WELLINGTON MANAGEMENT COMPANY LLP

280 Congress Street, Boston, MA 02210 USA
T +1.617.951.5000
www.wellington.com

August 16, 2022

Via email (rule-comments@sec.gov)

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

Re: Investment Company Names; File No. S7-16-22

Dear Ms. Countryman,

Wellington Management Company LLP ("**Wellington Management**") appreciates the opportunity to provide comments to the United States Securities and Exchange Commission (the "**SEC**") on the SEC's proposed rule (the "**Proposal**") to Rule 35d-1 (the "**Names Rule**") under the Investment Company Act of 1940, as amended (the "**1940 Act**").[1]

Tracing its history to 1928, Wellington Management is one of the world's largest independent investment management firms, serving as a trusted adviser to over 2,400 clients in more than 60 countries. As a private partnership whose only business is investment management, the firm is able to align its long-term views and interests with those of its clients. The firm manages more than US $1.19 trillion as of 30 June 2022, US $500 billion of which is actively-managed for unaffiliated US mutual fund sponsors across equity, fixed income and alternative asset classes. With more than 900 investment professionals located in offices around the world, Wellington Management pairs deep multi-disciplinary research resources with independent investment teams (we have no Chief Investment Officer) operating in an entrepreneurial "boutique" environment.

We agree with the SEC that fund names are important tools for communicating key characteristics of funds to investors and should be accurate and not misleading. Moreover, we appreciate the SEC's policy goal of addressing the potential for "greenwashing" in the mutual fund industry. As described in further detail below, we are concerned, however, that the proposed expansion of the scope of the Names Rule and the amendments effectively requiring continuous compliance testing, particularly in combination, could have unintended negative consequences for U.S. mutual fund shareholders, especially those who invest in actively-managed funds.

I. BACKGROUND

As a threshold matter, we note that Wellington Management is a fundamental active manager. Active management at Wellington Management is a process that requires evaluation of inputs on individual

---

[1] Investment Company Names, Release No. 33-11067; 34-94981; IC-34593 (Jan. 26, 2022).

investments, industries and macroeconomic factors, none of which are necessarily controlling in any particular circumstance. We believe that successful active management requires investors[2] to clearly articulate an investment philosophy and process that guides their analysis and defines the process they use to identify investments and construct portfolios. In applying their philosophy and process, investors exercise judgment in complex and changing markets informed by fundamental research, individual perspectives, experience, and education. This is the value and the attraction of active management and why fund shareholders may choose to invest in actively-managed funds instead of (or in addition to) passive funds as part of an overall well-diversified investment portfolio. We believe active management will be critical for fund shareholders as we approach a period where there may be more modest passive market returns, higher levels of volatility, evolutions in market structure and the explosion in investment data. In more challenging markets, active management can capture value from market inefficiencies, identify overlooked and undervalued investments, and implement defensive portfolio positioning in an effort to preserve capital.

II. THE PROPOSED INCREASE IN THE SCOPE OF THE "NAMES RULE"

The Names Rule sets forth specific categories of fund names that are "materially deceptive and misleading" under Section 35(d) of the 1940 Act unless the funds with such names have adopted an investment policy to invest 80% of their assets in securities suggested by the fund's name (an "80% Investment Policy") and disclose such policy in their prospectus.[3] The Names Rule (in relevant part) currently applies to the following categories of fund names: (i) names that suggest the fund focuses its investments in a particular type of investment(s) or industries/groups of industries;[4] (ii) names that suggest the fund focuses its investments in a particular country or geographic region;[5] or (iii) names suggesting that the fund's distributions are exempt from federal income tax or both federal and state income tax.[6]

Under the Proposal, the Names Rule would be expanded to also apply to names that "include[] terms suggesting that the fund focuses its investments in … investments that have, or investments whose issuers have, particular characteristics (e.g., a name with terms such as 'growth' or 'value,' or terms indicating that the fund's investment decisions incorporate one or more ESG factors),"[7] but would not apply to names that "reference characteristics of a fund's portfolio as a whole" or that reference "elements of an investment thesis without specificity as to the particular characteristics of the component portfolio investments."[8]

As an active manager, we use the terms "growth" and "value" to describe investment approaches (e.g., Opportunistic Growth or Asia Contrarian Value) or refer to portfolios as a whole (e.g., a portfolio with a "growth" or "value" tilt). Used in this way, a "growth" or "value" designation does not imply that each of the

---

[2] As used herein, the term "investors" refers to the Wellington Management investment professionals, i.e., our investment analysts and portfolio managers.
[3] Rule 35d-1(a).
[4] Rule 35d-1(a)(2).
[5] Rule 35d-1(a)(3).
[6] Rule 35d-1(a)(4). In addition to these specific categories, the SEC staff has, through the review of fund registration statements, developed standards for names that include terms such as "global" or "international".
[7] Proposed Rule 35d-1(a)(2).
[8] Proposal at 24 ("[fund names that would not connote an investment focus] would include names that reference characteristics of a fund's portfolio as a whole, or that reference elements of an investment thesis without specificity as to the particular characteristics of the component portfolio investments.").

underlying investments has common "growth" or "value" characteristics; instead these terms imply that the portfolio as a whole was assembled with growth prospects or relative value propositions in mind. Our goal in implementing a "growth" strategy is to intelligently construct a diversified portfolio where investments have different but complementary characteristics that when aggregated enable the portfolio to achieve specific client outcomes (e.g., a growth tilt). In other words, as we use the terms "growth" and "value," they align more closely to terms that "reference characteristics of a fund's portfolio as a whole" or that reference "elements of an investment thesis without specificity as to the particular characteristics of the component portfolio investments," terms that the Proposal would specifically exclude from the expanded scope.

While terms such as "growth," "value" and similar terms like "momentum" and even "sustainable" can be used when discussing an investment or an issuer (e.g., XYZ is a "growth" stock), such use is actually describing a judgment about an investment or an issuer and not a "particular characteristic" of the issuer. Indeed, XYZ may be a "growth" stock to one investor and may be a "value" stock to another issuer. Likewise, different data providers and rating agencies may, and often do, arrive at different conclusions about the same issuer. For example, a recent review of the Russell 2000 Growth and Value indices on the same day revealed a large degree of overlap between their constituents. Of the 1124 constituents of the Russell 2000 Growth index, 529 of those constituents (nearly half) were also part of the Russell 2000 Value Index.[9]

Indeed, even "growth" or "value" classifications by third-party rating agencies or index providers are based on investment judgments that are subjective. For example, a fund might be classified as a growth fund by Morningstar Style Box on the basis of a formula developed by Morningstar and applied to each underlying investment in the portfolio.[10] This classification, however, remains subjective because it is based on Morningstar's own formula for determining what is "growth" and slight variations to this formula could change the results (e.g., a stock may move from "growth" to "value" by emphasizing price/sales figures instead of dividend yield). This same reasoning holds true for indices. Inclusion in a "growth" or "value" index is based on issuers meeting specific criteria determined by the index provider based on the investment judgment of that provider.

As discussed in more detail below, we are concerned that this expansion of the Names Rule into subjective investment judgments will make it challenging to develop and test an 80% Investment Policy – particularly in light of the provisions of the proposal that would require such Policies to be tested at all times.

III. DEVELOPING AND TESTING AN 80% INVESTMENT POLICY FOR SUBJECTIVE TERMS

At Wellington Management, compliance with investment guidelines, such as the 80% Investment Policy, are tested systematically by our compliance systems. These systems require objective data inputs to perform their tests. An 80% Investment Policy adopted under the current Names Rule requiring a fund to

---

9 Source: Bloomberg, August 15, 2022.

10 The nine-square style box sorts mutual funds based on their market capitalization (small, medium or large) and their "growth" and "value" factors. In order to perform this classification, Morningstar assesses the "growth" and "value" factors of each stock held by a fund based on a specific formula that includes objective inputs such as: price/prospective earnings; price/book; long-term projected growth; historical earnings growth, etc. Stocks are scored based on this calculation. A stock with a score below -15 is generally considered "value" and a stock above 25 is generally considered "growth." See Morningstar Style Box, at: https://www.morningstar.com/invglossary/morningstar_style_box.aspx.

invest at least 80% of its assets in companies domiciled in a certain jurisdiction can be objectively tested. We have access to data showing the jurisdiction in which issuers are domiciled, so our systems can objectively determine both the numerator (i.e., issuers who are domiciled in a certain jurisdiction) and the denominator (i.e., the total holdings of the portfolio). These criteria will yield consistent objective results that will be the same even when different individuals make this determination.

On the other hand, applying an 80% Investment Policy to subjective criteria based on investment judgment (as would be required in order to determine whether a particular stock is a "growth" or "value" stock for example), is more challenging. As a result, funds may limit their investable universe to holdings that are clearly compliant (as per an index or other third-party standard) or alter their investment process by attempting to reduce subjective criteria to objective characteristics.

The first approach, reliance on an industry standard or index, would be problematic for at least two reasons. First, there is no standard for many of the terms that might be captured in the "particular characteristics" category. Secondly, where there is an industry standard with an objective definition, using such standard for compliance testing comes at a cost with respect to active manager choice. Investors who are trying to maximize their "active share" (i.e., who are seeking to provide portfolios that are different from indices) would find their universe of eligible investments to be artificially limited based on the applicable indices or other third-party standards. This would pressure actively-managed funds to become more like passive funds, diluting the value of active management for fund shareholders and eliminating a critical element of investor choice. Indeed, if a shareholder is only seeking exposure to a particular index, that shareholder would presumably invest in an index fund.

The second approach, reducing subjective criteria to objective characteristics, is sub-optimal even where it is possible. Many investment philosophies and processes cannot easily be reduced to formulas and data characteristics, as they rely on fundamental investment analysis, years of investment experience, and subjective impressions of issuer management teams. This is one of the key differences between a fundamental actively-managed fund and a quantitative model-based fund. Even where a "characteristic" can be reduced to specific criteria (e.g., "momentum" could be defined as stocks whose 50-day moving average crosses its 200-day moving average), those criteria can change quickly over time, potentially resulting in increased portfolio turnover (particularly when coupled with the Proposal's proposed correction requirements). Further, active managers often revisit their philosophies and processes as market environments change; a "dividend" stock in 2008, when most financial issuers ceased paying dividends may be different than a "dividend" stock in other periods. Locking in specific criteria may, in such cases, result in potential harm to funds and their shareholders, as active managers would be unable to effectively express their investment judgment, which is critical to their ability to produce positive results and beat their reference benchmarks.

One potential outcome of these challenges is that funds that offer fundamental active strategies may be limited to less-descriptive names that do not attempt to describe their investment style, which could make it more challenging for fund shareholders to identify the universe of actively-managed funds available within a particular style.

IV. THE DIFFICULTY OF CONTINUOUS OR DAILY COMPLIANCE TESTING

Currently, the Names Rule requires an 80% Investment Policy that applies at time of investment[11] and "under normal circumstances."[12] This framework provides investors with a reasonable amount of flexibility to manage the portfolio under abnormal conditions while still holding them accountable to an 80% Investment Policy linked to the fund's name. The Proposal would eliminate the "under normal circumstances" standard and instead (i) enumerate a limited set of circumstances under which a fund may depart temporarily from the 80% Investment Policy and, (ii) prescribe the time frames within which a fund must restore its compliance.[13] We are concerned that these changes could be interpreted as effectively requiring an "at all times" standard.

The compliance testing that would be required to satisfy an "at all times" standard has significant and potentially adverse implications, especially when coupled with the increase in scope described above. First, to ensure compliance with an 80% Investment Policy "at all times," every investment in a portfolio would need to be re-evaluated on a continuous basis to ensure that the fund had not deviated from its 80% Investment Policy for greater than the prescribed minimum period. When coupled with the proposed increased scope of the 80% Investment Policy requirement to subjective judgments (e.g., whether an investment is "value" or "growth"), this "at all times" requirement becomes even more challenging, as the subjective judgments made by investors with respect to each issuer would need to be revisited daily.[14]

Further, testing with respect to any term that is temporal or conceptual would be difficult to standardize and perform daily. As an example, the term "impact" would presumably require an 80% Investment Policy under the Proposal.[15] As a concept, impact funds are built on the notion that the investments are having a positive impact on a certain market or demographic and/or reducing harm to the environment or society. This impact is measured over time. A sustainable portfolio may make an investment in a personal hygiene company on the basis that the company is transforming its products to be 100% sustainably sourced by 2030. This transformation does not only impact the company's products but also supports the development of new capabilities along its entire supply chain. In order to effect these changes, the company needs to invest in R&D to develop new formulations for its products and packaging, mobilize its entire

---

[11] Names Rule Adopting Release at fn 32 and accompanying text.

[12] Rule 35d-1(a)(2)(i); Rule 35d-1(a)(3)(i); and Rule 35d-1(a)(4)(i) and (ii). See also Names Rule Adopting Release ("The 'under normal circumstances' standard will provide funds with flexibility to manage their portfolios, while requiring that they would normally have to comply with the 80% investment requirement.").

[13] Specifically, the Proposal permits deviations that are: (i) as a result of market fluctuations, or other circumstances where the temporary departure is not caused by the fund's purchase or sale of a security or the fund's entering or exiting an investment, (ii) to address unusually large cash inflows or unusually large redemptions, (iii) to take a position in cash and cash equivalents or government securities to avoid a loss in response to adverse market, economic, political, or other conditions, or (iv) to reposition or liquidate a fund's assets in connection with a reorganization, to launch the fund, or when notice of a change in the 80% Investment Policy has been provided to fund shareholders at least 60 days before the change. Proposed Rule 35d-1(b)(i)-(iv).

[14] This challenge is exacerbated further by the "antithetical investments" provision of the Proposal which would appear to require an inverse evaluation of each investment (e.g., whether an investment is antithetical to "value" or "growth"), which is not the type of investment analysis that is performed by investment managers. See Proposal at 69. While we have always understood that the Names Rule was not a "safe harbor," we are concerned that the codification of the SEC's prior guidance on this point would discourage managers from utilizing the 20% of the fund not subject to the 80% Investment Policy for fear of inadvertently acquiring issuers "antithetical" to the fund name.

[15] For the purposes of this discussion, we are assuming "impact" is a term that indicates the fund's investment decisions incorporate one or more ESG factors.

supply chain to change the ingredients used, and adjust manufacturing processes to accommodate all of these changes. Key Performance Indicators ("KPIs") are set at time of investment and would be monitored throughout the investment time horizon (e.g., progress towards 100% sustainable sourcing by 2030). The work of an active manager is to monitor, through time, the company's success in this transition. There is, however, no way to, on a daily basis, objectively measure, monitor, and ensure the compliance of individual investments and define on an investment level what constitutes a positive impact. At Wellington Management, we assess whether issuers are having a positive impact based on an evaluation of KPIs annually, and in many cases, over multiple years.

We are also concerned with the potential unintended consequences of the prescribed minimum periods for bringing a portfolio back into compliance.[16] As a general matter, such a requirement would limit investors' ability to react to market conditions and make purchase and sale decisions in the best interest of fund shareholders, utilizing their investment judgment and subject to fiduciary principles. It is unclear how the proposed time frames will work with respect to potentially chronic or longer-term market situations. Presumably, funds responding to market changes with a widespread impact would be required to make the same corrective trades at approximately the same time, especially funds that use indices for compliance testing purposes. This could increase market instability and potentially drive down prices. Further to the negative market and investor consequences, forcing divestment within 30 days may be impossible or, more often, not in the best interests of fund shareholders.[17]

V. CONCLUSION

As described above, we are concerned that several aspects of the Commission's proposal—particularly in combination—could have significant adverse impacts on actively-managed funds and their shareholders. For the reasons set forth above, we urge the Commission to reconsider these elements of the Proposal. We appreciate the opportunity to comment, and if you have any questions or would like to discuss our comments, please contact Sara Martin at [redacted]

Sincerely,

/s/ Maureen Pettirossi

Maureen Pettirossi
Senior Managing Director and Director, Equity Boutiques

[16] See Proposal at 34 (30 days, or within 180 days for fund launches).

[17] We note that the Commission has, in other circumstances, considered rule amendments that would require funds to divest certain holdings, but has ultimately chosen to adopt more flexible frameworks, including those that require the adoption of plans subject to Board supervision. See, e.g., Investment Company Liquidity Risk Management Programs, SEC Rel. No. IC-32315 (at p 235) (noting that a requirement to sell illiquid assets could result in sales at significant discounts or fire sale prices); see also, Use of Derivatives by Registered Investment Companies and Business Development Companies, SEC Rel. No. IC-34084 (at p, 141) (noting that a requirement for the fund to come back into compliance "promptly" as opposed to within a limited number of business days was designed to avoid the potential for deeply discounted transactions).