the exceptions as of the compliance date would be more workable. By providing exceptions for UITs deposited prior to the effective date as opposed to the compliance date, the proposed rule effectively requires UITs to either comply as of the effective date or engage in potentially difficult portfolio composition adjustments for any deposits made after the effective date but prior to the compliance date. The same reasoning for excepting UITs deposited prior to the effective date is equally applicable for any UITs deposited prior to the compliance date, and thus the exception provided in the proposed Names Rule should be extended to any deposit made prior to the compliance date.

## X. Timing/Implementation

The Commission proposes a one-year compliance period for the proposed amendments to the Names Rule.[110] We believe that the proposed compliance period sets a completely unrealistic and wholly inadequate timeframe given the significant legal, compliance and operational challenges

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[109] Further, excepting UITs from the proposed notification requirement regarding departures from any 80% policy would be consistent with the 1940 Act's exception of UITs from providing shareholder reports and the lack of any requirement for UITs to notify unitholders when market movements change a portfolio's weighting of securities. *See* Rule 30e-2 under the 1940 Act (requiring only UITs that hold securities issued by a single management company (*i.e.*, separate accounts registered as UITs offering variable insurance contracts) to issue shareholder reports); Section 26(a)(4) of the 1940 Act (requiring UITs to notify shareholders of a change in portfolio composition only when a security is substituted with another security).

[110] Release at 111-112.

that would be presented by the proposal.[111] Implementation of other new or changed rules also will likely be occurring simultaneously.

If adopted as proposed, the amendments would require fund sponsors to (i) evaluate the impact of amendments to the Names Rule on existing funds; (ii) determine what, if any, changes need to be made to the funds' investment strategies and names; (iii) seek approval of such changes, as appropriate, from the funds' boards of directors/trustees and/or shareholders; (iv) adopt policies and procedures, and design, modify or acquire systems to comply with the funds' new investment strategies and the broader amendments to the Names Rule, including the new N-PORT and recordkeeping requirements; (v) amend the funds' prospectuses and/or SAIs to disclose any amended investment policies or strategies; and (vi) draft, print and mail shareholder notices for those funds that would be required to amend their existing 80% investment policies.

In addition, it is anticipated that many fund sponsors would need to rely on third-party service providers to assist in conducting ongoing assessment of fund portfolios. It will likely take service providers considerable time to develop and test the systems and capabilities necessary to support these activities. The proposed amendments impact all registered funds in varying degrees, and we believe the Commission has grossly underestimated the time, resource and cost commitment that would be necessary to come into compliance with the amendments. In making this assessment, the Commission must consider how challenging, if not impossible it will be, for the large number of funds with common fiscal year ends (*e.g.*, May 31, October 31 or December 31) to come into compliance simultaneously with the necessary support of the limited number of third-party service providers.

Instead, the Commission must provide fund sponsors with at least three years to conduct an evaluation of the impact of the proposed amendments, determine necessary changes and seek board and/or shareholder approval of any required changes to funds' names or investment strategies, adopt necessary policies and procedures, and make any necessary or appropriate disclosure changes. Funds of course also should have the option to voluntarily comply earlier.

## XI. Release's Economic Analysis and Evaluation of Other Impacts

We believe the economic analysis set forth in the Release has significant shortcomings, especially given the scope and impact of the proposed changes discussed above and further in this section. First and foremost, the economic analysis does not provide compelling evidence for

[111] We discuss in more detail the complexities, burdens, and costs of the proposal in Section XI below.

why the proposed expansion of the Names Rule is necessary.[112] To the contrary, academic evidence provided by the Commission suggests that fund names are not inaccurate, when appropriately evaluated against objective criteria. This is also consistent with the general lack of enforcement actions or investor lawsuits alleging use of misleading names. Second, the economic analysis has not adequately examined the complexity and operational challenges associated with the proposed expansion and changes to the Names Rule (and related changes to other rules and forms). We believe the Commission has significantly underestimated the implementation and ongoing compliance costs of the proposed changes. Additionally, the economic analysis does not consider unintended consequences of the proposal and fails to account for the direct and indirect economic impacts of unintended outcomes.

### *A. Commission's Economic Analysis Fails to Account for Negative Impact on Fund Industry and Its Shareholders*

The sweeping changes proposed to the Names Rule and other related requirements would have considerable negative economic impacts on the fund industry and its shareholders by increasing costs. The aggregate costs of complying with the proposed amendments could total—by the Commission's own estimates—as much as $5 billion, and fund shareholders ultimately would bear much of this monetary burden because compliance costs, (including compliance with this proposal changing the fund Names Rule), are generally passed on to shareholders as a fund expense. The Commission is required to conduct a cost benefit analysis and, doing so is particularly critical for a rulemaking like this, where significant costs will be borne by fund shareholders. The Commission therefore must conduct a more detailed cost assessment that better reflects funds' obligations, with the opportunity for public comment, before moving forward on this regulatory initiative.

For the over 10,000 funds impacted by the proposed Names Rule,[113] the Commission's economic analysis translates into an aggregate overall cost of between $500 million and $5 billion for fund

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[112] The Commission's Current Guidance on Economic Analysis lists identifying a clear justification for regulatory action and how the proposed rule will meet that need as the first substantive requirement for conducting economic analysis in SEC rulemakings. *See* https://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_secrulemaking.pdf.

[113] The Commission estimates 10,394 funds would be subject to the proposed rule amendments. *See* Release at footnote 6 of Table 1.

investors.[114] This is a huge range and total costs could easily be at the upper end or even exceed it—a dreadful consequence for fund shareholders. The lower end of this range reflects the Commission's belief that funds have practices already in place that could readily be adapted to the proposed amendments. However, our analysis shows that this is not an accurate assumption because there are such considerable and fundamental differences between the current and proposed Names Rule. In addition, the substantial cost of the proposed Names Rule will put funds at a further competitive disadvantage to other investment vehicles that are not subject to the same requirements and all their associated costs and burdens.

### *B. Commission's Economic Analysis Does Not Provide Compelling Evidence for the Regulatory Need of the Proposed Amendments.*

We believe that the Commission has not provided a compelling justification for the proposed changes to the Names Rule and other requirements. The Commission's economic analysis claims that funds may have misleading names and seems to rely on a small number of academic papers on fund names as evidence for its concerns.[115] However, an analysis of these papers show that they do not support the Commission's economic analysis. Most of these papers examine impacts of fund name changes on investor flows. As a result, these papers narrowly focus on events surrounding fund name changes and are not directly related to the much broader scope of the proposed amendments.[116] For example, an academic paper—Cooper, Gulen and Rau (2005)—that the Commission refers to as the "Cooper Paper" and cites several times, examines the impact of 297 equity mutual fund name changes during the 1994-2001 period.[117] It is not clear how this paper's findings that are based on a few hundred mutual fund name changes more than two decades ago, *during a period that predates the adoption of, and compliance date for, the current*

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[114] The Commission's economic analysis estimates that the overall costs to establish and implement practices designed to meet the requirements of the proposed amendments will range from $50,000 to $500,000 per fund. *See* Release at 145.

[115] *See* Release at 114-116. These academic studies appear to be the evidence provided by the Commission to substantiate its concern that funds have misleading names and, as a result, the proposed expansion of the Names Rule is necessary.

[116] *See*, e.g., Ghoul and Karoui (2021), Cooper, Gulen and Rau (2001), and Espenlaub, Haq, and Khurshed (2017) cited in Release at 114-116.

[117] *See* Release at 115-116, notes 166, 168, 169 and 170.

*Names Rule*,[118] substantiate the need for wholesale changes to the current Names Rule that would impact more than 10,000 mutual funds, ETFs, closed-end funds, and UITs.

Additionally, the economic analysis cites a working paper, Allard, Krakow and Smedts (2021), which examines a broader sample of US equity mutual funds that is not restricted to funds with name changes.[119] The paper asserts that a significant proportion of mutual funds with "growth" and "value" in their names have misleading names. This assertion is based on the authors' definition of a fund name to be "misleading," if the fund's exposure to a benchmark—that is based solely on book-to-market ratio of underlying stocks—differs from that of other funds.[120] In other words, the authors implicitly assume that "growth" (or "value") funds should have holdings with similar book-to-value ratios or otherwise, they have misleading names. This flawed assumption fails to recognize that "growth" and "value" are classifications and strategies that cannot be reduced to a single "book-to-market ratio" benchmark for categorizing securities.

ICI analysis shows that even leading index providers use a wide range of metrics—in addition to book-to-market ratios—for identifying "value" and "growth" stocks for their style indexes, and these metrics can differ significantly across providers (see Figure 3). Additionally, there is substantial overlap in securities between growth and value indexes even among indexes of the same provider (see Figure 4). As a result, it is not surprising that the Allard et al paper finds differences in exposure to a single benchmark across funds given the inherently subjective and overlapping nature of "growth" and "value" concepts.[121] More importantly, the Allard et al paper also examines funds with names that suggest investments in securities of companies within a

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[118] The Names Rule was adopted in January 2001 with a compliance date of July 31, 2002. Investment Company Names, SEC Release No. IC-24828 (Jan. 17, 2001), available at https://www.sec.gov/rules/final/ic-24828.htm.

[119] See Release at 115-116, notes 165 and 167. Anne-Florence Allard, Jonathan Krakow, and Kristien Smedts, "When Mutual Fund Names Misinform," 2020, working paper. The sample includes US equity funds with size or style characteristics in their names during 2010-2018.

[120] The authors use a "HML" (or High minus Low) benchmark that captures the difference in returns between stocks with *high* book-to-market value (a proxy for "value" stocks) and stocks with *low* book-to-market value (a proxy for "growth" stocks). As a result, this benchmark is based solely on a single metric—the book-to-market value of underlying stocks. The authors use this benchmark to estimate an exposure metric for each fund that captures the relationship between the fund's returns and benchmark's returns and use the exposure scores of funds to group them into funds with "accurate" versus "inaccurate" names based on their similarity (dissimilarity) to other funds.

[121] For example, funds that primarily use book-to-market ratios to identify "value" versus "growth" stocks can have substantially different exposure to the paper's "book-to-market ratio" benchmark than funds that use other metrics commonly used by leading index providers (*e.g.*, momentum, dividend yields or sales-to-price ratios). Similarly, funds that benchmark their performance to Russell indexes (and possibly rely more on Russell's "growth" and "value" criteria) can have materially different exposure than funds that benchmark their performance to S&P indexes.

certain range of market capitalizations— a more objective and quantifiable criteria—but does *not* find evidence of prevalence of "misleading" names among these funds.[122] This research suggests that fund names are not inaccurate when appropriately evaluated against objective criteria. These results raise significant questions about the Commission's basis for the need for such changes and we believe the Commission must address fully these questions before it adopts any of the proposed amendments to the Names Rule and other rules and forms.

### *C. Commission's Economic Analysis Significantly Underestimates the Implementation and On-going Compliance and System Costs of the Proposal*

In its Release, the Commission considered four elements of cost[123] related to funds' complying with the proposed amendments to the Names Rule. We believe the Commission has not taken into account all relevant elements and failed to fully consider a multitude of factors including:

- Number of internal and external systems affected by the proposed amendments;
- Interconnection of funds' internal systems with various interfaces;
- Connection of funds' internal systems with third-party service providers;
- Role of third-party service providers and their systems in assisting funds' compliance with various aspects of the proposed amendments;
- Associated costs which will be passed on to the fund(s);
- Need for increased oversight of any third-party service provider;
- Overall cost of technology; and
- Lost opportunity costs associated funds' efforts to comply.

While funds have compliance systems in place to monitor for a number of factors, the Commission overlooks the fact that these compliance systems are generally tied into numerous other ancillary systems for downstream reporting and monitoring. Enhancements to any one system need to be evaluated for any significant impacts to any other system that is connected to

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[122] The authors conclude that the "size dimension displays relatively few inaccurate fund names while inaccurate fund names are abundant in the investment strategy dimension."

[123] The main costs the Commission considered in their Economic Analysis are 1) reviewing the proposed rule's requirements 2) modifying investment practices, 3) modifying policies and procedures, and 4) modifying recordkeeping processes.

it. Therefore, programming and testing efforts are far more complex and time consuming than contemplated by the Commission.

Our members consistently cite one-time compliance costs (e.g., legal costs, preparation of new policies and procedures, creation of internal controls and ongoing testing, and staff training), increased technology expenditures, increased use of third-party vendors,[124] development of appropriate oversight programs, and increased staffing needs as the primary drivers of the overall cost of implementing a new or revised process in response to a new regulatory mandate.

Additionally, the Commission ignores the opportunity costs associated with funds' efforts to comply with the proposed amendments, including the diversion of resources that may otherwise be focused on, for example, bolstering portfolio and risk management capabilities, enhancing oversight of existing legal and compliance, and accounting obligations, improving customer service, and product innovation. As noted above in our comments, the Commission has many other proposals pending, or planned, that will impact various systems and resources. The specter of so many new requirements likely being required to be implemented at the same time raises very serious issues and risks.

In recognition of the complexity of funds' systems, ICI conducted a survey of member's Chief Compliance Officers to gain insight into the potential impact on funds' compliance, reporting, and recordkeeping systems from the proposed amendments to the Names Rule and other forms and rules. Overall, 122 fund complexes representing at least 41% of funds and at least 68% of industry assets responded to the survey.[125]

Respondents indicated that the proposed amendments to the Names Rule will significantly increase the number of funds covered by the rule while increasing funds' overall compliance burdens and costs. For example, one-third of fund complexes reported that more than 75% of their funds are subject to the current Names Rule. However, this share increases substantially under the proposed Names Rule—59% of complexes reported that more than 75% of their funds would be subject to the new requirements.

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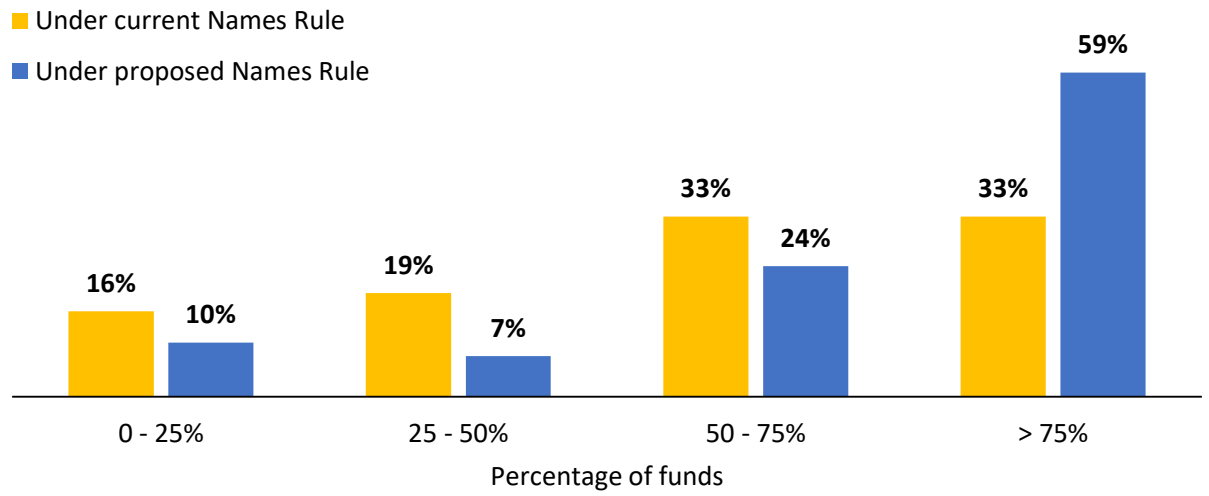
[124] Many members have indicated that they would rely on third-party service providers to assist them in complying with various aspects of the proposed amendments.

[125] These percentages reflect the number and total net assets of long-term mutual funds and ETFs as of June 2022 and the number and total assets of closed-end funds and UITs as of March 2022. In addition, these percentages are minimums as some respondents did not identify their fund complex for us to include their number of funds or assets in the survey coverage calculations.

**Figure 1**
**Majority of Respondents Estimate That More Than 75% of Their Funds Would Be Subject to the Proposed Names Rule**
Percentage of respondents*




*122 fund complexes responded to this question.
Source: Investment Company Institute

As the Commission notes in the Release, the majority of funds have systems in place to monitor for both compliance with investment policies and the current Names Rule. However, the Commission does not take into account the complexity, effort, resources and expense necessary to enhance existing systems and processes, or to build new systems and processes, to comply with the proposed amendments. In fact, a majority of members reported that the estimated impact of the proposed Names Rule on their systems would be substantial or extremely significant.

Even for those funds with systems in place to monitor for compliance with the current Names Rule, those systems would need to be redesigned, or new systems purchased, or new vendors engaged, to comply with the proposed amendments. Redesigning systems is not a simple task. Indeed, because there are fundamental differences between the two rule sets, a significant number of hours and resources will be necessary to determine the scope of the differences, outline required system specifications, determine the appropriate architecture and design of the systems themselves, complete extensive testing both for internal systems and those that interface with external service providers (*e.g.*, data providers, fund administration/custodial providers, N-PORT filing vendors), and to successfully implement the appropriate enhancements to comply with the proposed amendments.

Examples of critical fundamental differences affecting enhancement of existing systems and the development of processes and procedures include:

- *Expanded scope of rule* – the volume and variety of funds covered by the proposed amendments significantly increases the hours necessary to enhance appropriate systems and intensifies the manual interventions that are expected to occur related to definitions of specific terms (*e.g.*, growth, value) proposed to be included under the new rule or whether a security falls into the 80% bucket for a fund included under the rule.

- *Limits on temporary departures from compliance* – The strict requirements regarding when a fund may depart from the 80% threshold and the related tracking are complex and difficult to automate and would require additional manual resources to determine the reason for a departure from compliance.

- *Requirement for funds to use a derivatives instrument's notional amount for purposes of determining the fund's compliance with their 80% investment policies* – Although, as the Commission notes, funds that use derivatives may calculate notional amounts for purposes other than Names Rule compliance, with certain adjustments, existing compliance systems and N-PORT filing systems would need to be enhanced to include notional amounts, as adjusted under the new rule, in the calculations for determining whether a fund is in compliance with the 80% threshold. Funds believe that incorporating derivatives as specified into the compliance calculation will be both complex and laborious.

- *Requirement to calculate and report the number of days when a fund has not reached the 80% minimum* – To monitor for, and report, the number of days out of compliance, using a new standard with a 30-day period, funds will have to implement daily monitoring processes and procedures which will increase costs, programming time and necessary personnel, and will enhance the overall burden on funds.

- *Form N-PORT filing requirements* – Funds will need to modify compliance systems to provide data to their N-PORT filing systems (or their vendors' N-PORT filing systems) with the appropriate tags by security, number of days in or out of compliance, and other necessary data for each fund under the new rule. The fund's N-PORT filing system (or its vendor's system) will need to be updated to be able to import, store, and report out the new data points for the funds covered by the new rule while also maintaining the system for reporting for funds not covered by the rule amendments. As noted, funds in the same complex may need to tag the same security differently e.g., no single set of objective criteria for certain securities.

The process to design and implement appropriate monitoring systems is further complicated by a number of factors described earlier, including but not limited to the variations in defined terms, the subjective nature of certain terms, criteria, and requirements, reliance on third-party data providers to supply specific reference data,[126] the need for manual input into certain decisions or classifications which limits use of automated processes and increases risk, the concept that one security may be categorized one way by one portfolio manager and differently by another portfolio manager, and the overall volume of securities that will need to be categorized for each fund complex.

The Commission also did not appear to consider the number of systems and interfaces each fund complex would need to update to comply with the proposed amendments. Indeed, based on ICI's survey, 66% of fund complexes reported that they would need to modify anywhere from two to four separate internal systems to comply with the new requirements, with an additional 11% of complexes reporting that they would need to modify more than four systems.

Members also would likely need to enhance or build interfaces with third-party providers to take in required reference data and to provide new data points for making Form N-PORT filings. Funds that use subadvisers also would likely need to update their oversight processes and monitoring systems. Additional examples, as reported by members, of systems that would need to be modified include order management systems, trading systems, pre- and post-compliance monitoring systems, reconciliation tools, N-PORT extract tools, N-PORT filing systems, and various fund administrator and custodial systems. Finally, some members indicated that they maintain multiple compliance systems for equity funds and fixed income funds, which would increase the programming hours and costs for overall compliance with the proposed amendments.

[126] Per conversations with our members, the reference data for terms such as "growth" and "value" are not currently available and will need to be tailored for a fund's investment criteria.

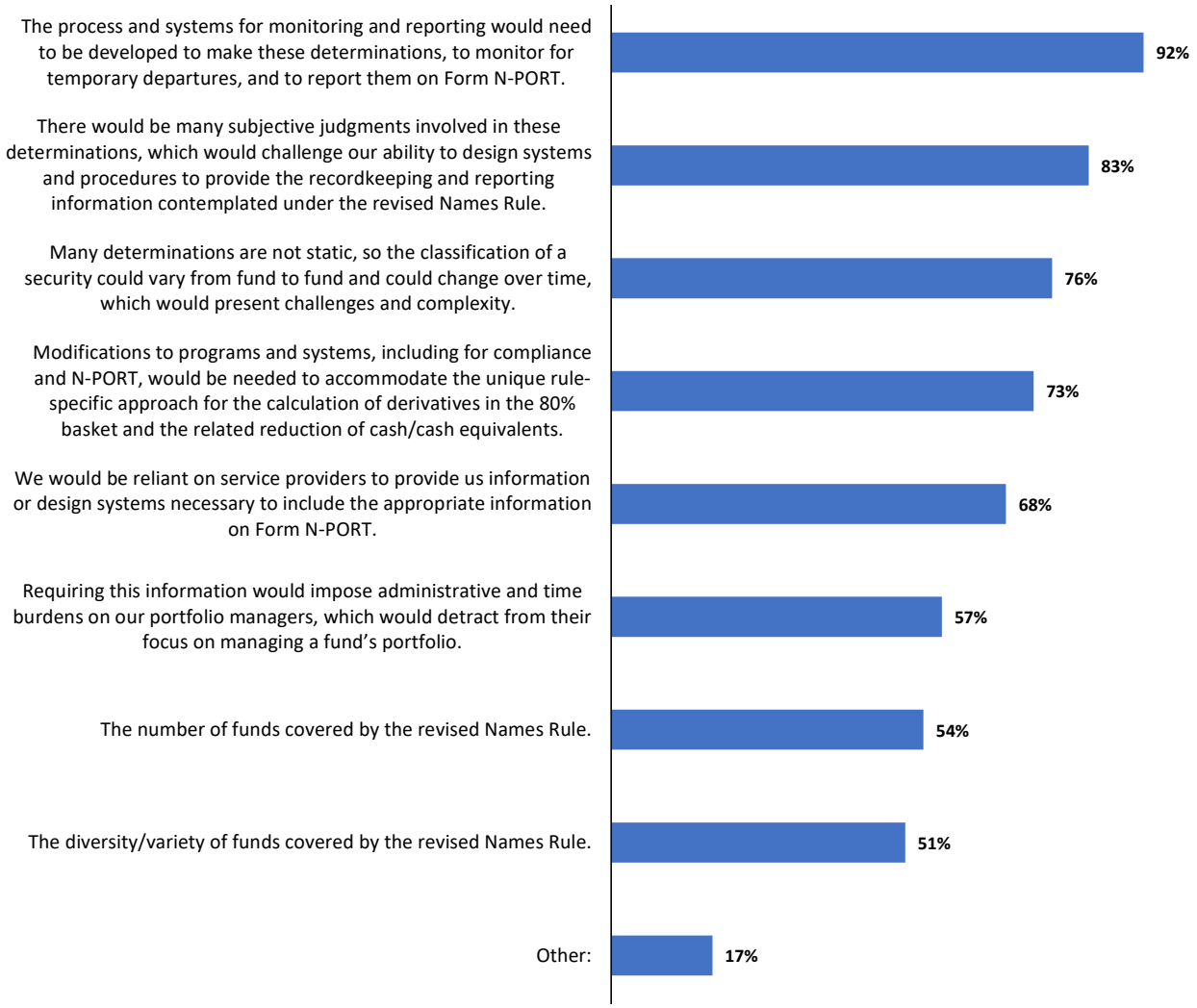
Based on ICI's survey, two-thirds of fund complexes reported that the estimated impact of the proposed names rule on their systems would be substantial or extremely significant. As shown in Figure 2, although the reasons for substantial or extremely significant impact vary, they clearly demonstrate the complexity and burdens of the proposed changes to the Names Rule. For instance, new sophisticated and specially tailored processes likely will be required,[127] including significantly more staff resources, including investment personnel.[128] In addition, fund complexes anticipate that more manual intervention will be required.[129]

[127] Ninety-two percent of fund complexes reporting substantial or significant impact on their systems noted processes and systems for monitoring and reporting would need to be developed to make determinations, to monitor for temporary departures, and to report them on Form N-PORT.

[128] Fifty-seven percent of fund complexes reporting substantial or significant impact on their systems noted that requiring this information would impose administrative and time burdens on their portfolio managers and detract from their time focusing on managing the funds' investments.

[129] Eighty-three percent of fund complexes reporting substantial or significant impact on their systems noted that there would be many subjective judgements involved in determinations which would challenge their ability to design systems and procedures to provide recordkeeping and reporting information under the proposed Names Rule.

**Figure 2**
**Reasons Respondents Estimate a Substantial/Extremely Significant Impact on Their Systems Vary**
Percentage of respondents*




*Total respondents are 63.
Note: Multiple responses are included.
Source: Investment Company Institute

Furthermore, the Commission's Economic Analysis either overlooked or did not comprehensively evaluate certain other major costs of complying with the proposed amendments including the following:

- Cost to obtain necessary data from external sources/vendors;
- Costs related to preparing and providing disclosure updates and notices to shareholders;[130]
- Costs associated with updating policies and procedures and training;
- Cost of engaging outside counsel and other specialists to assist with compliance and implementation;
- Cost of oversight of the overall program including the shift to daily monitoring for compliance with the 80% threshold;
- Additional resources needed to make determinations (and adjust as needed) related to which bucket a security falls, monitoring for overall compliance, etc.;
- Costs associated with updating recordkeeping processes, procedures, and systems to demonstrate compliance with proposal; and
- Costs of forcing funds to sell securities at undesirable prices and inappropriate times.[131]

The Commission's Economic Analysis failed to fully consider the magnitude and complexity of the system enhancements and many other ancillary costs required to comply with the proposed amendments. Therefore, we do not believe that the Commission has provided a compelling cost

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[130] Although the Commission incorporated some of these costs as outlined in Tables 1 through 6 in Section IV of the Release (Paperwork Reduction Act Analysis), we believe these costs have been significantly underestimated. For example, we believe the Commission has significantly underestimated the number of annual update and other filings that would be required to be made pursuant to Rule 485(a) under the Securities Act of 1933, as amended, which would impose considerable additional costs on fund sponsors and place significant burdens on the Commission's disclosure review staff. For example, many funds explicitly reference the existing Names Rule's "under normal circumstances" standard in their 80% investment policies. Under the proposal, the use of this standard would no longer be permissible and, presumably, all of these funds would need to amend their policies to comply with the new standard. Thus, the Commission's economic analysis appears to have drastically underestimated the number of funds that would be required to change their 80% investment policies as a result of the proposed amendments, which would include the significant expenses associated with obtaining shareholder approval in some cases.

[131] A continuous testing regime would harm shareholders by forcing funds to sell securities at undesirable prices and inappropriate times. Such transactions could generate unwanted capital gains, increase transaction costs, risk diversification and longer-term negative consequences for a portfolio.

benefit analysis which demonstrates that the benefits of the proposed amendments outweigh the costs.

### *D. Commission's Economic Analysis Does Not Consider Substantial Unintended Consequences of the Proposed Requirements*

#### 1. Proposed expansion to include subjective terms, such as "growth" and "value," would not decrease interpretative issues and search costs for investors

We believe the proposed expansion of the Names Rules to include subjective terms, such as "growth" and "value," would create significant interpretive issues that the economic analysis has not considered. "Growth" and "value" are fluid concepts that lack precise definitions or standardized criteria for classifying securities. As a result, there can be significant differences in market participants' assessment of whether a security is a "value" or a "growth" stock. Even leading index providers, such as Russell, S&P and MSCI,[132] can differ substantially in the criteria they use for identifying "value" and "growth" stocks for their style indexes (Figure 3). For example, Russell's uses a single factor for including stocks in its value indexes are (book-to-price ratios of the underlying stocks) whereas S&P's value criteria include two additional factors (earnings-to-price ratios and sales-to-price ratios). Similarly, while both the Russell and S&P growth criteria account for earnings-per-share and sales-per-share of the underlying stocks, the S&P criteria includes an additional factor − "momentum" − that measures the tendency for rising stock prices to increase further and falling prices to decline further. Additionally, there are differences in the weightings and time periods over which these growth factors are applied across index providers.[133] These differences in growth and value factors and their application can lead to discrepancies across index providers, such that a security classified as a "growth" stock by one index provider can be classified as a "value" stock by another index provider.

Additionally, these criteria can result in overlap in securities between growth and value indexes even for the same index provider. For example, Russell, S&P or MSCI can simultaneously

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[132] Russell, S&P, and MSCI are three widely recognized index providers in the asset management industry. An overwhelming majority of mutual funds and ETFs, including actively managed funds, benchmark their performance to Russell, S&P, and MSCI indexes. We estimate that over 81 percent of mutual funds and ETFs with "growth" in their names, and 85 percent of mutual funds and ETFs with "value" in their names list Russell, S&P or MSCI indexes as their primary performance benchmark in their prospectuses.

[133] For example, Russell's growth criteria are based on *projected* EPS over a two-year period, whereas S&P's criteria are based on *historical* EPS over a three-year period.

categorize the same security as both a "growth" stock and a "value" stock, resulting in the security being included in both growth and value indexes of the same provider.

**Figure 3**
**Leading Index Providers Use a Wide Range of Metrics to Classify "Value" versus "Growth" Stocks**

| | Russell | S&P | MSCI |
|---|---|---|---|
| **Growth criteria** | ‣ Two-year projected earnings growth rate<br>‣ Five-year historical sales-per-share growth rate | ‣ Three-year historical change in earnings-per-share (EPS) over price per share<br>‣ Three-year historical sales per share growth rate<br>‣ Momentum (12-month historical percentage price change) | ‣ Long- and short-term projected EPS growth rates<br>‣ Current internal growth rate<br>‣ Long-term historical EPS growth rate trend<br>‣ Long-term historical sales-per-share growth rate trend |
| **Value criteria** | ‣ Book value-to-price ratio | ‣ Historical book value-to-price ratio<br>‣ Historical earnings-to-price ratio<br>‣ Historical sales-to-price ratio | ‣ Book value-to-price ratio<br>‣ 12-month projected EPS<br>‣ Dividend yield |
| **Overlap** | ‣ Securities may be classified proportionately in both growth and value indexes | ‣ Securities may be classified proportionately in both growth and value indexes<br>‣ Securities are placed in either growth or value for "pure" style indexes | ‣ Securities may be classified proportionately in both growth and value indexes |

Sources: Russell US Styles Indexes, S&P Dow Jones Indices, MSCI EAFE Growth Index, and MSCI EAFE Value Index.

To quantify the magnitude of this "value" and "growth" overlap in securities among widely recognized index providers, the ICI examined the constituents of Russell, S&P, and MSCI indexes.[134] For each index provider, the ICI selected a growth index and a value index, and

[134] Specifically, ICI identified ETFs of the two largest sponsors that track the Russell, S&P and MSCI indexes and used holdings of these ETFs to proxy constituents of the underlying indexes. These ETFs have an average tracking

identified securities that are included in both indexes. This analysis shows that the overlap in securities between growth and value indexes is substantial (Figure 4). For example, 69% of securities included in the Russell 1000 Growth Index are also simultaneously included in the Russell 1000 Value Index. These overlapping securities account for 38% of weight in the growth index. Similarly, 76% of securities in the S&P 500 Growth Index (accounting for 34% of index weight) are also included in the S&P 500 Value Index.

**Figure 4**
**There is Substantial Overlap in Securities Between Growth and Value Indexes**

| | Russell[1] | S&P[1] | MSCI[2] |
|---|---|---|---|
| **Indexes** | | | |
| **Growth** | Russell 1000 Growth Index | S&P 500 Growth Index | MSCI EAFE Growth Index |
| **Value** | Russell 1000 Value Index | S&P 500 Value Index | MSCI EAFE Value Index |
| **Overlap[3]** | | | |
| **Overlap in number of securities** | 69% | 76% | 27% |
| **Overlap in index weights** | 38% | 34% | 13% |

[1] Index constituents are proxied by portfolio holdings of the two largest ETFs that track the specified indexes.
[2] Index constituents are proxied by portfolio holdings of the ETF that tracks the MSCI EAFE Growth Index and the ETF that tracks the MSCI EAFE Value Index.
[3] Measures the percentage of securities and their total associated weights in the specified growth index that were also listed in the specified value index as of June 30, 2022.
Source: Investment Company Institute tabulations of Morningstar Direct data

The substantial overlap in securities between value and growth indexes and significant differences in criteria used by index providers underscore the inherently subjective nature of classifying "growth" versus "value" securities, which will increase (not reduce) interpretive issues for funds and their investors. It will also make it extremely challenging for funds to conduct quantitative asset-based tests for these style characteristics. These operational challenges

difference of less than 0.15 percent over the past 5 years, indicating that their holdings can represent the index constituents reasonably well.

could also result in funds using more generic names and excluding "growth" and "value" from their names, which would increase (not decrease) "search costs" for investors seeking to gain exposure to securities with growth and value characteristics. In contrast to the Commission's conclusion, these increased search costs could lead to investors withdrawing capital from funds, thereby undermining capital formation in the fund industry. The Commission's economic analysis fails to consider these unintended consequences associated with the proposed expansion of the Names Rule.

**2. Proposed Requirements on Index-based Funds Could Force Deviations From Underlying Indexes, Contradicting Disclosure and Investor Understanding of These Funds**

The proposed requirements on index funds would force index funds to constantly monitor index-providers to ensure the underlying index constituents that the funds replicate continue to represent the characteristics in the funds' names. As a general matter, index providers periodically rebalance indexes to ensure their constituents continue to adequately represent the market segments they are designed to track. The frequency of rebalancing, however, varies across index providers, with the S&P rebalancing its indexes quarterly while Russell only rebalancing once a year. Because markets change continuously, the cumulative change between rebalancing dates can be significant. For example, top performing stocks in a small-cap index can quickly outgrow their market capitalization thresholds, requiring significant proportion of assets to be dropped from the index in the next rebalancing cycle.[135] A small-cap index fund replicating such an index would need to hold these top-performing stocks with relatively large market capitalizations to minimize tracking error, but doing so could violate the proposed 80% investment policy.

To assess the extent to which assets are dropped during rebalancing cycles, the ICI examined constituents of the Russell 2000 Growth Index on rebalancing dates over the 2019-2022 period. Specifically, ICI compared index constituents across consecutive rebalancing dates to identify securities that are dropped from the index. This analysis shows that at least 30% of securities—accounting for more than 20% index weight—were dropped on Russell rebalancing dates each year for the past four years (Figure 5).[136]

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[135] Stocks can also be dropped for other reasons, such as mergers and acquisitions, decline in market capitalization or bankruptcies and liquidations.

[136] Index weights of these securities are calculated as of the prior rebalancing date. These index weights can increase or decrease continuously with market fluctuations, particularly around times when market volatility is high. ICI

**Figure 5**
**More Than 20% of Index Assets Were Replaced During Rebalancing of Russell Growth 2000 Index**

| Russell rebalancing date | Number of securities dropped from index[1] | Weight of securities dropped from index[2] |
|---|---|---|
| June 28, 2019 | 30% | 22% |
| June 26, 2020 | 30% | 24% |
| June 25, 2021 | 33% | 24% |
| June 24, 2022 | 35% | 22% |

[1] Measures the percentage of securities in the Russell 2000 Growth Index that are dropped from the index on rebalancing date
[2] The weights of these securities correspond to index weights as of the prior rebalancing date.
Note: Index constituents and their weights are proxied by portfolio holdings of the two largest ETFs that track the Russell 2000 Growth Index.

These results demonstrate that index funds could fail the proposed 80% asset-based test merely by replicating the indexes they are designed to replicate. The proposed amendments could force these funds to modify their investments and deviate from underlying indexes, contradicting the very reason investors chose to invest in these funds. For example, recent academic literature shows that investors value index providers over fund managers when choosing between ETFs.[137, 138] Academic papers attribute this greater importance of index providers to their active role in

examined index weights of the securities that were ultimately dropped from the Russell 2000 Growth Index on June 26, 2020, over the June 2019 to June 2020 rebalancing cycle – a period that included the COVID-19 market volatility. Specifically, ICI calculated index weights of these dropped securities on September 30, 2019, December 31, 2019, March 31, 2020, and June 4, 2020 (i.e., the day before Russell disclosed the list of securities that were to be replaced on the next rebalancing date, June 26, 2020). We found the combined weight of these securities on these dates to be 23.3%, 21.8%, 21.7% and 20.2%, respectively. This analysis indicates that index funds replicating the Russell 2000 Growth Index likely would have departed from the proposed 80% policy (if such a policy had existed during June 2019 – June 2020), suggesting these index funds would have failed the asset-based test and would have been forced to sell securities during volatile markets, possibly at fire-sale prices.

[137] See, e.g., An, Benetton, and Song (2021), "Index Providers: Whales Behind the Scenes of ETFs," Working Paper, and Kostovetsky and Warner (2022), "The Market for Fund Benchmarks: Evidence from ETFs," Working Paper.

[138] For example, Kostovetsky and Warner (2022) find that investor demand for ETFs is related to size (a proxy for reputation) of index provider but not to size of ETF manager.

selecting index securities, compared to the passive and relatively mechanical index-replication role of ETFs.[139] The findings in these studies suggest that forcing index funds to deviate from their underlying indexes could be antithetical to investors' investment objectives. It could also lead to investors withdrawing capital from index funds, undermining capital formation in the asset management industry. The Commission's economic analysis fails to consider these unintended consequences of the proposed requirements on index funds.

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We appreciate the opportunity to provide comments on the proposed amendments to the Names Rule. If you have any questions, please contact Eric Pan at (202) 326-5824, Susan Olson at (202) 326-5813 or Dorothy M. Donohue, Deputy General Counsel – Securities Regulation, at (202) 218-3563.[140]

Sincerely,
/s/ Eric J. Pan
Eric J. Pan
President & CEO

/s/ Susan M. Olson
Susan M. Olson
General Counsel

cc: The Honorable Gary Gensler
The Honorable Hester M. Peirce
The Honorable Caroline A. Crenshaw

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[139] Kostovetsky and Warner (2022) note that "[t]he importance for investors of the size and reputation of the index benchmark provider, and not the company actually sponsoring and managing the fund, is consistent with the key decision-making power at the index provider level, with the fund managers' involvement (index replication) mostly mechanical once the sponsor sets the strategy."

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The Honorable Mark T. Uyeda
The Honorable Jaime Lizárraga

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