IDC Independent Directors Council
Promoting Excellence in Fund Governance

August 16, 2022

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

Re: *Investment Company Names Rule Proposal; File No. S7-16-22*

Dear Ms. Countryman:

The Independent Directors Council[1] appreciates the opportunity to comment on the Securities and Exchange Commission's proposal to amend Rule 35d-1[2] under the Investment Company Act of 1940 (the "Names Rule"). The proposal seeks to expand the universe of funds that are required to adopt a policy to invest at least 80% of their assets in the types of investments suggested by the fund's name.[3] The proposal also would, among other things, update the rule's shareholder notice requirements, establish new recordkeeping requirements, and create additional prospectus disclosure requirements.

IDC has a substantial interest in the Commission's proposal. In broad terms, fund independent directors have a fiduciary duty to protect the interests of fund shareholders through independent oversight of the management and operations of the fund. Independent directors also have significant and specific responsibilities under the federal securities laws to safeguard shareholder interests, including as signatories to fund registration statements with general oversight over the process by which fund disclosure is prepared,[4] as well as oversight of a fund's compliance program pursuant to Rule 38a-1 under the Investment Company Act.[5]

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[1] The Independent Directors Council ("IDC") serves the US-registered fund independent director community by advancing the education, communication, and public policy priorities of fund independent directors, and promoting public understanding of their role. IDC's activities are led by a Governing Council of independent directors of Investment Company Institute ("ICI") member funds. ICI's members manage total assets of $28.1 trillion in the United States, serving more than 100 million US shareholders, and an additional $9.3 trillion in assets in other jurisdictions. There are approximately 1,600 independent directors of ICI-member funds. The view expressed by IDC in this letter do not purport to reflect the views of all independent directors.

[2] Section 35(d) of the Investment Company Act prohibits a fund from adopting as part of its name or title any word or words that the Commission finds are materially deceptive or misleading. *See* 17 CFR 270.35d-1.

[3] Investment Company Names, SEC Release No. IC-34593 (May 25, 2022) ("Release"), *available at* https://www.sec.gov/rules/proposed/2022/ic-34593.pdf.

[4] *See* Form N-1A.

[5] 17 CFR 270.38a-1(a)(2).

As a general matter, IDC believes fund boards should be afforded the flexibility to determine how to best fulfill their fiduciary duty and attendant oversight responsibilities. Accordingly, we support certain elements of the Commission's proposal that refrain from imposing prescriptive requirements on fund boards. We are, however, concerned that the collateral consequences of the proposal may diminish the value of fund names without providing meaningful benefit to investors and shareholders.

Expanding the scope of the Names Rule, while seemingly mandating a continuous testing regime that limits the circumstances under which a fund can temporarily depart from certain investment policies, may disrupt investment management activities by imposing forced sales of securities at inopportune times. The Commission, in our view, should carefully consider the consequences of investment allocation decisions driven by the Names Rule during what may be temporary periods of noncompliance. The results produced by the Names Rule may not be in shareholders' interests and may very well lead to the adoption of generic fund names that do not convey meaningful information to investors. We, therefore, recommend that the Commission modify the proposal in ways that will mitigate such impacts.

I. Overview of the Proposal

The Commission adopted the Names Rule in 2001 to help "ensure that a fund's name does not misrepresent the fund's investments and risks . . . [and] ensure that investors' assets in funds are invested in accordance with their reasonable expectations based on the fund's name."[6] Broadly speaking, the rule provides that, if a fund's name suggests a focus in a particular type of investment, or in investments in a particular industry, country, or geographic region, then the fund is required to adopt a policy to invest (under "normal circumstances") at least 80% of the value of its assets in the investment type, industry, country, or geographic region suggested by its name ("80% investment policy").[7]

Currently, if a fund falls out of compliance with its 80% investment policy, its future investments must bring the fund into compliance with the policy.[8] If the fund's 80% investment policy is a "fundamental policy," it cannot be changed without shareholder approval.[9] If it is not a fundamental policy, the fund may change the 80% investment policy, so long as it gives shareholders at least 60 days' notice.[10]

The Commission proposes to amend the Names Rule with the goal of modernizing and enhancing investor protections. The rule proposal does not impose specific requirements on fund boards. The

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[6] Investment Company Names, SEC Release No. IC-24828 (Jan. 17, 2001), *available at* https://www.sec.gov/rules/final/ic-24828.htm. *See also* Release at p. 6.

[7] 17 CFR 270.35d-1(a)(2)(i), (3)(i). *See also* Release at p. 8-9.

[8] 17 CFR 270.35d-1(b). *See also* Release at p. 9-10.

[9] 17 CFR 270.35d-1(a)(2)(ii), (3)(iii). *See also* Release at p. 9.

[10] *Id.*

Commission, however, seeks comment on the following elements of the proposal that could implicate the board's compliance oversight role:

- Changing the requirement that a fund's 80% investment policy applies at the time of investment and "under normal circumstances" by specifying the circumstances under which a fund may depart from the policy, as well as the time frame for returning to compliance.[11]

- Requiring funds to use a derivatives instrument's notional amount, not its market value, when determining the fund's compliance with its 80% investment policy and identifying derivatives instruments that may be counted towards a fund's 80% investment policy.[12]

- Requiring funds that do not adopt an 80% investment policy to maintain a written record of their analysis that such a policy is not required under the rule.[13]

Our letter addresses these aspects of the proposal and the Commission's related requests for comment.

II. Comments on the Proposal

A. Notification of a Fund's Temporary Departure From its 80% Investment Policy

The Commission's proposal contemplates, but does not require, a board to approve, or be informed in writing about, a fund's departure from its 80% investment policy that exceeds 30 days.[14] The Commission explains that requiring board approval or notification of such departures "would increase burdens on fund boards" – particularly if the approval or notification must be immediate.[15] And, if the Commission were "to require the approval or notification be made at the next regularly scheduled board meeting," the "conditions that gave rise to the need for the departure may have resolved."[16]

IDC agrees with the Commission's approach to require neither board approval nor notification. Fund boards already oversee fund compliance with the Names Rule in connection with their general oversight of the fund's investment management activities. The compliance oversight framework is established in Rule 38a-1, which requires funds to adopt and implement written compliance policies and procedures reasonably designed to prevent violations of the federal securities laws by the fund,[17]

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[11] Release at p. 16-17.

[12] Release at p. 17.

[13] Release at p. 19.

[14] Release at p. 45.

[15] Release at p. 151.

[16] *Id.*

[17] 17 CFR 270.38a-1(a)(2).

including the Names Rule.[18] Rule 38a-1 also requires a fund's compliance officer to report annually to the board regarding the operation of the fund's compliance policies and procedures,[19] including any material compliance matter involving the Names Rule.[20]

The existing compliance framework that has operated effectively since Rule 38a-1 was implemented in 2004. We do not believe that a new regulatory requirement that a board approve certain temporary departures from a fund's 80% investment policy is necessary or warranted for the board to effectively fulfill its oversight role.

If the Commission seeks to require *notification* to fund boards to the extent a fund falls out of compliance with an applicable 80% investment policy for a substantial period (*e.g.*, more than 60 days), we would be supportive of such a proposal. Fund boards today are typically notified in these circumstances.

B. Application of the Names Rule to Derivatives Instruments

The Commission's proposal addresses how derivatives instruments may be valued when calculating a fund's assets for purposes of compliance with a fund's 80% investment policy. The proposal would require funds to use a derivatives instrument's notional amount, with certain adjustments, rather than its market value when assessing compliance with the fund's 80% investment policy.[21] The rule proposal does not contemplate any board involvement in this calculation.

IDC agrees with this approach. When assessing compliance with the fund's 80% investment policy, requiring board involvement – in the form of board notification or approval[22] of the fund's decision to use the notional amount or market value of a derivatives instrument – would draw the board too far into the investment management function. If, as proposed, notional amounts would be required for calculating derivatives for purposes of the fund's 80% investment policy, boards would be made aware of the Commission-mandated methodology. Beyond this, we do not believe board approval or notification requirements regarding derivatives instruments need to be mandated in the Names Rule.

[18] *See* Release at p. 11, 107.

[19] 17 CFR 270.38a-1(a)(4)(iii)(B).

[20] *See* Release at p. 11.

[21] Release at p. 51-52.

[22] Release at p. 62.

C. Recordkeeping Requirement for Funds that Do Not Have an 80% Investment Policy

The rule proposal would require a fund that *does not* adopt an 80% investment policy under the Names Rule to maintain a written record of its analysis that an 80% investment policy is not required.[23] In a related request for comment, the Commission asks whether (a) a fund that does not have to adopt an 80% investment policy should be required to designate a party, such as the fund's board or chief compliance officer, to make such a finding, or (b) the board should be required to approve such a finding made by another designated party.[24]

IDC does not support either alternative. The required level of board scrutiny over any arrangement historically has depended on the potential for conflicts of interest raised by the arrangement. Like matters that are squarely issues of compliance but do not involve the potential for greater conflicts of interest (*e.g.*, code of ethics violations), Names Rule violations merit board oversight consistent with the robust governance framework established in Rule 38a-1. In our view, fund boards should *not* be required to make or approve such specific determinations.

Moreover, additional recordkeeping requirements should not be imposed when a fund's name does not suggest a focus on a particular investment type, industry, country, or geographic region, and the fund is not subject to the restrictions contained in the Names Rule. To mandate otherwise would be akin to requiring a fund to "prove a negative" in these circumstances.

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IDC appreciates the opportunity to comment on the Names Rule proposal. While we generally agree with the proposal's approach to the role of fund boards, we question the need to alter a compliance framework that has operated effectively for almost two decades. We also have concerns over the potential unintended consequences of the proposal that would be inconsistent with the Commission's policy objectives and the role of independent directors in supporting the interests of shareholders.

[23] Release at p. 106-107.

[24] Release at p. 108.

If you have any questions regarding our letter or would like additional information, please contact Nicole Baker, IDC Associate Counsel, at 202-326-5822 or me at 202-326-5463.

Sincerely,

/s/ Thomas T. Kim

Thomas T. Kim
Managing Director
Independent Directors Council

cc: Gary Gensler, Chair, Securities and Exchange Commission
Hester M. Peirce, Commissioner, Securities and Exchange Commission
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