Names can be a beginning, yet they can only describe so much. To make investment decisions, an accurate description of the product is far more important than the name alone. It's like choosing a movie based solely on its title: do you simply look at the name, or do you watch the trailer first?

For 20 years, the US Securities and Exchange Commission has required regulated funds to have a name that is not misleading. For example, funds with names that suggest specific types of investments, industries or geographic regions, such as “healthcare” or “Europe”, must hold at least 80 per cent of their assets accordingly. This makes sense.

The SEC now wants to expand this 80 per cent rule to cover names that reference certain investment strategies, such as “growth”, “value” or “ESG” for funds that focus on environmental, social and governance factors. These are subjective terms.

The difference in how leading index providers identify value stocks illustrates how experts can see the same investment differently. For Russell, its criteria are based on relatively low book value-to-price ratio. S&P’s criteria add earnings-to-price ratios and sales-to-price. MSCI starts with book value-to-price ratio and adds 12-month projected earnings per share, as well as dividend yield. The same strategy by name is described and executed in various ways, giving investors choice. Clearly the word “value” alone cannot fairly explain that investment strategy.

The risk is that the SEC places itself as a fund labeller and final arbiter, inviting itself into the management of funds. While a manager would make their own definition of a strategy such as value, the SEC could question whether the securities held actually meet the declared description for the fund. It could then push those holdings into an arbitrary 30-day rebalancing timeline, overriding the investment judgment of the fund manager.

The SEC is missing the bigger picture. A reasonable investor or adviser doesn’t expect a fund’s name to spell out everything necessary to know before investing. Our research shows that nine in every 10 investors consider important information like a fund’s investment objective and risk before deciding to invest. Some 90 per cent of investors consider performance, and 87 per cent consider fees too.

The rule would bring enormous costs — up to $5bn, according to the SEC. Our data show that the regulator drastically understated costs associated with the new rule. The SEC failed to fully consider the magnitude and complexity of new compliance costs, which go far beyond those of the existing regime.

For example, they didn’t consider the costs of redesigning systems, purchasing new data, reworking system interfaces and designing automated processes for subjective terms. There’s also the increased use of a broad swath of staff to operate these systems. Daily monitoring for compliance with the 80 per cent is a huge endeavour. It brings onerous new record-keeping processes with it.

Fund managers may even have to decide quickly whether to sell a well-performing stock simply to satisfy the blunt, 30-day regulatory timeline to stay within investment requirement. You could see that happen when a successful “small-cap” firm grows into a “mid-cap company”. Imposing a regulatory judgment on portfolio management isn’t what investors want or expect. It could compel funds to sell positions quickly, possibly at fire sale prices or during market volatility. This requirement would ultimately harm investors.

And unduly emphasising names could result in generic labels like “Fund Six”, or overly detailed names with multiple words. These are poor outcomes driven solely by the re-imagination of this rule.

What’s the goal here? There’s no slew of enforcement cases or investor lawsuits about misleading names. Fund names aren’t even
on the SEC’s list of examination priorities. It’s yet another ill-considered regulatory proposal dreamt up and pushed out by the current SEC leadership.

The fund industry wholeheartedly believes that truth in labelling is critical. We want investors to understand what they are investing in. However, the SEC’s proposal to change the names rule isn’t the solution. It doesn’t help get investors the information they need to understand a fund. The SEC should be encouraging investors to watch the movie rather than rating it based on the title. Now is the time to abandon this nonsensical proposal.