Consumer Federation of America

Aug. 16, 2022

Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: File No: S7-16-22: Investment Company Names

Dear Secretary Countryman:

On behalf of the Consumer Federation of America (CFA),[1] I am writing in support for the above-captioned proposal to enhance the investor protections afforded by the Fund Names Rule under the Investment Company Act.[2] The proposed rule would, among other things: expand the scope of the current Names Rule to cover a broader set of fund naming conventions that have the potential to be misleading or deceptive; apply the rule to instances when funds' portfolios change, either through active management decisions or passive market developments, and may no longer be accurately reflected by their funds' names; modernize the rule to better reflect funds' increased use of derivatives; and address the growing use of Environmental, Social, and Governance (ESG) or similar terminology in fund names. These proposed rule changes are urgently needed to protect the many investors that reasonably rely on the accuracy and reliability of fund names when making investment decisions and throughout the duration of their investments.

In May 2020, we submitted comments in response to the Commission's Request for Comment on Fund Names (hereafter "Request for Comment"), wherein we urged the Commission to propose changes designed to better protect investors by covering a broader range of potentially misleading or deceptive fund names and closing certain gaps and loopholes in the existing rule.[3] While the proposal does not address all of our concerns with the existing rule, it represents a significant improvement over the status quo. Accordingly, we encourage the Commission to finalize those aspects of the proposal without undue delay, with our suggested modifications.[4]

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[1] The Consumer Federation of America is a non-profit association of more than 250 consumer groups that was established in 1968 to advance the consumer interest through research, advocacy, and education.
[2] *See* Proposed Rule, Investment Company Names, Release No. IC-34593 (May 25, 2022), https://bit.ly/3JMyYaS [hereafter "Proposing Release" or "Proposal" or "Proposed Amendments"].
[3] *See* CFA, *Comment Letter Re: Request for Comments on Fund Names*, at 2 (May 12, 2020), https://bit.ly/3zLYVnP.
[4] In particular, the Commission must address the ability of single-state tax exempt funds to use names that mislead or deceive investors about what they are investing in. Continuing to allow single-state tax exempt funds to use

1. Background on Fund Names

Retail investors routinely use funds (registered investment companies) to save for retirement, college, or other important savings goals. Many retail investors rely on fund names to help determine a fund's investments, strategies, and risks. Indeed, fund names are often the first piece of information about a fund that investors receive. And in some cases, the fund name may be the primary or only piece of information the investor considers when deciding whether to invest. As a result, a fund's name can have a substantial influence on an investor's purchasing decisions.

Funds clearly understand both how important fund names can be in communicating and advertising to investors and that fund names can influence investor decisions. Accordingly, funds are very careful to choose names that are appealing to investors and likely to attract assets.[5] Indeed, research suggests that when funds make name changes, it often has the intended effect of increasing flows to those funds.[6] Moreover, recent research on the use of ESG or similar terminology in fund names found that "greening a fund name is beneficial for fund flows…."[7]

Given these incentives for funds to adopt names that maximize their potential attraction, this creates the risk that funds may use names that are deceptive and misleading, to investors' detriment. To the extent that investors purchase funds based on their names and the funds' names don't match the way funds invest, this can result in investor harm if those funds do not meet the investor's needs, goals, or expectations, or expose them to unintended or misunderstood risks.

Section 35(d) of the Investment Company Act prohibits a registered investment company from using a name that the Commission finds by rule to be materially deceptive or misleading. Section 35(d) reflects Congress' concern that misleading or deceptive fund names were not adequately being policed by the Commission and, as a result, investors weren't being protected adequately. Pursuant to this congressional directive, the Commission promulgated the Names Rule in 2001.[8] Unfortunately, there are significant gaps and loopholes in the rule that do not ensure that funds invest in a manner that is consistent with their names in all circumstances. Some of these gaps and loopholes have existed since the Names Rules was originally promulgated. Others have developed over time. As a result, investors continue to be at risk of being misled or deceived by fund names and suffering harm as a result. This issue has taken on

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names that mislead or deceive investors is anti-investor and inconsistent with what Congress intended when it directed the Commission to address materially misleading or deceptive fund names.

[5] *See* Ben Carlson, *What's In a (Mutual Fund's) Name?*, A WEALTH OF COMMON SENSE, March 10, 2015, https://bit.ly/3dxE2hY.

[6] *See* CFA, *Comment Letter Re: Request for Comments on Fund Names*, at 2-3 ("Research by Michael Cooper, Hyseyin Gulen, and P. Raghavendra Rau found, for example, that the year after a fund changed its name to reflect a hot style, the fund experienced an average cumulative abnormal flow of 28 percent, with no improvement in performance." (*citing* Michael J. Cooper, Huseyin Gulen, and P. Raghavendra Rau, *Changing Names with Style: Mutual Fund Name Changes and Their Effects on Fund Flows*, THE JOURNAL OF FINANCE, November 10, 2005, https://bit.ly/2WpyHUb.)).

[7] Sadok El Ghoul and Aymen Karoui, *What's in a (Green) Name? The Consequences of Greening Fund Names on Fund Flows, Turnover, and Performance*, at 5 (April 9, 2020), https://bit.ly/3yCPtB0.

[8] *See* Investment Company Names, 17 C.F.R. 270.35d-1 (2022).

added importance given the significant growth in fund assets and the number of investors who invest in funds, as well as an evolving fund ecosystem.[9]

It is therefore well past time for the Commission to revisit and update the Names Rule in order to better align its scope and requirements with the policies and purposes underlying the rule. Doing so would help to ensure that fund names do not deceive or mislead investors about funds' investments and risks.

2. **The current Names Rule inadequately protects investors from potentially deceptive or misleading fund names.**

As we discussed in our previous comment in response to the Commission's Request for Comment, the current Names Rule has several regulatory gaps and loopholes that allow funds to use misleading and deceptive names. Chiefly, the current Names Rule, which requires a fund to invest at least 80% of its assets in the type of investment suggested by its name, covers only a narrow slice of the fund market. The rule applies only if a fund's name suggests that the fund focuses its investments in a particular type of investment (e.g., the ABC Stock Fund, XYZ Bond Fund, or QRS U.S. Government Fund), industry (e.g., the ABC Utilities Fund or XYZ Health Care Fund), or particular country or geographic region (e.g., the ABC Japan Fund or XYZ Latin America Fund). The Names Rule does not, however, apply to fund names that imply something about the fund's investment objective, strategy, or policies. The Commission has previously taken the position that fund names that incorporate terms such as "growth" and "value" connote an investment objective, strategy, or policy and are therefore not within the scope of the 80% investment policy requirement.

Additionally, the current Names Rule doesn't always apply. Specifically, the 80% investment requirement applies only at the time when a fund invests its assets (i.e., the date of the fund's purchase of those assets). Thus, a fund that begins by complying with the rule could experience drift at certain times to an entirely different composition that does not comply with the 80% requirement. For example, a fund could originally be marketed as a small cap fund and comply with the rule by investing 80% of its assets in small cap companies. However, over time, many of the small cap companies could grow to be mid- and large-cap companies, changing the composition of the fund and its exposure.

Further, the current Names Rule applies only during "normal circumstances." The 2001 adopting release for the current Names Rule stated that this provision was intended to provide "flexibility" to permit funds to take "temporary defensive positions" to avoid losses in response to adverse market, economic, political, or other conditions, or to otherwise depart from the 80% investment requirement in other limited, appropriate circumstances, particularly in the case of unusually large cash inflows or redemptions. However, as an extreme example, this effectively

[9] *See* Proposing Release, at 12 ("… commenters stated that registered investment companies manage considerably more assets than they did in 2001 ($22.8 trillion total net assets as of March 2020 compared to $7.2 trillion in 2001) and that the variety of fund types and fund strategies has increased since 2001, with exchange-traded funds ("ETFs") and funds of funds having grown since then and funds such as emerging market, international, and alternative strategy funds having attracted substantial amounts of investment.").

allows a fund to call itself a stock fund while holding a 100% cash position for a potentially significant amount of time.

Next, the current Names Rule allows single-state tax exempt funds to use names that mislead or deceive investors about the portfolio assets in which they are investing. Specifically, a single-state tax exempt fund can invest heavily in securities issued by another municipality, despite that investors would reasonably expect a fund that indicates a specific state in its name to invest primarily, if not exclusively, in that state's securities.[10]

In addition to shortcomings of the Names Rule that have been present since its issuance, significant gaps have also emerged as the fund market has continued to grow and evolve.[11] For example, investment companies increasingly use derivatives as part of their investment strategies.[12] Yet, the Commission has not specifically addressed how derivatives should be accounted for when determining the fund's compliance with its 80% investment policy.[13] Because derivatives exposure can affect a fund's risk/return characteristics, the way a fund accounts for derivatives under the Names Rule can affect whether the fund's name accurately reflects that exposure. To the extent that some funds do not include derivatives in the 80% bucket or account for them using the market value of the derivative, that may not reflect the fund's true economic exposure to the reference asset. As a result, the fund's name may not accurately reflect the fund's underlying exposure, and investors may be unknowingly exposed to risks that do not reflect their preferences, objectives, and expectations.

Finally, there has also been a growing use of Environmental, Social, and Governance (ESG) or similar terminology in fund names, which raises the risk that funds may be using such names to attract assets without actually making bona fide investment decisions based on ESG considerations or are exaggerating the extent to which they are considering ESG factors.[14]

3. **This proposal would more effectively require that funds invest in a way that accurately reflects their name and would make fund names more consistent with investors' reasonable expectations.**

The proposed rule would, among other things: expand the scope of the existing rule to cover more fund naming conventions that have the potential to be misleading or deceptive; apply the rule to instances when funds change their portfolios and may no longer be accurately reflected by the funds' names; modernize the rule to better reflect funds' increased use of

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[10] Richard Teitelbaum, *Oppenheimer's Tax-Free Puerto Rican Muni Bond Junket*, INSTITUTIONAL INVESTOR, November 5, 2015, https://bit.ly/3Qt7nhA (highlighting how the current Names Rule allows a fund to state that Puerto Rican securities "are considered to be 'Virginia municipal securities' for purposes of this prospectus." This kind of disclosure perpetuates a deception on investors.).

[11] *See*, e.g., Proposing Release, at 6; *and* Proposing Release, at 7 ("The rule also is not currently well-suited to address ways in which the fund industry has evolved since its adoption, both in terms of funds' increasing use of derivatives to further their investment strategies and investors' increasing election for the electronic delivery of fund documents, such as prospectuses and shareholder reports.").

[12] *See* Final Rule, Use of Derivatives by Registered Investment Companies and Business Development Companies, Release No. IC-34084, November 2, 2020, https://bit.ly/3P9Gldy.

[13] Proposing Release, at 15.

[14] *Id.*, at 7.

derivatives; and address the growing use of Environmental, Social, and Governance (ESG) or similar terminology in fund names.

A. The proposed rule would, among other things, expand the scope of the existing rule to cover a broader set of fund naming conventions that have the potential to be misleading or deceptive.

As discussed above, the current Names Rule generally covers only a narrow slice of the fund market. This rule requires that if a fund's name suggests a particular type of investment, industry, or geographic focus, the fund must invest at least 80% of its assets in the type of investment, industry, country, or geographic region suggested by its name. As the Proposing Release states, the Proposal would "expand the rule's 80% investment policy requirement beyond its current scope, to apply to any fund name with terms suggesting that the fund focuses in investments that have, or investments whose issuers have, particular characteristics."[15] This would include, for example, expanding covering to fund names that incorporate terms such as "growth" and "value." By expanding the scope of the Names Rule to a broader set of fund names that have the potential to be misleading or deceptive, this proposal would reduce the extent to which funds could choose names that are misleading or deceptive. Given that this is a meaningful improvement over the existing rule, we support this aspect of the proposal.

Unfortunately, the proposal does not go as far as we think is necessary to address the risk that funds could still choose to utilize misleading or deceptive terminology in their names. Because the proposal's formulation does not explicitly apply to fund names that imply something about the fund's investment objective, strategy, or policies, there is still a gap to the extent that a fund's investment objective, strategy, or policies do not connote an investment focus.[16] In other words, if a fund's name suggests the fund does a particular thing without suggesting that its portfolio or underlying securities have particular characteristics, the rule would not appear to apply. By extension, this would seem to mean that funds with names such as "tactical," "hedged," "long/short," "buffered," "managed risk," "tax-managed," "tax-sensitive," or "tax-aware," among others, would not be covered by the rule because none of these words would suggest that the portfolio or underlying securities have particular characteristics. This formulation would allow funds to use names that give investors the illusion of engaging in certain activities without having to necessarily invest in ways consistent with those names.

If our understanding on this point is incorrect, the Commission should clarify where the limits of the rule are. If, however, our understanding is correct, the Commission should address these deficiencies, including by stating that, regardless of whether a fund name suggests a particular investment focus, funds are prohibited from using names for which a reasonable investor would conclude that the fund invests inconsistent with the one implied by its name. Then the Commission should examine and enforce that principle.

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[15] *Id.*, at 16.
[16] *Id.,* at 20 ("The proposed scope expansion recognizes that even where a fund's name could be construed as referring to an investment strategy, it nevertheless can also connote an investment focus, and we believe this connotation is likely to be materially deceptive and misleading unless supported by an 80% investment policy. That is, a fund name might connote a particular investment focus and result in reasonable investor expectations regardless of whether the fund's name describes a strategy as opposed to a type of investment.").

B. The Proposal would apply the Names Rule to instances when funds change their portfolios and may no longer be accurately reflected by the funds' names.

As discussed above, the current Names Rule also doesn't apply at all times. Indeed, the 80% investment requirement applies only at the time when a fund invests its assets (i.e., the date of the fund's purchase of those assets). Thus, a fund that begins by complying with the rule could experience drift at certain times, leading to a fund having an entirely different composition that does not comply with the 80% requirement. Additionally, the current Names Rule applies only during "normal circumstances."

This Proposal would replace the requirement that a fund's policy apply at the time of investment and "under normal circumstances," with enumerated circumstances under which a fund may depart from its 80% investment policy and specific time frames for bringing the fund's asset mix back into compliance.[17] As part of the amended rules, a fund would be required to come back into compliance with the 80% asset allocation constraint "as soon as reasonably practicable," but in no case longer than 30 days.[18] These changes to the rule would effectively address the risk of funds changing their portfolios such that the portfolios are no longer accurately reflected by the funds' names. In so doing, this aspect of the proposed rule would ensure that fund names do not become misleading or deceptive over time.

C. The proposal would modernize the Names Rule to better reflect funds' increased use of derivatives.

As discussed above, investment companies increasingly use derivatives as part of their investment strategies.[19] Yet, the Commission has not specifically addressed how derivatives should be accounted for when determining the fund's compliance with its 80% investment policy.[20] Because derivatives exposure can affect a fund's risk/return characteristics, how a fund accounts for derivatives under the Names Rule can affect whether the fund's name accurately reflects that exposure. To the extent that some funds do not include derivatives in the 80% bucket or account for them using the market value of the derivative, that may not reflect the fund's true economic exposure to the reference asset. As a result, the fund's name may not accurately reflect the fund's underlying exposure.

[17] *See Id.*, at 33-34 ("These temporary departures would be permitted only: (1) as a result of market fluctuations, or other circumstances where the temporary departure is not caused by the fund's purchase or sale of a security or the fund's entering into or exiting an investment; (2) to address unusually large cash inflows or unusually large redemptions; (3) to take a position in cash and cash equivalents or government securities to avoid a loss in response to adverse market, economic, political, or other conditions; or (4) to reposition or liquidate a fund's assets in connection with a reorganization, to launch the fund, or when notice of a change in the fund's 80% investment policy has been provided to fund shareholders at least 60 days before the change pursuant to the rule.").

[18] *Id.*, at 34 ("'As soon as reasonably practicable' would not strictly mean 'as soon as possible' in all cases and is intended to allow for consideration by the adviser of how to return to compliance in a manner that best serves the interest of the fund and its shareholders (but in no case longer than the proposed 30-day limit where applicable).").

[19] *See* Final Rule, Use of Derivatives by Registered Investment Companies and Business Development Companies, Release No. IC-34084, November 2, 2020, https://bit.ly/3P9Gldy.

[20] Proposing Release, at 15.

The Proposal would amend the Names Rule to require funds to use a derivatives instrument's notional amount, rather than market value, for the purpose of determining the fund's compliance with the 80% asset allocation requirement. The Proposal would also amend the rule to address which derivatives a fund may include in its 80% basket. In our view, notional amounts are a more accurate reflection of funds' economic exposure, as compared to market values. [21] This is because typically a derivative's market value is very small (if not zero), given that a derivatives market value reflects only the parties' current obligations rather than the potential obligations that can arise in the future.[22] Thus, allowing a fund to use derivatives' market values for purposes of assessing names rule compliance could result in a fund being in compliance with the fund's 80% investment policy despite the fund having significant exposure to investments–and their accompanying risks and return characteristics–that are not suggested by the fund's name.

We understand some commenters may take the position that the use of notional amounts can allow funds to fill the 80% bucket, and that therefore the Commission should use another measurement for derivatives exposure. We find this position to be unpersuasive for several reasons. The Commission adopted the same notional-based approach when considering funds' derivatives exposure for purposes of the funds' use of derivatives rule, as applied to limited derivatives users. In that rule, limited derivatives users, those funds that limit their derivatives exposure to 10% of its net assets, are not subject to the full scope of the derivatives risk management program, the value-at-risk (VaR)-based limit on fund leverage risk, and the related board oversight and reporting requirements. Applying the same approach with regard to derivatives measurement makes sense here for efficiency's sake. Funds that use derivatives already have to measure their notional amounts to ensure that they remain below the 10% threshold to qualify as limited derivatives users.

Moreover, we doubt highly that funds that would not otherwise use derivatives would suddenly decide to take on significant notional exposure in order to evade the Names Rule because it would mean that they would no longer be limited derivatives users and would have to comply with the full blown derivatives risk management program. We do not think it's likely that funds would hire a derivatives risk manager, create a formalized derivatives risk management program (which can be process intensive), comply with various VaR tests, and be subject to related board oversight and reporting requirements merely to fill the 80% bucket in order to use a particular name.

To the extent that commenters suggest different measurements for different derivatives, we think such an approach would be unworkable and raise a host of interpretive issues. Specifically, a threshold question is whether the Commission would adopt a different approach based on the type of derivative or the type of reference asset. For example, would it treat total return swaps differently from interest rate swaps and, if so, why would that be appropriate? Would the Commission treat total return swaps that reference equity differently from those that reference debt? Therefore, rather than trying to address each type of derivative and each type of reference asset—which would likely result in inconsistencies in treatment, would complicate

[21] *See* CFA, *Comment Letter Re: Use of Derivatives by Registered Investment Companies and Business Development Companies*, at 5-6 (March 28, 2016), https://bit.ly/3zRTT7J.
[22] *Id.,* at 4.

funds' compliance, and would raise challenges for the Division of Examinations to examine funds' compliance—we think the better approach would be the consistent, simple approach that the Commission has proposed.

Ironically, despite some commenters' apparent concerns that the proposal would allow funds to evade Names Rule compliance, there is evidence that funds are *currently* using derivatives to evade the purposes of the Names Rule.[23] Indeed, it appears that, at least with regard to some ESG funds, allowing funds to account for derivatives using market values is incentivizing funds to gain exposure to high-emitting issuers through derivatives that are inconsistent with their names.

D. The proposal would modernize the Names Rule to better address the growing use of Environmental, Social, and Governance (ESG) or similar terminology in fund names.

As discussed above, there has been a growing use of Environmental, Social, and Governance (ESG) or similar terminology in fund names, which raises the risk that funds may be using such names to attract assets without actually making bona fide investment decisions based on ESG considerations or are exaggerating the extent to which they are considering ESG factors.[24] In other words, there is heightened risk that funds will "greenwash" their names to attract assets, without investing consistent with their names. Greenwashing heightens the risk that investors will be misled about the features and risks of the funds that are marketed and sold to them.[25]

The proposal would address this risk by formally applying the Names Rule's 80% investment policy requirement to funds that employ ESG-oriented terminology in their names. The Proposal would also limit certain uses of ESG-oriented terminology in fund names by deeming the terms materially deceptive and misleading. The latter prohibition would apply to ESG "integration funds," funds that considers one or more ESG factors alongside other, non-ESG factors in its investment decisions, but where such ESG factors are generally no more

[23] *See, e.g.,* BlackRock, *BlackRock Sustainable Advantage International Equity Fund (BRZIX) Prospectus*, at 4 (December 2021), https://bit.ly/3JOZn7R ("[T]he Fund may gain indirect exposure (through, including but not limited to, derivatives and investments in other investment companies) to issuers with exposures that are inconsistent with the ESG-related criteria used by BlackRock."); *and* DWS, *DWS ESG International Core Equity Fund (DURAX) Prospectus*, at 4 (December 1, 2021), https://bit.ly/3pjsG97 ("Derivatives used by the fund do not receive a DWS ESG Quality Assessment rating.").

[24] *See* Proposing Release, at 7.

[25] *See, e.g.*, IOSCO, *Recommendations on Sustainability-Related Practices, Policies, Procedures and Disclosure in Asset Management* (November 2021), https://bit.ly/3CgDXz5 ("The term 'greenwashing' refers to the practice of misrepresenting sustainability-related practices or the sustainability-related features of investment products. In the 'race to promote their green credentials,' some asset managers may misleadingly label products as sustainable without meaningful changes in the underlying investment strategies or shareholder practices."). *See also* Eshe Nelson, *Sustainable investing risks becoming a victim of its own success*, QUARTZ, December 13, 2018, https://bit.ly/2yT4kfQ ("George Serafeim, a professor at Harvard Business School and one of the world's leading experts in sustainable finance, …[said that], 'There are now stronger incentives for asset managers to greenwash.' … 'ESG cannot be just a marketing tool to attract capital. Right now there is a false sense of security or satisfaction if an investor buys an ESG product that might not be what the investor thinks it is.'"); *and* Tom Eckett, *FCA Called to Step in on 'Shameful' Industry Greenwashing*, ETF STREAM, November 5, 2019, https://bit.ly/3fJBNu3.

significant than other factors in the investment selection process, such that ESG factors may not be determinative in deciding to include or exclude any particular investment in the portfolio.[26]

We agree that allowing funds to use ESG-oriented terminology in their names where ESG factors are not determinative in the investment decision making would be misleading because it would suggest that the ESG factors play a central role in the fund's strategy when that is not the case. Moreover, by definition, an ESG Integration fund is different than, and distinctly not, an ESG-Focused Fund.[27] Therefore, suggesting an ESG Integration has an ESG Focus would be deceptive and misleading by definition, given that the rule requires a fund to adopt a policy to invest at least 80% of their assets in accordance with the investment *focus* that the fund's name suggests.

However, we think the prohibition on ESG Integration Funds using ESG-oriented terminology in their names should be applied more broadly to all "Integration" funds. Specifically, where funds consider certain factors alongside other factors, but those factors are not determinative in deciding to include or exclude any particular investment in the portfolio, such funds should be prohibited from using names that suggest that those factors play a central role in the fund's strategy. For example, to the extent a fund considers value factors alongside other factors but where value is not central to (i.e., not the focus of) the fund's strategy, the fund should be prohibited from using "Value" in its name. To do so would be deceptive or misleading for the same reasons using ESG-oriented terminology would be.

E. The proposal would improve fund transparency and accountability regarding how fund investments match the investment focus the fund name suggests.

Currently, there is no way for investors, third party analysts, or the Commission to understand how funds categorize securities under their 80% investment policy. The proposal would amend Form N-PORT to require greater transparency on how fund investment selection methods match the investment focus that the fund's name suggests. Specifically, a fund subject to the 80% investment policy would be required to indicate, with respect to each portfolio investment, whether the investment is included in the fund's 80% basket. This information would help investors and third party analysts to understand how funds categorize securities in order to help determine whether that categorization matches investors' expectations. It would also facilitate the Commission's oversight of funds' Names Rule compliance and assist Commission staff in examination, enforcement, and monitoring with respect to the consistency between funds' portfolio investments and the investment focuses that those funds' names suggest. Because these Proposed Amendments would enhance transparency and accountability with the names rule compliance, we support these proposed additions.

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[26] *See* Proposing Release, at 18.

[27] *See* Proposed Rule, Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices, Release No. IA-6034; IC-34594, at 14 (May 25, 2022), https://bit.ly/3QFUmkv ("[I]nvestment products that incorporate one or more ESG factors vary in the extent to which ESG factors are considered relative to other factors. This generally falls along a three-part spectrum: integration, ESG-Focused, and impact investing.").

4. **The Commission must address the ability of single-state tax exempt funds to use names that mislead or deceive investors about the funds in which they are investing.**

As we stated in our previous comment, the current Names Rule allows single-state tax exempt funds to use names that mislead or deceive investors about the funds in which they are investing. This issue has taken on added importance with the growing number of retail investors and retail assets moving into municipal funds.[28] Specifically, a single-state tax exempt fund can invest substantially in securities issued by another municipality, despite the fact that investors would reasonably expect that a fund that indicates a specific state in its name would invest primarily, if not exclusively, in that state's securities. Disturbingly, this activity is permissible as long as the fund discloses in its prospectus that it is investing in this manner,[29] despite the fact that investors may not read or understand such a prospectus disclosure, in part, because such disclosures are nonsensical, as illustrated below.

Recent experience illustrates how several single-state tax exempt funds invested substantially in securities issued by another municipality and suffered as a result. As reported in a November 2015 article in *Institutional Investor*, the Oppenheimer Rochester Maryland Municipal Fund and the Oppenheimer Rochester Virginia Municipal Fund held 42.7% and 37.5%, respectively, of their portfolios in Puerto Rican government debt in September 2015, nearly two months after the commonwealth defaulted on interest rate payments.[30] Despite the fact that the names of these funds strongly suggest that the funds invest primarily or exclusively in Maryland and Virginia municipal securities, respectively, this activity by the funds was permissible. Investors who reasonably expected, based on the funds' names, that they would invest according to that mandate, were misled or deceived.[31] The funds were apparently allowed to do this because they disclosed that they would be investing in securities issued by other municipalities. For example, according to *Institutional Investor*, the prospectus for the Oppenheimer Rochester Virginia fund stated: "The Fund also invests in the obligations of the governments of U.S. territories, commonwealths and possessions such as Puerto Rico, the U.S. Virgin Islands, Guam, or the Northern Mariana Islands to the extent such obligations are exempt from state income taxes. These investments also are considered to be 'Virginia municipal

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[28] *See* Nic Querolo, *Mom and Pop Buying Fewer Muni Bonds Directly as ETFs Heat Up*, BLOOMBERG, March 24, 2022, https://bloom.bg/3zUldCF ("The value of bonds directly owned by households fell by $18 billion in the fourth quarter of 2021, dropping to the lowest level since 2008, according to Federal Reserve data. Instead, those buyers are moving toward mutual funds and exchange traded funds, which have roughly doubled their muni holdings over the last decade.").

[29] *See* Final Rule, Investment Company Names, Release No. IC-24828, at n.30 (Jan. 17, 2001), https://bit.ly/3SO3Ewr ("Under rule 35d-1, a single state tax-exempt fund may include a security of an issuer located outside of the named state in the 80% basket if the security pays interest that is exempt from both federal income tax and the tax of the named state, provided that the fund discloses in its prospectus that it may invest in tax-exempt securities of issuers located outside of the named state."). *See also* SEC Staff of the Division of Investment Management, Frequently Asked Questions about Rule 35d-1 (Investment Company Names), at Q.3, https://bit.ly/3SHszSv ("A single-state tax-exempt fund may include a security of an issuer located outside of the named state in the 80% basket if the security pays interest that is exempt from both federal income tax and the tax of the named state, provided that the fund discloses in its prospectus that it may invest in tax-exempt securities of issuers located outside of the named state.")..

[30] Teitelbaum, *Oppenheimer's Tax-Free Puerto Rican Muni Bond Junket*.

[31] *Id.*

securities' for purposes of this prospectus."[32] Thus, to the extent the fund's investments were not consistent with the needs or goals of the fund's investors—exposing them to significantly more risk in this case, and indeed, suffering the losses associated with those risks—they were harmed.

Even more egregious, the existing rule allows a single state tax-exempt fund to invest 100% of its securities in another municipality's securities. According to the rule, a single state tax-exempt fund can include a security of an issuer located outside of the named state in the 80% basket if the security pays interest that is exempt from both federal income tax and the tax of the named state, provided that the fund discloses in its prospectus that it may invest in tax-exempt securities of issuers located outside of the named state. Thus, there is nothing stopping a Maryland fund from investing 0% in Maryland securities and 100% in Puerto Rican securities.

This is simply nonsensical.

In trying to justify allowing this charade, the Commission explained that "Investors are generally more interested in the tax-exempt nature of an issuer's distributions than the issuer's location."[33] First, the Commission has no basis for this statement. Second, it appears that funds views things differently. They are likely to receive some benefit from being closely associated with a particular state and using its name. Otherwise, they would simply choose a different state's name. And where a state's securities may not be appealing to investors because the state is having financial difficulties, for example, funds may be incentivized to use another state's name to attract investment in its fund, thereby increasing investment in its own securities. This tactic would clearly be misleading and deceptive to investors, who would reasonably expect the fund to invest in the securities of the state suggested by the fund's name. Yet, the Commission's approach would appear to allow this deceit.

We see no legitimate reason why a fund that uses a state's name should be allowed to engage in this misleading and deceptive behavior. If a fund can't invest, at all times, at least 80% of its securities in the state's securities for which it is named, then it shouldn't be allowed to use the name of that state. After all, if the real purpose, as the Commission suggests, is to signal the tax-exempt nature of the distributions, funds are free to use names that reflect that fact without falsely associating their fund with a particular locale. Allowing single-state tax exempt funds to continue to use names that mislead or deceive investors is anti-investor and inconsistent with Congress' intent when it directed the Commission to address materially misleading or deceptive fund names.

Therefore, the Commission must address the ability of single-state tax exempt funds to use names that mislead or deceive investors about the funds in which they are investing. The most direct way to do so is to retract the Commission's previous position that a single state tax-exempt fund may include a security of an issuer located outside of the named state in the 80% basket if the security pays interest that is exempt from both federal income tax and the tax of the named state, provided that the fund discloses in its prospectus that it may invest in tax-exempt securities of issuers located outside of the named state.

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[32] *Id.*

[33] Final Rule, Investment Company Names, Release No. IC-24828 (Jan. 17, 2001), https://bit.ly/3SO3Ewr.

In addition, the Commission should explicitly state that prospectus disclosures, like that referenced above stating that securities issued by Puerto Rico "are considered to be 'Virginia municipal securities' for purposes of this prospectus," are *per se* materially deceptive and misleading. It is possible that the proposal would already prohibit the use of such disclosures, yet the Release is not clear on this point.[34]

However, even if such disclosures were prohibited, it would still not address the fact that the Commission has taken the position that a single state tax-exempt fund may include a security of an issuer located outside of the named state in the 80% basket. Thus, if the Commission prohibited disclosures deeming out of state securities as in-state securities for purposes of the prospectus, funds would merely have to change their disclosures to state that they include securities of an issuer located outside of the named state in the 80% basket if the security pays interest that is exempt from both federal income tax and the tax of the named state. In this scenario, retail investors would be no better off, as they would continue to be at risk of being misled by the fund's name.

Conclusion

By expanding the scope of the existing rule to cover a broader set of fund naming conventions that have the potential to be misleading or deceptive, applying the rule to instances when funds change their portfolios and may no longer be accurately reflected by the funds' names, and modernizing the rule to better reflect funds' increased use of derivatives as well as to address the growing use of Environmental, Social, and Governance (ESG) or similar terminology in fund names, these proposed rule changes represent a significant improvement over the status quo. Accordingly, we encourage the Commission to finalize those aspects of the proposal without undue delay, with our suggested modifications.

In addition, the Commission must address the ability of single-state tax exempt funds to use names that mislead or deceive investors about the funds in which they are investing. Continuing to allow single-state tax exempt funds to use names that mislead or deceive investors is anti-investor and inconsistent with Congress' intent when it directed the Commission to address materially misleading or deceptive fund names.

Respectfully submitted,

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[34] *See* Proposing Release, at 79 (The proposed plain English or established industry use requirement states that it "would address concerns that a fund sponsor may subvert an investor's reasonable expectations of a fund's investment focus by using terminology in the fund's name in a manner that is inconsistent with the plain English or established industry use. The proposed amendments similarly reflect our belief that a name's meaning should not be permitted to be materially altered by fund disclosure.").