CFA Institute

915 East High Street
Charlottesville, VA
22902-4868 USA

+1 (434) 951 5499 tel
+1 (434) 951 5262 fax
info@cfainstitute.org
www.cfainstitute.org

5 May 2020

Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File Number S7-04-20, Request for Comments on Fund Names

Dear Secretary:

CFA Institute[1] appreciates the opportunity to submit our comments to the Securities and Exchange Commission's ("SEC" or the "Commission") on its request for comment on *Fund Names* (the "Proposal). CFA Institute represents the views of those investment professionals who are its members before standard setters, regulatory authorities, and legislative bodies worldwide about issues affecting the practice of financial analysis and investment management, education and licensing requirements for investment professionals, and on issues affecting the efficiency, integrity and accountability of global financial markets.

Background

The Securities and Exchange Commission is seeking public comment on the framework for addressing names of registered investment companies and business development companies that are likely to mislead investors about a fund's investments and risks pursuant to section 35(d) of the Investment Company Act of 1940, Rule 35d-1[2] (the "Rule" or the "Names Rule") thereunder, and the antifraud provisions of the federal securities laws. The Commission is seeking public comment particularly in light of market and other developments since the adoption of the Rule in 2001.

Because of the importance of fund names to investors, and certain challenges regarding the application of the Rule, the SEC is seeking input on whether the existing Rule is effective in prohibiting funds from using names that are materially deceptive or misleading. It also is asking whether there are alternatives the Commission should consider.

The Commission proposed the Rule in February 1997 and adopted it in January 2001. In adopting it, the Commission cautioned against investors relying on a fund's name as the sole

---

[1] CFA Institute is a global, not-for-profit professional association of nearly 171,000 investment analysts, advisers, portfolio managers, and other investment professionals in 165 countries, of whom more than 164,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 154 member societies in 77 countries and territories.

[2] Rule 35d-1 that implements Sec. 35(d) of the Advisers Act is found at 17 CFR § 270.35d-1, Investment Company Names. See: https://www.law.cornell.edu/cfr/text/17/270.35d-1.

source of information about the fund's investments and risks, but recognized that "the name of an investment company may communicate a great deal to an investor." The final Rule requires a fund to invest at least 80 percent of its assets in the manner suggested by its name, whereas previously funds considering then-current staff guidance would typically select fund names based on a 65 percent threshold.

The Rule does not apply to fund names that describe a fund's investment objective, strategy, or policies.

The Rule has not been amended since its adoption in 2001 though since that time, staff and industry have identified a number of challenges regarding the application of the Rule.

CFA Institute Response:

In this response to the Proposal, CFA Institute will only answer those questions where we have sufficient expertise that we believe can be useful to the decision making of the Commission.

Questions:

How do funds select their names? Do funds use their names to market themselves to investors or convey information about their investments and risks?

CFA Institute believes that firms use fund names to both market themselves and to inform investors.

We do not believe most retail investors will make the distinction the Rule makes wherein a fund name is determined by the type of assets the fund holds as opposed to the strategies a fund may use when investing client assets. They are likely to conflate a fund's name with an indication of how a fund will invest their money.

Consequently, and regardless of the reasons for adopting a name, investment companies and the Commission need to be cognizant of the potential information fund names will convey to investors, whether that information is accurate or not. This is particularly true in the current issue with funds promoting ESG bona fides.

Is the Names Rule effective at preventing funds from using deceptive or misleading names? If it is not effective, should it be changed, and if so how?

The Rule's effectiveness is impaired, in part, because it does not apply to fund names that describe a fund's investment objective, strategy, or policies. CFA Institute believes fund names that use terms to describe these aspects of a fund to be as significant to investors as are terms that describe a fund's assets. Therefore, the Rule as currently constituted is not as effective as it might be.

Should the Names Rule be repealed?

CFA Institute believes the current rule provides some measure of investor protection and repealing the rule would result in lessen that protection. Moreover, if the Rule did not exist, investment companies would still be subject to anti-fraud provisions of the law for the names they use, and therefore would face potentially greater liability as the court system defines the issue over time. In that sense, the Rule provides an important benefit to the investment products industry by providing clarity and specificity to naming conventions for investment products that its omission would fail to provide.

The Names Rule does not apply to the use of terms that suggest an investment strategy (such as "growth" or "value"), rather than a type of investment. Often, funds assert that a name connotes a "strategy" not subject to the Names Rule when the term may appear to others as indicative of a type of investment. Should a strategy be differentiated from a type of investment and, if so, how? Should we amend the Names Rule to apply specifically to investment strategies (such as tax-sensitive, income, growth or value) and, if so, how?

CFA Institute does not believe that the Rule should be changed to include strategy considerations. If so, names of funds would have to include objective and strategy and it would have to be made clear to investors which is which.

As noted in the Proposal, a small investment in derivative instruments can have a significant effect on the performance and function of a fund portfolio. Such matters are particularly relevant as it relates to synthetic, leveraged, and inverse exchange-traded funds.

We believe the use of such instruments in not a matter of style or strategy when their use is more frequent than for occasional and tactical risk management purposes, or when the frequent, non-tactical use of such instruments creates exposures equal to or greater than one-third of the total exposures for all investment vehicles in the fund's portfolio. In those cases, funds' names should reflect this fact.

If a fund's investment strategy is not designed to maximize returns to investors, should that be noted in the name?

In general, funds are designed to maximize returns to investors subject to a set of constraints described in a fund's prospectus. Certain funds, however, offer investors the opportunity to achieve other objectives as well as financial returns. CFA Institute believes it is critical for investors to understand the prioritization of objectives when a fund has multiple objectives and that the priority of objectives would be best communicated in a disclosure rather than the fund name.

The staff has observed a number of challenges that funds face in applying the Names Rule and assessing whether certain terms in fund names comply with the rule. For example:

Should the Names Rule apply to terms such as "ESG" or "sustainable" that reflect certain qualitative characteristics of an investment? Are investors relying on these terms as indications

of the types of assets in which a fund invests or does not invest (e.g., investing only in companies that are carbon-neutral, or not investing in oil and gas companies or companies that provide substantial services to oil and gas companies)? Or are investors relying on these terms as indications of a strategy (e.g., investing with the objective of bringing value-enhancing governance, asset allocation or other changes to the operations of the underlying companies)? Or are investors relying on these terms as indications that the funds' objectives include non-economic objectives? Or are investor perceptions mixed among these alternatives or otherwise indeterminate?

As noted above, we do not believe most retail investors will make the distinction between a name reflecting the type of assets a fund holds and the strategies/styles a fund may use when investing clients' assets. They are likely to conflate a fund's name with an indication of how a fund will invest their money.

The terms "ESG" and "sustainable" are used by funds to describe objectives (economic and non-economic), types of assets in which a fund invests or does not invest (i.e., constraints), strategies, and characteristics of an investment. Likewise, investors interpret these terms in a variety of ways.

One of the main problems around ESG/Sustainable products is that individuals bring to them their own definitions of what ESG or Sustainable Investing. If someone is looking for an ESG fund and they see a title ESG or Sustainable, they are likely to project their own expectation of what that fund is onto the fund. Because these terms are used and interpreted in many ways, they are a source of confusion in the marketplace.

If investor perceptions are mixed or indeterminate, should the Names Rule impose specific requirements on when a particular investment may be characterized as ESG or sustainable and, if so, what should those requirements be? Should there be other limits on a fund's ability to characterize its investments as ESG or sustainable? For example, ESG (environmental, social, and governance) relates to three broad factors: Must a fund select investments that satisfy all three factors to use the "ESG" term?

CFA Institute believes that the Names Rule should not impose specific requirements for, or limitations on, the use of "ESG" and "sustainable." As noted earlier, these terms are used to described objectives, constraints, strategies, and characteristics of investments. If the Rule were to apply to these terms, it would require a significant expansion beyond its current scope. Furthermore, these terms are difficult to define with a technical precision that suits all applications.

Therefore, we believe it would be very difficult to devise a "bright line" test like the asset-based test that is currently in use. A fund name can only say so much, and regulation around fund names risks being too cumbersome to be useful. A fund name is just one short piece of information.

Instead of tying terms such as "ESG" in a fund's name to investments or investment strategies, should we instead require funds using these terms to explain to investors what they mean by the use of these terms?

We believe fund names are important, but especially in the case of the current challenges with funds that advertise themselves as "ESG" or "sustainable." We believe disclosures would be most helpful - regardless of whether the terms "ESG" or "sustainable" are used in the fund's name and regardless of whether the terms refer to objectives, constraints, strategies, and characteristics of investments.

Requiring funds to explain to investors what they mean by the use of these terms might be helpful. However, because funds use these terms in different ways, there is also the risk that investors trying to compare funds would end up even more confused. CFA Institute believes the best way to achieve transparency and comparability, and to protect investors, is to require funds to explain to investors how the terms "ESG" and "sustainability" relate to the fund's objectives, constraints, strategies, and characteristics of investments in a way that is both transparent and comparable.

CFA Institute is currently developing an industry standard for the classification and disclosure of ESG investment products. The purpose of the standard is to enable investment managers to better communicate the features and benefits of ESG investment products and to allow clients to better understand and compare ESG investment products with respect to objectives, constraints, methods (strategies), and holdings (assets), much like the CFA Institute Global Investment Performance Standards (GIPS®) enable transparency and comparability with respect to past performance.

CFA Institute selected 15 individual volunteers, from over 200 applicants, to serve on a working group whose purpose is to propose the structural elements of the standard and to seek public comment on the proposal. The members of the working group come from seven different countries, have deep ESG expertise, and bring experience as asset owners, investment managers, consultants, service providers, and standard setters. The Working Group aims to have a proposal out for consultation near the end of July 2020 and final recommendations near the end of the year. We expect an exposure draft of the standard to be released in the summer of 2021 and the final standard to be release in 2022.

Conclusion

The confusion around the terms "ESG" and "sustainability" warrants action to protect investors. We believe the best solution to the problem is a standard that enables transparency and comparability through disclosures, classification, standardization of terminology, and verification. We believe such a standard would reduce the amount of greenwashing that funds would be able to engage in, as they would have to disclosure and explain with more granularity their reasoning behind calling a fund an ESG or Sustainable fund.

We therefore invite the Commission to discuss this and other related matters further and will be happy to share the findings of our working group and our progress on our standard with the Commission when appropriate. Should you have any questions about our positions, please do not

hesitate to contact James Allen, CFA james.allen@cfainstitute.org, or Matt Orsagh at matt.orsagh@cfainstitute.

Sincerely,

/s/ Jim Allen

James Allen
Head, Capital Markets Policy
CFA Institute

/s/ Matt Orsagh

Matt Orsagh
Senior Director, Capital Markets Policy
CFA Institute