

Q&A with Commissioner Peirce

Below is a transcription of an exchange between Commissioner Hester Peirce and presenting members of the SEC Staff that occurred during the Open Meeting on September 20, 2023.¹ This exchange included information beyond that contained in the proposing and adopting releases. Consequently, we thought this information could be useful to registered funds when considering the impact of the amendments to Rule 35d-1.

Commissioner Peirce	So, currently, a term like “mid cap” is interpreted differently across fund complexes. Do you anticipate these different interpretations will persist under the amended rule?
SEC staff member	Commissioner, I'll take this question. We do anticipate that fund managers will continue to have different points of view about how the terms used in names are defined. The rule isn't designed to require funds to coalesce around one singular definition of terms used in fund names, and we don't think that the rule would have that result. As you noted in your remarks, funds would have discretion to reasonably define the terms [in] their names and then invest accordingly with those definitions, and the underlying disclosure would provide more detail about how those name terms are defined.
Commissioner Peirce	Thank you. If two funds in the same complex classify the same investment differently – so one fund might classify it as “growth,” one fund might classify the same security as a “value” investment – is one of those funds violating the Names Rule?
SEC staff member	I'll take this one also. We think definitely not – there can be different points of view about how an investment is categorized, and just because when [an] investment is categorized in different ways, [that] doesn't mean that either fund has violated the rule.
Commissioner Peirce	Okay, that's helpful. So, on a technical – more technical question I guess. So, a fund might have multiple terms in its name. How does the 80 percent [test] get applied to those terms?
SEC staff member	So, the [adopting] release provides some guidance about fund names that include multiple terms and provides guidance that there can be multiple reasonable ways that a fund's 80 investment policy would consider multiple terms in a name. Both terms or multiple terms would have to be considered in the 80% investment policy, but there are multiple reasonable ways that that can be done, and the release gives several examples of different permutations of how that would be accomplished.
Commissioner Peirce	So, you don't have to – each term doesn't have to, on its own, be the 80 percent?
SEC staff member	That's correct, Commissioner.
Commissioner Peirce	Okay. When we talk about “established industry use,” are we talking about the fund industry, or the industry in which the fund is investing?
SEC staff member	I think that really depends on the context. It could be either depending on context, and I can give a couple of examples of that. The [adopting] release gives as an example of a term that might be used in a way that's not consistent with plain English: the term “value.” Value investments might be selected according to criteria that a mom-and-pop investor might not necessarily think of when they think of the term “value,” but the term in that name would be defined consistent with established industry use. But, on the other hand, if a fund name includes terms that refer to specific industries or technologies, the industry use would not be the fund industry, but the industry of the investments that the fund is focused on.

¹ The transcription was prepared from the publicly available video recording of the Open Meeting published by the SEC and begins at the 22:43 mark of the recording, which is available [here](#).

Morgan Lewis

Commissioner Peirce	That's helpful. So, I did think there were a few places where it was unclear whether it had to be plain English or establish[ed] industry use or it had to be both. Can you just clarify that?
SEC staff member	Absolutely – it's either. The thought is that there are certain terms that do not necessarily have a plain English definition when used by funds in their names, and that is the reason why the recommendation includes the established industry use standard: to pick up on the fact that those uses of names might still be appropriate if consistent with established industry use.
Commissioner Peirce	Okay, great. Now, I'm going to give you a little bit of a harder question, which is a hypothetical. So, we have a fund that calls itself the “Green Auto Fund.” This fund only invests in companies that make fuel-efficient internal combustion engines – for engine cars that have fuel efficient internal combustion engines. [The fund] does not do so with the intention of nudging those companies into producing electric vehicles. The thesis of the fund is – and it describes this thesis in its prospectus – the environmental costs associated with mining the rare minerals that are necessary for electric batteries and the environmental costs associated with disposing of those batteries are greater than the cost associated with cars that have highly efficient internal combustion engines. May the fund retain its name the “Green Auto Fund”?
SEC staff member	Yes – I think – so, one important point to note is that the rule is not intended to result in members of the industry coalescing around one singular definition of terms used in that name; that would not need to happen for a term to be consistent with established industry use. So, assuming the conception of “green” in the hypo that you laid out isn't contrary to industry use even if it's not the predominant definition within the industry, the fund then could adopt that definition and it would disclose how it defines that term in its prospectus to investors. I think a corollary hypo similar to how you mentioned that a pizza shop wouldn't be able to sell sushi, that fund would not be able to call itself an electric vehicle fund.
Commissioner Peirce	Okay, fair enough. Does IM think that we've addressed commentor concerns – there were a lot of concerns that came in around expanding the rule to cover “growth” and “value” and “ESG.” You know, I think especially “growth” and “value” drew a lot of – a lot of concern. Has IM addressed those concerns in the recommendation?
SEC staff member	So – I'll take this one. Well, we believe we have – you know, I think there's really two areas I would point to, one as reflected in the last sort of a few responses here and, as [SEC staff member] was mentioning, the rule gives managers flexibility to sort of describe their own conception of “growth,” “value” and “ESG” terms and then invest accordingly, but also perhaps maybe more importantly with respect to commenters' concerns in this area, you know a number of those concerns related to the parts of the rule that spoke to the operation of the funds' 80 percent investment policy, and, particularly, the requirement to come back into compliance within 30 days. When the part – when the fund departed for on purpose or as relative market movements, because the practical effect of that proposal was the fund management – would have to each day invest its assets, which usually is daily, perform an assessment of all the investments in the fund's portfolio to determine if they remained, you know, growth, value or ESG investments and fund managers were particularly concerned about the burden of that exercise, and especially for names like these that may be less susceptible to automated analysis, you know, for example like an investment in Japan fund may remain a Japanese investment without individual analysis but these – these names, that might not be the case, so the recommended rules before you speak to these burdens particularly by, as you mentioned in your remarks, moving to a quarterly review process when – and so that stage rather than daily fund manage would take that time to take a check and look at the composition 80 percent basket and with additional time if they find a misalignment upon that quarterly review.