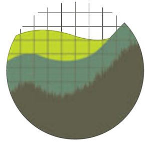

August 16, 2022

VIA ELECTRONIC SUBMISSION

Attn: Secretary Vanessa Countryman

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

The Institute for Policy Integrity (Policy Integrity) at New York University School of Law respectfully submits the following comments to the Securities and Exchange Commission (SEC) regarding its proposal to update the Names Rule (Proposed Rule).[1] Policy Integrity is a non-partisan think tank dedicated to improving the quality of government decisionmaking through advocacy and scholarship in the fields of administrative law, economics, and public policy.[2]

Our comments focus on the Economic Analysis for the Proposed Rule. We commend the SEC for conducting a preliminary analysis that is consistent with relevant case law, and we suggest additions and minor revisions that would strengthen the final version. The Commission should consider:

- including any **relevant compliance cost data** from its PRA Analysis in its Economic Analysis and **explaining** whether the PRA totals represent the incremental costs of the Proposed Rule;
- **expressly concluding** that benefits justify the costs, for each element of the Proposed Rule;
- incorporating the **relevant economic baseline** more directly into its assessment of costs and benefits;
- **contextualizing** the Proposed Rule's costs by comparing them to **current Names Rule expenditures**; and
- **providing further explanation** in support of some of its cost estimates.

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[1] *See* Sec. & Exch. Comm'n, Investment Company Names, 87 Fed. Reg. 36,594 (June 17, 2022) [hereinafter "Proposed Rule"].

[2] These comments do not purport to represent the views, if any, of New York University School of Law.

I. The SEC should consider including any relevant compliance cost data from its PRA Analysis in its Economic Analysis and explaining whether the PRA totals represent the incremental costs of the Proposed Rule.

The SEC's Paperwork Reduction Act (PRA) Analysis contains explicit cost estimates of the "collection of information burdens," of the Proposed Rule.[3] However, this analysis may be both too broad and too narrow. The SEC should consider integrating any relevant compliance cost data from its PRA Analysis into the body of its Economic Analysis and explaining, for each item, whether the PRA totals underestimate or overestimate the full incremental costs of the Proposed Rule.

Under the PRA, the burden of information collection is the "total time, effort or financial resources" associated with "generat[ing], maintain[ing], disclos[ing] or provid[ing] information to or for a Federal agency."[4] Costs that persons incur "in the normal course of their activities" may be excluded from this estimated burden only if the agency can show that the activities required for compliance are "usual and customary."[5] As a result, in certain areas, the PRA Analysis might overestimate the marginal cost of the Proposed Rule because it does not take into account the status quo costs that certain funds already incur voluntarily.[6] These could include, for example, voluntary recordkeeping practices or prospectus disclosures.[7]

At the same time, the PRA Analysis may also underestimate certain costs because it covers only the costs of information collection and not other compliance costs.[8] For this reason, the Commission should consider systematically integrating the PRA Analysis figures into its Economic Analysis and explaining their relationship to the incremental costs of the Proposed Rule.

II. For each element of the Proposed Rule, the Commission should consider expressly concluding that benefits justify the costs.

In general, we suggest that the Commission supplement its analysis with a side-by-side comparison of the costs and benefits associated with each element of the Proposed Rule, relative to the economic baseline. Although a simple numerical comparison of the Proposed Rule's costs and benefits is not practicable given that many important effects are unquantifiable, there are

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[3] Proposed Rule, *supra* note 1, at 36,632.

[4] 5 C.F.R. § 1320.3(b)(1).

[5] *Id.* § 1320.3(b)(2).

[6] *See infra* Section III.A; *see also* Proposed Rule, *supra* note 1, at 36,629 n.222 ("the PRA estimates likely overestimate the costs associated with the proposed amendments for those funds whose disclosure is currently in line with the disclosure the amendments would require."). Incorporating similar discussions for other provisions of the Proposed Rule and, where possible, providing estimates of funds that are already compliant, would strengthen the Commission's analysis.

[7] *See infra* Section III.A.

[8] *See* Proposed Rule, *supra* note 1, at 36,629–30 (treating the information collection costs that are estimated in the PRA analysis as separate from other costs, such as staff training costs).

other ways the Commission could enhance the clarity and accessibility of its analysis. The Commission should consider, for each proposed requirement, aggregating in a single place—such as a two-column table—all the available information on the requirement's expected costs and benefits, including the unquantified investor protection, efficiency, competition, and capital formation-related benefits, and expressly concluding that each requirement is net beneficial. This would help the public understand why the Commission believes that the benefits of each requirement, and the overall benefits of the Proposed Rule, justify the associated costs.

III. The SEC should consider incorporating the relevant economic baseline more directly into its analysis of costs and benefits.

The baseline in an Economic Analysis lays out "how the world would look in the absence of the proposed action."[9] This includes, for example, "the existing regulatory structure" and "economic attributes" of the market.[10] Throughout the preamble, the SEC assesses how the Proposed Rule differs from the status quo in terms of regulatory structure and current market practices. The SEC should better explain how these baseline conditions affect its assessment of the incremental costs and benefits of the Proposed Rule. Specifically, the SEC should consider: (a) clarifying how voluntary baseline practices may affect the Proposed Rule's anticipated costs and benefits, particularly regarding proposed recordkeeping requirements; and (b) examining the costs and benefits of the Proposed Rule's revisions to the temporary departure provisions of the Names Rule with a clear reference to the status quo regulatory baseline.

A. The SEC should more clearly describe the extent to which voluntary baseline practices can be expected to reduce the incremental costs and benefits of the Proposed Rule.

The SEC acknowledges that a substantial percentage of funds are already in partial compliance with the Proposed Rule due to internal investment policies that go beyond the requirements of the existing Names Rule. In addition, the SEC expects that many funds already keep records that would fulfill the proposed recordkeeping requirements. The Commission could, however, more clearly estimate the extent to which the existence of these voluntary policies in the baseline scenario can be expected to reduce the incremental costs and benefits of the Proposed Rule. We encourage the SEC to more carefully distinguish its estimates from the PRA Analysis with the anticipated real-world costs, compared to the status quo.

The Commission estimates that 62% of funds are subject to an 80% investment policy requirement under the current Names Rule, and that 75% of funds would be subject to such a requirement under the Proposed Rule.[11] The SEC further estimates that, despite only 62% of funds being subject to the 80% requirement, 69% of funds already have investment policies that align with such a requirement,[12] and 84% of funds have investment policies that specify at least

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[9] Memorandum from RSFI and OGC to Staff of the Rulewriting Divisions and Offices on Current Guidance on Economic Analysis in SEC Rulemakings at 6 (March 16, 2012), https://perma.cc/S35K-QQ7V.

[10] *Id.* at 6–7.

[11] Proposed Rule, *supra* note 1, at 36,627.

[12] *Id.* at 36,623.

some minimum percentage of investments.[13] In other words, as the SEC points out, "more funds have minimum investment policies than are required to do so under the current names rule."[14] Given these figures, the baseline for funds affected by the new 80% requirement should be 75% of funds less the 62% of funds that are covered by the existing rule (13% of funds), less the funds that are voluntarily complying. Since an additional 7% of funds have an investing policy with an 80% requirement—even though they are not covered by the current rule—the baseline number of funds affected by the new 80% requirement may be as low as 6%.[15] The SEC does mention that many funds that would be newly covered by the rule may already be compliant,[16] but it would be helpful for the SEC to estimate how many funds would actually be newly affected, and to compare this to the assumptions in the PRA Analysis.

The importance of connecting the economic baseline to the discussion of costs and the PRA Analysis is perhaps most clear in the context of recordkeeping compliance costs.[17] The SEC's PRA Analysis estimates that the new recordkeeping requirements for funds subject to the 80% requirement will carry annual costs of $185,013,200 in internal time costs and $5,155,424 in external costs.[18] The SEC estimates 10,394 funds (75% of funds) will face these full recordkeeping costs, while the remaining 25% will face lower costs.[19] Earlier in the Proposed Rule, however, the SEC explains that:

> [T]he compliance burden of the new recordkeeping requirements would be *incremental* for a fund that is currently required to adopt an 80% investment policy. Funds that are subject to the current names rule likely keep such records, even absent the proposed requirement to do so, in order to support their ongoing compliance with the rule's requirements.[20]

Similarly, in its Economic Analysis, the SEC notes that it "believe[s] funds with names that would be newly scoped into the names rule's 80% investment policy requirement under the proposed amendments already have systems in place for monitoring compliance with existing principal investment strategy disclosure requirements."[21]

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[13] *Id.*

[14] *Id.* at 36,626.

[15] It is, of course, possible that some funds that are voluntarily complying with an 80% requirement would *not* be covered by the new rule. Thus, this is a minimum estimate.

[16] *See* Proposed Rule, *supra* note 1, at 36,623; *see also id.* at 36,626–27 (explaining that many funds already have minimum percentage investment policies and quantifying the number of funds that would be subject to the Proposed Rule, but failing to quantify how many of those funds are already voluntarily complaint).

[17] *Id.* at 36,633 tbl.1.

[18] *Id.*

[19] *Id.*

[20] *Id.* at 36,619 (emphasis added).

[21] *Id.* at 36,627.

In other words, the SEC seems to suggest that—for the vast majority of affected funds—the increase in recordkeeping costs will actually be quite small. As discussed above, while it may be appropriate to discuss the full paperwork burden in the PRA Analysis,[22] the Economic Analysis should discuss the costs of the Proposed Rule as compared to the relevant economic baseline. For example, if we very conservatively assume that only half of affected funds have a recordkeeping system in place, and that those funds can reduce their compliance costs by 90% (relative to a fund that has to create a recordkeeping system from scratch), the total recordkeeping costs would be $83 million (or 45%) lower than those estimated in the PRA Analysis.[23]

Accordingly, the SEC should consider more clearly explaining how the incremental costs of the Proposed Rule compare to those that funds could expect to incur under the status quo. The comments that the SEC receives regarding Question 89—which inquires as to existing recordkeeping processes at funds subject to the 80% requirement—should inform this analysis.[24] If possible, the SEC could also consider gathering information specifically on recordkeeping practices at firms that are not subject to the existing 80% requirement, but that would be under the Proposed Rule.

Consistent with the above, the SEC should also consider discussing the benefits of a formal recordkeeping requirement as compared to the baseline informal recordkeeping systems. This is particularly true, given that the SEC is "not prescribing a particular form of documentation" so the benefits of a formal requirement may be less immediately clear.[25] For example, it may be the case that the SEC has found that the current informal recordkeeping practices lead to challenges in pursuing enforcement actions, or that formal recordkeeping requirements would interface well with the new proposed prospectus disclosures. The SEC discusses some of these possible factors when reviewing the benefits of the proposed Form N-PORT disclosures, and could consider including them in the recordkeeping section, as well.[26]

B. The SEC should consider examining the costs and benefits of the proposed temporary departure provisions with a clear reference to the status quo regulatory baseline.

The SEC describes the current principles-based approach to temporary departures in the preamble to the Proposed Rule,[27] but should consider carrying this discussion more explicitly into its assessment of costs and benefits.

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[22] *See supra* Section I; *see also* 5 C.F.R. § 1302.3(b).

[23] $185,000,000 x 50% of funds + $185,000,000 x 50% of funds x 10% compliance costs = $102,000,000, which is $83,000,000 less than $185,000,000.

[24] Proposed Rule, *supra* note 1, at 36,619.

[25] *Id.* at 36,626.

[26] *Id.* at 36,625.

[27] *Id.* at 36,602–03, 36,623.

Under the current Names Rule, affected funds may not deviate from the 80% requirement "under normal circumstances."[28] The Proposed Rule uses a more rules-based approach that allows temporary deviations only in four defined scenarios.[29] Under the Proposed Rule, when a fund deviates from the 80% requirement, it must come back into compliance as soon as "reasonably practicable" and, in all cases, within thirty days.[30] The SEC gives clear reasoning for why it is moving to a more rules-based approach.[31] The Commission also clarifies that the listed circumstances, "generally reflect prior Commission statements regarding some circumstances in which departures from the 80% investment requirement would be appropriate under the current rule."[32] This suggests that the proposed changes may not be a significant departure from the status quo.

In the Economic Analysis, the SEC properly discusses the benefits of the proposed temporary departure provision, as it compares to the current rule. It explains, for example, how the rules-based approach adds flexibility for funds to deviate from the 80% requirement, when necessary, while also creating a rule that allows investors to align their expectations.[33] The SEC also correctly defines the scenarios in which the proposed temporary departure provision would lead to increased costs. In particular, the proposed provision:

> could create a cost for investors if there exist circumstances where departing from the 80% investment requirement would be beneficial to the fund and its shareholders, the proposed amendments would not allow a departure, and absent the proposed amendments, *an adviser would have characterized the circumstance as allowing a departure*.[34]

The SEC could further strengthen this analysis by drawing a conclusion about the comparative scope of departures that would be allowable under the current rule but not under the Proposed Rule, and vice versa. For example, the SEC could clarify whether the Proposed Rule covers "some," "most," or "nearly all" scenarios under the current rule. Having a clearer understanding of the difference between the baseline and the proposed limitations on adviser behavior would

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[28] 17 C.F.R. § 270.35d–1(a).

[29] Proposed Rule, *supra* note 1, at 36,602 ("(1) 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 into or exiting an investment; (2) to address unusually large cash inflows or unusually large redemptions; (3) 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 (4) 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 fund's 80% investment policy has been provided to fund shareholders at least 60 days before the change pursuant to the rule.").

[30] *Id*.

[31] *Id.* at 36,602–04

[32] *Id.* at 36,603 & n.69.

[33] *Id.* at 36,624.

[34] *Id.* at 36,627 (emphasis added).

strengthen the rule against critiques, such as Commissioner Peirce's, that the proposal "unduly constrain[s] advisers' ability to make decisions that are best for the funds they manage."[35]

IV. The SEC should consider contextualizing the Proposed Rule's costs by comparing them to the costs of compliance with the existing Names Rule.

In its PRA Analysis, the SEC compares the estimated paperwork burden of the Proposed Rule to the total paperwork burdens under the existing Names Rule, and the anticipated changes in paperwork burdens associated with each disclosure form, before and after the proposed revisions. The SEC could strengthen its Economic Analysis by including a similar comparison.

The costs of the Proposed Rule may seem large in isolation but be small relative to funds' other regulatory expenses or overall revenues. Expenses that seem significant to an individual may be insignificant to a fund or advisor. For example, from the PRA Analysis, the new Form N‑1A requirements increase the annual paperwork burden by 7.3%, the additions to Form N‑2 increase paperwork costs by less than 1%, and the additions to Form N-PORT increase costs by approximately 0.1%.[36]

The SEC could help the public contextualize the cost of the Proposed Rule by comparing it to funds' overall expenditures on disclosure and recordkeeping, or by projecting how the costs could affect a fund's overall valuation. For example, in the context of the SEC's climate risk disclosure proposal, Professor Shivaram Rajgopal, an expert in corporate accounting and auditing, contextualized the proposed policy's compliance costs by estimating their effects on a typical public company's market capitalization. He concluded that "the loss in market capitalization, if any, from compliance costs is too tiny for any outsider to detect."[37]

V. The SEC should consider adding additional support for some of its estimates.

There are a handful of places where certain estimates would benefit from further discussion and support. We encourage the SEC to provide further explanation of the following areas in its final analysis.

First, in its Economic Analysis, the SEC estimates that the per-fund compliance costs of the Proposed Rule will range from \$50,000 to \$500,000.[38] The SEC should consider explaining how it arrived at this estimate and whether the estimate accounts for the voluntary baseline practices discussed in Section III.A.

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[35] Comm'r Hester M. Peirce, *Statement on Investment Company Names*, SEC. & EXCH. COMM'N (May 25, 2022), https://www.sec.gov/news/statement/peirce-fund-names-statement-052522.

[36] Proposed Rule, *supra* note 1, at 36,635 tbl. 2, 36,636 tbl. 3, 36,639 tbl. 6.

[37] Shivaram Rajgopal, Comment Letter on Proposed Rule on the Enhancement and Standardization of Climate-Related Disclosures for Investors 3 (June 12, 2022), https://perma.cc/DJ72-25TH.

[38] Proposed Rule, *supra* note 1, at 36,629–30.

Second, the SEC explains in a footnote that fund families may be able to share costs of the Proposed Rule, particularly when considering fixed costs.[39] The SEC should consider identifying how many unique fund families may be affected by the rule and by what order of magnitude pooling these fixed costs could reduce overall compliance burdens.

Third, in its PRA Analysis, the SEC estimates that setting up the recordkeeping requirements will take 9 hours and that subsequent recordkeeping will "be largely automated."[40] However, the SEC then assumes an annual ongoing burden of 50 hours of work by a compliance attorney and senior programmer.[41] It could be helpful for the SEC to incorporate additional detail explaining this discrepancy in the PRA Analysis and the Economic Analysis.

Respectfully,

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[39] *Id.* at 36,630 n.233.

[40] *Id.* at 36,634 n.8.

[41] *Id.* at 36,633 tbl.1.