



August 16, 2022

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

VIA Electronic Filing

Re: Investment Company Names (File Number S7-16-22)

Dear Chair Gensler,

The Center for American Progress¹ (CAP) is pleased to submit its comments on the Securities and Exchange Commission's (SEC or the Commission) proposed rule on "Investment Company Names" (the proposal or the proposed rule).² The proposed rule amends an earlier rule finalized by the Commission in 2001 (the Fund Names Rule).³ All page references are to the Federal Register version of the proposal.

Since the Commission adopted the Fund Names Rule in 2001, the capital markets have experienced expanded digitization, internet-based marketing of securities, substantial growth in the number and diversity of retail investors, and many other changes that have accelerated and increased the complexity of capital markets investing even as trading itself can be accomplished with ever greater speed and ease. Meanwhile, as the proposal points out,⁴ new types of funds such as exchange-traded funds, funds of funds, and passive management funds that claim to replicate the return on a particular index have proliferated. And funds that suggest an investment focus in companies that meet environmental, social, and governance (ESG) standards are growing rapidly to meet investor demand.

These new developments arguably make the naming of funds even more important today as fund names instantly reach significantly more investors, many of whom may be new to and inexperienced at trading. As Congress recognized when it authorized the Commission to address potentially misleading investment company names, investors may focus on an

¹ The Center for American Progress is an independent, nonpartisan policy institute that is dedicated to improving the lives of all Americans through bold, progressive ideas, as well as strong leadership and concerted action.

² Securities and Exchange Commission, "Investment Company Names," 87 Fed. Reg. 36594 (June 17, 2022), available at <https://www.federalregister.gov/documents/2022/06/17/2022-11742/investment-company-names>.

³ SEC, "Investment Company Names," 66 Fed. Reg. 8509 (February 1, 2001), available at <https://www.govinfo.gov/content/pkg/FR-2001-02-01/pdf/01-1967.pdf>; 15 U.S.C. § 80a-34(d), available at <https://www.law.cornell.edu/uscode/text/15/80a-34>.

⁴ Proposal at pp.36596-36597.

investment company's name to determine the company's investments and risks,⁵ and the current environment makes that even more likely.

Investment companies recognize the power in a fund's name. The investing environment described above creates strong incentives for investment companies to name funds in ways that will attract investors, and, as Commissioner Hester Peirce has pointed out, some funds may be offering products with specific names because it is lucrative to do so⁶—the name may attract investor interest or enable the firm to charge higher fees—while the investments in the fund may not match the name or investors' expectations.

We agree with the Commission's approach to this problem—enhancing and modernizing the Fund Names rule—and recommend only modest amendments. Accordingly, we encourage the SEC to expeditiously finalize this proposal.

The amendments to the 80 Percent investment policy requirement are important and logical for both investors and investment companies

The Commission's modification of the 80 percent investment policy requirement includes expanding when the requirements should be applied and how assets are considered for purposes of the requirement. We generally agree with this approach.

The Commission's expansion of fund names that would be subject to the 80 percent requirement, from names that focus on a particular type of investment or industry to those that suggest that the fund focuses on investments that have, or whose issuers have, particular characteristics,⁷ is exactly what is needed to protect investors today and is an entirely logical step to ensure that investment companies cannot circumvent the intent of the rule when naming funds.

The Commission has provided several examples that are very helpful in understanding its meaning in referring to funds whose investments have, or whose issuers have, particular characteristics. For example, it has specified how the rule expansion could permissibly be interpreted in the case of a fund name that suggests multiple characteristics.⁸

While the media and others have focused on the use of ESG-related terms in a fund name—an understandable result of growing data on how climate, diversity, and other ESG issues impact an issuer's profitability and resilience—the Commission has wisely expanded the rule to any situation where a fund name suggests that the fund focuses on investments that have, or whose issuers have, particular characteristics, for example, where a fund name uses terms like “growth,” “value,” or “income.”

Although all investment companies are subject to Section 35(d)'s prohibition on fund names that are materially misleading or deceptive and are subject to the federal securities laws' anti-fraud provisions, it is clear that more specificity is needed from the Commission

⁵ See Investment Company Names (2001), citing S. Rep. No. 293, 104th Cong., 2d Sess. 8-9 (1996).

⁶ See Commissioner Hester M. Peirce, “Statement on the Staff ESG Risk Alert,” US Securities and Exchange Commission, April 12, 2021, available at <https://www.sec.gov/news/public-statement/peirce-statement-staff-esg-risk-alert>.

⁷ Proposal at p.36597.

⁸ Proposal at p.36600.

with respect to fund names that suggest a focus on investments with, or investments whose issuers have, a particular characteristic—and we believe that this proposed expansion of the fund names rule will go far toward closing the gap between fund names and investors’ reasonable expectations and assumptions based on a fund’s name.

The proposed rule is equally and appropriately clear that it does not apply to names that do not connote an investment focus, such as those that reference the fund’s portfolio as a whole or a non-specific investment thesis.⁹

The proposed rule’s new limits on temporary departures from the 80 percent investment requirement also represent an important step.¹⁰ This brings the rule in line with investor’s expectations and investment practices, which often assume that investments in a fund will remain consistent with the name over the longer term. Investors who wish to change their own mix of investments typically do so by changing funds. Moreover, this key aspect of the rule establishes guardrails around a fund’s use of names to attract investors, preventing them from doing so disingenuously or later abandoning those characteristics while retaining the name.

An important aspect of the proposal is that it would require investment companies to disclose on Form N-PORT information about their compliance with the Fund Names Rule.¹¹ In particular, the requirement that this reporting separately indicate with respect to each portfolio investment whether the investment is included in the fund’s 80 percent basket would be beneficial for investors and other market participants.¹²

The application of the 80 percent rule to derivatives is appropriate but may need further clarification

The Commission has appropriately provided more clarification on the inclusion of derivatives for purposes of the 80 percent policy requirement. As the Commission points out, the use of derivatives in funds has increased dramatically since the creation of the Fund Names Rule, and derivatives can serve an important role in investment funds, particularly with respect to balancing or offsetting risks.¹³

We generally agree with the proposal’s attempt to ensure that the valuation of derivatives for purposes of inclusion in the 80 percent basket reflects exposure, since exposure is likely what investors assume a fund name reflects. We also appreciate that the proposal attempts to provide a clear rule—that notional value should be used for most derivatives—while also adjusting for accuracy in reflecting exposure. For example, we agree that options should be included at delta-adjusted notional values and interest rate swaps at notional but 10-year bond equivalent values.¹⁴

At the same time, we encourage the Commission to consider further adjustments in the final rule. For example, it seems more appropriate to include total return swaps at their

⁹ Proposal at p.36599.

¹⁰ Proposal at p.36602.

¹¹ Proposal at p.36598.

¹² Proposal at p.36598.

¹³ Proposal at p.36624.

¹⁴ Proposal at p.36606.

net notional value. In addition, we encourage the Commission to add an anti-evasion provision to avoid situations where a fund could use derivative notional values to inaccurately suggest that the fund’s economic exposures fall into or out of the 80 percent divide. For example, it could be misleading to investors if a fund markets itself as a “climate” fund, but its compliance with the 80 percent requirement depends upon the high notional value of a derivative position. Accordingly, if a fund’s compliance with the 80 percent rule hinges upon the notional value of a single or small number of derivative positions, the fund should be required to explain why the fund has determined that the positions are appropriate and not misleading. There may be other adjustments that make sense for purposes of reflecting a fund’s exposure.

The proposal’s additional guidance on ESG terminology is particularly important to protect investors

Although the proposal expands the Fund Names Rule to a range of funds whose names suggest that they focus on investments that have, or whose issuers have, particular characteristics, the proposal appropriately provides additional specificity around the use of ESG terminology in fund names by identifying when the use of ESG terminology in a fund name will automatically be considered materially deceptive and misleading.¹⁵

This additional guidance on the use of ESG terminology is important. There is more variability in investors’ understanding of what many ESG terms mean than with terms like “growth” or “global” because the use of ESG terms is relatively new and their use often is not tied to specific information about their meaning.

Thus, the Commission helpfully identifies a baseline case in which the use of ESG terminology in the fund name would be materially deceptive and misleading—a so-called “integration fund” whose name includes terms indicating that the fund’s investment decisions incorporate one or more ESG factors but where the identified ESG factors are considered alongside other, non-ESG factors and are generally no more significant than the other factors in the investment selection process.¹⁶

When an investor sees an ESG term in a fund name, they expect much more than this baseline consideration of ESG factors, and we are relieved that the Commission’s proposal clarifies this fact. If ESG factors are not central to how a fund operates, then ESG terminology should not be in the fund name.

This provision, when combined with the expanded 80 percent requirement, the provision requiring investment companies to disclose the meaning of ESG and other “characteristics” used in a fund name in their prospectus, and the requirement that registered investment companies report on Form N-PORT their compliance with the Fund Names Rule—including separately identifying with respect to each investment whether it is included in the 80 percent basket—would provide significant protection to investors while allowing flexibility for investment companies.

¹⁵ Proposal at p.36613-36615; Qs 63-65.

¹⁶ Proposal at p.36613.

Finally, CAP has encouraged the Commission to require investment advisers to disclose their policies and procedures with respect to ESG investing.¹⁷ The proposal would begin to implement this recommendation with respect to funds that investment companies choose to identify as ESG focused, which is an important step forward for investors.

Conclusion

The Fund Names Rule urgently needs modernization, given the pace and nature of the changes in the market today—change that is likely to accelerate as investment companies seek to attract investors interested in investments with particular characteristics, such as ESG-related factors. While investors should research their investments, fund names are the entry point. And no one can blame investors for relying on fund names when faced with a proliferation of funds and information that is as inadequate as it is overwhelming. We encourage the Commission to finalize and implement this proposed rule as quickly as possible for the protection of investors.

Sincerely,

Center for American Progress

¹⁷ See, e.g., Tyler Gellasch and Alexandra Thornton, “Modernizing the Social Contract With Investment Fiduciaries,” Center for American Progress, November 18, 2020, available at <https://www.americanprogress.org/article/modernizing-social-contract-investment-fiduciaries/>.