



May 5, 2020

Ms. Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

Submitted via electronic filing: <https://www.sec.gov/cgi-bin/ruling-comments>

Re: Request for Comments on Fund Names (RIN 3235-AM72; File No. S7-04-20)

BlackRock, Inc. (together with its affiliates, “BlackRock”)¹ respectfully submits its comments to the Securities and Exchange Commission (“SEC” or “Commission”) in response to the SEC’s request for comment on Rule 35d-1 (“Names Rule”) under the Investment Company Act of 1940 (“1940 Act”) and the antifraud provisions of the Federal securities laws, regarding names of registered investment companies and business development companies.²

We are very supportive of the SEC requesting public comment in an effort to modernize and address challenges posed by the Names Rule. Since the Names Rule was adopted in 2001, the fund industry has changed considerably (e.g., funds’ increasing use of derivatives), warranting revisions to the existing guidance. Below, we detail some of the areas that we believe could benefit from clarification or updating in light of these developments.

I. Executive Summary

BlackRock is very supportive of the Commission’s efforts to revisit the Names Rule and review challenges to the current framework. While we appreciate that the Names Rule has been largely effective thus far in regulating misleading or deceptive fund names, we welcome updates to the Names Rule to address the evolutions in the asset management industry and current, specific challenges. Here, we summarize our recommendations and provide further detail in the remainder of the letter.

- **Environmental, Social, and Governance (“ESG”) and Sustainable Funds**
 - Given the increasing interest in ESG and sustainable funds, we appreciate and support the SEC’s focus on this area. However, we believe that terms such as “ESG” and “sustainable” in fund names

¹ BlackRock is one of the world’s leading asset management firms. We manage assets on behalf of institutional and individual clients worldwide, across equity, fixed-income, liquidity, real estate, alternatives, and multi-asset strategies. Our client base includes pension plans, endowments, foundations, charities, official institutions, insurers, and other financial institutions, as well as individuals around the world.

² See Request for Comments on Fund Names (“Request for Comment”), Investment Company Act Release No. 33809, 85 Fed. Reg. 13221 (Mar. 2, 2020), available at <https://www.sec.gov/rules/other/2020/ic-33809.pdf>.

should not be included in the Names Rule, as they are investment strategies rather than investment types. We would welcome further dialogue on this topic with the SEC separate from the discussion of the Names Rule.

- **Derivatives**

- As noted in the Request for Comment, the current Names Rule is an asset-based test. We agree with the Commission's assessment that for the increasing number of funds that utilize derivatives, a market value-based test (which is the standard approach used today) is not always well-suited.
- We recommend that the SEC allow funds the flexibility to decide whether to use a market value- or notional value- based test. We also recommend that the Commission give flexibility for funds to use absolute value when appropriate. Furthermore, we request clarification on whether collateral should be included as an eligible asset for purposes of the Names Rule test.

- **Index Funds**

- As the Commission recognizes, under the current Names Rule, index funds are faced with unique challenges because their underlying indices are not investment companies and therefore not subject to the rule.
- BlackRock recommends that the Commission allow an index fund to comply with the Names Rule when using all or a portion of the name of its underlying index in the fund name, so long as (1) 80% of the fund's investments are in component securities of the index (or investments with economic characteristics that are substantially identical) and (2) the relevant aspects of the index methodology that support the use of the fund name are disclosed in the fund's prospectus. In addition, we believe that index fund names should continue to be subject to the general prohibition of misleading names in Section 35(d), as well as other antifraud provisions of the Federal securities laws to further mitigate the risk that a fund name may be deceptive or misleading.
- The SEC should clarify that index funds that use optimization techniques and provide a representative sampling of the underlying index should be allowed to reference the name of the underlying index in whole or in part, so long as the above criteria are met.

- **Application of the 80% Investment Requirement**

- The Names Rule 80% investment threshold currently applies only at the time of investment and "under normal circumstances." We recommend that there be no changes to either portion of this rule.

- **Fund Ticker Symbols**

- We believe that fund ticker symbols differ from fund names in a variety of ways and are not necessarily designed to convey meaningful information to an investor. We thus believe that ticker symbols should continue to be considered out of scope of the Names Rule.

- **Hybrid / Convertible Securities**
 - We request that the SEC allow funds to incorporate convertible securities into the 80% investment calculation, so long as the use of those convertible securities for purposes of the Names Rule is clearly documented and disclosed.
- **Exchange-Traded Products (“ETPs”)**
 - BlackRock has long advocated for a classification system for ETPs so that investors have a clearer understanding of the range of different structures that currently exist, particularly those with materially different risks embedded in their structures as compared to more traditional index-based exchange-traded funds (“ETFs”). We believe that the Names Rule may be an appropriate forum for this discussion, and we would welcome further engagement with the Commission on this important issue.

II. ESG

In the Request for Comment, the Commission notes that the number of funds that incorporate ESG assessments into their investment mandates has vastly increased since the advent of the Names Rule, and thus requests comment on whether the Names Rule should apply to terms such as “ESG” or “sustainable.”

Given the growing investor interest in sustainable investments, we believe that the SEC is rightfully focusing on this area. As we stated in our *ViewPoint* “Towards a Common Language for Sustainable Investing,” we agree with the Commission that there need to exist robust standards to mitigate the risk of “greenwashing” (i.e., the risk that either through confusing or outright misleading investment approaches, investors cannot make informed choices about the actual sustainability characteristics of their investments).³ One key focus in this effort should be to eliminate any potential gaps between a fund manager’s claims about what the product seeks to achieve and an investor’s expectation of what that means. This will necessitate alignment around a clear, standardized system of naming classification that allows investors to easily differentiate among types of ESG products and more clearly understand the different ESG funds’ strategies. At the same time, policy should avoid a “one size fits all” definition of sustainable investment that could constrain investor choice. Policy should also foster the flexibility needed for product innovation that may achieve sustainability goals by different routes.⁴

However, BlackRock does not believe that the Names Rule is the appropriate forum for the codification of ESG standards and a naming classification. As the Commission acknowledges, the Names Rule only applies to fund names that suggest specific investment types and not to “fund names that describe a fund’s investment

³ See BlackRock, *Towards a Common Language for Sustainable Investing* (Jan. 2020), available at <https://www.blackrock.com/corporate/literature/whitepaper/viewpoint-towards-a-common-language-for-sustainable-investing-january-2020.pdf>, at 7.

⁴ *Towards a Common Language* at 10-11.

objective, strategy, or policies.”⁵ We believe that the terms “ESG” and “sustainable” describe investment strategies rather than investment types, as these funds typically pursue one of three investment objectives: 1) investing in companies that contribute to positive sustainability-related outcomes, 2) offering investors exposure to overall ESG performance or to a particular theme, and 3) limiting investor exposure to a specific sustainability risk through an exclusionary approach. We therefore believe that the Names Rule does not and should not apply to terms such as “ESG” or “sustainable” in fund names.

While ESG fund names should be out of scope for purposes of this rule, we would note that in any future efforts to address ESG- and sustainability-related fund names, BlackRock recommends that the SEC continue to opt for principles-based regulation and avoid prescriptive definitions of the terms “ESG” and “sustainable.” We believe that policy measures around sustainable finance should address a wide variety of investor needs, which in turn is critical in facilitating asset owner choice. Moreover, there is a risk that prematurely prescriptive regulation could result in differing approaches, leading to regulatory fragmentation and more confusion. We therefore believe that there should be alignment around a globally standardized naming classification for ESG products that is fostered by policymakers. That is why BlackRock supports efforts like those of the Institute of International Finance’s (IIF) Sustainable Finance Working Group to recommend a global taxonomy classification.

Under any future regulation relying upon a principles-based approach, we would support a requirement for a fund that positions itself as “sustainable” to provide a clear sustainability objective documented in its investment process or strategy.

We would welcome the opportunity to engage further on this important issue around ESG naming conventions outside of the discussion on the Names Rule.

III. Derivatives

The Names Rule is currently an asset-based test; a fund is required to invest at least 80% of its assets in the type of investment suggested by the fund name. The Commission requested comment on whether an asset-based test was the appropriate way to determine whether the use of a particular name is misleading, specifically noting that the asset-based approach may pose difficulties for funds that utilize derivatives.

As the Commission acknowledges, funds are increasingly relying on the use of derivatives. We believe that when used appropriately, derivatives can be an important and efficient tool in seeking to achieve returns and control risks. BlackRock portfolio managers often rely on derivatives to hedge or mitigate risks, to replicate the characteristics of physical securities, and to generate portfolio exposures to implement an investment objective.

The Commission requested comment on whether notional values should be permitted to be utilized in calculating compliance with an asset-based test. While using the market value of a derivatives position is the standard approach utilized today and is generally appropriate, we believe that for some funds that use derivatives, the market value test does not provide an accurate depiction of potential market exposure. For

⁵ See Request for Comment at 1.3222.

example, certain mutual funds utilize total return swaps for a significant portion of their exposure to companies in certain markets. These funds use swaps to seek to obtain a return that is the economic equivalent of the return that would have been obtained from a direct investment in the notional amount of the instrument underlying the swap. As such, in this type of fund, a notional-based test may be a more appropriate measure of the fund's derivatives exposure.

Rather than prescribe what kind of test would be most appropriate, we recommend that the Commission provide flexibility to fund managers around whether to use a market value or rather a notional value when complying with the 80% investment test. To provide transparency to investors, the Commission could require that a fund expressly describe the methodology used for purposes of the 80% investment test in its prospectus.

The Commission also requested comment on whether a revised methodology should include any requirements around adjustments to the derivatives' notional values. We submit that, instead of creating prescriptive requirements, the SEC should allow for flexibility as to how derivatives should be factored into the 80% investment test depending on each fund and how such fund uses derivatives as a part of its specific investment strategy, so long as the fund properly documents and describes the methodology used to calculate adherence to the 80% investment test in the fund's prospectus. For instance, funds should be allowed the flexibility to use the absolute value of derivative positions, rather than netting them, provided such practice is disclosed. In a fund with extensive total return equity swap exposure, taking the absolute value may be appropriate.

Finally, we also request clarification on the treatment of collateral (e.g., cash and US Treasury Bills) for initial and variation margin for derivatives for purposes of the 80% investment test. Specifically, we recommend that the SEC clarify that the market value of such collateral should also be deemed an eligible asset and considered a part of the derivatives exposure in the 80% investment test calculation.

IV. Index Funds

In the Request for Comment, the Commission recognized that there are Names Rule challenges related to index-based funds. The underlying indices for index-based funds are not investment companies and therefore are not subject to the Names Rule. Because the underlying indices are not subject to the Names Rule requirements, this can create problems for funds that seek to align or incorporate all or portions of the index name into the fund name. We appreciate the Commission's acknowledgment that this currently poses a challenge for funds.

BlackRock recommends that the Commission include language in the Names Rule allowing index funds to use all or portions of the name of its underlying index in the fund name as long as 80% of the fund's investments are invested in component securities of the underlying index and other investments that have economic characteristics that are substantially identical to the economic characteristics of the component securities of its underlying index (e.g., To Be Announced ("TBA") securities and depositary receipts representing securities in the underlying index), subject to the additional requirements below. Inclusion of TBAs and depositary receipts for purposes of the 80% investment test for all index-based funds would be consistent with the

approach taken by the SEC in the context of exemptive relief requirements for investment strategies for index-based ETFs. We believe that a fund name that includes all or portions of the name of its underlying index and invests at least 80% of its assets in that underlying index (with disclosure of the relevant aspects of the index methodology that support the use of the fund name disclosed in the fund's prospectus) should be deemed compliant with the Names Rule. In addition, we believe funds should still be subject to the general prohibition on misleading names in Section 35(d), as well as other antifraud provisions of the Federal securities laws and that fund sponsors should consider engaging in periodic testing for compliance with these standards to prevent misleading fund names. We believe this suggested approach would allow the fund name to align with the fund's investment objective of closely tracking its benchmark index, while mitigating the risk of a fund name that is materially deceptive or misleading.

Furthermore, we recommend that the SEC provide clarity for index funds that use optimization techniques (i.e., funds that include a subset of securities from the underlying index that provide a representative sampling of the index) instead of fully replicating the underlying index (i.e., funds that hold every security of the underlying index). Despite the fact that not all securities in the index are included in the fund, portfolio managers seek to match the major risk characteristics of the index, like duration, yield, sector allocation, and credit quality. We request that the Commission clarify in the Names Rule that an index fund that optimizes its holdings to provide a representative sampling of the underlying index should be considered representative of that underlying index, so long as it invests at least 80% of its assets in the component securities of the underlying index and other investments that are substantially identical.

We would also note that in contrast with the environment in 2001 when the Names Rule was originally adopted, there is now significantly more information available to investors. Investors have more information about funds on websites; for example, with the recently adopted ETF Rule in 2019, most index-based ETFs are required to make their holdings available daily on their website, offering full holdings transparency into each fund. Furthermore, under the enhanced disclosure rules adopted in 2009, funds are required to include key information about the fund in plain English at the beginning of the prospectus.⁶ There is an overall increased level of transparency into funds due to enhanced information being made more readily available to investors. As a result, we believe that the risk of investor confusion around index-based funds due to the fund name is highly unlikely.

V. Application of 80% Investment Requirement

In the 2001 Names Rule, the Commission specified that “the 80% investment requirement generally applies, as proposed, at the time when an investment company

⁶ See Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies, Investment Company Act Release No. 28584, 72 Fed. Reg. 67789 (Nov. 2007), available at <https://www.federalregister.gov/documents/2007/11/30/07-5852/enhanced-disclosure-and-new-prospectus-delivery-option-for-registered-open-end-management-investment>.

invests its assets” and “under normal circumstances.”⁷ In the Request for Comment, the SEC asks whether the Names Rule should continue to apply at the time of investment, or if a fund should be required to maintain that level of investment.

We believe that there should be no change to this requirement and that the Names Rule should continue to be applied only at the time of investment. First, keeping this as a “time of investment” requirement would ensure consistency with other provisions under the 1940 Act. For example, as the Commission acknowledged in its original Names Rule proposing release, under Section 5(c), a registered “diversified company” would not lose its status as such because of any “subsequent discrepancy between the value of its various investments and the requirements” so long as it had met the criteria “at the time of its qualification.” Similarly, under Section 12(d)(1) of the 1940 Act, which puts limits on acquisitions by investment companies of securities of other specific businesses, the value of an investment company’s total assets are to be “computed as of the time of a purchase or acquisition or as closely thereto as is reasonably possible.” These provisions, along with many others, apply tests at the time of investment and do not impose maintenance requirements. We recommend that the SEC maintain consistency with this approach.

Second, updating the Names Rule application requirement to be a “maintenance test” rather than a “time of investment test” could be highly disruptive to the management of a fund. For example, in situations where the value of a portfolio’s holdings changes due to circumstances or market movements beyond the fund’s control, having to maintain the 80% investment level would require the fund to sell securities in order to get back into compliance, even if the temporary breach were not indicative of a change in investment strategy. To require a fund to change its holdings in these circumstances rather than focus on following its investment strategy when making investments seems to run counter to the Names Rule’s underlying motivation of investor protection.

For similar reasons, we believe that there should be no change to the Names Rule applying “under normal circumstances.”⁸ The Commission states that this standard would give funds the flexibility to manage their portfolio “in response to adverse market, economic, political, or other conditions” as well as in other cases, including unusually large cash inflows or redemptions.⁹ We support the Commission’s reasoning in the Names Rule that this standard is necessary in order to allow funds to deviate from their stated investment policies during abnormal circumstances, and that a temporary breach of the 80% investment requirement would not be considered reflective of a change in the fund’s investment strategy and policies. The importance of this “under normal circumstances” standard was highlighted in March 2020 during the period of heightened market volatility due to the COVID-19 pandemic, when certain funds may have fallen below their respective 80% investment policies due to market conditions and/or unusually large redemptions. Such funds were able to rely on the flexibility provided by this language to manage the funds as the portfolio managers

⁷ See Investment Company Names, Investment Company Act Release No. 24828, 66 Fed. Reg. 8509 (Feb. 2001), available at https://www.sec.gov/rules/final/ic-24828.htm#P133_40720, at 8513.

⁸ See Investment Company Names at 8513.

⁹ See Investment Company Names at 8513.

deemed most appropriate under the abnormal circumstances presented, rather than be forced to make investment decisions and incur potential additional losses solely to comply with their 80% investment policies.

We therefore recommend that the application of the 80% investment test under the Names Rule should continue to be applied only at the time of investment and under normal circumstances.

VI. Fund Ticker Symbols

In the Request for Comment, the SEC asserts that some funds may have ticker symbols that “are intended to convey information about how a fund invests” and asks whether the Names Rule should be expanded to encompass fund ticker symbols.¹⁰ We do not believe that fund ticker symbols should be included in the Names Rule, as they are strikingly different from fund names for a variety of reasons.

Tickers are not necessarily designed to convey meaningful information about how a fund invests, and we do not believe that they have a significant impact on an investor’s investment decision. Unlike fund names, ticker symbols have a very limited number of characters, which prevents funds from being able to accurately and thoroughly describe the fund through its ticker. In addition, funds are limited to using available ticker symbols, and therefore, issuers have less flexibility with respect to ticker symbols than with fund names. Furthermore, ticker symbols are generally not as prominently displayed as fund names and are thus unlikely to be misleading or deceptive.

We therefore recommend that fund ticker symbols continue to be considered out of scope for purposes of the Names Rule.

VII. Hybrid / Convertible Securities

The Commission noted in the Request for Comment that one of the significant developments since 2001 has been the increasing use of hybrid financial instruments like convertible securities. We agree with the SEC’s description that convertible securities can have “characteristics of both debt and equity securities” depending on the market conditions.¹¹ For example, before conversion, convertible securities have characteristics similar to nonconvertible income securities in that they ordinarily provide a stable stream of income with generally higher yields than those of common stocks of the same or similar issuers, but lower yields than comparable nonconvertible securities. It may therefore be appropriate for a fund with a policy to invest at least 80% in debt securities to count convertible securities toward satisfaction of the 80% investment test.

On the other hand, convertible securities also derive a portion of their value from the common stock into which they may be converted and have the potential for capital appreciation as the value of the underlying common stock increases. Therefore, it may be appropriate for a fund with a policy to invest at least 80% in equity securities to

¹⁰ See Request for Comment at 13224.

¹¹ See Request for Comment at 13223.

value convertible securities as equities, even prior to conversion. We believe that this would be consistent with the position taken by the Commission with respect to other instruments that have economic characteristics similar to the securities included in a fund's 80% investment policy. Accordingly, we would submit that funds be allowed to incorporate convertible securities into the 80% investment test calculation.

VIII. ETPs

BlackRock has long advocated for a clearer identification and categorization of ETPs to improve investors' ability to understand and analyze the risks that the different products pose. While all ETPs share certain characteristics, including exchange-tradability, "ETF" has become a blanket term describing many products that have a wide range of structures. For example, exchange-traded notes ("ETNs") and levered and inverse ETPs have greater embedded structural risks and more complexity than traditional index-based ETFs, which may not be well-understood by investors. In our view, clearer labeling of ETPs will help investors better understand that different ETPs can carry materially different risks and considerations. Given the Commission's motivation to protect investors and prevent misleading or deceptive names via the Names Rule, we believe that this could be a forum to address this important issue around ETP classification. We would be happy to engage further on this topic.

We thank the SEC for the opportunity to comment and express appreciation and support for your efforts to modernize the Names Rule.

Sincerely,

Deepa Damre Smith
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Kate Fulton
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cc:

The Honorable Jay Clayton
Chairman
Securities and Exchange Commission

The Honorable Hester M. Peirce
Commissioner
Securities and Exchange Commission

The Honorable Elad L. Roisman
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The Honorable Allison Herren Lee
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