Council of Institutional Investors®
The voice of corporate governance

Via Email

May 5, 2020

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

*Re: File Number S7-04-20*

Dear Madam Secretary:

I am writing on behalf of the Council of Institutional Investors, a nonprofit, nonpartisan association of U.S. public, corporate and union employee benefit funds, other employee benefit plans, state and local entities charged with investing public assets, and foundations and endowments with combined assets under management of approximately $4 trillion. Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers and their families, including public pension funds with more than 15 million participants – true "Main Street" investors through their pension funds. Our associate members include non-U.S. asset owners with about $4 trillion in assets, and a range of asset managers with more than $35 trillion in assets under management.[1]

The purpose of this letter is to respond to the Securities and Exchange Commission (SEC or Commission) request for comment (RFC) 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 thereunder, and the antifraud provisions of the Federal securities laws."[2] We offer the following comments on select issues raised by the RFC:

**Derivatives**

We agree with the SEC that "[c]omplying with the Names Rule (and its asset-based test)[[3]] may raise particular challenges for funds that gain exposure to a 'type of investment' . . . through the use

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[1] For more information about the Council of Institutional Investors ("CII"), including its board and members, please visit CII's website at http://www.cii.org.

[2] Request for Comments on Fund Names, Investment Company Act Release No. 33,809, 85 Fed. Reg. 13,221 (Mar. 26, 2020), *available at* https://www.federalregister.gov/documents/2020/03/06/2020-04573/request-for-comments-on-fund-names.

[3] Investment Company Names, 17 C.F.R. § 270.35d-1(a)(2)(i) (2001), *available at* https://www.law.cornell.edu/cfr/text/17/270.35d-1 ("The Fund has adopted a policy to invest, under normal

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of derivatives."[4] We disagree, however, with those funds "that . . . have asserted that a derivative's notional value would be more appropriate than its market value for purposes of complying with the 80 percent investment policy . . . ."[5]

We generally believe that valuing the financial assets of a fund at market or "fair value" for purposes of the Names Rule asset-based test is appropriate.[6] Measuring a fund's financial assets at fair value is superior to the use of notional amounts.[7] As recently described in *Barron's*, the use of notional amounts may "underestimate[s] the market exposure and economic impact" of derivatives.[8]

More specifically, fair value measurements are generally more accurate, timely, and comparable across different positions than alternative measurement attributes.[9] Fair values reflect current information about future cash flows and current risk-adjusted discount rates.[10] The comparability of fair values of different positions is particularly important in assessing the net value and risks of a fund's portfolio.[11]

**Environmental, Social, and Governance (ESG) & Sustainability**

We agree with the SEC staff that "the . . . number of funds . . . that include one or more environmental, social, and governance-oriented assessments or judgments in their investment mandates . . . is growing."[12] We also understand that the "staff has observed that some funds appear to treat terms such as 'ESG' as an investment strategy (to which the Names Rule does not

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circumstances, at least 80% of the value of its Assets in the particular type of investments, or in investments in the particular industry or industries, suggested by the Fund's name . . . .").

[4] 85 Fed. Reg. at 13,223.

[5] *Id.*

[6] *See, e.g.*, Stephen G. Ryan, Fair Value Accounting, Understanding Issues Raised by the Credit Crunch, CII 2 (July 2008), https://www.cii.org/files/publications/white_papers/07_11_08_fair_value_accounting.pdf ("The goal of fair value measurement is for firms to estimate as best as possible the prices at which the positions they currently hold would change hands in orderly transactions based on current information and conditions.").

[7] *Id.* at 1 ("The . . . relevant question is whether fair value . . . provides more useful information to investors than alternative accounting approaches [and] [t]he answer to that question is 'yes.'").

[8] Daren Fonda, SEC Cracks Down On Fund Names, Barron's, Mar. 6, 2020, https://www.barrons.com/articles/sec-cracks-down-on-fund-names-51583520632.

[9] *See, e.g.*, Stephen G. Ryan, Fair Value Accounting, Understanding Issues Raised by the Credit Crunch, CII at 1 ("It requires or permits companies to report amounts that are more accurate, timely, and comparable than the amounts that would be reported under existing alternative accounting approaches, even during extreme market conditions").

[10] *Id.* at 11 ("Fair values . . . reflect the expected future cash flows based on current information as well as current risk-adjusted discount rates for positions.").

[11] *Id.* at 15 ("The comparability of the fair values of different positions is particularly important in assessing the net value and risks of financial institutions' portfolios of financial instruments . . . .").

[12] 85 Fed. Reg. at 13,223; *see, e.g.*, OICU-IOSCO, Sustainable Finance and the Role of Securities Regulators and IOSCO Final Report 2 (Apr. 2020), https://www.iosco.org/library/pubdocs/pdf/IOSCOPD652.pdf ("In the last few years, investment instruments designed to be, or labeled as, sustainable have reached considerable volumes [and] [a]ccording to recent figures, these investments were in the range of 30 to 80 trillion US dollars in 2018, depending on definitions.").

apply) and accordingly does not impose an 80 percent investment policy, while others appear to treat 'ESG' as a type of investment (which is subject to the Names Rule)."[13]

We believe the current lack of a common understanding of ESG and "sustainable" investment products[14] makes it exceedingly difficult for the SEC to establish rules that would distinguish funds that use ESG or "sustainable" as an investment strategy versus those funds that treat those terms as a type of investment.[15] Moreover, as the RFC indicates, developing such rules would likely require addressing a number of difficult questions where investor views are currently "mixed . . . or otherwise indeterminate."[16]

Instead of tying ESG or "sustainable" in a fund's name to any particular investments or investment strategies, we believe the better approach is for the Commission to require *all* funds using those terms to explain to investors in its summary, and full length, prospectus what they mean by the use of the terms.[17] The explanation should include, at a minimum, how the terms relate to the objectives, strategies, risks, and outcomes of the fund and the characteristics of the fund's investments. We generally agree with the recent comments of Hortense Bioy, director of passive strategies and sustainability research at Morningstar:

> [I]t is key that funds are transparent . . . and that investors closely inspect the funds, including their holdings . . . . 'The reality is that there are many shades of green.'[18]

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Thank you for considering our views on this matter. Please contact me with any questions.

Sincerely,

Jeff Mahoney

Jeffrey P. Mahoney
General Counsel

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[13] 85 Fed. Reg. at 13,223.

[14] *See, e.g.*, OICU-IOSCO, Sustainable Finance and the Role of Securities Regulators and IOSCO Final Report at 24 ("Market participants report the lack of a common understanding of what is meant by sustainable investments and sustainability risks.").

[15] To be clear, we believe that various Environmental, Social, and Governance approaches may be legitimate. Some funds labeled "ESG" or "sustainable" do so in a way intended to reflect qualities of an investment; some funds pursue "ESG" or "sustainability" as a strategy, including those to bring about change; and some funds are a mixture of these approaches. We believe all these types can legitimately claim to be "ESG" or "sustainable" funds (depending of course on whether they actually do what they say).

[16] 85 Fed. Reg. at 13,224.

[17] *See id.* ("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?").

[18] Dieter Holger, As Funds Jump on the 'Sustainable' Bandwagon, Regulators Raise Concerns, Wall St. J., Apr. 5, 2020, https://www.wsj.com/articles/as-funds-jump-on-the-sustainable-bandwagon-regulators-raise-concerns-11586103274.