

MEMO# 32260

March 4, 2020

SEC Requests Comment on Funds Names with ESG Investing Strategy

[32260]

March 4, 2020 TO: ESG Task Force RE: SEC Requests Comment on Funds Names with ESG Investing Strategy

The Securities and Exchange Commission published a release seeking public comment on the framework for addressing potentially misleading names of registered investment companies and business development companies under section 35(d) of the Investment Company Act of 1940, rule 35d-1 thereunder (the “Names Rule”), and the antifraud provisions of the Federal securities laws.[\[1\]](#) The Release notes that the Commission is seeking public comment particularly in light of market and other developments since the adoption of the Names Rule in 2001. It also notes that the staff and the industry have identified a number of challenges regarding the application of the Names Rule since the rule’s adoption.

ICI will be submitting a letter responding to the request for comments. Comments are due to the SEC 60 days after publication in the *Federal Register*. This memorandum briefly describes the reason the Commission has taken this action and then describes the aspect of the Release that requests specific comment about funds with ESG-related investment strategies.

According to the Release, “[b]ecause of the importance of fund names to investors and certain challenges regarding the application of the Names Rule, the Commission is assessing whether the existing rule is effective in prohibiting funds from using names that are materially deceptive or misleading, and whether there are alternatives that the Commission should consider.”

The Release recites the history and intent of the Fund Names Rule and notes that “fund names remain a common area for staff comment as part of the disclosure review process.”[\[2\]](#)

The Release also notes that the Names Rule does not apply to the use of terms that suggest an investment strategy (such as “growth” or “value”) but does apply to a type of investment and asks whether an “investment strategy” should be differentiated from a “type of investment.” It notes that 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 and asks a series of related questions, including those set forth below.

- 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? 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 those requirements be?
- Should there be other limits on a fund’s ability to characterize its investments as ESG or sustainable? For example, ESG (environment, social, and governance) relates to three broad factors: must a fund select investments that satisfy all three factors to use the “ESG” term?
- For funds that currently treat “ESG” as a type of investment subject to the Names Rule, how do such funds determine whether a particular investment satisfies one or more “ESG” factors? Are these determinations reasonably consistent across funds that use similar names?
- Instead of tying terms such as “ESG” in a fund’s name to any particular 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?

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endnotes

[1] See SEC Release No. IC-33809 (March 2, 2020) (“Release”), *available at* <https://www.sec.gov/rules/other/2020/ic-33809.pdf>. The Release is a request for comment, not a rulemaking proposal. If, and to the extent that, the Commission determines to issue specific proposed amendments to the Names Rules, it would need to do so through a separate rulemaking proposal subject to public comment.

[2] Release at page 7.