August 16, 2022

Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Investment Company Names (File No. S7-16-22, RIN 3235-AM72); 87 Fed. Reg. 36,594 (Jun. 17, 2022)

Dear Ms. Countryman:

Better Markets[1] appreciates the opportunity to comment on the above-captioned Proposed Rule ("Proposal" or "Release")[2] which would amend Rule 35-1, the "Names Rule," to expand the scope of the existing 80% investment policy requirement and provide enhanced disclosures to investors. The Names Rule currently requires funds with certain names to adopt a policy to invest 80 percent of their assets in the investments suggested by that name. The Proposal, if adopted, would make several amendments to the Names Rule to better ensure the name of a registered investment company or business development company (BDC) is not materially deceptive or misleading. Specifically, the Proposal expands the scope of the 80% investment policy requirement to include fund names that incorporate terms suggesting a particular focus in investments that have particular characteristics, such as "growth," "value," or one or more environmental, social, or governance (ESG) factors.

The Proposal appropriately seeks to modernize the Names Rule, which has not been revisited since its implementation in 2001. While growth in the funds industry has been dramatic over this period, the rules that govern the names of funds have been stagnant. This problem is particularly acute today with the increasing usage of terms such as "ESG" and "Sustainable" in

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1 Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system that protects and promotes Americans' jobs, savings, retirements, and more.

2 Investment Company Names, 87 Fed. Reg. 36,594 (June 17, 2022).

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fund names, which can lead to hundreds of millions of dollars in net flow for a fund with little or no changes to the fund's investment holdings.

BACKGROUND

The mere naming of an investment fund can have an enormous impact on the amount of money a fund can attract from investors. Consider this example: The *Impact US Equity Fund*, the *Advantage ESG US Equity Fund*, the *Sustainable Advantage Large Cap Core Fund*, one fund with three names over six years and a difference of hundreds of millions of dollars in assets under management. This is the story of one of BlackRock's largest actively-managed sustainable-branded US equity mutual funds. Originally launched in 2015,[3] BlackRock's *Impact US Equity Fund* averaged annualized returns of roughly thirteen percent through November 2019, but net inflows totaled just $78 million.[4] In December 2019, BlackRock decided to rebrand the fund as the *Advantage ESG US Equity Fund* and the "money flowed in—$9.8 million in January 2020, $18.4 million a month later, and $13 million in March, according to Morningstar. By the end of November 2021, the fund had taken in a net $510.5 million."[5] Compared to the $78 million net flows the fund had taken in under the previous name, it clearly illustrated how lucrative a simple change in the name of a fund could be. BlackRock once again changed the name of the fund a year later to the *Sustainable Advantage Large Cap Core Fund*, "as part of a larger push to offer clients more actively managed products that incorporate ESG criteria and sustainability."[6] Today, the BlackRock *Sustainable Advantage Large Cap Core Fund* has more than $700 million in assets under management, reflecting yet further inflows following the latest name change.[7] This is just one example of the effect a name change can have on the redirection of capital in our markets.

Section 35(d) of the Investment Company Act regulates the use of names of registered investment companies and BDCs. Specifically, Section 35(d) states that "[i]t shall be unlawful for any registered investment company to adopt as a part of the name or title of such company…any word or words that the Commission finds are materially deceptive or misleading."[8] However, despite the express language in the Act, the Commission did not have delegated rulemaking authority to implement Section 35(d) by rule until congressional passage of the Securities Investment Promotion Act in 1996.[9] Among other provisions, the bill expressly delegated

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3 Press Release, BlackRock, BlackRock Launches Impact Equity Funds (Oct. 13, 2015), https://ir.blackrock.com/news-and-events/press-releases/press-releases-details/2015/BlackRock-Launches-Impact-Equity-Funds/default.aspx.

4 Silla Brush, *One Fund, Three Names and Lots of Questions for 'ESG'*, BLOOMBERG, July 25, 2022, How BlackRock Rebranded One 'Sustainable' Mutual Fund - Bloomberg.

5 *Id.*

6 Prospectus, BlackRock Sustainable Advantage Large Cap Core Fund (Dec. 1, 2021), https://www.sec.gov/Archives/edgar/data/844779/000119312521348764/d181350d497.htm.

7 BlackRock Sustainable Advantage Large Cap Core Fund, https://www.blackrock.com/us/individual/products/279570/blackrock-sustainable-advantage-large-cap-core-fund ($700.2 million in assets under management as of Aug. 8, 2022).

8 15 U.S.C. § 80a-34(d) (BDCs are subject to Section 35(d) through U.S.C. 80a-58).

9 *See* Securities Investment Promotion Act of 1996, Pub. L. No. 104-290 (1996).

rulemaking authority to the Commission to regulate investment company names that are materially deceptive or misleading.[10] Prior to enactment of the bill, the Commission had to go through the arduous process of finding a name that was materially deceptive or misleading, issuing an order to that effect, and obtaining a federal court order to enjoin use of such name.[11]

In response to this newly delegated authority, the Commission adopted Rule 35d-1, otherwise known as the "Names Rule," in 2001.[12] The Names Rule requires any registered investment company with a name that suggests a "focus on a particular type of investment (e.g. an investment company that calls itself the ABC Stock Fund, the XYZ Bond Fund, or the QRS U.S. Government Fund) to invest at least 80 percent of its assets in the type of investment suggested by its name."[13] Notably, the Names Rules also requires an investment company with a name that suggests a particular focus on investments in a particular country or geographic area, tax-exempt status, or industry, in addition to a particular type of investment, to adhere to the 80% investment policy requirement.[14] The Names Rules has continued to regulate the use of investment company names, unchanged since its adoption in 2001.

While the Names Rule has remained unchanged over the last 20 years, the funds industry has changed dramatically. In particular, the amount of money that registered investment companies manage has exploded. By the end of 2021, registered investment companies managed $34.5 trillion, almost five times the $7.2 trillion those companies managed back in 2001 when the Names Rule was adopted, as displayed in the figure below.[15] During this time period, there has also been a shift in the types of investment products that investors have invested in. For example, there were $7.1 trillion in total net assets in Exchange-Traded Funds ("ETFs") at the end of 2021 compared to only $83 billion invested in ETFs at the end of 2001.[16] Additionally, while the number of investment companies has remained largely unchanged since 2001, the number of ETFs has exploded from 102 investment companies to 2,690 in 2021.[17]

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10 Securities Investment Promotion Act of 1996 § 208, 15 U.S.C. § 34(d).

11 S. Rep. 104-293, at 8 (1996).

12 *See* Investment Company Names, 66 Fed. Reg. 8,509 (Feb. 1, 2001).

13 66 Fed. Reg. 8,509.

14 17 CFR § 270.35d-1.

15 Investment Company Institute, 2022 Investment Company Fact Book: A Review of Trends and Activities in the Investment Company Industry 22, https://www.icifactbook.org/pdf/2022_factbook.pdf.

16 *Id.*

17 *Id.* at 21.

Investment Company Total Net Assets by Type

Billions of dollars, year-end

	Mutual funds	ETFs	Closed-end funds[1]	UITs	Total[2]
2000	$6,956	$66	$150	$74	$7,245
2001	6,969	83	145	49	7,246
2002	6,380	102	161	36	6,680
2003	7,399	151	216	36	7,801
2004	8,093	228	255	37	8,614
2005	8,889	301	276	41	9,507
2006	10,395	423	299	50	11,167
2007	11,995	608	316	53	12,973
2008	9,616	531	185	29	10,360
2009	11,104	777	224	38	12,144
2010	11,825	992	239	51	13,107
2011	11,624	1,048	244	60	12,976
2012	13,046	1,337	265	72	14,720
2013	15,039	1,675	282	87	17,082
2014	15,867	1,975	292	101	18,234
2015	15,648	2,101	263	94	18,106
2016	16,342	2,525	265	85	19,216
2017	18,750	3,401	277	85	22,513
2018	17,698	3,371	252	70	21,391
2019	21,277	4,396	279	79	26,031
2020	23,883	5,449	282	78	29,692
2021	26,964	7,191	309	95	34,559

Part of the reason for the increased flow of assets into registered investment companies, namely mutual funds and ETFs, is the rise of environmental, social, and governance (ESG) investment strategies. ESG was first coined in 2006 in the Principles for Responsible Investment, which was an effort led by the United Nations and signed by a few dozen of the largest institutional investors and asset managers in the world to achieve long-term, sustainable investment returns by incorporating ESG factors into their investment strategies.[18] Since that time, investment managers and investors continue to manage and invest more and more assets into funds that focus on the ESG factors. For example, according to financial services firm Morningstar, assets in funds that claim to focus on ESG factors or sustainability reached $2.78 trillion in the first quarter of 2022, compared to the less than $1 trillion invested in those same funds in 2020.[19] The rate of investor assets flowing into these types of funds reflects the appetite of investors not only for reliable long-range financial returns but also for investment options that align with an investor's core values and beliefs. There is ample evidence that investors are increasingly taking ESG factors into account when making investment decisions. For example, a recent survey of investors found that 60 percent of all adults determined ESG ratings important when it came to investment decisions.[20]

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[18] Press Release, Secretary-General Launches 'Principles for Responsible Investment' Backed by World's Largest Investors, U.N. Press Release SG/2111-ECO/106 (Apr. 27, 2006).

[19] Dave Michaels, *SEC Is Investigating Goldman Sachs Over ESG Funds*, WALL ST. J. (June 10, 2022).

[20] Amanda Jacobson Snyder, *As SEC Closes In on ESG Rules for Funds, the Bulk of Frequent Investors Say They Value Such Standards*, MORNING CONSULT, July 12, 2022.

As investor demand has increased, financial services companies have ramped up their own use of ESG factors in their product offerings to respond to increasing demand. While this market reaction to offer products to investors that are in high demand is understandable, it also can create its own problems and perverse incentives for companies to deceive and mislead investors by including attractive buzzwords in the names of their funds, such as "ESG" or "Sustainable," even if the underlying investment strategy is not what the name suggests. This practice of false or misleading representation of environmentally beneficial or conscience products and practices by companies has become so prevalent that it even has its own label – "greenwashing."[21] From 2019 to 2021, "at least 65 US funds at a range of asset management companies were repurposed as 'sustainable,'" according to data from Morningstar Inc.[22]

In addition to investor demand for these products, another reason for the rise of ESG funds is that funds can often charge higher fees for funds focused on ESG or sustainability. According to Bloomberg, "investors pay on average 15 times more" for ESG funds, despite many of those funds investing in a similar manner as non-ESG funds.[23] Perhaps that is why some of the largest asset management companies, such as BlackRock, have advocated to the Commission that "terms such as 'ESG' and 'sustainable' in fund names should not be included in the Names Rule."[24] If they had their way, these companies would continue to attract net flows of capital to their funds simply by changing their names to include terms such as "ESG" or "Sustainable," as was so lucratively illustrated by the example of BlackRock's *Sustainable Advantage Large Cap Fund*– which includes Exxon Mobil Corp amongst its top ten holdings, the largest oil and gas company in the U.S..

OVERVIEW OF THE PROPOSAL

The Commission has proposed amendments to Rule 35d-1, the Names Rule, which ensures the name of a registered investment company or BDC[25] accurately illustrates a fund's investment strategy. The Proposal includes several amendments including but not limited to expanding the scope of the rule, clarifying and limiting permissible temporary departures from the rule, specifying a valuation methodology for derivatives and ESG terminology, enhancing prospectus disclosures, and modernizing notice requirements.

Expanding the Scope of the 80% Investment Policy

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[21] Eric L. Lane, *Greenwashing 2.0*, 38 COLUM. J. OF ENVTL L. 279, 282 (2013).

[22] Silla Brush, *One Fund, Three Names and Lots of Questions for 'ESG'*, BLOOMBERG (July 25, 2022), How BlackRock Rebranded One 'Sustainable' Mutual Fund - Bloomberg.

[23] Rachel Evans, *How Socially Responsible Investing Lost Its Soul*, BLOOMBERG BUSINESSWEEK (Dec. 18, 2018), https://www.bloomberg.com/news/articles/2018-12-18/exxon-great-marlboros-awesome-how-esg-investing-lost-its-way.

[24] Comment Letter, Deepa Damre Smith and Kate Fulton, Request for Comments on Fund Names (May 5. 2020), s70420-7153851-216451.pdf (sec.gov).

[25] The Proposal refers to registered investment funds and BDCs collectively as "funds."

The Proposal would expand the scope of funds subject to the 80% investment policy requirement to include funds whose name suggests a focus on particular characteristics. The Proposal specifically uses the example of funds that have terms such as "growth" or "value" in the name of the fund, or that indicate incorporation of one or more ESG factors in its investment selection process.

Limiting Temporary Departures from 80% Investment Policy

The Proposal would specify and restrict the circumstances when a fund may depart from the 80% investment policy to include changes resulting from: (1) market fluctuations; (2) unusually large inflows or redemptions; (3) investments in cash or cash-like securities in the face of adverse market conditions; and (4) the decision to alter, liquidate, or launch the fund. These temporary departures from the 80% investment policy requirement would need to be limited to 30 days, except in the case of reorganizations, fund launches (not to exceed 180 days), and alterations to the investment policy (60-day notice to shareholders required).

Specifying the Valuation of Derivatives

The Proposal would require funds to value any derivative investment using its notional amounts rather than its market value for purposes of determining compliance with the 80% investment policy.

Requiring Shareholder Votes for Altering the 80% Investment Policy for Unlisted Closed-End Funds and BDCs

The Proposal would restrict the ability of unlisted closed-end funds and BDCs to alter the 80% investment policy of a fund unless authorized by a majority vote of shareholders.

Clarifying that Compliance with an 80% Investment Policy is not a safe harbor

The Proposal would clarify that compliance with Rule 35d-1 is not a safe harbor from a potential violation of Section 35(d) of the Investment Company Act. Therefore, a fund name may be materially deceptive or misleading even if it complies with the 80% investment policy.

Enhancing Prospectus Disclosures and Plain English Requirements

The Proposal would require funds subject to the 80% investment policy to include relevant disclosures in their prospectuses regarding how the fund defines the terms used in the name. Additionally, the Proposal would require terms used by funds in their names to be consistent with the plain English meaning or established industry use of those terms.

Prohibiting Use of ESG Terminology

The Proposal would prohibit Integration Funds—funds that equally consider one or more ESG factors alongside non-ESG factors in their investment selection process—from including ESG terminology in their fund name.

Requiring Books and Records

The Proposal would require funds subject to the 80% investment policy to maintain certain books and records documents compliance with the 80% investment policy.

COMMENTS

I. The Proposal appropriately expands the scope of the 80% investment policy requirement, but should go further to protect investors.

Revisiting and modernizing the Names Rule is an overdue necessity in light of the dramatic transformation the fund industry has experienced in the past two decades since the rule was first adopted in 2001. The growth in the number of ETFs and funds focused on "ESG" and "Sustainable" investment strategies alone warrants Commission action to ensure investors are not being materially deceived or misled in violation of Section 35(d) of the Investment Company Act. The Proposal would appropriately expand the scope of the 80% investment policy requirement to funds that incorporate certain terms in their names suggesting they focus on certain types of investments, including terms such as "growth" or "value, or reference to one or more ESG factors.

The need for an updated rule is clear. When Congress passed the Securities Investment Promotion Act of 1996, which delegated rulemaking authority to the Commission to restrict materially deceptive and misleading fund names, it wisely recognized the power a fund name has on investor psyche. Specifically, Congress said "[w]hen making an investment decision, investors may focus on fund names to determine the fund's investment objective and level of risk."[26] Adopted in 2001, the Commission's Names Rule has helped protect investors from materially deceptive and misleading fund names for more than two decades. However, as highlighted above, the fund industry has drastically grown and evolved over this same time period. Modernization of the Names Rule is wholly appropriate given the changes in the fund industry and the two decades that have passed since it was originally implemented. The Proposal is a logical effort by the Commission to modernize the Names Rule to account for changing market trends, especially those that have emerged in the ESG investment landscape.

Some of the behavior we saw in the market prior to implementation of the Names Rule in 2001 has reemerged in the ESG investing landscape. For example, the practice of changing the name of a fund to reflect an emerging trend, which we are currently witnessing in the rise of ESG factors, is a practice we have seen before. A study conducted on a sample of 296 equity mutual funds that changed their names between April 1994 to July 2001, prior to implementation of the Names Rule, found funds that changed their name to reflect a current "hot style" would experience

[26] S. Rep. 104-293, at 8 (1996).

an abnormal increase in flow of 28%, despite no improvement in performance.[27] This type of behavior is eerily similar to what is happening with ESG focused funds today, as illustrated by the BlackRock fund mentioned earlier that experienced a net flow of $510.5 million the year after it introduced the term "ESG" into its fund name. By applying the Names Rule and the 80% investment policy requirement to funds that have incorporated one or more ESG factors into the name of the fund, the Commission will better protect investors from practices such as "greenwashing" by ensuring a fund's investments actually match up with its name.

Nevertheless, the Proposal can and should go further. Consistent with expanding the scope of the 80% investment policy requirement for funds whose names have particular characteristics, the Proposal should explicitly recognize funds with ***allocation designations*** in their name as being subject to the 80% investment policy requirement. For example, "XYZ 60/40 Target Allocation Fund" or "XYZ 80/20 Allocation Fund" are funds that invest assets according to a specific allocation between stocks and bonds. Hence, a 60/40 allocation fund would in theory invest 60% of its assets in stocks and 40% in bonds. A cursory review of listed funds on Morningstar reveals several dozen funds that include allocation matrixes in their fund names, including "MassMutual 60/40 Allocation I," "BlackRock 60/40 Target Allocation R," and "DFA Global Allocation 60/40 I." Funds that include this allocation strategy within the name of the fund, much like funds that use the terms "growth" or "value" in their names, "communicate to investors that the fund focuses its investments in a particular way."[28] Therefore, the Proposal should explicitly identify funds that include particular characteristics, including investment allocations, as falling squarely within the 80% investment policy requirement.

II. **The Proposal would strengthen shareholders' rights for investors in unlisted closed-ends funds and BDCs, but it should be strengthened even further.**

For those investors who invest in unlisted closed-end funds and BDCs that are subject to the 80% investment policy requirement, changing the fund's investment policy presents a unique set of issues. This is because investors in these types of funds generally have little recourse for exiting their positions if they disagree with the change in investment policy. Currently, unlisted closed-end funds and BDCs that seek to change their 80% investment policy must only provide their shareholders with a 60-day notice of the change in policy.[29] While this policy may be reasonable for more liquid funds, where the shareholders have the ability to transfer or sell their shares in the fund on a liquid secondary market for little or no loss, it is wholly unreasonable for investors in unlisted closed-end funds and BDCs because of their inability to exit their positions quickly and suffer a price downgrade. As the Proposal points out, "[a] shareholder in an unlisted closed-end fund or BDC generally will have no ready recourse, such as the ability to redeem or quickly sell their shares, if the fund were to change its investment policy and the investment focus that the fund's name indicates."[30] The Proposal seeks to remedy this untenable situation

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[27] Michael J. Cooper, Huseyin Gulen, and P. Raghavendra Rau, *Changing Names with Style: Mutual Fund Name Changes and Their Effects on Fund Flows*, 60 J. OF FIN. 2,825, 2,825 (Dec. 2005).

[28] Release at 36,598.

[29] Release at 36,610.

[30] Release at 36,610.

confronting investors in unlisted closed-end funds and BDCs by requiring a majority shareholder vote for changes in investment policy.[31] By strengthening the requirement for unlisted closed-end funds and BDCs to change their investment policy from a 60-day shareholder notice to a majority vote of shareholders, the Proposal empowers shareholders and thus helps cure a defect in the original Names Rule.

While the Proposal correctly cures one defect in current regulations for investors in unlisted closed-end funds and BDCs, it also creates a second that must be addressed. As previously mentioned, the Proposal would require a majority of shareholders to approve a change in investment policy at an unlisted closed-end fund or BDC. However, as a result of this change, there will almost always be a certain percentage of minority shareholders who did not vote to approve of the investment policy change yet are forced to keep their money invested in the fund due to an inability to sell or transfer their shares. The same reasoning offered by the Proposal for changing the current 60-day notice of change of investment policy to a majority shareholder vote, because investors "have no ready recourse, such as the ability to redeem or quickly sell their shares," will still apply to the minority of shareholders who disapprove of the change in investment policy. Therefore, consistent with the concerns cited by the Proposal for amending the Names Rules to require a majority vote for a change in investment policy, unlisted closed-end funds and BDCs should be required to offer to repurchase 100% of the shares of investors who voted to disapprove of the change in investment policy. This would enable investors who disapprove of the change in investment policy adequate recourse to exit their position in a fund they no longer wish to be invested in after such change. The Proposal indicates that this reform is at least under consideration, and we urge the Commission to adopt it.[32]

III. The Proposal appropriately provides that compliance with the investment policy requirement does not act as a safe harbor from violations of Section 35(d).

The Proposal capitalizes on the opportunity to codify that compliance with the 80% investment policy is not a safe harbor for compliance with Section 35(d) of the Investment Company Act. The release accompanying the original Names Rule adopted in 2001 clearly mentions that the "80% investment requirement is not intended to create a safe harbor for investment company names."[33] Despite its mention, it is not currently codified in existing regulations.[34] The Proposal appropriately recognizes that despite compliance with the 80% investment policy requirements, "a fund's name could be materially deceptive or misleading for purposes of Section 35(d)."[35] The Proposal reiterates the example first used in the 2001 rule that

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31 Release at 36,610.
32 Release at 36,610. Question #48 of the Proposal asks "…should we mandate that these funds must make an issuer tender offer or a repurchase offer when they change an 80% investment policy and are not already required to redeem their shares? Should we offer this as an alternative in the names rule to the proposed fundamental policy requirement? If so, how much should we require these funds to offer to repurchase, for example, 100% or some other percentage?"
33 66 Fed. Reg. 8,509, 8,511.
34 Release at 36,628.
35 Release at 36,610.

an index fund could still violate Section 35(d) even if it complied with the 80% investment policy requirement because the name may create an expectation that more than 80% of the fund would be invested in assets similar to the applicable index and not in assets that fall outside that group of stocks.[36]

Another example the Commission should explicitly recognize is when a fund focuses on a particular allocation in its fund name. For example, as discussed above, there are several funds with names such as the "XYZ 60/40 Allocation Fund" or "XYZ 80/20 Allocation Fund," which focus on maintaining a particular allocation between stocks and bonds in their investment strategy. Just as investors could reasonably expect a greater than 80% adherence to an index fund whose name suggests a particular investment focus that is similar to the applicable index, investors in a fund that prescribes a particular allocation of stocks and bonds could reasonably expect a greater than 80% adherence to those specific allocations. Yet funds labeled as the "XYZ 60/40 Allocation Fund" or "XYZ 80/20 Allocation Fund" could both invest closer to a 70/30 allocation while still being compliant with the 80% investment policy requirement or they could invest 20% of assets in alternatives. It is therefore critical to dispel the notion that compliance with the Names Rule is a safe harbor; continued application of the antifraud provisions remains an important component of this framework.

As mentioned previously, the fund industry has greatly expanded and evolved since the adoption of the Names Rule in 2001. As the fund industry continues to expand and evolve, it is important to maintain the Commission's statutorily delegated authority to identify materially deceptive and misleading investment company names. By clearly codifying that compliance with the Names Rule does not act as a safe harbor for violations of Section 35(d) of the Investment Company Act, the Commission maintains its enforcement authority to identify materially deceptive and misleading investment company names as the industry continues to evolve.

CONCLUSION

We hope these comments are helpful as the Commission finalizes the Proposal.

Sincerely,

Stephen W. Hall
Legal Director and Securities Specialist

Scott Farnin

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36 Release at 36,611; 66 Fed. Reg. 8,509, 8,511.

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